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Riding out the economic storm in Maine: Cautiously optimistic that the worst is behind us

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Maine was certainly not immune from the well documented market collapse. All major sectors of the commercial real estate industry were affected. The retail vacancy rate in Greater Portland rose from a modest 6.05 to 10.8%*. The office market, especially in suburban areas, saw significant increases in vacancy as companies began to layoff employees and downsize. The industrial sector experienced a slashing of lease rates as Landlords fought to retain tenants and attract the few prospective tenants that were available. Overall, the downturn certainly represented the worst collapse for the Maine commercial real estate market since September 11, 2001.

Fortunately, as we neared the end of the 4th quarter of 2009 our office began to see signs that the market in Greater Portland was beginning to stabilize. After a long hibernation from prospective tenants, activity started to pick up across the board. Industrial lease rates bottomed in Maine at around $4.50 per s/f NNN from their high of $5.50-$6 per s/f NNN in early 2008. The office market's activity picked up as Tenants began to request lease modifications and extensions trying to take advantage of the record low rates and highly leveraged Landlords. Even the retail market in Greater Portland started to show signs of life as retailers started looking for more desirable locations in the strong Tenant's market. In fact, Cardente Real Estate's market survey from January, 2009 indicated that there was nearly 60,000 s/f of available space in Portland's Old Port District. Today the Old Port has very limited availability with prospective tenants even competing for ideal properties. With lease rates reduced, retailers have been able to consider better locations, at similar rates to what they had been paying in less ideal locations prior to the downturn.

With the unique challenges that the market downturn created, several trends have emerged that we expect to see throughout 2010:

* Incentives offered by landlords to prospective tenants have become a common tool in negotiations. Examples of incentives include free rent, more substantial landlord improvements, and aggressive introductory lease rates. Incentives have also been offered to outside brokers. One class A office building in downtown Portland recently offered to outside brokers a fully paid three year lease on a luxury car if certain criteria where met on a long term lease for space in the building. With tougher competition in the market incentives have been an attempt by landlords to separate themselves from their competition.

* Lease modifications have been a popular trend nationally, as well as locally in Greater Portland. Often called "blend and extend", tenants are taking advantage of low lease rates and over-leveraged landlords by requesting aggressive modifications, renewals and extensions. While initially this scenario reduces the net operating income for the property, landlords are able to maintain low vacancy rates and ensure long term stability by offering modifications.

* Industrial flex units, also known as "incubator" units, are also on the rebound in Maine. A couple of

years ago, flex buildings had saturated the southern Maine market causing lease rate reductions and higher vacancies. Today, there are very few units available for lease or sale in Greater Portland. This is largely due to industrial companies downsizing their workforce and square footage during the economic downturn. As the economy started to improve, some of the unemployed workforce began to emerge with smaller start-up businesses, and naturally they have gravitated towards the small industrial units. We expect to see steady absorption of the remaining flex units, and anticipate new construction of flex units by the 1st quarter of 2011.

* The one sector that didn't show much sign of recovery heading into the 1st quarter of 2010 was land sales and development. This can be attributed to stricter financing requirements, lack of absorption of the existing new construction, and reduced lease rates. We expect a slowdown in new construction, especially in retail development, through 2010 and into 2011. However, we still expect to see limited owner-occupant new construction and build-to-suit developments for national credit tenants.

Overall, we are cautiously optimistic that the worst is behind us in Greater Portland. In comparison to larger cities such as Boston and New York that carry significantly higher vacancy rates, Portland is riding out the storm relatively well. Leasing activity has picked up, and rates have stabilized. There are excellent opportunities available to prospective tenants and buyers, and we expect a slow, but steady improvement through 2010.

*MEREDA Forecast Conference, 2010 Malone CB Forecast

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