FEATURED ARTICLE

INDUSTRIAL DEVELOPMENT CONTINUES

Across North America

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Los Angeles

New York City

Last year, industrial markets enjoyed a long awaited renaissance of new construction. That won't change in 2016, with most SIOR professionals reporting traditional industrial markets blooming and new locales blossoming.

Industrial markets, big and small, experienced significant gains in 2015, and if the prognostications are correct, SIOR specialists should expect another busy year in 2016.

Analysts on the Building Design + Construction website looked at numerous surveys and concluded industrial construction will be up 9.9 percent in 2016, the third busiest commercial real estate sector behind office and hotel development.

Meanwhile, the MAPI Foundation's U.S. Industrial Outlook, a quarterly report that analyzes 27 major industries, says industrial product will be up about 3.3 percent for the first half of 2016. The biggest growth will come in computer and electronics products, followed by general manufacturing and finally non-high-tech manufacturing.

For a boots-on-the-ground look at industrial markets across North America, *SIOR Report* checked in with SIOR professionals in primary, secondary and tertiary markets, and the consensus is 2016 will be a continuation of healthy construction trend lines established in the past few years. A number of SIOR industrial specialists reported new development activity hasn't been this good since before the recession.

"Kansas City is on fire right now," exclaims Joe Orscheln, SIOR, CCIM, a vice president in the CBRE office in Kansas City.

"2015 was a good year to be in real estate," comments Norm Khoury, SIOR, CCIM, a senior vice president and principal for Colliers International in Cincinnati, Ohio.

"Things look good for 2016 and beyond," predicts David Liebman, SIOR, JD, LEED Green Associate, a managing broker with Merit Partners LLC in Chicago, Ill.

The responses from SIOR industrial specialists were almost 100 percent positive concerning development for 2016. So let's take a look at where the new development opportunities for 2106 will be in specific locales.

Tertiary Markets

Although a lovely city, home to investor exemplar Warren Buffett and his mighty Berkshire Hathaway company, at just 66 million square feet of industrial market space, Omaha, Neb. is the smallest market in this eclectic survey.

New, commercial development of note has been in two sectors, most notably, office, which has a 4 percent vacancy in Class A space and 12 percent in Class B. Last year saw such ground up developments as a 125,000-square-foot build-to-suit for Pacific Life, a 90,000-square-foot medical office and the announcement of a new 300,000-square-foot corporate headquarters for HDR, the large architectural and engineering firm, reports Tim Kerrigan, CCIM, SIOR, a vice president with Investors Realty Inc. in Omaha.

Industrial vacancies are a low 2.3 percent in Omaha and construction was started on five new flex buildings in 2015 totaling approximately 400,000 square feet. "We expect to see more construction in 2016," says Kerrigan.

The big surprise is that Omaha has become a "hotbed" for data centers. In the past two years, Travelers Insurance and Fidelity Investments have each built $200 million data centers in Omaha, joining a very long list of companies such as Yahoo, Google, PayPal, Century Link, First Data and Verizon that have data centers in the area. Even Major League Baseball keeps its most prized data in Omaha.

What's the secret in becoming a data center hotbed? "We are a good location because we have high-quality and affordable power, low risk of natural disasters and a strong incentive package from the state," says Kerrigan. It also doesn't hurt to have a fantastic communications infrastructure, courtesy of the nearby US Strategic Command (USSSTRATCOM) at Offutt Air Force Base.

Secondary Markets

Talk about surprising. For secondary markets, the big news is that the industrial market in many older Midwest cities are not only thriving but are buoyant and those who toil in the commercial real estate world are looking forward to even more new development in 2016 and the coming years.

Before *SIOR Report* tackles the Midwest, its first stop is also in the middle of the country, but much further south in Texas, where we can find the blossoming, tech-loaded city of Austin.

It will be no shock to anyone when Matt Levin, SIOR, a managing principal with ECF/Equitable Commercial Realty in Austin, says, "in 2015, our company blew away by a wide margin every record we had; from a personal standpoint most of us had our most productive year ever."

Good tidings won't change much in 2106 as the pipeline just for office is for another 2 million square feet.

Here is where the new opportunities will be found in 2016, says Levin. In Northwest Austin, a newer live/work/play development called The Domain is now under further construction, with around 500,000 square feet of additional office product to be delivered this year. "A lot of tech companies are moving here as well as professional and financial service companies," says Levin.

