

TENET HOLDINGS UPDATE: STATE OF THE INDUSTRIAL MARKET Q1 2024

OUTLOOK

The U.S. industrial sector continues to cool after two years of unprecedented, pandemic-driven expansion. While tenant activity slowed in the first few months of 2024, demand remains positive relative to Q1 2023. As expected, new completions (supply) continue to exceed net absorption (demand), causing the national vacancy rate to trend marginally higher. At 5.8%, however, the Q1 2024 vacancy rate remains well beneath its long-term historical average of 7%. Rent growth is also trending back towards the long-term average. In Q1 2024, industrial rents grew 6% on an annualized basis, versus 10% and 20% in '23 and '22, respectively.

As we have detailed in prior updates, the project pipeline is thinning out, and rather quickly at that. In today's higher interest environment, fewer developers are breaking ground; in fact, industrial construction starts are down 50% year-over-year (YOY). In our view, the stage is set for the fundamentals to quickly tighten on the other side of the supply wave. So, while demand growth is currently cooling, at present net absorption appears to be retracing in an orderly fashion. Similarly, vacancy rates are rising as new capacity outstrips demand growth, yet controllably so. Finally, while rent appreciation is slowing, growth remains solidly positive. Based on our experience, this is exactly what a soft landing looks like for the industrial sector.

U.S. Industrial Market Q1 2021¹

5.8% Vacancy Rate
(Increased 60bps from prior quarter)

23.9MM SF Net Absorption

\$9.73 SF Asking Rent

5.9% Rent Growth Year-over-Year

404.7MM SF under construction

Economic Indicators Q1 2024

43.1MM Industrial Employment

157.7MM Total Nonfarm Employment

3.7% U.S. Unemployment Rate

KEY TAKEAWAYS

- Industrial rents continued the trend upward, with March in-place rents growing 5.9% YoY.
- Historic levels of new supply continued to push vacancy rates higher, reaching 5.8% at the end of Q1.
- 404.7 million square feet of new supply remained in the construction pipeline as of March '24, roughly 67% of Q1 '23 volume.
- Industrial transactions totaled \$10 billion through Q1 2024, at an average sale price of \$147 per sq. ft.

¹ Cushman and Wakefield US Market Beat Industrial Q1 2024

- The **Bay Area** recorded the largest sales volume of any city in the U.S. during the first quarter, driven by one \$1.2 billion transaction.
- **Chicago** recorded the third-largest sales volume nationwide, totaling \$585 million during the first quarter.
- **Miami** boasted the highest rent growth in the U.S. (even outpacing SoCal markets), increasing 11.9% year-over-year.
- At \$10.49 per square foot, **New Jersey** in-place rents were the highest in the Northeast.

SUPPLY AND DEMAND

Industrial groundbreakings topped out at nearly 700 million sq. ft. in the third quarter of 2022. Since then, however, there has been a notable absence of replacement projects backfilling the construction pipeline. To compound the issue, roughly 55% of the existing construction pipeline is set to deliver prior to Q3 2024. As a result of this supply “cliff,” we anticipate that new projects within the construction pipeline will total less than 150 million sq. ft. by the end of the first half of 2024, which is a figure we haven’t seen since 2009. Assuming the economy does not materially alter course beforehand, we believe this sharp reduction in capacity will materially enhance the rate of net absorption. Accordingly, industrial asset values and market rent appreciation should begin to accelerate, as tenants looking for newly constructed space will have increasingly limited optionality relative to prior years.

Total leasing volume for the start of 2024 was significantly lighter versus the 3-year moving average; however, pre-leasing activity picked up throughout the U.S. industrial market, continuing an uptrend that commenced in the third quarter of 2023. It is important to remember that leasing is a lagging indicator; more specifically, decisions regarding tenancy that were made 6-12 months ago are only now being reflected in the market. Hence, the observed softening in leasing activity appears to be directly correlated to the sharp slowdown in Port activity experienced at the beginning of 2023. Conversely, pre-leasing tends to be a leading indicator. In January 2024, more tenants commenced the pre-leasing process, indicating that leasing activity is beginning to ramp back up in 2024. We would add that the quarterly container volumes for the top 9 U.S Ports showed a significant uptick in Q1 activity, increasing 14% over the prior comparable quarter, another positive sign for the back half of the year.

