

Industrial Construction Hits Record. It's Not Enough.

Demand for Space Justifies Even More Building of
Warehouses and Distribution Centers



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As we continue to take steps toward a national recovery, many of the logistics trends accelerated by the pandemic are holding

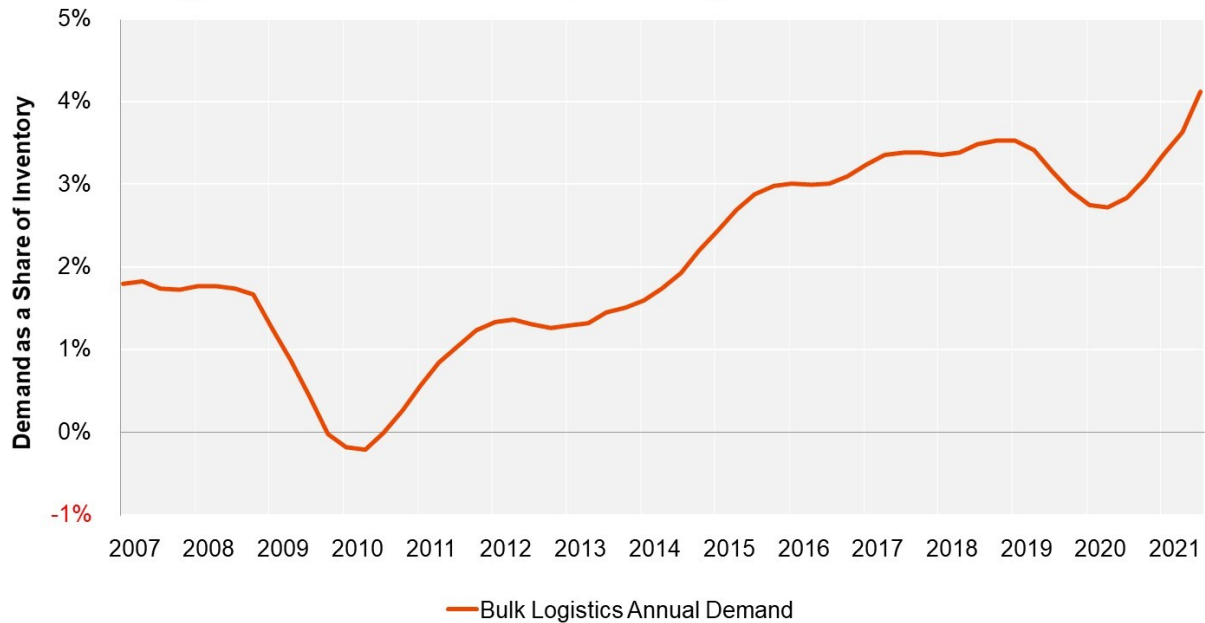
strong, making additional development of bulk logistics buildings an appealing proposition for investors, even with the record level of 540 million square feet already in the pipeline.

According to the Federal Reserve Bank of St. Louis, e-commerce sales remain elevated, representing 13.3% of retail sales as of the second quarter of 2021, up from 11% before the pandemic, and in-store retail sales have jumped 6% since the fourth quarter of 2019. These strong tailwinds from e-commerce and overall retail sales have accelerated both tenant and investor demand for bulk logistics space, defined as warehouses and distribution centers greater than 150,000 square feet.

In fact, investor interest in this type of space has been so strong that capitalization rates for the sales of logistics properties have compressed significantly, with the number of transactions occurring with cap rates below 5% doubling since the pandemic started. Bulk logistics cap rates have been pushed to all-time lows, averaging 4.73% as of the third quarter of 2021. This contraction in cap rates has cut into the investment yields available from leasing and operations, pushing many investors to seek higher returns through development.

A major reason why development remains such an appealing proposition has been the historical record demand for space as the economy reopened. Net absorption for bulk logistics properties currently stands above 4% of inventory, an all-time high.

