STATE OF THE INDUSTRY

By Sibley Fleming

Technology continues to disrupt both industrial and office real estate, from industrial design to office tenant apps and flex space.

"Technology is accelerating everything, and the challenge for traditional industrial environments is finding ways to keep pace," says Patrick Holleran, vice president of St. Louis, Mo.-based HDA Architects. "We are entering another industrial revolution that can be defined as the marriage of physical and digital technologies, such as analytics, artificial intelligence, cognitive computing, and the Internet of Things."

For example, Holleran points to client Fisher59 in Denton, Texas. The beer distributor opted to include an automatic storage and retrieval system—provided by Cirrus Tech—in its 203,000 square foot headquarters and beverage distribution facility completed in October 2019. The technology achieves efficient product storage and movement to the market, Holleran explains.

Another dominant trend reshaping industrial real estate is e-commerce and just-in-time delivery. "Amazon has multiple logistic strategies, which include very large distribution centers and then a network of smaller distribution points deeper into their trade areas," says David Klein, SIOR, senior vice president Transwestern in San Francisco. Klein says the enormous footprint of the e-commerce giant has been moving the needle in the Bay Area in terms of availability of space and asking rents.

That's exacerbated the land-constrained market that's undergone boom and bust cycles back to the gold rush, with the current boom now fueled by technology. "In Bay Area , higher more intensive uses of space have also run out of space," Klein says. Sectors like office, retail residential, research and development are "in a superior position to compete in purchasing land because those uses generate higher rents and, by elimination, generate higher land values."

The shrinking inventory has not only driven rents higher, but also literally changed the shape of industrial real estate. While ProLogis's highly publicized multi-story warehouse in Seattle—Amazon signed for 500,000 square feet there—may ultimately be the future of warehouse space in the United States, warehouses from coast-to-coast are already morphing into taller spaces as one answer to land constraints.

"Computers can be programmed to lift inventory and put inventory on pallets much higher than what a forklift driver can do, so there will be a continuation of the trend to build taller," says Klein. The standard clearance years ago was 18 feet, which rose to 24 feet, and now 32-feet clear, which has become the standard. Klein has even seen one outlier warehouse in his market built to 54 feet, though he admits that example is as yet unusual.

In Miami, John Steinbauer, SIOR, president of Steinbauer Associates, a boutique industrial and office brokerage firm with offices in Miami and Lakeland, Fla., says that since 2008, Miami industrial has been steadily developing, particularly ignited by the internet and the fact that businesses "don't have to be centrally located to serve the nation." To that end, Steinbauer says he works closely with other SIORs across the national and internally.

The deepening and widening of the Miami Harbor—which now accommodates the super-sized container ships entering through the recently expanded Panama Canal—coupled with the growth of e-commerce have both served to drive demand for more industrial space.

George Pino, SIOR, president of State Street Realty, based in Doral, Fla. near Miami, says while local economic growth and trade have fueled Miami industrial, e-commerce alone has had a "tremendously positive impact on industrial real estate." He notes that Amazon has quadrupled its presence in Miami-Dade County over the last five years and now occupies about 1.6 million square feet there.

But even those frothy numbers are likely only the tip of the iceberg. "The reality is that only about 16% of all retail purchases are being done online," says Pino. Within five years, he predicts that at least 50% of shopping will be conducted online, thereby creating greater demand for

warehouse fulfillment and distribution space.

Pino notes that as the market experienced 4% rent growth last year, his boutique brokerage was kept busy leasing roughly 2 million square feet of primarily industrial space with a transaction value of $190 million over 83 deals.

In Charleston S.C.—another port industrial market—Mike White, SIOR, broker-in-charge of Charleston Industrial, also attributes part of the rise in industrial demand along the East Coast to the reopening of the Panama Canal, which he says has brought more cargo containers from the West Coast to the East Coast. The Port of Charleston—a former Navy base—is already the fourth busiest port in the nation but will expect more traffic once a major expansion and deepening are completed in 2021.

The past decade has brought Charleston—with its population of fewer than 1 million people—a "robust expansion across a diverse manufacturing and logistics space," White explains.

White need look no further for an example than Crosspoint, a seven-building industrial park with more than 2.7 million square feet of Class-A space that caters to aerospace and automotive suppliers, manufacturers, and logistics providers. The Childress Klein developed and owned project—which opened eight years ago—marked its first five years on the market with "steady" leasing, while the last three have been what White describes as "frenetic."

Crosspoint's tenant's roster reads like a who's who of market-defining companies, including Boeing (it's building its 787 Dreamliner there); Mercedes Benz's Sprinter factory (it took an order for 20,000 of these delivery vans from Amazon in 2018); German auto seat maker, Isringhausen; international logistics company Jas Forwarding-USA; Expo Logistics; Amazon; and FedEx.

"We're about to start building number eight, and I'm sure we'll fill at least half of it with existing customers who will expand with us," says White.

Simons Johnson, SIOR, a senior vice president with Bridge Commercial, Charleston, S.C., agrees about the pace of the market. "Speed to market is important in our market. If you're partially built out, your potential for more downtime is likely," he says. "We've seen that play out in the past couple of years where people who invest early on in a build-out have seemingly done a lot better in terms of their building perspective."

Bridge Commercial president Peter Fennelly, SIOR, observes that the entire Southeast—from the Carolinas all the way across to Texas—has undergone a "blossoming" in the past decade following the Great Recession. Fennelly, who headed up Colliers in Charleston for 18 years, opened his own shop two years ago with a staff of 18 that has already grown to 25 specialists who cover office, industrial, retail, and multifamily in the South Carolina region.

Fennelly says that in addition to manufacturing in both aviation and automotive, this thriving economy is also a burgeoning tech hub, marked by tech companies started in garages that have grown into real companies with employees that are taking office space. The market is also home to more than a dozen publicly traded tech companies listed on the Fortune 5000.

Nationwide, technology companies continue to take an increasing share of U.S. office space in the top 30 tech markets, with CBRE reporting that tech tenants accounted for 21% of major office leasing activity in the first half of 2019.

"The current key questions revolve around how long demand will remain strong, whether or not rents have truly peaked and what the impact of new supply will be as construction is at an all-time high," says Kevin Morgan, president of the Northwest for Colliers International.

The first quarter of 2020 started on "solid ground" with positive net absorption of 22% year-over-year, with a historically low national vacancy rate of 11.4%, according to Morgan. "As it has been for some time, overall leasing volume will be dependent upon the tech sector, which continues to expand with no signs of slowing."

In addition, creating a workplace that is an "experience" rather than a "location" to do work is key to how landlords and investors will attract and retain tenants, according to Morgan. "Technology is a key factor in creating such an environment, with tenant experience apps at the center of this trend."

Coworking and flex workspace also continue to gather steam, even against the backdrop of events surrounding WeWork's botched IPO as well as multiple news reports that the coworking giant pulled back in at least a couple of major markets in the last quarter of 2019.

Finally, growing demand for sustainable development is not expected to abate. The reason: highly educated millennials are often cited as the main demand-driver but perhaps more pressing are these data points offered by Holleran: "Our population is experiencing dramatic growth: by 2030 we'll need 50% more energy, 40% more water, and 35% more food. This means new properties will be designed with a green strategy in mind." ∇

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