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Industrial market for Northern New England - by Bill Pastuszek

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Industrial markets – which include warehousing, manufacturing logistics, etc. – continue to hold a dear place in the hearts and minds of investors. COVID sparked a boom in industrial real estate across the country and released an incredible amount of pent-up demand in New England.

A few months back, CBRE's 2022 Market Overview announced that "on the heels of record transaction volume and rent growth amid extremely tight supply and high demand, the industrial real estate market will remain very strong in 2022. Demand will primarily be driven by growing e-commerce sales, the improving economy, population migration and the need for onshore "safety stock" inventory to avoid the supply chain disruptions of the past 18 months." Here's a vote of confidence for a continuation of the current positive climate for industrial.

CoStar reports that, nationally, vacancy is 4%, with a cap rate of 6% and a market rent of $10.72. The average market sale price is $150 per s/f. CoStar reports that the record low vacancy rate is set to increase going forward. The Boston market shows a similar vacancy rate and average cap rate with rents of $14.38 per s/f and an average sale price of $183 per s/f. On the other hand, Portland, ME., admittedly a smaller market, is reported to have vacancy of less than 2%, an average cap rate of 7.3%, with an average market rent of $8.75 per s/f and a market sale price of $94 per s/f. CoStar forecasts slightly rising cap rates for Portland and the United States, together with decelerating rent growth going forward but with a positive rent trend.

The good news is that the Northern New England industrial market continues to do quite well, following but not duplicating the metrics of the U.S. as a whole or Boston. An early 2022 The Boulos Company report notes: "We have seen record absorption in 2021 due to demand; and although construction costs have risen due to the increased price of steel and lack of labor in the market, new construction projects have not slowed down, as the demand needs to be met." Absorption in 2021 was positive. Demand is strong for existing product and for new product. The report states: "Warehouse and distribution were the leading uses of the space that was absorbed, due to continued e-commerce demand and final mile needs to keep up with consumer sales."

Looking ahead, vacancy rates across the Northern New England market will stay at current levels - below 2%, consumer e-commerce demand as the effects of COVID continue to guide behavior. Consistent with national trends, the Greater Portland market will continue to experience low inventory, which should continue to propel new construction and to imaginative adaptations of existing buildings.

The Boulos report goes on to say that "while the average lease rate in the industrial sector has certainly increased over the last few years, one would think that there is a ceiling to these asking rates beyond which tenants will not find feasible."

Without doubt, Greater Portland's industrial sector will continue to be attractive to local and regional investors. With rents and land prices lower than further down the coast, it will attract users that don't want or can't pay Boston prices. Additionally, the port provides shipping access for those users that need it. The Boulos report notes: “It is feeling more and more evident that the gap between “major markets” and the Greater Portland market is much smaller than it once was.” Boston, without the high barriers to entry. And Portland has become an appealing place to live, with a good quality of life and robust arts and night life scenes.

A note of caution. The industrial market in 2022 looks just a little bit different than in 2021. With lingering COVID effects, the war in Ukraine, and a doubleheader dose of inflation and higher interest rates.

CoStar News (8/24/2022). The article tells us that after a slowdown in property sales, ‘repricing’ becomes this summer’s dreaded word and rising interest rates, higher costs, and other economic challenges plague commercial real estate nationally. The articles goes on to say that deal volume is reported as being off, lenders are less excited about lending, and market participants are no longer buying on the expectation of high rents.

A west coast broker is quoted as saying: “Investors were underpricing risk at the end of 2021 and early 2022 and now the market appears to be over-adjusting for risk…“This is the first time we can really remember, especially in industrial, where the fundamentals don’t line up with the capital markets…The leasing fundamentals are very, very strong and there’s a disconnect with the capital markets.”

Interestingly, the 2020 CBRE report said 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.” This proved not to be so much the case in 2020: who knew at that time!

But, could 2022 look like the 2020 report’s projections? Even in quiet little New England, we may want to take note of these headwinds that may blow our way.

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