Tracking Changes in Commercial/ Multifamily Property Prices

The U.S. commercial/multifamily real estate market includes such diverse properties as the Conde Nast building in Manhattan; the original Dunkin' Donuts store in Quincy, Massachusetts; the Mall of America in Bloomington, Minnesota; a 20-unit apartment complex in the suburbs of Los Angeles; the Mandalay Bay Hotel & Casino in Las Vegas; and many, many, many more. From primary to secondary markets, East Coast to West Coast, apartment buildings to industrial properties, 1970s-era to new construction, the variety is mind-numbing.

And yet, we often speak about what's happening to these properties as one collective entity. "Nationally," we say, "rents increased X percent in the first quarter." A topic that has been gaining increased attention in this regard is property prices.

It's easy to understand why. With what's been happening in the single-family housing market, we all want to know: Are commercial/multifamily property prices holding up? If not, then, by how much?

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So are they falling? So far, the story is . . . a little bit confusing.

According to an Aug. 19 press release from Standard & Poor's (S&P), New York, "Nationally, [May 2008] commercial real estate prices are up +3.6 percent versus May 2007." One month earlier, Moody's Investors Service, New York, reported that May "commercial real estate prices as measured by Moody's/REAL Commercial Property Price Indices (CPPI) . . . [are] now 5.7 percent below what [they were] a year earlier."

So which is it? Depending on which source you look at, prices could be up nearly 4 percent or down nearly 6 percent over the course of the year.

Add in the Chicago-based National Council of Real Estate Investment Fiduciaries' (NCREIF's) Transaction-Based Index (TBI)—which recorded a 9.2 percent decline between second-quarter 2007 and second-quarter 2008—and you have a full spectrum of values from which to choose.

Different measures measure different things

But you shouldn't necessarily blame the indexes. One of the challenges in comparing different measures of changes in property prices is that each measure comes from a slightly different angle. They don't try to measure the same things—neither do they measure in the same way.

The NCREIF TBI, for example, was created to help members of NCREIF (generally institutional real estate investors) track sales-price trends of properties comparable to their own. Because the index is geared to NCREIF members—who tend to invest in larger, more stable properties—it is not, and is not intended to be, representative of the property market as a whole.

Different indexes also differ in the ways they account for changes in the composition of the market. The Moody's/REAL index does this by using "repeat sales," meaning it compares a property's current sales price with the price at which that property last sold.

The S&P/GRA Commercial Real Estate Indices (SPCREX™) and NCREIF index, on the other hand, use a "hedonic" model that adjusts observed sales prices based on an external gauge of the quality of the properties changing hands—so that if more class-A properties sell during a period, it shouldn't skew the results.

As a result of these differences, we end up with a variety of different measures—each of which describes what's happening in the market, but from a slightly different angle.

What do they say?

As of May, the three commercial/multifamily price indexes presented here were all down from their recent peaks (although the Standard & Poor's index is up for the year)—ranging from a 1 percent decline recorded by the SPCREX to a 7 percent decline in the NCREIF TBI and a 9 percent decline in the Moody's/REAL index.

(For comparison purposes, two indexes tracking single-family housing prices—the Case/Shiller U.S. 20-City Composite Home Price Index and the Office of Federal Housing Enterprise Oversight [OFHEO] purchase-only index—recorded declines of 18 percent and 5 percent in May from their respective peaks.)

Looking at Figure 1, all the indexes record a strong increase in property prices over recent years, and a (marginal) drop from recent peaks. But they also show different dynamics, including:

- The Moody's/REAL numbers show a relatively steady increase in prices over the years, peaking most recently in February 2008, after which prices came down relatively quickly.

■ The NCREIF TBI numbers show a more rapid period of price appreciation from 2005 to mid-2007, with the downward price adjustment occurring in the latter half of 2007. NCREIF TBI prices have been relatively stable since then.

■ The SPCREX numbers show a more modest climb since 2000, as well as a much more modest price adjustment.

