ARTICLE | Intelligent Investment

CBRE EA Introduces Industrial Taking Rent Series

By Nicholas Rita

Executive Summary

The CBRE Econometric Advisors' (EA) Taking Rent series leverages proprietary CBRE transaction data to model the spread between asking and taking rents across markets over time. By combining transaction data with asking rents at the time of transactions, we can accurately track this difference. Here are some key takeaways from the data:

- Although industrial taking rents have historically been lower than asking rents, their growth rates have varied. From the onset of the pandemic to the present (Q2 2020 to Q1 2024), taking rents have increased by 36%, compared to a 35% increase in asking rents.
- At the market level, the strength in deal level pricing growth largely reflects what we have seen nationally. As of Q1 2024, out of the 74 markets tracked, 22 have taking rents that surpass their asking rents. This marks a significant increase from Q1 2023, when only nine markets showed a premium in taking rents over asking.

Since Q2 2020, taking rents have increased by

36%

Markets in which taking rents surpass asking rents

22

Introduction

In 2021, EA introduced the EA Asking Rent series for Tier I office, industrial and retail markets across the U.S. This series—a repeat rent methodology, which is widely considered the gold standard in the industry—leverages a more advanced statistical model than any rent series. After incorporating building-level interpolation and a chain-linked aggregation, the EA Asking Rent series provides data back to 1988 for major office and industrial markets and offers projections for the next 10 years.

While the EA Asking Rent series captures market movements that are absent from nearly any other competing series, the pandemic has highlighted the limitations of relying solely on asking rents to track real-time market dynamics. For this reason, the EA team developed the EA Taking Rent series. Building off the successes of the EA Asking Rent series, the Taking Rent series takes things a step further by mapping out the spread between asking and taking rents, how it changes over time, and what drives this spread.

EA Industrial Taking Rent Approach

The EA team leveraged CBRE's extensive proprietary transaction data as a crucial component of the Industrial Taking Rent Series. Our methodology aims to capture the nuances of market rent dynamics by focusing on calculating take-up and then analyzing rent adjustments over time. The process consists of several key stages:

Data Acquisition And Preparation:

Our analysis begins by examining internal leasing vouchers, which encompass a broad range of transaction details such as initial rents, deal size and lease terms. We refine this dataset to include only transactions that meet our criteria, ensuring they reflect current market trends and leasing characteristics of each specific market.

Take Up Ratio Calculation:

A pivotal aspect of our methodology is the calculation of the take-up ratio, which measures the difference between initial asking rents and the rents eventually agreed upon in leasing transactions. This ratio is determined by evaluating the variance between the initial lease rent and the asking rent at the matched space level. In cases where no matched rent is available, we utilize EA Asking Rents.

Modeling:

In this phase, we deploy a PanelOLS model to analyze and quantify the relationships between take-up ratios and market indicators. This fixed-effects model is crucial as it controls for unobserved heterogeneity across various industrial markets, which could otherwise bias our findings.

Specifically, we focus on the interplay between take-up and key predictors such as market-level EA Asking Rents and metro-level availability rates. The model incorporates market fixed effects, which control for intrinsic characteristics of each market that remain constant over time. This setup enables us to isolate the impact of changes in asking rents and availability rates on the take-up ratio, providing an accurate assessment of how market dynamics influence pricing. Once the model is fitted, the coefficients for EA rents and availability rates show how sensitive take-up ratios are to changes in these variables. Using the modeled take-up ratios, we can predict the taking rent: EA Rent X (1 - modeled take-up).

Spline Approach For Data Interpolation:

To address the temporal aspect of our analysis, we employ spline interpolation techniques, specifically univariate spline interpolation, to generate a smoothed representation of rent trends over time. This approach allows us to interpolate data points throughout the observed period, providing a more continuous view of rent adjustments.

