LAND SCARCITY IN BALTIMORE DRIVING MORE 'SMART GROWTH' FOR INDUSTRIAL SECTOR

Matt Laraway
Partner,
Chesapeake Real Estate Group

Best Buy recently leased space at Brandon Woods III, an industrial park that CREG is building in Anne Arundel County.

Continuing a trend that started approximately 10 years ago, the Central Maryland region remains an extremely attractive area for warehouse and industrial development with vacancy rates hovering in the 7 percent range, more than 3 million square feet currently underway and an additional 5 million square feet of space expected to break ground over the next 18 months.

But new challenges are also starting to emerge in this marketplace, driven by barriers-to-entry such as land scarcity and increased government regulations. On the positive side, rental rates continue to inch upwards and end-user requirements in the 30,000- to 100,000-square-foot range, long the bread and butter of this region, have returned.

Over the past decade, numerous local and national developers have been enjoying the high life in the Interstate 95 corridor spanning from Harford County north of Baltimore City, through Howard County and touching Prince George's County, which is considered a suburb of Washington, D.C. A who's who of retail royalty have signed substantial leases such as Amazon, Best Buy, FedEx, Floor & Décor, The Container Store, The Home Depot, Pier 1 Imports, Sephora Cosmetics, XPO Logistics and Under Armour. While many touched 1 million square feet of space, what previously was lacking in this region — leases considered in the "middle of the fairway" at 30,000 to 100,000 square feet — are now becoming more commonplace, which has contributed to the health of this product category and overall long-term optimism.

What's not to love?

Baltimore-Washington, D.C. is the third largest MSA in the country with more than 10 million people in the combined statistical area. In addition to the Port of Baltimore, which unloaded 43 million tons of cargo last year, the Wilmington and Philadelphia seaports are just up I-95 and approximately one-third of all consumers residing in the United States can be accessed within a one-day truck drive.

The labor market is highly skilled to support complicated logistics operations. With land opportunities diminishing, the trend is shifting toward "smart growth" development involving the demolition of unusable or outdated product to make way for buildings that can support modern and effective logistic facilities.

Emerging issues

Worrisome trends worth monitoring include the availability of capital to developers, but deal velocity has not kept pace, resulting in a "responsible" development philosophy that makes this area different from areas including central Pennsylvania, New Jersey and Southern California. The most recent election cycle has infused an increased "anti-growth" stance into the political climate in certain counties, which has quickly been followed by the implementation of additional entitlements and other municipal issues that makes it more difficult to construct a building. The timeframe to initiate construction, given an elongated entitlement process, is now approaching 24 months.

Speculative construction continues but has slowed to approximately two sites per county, including Anne Arundel, Cecil, Harford and Baltimore counties, which is down from previous years. This is led by Eastgate, a more than 2 million-square-foot industrial park being developed by MRP Industrial; Principio Business Park, a project in Cecil County that Stewart Properties is developing; Nottingham Ridge Logistics Center, a 750,000-square-foot joint project between Chesapeake Real Estate Group (CREG) and Atapco Properties at the intersection of MD Route 43 and I-95 in Baltimore County; Tradepoint Atlantic, the 3,100-acre warehouse/industrial site underway in eastern Baltimore County; and CREG's continuing development at Brandon Woods in Anne Arundel County. CREG also has another 600,000-square-foot project on the drawing boards in western Anne Arundel County adjacent to Baltimore/Washington International Thurgood Marshall Airport (BWI).

Companies are apt to renew their existing leases because available options are shrinking. With a plethora of buildings in which to choose, tenants were able to exercise the market, drive their landlords' renewal rate down and ultimately choosing to remain in their current location. But now, with fewer places to relocate, companies have the choice or renewing or paying new building prices. Finally, this has led to sustained rental rate growth in this market.

Smart growth in the works

Land scarcity is contributing to smart growth as developers are transforming under-utilized or functionally obsolete buildings into Class A real estate environments. One model for this is the Port 95 Industrial Park in Baltimore City that formerly housed manufacturing operations for Sun Products Corp. Five structures were demolished, one 500,000-square-foot building was redeveloped and two buildings offering 500,000 square feet of space were built on the site that has attracted four major users over the past two years, including Amazon and Johns Hopkins Hospital.

We're watching for an overall flight-to-quality as end-users become increasingly drawn to buildings that can support effective logistics models, led by food and e-commerce concepts and companies that overlap both sectors. Site plans will also change to with a focus to traffic circulation patterns and larger amounts of vehicle and truck parking.

Additionally, with less greenfield and more brownfield development available, developers are taking increased environmental risks.

How much runway is left on this cycle that has landed so many large investments in the Baltimore metropolitan region? Our best guess is 18 to 24 months, but the market has fooled us before, and we wouldn't be surprised if this extends longer.

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international talent, along with new industries that are also flocking to the market. Tech startups and cybersecurity agencies are taking advantage of Baltimore's highly educated workforce and low cost of business compared to other large Northeastern cities. These attributes led *The Wall Street Journal* to name Baltimore as one of the top three U.S. cities for recent college graduates.

Baltimore has long been a stronghold for industrial employment due to its strategic Mid-Atlantic location. This sector is experiencing increased expansion due to the transformation of the former site of Bethlehem Steel. The nearly 2,500-acre Trade Point Atlantic industrial project has attracted large-scale distribution centers, establishing Baltimore as a major benefactor of the e-commerce economy.

Cap rates, opportunity zones

As cap rates for Class A product have stabilized around 5.5 percent, stakeholders have shifted their focus to secondary multifamily product. Funded by private capital increasingly sourced from tri-state area investors, increased capital flow has pushed cap rates for Class B and C product below 6 percent.

While the stabilization of cap rates across all classes of multifamily product indicates a potential peak in the market, opportunity zones that may continue to fuel activity. Baltimore City contains nearly 80 percent of the state's opportunity zones, making it one of the densest urban areas for this type of investment vehicle.

These zones have attracted significant capital from investors across the nation. While the future appears to be focused around development in the suburbs, opportunity zones could lead to yet another multifamily renaissance in Baltimore City.