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2007 office market survey: new construction was active as well as large-tenant leasing sector

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2007 was a year of mixed messages for the Greater Portland office market. Direct and overall vacancy increased two full percentage points each to 6.53% and 7.15% respectively; net absorption was negative for the first time in over a decade; and leasing activity decreased 29% with respect to the number of leases signed. However, new construction was active, as was the large-tenant sector of the leasing market.

* Downtown overall vacancy increased for the first time in three years, rising 1.23 percentage points to 8.09%. The results were mixed by Class with the A sector down by 2.6 points to 4.9% and the B sector up 3.46 points to 9.94%. The recent vacancy of 85,470 s/f by Anthem BC/BS at 110 Free St. is the primary contributor to the increase in the B sector.

* Suburban overall vacancy increased sharply from last year rising to 6.35% vs. 3.69% in 2006. However, the increase can be attributed to the vacancy of 116,514 s/f at 300 Southborough Dr., where Unum's lease expired in the fall. The current level of overall vacancy is more in line with the 5-year and 10-year averages of 5.64% and 5.14% respectively.

* The Greater Portland office market grew by 205,209 s/f in 2007, or 2.2%, with new construction and renovation projects spanning downtown and suburban markets. The Greater Portland office market now stands at 9.5 million rentable s/f, with an average annual growth rate of 2.65% since 1993.

* Net absorption was negative in 2007 by 1,878 s/f or .02%, the first negative posting since 1995. Prior to this year, the rolling 5-year and 10-year averages were positive at 1.82% and 2.35% respectively. The national office absorption average for 2007 is expected to be 1.6%.

* For the year, asking rental rates remained flat in the downtown market but increased nearly 5% in the suburban market. Nationally, asking rental rates ended the year up 8%, but are anticipated to fall to just 2% growth for 2008.

* The national office market vacancy rate is anticipated to end 2007 at 12.9%, with a rise to 13.2% for year-end 2008. With direct and overall vacancy rates of 6.53% and 7.15% respectively, we continue to maintain a healthy level of vacancy at nearly half the national average.

Lease transactions and small owner/user sales were down in 2007. However, quality investment properties attracted multiple offers and large-tenant leasing was active. Looking toward 2008, we know 100,000 s/f of fully-leased Class A office space will come on-line at 84 Marginal Way. Furthermore, we know that multiple large tenants are actively seeking space. We believe several of these large tenants will absorb enough space to back-fill the 60,000 s/f to be vacated by Citigroup at Canal Plaza and Two Portland Sq. in 2008, as well as absorb some of the existing vacancies. In the end, we predict overall vacancy will remain near 7% and net absorption will be positive by 50,000 s/f. We further anticipate asking rents and leasing activity to remain even with last year through the first half of 2008, but to gain momentum heading into the third and fourth quarters.

Downtown

2007 was a relatively positive year for the downtown office market. Overall vacancy increased slightly to 8.09% as of year-end, but new construction added nearly 90,000 s/f to the market. The by-product was positive absorption of 44,425 s/f with asking rental rates level with 2006.

In the Class A sector, direct vacancy decreased nearly 45% dropping to 3.76% vs. 6.72% the prior year. Contributing to the reduction was the 29,540 s/f lease by Pierce Promotions at One Monument Sq. and the 7,600 s/f lease by Legacy Properties at Two City Center.

Additionally, a 10,400 s/f reduction in available space at Two Portland Sq. aided in lowering the rate. Overall vacancy was also down for the year, decreasing 2.6 percentage points to 4.9%. Earlier in the year Visa's decision to leave the state left a large sublease vacancy at Two Canal Plaza. But with subleases by Kemp Goldberg for 17,710 s/f and Wachovia Securities for 2,530 s/f, all but 6,000 s/f of sublease space was absorbed during the year. In the end, the A sector downtown absorbed close to 50,000 s/f in 2007.

