

MANSFIELD COMMERCIAL REAL ESTATE

Overview of the Commercial Real Estate Market in Orange County, NY at Year-End 2015

By Elisabeth Mansfield
Mansfield Commercial Real Estate

The Industrial Market in 2015

With no significant speculative construction for the past ten years, the vacancy rate for prime industrial space in Orange County, NY has been reduced to an all-time low of 3.3%. Although the inventory of existing buildings was severely limited, the availability of shovel ready sites enabled companies seeking space to build what they need. At year-end 2015, nearly 1,000,000 square feet of build-to-suit industrial space was either under construction or nearing final approval and expected to break ground soon thereafter. But the County needs more speculative industrial development and one developer has stepped up to build the first significant amount of it in a decade. In conjunction with the 317,000 square foot distribution center that they are building in the Town of Newburgh for pharmaceutical provider AmerisourceBergen, Matrix Development Group will construct an additional 248,000 square feet of sorely needed spec industrial space, expected to come on-line in early 2017.

The total inventory of prime industrial space at year-end 2015 increased slightly to 21.0 million square feet, with only 31,000 square feet of new space added to inventory. Among the three new buildings to be constructed: Angry Orchards, a division of Boston Beer Company, constructed a new 15,000 square foot Innovation Cider House for research and development; Lynn Warren Landscaping constructed 4,000 square feet for its own use; and a 3,600 square foot spec building was constructed in the Town of Goshen. There were also expansions of two existing buildings: BYK USA added 5,100 square feet to their facility in Chester Industrial Park; and Pavestone added 3,100 square feet in the Town of Montgomery.

Several new build-to-suit projects were announced in 2015: pharmaceutical giant McKesson commenced construction on a 340,000 square foot distribution center at the shovel ready corporate park known as Hudson Valley Crossing in Hamptonburgh. Completing the planned development there will be PharmaCann, one of New York State's approved medical marijuana growers, which has begun construction on their complex that will include a 26,000 square foot research, development and processing facility, in addition to two 47,500 square foot grow houses. In the Town of Montgomery, FedEx Ground also announced plans to construct a 250,000 square foot distribution center on Neelytown Road, adjacent to the existing FedEx Freight facility.

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Phone: (845) 294-1000 Fax: (845) 294-1070 www.mansfieldcommercial.com e-mail: info@mansfieldcommercial.com

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Other projects that commenced construction in 2015 and were nearing completion at year-end include a 40,000 square foot distribution facility for Old Dominion Freight Lines on Ballard Road; Piller's new 24,000 square foot facility on Wes Warren Drive; and Monroe Cable's 40,000 square foot expansion, all in the Town of Wallkill. Steris commenced construction on their 71,000 square foot building in Chester Industrial Park, with an expected completion of August 2016. And there were two spec buildings under construction as of year-end. In the Town of Goshen, a 40,000 square foot flex building is expected to be ready in early 2016, with additional development planned on the site. In the Town of Chester, construction resumed on a 58,000 square foot building, originally started over 25 years ago as a fitness center; the new owner has amended the use to industrial, partially completed it, and is seeking the end user before finishing it.

Two other previously announced projects were still in the works as of year-end 2015. In the Town of Goshen, Amy's Kitchen continued to seek approvals for a 350,000 square foot facility to manufacture frozen organic and vegetarian meals; and in the Village of Goshen, Kikkerfrosch Brewery was finalizing approvals and preparing to commence construction on their 100,000 square foot facility (to be constructed in two stages) to manufacture German-style lager beer. Continually an integral part of economic development, the County seeks to improve and provide the necessary infrastructure to accommodate those businesses looking to create jobs; in the case of Amy's Kitchen, additional wastewater capacity will be required.

