INDUSTRY ON THE RISE

Texas brokers discuss how the industrial market is taking off in the Lone Star State.

Lindsey Walker

The industrial market in Texas has traditionally been one of the state's most successful sectors. Between Toyota's new assembly plant in San Antonio and the growing I-20/I-45 corridor in Dallas/Fort Worth, this already bustling market is on course to become one of the strongest in the country. *Texas Real Estate Business* recently spoke with professionals from across the state to discuss the industrial climate in Dallas/Fort Worth, Houston, Rio Grande Valley, San Antonio, El Paso and Austin.

Dallas/Fort Worth

Catering to various transportation needs is the name of the game in the Dallas/Fort Worth industrial market. "There is a continued trend of building larger, higher capacity buildings giving tenants greater flexibility," says John Fulton, senior vice president in Transwestern Commercial Services' Dallas office. "Higher clear heights, wider column spacing, deeper truck courts and designs that can accommodate trailer storage are the building features that are in demand. Given higher energy costs, more tenants are also considering utilizing rail service to a greater degree if their product can be delivered timely by rail."

Trey Fricke, managing principal in Lee & Associates' Dallas office, agrees. "Efficient dock door layout, adequate trailer parking and access to different types of transportation such as rail, intermodal and air freight are increasingly important," he says.

For example, millions of square feet of space will be developed in the I-20/I-45 corridor during the next few years due to the intermodal facilities' superior highways, cost of land and workforce, according to Kenneth Wesson, also a managing principal in Lee & Associates' Dallas office. "The big buzz will be on the mega rooftops that get built around I-20 and I-45 in the southern sector with the Union Pacific (UP) and Burlington Northern and Santa Fe Railway Company (BNSF) intermodal facilities that are existing and coming on line," Wesson says. "All the major developers are staking out big parcels of land to do development."

In particular, the new Union Pacific Dallas Intermodal Terminal facility (DIT), which opened last fall, is spurring additional development on the south side of Dallas. San Diego, California-based The Allen Group has entered the market by purchasing land for a master planned park in the southern sector at I-20/I-45, and other developers have taken positions more to the north. "The new DIT is the catalyst for this investment by the development community," Fulton says. "This new facility will result in some buildings being built on a speculative basis and it will stimulate what had previously been a fairly stagnant area within the marketplace."

While the southern sector is becoming a popular submarket, the area north of the Dallas/Fort Worth (D/FW) International Airport continues to be a hot bed of activity for the industrial market, according to Fulton. "Close proximity to D/FW International Airport, quality highway infrastructure and a growing employee base continue to make this the favored submarket in our area for developers and tenants," Fulton says.

As Dallas/Fort Worth continues to primarily be a distribution market, most new developments are being built with the large distributor in mind. However, according to Fricke, manufacturing requirements in the 100,000-square-foot to 250,000-square-foot range are increasingly active — and the area's newer buildings are accommodating this trend. "These buildings are flexible and readily converted for manufacturing or high tech with the advent of additional electrical power and air conditioning," Fulton says.

While no major tenant is absorbing the majority of space in Dallas/Fort Worth's industrial market, which currently has a vacancy of 10.5 percent, national and regional third-party warehousing companies, such as Exel, Saddle Creek and Shippers Warehouse, continue to increase space in the area. The largest deal of 2005 was Whirlpool Corporation taking 852,000 square feet at 1101 Everman Parkway in Fort Worth. In another big transaction, Amazon.com signed a lease for 630,800 square feet at 2700 Regent Boulevard near the airport.

Rental rates for distribution and bulk warehouse space in the Metroplex are climbing, primarily due to increased construction costs and a tighter supply of functional land, according to Fricke. While they were sitting at $2.75 per square foot for second-generation space and $3.05 for new space, rates have now increased to $3.00 for second generation and $3.15 to $3.35 for new space. "For higher finish product, the rates fluctuate greatly depending on the percentage of finished out and air conditioned space," Fulton says.

In the near future, Denton County along I-35 will be a submarket to watch. With a good mix of available land, competitive tax structures, quality labor base and access to major highways, this area should be an active market during the next 5 years, according to Fricke. "Additionally, rail-served sales, particularly with neutral rail such as Railhead Fort Worth, are experiencing both speculative and build-to-suit activity," Fricke says.

