INDUSTRIAL SPECULATIVE DEVELOPMENT

A MUCH NEEDED WAVE OF NEW CONSTRUCTION IS ROLLING INTO THE DISTRIBUTION CAPITAL OF THE SOUTHEAST IN 2015.

By Bradley C. Pope, SIOR, CCIM

Unlike the other major distribution hubs around the country, Atlanta has seen very little speculative development since the "Great Recession." In fact, you can literally count on one hand the significant spec buildings delivered in Atlanta since the dark days of the recessionary period, a remarkable lack of development for a 655-million square-foot industrial market.

Atlanta, like most markets, struggled with negative absorption from 2008–2010. During that three year stretch Atlanta experienced consecutive annual negative net absorption totaling 12.5 million square feet. It is certainly no surprise that the spec pipeline was cut off at that time.

However, the following three years tell a very different story. From 2011–2013, Atlanta enjoyed over 24 million square feet of positive net absorption, and 2014 had the highest absorption in any single year since 2000. This confluence of factors has also naturally led to the lowest vacancy rates in fourteen years.

That's great...unless you are a tenant. Keep in mind that as of the 2014 year-end you could still count the significant spec deliveries in Atlanta since the recession on one hand.

All of that is about to change. Today there are 24 spec buildings (and counting) in the pipeline totaling over 12.5 million square feet on the way to provide relief to tenants who are finding very few quality options in many segments. It is notable that almost half of these new developments are over 500,000 square feet.

Atlanta has historically maintained some of the lowest rental rates nationally for quality distribution space. Rates in the mid $2's net for first generation bulk space had not been uncommon – even preceding 2008. Fortunately for developers, there have been several recent transactions that indicate rates have been pushed to somewhat higher levels. The question is, will rates continue to hold after the addition of over 12.5 million square feet of new inventory?

Time will tell; however, with more disciplined capital, higher construction costs and more constrained transportation capacity than previous development cycles, the deck is stacked today for rates to hold. One key to rate stability and growth this time around could be a more thorough understanding of how efficient a solution each available building is for a prospective tenant's operation relative to the other options.

We have all seen the metrics that show what a small percentage the cost of a typical lease can be for a distribution center when compared to labor and transportation costs for that same operation. As e-commerce fulfillment gains more of the overall market share of warehouse inventory, the position that rent enjoys as being the "low man" on the cost totem pole could become magnified. Granted, lower fuel prices do offset somewhat but do not adequately compensate for the lingering capacity issues the transportation sector is experiencing.

As this happens, it should follow that the optimal location for a major distribution center with a material e-commerce component will become more geographically specific than one that is only replenishing bricks and mortar destinations in a region. In other words, for certain operations and locations, buildings that historically would have been the third and fourth choice on the short list might find they are uncompetitive, even at substantially discounted rates.

Gone are the days when preparation for showing a bulk building ended with printing flyers and memorizing your own building specifications. Today when developers say "location," tenants hear "transportation." Knowing how a specific building stacks up to its competition relative to each tenant's operational needs (parcel hub proximity, intermodal proximity, same day delivery service, on site truck flow, last mile model, labor, parking, trailer storage, incentives, etc.) can go a long way to inform owners as to how competitive their option is before they ever receive an RFP.

While the spec wave is coming to Atlanta – and is needed – not everybody is jumping on the bandwagon. There is another school of thought in Atlanta's development community that believes that due to the fluidity of today's requirements, chances at securing the next major deal are better with a

pad-ready site than with a vacant spec building.

It hasn't been that long ago when 150 parking spaces and 25 extra trailer parks for a 500,000-square-foot building seemed adequate. Today, with multiple picking methods, large numbers of SKU's, and intensive parcel volume that come with omni-channel distribution, parking and truck flow are often the first criteria, after location, that cause existing buildings to be cut from the short list. Pad-ready sites with proximity to online shoppers, flexibility to accommodate both flow and parking, as well as immediate interstate access are certain to be preferred for many such requirements, and several are already in play.

Even so, if a tenant were looking for a 32' clear space over 600,000 square feet in the Atlanta market that is both vacant and available; as of the fourth quarter of 2014 there would have been exactly one option in this 655 million square foot market. Atlanta's development community is diligently working to ensure that type of supply imbalance is temporary. 2015 is setting up to be a year when Atlanta is open for business on every level; tenant activity, investment capital, and now spec development are all starting the year on optimistic notes, a scene welcomed by tenants and brokers alike! ■

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And he has seen a number of what he calls wanna-be developers swoop into Dallas. They come not knowing the local market and armed with concepts that they say worked in California and the attitude that, "the yokels here don't know enough." But these, he says, are few and far between, and the majority voice is that of well-financed and savvy developers with the wherewithal to sustain an economic blow should – or when – one occurs, names like Duke, Prologis and IDI.

And while Gump is not on the front lines of capital trends, he measures the stability of that market by its production: "What I see every day is solid projects being built by extremely qualified developers. Given the leasing performance, it's hard to argue that they're making a mistake."

And as the market continues to accelerate, the percentage and volume of such deals is sure to rise. Which further underscores the need for caution, for so too will the volume of wanna-be deals and dealmakers, and without a careful eye to see through the growing roses, we might very well be left in the weeds. Excessive optimism, to reprise the words of Emerging Trends, can lead to recklessness. And at the end of the day, who wants to party like its 2007? ■