Commercial values: Headed for a decline?

BY MIKE FITTS
mfitts@scbiznews.com\

EXECUTIVE SUMMARY
Market watchers are looking to see if commercial property values and rents are on the decline locally amid the recession.

The next phase of the slowdown seems to be coming for commercial real estate, and it may be a messy one for South Carolina: the writedown of property values.

The nationwide numbers show the trend. Commercial property prices dropped by almost 15% in 2008, even faster than home prices, according to a report from Moody's Investors Service. Stocks in trusts that invest in real estate took a tremendous pounding, down 41% for 2008.

Is the market locally already feeling the effects of a decline in property values, with a corresponding descent in commercial rents? Many see localized signs of it, but there's no consensus that commercial prices are broadly in decline.

Michael Dodds, managing director of Integra Realty Resources, an appraisal and real estate consulting firm, sees evidence that such a downturn in values and rents has begun. Commercial renters are pushing for reductions in their rents "because all the landlords are running scared," Dodds said.

National real estate investment firms are ignoring South Carolina right now, Dodds said, because they see more economic security in bigger cities. Investment groups are not much interested in commercial property right now unless there is a large percentage of owner occupancy, which is believed to bring more reliable rental income.

Others don't see such a broad push toward lower rents and values yet. Ryan Hyler, director of research and marketing for Colliers Keenan, sees only "very limited" evidence locally that rents are dropping. Often tenants are in long-term leases, with built-in 3% annual increases, Hyler said.

Hyler cites high office occupancy rate as one reason metro Columbia is likely to be resistant to a downturn in values. Commercial rents even rose slightly on average during the year, according to a Colliers Keenan report. Some retail areas that have lost big box stores, and their attendant traffic, are likely to see lower rents, he said.

But bigger retail areas, such as the Village at Sandhill, can withstand the loss of some retail tenants without cutting prices, he said.

The Collins Keenan report predicts a decline of occupancy of 2% to 3% in the Midlands office market in 2009, citing the move of SCANA to Cayce and the continued downsizing of state agencies.

"While many observers predict that the U.S. economy will remain in a recession during 2009, the Columbia market is not expected to deteriorate to levels seen in major markets during the current year," the report said.

Hyler said that Greenville's commercial market is holding up OK, with considerable evidence of companies using subleases to keep properties full. Charleston, he said, has seen some price reductions, in part because it was building properties so feverishly just before the boom crested.

Commercial and retail values are holding up pretty well in the Midlands, according to Gene Green, broker in charge at NAI Avant. So far, Green said, there's little evidence that the battering of the retail sector is hurting values there any worse than the overall commercial market.

Everyone is keeping a careful eye on values because of the uncertainty in the market, he said.

Part of that uncertainty: Few transactions with which to judge current prices. "How do you know what it's worth? Nothing's sold," Dodds said.

Dodds sees the lack of capital for investment amid the credit crunch as the biggest culprit in the lack of business. Hyler points to a different issue as the No. 1 hindrance: the state's new law appraising property at the sale price.

The new law is a disincentive for buyers, Hyler said, and creates huge tax inequities. Any sale bumps a property's value up with a jolt, because of the difference between the sale price and the previous appraisal, which usually is much lower.

He cited a Colliers Keenan study of two commercial properties in the St. Andrews area. It describes two properties in the same office park, with one of the buildings getting reappraised at its sale price. The result, according to the study: One building will pay 89% more in property taxes than the one that has not sold recently. The estimated difference for 2009 will be a tax of $3.98 per square foot in the building that sold recently, versus just $2.10 in the building that has not sold.

If the law isn't changed, Hyler said, it could become an exacerbated problem when the economy finally turns around, if investors take their money to other states.

"It's going to be difficult to draw new investment in with the tax law written as it is," Hyler said. ■

Reach Mike Fitts at 803-401-1094, ext. 204.