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Industrial Commercial Real Estate Investment: Trends During and Beyond the Pandemic

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The 2020 COVID-19 pandemic is impacting commercial properties in every asset class with lasting effects that will be felt for years to come. On-shoring, re-shoring, e-commerce fulfillment, cold storage, and data center development were trending prior to the third-quarter recovery and continue to accelerate in demand, making these sectors prime opportunities for CRE investment. As we enter a new phase in economic recovery, industry experts weigh in on the long-term outlook for industrial real estate investment.

Acquisitions Professionals, Private Owners and Lenders RemainBullish on the Long-Term Outlook of Industrial Real Estate

Marcus & Millichap hosted an Industrial Outlook Webcast on May 27, 2020, featuring Michael Brennan, chairman of Brennan Investment Group, and Curtis Spencer, president of IMS Worldwide, along with Marcus & Millichap's Al Pontius, SVP of office and industrial divisions, and John Chang, SVP and national director, research services. As discussed during the webcast, the industrial sector has remained a strong performer with rent collections equal to 96% of typical rents in May (Nareit Membership Survey, May 18, 2020). Shuttered sectors, including retail and hospitality, saw a drop off in rent collections, and also lead in commercial mortgage-backed securities (CMBS) delinquencies. CMBS delinquencies climbed 317 basis points to 10.32% in June 2020, but are still below the peak delinquency rate recorded in 2012, according to Trepp. The industrial sector, driven by the demand for e-commerce space, saw a 25-basis point decline in delinquencies, to 1.57%, while lodging and retail properties delinquencies rose sharply to 24.3% and 18.07% respectively.

COVID-19 Accelerates On-Shoring

COVID's rapid spread during the second quarter of 2020, coupled with mandatory closures of office, retail, and manufacturing, has had a deep and profound impact on the economy. The realization of the dependency on China and other countries for personal protective equipment (PPE), drugs, equipment, and manufacturing parts, inspired many companies to react and adapt, bringing manufacturing back to the United States, a trend known as "on-shoring and re-shoring" (transfer of a business operation that was moved overseas back to the country from which it was originally located). During the Marcus & Millichap webcast, Brennan Investment referred to the on-shoring concept as the need for supply chain reconfiguration. This will create demand for manufacturing and distribution space in the U.S. over the next decade.

E-commerce Breaks Records in 2020

Along with the trends identified above, e-commerce accelerated demand for space closer to manufacturer (distribution) and population centers (last mile). The ease and convenience of shopping online became a necessity for many individuals mandated to shelter in place. During the webcast, IMS Worldwide's Curtis Spencer stated, "With E-Commerce blowing up, sales are two years in advance of where they had been tracking before." According to eMarketer (May 2020), e-commerce sales will climb by 18% to reach $709.78 billion in 2020, representing 14.5% of total U.S. retail sales. Leading the way are groceries (food and beverage) with a sales increase of 58.5%; close behind are health/beauty/personal care, which saw sales increasing by 32.4% for the year. Even prior to the pandemic, the demand for organic foods and fresher ingredients was already a driving trend increasing demand for additional cold storage space.

A Temporary Pause to a Promising Remainder of the Year

In the first quarter of 2020, the capital markets for industrial properties looked to be very strong and sustainable for the year, but COVID interrupted the momentum. Marcus & Millichap's Al Pontius noted, "There was a temporary pause as the market absorbed COVID. However, now the industrial market is largely unchanged from the first quarter. In selective cases, cap rates are arguably lower than in the first quarter for 'best in class' industrial product."

Investors are still eager for deals. Private investors, whose 1031 like-kind exchange identification periods were extended by the IRS through July 15, have driven demand, and institutional money is also reentering the market. Pontius cited, "Major investors are somewhat frustrated by the limited supply of inventory available. Provided there is supply, all indicators show there is ample investor demand. This could create a robust second half of the year."

Looking forward, as the economy continues to reopen, with the potential for another pause, due to local and regional COVID spikes, industrial real estate's viability and resilience remains stronger than other asset classes. Keep your eye on the horizon and stay the course. Investments are long term.