



Jeremy Woods, CCIM, SIOR

ON MIDDLE GROUND

Industrial leasing is beginning a slow and tentative shift from a tenant's market to a landlord's market. The drivers of demand — production, shipping, and trade — have bottomed out and are growing again, according to Grubb & Ellis. And a dearth of speculative development during the last 12 to 24 months already is translating into competition for class A space.

Overall, industrial vacancy increased to 10.9 percent in the first quarter, but the rate of increase declined for the fifth consecutive quarter, Grubb & Ellis reports. First-quarter net absorption totaled -12.4 million sf — a significant improvement when compared with 2009's total of -140 million sf. Average asking rents declined 0.8 percent from 4Q09 to \$5.16 per square foot. However, rents are expected to stabilize this year and may rise in some markets to meet replacement costs in 2011.

In markets where construction deliveries have subsided, the future looks especially promising. "We have had no speculative development for 18 months," says Brian Young,

CCIM, associate with CB Richard Ellis/The Furman Co. in Greenville, S.C. "Considering the 11 percent vacancy rate and some tenant activity, there could be a real demand for quality space in the next 24 months with very little to choose from. This could become a landlord's market in as little as two years."

While they wait for demand to pick up, landlords are taking a cue from lenders and blending and extending leases to keep tenants in place. But tenants, for their part, are slippery. Though defaults are becoming less common, many warehouse/distribution users are consolidating and moving closer to their retail clients to reduce transportation costs. Many more are demanding additional tenant improvements, smaller security deposits, up to 12 months of free rent on a five-year lease, and modified gross lease renegotiations.

These concessions often are necessary, but from a lessor's perspective current rental rates are unsustainably low. Owners and landlords should take steps to protect themselves when entering into new leases with creditworthy tenants. "Don't

agree to fixed renewal options in this climate," says Chase Monroe, CCIM, SIOR, of Keystone Partners in Charlotte, N.C. "This is a mortal sin that is guaranteed to devalue an asset. Offer low rates on the front end and negotiate to get a higher rate within 12 months or so while you and the tenants ride out the storm together."

In Indianapolis, where, according to Cushman & Wakefield, industrial leasing activity has returned to pre-recession levels with more than 2.5 million sf leased in 1Q10, landlords and tenants seem to have found a viable middle ground. "The best situation results when tenant improvements are funded by the owner in return for longer lease-term commitments — both sides win," says Jeremy Woods, CCIM, SIOR, executive vice president for Summit Realty Group in Indianapolis. Retrofitting buildings with T-5 lights, for example, can save 10 cents to 20 cents psf per year in utility costs. When tenants save on utilities, owners are able to stabilize rents to preserve net operating income, Woods explains. Until the market once again favors landlords, this middle ground is solid ground.