THREE DRIVERS OF INDUSTRIAL SPACE

words NATHAN ANDERSON

Nathan Anderson, SIOR, CCIM, is a principal and director of brokerage for Harbinger Property Group.

Location, location, location. Location has long been the mantra for real estate valuation experts and weekend investors around the globe. This may hold true for coffee shops and second homes, but it doesn't translate to industrial properties. Industrial real estate covers a broad range of facilities including those designed for manufacturing, warehousing, assembly, fabrication and distribution. Most of the industrial properties built in the last 50 years were built in locations that have become undesirable to the modern day executive and his or her employees.

There are three primary components influencing the market demand for industrial real estate in the U.S.: functionality, location and price.

Functionality

It's no secret that industrial buildings have steadily evolved since the 1950s. Ceiling heights of 12 to 14 feet now average 24 to 26 feet, column spacing has more than doubled, even the size of the overhead doors has increased by 50 percent.

In the world of warehousing and distribution, functionality centers on the movement and storage of products. Thirty-foot ceilings may seem more valuable than 24-foot ceilings, but only if your racking and forklifts are designed to handle the increase in cube.

While it's possible to make functional improvements to older structures, more often the market will shift to accommodate their flaws. Buildings once designed for distribution, for instance, may now be suitable for assembly and light manufacturing. It's not uncommon to see 1950s vintage single-story industrial buildings trading for 25 percent of replacement cost. Local manufacturing companies can take advantage of their ability to adapt operations to facilities that the overall market has dismissed.

Most of the multi-story industrial facilities built in the early 1900s have effectively made the final shift to loft living and condos.

Clever business owners are quick to recognize that their facility is simply a tool for improving profitability, not unlike the giant machines on their production floor. There is always a balance to be had between immediate costs and future productivity. Sure, there is a certain amount of emotion involved in the real estate decision, but it's quickly put away to appease the bottom line. Functionality drives the deal in industrial real estate.

Location

Location of the property still plays a key role in the facility decision, but not for the same reasons you might find in the office or retail markets. Proximity to interstates is commonly the first factor in evaluating buildings. The next criteria are often the availability and type of workforce surrounding the facility, skilled or unskilled depending on the nature of the company. Local labor unions can often influence the process as well. Available rail access, either directly to the property or by nearby intermodal yard, has again become a driving factor for many companies.

Economic factors are increasingly driving the location decisions. The statewide team approach to economic incentives has sweetened the pie for many local manufacturing companies. Local factors such as city earnings taxes and challenging development procedures can quickly push a company from one municipality to another, often without the losing party knowing they had a chance to land the deal.

The irony in the location formula is that interstate access and rail service tend to run hand-in-hand through older industrial areas, where demand can be fickle. The perception of high crime or ongoing flooding will likely devalue an otherwise functional industrial facility with great interstate access. Business owners are caught balancing their desire for a central location with their 30-minute commute from the suburbs and their fear of the unknown. When it comes to industrial real estate, location issues have been known to kill the deal more often than they secure it.

Price

It may go without saying, but pricing is the third factor in the industrial real estate selection process. It's the easiest of the three to modify but is always determined by the merits of the other two.

Building owners are often confused by the inability to easily "thumbnail" lease and sale values for industrial properties. Unfortunately, industrial real estate's unique functionality and location issues simply don't translate well from submarket to submarket. How does a 1 percent corporate earnings tax, for instance, affect the value of a 50,000-square-foot manufacturing facility across the river from another? What about the discount for a 500-year flood plain versus a 100-year?

Appreciation of industrial real estate over time should be a factor in evaluating the initial pricing, but it's usually taken for granted by business owners. The residential mentality of 2 to 5 percent annual appreciation is simply not applicable to industrial properties. A building's ability to hold its value over a 20-year period should be a primary factor in the value decision for buyers. Too often building owners are surprised by the actual deprecation of their facility over time, which at this point is obviously too late to adjust purchase price.

At the end of the day, pricing can only speed up the sale cycle, shortening the vacancy period. In a market the size of St. Louis, there may be five or six companies in the market for a 50,000-square-foot facility at any one time. The aging industrial property base may yield 20 options in that same size range. Adjusting a building's pricing can broaden the audience of users, those who may not normally entertain an urban location for instance, but it can rarely influence the number of users in the market. Good pricing is paramount, but timing is everything.

Whether a company is buying, selling or leasing an industrial facility, these components will continue to drive the evaluation and decision-making process. □