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Kia Motors Manufacturing Georgia decided to temporarily halt production at its West Point facility from March 30 through April 13 in the face of the worldwide COVID-19 outbreak. Kia is one of several manufacturers disrupted by the pandemic.

DISRUPTION REACHES INDUSTRIAL MARKET

SIOR chapter leaders assess demand drivers for their local industrial markets, which are threatened by the COVID-19 pandemic.

By John Nelson April 2020

The outbreak of the novel coronavirus has upended the daily lives of all Americans as millions work from home in March and April in an effort to self-quarantine, and a large swath of the population is not working at all as restaurants, bars, movie theaters, stores and hotels suspend operations and cut staff.

In addition to the retail and office sectors, industrial real estate is experiencing headwinds as some manufacturing plants and distribution centers of "non-essential" items temporarily cut back production.

Kia Motors Manufacturing shut down its West Point, Georgia plant for two weeks in late March and early April, citing "supply chain issues" as one of the reasons behind the move. General Motors, Ford and Fiat Chrysler also temporarily closed their North American plants. **Elliot Embry**, vice president of NAI Saig and president of the Memphis Chapter of the Society of Industrial and Office Realtors (SIOR), says that retailers like The TJX Cos. and Tailored Brands, parent company of Men's Wearhouse and Jos. A Bank, are also temporarily closing distribution centers in an effort to protect their work- force from exposure.

"Unfortunately, the impact down the road for some of these retailers with large warehouses and distribution operations depends on how long the crisis lasts and the depth of a recession,"

Elliott Embry
SIOR Memphis

says Embry. "If they are still around or if these large third-party logistics firms have been doing the work for them, the impact is still to be determined as these retailers downsize in the next 12 months. You're seeing the retailers getting aggressive early trying to draw in as much business as they can under the circumstances."

At the time of this writing, the coronavirus outbreak is in its infancy in the United States, so it's tough to forecast the long-term outlook for the U.S. industrial market. **Ted Konigsberg**, president of Infinity Commercial Real Estate and vice president of the SIOR Florida Chapter, says that ultimately the legacy of the outbreak won't be realized until the crisis passes and industrial real estate owners and tenants re-evaluate their business operations.

"Companies that have supply chains across the world are rethinking their business model. Tenants are going to be rethinking their needs for space, and landlords are going to be re-evaluating their development strategies," says Konigsberg. "We have no control over these things that are critical to our industry. No one has quantified this yet because these things have never happened before or happened at the same time before."

Southeast Real Estate Business reached out to five SIOR industrial specialists and chapter leaders in the Southeast to discuss their local markets.

In addition to Embry and Konigsberg, SREB spoke with **Don Moss**, industrial partner at Colliers International's Charlotte office and treasurer of the SIOR Carolinas Chapter; **Scott Skogmo**, senior director of Chesapeake Real Estate Group and president of the SIOR Maryland, District of Columbia and Virginia Chapter; and **Deborah Smith,** vice president of industrial brokerage and consulting at Cushman & Wake- field | EGS Commercial Real Estate and secretary and treasurer of the SIOR Louisiana, Mississippi, Alabama and Northwest Florida Chapter.

The following are edited Q&A responses from interviews conducted in the days before and after the coronavirus outbreak in the United States in early March:

Southeast Real Estate Business: How would you characterize the supply-demand balance in your local industrial market overall?

Elliot Embry: In Memphis, the demand is outpacing the supply. Over the past 12 months we've had 2.7 mil- lion square feet of positive net absorption, so in our Class A market there's limited existing product. We currently have 10 million square feet of brand new product under construction, with about 8 million square feet of that speculative, which is not a standard ratio for our market. Toward the fourth quarter or first-quarter 2021, we'll start to see some of that imbalance level out as new product starts to come on line. Ted Konigsberg: If you are a foreign company or one wanting to do business in Central and South America, you need to be in Miami-Dade County. We are very different from other major markets because of that. We are also very much tourism driven, so a lot of the dynamics that are valid here don't apply if you're in Chicago. We are incredibly land constrained as well, and our geology is rare. A lot of our developable land has been preserved in perpetuity so that our freshwater has a place to go. The last few tracts of developable land of any size and scale are gone. We are in the very low single digits in vacancy. We've got 6 million square feet of Class A industrial being built right now.

