Lee County Industrial Market Review
By Mark Alexander, CCIM]

I am tired of hearing all this doom and gloom news about the real estate market…aren't you? I figured the natural solution would be to watch more sports. This worked well during baseball season when my Red Sox played six days per week. But now the Patriots only play once per week…so the rest of the week has become a real problem for me.

All this talk about our residential real estate market searching for a bottom while most of our county home building industry tries to keep their bottom by finding work…has been gnawing at my conscience…only to be disturbed by brief hours of euphoria when the Patriots play. I am thankful for Sundays.

But try as I might, I can't seem to escape the fact that business appears down for many Lee County builders and tradesmen tied to the residential housing market. I have heard stories of these businesses downsizing or just walking away from warehouses that have been relegated to mostly storing dust these days. I have also noticed with alarm…plenty of new construction of industrial and flex-type buildings (which are part office and part warehouse combined). Thus the questions arose: "What is happening in our Industrial market?" and "Should we be concerned?" I did some digging and owners of industrial buildings need to be a little concerned. Here's what I found.

SUPPLY

According to Co-Star, our Lee County industrial supply grew from 28 million square feet in the 4th quarter of 2005 to 29.4 million square feet today (4Q 2007). Business for commercial contractors has been pretty good because they built 1.4 million square feet of new industrial space over the last two years. This new industrial property construction came to an average of 700,000 SF per year. Just to give you a frame of reference, since the Edison Mall is roughly 900,000 SF, there has been new industrial construction equal to 1.5 Edison Malls over the past two years.

DEMAND
Lee County had 27.6 million square feet of occupied industrial space in the 4th Quarter of 2005. But demand (i.e. occupied space) went down by 200,000 SF over the next 12 months when Lee County Industrial showed 27.4 million SF occupied in 4Q 2006. Demand then went down another 300,000 SF over the following year to bring us to where we now squat today at 27.1 million SF of occupied industrial space in 4Q 2007. While industrial supply increased 700,000 SF per year over the past two years from new construction, industrial demand (or occupied space) was shrinking by 250,000 SF per year…to produce net vacant industrial space of (700,000 + 250,000 =) 950,000 SF per year…for each of the past two years. There must be a game on someplace. Where's that remote?

VACANCY
In the 4th quarter of 2005, the Lee County industrial market displayed an enviable 2% vacancy factor with just 450,000 SF vacant. If you were an Industrial developer back then, the last day of 2005 was truly a fun time to pop that bottle of celebratory Champaign. By 4Q 2006 Lee County Industrial was up to 1.3 million SF vacant for a 5% vacancy factor. This was still an "Owners' Market" in my opinion since I believe vacancy factors of 0-6% favor the owner, 7%-9% is "no-man's land" (where there are degrees of balance in the market) and any vacancy of 10% or higher favor the tenant. Today (4Q 2007) we have 2.1 million SF of vacant Industrial space for a 7% vacancy factor. If we could just turn off the Industrial supply spigot right now…and stop at 7% vacancy, we would be in good shape. But alas markets are not perfect as they tend to build up steam running in one direction…until they correct themselves. Based on new industrial properties that are under construction now, the Lee industrial vacancy is projected to reach 3.1 million SF vacant by 4Q 2008 for an 11% vacancy. The brunt of this 2008 new industrial construction…or 865,000 SF…is due to be completed in the first quarter of 2008. Welcome to a "Tenant's Market" for Lee County industrial properties. We are overbuilt with too much supply. You can expect industrial rents and values to soften over 2008 with owners providing more concessions as they fight over the existing industrial tenant base. I'm ready to watch a cricket match at this point.

Why?

