VACANCIES SHRINK, RENTS EXPAND IN OAHU'S INDUSTRIAL MARKET

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Looking back on an industrial article published by Colliers in April 2013, it was evident this market had almost completely left the recession behind, showing many signs of economic and industrial strength. Oahu's 39-million-square-foot industrial market posted a declining 3.75 percent vacancy rate, and a $0.96 per-square-foot monthly triple-net asking rate. This was the tightest and highest in the country.

Moving forward through the first half of 2014, tourism numbers are at an all-time high and military spending is solid (our two biggest drivers). A historic residential condo boom left Hawaii unable to keep up with housing demand, while large-scale roadway and sewer infrastructure improvements were underway. The market also experienced the loss of 1 million square feet of industrial product owned by the State of Hawaii due to harbor expansion, while the start of a $5-billion light rail system shows there is a lot to be excited about.

Adding to that is Hawaii's general economic recovery and resulting business confidence, which has pushed our industrial vacancy rate down to 2.59 percent. Asking triple-net monthly rental rate averages hover at $1.08 per square foot, almost a 10 percent increase over 14 months.

The rising cost of raw materials and the aforementioned economic factors have resulted in a 40 percent increase in construction costs over the past four years. Industrial land costs start at $25 per square foot, rising to more than $125 per square foot, and creating an environment where spec building makes little economic sense. When we say "little," we mean little. There have only been two, 20,000-square-foot buildings built by contractors in the first half of this year.

The one release valve on the horizon is the upcoming availability of raw land on Kapolei in Honolulu. A partnership between a local developer and a Chicago venture fund has acquired almost 177 acres of industrial land at a bulk cost of more than $80 million. This much-needed industrial inventory will give owner-users the opportunity to control their own destinies and build facilities that will position themselves through the next market cycles. Horizontal infrastructure construction will commence this fall. The first phase, which will consist of 18 finished lots ranging in sizes from one to five acres, will be delivered in summer 2015.

Going forward, Colliers projects the industrial vacancy rate on Oahu to continue to decline to less than 2 percent. Meanwhile, industrial rental rate averages are expected to grow at a yearly pace of around 10 percent over the next two to three years.

THE MORE THINGS CHANGE, THE MORE THEY STAY THE SAME IN HONOLULU

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The recent expansion of healthcare- and construction-related businesses in Honolulu may lead some to believe there's a little shape shifting going on in the city's commercial real estate landscape. This assumption is particularly understandable when you factor in the start of a fixed rail project and the residential development frenzy in the Kakaako area next to Downtown Honolulu.

Those of you who think this, however, should think again. Honolulu is still very much a tenant's market. The competition among landlords for credit tenants within the central business district has continued unabated since this time last year. There has been no appreciable increase in base rents, free rent, tenant improvement allowances or moving allowances year over year. Compounding this lassitude is the relocation of government agencies from privately held properties to government-owned buildings, not to mention the continual trend of "right sizing."

Class A vacancy rests at 13.8 percent in the Honolulu CBD. This is down a virtually nonexistent 0.2 percent since mid-July 2012. The Kapiolani corridor and Waikiki are showing higher than normal vacancies. Kapiolani's rate sits at 20.2 percent, due primarily to the relocation of the National Oceanic and Atmospheric Agency, which vacated a 70,000-square-foot space at the 1601 Kapiolani Building, as well as a few other companies that have downsized their spaces. Waikiki sits at 6.5 percent vacancy, largely due to a massive block of space at Waikiki Trade Center that was taken off the market while the building owner considers repositioning the property.

There's currently little discrepancy in pricing between the best and worst space in the CBD with respect to rent and concessions. This could signal a slower than projected lease up. It may even lead to a "silver bullet tenant," which could require massive concessions.

Some areas of Honolulu show stronger vital signs than others. A potential new medical office development by Glimcher in the supply constrained medical office building market of Pearlridge-Aiea could add about 125,000 square feet to 150,000 square feet of new space.

New owners have generally discovered that pricing returns for office property investments in Hawaii have followed national trends. A few of the notable leases this year include: the leasehold interest in the 185,000-square-foot Ocean View & Haseko Centers acquired by Atalanta; the mostly vacant, 90,000-square-foot, fee-simple interest in One South King that a local investor purchased for less than $100 per square foot; and the Clifford Center, which is currently under contract with a West Coast investor.

Right-sizing remains with us almost as part of the corporate culture. Right-sizing began in earnest as a response to the Great Recession, the need for a more efficient use of space, and a push by national and local entities toward collaborative space. There is a caveat, however. The economic benefits of a smaller footprint may be immediate, but they come at the risk of being unable to adapt or expand in anticipation of the next economic upswing. There are also effects on corporate culture that are difficult to quantify, specifically the risk of creating a fragmented organization if employees are forced to work at home or simply feel more comfortable doing so. It may take at least a market cycle for these narratives to play out.