Research

United States | Q3 2023

Industrial Outlook

Industrial and logistics sectors feel the squeeze amid headwinds

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Executive summary

Industrial and logistics sectors feel the squeeze amid headwinds

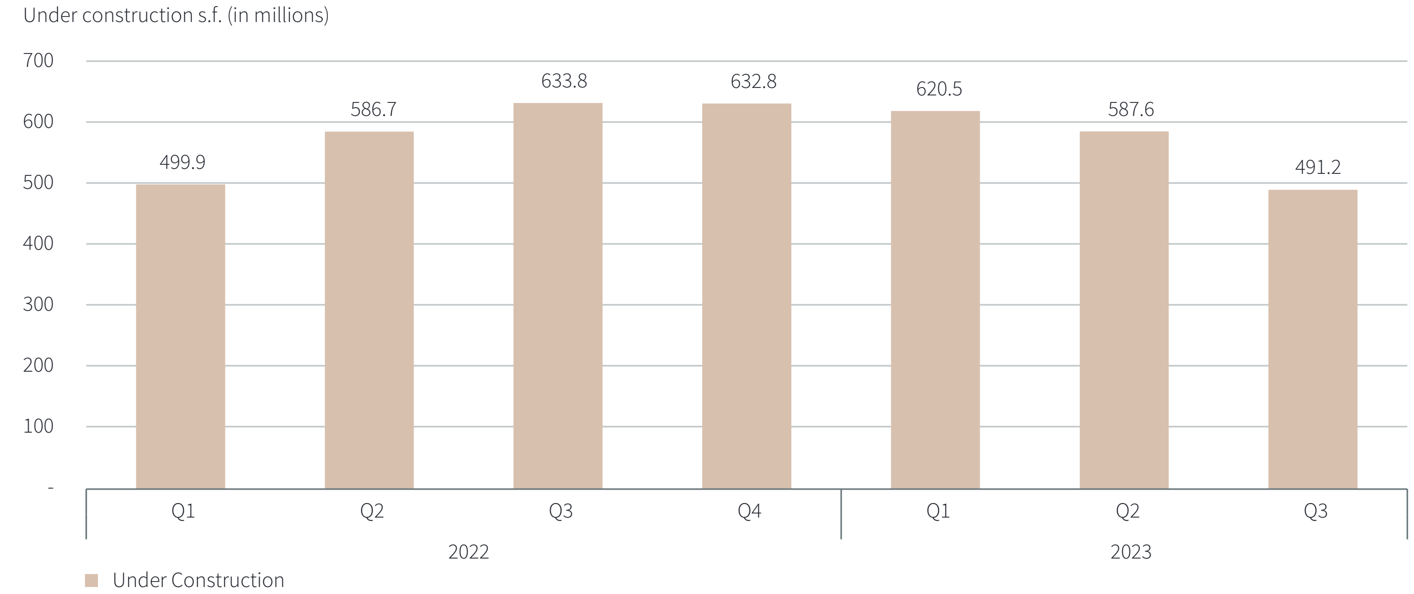
Industrial fundamentals showed increasing signs of slowing in Q3 as the turbulent macroeconomic environment persists. Net absorption in Q3 measured 47.2 million s.f., the lowest quarterly figure over the past three years, and brings the year-to-date absorption figure to 167.8 million s.f. Average asking rates continued trending upward with a 15.3% year-over-year increase to $9.74 p.s.f. With the wave of new deliveries, the vacancy rate increased 70 basis points quarter-over-quarter to 4.9% as anticipated. While this figure seems high on the tail of historic low vacancy rates during the Covid era, the current figure is below the historical average, which was 7.7% in 2013. Although there is still demand from industrial tenants, many users either have pressed pause on executing new deals or are taking much longer to finalize deals as they evaluate all possible outcomes. Furthermore, real estate decisions are being reviewed by more people within the company, going as far up as the C-suite in some cases, adding to the prolonged timeline. Those with upcoming renewals in markets that have seen tremendous rental rate growth are weighing the options of moving locations to a more cost-effective market.

Historical quarter of new deliveries as 162.4 million s.f. was completed

New deliveries ballooned 18.6% quarter-over-quarter as a historical 162.4 million s.f. was delivered in Q3, bringing the 2023 total to 424.9 million s.f. Due to the record delivery figure, the total amount of industrial assets under construction fell to 491.2 million s.f., a nearly 22.5% year-over-year decline, as groundbreakings continue to slow. With the record deliveries year-to-date, the national industrial inventory has grown by over 1 billion s.f. from Q1 of 2022 to the present and is anticipated to grow by an additional 3.2% through the first half of 2024. Dallas/Fort Worth, Chicago, Inland Empire, Phoenix and the Houston markets accounted for 40.6% of all deliveries this quarter. The preleasing rate on new deliveries also continued to decline, dropping to 32.7%.

