U.S. industrial market report

Q3 2023

AVISON YOUNG

U.S. industrial market trends

-33.5%

Q3 2023 net absorption vs. five-year average

Industrial net absorption remained positive but declined relative to 2021 levels in late 2022 and the first half of 2023 due to global economic and financial headwinds and record levels of new construction deliveries. Net absorption was down just under 20% from 10-year averages, and slightly gained in the third quarter of the year over the second quarter. If the sector's net absorption remains positive over the next three to six months, despite surging new supply via deliveries, there could be a supply imbalance in favor of developers due to the comparatively limited pipeline that has broken ground since Q3 2022.

402.3 msf

Q3 2023 gross leasing, on par with pre-COVID average

Overall leasing volume through the first three quarters of 2023 is substantially smaller when compared to the previous two years, however demand remains active throughout the U.S. industrial market. Despite the decline compared to recent performance, current leasing volumes are on par with the sector's pre-COVID 10-year average. As the economy continues to showcase resiliency, more users have been actively entering the pre-leasing process, indicating that leasing activity is aligning for increases in 2024.

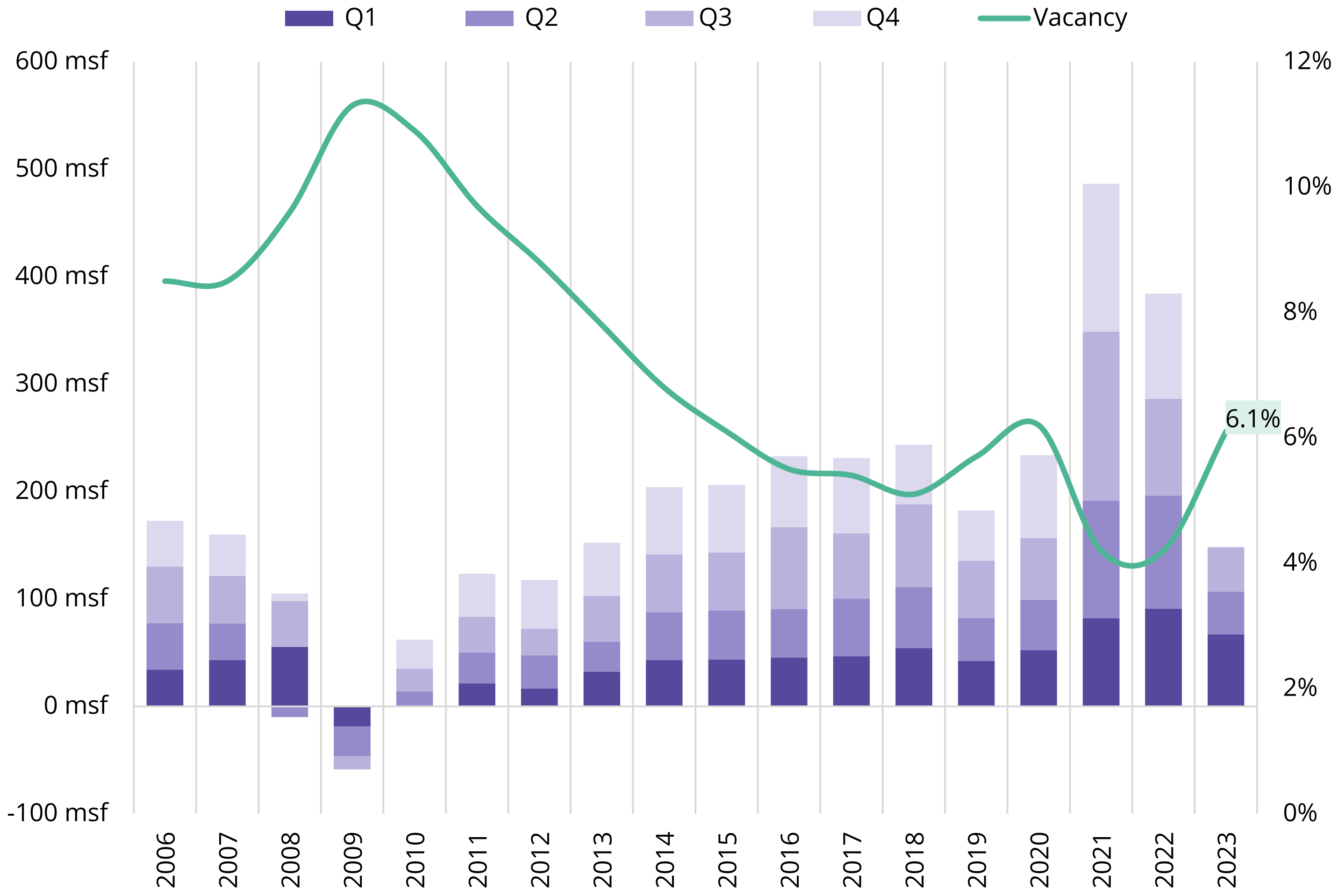
-27.4%

Construction pipeline has fallen since Q3 2022 high

New construction groundbreakings topped out in the third quarter of 2022. We are closely monitoring the market shift that decreasing groundbreakings will have on new space availabilities in six to nine months, as tenants looking for newly constructed space may have limited optionality relative to prior years.

Source: AVANT by Avison Young, CoStar, MSCI Real Capital Analytics

U.S. industrial net absorption vs. vacancy

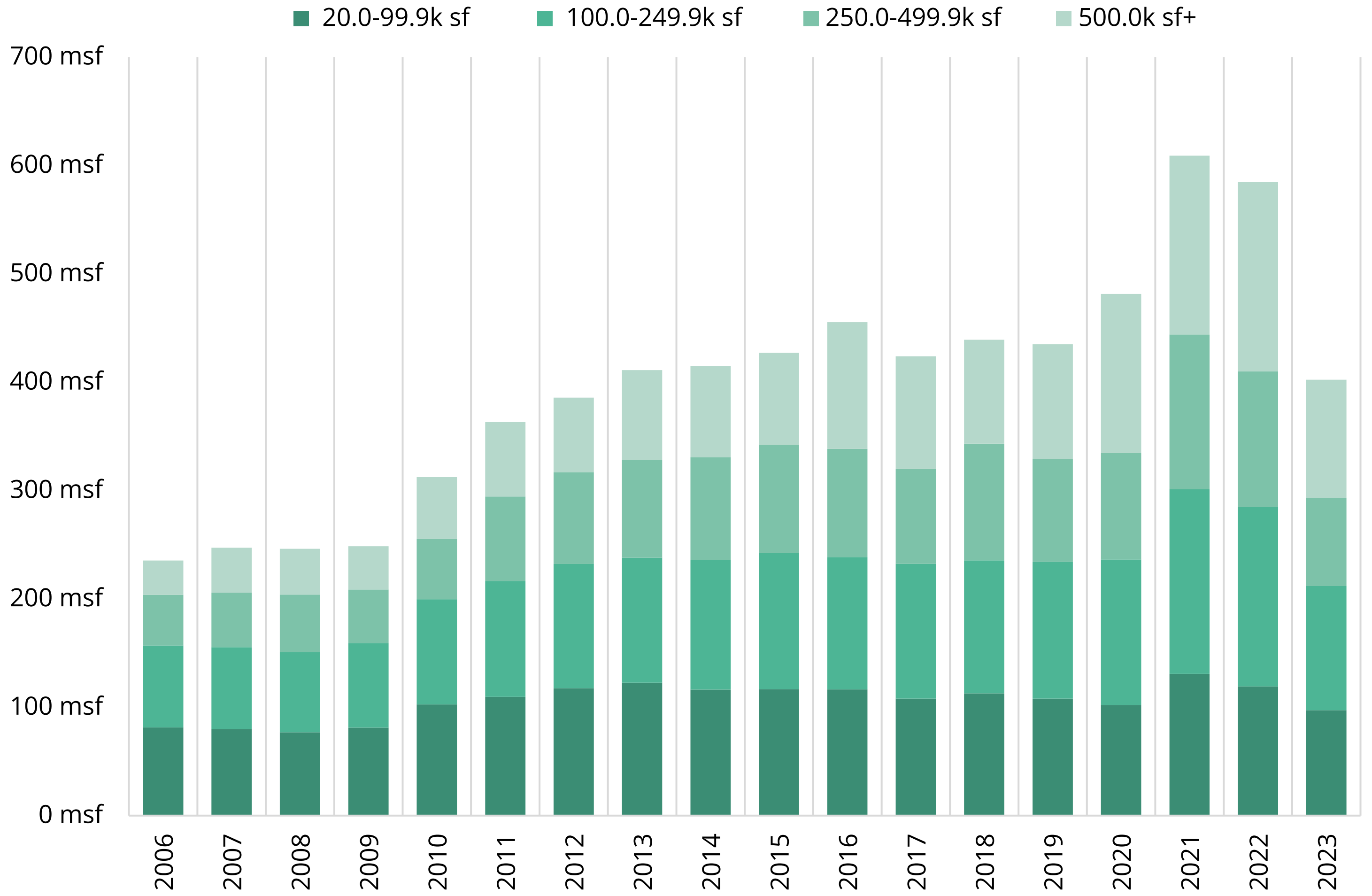


Demand remains robust throughout the country; however, a flood of new deliveries are driving vacancies higher, and net absorption lower.

