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Speakers at MEREDA annual forecast: Encouraging signs, but growth will be slow

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While economists say that the recession officially ended in 2009, the dozen speakers at this year's Annual Real Estate Forecast Conference sponsored by the Maine Real Estate & Development Association (MEREDA) generally agreed on that while there are some encouraging signs in certain sectors, the recovery is going to be slow. (visit http://www.mereda.org/pressrelease.php?id=100 for original MEREDA press release)

Tom Lea, MEREDA president and senior vice president and group manager of commercial real estate at Peoples United Bank also noted in his opening remarks that this is "a time of transition" for the commercial real estate industry and Maine.

"I would like to believe that we have weathered the worst of the economic storm that hit us two years ago," Lea said, "but regardless of where our economy is or isn't there is no question that the change of power in Augusta has the potential to bring about profound changes in how our industry is viewed and regulated."

More than 500 real estate developers, brokers, architects, bankers, attorneys, accountants and other professionals gathered at the conference to hear a prominent economist and leading members of the commercial real estate industry give their predictions for the coming year in various regions of the state and market sectors. Newly elected state treasurer Bruce Poliquin also addressed the conference and annual awards were presented to industry leaders.

MEREDA's Seventh Annual Member Showcase, where 60 MEREDA members exhibit their products and services, was held in conjunction with the forecast conference. The conference and exhibits offer members of Maine's commercial real estate industry an opportunity to network and share information each year.

The following are some highlights of the Forecast Conference presentations:

Southern Maine Retail Forecast

Mark Malone, Malone Commercial Brokers

In the first half of 2010, increased vacancies and lower lease rates gave savvy retailers access to improved locations and upgraded facilities, while others gained access to prime locations that previously were out of reach. In the second half of the year, landlords of prime space in southern Maine were finally able to turn their focus from saving tenants by slashing rates or forgiving rent to filling vacancies and stabilizing income.

The big story in retail was the arrival of national names like Trader Joe's in Portland and Cracker Barrel in South Portland. In downtown Portland, the loss of L.L. Bean and Olympia Sports was offset by the pending arrival of Reny's.

But while there was encouraging news in declining vacancy rate and increased absorption rates last year, the not so encouraging news is that vacancy dropped mainly due to a few large deals, and the bulk of the market is still struggling. In fact only 25% of the space that was available at the end of 2009 was leased at the end of 2010.

In terms of new construction, Malone said that with 500,000 s/f still available, construction is unlikely to rebound in the near term. However, the overriding trend nationally and locally is more upbeat, with an increasing sense of stability in the retail market as consumers gain confidence.

Looking to 2011, Malone predicted that:

* Vacancy rates will remain flat in the 8% range.
* Lease rates for prime space will remain flat while those in secondary locations will drop and include even greater incentives.
* New construction will stay at current level or decline further.
* The majority of growth will be in value-oriented (e.g., "dollar" stores) and needs-based retail such as technology, apparel and personal care.
* Investment sales will increase as lenders loosen up and some owners are forced to sell.
* Further integration of traditional retail and the internet, smart phones and social networks will continue to grow, which will likely have an impact on the size of stores.

Looming on the horizon, Malone warned, are proposed new Financial Accounting Standards Board (FASB) standards that would require full disclosure of the total obligations of leasing transactions. The net result of this change could be higher upfront leasing costs, increased costs and complexity of reporting by tenants and adjustments for adverse impacts on financial ratios, loan covenants and earnings. The change could also cause shorter-term leases without renewals and lower property values.

Midcoast area Market Overview

Douglas Erickson, Coldwell Banker SoundVest

Erickson, described Thomaston, Rockland, Rockport and Camden as "four bustling and vibrant communities linked as one economic district in mid-coast Maine, one of the fastest growing business regions in the Northeast." He noted that more than 25 national and international publications - from the New York Times to The Economist - have called the communities some of the best places to live in the U.S.

Annually visited by more than 2 million people, the area will continue to grow due to its well-developed tourism and marine trades infrastructure, as well as cultural assets, natural beauty, and small, safe communities. Development in the region, which has an unemployment rate below the state average, benefits from a variety of local, regional and state incentives and inter-community collaboration among economic and community development directors and Chambers of Commerce.

A new 150,000 s/f Super Wal-Mart is planned for Thomaston in 2011 and the area also will be getting a new Tractor Supply Company store and several new residential and commercial developments.

Central Maine Market Forecast

Chris Paszyc, CB Richard Ellis/The Boulos Company

While there was some local business growth in the Lewiston/Auburn area, notably in the medical industry, optimistic predictions for increased activity in 2010 did not come to pass. Corporate expansion plans were put on hold, while other corporate entities downsized and placed significant office space up for sublease, adding to already significant office vacancy in downtown and at The Fairgrounds Business Park.

On a positive note, the City of Lewiston continues to be bullish on the Bates Mill redevelopment, committing $5 million to construction of a 400 space parking garage to support more than 200,000 s/f of office space development in the mill complex. Paszyc believes that the floor has been set for apartment transactions in the area and the big unknowns for the coming year are the possibility of a casino at Bates Mill #5 and the future of Auburn Mall, which is for sale.

