INDUSTRIAL SUPPLEMENT:

Revisiting the SIOR/LightBox Industrial Sentiment Report

COVID-19: Shifting Industrial Sentiment at Mid-Year 2020

In light of COVID-19, LightBox reached out to industry sources, many of whom were quoted in the third annual ***LightBox-SIOR Industrial Investor Sentiment Report*** in Fall 2019. Their current perspectives shape a narrative about resiliency and long-term growth.

"Clearly, no commercial real estate asset class is immune to the immediate and long-term impact of COVID-19, a black swan event unlike anything anyone has experienced," says Tina Lichens, SVP, Broker Operations, LightBox. "Industrial real estate, however, is in the best position to return to a place of strength once we get past the short-term pain and uncertainty."

Approaching mid-year 2020, the industrial sector is seeing mixed activity across the U.S. as rapid growth in online grocery shopping pushes against various state lock down measures and periods of supply chain disruption. Some construction is still progressing while new speculative developments are pushed out into the future. Amidst continued uncertainty, this sector is showing its tenacity and ability to support many facets of consumer spending. Overall, the sector has fewer long-term question marks and is emerging as the top choice for investors as they focus on deal flow in the next few quarters.

> *"The good news is that the industrial markets were very healthy going into this crisis. Some markets were overheating, but we saw the highest overall rental rates in the country and the highest occupancy rates in history for the industrial sector."*
>
> Mark J. Duclos, SIOR 2020 President, CRE, President, Sentry Commercial

Advantages and Disadvantages

COVID-19 has dealt a harsh blow to many business sectors, while others, such as ecommerce, grocery and construction related businesses, have benefited from a sizable upswing in volume.

In-Demand Sectors

Construction equipment, materials
Ecommerce
Grocery store logistics and delivery
Medical supplies
Pharmaceuticals

Heavily-Impacted Sectors

Aerospace
Automotive
Gaming
Oil and Gas
Restaurant food providers

"Despite the severity of the current situation, there are bright spots and we will see a bounce back", says Geoffrey Kasselman, SIOR, LEED AP, Senior Vice President and Partner, Workplace Strategy at CRG. "It will trickle to a stream and then return to a river over a graduated period of time. Consumer spending is 70% of our GDP so the big question is when will consumer confidence and consumer spending come back?"

By the Numbers: Temporary Fundamental Shifts

At mid-year, data from CBRE found that there are positive benchmarks and projections for the industry as brokers, owners, and investors look toward increased activity levels by year-end.

- 16 of the top 2 construction markets still have active crews on site
- New project starts were paused as of mid-May in many markets amidst the uncertainty.
- Near record vacancy rates (4.5%) will likely increase in the near term as deliveries will outpace leasing; then pent up demand is expected to return rates to pre-pandemic levels.
- Rental rate growth, up 4.8% year-over-year, likely will flatten for a period of time before returning to that level toward year end.

Jack Fraker, SIOR, Vice Chairman and Managing Director, Capital Markets at CBRE expects industrial rents and sales pricing to increase about 5% nationally after the market stabilizes. Geographic projections on increases include: Top West Coast markets (Los Angeles and Inland Empire, for example) and New York/New Jersey, 7%; Chicago, Dallas and Atlanta, 5-7%. Strong secondary markets, including Charlotte, Nashville, Indianapolis and Columbus will see 3-5% increases.

Spotlight: Last Mile Rent Boost

Growth in last mile delivery in recent years has spurred demand for core infill developments in high population centers across the U.S. With the onset of COVID-19, this focus on movement of goods from transportation hubs to the final consumer destination has become more intense. Will this activity push rents higher in those coveted locations? The early answer is yes; the long-term outlook is evolving.

A May review of asking rental rates in several markets shows the differential in last mile versus outside the city core as most notable in Chicago, Nashville and New Jersey, where rents were 20 to 40 percent higher for many properties. Other cities reviewed had the following differentials Los Angeles, 14.6%, Atlanta, 12.5%, and Inland Empire, 7.5%, according to Avison Young research. While the definition of "last mile" varies widely and shifts with market dynamics, the industry is closely watching the performance of facilities that provide the "last touch" before reaching the consumer's doorstep. Amazon has 208 last mile delivery stations in the U.S. totaling 18.7 million square feet, for example, with nearly 100 others planned.

> *"There is a significant rent differential in some last mile locations across the country and we see this continuing at varying levels as consumer demand and market conditions dictate. Investors are continuing to focus on close in locations that provide growth potential due to their proximity to large population centers."*
>
> Erik Foster, Principal and Head of Industrial Capital Markets for Avison Young

Top 5 Trends to Watch

Doubling of Online Food and Grocery Volume — as consumer demand increases and more consumers adopt online shopping habits. It is estimated that food delivery doubled from 20 million households in February 2020 to 40 million in March, and 40% of those consumers were first time online shoppers who will likely continue to order online. This could lead to a 75 to 100 million-square-foot increase in demand for freezer cooler space over the next five years, according CBRE.

Increased leasing for "Insurance" Warehouse Space — to boost close in inventories. "We're hearing about industrial businesses starting to stockpile inventory to guard against future supply chain disruption," says Duclos. "In the near term, the net effect is that it will increase demand for industrial space." According to CBRE research, this could increase demand for warehouse space by 5% — or 500 to 700 million square feet over the next five years.

Expansion of Onshoring — as concerns over supply chain disruption shape leasing decisions. "Each CEO and CFO of a company whose operations are deeply rooted within the supply chain is taking a risk management mindset, looking at what level of 'insurance' is needed," says Anthony J. Lydon, CDCMP, National Director, JLL in Phoenix. "Companies will still source materials from outside of the U.S., but many are looking to set-up back-up operations here."

Top 5 Trends to Watch cont'd

Increased Demand for Data Centers — as remote working continues. There is a notable shortage of mission critical space and companies need extra bandwidth and data throughput, along with backup storage, to support operations during shelter-in-place directives. "With everyone working remotely, many companies didn't initially have enough infrastructure to operate, which has unmasked notable capacity shortages in the data center market," says Kasselman.

Return to Core Markets for Investors — as investors seek the stability and predictability of markets such as New York/New Jersey, the Inland Empire, Dallas and Chicago.

Conclusion

At mid-year, the industrial sector has shown its ability to shift and turn with surges in online grocery shopping and supply chain disruption. Many brokers are reporting pent up demand from investors as they look at long-term options for growth. There is an overall optimism that could turn into a rush to market by year-end.

"We are already starting to see tremendous pent up investor demand in the industrial sector," says Fraker. "We expect that to lead to a strong second half of the year and into 2021."

Comments for this Report were Provided by:

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ABOUT THIS REPORT

LightBox regularly surveys industry professionals to understand trends in the current commercial real estate market. The Industrial Sentiment Report was released in October 2019. The sentiments outlined in the original report were revisited to understand how the COVID-19 pandemic was impacting the Industrial Real Estate Sector. Download the Fall 2019 Industrial Sentiment Report ***here***.

ABOUT SIOR

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ABOUT LIGHTBOX

Through the delivery of market-leading workflow, data and GIS capabilities, LightBox enables the success of over 100,000 CRE brokers and investors, 1,100 banks and lenders, 2,000 appraisal firms, 5,000 environmental consulting and engineering firms as well as thousands of home builders, land developers, government agencies, and energy companies. Visit us at ***https://www.lightboxre.com.***