Source: AVANT by Avison Young, CoStar

AVANT by AVISON YOUNG

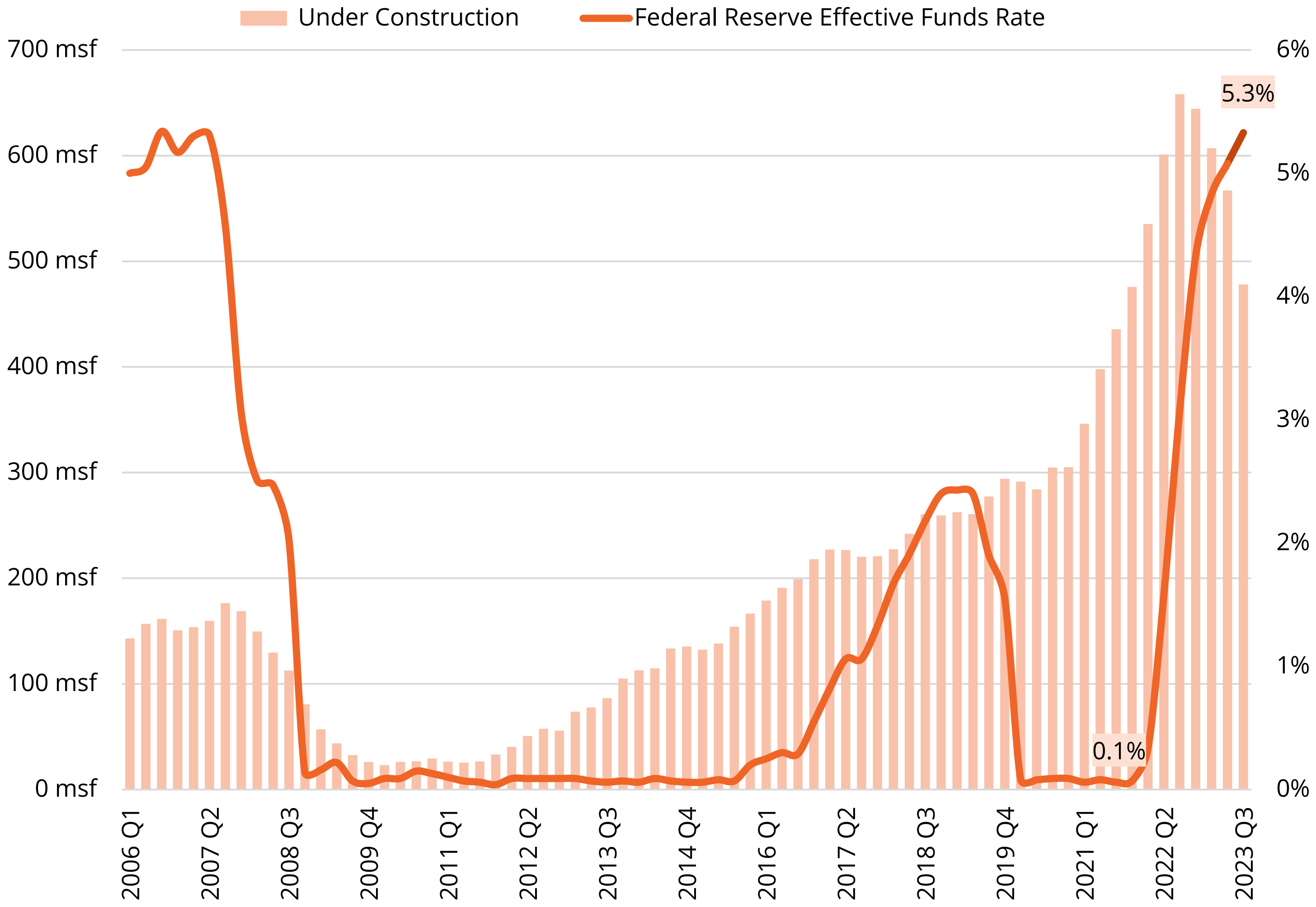
U.S. industrial gross leasing volume



Leasing volume through the third quarter for buildings +500k sf is down 32.7% from its three-year average. Overall leasing is down 20.9% compared to the three-year average, however, leasing is only slightly below the pre-COVID average by 6.9%.

*Note: All totals through Q3 of referenced year
Source: AVANT by Avison Young, CoStar

New construction groundbreakings

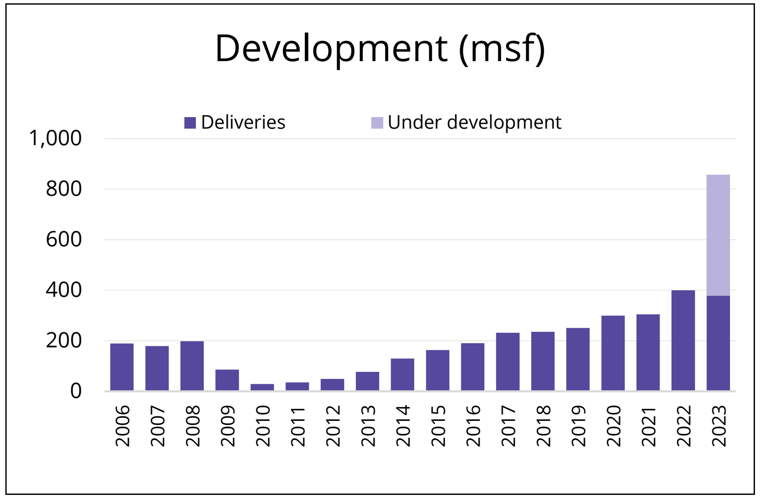


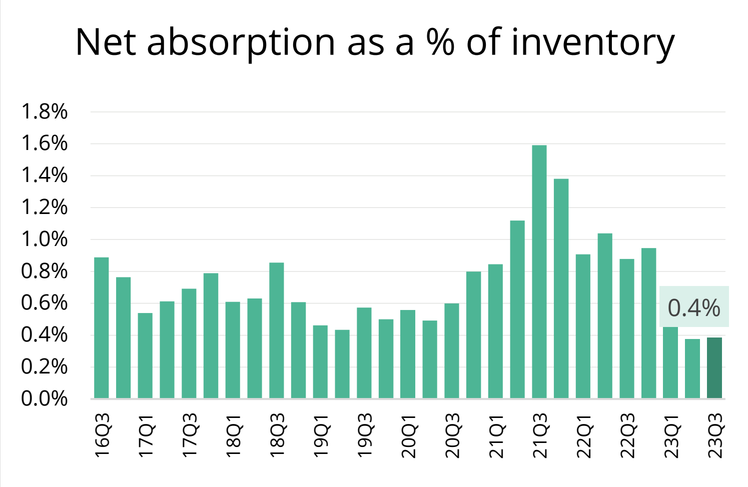
Source: AVANT by Avison Young, CoStar

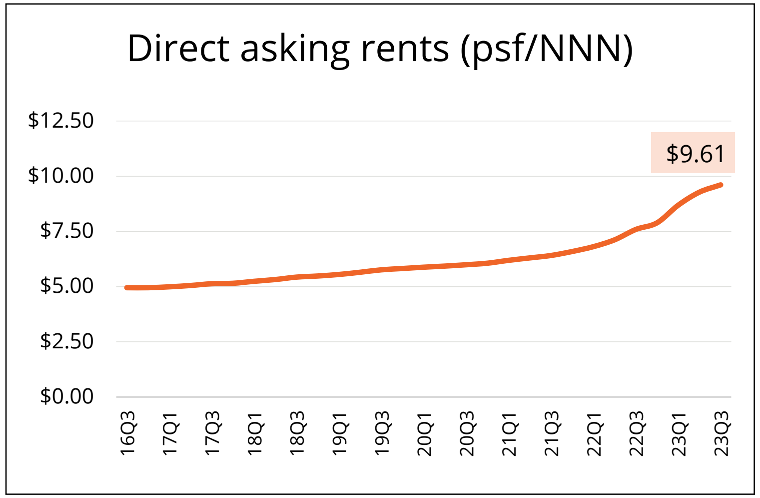
With limited exceptions, groundbreakings have effectively stalled throughout the country as access to construction loans has been challenging since Q3 2022.

