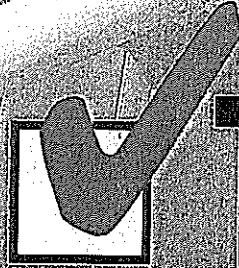


Tenant Demand **TRENDS**



## Trends Bode Well for W/D

By Joe Cavaluzzi  
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**A** midyear faltering of activity seems to have abated in the New Jersey warehouse and distribution markets, although there remains a significant amount of new spec space coming online and even more in various stages of development. This may bode well for W/D tenants, both in terms of finding the modern space that meets their demands and keeping rents from rising very much in the year ahead. And New Jersey landlords increasingly feel competition from Pennsylvania, where land is more available and rents are lower.

High-quality, high-ceiling warehouse buildings that can match the more precise racking systems of today continue to see pretty good demand, although what tenants are looking for varies with the diverse base of companies moving goods through New Jersey. Demand for security, parking, power and fiber varies with uses, but all play a role in making properties attractive to tenants. And tenants, for now, are in a fair-to-good position to negotiate.

Following seven consecutive quarters of positive absorption, the Central and Northern New Jersey industrial markets turned downward in the Q2 of this year, with nearly 1.4 million sf of negative absorption. An increase in Q3 activity all but wiped that out, according to Stephen Jenco, client services manager of Grubb & Ellis' New Jersey offices. The NJ Turnpike Exit 8A market accounted

for more than half of the 1.2 million sf absorbed in the quarter.

Looking ahead, Jenco notes, slower U.S. economic growth could result in declining corporate earnings and reduced real estate requirements. "We will need to closely monitor what impact the recent turmoil in the credit-lending markets combined with the slumping housing market will have on the psyche of consumers as we enter the holiday shopping season," Jenco says, noting that consumer spending accounts for two-thirds of U.S. economic activity and drives much of the warehouse demand in the Garden State.

More than 1.5 million sf of speculative projects—90% of all new industrial construction—has been completed since the beginning of the year, causing the overall warehouse vacancy rate to rise slightly from 8.7% to 8.8%. Almost 5.8 million sf of spec industrial space currently is in some phase of development.

Still, tenants remain leery about the state of the economy, and that is filtering down to the industrial markets.

"Everyone is in a holding pattern," Andrew Somple, senior vice president at NAI James E. Hanson, Hackensack, said during a panel discussion at RealShare 2007 in October. "Renewals that start out as five years wind up at three years. I'm receiving fewer calls from people looking to buy industrial properties. People have pulled back. Tenants are looking at operating expenses, labor and

getting approvals—a relationship with the local community. I don't know of any community in New Jersey that is helpful."

As far as big box demand, attempts to better utilize the ports are helping generate demand for large-scale warehouse and distribution space.

"Right now, the largest demand we're seeing is from 3PLs [public warehouses performing third-party logistics] and houseware product companies," says Mindy Lissner, senior vice president at CB Richard Ellis. "We're also seeing a lot of interest from beverage distributors. You know what they say: When times are good, people drink. When times are bad, people drink."

Those third-party logistics companies are looking for inexpensive space, but they also want warehouses with modern amenities, including state-of-the-art, 32-foot-clear ceiling height, advanced sprinkler systems and cross-loading facilities with ample trailer parking. Then, there are the larger corporate clients that are looking for higher-end facilities and are willing to pay for them.

"What's different from a year ago is that decisions are coming a little slower and with more concentration in the last few months as far as new users are concerned," Lissner says. "That may be because of the uncertainty in the economy. Tenants may be looking to outsource temporarily because their space needs could change if the economy weakens."

While Lissner reports that the summer was slow, since the beginning of Q3 activity and leasing seemed to have picked up.

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"From ground-up construction, we're finding more opportunity in Pennsylvania because of the availability of the land," Knowles says. "Obviously, we still have availability in New Jersey. But for bigger-scale centers, we recently had requirements for three large production and distribution facilities and they all landed in Pennsylvania."

Jeff Milanaik, president of Heller Industrial Parks in Edison, recently noted that the increasing demand for additional parking is creating problems for landlords and developers and often turns out to be overestimated.

"The difficulty is in getting a site plan through approvals that you don't want to have to go back and change," Milanaik said during the same panel discussion with Somple. "But you really have to, because parking is so much in demand, although most companies don't use all of the parking."

Cross-dock loading facilities, too, have proven not to be a necessity to many users with warehouses below the size of regional distribution centers and the so-called mega DCs. Security, on the other hand, is something tenants like to see.