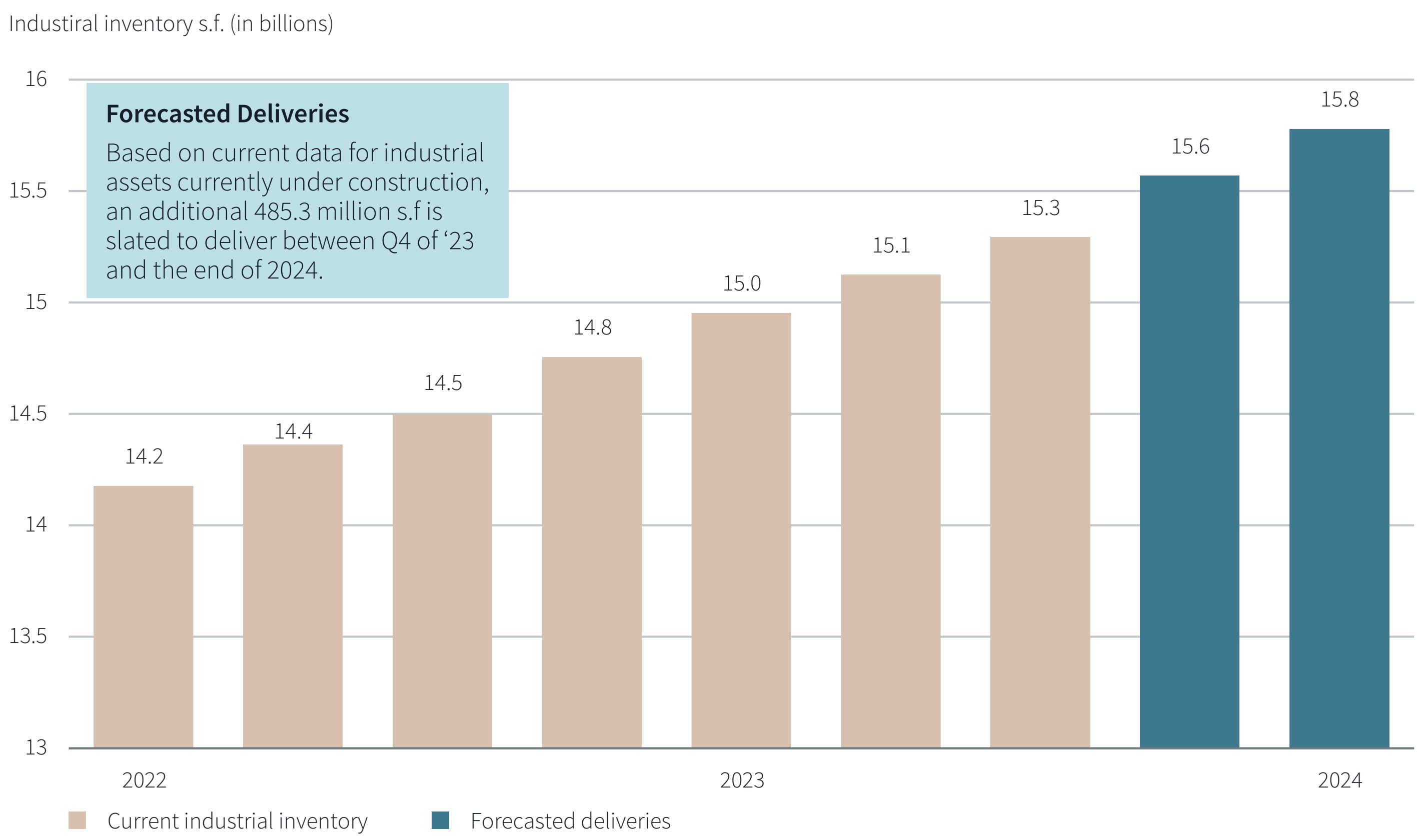
New groundbreakings will continue to decrease in the near term amid high interest rates, high cost of materials and a surplus of new space delivered to the market. The preleasing rate on industrial assets under construction increased from 31.5% in Q2 to 34%. This uptick in the preleasing rate is due to having less volume under construction while still maintaining the strong preleasing figures that took place over the past two years while these projects were being built. Once these assets are completed, the rates of preleasing on new construction are likely to decrease, as occupiers may not be actively seeking new spaces for further occupancy, which will contribute to the ongoing slowdown in demand for new industrial properties.

Industrial product under development drops 16.3% from previous quarter amidst record deliveries



Source: JLL Research Q3 2023

Industrial inventory grew 5.4% year-over-year and is forecasted to grow another 3.2% by Q1 2024

