KEYNOTE INTERVIEW

Industrial demand remains overwhelming

Covid has accelerated secular trends driving the industrial real estate sector and growth is expected to continue long-term, believes Crow Holdings CEO Michael Levy

The covid-19 pandemic has accelerated demand for US industrial and logistics real estate, which, coupled with continued strong macro trends, are anticipated to drive the sector in the medium to long-term. E-commerce growth, onshoring of manufacturing and the need for resilient inventories have increased the need for industrial space.

As a result, the sector is more popular than ever with investors looking for resilient returns.

Michael Levy, chief executive officer of Crow Holdings, a national real estate investment management and development firm, considers the prospects for the sector.

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Q What has been the impact of the covid-19 pandemic on US industrial and logistics real estate?

Covid and its effects on society have reinforced certain trends underpinning the industrial and logistics sector and have also created some positive new trends. Pre-covid, e-commerce penetration of total retail sales was in the mid-teens. The pandemic accelerated e-commerce growth and brought forward years of demand.

When the pandemic stabilizes, we expect e-commerce penetration to be in the 20s, and some industry research projects it will comprise up to 40 percent by 2030. That accelerated growth means an increased need for modern logistics space.

Another trend that perhaps gains less attention is the need for resilient inventories. Companies all over the world had adopted just-in-time inventories to maximize efficiencies in their manufacturing and sales processes. However, covid exposed supply chain disruption risk across many different types of industries, resulting in a shift from just-in-time to

> *"The secular trends underpinning e-commerce will continue to drive the industrial sector"*

Q Crow Holdings has both development and investment management businesses; what are the opportunities for acquiring industrial and logistics assets?

Industrial development is the foundation of our firm. Seventy years ago, Trammell Crow began his real estate career by building and leasing his first warehouse in Dallas. Today we remain one of the nation's largest industrial developers because, for one thing, we like the risk-adjusted returns of development. We also have an investment management company that has been investing in industrial for over 20 years, which provides capital and partners with other developers to build ground-up industrial real estate.

To the extent one can acquire high quality industrial real estate, there is no asset class that has more demand from investors. Investors are competing for high quality, stabilized core industrial real estate, which is driving down initial yields to as low as 3.5 percent in the US.

Even though those cap rates sound low, we experience mid- to high-single digit revenue growth year-over-year. And if that trend continues, we could continue to see excess returns, even at those relatively low cap rates.

We are also seeing investors generally shifting away from office and retail to what we believe to be more resilient sectors such as logistics, multifamily and certain niche sectors. This means a lot of capital pursuing the industrial and logistics sector, and, fortunately, there is currently unprecedented demand to meet that need.

resilient inventories, which also adds to a tremendous need for additional industrial space.

Finally, in the US, we had already seen a shift – due to trade and tax policy, rather than anything to do with covid – towards onshoring of manufacturing. So effectively you have a perfect storm, with three trends accelerating.

Q Is it possible to quantify the additional demand for space?

It is difficult to make very specific forecasts with respect to medium-term supply and demand, as we are still in the middle of this pandemic. The US was operating pre-covid at close to 300 million square feet a year of new industrial space being developed, and demand exceeding supply. Recent reports show the fourth quarter of 2020 at over 360 million square feet under construction and net absorption of 268 million square feet at year-end, which reflects a double-digit increase over prior year despite an initial pullback in Q2 from covid.

Also, 89 million square feet of net absorption occurred in the fourth quarter of 2020 alone which was the strongest single quarter ever recorded. So, undoubtedly, we're going to continue to have a need for newly developed industrial real estate across the country.

Q Do you expect these trends to decelerate once the US has recovered from the pandemic?

As covid has reinforced, isolation is not good for us and people want to go out. Consumers will continue to shop in brick-and-mortar stores, but I believe the shift in behavior towards an increased reliance on e-commerce will be permanent. For example, my 90-year-old father had never used Amazon before the pandemic, and now he cannot believe what a fabulous tool it is. I think he will continue to use Amazon for much of his shopping post-covid, and he won't be alone in this.

