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Commercial real estate market showing continued strength as move into spring of 2015

March 26, 2015 - Spotlights

The commercial real estate market in Vermont is showing continued strength as we move into the spring of 2015. 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: As of December 2014, retail vacancy remains at a record low of 4.3% inching up slightly from the all time record low of 4.1% in the middle of 2014; these recent vacancy rates are well below the 10-year average of 6.6%. Rents have been strengthening on the Church St. Marketplace in downtown Burlington along with premium suburban locations and have stabilized in other areas. Suburban vacancy is anemic at just 3.1% with higher vacancy in the CBD in Burlington at 10.1% due primarily to recent vacancies in the Burlington Town Center mall. Overall growth is projected at a very modest level at 0.8% for 2015 after growth of 1.5% for 2014, both way below the historical average growth rate of 2.5%. We are back down to dismal growth for 2015 after a slight upward trend from 2012-2014. Sites suitable for strong retail development are few and far between with a number of potential projects either stalled or on the boards for some uncertain future date. A significant amount of the growth from 2014 is from 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. The future of the Burlington Town Center is in question as the current owner, who acquired the property in late 2013, is rolling out a public vision for large scale mixed-use redevelopment of the centrally located downtown 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 11.2% suburban vacancy, improved slightly from 12% vacancy in the middle of 2014. The CBD vacancy rate came down significantly in the first half of 2014 to 5.3%, but then ticked up at the end of 2014 to 6.7%, equal to the long-term average vacancy rate for the CBD indicating a balanced market. Growth in the office sector is entirely concentrated in the suburban market with 1.7% growth projected representing 144,000 s/f of space. The office market is expected to remain oversupplied with substantial vacancy into at least 2016, but could last longer as the state of Vermont vacates temporary office space in the Burlington area to move back into space in the Waterbury State Office Complex that was severely damaged by Hurricane Irene. 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 office space within a walkable mixed-use environment will win the day.

INDUSTRIAL: Industrial vacancy grew more substantially to 6.8% at the end of 2014 from 5.5% midyear, however current vacancy is still below the long-term average of 7.4%. Growth for 2015 is projected at 1.6%, which is slightly lower than the long-term average annual growth rate of 2.3%. Vacancy is expected to remain slightly below long-term average levels. Supply projections can shift quickly in the industrial market, so depending on demand, we may see the supply projection for 2015-2016 inch up as we get closer to the middle of this year. Rents are expected to remain stable with the industrial market favoring landlords over tenants to some extent.

MULTI-FAMILY: As we have been seeing across the country, the apartment market has predictably seen sustained growth into 2015 and is projected to continue for the foreseeable future. 310 new units were completed in 2014 and 487 are projected to come online by the end of 2015, more than double the average annual supply increase of 204 units. This level of growth has been consistent since 2012 and growth has been above average since 2009 with the most significant growth projected for 2015. Despite this high level of increased supply, the vacancy rate has been holding low and stood at 1.7% at the end of 2014, nearly equal to the 1.8% vacancy rate at the end of 2013. The vacancy level typically dips down midyear and will likely be in the neighborhood of 1.0% by June, it was 0.9% in June 2014 and 1.2% in June 2013.

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 2.3% in 2014, 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 2012-2014 period standing at 9% vs. 8.7% during the 2006-2011 period. Office cap rates have remained stable at 8.5% over the 2006-2014 period. Conversely, retail cap rates have dropped slightly to 8.3% in 2012-2014 vs. 8.7% in 2006-2011. Cap rates for multi-family properties inched back down slightly to 6.8% in 2014 versus 6.9% in 2013. It will be interesting to see how rates of return shake out for 2015, my prediction is that industrial and office cap rates will remain stable while retail and multi-family cap rates will decline slightly.

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

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