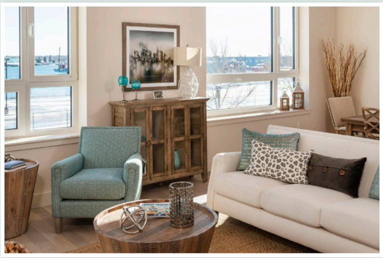
# 100.1

# MEREDA INDEX

## SPRING EDITION

## 2019

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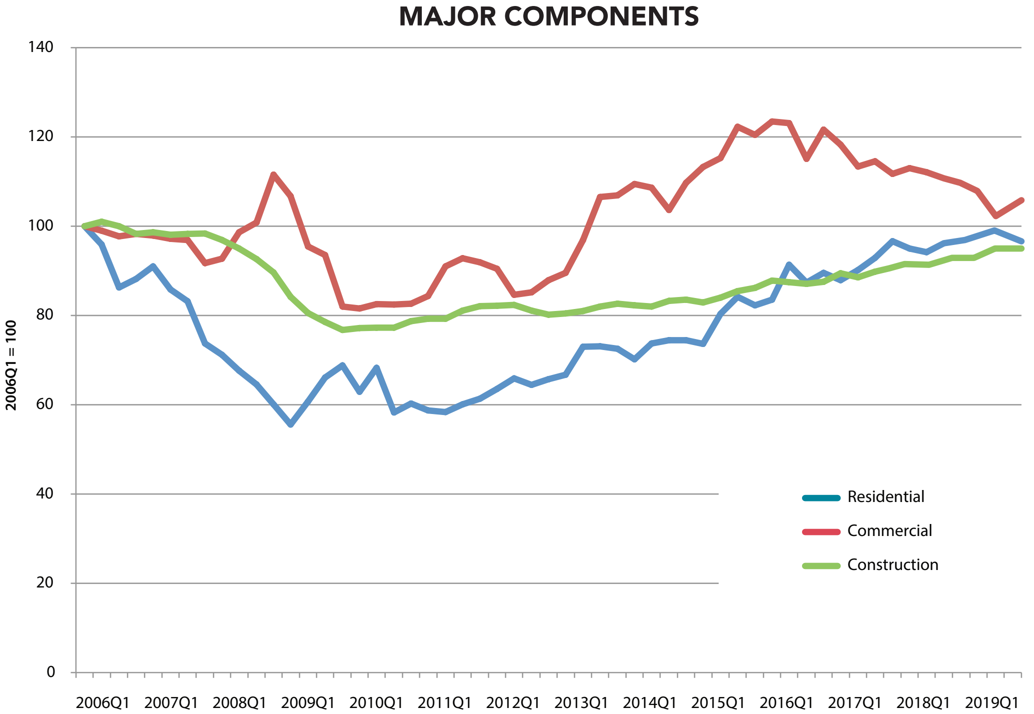
# WHAT IS THE MEREDA INDEX?

The MEREDA Index is a measure of real estate activity designed to track changes in Maine's real estate markets. The Index is a composite of nine seasonally adjusted measures reflecting both new development and transactions involving existing properties and it covers both the commercial and residential markets statewide. The Index is measured quarterly beginning in the first quarter of 2006. This report covers the Index through the first quarter of 2019.*

# THE MEREDA INDEX: 100.1

The MEREDA Index declined over the past six months by 2.0%, primarily because of declines in the commercial component. Over the past year the Index has declined 3.4%, also primarily due to the commercial component. The residential and construction components gained slightly. The commercial component remains above 100, the level of activity in the base period of the Index, the first quarter of 2006.




*See the Special Note in the Technical Notes for information about data used in this edition of the Index.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MEREDA
Maine Real Estate & Development Association