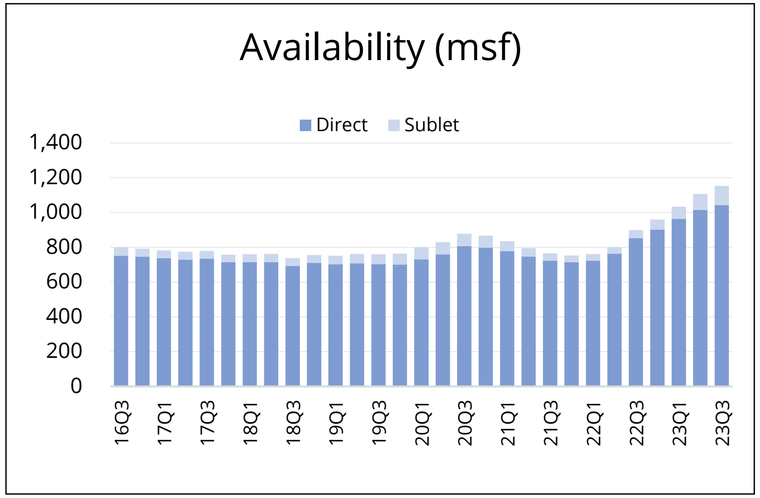
AVANT by AVISON YOUNG

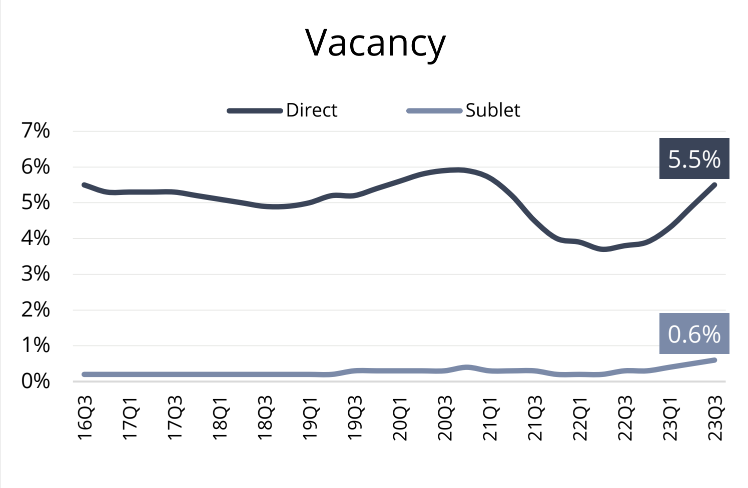
U.S. industrial market indicators

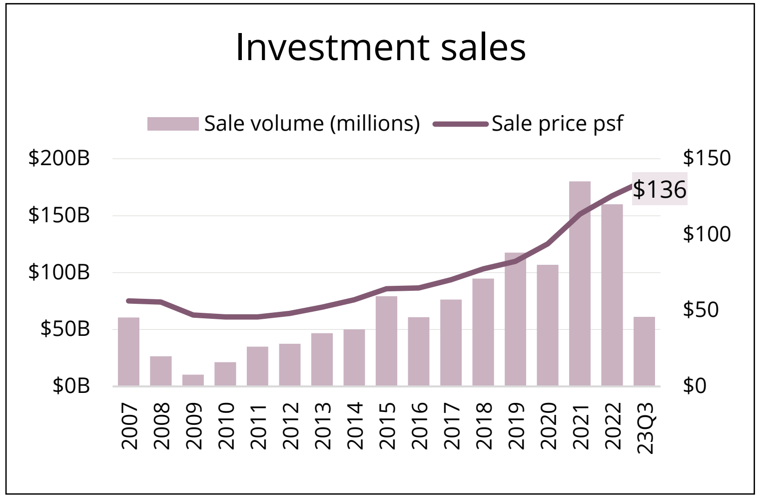








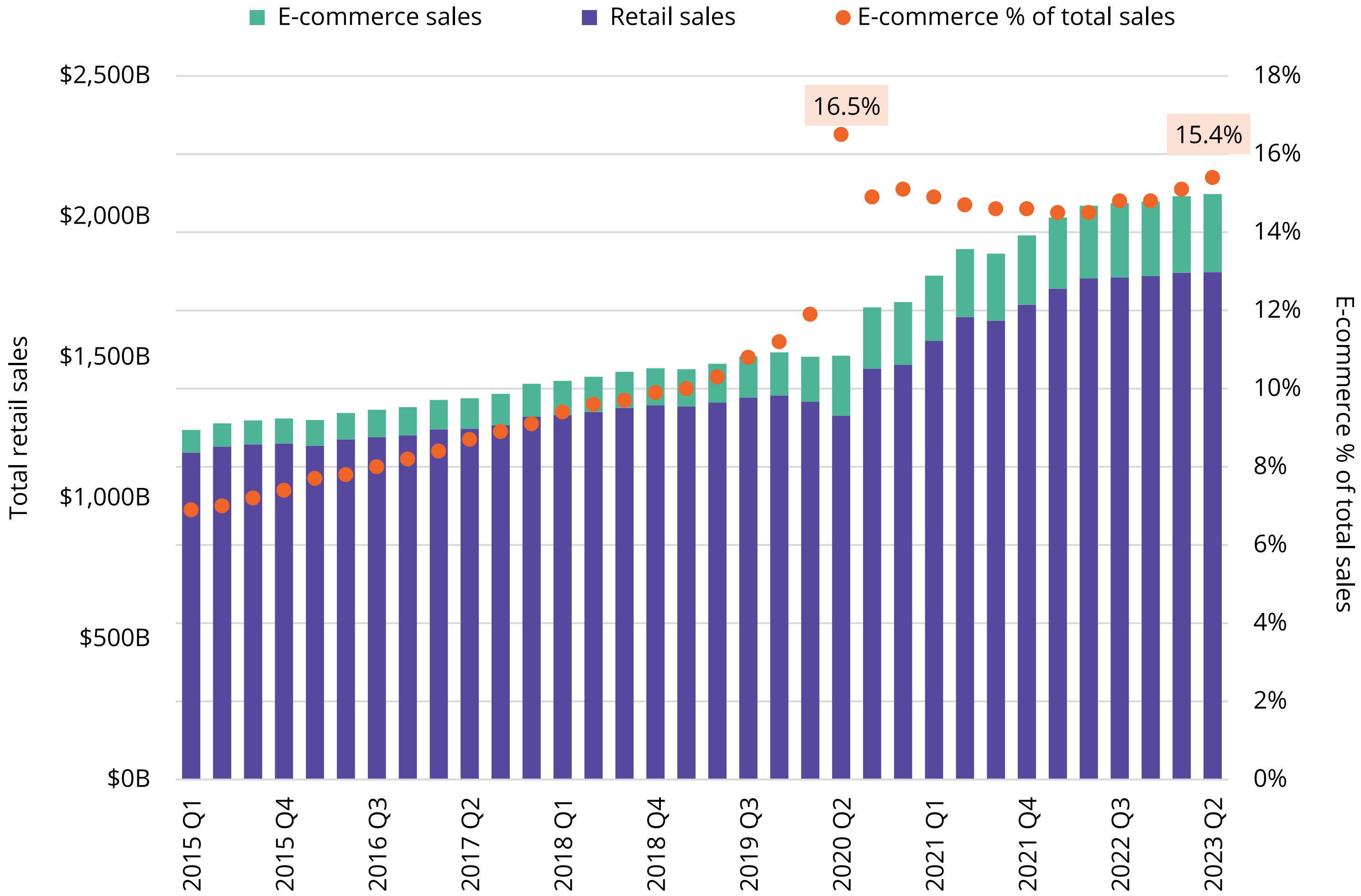




Source: AVANT by Avison Young, CoStar, MSCI Real Capital Analytics

AVANT by AVISON YOUNG

Expanding e-commerce industrial demand

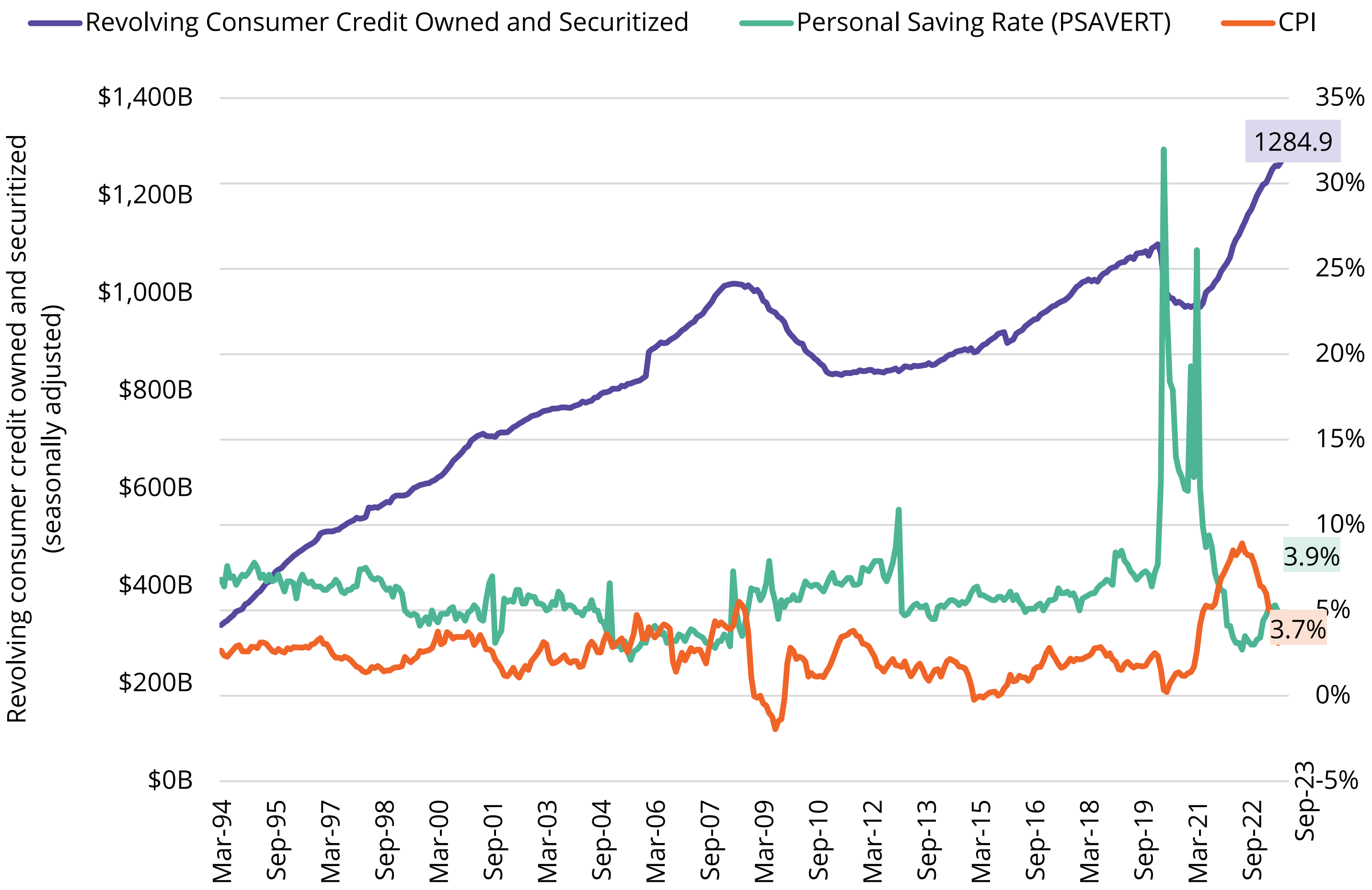


Note: As of August 17, 2023 (most recent update)
Source: Federal Reserve Bank of St. Louis

E-commerce retail spending has increased by 30.2% since the beginning of 2020, making e-commerce a sustained source of industrial demand.

AVANT by AVISON YOUNG

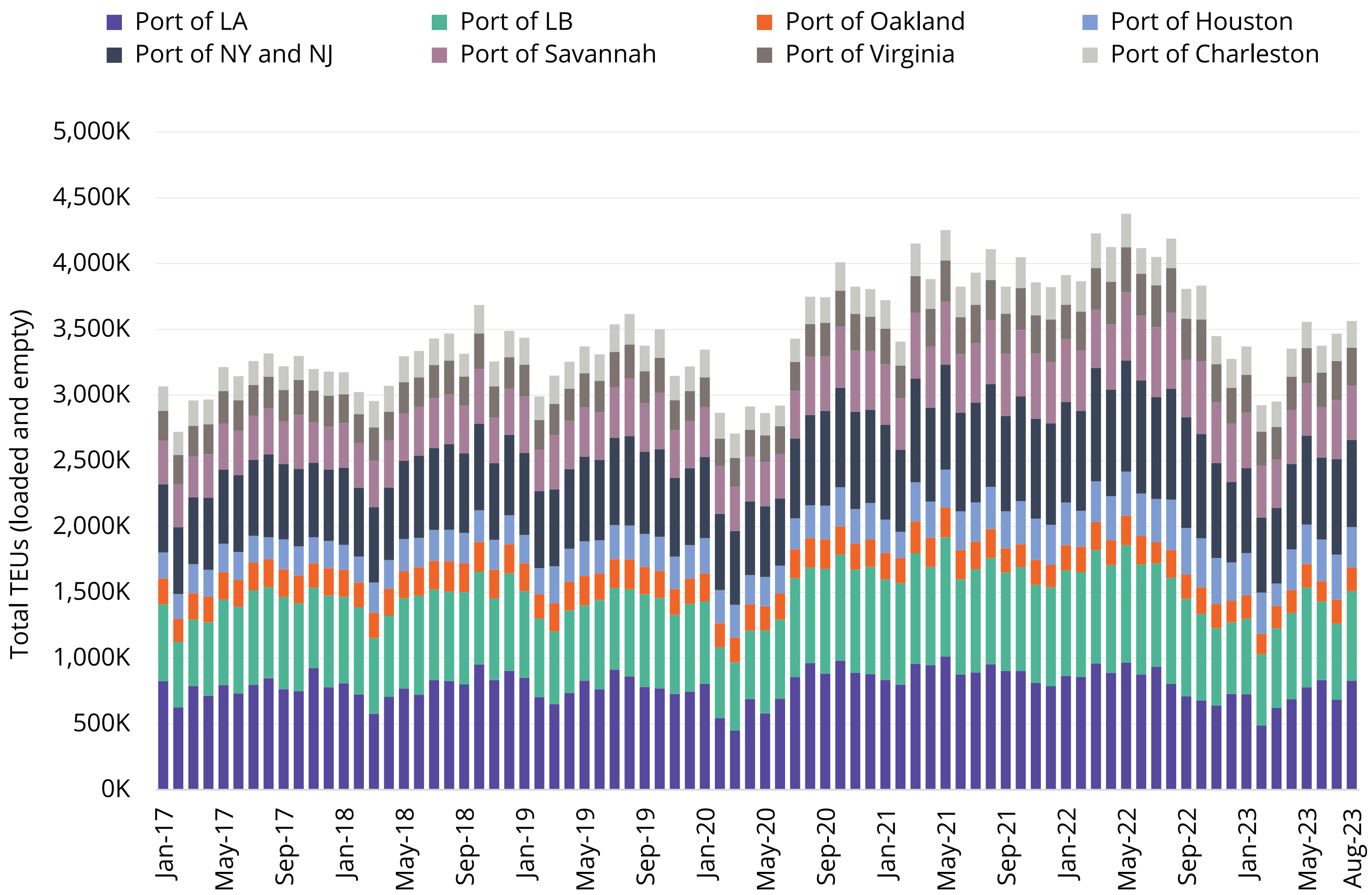
Consumer conditions guiding industrial demand



CPI is beginning to rise again, just as student loan payments are set to resume in October. Consumer credit utilization continues to surge at historic highs as core inflation left many consumers borrowing to pay for increased costs.

