THE BALTIMORE SUN

Industrial Market Booms in Baltimore

Optimistic developers put up warehouses in region before securing tenants

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By Natalie Sherman The Baltimore Sun

Work will begin Monday on a massive new warehouse in Aberdeen for which the developer has not signed a tenant.
The 571,000-square-foot project at the Perryman Logistics Center is one of six new buildings Chesapeake Real Estate Group has in the works, representing 1.5 million square feet and more than $120 million in investment. Of those six, three are being built without tenants.

"We are exploding now," said Jim Lighthizer, Chesapeake's founder and owner. "I know industrial doesn't get the headlines that office and retail gets in Baltimore City, but there's more opportunity, in my opinion. The fundamentals are better. … There's decent demand and very little supply."

More than a million square feet of warehouse space is being developed speculatively around the Baltimore region, according a report released this month by Colliers International. The return of speculative construction in the warehouse market around Maryland and nationwide reflects surging demand for the big empty buildings that can be configured however a tenant likes.

The demand is being driven by companies, including many big-name retailers, reorganizing distribution networks to be more competitive and more responsive to online sales. Mixed with Maryland's scarcity of large parcels and access to a large population within a day's drive, it makes the state an attractive place for investors seeking steady returns higher than they can find in low-interest-rate bonds.

"This is one of the favored markets across the country," said Bo Cashman, senior vice president of CBRE. "We continue to see significantly more capital than offerings in the market."

Others building speculatively in the region include Baltimore-based MRP Industrial and Liberty Property Trust.

MRP has five speculative buildings under construction from New Jersey to Washington, including two in Maryland, and another six in the works, representing about $250 million in investments, said principal D. Reid Townsend. It's got some $500 million in deals in the pipeline, he estimated.

Liberty is finishing a 945,000-square-foot project for Clorox in Harford County and is working on two buildings on New Ridge Road in Hanover, totaling 243,500 square feet, both built without commitments.

Yet even with the new construction, Baltimore's industrial vacancy rate is falling, dropping to about 9.6 percent in the third quarter from 13 percent three years earlier, according to a report issued Friday by Cassidy Turley.

Retailers such as Sephora, Pier 1, Kohl's and Restoration Hardware have signed major leases recently.

Many such big names are building or leasing massive super-regional centers that stock a wide variety of products in proximity to customers or stores in an effort to compete with the likes of Amazon, said Ravi Srinivasan, assistant professor of information systems and operations management at Loyola University Maryland's Sellinger School of Business & Management.

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The warehouses not only provide customers with better service, but they're less costly than stocking stores, thanks in part to advances in warehouse technology that send robots, rather than workers, to retrieve products for packing, Srinivasan said.

The new systems often require taller ceilings and greater electrical capacity than what's found in a traditional warehouse, another spur to new construction. Direct-to-consumer sales also means more workers — and parking spots — and a premium on locations that are close to urban centers or facilities such as FedEx and UPS.

Amazon's new distribution hub under construction in Baltimore reflects these trends.

Even some businesses less driven by e-commerce are looking for new space.

Liberty's Clorox project will replace an older, smaller facility for the bleach maker. Reliable Churchill is relocating its liquor distribution operation to a new, nearly 450,000-square-foot building in Baltimore County. Coca-Cola Refreshments announced in February it would move to a new 291,000-square-foot location in Hanover.

"We're not firing on all cylinders, but we continue to feel very positive and very strong about this marketplace," said Curtis Etherly, a spokesman for Coca-Cola Refreshments.

While the new facility is similar in size to its existing one nearby, it offers a better layout, he said.

"It definitely will be an upgrade for our associates and operational capabilities," he said.

Increasing demand, and new, typically more expensive projects, have driven up rental rates.

Baltimore's average asking rent hit an estimated $5.18 per square foot in the third quarter, up 13.8 percent from a year ago — one of the biggest increases in the country, according to Friday's Cassidy Turley report. Those rates are in line with the U.S. average of $5.20 per square foot, up from $5.06 a year ago.

Those increases have drawn the notice of institutional investors, such as pension funds and insurance companies, which have turned to real estate as low interest rates have reduced returns from other steady investments, such as bonds.

Chesapeake's financial partner on its Aberdeen project is USAA Real Estate Co., a unit of the insurance company USAA, Lighthizer said. MRP Industrial, an affiliate of MRP Realty, launched in 2013 because of demand from investor clients.

CBRE predicts Baltimore-area rents will increase 4.9 percent in 2016 and 7.7 percent in 2017.

Maryland's tight supply of land and limited potential for future construction makes the state more attractive for investors, assuring buyers their property won't have to compete with a surge of new buildings that inhibit future rent inflation, CBRE's Cashman said.

As retailers increase competition for industrial properties, some said they expect demand for older sites to remain strong.

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“Not all commercial players can afford to do what Amazon’s doing downtown,” said Erik Weinberg, vice president of Chevy Chase-based Federal Capital Partners, which earlier this month announced the $11.5 million acquisition of a 313,000-square-foot building at 2209 Sulphur Spring Road, south of Baltimore.

The firm historically invested in office buildings and apartment complexes, but unsteadiness in the office market made industrial more attractive, he said.

“From a diversification standpoint it provides that avenue of commercial investment,” he said.

Those dynamics also made industrial property more expensive. The average sales price per square foot in Baltimore jumped from $46 between January and August last year to $66 per square foot during the same period this year, according to Cassidy Turley.

Lisa Goodwin, vice president for Liberty Property Trust’s Maryland office, said her firm wants to expand its presence in the market but is focused on development, rather than buying.

She said she expects the company to have its speculative buildings 80 percent leased by the end of the year, but is keeping an eye on the lack of expansion from smaller tenants.

“I think overall the market is very healthy,” Goodwin said. But “the demand has been driven by larger tenants, and there seems to be a slowdown in what I call the bread-and-butter in the corridor, that 40,000- to 80,000-square-foot tenant. … They’re mostly renewing and maybe not growing.”

Bob Jirsa, a Baltimore-based partner at the accounting and consulting firm McGladrey LLP, said the manufacturers and distributors his firm works with have seen “incremental growth” in their businesses, with larger gains among those with international ties.

The more traditional industrial tenants are also grappling with a shift in distribution norms as buyers expect “Amazon accessibility” even for nonconsumer products.

But that’s leading firms to double down on making their logistics more efficient, rather than expanding, he said.

Even so, developers, including Chesapeake’s Lighthizer, continue to pursue additional development opportunities, saying the market remains healthy.

“Lenders are back offering financing for speculative development, but remain very mindful of aggressive underwriting mistakes that have been made in the past,” said MRP’s Townsend. “It’s a high volume, but it’s based on solid market fundamentals and conservative financing. It’s not overheated.” nsherman@baltsun.com