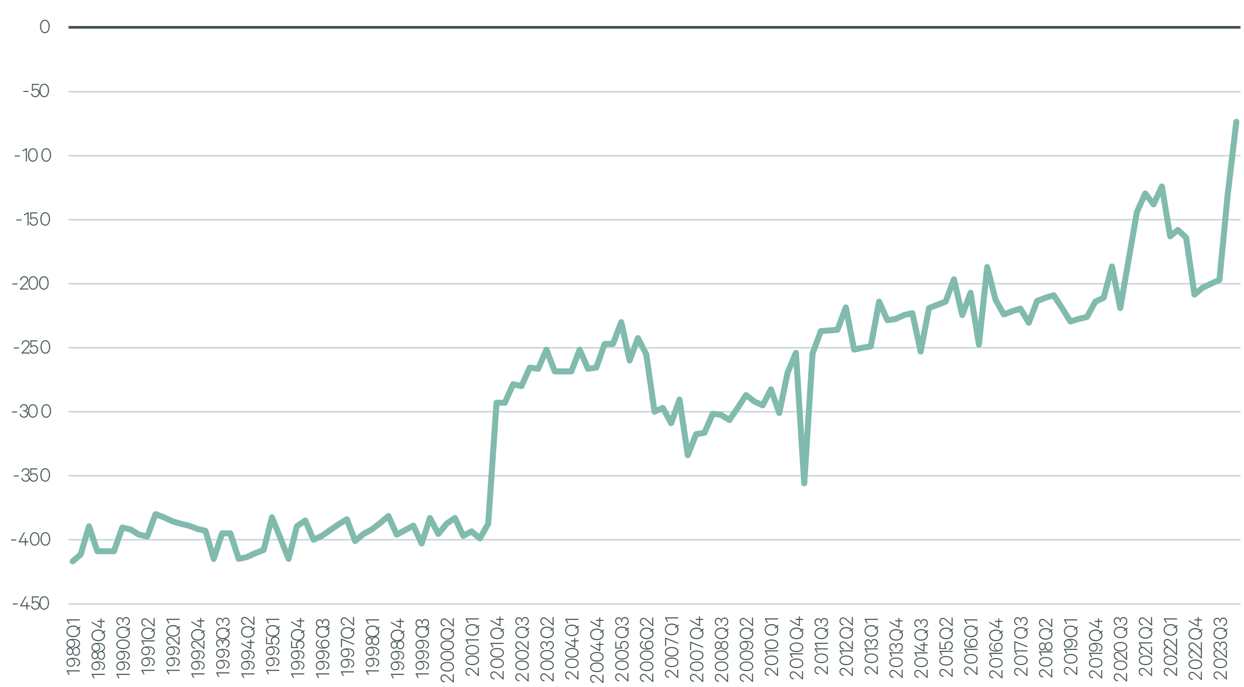
Adjusting For Sample:

In our model, we use differentiated filtering to refine our dataset, tailored to the number of lease observations in various markets and their respective leasing characteristics. This ensures that our analysis is both accurate and representative of diverse market dynamics.

For markets with a substantial number of lease transactions, we apply more stringent filters that focus on core market activities. Parameters such as lease square footage (50,000 to 1,300,000 sq. ft.), beginning rent (3 to 22 USD/sq. ft.), and lease term (2 to 8 years) are tightly defined to exclude outliers and non-representative deals.

In markets with fewer transactions, we adopt broader filters to encompass a wider range of deals. Here, criteria are less stringent (leased sq. ft. from 5,000 to 1,000,000 sq. ft., beginning rent from 2 to 26 USD/sq. ft., and lease term from 2 to 20 years), ensuring inclusivity even in less active markets.

FIGURE 1: Taking Rent Discount to EA Asking Rent (BPS) (Sum of Markets)

