

“Professor’s Comments”

(For the March 2009 Moody’s/REAL Index returns.)

This is a periodic commentary which will generally be posted monthly on the “RealIndices” web site, offering the perspective on the indexes of Professor David Geltner (or occasional guest commentators). Geltner was a leader of the team at MIT that developed the methodology for the Moody’s/REAL Indexes.

Putting an Anemic Quarter to Bed...

The March 2009 Moody’s/REAL All-property index registered a drop of 1.7% compared to February. This is greater than the February drop, but less than the drop in several recent months. It represents an annual rate of price decline of more than 18%, about twice the annual volatility in the index. In other words, the March result for the index continues to track prices that are falling very rapidly by historical standards in commercial real estate. The total drop for the 1st Quarter was 7.7% (which is twice the quarterly volatility in the index). The index is now 20.8% below a year ago and 22.8% below its October 2007 peak. In nominal terms, this places prices approximately where they were in the 1st Quarter of 2005, four years ago, and in real terms (after removing inflation) prices are now more than 24% below their peak and back to levels last seen in mid-2004, almost five years ago.

The above statistics are even more compelling when accompanied by corresponding trading volume and distress statistics. Total RCA-tracked sales were down in March to 347 (totaling \$3.4 billion, of which 82 were valid repeat-sales observations on which the price index was estimated). This puts sales volume down to less than 10% by dollar and less than 20% by number, compared to the trading volume during the peak years of 2006-07. Perhaps even more ominous (or portentous), March did not exhibit the usual end-of-quarter uptick in volume, the first time that has happened since the 3rd Quarter of 2007 (when the financial crisis first began). Year-to-date completed sales are only about one-fourth the value of properties that have been put on the market for sale during that period. And RCA-classified “troubled assets” grew by roughly 50% during the 1st Quarter, to almost 4000 properties nationwide representing over \$70 billion in book value. Yet distressed sales (the actual selling of troubled assets) were still very few through March. Through the 1st Quarter, loss-aversion is still playing a major role in the U.S. commercial property markets, and this is surely one factor underlying a far greater drought in sales than I believe anyone thought possible in the 21st century. But one gets the sense of a dam about to give way.

Interesting results in the sectors...

The May report of the CPPI also includes the 1st Quarter 2009 results for the quarterly property sector indexes, including the national and “Top-10 metros” results for each of the four sectors. Most striking was the virtual collapse in the office sector at the national level, dropping 18.6%. Retail was not far behind, dropping 12.9% in 1Q09. Somewhat curiously, apartments and industrial only dropped slightly, -0.4% each (although apartments had previously dropped quite a bit in earlier quarters). With so few

transactions, it must be cautioned that individual sector returns in any given quarter could be subject to more random “noise” than usual, and this could partly explain the discrepancy across the sectors in 1Q09. It seems likely that the apartment and particularly the industrial sector may drop farther in the future compared to office, for example. Nevertheless, the magnitude of the drop in office and retail is impressive, taking these sectors down below their peaks respectively 30.2% and 23.1%. Also interesting is the fact that in the Top-10 MSAs the office index only dropped 6.8% (and is now 14.3% below its peak in that index). This suggests that the office sector is being particularly hard-hit in the secondary and tertiary markets.

-David Geltner, May 2009.