While Augusta has typically been characterized by low vacancy and strong demand, primarily driven by state government and Maine General Medical Center, there are many questions for the capitol area as 2011 begins. Most notably: what impact will the LePage administration have and what will happen on the east side of the city as the new medical center (slated for 2015) takes shape in north Augusta?

Growth continues around the Central Maine Commerce Center on Civic Center Dr. as Maine General has committed to a 51,000 s/f building to consolidate multiple medical services and construction continues on the new 100,000 s/f office building for Maine Revenue Services and the Office of Information Technology. Another interesting development is the sale of the Maine Today Media building on Western to the Crisis and Counseling Center, whose current offices could be a the site of a new $55 million court building housing district and superior courts first proposed in 2009.

Following the state's decision to vacate most of the 13 buildings at the former Stevens School in Hallowell, the 136,129 s/f complex was marketed as a package to developers during 2010. With no takers, the complex now will be broken up and buildings sold individually during 2011.

Southern Maine Office Forecast

Drew Sigfridson, CB Richard Ellis / The Boulos Company

With a total market size of 11,582,458 s/f, the Southern Maine office market finished 2010 with 1,297,006 s/f available for lease, a vacancy rate of 11.19%. Despite the fact that these new totals represent an approximately 250,000 s/f of additional vacancy from the previous year, overall vacancy rates in the this market are low historically and our market swings are restrained, making for a very stable market from an investor perspective. The national office vacancy rate is currently 16.4%, in comparison.

Sigfridson said that suburban office markets continue to outperform downtown areas and there is strong growth in energy and health care. Market confidence is increasing, rents are stabilizing and steady, gradual improvement will start to occur. We are not looking at a booming 2011, he said, but certainly a better market than in 2009-2010. Rents will be stable to slightly decreased and aggressive office landlords will continue to offer incentives. The highest quality spaces will be leased at lower rates and smart companies will take advantage of the down market. Downtown vacancies will increase as the suburban market continues slow recovery.

The good news is that tenants and users are now looking out three to five years, rather than next six months, and improving demand and limited new construction will enhance rental growth in 2012 and 2013.

Southern Maine Industrial Forecast

Greg Perry, Cardente Real Estate

The Southern Maine industrial market got off to a slow start in 2010, but there was more activity than in 2009 and the year overall was rescued by a strong 4th quarter. It was an excellent tenant's market in part due to landlords making significant concessions. There was an increase in flexible space leases and sales. Very limited new development helped to steady lease rates and sale prices. Looking ahead to 2011, Perry sees a continuation of the excellent tenant's market and absorption of existing newer space. In addition, he also forecasts:

* Limited investment sales
* Steady lease rates and sale prices
* An uptick in flex unit sales, leases and developments
* Continued vacancies at functionally obsolete industrial buildings
* Good opportunities for owner-users thanks to lower construction costs

Maine Vacation/Hospitality Forecast

Daren Hebold, Daigle Commercial Group, Inc.

Thanks to the best summer weather in a decade, summer visitors were up 8% (to 13.7 million) last year. The average stay was four nights, with total overnight guests up 14% to 9.5 million. Occupancy was up 3%, the average daily rate was up 3%, and RevPar (revenue per available room - the principal measure of a property's performance) was up $5.00.

Buyers of hospitality properties are focused on vibrant coastal submarkets, said Hebold, with the active markets including York, Ogunquit, Kennebunkport, Portland, Camden, and Bar Harbor. A handful of multi-property ownership groups have cash and are making strategic acquisitions.

The strongest demand is for high quality, coastal properties with robust revenues, while buyers are staying away from redevelopment opportunities and entry-level properties with a value of less than $1 million. The lending environment for properties remain tough, with banks blending or extending loans with a limited number of distressed property owners. "Viable" property transactions, however, are still being financed by local banks that have a comfort level with the hospitality market. 75%+ loan-to-value and approximately 6% interest rates are still available for strong buyers, but banks often have a preference for SBA Section 504 loan enhancements, and appraisals MUST support contract prices.

Looking ahead, Hebold said adverse trends impacting the industry could include:

* A poor economy presenting continued hospitality challenges
* Group business travel is slow to recover, creating continued pain for franchised properties
* Spotty recovery among leisure tourism submarkets
* Dim hope for older, underperforming properties with intrinsic challenges such as: less sophisticated owners and inadequate reservation systems; geographic, economic and physical obsolescence; and being dropped by national franchises
* Slow growth of room rates
* No interest or tolerance for lower tier properties among buyers

On the other hand, Hebold sees favorable trends that could help the industry in the year ahead:

* The supply of new rooms is very light.
* The industry's high barrier to entry will buoy existing properties' performances.
* Maine's "Quality of Place" will continue to pay dividends in terms of strong tourism.
* High quality properties in hot submarkets are in vogue; they will continue to rebound from 2009 lows and thrive, and there is substantial acquisition money on sidelines for such properties.
* Banks will increase disposition of distressed assets, creating liquidity and enabling healthy restructuring.

