Kidder Mathews

MARKET TRENDS | WEST COAST

INDUSTRIAL

YEAR END
2019

The Industrial sector continues to evolve and expand as the e-commerce industry continues its charge. E-commerce hasn't been the only factor influencing Industrial demand. Occupier demand is also impacted by manufacturing, domestic production and global trade. 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.

In addition, construction completions have slowed by 22%, yet the amount of space under construction has increased by 11%. Lease transactions are down 26% from a year ago, the largest contributing factor is the lack of available space in some markets. Volume and pricing do not always move together. There is a notion among industry professionals that as volume declines, prices decline. However, the mechanics of the current market follow a different pattern where, as volume falls, prices grow because there are not enough assets to satisfy the demand. With the preference in place for industrial assets, owners are raising their expectations on prices and buyers must pay up to be able to place capital. With the challenge to find assets, investors are still looking to buy large portfolios. Can industrial prices go higher than they already have this cycle? That is a question every investor faces when underwriting new deals. The answer is yes, prices can go higher, but how they get there will need to change. It is unclear that this recent rebound in the strength of capital market forces can continue without the tailwind of falling interest rates. Certainly, there is more investor interest in the sector than at any time in history but there is a limit to the cap rates which buyers will accept. Growth in prices will need to become more a function of income growth moving forward.

Cap rates continue to compress and are down by 41 basis points year over year, reaching a new historical low of 5.29% in 2019. Over the past 10 years, the Inland Empire led the West Coast in price growth (141%), followed by Los Angeles (124%), East Bay - Oakland (120%), San Diego (116%), and Silicon Valley (103%). Recently, the incoming capital from large portfolio sales pushed volume in 2019 to a new high. According to Real Capital Analytics, the top buyers were Blackstone, Prologis, Rexford Industrial, Colony Capital TIAA and Square Mile Capital. Some of the top sellers were GLP, DCT Industrial, IPT, Liberty Property Trust, Dermody Properties and Westcore Properties.

Robust industrial demand continues to put upward pressure on lease rates, with year-over-year double digit gains (11.8%). Annual deliveries remain at high levels and demand continues to outpace the rate that new supply is delivered. Large spaces remain highest in demand, which tends to place super-regional distribution markets at the center of leasing. The Inland Empire ranks #1 overall in rent growth, absorption and deliveries.

Source: CoStar, Harvard Joint Center for Housing Studies as reported by Urban Land Institute, Real Capital Analytics

Market Breakdown

	2019	2018	2017	Annual % Change
Completed Construction	46,608,471	59,831,192	53,161,814	-22.10%
Under Construction	65,669,229	59,236,400	57,086,642	10.86%
Vacancy Rate	4.2%	3.6%	3.6%	16.67%
Availability Rate	6.8%	5.7%	5.8%	18.57%
Asking Lease Rate	$0.89	$0.80	$0.73	11.77%
Lease Transactions	159,753,857	216,550,675	196,853,768	-26.23%
Sale Transactions	109,178,651	110,176,622	103,676,037	-0.91%
Cap Rates	5.29%	5.70%	5.90%	-7.19%
Net Absorption	34,835,950	56,340,909	53,913,839	N/A

Seattle

▲ 6.68M SF UNDER CONSTRUCTION	▲ 4.7% VACANCY
▲ 2.71M SF NET ABSORPTION	▲ $0.81 ASKING LEASE RATE

Investment activity remained strong throughout 2019. Cap rates are well below the national average and have compressed significantly this cycle due to a significant increase in pricing. Sales volume in 2019 is characterized by large trades, including national portfolio deals. Development activity has been especially dynamic near the ports, particularly the Port of Tacoma. Faster deals and lease ups should color early 2020 before the market feels the effect of the new tax (REET). Submarkets like Port of Tacoma/Fife and Puyallup/S Hill offer developers lower land costs and tenants a discount to other submarkets. Net absorption has been among the highest in the metro in these areas over the past five years and most new leases were in large distribution centers or warehouses.

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Portland

▼ 5.62M SF UNDER CONSTRUCTION	▲ 3.8% VACANCY
▼ 602,905 SF NET ABSORPTION	▲ $0.69 ASKING LEASE RATE

While vacancy held below the historical average, a large influx of speculative deliveries contributed to some volatility. Investment over the past 12 months was well above Portland's historical average as 1.6 billion dollars traded hands and market cap rates held at 6%. Favorable fundamentals, growing sale prices and volume moving towards $2 billion, and positive absorption can all be found here for a reasonable cost. At the end of 2019, rent growth was at its lowest point since 2013. As logistics space comprises nearly 70% of Portland's industrial inventory, performance for this product type has driven the pace in rent growth. Timelines for construction were stalled in 2019, although the pipeline anticipates 2020 to be a record-breaking year in new construction.