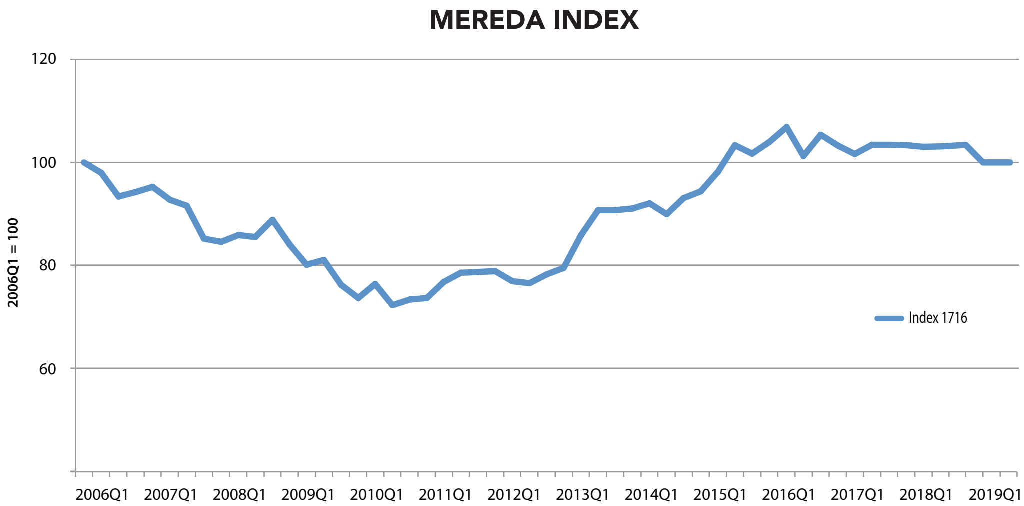
**Supporting Responsible Development**

# INTRODUCTION

"I've always found the MEREDA Index to be an extremely valuable tool. Not only is it a great source for measuring changes in our industry over time, but it is also a wellspring of information from industry leaders sharing their insights. The Spring Index provides us with a full look at 2018 and allows us a peek at how 2019 is setting up.

Having grown up in mid-coast Maine and been active in commercial real estate in southern Maine over the last 30 years, I have never seen such a broad-based, diverse, and robust expansion. From industrial to flex, to development land, to residential condominiums and rentals, to large companies' office space and hospitality—the growth is unprecedented in modern times. While mostly concentrated in southern Maine, it is late in the current market cycle and the growth is demonstrating weakness. During the 3 economic cycles I have experienced in my career, people always say that "this time is different" – it never is. Lateness is sometimes measured in years, and sometimes in frothy activity which does not mirror the underlined fundamentals. I believe that both conditions apply now.

Maine is following a nationally choreographed path now affected by increased interest rates, international trade tensions, post tax stimulus let-down, and market cycle expansion fatigue.




For example, in Portland I see this represented by stagnant office demand from the typical 1,000 to 3,000 square foot office tenant. We also see residential condominium demand begin to slow.

Having said all that, and having no crystal ball telling me when the recession will occur, I have never been more excited about the fundamental and foundational potential of the real estate economy focused in southern Maine. I see unprecedented opportunity in elevating the level of design and construction quality in Portland's built environment.

There are geographic locations of strengths in specific industries or businesses, but nothing broad-based. One of the differences about this expansionary period is that Maine has not seen uniform growth statewide.

Quality of life, a mantra heard here for a couple of decades, is bringing young workers and older retirees to live here. Tourism has never been greater or as seasonally diverse, and provides possibilities. Tourism is one of Maine's largest industries, therefore most important exports. In our relatively rural, economically disadvantaged state, tourism provides our best opportunity to export our tax burden. Finally, large, growing companies are either expanding outposts here, or are willing to call Portland, Maine their home. I see opportunity in the cyclical dark clouds ahead."

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**TIM SOLEY**
PRESIDENT
East Brown Cow Management, Inc.