Bulk Logistics Demand Accelerating Thanks to E-Commerce

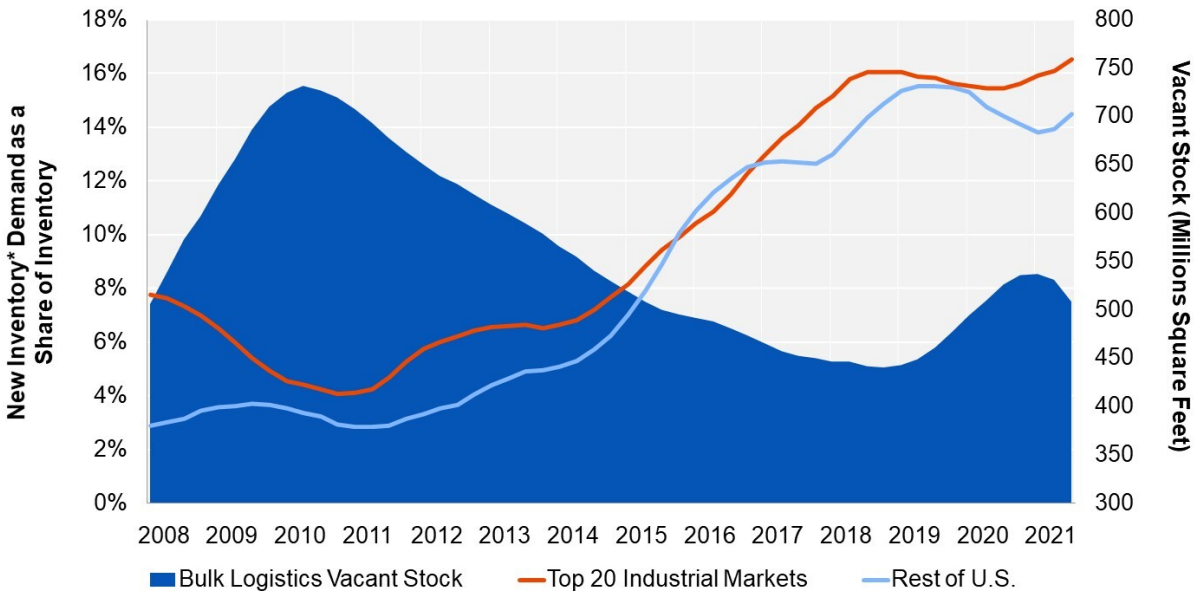


Source: CoStar Advisory Services, Third Quarter 2021
Note: Limited to bulk logistics properties 150,000 square feet or more.



New inventory, defined here as bulk-regional logistics buildings built in the prior 10 years, continues to see strong demand, even in the highest-supply markets. Despite the third quarter of 2021 seeing a record level of new deliveries relative to prior supply waves, the top 20 markets with the most space under construction, representing 57% of the total bulk logistics space underway in the country, have seen absorption as a share of new inventory outperform at an average of 16.7% relative to 14.5% for the U.S., as logistics tenants show a strong preference for newly built space in larger markets.

Demand Skewed Toward Newer Product in Largest Markets



Source: CoStar Advisory Services, Third Quarter 2021

Note: Bulk logistics greater than 150,000 square feet in U.S.

*New inventory delivered 10 years or less from date of chart. Top 20 industrial markets based on largest under construction inventory.



