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Industrial Leaders Discuss Class B, Build to Suit and Spec Trends

By Jennifer LeClaire

When it comes to just about any commercial real estate class, institutional investors are looking for core product in core markets. But when it comes to industrial, the definition of markets is changing and the appetite for class B is growing. At the same time, build to suit and speculative industrial development is picking up in some markets, core or not. These were among the insights industrial real estate leaders discussed at RealShare Industrial in Miami on Thursday.

Southeast editor Jen LeClaire caught up with Aaron Gordon, vice president at Schwartz Media Strategies, during the event.

Walter Byrd, managing director of Transwestern, moderated, "Transactions Panel: Outlook for Investment and Leasing." Panelists included Mike Davis, executive director of Capital Markets at Cushman & Wakefield, Erik Foster, principal of Capital Markets at Avison Young, Mitchell Katz, managing director of Newmark Grubb Knight Frank, Douglas Mandel, senior director of Marcus & Millichap, and Steve Medwin, managing director of Jones Lang LaSalle.

"I'm bullish about Miami industrial," Medwin said. "We have a lot of organic growth with local companies that are expanding by 30, 50, 100% or more. There is pent up demand. With 2 million square feet in speculative development, it may put a ceiling on rental rates. But with the supply constraint I'm still bullish."

In the Midwest, Foster said there is a lot of demand from private REITs that need to put their money to work—and a lot of that cash is looking for a home in industrial. He noted spreads are compressing on B industrial assets in B markets. "Historically, CMBS played in these markets, but the B markets didn't get over built," Foster said. "CMBS is coming back."

Davis said there is a wide bandwidth to consider in the B markets: Is it B-plus or B-minus? "Investors will chase B product hard," he said. "Investors have moved from chasing core assets in core markets to chasing core assets in secondary markets and now to B assets in core market. We aren't seeing them chase B assets in B markets yet but it will happen."

In the "Development Update" panel, Jack Fraker, managing director of Industrial Practice at CBRE moderated. Panelists included Mark Allyn, senior managing director at Trammel Crow Company, David Buck, executive managing director of Industrial Development at USAA Real Estate, Patrick Gallagher, senior vice president at The Alter Group, and Malcolm Butters, principal of Butters.

The general consensus among the panelists: lenders are coming back but are still conservative. Non-credit tenant built to suits are more attractive to lenders than speculative buildings, but industrial spec deals are still getting done, especially when tenant terms exceed 10 years. And the number of investors in the space has increased from two in 2009 to about 10 today.

But the costs associated with constructing industrial assets is a growing concern. "We're forecasting material costs up 3% to 8% a year and labor costs up 2% to 4% a year for the next three years," Allyn said. "We expect bids to come up 2% to 5% higher. But it's the entitlement costs that are concerning. Cities are pushing those costs to developers. And land is still the biggest cost."