Kidder Mathews

Year-End 2017

Real Estate Market Review

West Coast Industrial

Industrial's strong run continues into 2018 as the e-commerce industry expands into uncharted territory. 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 all other property types.

Leasing has kept up with supply, though much of the product delivered prior to 2016 was build-to-suit. In turn, rents have grown vigorously since the first quarter of 2015. Spec projects account for a greater proportion of recent deliveries and projects under construction, and while leasing velocity has been impressive, the waters will be tested in 2018 when new supply enters the market at record-breaking levels. Since hitting a peak in 2016, sales volume has moderated through 2017, while prices reached new highs.

Robust industrial demand continues to drive outsized rent growth, 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 2017, industrial vacancies were near or at historical lows in most markets. Absorption in 2017 exceeded 47.6 million square feet, surpassing the previous cycle's peak by about 20%. Reconfigurations of supply chains to accommodate e-commerce is driving this demand. Demand is forecast to decline slightly in 2018 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 the first quarter of 2017. It then recovered by the end of 2017, giving that market a total of almost 14 million square feet of positive absorption for 2017, which led the pack on the West Coast. Phoenix had a total of just over 10.1 million square feet of positive absorption, Seattle almost 6 million square feet, Los Angeles just over 5 million square feet, Sacramento 5 million square feet, and Portland came in at just over 2.7 million square feet for 2017.

Data Source: CoStar

Overall Market Breakdown

	2017	2016	2015	ANNUAL % CHANGE
Completed Construction	45,823,350	44,128,228	46,756,122	3.8%
Under Construction	54,303,452	38,541,914	40,996,439	40.9%
Vacancy Rate	3.9%	3.8%	4.3%	2.6%
Availability Rate	6.1%	5.9%	6.7%	3.4%
Asking Lease Rate	$0.75	$0.63	$0.55	19.1%
Lease Transactions	147,123,642	218,846,548	218,639,386	-32.8%
Sale Transactions	107,925,305	115,145,124	145,624,312	-6.3%
Net Absorption	47,617,207	57,716,061	61,513,800	N/A

Market Reviews

Seattle

5.6M SF	3.0%	6.0M SF	$0.75
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

Fueled by a major port and a vibrant local economy, vacancies in the Seattle industrial market continue to fall to new cycle lows, with rents rising to new post-recovery highs. However, this is a builder's market, and as construction ramps up to meet demand, occupancy gains and rent growth could face near-term pressure. Institutional investors appeared to tread with caution in 2017, as sale volume lagged behind 2015 and 2016 levels.

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Portland

3.3M SF	3.6%	2.7M SF	$0.66
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↔	↑	↑	↑

Favorable demographics, increasing housing construction, low vacancies, and exposure to trade through a moderately sized seaport all contribute to the strength of this growing regional industrial market. Companies that continue to expand their presence in Portland include third-party logistics firms, retailers/wholesalers, and suppliers to the local market. Above-average cumulative rent growth and very reasonable yields help boost returns, putting them in line with the benchmark average. Sales volume peaked in 2016 before slowing in 2017, but cap rates remain in the 5-6% range on average.

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Oakland / East Bay

2.2M SF	3.5%	163K SF	$1.08
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

East Bay industrial landlords continued to benefit from robust demand during the fourth quarter of 2017, while developers and institutional buyers raced to provide high-quality distribution spaces to capitalize on the sizzling market. The vacancy rate was 3.5% marketwide at year's end, and virtually all submarkets were well below 5%. An increase in availabilities, driven in part by cycle-high construction levels, allowed for 1.6 million s.f. of fourth-quarter leasing activity, with more likely to come in the first half of 2018. State-of-the-art spaces have enjoyed a 20% jump in rents over the past 12 months, attracting investors from around the country to purchase, renovate, and reposition industrial assets along Interstate 880.

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San Francisco / Peninsula / San Mateo

50K SF	2.2%	125K SF	$1.37
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	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.

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Silicon Valley

607K SF	2.8%	498K SF	$1.08
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↔	↓	↓	↔

The Silicon Valley market revolves around the tech industry, limiting opportunities for industrial tenants to grow and expand in the San Jose metro area, which has been slow to recover from an absorption standpoint this cycle. More affordable rents and superior infrastructure make the East Bay a more attractive location for Bay Area users than Silicon Valley. Nonetheless, increased demand over the past 36 months has fueled the delivery of the first round of new supply this cycle, which began to come on line in late 2016. Rents have been robust against this new supply, but buyers continue to target redevelopment projects rather than investment or owner-user assets, furthering the notion that industrial is not the highest and best use in Silicon Valley.

