

MANSFIELD COMMERCIAL REAL ESTATE

Overview of the Commercial Real Estate Market in Orange County, NY at Year-End 2009

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The Industrial Market in 2009

The prolonged recession continued to dominate the real estate markets worldwide in 2009 and Orange County, NY was no exception. While a cursory look at the numbers indicates that the industrial inventory increased by over 625,000 square feet in 2009 – a level of growth not seen since 2002 – a closer look shows that it is the addition of one building that accounts for the significant jump. The build-to-suit construction by Panattoni Development of the 500,000 square foot distribution facility at Pine Lane Business Center in Wawayanda for Medline Industries is now completed, but not fully occupied; Medline occupies 350,000 square feet, and has been seeking an interim tenant for the balance of the space.

The inventory of prime industrial real estate at year-end 2009 stood at 19.4 million square feet. Other than the Medline build-to-suit, there were four other new buildings constructed in the County in 2009. Two were built-to-suit: 60,000 square feet in Newburgh for F.W. Webb, and 20,000 square feet in Chester for Best Mexican Foods. The other two were constructed on spec: a 26,000 square foot building in Crawford that is presently vacant, and a 6,300 square foot building in Montgomery that is now fully leased. The other additions to inventory were expansions of two existing buildings in Chester and Monroe.

There are also a few new buildings presently under construction in the County, all of which are build-to-suit. Among them are the 348,000 square foot building in Chester Industrial Park for C&S Wholesale Grocers (slated to come on line in 2011) and the 67,000 square foot steel fabrication facility for Orange County Iron Works in Montgomery that is expected to be completed in 2010.

As expected, the larger projects planned by developers are on hold pending a turnaround in the economy. Panattoni has a pre-approved pad site ready to accommodate a 240,000 square foot building, also at Pine Lane Business Center, and has finally received approvals for its 500,000 square foot facility in Montgomery. Hudson Valley Crossing has approvals in place for three buildings totaling 1.2 million square feet on the Montgomery / Hamptonburgh border. Whenever the economy rebounds, the County will easily be able to meet demand for large industrial facilities.

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But nearly 90% of the roughly 500 existing industrial buildings in the County are less than 100,000 square feet in size, and the bulk of demand from existing companies has historically been for relatively smaller units of space. Demand for these existing buildings remains strong, given the comparative cost of new construction, and supply continues to be limited. This sector of the industrial market never experienced the rapid expansion of its inventory, nor (to-date) has it been plagued by an abundance of distressed loans, as has been the case with the residential and retail sectors. Yet many potential buyers remained on the sidelines, waiting out this period of uncertainty, or anticipating that the market would further “bottom-out”. Those buyers who were able to participate in 2009 reaped the benefits. Sale prices of some industrial buildings that closed in 2009 were as much as 10% to 15% lower than previous years, but other sales indicate price declines of only about 5% to 8%. It should be noted, however, that this is more supported by consensus of opinion rather than actual data, given the limited number of deals that closed in 2009.

Approximately 725,000 square feet of industrial space was absorbed in the County in 2009 (in addition to Medline’s 350,000 square feet). Nearly 60% of this activity was through lease transactions and 97% of those were in existing buildings, not spec space. Among the more significant transactions are Amazing Savings’ lease of 90,000 square feet in Chester; Corsicana Bedding’s lease of 85,000 square feet at Panattoni Business Center in the Town of Wallkill; and 40,000 square feet leased by Safelite AutoGlass on Turner Drive in the Town of Wallkill.

All of the industrial space absorbed in 2009 through sale transactions was purchases of buildings under 60,000 square feet in size. Some of the notable deals were Gabrielle Manufacturing’s acquisition of the 53,000 square foot former furniture manufacturing facility on Bond Street in Central Valley; Feinkost Foods’ purchase of a 40,000 square foot facility in the Town of Montgomery; and Kal Pac Corp.’s acquisition of a 33,000 square foot building in the Village of Montgomery.

At year-end 2009 the overall vacancy rate for prime industrial space stood at 15%; however, after removal of the largest available building in the County (which is in contract and reportedly closing in early 2010), the vacancy rate drops to 12%. While this is higher than the national industrial vacancy rate of 10.2% (as per *Integra Realty Resources*), over 65% of what was available in Orange County at year-end 2009 were blocks of space exceeding 100,000 square feet in size. Until employment rebounds and consumer spending increases, it is likely that the large distribution centers will generate a low level of activity.

