NATIONAL REPORT
INDUSTRIAL

INSTITUTIONAL PROPERTY ADVISORS

MIDYEAR 2022

International Forces Position U.S. Industrial Properties Favorably; Nearshoring and Reshoring Potential Raises New Prospects

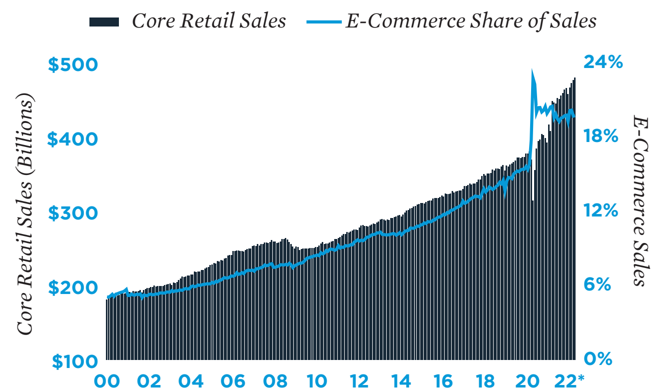
Global trends place industrial sector in favorable position. Multiple factors are driving record demand for industrial space. Retail spending is elevated both at store and online, fueling the need for more distribution and logistics resources. The inability to source both raw materials and finished goods from overseas on time has also pushed companies to expand their domestic storage capacities to set aside additional inventory when it does arrive. Meanwhile, the quest for treatments and other medical aides amid an aging population and the ongoing threat of COVID-19 has underscored the need for life science research and development space. Combined, all of these factors have propelled the national vacancy rate down 120 basis points from the pre-pandemic mark to 3.8 percent in March, despite substantial new supply. The average asking rent has climbed almost 20 percent as a result, with ample positive momentum to overcome any hurdles moving forward.

Inflation, shipping present near-term headwinds. High inflation, exemplified by the 8.6 percent year-over-year CPI climb in May, has yet to erode consumer spending. Inflation-adjusted retail sales were up about 17 percent entering June relative to February 2020. Sentiment is cooling, however, and the lockdown-era surge in e-commerce shopping, which briefly topped 22 percent of all retail sales, has now fallen closer to the pre-pandemic growth trend line. Companies that expanded logistics resources rapidly in that time may now slow or consolidate, as is the case with Amazon, which is looking to sublet certain older warehouses. Other major retailers, including Target, may relinquish some warehouse space as they pare down outdated inventories. At the same time, these same firms are committed to accelerating their distribution times, which requires additional facilities, keeping both first and last-mile buildings in demand.

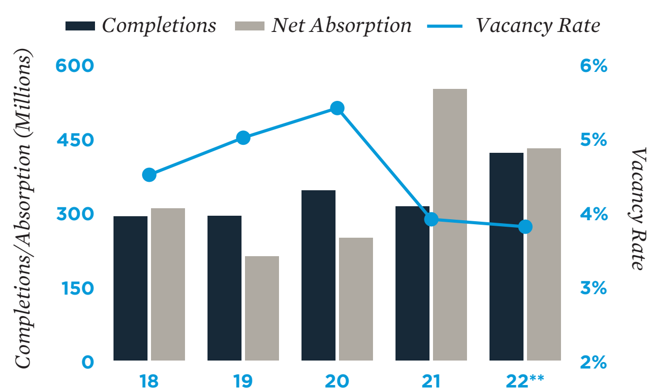
Adapting logistics networks changing geographic supply flows. Supply chains remain snarled, pushing more companies to re-evaluate their shipping methods. Backlogs at major sea ports, particularly on the West Coast, have directed more vessels to other docks. Even so, transport times are elongated, with transoceanic shipping costs up by a factor of 10 relative to before the pandemic began. To compensate, some firms are utilizing air freight to move high-value products and perishables, benefiting industrial properties near airports. Some firms are also moving production from overseas to North America, circumventing cargo ships for rail and trucks. While the process of nearshoring or reshoring operations to Canada, Mexico or the U.S. will be multi-year endeavors and not undo globalization at large, it will change the geographic impact of industrial space demand. Already, shipping across the U.S. border from Canada and Mexico was up over 20 percent year-over-year in March.

