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# Q1 2018 MARKET REPORT

## Los Angeles, CA Industrial (San Gabriel Valley Submarket)

## OVERVIEW

The Los Angeles industrial market has reported extremely strong fundamentals and growth metrics for some time now, with key market indicators for both the overall economy and real estate market trending in a positive direction and consistently topping record-breaking levels. Unemployment in the month of February was 4.5%; unchanged from January and down from 4.9% from one year ago. With an adult population over 8.6 million in Greater Los Angeles (including very dense residential communities and strong household income levels), the region has become the center of focus in the e-commerce world. This explosive growth industry coupled with strong trade volume at the ports have translated into historic demand for industrial space. Online sales will continue to outperform growth in total retail sales, and the National Retail Federation projects that import volume will be up nearly 5% in the first half of 2018. The need for warehousing and distribution space shows no signs of diminishing. In addition to low unemployment, the economy is humming near top speed with tax cuts, low interest rates, and overall good financial health of the market's tenant base. Demand has been especially strong in Logistics & Distribution, Apparel, and Manufacturing sectors. The arrival of newer needs such as legalized cannabis have also contributed to the already pent-up industrial demand.

## MARKET REVIEW

Despite record-breaking development levels in 2017 (6.7 million square feet), and a massive inventory base of over 900 million square feet, the industrial market's all-inclusive vacancy rate is still one of the lowest in the country at 2.5% overall. Some reports that may use smaller market samples limiting the inclusion of flex-style product or less relevant submarkets quote vacancy rates as low as 1.3%, putting Los Angeles at the lowest vacancy rate in the country. Net absorption in the overall market was actually negative (1,254,536) square feet in the first quarter 2018, which compares to positive net absorption over 2,000,000 square feet in each of the prior two quarters. The intense swings in net absorption speak to both the elevated construction activity in the market, as well as the extreme speed as to which available space is absorbed by tenants. Tenants are competing for space and overbidding in some cases to secure the right location. More than 60% of new product delivered this quarter was pre-leased. Notable leases during Q1 2018 include Glenair occupying a 520,000 SF building in Arcadia, and RIM Logistics leasing over 310,000 SF in Santa Fe Springs.

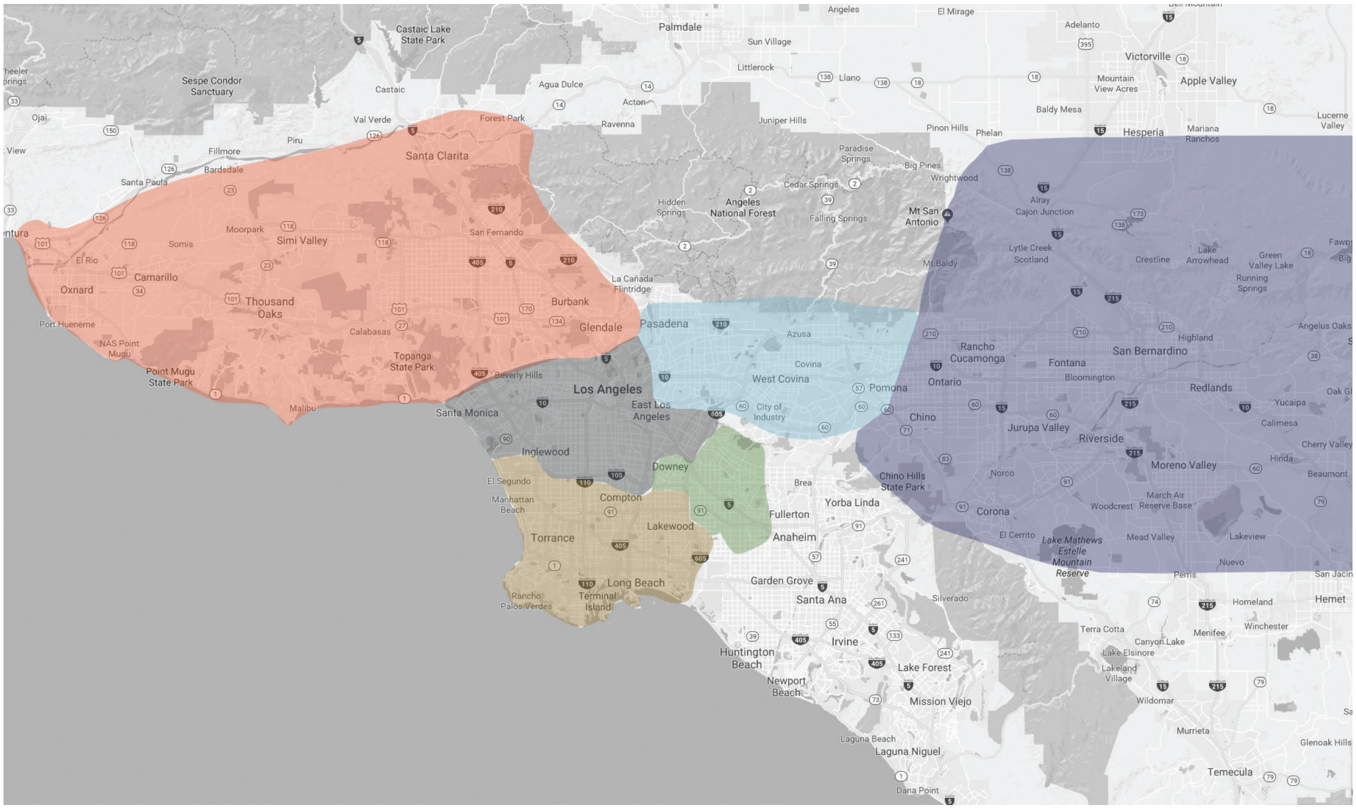
The average quoted asking rental rate for available industrial space (excluding flex space statistics) overall stood at $10.88/SF at the end of the first quarter 2018, up from $10.52/SF at the end of 2017, and up from $8.96/SF a year ago. As rates are typically quoted on a monthly basis on the West Coast, this new record high of $0.90/SF is creating a situation where users and landlords are at a disconnect on length of term. Renewals remain common, and while tenants attempt to push for shorter-term extensions, landlords insist on five-year commitments or longer to continue to escalate rates. The competition in the market limits relocation options and significantly reduces leverage in renewal negotiations.

