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Avison Young U.S. Industrial Market Report

Spring 2020

"Consensus is uniform on this point… industrial real estate will be the most desired asset class by property investors in 2020-2021. The quarantine of millions of Americans proved that online shopping needs to be expanded, resulting in more logistics facilities."

- Christopher J. Skibinski, SIOR, Principal
Managing Director

U.S. Economic Overview

On the heels of the longest economic expansion in history, the U.S. was not immune to the economic impacts of a global pandemic.

As spring emerged in the U.S., early impacts of COVID-19 were far reaching, with disruption to some degree affecting every corner of the U.S. economy. Over 30 million Americans have filed for unemployment since the coronavirus pandemic began to shutter businesses across the country in mid-March. The number of claims imply a jobless rate of around 22%, the highest since the Great Depression in the 1930s. That's also far above the peak of 10% reached during the 2009 financial crisis and most recent recession.

U.S. gross domestic product turned negative for the first time since 2014 in the first three months of the year as the pandemic broadened and began to spread across the country in March. Output came to a near standstill and drove a deep contraction in consumer spending. The U.S. economy shrank a reported 4.8% vs. the revised estimate of -4.0%, and the +2.1% forecasted in Q4 2019.

The Federal Reserve took the emergency step of cutting U.S. interest rates by half a percentage point in early March, an attempt that they hope would limit the economic and financial fallout from COVID-19. In April, the Fed made a pledge to hold rates between 0.25 and zero and keep them there until full employment returns and inflation gets back to around the Fed's long-stated 2% goal.

It is likely the U.S. will continue to see a contraction of economic activity through the second quarter, but as the economy and states begin to open, expect some signs of recovery to begin. According to estimates released by The Conference Board, the economy will see a slow recovery in the second half of the year with June economic output returning to 87% of what it was in December 2019 and 96% by December 2020, estimating total GDP for 2020 will contract by -7.2%.

U.S. Industrial Overview

Lasting demand sparks tight conditions, investor appetite for U.S. industrial

The U.S. industrial market continued to record exponential supply growth over the year as it struggled to keep pace with the growing demand for modernized facilities from industrial users. Last-mile logistics have been fueling more adaptive reuse projects and urban-centric industrial leasing patterns. E-commerce companies are driving demand for build-to-suit distribution centers that are fully automated and create increased supply-chain efficiencies. In land-constrained metros, the redevelopment of obsolete assets like vacant big-box retail stores and aged office buildings continue to be a trend that caters to demand for urban warehousing and distribution locations.

The vacancy rate within the U.S. industrial market remained relatively unchanged year-over-year as it stood at 5.2% at the close of Q1, compared to 5.0% one year earlier. Despite strong leasing and market indicators, the lack of vacant and available space in the market limits the opportunity for growth, and as a result, net absorption was down from 195 million square feet (msf) the year prior to 168 msf during the most recent 12-month period. Despite the slowing pace of absorption, nearly all industrial markets remain significantly supply-constrained, and all U.S. markets monitored by Avison Young reported single-digit vacancy rates.

With a growing construction pipeline of 330 msf, and only 30% of it preleased, vacancy could tick upward slightly in the coming months. Many U.S. cities watched as construction came to a standstill at the close of the first quarter, as safety measures aimed to limit the spread of COVID-19 required non-essential businesses to shut down. For those which remained open, new challenges presented themselves and slowed progress on site. Supply chain delays make it difficult to get materials needed and heightened security measures limit the number of workers allowed on site. As construction delays persist this will further limit supply and push out delivery dates adding to a supply demand imbalance in many markets as growth in online shopping and restructuring of supply chains could result in an increase in demand for new supply in many segments.

