NATIONAL REPORT

Marcus & Millichap

INDUSTRIAL

MIDYEAR 2024

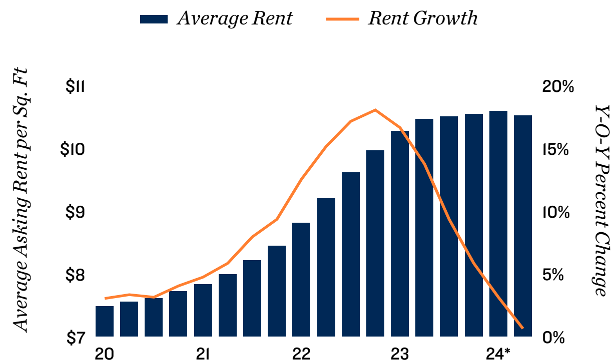
Industrial Sector Poised to Regain Footing as Construction Pipeline Eases

Transitionary period coming to a close. After ending 2022 at an all-time low, industrial vacancy has now risen for six straight quarters, to 6.1 percent at the midpoint of 2024. Over the same span, nearly 629 million square feet was delivered nationwide, stoking a 3.5 percent increase to inventory. While vacancy in June was still 130 basis points below the pre-pandemic average, additions to vacant stock, including from new supply, have reined in a previously red-hot pace of rent growth. The three-month span from March to June marked the first quarterly drop in the average asking rent since early 2011, following a 44 percent climb over the five years prior. Nevertheless, a narrowing pipeline suggests property metrics should improve after 2024. As of June, over two-thirds of active construction was slated to deliver before year's end. Additionally, more than one-fifth of the space underway is located in only five major metros. As proposals with established timelines for 2025 and beyond represent under 5 percent of total stock, completions may fall short of long-term demand in most markets, as tenants frequently favor newer and higher-tech facilities.

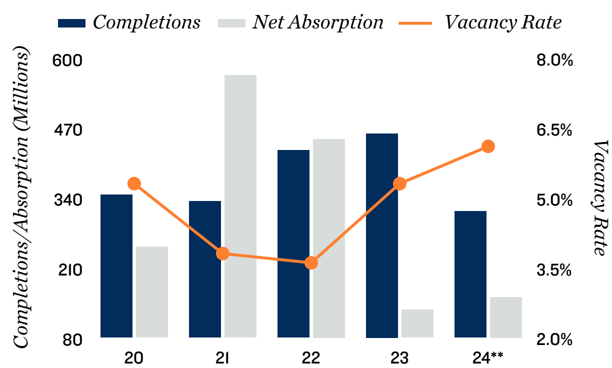
Vacant supply is concentrated in a handful of markets. Automation and robotics are leading many end-users of big-box product to prioritize amenities that are typical of newer-built supply. While physical characteristics can vary widely within the space, from small-bay multi-tenant warehouses to high-end distribution centers, new move-ins have generally entailed tenants vacating older, more rudimentary facilities. Still, trade-outs to newer spaces should only meaningfully impact a handful of major metros moving forward. As of June, Atlanta, Dallas-Fort Worth, Houston, Riverside-San Bernardino and Phoenix held 27 percent of the still-vacant supply delivered nationwide during the past five years. While these areas exhibit some of the strongest demand in the country, local vacancy rates will continue to rise as they collectively host the delivery of 108 million square feet together in 2024. The remaining 31 major U.S. metros are expected to combine for only 129 million square feet, raising the potential for metrics in these areas to regain momentum over the long term.

Continued expansion in e-commerce sales supports space demand. Online sales captured a rising share of core retail spending in the first half at 23.2 percent, a figure 1.1 percent higher than the same period last year. Continued growth reflects more shoppers embracing digital means of buying and greater e-commerce integration from retailers. These factors will amplify omnichannel retailers' and logistics providers' long-term space demand, with leasing activity showing strength in the first half of 2024. Amazon committed to over 11 million square feet of additional space in the span. Walmart, Home Depot and Burlington also committed to over 1 million square feet together, as these and other retailers continued to focus on expanding omnichannel capabilities.

