Industrial First Glance

2019 Quarter 1

Pre-Release Analysis of First Quarter 2019 Reis Findings in the Industrial Sector

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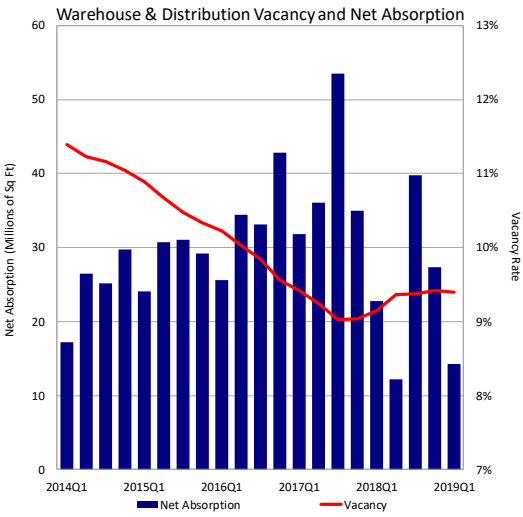
Another Tepid Quarter

Following a healthy second half of 2018, the industrial sector slowed a bit as net absorption was weaker than the prior two quarters. The overall economy seemed to decelerate a bit in the first quarter and news of a trade war threat was less prominent, but the issue remains unsettled. Fears of a tariff war had sent a chill through the industrial sector in the first half of 2018, which prompted less occupancy growth. Now the continued "tit-for-tat" tariff spat keeps many guessing as to how trade will fare in the coming months along with the warehouse/distribution and Flex/R&D sectors. Net absorption in warehouse /distribution of 14.3 million SF was below the 2018 quarterly average of 25.5 million SF. In flex/R&D, net absorption of 2.2 million SF was below the average for the previous two quarters but the vacancy rate fell 10 basis points.

Construction was lower in the first quarter for warehouse/ distribution but in line with previous quarters in Flex/R&D. The balance in supply and demand for warehouse/distribution kept the vacancy rate unchanged at 9.4%, up from 9.1% in the first quarter of 2018. In flex/R&D space, the vacancy rate fell to 9.7% from 9.8% at the end of 2018 and from 9.9% in the first quarter of 2018.

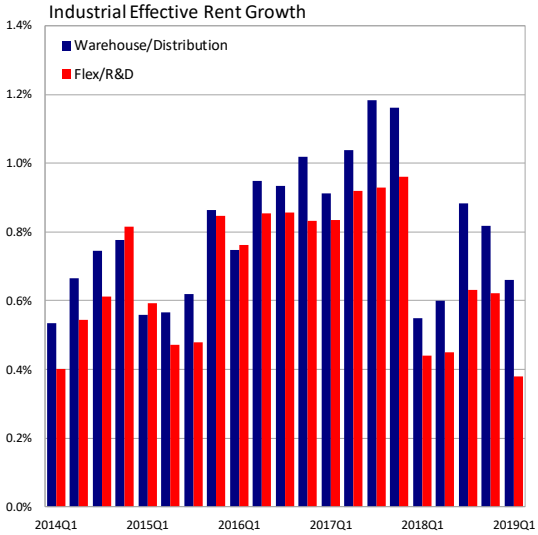
While these numbers reflect a static market, a number of metros had strong growth.

Warehouse and Distribution



Construction in the warehouse/ distribution market was 14.1 million SF in the first quarter, down from 33.1 million SF in the fourth quarter of 2018 and an average of 36.5 million SF in the previous four quarters. Net absorption of 14.3 million SF in the quarter was also lower than the 27.3 million SF absorbed in the fourth quarter. In the first quarter of 2018, net absorption was 22.7 million SF.

Consistent with this slower growth, the average asking rent grew by 0.6% in the first quarter, down from a rate of 0.7% in the fourth quarter but on par with the first quarter of 2018's 0.6%. In 2017, the warehouse/ distribution asking rent increased 1.0% per quarter, on average. The effective rent increased 0.7% in the first quarter, down from 0.8% in the fourth quarter but higher than the 0.5% growth in the first quarter of 2018. The annual growth rates for asking and effective rents were 2.8% and 3.0%, respectively, similar to the annual rates at the end of 2018.



Construction was spread out across a handful of metros as only four saw completions of 1 million SF or more –consistent with previous quarters. Dallas had the most growth with 3.1 million SF followed by San Bernardino/ Riverside 2.0 million SF, Chicago (1.3 million SF), Denver (1.2 million SF) and St. Louis (868,000 SF). Much of this space is pre-leased. These five metros accounted for 60% of the total completions and nearly half of total absorption in the quarter – San Bernardino alone saw 4 million SF of absorption which accounted for over a quarter of the national total.

Number of Metros with Improving/Flat or Declining Fundamentals
Combined Warehouse/Distribution and Flex/R&D

	Absorption		Occupancy		Effective Rent	
Q1 2019	33 +	14	23↑	24	43↑	4
Q4 2018	33 +	14	20↑	27	46↑	1
Q3 2018	41 +	6	27↑	20	47↑	0
Q2 2018	33 +	14	16↑	31	43↑	4
Q1 2018	41 +	6	21↑	26	44↑	3

Figures are based on 47 metro markets per subsector.