"They like to see fenced-in yards. There is more discussion of security of the unit or individual buildings, but not more demand for personnel," says Knowles. "A gatehouse is great if they can get it, but in multi-tenant buildings, efficiency becomes an issue

## Activity faltered a bit at midyear, but things have picked up and users have plenty of options.

"There seems to be a lot of activity in larger requirements, those of more than 200,000 sf," she says. CBRE is marketing Panattoni's iPort 12 at Exit 12 of the NJ Turnpike in Carteret. Lissner says that Panattoni has contracts for about 700,000 sf of space, although it had not signed any leases as of mid-October at the 1.2-million sf state-of-the-art facility. "There is always good activity in buildings of less than 50,000 sf. It's the 50,000- to 200,000-sf range that has been a little slow."

Brian Knowles, principal of industrial advisory services for The Staubach Co., Murray Hill, says tenant demands include access to labor: "For some of our larger tenants, especially the consumer products people and retail folks, labor is a key factor to being in the Northeast and in Northern New Jersey and Pennsylvania. Not only can they acquire that first wave to warehouse staff, but they also need to know the labor is there for them moving forward."

"I'm referring to larger distribution centers where you need a mix of skilled and unskilled labor," he continues. "These have become very automated and very technical. As operations become more sophisticated, the labor they are looking for becomes more important."

In terms of buildings, Knowles says the demands remain the same: High clearance, multiple doors and storage outside. Parking de-

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mands have increased with the sophistication of distribution centers, but land availability in many New Jersey markets is restrictive. So far this year, he reports increased availability on the leasing side as more of the new space hits the market, resulting in flat to negative absorption across all of the state. That already has led to an increase in tenant inquiries about acquiring properties.

"They are leasing properties now, but they may see some opportunities to buy in 2008," Knowles says. "Although it's still fairly tight, if availability continues to grow they probably will see some opportunities."

And property aesthetics become important where the uses mix. For Mike Pembroke, SVP for leasing and marketing at Hackensack-based Russo Development, demand for combination office and warehouse space in the same building brings its own set of tenant demands. Russo owns and manages about 2.5 million sf.

"Our tenant mix is not typical. We have a large number of tenants with large amounts of office or back office requirements as well," Pembroke says.

Sun Guard, a recent tenant that provides disaster recovery is a good example. "All of their space is back office," Pembroke says. "Power is a key requirement for our back office and data centers. In Carlstadt, our main building has access to two power stations. So

we can accommodate those requirements.”

Russo has access to multiple fiber providers for its 1.7 million sf in Carlstadt to help tenants meet their needs for rapid data transfer and redundancy, with the latter creating demand for increased water capacity.

“Water capacity is key for larger requirements,” Pembroke says. “If they cannot cool the facility, they cannot run it, so water requirements become almost as critical as power. If you don’t have redundant water sources you try to pull water from at least two mains in case you lose one.”

And Russo is finding that its new tenants

are looking for aesthetic appeal as well as modern space.

“We have a lot of tenants who locate their office space alongside their primary distribution space,” Pembroke says.

The company recently completed a 135,398-sf build-to-suit lease with Pepsi Bottling Group at Saw Mill Park in Kearny. It’s one of Pepsi’s largest distribution facilities in North America and will directly serve cus-



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tomers in North Jersey. Once a contaminated brownfield site that Russo remediated, Saw Mill Park is also home to H.D. Smith, the largest privately held national full-service wholesale distributor of pharmaceuticals, OTCs and seasonal merchandise. The company has more than 200,000 sf at the site.

“In the Meadowlands, ceiling heights are always an issue. Our new buildings are 36-foot clear, although we don’t find most tenants use that full height,” Pembroke says. “In terms of size, the 30,000- to 50,000-sf requirements still are the bread-and-butter of the Meadowlands.”

Russo’s buildings in the Meadowlands are fully occupied now, but the company has begun marketing some facilities where leases expire in June of next year.

“Floor loads in the Meadowlands are always an issue, too. We are fortunate that we have good land conditions under our facilities,” Pembroke says. “We have been able to accommodate paper companies with high floor-load requirements. Our Kearny facility accommodates loads of 500 pounds per sf.”

Looking ahead, landlords may have to be more aggressive. The large amount of new construction taking place at Turnpike Exits 8A and 7A is going to give tenants solid ground to negotiate for the next couple of years, as CBRE’s Lissner sees it.

“Some landlords are going to have to start getting aggressive and it may entail some free rents and other concessions,” she says. “I see that happening over the next 12-24 months. With six million sf of new space in a market that typically takes two million sf a year, there is three years of supply out there.”

Pembroke says many of the institutional investors and REITs are offering some free rent, so Russo is fielding more requests for that than in the past. So far, however, the company is holding the line, although he acknowledges that every deal is different.

“Depending on the tenant, we’ll give work letters and agree to refit a space and roll the cost of that back into the lease as long as we can securitize it,” he concludes. —REB