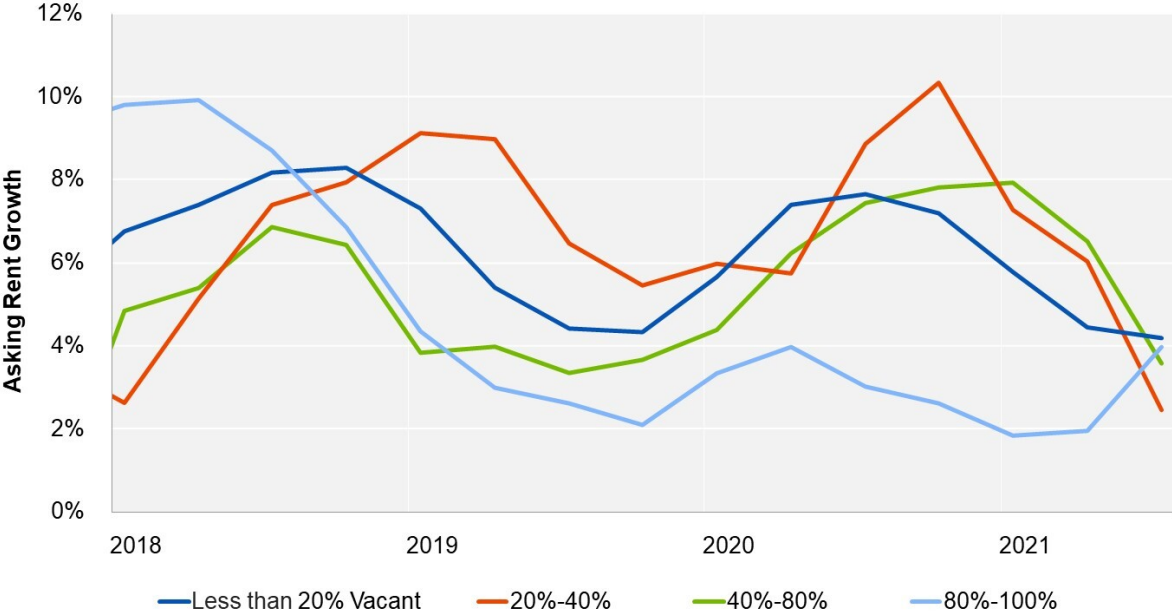
During the last supply wave of industrial space in 2016-17, which saw 150 million less square feet delivered than the current quarter, the demand for new inventory reached historically high levels as well, partly driven by Amazon's leap toward same-day delivery, as well as additional demand from third-party logistics providers and an expansion of domestic manufacturing.

Today, much of the story remains the same, although a strengthened demand from e-commerce and omnichannel retailers is now present. Moving ahead, these trends should continue to provide enough demand to meet the elevated levels of incoming supply.

Even with 595 million square feet already completed since the start of the pandemic and an additional roughly 500 million square feet of bulk logistics inventory expected to be delivered over the next four quarters, double the level in 2016-17, the current national vacancy rate for this space remains similar compared to pre-financial crisis at roughly 7%.

In such a competitive market where vacancies are tight across the board, market asking rents continue to trend upward even for fully vacant properties.

Strong Demand Helping Push Rents in All Vacancy Buckets



Source: CoStar Advisory Services, Third Quarter 2021
Note: Limited to bulk logistics properties 150,000 square feet or more.



We have seen this trend before. In 2016, when logistics deliveries started to ramp up, asking rents for buildings that were 80% to 100% vacant started increasing at a faster pace

than similar buildings with lower vacancy, peaking in the second quarter of 2018 at 10%.

Today, high-vacancy logistics buildings continue to see asking rent growth move with the market, currently at a 3.9% increase year over year as of the third quarter of 2021. Since demand and rent growth for new product is strong, [an interesting dynamic has emerged](#) for developers who can now wait to the last minute of the development process to sign a tenant in order to capture a higher rental rate.

This new dynamic plays differently across markets, with some such as Charlotte, North Carolina, and Nashville, Tennessee, seeing weaker asking rent gains for highly vacant space versus markets like Atlanta and the Dallas-Fort Worth area. These two markets are seeing asking rent growth for properties that are 80% to 100% vacant outperform other construction hubs, showing it can pay off to deliver a speculative logistics building in the right market.

Current dynamics in the industrial market largely benefit those with sizable development platforms that can capture investment yield from new construction given the cap rate compression that has occurred. Major players such as Hillwood Development, Panattoni Development and Core5 industrial, which are some of the largest developers of current bulk logistics space underway, all have major concentrations in high supply markets such as Dallas-Fort Worth and Atlanta, as well

as other areas of the country, and are well positioned to outperform their peers.

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