Commercial RealEstate Direct

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Sales of Small-Cap Commercial Properties Increased 6.9% Last Year

Sales of small-capitalization commercial properties increased by 6.9% last year to $128 billion, according to Boxwood Means.

But the market hasn't yet fully recovered, as last year's sales volume remained 1.2% less than that of 2019. Sales volume had peaked in 2021, at $195.1 billion. It slipped to $180.2 billion the following year, and plunged by 33% to $119.5 billion in 2023.

If you exclude the outlier years of 2021 and 2022, the small-cap market has seen an annual average volume of about $120 billion.

Boxwood Means, a Stamford, Conn., valuation and consulting company that tracks the small-cap market, noted that the recovery showed that investors had adjusted to the relatively high interest rates. The company relies on data from CoStar for its analysis.

It added that the increase in sales might indicate that the slump that was prompted by the spike in rates had subsided.

It defines small-cap properties as those having fewer than 50,000 square feet or between five and 50 apartment units.

Retail properties, which typically drive sales in the small-cap sector, did so once again, accounting for $51.2 billion, or 40% of the year's total. While relatively little development is taking place in the overall retail sector - CBRE has reported that only 4 million sf was completed during the fourth quarter, the lowest volume in more than 10 years - it's nearly nonexistent in the small-cap market. Driving the dearth: costs. CBRE has estimated that it can cost $300-$500/sf to build retail space. At those prices, rents would have to be much higher than most retailers in most regions could bear.

Boxwood Means noted that space availability in the strip and neighborhood retail centers it tracks remains scarce.

Still, prices for retail properties increased by only 3.7% from a year earlier. That, it noted, was due to the relatively lengthy lease terms prevalent at retail properties. In addition, it noted that small-cap properties typically are purchased and owned by relatively small, local investors. The sector isn't influenced by large capital inflows. But prices are up 29.6% since 2019.

Capitalization rates, meanwhile, increased last year by 20 basis points from 2023, to 6.4%.

The small-cap office picture, meanwhile, is completely different than that for large-cap properties.

A total of $31.5 billion of small office properties changed hands last year. That's nearly a quarter of the year's total sales volume and up 8.25% from 2023. Small-cap office properties tend to have fewer availabilities than do large-cap properties, given their relative sizes and location, generally in suburban markets. They tend to draw local law firms and other professional service providers that cater to their communities and aren't as susceptible to the remote-work phenomenon that some argue continues to plague major office markets.

Cap rates for office properties had increased by 10 bps last year to 6.3%. But Boxwood Means noted that they remain lower than they were before the Covid lockdowns.

The company noted that $32.3 billion of small-cap industrial properties had changed hands last year, up nearly 11% from the previous year. The sector benefits from the fact that many last-mile distribution facilities, relied on by many e-commerce vendors, are squarely in the small-cap segment.

And while multifamily sales volume increased by 11.3% to $12.8 billion, that volume pales in comparison to the more than $20 billion of deals completed during the market's peak in 2021. Boxwood Means noted that higher mortgage rates, which have pushed the cost to own homes higher, have benefited the rental market, and specifically the small-cap apartment market. Cap rates increased by 80 bps since 2021, putting them near where they were in 2019.