With regard to resilient inventories, some industries, such as pharmaceuticals, will continue to need more resilience whether it is because of regulation or best practices.

I am confident the secular trends underpinning e-commerce will continue to drive the industrial sector, and I believe the demand needs in the space will be overwhelming as a result.

Q With such strong demand, does that mean little risk of oversupply in the near future?

Industrial real estate is relatively easier to build than other property types, such as urban apartment buildings. It does not have the same entitlement and zoning considerations and the construction process is shorter.

Some companies that were previously in the development of retail or hotel buildings, or even office and apartment buildings, are adding industrial or shifting to become industrial developers. So, undoubtedly the supply-demand balance will start to align and may shift out of favor at some point; however, due to the explosion of demand, I believe that is several years out.

Additionally, you have to consider the situation in sub-markets. For example, Dallas-Fort Worth, which is one of the biggest markets in the US, is not a single monolithic market. There are many sub-markets in DFW that already have more than sufficient supply. Meanwhile, there are other sub-markets which need new space.

Q Are logistics tenants looking for different types of space to meet their developing needs?

There have been a few main shifts in what tenants are looking for. For one, there has been a long-term trend towards taller clear heights and use of robotics in facilities.

There is also a need for last-mile logistics facilities, as consumers expect their goods faster. The location and space needed is market-dependent. In certain markets where there is lower traffic, you can still be 10 miles outside the ring road. But in dense urban markets, such as New York City, you are seeing multi-story buildings built to accommodate 45-minute delivery times.

The desire to get closer to the customer means more creativity with respect to the use of space, such as the ultimate last mile, where a small retail store is leased out to Amazon.

Another thing that has changed with respect to design is the need to provide flexible space to accommodate more staff. Fifteen to 20 years ago, you might have had a million square foot building with 30 people working in it. Today, many of those buildings are fulfillment centers where you have hundreds of employees who need a place to park, a place to eat, a place for breakout facilities and other amenities.

Last-mile facilities also rely on heavy parking counts for delivery vans. There is also a need for more trailer parking because trucks are coming and going at such a rapid pace. Many of these fulfillment centers need staging or queuing areas for the trucks to be able to park their trailers and move through the facility.

Q How difficult is it for industrial and logistics developers to acquire the land needed to meet the growing needs of the economy?

The US is a very large country, but distribution centers are concentrated; there are six markets which account for nearly half of the total net absorption. These include Los Angeles and Southern California, Chicago with its incredible rail infrastructure, Dallas-Fort Worth, Houston, Atlanta, and the New Jersey-Pennsylvania corridor. These are huge distribution centers, so building in those markets, particularly in dense, congested areas such as Southern California or NJ-PA, is clearly a difficult task due to land constraints and longer entitlement periods.

One of the ways to increase the probability of acquiring the best sites is to have a local presence. An investor-developer sitting at a desk in New York and trying to acquire sites and land or even buildings in a local market, without knowing the nuances and having people on the ground, is at a competitive disadvantage.

Real estate remains a relationship-oriented business and having a long-standing reputation and deep presence in a local market is a major advantage. Crow Holdings is active in these top industrial markets, which we believe will be more resilient over time.

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Q Will demand for prime space spill over into secondary industrial markets? Are there secondary markets which have more potential for growth?

There is no doubt these macro trends are affecting the entire country. Markets such as Columbus, Ohio, the Raleigh-Charlotte area, Central Florida and Indianapolis are all experiencing growth in the industrial sector. We happen to have a focus on more of the primary markets, but we also participate in the top 20 markets in the US as an investor. We expect demand will spill over to secondary markets as consumers' delivery expectations have shifted from 4-5 days to same day, or within hours, requiring e-commerce distributors to hold more inventory in every market to meet the delivery requirements.

Our investment management company recently pursued new opportunities in Salt Lake City, the economic center of the Intermountain West, where the population is approaching 30 million, and those people and businesses need goods quickly. With continued migration to the south-east and south-west United States, there will be a considerable need for more logistics space in those regions. Even in markets where there is population decline, we anticipate continued strong demand for industrial real estate due to the increased adoption of e-commerce. ■