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# CB Richard Ellis' New Hampshire Commercial Real Estate Market Survey

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Reprinted from the CB Richard Ellis' New Hampshire Commercial Real Estate Market Survey

The vacancy rate in the Southern New Hampshire office market, comprised of over 27 million s/f of space, increased slightly over this past year from 16.3% to 18.5% in the Seacoast and remained stable at 13.7% in the I-93/Rte. 3 corridor. This increase in vacancy in the Seacoast is caused by an overall lack of demand from new office users entering from outside the market, coupled with an increase in sublease space coming onto the market and further consolidation in the mortgage industry.

SEACOAST/I-95 OFFICE MARKET

The overall Seacoast/I-95 office market vacancy rate has increased over the past year from 16.3% to 18.5%. The Seacoast office market is comprised of approximately 7.9 million s/f of space with over 70% of the market located in the Portsmouth downtown and suburban submarket (2 million s/f), the Pease Tradeport submarket (1.6 million s/f) and the Dover submarket (1.9 million s/f). Within these three submarkets, Pease has seen a drastic decrease in its vacancy rate, down from 18.7% to 11.6%.

This significant net absorption is attributed to a migration of downtown and suburban Portsmouth office users to the Tradeport. Existing Pease office tenants have also expanded; the United States Passport Center recently back-filled the 75,000 s/f vacancy left by Liberty Mutual at 207 International Dr. The Pease submarket has benefited from tenants being forced to relocate from the Parade Mall in downtown Portsmouth to facilitate the potential redevelopment of the site into a mixed-use retail, office, and residential project in the upcoming years.

Further decreasing the Pease vacancy rate has been the redevelopment of office space at 320 Corporate Dr. into classroom space for Great Bay College as well as the addition of 84,000 s/f of new construction for Newmarket International and a new 56,000 s/f building for Salient Surgical Technologies.

This trading of spaces has resulted in an increase in vacancy for the Portsmouth suburban and Dover submarkets as the Newmarket International and Salient Surgical Technologies spaces that were vacated have not yet been re-tenanted. The Portsmouth submarket vacancy rate increased from 10.7% to 13% while the Dover market vacancy rate increased from 21.4% to 24.4%. In Dover, this increase can also be attributed to the repositioning of the 60,000 s/f McIntosh College Campus as available sublease space and the redevelopment of 110,000 s/f of industrial space into office space at the former Moore Business Forms building at 279 Locust St.

Existing tenants continue "trading spaces" within the office submarkets without an increase in new tenants looking to relocate to the Seacoast. Healthcare, government, software and insurance/finance companies continue to be the leading business sectors driving demand for office product in the Seacoast market.

Given the current market climate and the expected further deterioration of the national economy, landlords are leaving asking rents unchanged. Class A lease rates are currently in the $16 to $21 per s/f, NNN range in the Portsmouth office market. Rates remain steady in the $10 to $13 per s/f NNN range in most of the other submarkets.

There has been continued sales demand for office space in downtown Portsmouth and surrounding areas; however, the virtual freezing of the capital markets may have an impact on the sales market in the Seacoast as we enter 2009. Lending continues on the Seacoast as most properties are financed through traditional local banking relationships for both qualified developers and end-users alike.

Developers are optimistic that the Seacoast office market will remain somewhat insulated from a significant downturn. New construction of build-to-suit projects for qualified tenants both at the Pease Tradeport and in the Dover submarkets should continue. Projects like the 110,000 s/f office build-to-suit for Wentworth Douglas Hospital on Indian Brook Dr. in Dover, and the 50,000 s/f expansion of 155 Borthwick Ave. in Portsmouthâ€”primarily for Portsmouth Regional Hospitalâ€”will continue during 2009.

We do not expect to witness any significant increases in vacancy in the Seacoast/I-95 office market during 2009. Office tenants are clearly taking a wait-and-see approach to their real estate decisions. Tenants actively looking for office space will find the environment increasingly friendly due to the increase in sublease availabilities and more aggressive landlords hoping to make deals on existing space.