Source: AVANT by Avison Young, Federal Reserve Bank of St. Louis

Port activity on currently third highest on record despite slow start to year

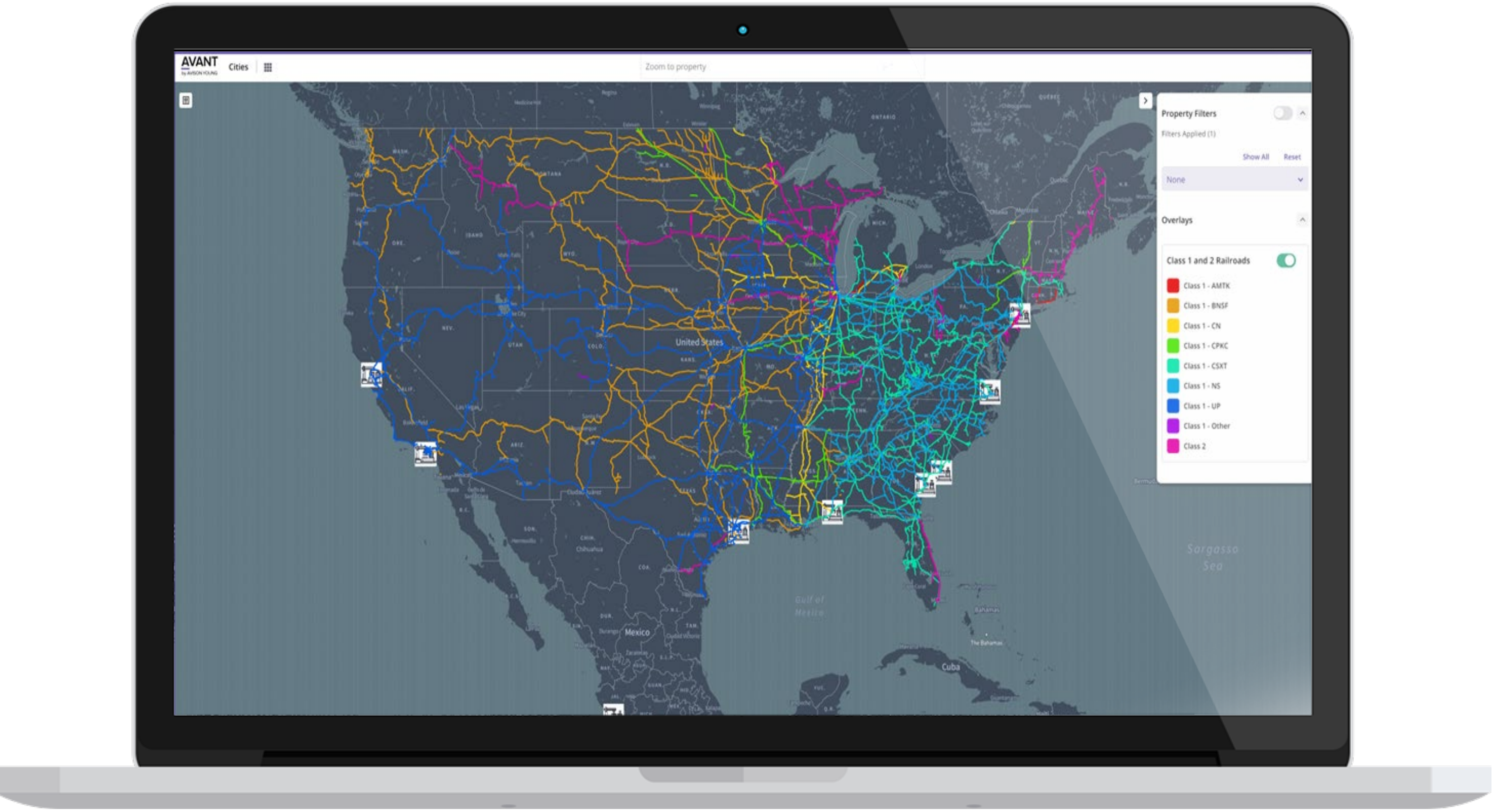


Source: AVANT by Avison Young, Individual Port Authorities
*Most recent data through August totals

Port activity continues to accelerate despite economic concerns. Mexico's two largest ports also contribute close to 5M TEUs to North American volumes, offering supply chains ever more options.

AVANT by AVISON YOUNG

Reshoring and nearshoring strategies continue to focus away from economies of scale and toward diversification



1M TEU

Port of Mobile capacity in 2025 when expansion and dredging are complete

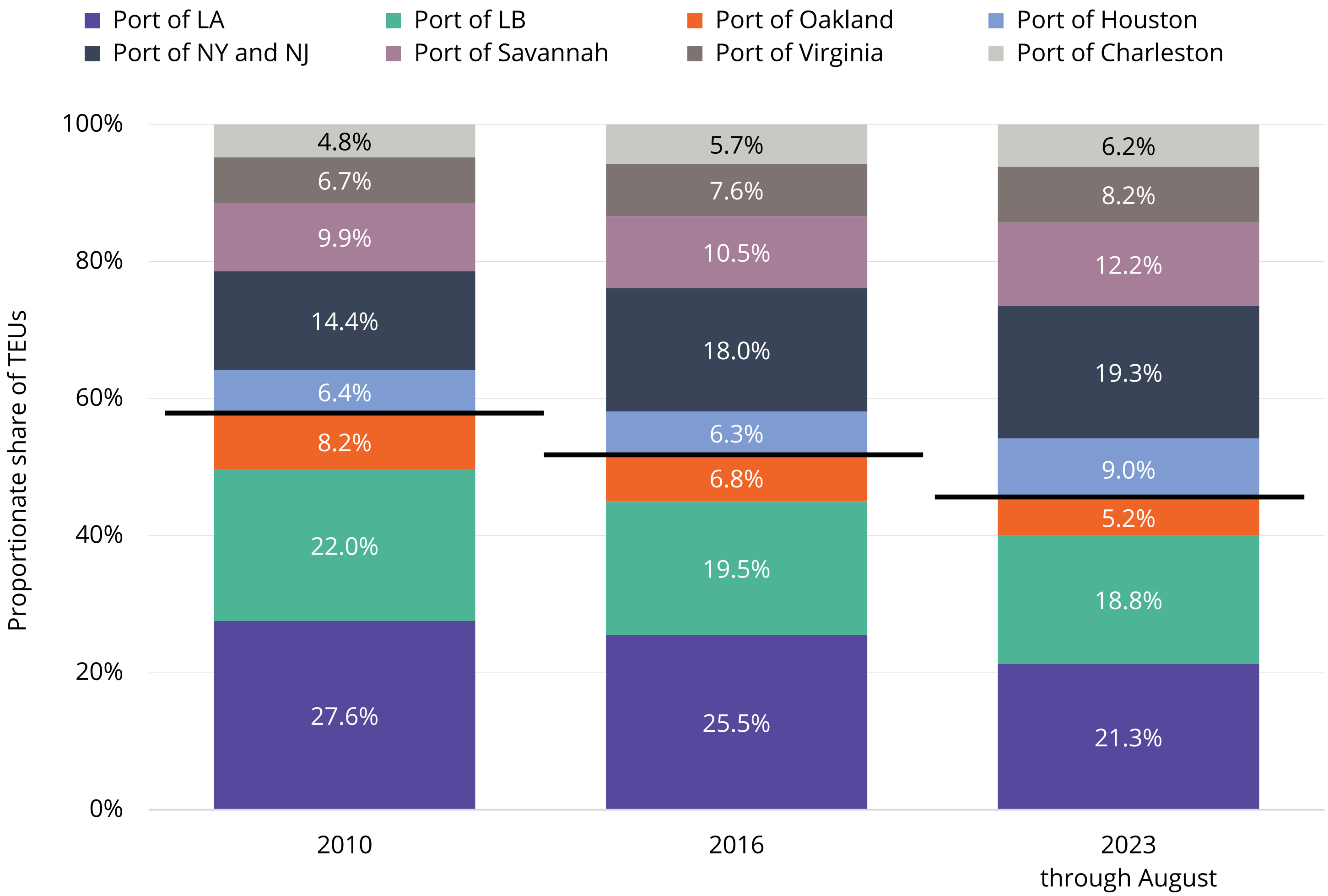
3.5 + 2.0M

Record TEU volume in 2022 for Mexico's Port of Manzanillo and Port of Lazara Cardenas, respectively

