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2020 FORECAST: OFFICE & INDUSTRIAL MARKETS WILL REMAIN SUNNY

By Michael Hoban

As 2020 approaches, the forecast for the U.S. office and industrial markets calls for continued sunny skies, although a few minor storm clouds may be forming on the horizon. That was the consensus of market professionals assembled at the 2019 SIOR Fall World Conference held in Portland, Ore. in mid-October.

Driven in part by the growth of e-commerce, the industrial sector continues to outperform all other real estate assets. Rents are still rising, national vacancy rates remain low and investment capital continues to flow to the asset class, as evidenced by Prologis' $12.6 billion acquisition of Liberty Property Trust's 107 million square foot portfolio in late October. And following a slight slowdown at the beginning of 2019, the office market has rebounded and is expected to continue to perform well into 2020, although there are some concerns in the major markets regarding the troubles being experienced by WeWork.

Industrial Market

Brad Pope, SIOR, senior vice president with JLL Atlanta and SIOR Industrial Member Group Chair, says that the overall sentiment of his constituency is overwhelmingly positive, as more than half of the members reported an increase in net absorption year-over-year in their respective markets. In addition, the investment market appears to be as strong as it has ever been. "There continues to be downward pressure on cap rates, because there's not a lot of inventory to purchase, so there's a lot of dollars chasing fewer deals," says Pope. "And while interest rates have gone down, the 10 year treasuries have gone down so much (1.75% versus nearly 3.25% at this time last year) that the spread between the 10-year treasuries and cap rates is probably wider than last year, so cap rates can further compress."

The number one concern for industrial brokers is the skilled labor shortage in the warehouse and logistics sectors. "In literally every market that we spoke to, labor was a major concern," says Pope. The issue is especially acute for users with an e-commerce component, which typically requires more workers than other industrial users. And while automation will eventually reduce the number of workers needed to operate a facility, "it really hasn't offset the labor shortage in any meaningful way," Pope says.

Tariffs and their impact on the industrial sector were also a hot topic at the conference, but according to brokers, they have not translated into an interruption to deal flow—save for some anecdotal accounts from the West Coast major port markets.

Office Market

Like the industrial sector, office brokers in virtually all markets report continued strong leasing activity and low vacancy rates. Demand for space in amenity-rich

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walkable environments in both the urban and suburban markets "is still the end-all, be-all for office leasing," reports Tim Kerrigan, SIOR principal and vice president for Investors Realty in Omaha, Neb. and SIOR Office Member Group Chair. And landlords with properties that don't meet that standard—particularly suburban Class B properties in some markets—are now struggling to fill space. "It doesn't matter how cheap it is," says Kerrigan. "Attraction and retention of employees is so critical for companies now because the cost of human capital is so much more significant than the cost of the rent, so some spaces are practically obsolete in today's market."

There also appears to be an increase in sublease activity—often a harbinger of an economy that is slowing. "I don't want to sound any alarms, but we're seeing some sublease space in the secondary and tertiary markets—and we haven't seen that in a long time," says Kerrigan.

Despite the potential blips, as well as the ongoing saga with WeWork in the major markets, consensus among the SIOR office brokers is that office investment and leasing momentum will continue to be strong in 2020. ∇