

Real Estate Market Review

West Coast Industrial

Industrial’s strong run continues into the first half of 2018 as the ecommerce industry expands into uncharted territories. Some perceive this asset type as cycle-proof due to a fundamental change in the way Americans consume products, which has driven construction higher than for all other property types. Leasing has kept up with supply, though much of the product delivered prior to 2016 was built-to-suit. In turn, rents have grown vigorously since the first quarter of 2015.

Spec projects, however, account for a greater proportion of recent deliveries and projects under construction, and while leasing velocity has been impressive, the waters will be tested later this year when new supply enters the market at record-breaking levels. Since peaking in 2016, sales volume has moderated recently, due to limited supply, while prices reached new highs. Robust industrial demand continues to put upward pressure on lease rates, with year-over-year double digit gains. While annual deliveries have grown every year since 2011, industrial demand continues to outpace the rate that new supply hits the market. At the end of the second quarter, industrial vacancies were near or at historical lows in most markets. Absorption for the quarter exceeded 23 million square feet, surpassing 2017 first half absorption of 21 million square feet. Reconfigurations of supply chains to accommodate e-commerce

have driven this demand. Demand is forecast to decline slightly this year relative to the past two years. This, coupled with a robust development pipeline, may put upward pressure on vacancies going forward. Large spaces remain in demand, which tends to place super-regional distribution markets at the center of leasing. The Inland Empire, which ranked at or near the top of national metros for absorption earlier in the cycle, posted 13 million SF of positive absorption in the first half of 2018, which led the pack on the West Coast. Sacramento had a total of over 2.1 million square feet of positive absorption, Phoenix almost 4.0 million square feet, Los Angeles 794,322 square feet and Silicon Valley 785.378 million square feet for the quarter. All in all, the West Coast industrial market occupancy expanded by 23 million square feet in the first half of 2018.

Overall Market Breakdown

	1H18	2H17	1H17	ANNUAL % CHANGE
Completed Construction	21,687,644	27,790,943	22,310,868	-2.79%
Under Construction	54,187,281	54,752,921	57,284,200	-5.41%
Vacancy Rate	3.60%	3.60%	3.70%	-2.70%
Availability Rate	5.80%	5.90%	5.80%	0.00%
Asking Lease Rate	\$0.80	\$0.75	\$0.70	13.80%
Lease Transactions	74,755,341	92,723,402	104,972,711	-28.79%
Sale Transactions	56,053,402	59,951,916	44,317,503	26.48%
Cap Rates	5.48%	5.92%	5.89%	-6.96%
Net Absorption	23,825,245	30,469,069	21,262,742	N/A

Market Reviews

Seattle

7.0M SF UNDER CONSTRUCTION	3.3% VACANCY	1.27M SF NET ABSORPTION	\$0.75 ASKING LEASE RATE
▲	▲	▼	◀▶

The Puget Sound region's industrial market saw an increased level of activity from the construction and leasing sides. Construction volume increased to 7,004,711 s.f. now under development (38 buildings) compared to 6.1 million s.f. (24 buildings) last quarter. The second quarter also saw delivery of 1.36 million s.f. of new product with the overall market supply standing at nearly 333 million s.f. After a slow first quarter, net absorption totaled nearly 1.2 million s.f. this quarter, keeping close pace with deliveries.

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Portland

1.25M SF UNDER CONSTRUCTION	3.7% VACANCY	859K SF NET ABSORPTION	\$0.64 ASKING LEASE RATE
▼	▲	▼	▲

Q2 was an excellent quarter for the Portland industrial market. All the primary indicators of market strength and health were fundamentally strong at mid-year 2018. At 3.7%, market-wide direct vacancies dropped more than 30 basis points from last quarter, while rental rates climbed to an average of \$0.64 NNN per square foot, a 6.67% hike from a year ago. Leasing activity, both for the quarter and year to date was extremely strong, exceeding 1.8 million square feet for the quarter and 5.3 million square feet for the year. Moreover, both developers and investors remain bullish about the near-term prospects of the Portland industrial market, with 2.65 million square feet under construction at quarter's end, and cap rates on investment sales in the range of 5-6%.