Source: AVANT by Avison Young, Getty Images

AVANT by AVISON YOUNG

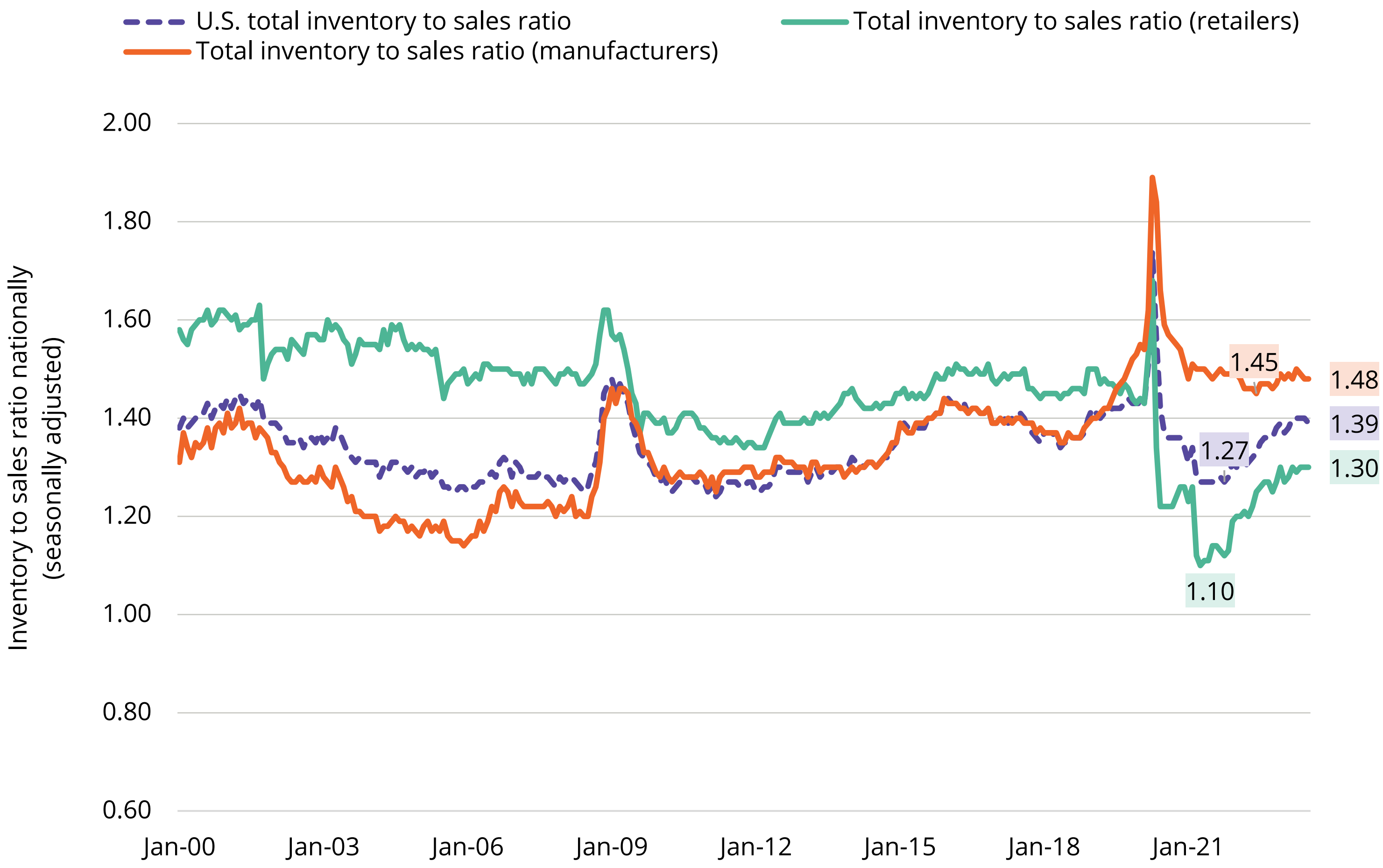
East Coast ports continue to build significant market share as firms seek diversified risk



Note: Percentage of activity for specific Ports listed; Most up-to-date data through August.
Source: AVANT by Avison Young, Individual Port Authorities

Led by reshoring and an elevated focus on diversification, supply chain strategies begun in 2016 are now well into their execution, largely benefiting U.S. Eastern ports and, increasingly, Mexico's Western ports.

Inventory to sales ratios driver of demand for industrial space

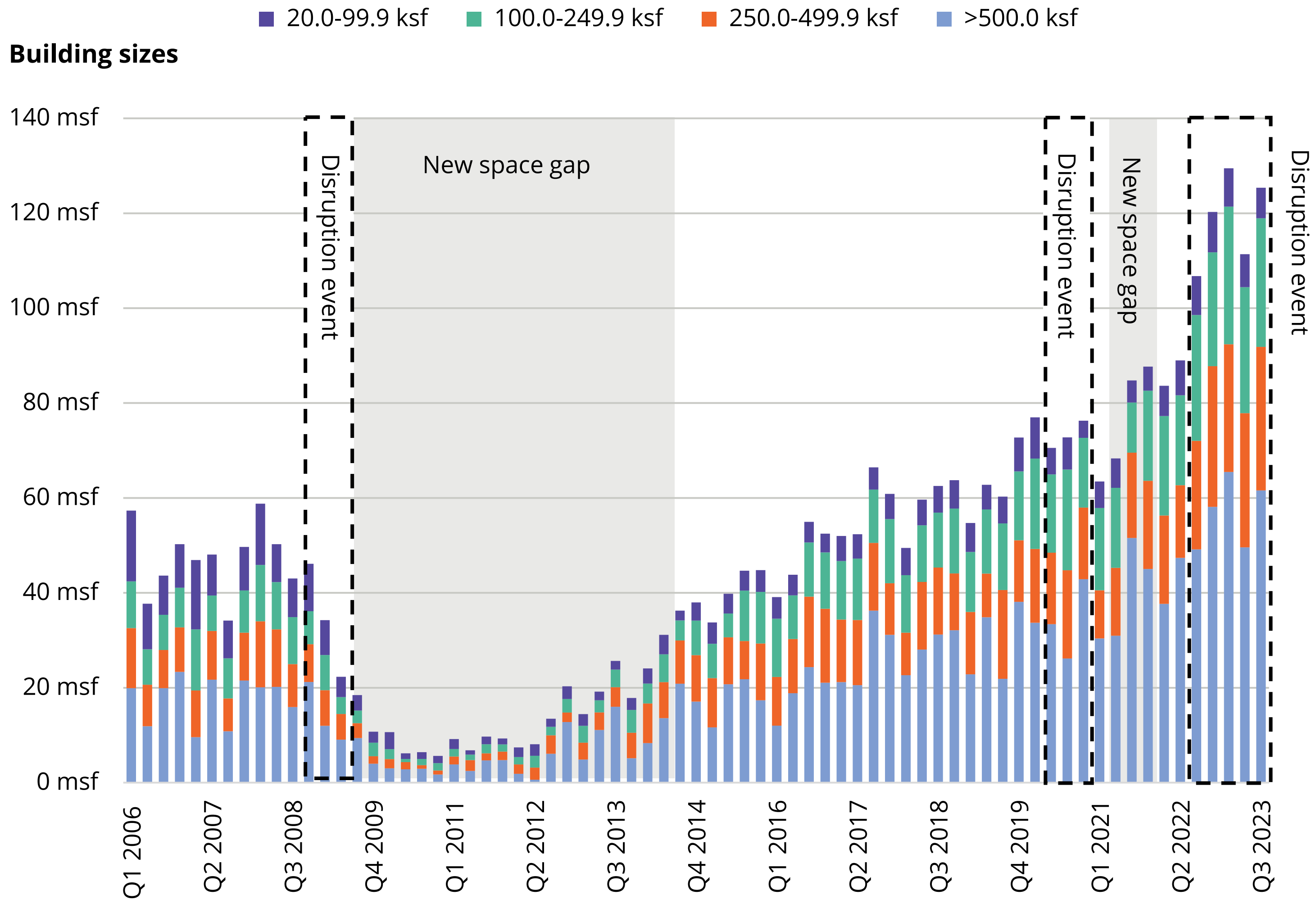


Note: As of July 2023 (most recent update)
Source: AVANT by Avison Young, Federal Reserve Bank of St. Louis

Retailers have inventories that are slowly building, suggesting why they may be delaying lease decision-making. Manufacturers, however, are building at historic new levels in efforts to limit production disruptions experienced during COVID.

AVANT by AVISON YOUNG

Future new space will be extremely limited, as experienced in previous volatile environments

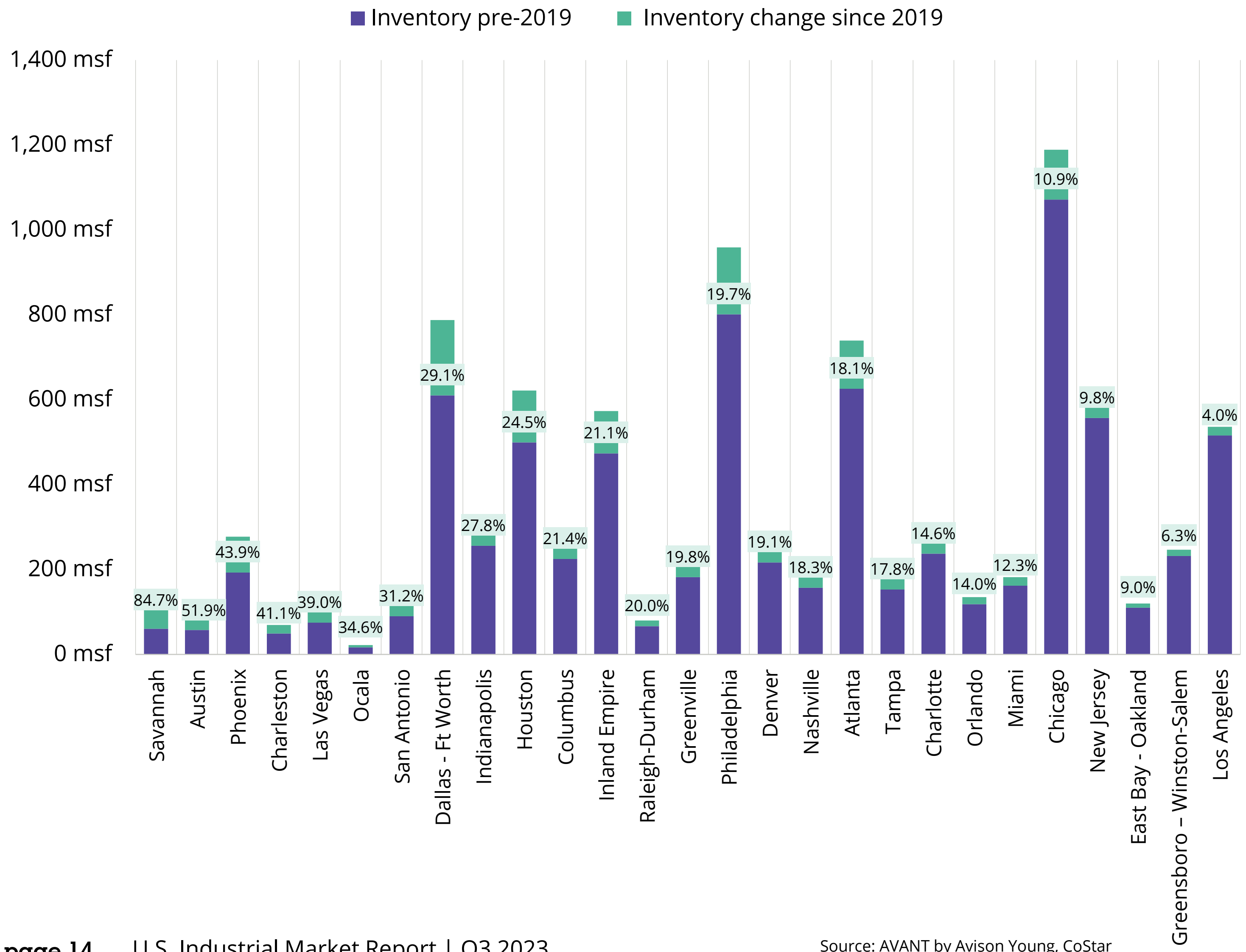


Due to the challenging financial environment and the lack of new groundbreakings, a large delivery gap can be expected in 12-18 months.

