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## CRE Pricing Recovery Continues With September Rebound

*Third-Quarter CoStar Sales Data Reflects Less Distress, Firmer Retail Pricing and Broadening Strength Across the Spectrum of CRE Properties*

Commercial real estate prices resumed their steady if modest rise in September following a pause the previous month, helping lift the CoStar National Composite Index to a nearly 1% gain in pricing for the third quarter of 2011 over the previous three months.

Two main factors, the ongoing decline in distressed sales activity and the recovery in pricing of retail and multifamily sales -- drove the 0.9% increase for the quarter and the modest 0.4% bump, according to the latest release of the CoStar Commercial Repeat Sale Index (CCRSI).

CoStar counted 825 sales pairs for September, 682 general property purchases and 143 investment grade deals, in slightly lower transaction activity from the previous month. By comparison, only 385 transactions were recorded in January 2009, the bottom of the last downturn, and the September figure is within the historical range of the real estate boom period from 2004 to 2008.

Total deal dollar volume declined slightly in September by 1.2% from its six-month average, chiefly reflected in the general property index, which fell 5.9%, while investment grade volume remained at about par with its six-month average.

Distress sales accounted for 25% of repeat-sale transactions in September and have declined steadily as a percentage of total sales from a peak of 35.4% in March 2011. While distress sales have drifted down over the past six months, the overall level remains high, suggesting that distress continues to be a significant factor in CRE pricing.

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Both the investment-grade and general commercial property indices rose about a half-percentage point in September - further evidence that the pricing bifurcation between high-quality and lesser-quality assets is starting to level out. The fifth consecutive monthly increase pushed the general property index to a 1.6% gain during the third quarter over the prior three months, the second straight quarter of positive price growth. The Investment Grade Index edged down 1.4% in the third quarter, reflecting the August softening in pricing.

Sales of non-distressed property sales posted solid quarterly price increases of 2.3% for general properties and 1.9% for all commercial properties. Distressed property sales continued their gradual decline.

The CCRSI Multifamily Index posted a 2.1% pricing gain following the strong 7.3% increase in the second quarter. The multifamily index has jumped 12.3% and outperformed all the other property indices since bottoming out in the second quarter of 2010.

The Retail Index posted the highest gain, rising an impressive 5% over last quarter. However, retail has a lot of ground to make up and was still 3.9% below the same period last year, and 32.8% below its peak.

"Despite great uncertainties in current economic conditions, the commercial real estate market recovery continued, albeit slowly and at a bumpy pace. The steady and solid recovery of the General Commercial Index also indicated broad interest in commercial real estate among investors," according to the monthly

CoStar report.

Still, many challenges remain. While overall U.S. retail and multifamily prices advanced in the third quarter, office and industrial prices retreated, and pricing for everything except apartments continues to oscillate in 2011, with the lack of a clear upward trend reflecting the uneven recovery for those sectors in the volatile economy.

Despite the gradual strengthening in pricing of higher-end properties, the investment-grade repeat sales index remained 35.8% below its August 2007 peak, with the composite and general property indices both down from last year and nearly 34% below their peak.

The Office Index fell by 5.1% in the third quarter after posting a strong 15.5% gain in the previous three months. Office is 38.5% below its second-quarter 2008 peak, the largest decline among the four property types. Similarly, the Industrial Index fell by 3.6% in the third quarter, with prices presently 9.3% below the same period last year and 33.1% below their early 2008 peak.

The latest CCRSI results reflect trends noted by CoStar analysts during the recent round of third-quarter market reviews for the office, industrial, retail and apartment sectors.

"The demand for real estate in terms of capital is returning. There is tremendous pressure on investment managers to place money, principally because real estate looks cheap relative to other asset types," said Walter Page, director of research and office specialist for Property & Portfolio Research (PPR), CoStar's forecasting and analytics subsidiary, during the third-quarter office review last month.

While continuing to struggle, general property transaction activity is showing some improvement of late. While the office market is seeing the lowest level of pricing among the property types by historical numbers, high-quality assets that have traded at premium prices have fueled recent improvements on that front, said Jay Spivey, CoStar director of analytics.

While still prevalent, distress is not as deep in real estate markets as some had expected. The recent Operation Twist move by the Federal Reserve to lower interest rates may have slowed the momentum of distressed sales by flattening the yield curve for banks, Senior Real Estate Strategist Suzanne Mulvee said during the CoStar's retail outlook.

The Northeast, which saw the smallest pricing losses during the recession, recorded an increase of 2%, the largest quarterly price increase among the CCRSI's four regional indices. The Northeast Index was only 19.8% below its peak value at the end of the third quarter. By comparison, pricing was 34.8% below peak value in the South, and down 36.4% and 40.1% in the West and Midwest, respectively.

Further color on the quarterly CCRSI regional results includes the following:

All property types in the Northeast except retail showed price increases, led by office at 2.1%, multifamily (1.3%) and industrial, barely, at 0.1%. The Northeast retail index declined by 3.34%.

In the West, the composite index posted a 1.36% quarterly increase, offsetting declines over the same period last year. Retail led all gainers at 10.1%, followed by multifamily at 0.2%. However, a 3.7% decline in office prices wiped out gains made in the region since the third quarter of 2010. The West's industrial index continued its two-year decline, falling another 1.7% in the third quarter.

The composite index edged up slightly by 0.5% in the South during the quarter, but is still 2.6% below the same time last year. Price gains were mainly in retail (8.9%) and industrial (6.7%). But a big quarterly decline of 6.4% in office mostly offset those gains.

Of the four regions, the Midwest is still waiting for prices to reach bottom, with the Midwest Composite Index declining by another 0.8% in the third quarter and currently 9.8% below the same period last year. Prices for all property types except for office continued to fall in the quarter and overall, the Midwest's prices are 40.4% below their peak -- the largest decline among the four regions.