



nerej

New Hampshire midyear report and trends: Commercial office and industrial markets - by Bob Rohrer

July 26, 2019 - Spotlights

Bob Rohrer,
Colliers International|N.H.

A look at occupancy rates and lease rates in the office and industrial markets across the state point to several interesting trends – trends that have been the calling card for the New Hampshire market for several years. Occupancy rates continue to tighten, while rents, in general, remain stagnant. Typically, high occupancy rates lead to an increase in rental rates. This has not been the case in New Hampshire. We see several market factors that have contributed to this anomaly along with some indicators that could apply upward pressure on lease rates for the back end of 2019 and into 2020.

In New Hampshire, Colliers tracks 67.7± million s/f of industrial space and 20.8± million s/f of office space in buildings or condominiums larger than 10,000 s/f across six submarkets.

At the close of Q2 2019, our research shows the New Hampshire industrial market at an overall occupancy rate of 94.21% (63.8± million s/f), which is marginally lower on a year-over-year basis. This is likely the result of an increase in the inventory we track, specifically the addition of 3.1± million s/f to our industrial inventory at the beginning of 2019. Even with the slight drop in occupancy rates, 362,240 s/f was absorbed year-over-year, bringing the market as close to full occupancy as we have seen. This should translate into upward pressure on lease rates, but with the exception of the Salem submarket, rent increases were nominal.

The office occupancy rate at the close of Q2 2019 was at 92.14% (19.2 million s/f) - a meaningful year-over-year increase of 2.3%. Lease rates, however, were unchanged. Absorption, on a year-over-year basis, was 318,500± s/f, which includes 755,000± s/f of space added to the asset base. With very little space available, particularly in Portsmouth, one would expect rents to climb. That is how markets are supposed to perform when demand outpaces supply. Why is that not the case here?

There are several contributing factors that are impacting the lack of effect high occupancy rates are

having on lease rates. The first is that, while the economy is good, tenant space needs are not increasing at the rate of overall business activity. That is likely because office users and industrial users are looking at even more efficient ways to use space. Offices that once leased at 250 s/f per employee are not now typically seeing utilizations around 150 s/f per employee and lower. Flexible work schedules and home office utilization are also used to lower a company's need for office space while increasing output. On the industrial side, improved efficiencies in manufacturing and warehouse/distribution processes (robotics, etc.) have increased productivity per s/f.

The cost of construction also plays a role – costs continue to rise, with an estimated year over increase of 5% added on to similar increases from the previous five years. This makes it difficult to consider adding office or industrial inventory when current lease rates are too low (as much as 30 to 40% too low) to make it feasible to build spec or near spec office or industrial space. This eliminates the “if you build it, they will come” possibility from the market.

Another contributing factor is the affordability and availability of debt. Interest rates are again at the low 4% range, lower year-over-year, and historically well below the 10-year average. Additionally, many companies can take advantage of financing vehicles such as SBA loans. Low debt not only helps offset the increased cost in construction, but also makes it very attractive for companies to build their own facilities when compared to leasing at new construction rates.

So, will the supply/demand relationship have the expected impact on lease rates anytime soon? That is tough to say, given the myriad of variables. I believe that if the U.S. economy continues to expand, New Hampshire will as well. It will take an increase in new entrants to the state to add to the organic growth of New Hampshire companies. If office users continue to focus on the need to attract quality employees, the increased cost of leasing new office space will become more palatable. This has certainly contributed to the growth of the greater Boston markets and many other regions. If industrial users find that the efficiency of new construction is worth the increased lease cost, space will be added. Such growth is starting to take place in the Rte. 128/I-495 areas. If debt becomes more difficult and more expensive, users could again find leasing new facilities more palatable. We have been waiting for these variables to align for several years.

While the majority of the submarkets we track are still waiting for the variables to align, there are already some locations where market pressures are working. Unique opportunities like new construction (or newly renovated) office space with water views in Portsmouth are garnering considerable interest at lease rates significantly higher than the statewide average. With the office park on Constitution Dr. in Bedford almost at full occupancy, 92.9%, a new 44,000 s/f spec office building broke ground in May 2019. Additionally, there have been several large scale build-to-lease warehouse/distribution facilities developed around the Manchester-Boston Airport over the past few years. If the surrounding areas start to see variables align maybe the second half of 2019 and into 2020 we will see more growth.

Bob Rohrer is managing director for Colliers International, Manchester, N.H.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540