Source: AVANT by Avison Young, CoStar

AVANT by AVISON YOUNG

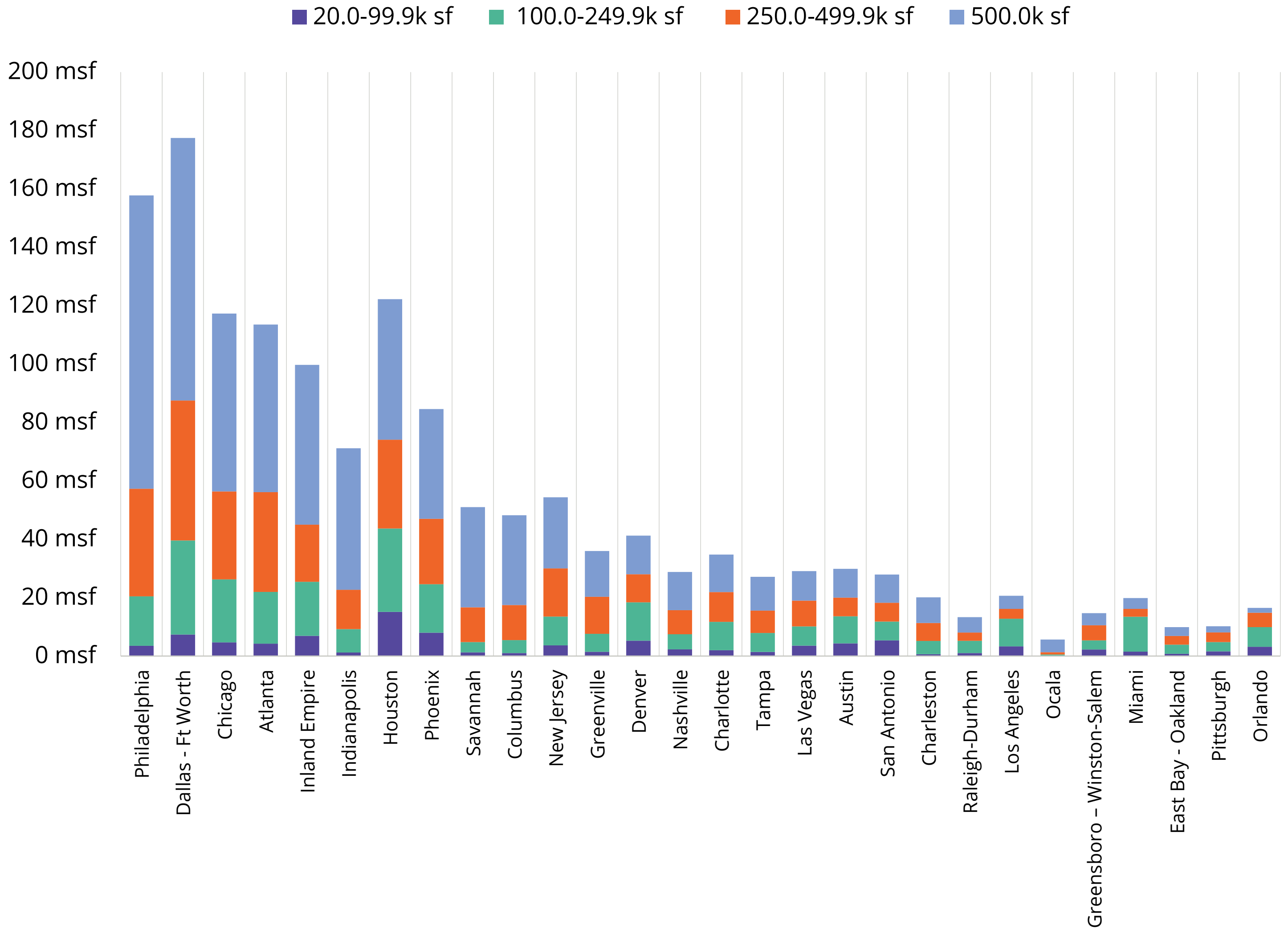
Inventory growth since 2019



Source: AVANT by Avison Young, CoStar

Several markets have increased their inventories by over 20% since 2019, largely centered around the accelerated demand experienced during the initial years of COVID.

Inventory growth since 2019 by building size

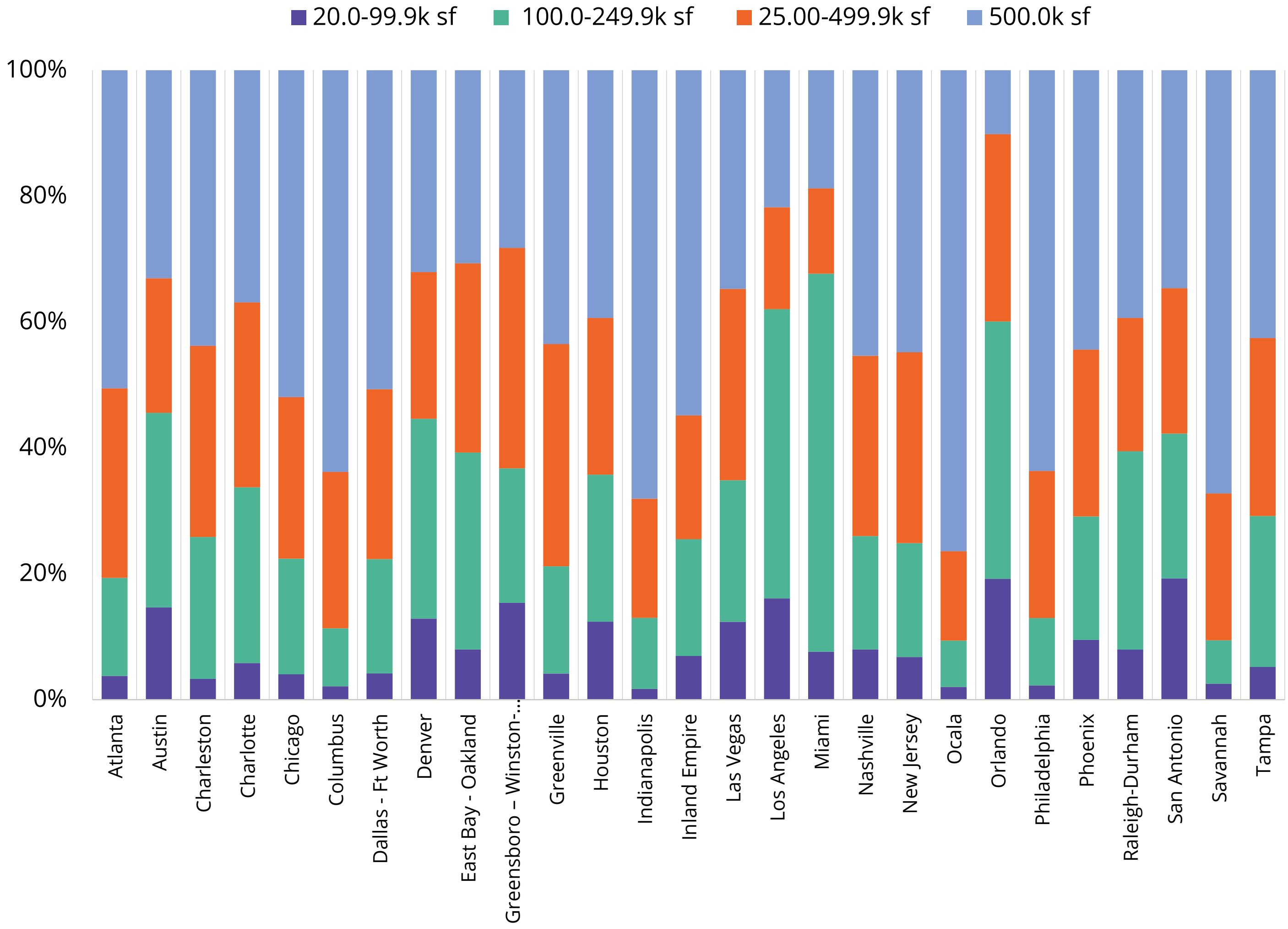


Source: AVANT by Avison Young, CoStar

Many traditionally easy-to-build markets greatly expanded their Big Box inventory since 2019, as industrial expansions required larger space that was almost never available.

AVANT by AVISON YOUNG

Building size as percent of all deliveries

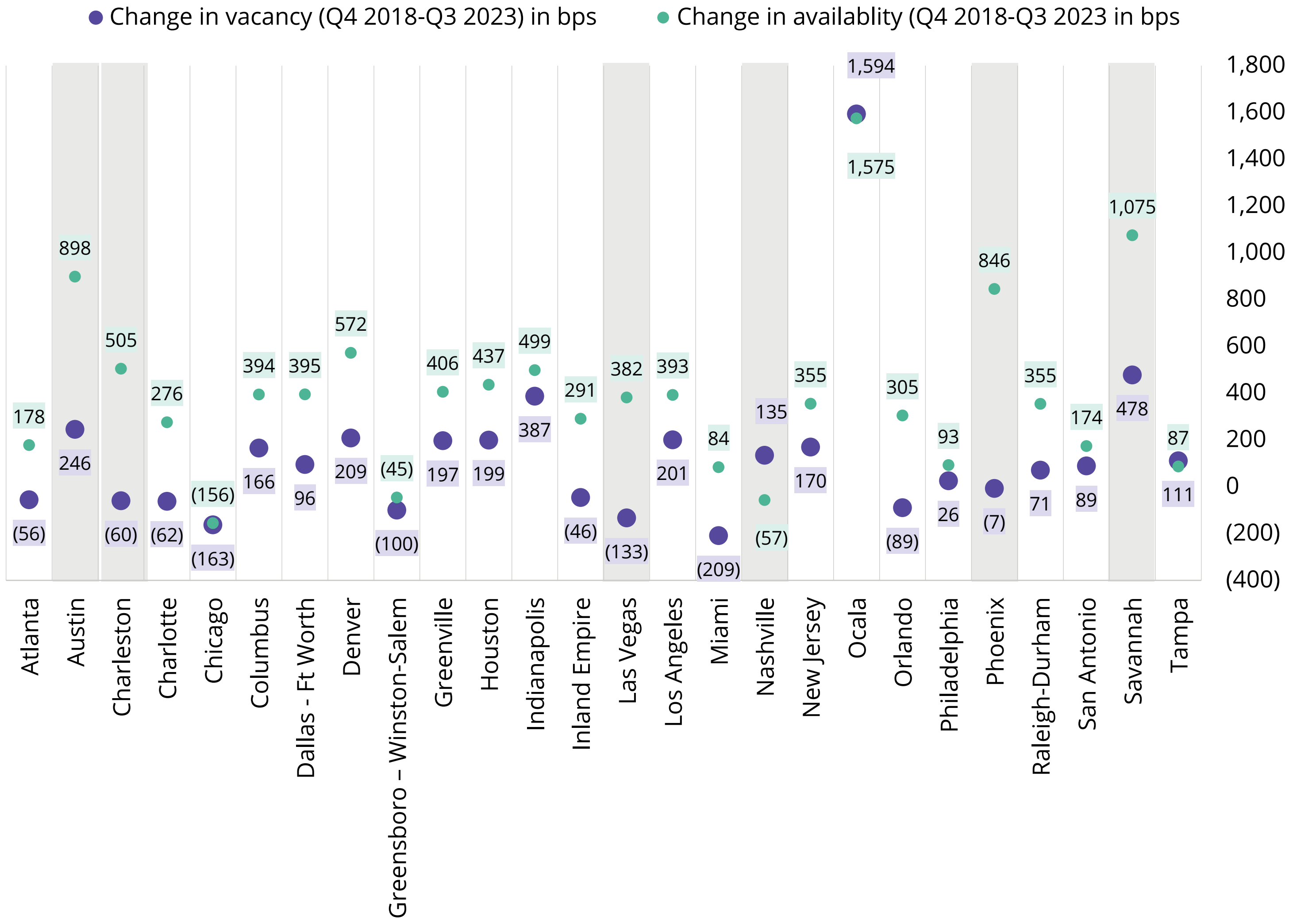


Source: AVANT by Avison Young, CoStar

Markets like Ocala, Indianapolis, Savannah, Philadelphia, and Columbus had +60.0% of their total inventory delivered since 2019 fall within the +500.0k sf range, leading to large vacancy jumps.

