APRIL 5, 2021 Plonline.com CRAIN

Pensions&Investments

THE INTERNATIONAL NEWSPAPER OF MONEY MANAGEMENT

P&I | EDITORS' PICKS

Investors hungry for industrial properties

Growth of online shopping during pandemic driving rise in warehouse interest

By Arleen Jacobius

Before the pandemic, industrial properties were a more of a snack than a main course among real estate's primary food groups, but investors' voracious appetite for the sector may result in it occupying a larger place in their portfolios.

Many investors were already overweighting warehouses and other logistics properties in their portfolios to take advantage of consumers' growing acceptance of online shopping. But the COVID-19 crisis and stay-at-home orders supersized the trend and investor demand.

Traditionally, office and retail have been the largest property types in institutional portfolios. At 34%, office remains the largest investment category in institutional real estate portfolios, even as questions remain about the future of work post-pandemic, according to the Pension Real Estate Association. But in 2021, asset owners plan to invest the most capital in industrial, followed by multifamily, according to a 2021 investment intentions survey issued jointly by real estate investor trade groups PREA, INREV and ANREV.

According to Real Capital Analytics Inc., the office sector's share of total deal flow in 2020 shrunk to 23% in the Americas, below industrial for the first time. In Europe, the Middle East and Africa, office sales fell below apartment and industrial, Real Capital Analytics data show.

Jim Costello, New York-based senior vice president of Real Capital Analytics, called it a "sea change" for the industrial sector. In the past, industrial had not been a big part of institutional portfolios because it seemed boring, he said.

"It was slow, stable and steady. Nobody wanted to focus on it," Mr. Costello said. "Slow, stable and steady are fantastic right now."

Whether industrial supplants office and/or retail as a leading property sector among institutional investors depends on where their investment dollars end up, Mr. Costello said.

"It's a capital race," he said.

Office deals down

Office deals continue to be down from prior periods — $2.8 billion in February, down 71% from a year earlier, RCA data shows — because buyers and sellers cannot agree on price, Mr. Costello said. Banks are not forcing properties into default based on technical breaches of lending agreements, buyers want bargains and sellers aren't willing to take a price cut, he said. There were $4.9 billion in industrial transactions in February, the most of any sector tracked by RCA, even though the deal volume was

Jim Costello sees the groundswell as a 'sea change' for the industrial sector, which had previously been thought of as boring.

also down, by 69% from February 2020 due to a large portfolio deal that occurred last year.

Asset owners are continuing to invest in the asset category, in part, drawn by outperformance. In 2020, industrial along with self-storage were the only real estate investment trust sectors with positive total returns, according to PitchBook Data Inc.'s latest global real estate report released in March. Industrial REITs earned 12.2% total return and self-storage had a total return of 12.9% for the year ended Dec. 31, PitchBook data show.

"Industrial is a nice cash-flowing business and probably one of the lowest risk category of real estate," said Glenn Brill, New York-based managing director in the real estate solutions practice of FTI Consulting Inc. "It can be perceived as a core asset under the right circumstances because it is relatively low risk and cash flowing," he added.

By comparison, in the office market, every major employer is rethinking its office needs, making office investment an iffier proposition, Mr. Brill said. "You can't continue to pack people in like sardines," he added.

"The recovery or growth of office into the future is a bit of a question mark while the demand for industrial space is strong," Mr. Brill said.

Industrial was also the highest-performing private real estate category in the NCREIF Property index in 2020 at 11.78%, surpassing the next-highest-performing sectors of multifamily at 1.83% and office at 1.57%.

Getty Images/iStockphoto

Photo: Nick Carver

Rialto North is one of five industrial properties that CalSTRS is acquiring from Crow Holdings.

Asset owners are not only accessing the sector by investing in diversified and specialist funds but also in open-end funds, separately managed accounts and in some cases, direct portfolio investments.

CalSTRS makes a move

The $286.9 billion California State Teachers' Retirement System, West Sacramento, is acquiring a five-property industrial portfolio in Southern California for $320 million from real estate developer and investment manager Crow Holdings.

CalSTRS officials declined to comment beyond confirming the transaction.

The story of how the CalSTRS deal came to be reflects the broader trend around industrial, which grew stronger during the pandemic, said Michael Levy, Dallas-based CEO of Crow Holdings.

CalSTRS is buying half of a portfolio that Crow Holdings originally was to sell to another buyer in January 2020, a few months after it had been put on the market. Crow Holdings had assembled the portfolio two years earlier, buying the land and constructing the buildings, he said.

"Then came COVID and the market froze for a $700 million portfolio," Mr. Levy said.

In May, PGIM Real Estate offered to buy the stabilized, or leased, properties in the portfolio, leaving the rest of the portfolio that had yet to be leased, he said.

"We have strong relationships with CalSTRS and, like many institutional investors, it was seeking more industrial," Mr. Levy said. "As each month went by, the zero-percent leased portfolio got leased up — and CalSTRS got more comfortable."

By the time CalSTRS and Crow Holdings close the transaction in the second quarter, all of the properties in CalSTRS' portfolio will be fully leased, "demonstrating that the industrial market is even stronger after COVID," Mr. Levy said.

Since January, demand from institutional investors for industrial properties has accelerated, he said. At the same time, banks and other lenders "are out in force, more than in even 2020," Mr. Levy said.

"I think that we have several years of outperformance ahead for industrial," he said.

Eventually, supply will increase and meet the demand "and the torrid growth will settle down a bit," Mr. Levy said.

"I don't know about five years or 10 years, but I feel awfully comfortable saying it will continue to outperform for the next several years," he said. Crow Holdings has about $20 billion of assets under management.

Uncertainty about office

There's a cyclical aspect to investors' current demand for industrial, said Greg MacKinnon, Hartford, Conn.-based director of research for the Pension Real Estate Association.

"There is a lot of uncertainty surrounding office at the moment as investors try to figure out what the future of work will look like in a post-COVID world, while at the same time industrial has been the big winner among the property types," Mr. MacKinnon said. "That naturally leads to more interest in industrial and less in office."

However, while COVID-19 has accelerated the trend, it has been in place for a few years, he said. Allocations for open-end real estate funds, as represented by the MSCI/PREA U.S. Property Fund index, have shown a rising allocation to industrial and a decline to office since the end of 2017. Office fell to 31% at the end of 2020, from 34.9% in the fourth quarter of 2017, the MSCI/PREA U.S. Property Fund Index shows. Industrial rose to 24.1% at the end of 2020 from 16.5% at the end of 2017, according to the MSCI/PREA U.S. Property Fund index.

However, office is still the largest allocation, followed by multifamily, in the MSCI/PREA index of open-end funds, so there is a ways to go before industrial could overtake office, he said.

That said, asset owners such as the Oregon Public Employees Retirement Fund and the $9.8 billion San Diego City Employees' Retirement System have long-term goals of overweighting industrial and underweighting office in their portfolios.

Oregon Investment Council, Tigard, which manages the $82 billion OPERF's long-term investment strategy for its $8.4 billion real estate portfolio, is to underweight office and overweight industrial and multifamily, and to a lesser extent niche assets, according to a report by its real estate consultant Townsend Group.

SDCERS began actively building up its exposure to industrial in 2019 with commitments to the RREEF Core Plus Industrial Fund LP of $50 million and Lion Industrial Trust of $30 million, said CIO Liza Crisafi in an email. By design, the pension plan's $1 billion real estate portfolio is underweight office, multifamily and retail, she said.