Redirected supply flows have investment implications. The impact to space demand from changing supply chains is influencing investor decision-making. Against the general backdrop of rising direct-to-consumer delivery, nearshoring production will place added emphasis on border locations and intermodal hubs with sizable rail and road infrastructures. Tenants and investors may look more toward warehouse and distribution assets in cities like San Diego, Detroit and San Antonio as a result. Domestic manufacturing space is also becoming increasingly popular among investors as some firms look to build new operations or reshore, often utilizing advanced production techniques. This is the case with silicon chip and automotive manufacturers. Similar motivations are drawing the attention of investors to markets that support sizable air cargo operations, including in Memphis, Chicago and Miami.

E-Commerce Sales Trends



Supply and Demand



* Through April ** Forecast
Sources: CoStar Group, Inc.; U.S. Census Bureau

Shipping Activity Improving Nearly Across the Board: Air, Sea & Land Trends

Notes: Annual airport cargo volumes based on preliminary 2021 estimates, sea, rail and truck freight comparing quarterly totals.
Sources: Marcus & Millichap Research Services; Department of Transportation; Federal Aviation Administration; The Northwest Seaport Alliance; Port Authorities for Los Angeles, Long Beach, Houston, New York, New Jersey, Oakland, Savannah, Virginia, and South Carolina.

RAIL & TRUCK METRO'S HIGHLIGHTS

- **San Diego (Otay Mesa):** North American transborder freight continues to grow, benefiting industrial properties along key transit lines. Otay Mesa in the San Diego metro is one such location, where the volume of cargo moving by rail and truck in the first quarter of this year surpassed the same period in 2019 by over 10 percent. Industrial space demand has improved as a result, with metrowide vacancy down 290 basis points from the end of 2019 to March 2022.
- **Port Huron (Detroit):** Port Huron in the Detroit metro is consistently one of the three busiest rail and truck entry points in the country, in terms of dollar value of goods shipped. As such, industrial properties in the area are benefiting from greater shipping between the U.S. and Canada, which was up 31.2 percent year-over-year in April. While Detroit industrial vacancy has yet to undercut the pre-pandemic low, asking rents are up by an average of 9.5 percent from the end of 2019.
- **Laredo (San Antonio):** Freight activity between Mexico and the U.S. was up 20.9 percent year-over-year in April. Laredo is the busiest port on the southern border, connecting to nearby San Antonio along Interstate 35. Corresponding to the uptick in trade, industrial vacancy in the metro has dropped 320 basis points since the end of 2019 to 3.8 percent in March, despite a substantial 9.1 percent inflation of inventory. Over 737 million square feet has opened here in that span.

CARGO AIRPORT HIGHLIGHTS

- **Memphis:** Air cargo demand globally reached pre-COVID-19 levels earlier this year, despite labor shortages and higher fuel costs. Memphis hosts the busiest cargo airport in the country, a major hub for FedEx operations, supporting demand for local distribution and warehouse space. Asking rents have been climbing since 2020, prompting development. Inventory has grown over 10 percent in the 27 months preceding April, yet vacancy is set to return to the pre-pandemic level by year-end.
- **Louisville:** Muhammad Ali International Airport was the sixth busiest cargo airport in the world in 2021, handling roughly 20 percent more volume last year than in 2019. Facilities are popping up around the airport as a result. The South Central submarket has a construction pipeline extending through 2023 of 4.3 million square feet, representing a 7 percent increase to inventory. These arrivals should be well met by tenants, with a local vacancy rate of 1.7 percent in March.
- **Miami:** Miami International Airport handles more than three quarters of all air freight to and from the Latin American and Caribbean region. Overall, cargo volume through the airport was up 34 percent in 2021 relative to 2019, adding additional momentum for space demand in the area this year. The Miami Airport submarket's vacancy rate fell 40 basis points to 2.3 percent in just the opening three quarters of 2022, supporting rent growth of 26.6 percent since year-end 2019.

Strong Fundamentals Underscore Investor Confidence

2022 Forecast

U.S. EMPLOYMENT

2.9% increase Y-O-Y

- The national employment base is projected to surpass the pre-pandemic high this year amid robust demand for workers. The composition of the labor market is shifting slightly, however, as some jobs in professional services, transportation and warehousing offset other sectors.

U.S. CONSTRUCTION

420 million square feet completed

- Inventory will expand by a record 2.4 percent this year, inflated by a large share of sizable projects. About half of the pipeline is comprised of facilities with floor plans of 500,000 square feet or larger. Few arrivals under 50,000 square feet will keep competition high for such spaces.

