OAK INVESTMENT MANAGEMENT GROUP

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Industrial Real Estate

Industrial property is characterised by an actual (as opposed to merely financial) depreciation of an asset during its physical life. Whereas with most other segments of real estate it can be assumed that there is more of a residual value in the building itself (as opposed to the land) the same cannot be said for industrial property.

Why is this? First of all industrial property is cheaper to build in the first place. It usually consists of a space that provides shelter from the elements. To this end specification does not usually matter that much. The tenant themselves usually bring their plant and machinery which can sometimes be very sophisticated but does not really need to be.

From an investment or landlord's point of view this presents many challenges. What is the right and sustainable price to price to charge for such a space? At what level does such a space become uncompetitive? Does much thought or effort need to go into the original specification for the tenant? Does the tenant really require much 'after lease granting' maintenance? What makes it more or less likely that a tenant extends or breaks their occupation of a particular site.

The consequences are real. An industrial property throws off a lot of free cash flow during its heyday but that comes to a precipitous end as rising maintenance costs catch up with this healthy headline yield over the life time of the investment. Therefore, over-specification can be as disastrous as sub-standard client care. It requires seasoned managers to read the specific signs how to specify the original property, dispense appropriate and on-going capital expenditure on the space but also to manage the needs of the tenant to the right degree.

As a direct result, in the industrial sub-sector of real estate management costs are definitely higher. So too, the difference between a good and a bad industrial asset manager is considerable. Like any bad manager an industrial manager will not understand or appreciate the needs and requirements of their property or their tenants. In a single let industrial unit if not carefully managed the site or the tenant's use for it can become obsolescent very quickly. In a multi-let industrial estate tenants can fall like dominoes from an inter-dependent business community if not managed in the correct way. Equally, it must also be remembered that many occupiers have such low expectations that a little effort goes a long way in this sub-sector.

Industrial property can easily be misunderstood by outsiders to the sub-segment. The residual value of a site need not be set to zero; a low weighted unexpired lease term (WAULT) is not necessarily an indication of bad health of an industrial park; weak covenants does not necessarily mean high bad debt rates. The distinction between these aspects creates a great deal of variance between the top and the bottom quartile in this sector. It places a higher premium on professional and thoughtful managers than any other segment in real estate.

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