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COVER STORY, APRIL/MAY 2009

A TALE OF TWO MARKETS

While other sectors experience the worst of times, industrial holds strong.

By Coleman Wood

Despite the changes the Northeast's industrial sector has undergone in recent decades, the sector continues to thrive. Many of people think of industrial in the region as nothing but cavernous warehouses, but the market is actually very diverse. This month, *Northeast Real Estate Business* takes a look at two markets worlds apart — the niche industrial sector of New York City and the regional logistics hub of central and eastern Pennsylvania — to demonstrate how diverse markets are reacting to the current market.

New York City

In New York City proper, the boroughs of Queens, Brooklyn and the Bronx contain much of the city's industrial sector. While many major companies were located in these areas during the turn of the 20th century, the middle part of the century saw most of them relocating out of the boroughs and into markets such as New Jersey.

"Today, what we have here in the boroughs is more of a mix of local businesses and some of those leftover large companies," says Frank Zuckerbrot, president of Sholom & Zuckerbrot, a commercial realtor headquartered in Long Island City, Queens.

Industrial tenants in the boroughs today mainly serve the greater New York City market, due to the difficulty in shipping large amounts of freight out of the city. Most tenants work in warehousing, but there is also some light manufacturing. A growing sub-sector in the city is just-in-time delivery: products such as food, light assembly and building materials that need to be quickly delivered to local buyers. The biggest areas of industrial activity are in the boroughs of Queens and Brooklyn, but the nature of industrial in the city is changing due to gentrification.

"Large areas of industrial property over the last 15 years have been re-zoned and redeveloped for things such as shopping centers, office buildings and large residential developments," Zuckerbrot says. "What we've done is, through that process, permanently removed warehouse properties from the inventory. Therefore, the remaining stock of warehouses is much as smaller."

This has had a two-fold effect. The first is that new industrial development has spread east from Brooklyn and Queens to the rest of Long Island. This market also mostly serves the New York City market for the same reasons as the inner city boroughs. The difference here is that land prices are still affordable — the fact that land is still available for new development is a draw in itself — and many Long Island cities offer incentives for companies willing to build here. Brookhaven, in particular, has emerged as a hot spot for new development, due to attractive property tax abatements.

New development consists of smaller warehouse users, typically ranging from 25,000 to 35,000 square feet. While the buildings are smaller, the number of them is greater than other industrial markets.

"High-ceiling warehouse is what's in demand," says Bill Greiner of Greiner-Maltz Company of Long Island.

The industrial market has also done better than many other property types in New

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York City in the recession.

"We have not yet experienced any foreclosures of industrial properties on Long Island, the reason being that if things go bad there, there is still plenty of equity for owners to sell the property, rather than go into foreclosure," Greiner says, adding that industrial did not get over-valued or over-financed like other sectors of commercial real estate in recent years.

The second effect of New York City's redevelopment of existing warehouse space has been that the space that remains is now at a premium. This has resulted in pricing and vacancy rates holding steady even in the midst of the current worldwide recession. According to Zuckerbrot, rental rates currently range from \$10 to \$16 per square foot, with even greater numbers around JFK Airport. In comparison, on the other side of the river in New Jersey, rates range from \$6 to \$8 per square foot.

"The reason we have this price differential is we are servicing New York City in a way that you can't in those other [outlying] markets...So, it's kind of a self-contained support system and the barriers to entry are enormous. You can't build new buildings; you're not creating additional industrial land," Zuckerbrot says.

The city is making efforts to protect the existing industrial space from redevelopment, but it is not zoning any new land for industrial use. This has resulted in no new industrial development in the boroughs since 2001, eliminating the problem of absorption that many boom markets face, while bringing vacancy rates to below 5 percent.

