

Scarcity of Investment-Grade Property Sales Cuts Into Prices Growth Turns Negative Across All Asset Types Except Land, CoStar Data Shows

By Mark Heschmeyer

Commercial real estate sales price growth slowed across all property types last year, with the cost of assets except land falling in December as concerns about high interest rates and inflation curb demand.

Transaction volume slid for the sixth straight month in December, according to the latest CoStar Commercial Repeat Sale Indices that monitor price differences in repeat sales of the same property.

The new CoStar report indicated fewer sales of investment-grade properties, the large assets favored by institutional buyers such as private equity or pension funds. And the pricing slowdown, particularly in apartments, comes as the lingering high rates and inflation lead to worries of a possible recession, giving some investors pause, at least for the time being, on buying real estate.

Repeat-sales transaction activity fell to \$11.2 billion in December, a 2.5% decline from the prior month's volume and the lowest volume since March 2021. Sales of \$192.7 billion in the 12 months ended in December was 8.5% lower than the year ended in December 2021.

"This was largely driven by the pullback in investment-grade transaction volume, which fell by 12.5% in December over the prior month to \$6.6 billion," said Christine Cooper, chief U.S. economist for CoStar Group and lead author of the new report. "Annual volume was also down 12.5%."

CoStar's value-weighted U.S. Composite Index, which tracks larger property sales common in major cities, edged up in December by just 0.2% after falling for the prior four consecutive months. But the index was down by 1.6% for the year. In the value-weighted index, a \$50 million property sale is calculated as 50 times more important than a \$1 million sale.

Smaller Market Demand Eases

The CoStar indices also include an equal-weighted method in which a \$50 million property sale carries the same weight as a \$1 million sale. Because there are many more sales of small properties than large properties, the equal-weighted index tends to better reflect price changes in small markets. That equal-weighted index fell 0.7% in December, its second consecutive monthly loss, as it gained 5.2% for the year.

"Both composite indices have been on a broad decelerating trend in year-over-year growth for the last six consecutive months as markets respond to an environment of higher interest rates as the Federal Reserve battles decades-high inflation," Cooper said.

Apartment trades accounted for an outsized share of repeat sales, comprising 46.6% of the total December volume, the indices showed.

The U.S. Multifamily Index fell by 1.4% in December, its fifth consecutive month of decline. The index saw price growth of 1% in the 12 months ended in December, its slowest year-over-year gain since June 2010, when the index recorded an annual decline.

In 2021, as a result of the pandemic's impact, apartments posted "double-digit annual price gains," which made the property type attractive to investors, Cooper said. "However, with both prices and mortgage rates elevated, eroding affordability has tempered" demand, she said.

Jay Lybik, CoStar's national director for multifamily analytics, has pointed out recent lackluster apartment demand. The third quarter recorded 27,000 more units were rented in that time than came on the market, while that dropped to just 9,000 units in the fourth quarter. He said in a report "there is no doubt that economic uncertainty and high inflation are holding back renter household formations."

'Significant Oversupply'

CoStar analysts had been expecting the usual upswing in apartment sales that occurs in the fourth quarter to be lower than the preceding third quarter for the first time in a decade.

Most "Sun Belt markets that were high on everyone's acquisitions list are now having significant oversupply conditions, because of a huge construction pipeline, hitting the top end of the market, making underwriting in those markets even more difficult," Lybik said in December.

Here's how the other property sector indices fared in the fourth quarter:

- The U.S. Industrial Index fell 1.9%, its first decline since the fourth quarter of 2017. The index gained 15.6% in the 12 months ended in December.
- The U.S. Office Index posted a 1.5% loss, its first quarterly decline since the fourth quarter of 2018. Over the 12 months ended in December, office prices were up 3.5%, their slowest annual gain since June of 2019.
- The U.S. Retail Index slumped by 0.6%, its first quarterly decline since June 2020. The index gained 4.3% in the 12 months ended in December.
- The U.S. Hospitality Index tumbled 3.2%, the largest quarterly decline across all property types. The index rose by 8.4% in the 12 months ended in December, after facing the most challenging operating environment during the pandemic.
- The U.S. Land Index is the most volatile of the property type indices. The index gained 1.1%, the only property sector to show a price gain. It rose 16.6% in the 12 months ended in December, the

fastest annual gain.

The CoStar indices provided commercial real estate pricing trends based on 1,495 sale pairs in December and more than 285,200 repeat sales since 1996.