FEATURED ARTICLE

BATTEN DOWN THE HATCHES: HOW NATURAL DISASTERS ARE IMPACTING U.S. COMMERCIAL REAL ESTATE

BY AMANDA MARSH


Photo by Jeff Turner

Last year, the United States experienced 16 weather- and climate-related disasters totaling over $1 billion each in losses, from hurricanes ripping through the Southeast to wildfires in the West. Damages totaled over $306 billion—a new record, according to the National Oceanic and Atmospheric Administration (NOAA).

NOAA reports at least 362 people died in the weather events, which included Hurricane Harvey. The storm made landfall in Texas on August 25 as a Category 4, causing more than $125 billion in damages, only second to 2005's Hurricane Katrina. Maria and Irma, which followed in September, caused respective $90 billion and $50 billion in damages.

While residential properties are more likely to suffer the effects of natural disasters due to construction and location, commercial real estate is not immune to damage nor post-storm market perceptions.

THE HARVEY IMPACT

While Hurricane Harvey caused significant damages to residential, retail and office properties in Houston, the industrial sector was mostly spared, said NAI Partners partner Travis Land, SIOR. Despite a halt in commerce for a week, these properties sustained much less damage, due to being dock-high at four feet off the ground.

Since the storm, industrial rental and vacancy rates have been essentially flat, according to NAI Partners research. Flex space, for one, only dropped from the second quarter's $9.52 per square foot to $9.11 post-Harvey, increasing to $9.26 in the fourth quarter of 2017.

"Despite this, the sweeping regulations being put forth by the county and city may affect the market significantly," Land cautioned, noting that major events often trigger regulatory changes.

Harris County and the City of Houston passed new development codes post-Harvey for how industrial buildings are constructed and elevated, he said. (A significant amount of Houston's industrial product is located outside the city itself but is still within incorporated Harris County.) Currently the codes will raise those buildings two feet above the 500-year flood plain, he explained, which may increase development costs for new projects.

Land said the new measures are now trickling into the commercial real estate market. Investors who are looking to acquire land for speculative industrial development have expressed concerns about project cost increases; leasing rates will need to rise for developers to maintain their existing yield requirements; and landlords and developers are concerned about meeting proformas on planned projects.

"Other investors have decided not to pursue transactions they have been going after until the dust settles," he said, while tenants with needs over the next 18 to 24 months worry about potential rental rate increases on new inventory.

Clients based in other cities looking to make deals in Houston have also inquired about the impacts after watching national media coverage, but have decided not to pull back after seeing industrial as being the least impacted.

What Land has advised clients: the higher you are, the better. If they can be outside the 500-year flood plain, it will mitigate cost exposure. If they own a site or are looking to acquire one, understand the new rules. And if tenants have flexibility now, capitalize on finding new space from the current building supply. In a year or two, all new products will be under new building code standards and rental rates will be higher, he said.

Corpus Christi, 182 miles southwest of Houston, was also impacted by Hurricane Harvey, but given its path and landfall, was spared the damage other areas experienced.

"When a hurricane is noted, we watch it for three weeks out and decide whether we need to make arrangements for the storm," said Cravey Real Estate Services president Matthew Cravey, SIOR, CCIM.

It is an attractive market for many outside investors, given Port Corpus Christi, a key facility for the petrochemical and windfarm industries, and its abundant natural gas, he noted.

"We always wonder if we're going to dodge the bullet," he said. "We'd have a buyer come in from California and say, 'We're not buying in Corpus Christi because of the hurricanes.' But then you remind them that hurricanes are not usually as bad as mudslides, wildfires and earthquakes. Then they get quiet. You also have people in the central part of the United States dealing with tornados. No matter where you are, you learn to adapt and live."

Fortunately for Corpus Christi, recent hurricanes have not been as large or as strong as in the past, like 1980's Hurricane Allen and 1970's Hurricane Celia.

"That's why you don't see a lot of historic buildings—many have been wiped out by past storms," Cravey explained. "Today, everything from garage doors to windows have to be windstorm rated."

When damage does occur, it sometimes requires his company to use service providers from areas not impacted by the storm. In the case of Hurricane Harvey, Corpus Christi was the helper, he said. The Federal Emergency Management Agency (FEMA) set up shop in the city, filling hotels and offices as its home base. And since local contractors were in devastation zones to help with repairs, Cravey had to hire contractors from San Antonio to fix damages to his own properties.

Overall, Corpus Christi commercial real estate was initially impacted, as potential investors and tenants pulled back.

"The news media made it look like we were leveled, when we were fine comparatively," Cravey said. "As commercial real estate professionals, it's our job to calm people down and make them realize that most of the damage was anything loose or torn off like metal, signs, fencing, and awnings."

One effect still being felt is uncooperative insurance companies. Many are being sued by owners who have yet to see money owed from fixing things, he said.

