Appraisal - Northern New England industrial market - by Bill Pastuszek

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As we all pretty well know, industrial markets – by that, including warehousing, logistics, etc. – have been the darling property sector during COVID-19. CBRE's 2020 Market Overview noted that "the U.S. industrial market will see some dramatic shifts in 2020. Absorption gains will be difficult to achieve and some overhand of inventory is likely."

The 2021 Greater Boston industrial market continued to "surge" in 2021, recording over 1.6 million s/f of positive absorption in 4Q2021 with 7.7 million s/f absorbed in 2021, "the most ever recorded in the market in a single year." "Asking rents continued to rise quickly, finishing the quarter at $12.55 per s/f NNN, an increase of more than 8% from Q3, and up an unprecedented 21.8% year-over-year." Availability rates - down 50 basis points (bps) to 3.2%, quarter-over - quarter - and vacancy rates - down 40 bps to 1.5% - reached historic lows in the 4Q2021. The availability rate declined by 50 bps to 3.2%, while vacancy dropped by 40 bps to 1.5%.

The report goes on the say that "[d] riving Greater Boston's insatiable level of demand is a tenant landscape more diverse than perhaps any other market in the country." CBRE forecasts that this "current level of demand will continue to outpace supply for the next 18 to 24 months at minimum, as there is just 2.9 million s/f of speculative development under construction," much of which is spoken for. CoStar reports similar news.

The Northern New England industrial market has continued to thrive. A January 2022 Boulos Company report notes, there is an "extremely tight industrial market with vacancy rates hovering between 1.5% and 2% in Greater Portland and demand remaining strong." Demand is reported to be particularly strong in the 5,000 s/f segment of the market.

The Boulos reports states that the Portland market is in a position to address supply chain issues that have plagued the economy since the work of COVID ended. With high rents and little to choose from further south, tenants and investors are willing to invest in the "small(er)" markets of Northern New England.

The Boulos Company states that the Greater Portland's industrial sector will continue to be attractive to local and regional investors. The report states: vacancy will "remain in the range that we have seen the last few years until new inventory can catch up to demand. Speculative development may increase, so long as construction costs do not prove to be too prohibitive for developers/investors." "while the average lease rate in the industrial sector has increased over the last few years, there is probably a "ceiling to these asking rates beyond which tenants will not find feasible," consistent with the smaller scale of those markets.

CoStar shows vacancy in the three Maine markets it surveys – Portland, Bangor, Lewiston-Auburn – to be between 2 and 3% and vacancy should remain below 5%. Portland market rents - at $8 per s/f – are about $2 per s/f higher than the other markets.

Portland has seen rent increases of 7%+ with a 5.7% gain over the past 3 years and shows the strongest absorption among Maine markets. Market cap rates range from 7.5 – 8.2%.

Cushman & Wakefield noted that, for 2021, strong investor appetite with tight supply, strong tenant demand, and NOI growth would keep cap rates at or near record lows. Cap rate declines have been “broad-based” across industrial market classes, and, while probably at bottom, have shown the way to an “impressive shift” in values. Industrial continues to be perceived as a “top performing asset class” there aren’t a lot of indications of a slowdown. Over the past decade, total annualized industrial returns have outpaced non-industrial product types.

What challenges do appraisers face in dynamic industrial markets, especially in Northern New England? The performance of these markets in general and specifically of the traditionally stable, if not slightly sleepy, northern New England is subject to that cherished appraisal principle of change. It’s at work in these markets, which means appraisers have to cast aside historical perceptions and have cutting edge information and perspective in order to arrive at valuation that accurately taken into account market shifts and current trends.

Market dynamics include a shift in buyer demand as buyers are priced out of Boston market, under development over many years, and an older existing building stock. Appraisers need to consider how rapid increases in rents and prices and a downward trend in cap rates play into strong demand, limited inventory, and, suddenly and surprisingly, an inflationary environment. Small markets mean appraisers do not have the luxury of a multiplicity of data points, thus requiring careful evaluation of rentals, sales, and development activity.

Market bubbles, a market tipping point being reached, and the inevitable deceleration on the back side of the market cycle are all concerns shared by appraisers, analysts, and investors. In these uncertain times, it is always the right time to watch markets carefully and to consider the long view that prudent investors take, while also recognizing short-term market shift. Even assuming worst cases, and with all things being reasonably equal, the prospects for the underserved New England industrial sector in general will continue to track positive.

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