



HOULIHAN LOKEY

INDUSTRIAL PROPERTY UPDATE

The Impact of COVID-19



Market Update

Despite the difficulties imposed by the COVID-19 pandemic, the industrial sector has shown impressive resilience and will likely emerge from this crisis in comparably better shape than other real estate asset classes. The increasing importance of e-commerce, last-mile delivery, and online shopping continues to increase demand for industrial space. As e-retail and online sales continue to further their impact on retail as a whole, the industrial sector stands to reap the benefits of a lagging brick-and-mortar retail sector. While industrial properties are not immune to the economic impact, net absorption in the three quarters before the pandemic was 15% higher than in the same period before the global financial crisis.⁽¹⁾ The industrial sector is on better footing now than in the last recession and should be in a strong position to rebound once the economy fully reopens.



Rents are projected to decline in Q2

- Moody's Analytics projects that rents will fall from an average of \$5.20 per square foot (psf) in 2019 to \$4.82 psf in their baseline and \$4.77 psf in their protracted slump forecasts for 2021.⁽²⁾
- Green Street Advisors forecasts that NOI growth will drop 5% from pre-COVID estimates through 2022.⁽³⁾



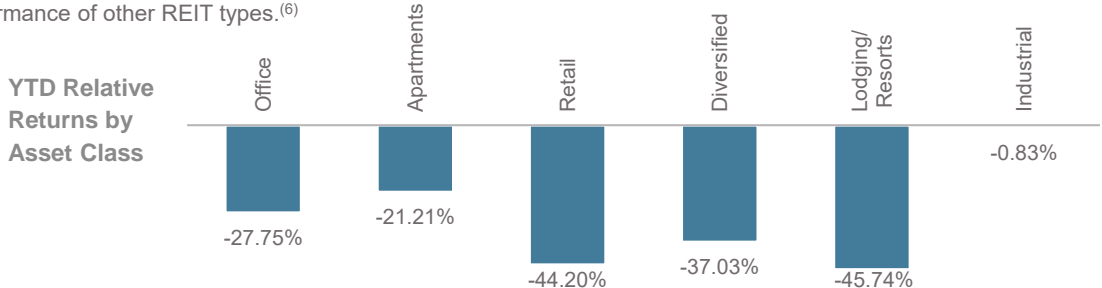
Vacancy rates are likely to increase in the short term

- According to CoStar Analytics, the national industrial vacancy rate is 5.4%, which is 0.5% higher than 12 months prior,⁽⁴⁾ with its forward-looking base-case scenario projecting a peak 5.46% in 2021 and a downside scenario topping out at 7%.⁽⁵⁾



Valuations are down due to COVID-19, but industrial is the least impacted sector

- Per Nareit, total returns for industrial REITs were -0.83% year-to-date through May 31, significantly better than the performance of other REIT types.⁽⁶⁾



Transaction volume has already seen a sharp decline in Q2

- RCA reported that industrial transaction volume from March 1 to June 2, 2020, totaled 807 closed deals, down 55.9% from the same period in 2019.⁽⁷⁾



Leasing activity is still in flux, as construction starts to see an increase

- As of May 21, the trailing 12-month national net absorption totaled 151 million square feet (SF).⁽⁸⁾ CoStar's leasing forecast predicts that net absorption will turn negative in Q2, hitting a trough of negative 20 million SF in Q4 2020.⁽⁹⁾
- As of Q1 2020, 322.7 million SF were under construction, compared with 291.9 million SF in Q1 2019.⁽¹⁰⁾ While this is a positive indicator for the sector, it does present a potential risk if industrial market demand were to slow, resulting in a near-term supply pipeline imbalance.



The biggest uncertainties are how supply chains will operate

- Supply chains are going to be deeply impacted after the crisis is over. As seen in China, there are long backlogs of shipments, with inventory levels in flux for various industries. Some industries that may be negatively impacted include construction, automotive, and oil.
- However, industrial space for last-mile delivery in major cities like New York and Los Angeles continues to be at a historic low, given ever-growing demand for last-mile delivery services.⁽¹¹⁾

Action Items

Houlihan Lokey is ready to assist industrial owners and investors with assessing their real estate portfolios and provide guidance to best position the sector to get through this crisis.



Revisit **underwriting assumptions**, recasting cash flow forecasts in light of the current disruption.



Be **proactive**—opportunistically begin lease renewal discussions and consider strategic portfolio adjustments.



Have an **assessment done on your property values** to understand the potential impact of COVID-19, if any.



Perform a detailed **tenant credit analysis to inform cash flow projections** and anticipate potential defaults in light of COVID-19 disruptions.

? Contact Us

Houlihan Lokey has a successful track record in assisting real estate investors and owners through times of extreme volatility and exogenous events.

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Sources:

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