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Vermont commercial real estate market continues to show strength at mid-year

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The commercial real estate market in Vermont is showing continued strength as we move through the middle of the year in 2014. The one exception to the overall strength of the market continues to be the office segment and particularly the suburban office market in the greater Burlington area.

RETAIL: From the beginning of the year, retail vacancy has moved down to a record low of 4.1% from the end of 2013 when the previous low point was 4.4%; these recent vacancy rates are well below the 10-year average of 6.8%. Rents have been strengthening on the Church St. Marketplace in downtown Burlington along with premium suburban locations and have stabilized in other areas. Overall growth is very modest at 1.1%, way under the historical average growth rate of 2.6%. Even though retail growth is slow, it is the second consecutive year we have seen positive growth after a dismal four years prior, and the highest growth since 2008. A significant amount of the projected growth is through the conversion of former office space in the CBD in Burlington including a couple of locations along College St. and a large new retail presence for L.L. Bean on Cherry St., connected to the Burlington Town Center mall.

OFFICE: We continue to see a clear dichotomy in the office market trends between localized Class A and Class B inventory as well as the CBD market versus the suburban market. While CBD rents have stabilized, we have seen continued negative pressure on suburban market rents as the result of a massive 12.0% suburban vacancy. The CBD vacancy rate came down significantly in the first half of 2014 to 5.3% from 2013 year end vacancy rate of 7.5% through positive absorption, no new supply and the conversion of some former ground floor office space to retail space. Growth in the office sector is entirely concentrated in the suburban market with 1.7% growth projected representing 150,000 s/f of space. The office market is expected to remain oversupplied with substantial vacancy for several years. What will be interesting to watch is whether CBD office tenants will be lured to the suburban market by lower rents and free parking, or if a preference for urban space office space within a walkable mixed-use environment will win the day.

INDUSTRIAL: Although industrial vacancy grew slightly to 5.5% from 5% at the end of 2013, current vacancy is still substantially below the long-term average vacancy rate of 7.4%. Growth for 2014 is projected at 3.0%, which is slightly higher than the long-term average annual growth rate of 2.3%. Vacancy is expected to edge slightly higher by the end of 2014, but will remain below long-term average vacancy levels, and very little new supply is projected for 2015. Supply projections can shift quickly in the industrial market, so depending on demand, we may see the supply projection for 2015 inch up as we get closer to the start of next year. Rents are expected to remain stable with the industrial market favoring landlords over tenants to some extent.

MULTI-FAMILY: As we are seeing across the country, the apartment market has predictably seen sustained growth into 2014 and is projected to continue for the foreseeable future. 388 new units are projected to come online by the end of 2014, nearly double the average annual supply increase of 196 units. This level of growth has been consistent for the last 3 years and growth has been above average since 2009. Despite this relatively high level of increased supply, the vacancy rate has been trending lower and currently stands at 0.9%, almost a full percentage point lower than the 1.8% vacancy rate at the end of 2013 and significantly lower than the long-term average vacancy rate of 1.4%. Additional new supply may begin to soften the market with increased vacancy levels, though supply is expected to remain anemic and it is highly unlikely that the market will reach what most would consider a healthy balance of supply and demand. Rental rate growth was at 2.9% in 2013, slightly lower than the long-term average growth rate of 3.4%. Our company is currently under construction with over 100 new apartments in the Burlington area market and projects that are currently close to completion are leasing quickly. Sale prices for existing inventory are at an all time high and continue to increase with very little inventory of existing apartment buildings for sale.

RATES OF RETURN: Industrial cap rates have increased modestly in recent years with average industrial cap rates in the 2010-2014 period standing at 9.1% vs. 8.7% during the 2006-2009 period. Office cap rates have remained stable at 8.5% over the 2006-2014 period. Conversely, retail cap rates have dropped slightly to 8.4% in 2010-2014 vs. 8.7% in 2006-2009. Cap rates for multi-family properties inched up slightly to 6.9% in 2013 versus 6.8% in 2011 and 2012. It will be interesting to see how rates of return shake out for 2014, my prediction is that industrial and office cap rates will remain stable while retail and multi-family cap rates will decline slightly.

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The Allen and Brooks June 2014 Report provided information for this article. Allen and Brooks is a leading appraisal services firm located in South Burlington, VT.