

Real Estate Market Review

# West Coast Industrial

A reconfiguration of supply chains to accommodate e-commerce has driven this cycle’s demand, helping to outpace a U.S. economy growing by about 2.5%. While 2017 is expected to be the peak development year of this cycle, demand continues to accelerate, which is preventing any significant supply-driven vacancy expansion.

Robust industrial demand continues to drive outsized rent growth, with year-over-year double digit gains and more than triple the historical average as of the first half of 2017. Through the first two quarters of the year, investment volume was roughly equal to the pace set in 2016, while the average price per square foot increased by 13.77% on the West Coast.

While annual deliveries have grown every year since 2011, industrial demand continues to outpace the rate that new supply hits the market. At mid-year 2017, industrial vacancies were near or at historical lows in most markets. Absorption in 2014 exceeded 63 million square feet, about 20% stronger than at the peak of the last cycle. In 2016, demand exceeded 57 million square feet, surpassing the previous cycle’s peak by about 30%. Reconfigurations of supply chains to accommodate e-commerce have driven this demand. Demand is forecast to decline slightly

in 2017 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, was hit by nearly 1.4 million square feet of negative absorption in first quarter of 2017. It then recovered in the second quarter, giving that market a total of almost 7 million square feet of positive absorption for the first half of 2017, which led the pack on the West Coast. Phoenix had a total of just over 4.1 million square feet of positive absorption, Seattle 2.7 million square feet, Reno 2.1 million square feet, Sacramento just under 2 million square feet and Portland came in at 1.6 million square feet for the first half of 2017.

Data Source: CoStar

## Overall Market Breakdown

	MID-YEAR 2017	YEAR-END 2016	MID-YEAR 2016	ANNUAL % CHANGE
Completed Construction	22,299,400	22,245,208	26,430,817	-15.63%
Under Construction	57,410,101	50,792,141	41,433,216	38.56%
Vacancy Rate	3.90%	3.90%	4.30%	-9.30%
Availability Rate	6.30%	6.10%	6.20%	1.61%
Asking Lease Rate	\$0.63	\$0.59	\$0.57	10.53%
Lease Transactions	64,099,945	100,523,746	118,266,456	-45.80%
Sale Transactions	130,487,164	170,214,343	139,939,008	-6.75%
Net Absorption	21,086,527	37,930,898	19,943,217	N/A

# Market Reviews

## Seattle

<b>5.8M SF</b> UNDER CONSTRUCTION	<b>3.2%   4.8%</b> VACANCY   AVAILABILITY	<b>2.7M SF</b> NET ABSORPTION	<b>\$0.75</b> ASKING LEASE RATE
↑	↑	↑	↑

Vacancies in the Seattle industrial market are lower than their prerecession cyclical lows and rent growth is the highest it has been since the recovery. However, this is a builder's market, and as construction ramps up in response to low-single-digit vacancies, occupancy gains and rent growth are already facing pressure. Institutional investors are attracted to this market, and sales volume has been high as a result, with record numbers in 2015-16.

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## Portland

<b>3.3M SF</b> UNDER CONSTRUCTION	<b>3.3%   5.6%</b> VACANCY   AVAILABILITY	<b>1.6M SF</b> NET ABSORPTION	<b>\$0.61</b> ASKING LEASE RATE
↑	↓	↑	↑

The fundamental drivers in this rapidly growing regional distribution market remain strong. Favorable demographics, increasing housing construction, a structurally low vacancy rate, and exposure to trade by way of a major seaport can all be found here at a reasonable cost basis. Companies that continue to expand their industrial presence in Portland include third-party logistics companies, retailers / wholesalers, and suppliers to the local market. Above-average rent growth and very reasonable yields help boost returns, putting them in line with the benchmark average.

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## Oakland / East Bay

<b>1.6M SF</b> UNDER CONSTRUCTION	<b>4.8%   9.2%</b> VACANCY   AVAILABILITY	<b>147K SF</b> NET ABSORPTION	<b>\$0.95</b> ASKING LEASE RATE
↑	↓	↓	↑

Landlords of East Bay industrial properties are in a comfortable position. Absorption has surged here during the past two years, pulling vacancies near 15-year lows and rents and sales prices to all-time highs in 2017. Speculative development has emerged in response to this market's strength. This is a welcome change given as of June 2017, there was only about 400,000 square feet of existing industrial space built since 2005 that listed as available throughout the entire market. Furthermore, most prime distribution hubs along the I-880 corridor are largely built out, meaning that although new construction is turning up, developers are unlikely to overwhelm this market. After a year of strong leasing, a healthy lineup of tenants are set to expand here over the next few years. And though there were slightly less trades in 2016 than there had been in 2015, pricing continues to increase.