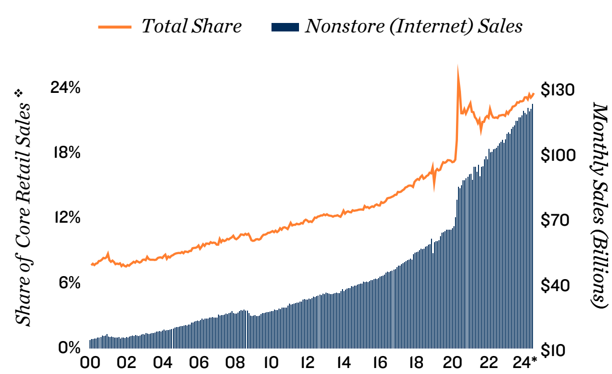
Industrial Asking Rent Growth Flattening



Completions Temporarily Outpace Demand



E-Commerce Sales Continue to Grow



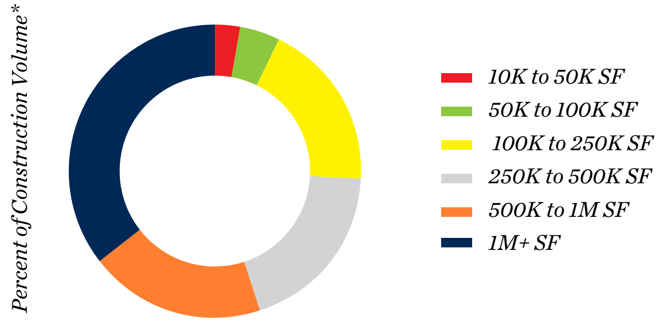
* Through 2Q ** Forecast ◆ Core retail sales exclude auto and gasoline purchases

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; U.S. Census Bureau

New Supply Lifts Rents Across Segments

Size Tranche	Vacancy Rate*	T-12 Net Absorption**	Y-O-Y Asking Rent Change*
10K to 50K SF	3.6%	-29.6M sq. ft.	3.6%
50K to 100K SF	4.9%	-23.1M sq. ft.	4.4%
100K to 250K SF	6.3%	3.2M sq. ft.	4.6%
250K to 500K SF	7.4%	3.2M sq. ft.	4.8%
500K to 1M SF	8.0%	32.9M sq. ft.	5.0%
1M+ SF	5.5%	90.4M sq. ft.	4.6%

1M+ SF Facilities Comprise Largest Share of the U.S. Pipeline



Manufacturing Vacancy Remains Low

Secondary Type	Vacancy Rate*	T-12 Net Absorption**	Y-O-Y Asking Rent Change*
Distribution	8.0%	116M sq. ft.	4.3%
Light Distribution	6.6%	188M sq. ft.	4.3%
Manufacturing	4.5%	-13.6M sq. ft.	3.2%
Light Manufacturing	6.6%	188M sq. ft.	4.3%
Warehouse	6.1%	-14.1M sq. ft.	4.3%
R&D	6.6%	188M sq. ft.	4.2%

New Manufacturing Supply is Limited

Upsizing and Consolidation Coincide With Focus on Big-Box Development

Tenant demand skews larger. Many tenants are consolidating their footprints due to restrictive monetary policy and rising operational costs, while also prioritizing larger facilities to make room for robotics and automation technologies. As such, the 1 million square-foot-plus segment was the only property size tranche to post an improvement to net absorption over the year ended in June. This coincides with developers' growing focus on delivering mega-facilities, with over 35 percent of the construction pipeline being comprised of properties sized at 1 million square feet and above. Despite ongoing trends of upsizing and consolidation contributing to net relinquishment among smaller to mid-size property segments, multiple factors suggest that space demand for these options should rise over time. In particular, the CHIPS Act, the Inflation Reduction Act, and corporate efforts for reshoring and nearshoring are continuing to drive tenant needs for manufacturing capacity. To illustrate, as of June, roughly 92 percent of the manufacturing space under construction already had a tenant in place. While less likely to characterize areas seeing substantial supply increases in smaller-sized stock — like Riverside-San Bernardino and Dallas-Fort Worth — these dynamics position most metros to observe upticks in manufacturing demand for older, sub-250,000 square foot properties, influencing some owners to upgrade existing facilities to attract prospective tenants.

