nerej
CELEBRATING 55 YEARS

A tale of two markets: Commercial and residential

June 12, 2008 - Appraisal & Consulting

Over the past 12-18 months my work has been split between analyzing the residential development market, and completing appraisals of investment grade commercial real estate. As part of this work I am constantly sifting through media reports to try and garner meaningful evidence of where the markets are headed. Combining media reports with actual data and evidence I draw the following conclusion: The residential market in Mass. is in much better shape than the media reports, and the commercial market is portrayed as healthier than it really is.

Indeed the residential market is in a correction/down period and has been since mid 2005. Properties are taking longer to sell and prices are down nearly 10% from their highs reached in 2005 per several sources. The media is full of stories portraying the negative. The news is particularly bad in overbuilt markets like South Florida, Las Vegas, Phoenix and California. While conditions are down in Mass., they are 'mildly' down in comparison to other parts of the country. In fact, there is recent evidence that a bottom may have been reached, and there is a foundation started for a recovery in the Mass. market. Here is some recent numbers from the Mass. market:

* For the first time in nearly five years, the inventory of single family homes and condominiums listed for sale declined. For May 1, 2008 vs. May 1, 2007 the number of single family homes listed for sale through MLS was down 2% while condominiums were down 7%. For some counties, including Middlesex, Norfolk, and Essex, the decline in existing inventory of single family homes was even greater; 15%, 15%, and 12.5% respectively year over year.

* The number of residential building permits issued in 2007 was down 38% since 2005. In fact, 2007 was the lowest number of building permits issued since 1991.

* The projected number of permits for 2008 via the U.S. Census Bureau is under 10,000, which will be the lowest number in past 25 years. The Q1 2008 figure was lowest since 1975.

In short, the new construction pipeline has 'gone dry' while existing inventory has begun to decline.

Again, a foundation is beginning for a true recovery in the residential market, but that is hardly what is being reported.

On the commercial side of the real estate market, after a brief frenzy of negative stories last summer surrounding the credit crunch, the declining fundamentals of the commercial sector have been largely ignored by the mainstream media. But the data is not ignoring these fundamentals.

The recently released MIT Commercial Property Price Index shows a decline of 1.3% in transaction prices between the first quarter of 2007 and the first quarter of 2008. This index tracks transactions of properties from the National Council of Real Estate Investment Fiduciaries (NCREIF) and includes office, industrial, retail and apartment properties. The 1.3% decline is deceivingly low as the apartment sector, which showed a 12.6% annual increase brought the negative showings of the other sectors up substantially.

Investors are beginning to properly recognize that the decline in US employment over the past four months of over 260,000 jobs may eventually lead to less demand for office space, lower occupancy, lower rental rates and eventually lower net operating incomes.

In the retail sector, investors are projecting a significant drop in spending as the rapid rise in food and energy costs are stripping away the disposable income of consumers, which in turn will lead to less demand for retail space and eventually lower NOI's for this property type.

A similarity between the commercial and residential markets at present is that no comparison can be made to the downturn of the early 1990's. That downturn was a true real estate depression characterized by oversupply, lack of demand, and a banking crisis. The present downturn in the real estate markets is not due to oversupply. Rather, there has truly only been a decline in demand. Historically, the current downturn is quite mild.

In closing, when assessing the status of current real estate markets, it is best to ignore the daily reports of the mainstream media, forget historical comparisons, and simply look at the data.

Chris Bowler, MAI, SRA is the 2008 president of the Mass. Appraisal Institute, Malden, Mass.