Some economic data and it’s translation for the Greater Boston industrial world - by David Skinner

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Over the past two years, a billion s/f of new industrial space has been built in the United States. Rising vacancies are happening due to supply challenges and lower demand, but the effect varies depending on the market and property type. Inflation is still above the 2% target. With a strong job market, the first Fed rate cut is being delayed. At the end of 2023, the first cut was expected in the first half of 2024, but now it's looking more like September. And even that might be too hopeful. E-commerce is bouncing back in leasing, making up 14.7% of the top leasing activity in Q1 2024 nationally, up from 3.5% a year ago. Additionally, the global economic uncertainty in trade with nations like Russia and China is encouraging many manufacturers to find ways to bring manufacturing components back to the United States.

Now, what does this mean for our Boston area industrial world?

I don't believe the bottom will fall out of the industrial market. It would seem logical that with the delivery of a significant supply of industrial product in the last few years, particularly in the South Shore market, the rents should similarly adjust down due to increased supply and decreased demand. However, the developers purchased these sites based on certain pro-formas in their minds, and leasing the sites below rental rate "x" would only solidify a losing proposition for them. An owner in this situation would likely rather sell the asset and break even, or perhaps willingly sustain a small loss.

I also don't believe that we are going to undergo a "Great Unloading" of industrial property in the next few years. Yes it is true, record industrial loan maturities are due in 2024 and 2025, and many owners who purchased assets in 2019 and 2020 will need to consider a repositioning due to interest rates on the loans possibly doubling in this process. However, many of the institutions who fueled the purchasing frenzy over the last few years would rather add equity into the property than sell. For example, a rate reset from 4% for a property purchased in 2020 to a 7.5% rate for the reset in 2025 will obviously crush cash flows for any buyer who was highly leveraged on the purchase. However, assuming a 6% cap rate, if the owner moves from a 75% debt / 25% equity position to a 35% debt / 65% equity position, the cash flows will improve significantly.

Ongoing tension in the Middle and Far East is encouraging manufacturers to find ways to bring product lines back to the United States. While New England on the whole is nationally more expensive to locate and operate a manufacturing concern, the global and national economic fundamentals would lead us to direct our attention to domestic, United States production. Technology in manufacturing is also growing at a blistering rate and as such, these technological improvements have given rise to greater power requirements for the users. Now, I would, of course, never deign to undermine the power and authority of the almighty regional utilities throughout New England. However, the near monopolistic effect that each nameless utility provider possesses that encourages egregious response times for power upgrades or modifications, or wildly poor customer service, has encouraged most manufacturers or power user to seek the greener pastures of municipalities that own and operate their own electricity service (eg: Hudson, Mass. Light and Power). It is my opinion, or as my college buddy would say, "my personal, objective opinion" that the industrial properties that stand to benefit from the most upside in the coming years are the ones that have the following characteristics:

1) already existing and need very little construction improvement because of difficultly to build with high interest rates;

2) located in areas with reasonable manufacturing workforce; and

3) also located in a town that owns and operates its own electrical service.

I would love to talk about politics, because it is that conversational stew (or, slop) into which all my pot-stirring clients want to goad me to jump. But in the interest of truth and reality, the industrial companies that have been running sound businesses for the last few years will continue to grow and expand regardless of the election outcome.

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