| | Vacancy (%) | | Asking Rates / SF | |
|---|---|---|---|---|
| Period Ending | U.S. | LOS ANGELES | U.S. | LOS ANGELES |
| Q1 2018 | 4.7% | 2.3% | $6.32 | $10.88 |
| Q4 2017 | 4.7% | 2.0% | $6.16 | $10.52 |
| Q3 2017 | 4.8% | 2.1% | $5.96 | $9.44 |
| Q2 2017 | 4.8% | 2.1% | $5.86 | $9.28 |
| Q1 2017 | 5.0% | 2.2% | $5.74 | $8.96 |
| 2016 | 5.0% | 2.1% | $5.65 | $8.82 |
| 2015 | 5.6% | 2.2% | $5.30 | $8.25 |
| 2014 | 6.3% | 3.1% | $5.04 | $7.54 |

In a market where small footprints have been uncommon for some time, more and more tenants are now demanding availability for this market's definition of "medium" sized blocks of space (100,000-200,000 square feet), which has led to increasing investor purchase and construction activity in the submarkets where land is still available. In the market areas considered here, hardly any land is available for new construction. Therefore, the rise of the Inland Empire Market (East of Greater Los Angeles / starting at the San Bernardino County border) has become the haven for industrial relocation, often at slightly lower rental rates and operating expenses, especially real estate taxes. However, even these rates are showing steady increases year-over-year as demand continues to outpace new supply.

Rental rates vary by submarket, as well as by site finishes and property attributes, which is largely influenced by the age of the buildings. In the LA market, Class A and B industrial space are separated by a 10-20% premium for first-generation space with more modern specifications. Older product (15+ years) is typically listed at a $1.00 - $2.00/SF discount to the market average. It is common to see rental agreements with 3.0% annual base rent increases or more. Properties of all ages are typically equipped with drive-in doors and dock-level doors, as local distribution is common in the market. ESFR sprinkler systems are standard in new construction, but are not necessarily present in older product. Landlords are willing to upgrade older buildings with ESFR, but with concessions only offered for tenants willing to pay top dollar rental rates. Clear heights in the area's newest buildings are 32'+, whereas existing product more than 15 years old is likely to be at or below 24'. Traffic patterns can be a major location driver depending on a tenant's use and required reach.

