# Industrial First Glance

**2018 Quarter 4**

Pre-Release Analysis of Fourth Quarter 2018 Reis Findings in the Industrial Sector

Barbara Byrne Denham
Senior Economist

New York — January 15, 2019

## Healthy Momentum but Flat Statistics

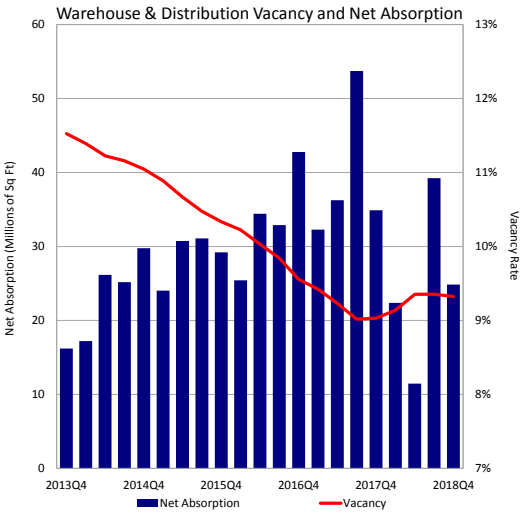
The industrial sector continued to see occupancy growth in the fourth quarter, but the somewhat flat vacancy and rent growth belie an otherwise healthy market. The status on the trade war did not change in the quarter. The winds of the tariff war had sent a chill through the industrial sector in the first half of the year, which prompted less occupancy growth. Growth resumed in the third quarter but was less pronounced in the fourth quarter numbers. Still, net absorption in warehouse /distribution of 24.9 million SF was above the average in the first two quarters of 16.9 million SF. In flex/ R&D, net absorption of 1.0 million SF was below the average for previous quarters but the vacancy rate increased only 10 basis points.

Construction was subdued in the fourth quarter for both categories. The balance in supply and demand for warehouse/distribution pulled the vacancy rate down to 9.3%, from 9.4% in the third and second quarter but up from 9.0% at the end of 2017. In flex/R&D space, the vacancy rate increased to 9.8% from 9.7% in both the third quarter as well as at the end of 2017.

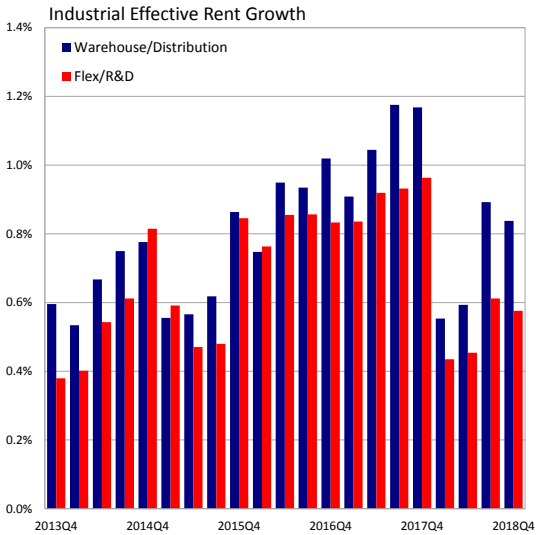
While these numbers reflect a tepid market, a number of metros show significant growth.

## Warehouse and Distribution

Construction in the warehouse/distribution market was 25.2 million SF in the fourth quarter, down from 43.4 million SF in the third quarter and an average of 32.7 million SF in the previous six quarters. Net absorption of 24.9 million SF in the quarter was also lower than the 39.2 million SF absorbed in the third quarter. In the fourth quarter of 2017, net absorption was 34.9 million SF.




Despite the tepid absorption, the average asking rent grew by 0.8% in the fourth quarter, the same rate as the third quarter yet higher than the growth rate of 0.6% in both the first and second quarter. In 2017, the warehouse/distribution asking rent increased 1.0% per quarter, on average. The effective rent also increased 0.8% in the fourth quarter, down from 0.9% in the third quarter. After decelerating in the first half, the annual growth rates for asking and effective rents were 2.8% and 2.9%, respectively, down from 3.9% and 4.4% at the end of 2017.




Once again, construction was spread out across a number of metros with eight metros seeing completions of 1 million SF or more – consistent with previous quarters. San Bernardino/ Riverside again saw the highest construction with 4.5 million SF followed by Atlanta (3.1 million SF), Dallas (1.9 million SF), Kansas City (1.3 million SF) and Fort Worth (1.3 million SF). Much of this space is pre-leased. These five metros accounted for 48% of the total completions and 43% of total absorption in the quarter.

The more puzzling finding was that 12 metros saw negative net absorption in the quarter, up from six metros last quarter. The declines in occupancy were led by Memphis (-642,000 SF), Phoenix (-535,000 SF), Nashville (-455,000 SF), Oakland (-422,000 SF) and San Antonio (-392,000 SF). Metros with the

