INDUSTRIAL MARKET OUTLOOK

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Has supply met demand? Has demand softened? It's a bit complicated right now. We are still living in a market with an approximate two percent vacancy rate for the industrial sector. With that said, we are also living in a new economic reality, with inflation creating headwinds in an environment where construction costs are already inflated, thanks to continuing supply chain issues and a labor shortage. It seems like the perfect storm for a huge dip, and perhaps it will happen in larger markets, where there is more speculative building with increased risk exposure. In the Greater Portland market, we seem to be shielded from both the highest of highs and the lowest of lows. Will that continue? First, I'll break out the sector in two ways: leasing vs. capital markets.

LEASING

Flight to quality

Lease rates in our market continue to climb for Class A space due to the lack of supply. I wrote about this last year (and the year prior). Will we hit a tipping point where it is not feasible for tenants to pay the new market rate?

There is a flight to quality across the board. Tenants, big and small, are willing to "pay up" for an efficient building that suits their needs perfectly. When I say "big," I mean tenants leasing manufacturing and warehouse space. Flex buildings are smaller and appeal to tenants looking to bring all operations under one roof.

These smaller spaces, or flex spaces, have incredibly high demand. If a 2,000± SF space with a drive-in door and small office hits the market, it has multiple tenants vying for it, and it commands lease rates in the low to mid-teens. Tenants range from small start-ups to large Fortune 100 companies. Landlords are typically able to lease the space as-is and can dictate their terms as it relates to the lease rate and length of the lease term. I think we have hit our top when it comes to pushing lease rates for these flex spaces.

For the second bucket, I'll focus on space that is over 20,000± SF. If you search today for available space that is 20,000± SF or greater, the results are very thin. Narrow that down to Class A or Class B space, and it gets even thinner.

So, what is the trend we're seeing for tenants looking to lease? Consistent with the last two years, there is a lack of supply. However, it does seem that some of the available space currently being marketed has been on the market longer than what we've seen in the last two years. Does that mean the market is softening? I tend to think so in the sense that the current economic environment is causing some tenants to pause before making a leasing decision. However, this goes back to the "flight to quality" thesis, which remains the theme. If available product in the market doesn't fit for a company looking to lease, new construction is the only avenue. Construction costs have increased, so lease rates must increase accordingly to meet yield expectations. Companies can justify a higher lease rate than they were historically paying because they are able to streamline logistics and save money elsewhere through the process. I also attribute this flight to quality to companies trying to retain their workforce and attract employees. It's not news that there is a labor shortage, especially among skilled labor in the manufacturing and warehousing industries.

The issue we see with new construction is timing. Many tenants in the market are looking for space within 6–12 months. New construction typically takes 18–24 months. Tenants end up saying it doesn't work for their timeline and wait to see if other options become available. When none do, they're back to square one and looking at trying to make new construction work. An owner and/or developer needs to have the right team in place, one that can execute on budget details and provide a proposal to tenants for their evaluation. The more efficient the process, the higher the likelihood that the deal comes to fruition.

With new construction that is not driven by an owner/user, we see space being offered in two different buckets: build-to-suit, where the developer waits for a tenant to sign a lease before starting construction, and speculative building, where the developer gets a building permitted and approved and starts construction. Speculative building is risky, but we have seen deals in 2022 that successfully transacted because the developer broke ground and the tenant felt comfortable with the project's likelihood of completion. This goes back to what I previously stated regarding occupancy timing expectations of tenants.

CAPITAL MARKETS

Stalemate

The capital markets for the industrial sector started out incredibly strong in Q1 and Q2 of 2022. We saw quite a few investment transactions of scale go under contract and close prior to and through the first couple of interest rate increases. The fear of rates increasing further accelerated deals throughout Q2. However, we saw investment sales come to a halt in the second half of the year. What's causing this pause? It isn't solely driven by increasing interest rates.

There is a disconnect between seller expectations and buyer reality. The fact is, there is plenty of capital out there aiming to be deployed in the industrial market. We've seen yield expectations tighten a bit, but if there is no movement on the seller side, the deal doesn't make sense, given the current rate environment. With interest rates doubling over the last nine months, deals have become incredibly tight or just not feasible for buyers looking to make any type of return.

Capital wants to be placed in the Greater Portland market. As I referenced earlier, we don't see the highest of highs, but we also don't see the lowest of lows. This is a strong market from a fundamental standpoint. If we can bridge the gap between seller expectations and buyer reality, deals will continue to transact, and we will see demand continue from a capital markets standpoint.

2023 OUTLOOK

We will continue to see a bit of a slowdown in the first half of 2023, dictated by the overall economic conditions and forecast. If the market finds a "new normal," that could change things significantly. If businesses and investors feel as though the environment has stabilized, they can predict and plan for the future with more confidence. It is widely known that you can't time the market perfectly, but when you can navigate the waters with more confidence, it helps businesses and investors make faster decisions. It's time for sellers to hit reset. Closing the gap between buyer reality and seller expectations would be an excellent thing for market activity. The fundamentals are still strong in our market as long as the return expectations are met. We'll see where things shake out over the next 12 months – Watch for our mid-year industrial market update so that we at The Boulos Company can continue to keep you in the loop.

SIGNIFICANT INDUSTRIAL LEASE TRANSACTIONS

	PROPERTY LEASED	PROPERTY CITY	TENANT COMPANY	SF LEASED
⬢	45 Industrial Park Road	Saco	Major National Retailer	125,000
	341 & 345 Park Street	Rockland	DuPont Nutrition USA Inc.	88,000
	14 Yarmouth Junction	Yarmouth	Cuddledown of Maine	76,000
	28 Pond View Drive	Scarborough	Eco-Build USA LLC	74,724

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SIGNIFICANT INDUSTRIAL SALE TRANSACTIONS

	PROPERTY SOLD	PROPERTY CITY	SALE PRICE	PROPERTY SF	SALE PRICE/SF	CAP RATE
⬢	119 Lisbon Street	Lisbon	$22,917,681	293,763	$78.01	7.05%
	315 Cumberland Avenue	Portland	$20,000,000	243,000	$82.30	DND
⬢	70 Bennett Street	Bangor	$8,100,000	195,690	$41.39	7.90%
	331 Main Street	East Waterboro	$7,000,000	58,800	$119.05	DND
⬢	953 Benton Avenue	Winslow	$6,725,000	112,200	$59.94	7.50%

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