KEY DRIVERS OF INDUSTRIAL REAL ESTATE DEMAND²

E-Commerce: Over the past decade, e-commerce retail purchases have skyrocketed by a staggering 317.5%. This surge in channel spend has sparked relentless demand from top-notch supportive fulfillment operations, led largely by 3PLs.

Electric Vehicles: The auto industry’s move towards electrification, along with the subsequent investment in the fuel cells powering these vehicles, has significantly fueled new industrial demand over the past three years. For context, over 250,000 electric vehicles were sold in the United States in Q1 2024 alone, a remarkable figure. Additionally, there are over 120 battery cell-related facilities in the various stages of planning, construction and production, which collectively represent nearly \$120 billion in investment since 2020. An incremental \$29.3 billion has been invested in additional EV manufacturing lines.

²Source: Avison Young U.S. industrial market report Q1 2024

Semiconductors: Currently, there are 41 semiconductor-related facilities that are either in the final stages of planning or already under construction. Additionally, there are over 30 facilities dedicated to R&D or the production materials for semiconductors across the nation.

Venture Capital: VC Funding for Advanced Manufacturing set a record in 2023, at \$3.2 billion.

Amazon: “First Mover” Amazon is once again ramping up. Amazon’s active square footage has already increased by 43 million square feet 2024, in support of the company’s same day delivery strategic rollout.

Highest Market Rent/SF Annual	
San Diego, CA	\$22.44
Miami, FL	\$20.16
Orange County, CA	\$19.68
New York, NY	\$19.68
Los Angeles, CA	\$19.08
U.S. Index	\$12.00
Canada Index	CAD 12.84

Lowest Vacancy Rate	
Vancouver, BC	1.8%
Toronto, ON	2.3%
Omaha, NE	2.7%
Calgary, AB	2.8%
Miami, FL	3.4%
U.S. Index	6.2%
Canada Index	2.3%

Highest Market Sale Price by SF	
Vancouver, BC	CAD 345
Orange County, CA	\$341
San Diego, CA	\$331
Los Angeles, CA	\$317
Toronto, ON	CAD 273
U.S. Index	\$149
Canada Index	CAD 228

Most SF Under Construction	
Phoenix, AZ	37,760,958
Dallas-Forth Worth, TX	29,944,247
Savannah, GA	27,431,043
Inland Empire, CA	26,409,834
Toronto, ON	19,279,908
U.S. Index	390,725,364
Canada Index	47,121,343

Source: Lee & Associates Industrial Overview Q1 2024

Lowest Cap Rate Markets

Vancouver, BC	4.3%
Toronto, ON	4.3%
Inland Empire, CA	4.5%
Los Angeles, CA	4.9%
Orange County, CA	5.1%
U.S. Index	7.2%
Canada Index	5.2%

Largest Inventory by SF

Chicago, IL	1,407,297,880
Dallas-Fort Worth, TX	1,170,909,941
Los Angeles, CA	958,861,414
Toronto, ON	878,929,245
New York, NY	877,716,468
U.S. Index	18,932,226,775
Canada Index	1,875,165,461

Source: Lee & Associates Industrial Overview Q1 2024

DEAL FLOW

Industrial cap rates continued to tick upwards after hitting historic lows in 2022, averaging 6% in Q1 2024. Pricing, on the other hand, has shown incredible resilience and remains very near record levels, averaging \$116/SF. In fact, not only have Class B and Class C assets retained the value created during Covid, industrial is the single sector within real estate that has continued to appreciate through 2024, despite the elevated costs of debt financing.

As a final tailwind to the back half of 2024, we believe that confirmation of the Federal Reserve's policy pivot this year should result in intensified competition for industrial assets, particularly given the current backdrop of a what we view to be a suppressed transaction environment.

Cap Rate Q1 2024 by Market

Atlanta	5.60%
Chicago	6.75%
Dallas-Ft Worth	5.75%
New Jersey	5.75%
Southern California	5.25%