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The resilience of industrial real estate in the greater Boston marketplace: Optimistic outlook - by Nate Nickerson

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Overview and Context:

The industrial real estate sector in the Greater Boston market has experienced significant growth in recent years, primarily driven by the rise of e-commerce, increased capital availability from pandemic stimulus measures, and historically low interest rates. However, the current rising interest rates, inflation, and an increasingly pinched consumer discretionary spending has resulted in an overall decrease in warehouse demand, raising concerns about the market’s stability. Nevertheless, this article highlights the potential for the industrial market in Greater Boston to see little to no decline in lease rates and sales prices.

The E-commerce Boom:

E-commerce has been the primary catalyst behind the development and rent growth in the industrial sector over the past five years. Notably, Amazon’s dominance in the e-commerce realm accounts for nearly 38% of all online shopping sales in the U.S. The theoretical estimate for warehouse demand is that for every $1 billion in e-commerce sales, 1.2 million s/f of warehouse space is required. The COVID-19 pandemic accelerated the shift towards e-commerce, resulting in an increase in warehouse demand, historically low vacancy rates, record-high lease rates, and a surge in new development projects. In the Greater Boston market, the average asking rate currently stands at $15.52 NNN per s/f, with a vacancy rate of approximately 3.3%. This remarkably low vacancy rate persists despite the fact that 11.2 million s/f of industrial space has been added to the market since 2017.

Macroeconomic Factors and Market Stability:

Although concerns about the macroeconomic landscape persist, it is crucial to understand the unique dynamics that underpin the industrial real estate market. From a macro perspective, the inflation resulting from pandemic stimulus measures has led to a decline in average consumer discretionary income and savings. The e-commerce warehouse sector heavily relies on consumer products, which are primarily driven by consumer spending through discretionary income. As a result, this decline affects e-commerce revenue projections negatively. However, in the short term, it also leads to an increase in supply as products are left on shelves and this subsequently keeps warehouse demand high. Large occupiers within the e-commerce industry, such as packaging and corrugated box manufacturers’ warehouse demand are directly correlated with e-commerce demand. Moreover, various other industries, including medical product distributors, building and construction product distributors, and non-discretionary consumer goods suppliers, are less directly impacted by changes in consumer discretionary spending resulting in further stability.

Micro-level Implications and Market Adjustments:

On a micro-level, small and mid-sized companies that signed leases in the past 5-10 years are now facing lease expirations with significant lease-rate adjustments to match current market rates. In some areas, these adjustments have led to steep increases of 100% or more. As a result, companies located closer to the city are migrating further away to secure more affordable real estate options. Businesses along Rte. 128 are looking towards the I-495 corridor and surrounding highways, while those along the I-495 corridor are exploring regions even further afield.

Southern New Hampshire has witnessed a remarkable surge in lease rates, even in the past six months, as current rates are consistently in the low-mid teens. The market outside of I-495 along Rte. 2 has experienced relatively static supply, as market rents cannot support current construction costs on new builds. As a result, this market has witnessed a substantial 50-75% increase in lease rates due to persistently low vacancy rates. Massachusetts' limited availability of feasible sites for industrial construction further contributes to these strong dynamics.

An Optimistic Outlook:

Despite lingering uncertainties, an optimistic outlook for the industrial real estate market in the Greater Boston area is warranted. It could take a few years for large occupiers to execute a reduction in real estate footprints due to the length of term left on recent lease commitments. By the time commitment expirations approach, we could be on the other side of any market correction, and market forecasts could be more favorable, which could result in little to no decline in warehouse vacancy.

The resilience of the e-commerce sector, the diversification of industrial tenants beyond consumer discretionary goods, and the sustained demand for warehouse space from various industries collectively contribute to the market's potential for stability and growth in the future. Additionally, the recent resurgence of owner/occupant acquisitions, coupled with the challenges faced by investors penciling deals due to rapid increases in the debt market, has rekindled interest in owner/occupier acquisitions. This trend is likely to result in static valuations as owner/occupiers are currently able to bridge the pricing gap between sellers and investors. This will inevitably result in a reduction in trade volume as owner/occupants are limited to acquiring buildings with vacancy, which are increasingly hard to find with current vacancy rates. Thus, while the current state of the debt market and macroeconomic conditions may introduce short-term challenges, the underlying factors and dynamics within the industrial real estate market in the Greater Boston area offer hope for continued strength and future expansion.

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