I-93/ROUTE 3 CORRIDOR OFFICE MARKET

After showing a slow but steady recovery from a vacancy rate high of 18% in 2002 to a low of 13.7% in 2007, the I-93/Rte. 3 corridor office market stabilized in 2008 and ended the year with the vacancy rate still at 13.7%. The office market is predicted to decline in 2009 as leasing activity is expected to slow in the coming year as traditional users of office space, including finance, insurance and real estate, consolidate and re-evaluate their future needs. We anticipate that the vacancy rates will increase to a range of 14% to 16% range by the end of 2009, due to few new tenants entering the market and slower organic growth of existing companies.

Currently, there are over 550,000 s/f of existing office tenants with leases expiring in 2009 and early 2010 and potentially only 50,000 s/f of new tenants entering the market from outside the region. This environment will create opportunities for tenants to "trade-up" from Class B to Class A space but will not lead to any significant absorption as tenants move within the market. However, healthcare, high-tech and defense related firms are still expected to grow in 2009 but at a slower pace than in the past.

The most obvious shift in the I-93/Rte. 3 corridor resulted from tenants relocating from Class A buildings in Manchester's Central Business District to Class A buildings in the suburbs of Bedford. Bedford's improved infrastructure, lower rents and recent building renovations allowed Bedford to capture over 100,000 s/f of office tenants including USI and Health Dialogue.

As previously indicated, the overall predicted range of vacancy of 14% to 16% for 2009 in the I-93/Rte. 3 corridor office market will continue to create a positive environment for tenants in the market. As a result, tenants with good credit fortunate enough to be searching for space or renegotiating their leases in 2009 will continue to receive incentives including discounted asking lease rates by 5% to 10%, generous tenant improvement allowances and free rent for a period of one to three months on three- to five-year lease terms.

Asking lease rates for office space remained flat in 2008 ranging from around $8 to $14 per s/f NNN and are predicted to remain stable or decrease slightly in 2009. Tenant improvement allowances in 2008 ranged from $10 to $20 per s/f for five- and 10-year terms, respectively. Construction of speculative office space within this market continues to be virtually non-existent and is not expected to change in 2009. One continuing trend is the conversion of industrial buildings into other uses. The most notable of these is the purchase of the former Jac Pac Foods facility by Anagnost Companies, which has razed the building to make room for Elliot Hospital's new ambulatory care operation. When complete, the campus will also include a 100,000 s/f medical office building, a parking garage and supporting retail space. The entire project is expected to cost $100 million to construct.

N.H. INDUSTRIAL MARKET SNAPSHOT

The vacancy rate in the Southern New Hampshire industrial market, comprised of approximately 57.5 million s/f of space, increased in 2008 from 8.5% to 11.4% in the Seacoast and 12.6% to 13.8% for the I-93/Route 3 Corridor. However, demand still remains strong for well-located warehouse and manufacturing properties.

SEACOAST/I-95 INDUSTRIAL MARKET

The overall New Hampshire Seacoast/I-95 industrial market has seen a slight increase in the vacancy rate during 2008 with the downturn in the U.S. economy. The market is comprised of approximately 16.5 million square feet with an 11.4% vacancy rate at year-end 2008. This represents a 2.9% increase from the 2007 vacancy rate of 8.5% but is still in line with the United States National Industrial Availability Index, which at the end of the third quarter of 2008 was 11.4%. This fares better than the Boston industrial vacancy rate, which closed 2008 at 19.3% and the I-93/Rte. 3 corridor, which has a 2008 vacancy rate of 13.8%. Generally speaking the Seacoast/I-95 industrial market is relatively healthy and certainly fares better than other New England industrial markets.

There continues to be demand for industrial space in the Seacoast, especially in the defense, aerospace, medical, telecom, and "green" technology sectors. Albany Engineered Composites, a maker of high-tech textiles and composites for aircraft, has recently leased 84,000 s/f at Airport Dr. in Rochester. In Dover, CRT Processing, a recycler of computer monitors, televisions and other electronic equipment, will be occupying 72,000 s/f of space on Industrial Dr. during the first quarter of 2009. There continues to be a number of industrial tenants looking for space throughout the Seacoast. Landlords that can meet today's industrial tenants' requirements should find that their properties will lease or sell in 2009 if the asking lease rates and sale prices are aggressive.

