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LEHIGH VALLEY'S INDUSTRIAL SECTOR SEES INCREASING RENTS AND SPEC CONSTRUCTION

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The Lehigh Valley has experienced record-low cap rates for modern, stabilized industrial buildings in the past 12 months.

With increasing rental rates, strong investor demand for core product and record levels of speculative construction, spirits are high in the Lehigh Valley with regard to industrial real estate opportunities. The record volume of product deliveries the past two years underscores the strong industrial demand in the Lehigh Valley. Vacancy has dropped from 15.9 percent in the first quarter of 2009 to a record-low 4.9 percent at the end of 2015, according to CoStar. The average net industrial rental rate jumped 11.1 percent during the past 18 months, an even more impressive figure when compared against the 10-year average of 1.65 percent rental rate growth in Lehigh Valley for modern distribution buildings.

After many years of flat rental growth, year-end 2015 industrial leases were completed in the $4.75- to $4.95-per-square-foot range in the Allentown-Bethlehem-Easton, Pennsylvania MSA. In 2016, expect a modest increase in rental rates as the delivery of new construction across the northeastern Pennsylvania region will slow growth and push vacancy rates higher.

Leasing activity has been broadly distributed along the regional I-78 and I-81/I-80 corridors. Within the valley, industrial growth has occurred primarily along the main interchanges of I-78, U.S. 22 and Route 33. In the past 12 months, many major tenant commitments have occurred in the market, including online retailer Zulily for 800,000 square feet at a Bethlehem fulfillment center; European retailer Primark Stores Ltd. for 677,000 square feet within the redeveloped Lehigh Valley Industrial Park VII; Stitch Fix for 483,990 square feet of warehouse space, also in Bethlehem; and Genco for 435,000 square feet of new Class A industrial space near the Lehigh Valley International Airport.

Although global macro-economic conditions have raised concern for slowing demand, there is no immediate expectation for a major market slowdown in leasing activity in 2016.

A flood of public and private capital into Lehigh Valley's industrial sector, coupled with continued low interest rates, has cap rates in the low 6 percent range. A strong sign of the investment times, the market has experienced record-low cap rates for modern, stabilized industrial buildings in the past 12 months, going as low as 5.5 to 5.9 percent with corresponding property values ranging from $85 to $95 per square foot. Further cap rate compression is not expected in 2016, but the impressive investment sales momentum from last year should continue.

Land is typically priced on a floor-area-ratio (FAR) basis and is currently trading at $15 to $20 per square foot for well-located, improved and approved industrial sites in the market, demonstrating a return to pre-recession pricing. Low supply and stout demand have forced many developers to shift their focus west and north in the market to $8- to $14-per-square-foot sites in the I-78 and I-81/I-80 corridors.

Lehigh-Northampton Airport Authority's pending $9.8 million sale of 270 acres in Allen Township to The Rockefeller Group for the development of a 1.1 million-square-foot FedEx Ground distribution hub continues to draw a lot of attention. However, a legal dispute involving the property's previous owner has held up the deal, opening up the possibility that the global delivery services company could opt for Majestic Realty's pro-

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posed 981,321-square-foot distribution facility off of Route 412 in Bethlehem.

Known historically for the production of steel, cement and apparel, the Lehigh Valley first experienced big-box industrial development along the western I-78 interchanges with eastward expansion following the 2002 completion of Route 33, which connects I-78 and U.S. 22.

Lower development costs initially played a role in the Lehigh Valley's emergence as a distribution hub; it was a lower cost alternative to markets serving the New Jersey ports. As the market has matured, it has become recognized as a top industrial market endorsed by national developers and institutional players. The intersection of the highway network allows about half of the U.S. population to be served from this area within a day's drive.

CoStar currently tracks approximately 5.9 million square feet of development activity versus about 4.2 million delivered in 2015 — by developers such as Liberty Property Trust, Dermody Partners and Clarion Partners. The word "boom" certainly comes to mind when one considers that the new industrial inventory delivered in the last 24 months outpaces any other market period. Combined, we charted the delivery of 17 new buildings in 2014 and 2015, which added 8.06 million square feet of industrial inventory to the Lehigh Valley.

Contrasting the current vacancy by the market's five- and 10-year average absorption figures indicates an approximate 2.5-year supply of industrial inventory. From a historical perspective, anytime the ratio dips below three years, the market sees a surge in speculative development similar to what Lehigh Valley experiences today.

Strong demand for consumer products and subsequent e-commerce demand has benefited Lehigh Valley. The resulting growth trend for larger and centralized logistic hubs with access to the major markets of Philadelphia, New York, Boston and Washington, D.C., has fueled the valley's industrial sector as evidenced by what has been a 16-year development expansion.

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