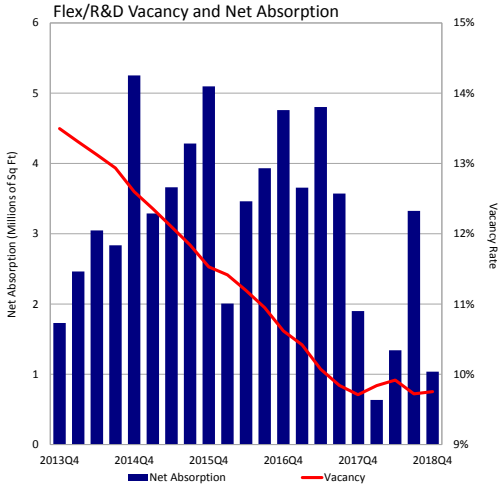
**Number of Metros with Improving/Flat or Declining Fundamentals**
Combined Warehouse/Distribution and Flex/R&D

| | Absorption | | Occupancy | | Effective Rent | |
|---|---|---|---|---|---|---|
| Q4 2018 | 33 + | 14 | 24↑ | 23 | 46↑ | 1 |
| Q3 2018 | 41 + | 6 | 27↑ | 20 | 47↑ | 0 |
| Q2 2018 | 33 + | 14 | 16↑ | 31 | 43↑ | 4 |
| Q1 2018 | 40 + | 7 | 21↑ | 26 | 44↑ | 3 |
| Q4 2017 | 40 + | 7 | 26↑ | 21 | 47↑ | 0 |

Figures are based on 47 metro markets per subsector.

largest increase in vacancy, however, included these along with Fort Lauderdale and Miami. With little to no new construction, Richmond, Columbus and Pittsburgh had the biggest drop in vacancy in the fourth quarter, but metros with the largest occupancy growth were the big ones: San Bernardino, Atlanta and Chicago with net absorption of 3.0 million SF to 3.3 million SF in the quarter.

Nearly every metro saw positive rent growth in the quarter, led by San Bernardino/Riverside, Tampa-St. Petersburg, Columbus, Atlanta and Orlando where the effective rents grew 1.2% to 2.0% in the quarter. Four metros saw flat growth in the quarter – Nashville, Portland, St. Louis and Pittsburgh -- but no metro incurred a rent decline in the quarter. For the year, metros with the highest rent growth were Orlando, Jacksonville, Sacramento, Kansas City and Fort Worth with growth rates of 4.2% to 4.9% for the year.




## Flex/R&D

New completions of flex/R&D space was 1.6 million SF, higher than last quarter's 1.1 million SF in the third quarter but below the average of 2.5 million SF added per quarter in the first half of 2018. This was also above the average added in 2017 of 871,000 SF per quarter. Net absorption slowed to 1.0 million SF in the quarter, the second lowest in eight years. In 2017, net absorption averaged 3.5 million SF per quarter. The combination of weak absorption and higher completions pushed the vacancy rate up to 9.8% in the fourth quarter from 9.7% in the third quarter and at the end of 2017. In other words, although occupancy growth was weak, the market remains stable.

Rent growth in the flex/R&D space was again low at 0.6% (both asking and effective rates) for the second quarter in a row. At $10.06 and $9.07 per SF, respectively, the average asking and effective rents were 1.9% and 2.1% higher, respectively, than at the end of 2017.

New completions were counted in twelve metros in the fourth quarter including Boston (438,000 SF), San Francisco (415,000 SF), San Jose (146,000 SF), Phoenix (123,000 SF) and Austin (100,000 SF). Only two of these, however, saw positive net absorption – Boston and San Jose. The others saw negative net absorption along with Philadelphia, San Antonio and Central New Jersey. Altogether, 18 metros incurred negative net absorption in the quarter up from nine metros with that distinction in the third quarter.

Metros that saw the biggest increase in vacancy include San Francisco, San Antonio, Phoenix, Kansas City and Pittsburgh. Metros with the biggest decline in vacancy were Suburban Maryland, Suburban Virginia, Cleveland, Jacksonville and Long Island.

Only three metros had effective rent growth of 1% or more in the quarter: Los Angeles, Oakland and Orlando. At the same time, five metros saw a rent decline in the quarter: Phoenix, Philadelphia, Atlanta, Indianapolis and San Antonio. 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), fell to 54.1 in December from 59.3 in November and a recent high of 61.3 in August. This diffusion index, for which any measure above 50 represents growth, averaged 59.2 in the first 11 months of the year. Thus, manufacturing activity increased every month in 2018 but it decelerated a bit in December. Separately, although goods imports is growing at a faster rate than goods exports, aggregate trade in goods (exports plus imports) continued to improve in recent months. At $1.076 trillion from August through October, the trade in goods increased 1.0% over the prior three months but climbed 9.8% from the same period in 2017. In other words, any increase in tariffs may have shifted trade away from some products and towards others, but trade overall is still growing. Finally, the warehouse and storage industry added 18,400 jobs in the fourth quarter of 2018, the largest quarterly increase since the first quarter of 2017. For the year, the industry expanded by 4.6% after growing 7.1% in 2017.

## Outlook

The fourth quarter numbers were a bit sluggish following a strong third quarter, but the market remains in a healthy state as occupancy gains generally kept pace with new completions. The slowdown in absorption in the first half of the year had been alarming given how much construction was underway. But two solid quarters suggest that any speculative development should see leasing activity.

Although the trade war issues remain unresolved, the impact of tariffs have not made a significant dent in the industrial sector, nor in the aggregate trade statistics that saw year-over-year growth every month this year. This is good news for the industrial sector as more goods entering and leaving the U.S. need to be stored.

Consumption growth has remained strong as has job growth, but the government statistics for the end of the year will be spotty due to the government shutdown. Thus, our outlook remains favorable that the industrial sector will withstand the impact from any tariff increases.