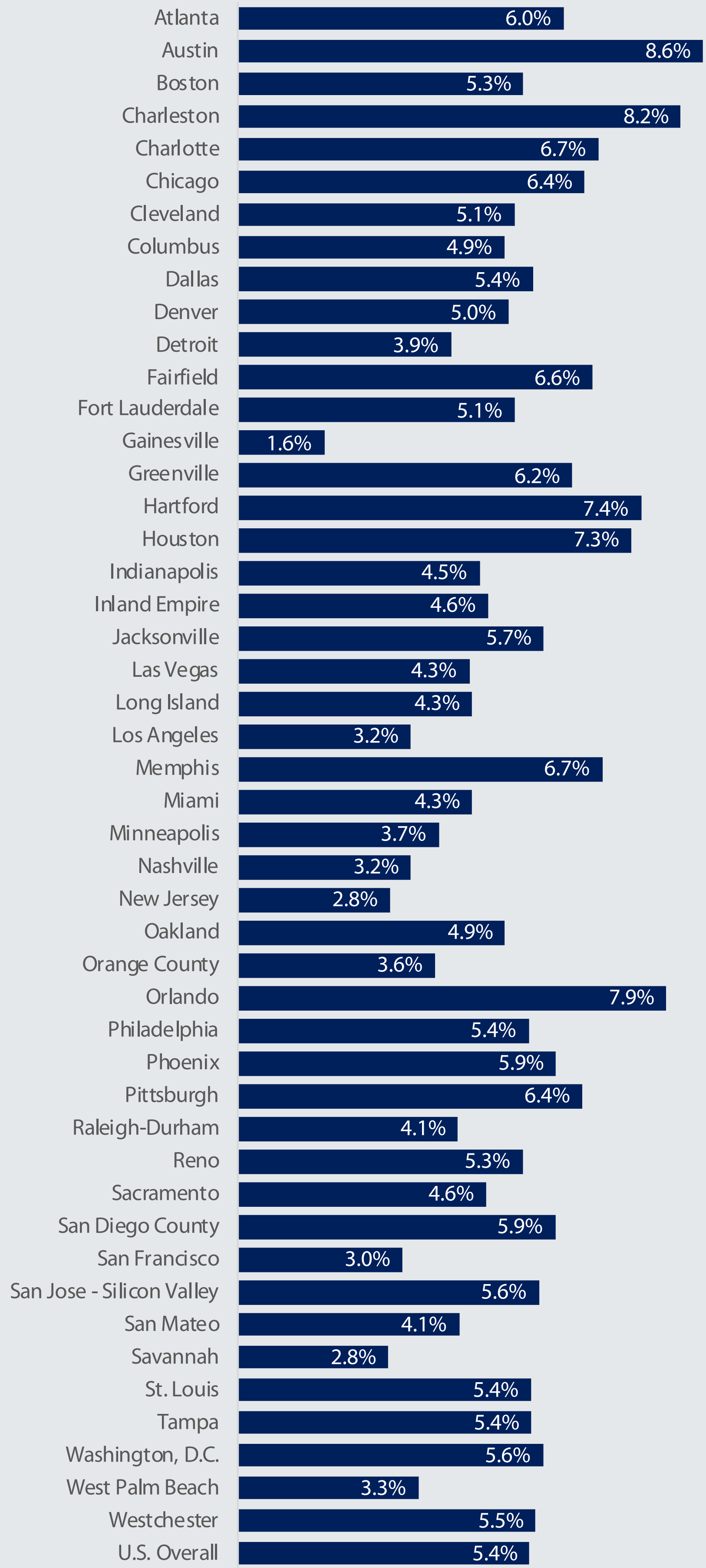
- Vacancy fell or remained flat in 19 of 41 industrial markets, and several secondary markets outperformed
- Six markets measured an increase of 50% or greater in total vacant space year-over-year
- Orlando and Jacksonville measured the steepest increase in vacancy at 261 and 245 basis point increases, respectively
- Savannah and Indianapolis measured the greatest declines in vacancy at -352 and -193 basis point decreases, respectively

539 MSF
Total Vacant Industrial Space

5.2%
Industrial Vacancy Rate

7.4%
Decline in total amount of vacant space year-over-year

Vacancy Rate By Market Q1 2020



Capital Markets

Historical deal volume softens

Investment volume within the U.S. industrial market climbed to $72.9 billion over the 12-month period ending at the close of the first quarter 2020, compared with $58.8 billion for the prior 12 months. Demand for product surged over the year as many new entrants were trying to get a foothold in the asset class. Of the markets tracked by Avison Young, ten measured investment volume over the most recent 12-month period of more than double that recorded in the year prior. Sale prices rose 13.1% year-over-year to an average $100 per square foot as more buyers entered the market and increased competition among buyers.