Ted Konigsberg
SIOR Florida

Don Moss: Absorption is slightly behind deliveries. The Charlotte market ended fourth quarter 2019 with 1 million square feet absorbed, while year to date absorption exceeded 3.5 million square feet. The overall vacancy rate for fourth-quarter 2019 hovered around 6.6 percent. The Charlotte industrial market continues to build momentum as new construction forges ahead, and we expect to see absorption rise.

Scott Skogmo: Vacancy rates have dropped in the Baltimore and Washington, D.C., markets to 8 and 6.1 percent, respectively, which are historically low rates. Absorption is still positive, in the 3.2 million range for Baltimore and 2.2 million range for D.C. Availability depends on the size you are looking for. If you want 100,000 square feet of Class A space with ESFR systems and high clear heights, there may be few choices. If you want 50,000 to 100,000 square feet of Class B space, you may have more choices, but some could be functionally obsolete.

Deborah Smith: The Birmingham industrial market has seen a tightening over the past few years. Overall vacancy for Birmingham's multi-tenant market ended 2019 at 6.5 percent, so options are becoming limited for tenants seeking quality space. The last speculative multi-tenant building was built in 2018 and had full occupancy by its delivery in 2019. This year, there have not been any new buildings delivered in the market.

***SREB:* What are the types of firms that have been actively leasing space in your local market?**

Embry: Memphis has always been primarily a third party logistics (3PL) market. We've had a minimal number of companies that have actually had their own distribution centers in Memphis. Over the past 24 to 36 months, we've actually seen activity from the end users lease space in Memphis versus the rapid growth of 3PLs. A variety of users are leasing space directly in the market, such as Kellogg's, Nike, Niagara Bottling, Toshiba and Cooper Tire. Companies realize the benefits that Memphis has with all five Class 1 railroads having intermodal facilities, plus FedEx. The distribution benefits of Memphis compared to our rental rates provide extraordinary value.

Konigsberg: There are a lot of e-commerce and last mile users in South Florida. More than anything it's freight forwarding industries, so companies actively moving in and out of Port Miami and Miami International Airport (MIA). More than 93 percent of perishables that come into the United States come through MIA.

Moss: We are seeing a continuation of past trends with the exception of Amazon, which is relatively new to the Charlotte market. The deal square footage is moving up in the 250,000- to 300,000-square-foot range, where in the past, 150,000 square feet was considered a large deal for the market.

Skogmo: Last-mile delivery and e-commerce have driven the Class A industrial market for the past few years in the Baltimore-D.C. region. A spec building that used to have a two year lease-up period and multiple tenants may now get leased right away with one major occupant. Land is getting scarce; local jurisdictions don't want more development, so tenant's choices should become limited.

Smith: Automotive, manufacturing and distribution projects continue to serve as the key drivers of growth, which has been an ongoing trend in our market. Additionally, Amazon recently completed construction on its 855,000 square-foot fulfillment center in nearby Bessemer.

***SREB:* How would you characterize the food and beverage activity in your industrial sector?**

Embry: Memphis has seen fairly limited activity in the food and beverage warehousing sector. Memphis is a fairly spread out market, and what we understand about the demand for food and beverage delivery from users like Amazon Fresh is that you need a denser population within the size range of Memphis to make the economics of it work.

Konigsberg: Food and beverage has been a significant component of South Florida's industrial market for many years, but it's not driven by local consumption, it's driven by movement of perishable goods to other parts of the country. On the beverage side, it's relatively a static component. As our population grows there will be more food and beverage distribution, but the 800 pound gorilla is imported perishables.

Don Moss
SIOR Carolinas

Moss: In the Charlotte region, Pactiv, which manufactures disposable food containers, leased 441,444 square feet at River Oaks Corporate Center in Concord. Bestco signed a lease for 233,000 square feet in the Mooresville Business Park for distribution, and it plans to expand its manufacturing campus in Mooresville.

Skogmo: The Baltimore-D.C., region has always had its share of large food distributors like Giant and Safeway, but today there are many more, with some focusing on the delivery market. Freshly leased more than 200,000 square feet in Savage with an existing freezer and cooler space. Coastal Produce, the former occupant, had a more traditional warehouse built exceeding 244,000 square feet. There are many smaller food distributors that typically want truck terminal buildings, with lots of doors and parking and minimal warehouse. Fresh Direct leased 15,000 square feet in Capitol Heights with cross dock loading, multiple doors and lots of parking. The beverage industry seems to be consolidating, with many of the old family liquor and beer distributors being bought out by major nationals, resulting in the need for bigger space.

