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Industrial markets – 2024 - by William Pastuszek

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Industrial has been a darling investment class and should continue to be, even with the following discussion which indicates moderation nationally and in Boston. This sector is highly diversified, ranging from the “Amazons” to “Main Street” industrial. The Boston market - as small as it is - has enjoyed a good run with dramatic shifts in supply, construction, pricing and rent increases.

The era of free money is long behind us, post-COVID inflation is still with us, and the geo-political environment is highly uncertain. Markets find ways to adapt to these realities.

After the COVID/Post-COVID euphoric run up, the faces of commercial real estate (CRE) have changed. Real estate is still perceived as a safe long-term - but management intensive – investment. The high interest rate environment will be a market fact for longer than in the short-term. Worth watching; what effect might the recent rate drops by several central banks – not the US Fed – have on financial activity.

Some observers note that nationally, the characteristics of the 2024 national industrial market continue to “downshift.” National vacancy rate does not seem poised to increase over a two-decade average of 7+%. However, observers note that there is a significant pipeline of “spec” space that, despite modestly positive absorption, may well drag on the market as tenant demand is not overwhelming in general.

Low home sales relate, to some extent, to decreased tenant space demand. Home sales drive demand for a variety of goods and services. Those goods and services need space in order to be distributed to end users. Less demand impacts warehouse space absorption. There is also the end of the COVID spike; many space users no longer need space upon renewal and that space now goes back on the market.

A comparison with the Canadian industrial market bears mentioning. The Canadian market is small, about a tenth the size of the U.S. market. Vacancy in the mid-two’s is much lower than in the states. The market clearly follows its own trajectory.

Construction is also down, as it is in U.S. markets. The average capitalization rate is just under 5.5% as compared to the average in the US, which is reported at $\pm 7\%$ by several sources. This market is also experiencing transition.

Closer to home, the Portland, Maine market is a related market. Vacancy is almost half that of the Boston market, with negative absorption. Cap rates are 200 basis points high with an average rent of about 2/3 of the Boston average. Rent growth is less dramatic as well.

In 2024 CoStar notes, “Boston’s industrial market continues to soften near the mid-point of 2024 amidst the tail end of a wave of new supply.” The report notes increasing vacancy and a large wave of construction deliveries.

Boston trends follow national trends to a point. Logistics follows the national trend. Flex space, according to one survey, represents a “disproportionate share” of the Boston market’s inventory: that market sector has seen softening demand. Demand is likely to remain quiet, but this is not expected to be a permanent condition and no major vacancy spikes are anticipated.

Rent growth in the Boston market peaked in 2023 at 10% annually. Rent growth is forecasted to fall to as much as half of that lofty rate of increase going forward. Rising vacancy will slow rent growth, another trend that looks set to continue into 2024.

To understand the industrial market in Eastern Massachusetts, it is important to carefully delineate the sector of this diverse market for which information is desired. For the broad view, however, subtracting out Amazon and other large space users, helps most analysts understand the “real market.”

The Boston industrial market is a sophisticated one, located in a dense, diverse, affluent area with a skilled consumer pool and work force. There is a strong mix of industrial users ranging from logistics to life science-related flex space. Life sciences is an important and pricy demand driver: that submarket operates in its own sphere: however, it represents a demand generator for related flex space.

Although there is some cloudiness in the short term, the sector continues to represent a viable, long-term arena for investment. In terms of valuation, as always, care should be taken to not rely overly on averages, broad brush indexes, and generalizations by persons who write articles! A property needs to be evaluated in the context of its specific market niche.

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