Back in Business?

IS DEVELOPMENT BACK ON THE

BY STEVE BERGSMAN

The United States' recovery is now four years in the making and the unemployment rate has fallen to 6.1 percent, the lowest it's been since 2008. Even the stock market is looking good, closing above 17,000 for the first time.

However, not all pieces of the economic pie are looking salubrious. Commercial real estate remains a bit of a laggard with national office vacancies stagnant at 16.8 percent in the second quarter and the industrial market growing in fits and starts.

Perhaps that is why developers and capital sources that bankroll real estate development have been so conservative coming out of the recession.

Initially, the path of commercial real estate in this recovery has been all about tenancy. New office or industrial product has depended upon the specific needs of a singular company — basically build-to-suits. This is a phenomenon that is not to be dismissed, if your market indicates the national and/or local economy is far healthier than it might have been just 24 months prior.

The first builders to try the spec market are often local and entrepreneurial, and if they hit that pot of gold which comes with full occupancy, institutional developers follow.

Most cities didn't start to see either office or industrial speculative construction until last year, even when local vacancy rates dipped far below 10 percent. There are still some cities in North America where there is no speculative development, although build-to-suits have returned. The commercial real estate recovery has been geographically erratic.

As always, *Professional Report*, checks in with SIOR members in cities scattered across North America to see what is happening at the local level, but first we'll peruse a tale of two cities, one a first-tier market industrial powerhouse, and the other, a sleepier but healthy second-tier city.

IT WAS THE BEST OF TIMES, IT WAS THE WORST OF TIMES

The distance from Toronto, Canada to Tampa, Fla., is just over 1,300 miles, or about 19 hours straight driving — depending how desperate you are to get out of the cold winter and arrive in the sunshine state.

Metaphysically, it's a much greater difference; Toronto is one of the powerhouse industrial markets in North America, with 856 million square feet — it ranks third in size on the continent. Tampa doesn't even rank number one in Florida. Yet, the two markets are tracking closely, each within its range of size. Toronto — a massive industrial market — moves forward like a boulder rolling down hill and picking up speed. There are no hills in Tampa so the rolling forward is more modest, but in-line with its capacity.

In Toronto, industrial development came to a halt at the end of 2008, reports **Colin Alves, SIOR**, a senior vice president with Colliers International in Toronto, Canada. "We didn't see any new development until 2012 when the market started to show signs of resurgence. Since then there has been a fairly consistent pipeline of new development with substantial growth over the last 12 months."

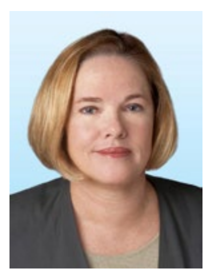
Down in Florida, **Mary Clare Codd, SIOR**, director of Office & Industrial Services in the Tampa, Colliers International, similarly reports, "we haven't seen expansion here since 2007 or 2008, when projects were being finished. It started again in 2013."

In Tampa, industrial vacancy has dropped below 10 percent; in Toronto the vacancy rate stands at 4.4 percent and could go as low as 4 percent by the next quarter.

"We are starting to see the market come back, both in build-to-suits and in spec because there is no product," observes **Doug Murray, SIOR**, a vice president with Colliers Internatinal in the Toronto suburb of Burlington, Canada.

contributing SIORs

COLIN ALVES,
SIOR



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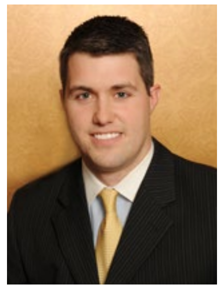
SIOR

ROBERT DIKMAN,
SIOR, ALC, CCIM, CRB

WILLS ELLIMAN,
SIOR, CCIM, MCR



TONY FLUHR,
SIOR, CCIM

SCOTT HENSLEY,
SIOR, CCIM

DOUG MURRAY,
SIOR

JILL RASMUSSEN,
SIOR, CCIM

"Secondly, the Toronto market has come back because of organic growth from Canadian companies that are expanding and need more space," Murray adds.

