Economic Headwinds Bring Northern Virginia Industrial to a Crossroads

▼ 3.4%
Vacancy Rate

▲ 353,936
SF Net Absorption

▶ 795,231
SF Under Construction

▲ $14.29
Average NNN Asking Rate

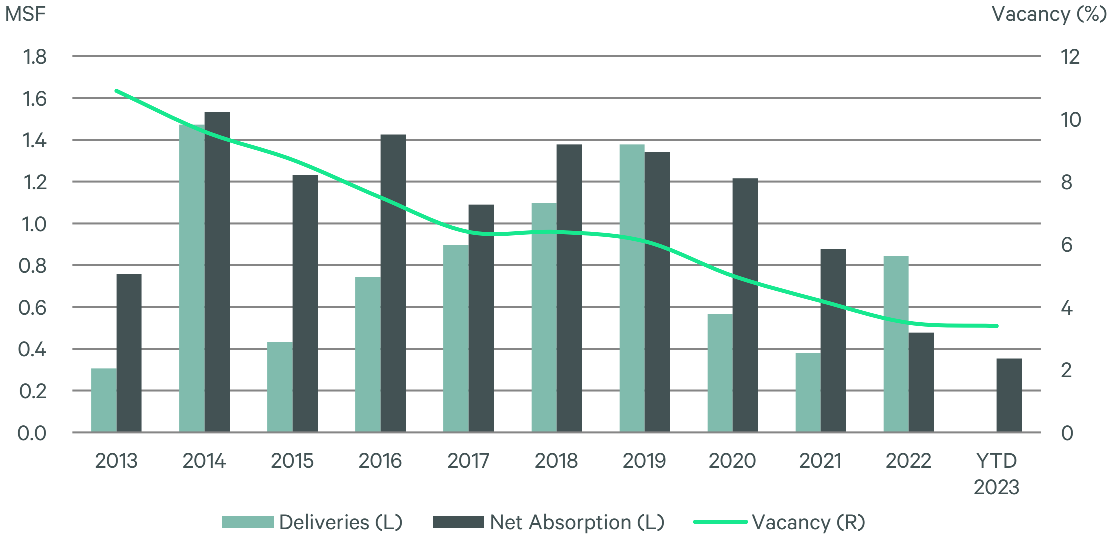
Note: Arrows indicate change from previous quarter.

Northern Virginia remains a bright spot in the Mid-Atlantic in the first quarter of 2023. Long material delays, labor challenges, and concerns of an impending recession had put into question the resilience of the market. However, demand continues to outpace supply for the moment, and rents continue to climb. While new construction starts have been hampered by the uncertainty in the capital markets, tenants continue to lease new space, and Q1 saw moderate leasing activity at 354,000 sq. ft.

The Northern Virginia industrial market reached its tenth consecutive year of positive net absorption in 2022. During the first quarter of 2023, vacancy decreased another 10 basis points (bps) to a new record low of 3.4%. Despite projections of persistent economic headwinds, CBRE has reported that global demand for e-commerce activity will drive an additional two billion sq. ft. of logistics space demand over the next 5 years.

Rents continue to climb as we experience a slight backtrack from the record-breaking previous 8 quarters. Since last summer, deliveries have outpaced absorption due to a moderate slowdown of tenant demand. However, the challenges facing new construction continues to exert upward pressure on rents through the first quarter.

FIGURE 1: Historical Supply & Demand Dynamics



Source: CBRE

Sector Snapshot

Third Party Logistics (3PL)

While supply chain challenges surrounding shipping, trucking, and unforeseen demand spikes continue to plague retailers, third-party logistics (3PL) companies have gained significant traction across the country, comprising up to 35% of leasing activity in most coastal markets over the past 24 months. As a result, many now lean heavily on 3PL companies to fulfill their orders. These companies often specialize in specific aspects of the supply chain to remain competitive in their respective niches like drayage, last-mile delivery, cold storage, and air freight.

GXO Logistics, the global XPO spin-off, signed the largest lease of the quarter, taking 121,672 sq. ft. on Randolph Ridge Lane. Others such as JT Logistics and A&A Transfer also signed significant new leases in the Route 28/Dulles North submarket near the airport.

