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Industrial trends: How does our market fit into the global picture?

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Ever wonder where your market fits into the big picture, the global picture?

Digging into that question, I thought there would be some logic in looking at the data from the Portsmouth submarket (Portsmouth plus 9 Seacoast towns) and move through to state, national and global market data and draw some conclusions. Fortunately, Colliers International has in-house research departments, so I was off to the races with data in hand. What I found looking back to 2008 in the local, state and national markets was not very exciting. The vacancy rates all tracked the way one would expect during a major recession and asking rents were relatively stable, except during the worst years of 2010-2011 (higher asking rents and high vacancy rates). The data supports our experience - that Portsmouth is one of the most insulated markets in the state. The exciting trends in the Industrial sector were not revealed until I approached the global stage.

Looking at the national picture and focusing on data compiled through the fourth quarter of 2013, we find that the U.S. industrial vacancy average was 8.36% (versus 4.2% in Portsmouth) and there are some significantly diverse markets, from top performing to contracting markets. North America and Mexico, especially the port cities, were strong with declining vacancy rates and increasing lease rates. Asia also remained strong with Hong Kong's high quality warehouse buildings nearly full and Beijing rents swiftly on the rise. Australia continued to attract investor attention. London topped the global warehouse rent chart at $21.95/SF gross ($9.00Â±/SF gross are average industrial rents in Portsmouth)! France and India were sluggish.

However, the clearest way the Portsmouth market is connected to the larger markets is through our common challenges, not statistics. What are the top factors influencing the Portsmouth submarket? Let's start with the cost of new construction. Almost all of the good sites have been developed (there was not much industrially zoned land to begin with) and site development costs have increased dramatically. Municipalities want more from developers in return for approvals and utility companies want more for the ability to tie in. The regulatory climate, including environmental, municipal code, OSHA, third party testing, inspections and insurance, is harsh for developers and the cost is ultimately passed on to the end user or tenant.

Our office works with owner-occupant buyers who are looking at existing industrial inventory with asking prices of $25 to $60/PSF and build-to-suit construction estimates of $90 to $125/PSF. We speculate about when those numbers will become closer. However, I think we are heading toward a point in the future where the gap between those numbers does not matter as much as answering the demand for modern uses. When the demand tips the scales, more build-to-suit and "scraping" (demolishing and rebuilding) will be seen in the Portsmouth submarket.

Inventory challenges and opportunities are present from the smallest to the largest markets. Portsmouth's inventory is dominated by older buildings erected in the 1970s and 1980s, leaving buildings in their mid-thirties or forties and often years beyond their expected functional life cycle. The issues arise when the modern requirements of users and tenants create a market where the square peg does not fit in the round hole. High bay, high power, ESF sprinklered space and flex buildings are a rarity, yet many users cannot function without these requirements.

Demand is another universal factor across the markets and in Portsmouth, the demand is for 1,000 to 3,000 s/f contractor bay space and buildings with over 20,000 s/f of space. There is precious little inventory to supply either demand. Zoning changes squeezing home occupation uses out of residential areas leave many contractors with nowhere to park work vehicles and equipment. Our local economy naturally lends itself to multiple small businesses within an industry needing smaller spaces rather than a few large consolidated corporations. Larger, older industrial buildings do not demise well for smaller users and reconfiguring the building's systems to respond to this demand is often not cost-effective. On the over 20,000 s/f demand, both availability and the ability to expand are obstacles. The industrial users in the Portsmouth market are small and the vast majority of the inventory reflect this. The 15,000 s/f building that could be an option for a 30,000 s/f user, based upon potential expansion, often has become less developable over time due to more onerous land use regulations like increased wetland setbacks.

So, how do the universal market factors tie into global market trends? Taking a view from space and comparing emerging markets like Eastern Europe, Vietnam, Peru and Brazil to mature, stabilized markets, it is important to remember the challenges from the Portsmouth discussion above. What do the hot emerging markets have in place for environmental regulations? What are the cost of labor and materials? Do they have land and are they matching demand with new construction? Is there solid infrastructure in place to support continued development? How safe is it to live and work there? The grass is not always greener on the other side, even when the other side is aggressively growing and poised to continue. When we experience shortfalls in our own market, it is important to remember all our markets are connected.

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