How did this happen? The answers lie in simple supply and demand dynamics with a look at our industrial market history. This flood of new industrial construction was triggered by the super low 2% vacancy factor in 4Q 2005. But it was an unanticipated 2004 event that created an overnight shift in our supply and demand dynamics. You may recall an uninvited guest that showed up in 2004 named “Charley”. God’s wrecking ball named “Hurricane Charley” swung through SW Florida on August 13th, 2004 with reckless abandon. When Charley left, he took with him almost a fourth of our roofs...and dampened more than our spirits. But Charley’s departure also caused an explosion of commercial and residential construction business. Interstate 75 became the life-blood artery for SW Florida that pumped an infusion of parts and labor in support of one of the biggest mobilizations of re-construction work in the south since Sherman burned Atlanta. I happened to drive to Tampa a week after Hurricane Charley and vividly remember driving on I-75 at 30 miles per hour (bumper to bumper) with lots of time to look out the window…and thinking that I had somehow stumbled on to the set of a ZZ Top music video production. I saw plenty of rusted old trucks with matching tool boxes thrown into the back, driven by guys with long scruffy beards. Their license plates represented a rainbow of southern states…some with confederate flags. They became the modern day carpetbaggers but used trucks now instead of carpet bags. Hurricane Charley caused a solid two years worth of new construction activity in our county….and many of these companies needed warehouses for their businesses to expand and homes for their workers to live. Since our residential market was simultaneously in full swing in 2004-2005, we had a spike in Industrial property demand (due to an all time high construction level) coupled with way to little supply of Industrial space which produced a dream market for industrial developers. It was all too easy to blink at these numbers in 2005, say “Wow!” and then started planning to construct new industrial properties. Industrial property owners raised rents dramatically in 2005 because they could. They owned the small industrial supply in a sea of high turbulent demand. Sale prices of industrial property skyrocketed in 2005 because of this supply & demand imbalance.

Land values are driven by demand from someone who needs it so that they can build a building that is needed. We had tremendous need for industrial buildings in 2004-2005. I remember industrial land sales peaking a decade ago at $3 per square foot along Metro Parkway. In 2005, Lee County industrial land sales were topping out in the $10-$12 per square foot range. As an example, Naples Lumber paid $10 PSF for a parcel of land off Alico Road during this heyday. Today we have excess supply of industrial space so there is very little demand for land to build new industrial buildings. There is a 20 acre site in the Alico Road area today being offered at $5.50 PSF…and there is a big difference between closed transactions and offered transactions. Offered transactions are merely conversation…until they close and become a real comparable sale that can be used by appraisers. Industrial sale comps have slowed while everyone feels for the bottom. Industrial Flex space that once peaked at $150 PSF is now being offered in the $110 to $115 PSF range. Can you say, "Correction?" In this wildly successful "Up-Market period of 2005", there were simply a few too many buildings planned to meet the future long term industrial demand needs. Industrial developers may not have counted on some of these Hurricane Charley vendors finishing their work and going home in 2006…and vacating their industrial buildings…and vacating their rental housing. We certainly didn't expect for the housing market to tumble like it has…causing less demand for new construction…causing less demand for industrial space…causing higher vacancies for industrial properties…causing lower industrial rents…causing lower industrial values. The knee bone is connected to the thigh bone. I'm ready to watch a good game of badminton.

According to Alan Greenspan's new book, free markets are amazingly resilient and self correcting. I should remind you that an 11% industrial vacancy rate in Lee County is not so bad in a down economic cycle….compared to say 16% or 19%...which we could have easily hit instead. 2008 will be the year of the industrial market correction. Even though home building construction is at an all time low, commercial building construction is the silver lining that will help many tradesmen get through 2008 to reach 2009 when the residential market should be back up on its' feet. When you look at commercial properties under construction now as reported from Co-Star and combine 2008 future deliveries from industrial, retail and office, we find quarterly completion totals for 2008 of 1,745,000 SF for 1Q, 546,000 SF for 2Q, 1,015,000 SF for 3Q and 110,000 SF for 4Q; bringing Lee County total commercial construction deliveries for 2008 to just over 3.4 million square feet of commercial construction…which is the equivalent of almost four Edison Malls. That's a lot of work for 2008 guys. It simply takes a longer period of time to build a commercial building than it does to build a home. All this commercial work is from the pipeline of new construction that started in late 2005 and early 2006 when the market was rocking. Plus we still live in Florida where there is very high supply of Sun and Sand which will continue to attract demand from vacationers and retirees in the future. If we can make state tax reform happen in 2008, we can increase market share of retiree relocations to boost our local economy and make living more affordable for all our residential and commercial owners alike.