Southern Maine Residential Forecast

multi-family

Brit Vitalius, Vitalius Real Estate Group

The number of multi-family properties for sale has started to climb back up, as have prices, but both are well below pre-recession levels. According to Vitalius, at least 25% of all multi-family sales are short sales or bank owned these days, and while the sale process is faster than previous years, second-position loans can delay or obstruct closings and incorrectly executed foreclosures can terminate transactions, resulting in headaches for both buyers and brokers. Moreover, the median sale price of short sale and bank-owned properties, or REOs, is about 66% of traditional sales.

Area vacancy rates are 0 - 5% for Portland; 10 - 15% for Biddeford; and 15 - 20% for Lewiston/Auburn. Landlords are split over whether or not it was more difficult to find tenants last year than in 2009, Vitalius said, with slightly more saying it was harder and most landlords saying that rental prices were unchanged from the prior year.

Hot issues for landlords in 2010 were bedbugs, including misconceptions about the problem and how to treat it, new EPA lead paint rules affecting the renovation of pre-1978 residential properties and finding good tenants.

Vitalius's forecast for 2011 includes the following predications:

* Short sales, foreclosures and REO's will continue at a similar pace.
* Portland commercial sales activity will remain steady with no decrease in pricing.
* Saco/Biddeford and Lewiston/Auburn properties will find buyers as aggressive investors seize on bargain pricing and awareness of good deals grows.
* 2-4 unit sales will remain steady, given that there will be no dramatic shift in the buyer pool or financing options. Any loosening of lending standards will increase first-time buyer activity.
* Residential interest rates as high as 5.5% will have little or no effect on the market, but 6% may create resistance.
* All sales will be helped by an increase in quality inventory. Long-term owners are getting tired of the difficult rental market, don't believe in near term appreciation, and will finally sell.
* Portland rents will increase marginally given the low vacancy rate.
* Rents and vacancies will stabilize in Saco/Biddeford and Lewiston/Auburn as the economy improves.

residential

Mike LePage, RE/MAX Heritage,

There was a jump in home sales in the middle of 2010 as the first-time homebuyers credit came to an end, but overall sales volume in dollars was at 2002 levels and at only 61% of the decade-high volume in 2005. The median U.S. home price is back to 2002 levels, and while the median sale price of a home in Maine climbed from $160,000 in January to $175,000 in June, it fell back to $172,500 by December.

In order for home values to stabilize, LePage the following things need to happen:

* Foreclosures steadily fall
* Strategic default lessens and underwater homeowners become hopeful
* FHA and Fannie/Freddie finances improve (will need less taxpayer funds)
* Consumer spending opens up
* Normal growth rates in sales and prices become self-sustaining

LePage offered what he called a baseline outlook for 2011:

* Mortgage rates rise to 5.0% next year and up to 5.9% in 2012
* People still fussing about home values could miss out on low rates

* No meaningful change in the national home values in the next 2 years
* Home sales continue to be choppy but improve overall in line with job growth
* Pent-up demand compelling affordability conditions draw people back into the market

Overall, LePage said 2011 will show modest growth in sales volume, value and interest rates.

Maine State Economic Forecast

Charles Lawton, Planning Decisions

According to economist Lawton, the view of the future is "murky." The best way to understand what is likely to happen in 2011, he said, is to understand how the recession of 2007-09 is different from the most recent recessions and think about what those differences mean for the coming year.

The 2007-09 recession has run deeper and longer than other recessions of the past two decades. Although the recession technically ended in 2009, 2011 will represent the fourth year of the economic downturn. Best estimates show 2011 getting us back to 96% of where we were when the recession began.

And while the 1990-91 and 2007-09 recessions are similar in terms of the fall in home prices, in 1990 and 1991 home sales picked up from bottom of recession; in 2009 and 2010 home sales picked up artificially and have fallen again.

Coming out of the 2007-09 recession, the weakest area of recovery has been non-residential construction. There is lots of vacancy in non-residential space and new construction has been discount store-oriented, with much of that the repurposing of existing buildings. Lawton also noted that in earlier recessions, the labor force continued to grow while this time around the Maine labor force fell from 706,000 in 2008 to 694,000 in the third quarter of 2010.

Lawton said that the key questions for 2011 are:

* Boomers say they want to move, but will they abandon sprawling suburbs for urban and village centers?
* Will Maine be sufficiently attractive to draw migrating boomers?
* Will Maine support or attract enough growing businesses to keep or attract young people and fill vacant commercial spaces?
* Has the bursting of the housing bubble fundamentally changed how Americans view housing?

Founded in 1985, MEREDA is an organization of commercial real estate owners, developers and related service providers, whose mission is to promote an environment for responsible development and ownership of real estate throughout the state of Maine. The organization provides governmental advocacy and education programs, as well as networking opportunities, on behalf of its members and the industry. The Annual Real Estate Forecast Conference and Member Showcase is the MEREDA's signature event.