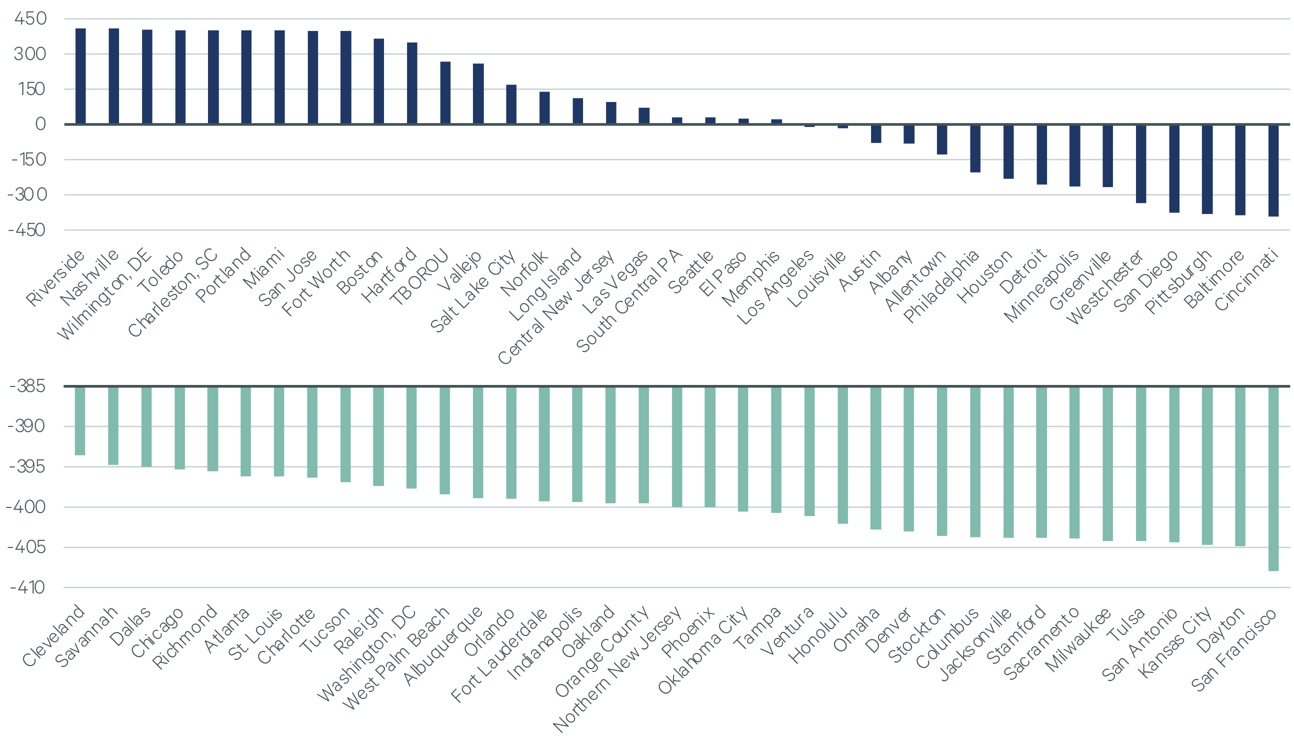


Source: CBRE EA Q1 2024

The EA Taking Rent Series In Action:

Historically, taking rents have always been lower than asking rents. However, with the rise of the internet and e-commerce in the late 1990s and early 2000s, demand for warehouse space increased, causing the discount to narrow.

FIGURE 2: Taking Rent Premium/Discount to EA Asking Rent (BPS)



Source: CBRE EA Q1 2024

Nearly one-third of all markets are leasing at a premium to asking rents, but most are still at a discount. Notable markets trading at a premium to their asking rates include Riverside, Nashville, Miami and San Jose.

Miami has consistently been a top performing market due to its impressive demographics and port activity. Much of the stock is smaller, infill warehouse and cold storage space, both of which typically demand a premium rate.

