The ElmTree Edge

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Sizing the Opportunity

Market dynamics, population growth, and the trends driving commercial real estate investment activity in secondary and tertiary markets

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In the commercial real estate sector, there is an understandable premium placed on quality locations in established and mature markets. But for commercial real estate investors—especially those who focus on industrial assets—secondary and tertiary markets may provide attractive alternative investment opportunities.

How do emerging markets differ from established markets? What factors influence developers, tenants, and investors looking to expand into new and emerging markets? And what demographic, economic, regulatory, and infrastructure dynamics do sophisticated investors focus on when making development and investment decisions?

Market forces

When evaluating promising growth opportunities in secondary and tertiary markets, industrial developers and investors consider a wide range of market characteristics and trends. Among the most important of those attributes are the following:

Population

The actual size of a market is not the only data point considered; trends pertaining to population growth in and around that market are also essential. Smaller market investment attraction has been influenced by regional population shifts, which has led to some of the highest population growth opportunities in recent years. Many regions have benefited from a significant migration from coastal gateway markets into growing secondary and tertiary markets that offer attractive live-work-play environments with lower costs of living.

Labor Trends

Another key factor related to population trends is the size and depth of the labor pool within a market. At a time when the cost and availability of qualified labor is one of the most significant constraints for many manufacturers, it is not surprising that labor dynamics in a given market are crucial factor impacting industrial sector decision-making. Many secondary and tertiary markets offer an educated and available labor force at a lower relative cost than coastal gateway markets.

Land availability

The scarcity of quality sites in established markets presents challenges for industrial investors and occupiers. Not only is the availability of quality sites generally more limited in gateway markets, but those sites also often come at a higher price per square foot. Thus, secondary and tertiary markets with attractive long-term growth prospects may offer investors and occupiers more efficient avenues to capitalize on current investment opportunities within the industrial sector.

Transportation

Existing transportation infrastructure in and around a market is another critical piece of information for investors and occupiers evaluating potential investment opportunities in secondary and tertiary markets. In some secondary and tertiary markets, an appealing blend of quality highway access and proximity to robust port infrastructure are key. The Port of Savannah in Georgia, for example, is the fourth busiest port in the nation and is home to the largest single-terminal container facility in North America. Charleston, South Carolina, boasts the sixth-largest port in the United States (by cargo value) and will continue to benefit from an ongoing harbor-deepening project that will further expand access to what is already the deepest harbor in the Southeast.

Business environment

Growth markets that are more friendly from a business and logistics operations standpoint are typically more appealing to investors and corporate decision-makers. From the contours of the regulatory environment to the details of the tax code to the willingness of civic leaders to be flexible and constructive in working with businesses to avoid excessive red tape for new construction, a favorable business environment can make a significant and sometimes dramatic difference for both investors and tenants within the industrial sector.

A gateway to gateways

The presence of potential expansion opportunities in neighboring sub-markets is an overlooked feature shared by some of the most popular secondary and tertiary commercial real estate investment areas. The best secondary markets eventually and inevitably become saturated, and nearby expansion into surrounding tertiary regions offers investors an additional avenue to capitalize on long-term growth patterns within the industrial sector.

Looking forward

For commercial real estate professionals and investors, the ability to identify and capitalize on emerging market opportunities early in a market's growth cycle is essential. That skillset is particularly important given the speed with which a market can transform from a high growth market to a crowded, established market. While variable, that window of time can sometimes be surprisingly short. Cities like Denver, Nashville, and Austin generally went from exciting growth opportunities to crowded and competitive markets with a much more challenging investment landscape in a span of several years.

Looking ahead and working hard to identify the next set of emerging markets (e.g., opportunities starting to emerge today in secondary markets that are benefiting from reshoring supply chains to North America) is at the forefront for commercial real estate investors. Early indicators to look for include critical areas like transportation, labor, and sometimes subtle or nuanced demographic trends. Understanding the role of geography and site availability/pricing dynamics is also highly important when trying to garner a keen understanding of the emerging market lifecycle. These factors allow investors to analyze the differences between more mature markets, emerging markets, and markets that fall somewhere in between. Once availability becomes scarcer, and larger and more established national buyers begin acquiring assets in these emerging markets, the window of opportunity to benefit from investing early in a fast-growing market begins to close.

In a business where being ahead of the curve is so critical and essential to an investment strategy with a long-term investment horizon, predicting those market changes and understanding the differing characteristics between different cities at various points in the real estate cycle is a highly important factor within a successful underwriting process.
