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The state of the union of industrial property values - by David Skinner

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David Skinner

I am a relative babe in the real estate business. And by the term “relative babe” I do not mean to refer to my boyish good looks, charming personality, or other relative babe-like qualities. I mean that I am a “relative babe” in that I started working in the real estate business in 2017, and am relatively a baby compared to many of my broker colleagues and associates in the marketplace today. The 2022 downturn in the economy is the first downturn that I have experienced, and there are a number of observations to make about what is going on with industrial cap rates since those initial interest rate hikes. Looking back to my nascent days as a baby agent in 2017, I first understood cap rates to be a measure of the value of investment risk, particularly with real estate. I learned the back-of-the-napkin trick of finding a property’s price per s/f and then dividing it by 10, and I felt like I could rent the property for that rental rate, it was probably a good buying basis. For example, if I presented a property to a buyer client for \$100 per s/f and we were confident that we could achieve \$10 in triple net rent, we knew we could stabilize around a 10 cap, which back in that day was a great deal.

I aim to address two questions here: first, I often hear “When will industrial property values go back to what we knew them to be in 2020 and 2021?” I also hear the corollary, “When will real estate pricing come back to values that normal buyers can afford?” These two questions are asked by different types of real estate stockholders. The former is typically asked by owners who want to sell but have the record-breaking sale prices during the times of record-breaking interest rates in their minds for the value of their real estate. The latter is asked by users and investors who likely have seen property values in a particular geography for a long time and are aware of what things have historically cost.

To address the former question about when values will come back up, it is important to recognize that there are more economic drivers that raise the value of a property than simply the lending interest rate. For property values to go up in the minds of the market, a shift must occur in the tenant base that would more broadly fuel tenant expansion. As tenants and even user-buyers grow and expand in their industrial marketplace, available space will become scarce which will make property values grow again. Many prognosticators and political pundits often posit that the election will impact not only interest rates, but also consumer confidence, which drives all sectors of the economy. The events of the last few weeks has clarified in my mind that this is certainly the case.

On the other hand, many buyers are continuing to ask when values will come down to what some would call “reality.” There is some truth to this, in that many sellers are not being, what one disappointed buyer called recently, “realistic.” It has remained true that many property owners are not “realistic” because they do not need to be. To put it another way, they don’t need to sell. However, there are owners who still do need to sell, and when they do, they will look at what the market is bringing them, and they will transact. As this continuously happens over the next few months and years, and appraisers see a steady increase of sale comps in a consistently lower range, appraisals will reflect this pricing adjustment, and property will begin to trade again at lower values.

In the industrial world, the recent high interest rate environment has rewarded the healthy local businesses with strong financials who have been looking for a location for their businesses. Investors who have a strong performance over a long period of time are also able to have some success with banks. However, speculative investments have been challenging to finance.

If you are a property owner, do your best to keep your financially healthy tenants, and if you are a buyer, don't give up looking for your dream home, it may be right around the corner!

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