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Vacancies edged up in warehouses, assembly plants and other blue-collar buildings during the second quarter, but the Albuquerque metro area's industrial real estate market appears to be holding its own.

The vacancy rate increased from 9.1 percent in the first quarter to 9.4 percent as downsizings and closings outweighed business expansions in the second quarter, according to the latest Grubb & Ellis New Mexico Industrial Trends Report.

The latest vacancy rate is also higher than the 9.1 percent registered in the second quarter of 2010.

"We've still got a relatively small number of leases, although activity has picked up from a year ago," said Jim Smith of CB Richard Ellis.

And the lease deals getting done were small scale. The median size of the space leased in the second quarter was 5,231 square feet, meaning half of the deals were bigger and half were smaller, Smith said. A third of the deals involved 3,000 square feet or less, he said.

The local industrial real estate market, however, is doing better than the country as a whole. The second quarter vacancy rate of 9.4 percent is still below the national average rate of 9.8 percent.

The vacancy rate peaked at 10.4 percent in Albuquerque in the third quarter of 2010, pushed upward by the closing of the 477,000-square-

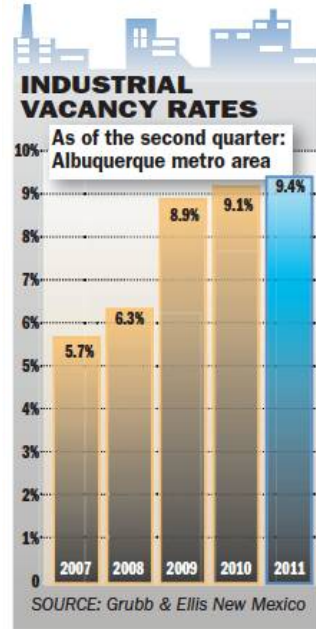


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Construction of U.S. Foodservices' 135,000-square-foot distribution center in the South Valley, shown here last week, is a bright spot in Albuquerque's industrial real estate picture.

INDUSTRIAL VACANCIES HOLD STEADY

Metro-area market manages to outperform national average in first quarter



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Metro industrial market holding its own

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foot General Electric jet engine plant in the South Valley. The rate dropped back down to 9.1 percent early this year after the plant was torn down.

Nationwide, the vacancy rate peaked at 10.6 percent in the first quarter of 2010 and has slowly but steadily dropped ever since.

Better than elsewhere

Albuquerque was rated one of the country's healthiest industrial markets in New York City-based Moody's recently released Red-Green-Yellow Update, a quarterly report measuring risk in metros where deals were financed through commercial mortgage-backed securities or CMBS.

The local industrial market scored a 70 on a scale of 0-100 in Moody's second quarter update, the seventh highest score among the 51 metros that were tracked. The average score for industrial markets in all metros was 61, which is a weak score compared to other commercial property types.

In general, commercial real estate across the country is moving from a fragile state in which supply and demand are out of whack to a more balanced state with stable-to-falling vacancy rates, Moody's update says.

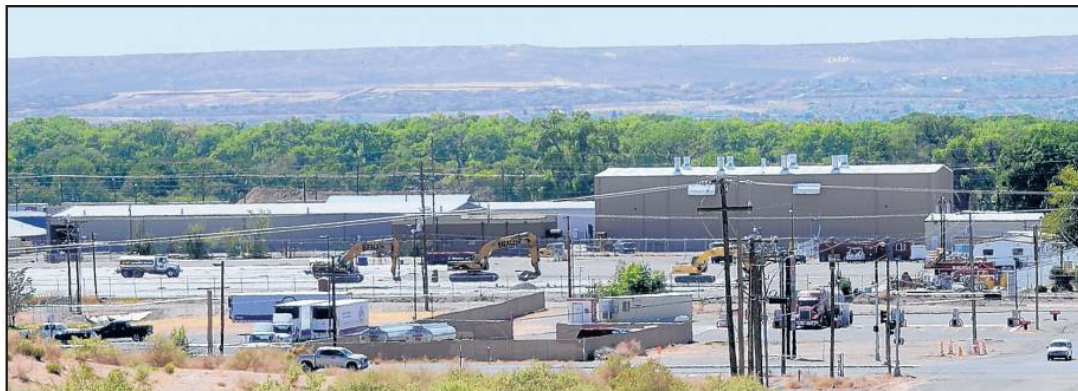
Job losses continue

The local industrial real estate market, like the local economy in general, is suffering from 32 consecutive months of job losses in the metro.

