Commercial RealEstate Direct

Small-Cap Property Market Continues to Suffer; Occupancy Plunges Again

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The small-capitalization property market got hammered during the third quarter as small businesses shut their doors, many for good, as a result of government-mandated closures stemming from the coronavirus pandemic.

Occupancy in the small-cap world, defined as properties with 50,000 square feet each or less, declined by 33 million sf during the third quarter, according to Boxwood Means. That brings negative absorption, or the amount of previously occupied space that became vacant, to 67 million sf for the year so far.

The market had been bustling up until early last year, when demographic-related issues resulted in a softening. Employers simply couldn't expand because of a super-tight job market. So, they pulled back from leasing new space or otherwise expanding. The market got hit hard in the first quarter, before it felt the true brunt of the pandemic-related shutdowns. Absorption was a negative 13.8 million sf. That marked the first quarter of negative absorption since the third quarter of 2009.

Things have gotten worse since then. The second quarter lodged 31.3 million sf of negative absorption, with the industrial sector accounting for 13.5 million sf of that. The third quarter brought more bad news as negative absorption continued, bringing the year-to-date number to a negative 25 million sf. The third quarter number was smaller than the second. As a result, the industrial vacancy rate increased by only 10 basis points during the latest quarter, to 3.8 percent.

Boxwood Means, a Stamford, Conn., provider of valuations, research and analytics on the small-cap property market, noted that those properties typically are leased for shorter durations than larger, institutional properties, so they tend to react more quickly to economic changes. And they tend to cater to smaller tenants that are more vulnerable to economic disruptions.

The 67 million sf of negative absorption so far this year wiped out the total amount of space that had been absorbed since the fourth quarter of 2018. That excess space has pushed the national vacancy rate for the entire small-cap property sector to 4.8 percent in the latest quarter from 4.6 percent in the second quarter. It's now the highest it's been since the middle of 2016.

Boxwood Means relies on a database that tracks some 600,000 buildings that have a total of 9 billion sf.

In the latest quarter, the office sector was hardest hit, with 16 million sf of negative absorption. Boxwood Means pointed the finger at remote working. It added that the move by companies, small and large, to postpone their back-to-the-office strategies has resulted in a quiet leasing market. Subleasing availabilities, meanwhile, jumped to 19 million sf, the highest level since 2009. The overall office availability rate was 9.5 percent for the sector, up from 8.4 percent a year ago.

The retail sector, meanwhile, suffered 15 million sf of negative absorption during the latest two quarters, marking the first time since 2009 that the sector had seen two straight quarters of negative absorption. The properties in the small-cap retail space tend to be free-standing stores, street retail spaces and certain neighborhood or community shopping centers. Vacancies in that sector increased by 20 bps from the second quarter to 4.6 percent.

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