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Oakland / East Bay

2.07M SF UNDER CONSTRUCTION	3.6% VACANCY	19K SF NET ABSORPTION	\$1.17 ASKING LEASE RATE
▼	▲	▼	▲

East Bay industrial landlords continue to enjoy robust demand during the second quarter of 2018, while developers and institutional buyers raced to provide high-quality distribution spaces to capitalize on the market. The vacancy rate remained at a very low 3.6% market wide at quarter's end, and all submarkets besides Richmond/El Cerrito were below 5%. Leasing activity remained high with 1,312,738 s.f. More than two million s.f. of industrial space was under construction at quarter's end, but tenant demand should keep rental rates steady.

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San Francisco / Peninsula / San Mateo

1.06M SF UNDER CONSTRUCTION	2.1% VACANCY	-135K SF NET ABSORPTION	\$1.52 ASKING LEASE RATE
▲	▼	▲	▲

Structural factors such as exorbitant rents and nearby East Bay's better distribution infrastructure severely limit demand growth in San Francisco. The tenants that tend to find a home in the metro are last-mile logistics tenants. Nonetheless, severe supply constraints keep vacancies low and fundamentals fairly steady. The market's low vacancies and strong rent growth are appealing to investors, but the relatively limited inventory keeps volumes low. Pricing is still well above the national average, and cap rates remain among the lowest in the nation.

Silicon Valley

1.54M SF UNDER CONSTRUCTION	1.7% VACANCY	785K SF NET ABSORPTION	\$1.19 ASKING LEASE RATE
▲	▼	▲	▲

The Industrial and Warehouse markets had a very strong start to the year, but self-adjusted during the second quarter. Net absorption for Industrial and Warehouse products was less than the first quarter, posting negative 29,871 square feet and negative 245,208 square feet respectively. Despite the negative absorption, vacancy rates still remain at historic lows with 1.70% for industrial and 2.90% for warehouse. The average asking rate for Industrial space came in at \$1.18 and Warehouse is now at \$1.06 per square foot per month on a triple-net basis. The market for Silicon Valley's Industrial and Warehouse properties remains tight, and the current construction projects cannot be finished soon enough.

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Sacramento

116K SF UNDER CONSTRUCTION	4.3% VACANCY	2.19M SF NET ABSORPTION	\$0.48 ASKING LEASE RATE
▼	▼	▲	▲

The industrial commercial real estate market is thriving throughout the greater Sacramento area. Direct and overall vacancy continues to decrease quarter over quarter, which is creating upward pressure on lease rates. The total vacancy rate stands at 4.3% and most submarkets remained stable or showed a decline in vacancy this quarter, the Downtown submarket remains one of the tightest submarkets, reporting direct vacancy of only 1.6%.

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Reno

5.86M SF UNDER CONSTRUCTION	3.7% VACANCY	40K SF NET ABSORPTION	\$0.46 ASKING LEASE RATE
▲	▼	▼	▲

The industrial market in the greater Reno area experienced a relatively positive and steady second quarter. Gross absorption totaled a healthy amount of 1,974,815 square feet, more than double the 927,731 square feet reported in the first quarter. The net absorption for the quarter came in a negative 216,098 square feet. This is a negative swing due to a surprising amount of large sublease givebacks in the market, thus pushing the overall availability rate up to 5.27%. Direct vacancy experienced a slight increase of 12 basis points from the first quarter, coming in at 3.73%.

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Los Angeles

2.09M SF UNDER CONSTRUCTION	2.3% VACANCY	794K SF NET ABSORPTION	\$0.90 ASKING LEASE RATE
▼	▲	▼	▲

Record-low vacancies and soaring rents continue to bestride the Los Angeles Industrial market. With the fundamentals of the Industrial market remaining strong, the sector is performing at the highest levels. Despite the lack of product to transact, at 8.3 million square feet (MSF) this quarter, leasing activity is stable and healthy, setting the stage for gains later in the year. Although direct occupancy gains declined this quarter, the vacancy rate stands at mere 2.3% in the second quarter—up 42 basis points (bps) year-over-year. Unlike the Inland Empire, where construction of Industrial space is at all-time highs, tenant demand is surpassing the capacity of developers to deliver new Industrial product because of the dearth of land to develop and its prohibitively high cost in Los Angeles. Moreover, the existing inventory is aging and becoming functionally obsolete.

