INDUSTRIAL INDEX

COVID-19'S IMPACT ON INDUSTRIAL INCOME RETURNS AND CAP RATE EXPECTATIONS

The industrial property sector has historically been a stalwart source of income returns within commercial real estate. Here, we examine the stability of those income returns across cycles and consider near-term return expectations.

Industrial sector returns totaled 2.58% in the first quarter of 2020, continuing the longest streak of quarterly outperformance since the inception of the NCREIF NPI in 1978. A deeper dive into the composition of quarterly return trends reveals that since mid-2016, appreciation returns have primarily led the outperformance of industrial total return relative to other property types, as e-commerce structural trends have fueled capital flows into the sector. While income returns have gradually declined for all property types over the last two cycles, it is worth noting the stability that industrial sector income returns have provided relative to the index during past downturns and exogenous shocks.

While the current economic shock is affecting demand and return expectations across all asset classes and property sectors, the historical trends from which the industrial sector has benefitted suggest it may prove more resilient. Going into the coronavirus pandemic, industrial property fundamentals were balanced for most markets and the national availability rate hovered near 20-year lows.[1] Similarly, capital markets activity remained healthy, with industrial reporting both a record transaction volume and a double-digit pace for pricing last year.[2] Given the structural tailwinds from e-commerce that continue to support demand, the balanced space market fundamentals, and the long-term lease structures and creditworthy tenants characteristic of institutional properties, we expect that industrial income returns today will provide the same stability as they have in the past.

In order to assess near-term industrial property valuations, we consider our income expectations in the context of our cap rate assumptions. While there is variation in industrial cap rates, for the most part they fall within one standard deviation of the long-term average, with some exceptions—namely the 1990s period and the post-2014 period. The recession of the early 1990s is of particular interest, as it was characterized by a financial market shock caused by the savings and loan crisis, an oil supply shock, high unemployment and a massive glut of vacant commercial real estate. After the early 1990s recession, industrial cap rates rose steadily for several years before cresting in the mid-1990s and gradually trending lower. In the latest cycle, and particularly since 2014, the industrial sector has attracted significant capital that has helped drive cap rates to record lows.

Recent PREA consensus surveys indicate that near-term industrial returns will once again be income-driven. Balanced space and real estate capital markets—which can provide an alternative to stock and bond markets in a prolonged slow-growth, low-rate environment—support expectations for relatively stable cap rates, rather than an outright expansion for the sector post-COVID-19. Going forward, we believe stable income returns and valuations, coupled with e-commerce tailwinds, will continue to support the industrial sector and drive investor interest.

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[1]Source: CBRE-EA.
[2]Source: Real Capital Analytics. Volume and pricing history begins in 2001.

INDUSTRIAL TOTAL RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
1st Q 2020	0.71	2.58	2.86	1.69	1.91	2.98
4th Q 2019	1.55	3.15	3.55	1.97	2.68	3.46
One Year	5.28	12.88	14.60	8.43	11.12	14.00
Three Years	6.41	13.48	14.13	9.42	11.38	15.14
Five Years	7.65	13.38	13.18	10.10	11.52	15.08
Ten Years	10.17	13.04	12.51	10.51	11.77	14.48
Twenty Years	8.64	10.02	9.93	7.72	8.68	11.40

INDUSTRIAL INCOME RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
1st Q 2020	1.10	1.13	1.20	1.25	1.21	1.03
4th Q 2019	1.10	1.13	1.16	1.33	1.21	1.04
One Year	4.51	4.64	4.80	5.34	4.99	4.27
Three Years	4.57	4.83	4.97	5.42	5.25	4.46
Five Years	4.68	5.03	5.24	5.58	5.47	4.63
Ten Years	5.26	5.66	5.98	6.13	6.03	5.25
Twenty Years	6.15	6.60	6.88	6.98	6.87	6.25

INDUSTRIAL APPRECIATION RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
1st Q 2020	-0.39	1.46	1.67	0.44	0.70	1.94
4th Q 2019	0.45	2.02	2.39	0.65	1.46	2.42
One Year	0.74	7.96	9.46	2.98	5.91	9.44
Three Years	1.77	8.35	8.83	3.85	5.91	10.34
Five Years	2.87	8.05	7.65	4.34	5.81	10.11
Ten Years	4.73	7.08	6.25	4.19	5.49	8.88
Twenty Years	2.38	3.26	2.89	0.70	1.72	4.91

INDUSTRIAL INDEX—QUARTILE RANGE OF RETURNS