nerej
CELEBRATING 55 YEARS

Sale prices per s/f will rise, and the gap between existing and new construction costs will shrink - by Justin Lamontagne

August 30, 2019 - Spotlights

Justin Lamontagne,
NAI The Dunham Group

NAI The Dunham Group is pleased to present, for the first time, a mid-year review and update to our annual industrial market survey. 2018 marked the first “correction” we’ve seen since we began tracking market conditions in 2011. Many of our industrial clients and property owners have asked how the trajectory is looking this calendar year. To that end, the following is a summary of what we’ve seen in the first six months of 2019.

At the close of 2018, greater Portland’s industrial market overall vacancy hovered at 3.5%, lease rates were plateauing at an average of $6.50 per s/f NNN and sales prices had climbed to an average of $65 per s/f. For the first time in many years we started to see slight signs of a slow-down. Several vacancies sat longer than anticipated, lease pricing seemed to get significant tenant pushback at the $7 per s/f NNN level. Furthermore, a small handful of speculative industrial projects languished empty longer than developers had prepared for.

Indeed, the first quarter of 2019 continued on a relatively slow trajectory. We began to hypothesize that this was the long-anticipated end of our bull market. Fortunately, the 2nd quarter and indicators for the 3rd suggest we still have steam left in this engine. Leasing activity picked up significantly this spring and sales action and volume continue to set records.

As of July 1, the greater Portland vacancy rate is down to 2.5%, a full 100 basis points lower than last year. This positive absorption suggests businesses are still growing and looking for expanded real estate solutions. On the other hand, it continues a challenging trend for end-users. 2.5% is simply not enough inventory to support a market like ours. Many industrial businesses are forced to consider new construction. As Sam LeGeyt points out herein, that decision comes at quite an expense. Despite the costs, we have seen several new ground-up projects in the last year or two with more to come. In Saco, there has been over 250,000 s/f of inventory added in the past calendar year. Even with the added square footage, their vacancy rate is less than 2%.

Sales demand for existing inventory remains at an all-time high. This constant demand has driven average sales prices towards $70 per s/f with peak pricing well over $100 per s/f. Anecdotally, the last two industrial properties I've put on the market lasted a total of 10 days on market and each had multiple offers. Appraisers are starting to catch up, but it isn't unusual for these transactions to appraise under contract pricing. This is forcing buyers to come out of pocket as seller's maintain significant leverage and aren't in a position of needing to negotiate.

The bottom line is that our industrial clients still prefer to buy existing buildings when possible. We have advised them to be ready to jump when opportunity arises and be willing to pay a premium in order to win a deal. Therefore, I predict sale prices per s/f will again rise, and the gap between existing and new construction costs will continue to shrink.

Nationally, the industrial sector remains as healthy as ever. Speculative construction has kept up with demand and vacancy rates remain historically low throughout most of the country. Tertiary markets, in particular, are seeing great new development as businesses are attracted by cheaper land, tax incentives and interstate connectivity to find employees. In fact, many manufacturing businesses are choosing labor pools over geography as the driving reason for plant location.

In summary, the industrial market has rebounded nicely from a slow six-month period towards the end of 2018 and heading into 2019. We anticipate continued demand for sales inventory, and I suspect lease pricing will maintain its average of $6.50 - $6.75 per s/f NNN range. The big question is how much additional inventory will be added in the coming years and how it will impact our market.

Justin Lamontagne, CCIM, SIOR is a partner | designated broker with NAI The Dunham Group, Portland, ME.