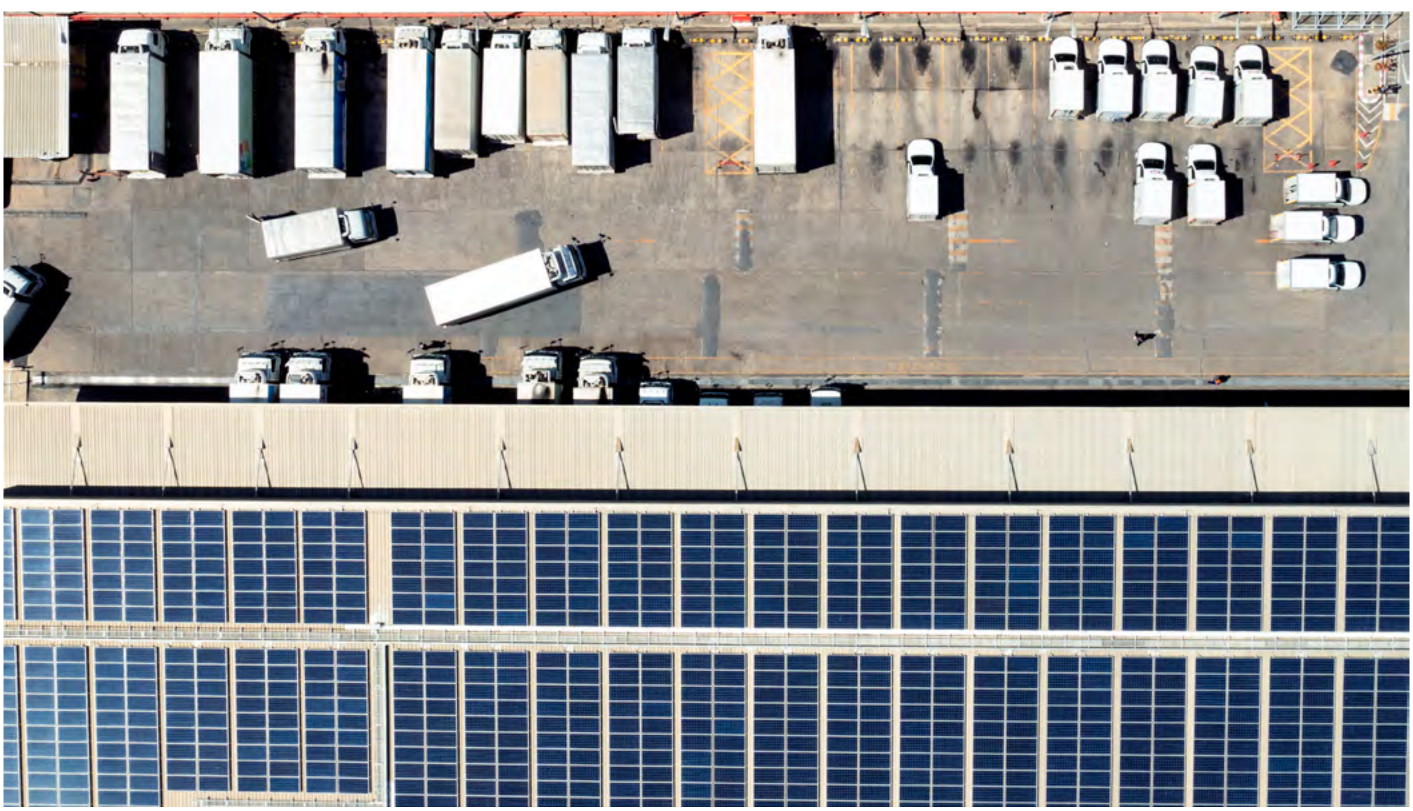


Source: JLL Research Q3 2023

Q3 leasing volume of 90.1 million s.f. lowest since 2015

There was a notable decline in leasing volume in Q3 as only 90.1 million s.f. of leases were executed. Around half of the leases signed were new leases, with major markets like Chicago, Inland Empire, Los Angeles, Columbus, Atlanta, Phoenix and Baltimore all recording over 3 million square feet of new leases. Leasing decision timelines are being extended as occupiers are extremely judicious in decision-making while considering all options and outcomes before executing a deal.

Additionally, the slowing of leasing coupled with cautious occupiers has contributed to the average lease size contracting by 19.7% year-over-year. The number of subleases executed (relative to total quarterly leasing volume) increased quarter-over-quarter, with subleases accounting for 8.1% of Q3 leasing figures. This is likely attributed to the recent influx of available sublease space, which has more attractive rates for occupiers.



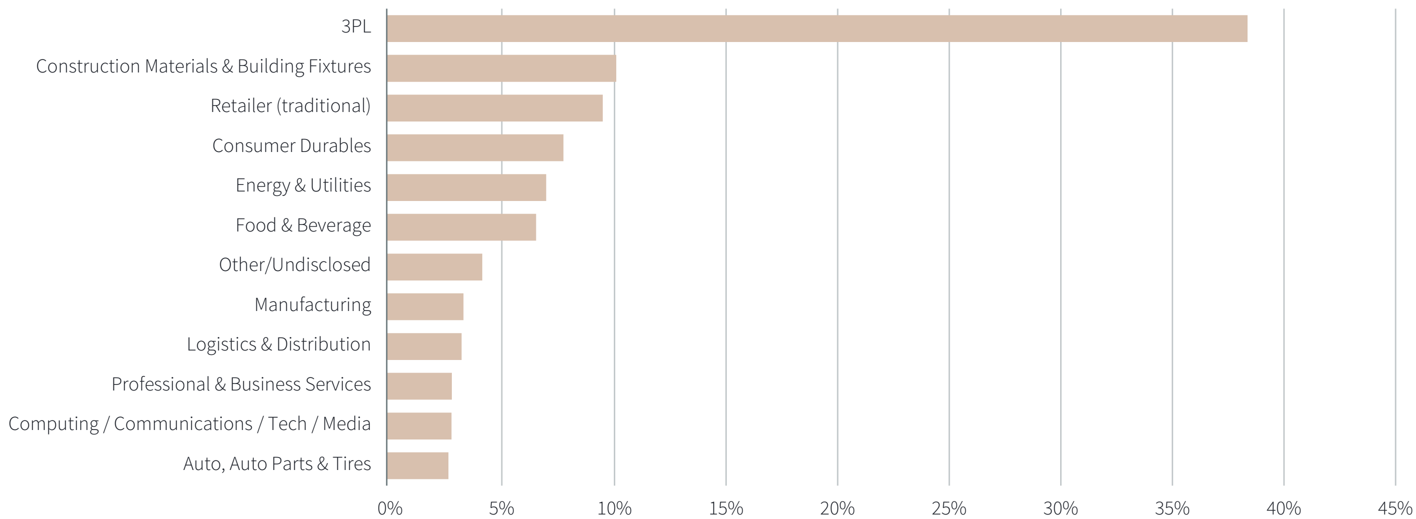
3PL leases accounted for 38.6% of the 25 largest leases in Q3

The increase in 3PL activity can be attributed to factors such as the sustained growth of e-commerce and ongoing nearshoring activity. According to Statista, e-commerce revenue is projected to grow by 33% from now until 2025, highlighting the need for warehouse space to support 3PL operations. Companies that are nearshoring their operations to the U.S. or Mexico often engage 3PL services during the initial stages, before their supply chains are established. Additionally, using a 3PL partner that is well versed in the nuances of cross-border logistics benefits occupiers. This approach also frees up cash flow by eliminating the need for additional warehouse leasing. The manufacturing, energy and utility sectors will be key players in the long term for both leasing and development.