As expected, sales activity has slowed. The good side is that many of the buildings located in the boroughs are smaller in size and trade under the \$25 million mark — an asset class that is still able to find lending. When properties do trade, high returns are often seen. The average sales price in New York City for industrial product as of June 2008 was \$280 per square foot, according to Sholom & Zuckerbrot. Much like Long Island, the industrial market of the boroughs is quickly emerging as the bright spot in the city's commercial real estate sector.

"As we stand here today, our industrial buildings are not burdened with heavy debt loads," Zuckerbrot says. They are not burdened from a marketplace that did an enormous amount of investor trading. Most of our buildings were traded between users."

Zuckerbrot expects this lack of trading to continue, because sellers that are not being forced to dispose of their properties will not want to enter the market at the low prices buyers are demanding. This will cause many users seeking space to choose to rent rather than buy.

"Who wants to buy something today if they feel they are not getting a discount compared to where they were 24 months ago, merited or not?" Zuckerbrot asks. "I think that will create a disconnect."



Source: Greiner-Maltz

While Philadelphia is located at the heart of Pennsylvania's industrial market, the city itself does not see much industrial activity. Instead, regions such as the Lehigh Valley, Wilkes-Barre, and the Harrisburg/York/Lancaster triangle see most of the state's industrial activity – due mostly to easy interstate access. From these roads, users can reach a majority of the American population in a day's drive. New York City is less than 2 hours away and Washington, D.C. is less than 3 hours. Boston can be reached in a little more than 5 hours, and even the Canadian cities of Toronto and Montreal are both roughly 8 hours away each. This prime location makes Pennsylvania an attractive market for industrial users, which has benefited it greatly this year.

"On the whole, the Pennsylvania market is seeing good activity in the first quarter, although we have not seen a lot of transactions closed yet," says Stephen Bonge, senior vice president with Grubb & Ellis and an expert on the northeastern and central Pennsylvania industrial markets. "As it compares to the overall national market, I would say that this is an area that is seeing more activity than most parts of the country."

Near the end of last year, there were a flurry of deals completed, mostly consisting of large leases. According to Bonge, the Lehigh Valley completed between 800,000 and 1 million square feet of industrial leases in the fourth quarter. Central Pennsylvania completed between 500,000 to 600,000 square feet of leases. Grubb & Ellis itself was responsible for representing Liberty Property Trust in a 400,000-square-foot lease in Carlisle.

"The bulk of activity right now is in that 200,000- to 600,000-square-foot range," Bonge says.

The Pennsylvania market is known for large-scale warehouse product. Out of the 300 million square feet of industrial space Grubb & Ellis tracks in the northeastern and central Pennsylvania markets, approximately half comprises Class A and B logistics space. Manufacturing is also prevalent in the region, including food, military products, plastics and apparel. The region has seen much speculative construction over the past few years, but this is a trend Bonge believes will slow down in 2009.

"I do not foresee any new speculative construction starting in 2009. I think developers are going to wait for build-to-suits throughout 2009 and possibly into 2010," Bonge says.

The upside to less construction is that it will give the market a chance to absorb some of its excess space, which Bonge believes it will do this year. Rents will soften and landlords will offer concessions to fill vacant space. In the long-term, Bonge still believes that the Pennsylvania market is driven by sound fundamentals and will continue to grow into the future.

"Our area is a low-cost alternative to the high-priced I-95 corridor between Boston and Washington, so we absolutely see this area continuing to grow," he says.

With investor confidence low and the coming year uncertain, many are looking for places to put their money that are less risky. Zuckerbrot believes that the industrial market may be the place to which investors turn.

"I think many small business owners and investors will feel that real estate is a safer place to put their money," Zuckerbrot says. "It's real; it's tangible; and industrial real estate, in particular, which tends to have a lower cost to carry and a lower requirement of capital to let, might be an attractive place to put their money."

Whether his prediction holds true or not remains to be seen, but the Northeast's industrial sector seems to be holding on relatively well. While it may not be the best of times for real estate as a whole, industrial is doing its best to keep its favored status in the market.

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