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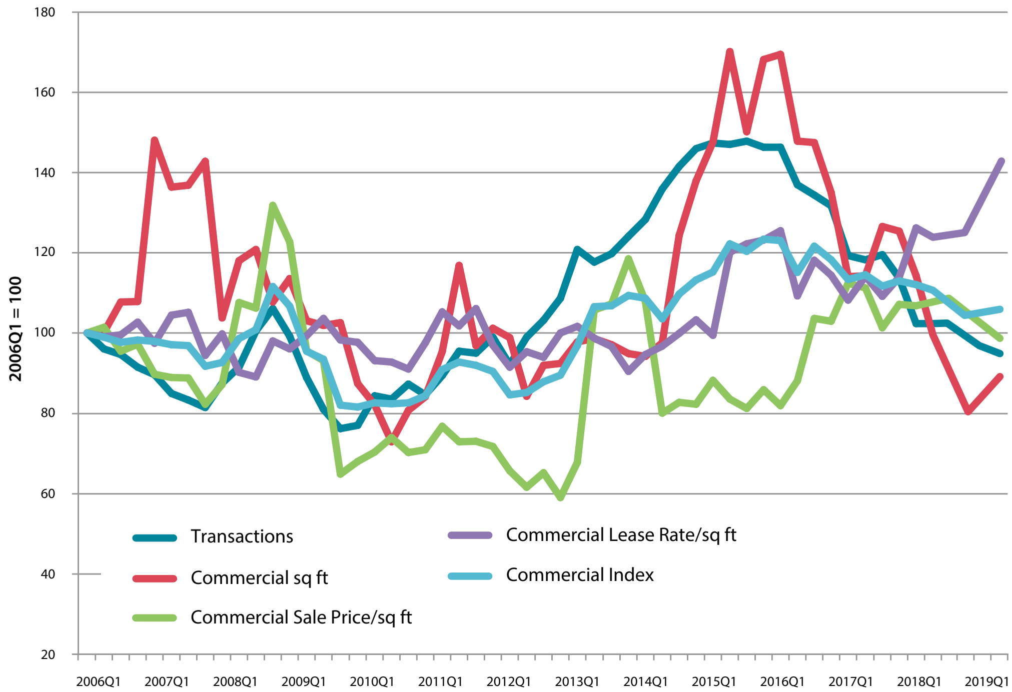
# THE COMMERCIAL COMPONENT: -7.4%

50% COMPOSITE INDEX

The commercial market component recovered to pre-recession levels in 2013 and peaked in the second quarter of 2016. Since then the volume of transactions and the total volume of building square feet leased and sold has been declining. The past six months have seen a sharper decline, primarily in the Index for the number of sale and lease transactions (-13.0%) and in square foot totals sold and leased (-41%), although this Index component is the most volatile from quarter to quarter. The Index for commercial sales price per square foot declined nearly 10% over the past six months after rising 3% in the last quarter of 2018. The Index for lease prices per square foot has, however, risen by nearly 25% over the past year, particularly in the first quarter of 2019.

COMMERCIAL COMPONENTS




With Q1 of 2019 behind us, and an active second quarter approaching, it's a perfect time to reflect on southern Maine's capital real estate markets. I am frequently asked; in a market where pricing is higher than it has been in over a decade how does anyone acquire investment real estate without over paying? In short, very carefully, but more specifically, by sticking to fundamentals with an increased focus on creating value between Net Operating Income (NOI) and after-tax cash flow. Investors are managing risk by prioritizing value over short-term cash flow.

Limiting risk is about managing a position's exposure to a worst-case outcome. To effectively do that late in a business cycle requires a readiness to reinvest capital, a willingness to rely on appreciation, and the patience to realize returns over longer periods of time (5-10+ years). For example, this could mean acquiring an empty building and repositioning it for a higher and better use as we've seen with recent redevelopments in Portland's Bayside neighborhood, or purchasing an asset based on its future ability to generate a higher rent as we've observed in Monument Square. The common denominator in both situations is an under performance of some kind where an asset's value is not exclusively derived from its existing income.

After 8 years of economic expansion and historically low interest rates, capitalization rates have dipped under 7% for the strongest commercial assets in southern Maine. This has produced soaring valuations with pricing in some instances trading at or above replacement cost. In effect, deal pricing is equally driven by factors relating to the capital stack and financing as it is from the relationship between NOI and price. Professional operators (owners/funds) utilize financing structures where membership equity (investor) is layered onto lower leveraged institutional lending to create a less expensive cost to capital. Opportunity zones have added yet another wrinkle to the life span of investment capital going into these designated areas. New class A office buildings for Sun Life Financial, WEX and Covetrus have been able to utilize these tax advantages, effectively opening pathways where new construction is a plausible solution.