Then there is Downtown Austin, which will also see about 500,000 square feet of new space delivered this year. Google already preleased 200,000 square feet of new development.

Historically, Southwest Austin has been a leading, desirable submarket although being an environmentally sensitive area there are high barriers to entry. Nevertheless, there is around 400,000 square feet of space within the SW Parkway corridor either recently delivered or underway with about 180,000 square feet of space being pre-leased.

The big surprise, says Levin, has been the emergence of the section of town just east of the I-35 interstate. A long ignored area, Levin now calls it a "high-energy live & play area." We should probably add "work" to that phrase as 100,000 square feet of office was delivered there in 2015 and Levin expects another 500,000 square feet to be built in 24 to 36 months. C3 Presents, which produces the Austin City Limits Music Festival, is moving its headquarters there.

For those who love good music, Kansas City, Mo., has always been a terrific blues town. While you can still hear some deep soulfulness in the local music halls, no one in the commercial real estate business there is singing the blues.

As Orscheln notes, the place "on fire."

"We are now seeing two waves of spec development," he says. "The first wave was about 4 million square feet, most of which was preleased before the final nails were hammered. The newest wave going up is about 5 million square feet, all industrial and buildings 350,000 square feet and larger. We are seeing GM and Ford suppliers, e-commerce groups and manufacturers take down space."

What happened to put Kansas City back on the map for industrial users?

Orscheln explains it this way: "We finally started putting up product. Developers took notice and we started landing deals in the market. The problem was we were always skipped over for other markets that had existing product. When we started putting it up, we started getting deals in KC."

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Traditionally, the big suburban industrial and office market has been in Johnson County, Kan.

"The real surprise is about how much space has been taken down and the velocity of deals," says Orscheln. "About 5 million square feet is coming out of the ground right now and we are running about 1.5 million square feet of tenant requirements right now -- that's just right here at CBRE alone."

The largest spec building in Kansas City was 260,000 square feet, now we are seeing 700,000+ square-foot, spec buildings going up, adds Mike Mitchelson, SIOR, CCIM, a first vice president at CBRE in Kansas City. "We just had a group come in and take 450,000 square feet."

The new hotspot for development is now in Riverside, Mo., where a 1,000-acre tract of flat land had been sitting vacant. About 2.5 million to 3 million square feet has been developed there since 2011.

Cincinnati, Ohio, another old, river-port city in the Midwest, is having a real estate renaissance.

"2015 was the year of the big box here," says Khoury. "All the major developers have come to the secondary marketplace where they said they would never go back to and started developing big boxes. They are leasing them up and selling them."

The overall vacancy rate in Cincinnati industrial stands at 4.6 percent, but in the important Northern Kentucky suburban market the vacancy rate is even tighter at about 2 percent.

Another important market is the I-75 Corridor from Cincinnati to Dayton, which is becoming one market," says Khoury. "They are our two biggest markets, north and south, and both are very tight."

The new opportunities for development in Cincinnati are not geographic, but product oriented, says Khoury. "The big box (500,000 square feet and larger) market segment is well supplied."

It's time to take care of the majority of space users in Cincinnati, he asserts. "Most companies/users in greater Cincinnati are in buildings that range in size from about 25,000 square feet to 40,000 square feet. Only two local developers have built smaller speculative buildings under approximately 100,000 square feet."

Khoury recommends building 20,000-square-foot to 40,000-square-foot, free-standing buildings. In addition, he recommends constructing speculative

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buildings from 100,000 to 200,000 square feet that can be divided for tenants into 50,000 to 75,000 square feet.

“Every economic development person will tell you there are not smaller, free-standing buildings available,” Khoury maintains. “In 2016, development will continue in the big box space, absorption will hurt if we don’t also build smaller.”

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Industrial brokers in another older Midwest City, this one on Lake Michigan, are also enjoying some great times again.

Milwaukee’s industrial market totals 270 million square feet with a 4.9 percent vacancy rate. “This market is strong,” says Jeff Hoffman, SIOR, CCIM, a principal with Cushman & Wakefield/The Boerke Company in Milwaukee Wis. “In our Cushman & Wakefield network of similar markets, from a volume standpoint, we are the second best performing industrial market from a vacancy standpoint.”

