A diamond in the rough: Multi-tenant industrial properties

In the face of high valuations throughout the real estate industry, multi-tenant industrial has not yet inflated in value

May 25, 2015 @ 12:01 am
By Brian Malliet

As the economy continues to strengthen, and with the steady availability of capital, many investors are seeking new yield-generating investment avenues, especially in real estate.
When counseling clients on real estate investments, many advisers look to multifamily and retail properties, based in part on a somewhat universal understanding of these property types. In short, people tend to be familiar with apartment communities and retail centers, and are thereby more apt to consider these properties as investments.

However, it's important to note that these product types are not necessarily poised for optimal growth in the current market.

Multifamily housing in particular has demonstrated such rapid growth since 2010 that its values are now quite high, which will greatly limit an investor's opportunity to achieve strong yields on these assets.

*(More: Real estate company seeks $20M for New York City mausoleum high-rise)*

In addition, e-commerce continues to put tremendous pressure on brick-and-mortar retail properties, making it extremely difficult to predict growth in these investment properties.

For this reason, it's important for advisers to understand the benefit of other property types that have the potential to provide strong returns.

**MULTI-TENANT INDUSTRIAL**

One such property type is multi-tenant industrial, which
has emerged as a “diamond in the rough” investment type over the past 12 to 24 months. In the face of high valuations throughout the real estate industry, multi-tenant industrial has not yet inflated in value, making it a strong investment to consider, as these assets are poised for future growth.

Multi-tenant industrial business parks are smaller than traditional big box industrial, typically encompassing 50,000 to 200,000 square feet. These properties are divided into approximately 20 to 75 units or suites, each consisting of 30% office and 70% warehouse space.

Companies that lease space in multi-tenant industrial properties are typically small, entrepreneurial firms that sign short-term leases — a situation that gives investors a dynamic opportunity for value creation. Based on the multi-unit layout of these properties, owners of multi-tenant industrial properties have the flexibility needed to accommodate changes in a company’s space requirements, and increase rents frequently.

By contrast, standard big-box industrial space generally accommodates only one or two tenants and is comprised of no more than 10% office space. Large companies and distribution centers typically lease these spaces for seven to ten years, which limits an owner’s ability to create value and increase cash flow.

**CHANGING RENTS**

Multi-tenant industrial investors can easily offer additional units to companies during growth periods, and can also help companies to downsize when needed while retaining these companies as tenants in the property.
In addition, the short-term nature of leases enables the investor to change rents more frequently in correlation with market shifts. Generally, each year, one-third or more of the leases expire in a multi-tenant property, allowing for quick rent increases.

In this way, the rent structure in multi-tenant industrial properties behaves much like that of an apartment building, which allows for rapid growth of net operating income, and the ability to constantly reposition the asset to ensure it is optimally marketed for lease. In addition, multiple tenants allow for a diverse credit mix, creating stabilized cash flow for investors.

(Check out InvestmentNews' Nontraded REIT Database)

As advisers and investors recognize the benefit of multi-tenant industrial investments, there is growing demand for this property type, especially throughout the western U.S. Much of this demand is being fueled by the recent resurgence of business start-ups, as well as growth within the service sector.

Prior to the Great Recession, many large service companies housed their corporate, operations and manufacturing divisions under one roof. Today, many of these large companies are contracting third-party service providers in order to keep costs low — a situation that is providing smaller service businesses the opportunity to grow.

ATTRACTION Pricing

Another factor driving investor interest in multi-tenant business park properties is attractive pricing. These properties are currently priced 30-40% lower than the peak of the market, and 40-50% below replacement cost, which is creating tremendous opportunities.
To best leverage these opportunities, advisers should steer investors toward experienced investment managers who are knowledgeable in this particular property type.

Naturally, a strong track record of success is also key. Advisers should counsel investors to select a fund manager with a cohesive team that has a history of strength in identifying and operating multi-tenant industrial properties.

By selecting a fund manager with a specialized focus and a strong track record in this particular property type, investors can feel confident that their investment will be managed in a way that will optimize profitability.

As the real estate market continues to grow in popularity among investors, advisers who recognize the potential in niche investments will be able to deliver strong value to their clients.

Brian Malliet is CEO and co-founder of BKM Capital Partners, a fund manager and operator platform targeting value-add, multi-tenant industrial real estate.
Eaton Vance offers to pay broker-dealers that adopt 'NextShares' active funds

Attrition and breakaways have shrunk head counts at wirehouses

When people account for 70% of a firm's expenses,
A diamond in the rough: Multi-tenant industrial properties