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Sacramento

547K SF	6.3%	5.0M SF	$0.47
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↓	↓	↑	↑

Despite abundant logistics product and proximity to major distribution hubs like the East Bay and Reno, the Sacramento industrial market typically depends on demand from local and regional tenants. One notable exception, however, is the demand created by Amazon, which opened its first fulfillment center in the metro in 2017. Sacramento's vacancy rate has declined impressively over the past few years after peaking above 14% in 2010, now falling well below the historical average. Following multiple years of stagnant growth because of the recession, metro rents have increased each year since 2013, to a new record high. Small local players and owner/users typically drive sale activity in the metro area, but deal volume reached an all-time high in 2017, with nearly $800 million worth of product transacting and bringing in several buyers from outside the region.

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Reno

4.5M SF	4.8%	3.8M SF	$0.37
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↑	↑	↑

Reno's economy has traditionally been weighted heavily toward two sectors: Trade, and Leisure and Hospitality. A more diversified post-recession economy is lending itself to a growing logistics market, facilitated by the metro's role as a conduit between the Western states as well as minimal regulations of interstate commerce. Reno has experienced outstanding rent growth since 2013, and vacancies are well below the metro's historical average, driven down in part by Tesla's new Gigafactory. Construction volume slowed significantly in 2017, after a very busy 2015 and 2016, but developers are now racing to meet fierce demand from inbound users and local tenants eager to expand. Investment activity in 2017 was more than double the area's historical average.

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Los Angeles

4.3M SF	1.8%	5.1M SF	$0.85
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↑

Industrial development in LA is typically characterized by persistent demand and slow supply growth, creating one of the strongest, most stable markets in the nation. 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 slightly above historical lows set in the fourth quarter of 2016, and that rise is largely supply-driven. New industrial construction has remained far below historical levels for most of this cycle, but several years of outsized rent growth are finally driving an upswing in development. The lack of buildable land puts a structural limit on supply additions. These constraints and strong demand should continue to give landlords the upper hand, and growth in rents will most likely continue to exceed the national benchmark. Despite these favorable factors, extremely low cap rates continue to limit overall investor returns in this market.

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Orange County

1.1M SF	2.6%	-412K SF	$0.85
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↑	↓	↑

Proximity to 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. Western Realco is developing the next significant campus in Orange County—Beckman Business Center in Fullerton—where several buildings can house a larger user. Investors continue to target Orange County, with notable campuses and distribution facilities selling over the last few years, though many major transactions are precursors to redevelopment.

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Inland Empire

22.4M SF	5.2%	13.8M SF	$0.53
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↓	↑	↑	↑

Inland Empire 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, with access to freeways and cheap, abundant product, this hub has grown by over 100% since China joined the World Trade Organization in December 2001, increasing trade and port traffic. With over 260 million s.f. of space delivered since then, growth in the Inland Empire has been unmatched by that of any other market. Trade volume remains strong in the ports and developers continue to build with expectations that the Inland Empire will continue to grow. More than 22 million s.f. of future space was under construction at the close of 2017, a majority of which was speculative development. Investment totals in the market continue to eclipse historical averages.

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San Diego

3.2M SF	4.4%	1.7M SF	$1.04
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	ASKING LEASE RATE
↑	↓	↑	↔

San Diego is the smallest logistics market in Southern California, seeing minimal spillover from the Long Beach and Los Angeles ports, although the trends toward same-day delivery has facilitated growth in the past several quarters. Last-mile carriers have been responsible for some of the largest recent transactions completed here. Despite the relatively slow growth, limited construction coupled with the redevelopment of industrial facilities into higher and better uses has dampened supply, while healthy demand has solidified the market's fundamentals and rents. Investment is typically tied to local players trading smaller properties, although institutional capital occasionally flows into San Diego, making a splash when industrial campuses sell.

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Phoenix

6.5M SF	8.0%	10.1M SF	$0.58
UNDER CONSTRUCTION	VACANCY	NET ABSORPTION	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 MSA, and in the southwest valley in particular, make it a popular target for developers. Strong population and job growth trends in Phoenix, and in the Southwest as a whole, are bolstering a growing consumer base. Overall, approximately 35 million consumers can be served within a single day's truck haul from the metro. With relatively few barriers to development and positive demographic trends, Phoenix has emerged as one of the fastest-growing industrial markets in the country, and logistics spaces accounted for nearly 90% of the new supply in 2017. Demand has outpaced the influx of deliveries, compressing vacancies to well below the market's historical average, though rent growth decelerated in 2017. With more than 8 million square feet under construction at the end of the year, supply-driven pressure on fundamentals could further slow rent gains moving forward.