Overall, the industrial market in Dallas/Fort Worth is healthy and poised for significant growth in the coming years. "The short term outlook for the next several years is excellent for occupancy and absorption," Fricke says. "If rental rates could ever show signs of increasing in a market that has been flat for a long time, then we would be the undisputed top industrial market in the country from an investors' perspective."

Houston

Industrial activity is increasing both in startups and in expansions, according to Audra Bentley, vice president of leasing for Houston-based Hartman Management. "The northwest side of Houston appears to be the emerging growth market with more than 2 million square feet of new development under construction this year," Bentley says.

"Houston's northwest and far west sectors are attracting the majority of new developments for several reasons," says Brian Harbuck, industrial leasing agent for Hartman Management. "Some area amenities include attractive, reasonably priced housing, excellent schools and improved arterial and freeway mobility. Businesses that locate in these areas will enjoy easy access to all parts of Houston that Beltway 8 and the expanding Katy Freeway will provide."

Indianapolis-based developer Duke Realty Corporation is new to Houston and has plans to aggressively develop all over the city. “Duke is expanding into the Houston market after identifying it as a top choice for expansion,” says Jackson Dawson, industrial leasing agent for Hartman Management. “Additionally, TIAA-CREF is set to develop a 131,620-square-foot build-to-suit distribution facility for Carrier Sales and Service.” The new facility is to be built at Houston’s 75-acre Port Northwest Business Park.

Property owners in Houston are trying to attract a variety of industrial tenants, depending on the submarket. “Each submarket has its own ideal tenant profile,” Bentley says. “Some areas pitch specifically to oil and gas companies while others advertise for medical supply and distribution firms. Service- and shipping-related companies also seem to be high on everyone’s list as of late.”

Rental rates in Houston’s industrial market can range from as low as $3.80 per square foot per year to $10.80 per square foot per year, according to Harbuck. “These numbers cover most new developments and second generation properties,” Harbuck says.

Although it is a tightening market, one can find suitable industrial space in most areas of Houston.

Several major industrial leases have closed recently in Houston, which has a citywide vacancy rate of 6.1 percent. Teadit North America, for example, plans to relocate its manufacturing and distribution operations into 52,000 square feet of a 128,090-square-foot warehouse in East Belt Business Park in July. Goodman-Amana also has completed a 400,000-square-foot build-to-suit distribution facility at the intersection of U.S. 290 and Beltway 8. The largest industrial development of all is Wal-Mart’s new regional distribution facility in Cedar Crossing, just east of downtown Houston. This 4 million-square-foot facility is helping to generate significant development interest from international companies.

The west side of Houston, including the burgeoning suburbs of Katy and Sugar Land, are the areas to watch in the coming months, according to Dawson. “Businesses and homes are expanding north and west of these areas, and large residential developments with 10,000 to 12,000 homes are now under construction,” Dawson says. “It seems that business and industrial developments are bound to follow this expansion. Land availability is becoming more scarce as our city rapidly expands outward.”

While, for many years, the office buildings seemed to dominate the Houston and Texas rental markets, today’s marketplace is shifting in a new direction. “Recent developments in the industrial/flex sector have become multi-use, and we’re finding that businesses that would not consider industrial 10 years ago will consider it today,” Bentley says. “The improved flexibility that these flex space/industrial developments provide — with an office environment look and feel — are becoming more and more attractive to professional firms.”

Rio Grande Valley

The South Texas/Mexican border area is still extremely vibrant when it comes to industrial development, according to Adrian A. Arriaga, CCIM, broker and owner of McAllen, Texas-based AAA Real Estate & Investments. “While the overall maquiladora business (a U.S. or foreign-owned manufacturing facility that processes or assembles components into finished or semi-finished products for export to other countries) has slowed down on the U.S./Mexico border, the South Texas area has experienced an increase in activity," Arriaga says. "Local South Texas elected officials presently are working together to attract a major automobile manufacturing facility that should rival the magnitude of the Toyota investment in San Antonio. In the meantime, industrial activity in this area is strong and increasing each year."

