



CAM's Industrial Corner

NEWSWORTHY INFORMATION FOR OUR INVESTORS

July 2014, Volume 5

www.cohenasset.com

Commentary from Cohen Asset Management®

By Bradley Cohen, President

The following article, provided by one of Cohen Asset Management's research providers, examines the roll of smaller industrial buildings in the economy and how an investor would be wise not to forget about the crucial role that small industrial space plays in the supply chain.

Feature Article

Small U.S. Industrial Properties Play an Important Role in a Complex Supply Chain

By Jim Costello & David Egan, CBRE

When most investors think of the industrial property market, they think of the bulk distribution facilities that dominate major transportation hubs in the U.S. Most of the industrial market, however, is concentrated in the light industrial segment—buildings of less than 200,000 sq. ft. – and its overall performance characteristics track most closely with these smaller assets.

For many of us, imagining the industrial market to be dominated by mega-scale assets is something that began at an early age. As kids growing up in Chicagoland, we (the authors) both visited the Museum of Science and Industry. There, in giant exhibition halls left over from the Columbian Exposition, kids are shown larger-than-life exhibits of the major industrial sectors that dominate the Midwest.

The coal mine exhibit was a particular favorite, with its massive elevator simulating a 600-foot descent into a mine. Many of the exhibits focused on transportation and farm equipment – given their importance to the economies of the Midwest – giving kids a sense of how this machinery was built and how it benefited society.

Maybe it was that everything looks bigger when you're small, but these exhibits gave us the impression that industrial activity happens only in big places. In truth, today the industrial market is not

dominated by facilities like the old River Rouge Plant in Michigan, where 100,000 workers once brought in raw ores and materials on one end and delivered Ford vehicles on the other. The supply chain today is longer and more complex, with a need for many smaller buildings.

While recent discussion of the industrial sector has focused on the proliferation of distribution centers of 1 million sq. ft. or more, most of the industrial activity in the U.S. happens in smaller buildings. As Figure 1 indicates, 68.8% of all industrial buildings are smaller than 200,000 sq. ft. These smaller buildings comprise 68.9% of the warehouse sector, while in manufacturing they claim a slightly smaller share, with 59.6%.

Figure 1. Breakdown of Industrial Space Across the 51 Largest U.S. Metro Areas

Building Size	Warehouse	Manufacturing	R&D	Other	All Industrial	
					Square Feet	as % of Total
10k-49k	2,608,929	663,820	614,597	126,172	4,013,518	31.4
50k-99k	1,542,007	495,372	348,185	48,363	2,433,927	19.0
100k-199k	1,556,719	548,633	190,159	55,282	2,350,793	18.4
200k - 399k	1,282,070	409,105	88,776	50,455	1,830,406	14.3
400k+	1,299,984	748,346	69,716	39,459	2,157,505	16.9
Total	8,289,709	2,865,276	1,311,433	319,731	12,786,149	

Source: CBRE Econometric Advisors Industrial Outlook, Q1 2014.

That small buildings are such an important component of the U.S. industrial property market has implications for how investors should think about the market's overall performance.



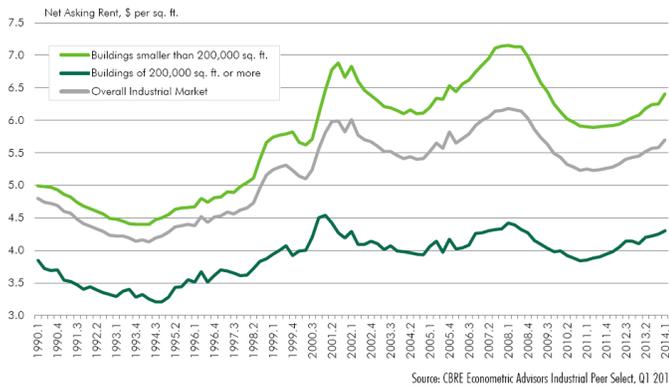


Consider that much of the warehouse inventory built since the 1990's is in the bulk distribution category and tends to be located near the fringes of metropolitan markets, where traffic to and from distribution facilities can flow more quickly on the ring-road highways. Fringe locations also mean more development sites and more potential for competition for tenants in the leasing market.

By contrast, smaller industrial assets tend to be located near the urban core and in infill locations. These assets tend to satisfy tenants that do business within a 5- to 50-mile radius; while the land at the fringes of a metro area may be cheaper, those tenants that have a clear business need to be closer to the final point of consumption are willing to pay a premium for these infill locations.

With the infill nature of many of these light industrial warehouse assets, across various market cycles they have tended to exhibit stronger rates of rent growth. Figure 2 shows net asking rent trends for various building size ranges, and smaller assets are the clear winner.

Figure 2. Rental Trends Show Smaller Assets Outperforming Larger Assets



In the early 1990s, net asking rents for assets smaller than 200,000 sq. ft. were just \$5.00 per sq. ft. per year. Discounting some cyclic highs and lows, by Q1 2014 this rent figure was approaching \$6.50 per year. Over this 24-year history, the compound annual growth rate was just over 1%. Meanwhile, assets larger than 200,000 sq. ft., which were just under \$4.00 per sq. ft. per year in 1990, are approaching just \$4.50 today – for a compound annual growth rate of 0.5%.

Smaller assets also have a more favorable ratio of rent growth to unit of volatility (as measured by

standard deviation around annual rent growth). This is consistent with the argument that smaller warehouses have generally benefited from lower long-run levels of new supply, as land and replacement costs are higher in infill areas, presenting barriers to construction. Trammell Crow did his first industrial development in the Old Trinity Industrial District of Dallas in the late 1940s, but today no developer would build such small assets so close to Downtown Dallas. New development in the area today focuses on the kind of residential, consumer and nightlife mix that is more common in the higher-rent Uptown market of Dallas. The small industrial assets that still exist in these types of locations are rarely the prettiest assets, but they frequently deliver high rents by serving a critical end space requirement in a complex supply chain structure.

Modern manufacturing techniques still require space, but today's complex supply chain structures generally need less space in any single location. With growth in 3D printing, this trend could accelerate. The Museum, for instance, has a new exhibit where small toys are produced on site by a computer integrated manufacturing setup. As kids, the best we could have for was a wax casting from one of the Museum's mold-a-rama machines. Still, what David and I (or, rather, our parents) paid for those plastic models was more than what David paid in a recent visit there with his kids, when adjusting for inflation. The lower price is for toys of arguable higher quality.

In this age of e-commerce and the mega bulk distribution center, the "boring" light industrial segment has been overshadowed. However, investors seeking a stable, long-term return would be wise not to forget about the crucial role that small industrial space plays in the supply chain. When investors look at broad national indicators of industrial market performance, they are looking, by and large, at indicators of the performance of smaller assets.



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