Aerospace & Defense

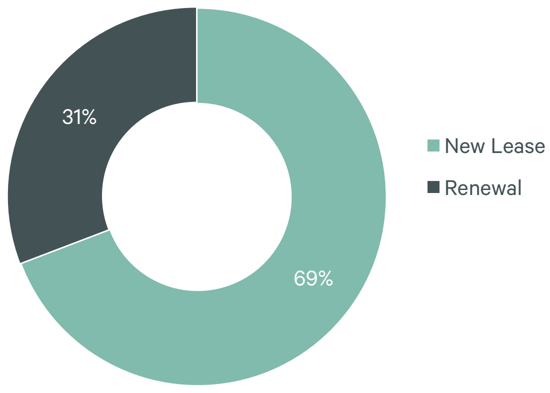
This quarter, government contracts spurred leasing activity from defense contractors and on-shored manufacturing operations across the region. Of note, Raytheon signed a new lease for 43,804 sq. ft. in the Dulles North submarket, adding to its substantial existing footprint in the area. Government tenants and government contractors have historically been a bright spot in the D.C. metro, staying active in times of economic uncertainty.

FIGURE 2: Select 2023 Lease Transactions

Tenant	Industry	Address	Submarket	Lease Type	SF
GXO Logistics	3PL	12875 Randolph Ridge Ln	Route 29/I-66	New Lease	121,672
ItRenew Inc.	Technology	45120 Global Plz	Route 28/Dulles North	Renewal	96,868
JT Logistics	3PL	44211 Mercure Cir	Route 28/Dulles North	New Lease	76,020
A&A Transfer, LLC	3PL	22895 Ladbrook Dr	Route 28/Dulles North	New Lease	62,700
Raytheon	Defense	23031 Ladbrook Dr	Route 28/Dulles North	New Lease	43,804
Ferguson Enterprises LLC	Wholesale	6621 Electronic Dr	Springfield	New Lease	39,052
7-Eleven, Inc.	Retail	6306 Gravel Ave	Springfield	Renewal	34,313
Decovita-USA Inc.	Manufacturing	45190 Prologis Plz	Route 28/Dulles North	New Lease	29,727
Dahlgren Laboratories LLC	Defense	6730 Fleet Dr	Springfield	Renewal	17,739
Accelerated Courier Inc.	3PL	45095 Old Ox Rd	Route 28/Dulles North	New Lease	10,363

Source: CBRE

FIGURE 3: YTD 2023 Gross Leasing by Transaction Type (Share by SF)



Source: CBRE

FIGURE 4: 2023 Typical Logistics Costs P&L Line Items

* Includes rent. ** Includes payroll.

Source: CBRE

Development Activity

The Northern Virginia industrial development pipeline remains very active. Nearly 800,000 sq. ft. of construction is underway in the Route 29/I-66 corridor submarket, the largest submarket in Prince William County. Increased turbulence in the capital markets have sidelined a handful of would-be groundbreakings over the previous two quarters, with projects already underway slated to deliver and capture excess demand in Northern Virginia. With warehouse vacancy sitting at a tight 2.5% and no available spaces above 500,000 sq. ft. in size, future developments and rollovers should help to temper the upward pressure on rent growth.

Spontaneous and unpredictable supply chain disruptions have also left developers struggling with project timelines, while lead times for various construction materials (such as roofing materials) have surpassed the 52-week mark.

Pricing

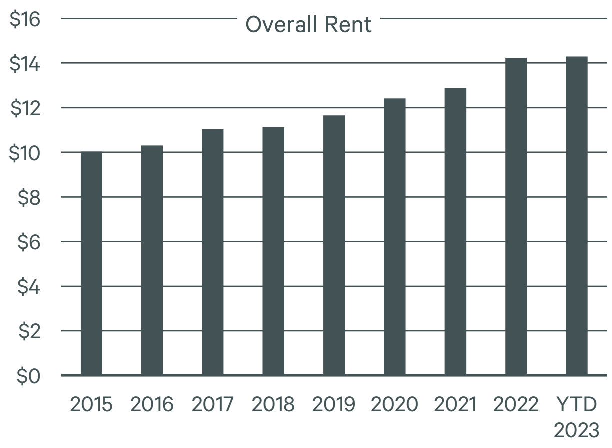
Asking rents have continued to see upward pressure and gradual increases through the first quarter, reaching $14.29 per sq. ft. per annum, up 10% year-over-year. Warehouse asking rents rose across the board, up 4.5% since the start of 2022 and 9.6% year-over-year. Rents are expected to continue rising slowly as the market juggles existing demand and stifled development starts.

