

# The Industrial Outdoor Storage (IOS) Bubble: Analyzing Market Risks and Opportunities

## Executive Summary

The Industrial Outdoor Storage (IOS) sector has seen unprecedented growth, largely due to rising e-commerce demand, supply chain adjustments, and shifts towards last-mile logistics. However, evidence suggests that the market may be experiencing a speculative bubble. This white paper provides a detailed analysis of the factors contributing to this bubble, identifies the risks for various stakeholders, and provides recommendations to help investors, developers, lenders, and tenants navigate the market with a strategic approach. This analysis includes a deep dive into each market driver, bubble indicator, and stakeholder recommendation, along with long-term implications for the IOS sector and broader commercial real estate market.

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# 1. Introduction

Industrial Outdoor Storage (IOS) has evolved from a relatively niche subset of industrial real estate to a highly sought-after asset class, especially in regions with limited infill space. This popularity is due to its strategic role in supporting logistics, construction, and industrial operations. However, the rapid growth in property values, coupled with speculative buying behaviors, has raised concerns of a potential bubble. This paper aims to dissect the underlying causes, identify the risks, and suggest a path forward for those involved in the IOS market.

## 2. Detailed Analysis of Market Drivers

### E-Commerce Boom and Last-Mile Logistics

E-commerce has driven much of the demand for industrial and outdoor storage spaces. As consumer expectations for fast delivery have grown, companies have focused on building infrastructure close to urban centers and major highways, making IOS properties essential for last-mile delivery. These sites are used to store large quantities of goods and vehicles, making them indispensable to the logistics networks that e-commerce companies rely on. However, as e-commerce growth stabilizes, questions arise regarding whether demand for IOS will maintain its recent pace.

## Supply Chain Resilience and Nearshoring

COVID-19 exposed vulnerabilities in global supply chains, prompting companies to rethink their strategies and invest in nearshoring to North America. This transition has led to demand for storage sites that can support assembly, storage, and distribution needs, placing IOS properties in high demand. The challenge lies in whether this trend will lead to long-term demand or if it is a temporary spike due to current supply chain issues.

## Investment Interest and Institutional Capital Influx

IOS properties, previously dominated by small private owners, have recently attracted institutional investors due to their relatively low capital expenditures and high barriers to entry due to zoning restrictions. As these large investors enter the market, prices have soared, leading to competition for limited assets. This investment pattern often inflates values and attracts speculative players, potentially creating an unsustainable cycle.

### 3. In-Depth Indicators of an IOS Bubble

#### Unsustainable Price Appreciation

Analyzing data from key IOS markets reveals an unusual surge in prices that outpaces historical norms for industrial properties. In regions like Dallas, Houston, and Southern California, average prices for IOS land have risen significantly, with some properties appreciating 30% since 2019. Such rapid increases raise questions about whether current values are justified by demand or inflated by speculative behaviors.



## Supply Outpacing Demand in Non-Core Locations

The expansion of IOS properties into non-core areas has led to concerns about oversupply.

While high-demand regions like major metros have relatively low vacancy rates, secondary markets have begun to see vacancies rise as new developments exceed demand. This oversupply risk can lead to softening rental rates and increased vacancy, both indicators that a market correction could be on the horizon.

## Increased Leverage and Financing Risks

Low interest rates over the last decade have enabled investors to finance IOS purchases with significant leverage. However, as interest rates rise, many investors are now facing higher financing costs, which could strain cash flows, especially for properties that have yet to secure long-term tenants. This high leverage, coupled with an increased cost of capital, heightens the risk of defaults and foreclosures should the bubble burst.

## Speculative Investment Patterns and New Market Entrants

The influx of non-traditional investors into IOS, including hedge funds and private equity firms, has contributed to price inflation. These investors often seek short-term returns, focusing on property appreciation rather than steady rental income. This speculative investment behavior has historically been a precursor to real estate bubbles in other asset classes.

## 4. Impact of Macroeconomic Factors

### Interest Rates and Credit Availability

The Federal Reserve's recent interest rate hikes have begun impacting the IOS market by increasing borrowing costs and reducing credit availability. Higher interest rates make it more challenging for new projects to achieve profitable financing, slowing down speculative development and curbing rapid expansion.

### Inflation and Construction Costs

Rising inflation has driven up the cost of materials and construction, making new IOS developments more expensive. While inflationary pressures could drive rental rates higher in the short term, they also increase the overall risk profile of IOS properties.

### Economic Cycles and Market Vulnerability

In the event of an economic downturn, demand for industrial storage may decrease, leading to higher vacancy rates and further compressing rental growth. These economic pressures could trigger a market correction, especially in areas where IOS development has already outpaced demand.

## 5. Understanding the Implications of a Bubble

If a bubble does burst in the IOS market, the ramifications will extend beyond investors to the entire real estate ecosystem.

**Overvaluation of Assets:** Properties purchased at inflated prices are at risk of devaluation, which could wipe out equity for investors and put stress on balance sheets.

**Rising Vacancy Rates:** If demand drops, properties in non-core locations could see extended vacancies, leading to financial strain for developers and owners.

**Lender Exposure:** With increased leverage in the sector, lenders may face heightened risk if borrowers cannot maintain payments, potentially leading to a tightening of credit for industrial properties.

## 6. Comprehensive Recommendations for Key Stakeholders

### For Investors

**Portfolio Review and Risk Assessment:** Regularly reassess each asset's tenant quality, location, and lease terms.

**Consider Asset Diversification:** A well-diversified portfolio can reduce exposure to a downturn in the IOS sector.

**Strategic Sales of Overvalued Assets:** Consider liquidating assets that are overvalued before a market correction.

### For Developers

**Pause Non-Core Development Projects:** Focus on projects in high-demand, well-located areas with a high likelihood of sustained demand.

**Secure Pre-Leasing Agreements:** Reducing speculative risk by securing tenants in advance ensures a smoother lease-up process.

**Conservatively Estimate Project Returns:** As financing costs rise, conservative return estimates are crucial to managing cash flow effectively.

### For Lenders

**Increased Underwriting Standards:** Prioritize projects with strong fundamentals and avoid speculative developments in overbuilt areas.

**Close Monitoring of Loan Portfolios:** Actively monitor loans for signs of distress, particularly those in high-risk areas.

**Adjust Loan Terms to Reflect Current Risks:** Offer conservative terms that reflect the heightened risk in the market.

## For Tenants

**Negotiate Lease Terms:** Explore opportunities to negotiate flexible lease terms or lower rental rates in overbuilt markets.

**Assess Long-Term Space Requirements:** With the possibility of a correction, evaluating long-term needs can help tenants lock in favorable rates in stable locations.

## 7. Long-Term Market-Wide Implications

Should the IOS bubble burst, it could prompt a shift in capital flows toward other asset classes. Investors may redirect funds into traditional industrial properties, multifamily developments, or retail. Additionally, municipalities may need to rethink zoning policies to prevent the spread of underutilized outdoor storage spaces. A correction in IOS could also affect other segments of commercial real estate, particularly in regions with extensive IOS development.



## 8. Conclusion

In conclusion, while the IOS market offers unique opportunities, stakeholders must be vigilant as the signs of a bubble continue to emerge. By proactively managing risk and prioritizing assets with strong fundamentals, investors, developers, lenders, and tenants can navigate the IOS sector's challenges and potentially capitalize on the opportunities that arise from market corrections.