During 2015, under 600,000 square feet of space was absorbed in the County, with approximately 365,000 square feet being prime industrial space. This is a low amount, but given the shortage of available space, it is not unexpected. Approximately 60% of this prime activity was leasing transactions: King Zak reoccupied their 71,000 square foot facility on Dikeman Drive in the Village of Goshen after listing it for sale or lease in mid-2014; Temptations, a distributor of handcrafted kitchenware, leased 51,000 square feet on Ballard Road in the Town of Wallkill; and Revere Smelting & Refining leased 40,000 square feet on Wes Warren Drive in the Town of Wallkill; Elmira Distributing leased 16,500 square feet on Industrial Drive and Milmar Food Group leased 13,000 square feet on Turner Drive, both of these in the Town of Wallkill. On the purchase side, Fine Fixtures purchased 51,000 square feet on Wembly Road in New Windsor; Road Entertainment Inc. purchased a 27,000 square foot facility on North Plank Road in the Town of Newburgh; and Quinta Groupe purchased an 11,000 square foot warehouse facility on Elkay Drive in the Town of Chester.

Given the decline in available prime industrial space, and the increasing momentum in the market, there will be upward pressure on rental rates. As the new spec construction becomes available, lease rates are likely going to be higher than that for existing product.

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The total industrial inventory, including non-prime space, remained at 27.4 million square feet. With such a dearth of modern industrial product available, the older (non-prime) buildings continued to generate activity, with approximately 230,000 square feet being absorbed, pushing the vacancy rate down to 4.8%. Nearly two-thirds of this activity was absorbed through lease transactions, the largest of which was the lease by Michelson Studio II of a 60,000 square foot former rail car repair facility on Midland Avenue Extension in Middletown. Eric Michelson, who runs Michelson Studio I in Manhattan, is converting the building into one of New York State's largest movie and sound stage production facilities. In the City of Newburgh, indoor shrimp farm ECO Shrimp Garden leased 10,000 square feet on South William Street. In New Windsor, Onsite Wheel Repair leased 14,000 square feet on Ruscitti Road. For sales transactions of non-prime buildings, Royal Candle Holding LLC acquired a 20,500 square foot building on Route 17K in Montgomery. In the City of Newburgh, Grand Food Market purchased a 21,600 square foot warehouse on Overlook Place, Rockledge Herb Farm established a 13,000 square foot packaging plant on Deyo Place, and Benninger Landscaping purchased an 11,000 square foot building on Pierces Road. And certainly more good news for Newburgh is the burgeoning art community expanding in the City. The 55,000 square foot complex purchased by furniture maker Atlas Industries in 2012 is one of several older buildings that has become home to artists who have repurposed the space for their studios.

Another interesting project announced in 2015 is the City of Middletown's plan to revitalize the 232-acre former Middletown Psychiatric Center complex which was abandoned by the state nearly ten years ago. While in the early stages, this large tract of land will reportedly offer some industrial/flex sites with all utilities – something the County clearly needs.

Prior to the recession, the County had shovel ready sites able to provide over 2,000,000 square feet of industrial space. Now only a few sites remain; most are now either developed or have deals pending. Speculative industrial development is starting to pick up again and it is anticipated that this new space will be absorbed quickly. The next step is for developers, municipalities, and the County to work together to commence the generic approval process on the remaining tracts of appropriately-zoned land in preparation for the inevitable demand that Orange County will continue to generate.

The Office Market in 2015

The Orange County, NY office market recovery continues to be slow, not unlike most of the Northeast. The vacancy rate for Class A office space at year-end 2015 was 9.5%, indicating only minimal improvement. Medical space, which over the last ten years accounts for over 55% of all new office construction in the County, continues to dominate.

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Two office buildings totaling approximately 90,000 square feet were built-to-suit in 2015, bringing the Class A office inventory in the County to 4.5 million square feet. In July, Crystal Run Healthcare opened its state-of-the-art 66,000 square foot medical facility in the Town of Newburgh. As the largest private healthcare provider in the County, nearly half of all medical office space constructed here over the last ten years has been for Crystal Run Healthcare. And in 2015 they commenced construction on another 70,000 square foot medical office building in the Village of Monroe with an expected completion of Summer 2016. The other office building to come on line in 2015 was the 24,000 square foot office on Avenue of the Americas in New Windsor constructed for the Federal Bureau of Investigation.