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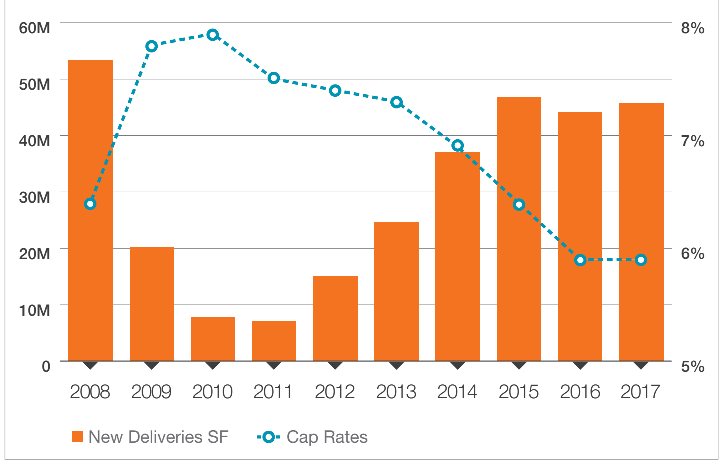
Year-End 2017 West Coast Industrial Statistics

	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	286,500,934	5,572,118	3,563,794	3.0%	5.9%	5,992,989	12,858,177	6.1%	$158.12	$0.75
Portland	186,489,214	3,337,662	2,765,423	3.6%	5.3%	2,744,109	7,410,731	6.2%	$88.82	$0.66
Pacific Northwest	**472,990,148**	**8,909,780**	**6,329,217**	**3.2%**	**5.7%**	**8,737,098**	**20,268,908**	**6.1%**	**$130.80**	**$0.71**
Oakland / East Bay	142,593,659	2,202,526	792,349	3.5%	6.3%	163,031	5,465,084	6.5%	$128.59	$1.08
Peninsula / San Mateo	31,960,539	0	0	1.9%	3.3%	(13,291)	1,947,975	7.0%	$188.15	$1.35
San Francisco	19,439,767	46,500	0	2.7%	4.0%	138,057	838,068	5.6%	$402.43	$1.65
Silicon Valley	115,908,924	606,673	435,695	2.8%	4.5%	(497,883)	1,453,565	6.0%	$225.04	$1.08
Sacramento	166,359,209	547,350	1,574,789	6.3%	8.5%	5,001,884	8,987,319	6.7%	$104.74	$0.47
Reno	85,573,519	4,495,047	1,676,203	4.8%	4.8%	3,821,511	8,068,207	6.9%	$65.98	$0.37
Northern California	**561,835,617**	**7,898,096**	**4,479,036**	**4.3%**	**6.1%**	**8,613,309**	**26,760,218**	**6.5%**	**$144.75**	**$0.83**
Los Angeles	741,216,164	4,328,790	5,166,422	1.8%	4.2%	5,069,497	30,942,081	5.0%	$167.79	$0.85
Orange County	235,106,450	1,104,754	683,753	2.6%	4.7%	(411,930)	9,389,531	5.1%	$176.43	$0.85
Inland Empire	545,726,816	22,439,235	20,895,959	5.2%	6.1%	13,798,391	32,727,272	5.8%	$108.47	$0.53
San Diego	186,233,079	3,160,004	1,458,793	4.4%	7.5%	1,662,039	11,810,133	5.8%	$169.31	$1.04
Phoenix	309,769,830	6,462,793	6,810,170	8.0%	11.4%	10,148,803	15,225,499	7.1%	$84.00	$0.58
South West	**2,018,052,339**	**37,495,576**	**35,015,097**	**4.0%**	**6.2%**	**30,266,800**	**100,094,516**	**5.6%**	**$140.03**	**$0.74**
West Coast Total	**3,052,878,104**	**54,303,452**	**45,823,350**	**3.9%**	**6.1%**	**47,617,207**	**147,123,642**	**5.9%**	**$139.47**	**$0.75**

VACANCY, AVAILABILITY & LEASE RATES

HISTORICAL NEW CONSTRUCTION & CAP RATES



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