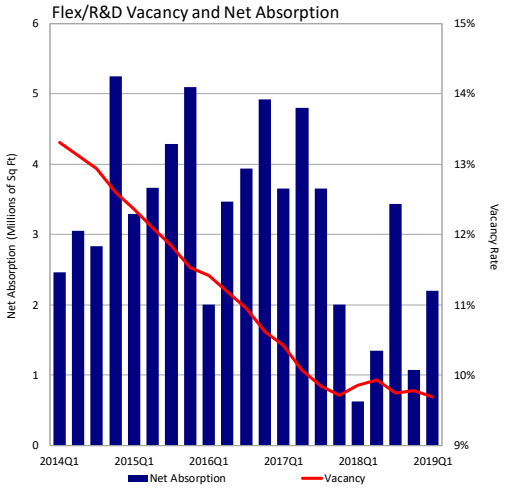
Once again a number of metros -- 15 -- saw negative net ab-

sorption in the quarter, up from 12 metros last quarter. The declines in occupancy were led by Kansas City (-772,000 SF), Central NJ (-762,000 SF), Nashville (-734,000 SF), Philadelphia, (-583,000 SF) and Long Island (-375,000 SF). Metros with the largest increase in vacancy, however, included these along with San Antonio, Suburban Maryland, Dallas and Orlando. With little to no new construction, Portland, Indianapolis, Fort Worth, Raleigh-Durham and Columbus all had the biggest drop in vacancy in the first quarter.

Nearly every metro saw positive rent growth in the quarter, led by Chicago, Phoenix, Portland, Raleigh-Durham and San Bernardino/Riverside that saw effective rent growth of 1.4% to 1.5% in the quarter. Only Central NJ saw a rent decline, of 0.4%, but eight metros saw no rent change including Pittsburgh, Cincinnati, San Francisco, Minneapolis and Boston. No metro incurred a rent decline over the year. Metros with the highest annual effective rent growth were Orlando, San Bernardino/Riverside, Chicago, Sacramento and Fort Worth with growth rates of 4.4% to 5.1% for the year.

Flex/R&D

New completions of flex/R&D space was 1.3 million SF, lower than last quarter's 1.6 million SF but below the average of 1.7 million SF added per quarter in the previous four quarters. However, this quarter's added inventory was above the average added each quarter in 2017 of 976,000 SF per quarter. Net absorption was relatively strong at 2.2 million SF in the quarter, the second highest of the last five quarters. In 2017, net absorption averaged 3.5 million SF per quarter.



The combination of healthier absorption and low completions pulled the vacancy rate down to 9.7% in the first quarter from 9.8% in the fourth quarter and 9.9% in Q1 2018. Thus, the market remains stable.

Rent growth in the flex/R&D space was again low at 0.4% (both asking and effective rates), down from 0.6% last quarter. At $10.10 and $9.11 per SF, respectively, the average asking and effective rents were 2.0% and 2.1% higher, respectively, than in the first quarter of 2018.

New completions were counted in five metros in the first quarter including Austin (687,000 SF), San Francisco (336,000 SF), San Diego (146,000 SF), Seattle (71,000 SF) and Fort Worth (14,000 SF). All of these saw positive net absorption. However, a number of others saw negative net absorption including Dallas, Houston, Detroit, Chicago and Atlanta – 24 metros in all. Metros with the highest net absorption were Memphis, Phoenix, Kansas City, San Diego and Fort Worth. Metros that saw the biggest increase in vacancy include Austin, San Francisco, Cleveland, Jacksonville and Dallas. Metros with the biggest decline in vacancy were Memphis, Nashville, Kansas City, Fort Worth and Phoenix.

Only four metros had effective rent growth of 1% or more in the quarter: Memphis, Phoenix, Fort Lauderdale and Pittsburgh. Yet eight metros saw a rent decline in the quarter, led by Houston, Jacksonville, Austin, Suburban Virginia and Cincinnati. No metro has a rent decline for the year, however.

Other Industrial Measures

The Institute for Supply Management's recent reading on manufacturing activity, the Purchasing Managers Index (PMI), rose to 55.3 in March from a low of 54.2 in February. At the end of 2018 it was 54.3. This diffusion index, for which any measure above 50 represents growth, averaged 58.8 in 2018. Thus, manufacturing activity has increased every month in 2018 but it has decelerated a bit over the last six months.

Separately, not only is the trade deficit widening, but aggregate trade in goods (exports plus imports) declined over the last few months. At $1.052 trillion from November through January, the trade in goods fell 2.1% over the prior three months, but it has increased 2.5% from the same period in 2018. Both exports and imports declined over the last three months but not significantly. Exports and imports had grown significantly in 2018 as businesses accelerated trade before the implementation of new tariffs. The recent slowdown may have been in response to this inventory build-up last year.

Nonstore (e-commerce) retail sales grew 10.1% in the first two months of 2019 over the first two months of 2018. Nonstore retail sales has consistently grown 10% annually since 2010.

Finally, the warehouse and storage industry added 16,500 jobs in the first quarter of 2019, slightly lower than the average quarterly growth of 2018, which was 21,000 jobs. Compared to the first quarter of 2018, warehouse and storage employment has grown 6.9%.

Outlook

The first quarter numbers were more sluggish than the two prior quarters, but they were in line with the first quarter of 2018 when the industry stalled in response to the trade war threat. The market remains in a healthy state as occupancy gains kept pace with new completions. The slowdown in absorption could be seasonal. Although the trade picture continues to look cloudy, e-commerce growth has been a perennial constant.

Consumption growth and job growth both decelerated in the first quarter but remain positive. Thus, our outlook for both warehouse/distribution and flex/R&D remains favorable given the continued growth in e-commerce, but we may see further deceleration in occupancy and rent growth this year.

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