The surge of EV plants, battery manufacturers and semiconductor chip facilities will bolster sustained manufacturing demand in the long- term. And global demand for industrial machinery, particularly mining-related equipment, is increasing as the world transitions from being reliant on oil and gas to other commodities such as lithium. Manufacturing leasing volume has seen a significant 62.4% increase since 2019, while the energy and utilities sector experienced a remarkable 101.5% increase. These sectors are expected to remain active as they further progress toward their environmental, social and governance (ESG) goals and expand their manufacturing operations.

3PL users account for 38.6% of the 25 largest leases in Q3

Industry composition of top 25 leases in Q3 2023



Source: JLL Research Q3 2023

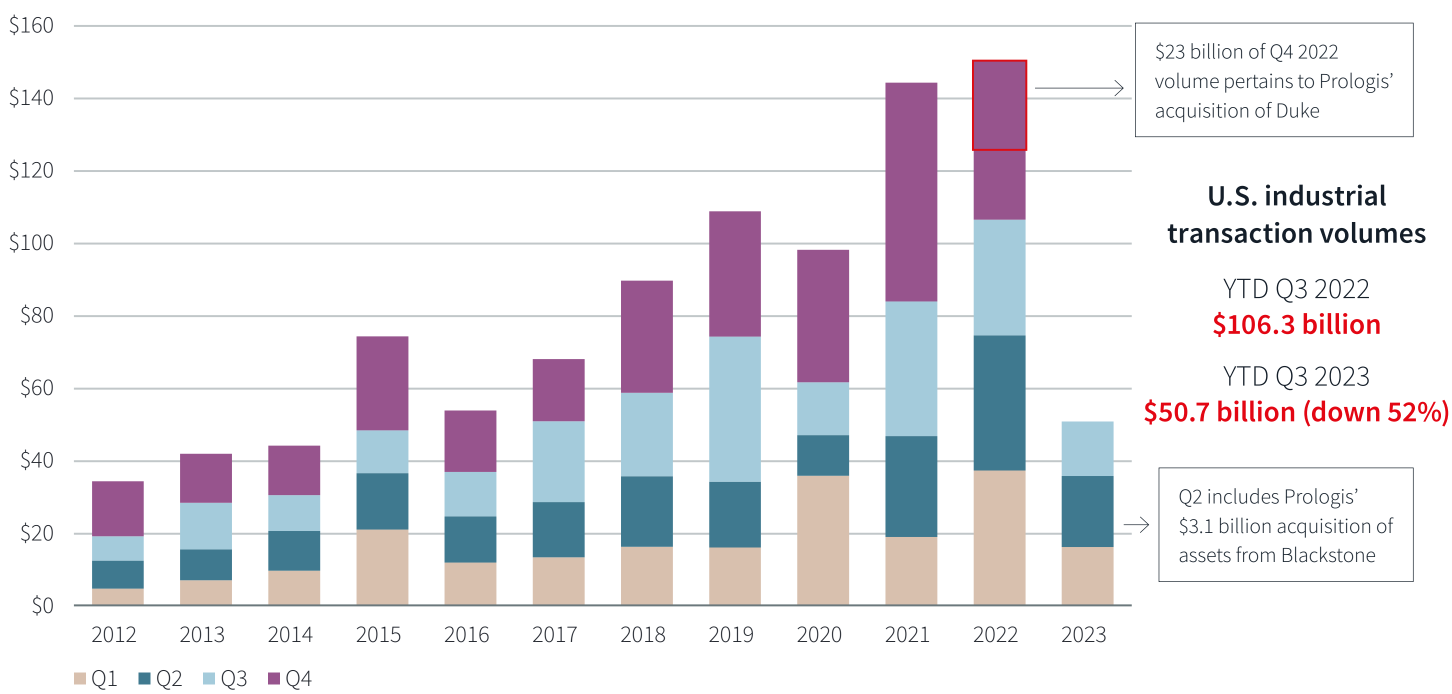
Volume of industrial transactions still below 2020-2022 levels

As it pertains to capital markets, industrial transaction volume is down by 52% year-over-year. Underwriting and bidder depth continue to vary by asset type. Transactions with three to five years of WALT remaining with a mark-to-market opportunity for rents continue to be in favor. Core assets generally continue to have shallower bidder depth given the disconnect between going-in yields and appraisal marks.

Transactions of scale (generally $150 million+ deals) without accretive existing debt are still more challenging in the market. The run-up in 10-year treasury since the middle of July is causing renewed uncertainty, and investors are evaluating their underwriting assumptions, with an increased focus on market rent and rent growth projections.

Volume of industrial transactions continues to be below 2020-2022 levels

U.S. industrial transactions volume ($ billions)



Source: JLL Research, Real Capital Analytics (transactions $5 million and above). Note: Q3 2023 transaction volume total is preliminary

Nearshoring trend remains long term as e-commerce will fuel the need for last mile facilities

While absorption will likely remain positive through the end of 2023, it will largely be attributed to the delivery of preleased assets. Rental rate growth is expected to remain positive, but it is anticipated to be less robust than the unprecedented growth witnessed over the past two years. Though it's predicted to remain a landlord-favorable market through 2024, some geographies might soften as certain indicators moderate. As companies nearshore their operations, some companies adjusted their distribution strategies by using ports on the Gulf of Mexico and the East Coast, such as New Jersey, Savannah and Charleston, which impacted West Coast port volumes slightly. Initial fears of port disruptions on the West Coast due to ongoing labor contract disputes have been resolved with a new contract that has reenergized West Coast ports such as Los Angeles and Seattle to vie for new import and export businesses. These competitive dynamics between port locations will endure amid the reshoring and regionalization efforts. Ongoing trade tensions and intellectual property protection disputes with China have driven industrial occupiers to diversify their supply chains, which also contributes to shifting port volumes and their futures.

