

inside small-balance

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

Regional rents dictate trends

AS THE NEW YEAR APPROACHES AND CONCERNS about the health of local and regional real estate markets linger, it pays for lenders and brokers to keep close tabs on the direction of rents on small-capitalization properties — aka, commercial properties valued at \$5 million or less that serve as collateral behind small-balance loans.

Nationally, the unemployment rate is steadily inching up as layoffs mount across many industries. Of course, the unemployment rate is a lagging indicator of an economy that has been showing signs of weakness for more than a year.

Similarly, commercial rents are typically viewed as a lagging gauge of real estate market performance. As the conventional wisdom goes, landlords tend to loosen rents on the downside of the cycle only after demand recedes and vacancies start to climb.

The tendency for asking rents to trail other property fundamentals is true for large commercial properties with long-term leases. But small-cap commercial properties are more responsive to economic changes.

This is because these facilities have fewer tenants, who customarily sign only three- to five-year lease terms. Thus, monthly rent trends can indicate local-property-market changes.

Asking rents are holding up nationally. As of September, small-cap office rents, at \$17.27 per square foot, have drifted lower for seven consecutive months. But

they are basically flat compared to the same period in 2007. Industrial rents have steadily contracted for the past six months. But at \$8.10 per square foot, they are only 3 percent off September 2007 levels. Retail rents, which have declined for 14 consecutive months to \$18.67 per square foot, are down only 2.6 percent in the same time period.

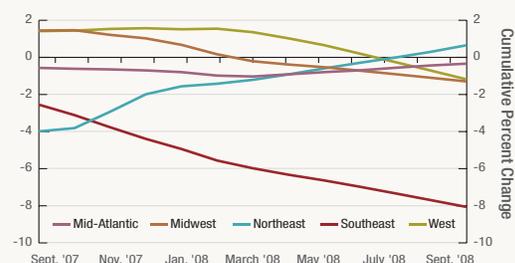
But rents on small-cap properties in some regions are showing signs of trouble. The Southeast, including its concentration of troubled housing markets in South Florida, is hurting across all property types. Small-balance industrial rents went down a sizable 6.9 percent from September 2007 to September '08, and retail rents have rolled back by 5.7 percent in that time. Office rents have followed suit, falling 4.3 percent in this period.

The Midwest and the West, which have their own regional economic challenges, also have suffered all-inclusive rent losses in the past year. On the other hand, the Mid-Atlantic and Northeast regions have posted some modest annual rent gains.



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Retail Small-Capitalization-Property Rent Trends



Sources: Boxwood Means Inc. and LoopNet Inc.