As one moves from the national level to regional or property-type breakouts, the different series show increased dispersion in their results.

Looking at March data (the latest for which sub-national details are available for all series) in Figure 2, differences among the indexes are the greatest for apartment properties, which saw either a 12.6 percent increase in values over the year or a 10.2 percent decrease; and smallest for retail properties, which still saw in excess of an 11-percentage-point range between the high and low estimates.

Keep in mind

There are a variety of other factors to keep in mind when looking at price indexes such as those reviewed here.

Portfolio sales: Because there is not a price for each individual property within the transaction, portfolio purchases are often excluded. Given the heavy volume of real estate investment trust (REIT) privatizations and other bulk transactions that have occurred recently, such exclusions can have a significant impact on the numbers and how they do or do not relate to what is happening in the market as a whole.

Sample size: The market has recently transitioned from seeing extraordinarily high volumes of commercial/multifamily property sales to seeing extraordinarily low volumes. As the volume declines, the representativeness of the sample becomes less meaningful. Because of the different techniques used and the different levels of specificity tracked, the sample-size issue will affect different indexes in different ways.

Stressed sellers: In different markets, different types of buyers and sellers emerge. As prices climb, "flip" buyers push prices higher, and reluctant sellers may be persuaded to sell properties they otherwise would have held. Conversely, as prices decline, opportunistic buyers look to purchase properties on the cheap; most owners are likely to balk at such offers, but stressed sellers may be left few alternatives but to make a deal.

Karl Case discusses this phenomenon on the single-family market in a June 2008 paper for S&P, entitled "Downward Stickiness in Prices," noting that the "stickiness" one normally sees in home prices—in which a seller waits for the price he or she wants—has been replaced by (what I would call) slipperiness, as those who are forced to sell clear the market at the market's bid price.

Take-away

Price indexes like the ones discussed here provide new insights into what's happening in the commercial/multifamily property markets—particularly at the national level—but they are less helpful in providing insights into how the value of a given property or portfolio may be changing. As with most such statistics, you'll be missing something if you don't bother to read them. You'll also be missing something if you read too much into them.

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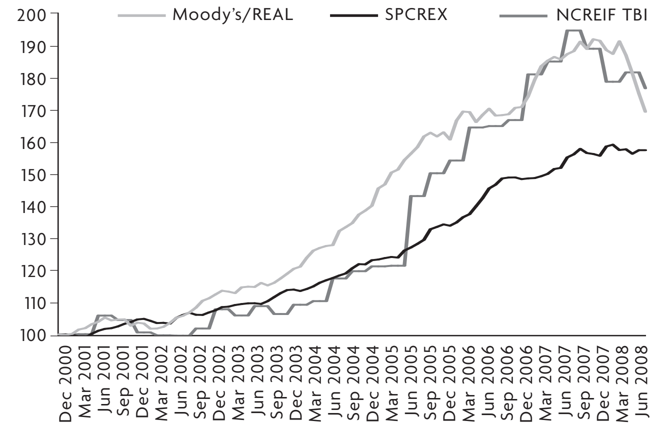
Figure **1** **Price Changes from December 2000 to June 2008, as Reported by Selected Commercial/Multifamily Price Indexes (December 2000 = 100)**



SOURCES: MBA, STANDARD & POOR'S, MOODY'S INVESTORS SERVICE, MIT

Figure **2** **Year-Over-Year Percent Change in Commercial/Multifamily Property Prices, as Reported by Selected Indexes, March 2008***

	Moody's/REAL*	SPCREX	NCREIF*
National	-7.8%	2.3%	6.6%
Apartment	-10.2%	7.7%	12.6%
Retail	-7.7%	3.8%	-4.6%
Industrial	-7.8%	6.1%	-1.6%

NOTE: At press time, March was the latest month for which detailed data for all series were available.

* The detailed Moody's and NCREIF figures are quarterly and compare Q1 2008 with Q1 2007

SOURCES: MBA, STANDARD & POOR'S, MOODY'S INVESTORS SERVICE, MIT