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## San Francisco / Peninsula / San Mateo

<b>50K SF</b> UNDER CONSTRUCTION	<b>3.4%   4.2%</b> VACANCY   AVAILABILITY	<b>629K SF</b> NET ABSORPTION	<b>\$1.84</b> 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 on its way up, and cap rates remain among the lowest in the nation.

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## Silicon Valley

<b>666K SF</b> UNDER CONSTRUCTION	<b>3.6%   4.6%</b> VACANCY   AVAILABILITY	<b>138K SF</b> NET ABSORPTION	<b>\$1.08</b> ASKING LEASE RATE
↑	↓	↑	↔

The San Jose market revolves around the IT industry. Despite a healthy metro economy, absorption had been slow to recover this cycle, as high rents and better infrastructure farther east are prompting Bay Area tenants to expand in the East Bay. However, increased demand since the start of 2014 has spurred the first round of new supply this cycle, which began delivering at the end of 2016. This new supply hasn't dampened rent growth; 2015 was the strongest year since the recession, but 2016 still saw substantial rent growth. Though pricing and sales volume have maintained momentum from previous years, buyers targeted redevelopment projects rather than investment or owner-user assets.

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## Sacramento

<b>1.65M SF</b> UNDER CONSTRUCTION	<b>7.5%   9.3%</b> VACANCY   AVAILABILITY	<b>2M SF</b> NET ABSORPTION	<b>\$0.46</b> ASKING LEASE RATE
↑	↓	↑	↑

Considering its proximity to major distribution hubs like East Bay and Reno, the Sacramento market typically depends on demand from local and regional tenants. One major exception to this norm, however, is Amazon, which will open its first fulfillment center in this metro in 2017. Considering it eclipsed 16% in 2012, Sacramento's vacancy level experienced impressive compression over the last few years, with the current level well below the historical average. After multiple years of stagnant growth as a result of the recession, the metro has seen its gains climb each year since 2013, and 2017 is on pace to set a record high. While there were a handful of exceptions over the last few years, small local players and owner/users typically drive investment in this metro, and median pricing has yet to see substantial growth this cycle.

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## Reno

1.2M SF UNDER CONSTRUCTION	4.2%   4.9% VACANCY   AVAILABILITY	2.1M SF NET ABSORPTION	\$0.35 ASKING LEASE RATE
↑	↓	↑	↑

Reno's industrial market saw vacancies rise from 2015 to 2016 because of a sustained stretch of widespread construction. Net absorption reached a cycle high in 2016, buoyed by rapid gains in industrial-using employment sectors such as transportation, trade, and utilities, but it was outpaced by deliveries. Even with rising vacancy rates, rent growth was remarkable compared with the rest of the cycle. The construction pipeline is shaping up for another year of ample deliveries, though not the volumes of 2015 and 2016. Reno's growing market is facilitated by its role as a conduit between the Western states, and minimal regulations of interstate commerce. Transaction volume, slightly elevated compared with the historical average, was bolstered by a busy year in the Sparks submarket.

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## Los Angeles

5M SF UNDER CONSTRUCTION	2.1%   3.9% VACANCY   AVAILABILITY	761K SF NET ABSORPTION	\$0.84 ASKING LEASE RATE
↑	↑	↑	↑

Few warehouse markets offer LA's depth of tenant demand paired with slow supply growth. In this core market, investors should be prepared to accept low returns in exchange for consistently strong fundamentals and plenty of liquidity. Vacancies have risen only slightly above the historic lows posted in the second quarter of 2016, and that rise is largely a supply-driven phenomenon. New construction has been far below historical levels for most of this cycle, but several years of outsized rent growth are finally driving an upswing in construction. Even with development ramping up, the lack of buildable land in the LA metro serves as a structural limit on supply additions. Supply constraints and strong demand should ensure that landlords continue to have the upper hand, and growth in rents will most likely continue to blow away the national benchmark. However, extremely low cap rates continue to limit overall returns in this market.

