A Market Divided

The industrial sector in the northern part of the state remains strong. But it's quite a different story in central New Jersey.

By Maria Wood

Despite the recession, the Northern New Jersey industrial market is faring quite well, boosted, in part, by a lack of developable land. Go further south, however, and the story is the polar opposite. Typified by the Exit 8A and 7A submarkets along the New Jersey Turnpike, the industrial sector in the central part of the state is weighed down by a vast amount of unoccupied inventory. There, in a nutshell, is the yin and yang of the Garden State's industrial marketplace.

David T. Houston Jr., president of Colliers Houston & Co. in Teaneck, says that the industrial vacancy rate in the northern portion of the state—an area that encompasses Union, Essex, Hudson, Bergen, Passaic and Morris counties—stands at 6.8%, well below the national rate of 9% and only 1% under what it was five years ago. Since the area is nearly built-out, developers have little developable land to construct on, he notes. "Only four million feet have been added in five years in a market of 428 million, so that's not even 1%," Houston points out.

Contrast that with the central part of the state, which is bounded by the counties of Mercer, Monmouth, Middlesex, Ocean and Somerset. There, as Houston tells it, the vacancy rate spiked from 5% five years ago to 10.7% now, no doubt helped along by the addition of 23 million square feet in a market of 280 million square feet.

Specifically, the Exit 8A submarket has an overhang of available space of 17.4%. Exit 7A has an even more alarming vacancy level of 42.3%, according to Colliers Houston statistics.

Why are those submarkets so overbuilt? Unlike the north, where land is scarce and expensive and buildings are being demolished for other uses, the central part of the state offered developers plenty of parcels at reasonable prices. "It was an easy place to build," Houston says. "There was lots of vacant land.

You could buy it, it was flat and it didn't have environmental and wetland issues. It was the path of least resistance. So for a lot of big, national developers who had a lot of money and had to build things, the easiest place to build them was at 8A."

Not only have those centrally located submarkets been hurt by a swell of new speculative development, but the area's demand feeders are regional retail distribution enterprises, which are in a pullback mode now. "If retail sales go down, the vacancy rate in central New Jersey at Exits 10, 9, 8A and 7A goes up," Houston says. "It's an absolute perfect correlation. The key to the central New Jersey industrial market recovering is retail sales and consumer confidence."

All that vacant space is having an impact on rents. "8A is a very difficult market now, where the vacancy rate is close to 20%," says Jay R. Cornforth, senior vice president and managing director, East Region for AMB Property Corp. in Boston. "You are seeing some very hungry developers offer some very aggressive rental rates. And those rental rates are probably down 30% to 35%" from the past 12 months.

David E. Knee, managing director at Jones Lang LaSalle in Hasbrouck Heights, and treasurer of the Industrial and Office Real Estate Brokers Association of the New York Metropolitan Area Inc., points out that there are several large buildings of 800,000 square feet or more along the central exits of the New Jersey Turnpike that now stand vacant, a testament to an overly optimistic surge of speculative construction. That includes Fortunoff's brand-new 600,000-square-foot leasehold. For that reason, quoted rents are deceptive. "The rates that are being whispered are significantly off whatever asking rates have been published," he says. "[The actual rents] could be 25% to 30% off of certain published rates, at least for the first couple of years of a lease."

JLL, in its Q1 overview of the Garden State industrial market, charts an overall effective rent in the north of $6.44 a square foot, down 2.3% over the preceding 12 months. Moving to the central part of the state, rents dipped 4.3% to land at $3.75 per square foot.

All Quiet on the Industrial Front

Taking in both the northern and central regions of the state, industrial activity has slowed considerably from recent years. "The fourth quarter was definitely very quiet," says Lori Zuck, managing director at FirstService Williams in Parsippany, "but the activity has picked up in terms of the interest level or people evaluating their options. Whether that translates into deals is a little too soon to say at this point. Compared to 2006, it's definitely slower than it was."

Further, the deals that are getting done are typically short-term renewals. "The trend is short-term leases at aggressive rents," Knee declares. "The landlords are making some pretty steep concessions, at least in the short term. Tenants—the ones that can—are trying to take advantage of it. Unfortunately, there are a lot of those who don't know what to make of it and are on the sidelines."

By sitting on the sidelines, those tenants could be missing out on a chance to lock in reasonable rents for a longer term. Instead, says Houston, they merely want a lower rent without giving the landlord the stability of more years on a contract. "This is a great time to renew and negotiate a lease going forward with probably a pretty favorable rent level and some TI work," he says. "The landlord, on the other hand, gets that extended term and stabilizes his asset. The problem is, a lot tenants don't want to make longer-term commitments right now. They want the landlords to reduce the rent, but they won't give anything in return. There is no incentive for the landlord to do that."

Earlier this year, Houston arranged a 120,000-square-foot renewal for International Playthings in Parsippany. "The lease was not due for about a year-and-a-half," he recalls. "The tenant wanted to renew it. He thought it was a good time, we liked the extra term and he wanted some improvements put in. It was a win-win for everybody. We are doing that for another tenant now, in a similar situation, where they are renewing early."

