

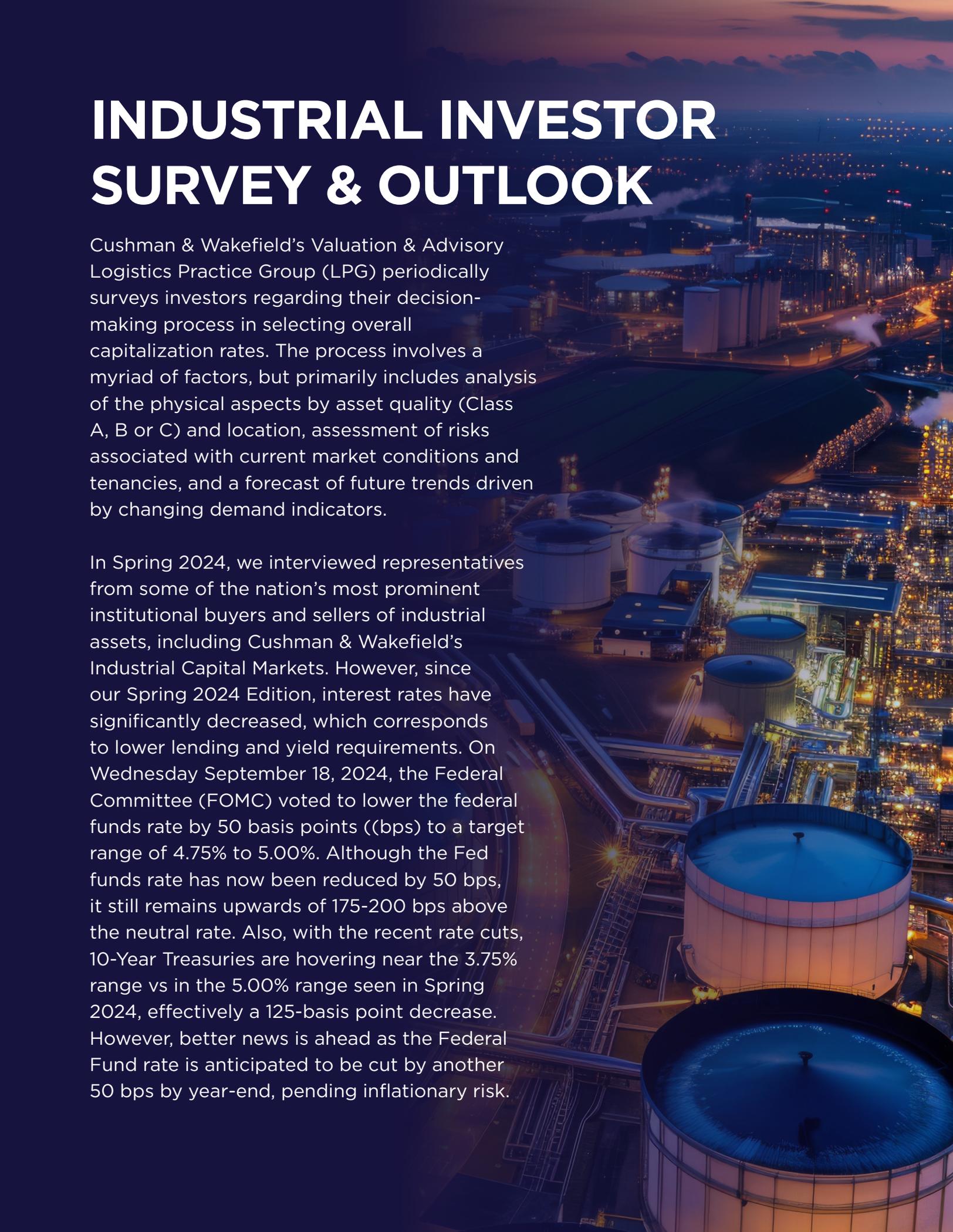
# INDUSTRIAL INVESTOR SURVEY & OUTLOOK

FALL/WINTER 2024 UPDATE



Better never settles

# INDUSTRIAL INVESTOR SURVEY & OUTLOOK

An aerial night view of an industrial facility, likely a refinery or chemical plant. The scene is illuminated by warm yellow and orange lights from the facility's operations, contrasting with the dark blue and purple twilight sky. In the foreground, several large, cylindrical storage tanks are visible, some with dark liquid inside. A complex network of pipes, walkways, and structural steel frames crisscrosses the site. In the background, a city skyline is visible, with numerous lights from buildings and streets, suggesting the industrial site is located near an urban area. The overall atmosphere is one of industrial activity and modern infrastructure.