Moving into the remainder of the year, however, these trends are likely to shift as many investors take a "wait and see" approach as the impacts of COVID-19 become clearer. In the most recent 30-day period, some participants have pulled out of deals, while others extend due diligence periods and the number of closed deals plummeted in early spring. Buyer and seller expectations no longer align as buyers are looking for steep discounts in value that have not yet emerged, while sellers have not fully adjusted from pre-COVID pricing expectations.

As a result of the continued demand coming from e-commerce and increased pressure on supply chains, the industrial sector is well positioned to recover quickly once investors come off the bench as the U.S. begins to move into a post-COVID phase.

"Industrial is now firmly situated in the pole position amongst the four major asset classes for a post-COVID recovery because of solid fundamentals, plus the heightened space needs by the type of tenants that are flourishing today."

- Erik Foster, Principal
Head of Industrial Capital Markets

Strong demand bolsters volume and prices

Year-over-year industrial sales volume jumps 23%

$72.5
Billion

Average sale prices climb 17.9% year-over-year

$100
Price PSF

CAP rates remain tight as prices continue to climb

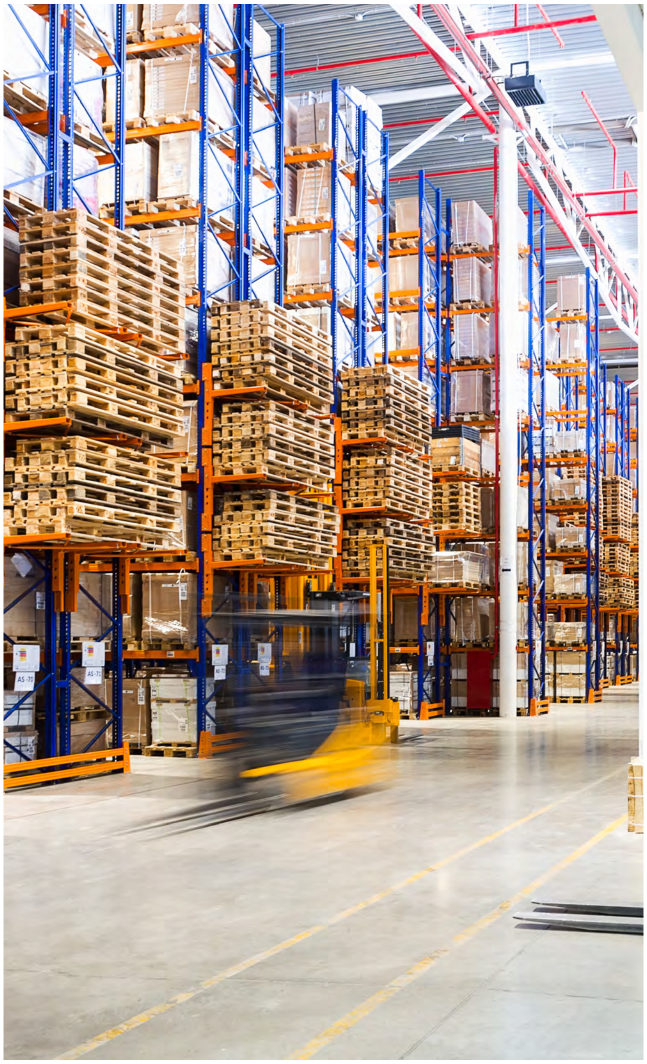
6.5%
Cap Rate

Logistics

Increased focus on supply chain efficiency

With marked declines in manufacturing, exports, and overall global commerce, transportation and logistics networks are being tested. All modes of transit have seen some impacts from COVID-19, showing up in softer volumes, reduced capacity needs and business. According to the National Retail Federation's Global Port Tracker, estimates show that imports at major U.S. retail container ports fell in March to the lowest level in five years. In February, imports were down 6.8% from the same time last year, and down 17% from January of this year. But that doesn't mean that importing and exporting have ceased completely.