"We've got to have job growth," said Walt Arnold of Sperry Van Ness/Walt Arnold Commercial Brokerage. "Until we do, we're not going to see much change in the industrial market."

The industrial real estate market itself is not home to a lot of jobs in Albuquerque. Warehousing and trucking, for example, are not very labor intensive, employing just a few thousand people.

Manufacturing is also not a big employment sector in the metro, accounting for less than 5 percent of the total labor force, or about 17,100 workers. Even



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The partially demolished site of the former GE jet engine plant at 336 Woodward SE as seen from the east this past May. The closed facility pushed the industrial vacancy rate up last year.

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in good economic times, manufacturing will only account for 6 percent or so of all jobs.

But industrial real estate houses "the backbone of the economy" because it's where goods are manufactured and delivered through the supply chain to consumers, said Tim MacEachen of Grubb & Ellis New Mexico.

Industrial real estate suffers when demand for those goods drops off because consumers are unemployed, underemployed or worried about a decline in wages, he said. In addition, companies are stocking less inventory as a belt-tightening measure, thus reducing the need for warehouse space.

The sustained downturn in home construction, once a major user of warehouses in the metro, will also continue to drag on the industrial market until there's a turnaround, Arnold said.

The closing or downsizing of construction-related businesses was largely responsible for a dramatic jump in the industrial vacancy rate from 7.5 percent in the fourth quarter of 2008 to 9.5 percent in the first quarter of 2009, according to Grubb & Ellis.

Home building is currently running at an average of 105

houses a month compared to 734 a month at the peak of the housing boom in 2005, according to DataTraq. The state reports that construction hiring, which typically surges in the metro with the onset of spring, has remained weak.

Smallish market

Albuquerque has an undersized industrial real estate market. Its inventory of 36.7 million square feet of space is substantially smaller than El Paso's 57.2 million square feet and Oklahoma City's 85.5 million square feet, according to Grubb & Ellis statistics.

The Dallas-Fort Worth metroplex, a distribution mecca with 664 million square feet of industrial space, has an inventory of vacant space twice as large as Albuquerque's entire industrial real estate market.

The undersized market points to Albuquerque's small role in the distribution picture. The metro is pretty much a distribution destination. Warehouses here primarily contain goods to be distributed locally rather than shipped elsewhere.

There's been some speculation that the metro could evolve into a more

substantial distribution center as the logistics or supply-chain management industry adjusts to the general trend of rising fuel costs.

"It's going to be interesting to see how the handling of material will play out," MacEachen said. "It's a question of logistics whether it will be better or cheaper to ship from a distribution hub like Phoenix or Dallas or have a satellite here in Albuquerque."

Asking and real rates

The average asking lease rate for warehouse space has been hovering around \$5.70 a square foot for about two years, according to Grubb & Ellis statistics. The asking rate is roughly where it was in late 2005 and early 2006.

"My contention would be that nothing is getting done at the asking rates," Smith said.

Asking lease rates are little more than a starting point in negotiations between a landlord and prospective tenant, he said. The actual rate on a signed lease will almost inevitably be lower in the current renter's market, he said.

The average asking lease rate for warehouse space peaked at \$6.88 a square foot in the second quarter of 2008, pushed upward by a flood of 2.5 million square feet of new industrial space built in 2006-07. As a rule of thumb, new space commands higher rents than older space.

The 17 percent drop from the peak to the current average asking lease rate is

not due entirely to landlords slashing their prices, said Ken Schaefer of Grubb & Ellis. Much of the new space built in 2006-07 has been rented, thus its higher rates no longer factor into the average asking rate.

"What's left on the market is the average stuff with lower rates," he said.

ABQ a bit pricey

The Albuquerque metro is a comparatively expensive place to lease warehouse space. Asking lease rates run about \$2.50-a-square-foot higher than in El Paso and Oklahoma City, more than \$2-a-square-foot higher than in Dallas and more than \$1.60-a-square-foot higher than in Denver.

For example, a 5,000-square-foot warehouse lease will cost on average about \$12,500 more a year in Albuquerque than it would in El Paso.

The most common explanation given by commercial real estate pros is that land zoned for industrial uses is more expensive here.

Another reason is that the majority of leases in the metro are typically for small blocks of space — a median size of 5,231 square feet in the second quarter, for example — as opposed to a place like Dallas where 100,000-square-foot leases are common, Schaefer said.

"We don't get the economies of scale in the size of the space being leased that you'll find in these larger industrial markets," he said.