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# industrial market analysis

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**Of all the real estate sectors, the industrial market was considered to be able to best withstand the difficulties brought on by the Covid-19 pandemic. This assessment appears to be supported as industrial real estate, although still taking a hit, has fared much better than the other sectors during this time.**

With rental rates remaining level and construction continuing to come into the pipeline, the industrial market seems like it has been able to cope with the impact of the virus relatively well. Because of industrial building's large floorplates, tenants have been more able to social distancing mandates for employees, allowing them to continue working and processing without being shut down or forced to close for periods of time like other businesses have had to do. Additionally, because almost all ecommerce requires industrial space for distribution and fulfillment, industrial space has still been in need with distribution centers still processing high volumes of product as consumers turn to online retail.

Yet, as the effects of Covid-19 continue to be seen as this year progresses and we enter into the third quarter, the future of the industrial market is in flux. One question is what will happen to distribution centers once brick and mortar stores begin to open back up? It is possible that there will be a reversion to previous shopping patterns, which would in turn lead to a decrease in the demand for distribution centers causing a need to retract. This would lead to negative absorption and the possible decline of rental rates. On the other hand, it is entirely possible that online shopping will remain popular even once brick and mortar retail opens back up, and the increased market capture by online retailers reflects a simple acceleration of trends we have been seeing over the last decade. This means that the need for distribution centers will continue to grow as more people turn to online shopping.

Beyond this, much of Portland's industrial space consists of manufacturing space. In almost all Portland submarkets, Central City, Westside, North/Northeast, and Southeast, vacancy has actually decreased since last quarter for manufacturing space.

All this indicates that the Portland industrial sector is still strong and will likely continue to be so even as the pandemic progresses. Although it is possible for the space to see rent decline and a slight vacancy increase, industrial is likely to remain a strong real estate sector throughout the pandemic.

## INDUSTRIAL RENTS

Industrial rents have been increasing to record highs in the most recent years. Prior to the pandemic, industrial market rents were increasing at a rate of about 6% year over year. This had pushed market rents to $9.47 per square foot in the second quarter of 2020. This growth is likely to reverse in the coming quarters as the effects of the pandemic begin to be fully realized in the industrial market. This will account for the first decline in industrial rental rates in over ten years. Despite this decline, the increasing development and construction of industrial properties throughout the Portland metro area point to Portland's growing status in the industrial real estate sector.

Of course, much of this growth has been due to large distribution warehouses that have come to completion in the last couple years around the Portland area. Many companies are beginning to see Portland as an opportunity for growth and expansion due to its relatively low prices as compared to the other major west coast cities such as San Francisco and Seattle. It is for this reason that vacancy has remained relatively tight in the industrial sector at about 4.4% even during the midst of the pandemic. This is only up slightly from its average of 3.5% in the past three years when it had the lowest recorded vacancy in the past 10 years. This minimal vacancy increase is likely due to the industrial sector's resiliency against the pandemic. For instance, online shopping has increased by $19 billion dollars year over year. This increase in online shopping requires high volumes of industrial space in order to store, manage, and distribute the merchandise. Additionally, the companies that often take up the most industrial square footage are the ones that have been best positioned to take advantage of the increased online shopping activity. As the report from Colliers puts it, "Users occupying more than 100K SF fare much better than smaller tenants due to e-commerce tailwinds, better balance sheets, and smaller reliance on the service industry, which is indicative of depressed leasing activity for requirements under 30K SF."

That all being said, the effects of Covid-19 on the industrial real estate market have taken their toll. For instance, in a survey created by the PSU Center for Real Estate, participants were asked "Overall, how long are you currently expecting COVID-19 to seriously impact your business operations?" Participants answered according to their various sectors. For the industrial market, the largest percentage of individuals (37.04%) believed that Covid-19 would impact their business for more than 12 months. This as compared to the 9.26% who said between 1-3 months expresses many industrial real estate market professional's opinions on the virus and its impacts.

## ABSORPTION AND VACANCY

In terms of absorption, industrial real estate has seen solid growth in the second quarter of 2020. In fact, net absorption has increased dramatically since last quarter which had negative absorption of 230,000 square feet. In this current quarter, absorption was at 1.2 million square feet. This is the highest rate of absorption that has occurred since the third quarter of 2018 when two 858,000 square feet Amazon distribution centers were delivered. This high amount of absorption is exceptional when recognizing how much of the new construction is speculative development. There is over 2 million square feet of speculative development underway. Despite this, absorption has been able to maintain.

Another evidence of the strength of this submarket is the vacancy level which is at 4.25%. This is incredibly low considering that the market was at 4.23% in the first quarter of 2018 when the market was at its peak.

## NOTABLE BUILDS AND TRANSACTIONS

Although construction on industrial projects has slowed as real estate professionals take time to assess how to best react to the pandemic, it has not stopped and there are actually some notable projects that are in progress.

The first and most notable is the expansion of Intel's D1X. This 1.5 million square foot expansion is "set to be the largest industrial development of the decade." This project is so large that an article in the Oregonian estimated that the cost of the entire fabrication of the project including construction and equipping the facility is likely to range somewhere "between $4 billion and $5 billion." Another build-to-suit that is dwarfed in comparison to D1X, but is still relatively large for the Portland area is the 236,000 square foot expansion of the Subaru Distribution Center. These two projects along with two other large 550,000 square feet projects for Columbia Distributing and United Natural Foods, account for a large portion of the construction happening in the second quarter of 2020.

In addition to these build-to-suits, there has also been a large amount of speculative development that is currently under construction. Trammel Crow's Blue Lake Corporate Park development consisting of two buildings that totaled 464,000 square feet were completed in this quarter. Additionally, as pointed out in the last quarter's industrial article, Bridge Development is still constructing their Bridge Point i5 project on Airport Way. This 677,000 square foot footprint is set to be delivered in quarter three of 2020.

Speculative development has represented a significant part of Portland's industrial development in the current business cycle. And although these large developments have generally been successful and sold quickly, they are not always leased up as quickly. But owners and developers seem unconcerned about this as more speculative development comes into the pipeline. According to CoStar, there is over 2 million square feet of industrial space under construction in the second quarter of 2020. It is still left to be determined what will happen to this speculative space as the economy and market progress into the third quarter and the effects of the pandemic become more pronounced.

## CONCLUSION

Coming into the pandemic, the industrial real estate market was red-hot. Properties were being developed at such an extent that, according to CoStar, "the metro had more space under construction than at any other point in the past decade." As the pandemic hit and the economy contracted sharply, so too did many real estate market sectors. Yet, out of all of the major sectors, industrial has been the most durable in withstanding the downward market forces. This is displayed in the comparatively steady vacancy rate, the high amount of absorption, and the relatively large amount of construction that is still progressing even as the pandemic continues to shut down the economy. There are many reasons for this, but two stand out as especially important – the high proportion of activities within an industrial space that is deemed "essential" and the increased online retail traffic. The proportion of "essential" activities is higher in the industrial sector as opposed to retail. Additionally, this sector is less reliant on the public in order to be sustainable. Secondly, the increase in online shopping has led to an ever-increasing need for industrial space to distribute these materials. With these situations in place, the industrial real estate market is likely to remain resilient as the market and economy fluctuate under the forces of this pandemic.

## REFERANCES

*1. CoStar*

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*3. Colliers*

*4. PSU Center for Real Estate Poll*

*5. CoStar*

*6. CoStar*

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*8. The Oregonian*

*9. CoStar*