In the submarket of Burlington, Murray worked with a client that was looking for 120,000 square feet with 28-foot clear and ESFR (early suppression, fast release) sprinklers. The product didn't exist, so the client jump-started a 350,000 new industrial build of which Murray's client will take the 120,000 square feet.

"Tampa-based BayCare Health System Inc. just moved into a newly built facility of 150,000 square feet and has another build-to-suit of 125,000 square feet in Pinellas County," reports Codd. "Bristol-Meyers have taken down 70,000 square feet to expand to 100,000 square feet, and Health Plan Systems recently came to the market and is expected to add 99,000 more square feet."

Commercial real estate development has lagged the economic recovery, with many cities not seeing post-recession, speculative projects until 2012 or 2013. In many cases, those early entrepreneurial efforts have proven wildly successful, enticing other developers back into the game. However, all recoveries aren't equal, so the degree of resurgence varies dramatically.

To which **Robert Dikman, SIOR, ALC, CCIM, CRB**, chairman and CEO of the Dikman Company in Tampa, Fla., adds: "With inventory slowly getting filled, there is demand for space. We will do two build-to-suits this year. The first is 18,000 square feet of industrial with seven acres of outside storage, and the other is a 32,000-square-foot, special-purpose building with tons of parking."

As for speculative development, here is where the two cities diverge, and in a big way. Tampa is getting its first spec building, 150,000 square feet, under development by Cabot Properties, whereas Toronto's first spec building opened at the beginning of 2013; it was such a success the market has since exploded.

Since the recession, Canada's largest privately-held industrial real estate developer, Orlando Corporation, has built the city's first spec building in the Toronto area with 500,000 square feet of space. It was leased in full by Amazon. The company now has a number of spec buildings underway in the Toronto market and has pulled permits to erect three more buildings.

"The Orlando Corp. is no longer alone; starting in January 2014 and going through the next 18 months, the Toronto industrial market will see 9.5 million square feet of new development," says Alves.

How far has Toronto come back? According to Alves, at the height of the boom in 2005 and 2006, the market saw about 10 million square feet of new development.

ELSEWHERE IN NORTH AMERICA

Louisville, Ky., which sits in either the South or Midwest — depending on your point of view — was one of those smaller metros that did not experience the real estate boom after the turn of the new century, nor the bust that followed. None of which prevented the city from going through a development dry period after the onset of the Great Recession — as the lack of financing for new projects was fairly universal across North America.

Still, the equanimity of the local commercial real estate market made Louisville attractive to entrepreneurial firms that understood the region. NTS Development Co. of Lewisville, Kentucky, struck first, developing a 125,000-square-foot, state-of-the-art, spec office building in 2010. The building attracted Churchill Downs as an anchor tenant and by the time it was completed it was 90 percent leased, and is fully leased today, reports **Tony Fluhr, SIOR, CCIM,** a director with NTS Development, Louisville, Ky.

The company is nearing completion on the second spec office building, being developed in cooperation with University of Louisville Foundation, in a 200-acre, in-fill development. "The 125,000-square-foot structure will open in the third quarter with two tenants taking down 15,000 and 20,000 square feet," says Fluhr. NTS Development is in conversation with a few other potential tenants.

"There are two more spec office buildings waiting to break ground," says Fluhr. "On the industrial side, we have about 1.6 million square feet of new spec under construction. Recently, Amazon leased about 1 million square feet in the nearby market of Southern Indiana. That was a build-to-suit."

Activity is due to the tightness of the market. According to Fluhr, industrial vacancy is in the single digits and the office market of 20 million square feet, split between the suburbs and downtown, stands at 14.7 percent vacancy.

