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## Sector Focus: Industrial REITs Could Benefit from Increased Space Demands in 2015

BY SARAH BORCHERSEN-KETO

**D**emand for industrial space is expected to remain healthy for the rest of 2015, supported by solid economic fundamentals, rising consumer demand and the continued expansion of e-commerce, according to market watchers.

A report from the NAIOP Research Foundation forecasts net demand for industrial space could grow 8 percent in 2015, up from 224 million square feet in 2014.

Similarly, industrial REIT Prologis Inc.'s (NYSE: PLD) most recent survey of customer activity and facility utilization in the United States reports that "leading indicators of demand are elevated, revealing another year of healthy net absorption for 2015."

The prospects of rising demand for industrial space are producing optimistic projections for operating results in the sector. For example, research firm SNL Financial is forecasting median funds from operations (FFO) growth in 2015 of 7.8 percent for industrial REITs, versus 7.2 percent for all Equity REITs.

### HIGH OCCUPANCY LEVELS

In a recent interview with REIT.com, Michael Landy, president and CEO of Monmouth Real Estate Investment Corp. (NYSE: MNR), said his company is currently enjoying rising occupancy rates and lease maturities. He also pointed out that industrial occupancy rates on the whole continue to rise.

Jason Lail, manager of real estate research at SNL Financial, said industrial REITs should continue to see high occupancy rates as a result of the growing demand for space. Industrial REIT occupancy



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at the end of 2014 stood at 94.3 percent, up from 93.7 percent in 2013 and 93.1 percent in 2012, Lail noted.

However, going forward, Lail said further occupancy gains will be hard to attain. Instead, rent increases will generate growth in same-store net operating income (SSNOI), according to Lail.

Tom Lesnick, a vice president and REIT analyst at Capital One Securities, Inc., expressed similar sentiments.

"Many markets are at or approaching full effective occupancy," he said. "Because of that, I expect rent growth in many markets to be the primary driver of revenue growth."

### E-COMMERCE PROVIDING ONGOING SUPPORT

Analysts appear to agree that e-commerce continues to be a leading factor supporting growth in the industrial sector.

“A great deal of the demand for industrial space is expected to come from firms that produce and distribute consumer goods, and that’s why commercial real estate is seeing such a boom in e-commerce fulfillment and distribution facilities,” said Thomas Bisacchino, NAIOP president and CEO.

Eric Frankel, analyst at Green Street Advisors, observed that supply chain dynamics of online retail create more need for warehouse space than brick-and-mortar retailers.

Lail noted that “all indicators seem to be pointing to continued e-commerce growth throughout the remainder of this decade, which will have a continued positive effect on industrial REITs.”

### **SUPPLY LEVELS INCREASING, BUT EXPECTED TO REMAIN IN BALANCE**

As demand fundamentals continue to look favorable, industry participants have been quick to respond.

While market rents for larger spaces have justified new construction, builders simultaneously have access to “ample availability” of debt and equity, according to Green Street. As a result, supply levels have “definitely increased a lot over the past year or so,” Frankel said.

Additionally, Lesnick pointed out that building industrial facilities tends to be less complex than other property types, which should assuage concerns about an overstock of industrial product. Because of the ease of construction, “developers can rein in supply, and the

market can right-size itself from a supply-demand equilibrium perspective much faster than other property types,” Lesnick said.

### **STEADY INCREASE IN TRANSACTION VOLUME**

In addition to heightened activity on the development side, the industrial sector has also witnessed an increased level of transaction volume.

Meanwhile, healthy capital markets and improving operating fundamentals have driven a steady increase in transaction volume in the industrial sector, according to Green Street.

“Industrial REITs are becoming more active on the acquisition front,” Lail confirmed. SNL data shows that total acquisitions by industrial REITs grew roughly 45 percent in 2014, up to about \$3.2 billion in 2014 from \$2.2 billion in 2013.

Domestic and foreign investor interest in large portfolios and operating platforms is lively, Green Street noted.

In the case of Monmouth, Landy said low interest rates and a “resurgent” market for build-to-suit industrial facilities have prompted the company to pursue more deals.

“We’ve been very successful in sourcing high-quality acquisitions with very favorable yield spreads,” Landy said. He noted that the new properties also have long-term leases with investment-grade tenants, leading to “meaningful earnings accretion.” ♦

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