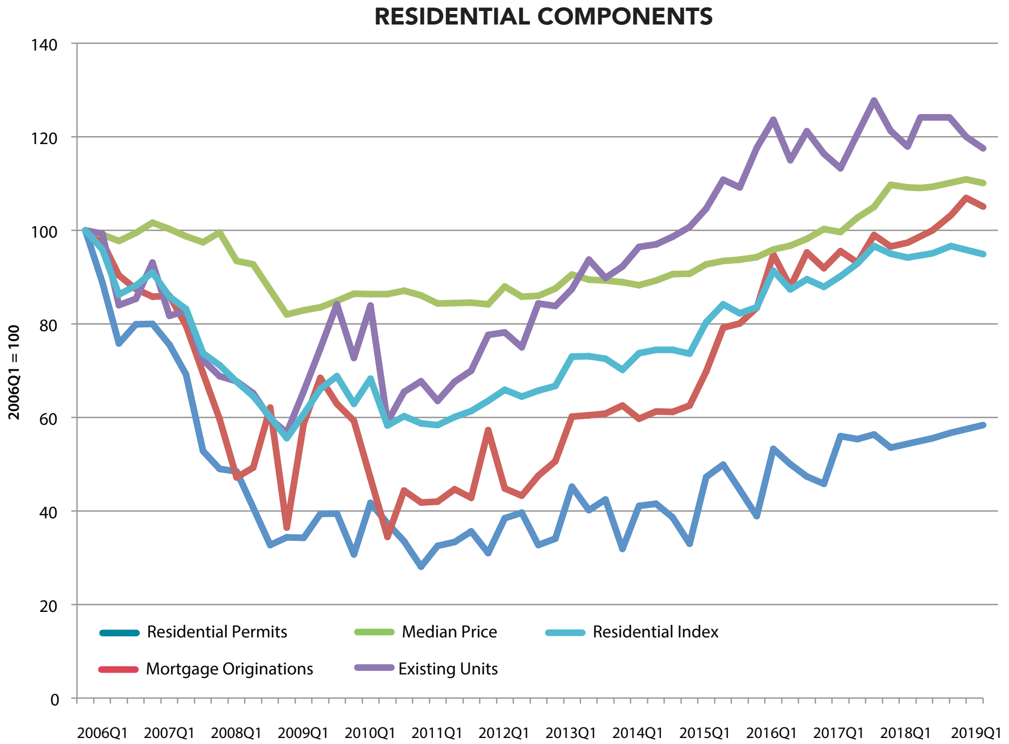
The underlying driver of this market growth is the sustained expansion of Portland's downtown and greater metropolitan statistical area (MSA). Entering Q2 and looking forward to Q3, we can expect a continued shift in emphasis onto internal rate of return, and the deployment of investment capital with the patience to utilize time in order to reach underwriting objectives.

**JOSEPH PORTA, SIOR**
BROKER/MANAGER
Porta & Co.

# THE RESIDENTIAL COMPONENT: +4.6%

**40%** COMPOSITE INDEX

In contrast to the commercial component, the residential component is showing a strong market. The Index for sales of existing units dipped slightly in the last six months (- 4.3%), but all other components of the residential Index showed growth, and even the existing units drop in the first quarter balanced a 4.8% increase in the Index over the past year. The Index for residential permits (single and multi-family) showed a 6.5% growth in the last 6 months, one of the larger six month increases in recent years. The Index for mortgage originations (new purchases) also showed solid growth over the past 6 months (8.5%) and past years (7.4%).




"We are continuing to see robust sales activity in Maine's residential market. 2019 has started off with relatively low inventory and strong demand across most price points. Volume of units sold may be lower in some sectors due to lack of inventory, but we are seeing some increases in sale prices. Properties in good condition and appropriately priced are seeing multiple offers with sale prices at or above list price. The pattern is similar to what we experienced last year at this time. Our spring selling window continues to start earlier in the year, encouraging some homeowners to list their homes in January and February, as opposed to April and May in years past, in the hopes of taking advantage of less competition.

One key driver of the healthy demand in our residential market is the hiring activities at a number of Maine based companies. For example, many of our buyers are coming from new hires at WEX, Covetrus, Idexx, Tilson and Tyler Technologies, along with the traditional hiring from Maine Medical Center. These organizations are attracting talent from both within and outside the state and the region. Part of our job is showing these potential new Maine residents the advantages of living in Maine. Essentially, we are serving as ambassadors for the state, a role we are proud to embrace. Maine has a strong lifestyle brand and reputation appealing to a wide variety of different demographic groups.

I meet with people every day who are looking to move to Maine. When I ask what is bringing them to this area, the response I most often hear is…lifestyle. The traditional draws are the iconic Maine trails, mountains, rivers, and coastline; but over the past few years, the food and beverage scene has become a strong economic driver for southern Maine and cities up and down the coast.

The biggest challenge that I see going forward is affordability – both with new construction development and work force housing. Certainly, Maine offers more affordable and manageable opportunities than our larger feeder markets in Boston and New York. However, the significant increase in construction costs (from both a severe skilled labor shortage and a rising cost in materials) is starting to impact new construction options. It is also impacting the effort to preserve, let alone, meet the increasing demand for affordable work force housing. In order to sustain the golden goose of the food and craft brewery economic drivers for the area, we need to ensure affordable housing for the people serving in these fields. The real challenge in addressing the affordable housing need is doing it in a strategic and effective way that encourages the private sector to have a voice in the solution."

