WHERE ARE THE LAND DEALS?

On April 23, SIOR held a Land Development Meeting in Las Vegas. We were fortunate to have four leading industrial building developers tell us about industrial land deals today. The comments have been updated to the publication date of this article.

The best time to sell land is now. It is also the best time to build spec in the past 15 years. Vacancies are low and building choices are limited in the best markets. Interest rates are low and it helps developers carry the land development. Demand is good and there have not been a lot of new buildings built over the past several years. Finally, there is a tenant preference for new, modern distribution buildings. All the fundamentals are in place to support new development.

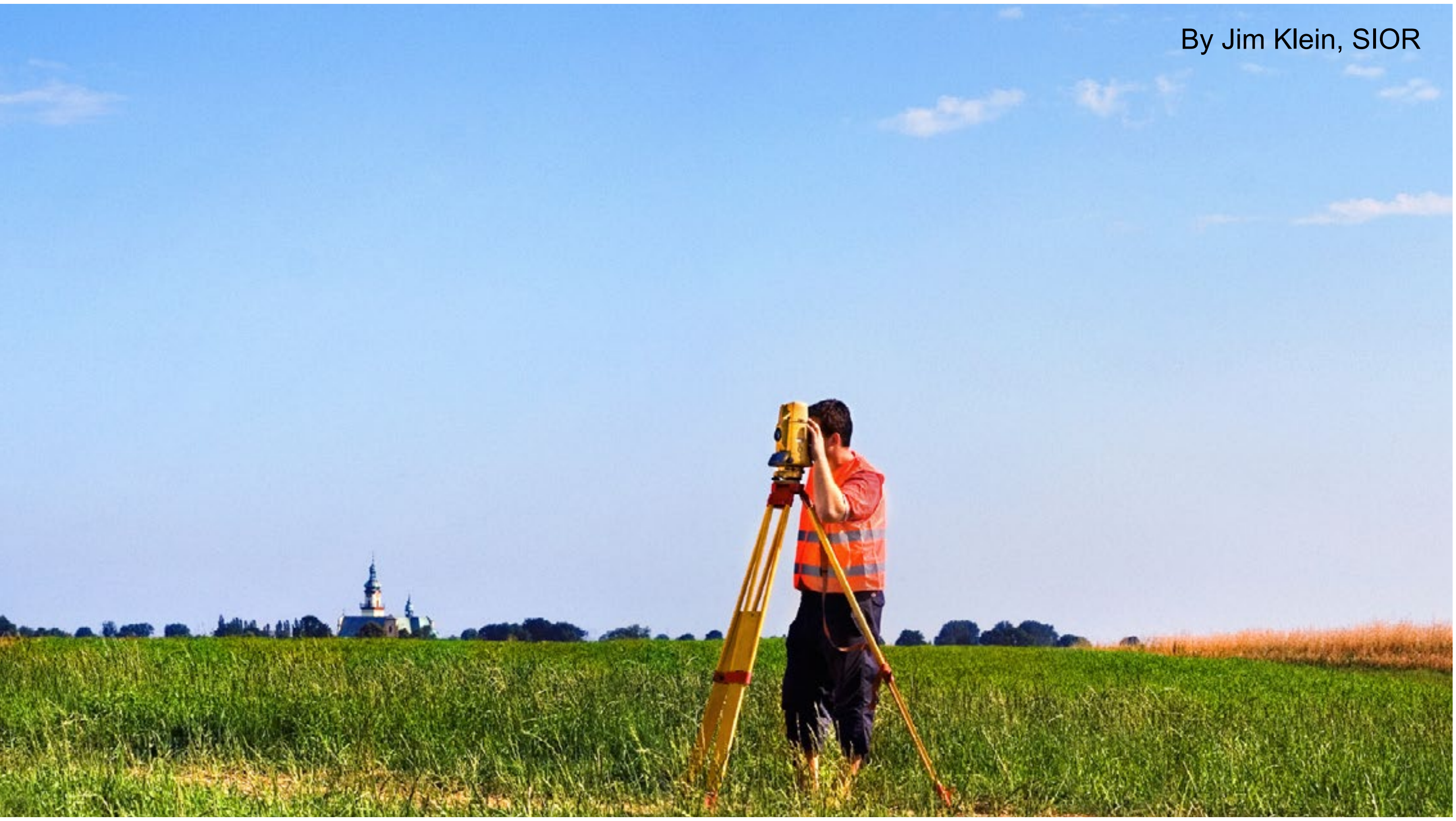
Land near freeways, ports, airports, and other nodes along the logistics infrastructure is of particular interest, especially in constrained markets where there are barriers to entry. Areas of focus include the so-called “Smile.” States with emphasis on Houston, Dallas, Chicago, Inland Empire, and Southern California. Land prices are increasing and, in many cases, selling at the highest prices ever. In developed, urban markets, the emphasis is on adding value to older buildings that have been in the hands of users. Raising the roof, adding loading doors, or simply tearing down the building are all techniques in infill markets.