***SREB:* How competitive is the acquisition activity in your market? And is there a bid-ask gap for industrial sales at all between buyers and sellers?**

Embry: It's a competitive situation, both on the larger portfolio sales as well as smaller one or two building transactions. Over the past 36 months we've seen a large increase in activity. Cap rates have continued to compress in primary submarkets, and we've seen a large increase of buyers looking to buy the same quality products at a more aggressive yield than they would pick up in a market like Dallas or Atlanta. We're not seeing a bid-ask gap, all the product going out to market is getting purchased very close to the seller's expectation.

Konigsberg: It's incredibly competitive. Our cap rates are at an all time low, and our dollar per square foot numbers are at an all time high. It's driven by trends that don't tie to the cost of capital, though that's a huge factor. One of the biggest drivers is the change in U.S. tax law. When state income tax no longer became deductible in federal tax returns, there was a tsunami of investment dollars primarily from the Northeast moving to the Southeast. It has pushed the demand curve for investment properties, which includes industrial, one of the safest categories. We watched second generation, functionally obsolete facilities that were well leased selling for prices significantly higher than the cost of new construction because there was nothing available. I bought a 70,000 square foot building for one client in 2018 for $5 million sold in 2019 for $7.3 million. I don't see that going forward because the changes in our tax law produced a sugar high for us in South Florida.

Moss: It's very competitive for single tenant industrial buildings in the Charlotte market. Deals are closing reasonably quickly if the property is modern and has no functional obsolescence.

Skogmo: Class A distribution space is selling at or above asking price with or without tenants in place, and there are numerous institutions prowling our market looking for opportunities. If the building is already leased with a credit tenant, cap rates have been

Scott Skogmo
SIOR Maryland, Virginia and DC

around 5 percent. Older buildings usually go to the user market, but if they are well-located and divisible, there are investors looking at them.

Smith: Due to the lack of available product, the average sales price has increased and the time to close has decreased most often as a condition of sale.

SREB: If you had to pick one storyline that you're watching for as it relates to either your market or industrial real estate at large, what is it and why?

Embry: Other than COVID 19, Memphis is going to make headlines in the years to come. The market is still $1.50 less on the rental rate perspective than some markets that are only three or four hours away. As we do a better job of letting these companies know and chasing business across the country, we're going to see continuous growth in the Memphis market.

Konigsberg: South Florida is really trade driven. I'm very nervous about the disruption in the supply chain due to the corona virus and trade wars. Those take time to filter through a system. We have all this new product being delivered just when international trade is beginning to take a huge hit. I see us really starting to see the impacts take effect in the third quarter. Because of the land scarcity, developers are starting to look at floodplain levels and they're starting to buy properties in really challenged neighborhoods that have good elevations. We're re-looking at brownfield redevelopment as well.

Moss: Sites within Mecklenburg County for larger bulk warehouses are becoming harder to find. We are seeing a trend for warehousing to move outside of Mecklenburg County to the surrounding counties that were traditionally just manufacturing. We, like everyone else in the country, do not know the impact that coronavirus will have on the market in terms of leasing. We do not necessarily feel it will impact development because of the long lead times needed to complete projects.

Skogmo: Tenants and user-buyers need to be careful in a rapidly changing market. Not only are the economics changing rapidly, but so are the rules. Unfortunately, there are times when the user doesn't figure this out until the lease has been signed and it's time for use and occupancy inspections.

Deborah Smith
SIOR La., Miss., Ala., and NW Fla.

Development of new product is also becoming much more difficult as local legislators don't want to see any type of development, and lead times are significantly extended for site plan review are taking longer. That combined with the lack of good sites can only result in higher rental rates and lack of new product.

Smith: Prior to the coronavirus, the top storyline affecting the local Birmingham market would be the lack of quality inventory. However, now we will be watching the global ramifications from the coronavirus, especially as we look at our international industrial climate, most specifically with the automotive industry's supply chain. There's potential for so many companies that will be temporarily absent in an already challenged labor force. I would imagine too that short-term automobile sales could be impacted. Both of these would ultimately create an impact for our automotive manufactures in Alabama.