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Oakland/East Bay

▲ 2.13M SF UNDER CONSTRUCTION	▲ 4.8% VACANCY
▲ 23,949 SF NET ABSORPTION	▲ $1.22 ASKING LEASE RATE

The East Bay industrial market continues to be attractive to tenants, as over 6.68 million s.f. was leased in 2019. Rental rates remain on an upwards climb, averaging $1.22/s.f. NNN, a 3.4% jump YOY. Even with some of the highest average rents in the country, the East Bay has remained well below most neighboring Bay Area metros. East Bay experienced an uptick in available industrial product as 1.26 million s.f. of space entered the market in 2019. This heavy development pipeline has caused an increase in vacancies as they grew 130 basis points (bps) to 4.8%. Average asset pricing market-wide continued to increase as properties are currently trading at $194/s.f., an increase of 6.9% YOY.

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San Francisco/Peninsula

▼ 203,865 SF UNDER CONSTRUCTION	▲ 3.7% SF VACANCY
▼ -888,390 SF NET ABSORPTION	▲ $2.01 SF ASKING LEASE RATE

Thanks to expensive land, few industrial properties have been built in San Francisco over the past decade, a trend that will likely continue going forward. . New development flourished throughout South San Francisco in the Oyster Point area. Auxiliary factors, for example, extravagant rents and close by East Bay's better distribution foundation limit speculative development in San Francisco. The occupants that will locate space in the metro are mainly last-mile logistics companies. In any case, vacancies are low for all types of tenants. The market's tight opportunities and solid rent growth are appealing to investors, however, the generally restricted stock keeps volumes low. Pricing remains well over the national normal, and cap rates stay among the lowest in the country.

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Silicon Valley

▼ 563,245 SF UNDER CONSTRUCTION	▼ 3.2% VACANCY
▲ 974,372 SF NET ABSORPTION	▲ $1.33 ASKING LEASE RATE

The Silicon Valley Industrial market experienced a stellar year with 2.8 million square feet of deliveries and 563,245 square feet still under construction. Overall, leasing activity picked up in 2019, soaring to over 6.9 million square feet as companies have turned their focus to brand-new developments entering the market. Even with the heavy influx of supply, steady demand market-wide has maintained downward pressure on vacancy. With minimal vacancies, rental rates have proceeded with its upward direction as Silicon Valley commands some of the priciest rental rates in the country. Rental rates tend to be higher in Silicon Valley due to the large amount of data hosting facilities in the market, as these assets typically rent at higher rates than do standard warehouses.

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Sacramento

▲ 1.43M SF UNDER CONSTRUCTION	▼ 4.6% VACANCY
▼ 923,831 SF NET ABSORPTION	▲ $0.68 ASKING LEASE RATE

Sacramento's opportunities are tight, prompting some of the highest lease rate gains in the country. As market rents go up, properties are on market about 5 months before executed leases. The increase in leasing activity has shifted absorption positively. Also, sales have been the most noteworthy they have been in 10 years. The hearty interest for industrial space specifically by cannabis related companies has flourished. Various submarkets clustered in the western portion of the metro profit by an assortment of demand drivers. Interstate 80 and Interstate 5 give turnpike access to other significant metros encompassing Sacramento. Natomas/Northgate likewise offers expressway access to Interstate 5, however might be most popular for the Metro Air Park, which lies nearby Sacramento International Airport.

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Reno

▲ 2.31M SF UNDER CONSTRUCTION	▲ 6.5% VACANCY
▲ 3.24M SF NET ABSORPTION	▲ $0.41 ASKING LEASE RATE

For almost the entirety of this cycle, solid renting action alleviated any stock driven weight, however vacancies have expanded since tumbling to a record low in 2Q2019. With the uptick in availabilities, overall rent growth has decelerated from 2018's unsurpassed high, yet is aligned with the national percentages. Asking rates offer a generous markdown compared to both the U.S. standard, and neighboring markets. Reno gets a significant amount of consideration from investors; institutional, private value, and REIT purchasers have dominated almost all ventures since 2010 to present. Yearly sales volume averaged nearly $300 million and pricing in 2019 bested $95/sf, subsequent to averaging about $85/SF in 2017–18. Cap rates have been drifting around 6% for quite a long while.