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**ELISE KIELY, ESQ.**
SENIOR VICE PRESIDENT
Legacy Properties
Sotheby's International Realty

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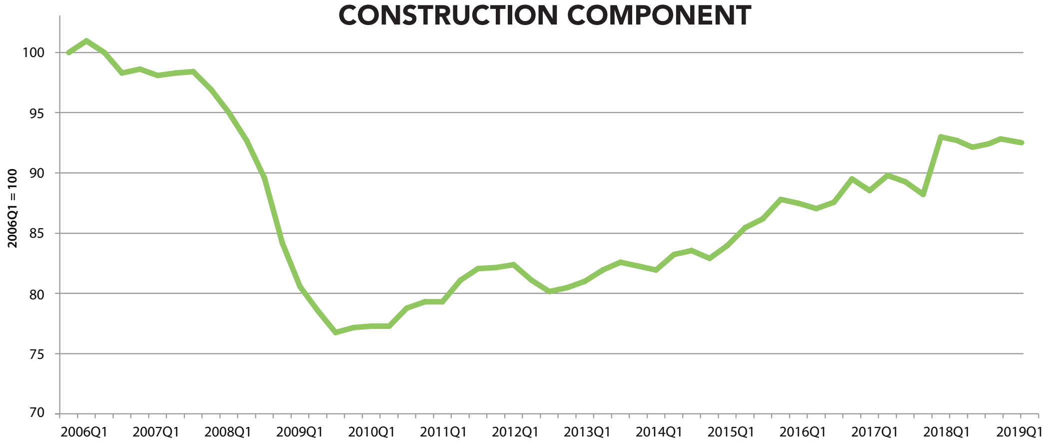
# THE CONSTRUCTION COMPONENT: +3.8%

10% COMPOSITE INDEX

The construction employment component was up 3.8% over the past six months but was unchanged over the past year. The Index value at the end of the first quarter of 2019 of 92 is the highest value since the depth of the recession in the fourth quarter of 2009 (77).




"In late 2018 and early 2019, Cianbro continued to see strong construction demand, including increased interest and investment from sources outside of Maine. What's more, the demand wasn't concentrated in our largest metropolitan markets, but stretched statewide, putting added pressure on construction resources and – subsequently – costs.

The building market was extremely active, especially in corporate office, senior living, and institutional markets, including healthcare, higher education, government, and life sciences. While we feel these markets will continue their momentum in the coming months and years, private development may be tempered by rising costs, particularly for labor and materials.

The driving forces behind increased construction costs can be attributed to a number of factors:

- Supply & Demand – Contractors and subcontractors are extremely busy. That means there are fewer bidders for any given project, which in turn means pricing is likely to be less competitive. Construction materials are also in high demand, affecting both pricing and availability.
- Skilled Labor Shortage – As older craft workers retire, there are far fewer young people entering the trades to replace them. To help remedy the situation for us and our clients, we created the Cianbro Institute where we educate our employees in a variety of trades, from rigging and welding, to carpentry and electrical. Hopefully we've started a trend.
- World Economy Uncertainty – Tenuous international trade agreements and commodity tariffs have led to some significant cost spikes in widely used construction materials such as steel and aluminum. That means items including I-beams, rebar, window casings, ductwork and exterior metal panels are now more expensive.

Considering that budgets for today's construction projects may have been developed a year or two years ago, the cost increases are sobering for owners. Looking ahead, Cianbro believes contractors can mitigate this by employing creative solutions such as lean construction principles and a collaborative construction management (CM) delivery approach.

The CM model is based on the owner and design and construction firms working together as a team from the conceptual stage through project completion. Most notably, it involves an iterative design and budgeting process that enables the project team to monitor real-time pricing at each design stage and, when necessary, make changes to materials, program or scope to attain the desired guaranteed maximum price (GMP) quoted by the constructor.

Add to that lean construction principles utilized by the CM and subcontractors, such as just-in-time material deliveries, modular components, advanced technology, smart construction practices and proper sequencing, and you have a recipe for optimal efficiency that will keep projects on schedule and within budget. In today's robust construction market, these will likely be the keys to success for savvy owners and astute contractors in Maine."


