Small-Property Sales Recovery Gains Steam

Commercial Real Estate Direct Staff Report

The recovery in the sales market for small-capitalization properties valued at $5 million or less has cranked up this year.

According to Boxwood Means Inc., a Stamford, Conn., research firm that focuses on the small-cap market, $5.7 billion of small-cap properties changed hands in January, up 76.5 percent from a year earlier, and $5.1 billion traded in February, up 52 percent.

By comparison, the market's $21.2 billion in fourth-quarter sales was essentially flat from the year prior. For all of last year, $73.3 billion of properties traded, up 22 percent from 2012, according to Boxwood, which tracks the small-cap property and loan markets. Fourth quarters are typically the most active periods in the sales market.

Boxwood attributes the most recent year-over-year sales improvement to the small-cap market's recovery in fundamentals, citing market data from CoStar Inc. that shows vacancy rates in the three sectors it tracks are down at least 100 basis points from their cyclical highs reached in the second quarter of 2010. "That's a game changer," Boxwood said. "And it's only a matter of time before expected property yields normalize and prices appreciate as an expanded base of small investors enters the market."

According to CoStar data prepared for Boxwood, the small-cap office market's vacancy rate of 9.9 percent in the first quarter was down 150 bp from its past high, while industrial's 6.2 percent rate was down 130 bp and retail's rate was down 100 bp to 6.7 percent.

Meanwhile, prices for small cap properties, as measured by Boxwood's Small-Cap Price Index, increased by 4.2 percent during the 12 months through the end of February to 5.5 percent above its cyclical low point reached in January 2012. However, it's still 17.4 percent below its high point, reached in October 2007.

Prices for larger-cap properties, in contrast, have increased to within 6.1 percent from their peak, reached in November 2007, according to the Moody's/RCA Commercial Property Price Indices, which track sales of properties valued at more than $2.5 million. That data, however, includes multifamily and hotel properties, two sectors that Boxwood doesn't track. The Moody's/Real index for all property types except multifamily as of February had recovered to within 10.7 percent of its peak, which also was reached in November 2007.

Small-cap properties typically lag their larger-cap brethren in recoveries because they tend to include larger volumes of distressed assets. Boxwood also noted that investors typically perceive smaller assets as being riskier than larger properties, and that perception also can delay their pricing rebounds.

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