Landlords are demanding that typical lease terms are 5 years in duration, with very little, if any concessions. The most creditworthy tenants are sometimes capable of obtaining 1-2 months of free rent OR the same value in a tenant improvement allowance (approx. $0.75-$1.50/SF). The amount of tenant improvements provided depends on term length, tenant creditworthiness, and the age of the building. Most arrangements are NNN with the tenant reimbursing for maintenance, real estate taxes, and insurance. These operating expenses average approximately $1.50 - $2.50/SF, but may be higher in higher tax cities. Some spaces are quoted all-in on an Industrial (Modified) Gross basis with maintenance responsibilities completed by the Tenant. The market has seen property owners get aggressive for longer-term commitments (10+ years) by offering additional concessions and increased tenant improvement dollars. However, options are limited for tenants seeking these 100,000-200,000 square foot blocks of space and there is stiff competition for newer product with modern specifications.




San Fernando Valley / LA North
Central Los Angeles
San Gabriel Valley
Mid Counties
Inland Empire
South Bay

## SUBMARKETS

The Greater Los Angeles industrial market is generally divided into five major submarket regions:

- Greater San Fernando Valley (or "LA North")
- Central Los Angeles (includes Downtown, Commerce/Vernon areas, and Westside)
- South Bay
- Mid-Counties
- San Gabriel Valley

It is worth noting outlying markets that are often evaluated in conjunction with the Greater LA market. This includes:

- Ventura County
- Orange County (including Anaheim, Irvine, etc.)
- Inland Empire (San Bernardino County)

When focusing specifically on the San Gabriel Valley submarket, the area overall is realizing rental rates which average in the $0.75-$0.79/SF/Month range. The Valley consists of 31 cities and 400 square miles, comprised of many individual communities and business parks. Rates have been rising overall, as construction completions hit record-high levels into this quarter (1 million square feet remain under construction today). However, the market is becoming a tight-infill landscape with few opportunities remaining to develop additional new space.

The submarket itself can be split into smaller distinct industrial market tracts as well. The Lower San Gabriel Valley (essentially, the City of Industry) possesses the largest amount of inventory within one city in the Greater LA market, and also has some of the highest rental rates. The rates here can reach the high $0.80's/SF/Month. The area also has higher taxes than its Upper San Gabriel Valley counterparts, one of the larger drivers of these increased costs. On the other hand, the Upper San Gabriel Valley (Irwindale, Azuza, Baldwin Park, etc.) still leases at a slight discount to the City of Industry, closer to the averages for the entire submarket, within the mid $0.70's/SF/Month. The area has seen one of the highest historical growth rates per year over the last 6 quarters and has seen heightened positive net absorption north of 300,000 SF in multiple quarters over the last year.

The San Gabriel Valley overall has had significant rental rate increases as of late, as the submarket runs out of developable land due to high construction levels over the last few years. The increased level of deliveries has pushed average rates to the mid to high $0.70's/SF/Month, but $0.80/SF+ quotes are trending in certain parks. Higher rates in the San Gabriel Valley has pushed construction activity into the Inland Empire, where users can expect a 10%+ discount on rates.

The other respective LA submarket rental rates can vary significantly due to supply, access to transportation corridors and proximity to coastal ports, and generally decrease as you move away from the Ports of Long Beach/Los Angeles in the southernmost part of the market. Brokerages reported estimated average rates for South Bay transactions at approximately $0.92-$0.95/SF/Month. Moving further north into the Mid-Counties area, which includes significant pockets of industrial space (especially in Santa Fe Springs, La Mirada, etc.), the rates are slightly lower at approximately $0.78-$0.82/SF/Month. Central LA is divided into the Downtown LA area, which also has very high rent (estimated to be in the high $0.80's/SF/Month) due to a lack of available land, and the Commerce/Vernon area with lower rents ranging from $0.67-$0.75/SF/Month. The "Westside" submarket does not have enough industrial inventory or activity to be relevant to the industrial market. The San Fernando Valley or northernmost submarket areas experience less activity than the other submarkets, due to the lack of developable land and high-quality space. Though rents average in the range of $0.79-$0.84/SF/Month, they are not expected to increase at the same growth rate as areas with potential for substantial new construction. Outlying Ventura County property (even further north) sees a discount from the inner-ring markets, with expected rates in the mid to high $0.60's/SF/Month.

*Data used in this report is based on publications from CoStar Realty Information Inc., various national brokerage market report publications and Allegro interviews conducted with multiple local market broker relationships.*

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