Anchored by Hunt Valley Development's Sharyland Plantation, a 6,000-acre master planned community that features a 900-acre and growing Class A business park, the Rio Grande Valley continues to be a power player in the industrial market. "In the city of Hidalgo, there is presently 300,000 square feet of new, prime Class A industrial space in the Tres Puente's complex, with an additional 300,000 square feet being planned," Arriaga says. "In the city of Mission, several developers have planned an additional 600,000 square feet, which is due to break ground this year."

On the Mexican side of the border, there is estimated to be approximately 750,000 square feet of warehouse space available, of which 400,000 square feet is being negotiated. "An additional 800,000 square feet is projected to be available by 2007," Arriaga says.

Besides Hunt Valley Development, several major players have emerged in the Rio Grande Valley. Titan Development, with roots in El Paso, Texas, and Monterrey, Mexico, has plans to develop an 80-acre subdivision in the city of Pharr for new, prime industrial development. Another company, Verde Realty, is becoming more active as well with speculative development planned in the area.

As the automotive industry grows in South Texas, properties in the Rio Grande Valley are trying to attract more automotive aftermarket tenants. "There is growing activity in the manufacturing of replacement parts for the auto industry," Arriaga says. In addition to automotive supply, there has been a resurgence in the technology manufacturing and software business in the region. "It is anticipated that the South Texas/Mexico area will become one of the top 10 markets for high-tech manufacturing expansions," he says.

The rental rates for industrial product on the U.S. side of the border are averaging a base rate of $.32 to $.35 monthly, according to Arriaga. "The common area maintenance or add on factor that includes taxes, insurance and maintenance is an additional $.10 to $.11 monthly for a total of $.42 to $.45 per square foot monthly," he says.

With such low rental rates, there is almost no vacancy in South Texas — less than 1 percent. "It is very difficult to find good industrial/warehouse space in the South Texas," Arriaga says. "Both the U.S. and Mexico sides have numerous projects ready to break ground, and it is projected that there will be approximately 800,000 square feet available within the next 8 to 12 months on the U.S. side."

The McAllen Economic Development Corporation 2005 Industrial Activity Report reflects that approximately 4.3 million square feet of industrial space was leased or sold in the South Texas/Mexico border area in 2005, and 2006 is shaping up to be just as solid. "Industrial development will continue to be strong," Arriaga says. "The opening of the new Anzalduaz International Bridge linking the McAllen metropolitan area with the

Reynosa, Mexico, metropolitan area in late 2007 or early 2008 will create an added incentive for the maquiladora program to expand to this area."

San Antonio

San Antonio's industrial market contains more than 70 million square feet of space, and approximately 500,000 square feet of new speculative industrial projects have been developed every year for the past 5 years in this growing market. Last year was a big year for industrial product in San Antonio with more than 1.5 million square feet of speculative space being developed — three times the annual average. In 2006, the horizon looks just as bright, if not brighter.

The automotive industry has started to look at some Texas markets in a new light, particularly San Antonio. San Antonio is on board to have some major automotive-related developments enter the city within the next few years — bringing jobs and dollars into the marketplace. The most noteworthy of these developments is Toyota's new $850 million assembly plant, which is being developed on approximately 2,000 acres on the south side of San Antonio. "Toyota's decision to locate its Tundra assembly plant here put San Antonio on the manufacturing industry map," says Kim Gatley, director of research for San Antonio-based REOC Partners. The plant, which will total 2 million square feet, is scheduled for completion later this year. An adjacent $150 million on-site supplier park will house 20 tier-one suppliers on another 1.5 million square feet. "This on-site park is unique to the industry and quite an achievement for San Antonio on the whole," Gatley says. "It is also the main reason that the competitive industrial market has experienced only limited direct impact related to Toyota."

Though Toyota's plant will spur future development on the south side, San Antonio's northeast quadrant is still the city's predominant industrial sector, according to Gatley. New development is moving north along the IH-35 corridor to parks such as Tri-County Business Park, where ProLogis currently is developing the 204,000-square-foot, The Home Depot-anchored Tri-County Distribution Center III. "Existing infrastructure, easy access to I-35 and the development-friendly environment provided by the city of Schertz are the main reasons for growth in this area," Gatley says. "Additional development also is occurring at KellyUSA in the southwest quadrant of the city."