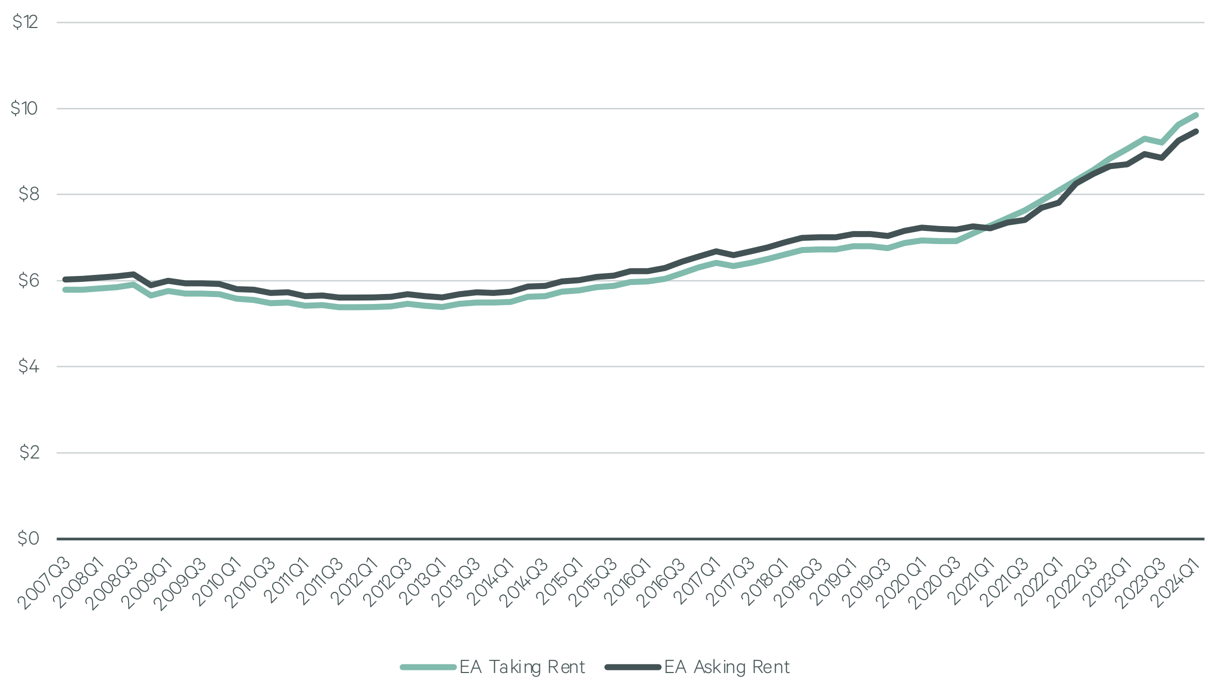
Riverside is still the most important industrial market in the United States. Going into 2021, taking rents in Riverside exceeded asking rents for the first time in the market's history. That premium over asking has maintained since; however, both taking and asking rents have declined in Q1 2024.

FIGURE 3: Los Angeles

Source: CBRE EA Q1 2024

After the pandemic-related boom, the difference between taking and asking rents in Los Angeles significantly decreased from its long-term average. In fact, up until 2022, there was almost no gap between the two, indicating a market where landlords and occupiers were in sync. However, around the middle of 2022, the growth in taking rents began to slow down, while asking rents continued to rise rapidly. Consequently, the market experienced negative demand quarters and a significant increase in availability. Asking rents took some time to respond to these changes, but they started to level off in Q3 2023. As of Q1 of this year, the difference between taking and asking rents is nearly zero.

FIGURE 4: Charleston, SC



Source: CBRE EA Q1 2024

A similar trend can be observed in Charleston, where historically, taking rents have been lower than asking rents. However, following the onset of the pandemic, this relationship flipped. Since the beginning of 2021, the premium over asking rents has gradually expanded and currently stands at 401 basis points.

About the Report

The EA Taking Rent Series offers critical insights into industrial rent dynamics. By highlighting the discrepancies between asking and taking rents, this series informs better investment and leasing decisions. Stakeholders will be able to anticipate market movements and leverage opportunities more effectively.

The EA team is now working on the EA Industrial Effective Rent series. This industrial series, which EA launched for office previously, will leverage the EA Taking Rent data and methodology, incorporating deal-level incentives and concessions such as free rent, tenant improvement allowances, and escalations to create a time series and forecast that captures the full picture of leasing fundamentals across markets and time periods. The EA Taking Rent series and soon-to-come EA Effective Rent series are just the latest in a long line of products that highlight EA's commitment to arming our clients with tools to ensure their continued success.

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