The biggest impact on the downtown market was the addition of 90,000 s/f in the Class B sector, with new buildings at 300 Fore St. (61,129 s/f over six floors) and 63 Marginal Way (27,740 s/f over four floors). The 300 Fore St. property, developed by Olympia Equities, was offered for sale as condominium units by floor. The Council on International Educational Exchange purchased the top five floors as a way to combine their Portland and Boston offices. The 63 Marginal Way property, developed by ATL Holdings, provided expansion space for AAA on the third and fourth floors, as well as office space for Gorham Savings Bank and Turner Barker Insurance.

In the Class B sector, 2007 marked the first increase in both direct and overall vacancy in four years, closing the year at 9.62% and 9.94% respectively. The most notable factor contributing to the increase was Anthem BC/BS vacating 85,470 s/f at 110 Free St. The building was subsequently sold to a Trammell Crow investment group, which is planning on significantly renovating the building with a possible addition of 20,000 s/f along the Spring St. side. Without this impact, the Class B sector would have ended the year roughly even with 2006 in terms of vacancy. The end result was negative absorption of 3,128 s/f

Looking ahead to 2008, Intermed and Drummond Woodsum will occupy nearly all of the 100,000 s/f building under construction at 84 Marginal Way. Occupancy of this Atlantic Bayside Trust LLC development, their third building at this corner, is expected in the fourth quarter of 2008. Several large national tenants, including Smith Barney and Stantec, are currently in the market and expect to secure leases in 2008. We expect 2008 to be an active and transitional year with downtown vacancy remaining close to 2007 levels and absorption remaining positive.

Part 2 will appear in the March Northern New England edition.

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Suburban

2007 was a year of mixed results for the Suburban office market. Direct and overall vacancy increased nearly two-fold and net absorption was negative by 46,303 s.f. However, new construction and renovation projects were active in the Class B Sector, adding 90,000 s.f., and asking rental rates increased by 5% across both A & B sectors. The Suburban office market now stands at 5,123,843 s.f., representing 54% of the Greater Portland office market.

The Class A sector posted the largest increase in direct and overall vacancy, increasing from below 1% to 5.99% on the direct side, and from 2.36% to 6.63% on the overall side. The largest factor for the increase was the re-emergence of 300 Southborough Drive to the survey. With Unum's lease now concluded, this full-building vacancy added 116,514 s.f., nearly 5%, of direct available space to the A sector. Furthermore, asking rents at this building have aided in boosting rental rates 6% above last year's levels. The net result was negative absorption of 127,663 s.f. There was no new construction in the A sector, and the only notable sale was the purchase of 600 Sable Oaks Drive by Brookwood Sable Oaks Drive LLC, an out-of-state investment group.

Multiple lease signings in the Class A sector that helped offset the rise in vacancy included: One Beacon's renewal of 28,114 s.f. at 707 Sable Oaks; IDEXX sublease of 23,770 s.f. at One Riverfront Plaza; Aetna's expansion into 14,436 s.f. at 175 Running Hill Road; New York Life's lease of 7,584 s.f. at 500 Southborough Drive; and APS Healthcare's partial sub/direct lease of 6,331 s.f. at 600 Sable Oaks Drive.

The results in the Class B sector were more favorable. New construction/renovations added 90,000 s.f. in 2007, with owner-user and investor projects in Scarborough (400 and 600 Technology Dr. at Enterprise Business Park), Westbrook (15 Saunders Way), Falmouth (12 Northbrook Drive and 380 US Route One), and Portland (41 Hutchins Drive). The by-product of this activity was net absorption for the year of 81,360 s.f. in the B sector, and a bump in asking rental rates of nearly 4%.

Vacancy increased in the B sector, but only by roughly one percentage point. For the year, direct vacancy was 5.51% and overall vacancy was 6.08%, both at levels very near their respective 5-yr and 10-yr averages. Class B leasing highlights for 2007 include: Woodfords Family Services lease of 26,880 s.f. at Saunders Business Park; United Health Groups 12,296 s.f. lease at 340 County Road; and Schaller Anderson's 8,762 s.f. lease at 207 Larrabee Drive.

We conclude that 2007 was a transition year for the Sub-urban office market. Vacancy rates returned to 5-yr and 10-yr averages, while expansion was evident in multiple towns. For 2008, we expect overall vacancy to tighten to below 6% in both A and B sectors, and asking rental rates to remain level with the increases posted this past year.