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Q4 preview of industrial real estate: Seeing an unmet demand for warehouse and flex/R&D space - by David Skinner

October 30, 2020 - Spotlights

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The popular coffee shop/party/Zoom call question is, "How is the pandemic treating you?" and everyone seems to have a different answer. The entertainment and event business sectors are having a tough time right now, but some of the larger companies have pivoted or gotten creative with how they can serve their customers, though perhaps with a different scope of work.

Retail has been hit hard, but many of the companies that we all may have anticipated to go under actually have not, whereas many mainstay restaurants and iconic attractions have not fared as well, especially those in high rent areas in places like Boston.

However, when people ask me how the industrial real estate business is going during the pandemic, I am grateful to say that we are seeing an unmet demand for warehouse and flex/R&D real estate. Industrial supply companies, localized manufacturing, distribution, and Cambridge/Somerville relocations continue to need more room and therefore grow outside of Boston, paying close to Boston rates, thereby driving up the localized lease comps.

There are a few tenants in the market now who have been displaced due to site redevelopment in the Dorchester, Roxbury, South Boston neighborhoods of Boston. Many of these companies do not need to be in the immediate proximity to downtown Boston and therefore do not need to pay the nearly $30 per s/f NNN asking prices for the spaces. This movement from inner-city to 128 and 128 to 495 coupled with the decrease of inventory is keeping the market a landlord's market, and has kept it that way for the last few years.

Current state of the market. Industrial tenants continue to need space to rack and stack their materials. Therefore, with a shortage of property that can accommodate a 24' clear height, many distribution tenants will continue moving further and further outside the city.

What to expect. We never want to be prideful and talk about how things cannot slow down, but when we believed that buyers and tenants would back out of deals, we saw a blip on the radar for about 1 month, but then the world was back to normal. Many of our clients have had 30%+ year over year increases in top line sales and are having problems getting enough product imported to sell.

Evictions. Not every industrial company is doing well right now. Most notably are the companies that were highly leveraged, or carried too much inventory, or did not manage employees very well and are now feeling the crunch of slowed sales and are having to stretch their vendors out for longer payment terms. In these cases, the squeaky wheel gets the oil and if the vendors refuse to ship more product, tenants may pay vendors before landlords. In this case, evictions are an inevitability.

Who will capitalize. The Landlords who own high-bay warehouses anywhere within 50+ miles of Boston with property in some proximity to major highways will likely continue to have low vacancy. Tenants who maintain strong cash positions and strong credit that have uses for retail will likely begin to start finding bargain pricing. Tenants who are able to tolerate industrial space with low ceilings (typically 14' or lower) will have an easier time finding space at discounts because the demand has so significantly shifted to high bay distribution.

Cap Rates. With the election around the corner, nobody knows how interest rates will respond once the identity of the next president is confirmed. But for the time being, fully leased suburban real estate is trading at cap rates below 7% in areas that were considered secondary or tertiary not 10 years ago, because the average ROI for any kind of investment vehicle has dropped across the board. Investors are flush with cash, and when there's cash, there's little return.

Summary. Industrial real estate is performing in a seller's and landlord's market, and we do not see anything that would change in the near future. However, if tax rates radically change and employment laws are altered in a significant way in the next few months, I cannot predict the future. If I was in fact able to predict the future, I wouldn't be in real estate, I would probably be a bookie or something.

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