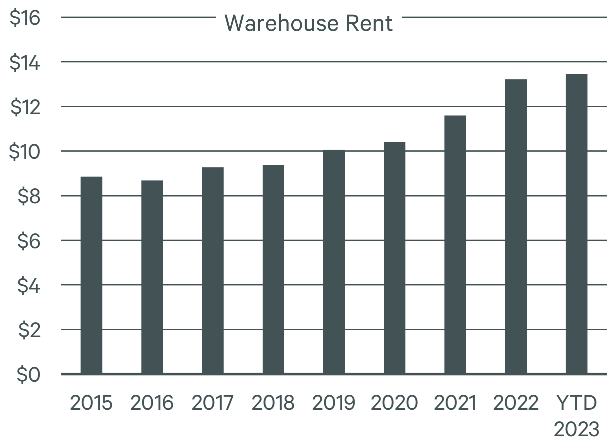
FIGURE 5: Select Notable Development Projects

Address	Submarket	SF	Expected Delivery	Developer(s)
10201 Golf Academy Dr, Building A	Rt 29/I-66	209,193	Q2 2023	Trammell Crow
10201 Golf Academy Dr, Building B	Rt 29/I-66	127,853	Q2 2023	Trammell Crow
7300 Century Park Dr	Rt 29/I-66	127,420	Q4 2023	West Dulles Properties
7300 Century Park Dr	Rt 29/I-66	114,760	Q4 2023	West Dulles Properties
7300 Century Park Dr	Rt 29/I-66	108,730	Q4 2023	West Dulles Properties
22913 Indian Creek Dr	Rt 28/Dulles North	76,275	Q4 2023	Foulger-Pratt
12001 Wilton Meadows Ct	Rt 29/I-66	31,000	Q2 2023	Benfield & Dressler

Source: CBRE

FIGURE 6: Historical Asking Rents





Source: CBRE

Economic Outlook

Downstream consequences of the Fed's tightening program are surfacing and signaling slower growth ahead. Specifically, trouble in the banking sector will likely weigh on even the strongest feature of the economy—the consumer—as banks limit lending to increase their own liquidity. This will erode demand for big-ticket items, such as housing and autos, but could also impede spending on services, which has been a key driver of job growth in recent months.

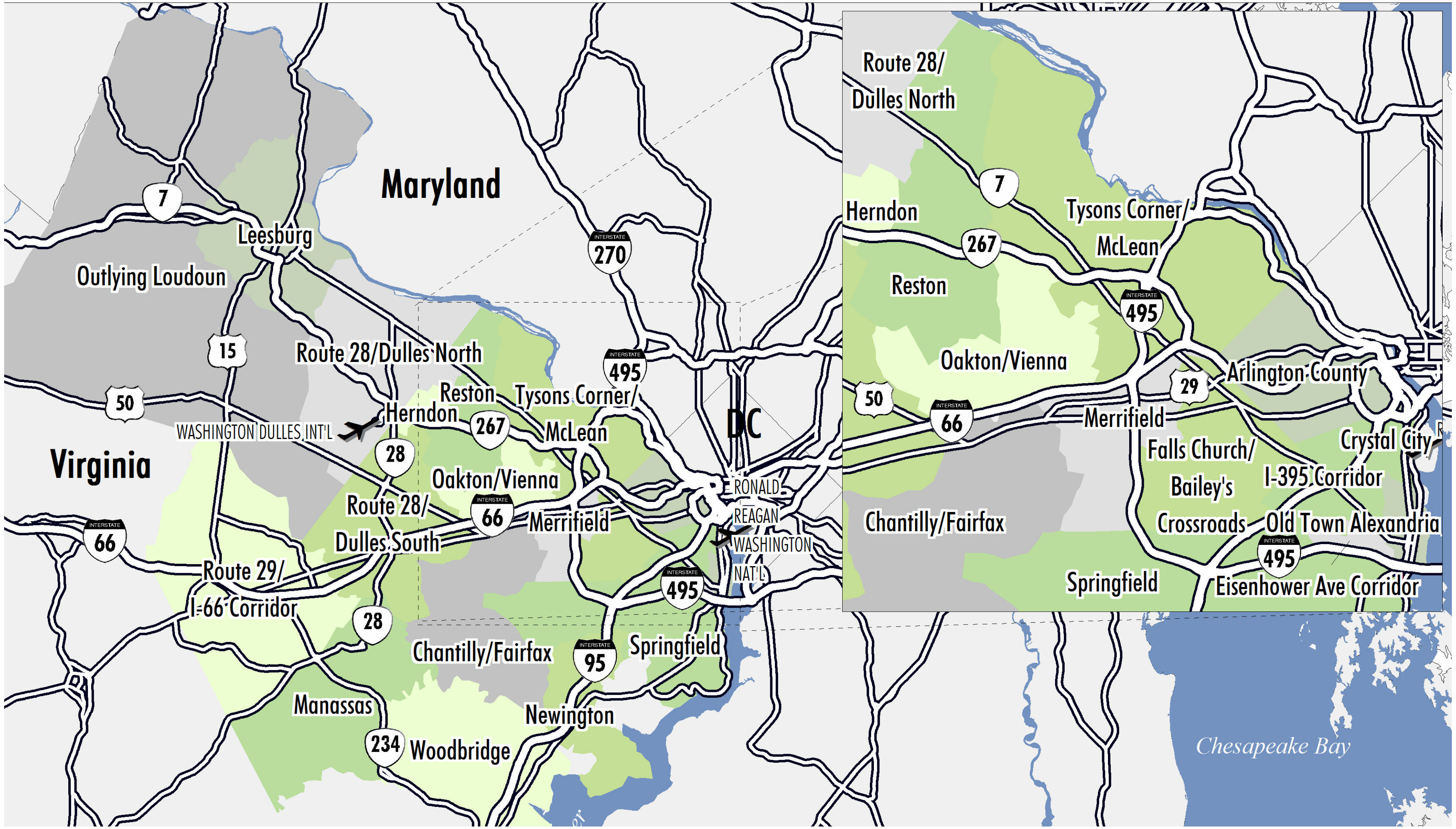
Meanwhile, other corners of the labor market, especially technology and corporate functions, are under pressure as hiring far exceeded revenue growth in recent years. Other operating challenges, such as inflation and cost of capital, are causing firms to shelve expansion plans and business investment is stalling. Like households, firms will certainly feel the pinch of constrained credit flows.