Cushman & Wakefield's Valuation & Advisory Logistics Practice Group (LPG) periodically surveys investors regarding their decision-making process in selecting overall capitalization rates. The process involves a myriad of factors, but primarily includes analysis of the physical aspects by asset quality (Class A, B or C) and location, assessment of risks associated with current market conditions and tenancies, and a forecast of future trends driven by changing demand indicators.

In Spring 2024, we interviewed representatives from some of the nation's most prominent institutional buyers and sellers of industrial assets, including Cushman & Wakefield's Industrial Capital Markets. However, since our Spring 2024 Edition, interest rates have significantly decreased, which corresponds to lower lending and yield requirements. On Wednesday September 18, 2024, the Federal Committee (FOMC) voted to lower the federal funds rate by 50 basis points ((bps) to a target range of 4.75% to 5.00%. Although the Fed funds rate has now been reduced by 50 bps, it still remains upwards of 175-200 bps above the neutral rate. Also, with the recent rate cuts, 10-Year Treasuries are hovering near the 3.75% range vs in the 5.00% range seen in Spring 2024, effectively a 125-basis point decrease. However, better news is ahead as the Federal Fund rate is anticipated to be cut by another 50 bps by year-end, pending inflationary risk.

## PHYSICAL CRITERIA/LOCATION CRITERIA

For the Spring 2024 and prior Editions, these participants, typical for the market, focused on the type (Class A, B and C) and location of an industrial asset prior to selecting an appropriate overall capitalization rate. While the criteria relative to defining the asset type may vary, most agree on the following, as defined by CoStar Group Inc.:

- **Class A Industrial:** Class A buildings generally qualify as desirable investment-grade properties that command the highest rents or sale prices compared to other buildings in the same market. Such buildings are well located and provide efficient tenant layouts as well as high-quality, and in some buildings, one-of-a-kind floor plans. These buildings contain the best quality materials and workmanship in their trim and interior fittings.
- **Class B Industrial:** Buildings in this category command lower rents or sale prices compared to Class A properties. Such buildings offer utilitarian space without special features, and have ordinary design or, if new or fairly new, good to excellent design. These buildings typically have average to good maintenance, management, and tenants. They are less appealing to tenants than Class A properties, and may be inferior in a number of respects, including floor plans, condition, and facilities.
- **Class C Industrial:** These structures generally qualify as no-frills, older buildings that offer basic space and command lower rents, or sale prices compared to other buildings in the market. Such buildings typically have below-average maintenance and management, and could have mixed or low tenant prestige, low clear ceiling heights, and/or inferior mechanical/electrical systems.

## RISK FACTORS/MARKET CONDITIONS/TENANCIES

Although the above criteria are of primary focus, the participants also identified the following risk factors influencing their purchasing decisions:

- Overall vacancy and strengths/weaknesses of the local market, occupancy, and near-term and weighted average rollovers
- Potential for market rent increases and/or decreases and competing buildings in the area
- Readily available developable land for potential competition
- The functionality of the asset (clear ceiling height, layout, design, ratio of office to total warehouse space, lighting, adequacy of parking and truck storage, truck turning radius), as well as the age and condition of the asset, including the roof structure and parking areas
- Access to major transportation linkages (interstate, rail, port access, etc.) in order to offer the ability to ship product more efficiently and faster
- Proximity to growing and/or declining populated urban areas
- Creditworthiness of the tenant(s) and contractual rent in place in relationship to market rent levels (above/below market)
- Replacement cost relative to purchase price and feasibility of new construction