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But that is a rare instance when a tenant actually decided to do a deal. According to Kenneth D. Lundberg, senior vice president at NAI Hanson in Hackensack, a "fear of commitment" is stifling leasing activity in the marketplace today. "To commit to a new lease requires a certain amount of monetary expenditure and people just have no clarity as to where their business is going to be six to 18 months down the road," he explains. "That's led them to tighten the purse strings and take a wait-and-see attitude."

Most of the activity Lundberg is seeing in the market is for smaller blocks of space under 50,000 square feet. He also agrees with Houston that tenants are missing a once-in-a-cycle opportunity. "The ironic thing is that people are renewing and yes, they are lowering their rental rates," he says. "But they are not locking in what I perceive as a market opportunity. Because of the uncertainty, a lot of the renewals are for one or two years, whereas they could lock in a great number for the next five or seven years."

AMB's Cornforth admits his firm is taking less of hard line on leasing terms. "Tenants may desire shorter-term leases and so we have to show some more flexibility," he says. "We have to be more flexible on rental terms as well. For the operating portfolio, we continue to expect our same-store growth, before lease termination fees and without the effect of foreign currency exchange, to be down 3% to 4.5%."

By definition, renewals mean that companies already here are staying here, at least in the short term. That's not necessarily a bad thing, yet what the state needs is more companies from outside its borders to set up business here. "Very few new firms are coming in because if that were the case, the vacancy rates would be going down, not up," Houston says. "It's mostly existing ten-

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ants either right-sizing their space, adding a little or taking a little out or staying where they are. But there is not a lot of new activity out there."

Yet Lundberg did manage to snag a new tenant in the market when he arranged a 208,899-square-foot sublease for children's products company Melissa & Doug in South Brunswick. The company is relocating from Connecticut.

Lundberg says his team was proactive in seeking out landlords who would be aggressive on that deal. "There is the added bonus, at least from a bigger point of view, that this is a company from out of state that chose to relocate into New Jersey. With the challenges lately, that's a good thing," he says.

One user group that is currently scouring in the marketplace is the third-party logistics business. "Generally, third-party logistics providers are pretty active because they represent companies looking to modernize and streamline their supply chains," Cornforth finds. "They offer an outsourced solution that reduces logistics costs to the underlying company."

Lundberg agrees that the 3PLs are behind what modest activity there is in the market, although, again, they are likely looking for short-term deals. "A number of foreign companies are milling about," he says. "Some of the larger consumer product companies are looking at space, but not committing. There has also been some activity from the third-party logistics providers because they seem to pick up more business, especially when retail sales are slow, as opposed to a company committing long term to additional space. Instead, they will use a third-party provider to handle that overflow or increase in business. But they themselves are not locking in a long-term commitment.

"Overall, even after having said that, every sector is slow right now," he continues. "Remember, Northern New Jersey is driven by the consumer markets, which is why a lot of the product stays in the region and a lot of that is fed through the ports. With retail sales down, imports are down, which is all the product that goes into the warehouses in North Jersey."

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JAY CORNFORTH
AMB Property Corp.

As Lundberg alludes to, even if Northern New Jersey is doing better than the central portion of the state, it is nevertheless a market dependent on the port in Newark, which has seen a slowdown in container traffic. According to Containerisation International, the Port of New York/New Jersey ranked second only to the Port of Los Angeles and Long Beach in the US and 19th in the world as of December 2008. In 2008, the Port of NY/NJ registered 5.3 million TEUs, a drop of 0.6%. (Container capacity is typically measured in 20-foot equivalent units, or TEUs.) In the first quarter, cargo volume plunged 17% compared to the same period a year earlier. Moreover, year to date as of January, traffic is down 21.7%, according to PIERS, which compiles a database of cargo traffic through ports in the US, Latin America and Asia.

Long-term, the port will benefit from the expansion of the Panama Canal in 2015 and an increase in world container cargo traffic of between 6% and 8% annually through 2020, Cornforth points out. Yet the port is taking a short-term hit due to the slump in retail sales.

"The TEUs are way down and it certainly impacts the demand for space in our marketplace," Knee says. "This recession is very different from past ones because it's hitting so many different sectors and the unemployment rate is staggering, and job losses keep mounting. Obviously, that impacts the ability of the consumer to spend, which certainly impacts the demand for consumer products and warehousing, and it spirals from there. That said, we still service probably one of the largest consumer bases in the country, we are the third largest industrial market and as things turn around, we are hopeful we will turn a little bit quicker than some of the other markets."

Another factor in the state's favor is the near stoppage of speculative industrial development. As reported by JLL, slightly over 400,000 square feet is under construction up north, while 327,465 square feet is under way in the central portion of the state.

AMB, according to Cornforth, is concentrating on filling the buildings it already has in New Jersey. "We are basically leasing what we have and we're fortunate our development in New Jersey is fairly modest and it's infill," he says. "We have no plans to start any new projects unless it's for a build-to-suit."

Zuck concurs that it's unlikely anything other than a BTS will be come out of the ground in today's environment. "Overall, you are seeing very little speculative development," she says. "I'm marketing a site right now that has full approvals in Morris County. The owners are deciding not to build spec. Instead, they are waiting for a user to come along and then they would build it to suit, or they would even sell."

Despite the current problems, Lundberg says a long-term perspective is in order. "This is my third recession," he says. "There is still business activity taking place and this is still one of the most affluent and dense states in the country. We will work through it and get the market back in balance probably before we know it."—RENJ