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Strange industrial market emerges in South Jersey as demand remains high throughout region

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Last summer, Sansone Group began developing the first phase of Tac-Pal Logistics Center, a 702,450-square-foot industrial building on Route 73 in Palmyra, New Jersey, and this past May, it reached a construction milestone that set it on course to be completed in September.

AVISON YOUNG/CUSHMAN & WAKEFIELD

The Tac-Pal Logistics Center is under construction in Burlington County, New Jersey.

Tac-Pal is being built on speculation, and though no leases have been announced for it, demand for these large-scale industrial properties and smaller ones remain strong in South Jersey and throughout the region.

“At a high level, the market is still performing very well and is fundamentally sound,” said Matthew Marshall, a broker with Avison Young who is marketing Tac-Pal with Cushman & Wakefield.

Trammell Crow Co. experienced how robust the industrial market is in Aston. The real estate company recently developed a 281,000-square-foot building on speculation and leased it to Thayer Distribution and has several prospects for another 210,000-square-foot building in the Delaware County town it is also developing on speculation.

"Rents are well above pro forma," said Andrew Mele, managing director at Trammell Crow Co. "We underwrote this two years ago with rents in the $7 to $8 range and now we're looking at the mid-$11s. I've been in this rodeo before and it always ends but there isn't anything out there that tells you that industrial demand is going to end."

While the market appears to be humming along on the surface, several unique trends have emerged over the past six months. Some projects under development are taking a longer time to lease but it's not because demand isn't there or the market is slowing down.

"Rents have been rising so fast and so much that developers haven't wanted to make deals because if they wait a month, rents may be higher," said Marc Isdaner, an industrial broker with Colliers who focuses on South Jersey. "They are being strategic in waiting because rents are increasing at an unusually fast pace. The question is how long it can be sustained and no one can answer that."

Rents in New Jersey have risen by 37% year over year with direct asking rents at more than $14 a square foot, according to JLL second quarter data. The overall vacancy rate in New Jersey is a tight 1.1%. Burlington County, one of the most active counties in the state, has an overall vacancy of 3.3% and average asking rents of $11.85.

Leasing volume in South Jersey is also down and that has been a function of too few buildings, especially those over 100,000 square feet, that are available for lease. "A lack of space constrains activity," Isdaner said.

In contrast to prior quarters, a single lease totaling more than 500,000 square feet was signed in the second quarter despite 17 active tenants needing 500,000 square feet or more, according to JLL research. There were 13 tenants of that size looking for space at the beginning of the year. As options have dwindled in Central Jersey, many tenants have focused on South Jersey where they have some but limited options.

Another dynamic at play involves a new set of landlords controlling the South Jersey market. It has shifted in recent years to have more institutional owners, which bought out local families who had dominated for a generation, and that has also affected leasing activity. These larger, well-financed landlords can stomach vacancy longer as they patiently wait for higher rents before striking a deal.

While leasing is in a hyper state, Mele noted that some of the "froth" has come out of the investment market in recent months. Higher interest rates, locked up capital markets and an uncertain economic future involving fears of a recession has meant fewer sales and more deals that have fallen apart or getting delayed until after Labor Day.

"Sale and acquisition volume is down but leasing is almost like it's living in its own world," said Tony Grelli, a partner at Velocity Ventures Partners. "We are seeing so much demand in Pennsylvania and New Jersey from small deals that are 2,300 square feet to 200,000 square feet and everything in between."

The availability of buildings and spaces that can accommodate smaller tenants enabled Velocity to do 750,000 square feet in leases in the second quarter compared with 250,000 square feet in the first quarter. The deals involved a mix of tenants ranging from distributors to service-based businesses and large manufacturers.

Also playing a role are construction costs and land prices that continue to increase, causing some developments to get repriced and that is contributing to higher rents. "Land prices are through the roof but a closure today may have been negotiated a year or two ago so it's really hard to get a handle on where land prices are," Isdaner said.

For the last decade or more, it has been relatively easy to predict how much it would cost to develop an industrial building. Projecting out what those expenses might be a year from now is even more of a challenge. Land in South Jersey now stands at around $100 a buildable foot. The cost of land is being driven by a scarcity of sites, especially large ones, and that has also started to push developers into areas that weren't considered prime locations such as Salem County.

“The good news for Tac-Pal is this project started two years ago and all of the construction pricing is locked in,” Marshall said. “Timing worked out very well here.”

Once the first phase of Tac-Pal is leased, Sansone and its partner, Crow Holdings Capital, will move forward with the second phase, a 1-million-square-foot building. The overall development totals $250 million. Tac-Pal is rising on a former drive-in movie theater and an old landfill that combined total 160 acres and had sat idle for 50 years.

Its development will join an unprecedented 24.1 million square feet currently under construction in South Jersey and provide more options and relief for those large tenants scouring for space in the market. However, the future of new warehouses that haven't been approved is starting to look tenuous.

"That portion of the market, specifically, saw significant pushback from some municipalities regarding warehouse development in recent months, creating higher barriers to entry for developers," said CBRE Inc. in its second quarter report. "As such, supply and demand should remain out-of-balance while current demand levels persist."

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