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New Hampshire's challenges will likely be more "supply - demand" based than recession related - by Kristie Kyzer

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2018 proved to be a refreshing year in terms of new companies entering the New Hampshire market and the continued trend of existing businesses and entities expanding their footprints. Will 2019 continue these positive trends? The media is fixated on what the Fed has planned, the "China trade talks," etc. and what impact that will have on the economy. The significant drop in most of the global stock markets has many economists suggesting that a recession is on the horizon. From our perspective, the state's commercial real estate market will remain strong in 2019. The challenges will likely be more "supply – demand" based than recession related.

Average office vacancy dropped by 100 basis points year-over-year, with the Concord, Manchester, and Nashua submarkets seeing decreases of 200 basis points. Accompanying this tightening of the market was an increase in rents, ending the year at $18.94 gross across the submarkets and property classes we track.

The Nashua submarket, in particular, saw a high amount of absorption this year finishing at 2.4% below last year's vacancy. This is impressive especially due to the significant amount of Class B office space that was added this quarter from the former Brookstone headquarters at 1 Innovation Way in Merrimack. The now vacant 100,500 s/f building sold for $6.1 million ($60.70 per s/f) to Innovation Acquisition LLC, a Brady Sullivan Properties related entity. If we take out the space that Innovation Way added to the market, the year-over-year change would have been the largest vacancy drop in the state at 4.6%.

With vacancy rates continuing to fall, we believe there is room for new construction of Class A and B space, particularly in Portsmouth and the state's southern submarkets. The road block for such development, which has persisted for years, is the delta between current average lease rates and the cash flow (from leases) needed to support new construction. This gap will shrink in 2019, but will likely not close enough to support much new multi-tenant focused construction.

2018 started with a surge in activity, with a focus on Class A and high B space. We believe this early surge will continue through 2019, but taper toward the end of the year as supply tightens and external market conditions begin to influence our economy.

Switching to the industrial market, the story through 2018 was capacity. Vacancy rates continued to decrease, ending the year at 5.16%. The Nashua submarket was the only market to see vacancy steadily decline each quarter this year, finishing at 5.75%.

Even with the large amount of activity in the industrial market, average rent rates increased a mere $0.11 per s/f. Interestingly, the New Hampshire submarkets that border Mass. saw a comparatively large increase in year-over-year rents; Nashua with $0.29 per s/f and Salem with $0.45 per s/f increases.

The industrial market, particularly in the southern-most submarkets, may already be at a tipping point. Vacancy rates are so low that tenants are finding it difficult to find ideal space. Rents may be finally responding to these constricted market conditions and current tenants could see larger than expected increases in lease renewal rates.

There has been some construction of industrial space, the majority of which have been expansion and renovation of existing facilities. We believe 2019 growth will keep coming from the owner/user sector, while tenants will continue to struggle to find optimal space.

Mirroring the office segment, current industrial lease rates cannot support multi-tenant focused construction. Could the next best solution be repurposing the use of existing surplus or obsolete property to industrial use? Out positioned retail properties might be one such property type to consider for such a conversion. Relocation to more tertiary markets is another possible solution to the tight market conditions. In our estimation, demand for space will not be sufficient to change the current dynamics enough to encourage multi-tenant focused industrial development (i.e. “spec or near spec” development).

As we have mentioned, the New Hampshire commercial real estate market had a strong 2018. We have already seen signs that this trend will carry over into 2019. The one challenge to our positive outlook is the shrinking availability of office and, even more so, industrial space. Our hope is that market conditions allow for such growth before the lack of available space hinders economic growth. Regardless, we believe 2019 will be a positive year for New Hampshire’s commercial real estate market.

For more information about transactions that occurred during the fourth quarter visit www.colliers.com.

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