# UNDERSTANDING THE IMPACT OF CHANGING POLICY

For reference, the results of our Investor Survey (overall capitalization rates), conducted in Spring 2024, were provided by representatives of some of the largest institutional/pension fund buyers and sellers of industrial assets nationally, and the results are as follows along with prior years:

Industrial Overall Capitalization Rates - Comparison Analysis Spring 2024									
	Spring 2024	Spring 2023	Spring 2022	Spring 2021	Spring 2020	12-Mth Change (BPS)*	24-Mth Change (BPS)*	36-Mth Change (BPS)*	48-Mth Change (BPS)*
<b>Class A</b>	4.50% - 6.25%	4.00% - 6.00%	2.50% - 4.75%	3.25% - 5.50%	3.75% - 6.00%				
Range Average	5.49%	4.91%	3.66%	4.22%	4.55%	0.58	1.83	1.27	0.94
<b>Class B</b>	5.50% - 7.50%	4.50% - 7.00%	3.00% - 6.00%	4.00% - 7.00%	4.00% - 7.50%				
Range Average	6.28%	5.83%	4.76%	5.14%	5.72%	0.45	1.52	1.14	0.56
<b>Class C</b>	6.50% - 9.00%	5.00% - 9.00%	4.25% - 7.50%	5.00% - 9.00%	6.00% - 9.00%				
Range Average	7.49%	6.97%	5.67%	6.57%	7.46%	0.52	1.82	0.92	0.03
<b>Overall Average</b>	<b>6.42%</b>	<b>5.90%</b>	<b>4.70%</b>	<b>5.31%</b>	<b>5.91%</b>	<b>0.52</b>	<b>1.72</b>	<b>1.11</b>	<b>0.51</b>

Note - The lower-end of the range reflects Class A assets with long-term credit tenants at market rent levels (with escalations) or short-term tenants with below market leases in-place located in Southern CA, New Jersey (Northern), Dallas, Southern Florida (Miami) and Chicago.

\*Ending Spring 2024

Compiled by Cushman & Wakefield's Valuation & Advisory Industrial/Logistics Practice Group (IPG).

Based on the Spring 2024 results, overall capitalization rates range widely by asset class, indicating a 79-basis point (bps) differential between Class A and B industrial product, and a 200-bps difference between Class A and C industrial facilities. Overall rates for Class C properties are 121-basis points higher than Class B industrial product. The lower-end of the range reflects Class A assets with long-term credit tenants at market rent levels (with escalations) or short-term tenants with below market leases in-place located in Southern CA, New Jersey (Northern), Dallas, Southern Florida (Miami) and Chicago. Atlanta, Charleston, Phoenix, Houston, Salt Lake City and Seattle markets were also noted as high demand and growth markets, but to a lesser extent.



However, with the recent decline in interest rates, with more rate cuts expected, and lower yields on 10-Year US Treasuries all correspond to lower cost of capital, yield rates and overall capitalization rates. Since our Spring 2024 Edition, overall rates have significantly decreased across the board for Class A, B and C assets by 25 basis points and in some cases by 50 basis points for Class A assets located in core US Markets, according to our market participants surveyed. In fact, most participants have stated overall rates will further decline in 2025 by another 25 to 50 bps, albeit continued rate cuts.

Based on the most frequent responses relative to overall capitalization rate decreases (by asset Class), the following illustrates the results/observations:

<b>Industrial Overall Capitalization Rates - Comparison Analysis Spring 2024 To Fall/Winter 2024</b>		
	<b>Fall/Winter 2024 (Adjusted) (*)</b>	<b>Spring 2024 Edition</b>
<b>Class A</b>	4.25% - 6.00%	4.50% - 6.25%
Range Average	5.24%	5.49%
<b>Class B</b>	5.25% - 7.25%	5.50% - 7.50%
Range Average	6.03%	6.28%
<b>Class C</b>	6.25% - 8.75%	6.50% - 9.00%
Range Average	7.24%	7.49%

(\*) The Fall/Winter 2024 Adjusted rates were calculated based on reducing the Spring 2024 rates by 25 basis points across the board, the most frequent reduction of OARs provided by the market participants surveyed.

