ILLINOIS REAL ESTATE JOURNAL

REjournals.com

VOL.16 NO.18 DECEMBER 2015

A major transaction this year in the O'Hare submarket was the $83 million sale of O'Hare Center, a 380,360-square-foot office building at 6250 River Road in Rosemont, Illinois. CBRE assisted CBRE Global Investors in the sale to a partnership represented by MDC Realty Advisors and Nicola Crosby, a subsidiary of Nicola Wealth Management. Hannay Realty Advisors acted as an advisor to MDC and Nicola.

Retracing steps: Chicago market left with large industrial foot print at year-end

By Stephanie Aguilar

Quarter after quarter, Chicago has proven to be one of the most dynamic markets for industrial. A significant amount of activity continues to pour in and a lot of major submarkets are seeing it more than others—notably the I-55 Corridor, O'Hare, I-88 and I-80, which have witnessed major occupier demand in 2015, according to George Cutro, director of industrial research at JLL.

Large companies like Mars and Saddle Creek continue to seek space in Chicago submarkets.

INDUSTRIAL FEATURE *(continued on page 8)*

INDUSTRIAL FEATURE *(continued from page 1)*

The two signed major leases this year at CenterPoint Intermodal Center in Joliet—Mars for 1.4 million square feet and Saddle Creek for 1.1 million square feet.

In the I-88 Corridor, Midwest Warehouse leased Opus/USAA's 604,000-square-foot speculative facility. According to Noel Liston, principal at Darwin Realty, that building was subsequently sold as stabilized at record pricing for the submarket.

Also in I-88, Duke Realty completed a 500,000-square-foot built-to-suit for Fellowes Manufacturing and McShane completed a 305,000-square-foot built-to-suit for PPG.

The I-55 Corridor was also hit with several lease transactions in Romeoville, according to Liston. Central American leased just under 500,000 square feet, PAE leased more than 700,000 square feet, and Ashley Furniture leased more than 400,000 square feet of space.

"The Greater O'Hare market and the I-55 Corridor, to no one's surprise, experienced the greatest leasing activity amongst the major industrial submarkets throughout the Chicagoland area," Liston explained.

Darwin had several significant transactions in 2015, including the investment sale of a FedEx sorting and distribution facility in Carol Stream, which commanded a purchase price in excess of $21 million.

JLL had plenty of successful transactions this year, too. The firm negotiated a 915,000-square-foot extension for M Block in Tinley Park and even assisted Whirlpool on its new 750,000-square-foot lease in Joliet.

"We were also given a 47 million-square-foot multi-state industrial property management assignment from IDI Gazeley," Cutro explained.

DEVELOPMENT

With the market performing extraordinarily well, it's no surprise that industrial development is on the rise. Cutro explained that there are 48 projects currently under development, which altogether comprise roughly 13.8 million square feet of inventory.

"However, this is not the same level of pre-recessionary high of 20.8 million square feet, which was reached in 2006," he added.

Neal Driscoll, vice president and city manager at Liberty Property Trust, said there has

Liberty Property Trust's 235,800-square-foot spec facility at 333 Howard Avenue in Des Plaines. The destination facility was finished in November 2015.

been a shift in building size over the last 18 months when it comes to new construction.

Driscoll said developers are seeing that big box industrial tends to be more commoditized than multitenant.

But Cutro said users still desire modern functional product. Submarkets such as O'Hare, North Cook County and the I-88 Corridor, however; have limited product, causing rents to rise in those markets. As for Lake County and North Kane markets, modern available product is drawing limited interest.

Liston said he has not seen supply outpacing demand despite a robust year for speculative construction.

"We project a healthy balance in 2016 based on land supply constraints and rising costs for construction," Liston said.

TRENDS

Industry experts have also seen many new trends entering the market this year. Cutro said one of the biggest trends he saw was the 1.0 million-square-foot user driving absorption.

"We had two new 1.0 million-square-foot-plus built-to-suit leases signed in 2015," he shared. "In a growing market, we typically witness one per year."

However, he also added that the small user demand of 10,000 square feet to 30,000 square feet is heating up, explaining that it is up about 15 percent from one year ago.

Another big trend he's seen this year? One that has undoubtedly been booming—e-commerce driving local demand. And that's no surprise considering Amazon, which signed five leases in the Chicago market this year. The largest one was its 475,100-square-foot space at 401 Laraway Road in Joliet.

ANY SURPRISES?

Liston said the firm's capital markets group noticed a staggering drop in capitalization rates in the past year. He explained there was a steady increase in the pricing institutional investors were willing to pay for Class A stabilized industrial assets. There has been significant capital chasing stabilized industrial assets.

What's interesting is that not long ago, foreign investment focused solely on office buildings in major central business districts, according to Liston. Now, they're willing to add industrial real estate to their portfolios.

To Liston, this cap rate compression was the biggest surprise of 2015. He said that as much as the firm felt the market was heading into positive territory, they did not anticipate cap rate compression that would result in recording pricing even above the peak seen in 2006 and 2007.

"The demand for infill development was also a pleasant but welcome surprise," Liston said. "The lack of available improved industrial sites in infill locations has kept speculative supply somewhat constrained and has forced pricing upwards for new development as well as market rental rates for those properties."

What surprised Driscoll most was the amount of spec activity that occurred in I-55. People argued that companies would have to go south to I-80 but there were a number of sites previously considered unavailable that dramatically changed the scene in Bolingbrook and Romeoville.

"In the span of a year, it went from no construction to a handful of construction," Driscoll explained.

Cutro said what surprised him the most this year was the amount of money chasing industrial product.

"There have been two pre-sales of speculative developments completed this year," he added. "We have not witnessed this activity since 2007."

Both speculative and build-to-suit development is thriving. Cutro noted that speculative development has actually surpassed build-to-suit completions.

So far in 2015, 8 million square feet of spec has been completed compared to 5.9 million square feet completed in build-to-suits.

Not to mention, speculative development was also higher for developments in the ground as 7.1 million square feet of the 13.8 million square feet under construction is speculative in nature.

Driscoll agrees that there's been this resurgence of spec development. He said that coming out of the recession, this is the first year with substantial spec development across the entire Chicago market.

And while there have been less build-to-suits, those that have occurred have been larger in size and are driven by specific requirements like location.

But for the most part, construction has been very strong for the majority of the year. Driscoll said there's been demand for pre-cast panels and since summer, developers have been trying to figure out how to get their projects in and running on schedule for material deliveries in 2016. He said it's necessary to consider certain constraints such as weather when it comes to new deliveries because it's a big factor in keeping the market in check.

Liston has also seen this. He said precast panels, one of the largest components of industrial new construction, has seen price increases in 2015 and lead times pushed out as long as eight months.

VACANCY

So where does this leave vacancy?

Chicago, the second largest industrial market in the U.S. with roughly 1.2 billion square feet of inventory, has seen a consistent and steady decrease in vacancy rates since late 2009 and early 2010, according to Liston.

He noted that rents have been rising approximately two percent to three percent annually during this period—Darwin estimates that rental growth in 2015 was plus or minus five percent year over year. And in the past seven years, he said vacancy rates decreased from 12 percent in 2009 and 2010, to roughly 7.2 percent, which is what is expected at the end of 2015.

JLL research data shows that Chicago vacancy was marked at 6.8 percent in the third quarter, which went down 70 basis points from the previous quarter. Third quarter net absorption, however, totaled 4.5 million square feet—marking the 20 consecutive quarter of positive results.