PRIVATE VS. PUBLIC DEVELOPERS

Private and public developers look at development opportunities differently. While both are active in all parts of the development business, varied sources of financing lead private and public developers to different preferences. For instance, when it comes to build-to-suits, public developers like the publicity of building for big tenants, especially with land they own in inventory. But the rate of return public developers receive building spec exceeds build-to-suit returns by a large margin. Spec construction is a much larger part of the public developer's focus. Tenants and tenant brokers are sophisticated and knowledgeable, therefore there is only a small developer profit left after negotiating a build-to-suit, even less so once the developer assumes all the construction liability.

However, on a risk adjusted basis, private developers generally like build-to-suits because they are not obligated to guarantee loans personally as they do for large vacant buildings. Having a tenant in tow reduces developer risk and opens up sources of capital from a much wider field. Private developers earn a reasonable fee for their experience and ability without having to take a personal risk on the development project.

In terms of product size, public developers are more likely to develop the mega warehouses of 1,000,000 square feet because they are not borrowing money with a personal guarantee. In addition most land loans require 50 percent down, and with the expensive cost of equity, it makes the hurdle rate even greater for the private developer. Banks are also not keen on large land loans whereas the public developers will often use funds on hand to purchase land. Public companies are more likely to buy big tracts of greenfield land and build the mega buildings than private developers.



ENTITLEMENTS

Entitlements are time consuming and generally set the critical path for building delivery. For instance, for California approvals, one to three years is common and it can take five years if an Environmental Impact Report is required. The entitlement process is becoming more expensive because local agencies are shifting more of the infrastructure costs on to the developer. In many parts of the country building warehouses is not favored by the local community. A Nimbyist reaction to large warehouses puts additional constraints on land supply.

Because of the large costs entitling and improving land, there is a big difference between buying wholesale, unfinished lots compared to selling retail, finished sites. Most non-professional land sellers have no idea what it takes to entitle and develop large sites. It's clear because when land prices are being discussed, there is a lot of confusion about development and entitlement costs. This is a typical obstacle in land negotiations when describing what costs go into a land development.

ADVICE TO BROKERS

In advice to brokers, the developers emphasized the importance of communicating the difference between retail and wholesale prices to seller clients. If sellers want to entitle and install the infrastructure themselves, developers would prefer to pay the higher price. Brokers should know all the costs and they should be able to run the proforma themselves. Brokers need to understand site coverage, all the infrastructure costs, and 'what goes under the building.'

Brokers should know the details of their markets. In order to sell land, developers want to know rental rates, building costs, lease up time, tenants in the market, vacancies, absorption, supply, demand, and size of market. The information should be easy to understand because it will also be shared with partners and lenders. Developers tend to return to the brokers when they have had the most success.

To answer the main question, 'where are the deals?', land deals are everywhere: infill and greenfield; and as one developer said, it's likely in your pocket if you look carefully enough.

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