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Industrial market overview in Boston - by Bill Pastuszek

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In surveying the Boston Industrial market, I came across the following. CBRE's 2020 Market Overview notes that "the U.S. Industrial market will see some dramatic shifts in 2020. Absorption gains will be difficult to achieve" where in some markets there are extremely low vacancy rates and limited space options. The study forecasts that supply will outpace demand by 20-30 million s/f, which will create a slight overhang of space – the first since the 2008 recession. Vacancy is likely to increase, but only slightly. On the other hand, the Boston industrial market is doing quite well, thank you very much. While not a major market in terms of size or scale but nonetheless a strong (and growing) presence. Despite steep negative absorption in the third quarter of 2019 by the larger industrial market. Conditions in Boston's market remain tight, historically.

Vacancies compare well with US averages after lagging behind for nearly two decades. While it may not be a national distribution hub, Boston's surging local economy has created strong demand for final-mile logistics space. Further, there is continued redevelopment pressure on general industrial properties for redevelopment, especially close to Boston, and that demand has pushed up prices and rents. Currently, overall vacancy is 5.2% with an average asking market rent of $11.75 per s/f.

Boston is an attractive retail and delivery market, given a sophisticated well heeled, and concentration of millennial types. For example, Amazon has increased it industrial presence in the area, with more than 1.7 million s/f added recently and reportedly negotiating a large - 800,000 s/f – space in Revere's NECCO factory, according to CoStar. In addition, there are plans for 3 million s/f of build-to-suit space, making the project one of the largest industrial buildings in the northeast with other companies also expanding in a bid to compete.

Life sciences the Boston need good quality space for design work, manufacturing, and distribution. There is plenty of owner-user demand. An interesting addition to the demand side is from the cannabis industry.

In terms of supply, Boston has net lost supply during this cycle: It is reported that more than 20 million s/f of industrial space has been demolished or converted since 2010. Multifamily and office developments have moved into former industrial sites. New construction is relatively anemic, so negative supply conditions are likely to continue. The supply-demand imbalance has pressured rents and rents probably have not yet peaked, with investors taking notice with strong sales activity. The average reported price, per CoStar, is $123 per s/f. Cap rates continue to a down trend and, even at low rates – an average 6.6% for the entire market, investment grade – the returns beat most other property returns.

Cushman and Wakefield notes, “Strong investor demand has combined with red hot fundamentals, particularly NOI growth, to drive cap rates to record lows. During the previous cycle, industrial cap rates bottomed at 7% in 2006 based on national transaction data from Real Capital Analytics. During the Great Recession, cap rates peaked at 8.4% in 2009. Since then, cap rates have compressed 222 bps to just 6.2%. The decline in cap rates has been broad-based across market tier, class and product subtypes.”

Industrial has been the top performing asset class for several years running—and there are no indications of a slowdown. Since 2010, quarterly industrial total returns have averaged 12.9% annualized compared to 9.7% for non-industrial product types.

Just a note, the rates quoted here are for the high end of the market, i.e., investment grade properties. The lower ends of the market show great vitality. Small user space is at a premium and there is strong interest in outlying areas due to the lack of supply in Boston. There is a wide audience for this small allotment of space.

Elements of uncertainty include global economic uncertainty, which appears to be headed for more problems as the virus outbreak continues to dampen activity, and political uncertainty, both in the U.S. and elsewhere. This is a time to watch markets carefully, not so much for the short term gyrations, but for evidence of large scale threats to stability. But, all things being reasonably equal, the prospects for the Boston industrial sector in general trend largely positive.

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