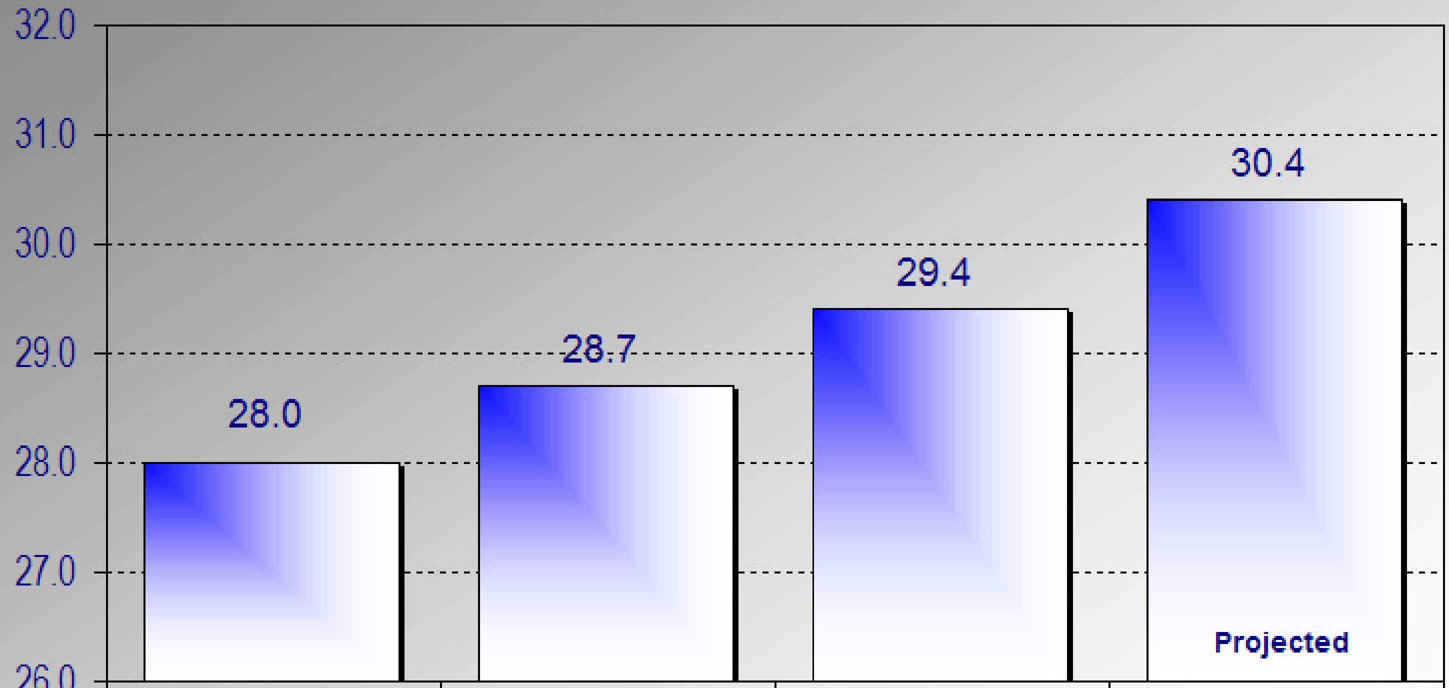
So we say good bye and good riddance to 2007 and welcome 2008 with open arms. We have a lot to be thankful for….family, health, commercial construction work in 2008 and ESPN.