Most companies prefer the suburban office market. "If you have a 100,000-square-foot requirement in Louisville and you want to be in the suburbs, that product doesn't exist," says Fluhr. "There is pent-up demand so developers are able to put packages together to do build-to-suits or spec projects."

The suburbs are also key to the industrial market in Charlotte. The overall industrial vacancy falls between 7 percent and 10 percent, but in the key Mecklenburg County market, the vacancy rate is 6.8 percent, notes **Scott Hensley, SIOR, CCIM**, a principal with Piedmont Properties/CORFAC International in Charlotte, N.C.

As with other cities, there was no new spec development since the recession until recently. Now, the gloves are off–or on if you're talking about work gloves.

"There is about 2 million square feet of spec industrial space coming out of the ground now," says Hensley, "and in Cabarrus County, north of Mecklenburg, 1.5 million square feet of new spec development has broken ground since the second quarter this year, all of it driven by market needs and infrastructure work coming to completion."

Why all the new building? Charlotte has seen excellent absorption numbers, says Hensley with 1.5 million square feet being taken up in the second quarter of 2013, followed by 1.9 million square feet in the third quarter, 1.3 million square feet in the fourth quarter, and almost 1 million square feet in the first quarter 2014.

Not all markets are experiencing the speculative glow. In Wilmington, Del., **Wills Elliman, SIOR, MCR**, a partner with Newmark Knight Frank Smith Mack, frankly declares, "no one is doing anything spec," but he adds, "based on user demand, build-to-suits are getting done."

Despite the lack of spec building, Elliman has turned optimistic on his market, because companies that have prevaricated on filling out their location needs are finally active. He gives this example of a 40,000-square-foot lease he negotiated for a build-to-suit.

"It was for a life science company in an outdated facility that needed to get out for the last five years, but always kicked the

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Executive Vice President, Sales Representative
+1 416 620 2841 | Graham.Meader@colliers.com
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COLIN ALVES, SIOR
Senior Vice President, Sales Representative
+1 416 620 2848 | Colin.Alves@colliers.com
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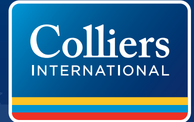

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can down the road," he explains. "Now, the company is more bullish on the economy and decided to go ahead and lease a new building."

Elliman is working another life science company lease, this time for 60,000 square feet that will also be a build-to-suit. He also negotiated a 175,000-square-foot lease in a build-to-suit for a company called Corporation Service Co.

"There's a fairly high vacancy in this market, but Class A space is getting tight," Elliman says. "The companies now going to build-to-suits couldn't find what was wanted."

Finally, there are some markets that are just outliers and behave differently than most others.

"In the Minneapolis metro, office and industrial leasing remains slow," says **Jill Rasmussen, SIOR, CCIM**, a principal in The Davis Group of Minneapolis. "Development, however, is not dead. There is one Minneapolis property sector that has been hot, hot, hot – medical office buildings."

"A few years ago we saw clinics going into retail space. Now we are seeing larger projects, freestanding medical office buildings with ambulatory surgery centers and a mix of primary and specialty care facilities, going up nearer to where patients reside," Rasmussen explains.

The sweet spot for these buildings is 40,000 to 50,000 square feet.

In the last four years, The Davis Group has built 12 of these projects, from 35,000 to 62,000 square feet in North Dakota, Idaho, but mostly in Minnesota. These are custom type buildings with heavy duty power, lots of plumbing, gurney-size elevators and most are build-to-suits with 15 to 20 year leases.

"We just finished two projects this year and we're starting a third," says Rasmussen. "We try to do three a year."

Not bad business for a market that Rasmussen says has "no office development and no spec development."

Some markets just behave differently.

ABOUT THE AUTHOR: *STEVE BERGSMAN is a nationally recognized financial and real estate writer. For more than twenty-five years, he has contributed to a wide range of magazines, newspapers and wire services, including the New York Times, the Wall Street Journal Sunday, Global Finance, Executive Decision, and Chief Executive.*