

Consulting during contractions in the industrial markets



David Kirk
Principal and Founder

Opportunities are plentiful in industrial markets during economic contractions, and consultants can be the catalysts. The economy weakened substantially during 2008 and the contraction in activity is expected to continue at least throughout 2009. During 2008, the New England region included moderate strength in Massachusetts and New Hampshire and recessionary weakness in Rhode Island and Maine with Vermont and Connecticut somewhere in between. The credit crunch has reduced business lending dramatically for any purpose and sources which traditionally served the commercial real estate

markets have substantially tightened underwriting criteria and reduced allocations for real estate. The lull is complete and affords the industrial user the luxury of time for planning and opportunities for optimization. For the owner and developer, engaging the user market is the best strategy.

Major real estate brokerage and service firms track data on an inventory of 131 to 400 million square feet of industrial inventory in the Boston metro market. Submarkets have vacancy rates ranging from 7% to upwards of 40%. One data service firm tracking 135 million square feet of industrial space reports overall vacancy of 15% for the third quarter 2008 down from 17% in the third quarter 2007. The commercial office market has slackened considerably in the last half of 2008. Whereas industrial rents have stabilized, commercial office rents have slackened, and exploiting the otherwise commercial inventory is increasingly an option for the industrial user.

The real estate consultant is an essential component in any proactive strategy in a market contraction. The general lack of activity has made market measurement and diligence a time consuming task requiring experience and expertise. Setting reality-based parameters for action steps to achieving goals and objectives require market research and expert analysis. The spread between the bid and ask delayed offerings during 2008 and will probably continue to do so during 2009. However, evidence of market trends, is always apparent and reasonable surrogates can be assumed. Distressed sales and foreclosures will be occurring during 2009, and lawyers and brokers are needed for the planning and implementation of changes in occupancy by the user. For the owner and developer, good data and trend analysis can put properties in the forefront of any user activity and propel engagement. Preparedness is the pathway to opportunities for all market participants.

Architects, planners and engineers can be helpful for all parties to the transaction. The green way to build, rehabilitate and operate real estate is politically correct and economically sound. Changing occupancy is an opportunity to go greener. Greenness is increasingly becoming a real estate priority in the local markets. Massachusetts' Governor Deval Patrick and Boston's Mayor Tom Menino have made sustainability an absolute requirement in the development of real estate for governmental use and a priority for any redevelopment of publicly owned property. Sony, Adobe, Walmart, Texas Instruments and PNC Bank are a few of the corporate users that have adopted green strategies for real estate which they own or occupy. The regional industrial markets still offer the user many options for rightsizing and going green in a

changed capital market which can selectively favor a reasonable real estate and credit risk with low leverage financing.

Going green is not just social investing. The 2nd quarter issue of Valuation, published by the Appraisal Institute, reports that of \$300 trillion to be invested by corporate investors, approximately 1% or \$30 billion is directed to sustainable properties. It is good economics. The Appraisal Institute started offering a course on Appraising Green Buildings in 2008. The Appraisal Institute reports that the United States Green Building Council (USGBC) claims that green buildings save on average 30% on energy costs, 35% on carbon costs, 30-50% on water use costs and 50-90% on waste costs. Marshall & Swift the cost estimating manual for the real estate industry has started to collect data on sustainable buildings and just recently has added cost adjusters to its data base and updated cost reports. The Urban Land Institute estimated a 10-15% bump to value for going green despite only a 2-3% bump to costs for sustainability based on an Argus modeling exercise prepared by Steven Zenker of Cushman & Wakefield.

All these construction and operating costs are measurable. However, the history is short and materials, technologies and methodologies are rapidly evolving in response to the green revolution. In addition to measurable operating costs, users are feeling the benefits of enhanced recruitment, retention and productivity of employees which are being attributed to an enhanced work environment and projected image. The case for green building is accordingly becoming more compelling every day. Sustainable buildings have a three-way bottom line impact by improving the well-being of the economy, the environment and society. Many predict that the high performance of green buildings combined with new government standards will make going green the de facto standard. It is one of those times when doing well will be doing good and vice versa!

The users' market can be reflected in pricing in leases and purchases and in terms and conditions of sale or occupancy. The industrial market was generally flat in 2008 and will probably weaken into 2009. With industrial vacancy in the range of 15% in the greater Boston market, choices are still plentiful and the user has a dominant market position. Industrial inventory includes warehouse/distribution, manufacturing and research & development/flex. Because of weakened economy, commercial inventory is also an option for the industrial user. However, liquidity for selling existing facilities has worsened in all property categories.

The user should analyze occupancy costs for the alternatives. The industrial market tends to be a net rental market, whether partially or fully net of expenses. Real estate taxes and insurance and most other costs or liabilities of occupancy accrue to the user whether a lessee or an owner. Although occupancy costs are normally marginal and not the deciding factor, these costs merit analysis. The users' advantage can be used to gross up the rent to provide predictability in occupancy costs and protection from escalation. Fixed and variable costs of occupancy are worth the exercise and comparative analysis.

Make the Right Deal

Strategic planning for space and financial resources provides the foundation for smart and deliberate real estate deals in the market. The users should plan for the rest of this cycle and into the next one and owners should engage the user community.

David Kirk is principal and founder of Kirk & Company, Real Estate Counselors located in Boston, MA.

*The Industrial Market
Making Informed Decisions*



David S. Kirk
CRE, MAI, FRICS

KIRK & COMPANY
Real Estate Counselors

99 Summer Street, Suite 930
Boston, MA 02110-1249
Phone (617) 261-7100
Fax (617) 261-7910
dsk@kirkco.com