Mark Alexander, CCIM
Senior Medical Office Advisor
Sperry Van Ness
6360-2 Presidential Court
Fort Myers, Florida 33919
marka@svn.com
239-433-0400

Sperry Van Ness
Commercial Real Estate Advisors

Lee County Industrial Supply

Growth in Millions (SF)

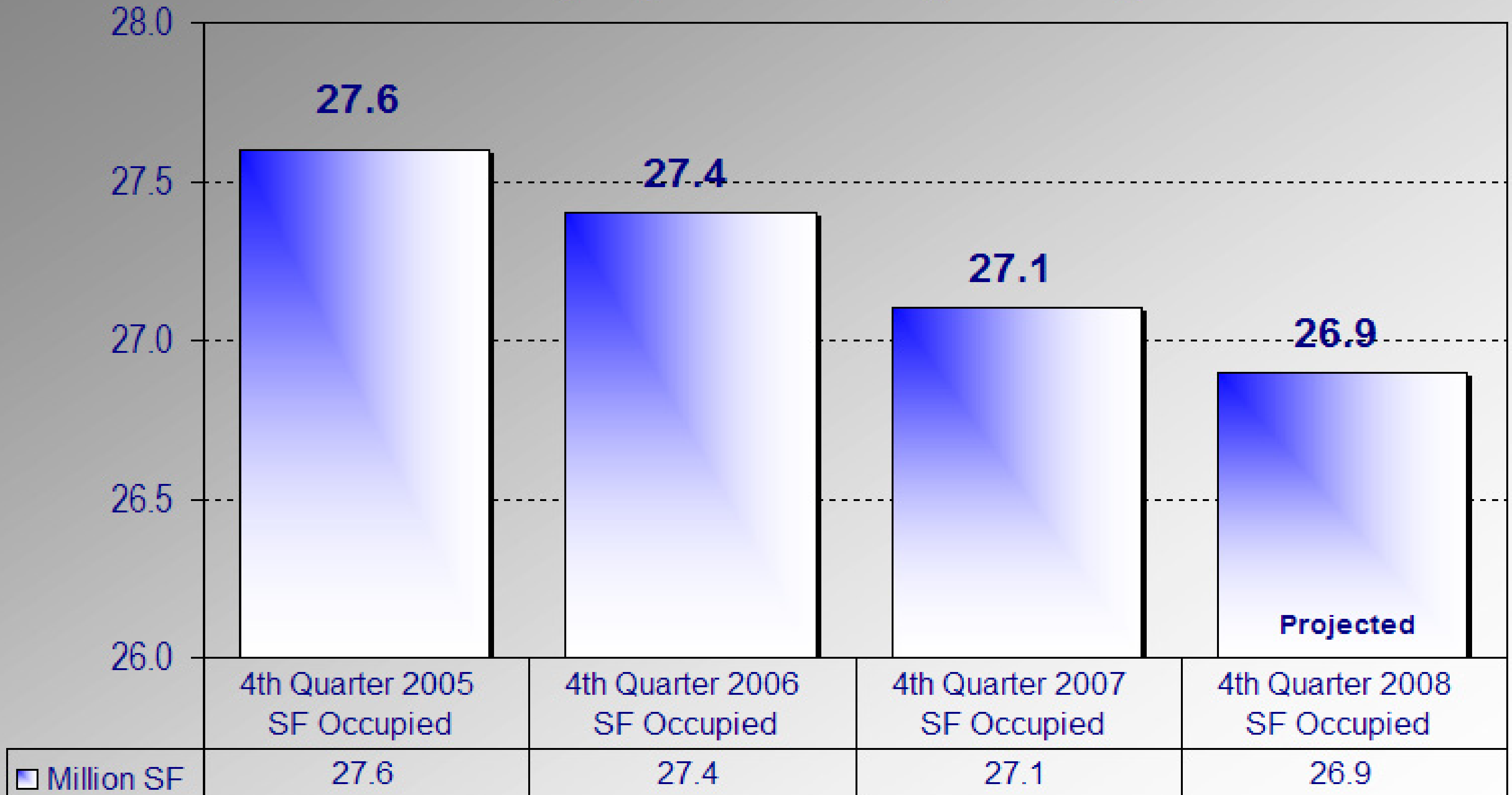


	4th Quarter 2005	4th Quarter 2006	4th Quarter 2007	4th Quarter 2008
Million SF	28.0	28.7	29.4	30.4

Source: www.Costar.com

Lee County Industrial Demand

Millions (Square Feet) Occupied



Source: www.Costar.com