



Demanding data

A new research paper by AMB looks at the current relationship between trade, production, and inventory and its impact on industrial real estate demand. **David Twist** reports



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Leading indicators of demand – the recent rebound in credit markets, production levels and cargo volumes – suggest that the global economy is recovering. Based on an AMB survey, the majority of our customers have seen their businesses improving since February with overall business expanding in September and October. AMB's recent research paper 'Inside the Global Supply Chain' * examines the link between trade, production and inventory and their relationship to customer demand for industrial real estate.

This is a crucial moment as we emerge from the global financial and real estate crisis. So it is critical to understand industrial real estate demand drivers. A current set of data on what drives demand for industrial real estate is topical for those managing current investments in this asset class, as well as those considering allocations to industrial real estate in 2010.

Research-driven perspective

The linkage between GDP and trade with industrial

real estate demand is long-standing, and has been strengthening over 50 years. While variations in trade are the primary drivers of demand for industrial real estate, production and inventory levels are also highly correlated with trade and are important indicators of this demand.

By studying the interaction of trade with production and inventory levels, AMB's new demand model – released in November – demonstrates significant correlation into the demand for industrial real estate and, most importantly, forecasts the turning points.

Goods, information and capital flow freely between production, trade and inventories, all three of which are inherently interconnected globally. We examined the correlation of the annual flow of real goods between these supply chain components for the period of 1990-2008. Findings indicate there is a compelling linkage of more than 77%. Production, trade and inventories are predictive of one another, and changes in production and trade lead to changes in inventory levels.

The findings

The research indicates that production and trade are in the early stages of recovery, while inventories have continued to contract in many countries, albeit at a slower pace than during the depths of the recession.

Manufacturing inventories are at very lean levels in Europe, and production is down between 15-25% in France, Germany and Benelux from peak levels until the trough reached in February of this year. Trade in these regions declined by 24-33% from peak levels until reaching bottom earlier this year. Consumption in Europe decreased 0.2%, a slight decrease relative to the steep declines in production and trade, indicating that industrial space demand drivers have fallen too far. They are now recovering.

After nearly 18 months of decline, production and trade are showing consistent positive gains around the world. In fact, production in France and Germany is up 5% and 10% from February to September 2009, respectively. Trade is up 3.1% in France, 6.1% in Germany and more than 13% in Benelux so far in 2009.

Translating to industrial space demand

The correlation of production, trade and inventory growth with demand for industrial real estate is significant, ranging between 85-89%. These findings suggest that trade and production are the primary drivers of net absorption of industrial space.

Increases in production and trade will result in restocking and positive net absorption of industrial space. The first wave of this restocking goes into filling existing space that is currently under-utilised. After buildings fill up – and we believe that there is some time before that occurs – we will see demand for incremental new space.

The study utilised a detailed time series of US production, trade, inventories and net absorption to explore and quantify the relationships between these interlinked supply chain components, and how each has an impact on the demand for industrial real estate. While improving by 33% in the third quarter of 2009 over the prior quarter, net absorption in the US was a negative 4.6m², bringing the year-to-date total to a negative 20.9m², the biggest annual decline on record. We expect the fourth quarter to show greater improvement, although absorption may still be negative. European countries have been more insulated from the downturn and have not experienced the same levels of deterioration as the US has.

What do we expect for the year ahead? Applying the US net absorption model to the European outlook for production and trade provides a forecast of potential net take-up in Europe. The 2010 consensus estimate for production is 2.1%, with significantly higher growth expected in France and Germany. The consensus outlook for trade in the Eurozone is 2.8%.

Incorporating these forecasts into our model implies positive net take-up of more than 7m² in Europe in 2010. This compares with a forecast of 9.3m² for the US. The consensus outlook for the drivers of this forecast (trade and production) are likely to continue being revised upward, which would then imply upward revisions to the absorption forecast.

Finally, the consensus estimates for trade and production are even higher for 2011, implying that demand will accelerate as retailers, shippers and other companies that rely on logistical real estate for global trade will be requiring more space.

Applying the findings

The industry is at a critical point on the road to recovery. For industrial real estate owners and operators, discussions with companies that move goods through the global supply chain are increasing as these customers consider ways to prepare for future growth.

Following encouraging messages of economic recovery, investors are cautiously assessing opportunities as they consider asset class-specific allocations in 2010, and industrial real estate presents a compelling opportunity. Our research demonstrates the correlation between trade, production and inventory levels as they relate to leasing activity, making the drivers of industrial real estate demand clear for pension funds, endowments and foundations.