U.S. VACANCY

10 basis point decrease Y-O-Y

- Voracious demand for industrial space keeps pace with historic development, resulting in a slight down tick in the national vacancy rate to 3.8 percent, 70 basis points under the pre-pandemic low set in 2018. Availability is tightest in metros with major ports.

U.S. ASKING RENT

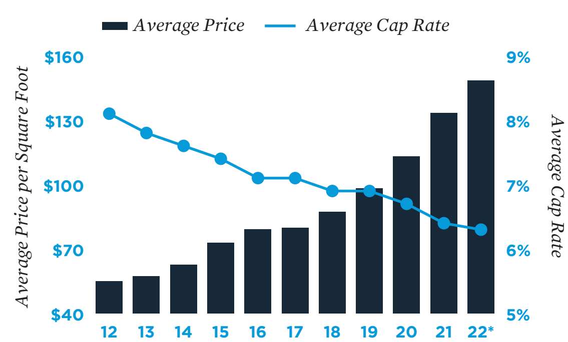
8.4% increase Y-O-Y

- Historically low vacancy, paired with some high-quality new arrivals coming to market, will lift the average asking rent across the country to $9.08 per square foot. This increase builds on the 9.5 percent jump from 2021 to raise the mean 22.0 percent above the pre-pandemic mark.

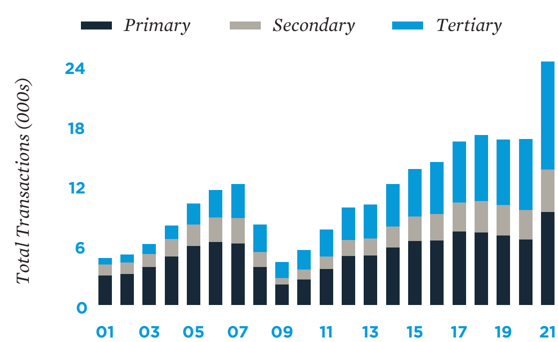
2022 INVESTMENT OUTLOOK

- **Potent tenant demand begets vigorous sales activity.** Robust property performance throughout the pandemic has fueled investment demand, with a record number of industrial and flex assets changing hands over the 12-month period ended in March. Increased buyer competition has jumped sale prices forward about 25 percent in that span to an average for the period of $148 per square foot, roughly three times the metric from a decade ago. The corresponding downward impact to cap rates is complicating transactions, however, with sales velocity so far in 2022 trailing the same time frame the year prior.
- **Higher lending costs add hurdle.** The average yield on properties changing hands in recent months has trended closer to the mid-5 percent band, although best-in-class or under-rented assets have traded at cap rates in the 3 percent zone. Lower implied first-year returns butt against climbing interest rates. Higher lending costs are narrowing the margin for investors that require financing. For well-capitalized buyers, however, the favorable long-term outlook for the sector, including strong rent growth, encourages transactions.
- **Nearshoring adds momentum to tertiary metros.** More investors are trading assets in secondary and tertiary markets, with almost half of all deals occurring in the smaller category during the four quarters preceding April. This trend was already underway before the pandemic, encouraged by population migration and comparatively higher cap rates, but both factors are equally, if not more relevant, today. Additional manufacturing activity coming to the U.S., Mexico and Canada over the next several years may also draw tenant and investor interest to cities hosting those operations or situated along key transit routes.

Investment Sales Trends



Investors Look More To Smaller Markets



* Through 1Q

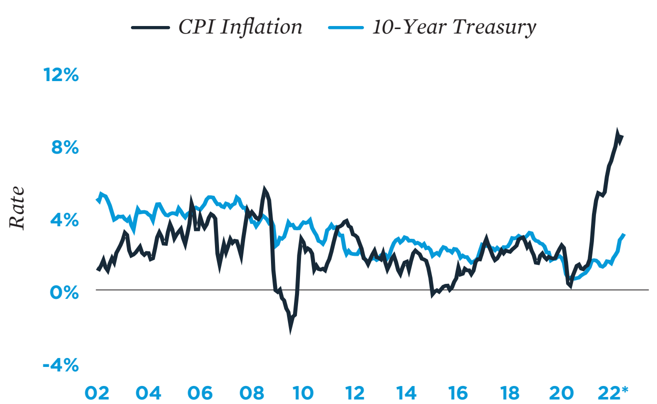
Sources: CoStar Group, Inc.; Real Capital Analytics