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## Orange County

395K SF UNDER CONSTRUCTION	2.4%   3.8% VACANCY   AVAILABILITY	-456K SF NET ABSORPTION	\$0.81 ASKING LEASE RATE
↑	↑	↓	↑

Proximity to the Los Angeles ports, supply constraints, and conversions from industrial to other property types have all played a role in tightening Orange County's fundamentals. Vacancies are low, demand has outpaced supply over the last few years (in 2015, demand more than doubled new supply), and rents continue to show steady, strong growth. Competition is fierce among companies in search of a sizable footprint, as the inventory skews smaller than in neighboring Inland Empire and LA, which can both accommodate a significant distribution and warehousing presence. Investors continue to target Orange County, and the sale involving seven buildings at Anaheim Concourse in September 2016 was among the largest industrial trades in Orange County history, not to mention the \$131 million sale of the former JCPenney distribution facility in Buena Park earlier this year.

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## Inland Empire

31.3M SF UNDER CONSTRUCTION	4.7%   5.9% VACANCY   AVAILABILITY	6.9M SF NET ABSORPTION	\$0.48 ASKING LEASE RATE
↑	↑	↑	↔

The Inland Empire (IE) is one of the largest and most critical components of the supply-chain infrastructure in the U.S. Just inland from the busy ports of LA and Long Beach, this hub has grown by over 100% since China joined the World Trade Organization in December 2001, increasing trade and port traffic. With over 215 million square feet of space delivered since then, growth in the IE has been unmatched by that of any other market. Although volume remains strong in the ports, containerized imports will likely not increase as quickly as they did in the last cycle. Developers are still building as if the IE will continue to grow exponentially, and so far demand has mostly kept up. However, with more than 31 million square feet of supply under construction as of August 2017, a hiccup in demand could drive up vacancies. Investment totals continue to exceed historical averages, but only time will tell how investors feel about the risk of oversupply here.

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## San Diego

1.1M SF UNDER CONSTRUCTION	5.3%   8.4% VACANCY   AVAILABILITY	459K SF NET ABSORPTION	\$1.04 ASKING LEASE RATE
↑	↓	↑	↔

San Diego's industrial footprint is dominated by local firms, with very little of the spillover from the Long Beach and Los Angeles Ports. As a result, it's the smallest logistics market in Southern California, although the trend toward same-day delivery is beginning to take hold here as it has in Orange County and elsewhere. Limited construction, conversion of buildings away from industrial, and healthy demand have helped solidify market fundamentals - rent growth being one beneficiary. Investment is typically tied to local players trading smaller properties, though institutional capital finds its way into San Diego from time to time.

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## Phoenix

5.4M SF UNDER CONSTRUCTION	9.4%   11.4% VACANCY   AVAILABILITY	4.1M SF NET ABSORPTION	\$0.58 ASKING LEASE RATE
↓	↓	↑	↑

Phoenix's southwest valley forms the core of this regional distribution market. The relative availability and affordability of land in the Phoenix metropolitan area, and in the southwest valley in particular, make it a popular target for developers. Furthermore, the strong population and job growth trends in Phoenix, and in the southwest as a whole, are bolstering a growing consumer base in the region. Overall, approximately 35 million consumers can be served within a single day's truck haul from the metro, according to the Greater Phoenix Economic Council. With relatively few barriers to development and positive demographic trends, Phoenix has emerged as one of the fastest-growing industrial markets in the country. A supply surge that began in 2013 has increased the metro's stock of industrial space by 18% over the past five years - an expansion of inventory that ranks second only to the Inland Empire during this time period.

