Commercial Real Estate Debt

Retail's Loss Is Industrial's Gain

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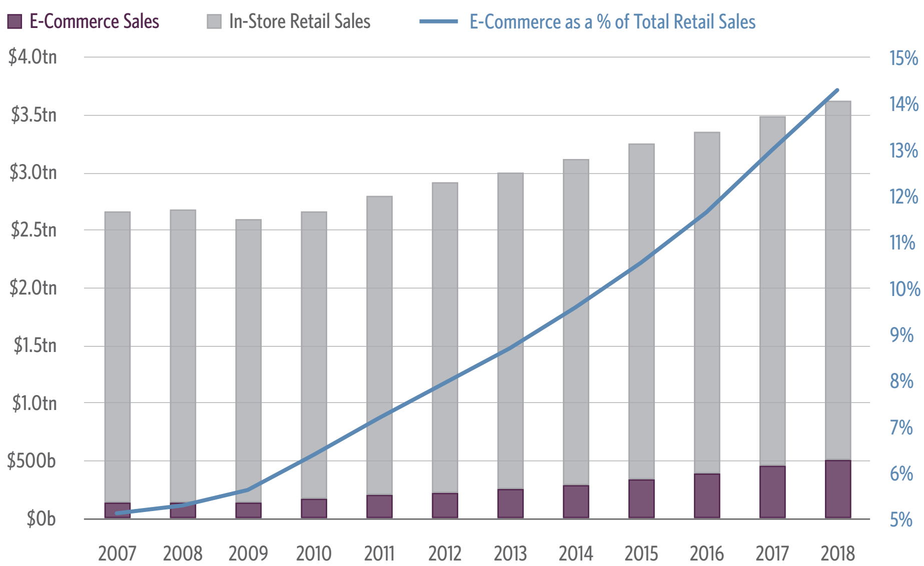
As the retail sector continues to struggle, investors compete for industrial opportunities driven by e-commerce.

All but two of the 50 companies identified by Finance 101 as being at risk of going out of business in 2019 fall within the "consumer cyclical" sector. Many are traditional retail store brands. Following estimates by Coresight Research that approximately 8,139 retail stores closed in 2017 and 5,528 in 2018, the predictions paint a negative picture for the retail real estate market. There are some bright spots, such as the grocery sector and the movement of online brands into brick-and-mortar locations, but the industrial sector has benefitted most from stress in retail.

For the decade ending in 2018, DigitalCommerce360 estimates that the Internet share of retail sales more than doubled, jumping to nearly 15 percent of total retail sales (see chart, top right). Developers are responding to the growing demand for warehouses, distribution, and "last mile" fulfillment centers. For many products, such as groceries, these facilities also need to provide cold storage and other customized space designed for efficient fulfillment and rapid consumer delivery. According to CBRE, rents for last mile properties, which tend to be smaller, Class B infill facilities located close to population centers, have grown rapidly due to increasing demand and lack of new development. Ironically, to take advantage of key locations near population centers, developers are looking to repurpose empty retail big box power center anchors.

Trends in real estate prices and cap rates reflect the strain on traditional retail assets and the increasing demand for new industrial sites. Prices for industrial properties rose nearly 10.3 percent in the 12-month period ending April 30, 2019, and 32.3 percent during the three-year period ending April 30, 2019, over which time retail prices rose only 2.5 percent and 6.5 percent, respectively. In 2017, average cap rates for the industrial sector fell below retail cap rates (see chart, bottom right), with CBRE identifying the widest divergence in major coastal population centers with the greatest access to consumers. Vacancy rates at industrial properties remain quite low, averaging 5 percent, according to JLL, indicating that the industrial market still has room to grow. We expect these trends to continue as e-commerce continues to grow and provide efficient delivery of goods to consumers living in an on-demand world.

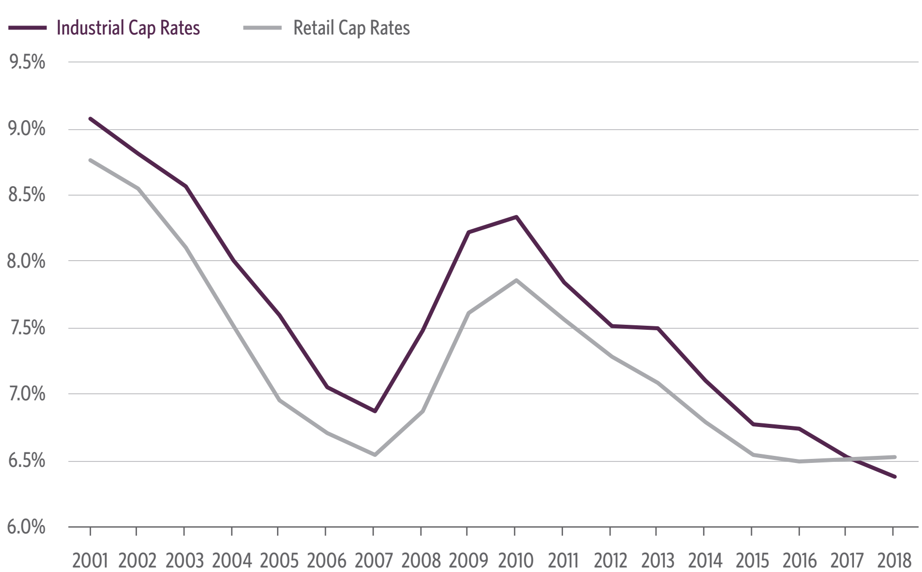
E-Commerce Sales Are an Increasing Share of the Retail Market



Source: Guggenheim Investments, DigitalCommerce360, U.S. Commerce Department. Data as of 12.31.2018.

As e-commerce captures nearly 15 percent of the market, warehouse and distribution properties become a favored investment class as online sellers respond to consumer expectations of on-demand delivery.

Industrial Cap Rates Dipped Below Retail in Q4



Source: Guggenheim Investments, Real Capital Analytics. Data as of 4.30.2019.

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