TA Realty

Small-bay warehouses: A critical link in modern supply chains

The U.S. industrial market, like other real estate asset classes, has experienced significant disruption in the past three years. One standout in this market is small-bay warehouses, especially in urban areas, which are prime for investment due to their promising outcomes. These warehouses typically range from 15,000 square feet to 50,000 square feet and are commonly utilized for purposes such as distribution, light manufacturing, and regional and last-mile ecommerce logistics.[1]

Key to optimizing the supply chain

Driven by a growth in ecommerce and changing consumer expectations for rapid delivery, small-bay warehouses play an increasingly important role in the modern supply chain. The demand for same-day or next-day delivery has recently become the expectation among American consumers. A testament to this trend is Amazon's disclosure in August 2023 that the company had delivered a record 1.8 billion units to Amazon Prime members on the same day or next day this year — nearly four times as many units as in 2019.[2]

This mounting demand has prompted sellers and manufacturers to realign their logistics strategies, highlighting the importance of accumulating inventory closer to end-users. Amazon has been at the forefront of implementing this approach. The company has seen a 15 percent reduction in the distance items travel from fulfillment centers to customers and minimized the frequency of package handling by 12 percent, utilizing what it calls same-day sites.[2] Same-day sites are often characterized by compact warehouses close to large metro areas, where the company fulfills, sorts and delivers products from a single location.

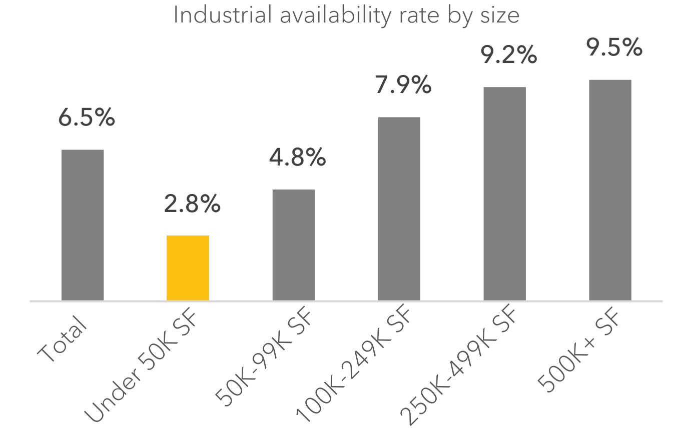
In the second quarter of 2023, the company announced plans to double its number of same-day sites during the next two years. CEO Andy Jassy touted the efficiency with which the same-day sites allow the Amazon logistics equation to operate.[2] Small-bay warehouses fit the bill for these same-day sites and are what other retailers will look for as they need to optimize delivery speeds. **"This ability to have shipments closer to customers is … driven by our development and expansion of same-day fulfillment facilities, which is our fastest fulfillment mechanism and one of our least expensive too,"** said Jassy in the company's second quarter 2023 Earnings Call.[2]

Small-bay warehouse space in short supply

While availability in the broader industrial market has ticked up in recent quarters, the small-bay segment remains near a record low. At just 2.8 percent, the availability rate for warehouse/distribution properties measuring under 50,000 square feet is more than 350 basis points below the U.S. industrial market average.

Despite accounting for the largest share of the existing industrial market, the development pipeline for the small-bay segment does not appear to be keeping up with demand. Small-bay space represents more than 30

Figure 1: Lowest availability among smallest-sized space

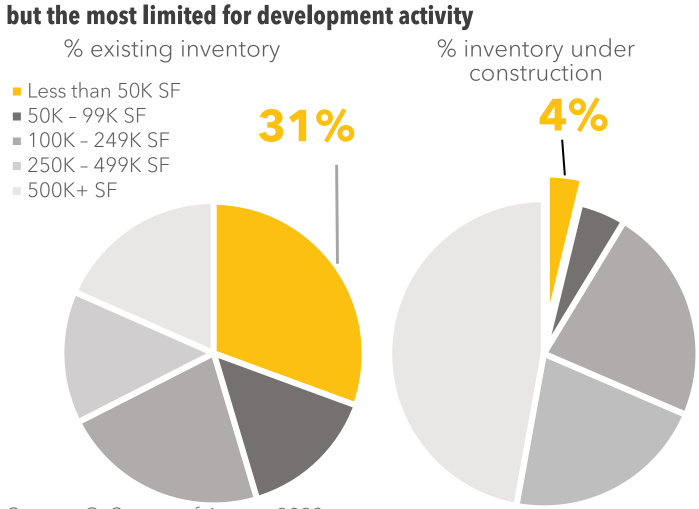


Source: CoStar, as of August 2023

percent of the U.S. industrial inventory. With larger spaces dominating development activity, however, the small-bay share is shrinking. Almost half of all new industrial space under way is in the 500,000-square-feet and greater segment, while just 4 percent of space under way falls in the small-bay segment.[3]

Limited supply, paired with continued strong demand, has helped to drive time on the market for small-bay space listings to a record low of just 3.4 months. This compares with an average of 7.5 months from 2010 to 2018.

