Building New Warehouses 'Very, Very Difficult' In Atlanta Despite Resilient Demand

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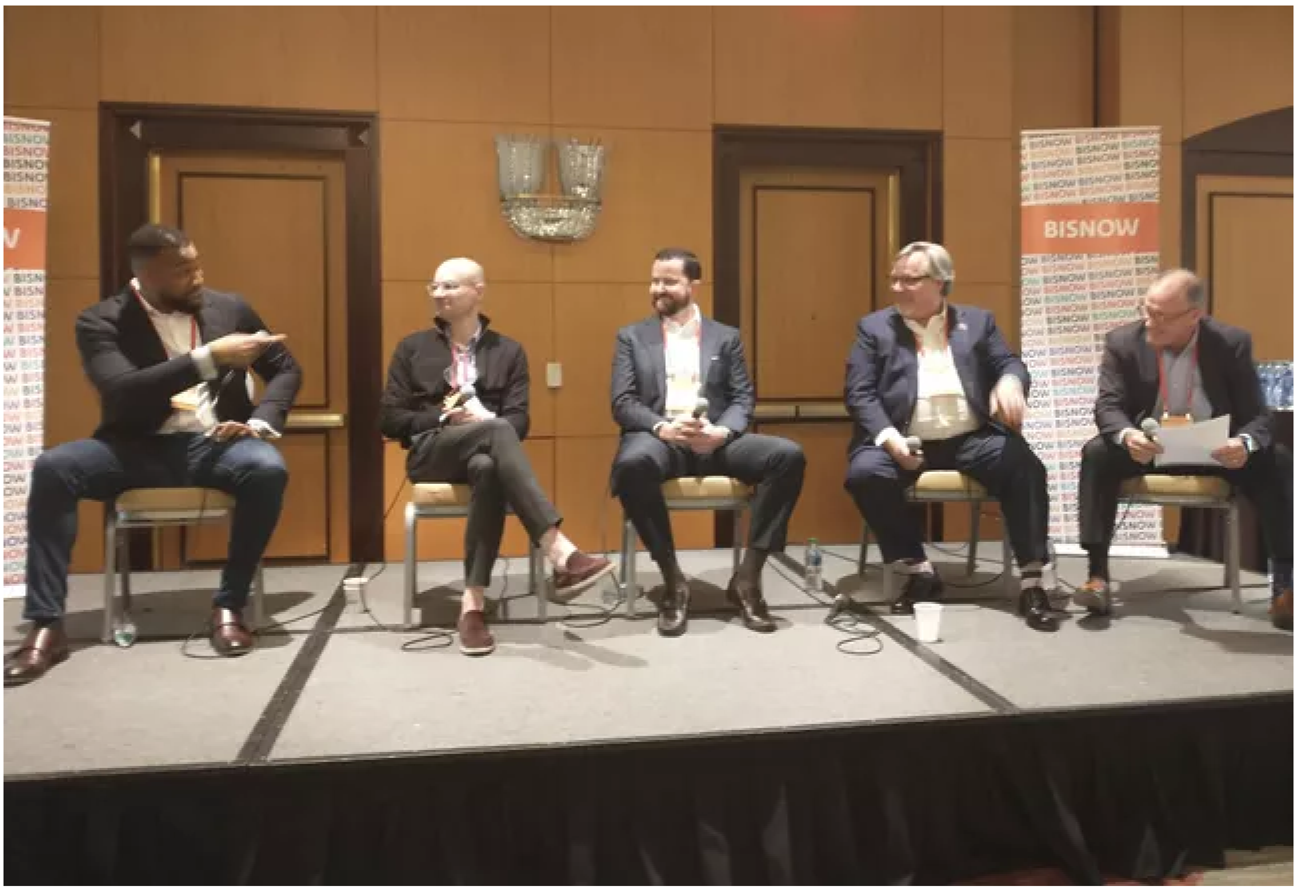
While Atlanta's industrial market remains flush with tenant demand, the Federal Reserve's aggressive interest rate hikes are poised to finally cool off rampant new warehouse development in the region.



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EQT Exeter Atlanta Market Leader Chris Merriewether, Legacy Investing President Daniel English, Inlight Principal Matthew DiLeo, MAPP Vice President Jim Eshleman and Moore Colson CPAs & Advisors Partner Steve Lamontagne.

There is a whopping 44M SF of industrial space under construction in the third quarter, but that number dipped from the 47.7M SF in development in Q2, according to Lee & Associates. But despite vacancy remaining at 3.7%, developers are having a harder time constructing new distribution centers, panelists said at *Bisnow's* Southeast Industrial Summit at the Hilton Atlanta Downtown Tuesday.