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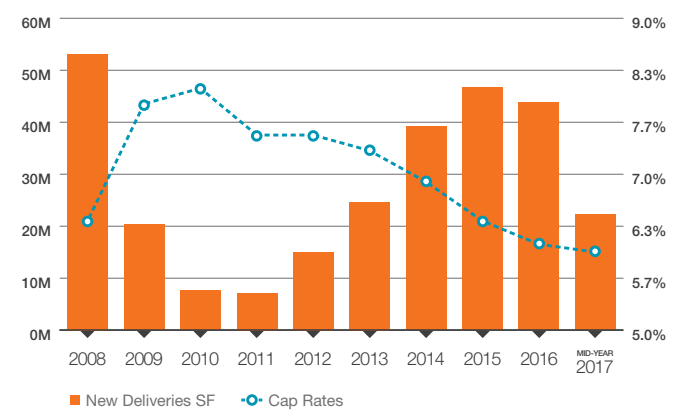
## Mid-Year 2017 West Coast Industrial Statistics

	TOTAL INVENTORY	UNDER CONSTRUCTION	YTD COMPLETED CONSTRUCTION	TOTAL VACANCY	TOTAL AVAILABLE	YTD NET ABSORPTION	YTD TOTAL LEASING	AVG CAP RATE	AVG \$/SF	AVG MO RENTAL RATE
Seattle	329,265,704	5,813,027	2,568,762	3.20%	4.80%	2,715,418	5,991,207	6.30%	\$176.71	\$0.75
Portland	184,311,715	3,320,230	1,026,487	3.30%	5.60%	1,628,031	2,037,856	5.70%	\$71.09	\$0.61
<b>Pacific Northwest</b>	<b>513,577,419</b>	<b>9,133,257</b>	<b>3,595,249</b>	<b>3.20%</b>	<b>5.10%</b>	<b>4,343,449</b>	<b>8,029,063</b>	<b>6.00%</b>	<b>\$121.22</b>	<b>\$0.71</b>
Oakland / East Bay	141,887,627	1,563,501	202,848	4.80%	9.20%	146,843	2,253,230	5.90%	\$173.75	\$0.95
Peninsula / San Mateo	41,333,009	0	0	3.40%	4.30%	666,154	1,108,453	7.00%	\$415.51	\$1.33
San Francisco	27,837,534	50,000	0	3.40%	4.20%	-37,508	578,159	4.30%	\$552.92	\$2.19
Silicon Valley	116,229,553	665,610	344,003	3.60%	4.60%	137,649	1,453,565	6.30%	\$239.39	\$1.08
Sacramento	165,825,699	1,649,455	443,734	7.50%	9.30%	1,958,193	3,847,935	6.80%	\$64.29	\$0.46
Reno	83,234,440	1,211,825	1,421,947	4.20%	4.90%	2,102,160	5,005,814	6.50%	\$94.90	\$0.35
<b>Northern California</b>	<b>576,347,862</b>	<b>5,140,391</b>	<b>2,412,532</b>	<b>4.30%</b>	<b>6.00%</b>	<b>4,973,491</b>	<b>14,247,156</b>	<b>6.30%</b>	<b>\$168.80</b>	<b>\$0.59</b>
Los Angeles	737,729,392	4,976,067	2,264,549	2.10%	3.90%	761,425	13,131,375	5.20%	\$170.78	\$0.84
Orange County	234,043,858	395,458	222,737	2.40%	3.80%	-456,130	3,334,330	5.40%	\$165.28	\$0.81
Inland Empire	534,720,371	31,264,011	9,888,186	4.70%	5.90%	6,904,975	13,973,737	6.30%	\$113.36	\$0.48
San Diego	182,437,609	1,140,153	864,318	5.30%	8.40%	458,703	4,517,529	6.20%	\$141.91	\$1.04
Phoenix	307,923,135	5,360,764	3,051,829	9.40%	11.40%	4,100,614	6,866,755	7.10%	\$82.08	\$0.58
<b>South West</b>	<b>1,996,854,365</b>	<b>43,136,453</b>	<b>16,291,619</b>	<b>3.90%</b>	<b>6.50%</b>	<b>11,769,587</b>	<b>41,823,726</b>	<b>5.90%</b>	<b>\$138.15</b>	<b>\$0.65</b>
<b>West Coast Total</b>	<b>3,086,779,646</b>	<b>57,410,101</b>	<b>22,299,400</b>	<b>3.90%</b>	<b>6.30%</b>	<b>21,086,527</b>	<b>64,099,945</b>	<b>6.00%</b>	<b>\$143.91</b>	<b>\$0.63</b>

### VACANCY & AVAILABILITY



### HISTORICAL NEW CONSTRUCTION & CAP RATES



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