The Federal Reserve's Inflation Response Tightens Underwriting for Industrial Investors

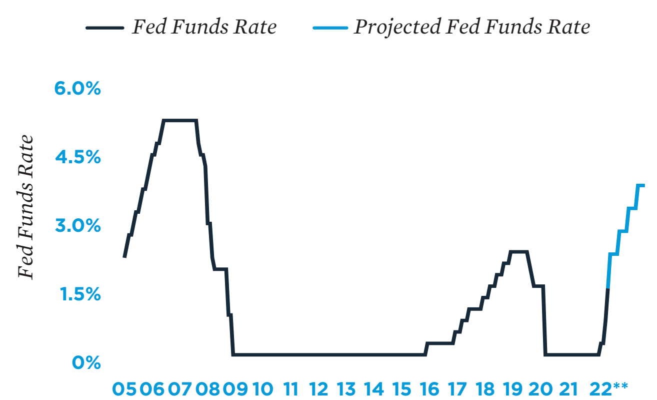
Fed makes fighting price increases the number one priority, interest rates rising as a result. Persistently elevated inflation and strong job growth through June has kept the Federal Reserve firmly committed to raising interest rates. At its June 15 meeting, the Federal Open Market Committee (FOMC) increased the target range of the federal funds rate by 75 basis points, the largest single hike in 28 years. Now with an upper range of 1.75 percent, the FOMC is signaling an intention to bring the overnight lending rate above 3 percent. At the same time, the central bank has begun reducing its balance sheet by a regulated pace of $47.5 billion per month from June to August, before accelerating to $95 billion per month in September. These actions are having notable upward impacts on both short-term and long-term interest rates, effecting equity and bond markets. Treasury yields have been increasing, with the two-year note surpassing the 10-year note by a minor margin in early July. While a persistent inversion in the yield curve of these two metrics has served as a recession predictor in the past, capital migration amid the dynamic investment climate is contributing to this current yield disparity. The spread between the three-month and 10-year treasuries, another possible recession predictor, has not inverted. Ultimately, the Fed hopes to curb price increases with higher borrowing costs without derailing economic growth.

Capital available with tighter underwriting, likely to impact sales activity at some level. Rapidly tightening monetary policy is prompting lenders to adjust quoted rates and widen spreads. This is especially true of financiers who benchmark to credit markets, including life insurance companies and CMBS sources, but balance sheet lenders, such as banks, will also have to follow suit over time. Capital continues to be readily available, however, especially for industrial assets, if borrowers can meet these tighter terms. Lending rates for industrial investment transactions are pushing into the upper 4 percent range on average and trending higher as of this writing, putting downward pressure on leverage. Loan-to-value ratios in 2021 were already below those observed in the years leading up to the pandemic, and conditions will not allow for loosening soon. Borrowers with established relationships with financiers and experience in the sector may be able to secure more favorable terms, although individual asset quality and location criteria continue to factor in substantially. Tighter terms may impede investment sales to a degree as some investors absorb the higher lending rates or reduce their leverage. Some sellers may re-trade, given the recent Fed moves as well. More buyers may turn to tertiary metros with strong population growth, where cap rates tend to be higher but property performance is strong. While institutional investors tend to favor larger assets in major markets, where cap rates are lower, these organizations may be able to secure capital at lower rates.

Inflation and Interest Rate Trends



Fed Funds Rate Over Time



** CPI through May; 10-Year Treasury through June 24 ** Forecast - assumes four rate hikes of 75 bps, 50 bps, 50 bps, and 25 bps*
Sources: Marcus & Millichap Research Services; Federal Reserve; U.S. Census Bureau

Industrial Division

Alan L. Pontius

Senior Vice President | National Director,

Tel: (415) 963-3000 | apontius@ipausa.com

Price: $1,500

Prepared and edited by

Cody Young

Senior Research Analyst, Editor | Research Services

For information on national industrial trends, contact:

John Chang

Senior Vice President | National Director, Research Services

Tel: (602) 707-9700 | jchang@ipausa.com

Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Department of Transportation; Federal Aviation Administration; Federal Reserve; The Northwest Seaport Alliance; Port Authorities for Los Angeles, Long Beach, Houston, New York, New Jersey, Oakland, Savannah, Virginia, and South Carolina; Real Capital Analytics; U.S. Census Bureau