** As of 2Q 2024*

*** Trailing 12 months through 2Q 2024*

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; White House

2024 U.S. Forecast

EMPLOYMENT

1.3% increase Y-O-Y

- The unemployment rate rose 40 basis points in the first six months, signaling labor supply is rising relative to demand. Employers are expected to add 2 million jobs in 2024, a 33 percent decline from the prior year.

CONSTRUCTION

315 million sq. ft. completed

- Stock grows by 1.7 percent, marking the slowest pace since 2016. Five metros — Riverside-San Bernardino, Phoenix, Houston, Dallas-Fort Worth and Atlanta — are slated to host 34 percent of all deliveries this year.

VACANCY

80 basis point increase Y-O-Y

- A moderate improvement to net absorption helps keep the nationwide vacancy rate stable at 6.1 percent over the second half of 2024. Still, this will represent a total 250-basis-point increase from 2022's record-low.

ASKING RENT

3.0% increase Y-O-Y

- More high-end supply additions pull the average asking rate up to $10.86 per square foot in 2024. The gain caps off a 46 percent jump over the last half-decade, the largest of the four major commercial property types.

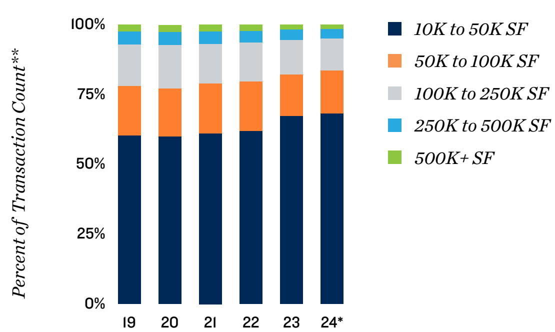
2024 INVESTMENT OUTLOOK

- **Conditions are ripe for investment sales to recover in 2025.** While a restrictive financing environment tempered deal flow, the industrial sector saw the least drawback in trading among the four major commercial property types over the year ended in June. Activity is poised to regain additional momentum after 2024. Alongside the potential of near-term interest rate cuts, the moderation of new industrial supply starting in 2025 may help reignite asking rent growth, likely helping more deals pencil among lenders and borrowers.

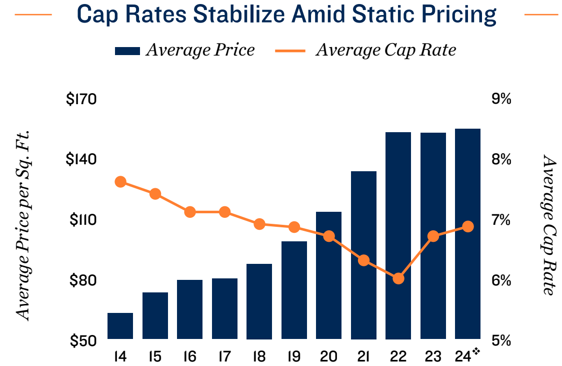
- **Smaller properties garner attention.** Ranking as the least-vacant size tranche as of mid-year 2024, assets between 10,000 and 50,000 square feet captured at least a 10-year-high share of trades in the first six months. While less upfront costs are enabling buyers to limit borrowing, nominal supply-side competition is also helping drive investment. The size tranche accounted for less than 2.7 percent of active industrial construction volumes as of June.

- **Owner-users are becoming more active in the investment landscape.** Less institutional competition compared to recent years, slowing per-square-foot price increases, and expectations for continued asking rent momentum are stoking favorable conditions for end-users to acquire their own facilities. From January through June 2024, the likes of Microsoft, NVIDIA, Nestlé and Fortinet all acquired more than $100 million of industrial properties.

