

INDUSTRIAL INDEX

INDUSTRIAL OUTPERFORMANCE CONTINUES

The second quarter of 2020 brought some clarity regarding the impact of COVID-19 on property market fundamentals and investment performance. The industrial sector, which entered the downturn as the strongest performing sector, maintained that position. Fundamentals softened slightly, with industrial reporting its first meaningful uptick in availability in the quarter (7.6% in 2020Q2 versus 7.3% in 2020Q1 per CBRE-EA); however, the upward pressure in availability was supply-side driven, as demand remained healthy despite the widespread shutdown of the U.S. economy. The continued expansion of e-commerce fueled demand, with Amazon, Target, Walmart and 3PLs/logistics operators taking down large blocks of space. Meanwhile, access and proximity to rooftops is broadening the scope of investable industrial markets, particularly as the lines between industrial and retail have blurred. Indeed, recent trends have shown healthy demand in a variety of markets, not just traditional gateway markets. Regionally focused markets, like Salt Lake City, Phoenix, Orlando, Tampa and Boston are reporting some of the strongest demand today and we expect that trend to continue.

With the relative stability of the industrial sector, investment performance held up reasonably well. Per NCREIF, all property sectors except industrial reported a meaningful decline in appreciation in the quarter. Indeed, apartment (-1.64%), office (-1.58%) and retail (-4.67%) appreciation were considerably weaker relative to industrial's essentially flat performance (-0.07%). Meanwhile, industrial rent collections and leasing have generally outperformed to date; thus, industrial net operating income (NOI) was stable, outpacing hotels (-150%), retail (-50%) and apartments (-4%), which all reported sizeable declines in NOI quarter over quarter. With steadiness in NOI, the income return in the industrial sector was the strongest at 1.09%, which, combined with relatively flat appreciation, yielded a total return of 1.02%. Again, this compares to negative total returns in the apartments (-0.63%), office (-0.50%) and retail (-3.85%) sectors. Regionally, with smaller markets showing considerable strength in fundamentals, as noted earlier, it is not surprising that San Diego, Orlando, Tampa, Washington, D.C. and Salt Lake City reported the strongest quarterly returns at 3.6%, 3.5%, 3.1%, 2.7% and 2.4%, respectively.

Going forward, cap rates will likely remain relatively stable or even edge down slightly, particularly for the industrial and apartment sectors. The BBB corporate bond spread to treasuries has come in significantly and without upward pressure from the BBB market and plenty of capital on the sidelines waiting to invest, it is unlikely cap rates will move upward. Meanwhile, we expect returns in industrial will be buoyed by 1) continued growth in e-commerce, 2) shifts in inventory management and 3) reshoring or near-shoring of manufacturing. With respect to the latter two demand drivers, the COVID-19 crisis has revealed shortcomings of just-in-time inventory management and a lack of diversity in manufacturing capabilities. Overall, with these factors and slowing supply, we expect industrial to outperform in the years ahead and this view is shared in the PREA consensus forecast. Per PREA, the total NPI return is expected to average 4.7% over the 2020 to 2024 period with industrial (7.0% return) outperforming apartments (5.4%), office (4.2%) and retail (1.9%) by a considerable margin.

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INDUSTRIAL TOTAL RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
2nd Q 2020	-0.99	1.02	1.54	0.61	1.06	0.88
1st Q 2020	0.71	2.58	2.86	1.69	1.91	2.98
One Year	2.69	10.26	11.98	6.57	8.66	11.14
Three Years	5.44	12.73	13.51	8.92	10.76	14.19
Five Years	6.77	12.77	12.77	9.48	10.95	14.37
Ten Years	9.70	12.90	12.44	10.45	11.61	14.30
Twenty Years	8.42	9.88	9.85	7.63	8.61	11.18

INDUSTRIAL INCOME RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
2nd Q 2020	1.01	1.09	1.13	1.24	1.18	1.01
1st Q 2020	1.10	1.13	1.20	1.25	1.21	1.03
One Year	4.40	4.57	4.73	5.24	4.92	4.20
Three Years	4.52	4.78	4.91	5.37	5.18	4.41
Five Years	4.63	4.98	5.18	5.53	5.41	4.58
Ten Years	5.19	5.59	5.89	6.07	5.96	5.18
Twenty Years	6.09	6.54	6.83	6.93	6.81	6.19

INDUSTRIAL APPRECIATION RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
2nd Q 2020	-2.00	-0.07	0.41	-0.63	-0.12	-0.13
1st Q 2020	-0.39	1.46	1.67	0.44	0.70	1.94
One Year	-1.65	5.50	7.00	1.28	3.62	6.72
Three Years	0.89	7.68	8.30	3.42	5.37	9.47
Five Years	2.07	7.52	7.31	3.80	5.33	9.47
Ten Years	4.35	7.03	6.27	4.20	5.41	8.78
Twenty Years	2.22	3.18	2.87	0.66	1.70	4.76

INDUSTRIAL INDEX—QUARTILE RANGE OF RETURNS