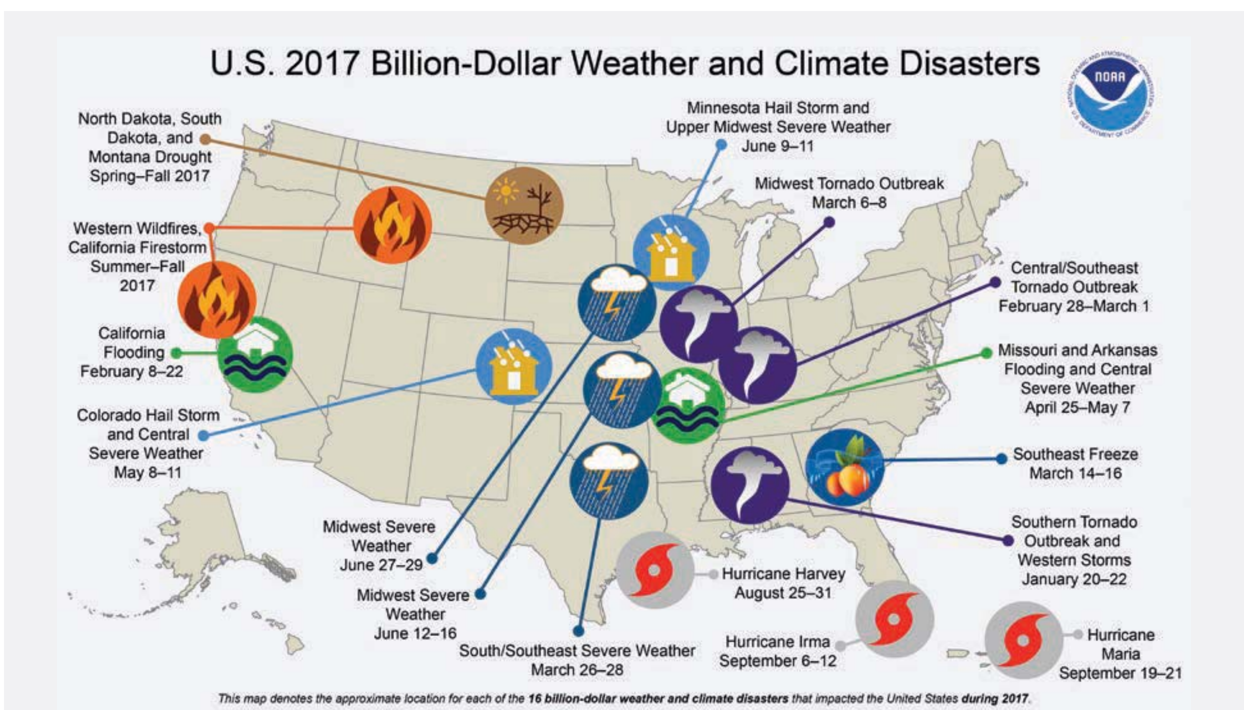
"Overall, buyers and tenants do not seem as worried as they once were. However, they still feel an impact on insurance. Rates are not insignificant and many companies require separate flood insurance."

SANDY AND SHORT MEMORIES

Six years ago, Hurricane Sandy was the second-costliest U.S. hurricane on record, at $71 billion, until surpassed by hurricanes Maria and Harvey. While most of the damage was to residential, there was still some hesitancy on the commercial side.

"After the storm, the areas that were impacted needed to make a comeback," said United Realty principal Gary Joel Schacker, SIOR. "Then the issue became resistance from new buyers or tenants from getting involved with those properties. They were concerned that it could happen again."

However, people have short memories, he said—and that initial resistance has faded



This map denotes the approximate location for each of the 16 billion-dollar weather and climate disasters that impacted the United States during 2017.

in the last year or two. Additionally, industrial inventory has tightened significantly due to tenants being priced out of Queens and Brooklyn, N.Y., and organic market growth. Valuations have also stabilized.

Most hurricane damage wasn't the result of the storm winds, but rather coastal flooding that happened during and afterwards, he pointed out.

"Buildings experienced as much as four or five feet of water infiltration," he said. "Once you have that kind of damage, you have to strip out all the Sheetrock above the level of water and dry everything out. All the electrical that was affected needs to be replaced. Then you have to go through mold mitigation and remediation. You can't just spray Clorox on black mold—you need specialists."

There is not a lot of preventative mitigation measures you can undertake in commercial properties to prepare for events like Hurricane Sandy—or even multiple nor'easters Long Island experienced in the beginning of 2018. Many of Schacker's tenants, however, have put together plans to alleviate damage quickly or raised racking so it starts higher off the floor. More people have also bought generators.

"Besides these measures, there's not much you can do," he said.

Overall, buyers and tenants do not seem as worried as they once were. However, they still feel an impact on insurance. Rates are not insignificant and many companies require separate flood insurance, Schacker said.

"If you look at Sandy, it was certainly a 100-year storm," he said. "The last one to cause such widespread damage on Long Island was the Great Hurricane of 1938. However, the hurricanes we had [in 2017] were definitely impacted by the sea temperature rise. Even one or two degrees has a big effect on tracks—look at Irma and Harvey. We're lucky they didn't come up towards Long Island. However, be forewarned climate change is having a huge effect worldwide. I fully expect hurricanes to become more prevalent and significant."

PHOENIX RISING

When there are back-to-back hurricanes or flooding in the United States, CBRE senior vice president Patrick Feeney, Jr., SIOR, finds inquiries coming into Phoenix increase, particularly from buyers or tenants from the Southern and Eastern parts of the country.

"Tenants are choosing Phoenix for many reasons, but its lack of natural disasters is recently being mentioned more frequently," he said, noting it also has affordable housing, a pro-business environment, short entitlement periods and is a right-to-work state.

This has garnered a marked increase of inquiries from out-of-state users over the last few years, many of which are coming from the more expensive and restrictive California.

He noted the worst market experiences are dust storms. Annual rainfall totals around eight inches, and there are no earthquakes, tornadoes or hurricanes. While hot in the summer, it's dry heat with little humidity.

As a result, Phoenix's electrical grid, natural gas, Internet, water, sewer and cable are in good shape, he said.

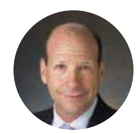
"Some leave their area after a third flood or second hurricane, saying, 'That's it,'" he added. "When checking the boxes for choosing where to live, a lack of natural disasters is a plus for our market. Users today are not as concerned about moving as today's digital technology allows employees to work from anywhere remotely." ▽

CONTRIBUTING SIORS

Matthew Cravey, SIOR

Travis Land, SIOR

Pat Feeney, SIOR



Gary Schacker, SIOR