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Orange County

1.36M SF UNDER CONSTRUCTION	2.0% VACANCY	-45K SF NET ABSORPTION	\$0.87 ASKING LEASE RATE
▲	▼	▲	▲

According to the State of California's Employment Development Department, total non-farm employment increased by 1.1% year over year, or 17,300 jobs between May 2017 and May 2018. North County's Beckman Business Center should alleviate further downward pressure on vacancies as it is slated to deliver in the following quarters. We expect moderate increases in sales and leasing activity to continue, setting the stage for gains later in the year. Additionally, we can anticipate another strong year of growth as the competition for industrial product remains vigorous.

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Inland Empire

22.47M SF UNDER CONSTRUCTION	4.1% VACANCY	13.62M SF NET ABSORPTION	\$0.60 ASKING LEASE RATE
▲	▼	▼	▲

In the second quarter, the Inland Empire industrial market reported positive net absorption (direct) for the 36th consecutive quarter. While nearly 10.3 million square feet of industrial space has been completed and delivered to the market year to date, an additional 22 million square feet of industrial space remains under construction. Despite this high level of development activity, net absorption is on par with occupier demand. Consequently, there are very few concerns about overdevelopment. Notwithstanding the potential ill effects of the recently commenced trade wars, with the US economy continuing to grow and the US consumer continuing to spend, expect very little to no slowdown in the Inland Empire industrial market for the foreseeable future.

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San Diego

2.89M SF UNDER CONSTRUCTION	4.7% VACANCY	356K SF NET ABSORPTION	\$1.04 ASKING LEASE RATE
▼	▲	▼	◀▶

The San Diego industrial real estate market remained a highly lucrative location for life science and R&D/biotech users, as well as for manufacturing and warehouse tenants as we close out the first half of the year. Rental rates soared to an all-time high, and vacancy and availability rates remain at historically low levels, only further increasing the competition for space. Fortunately, the boom in the development pipeline has helped to alleviate some of this pressure as the market experienced a post-recession record high in new construction this quarter.

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Phoenix

6.4M SF UNDER CONSTRUCTION	7.2% VACANCY	4.05M SF NET ABSORPTION	\$0.58 ASKING LEASE RATE
▼	▼	▲	◀▶

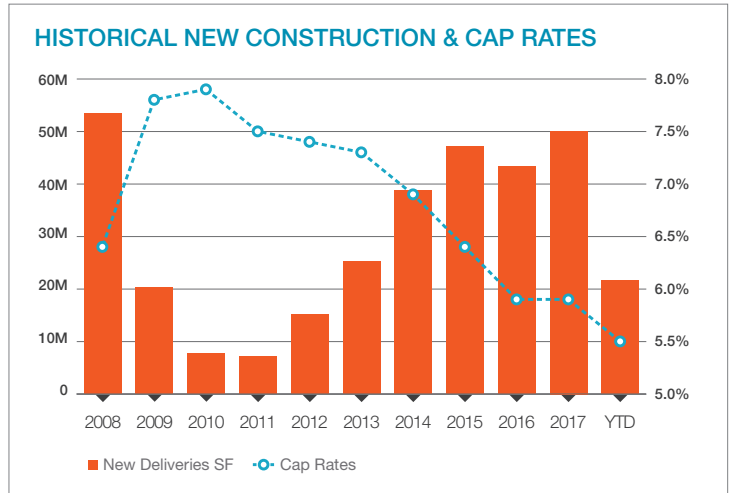
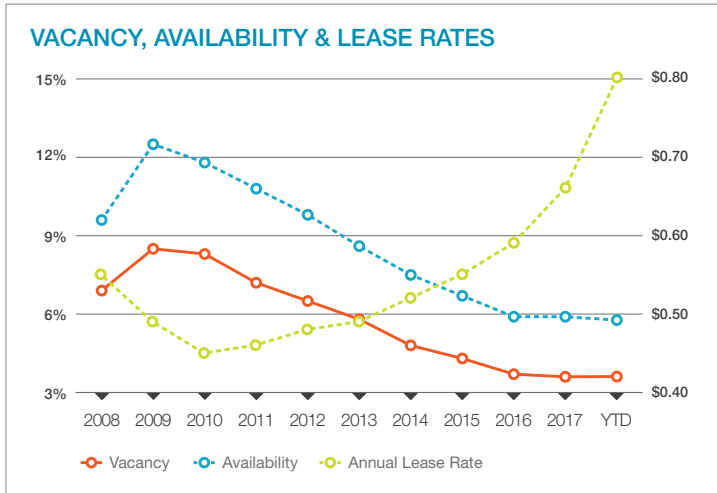
The Phoenix industrial real estate market showed no signs of slowing down in the second quarter, with robust leasing and sales activity, a record low in vacancy rate of 7.2%, and a post-recession record high in rental rates at \$0.58 per SF on a triple-net basis. Net absorption posted at a healthy 2.4M million square feet of positive absorption, and the development pipeline has hit a record high for this cycle with approximately 6.4 million square feet currently under construction, which the market hasn't experienced since 2007. The Phoenix unemployment rate dropped to 3.7% as of May 2018, down from 4.3% this time last year. We expect increased competition for space and higher rates to continue throughout the second half of 2018 as a result of the strong economy and business expansion.

