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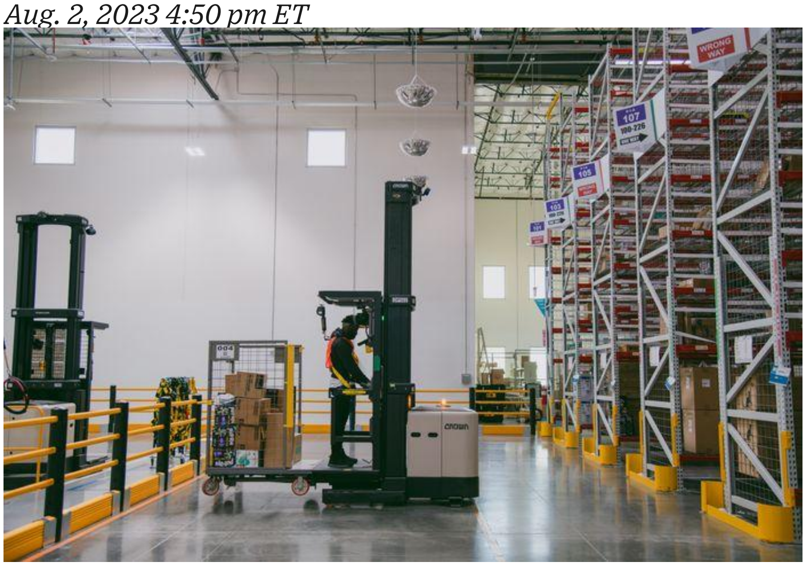
LOGISTICS REPORT

Why Warehouse Rents Keep Going Up While Demand Is Dropping

Industrial asking rents hit a record high last quarter even as companies leased less space

By Liz Young Follow

Aug. 2, 2023 4:50 pm ET



A worker operates a forklift at an Amazon same-day fulfillment warehouse in Richmond, Calif. PHOTO: MARISSA LESHNOV FOR THE WALL STREET JOURNAL

Warehouse rental prices across the U.S. have never been as high as they were in the second quarter, when the average asking rent for industrial space reached $9.59 a square foot.

That was 16.1% higher than the same period last year, said commercial real-estate services firm Cushman & Wakefield, and extended a four-year run of rising leasing costs that has pushed the price of warehouse space up 50% since the spring of 2020, when exploding consumer demand driven by the pandemic sent the market for warehouses skyrocketing.

In some markets, rents are rising even faster. The average asking rent in the Tampa Bay, Fla., region jumped 32.2% in the second quarter year-over-year, according to real-estate services firm JLL.

Yet vacancy rates for industrial real estate are also rising, reaching 4.1% in the second quarter after bottoming out at close to 3% late in 2022, when experts said hot markets like Southern California were effectively full.

The rush to find storage sites has slowed to a crawl: Newly-leased space fell by nearly 36% in the second quarter, according to Cushman & Wakefield, to 141 million square feet, as consumer spending pivoted from goods to services and big retailers sought to burn off excess inventories.

The gap between falling demand and rising prices is in part the result of particular dynamics of the industrial real-estate market, experts say, where warehouse operators and their customers typically sign deals for three to five years, basing leasing decisions on long-term prospects rather than short-term market conditions.

Industry experts also say the rising vacancy rates also disguise a fundamental factor driving the sector: The broader market for warehouse space remains extremely tight by historical standards, with availability still far below prepandemic levels.

The 4.1% vacancy rate last quarter was sharply higher than the 3.5% rate in the first three months of the year, but still well below the 5% average vacancy rate of 2020, according to Cushman & Wakefield.

Mehtab Randhawa, global head of industrial research at JLL, said companies are still competing for space in some cases, which is driving up rents even as shifting consumer spending and rising interest rates weigh on leasing decisions.

Suppliers to manufacturers that are opening production facilities in the U.S. are taking on warehouse space, for example, Randhawa said, helping replace some of the falling demand from e-commerce retailers.

Leasing has fallen "from the abnormal highs that we saw in 2021 and 2022 postpandemic," Randhawa said. "It's normalizing now."

Jason Price, senior research director for U.S. industrial at Cushman & Wakefield, said a flood of facilities built over the past year, as warehouse operators raced to keep up with demand, is also driving up the average rental rate. About 139.5 million square feet of industrial space wrapped up construction in the second quarter, some of it replacing older facilities with new sites better outfitted for automation and other contemporary logistics strategies.

“These are priced at a premium over the market average in most cases, and that just naturally pushes the recorded average asking rents upwards,” Price said.

Even though average rental rates are rising, some companies are able to find better deals on space than they had the past few years, Price said. Tenants have “more options on the table for them, whether it’s within new construction or previously existing product,” he said.

Developers have recently been paring back projects amid declining leasing activity and rising interest rates, which could prolong a shortfall of logistics space and put additional pressure on asking rents, industry experts said.

Prologis, the world’s largest builder of logistics properties, said construction starts were down about 40% in the second quarter across the U.S. markets where it operates.

“We see deliveries in 2024 falling short of demand, reducing vacancy over the course of next year,” said Timothy Arndt, chief financial officer of Prologis, on an earnings call July 18.

Price said he expects rents will keep rising this year and next, but at a slower rate than they did at the height of the pandemic-driven demand.

“We’re not projecting rents to revert downward at all,” he said.

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Appeared in the August 3, 2023, print edition as 'Warehouse Rents Climb to a Record'.