E-COMMERCE PROPELS INDUSTRIAL GROWTH AS HEADWINDS BEGIN EMERGING

By Michael Millar

When will the music stop in commercial real estate? It's a question on the minds of some commercial real estate professionals right now.

In the Third Annual Industrial Investor Sentiment Report, produced by Real Capital Markets (RCM) in partnership with the Society of Industrial and Office Realtors (SIOR), Jojo Yap, chief investment officer of First Industrial Realty Trust, Inc., notes "I am often asked 'When will the music stop?' I don't know, and I don't think anyone does. No one really knows the maximum potential of e-commerce. No one could have predicted the impact that e-commerce would bring to the supply chain, our industry, and the global economy."

In spite of Yap's tenure and success in the industry, he readily admits to "not knowing when the music will stop" or being able to predict the magnitude of the impact e-commerce would have/is having on industrial real estate. While 10 or more years ago, predicting the impact of e-commerce was daunting at best, participants in the 2019 RCM-SIOR Investor Sentiment Report fully acknowledge its impact now and moving forward. According to survey results, 57% of participants say that continued expansion along with the need for corporate supply chain realignment will help to propel activity in 2020.

"The significant expansion in e-commerce and the ongoing need for realignment of the corporate supply chain continues to shape the industrial sector and helps position it as a top asset class for investors, now and moving forward," says Tina Lichens, COO, Real Capital Markets. "There is also a significant push to tap into consumers in large, urban population pools, which is driving considerable warehouse and distribution activity."

Moreover, industry estimates suggest that e-commerce reflects approximately 10% to 11% of the economy, with the potential to grow to as much as 20% or higher. There are also statistics that suggest for every $1 billion increase in e-commerce spending, an additional 1.25 million square feet of warehouse and distribution space is needed. According to many, there is nothing that points to e-commerce growth being flat or even negative, which is good news for the industrial real estate community.

In pairing the truly global nature of e-commerce as well as locally-specific nature of real estate, 2020 SIOR Global President, Mark J. Duclos, SIOR, president of Sentry Commercial, says "E-commerce has brought a globalized focus to this sector—and may be a constant thread across the country—but the majority of markets also are driven by the local market users' needs and economic considerations."

In the eyes of most, this bodes well for the industrial real estate marketplace—for development, leasing, and acquisitions. At the same time, there are headwinds that are giving many reason to take pause and consider what lies ahead.

SIOR Immediate Past Presidet, Robert Thornburgh, SIOR, regional president of Kidder Matthews, suggested that the long-term view will remain strong. "As we look ahead and evaluate a softening in the market, we can still expect strong demand to continue for the foreseeable future. Further down the road, the corresponding rise in values, construction, labor and talks of a recession—while not new topics—could clearly develop into sizable headwinds."

Anthony Lydon, CSCMP, national director of JLL, agrees with the general assessment that the state of the industrial marketplace is a bit of a mixed bag, but nothing truly surprising. "We see continued growth, but at a slower pace compared to the past 24 months," he said.

According to the RCM-SIOR Report, investor sentiment on pricing levels is also strong, as it has been for the last three years of the report. In 2019, 94% of survey respondents believe that pricing levels will at least remain the same, comparable to the last two years. However, 59% believe that prices will go even higher, by as much or more than 5%. This level of optimism is down from 68% one year ago.

Participants are also increasingly bullish about the prospects for further cap rate compression. And the bullishness is significant—a level of nearly two to one. In 2017 and 2018, the prognosis for cap rate compression ranged from 17% to 18%. Today, in 2019, nearly 32% believe further compression is likely in the next 12 to 18 months.

There are headwinds, however, as commercial real estate investors, brokers, and owners adapt to the threat of ongoing U.S. trade wars and signs, in general, of a slowing economy. Industry experts also continue to be mindful of the global economic and political concerns of an economic slowdown.

The outcome of this is that investors are looking even more strategically at the markets they target and the assets they consider. Some are focusing on land constrained markets as a way to best position themselves for rental growth. Some are retreating to core markets and core assets. Still others are looking to capitalize on the potential for additional cap rate compression in secondary markets.

While there are definite shifts in the market heading toward 2020, the tone remains one of optimism, according to investors and brokerage professionals surveyed and interviewed for the RCM-SIOR Industrial Sentiment Report. This positive outlook is largely due to market fundamentals, long-range corporate growth projections, and the many ways e-commerce is transforming the economy. Further, while the commercial real estate industry often focuses on cycles, the consensus among many experts is that the industrial sector is moving on its own trajectory—and not following a traditional cycle.

“The industrial property investment market has been so good for so long which could lead some to believe that conditions are too good to be true, and change may be on the horizon,” said Steve Shanahan, executive vice president of RCM. “Yet at the same time, the basic fundamentals and the capital ready to be deployed points to a solid, long-term outlook.” ▽

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