THE WALL STREET JOURNAL.

February 13, 2008

Developers Betting on Texas-Size Warehouses

By Maura Webber Sadovi

Even in the face of a possible national recession, bullish Dallas-Fort Worth Metroplex developers aren't backing down from building more Texas-size warehouses.

This year, the region plans to develop the largest amount of warehouse-distribution space of any of the country's 54 major markets tracked by Property & Portfolio Research Inc., a Boston-based real-estate research firm.

Developers are betting that companies looking for regional and national distribution and storage hubs will continue to be lured to the Metroplex area, the informal name given to the region of about six million residents anchored by Dallas, Fort Worth and Arlington, Texas. Besides its location in the fast-growing Southwest, the region has rail access to West Coast ports, and its location along Interstate 35 facilitates trucking in and out of Mexico. Longer term, developers hope to benefit if the Panama Canal's expansion attracts more goods from China into the Port of Houston, about 240 miles from Dallas.

That optimism has helped fuel the planned delivery -- or completion -- of about 18.6 million square feet of warehouse-distribution space for the region this year, up 12% from last year, when about 16.6 million square feet were completed. The new development slated for the Dallas-Fort Worth Metroplex is sharply more than that expected in the Riverside-San Bernardino, Calif., region, which is in second place with 10.6 million square feet of new warehouse space on tap.

The warehouse-building surge in the Dallas-Fort Worth region has been "astounding," says Aaron Jodka, a real-estate economist with PPR. The new supply for 2007 and 2008 will add to the area more new-warehouse space than the total that already exists in the Austin, Texas, market, he notes. Leasing demand for warehouse space by shippers, retailers and manufacturers of everything from cellphones to soap and toys has been equally impressive. Last year about 17.4 million square feet of net space was leased, nearly one million more than was delivered.

The Dallas-Fort Worth area's economy for now is outperforming the national economy, thanks in part to its strong energy sector. Employment growth in December topped the national average, with an annual pace of 2.2%, according to the Bureau of Labor Statistics.

But the market isn't insulated from the chill settling over the nation. Employment growth has downshifted from a 3.4% annual rate in December 2006. Also, home prices that were already well below national averages are falling, and retail rents are declining. The office market is also dealing with the hangover resulting from Texas's aggressive building tradition, while construction is expected to surge in the apartment sector. While rents are rising, they are well below national averages.

Warehouse vacancies are expected to rise about two percentage points by the end of the fourth quarter and average rents to slip from a year earlier, PPR says.

Many developers in the Dallas-Fort Worth region are nevertheless pushing ahead with new warehouses, although the new supply will likely taper off next year, according to PPR. Builders say they are hopeful that rents, which were 28% below national averages at year end, will be attractive to penny-pinching tenants during leaner times.

Duke Realty Corp., an Indianapolis-based real-estate company, just completed what it believes will be one of the biggest "speculative" distribution buildings in Texas, or one built without tenants in hand. The roughly 1.1 million-square-foot Grand Lakes II building in Grand Prairie, near Arlington, contains about 24 acres of space. Jeff Thornton, senior vice president of Duke's Dallas operations, is confident he can get the property leased, though he acknowledged that the decision to build it was made before the credit crunch in August. If the market softens, will Duke continue building "spec" space? "We're probably not going to turn off the speculative machine, but we'll reign it in," Mr. Thornton says.