To meet the demands of sustained e-commerce growth and same-day/next-day delivery expectations, there will be an increased need for urban logistics facilities located closer to major population centers. These last mile facilities bring inventory closer to consumers, which reduces delivery times and transportation costs. At the same time, occupiers strive to achieve sustainability goals by implementing initiatives such as using a fleet of electric vehicles for deliveries or adding solar panels to unused rooftop space to offset any negative carbon footprint. Technology and automation activities are expected to advance significantly in the coming years, which will provide industrial users with increased opportunities for growth.

Outlook

Total United States

Type	Total inventory (s.f.)	Total vacancy (%)	Total availability (%)	YTD net absorption (s.f)	YTD completions (s.f.)	Under construction (s.f.)	Avg. total asking rent ($ p.s.f.)
Warehouse & distribution	11,622,159,468	5.8%	9.8%	172,055,885	411,244,636	448,683,645	$9.79
Manufacturing	3,631,493,873	2.3%	3.6%	-3,688,732	13,791,015	42,502,839	$9.15
Special purpose	43,178,430	2.6%	3.0%	-258,562	0	100,000	$11.08
Totals	**15,296,831,771**	**4.9%**	**8.3%**	**168,108,591**	**425,035,651**	**491,286,484**	**$9.74**

United States Industrial quick stats

Lowest vacancy

Miami-Dade	**1.6%**
Orange County	**2.4%**
Mid-Peninsula	**2.8%**
New York City	**2.9%**
Los Angeles	**3.0%**
Richmond	**3.0%**

Highest YTD net absorption

Dallas/Fort Worth	**24,879,880**
Houston	**14,578,897**
Eastern & Central Pennsylvania	**11,993,672**
Savannah	**10,467,051**
Atlanta	**8,588,423**
Phoenix	**8,334,889**

Highest under construction (s.f.)

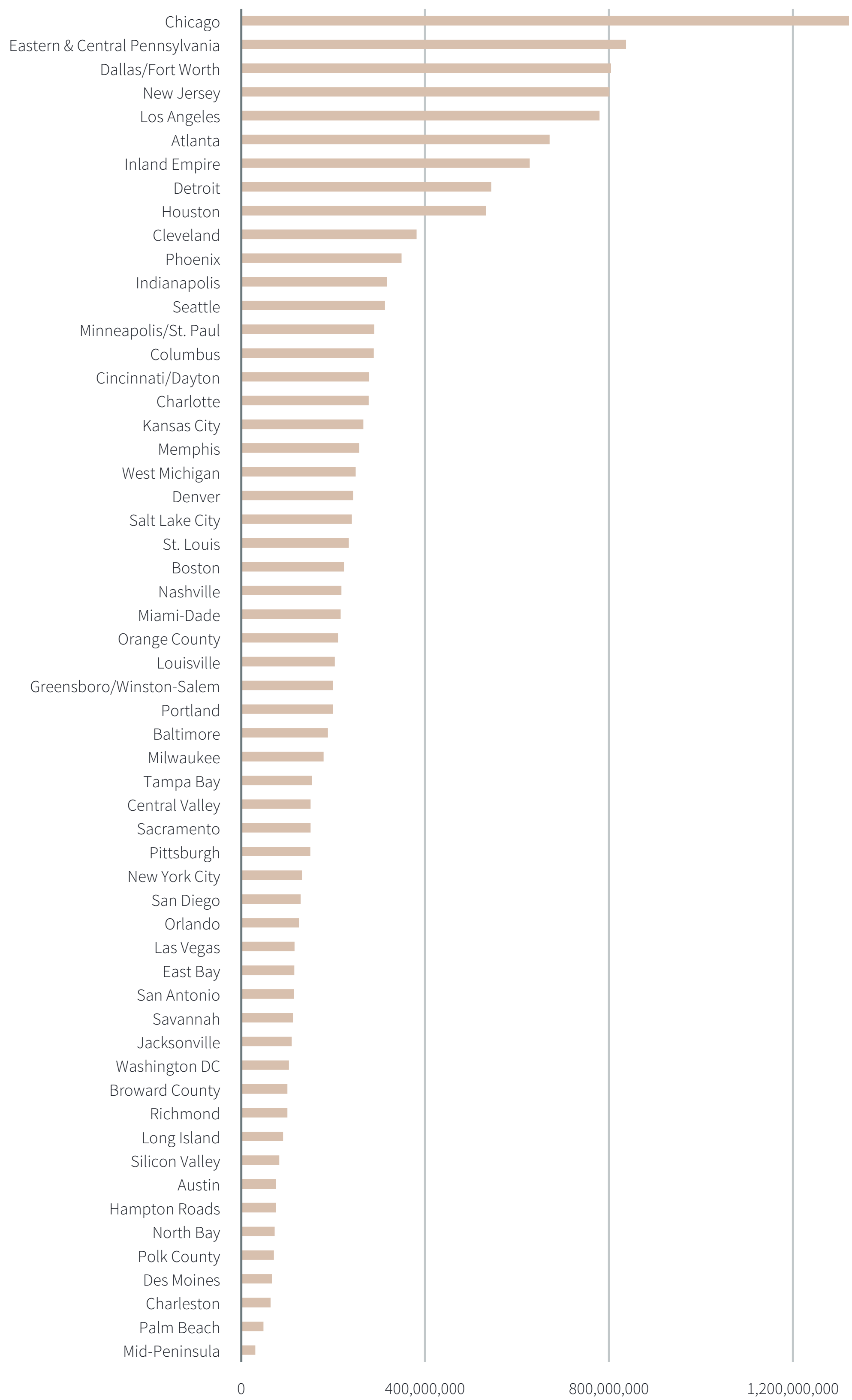
Dallas/Fort Worth	**49,003,317**
Phoenix	**35,934,861**
Savannah	**35,497,621**
Atlanta	**32,200,809**
Chicago	**26,104,640**
Eastern & Central Pennsylvania	**25,941,993**

Highest YTD completions (s.f.)

