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Commentary from Cohen Asset Management®

By Bradley Cohen, President

Will 2014 be the year new industrial supply ramps up? The answer is, "kind of". Without additional new construction, certain markets would start to report shortages of space—something that industry professionals in some isolated markets are currently reporting. The following article, provided by one of Cohen Asset Management's research providers, examines the impact on construction in the nation's industrial sector.

Feature Article

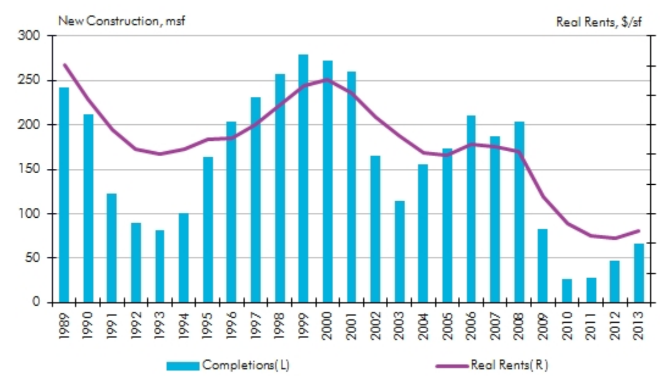
U.S. Industrial Construction: Will New Supply Ramp Up in 2014?

By Jared Sullivan, CBRE-EA

One of the most striking features of the recent recession and subsequent recovery has been the impact on construction in the nation's industrial sector. In the first year of the recession, the nation's industrial sector actually saw robust construction above the long-term average, with over 200 million square feet (msf) of new space completed. Starting in 2009, as the recession deepened and industrial rents plummeted—in some cases by more than 40%, peak to trough—projects were put on hold or canceled entirely, and completions that year fell to only around 81 msf. This 60% drop in one year represents the steepest fall in new construction the industrial sector has ever seen, while the level matches the historical record low from the recession of the early 1990s; with rents falling through 2011, it only got worse. The all-time record low level for construction—just 26 msf completed—was set in 2010, and new construction has simply floundered around the bottom. In 2013, CBRE EA Sum of Markets absorption came in at 233 msf, representing the nation's strongest year since 2005, yet construction added only 66 msf of space. The huge imbalance between demand and supply has caused the availability rate to fall by 140 bps in 2013. Being that the imbalance cannot continue indefinitely (as eventually the market would run out of space), will the industrial market start to see more normalized levels of construction in 2014?

Ask what it would take to start a speculative project, and any developer will tell you they need assurance that enough revenue to justify the project's expense will be collected. During the recession, with national industrial rents down nearly 20%, this became increasingly difficult; however, with rents now rising and expected to exceed 4% this year—a rate above inflation—speculative building will start to become more attractive.

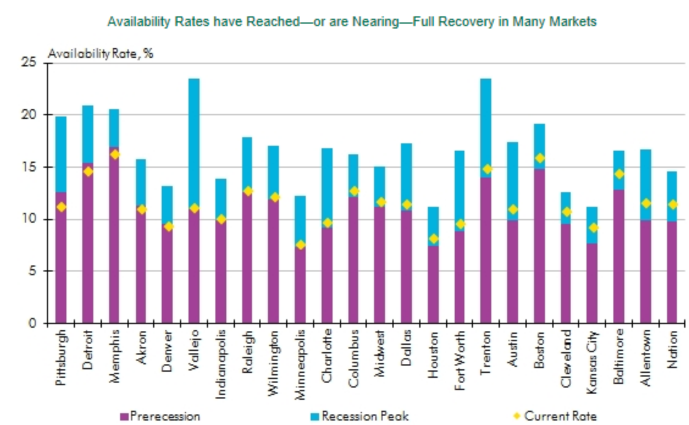
Real Rents Started to Grow in 2013, but Remain Low



Source: CBRE EA Industrial Outlook, Q4 2013.

Real rents are the most important factor in setting growth rates in new construction—rent levels need to justify the cost of building new facilities. Inflation-adjusted rent growth will finally turn positive on an annualized basis in 2013, for the first time since 2006. Historically, real rents have always trended down as newer construction methods and technologies and lower interest rates have allowed new facilities to be built for lower cost in real terms, allowing their construction even when real rents are lower. That said, current real rents remain well below the low set after the 2001 recession, and they will have to rise faster in order to justify new construction.

National numbers can sometimes be misleading, as not all markets improve at the same pace. Some markets are now fully recovered, their availability rates having fully corrected to pre-recession levels. Without additional new construction, these markets would start to report shortages of space—something that industry professionals in some isolated markets are reporting. In fact, several markets—including some of the larger markets such as Denver and Detroit—are now reporting availability rates that are below pre-recession lows.



Source: CBRE EA Industrial Outlook, Q4 2013.

The past year was remarkable with respect to industrial demand. With all of the important economic drivers for the industrial sector (trad growth, inventory growth, industrial production) firing on all cylinders, it is reasonable to think demand in 2014 will remain robust. The robust demand of 2013, however, has taken up much of the slack in the industrial sector, and if 2014 were to see another year of little construction with similar demand growth, we would quickly see shortages across a wide array of markets. To be sure, with the nation's availability rate is still above where it was as the recession started; slack remains, but the time for new construction is now. In 2014, new construction is likely to break the 100msf mark for the first time since 2008; this is still low by historical standards, however, and with demand running at nearly double that level, more construction projects will be needed to satisfy what is expected to be a year of continued healthy demand growth.

Will 2014 be the year new supply ramps up? The answer is, "kind of". This year will certainly see the most new construction in about six years, but it will be low by historical standards. Though they are climbing, in many markets real rent levels remain too low to justify major investment in speculative construction. Even with rents recovered in some markets, there is always a lag before construction can really ramp up. The new construction we do see this year will likely be concentrated in those markets where availability is back to pre-recession rates, and rents are rising more rapidly; but a full national recovery in industrial construction is still more than a year off.

About Us

Cohen Asset Management, Inc. ("CAM") is a private real estate investment firm. The firm's relationships extend to high net worth individuals, institutional investors and domestic business entities. The company was formed to engage primarily in the business of acquiring, owning, developing, and managing net leased income-producing industrial and office properties nationwide. CAM is an active operator and sponsor of real estate assets and has a well-established reputation as a value added investor focusing on real estate opportunities that are inefficiently priced due to a variety of circumstances such as vacancies, rollover risk, sub-optimal management, inefficient current use, deferred maintenance, long-term undervalued leases or other unfavorable property and market conditions. CAM creates value by correcting these deficiencies. Additionally, CAM has studied and completed research on capital flows that can impact the identified target markets on which it focuses.

CAM has acquired, developed, and sold real estate throughout the United States and its principals have had hands-on experience over many market cycles. CAM combines the talents and hands-on operating expertise of an entrepreneurial company with the discipline and research capabilities of an investment firm. CAM has established a reputation for excellence by providing superior results to its investors while focusing on measurable goals and what it takes to achieve them. It is this commitment that allows CAM and its Affiliates to continue attracting new investors while at the same time expanding its asset base.

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