

INDUSTRIAL INDEX

INDUSTRIAL RETURNS DECELERATE AS MACROECONOMIC UNCERTAINTY AND INTEREST RATE HIKES WEIGH ON OVERALL CAPITAL MARKET SENTIMENT

The U.S. industrial market's fundamentals remain strong across the country as the overall vacancy rate remains at a historic low despite record-high construction deliveries. Companies are expanding their warehouse footprint and "just in case" inventory as e-commerce sales continue to grow. New focus has been put on supply chain resiliency and, as a result, companies are diversifying their supply chains and considering onshoring production closer to the end consumer. Net absorption has approximately doubled above its normalized rate, which has led to outsized rent growth for functional product in core markets. This dynamic should continue as tenants struggle to find available space in an incredibly low vacancy environment.

The macroeconomic environment, which includes high inflation, war, supply chain challenges, and a global energy shock, has added uncertainty to an already complex investment landscape. The Federal Reserve's commitment to re-anchor inflation with steep rate hikes has caused a monumental shift in the U.S. economy. This has caused the 10-year treasury yield to rise more than 200bps YTD, residential mortgage rates to move above 7% for the first time in two decades, and created elevated costs across the spectrum of shipped goods despite supply chain issues slowly easing. Even with these major economic risk factors, the U.S. economy was resilient. GDP rose 2.6% in 3Q-2022 after two quarters of negative growth and the unemployment rate remains at a near 50-year low.

Third quarter industrial returns have moderated to 1.11%, a level not seen since the onset of COVID-19 and a byproduct of the current economic environment's impact on capitalization rates. For the past few years real estate appreciation has driven the industrial sector's strong quarterly returns, however the Federal Reserve's tightening monetary policy coupled with rising interest rates restricted this quarter's appreciation dramatically, a 475bps decrease from the prior quarter appreciation return. Of the 1.11% return, 68% was driven by income and 32% driven by capital appreciation versus 2Q-2022 when 87% was driven by capital appreciation. Across the sector, industrial's total returns ranked 3rd highest for the quarter behind hotels and apartments at 2.69% and 1.20%, respectively. Despite tapered returns for the quarter, industrial led returns across all property types (nearly double that of apartments - the nearest property type) at 18.78% YTD and 34.62% over the prior four quarters.

The industrial sector's outlook remains positive due to its secular drivers, however there are more risks today than in previous quarters. As the likelihood for recession increases, cap rates should continue to follow debt and treasury rates further limiting capital appreciation over the near-term. Despite these headwinds industrial fundamentals remain solid. Demand has been steady and vacancy remains low while rising construction costs and increased cost of capital should keep the market at a healthy equilibrium of supply and demand. These factors support continued rent growth which should drive NOI higher and help to partially offset cap rate expansion. Well located and functional industrial product should continue to lead NPI returns for the foreseeable future.

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INDUSTRIAL TOTAL RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
3rd Q 2022	0.57	1.11	0.84	0.85	0.98	1.34
2nd Q 2022	3.23	5.86	5.35	3.91	4.68	6.95
One Year	16.08	34.62	31.79	20.13	29.22	41.37
Three Years	9.91	25.21	25.75	16.18	21.13	28.82
Five Years	8.62	20.56	21.15	13.73	17.42	23.26
Ten Years	9.48	16.71	16.57	12.29	14.71	18.67
Twenty Years	8.91	12.10	11.84	8.92	10.65	13.70

INDUSTRIAL INCOME RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
3rd Q 2022	0.93	0.76	0.75	1.01	0.87	0.67
2nd Q 2022	0.97	0.78	0.78	1.00	0.90	0.69
One Year	3.98	3.34	3.30	4.26	3.78	2.98
Three Years	4.17	4.06	4.10	4.78	4.45	3.72
Five Years	4.33	4.37	4.43	5.03	4.77	4.02
Ten Years	4.73	4.98	5.21	5.55	5.41	4.57
Twenty Years	5.59	5.98	6.23	6.44	6.29	5.61

INDUSTRIAL APPRECIATION RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
3rd Q 2022	-0.37	0.35	0.09	-0.17	0.11	0.67
2nd Q 2022	2.26	5.08	4.58	2.91	3.78	6.26
One Year	11.76	30.56	27.83	15.40	24.77	37.59
Three Years	5.58	20.53	21.02	11.01	16.14	24.43
Five Years	4.15	15.68	16.18	8.38	12.20	18.68
Ten Years	4.59	11.31	10.93	6.46	8.93	13.64
Twenty Years	3.19	5.84	5.34	2.36	4.16	7.75

INDUSTRIAL INDEX—QUARTILE RANGE OF RETURNS