**RICHARD BRESCIA**
VICE PRESIDENT
Cianbro

# ABOUT MEREDA

The Maine Real Estate & Development Association (MEREDA) is an organization whose mission is to promote an environment for responsible development and ownership of real estate throughout the state. MEREDA accomplishes its mission through legislative advocacy, regulatory oversight, sponsorship of programs and conferences, and by serving as a unified and proactive representative for real estate and economic development interests.

MEREDA is the state's leading organization of commercial real estate owners, developers and related service providers. Founded in 1985, we now have nearly 350 members who employ thousands of Maine citizens and invest millions of dollars in the Maine economy each year. MEREDA is the only voice for the real estate development industry in Maine. Our success is dependent upon bringing together many different trades that are vitally interested in promoting positive growth in our great state. MEREDA advocates for fair, consistent, predictable regulations to create a healthy economic climate. Our efforts to promote responsible growth through fair and predictable legislation and regulation are vital for a return to a healthy, thriving economy.

# TECHNICAL NOTES

All data is either quarterly or monthly, converted to quarterly and then either seasonally adjusted or trended using moving averages and then compared to the value of each variable in the first quarter of 2006 (2006Q1=100). Data sources for the Index include: the Maine Association of Realtors, The Boulos Company, Maine Department of Labor, Mortgage Bankers Association, U.S. Census, and Moody's Analytics.

The relatively small volumes of real estate transactions in Maine and regular seasonal changes in the residential market mean that the raw numbers comprising the Index can be very volatile from month to month and quarter to quarter. The Index is constructed using methods that adjust for seasonal changes and better capture underlying trends in the real estate market. The underlying data is also subject to regular revisions as new information becomes available. Comparisons between the absolute values of the Index in different editions of the Index may not, therefore, be meaningful.

The source of all data for the commercial component has been commercial real estate information maintained by The Boulos Company, which has generously made the data available for purposes of the Index. In 2018 The Boulos Company transitioned data management vendors to a new supplier, resulting in inconsistencies between the old and new data sets. In order to minimize the effect of these inconsistencies, the commercial component was completely recalculated from 2005 through the third quarter of 2018.

# SPECIAL NOTE FOR SPRING 2019

This version of the Index was completed before all information for March 2019 was available. This included construction employment, sales of existing units, and median home price. Estimates for March were used based on past values in March. In addition, commercial real estate data from The Boulos Company data set may be incomplete for the first quarter. The calculations of all three components of the MEREDA Index should be considered preliminary and subject to revision in the next iteration of the Index utilizing 2019 data.

**Charles S. Colgan** is Professor Emeritus of Public Policy & Planning in the Muskie School of Public Service at the University of Southern Maine, where he chaired the Graduate Program in Community Planning & Development. He is also Senior Research Advisor for the Maine Center for Business & Economic Research at USM. He served 12 years in the Maine State Planning Office including positions as Maine State Economist and director of the Maine Coastal Program. He currently serves as Director of Research at the Center for the Blue Economy in the Middlebury Institute of International Studies at Monterey in Monterey, CA. He received his BA from Colby College and his PhD in Economic History from the University of Maine.

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**CHARLES S. COLGAN, PhD**
PROFESSOR EMERITUS OF PUBLIC POLICY AND PLANNING
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Maine Center for Business & Economic Research
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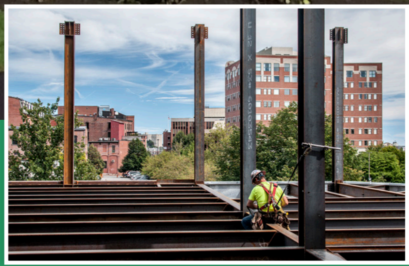

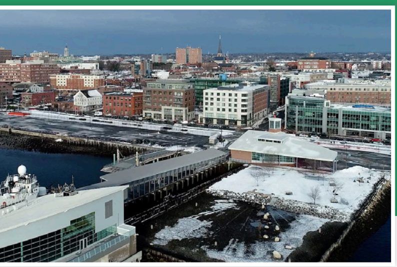

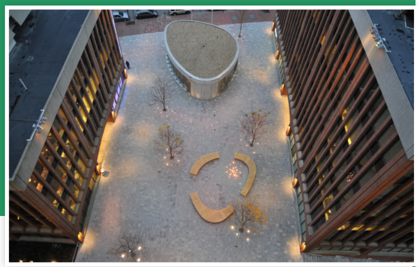

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