This risk-off environment points to a moderate recession this year. The impact on commercial real estate will be two-pronged—a weaker economy will slow NOI growth and tighter bank lending will limit investment activity. These conditions will likely accelerate and crystalize value loss in the office sector, but losses elsewhere will be less severe due to stronger fundamentals. The silver lining is that a faster slowdown in the economy will reduce inflation pressure later this year and allow the Fed to ease monetary policy, providing greater clarity to the real estate sector.

FIGURE 7: Key Market Statistics

Overall	Number of Buildings	Inventory (SF)	Overall Vacancy Rate (%)	Q1 2023 Net Absorption (SF)	2022 Net Absorption	NNN Asking Rent ($/SF)	Under Construction (SF)
Overall Industrial	City of Alexandria	4,414,983	4.4	(5,208)	(5,208)	12.71	
	Arlington County	869,717	-	0	0	-	
	Fairfax County	34,222,835	5.1	140,045	140,045	14.51	
	Loudoun County	23,000,989	2.2	172,478	172,478	13.24	
	Prince William County	16,490,011	1.5	46,621	46,621	14.75	
	Total	78,998,535	3.4	353,936	353,936	14.29	
Warehouse	City of Alexandria	3,695,838	4.7	(2,873)	(2,873)	12.06	
	Arlington County	730,908	-	0	0	-	
	Fairfax County	19,508,088	3.3	(46,821)	(46,821)	13.50	
	Loudoun County	13,626,151	2.0	264,083	264,083	13.88	
	Prince William County	10,660,768	1.2	28,407	28,407	13.26	
	Total	48,221,753	2.5	242,796	242,796	13.28	
Flex	City of Alexandria	719,145	2.7	(2,335)	(2,335)	16.05	
	Arlington County	138,809	-	0	0	-	
	Fairfax County	14,714,747	7.4	186,866	186,866	15.05	
	Loudoun County	9,374,838	2.6	(91,605)	(91,605)	12.80	
	Prince William County	5,829,243	2.0	18,214	18,214	15.63	
	Total	30,776,782	4.8	111,140	111,140	14.91	

Source: CBRE



Source: CBRE

Contact

Jack Pellington
Research Analyst
jack.pellington@cbre.com

Stephanie Jennings
Research Director
stephanie.jennings@cbre.com