AVANT by AVISON YOUNG

Delta between vacancy and availability change



Source: AVANT by Avison Young, CoStar

Austin, Charleston, Las Vegas, Phoenix, and Savannah have all experienced large upticks in availability since Q4 2018. Nashville has gotten tighter where new product is delivering but already leased.

Construction costs continue to stick at historic levels, pressing developers and landlords to push rental rates

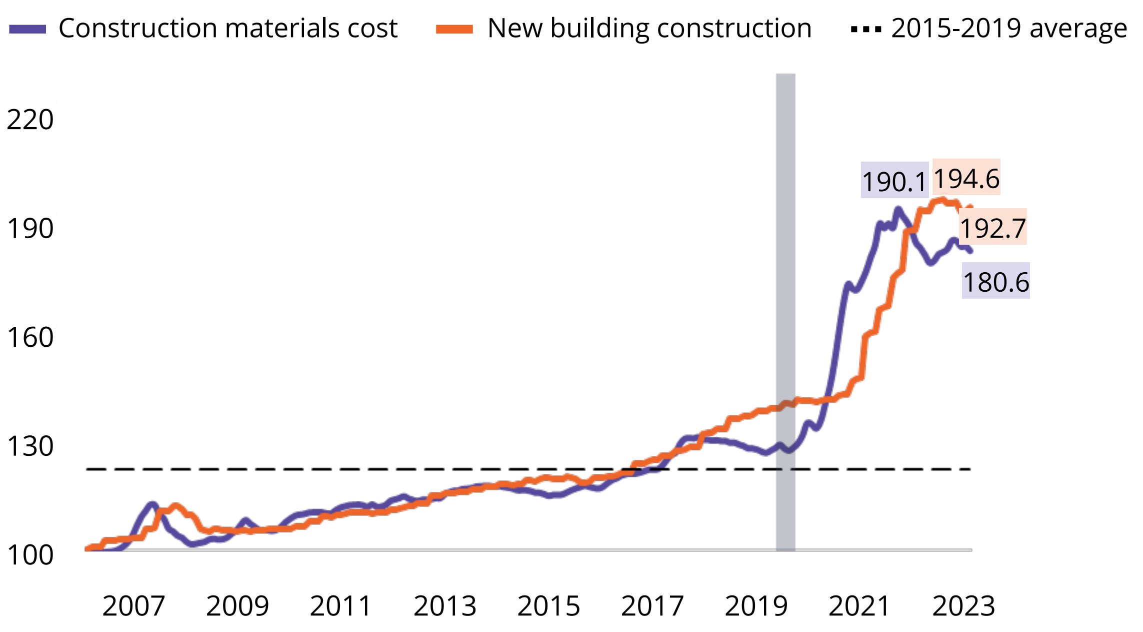
54.7%

Current industrial construction cost over pre-COVID, five-year average

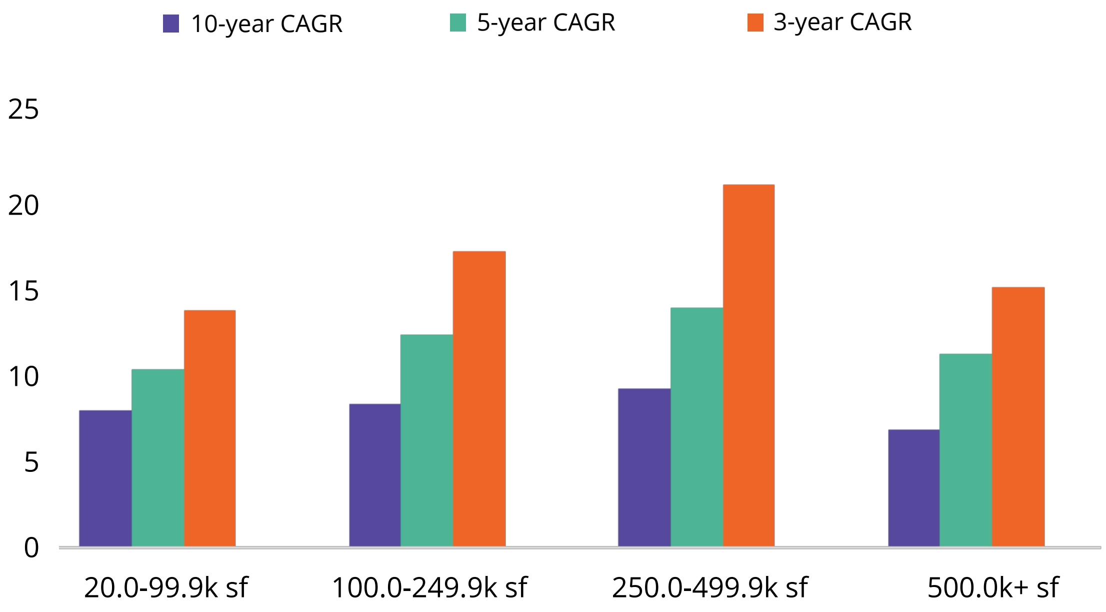
12.2%

Average five-year rental CAGR across industrial building sizes nationally

Cost of construction materials (index 100 = 07/2007)



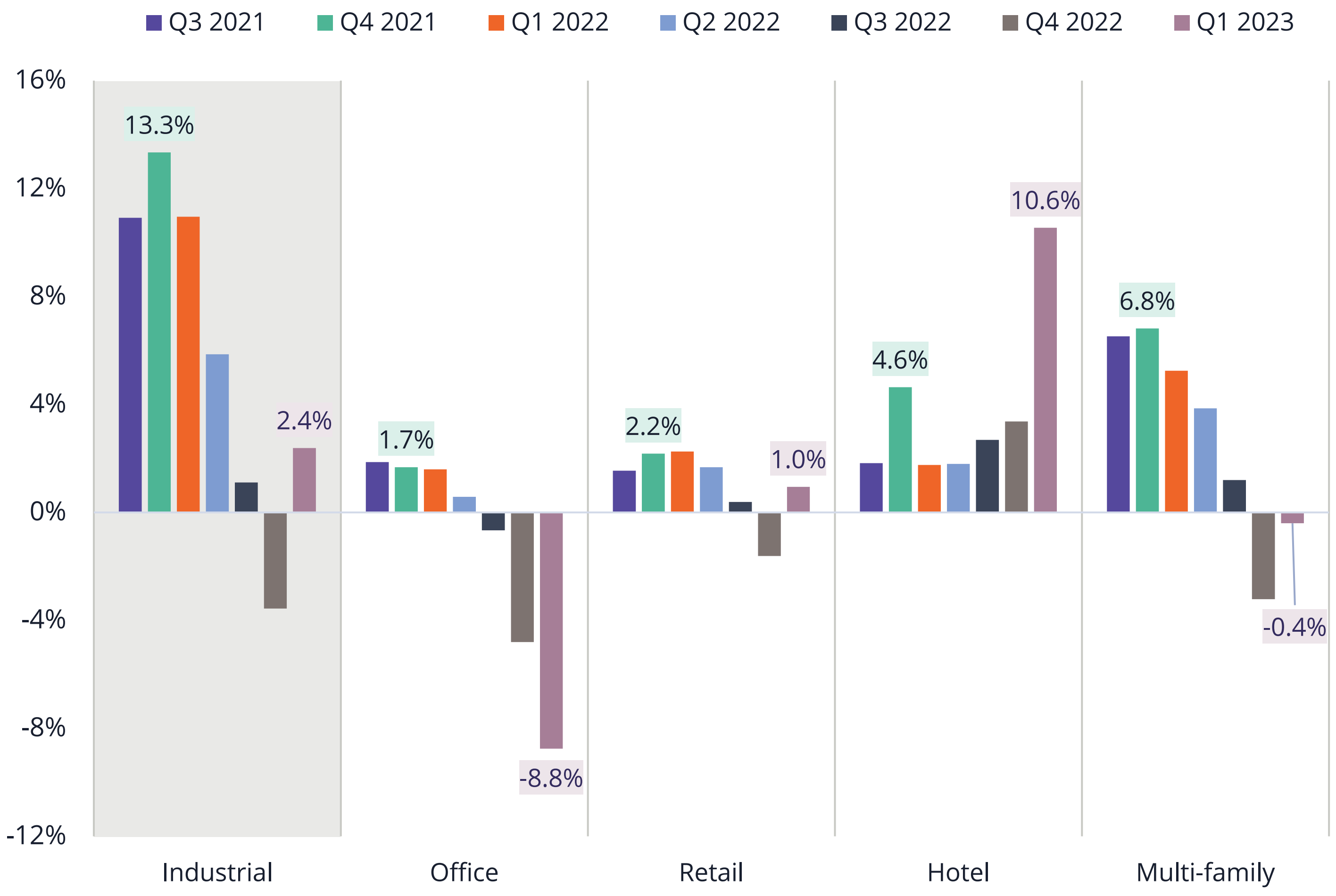
Compounded annual growth rate NNN asking rates



Source: AVANT by Avison Young, Federal Reserve Bank of St. Louis

AVANT by AVISON YOUNG

U.S. NCREIF NPI quarterly returns



Note: Most recent data available until Q2
Source: AVANT by Avison Young, NCREIF

Continued escalating cash flows are still driving investors to the industrial sector, despite the factors curtailing investor underwriting and deal velocity.