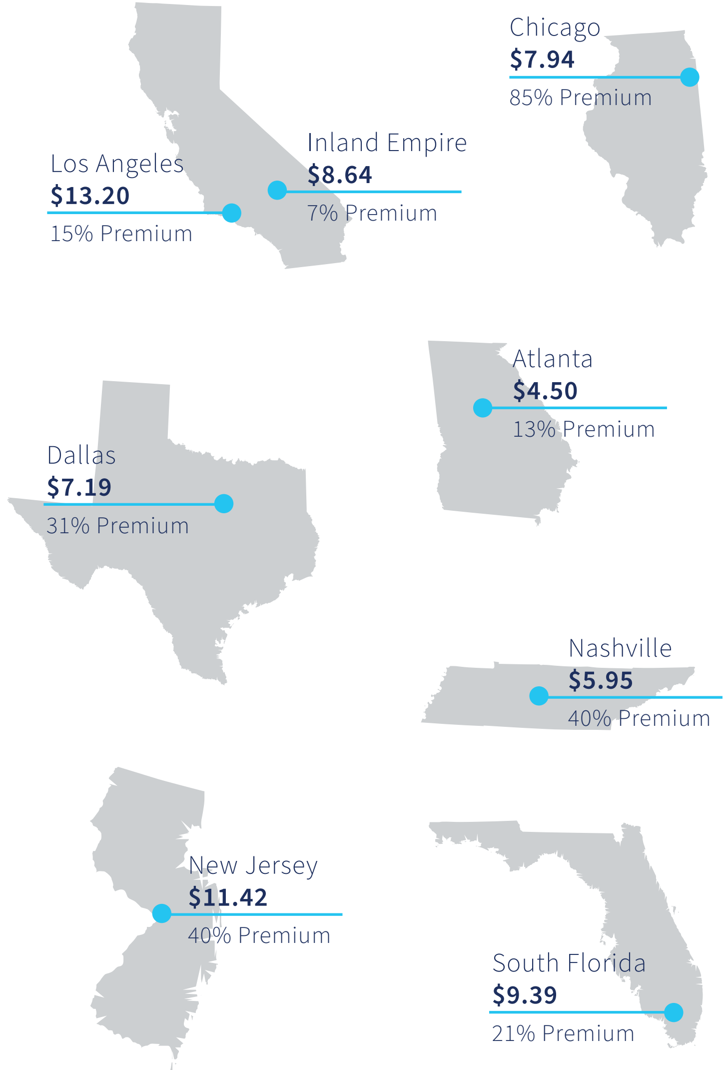
There is a rising trend of inland ports; one of the reasons these ports work is because of the efficiency of the operations. The sector is looking at bridging shorter and shorter distances. Inland ports become particularly viable if there is a natural anchor customer or if there is an anchor industry cluster. For East Coast harbors that can handle big ships, the expansion of the canal has changed the game. Now the majority of intermodal traffic is now coming through inland ports and reducing the amount of freight coming from the West Coast. That's also driving the volume of industrial development in terms of new warehouses and distribution centers in these inland markets, such as Savannah and Charleston. We expect that there will be continued investment in this infrastructure going forward, bringing increased demand for industrial space and jobs to these areas.



"Amazon is leasing distribution facilities in every primary and secondary market. We will see additional retailers follow suit and create competitive e-commerce facility networks."

- Christopher J. Skibinski, SIOR, Principal
Managing Director

Warehouse - Last Mile Distribution



Last mile distribution asking rates; select cities

Demand for warehouse and cross-dock projects were on the rise prior to COVID-19. This was driven, in part, by wholesalers moving to bridge the "last mile" with customers through fulfillment centers located in more densely populated areas. The evolution of "last mile" delivery in recent years has spurred demand for core infill developments in high population centers across the country. With the onset of COVID-19, the focus on the movement of goods from transportation hubs to the final consumer destination has intensified. The long-term outlook will evolve as the pandemic response continues, but early indicators point to increased premiums for these coveted locations. A survey of May asking rates within several last mile core city locations shows the differential is considerable in some markets (Chicago, 85%, Nashville, 40%, and New Jersey, 40.5%) and fair to strong in others (Los Angeles, 14.6%, Atlanta, 12.5%, and Inland Empire, 7.5%), when compared with locations outside the city core.

While the definition of "last mile" varies widely and shifts with market dynamics, the industry is closely watching the performance of these facilities that provide the "last touch" before reaching the consumer's doorstep. Companies such as Amazon, Walmart, and Target continue to drive demand signing notable deals throughout the country despite the onset of COVID-19. In January, Amazon leased 450,000 sf of warehouse in Staten Island next to their existing 850,000 sf fulfillment center. The e-commerce behemoth has also inked leases for another 2.5 msf across three warehouses in the Chicago area, a 1.0 msf warehouse near DFW International Airport, and more than 1.0 msf in the greater Bay Area, adding to its massive haul in recent months.