Titan Industrial, an independent rail operator new to the San Antonio market, announced plans last year to develop 62 acres in KellyUSA's East Kelly portion. The first phase of the 800,000-square-foot project will feature a 360,000-square-foot warehouse. "Titan has plans for more development in Tri-County as well as at Cornerstone Industrial Park," Gatley says.

The industrial leasing market in San Antonio reached record high absorption at the end of 2005. "A flurry of fourth quarter activity resulted in nearly 491,000 square feet of positive net absorption of industrial space, which raised the year-end total to more than 772,000 square feet," Gatley says. "The distribution warehouse market dominated with more than 518,000 square feet of positive absorption in the fourth quarter and nearly 619,000 square feet for the year."

In 2006, developers are trying to keep up with this absorption by attracting tier-two and -three Toyota suppliers — along with other manufacturing companies either related to

Toyota or those just following their lead — to the market. Sumitomo Wiring Systems, for example, has leased 87,000 square feet at Interstate Business Park, Building 5, and Toyota Tshusho America has leased 48,300 square feet at 1235 Gembler Road in the former AutoZone facility. “Additional Toyota-related activity is anticipated in 2006 with lease negotiations already underway,” Gatley says.

In addition to attracting automotive-related companies, developers also are feeding off of San Antonio’s growing call center industry by providing back-office flex space. A shortage of small-user buildings and distribution facilities with more than 300,000 square feet also will create opportunities for future development. “The market has already experienced an increased interest in larger facilities by outside companies evaluating San Antonio as a possible new location,” Gatley says.

The combined average rental rate for industrial space in San Antonio is $5.41 per square foot triple net, which is up 12 cents from last year. “Despite the influence of higher rates quoted among newer properties, the average quoted rental rate for distribution space still hovers just under the $4 mark,” Gatley says. “Landlords of older properties are pressured to keep rental rates low in an effort to offer a competitive advantage to tenants who have so many new options in the marketplace.”

Vacancy in San Antonio’s industrial market has risen slightly to 15.9 percent compared to 15.2 percent this time last year. “It is unusual to see so much construction, given that the market remains in double-digit vacancy,” Gatley says. “Developers, however, are optimistic about the potential of gaining more tier-two and tier-three suppliers as the completion of the new Toyota plant draws nearer. Developers are also aware that the needs of today’s industrial users call for new buildings to replace many of the older ones that have become functionally obsolete.”

With the development community forging ahead with plans for nearly 4 million square feet of proposed industrial projects in the area, San Antonio is set for big growth in the coming years. “The San Antonio market, ideally positioned at the crossroads of trade routes, has begun its transition into a major industrial city,” Gatley says. “The next decade holds tremendous potential for San Antonio and the surrounding area — the transformation has just begun.”

El Paso

The industrial market in El Paso continues to see a steady increase in activity. “The 60 million-square-foot El Paso industrial market has seen tremendous growth during the last 20 years,” says Adin Brown, principal with Sonny Brown Associates, LLC in El Paso.

El Paso’s sister city, Juarez, Chihuahua, Mexico, is very important to the economic growth of the region, according to Brown. As the fourth largest city in Mexico and the economic center of Northern Mexico, Juarez’s proximity has generated a lot of resulting activity in El Paso. For example, Electrolux recently chose Juarez as the location for a new 1.5 million-square-foot plant to go alongside the 1.5 million-square-foot plant it built there last winter. “The reason this 2006 announced transaction and the 2005 new plant are having such a tremendous impact in El Paso and Santa Teresa, New Mexico, is that Electrolux has requested that all of its suppliers from around the world make a visit to El Paso, Juarez and Santa Teresa in order to possibly set up a supplier plant within close vicinity of its new operation," Brown says. "Many different parts will be provided to Electrolux from supplier types in order for Electrolux to complete the final product. This is really good news for the three-city area."

The majority of newer development is taking place in four submarkets of the region: East El Paso (Vista Del Sol Corporate Center), Southeast El Paso (Verde Corporate Center/Pan American Center for Industry), West/Northwest El Paso (Northwestern Corporate Center) and Santa Teresa (Santa Teresa Bi-National Park). "All four submarkets have similar characteristics," Brown says. "They are in close proximity to the bridge crossings into Mexico, land is plentiful, there is easy access to and from I-10 and Loop 375, and there is an excellent workforce and infrastructure."