The trend of redeveloping manufacturing facilities into office, flex or straight warehousing spaces continues. One example is the repositioning of the vacant Celestica manufacturing facility at Pease Tradeport. Whaleback Systems, a straight office user, has leased 48,000 s/f and Kittery Trading Post, a warehouse user, has leased 70,000 s/f. The former Moore Business Forms building on Locust St. in Dover is currently being converted to a mixed-use project of office space. Agility

Manufacturing plans to occupy approximately 23,000 s/f at the Locust St. building for the assembly of printed circuit boards and electromechanical assemblies during the fourth quarter of 2008.

We also continue to see an increase in warehouse/ distribution requirements on the Seacoast, requiring 32-foot ceiling heights, increased loading docks and clear spans. Industrial users seeking build-to-suit opportunities demand well-situated land within a five- to ten-minute drive of major transportation routes. The Seacoast's industrial market will be limited in its growth for new construction as there is a lack of well-situated high quality industrial land suitable for development along I-95, Rte. 101 and the Spaulding Turnpike. In 2008, new construction was driven by Lonza's 280,000 s/f expansion at the Pease Tradeport and Arc Source's new 36,000 s/f building on London Lane in Seabrook.

During 2009 we expect the Seacoast/I-95 industrial vacancy rate to remain in the 11% to 12% range. Despite the national recession, the market remains partially insulated by the diversity of the Seacoast's economy. New Hampshire has already experienced an exodus of traditional manufacturers and the redevelopment of obsolete facilities over the last five years. With the support of local lenders and the projected loosening of available credit, businesses should continue to view New Hampshire as an attractive alternative. We do expect that leasing velocity will slow as tenants take a more cautious approach to their real estate decisions, although demand should remain strong for smaller (5,000 to 10,000 s/f) availabilities fueled by both start-ups and companies choosing to downsize. Landlords will likely become more accommodating and will keep lease rates flat in order to retain and attract quality industrial tenants.

I-93/ROUTE 3 CORRIDOR INDUSTRIAL MARKET

The New Hampshire I-93/Rte. 3 corridor is comprised of approximately 40.6 million s/f of industrial space. Of this amount, approximately 5.63 million s/f is vacant at year-end 2008. This represents a 13.8% vacancy rate, up from 12.6% in 2007. The vacancy rates had been improving over the past few years into the beginning of 2008, but began to deteriorate mid-2008 and are expected to continue their current increasing trend in 2009. We expect asking lease rates to remain flat in 2009 with increases in landlord incentives to capture the available tenants.

The strongest component of the I-93/Route 3 industrial market can be found in the defense, medical and energy related businesses. Axsys Technologies, a surveillance and imaging systems manufacturer for the defense and aerospace industries, doubled its capacity in 2008 to 145,000 s/f with the lease of 67,000 additional s/f at Liberty Woods Technology Center in Nashua. Another 2008 defense related expansion was Insight Technology, a privately held company that develops laser products for the armed forces and law enforcement, which expanded its location at 9 Akira Way in Londonderry by 50,000 s/f.

There was also activity in the medical sector in 2008. Atrium Medical, a manufacturer and distributor of chest drainage systems, PTFE vascular grafts, thoracic catheters, surgical mesh and related products, relocated its U.S. operations to 29 Flagstone Dr. in Hudson, a 44,000 s/f industrial building. Continued demand by defense, medical and energy businesses will help offset the weakness in technology and distribution. If the growth in defense and energy related businesses begins to stall or decrease in 2009, the increase in the overall vacancy rates could accelerate.

The weakest component of the I-93/Rte. 3 corridor industrial market continues to be the lack of demand for manufacturing space. The area has yet to recover from the outsourcing by manufacturing companies capitalizing on less expensive off shore labor. The fact that the current recession is global will reduce demand for New Hampshire exports, which have been on an increasing trend.

New industrial construction in 2008 consisted of industrial condominiums and some owner/user or multi-tenant industrial development. We expect much of the demand for owner/user industrial condominiums to disappear in 2009 even though interest rates will remain low for this type of borrowing. The recent trend of converting well located industrial properties to retail uses also came to an abrupt halt in 2008. Retail projects, in general, will remain shelved for the near term as sluggish consumer spending decreases the appetite for additional retail properties.

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