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Los Angeles

▲ 6.43M SF UNDER CONSTRUCTION	▲ 2.4% VACANCY
▼ -1.31M SF NET ABSORPTION	▲ $1.04 ASKING LEASE RATE

Record-low vacancies and soaring rents continue to proliferate in the Los Angeles industrial market. Despite the lack of product to transact, leasing activity is stable. Tenant demand is surpassing the capacity of developers to deliver new industrial product because of the dearth of land to develop and its high cost in Los Angeles. The handful of recent major modern developments were unique opportunities borne of external circumstances. A windfall for landlords, this has induced a fierce competition for industrial space. Tenants have less options to choose from and must take what they can. Accordingly, the occupants are seeing concessions decrease and stamped increments in starting rents. Landlords can achieve higher rates over all classes and asking rates remain at untouched highs.

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Orange County

▲ 835,279 SF UNDER CONSTRUCTION	▼ 3.4% VACANCY
▲ 18,570 SF NET ABSORPTION	▲ $0.97 ASKING LEASE RATE

The Orange County industrial market ended 2019 on firm footing. Vacancy levels have remained below 4% for 23 straight quarters and asking rental rates continue to record highs. Sales volume market-wide was the highest on record in 2019 with over $1.35 trillion as buyers have remained aggressive in order to capitalize on overall rent premiums and current market conditions. As the competition for a sizable presence stays fierce, numerous industrial spaces entering the market remain unpriced as landlords and sellers are letting the market set the rate. By doing this, rental rates can be influenced by a couple of low or significantly priced deals. With relentless demand and inventory constraints, we can expect the Orange County industrial market to stay sound pushing ahead.

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Inland Empire

▼ 25.11M SF UNDER CONSTRUCTION	▲ 4.1% VACANCY
▲ 20.72M SF NET ABSORPTION	▲ $0.75 ASKING LEASE RATE

2019 was another excellent year for the Inland Empire industrial market as it continues to outperform local markets . Tenant movement market-wide reported positive for the 29th consecutive quarter as Inland Empire remains at the top of the list as one of the most sought-after industrial markets in the country. Additionally, proximity to the ports, increasing population density, and a steady amount of construction have made it appealing for many companies to be located here. Moreover, steady demand fundamentals contributed by the rise of ecommerce and Amazon's frenetic expansion to perfect their last-mile delivery service, have further propelled rental rates past post-recession highs. With healthy fundamentals in place, we can anticipate another strong year of growth for the Inland Empire industrial sector.

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San Diego

▼ 1.5M SF UNDER CONSTRUCTION	▲ 5.6% VACANCY
▲ 355,747 SF NET ABSORPTION	▲ $1.16 ASKING LEASE RATE

The San Diego industrial market finished the year out strong, with asking rental rates at an all-time historical high and vacancy and availability rates remaining in range of the post-recession low. Additionally, San Diego not only established a new annual high in industrial sales volume but also experienced a record high in average price per square foot. Overall, developers have shown few signs of slowing down. Over 5 million square feet has been completed since 2018 and over 1.5 million square feet is currently under construction. Even though the San Diego industrial market is in the midst of a supply wave, vacancies are only expected to modestly soften and remain below the historical benchmark due to the strong local economy.

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Phoenix

▲ 12.86M SF UNDER CONSTRUCTION	▲ 7.0% VACANCY
▲ 7.46 SF NET ABSORPTION	▲ $0.60 ASKING LEASE RATE

Affordability, a large labor pool, and connectivity to 33 million people in a single day's truck haul are all contributing factors to the thriving Phoenix Industrial market. The industrial market finished 2019 on firm footing as vacancy rates continue to hover around record lows and asking rental rates push past post-recession highs. Strong demand generated from a growing mix of industrial tenants has caused the development pipeline at year end to hit an astronomical all-time high. Well over 12 million square feet is currently under construction with almost the entirety of the volume expected to deliver in 2020. With relatively few barriers to development, favorable demographics, and a flourishing economy, Phoenix will continue to be one of the fastest growing industrial markets in the nation.

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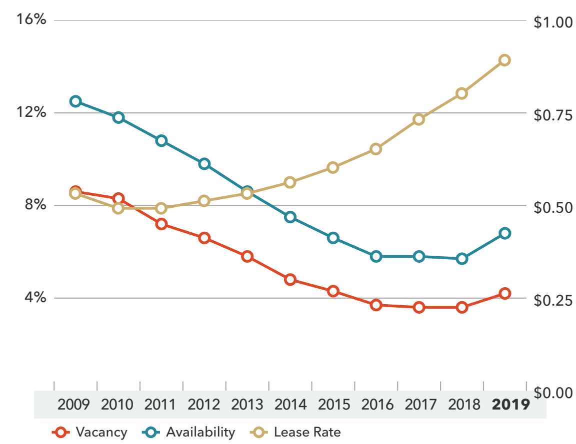
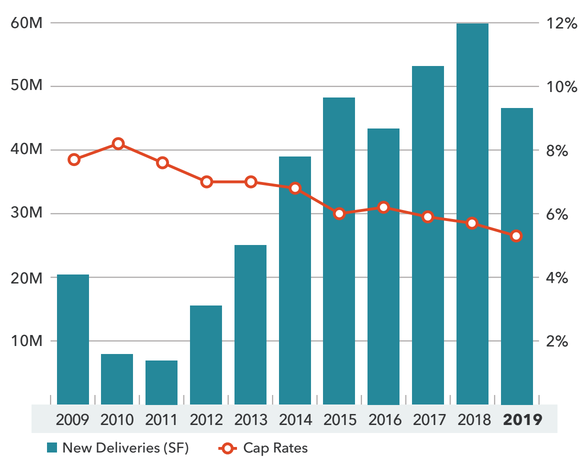
YEAR END 2019 WEST COAST INDUSTRIAL STATISTICS