Five Star Development, the largest local/regional developer in El Paso, and Verde Realty are the only developers currently building speculative industrial buildings, according to Brown. "Five Star has recently completed a 200,000-square-foot industrial building and Verde Realty has completed two new speculative buildings of 50,000 square feet and 76,000 square feet."

Some of the major leases that have closed recently include Tyco's 201,000-square-foot lease in the Five Star Technical Park and Molon Motor Corporation's 80,000-square-foot building lease in the Northwest Corporate Center. The majority of space in El Paso is being leased to a variety of manufacturers, warehouse/distribution companies, light assembly manufacturers, transportation/freight forwarding companies, third-party logistics providers, suppliers and companies storing both raw goods and finished product for distribution throughout the U.S. and Mexico. "New back office service centers and call centers such as Alltel, ACS, ADP and EDS that have been leasing vacant industrial buildings during the last 6 months have been a big reason for the overall vacancy rates in El Paso trending downward," Brown says.

As of the first quarter of 2006, vacancy in El Paso's industrial market is in the 7 percent to 9.5 percent range. "Class A space, on its own, is closer to 6.5 percent and trending downward," Brown says.

El Paso is poised for a substantial economic impact in the coming months as a result of an expansion of the U.S. Military Base at Fort Bliss, according to Brown. "The BRAC (Base Relocation and Closure) results were approved in September and the impact for the El Paso area is that 30,000 new soldiers will be moving to our marketplace during the next 4 years," Brown says. "This growth impacts our residential, multifamily, retail, office and industrial properties in a very positive manner."

Austin

Austin's industrial market is seeing the expansion of existing companies as well as more and more new firms entering the market for the first time, according to Jerry Heare, principal at NAI Commercial Industrial Properties Company in Austin. "High-tech firms such as software designers, hardware architects, communications and entertainment groups continue to move in, start up or expand due to the availability of human capital," Heare says.

Speculative development is also becoming a more popular option in Austin's industrial market. "Six months ago, the only construction we were seeing was for small build-to-suit users," says Lee Ellison, associate vice president of Austin-based Commercial Texas. Hill Partners and Simmons Vedder & Company, for example, have teamed up to develop the 60-acre Airport Commerce Park. Featuring 374,560 square feet of flex/industrial space, the park will break ground later this year. Other major speculative developments include Trammell Crow Company's 240-acre proposed industrial park at the northwest corner of Dessau and Parmer and its 122,000-square-foot Expo 8 and 104,000-square-foot Expo 9 buildings, which are set to break ground this month in Expo Business Park. Zydeco Development and Atlantis Properties also are expanding the MetCenter development by 350 acres. "These developments will provide additional options to both the flex and warehouse market that do not currently exist," says Daniel Farrar, associate vice president with Commercial Texas. "We expect it to be another 12 months before demand will really utilize this level of new industrial space."

The majority of industrial development is taking place in the southeast, northeast and in Round Rock, according to Dan Meyer, associate with Commercial Texas. "The southeast remains a strategic submarket because of its proximity to the airport and its convenience to I-35 leading south to San Antonio and the new State Highway 130," Meyer says. Currently under construction, SH 130 is a 90-mile, $1.38 billion toll road that will run from Georgetown to I-10 in Seguin.

In Round Rock, The Burke Real Estate Group is nearing completion on a new industrial building. "The Burke Real Estate Group is just finishing up 160,000 square feet of office warehouse in Chandler Creek Business Park in Round Rock," Heare says. "The development will offer small flex tiltwall buildings for sale — a new product for the Austin area."

Attracting high-tech tenants, such as data centers and call centers, has become a top priority for Austin developers. Advanced Micro Devices has selected a new location in southwest Austin, and The Home Depot is establishing a technology center in the area.

Even with these new companies coming in and absorbing space, a significant amount of flex space is available in the market, according to Heare. The city's overall vacancy sits at 14 percent, with flex space averaging at 25.4 percent and warehouse space at 9.9 percent.

In the near future, Austin's northeast and southeast submarkets will be the ones to watch because of the availability of land, according to Heare. "The northeast and Round Rock areas are very exciting because of the new roads," Ellison says.