

inside small-balance

By Randy Fuchs, principal and co-founder, Boxwood Means Inc.

What we can learn from rents

Common understanding has it that commercial real estate markets have remained healthy through the first quarter of this year. In large part, this benign condition occurs because of the constrained amount of new office, industrial and retail facilities added, compared to other late-stage real estate cycles.

As a result, in the larger commercial real estate market, office and industrial rents have increased nationally year over year.

Of course, our interest focuses more on the health and direction of the small-cap markets — and lending space — involving properties valued at less than \$5 million. Large and small markets are related, but the small commercial property arena has perhaps a stronger correlation with the residential housing market than the larger commercial market (*Inside Small-Balance, Scotsman Guide commercial edition, February 2008*).

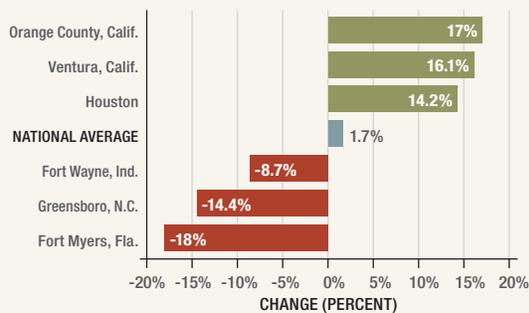
To illustrate the distinctions between the small and large commercial property markets, as of the first quarter of this year, small-cap commercial rents increased modestly at best across the nation compared with the previous year.

Small-cap office rents showed the most buoyancy, increasing 4.5 percent on average, followed by industrial with a 1.7-percent increase. Small-cap retail rents



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Industrial Rents: 1st Quarter '07 to 1st Quarter '08



Source: Boxwood Means Inc.

were basically flat, with a -0.03 percent decline year over year.

These modest rent changes are typical for commercial properties that tend to be small, less-competitive, often single-tenant and less-exposed to the extremes of national commercial real estate cycles.

That said, as shown in the graph above, some small-cap industrial markets posted outsized gains, including Orange County, Calif. (17 percent year-over-year), and Ventura, Calif. (16.1 percent). Others posted double-digit losses, such as Fort Myers, Fla. (-18 percent), and Greensboro, N.C. (-14.4 percent). There were similar winners and losers in the office and retail sectors.

This market movement at regional and national levels underscores the significant performance differences that play out between large- and small-cap markets.

Lenders and brokers that take heed of specific small-cap-market dynamics and trends in their underwriting will lower collateral risk and likely close more small-balance loans.