Note: The Lower-end of the range reflects Class A assets with Long-term Credit tenants at Market Rent levels (with escalations) or short-term tenants with below market leases in-place located in Southern CA, New Jersey (Northern), Dallas, Southern Florida (Miami) and Chicago.

Compiled by Cushman & Wakefield's Valuation & Advisory Industrial/Logistics Practice Group (IPG).

Investors are closely monitoring the volatility of the market as it relates to the recent interest, lending, and US 10-Year Treasury rate reductions, thus re-thinking their pricing strategies since positive leverage is on the horizon with lower cost of capital. While the fundamentals of the US Industrial market remain positive, investors are still closely monitoring rising vacancy rates, rent growth, leasing activity, net absorption, and demand.

The top U.S. Markets will continue to command more aggressive overall capitalization rates—predominately U.S. port cities, but as lending rates continue to decrease, return expectations have become more realized.



# FINAL OBSERVATIONS

Investors continue to see strong demand for industrial assets in the near term, but the volume of sales transactions have clearly slowed with higher return expectation requirements necessary to meet rising debt costs.

- Class A properties in the top U.S. Markets will continue to command more aggressive overall capitalization rates—predominately U.S. port cities. Class B and, in some cases, Class C assets in proximity (infill locations) to populated urban areas with readily available workforce are in demand as investors/occupiers continue to solve the last-mile dilemma in urban locations.
- Acquisitions are moving forward, and the deal flow/interest has significantly increased as the buyers are back in the market. Both buyers and sellers have become more realistic with their pricing expectations, as the “bid/ask” differential continues to narrow, but a gap remains.
- Industrial fundamentals are expected to remain solid throughout the remainder of 2024 and into 2025, with continued rent growth, albeit at a more normalized pace (2%-4%) than 2022 and 2023. Nonetheless, investors are closely monitoring the interest rate environment and fluctuations in 10-Year Treasuries regarding their pricing strategies. However, with the recent rate cuts and more expected by year-end, the risk rate as now softened with the lower cost of capital.
- Once a roadblock, rising interest rates is no longer a concern with more investors expecting another rate cut with would correspond to lower overall rates by another 25 to 50 basis points in 2025.

- Consumer spending is pushing fueling the industrial market not withstanding its recent deceleration. The U.S. Industrial market continues to perform positively. In the second quarter net demand climbed, asking rental rate growth persisted, and the rate at which vacant sublet space came on-line slowed for the second straight quarter. After a lackluster first quarter, overall net absorption more than doubled to 46.3 million square fee in the second quarter 2024. Vacancy ticked higher at a modest rate, as 121.11 million square feet of new construction deliveries were completed. Asking rents once again edged higher to \$9.97 per square foot up 3.7% year-over-year (YOY), the lowest growth rate since 2020.
- Banks are easing lending standards. According to the latest Fed Senior Loan Officer Opinion Q2 2024 survey, a rising share of banks are reporting they are loosening lending standards and seeing stronger demand for CRE loans. CMBS is firing back up. YTD non-agency CMBS issuance is up 160% through Q2 2024 vs a year ago. Meanwhile, YTD conduit CMBS issuance is measuring at \$20.0 billion, which has already surpassed the full-year conduit issuance level for 2023.
- Logistics, food and beverage, cold storage, Bio Tech/Pharmaceutical and Data Center assets are the preferred asset classes. However, e-commerce is clearly driving the demand as online shopping continues to accelerate, especially with the infusion of artificial intelligence driving the supply-chain efficiencies

With a strong infrastructure in place in most U.S. markets, vacancy rates still at historical lows, and the availability of natural resources, the long-term investment outlook for the national industrial market is positive; and, seaport cities and major logistics hubs are expected to remain the strongest performers, especially as e-commerce continues to expand in order to satisfy customer demand.





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