Investors Prioritize Small Facilites

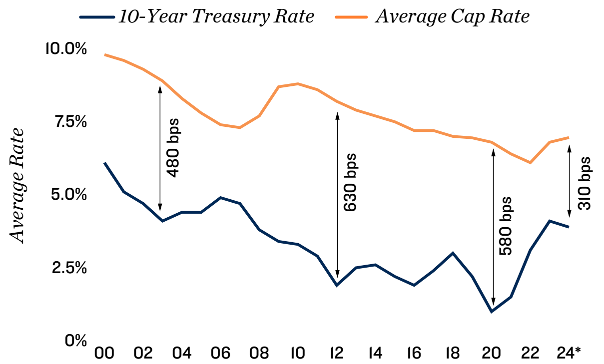


Cap Rates Stabilize Amid Static Pricing

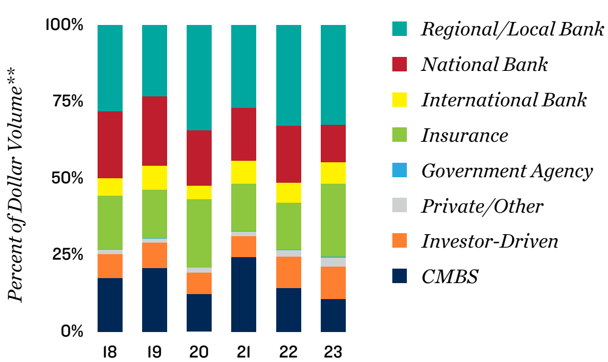


* Through 2Q ** Estimate
✦ Trailing 12 months through 2Q
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Real Capital Analytics

Margins Widen After Tight Span



Industrial Lender Composition



** Through early August*

*** Properties and portfolios $2.5 million and greater*

Sources: Marcus & Millichap Research Services; Real Capital Analystics; Federal Reserve

Rate Cuts Will Add Fuel to an Already Active Industrial Lending Environment

Normalizing job gains solidify 2024 rate cut. The Federal Open Market Committee held the overnight lending rate at the 5.25 percent lower bound in July, but that is unlikely to be the outcome at their next meeting in September. While inflation remains somewhat elevated, a moderating labor market is putting pressure on the Fed to avoid oversteering the economy into a downturn. Unemployment has risen by 60 basis points over the last six months, prompting concerns economic growth is slowing faster than expected. In August, this led Wall Street investors to posit an over-70 percent probability that the federal funds rate ends this year 50 basis points lower than its July level, shooting up from a 6 percent chance at the end of June. While a slowing economy may impact tenant demand, the increased likelihood and expectedly greater magnitude of interest rate cuts should add fuel to an already active industrial investment landscape. Following July's employment data, the 10-year treasury yield dropped to its lowest rate since December 2023. A lower benchmark cost of capital — along with the Fed's reduced pace of balance sheet runoff of $35 billion per month that started in June — are beginning to alleviate historically narrowed margins from the past two years, re-opening room for lenders to generate returns.

Insurance companies aid portfolio trades. With national banks and CMBS sources becoming more selective after the collapse of Silicon Valley Bank in early 2023, REITs and investment managers have turned to insurance companies to help them execute acquisitions. These lenders accounted for 25 percent of all industrial financing in 2023, the highest share in at least eight years, mostly in the form of portfolios priced at $25 million and above. For borrowers seeking loans below $10 million, regional and local banks remained the primary lenders, with a 33 percent share of overall volumes. Private investors continue to favor these entities, as they typically provide higher leverage than other sources, at a 66 percent average in 2023. Moving forward, the industrial sector's long-term leases, limited move-out risk relative to other property types, and high availability of federal grants and tax breaks will continue to lead lenders to view these assets positively. Financiers are prioritizing manufacturing and R&D sites due to each sector's attractive supply dynamics, with value-add projects with a tenant already lined up enabling borrowers to achieve more favorable exit cap rates.

Industrial Division

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Sources: Marcus & Millichap Research Services; Bureau of Economic Analysis; Bureau of Labor Statistics; Chain Store Age; CoStar Group, Inc.; Federal Reserve; Real Capital Analytics; U.S. Census Bureau; White House