E-commerce sales accounted for 11% of all retail sales in 2019, according to the U.S. Census Bureau. This online shopping trend could double with the current pandemic, given the surge in usage from existing e-commerce shoppers and the many new users jumping onboard. During this time of grand supply chain disruptions and logistics pushing delivery times back weeks rather than days, it could be the "last mile" or "last touch" that helps bridge the gap.

Construction Pipeline

U.S. development pipeline remains robust

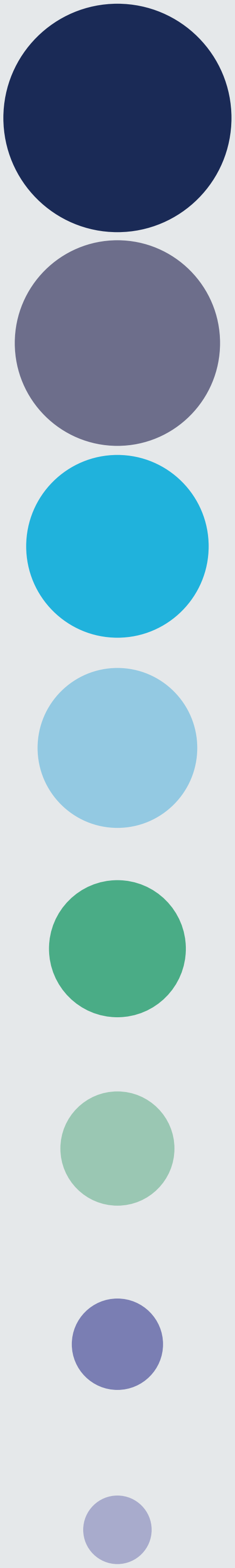
330 MSF

under construction up from 248msf one year ago

30.6%

preleased

Markets with largest pipeline



Dallas

36 msf under construction
67% preleased

Atlanta

22 msf under construction
42% preleased

Inland Empire

20 msf under construction
24% preleased

Houston

18 msf under construction
49% preleased

Chicago

16 msf under construction
15% preleased

Phoenix

15 msf under construction
38% preleased

New Jersey

12 msf under construction
37% preleased

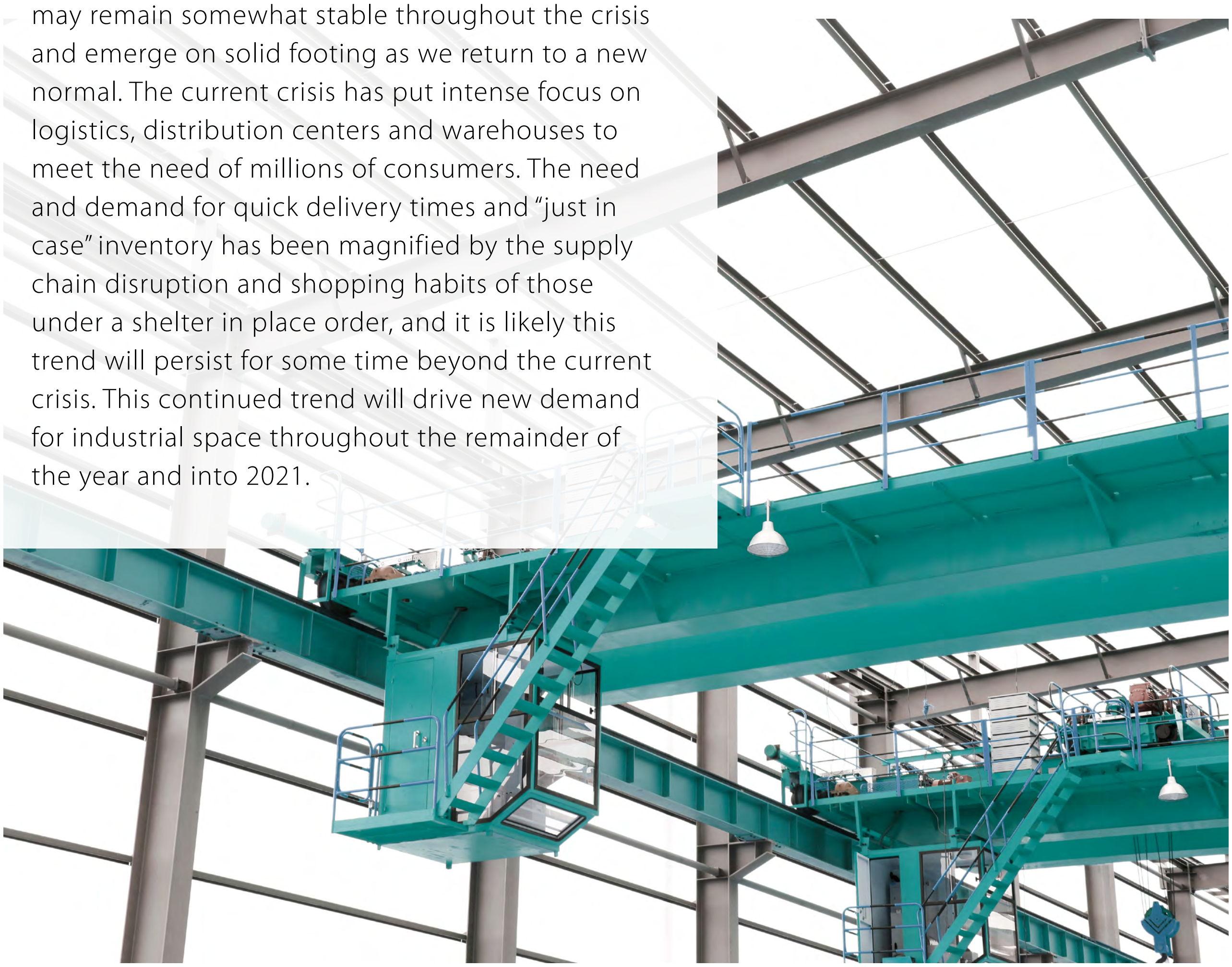
Memphis

10 msf under construction
80% preleased

Looking Forward

E-commerce to accelerate long-term growth and investment opportunities

The U.S. industrial market will likely see a pause in demand as concerns about the global economy amid the current COVID-19 pandemic point investors and tenants to the sideline for some time. However, demand for modern distribution space is likely to persist driven by the accelerated growth of e-commerce during the pandemic and the push for bringing much of the supply chain activity back to the U.S. While the near-term situation is uncertain, there are signals that indicate the market may remain somewhat stable throughout the crisis and emerge on solid footing as we return to a new normal. The current crisis has put intense focus on logistics, distribution centers and warehouses to meet the need of millions of consumers. The need and demand for quick delivery times and "just in case" inventory has been magnified by the supply chain disruption and shopping habits of those under a shelter in place order, and it is likely this trend will persist for some time beyond the current crisis. This continued trend will drive new demand for industrial space throughout the remainder of the year and into 2021.