Dallas/Fort Worth	**44,912,406**
Inland Empire	**25,774,586**
Houston	**25,745,209**
Chicago	**24,505,914**
Eastern & Central Pennsylvania	**23,965,505**
Atlanta	**21,924,368**

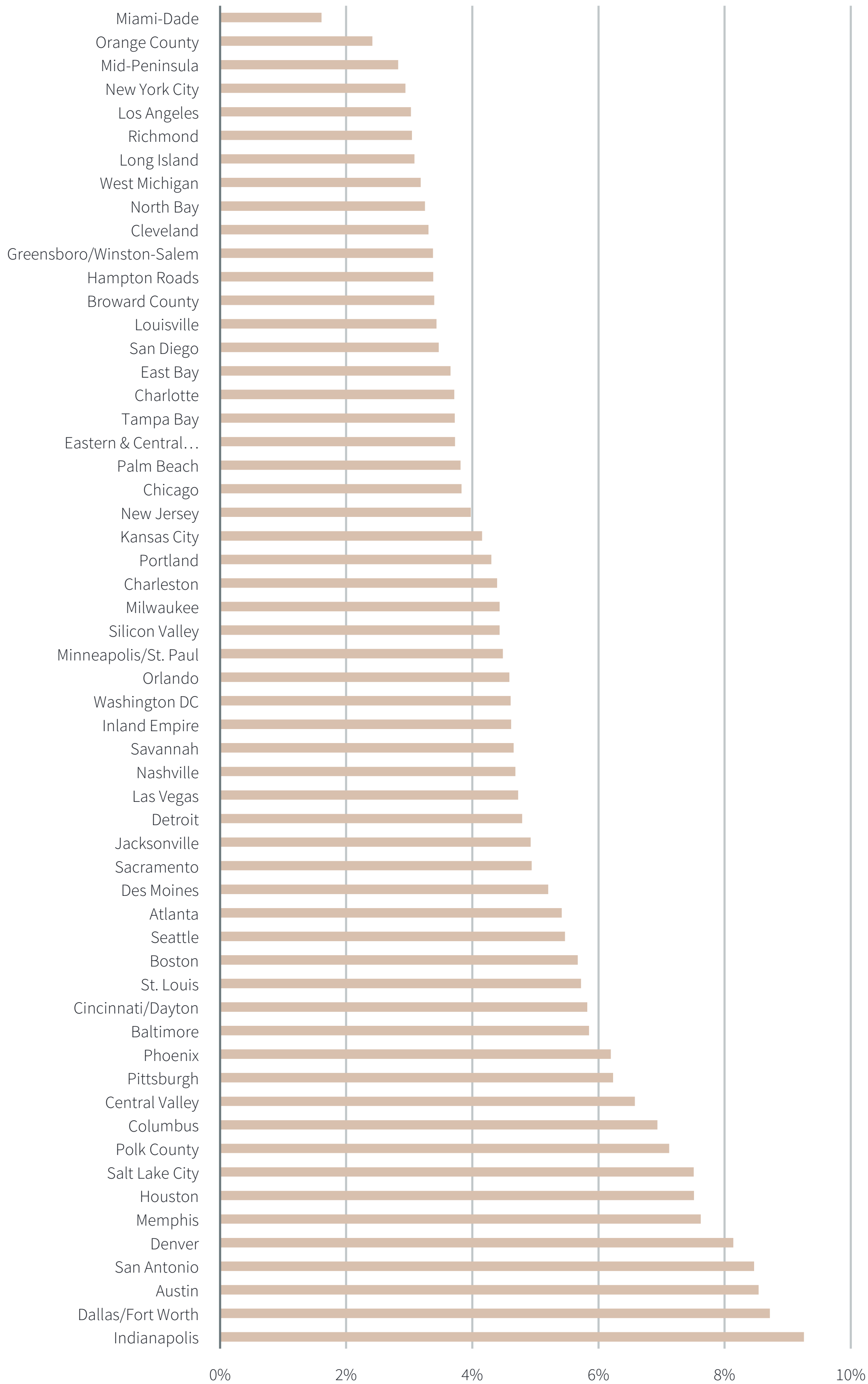
Appendix

Total inventory (millions of s.f.)



