Developers grapple with scarce opportunities, soaring prices while riding N.J. industrial wave

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May 1, 2018

By Joshua Burd

In New Jersey's booming industrial market — where rent growth is unprecedented and speculative development is rewarded — owners and investors still face a major challenge when it comes to deploying capital and keeping their pipelines filled.

That's according to panelists at a recent program hosted by the Urban Land Institute of Northern New Jersey. Developers say they are reaping the benefits of the current market, but also grappling with soaring land prices and a dearth of new value-add opportunities.

"Things are truly priced to perfection — and actually beyond — right now," said Ben Rosen, Duke Realty's vice president of leasing and development in New Jersey. "And it's hard to really get very attractive risk-adjusted returns on acquisitions."

With the challenge of creating value at existing properties, Rosen said "we're trying to add the value with our bread-and-butter development." So the real estate investment trust expects to spend the coming years pursuing new development sites, he said, also noting that "you're seeing land prices blow right past where building valuations were five or 10 years ago."

Rosen was among several executives who spoke during the ULI event on April 27, which took place at the Eisenhower Corporate Campus in Livingston. Panelists sought to take stock of the red hot market — where vacancy is just over 4 percent and average rents are approaching $8 per square foot — and gauge whether the boom will continue.

All signs point to yes, they said, citing the continued demand from ecommerce and other users for logistics space that is close to population centers. That has translated to high expectations for owners and developers.

“We are being pushed hard to deploy,” said Bill Bumber, vice president and investment officer with Prologis. “It’s not necessarily the easiest thing to do, especially here in the state of New Jersey, but our investor sentiment is really strong.”

Rob Borny, senior vice president with Dermody Properties, said it was “tremendous to see the investor response” as the developer was preparing to raise its second fund. In northern New Jersey’s industrial sector, finding a place to invest that capital could depend on site assemblage or razing and redeveloping existing buildings.

But even those strategies come with difficulties. Many existing buildings “have almost too much square footage for a modern ecommerce user,” Borny said, so a buyer could wind up overpaying for a property and ultimately not use the entire footprint during a redevelopment.

“Landlords will want to sell at $130 a foot for a vacant Class D building, and if you want to carve off square footage or you’ve got to scrape it, it’s tough,” he said. “There are opportunities out there … but sometimes you have to look to underwrite almost historic rents to make the deal work, so it’s a fine dance to find that balance.”

Even so, the overall response of large investors has been encouraging to Jose Cruz, who moderated one of the panel discussions.

“There’s aggressive pricing and there’s aggressive underwriting, but there is some discipline,” said Cruz, senior managing director with HFF. “And I think that’s important to continue with where we are and what we’ve seen so far in the industrial market.”

Other panelists at the ULI program included Todd Minerley of The Stro Cos., Greg James of NAI James E. Hanson, Robert Kossar of JLL, Christopher Galiano of NAI DiLeo-Bram and Michael Hines of CBRE. While the topics also ranged from emerging submarkets to sticker shock for tenants, they all reflected the continued upside for industrial owners.

Bumber and others speakers noted that demand continues to outpace supply in northern and central New Jersey. Research by JLL found that 89.3 percent of construction deliveries in 2017 were pre-leased, prompting developers to set their projects in motion.

To that end, the firm recently tracked nine speculative projects totaling 3.5 million square feet that were expected to break ground in the second quarter, which tenants were eagerly awaiting.

“It’s good that we do have some great projects that are coming that will bring supply,” said Kossar, head of JLL’s northeast industrial region and an international director with the firm. “But demand outpaces supply 3.5 to 1 right now. The reason leasing volumes are down in New Jersey is because there’s zero supply for Class A buildings.”

Soaring prices have similarly impacted local investors, but they are also able to reap the benefits if they succeed in finding new opportunities. Minerley, director of acquisitions and leasing for Stro, said that could require a willingness to take on sites that are not as attractive to larger investors, such as flex buildings or properties with a larger office component.

“The numbers are getting up there, which is making it a little bit difficult for smaller groups like ourselves to compete with the institutions of the world,” Minerley said. “But we’re pretty creative in buying properties that the institutions aren’t really focused on. And with that kind of property, we’ve been able to raise rents and we’ve been able to get some pretty good returns.”