> **“Given the positive fundamentals within the industrial sector despite impact of COVID-19, many investors are taking notice of the asset class. We anticipate that while some investors are waiting, many are taking serious focus on potential acquisitions opportunities. The price impairment of these assets as a result of COVID, is minimal, if at all in some cases.”**
>
> **- Erik Foster, Principal**
> ***Head of Industrial Capital Markets***

Trends to Watch 2020 and beyond

Increased Vacancy

With an abundant pipeline of new construction slated for completion in 2020 coupled with declines in leasing activity in the first half of the year, look for vacancy to trend upward in many U.S. markets. At the close of Q1, **Atlanta, Chicago, Dallas and Inland Empire** each had more then 10 msf of industrial space under construction and available for lease.

Declining Absorption

Twelve-month absorption totaled 168 msf, down 17% from the 203 msf recorded the year prior. With strong economic headwinds impacting the U.S., **a continued decline in the rate of absorption can be expected in the year to come.** Look for steep declines in less densely populated metros.

Investment Activity

Investors poured $72 billion into the U.S. industrial market during the year (up 23% year-over-year). Although investor activity slowed in the first half of 2020, **a quick recovery is expected** in the latter part of 2020 and early 2021 as market fundamentals within the sector remain relatively optimistic considering the economic climate.

Focus on "Nearshoring" and Supply Chains

As consumer expectations and needs shift as a result of COVID-19, business operations will too. **Logistics networks will focus more on integrating local and regional hubs**, rather than simply connecting efficiently to major ports that are the gateways from Asia.

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