Submarket	Total Inventory	Under Construction	2019 Completed Construction	Total Vacancy	Total Available	2019 Net Absorption	2019 Total Leasing Activity	Avg Cap Rate	Avg Sales Price / SF	Avg Direct Rental Rate (NNN)
Seattle	343,816,231	6,675,980	6,661,179	4.7%	6.7%	2,713,074	13,724,580	5.50%	$168.45	$0.81
Portland	209,066,801	5,618,810	2,285,347	3.8%	6.2%	602,905	9,076,324	5.80%	$135.24	$0.69
Pacific North West	**552,883,032**	**12,294,790**	**8,946,526**	**4.4%**	**6.5%**	**3,315,979**	**22,800,904**	**5.61%**	**$155.89**	**$0.76**
Oakland/East Bay	152,111,651	2,128,353	1,261,632	4.8%	8.0%	23,949	6,677,130	5.50%	$194.61	$1.22
Peninsula/San Mateo	31,508,826	0	0	4.7%	6.1%	(694,963)	1,445,093	4.70%	$332.55	$1.59
San Francisco	25,654,059	203,865	0	2.8%	6.8%	(193,427)	177,309	4.00%	$376.18	$2.43
Silicon Valley	112,441,822	563,245	2,808,967	3.2%	5.8%	974,372	6,925,772	4.55%	$254.02	$1.33
Sacramento	167,440,332	1,428,982	495,200	4.6%	7.2%	923,831	4,618,184	6.60%	$99.17	$0.68
Reno	91,308,276	2,308,847	1,569,128	5.6%	6.5%	3,238,785	6,924,784	5.10%	$102.00	$0.41
Northern California	**580,464,966**	**6,633,292**	**6,134,927**	**4.4%**	**6.9%**	**4,272,547**	**26,768,272**	**5.46%**	**$179.53**	**$1.03**
Los Angeles	731,437,716	6,429,751	1,703,361	2.4%	4.5%	(1,309,563)	28,026,450	4.50%	$200.94	$1.04
Orange County	228,780,932	835,279	422,630	3.4%	4.6%	18,570	12,529,910	4.60%	$203.47	$0.97
Inland Empire	596,443,140	25,111,206	20,265,989	4.1%	7.7%	20,718,132	42,743,482	5.20%	$131.84	$0.75
San Diego	190,247,881	1,504,646	1,574,352	5.6%	8.1%	355,747	9,861,601	5.70%	$228.79	$1.16
Phoenix	328,739,255	12,860,265	7,560,686	7.0%	10.9%	7,464,538	17,023,238	6.60%	$105.97	$0.60
South West	**2,075,648,924**	**46,741,147**	**31,527,018**	**4.0%**	**6.8%**	**27,247,424**	**110,184,681**	**5.15%**	**$168.87**	**$0.89**
West Coast Total	**3,208,996,922**	**65,669,229**	**46,608,471**	**4.2%**	**6.8%**	**34,835,950**	**159,753,857**	**5.29%**	**$168.57**	**$0.89**

VACANCY VS. AVG ASKING RENT



ANNUAL NEW CONSTRUCTION & CAP RATES



Kidder Mathews is the largest, independent commercial real estate firm on the West Coast, with 800 real estate professionals and staff in 22 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.

COMMERCIAL BROKERAGE

400+ NO. OF BROKERS

$9B ANNUAL TRANSACTION VOLUME

20M ANNUAL SALES SF

40M ANNUAL LEASING SF

VALUATION ADVISORY

1,600+ APPRAISALS ANNUALLY

36/24 TOTAL NO. APPRAISERS/MAI'S

PROPERTY MANAGEMENT

60M+ MANAGEMENT PORTFOLIO SF

The information in this report was composed by the Kidder Mathews Research Group.

JERRY HOLDNER
Director of Research
949.557.5050
jerry.holdner@kidder.com
LIC N° 01145748

KIDDER.COM