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Note: Arrows indicate current trends not forecasts

Mid-Year 2018 West Coast Industrial Statistics

	Total Inventory	Under Construction	YTD Completed Construction	Total Vacancy	Total Available	YTD Net Absorption	YTD Total Leasing	Avg Cap Rate	Avg \$/SF	Avg YR Rental Rate
Seattle	302,507,079	7,004,711	3,151,762	3.3%	4.5%	1,277,330	6,890,066	5.9%	\$155.79	\$0.75
Portland	188,750,653	1,252,711	2,944,432	3.7%	5.4%	858,958	5,396,775	6.4%	\$111.27	\$0.64
Pacific Northwest	491,257,732	8,257,422	6,096,194	3.5%	4.8%	2,136,288	12,286,841	6.1%	\$138.68	\$0.71
Oakland/East Bay	150,598,407	2,070,413	393,508	3.6%	6.1%	18,968	2,938,479	6.3%	\$214.84	\$1.17
Peninsula/San Mateo	31,963,539	1,015,690	360,000	2.1%	4.0%	(185,394)	501,056	4.8%	\$180.04	\$1.52
San Francisco	25,883,494	46,500	0	2.1%	3.1%	50,165	456,003	4.2%	\$520.13	\$2.13
Silicon Valley	113,035,184	1,544,661	450,610	1.7%	3.0%	785,378	1,783,203	6.2%	\$179.27	\$1.19
Sacramento	148,633,320	116,456	857,788	4.3%	6.1%	2,195,357	3,291,744	6.5%	\$87.38	\$0.48
Reno	85,775,012	5,858,690	201,493	3.7%	5.3%	40,310	2,509,826	4.9%	\$97.22	\$0.46
Northern CA / NV	555,888,956	10,652,410	2,263,399	3.3%	5.1%	2,904,784	11,480,311	5.9%	\$167.59	\$0.94
Los Angeles	743,036,058	2,098,112	3,215,867	2.3%	4.4%	794,322	16,505,953	5.5%	\$182.48	\$0.90
Orange County	232,773,638	1,367,108	148,930	2.0%	4.7%	(44,690)	4,738,213	4.7%	\$209.26	\$0.87
Inland Empire	557,575,829	22,479,036	6,134,766	4.1%	6.0%	13,622,787	16,386,247	5.4%	\$121.31	\$0.60
San Diego	187,332,916	2,896,857	1,045,656	4.7%	8.2%	355,822	4,717,188	5.9%	\$183.58	\$1.04
Phoenix	316,434,419	6,436,336	2,782,832	7.2%	10.6%	4,055,932	8,640,588	7.0%	\$105.39	\$0.58
Southwest	2,037,152,860	35,277,449	13,328,051	3.7%	6.2%	18,784,173	50,988,189	5.6%	\$156.92	\$0.78
West Coast Total	3,084,299,548	54,187,281	21,687,644	3.6%	5.8%	23,825,245	74,755,341	5.8%	\$155.94	\$0.80



Data Source: CoStar

Kidder Mathews is the largest, independent commercial real estate firm on the West Coast, with more than 700 real estate professionals and staff in 21 offices in Washington, Oregon, California, Nevada, and Arizona. We offer a complete range of brokerage, appraisal, property management, consulting, project and construction management, and debt equity finance services for all property types.

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\$7B
ANNUAL TRANSACTION VOLUME

360+
BROKERS

PROPERTY MANAGEMENT

50M+
MANAGEMENT PORTFOLIO

VALUATION ADVISORY

1,500
ASSIGNMENTS ANNUALLY

36/21
TOTAL # APPRAISERS / MAI'S

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