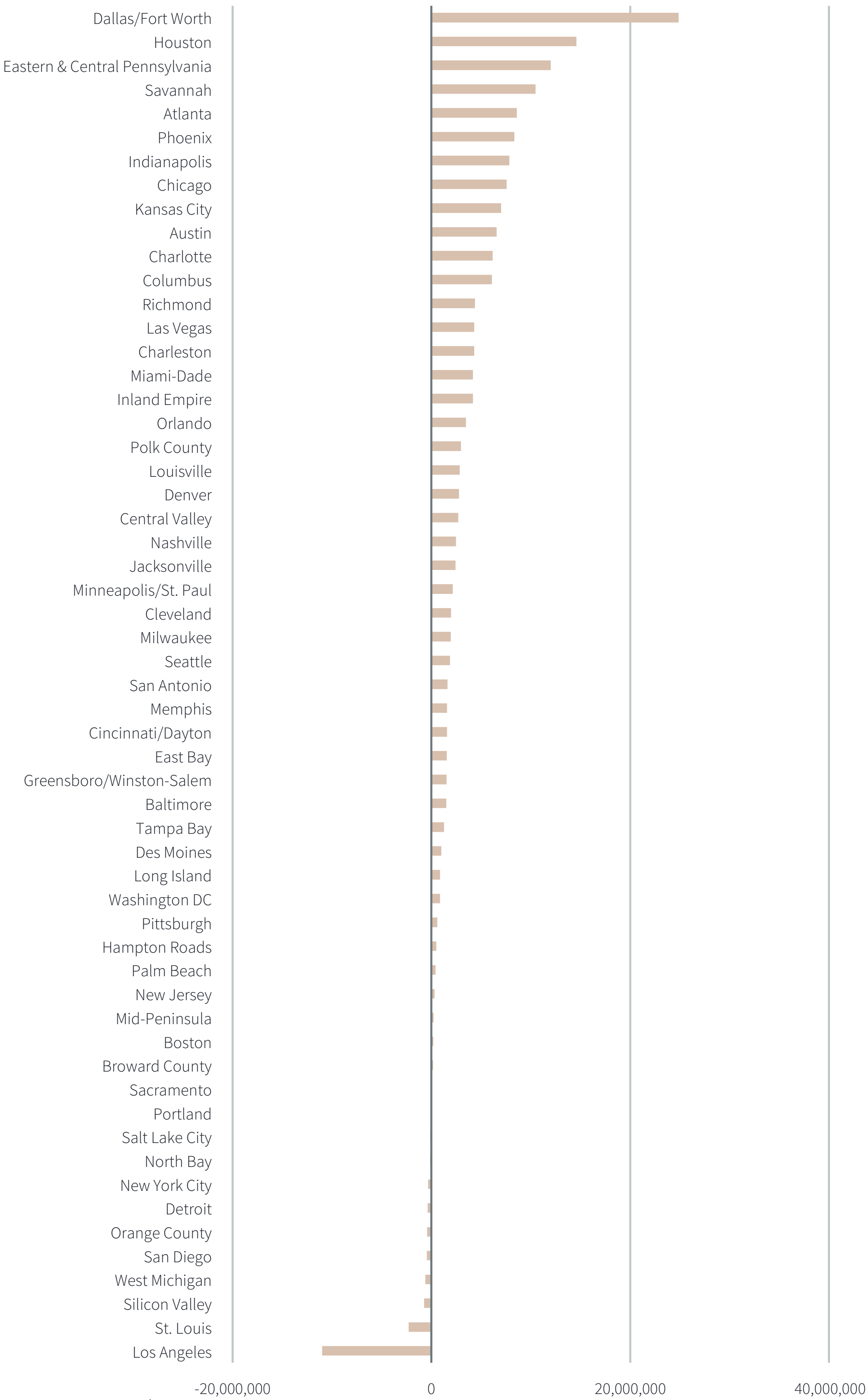
Source: JLL Research

Vacancy rate



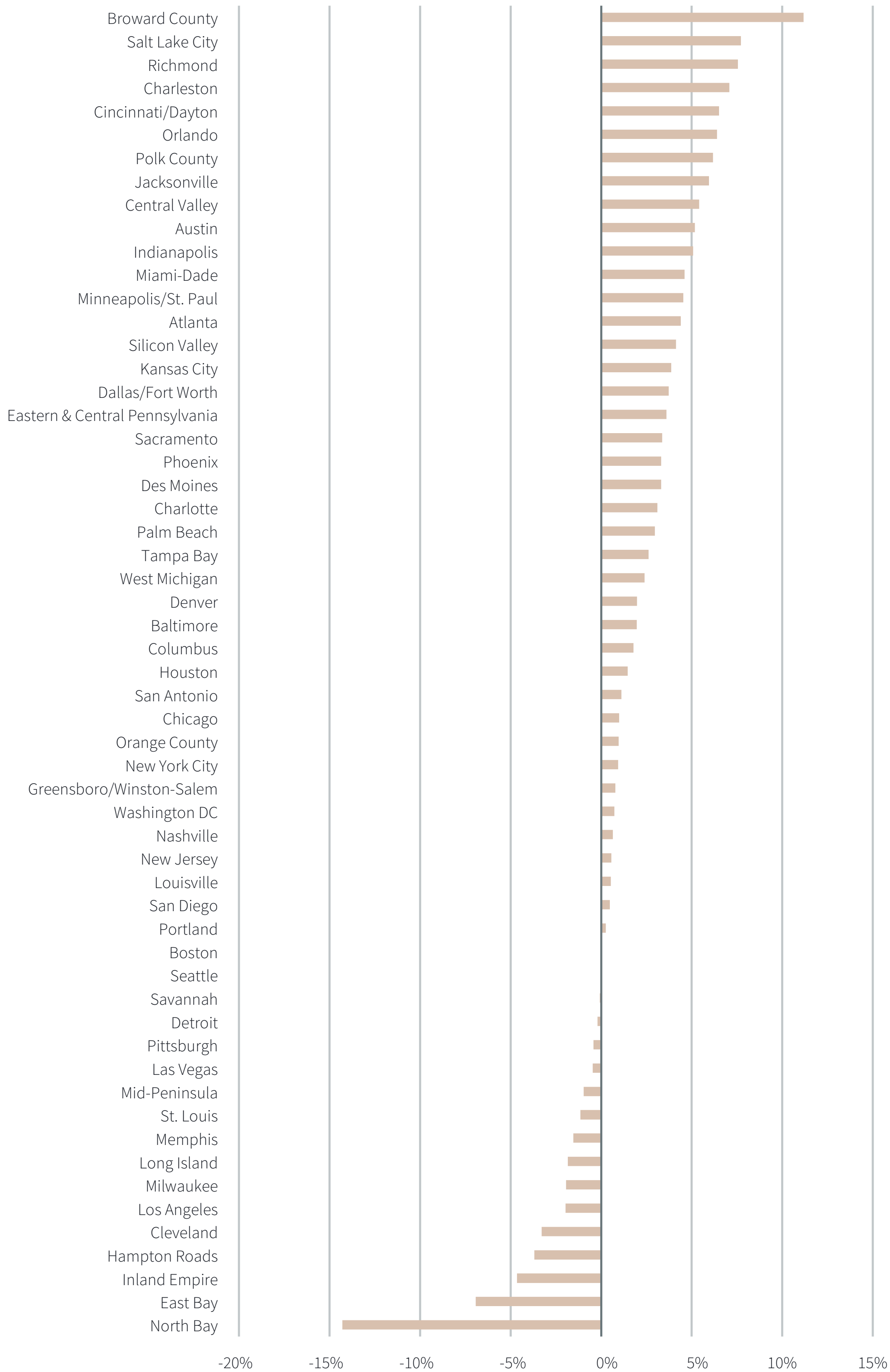
Source: JLL Research

YTD net absorption