Hoffman attributes this salubrious situation to what had been a lack of development and finally some spec development

“We have about 2 million square feet of spec space that is going to be delivered from the first of the year until Memorial Day, which for our market is a significant amount,” says Hoffman. “After that 2 million square feet, there is another 2 million square feet being contemplated as projects in the next year.”

The premier industrial corridor is called I-94 West, which starts two miles outside of downtown and goes about 15 miles west. Then there is the I-41 corridor that runs about eight miles to the north. That encompasses about 160 million square feet with very high barriers to entry, says Hoffman, “so we have seen a trend toward in-fill industrial development, where developers are coming in and buying old properties, tearing down and putting up new buildings. That has been very successful in our marketplace. We think that will keep occurring.”

The largest spec building going up is 600,000 square feet in the Kenosha Market, says Hoffman. “Last year, Centerpoint constructed buildings of 500,000 square feet and 400,000 square feet. They preleased the 500,000 and presold the 400,000 to a packaging company and a food distributor.“

Hoffman ruminates, “the last time 2 million square feet was delivered, it would pre-date my time here, which was in 2000. I don’t know if it ever happened before.”

Primary Markets

South of Milwaukee, also on Lake Michigan, sits the country’s second largest industrial market, Chicago, with about 1.3 billion square feet of space.

It’s getting even larger, says Liebman, “with all the spec development that has gotten done in the last couple of years as well as the build-to-suits. Saddle River Logistics is building 1.1 million square feet. That was announced a couple of months ago. There are probably at least one or two other 800,000 square foot to 1 million+ square-foot, build-to-suits that have been announced in the last 6 to 8 months.”

Two of the city’s larger, traditional submarkets are I-80/I-55 corridors which are southwest of Chicago and running for almost 40 miles, and Chicago O’Hare Airport, on the western edge of the city proper. These are huge submarkets. The O’Hare area alone totals about 141 million square feet of industrial space, more than most U.S. cities.

"O'Hare has seen a lot of good activity, redevelopment of infill sites as well as rehab of existing properties," says Liebman. "We haven't seen as much of that before."

The big surprise in regard to new development has been due north of the city in Southeast Wisconsin.

"The vacancy rate there has been low there for the better part of the last three years," Liebman says. "Even though there has been spec activity, all the properties that get built are leased or sold relatively quickly. This area has become a major warehouse location because of its strategic location between the upper Midwest and all points in between. The vacancy rate there is about 3.7 percent which is low compared to the whole vacancy rate in Chicago metro of just under 8 percent.

Just south of the Wisconsin border, three major spec warehouse projects have gone up or are under development.

"This is quite remarkable because this area in Lake County happens to be mostly an owner-occupied submarket with about 70 million square feet of industrial space,"

> "There has been a significant trend for infill or repurposing,"

says Liebman. Healthcare and pharmaceutical-oriented companies dominate the area. Now you see this new unprecedented spec development as institutional money is stimulating new development there – somewhat of a pioneering move for a lot of developers."

Toronto, with just shy of 1 billion square feet of industrial space, can also be found in the Top Five industrial markets of North America. The difference between Toronto and its brethren in the United States is that there is a lot greenbelt to contend with, which means empty land available for new development is becoming rare.

New greenfield developments are more prevalent near the suburban towns of Milton, North Brampton and Caledon, which are at the west end of the Greater Toronto Area, says Jeff Flemington, SIOR, CCIM, LEED AP, a senior vice president and principal with Avison Young Brokerage in Mississauga, in the heart of Toronto's industrial market.

The older industrial areas around Mississauga, Brampton and Etobicoke can expect more infill than greenfill development, Flemington observes.

"There has been a significant trend for infill or repurposing," Flemington reports. "We are getting to the point where the economics are such that we are knocking down obsolete buildings, taking the development charge credits that are available by municipalities and redeveloping. Often times, these sites are in mature neighborhoods with great access to the markets that a lot of these distribution concepts are trying to serve."

He adds, to make the economics work, rents have to be high enough and the supply of land has to be limited. Rents basically are in $6.50 to $7 per square foot range for the Greater Toronto Area. "

The Canadian economy has suffered due to the decline of oil and commodity prices, but little of that has affected the Toronto market. "We have been very stable," Flemington opines. "We have a diversified economy, large population, huge industrial market and any goods coming into Canada, at some point, have to pass through Toronto." ▽

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