Construction commenced on two other medical office buildings in 2015. Orange Regional Medical Center is constructing a five-story 153,000 square foot building on its Town of Wallkill hospital campus that will include outpatient surgical rooms, a pharmacy, and a cardiac rehabilitation center. Also on the hospital campus will be a 26,000 square foot state-of-the-art cancer center. Both are expected to be ready during the Fall of 2016. ORMC will then relocate from some of its leased space at The Orange Regional Medical Pavilion at 75 Crystal Run Road, creating an opportunity for other tenants seeking medical, surgical or administrative space along this desirable medical office corridor in the Town of Wallkill.

The Orange County medical office market has seen a consolidation of its medical tenants over the past few years. There are few sole practitioners remaining; most have joined up with larger medical groups. Crystal Run Healthcare's approach has been to establish larger facilities in the "primary" markets of Middletown, Newburgh, and now Monroe. Other medical groups such as Horizon Family Medical, Middletown Medical and Greater Hudson Valley Health System have opted to open facilities in local communities and retail centers. With this consolidation, there are now fewer medical tenants seeking space, but the competition among these practices has kept the medical office market active.

And there has been further consolidation with medical practices and hospitals in the County merging with medical players from New York City. Crystal Run Healthcare is now collaborating with Mount Sinai Hospital in Manhattan. St. Luke's Cornwall Hospital announced it will partner with Bronx-based Montefiore Health System. And Westchester Medical Center has entered a joint venture with Bon Secours Health Systems which operates two Orange County hospitals: St. Anthony's Community Hospital in Warwick and Bon Secours Community Hospital in Port Jervis. How these affiliations will affect the Orange County office market going forward remains to be seen.

There has been no speculative development of Class A office space in recent years. With landlords of existing buildings willing to offer significant concessions to attract and retain tenants, the higher rent required for new construction is not justified by most office users. One building constructed on spec in 2009 in the Town of Newburgh is still awaiting its first

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tenant. However, the last office building in the County to be constructed on spec has signed a lease for one-third of the space with dentists Masci & Hale. This Montgomery building had been vacant for two years.

A total of 220,000 square feet of office space was absorbed in 2015, and over 90% of it was in Class A buildings. Lease transactions made up over 60% of this Class A activity and the largest transaction was the FBI's lease of the 24,000 square foot building constructed-to-suit in New Windsor. In the Town of Wallkill, Northern Leasing Systems took 10,000 square feet on East Main Street. In the Village of Goshen, Catholic Charities Community Services leased 10,000 square feet in the building vacated by the FBI, and the County of Orange leased additional space on Matthews Street. Abbott House leased 9,200 square feet at New Windsor Business Park, and Maser Engineering leased 3,600 square feet at 555 Hudson Valley Avenue, both in New Windsor. In the Town of Wallkill, PathStone leased 8,000 square feet on Industrial Drive, and Time Warner Cable leased 6,800 square feet at 90 Crystal Run Road.

The total inventory of office space in Orange County at year-end 2015, including non-Class A space, was 5.9 million square feet, and the vacancy rate for this space was 10.5%. Some landlords of Class A space, motivated by their high vacancy rates, have offered incentives that have allowed many tenants to upgrade from non-Class A space. Rental rates for Class A office space have not changed much over the last ten years, ranging from \$12 to \$15 per square foot, triple net, with the lower range for larger tenants and the higher range for smaller tenants. Medical space continues to command higher rents given the more substantial tenant improvements required.

The Orange County, NY office market is and has always been a diversified but relatively small market with mostly localized demand. It is not a major headquarters location, nor is it a sought-after spot for large tenants in the financial sector. As such, growth will continue to be internal and healthcare will likely continue to lead the way.

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