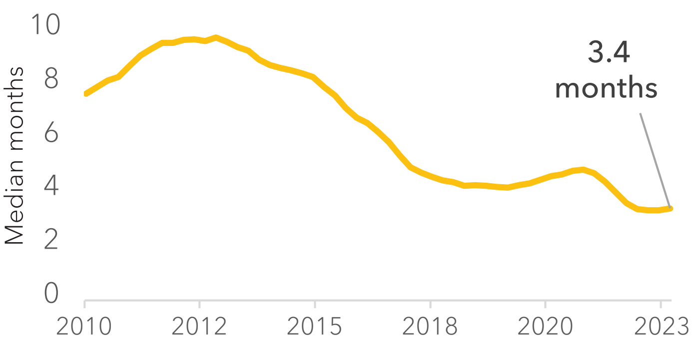
Figure 2: Small-bay is the largest segment of the industrial market but the most limited for development activity



Source: CoStar, as of August 2023

Figure 3: Small-bay time on market at record low

Median months to lease spaces smaller than 50,000 square feet



Source: CoStar, as of August 2023

While the pace of industrial new supply has placed some upward pressure on the industrial availability rate at the national level, solid leasing trends and limited completions should keep market conditions balanced in the small-bay segment.

Beyond the favorable supply-and-demand dynamics, small-bay warehouses offer other compelling reasons for investment. The shorter weighted average lease time (WALT) of one to three years compared with the five to 10 years typical in larger spaces enables faster value creation. In addition, these properties often provide built-in downside protection as their locations and access allow for alternative uses such as retail and wholesale showrooms, gyms, and breweries. In certain locations, the appeal of the land to multifamily developers further enhances its investment potential.

Diverse demand drivers provide a runway for growth

The growth of ecommerce activity has significantly fueled the demand for small-bay warehouses and all industrial real estate. Ecommerce experienced a steady rise in the United States throughout the 2010s, with a sharp increase during the COVID-19 pandemic. In the fourth quarter of 2019, ecommerce accounted for 11 percent of total retail sales, a figure that soared to 17 percent by the second quarter of 2020. While post-pandemic growth has moderated somewhat, it remains robust, with ecommerce sales representing 15 percent of all retail sales in the second quarter of 2023. When compared with global ecommerce adoption rates, the United States still has ample room for expansion. In 2021, China led the way with 52 percent of all retail sales occurring online, followed by South Korea at 29 percent and the United Kingdom at 28 percent.[4]

While a dominant force, ecommerce is not the only catalyst behind the growth in demand for small-bay warehouses. Chip technology–related sectors and advanced manufacturing have shown interest in such spaces, driven by the need to co-locate their office, manufacturing, assembly and warehouse functions as technological advancements such as 3D printing have reduced the space required for manufacturing.

Conclusion

The strength of small-bay industrial real estate in the United States is intrinsically tied to the changing supply-chain landscape, driven by the growth in ecommerce and evolving consumer expectations. With high barriers to entry for new supply and the need for small-bay space expected to grow, this sector presents a compelling opportunity to capitalize on the evolving dynamics of the modern economy.

Notes:

1 "A Deep Dive into Shallow Bay Industrial," NAIOP Commercial Real Estate Development Assn., Aug. 25, 2016

2 Amazon.com (AMZN) Q2 2034 Earnings Call Transcript, *The Motley Fool,* Aug. 3, 2023

3 CoStar, as of August 2023

4 "In global historic first, ecommerce in China will account for more than 50% of retail sales," *Insider Intelligence,* Feb. 10, 2021

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CORPORATE OVERVIEW

Founded in 1982, **TA Realty** is an experienced and established real estate investment management firm. The firm is headquartered in Boston, with additional offices in Newport Beach, Calif., Dallas and San Francisco. Since its inception, TA Realty has acquired, invested and/or managed approximately $40 billion of real estate assets through core, core-plus and value-add strategies and customized separate/advisory accounts.* TA Realty's investment philosophy focuses on creating diversified real estate portfolios that aim to generate strong cash flow, receive intensive asset management and seek to achieve long-term value creation. For four decades, TA Realty has maintained this philosophy through multiple real estate and economic cycles, a strength recognized by pension funds, endowments, foundations and high-net-worth individuals. For more information, please visit www.tarealty.com.

* As of June 30, 2023