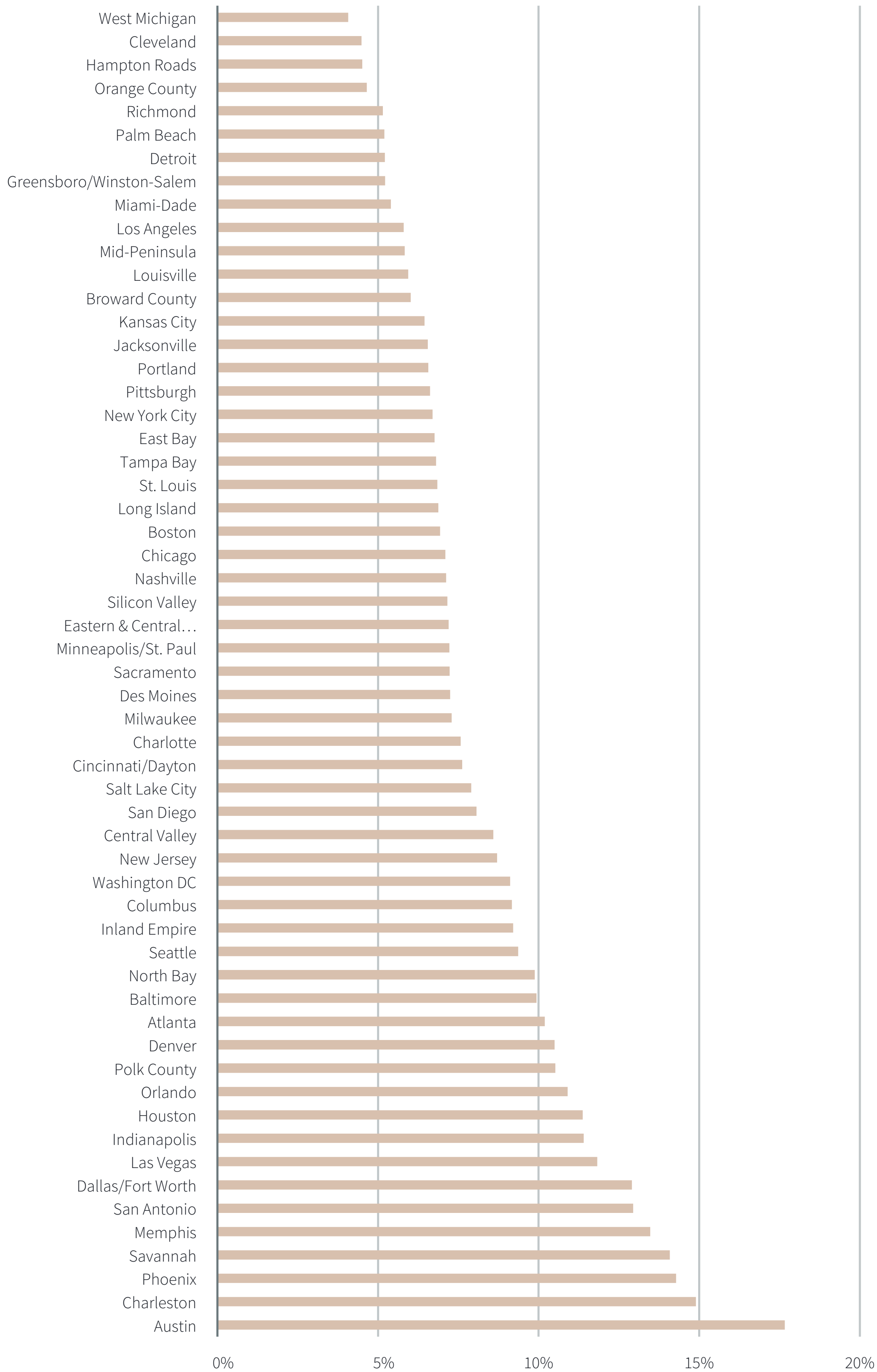
Source: JLL Research

Q-O-Q rent change



Source: JLL Research

Availability rate



Source: JLL Research

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