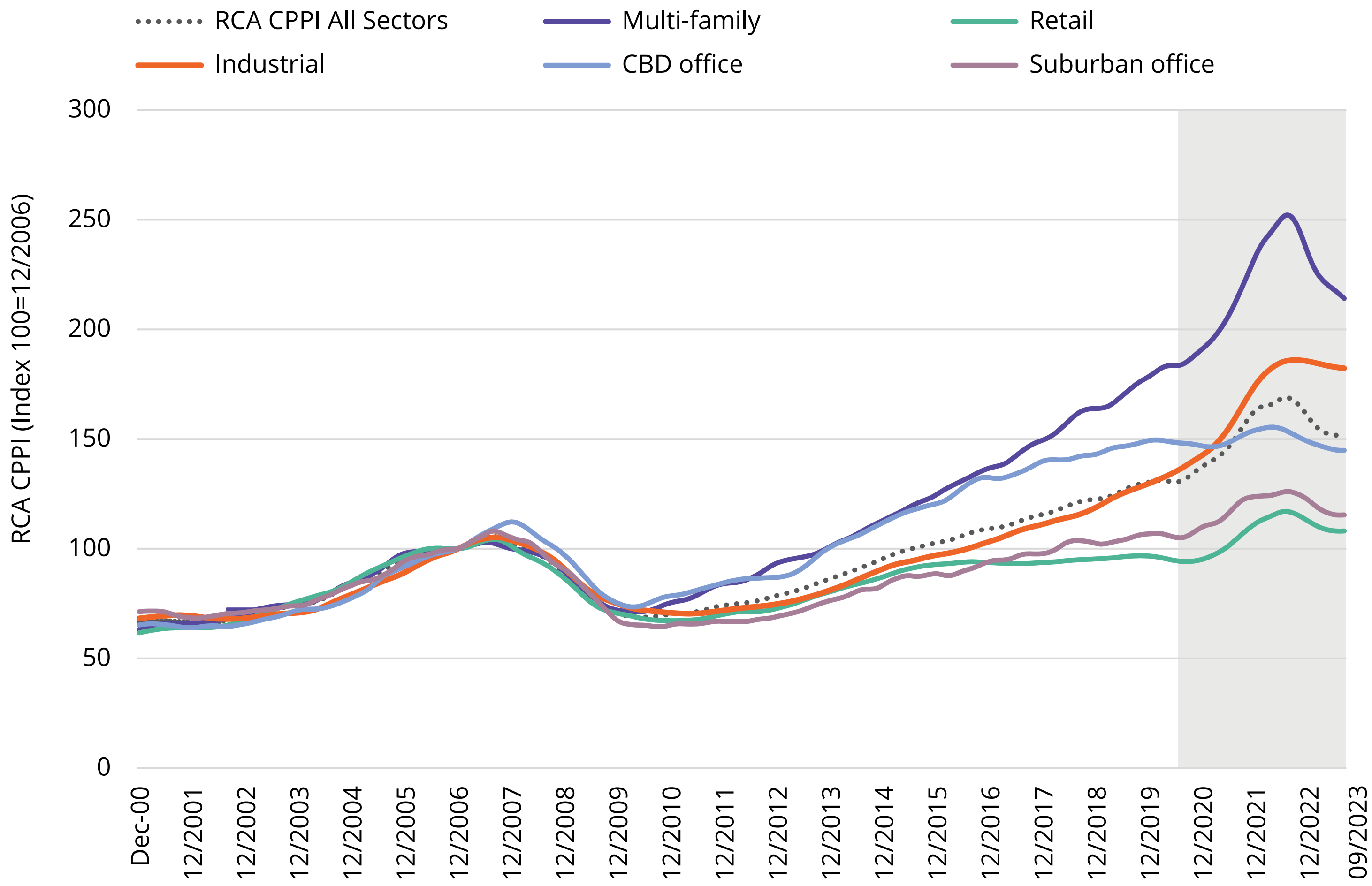
Industrial investment dollar volume

Note: Transactions >$2.5M.
Source: AVANT by Avison Young, MSCI Real Capital Analytics

Industrial portfolio and entity transactions are on pace for their smallest volume since 2016 as single asset transactions continue to disproportionately transact on the limited deals that do come to market in 2023.

AVANT by AVISON YOUNG

RCA commercial property price indices



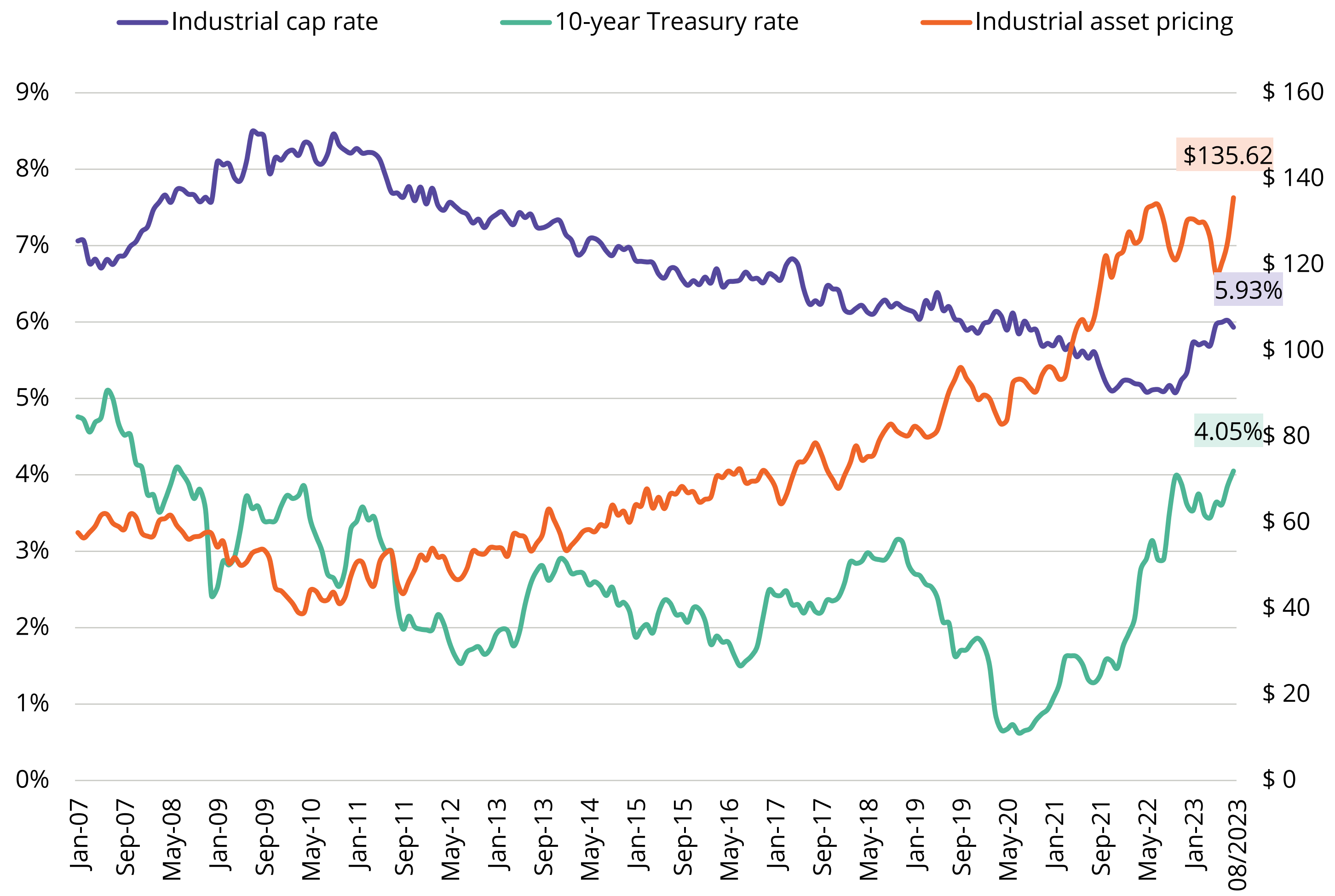
Note: Transactions >$2.5M. RCA CPPITM measure the actual price movements for commercial properties based on exclusive transaction data using repeat-sales regression methodology.

Source: AVANT by Avison Young, MSCI Real Capital Analytics

Industrial pricing has retained the gains experienced during COVID better than any other peer sector due to the low exposure to maturing debt, and the strength of continued demand emerging from foundational shifts in the U.S. economy.

AVANT by AVISON YOUNG

U.S. industrial cap rates vs. asset pricing



Note: Transactions >$2.5M
Source: AVANT by Avison Young, MSCI Real Capital Analytics, U.S. Department of the Treasury, Federal Reserve Bank of St. Louis

Investors continue to focus on cash-flow improvement opportunities within industrial assets that do trade, as asset appreciation has been slowed due to risk-free rates surging.

AVANT by AVISON YOUNG

Industrial insights glossary of terms

Demand

- **Leasing activity:** total square footage of relocations, renewals, expansions and subleases expressed when the leases are signed, not when tenants take physical occupancy of the space
- **Absorption:** period-over-period change in occupied square footage

Supply

- **Direct vacancy rate:** space operated by landlords that is ready for immediate occupancy
- **Sublease vacancy rate:** space operated by sublandlords that is ready for immediate occupancy
- **Total vacancy rate:** sum of direct vacancy rate and sublease vacancy rate
- **Availability rate:** space that is vacant plus space that will become vacant over an indefinite time horizon, including spaces that are occupied by vacating tenants and under-construction properties

Industrial rents and concessions

- **Triple net rents:** tenant is responsible for paying rent, utilities, taxes, operating expenses and common area maintenance
- **Asking rents:** pricing guidance provided by landlords to tenants for available space expressed as triple net (NNN)
- **Base rents:** fair market value of market-level lease pricing based on representative executed leases, expressed as triple net (NNN)
- **Free rent period:** months of free rent that are typically provided upfront by landlords to tenants as a concession to offset the total cost of a lease and/or the construction timeline of an industrial suite
- **Tenant improvement allowance:** an allowance expressed in dollars per square foot provided from landlords to tenants to offset build-out, engineering, space planning and related permit costs
- **Net effective rent:** base rents discounted by the dollar values of tenant improvement allowance and free rent concessions expressed as full service (FS)

Capital markets

- **Investment volume:** industrial sales dollars expressed when the transactions close and based on inventory thresholds; partial-interest sale dollar amounts are not grossed-up to reflect the 100% value of the sale
- **Asset pricing:** unweighted average per-square-foot asset pricing of market-level closed sales
- **Cap rate:** net operating income divided by sale price; this measurement of market-level investment returns is calculated as an unweighted average based on closed investment sales

For more market insights and information visit **avisonyoung.com**

Peter Kroner

Director, Supply Chain & Logistics
Market Intelligence
+1 312 273 1494
peter.kroner@avisonyoung.com

AVISON YOUNG