“You've got record supply in the pipeline right now, [but] construction starts are going slow,” said John Barker, the president of Red Rock Developments, which has developed more than 30M SF of warehouses in the Southeast. “Right now, you just can’t make it pencil.”

The Fed raised interest rates 75 basis points earlier this month, the latest in the most aggressive series of rate hikes since the 1980s. Federal Reserve Chairman Jerome Powell also signaled that the Fed would raise rates further to combat inflation, which clocked in at 7.75% in October.

The Fed's actions have made it harder for developers to secure construction loans in recent months, since it is hard to predict where they will land, EastGroup Properties Vice President John Ratliff said.

“I think a lot of people in this room are probably saying, ‘Well, where does the cap rate [go]?’ And if you don't know the answer to that, which a lot of us don't, it makes new development very, very difficult," Ratliff said.

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Robinson Weeks Partners CEO David Welch, Red Rock Developments President John Barker and Broe Real Estate Group Senior Vice President Sean Fitzsimmons.

Panelists at the event said demand for available industrial space remains robust in the Southeast, recent data suggests that Metro Atlanta's industrial market is beginning to cool.

While tenants absorbed nearly 5.6M SF in the third quarter, up from 4.4M SF in the previous quarter and 5.3M SF in the third quarter of 2021, according to Lee & Associates, new leasing activity dropped from 14.7M SF in the second quarter to 6.6M SF in the third.

Regardless, nearly two-thirds of the spec space delivered this past quarter was leased upon delivery, according to CBRE.

"While 2022 has not reached the astounding levels of net absorption seen immediately following the pandemic, demand remains very strong," CBRE Associate Research Director Scott Amoson wrote in the report.

But tenant demand dynamics have shifted. Where once Amazon dominated leasing activity, its recent pullback has allowed other e-commerce tenants to claim their own industrial space, said David Welch, CEO of Robinson Weeks Partners whose firm is redeveloping former U.S. Army base Fort Gillem into an industrial park.

Food storage also is seeing a jump in demand — FCL Builders Vice President Eddie Slay said two cold storage facilities in Florida his firm built on spec were quickly absorbed by tenants. And chip manufacturers and other companies are increasingly seeking to onshore their manufacturing capacity in the U.S., Broe Real Estate Group Senior Vice President Sean Fitzsimmons said.

“In the United States, manufacturing is definitely the driver,” Fitzsimmons said. “We’re seeing supply chain driving all the projects and initiatives.”

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Stream Realty Vice President Catherine Giel, Brookfield Properties Senior Vice President Keith Edwards, EastGroup Properties Vice President John Ratliff, Realterm Associate Vice Presidet Arnie Capute and Catamount Constructors Vice President Rick Rodman.

Developers said they have to get new warehouses prepped for occupancy earlier, including adding in lighting fixtures and HVAC systems before a potential tenant issues requirements. Doing so allows tenants to move into facilities faster than in the past — and speed-to-occupancy is a key decision driver in leasing activity, said David McGoldrick, the director of the industrial studio at Nelson Worldwide.

“Traditionally, [tenants] would be a lot more particular about the design and features. But they want to get in right now,” Welch said. “We've done stuff [where the tenant needs to] get in in 30 days, and if you can't do that, you're off the list. So I'd say it's less about specifics, and more about 'I've got to have a space.'”

Stream Realty Vice President Catherine Giel said that the fact that new development is slowing will be a net positive for the 44M SF warehouses yet to come online.

“Whatever is under construction has to get delivered. But we may not see a lot being added to our development pipeline,” Giel said. “If your development slows, we still have a lot of supply that’s going to get snapped up … which will hopefully drive demand for future development once the lending loosens up a bit."

Despite the growing challenges facing commercial real estate as a whole, the Southeast is poised to weather a potential recession better than other areas of the country thanks to the sheer number of people who have moved into the region over the past decade, Ratliff said. The Carolinas, Tennessee and Florida experienced a huge bump in inbound migration from the Northeast and West Coast in 2021, according to data compiled by North American Moving Services.

Metro Atlanta alone has added 800,000 new residents since 2010, according to the Atlanta Regional Commission, with the 11-county region reaching a population of more than 5 million last year.

"In terms of population growth, we had almost a million people from 2010. I think the result of that as well is they need goods and they need industrial space," Ratliff said. "So I think we're poised for continued success."