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Going forward, most of the demand for industrial space will probably continue to be for “smaller” units, particularly as some companies downsize in an effort to reduce costs and weather the storm. But Orange County’s vacancy rate for industrial space under 100,000 square feet in size was a critical 5.8% at year-end 2009. For property owners with large vacant units that are able to be subdivided for smaller tenants, there exists an opportunity here. Or perhaps the irony of this extended recession is that it may generate further availability of inventory to correct this market imbalance.

The positive news about the Orange County market is that financing is available for those companies seeking to purchase industrial facilities. Primarily a market of community banks and credit unions, these lenders avoided the risky practices that got other institutions into trouble. Let’s be clear, though: the underwriters are not making it easy, but financing is available.

The Office Market in 2009

Approaching a level not seen in nearly 20 years, over 275,000 square feet of office space was added to the Orange County, NY market in 2009. More than 60% of it was medical office space, and it is one building – Crystal Run Healthcare’s 127,000 square foot built-to-suit facility in the Town of Wallkill – that accounts for most of the increase. Since 2000, nearly half of the Class A office space constructed in the County has been medical office space, and Crystal Run Healthcare has constructed one-third of it (and reportedly has plans for another 120,000 square feet in Monroe). Other medical facilities constructed-to-suit include the Roberta Ginton Medical Office Building, which added 27,000 square feet of Class A medical office space in Port Jervis (it is 80% occupied with leases pending for the balance); the 10,000 square foot Hudson Valley Ophthalmology building in New Windsor (a portion of which was spec); and 7,000 square feet in the Town of Wallkill to house Mid-Hudson Hematology-Oncology. At year-end 2009, Orange County’s Class A inventory of office space stood at 4.1 million square feet.

Of the eight other office buildings that went up in 2009, all were initially planned as “spec” buildings, but by the time construction had begun, much of the space was spoken for. The 24,000 square foot Wallkill II Professional Commons on Crystal Run Road is at 75% occupancy; First Columbia added (and leased) 20,000 square feet as its latest addition to New York International Plaza; a 13,500 square foot building in Goshen that was constructed for Real Estate Solutions and Blustein, Shapiro, Rich & Barone is over 90% occupied; and a smaller building constructed in New Windsor is about 75% occupied.

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In the City of Newburgh, an 18,000 square foot office building was constructed in the new West Street Office Park. Developed by Walter Lambert of Northeast Development, with four additional lots available for future development, this vacant Class A building is the first to be constructed in the City in years.

In addition to the Crystal Run Healthcare space, over 165,000 square feet of Class A office space was absorbed in Orange County in 2009, over 80% of which was through lease transactions. Some of the notable deals were Orange Regional Medical Center's lease of 17,000 square feet for non-clinical staff at 75 Crystal Run Road; the Dynegy and Orange County IDA leases at First Columbia's new building (each 10,000 square feet); and the 8,500 square foot lease to Everything Grows Childcare at Walkill II Professional Commons. The remaining deals were all less than 5,000 square feet in size, representative of what is typical for this office market.

The vacancy rate for Class A office space in Orange County was 12% at year-end 2009, with approximately 490,000 square feet of space available. Although the County's vacancy rate is higher than it has been in over a decade, it is lower than the national average of 16.4% for suburban office markets (as per *Integra Realty Resources*). The total inventory of office space, including non-Class A space, at year-end 2009 was 5.4 million square feet with a vacancy rate of 13.2%.

Effective rents have lowered a bit from previous years as tenants turn to landlords for whatever assistance they can negotiate. Whether landlords provide a period of free rent, more tenant improvements, or some other concession, they are wise to hold onto existing tenants and to provide incentive for new tenants to join their roster. But a few landlords, with office buildings that are 45% to 65% vacant, are doing deals at more than 30% below market, and the newer buildings just cannot compete. For landlords who continue to provide a well maintained, higher quality product, the universe of prospects has shrunk as many tenants opted for cost-savings in reaction to the current economy.

For much of 2009, the non-medical transactional activity was dramatically reduced (over two-thirds of office deals were medical-related). Many inquiries received by brokers were merely tenants seeking to gather ammunition for negotiating their renewal leases. Clearly the economy has been the overpowering force in the market. But there did seem to be more activity later in the year, continuing as 2010 has begun. Perhaps it is reports of the economy rebounding (or getting worse at a slower rate) or maybe the present operating environment has become "the new normal", but office users seem to be coming out of hibernation.

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