Industrial First Glance

2019 Quarter 2

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

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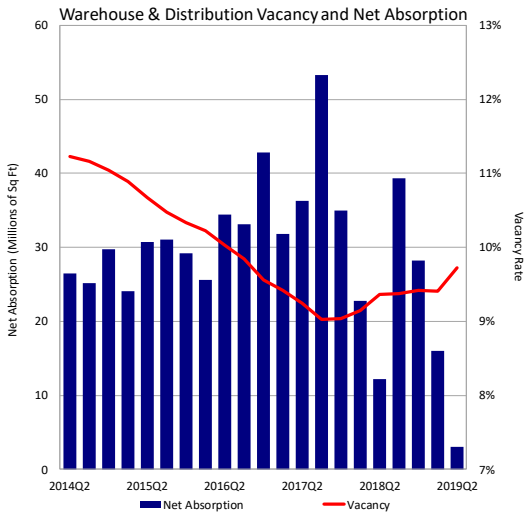
A Weak Second Quarter

Following a healthy second half of 2018 and a tepid first quarter, the industrial sector saw weakness in the second quarter as net absorption fell significantly. The deceleration in GDP growth along with the ongoing uncertainty stemming from the trade war constrained occupancy growth. Now the continued "tit-for-tat" tariff spat keeps many guessing as to how trade will fare in the coming months. This guessing game has and will continue to spill into the leasing market for the warehouse/distribution and Flex/R&D sectors. Net absorption in warehouse /distribution of 3.1 million SF in the second quarter fell far below the 2018 quarterly average of 25.6 million SF. In flex/R&D, net absorption of 126,000 SF represented a lackluster showing for the subsector but the vacancy rate remained flat nonetheless.

Construction was higher than the first quarter for warehouse/distribution but still lower than the average quarterly new construction figure for 2018. Construction for flex/R&D saw its weakest quarter since the second quarter of 2013. The balance in supply and demand for flex/R&D kept the vacancy rate unchanged at 9.8%, down from 9.9% in the second quarter of 2018. In warehouse/distribution space, the vacancy rate rose to 9.7% from 9.4% last quarter.

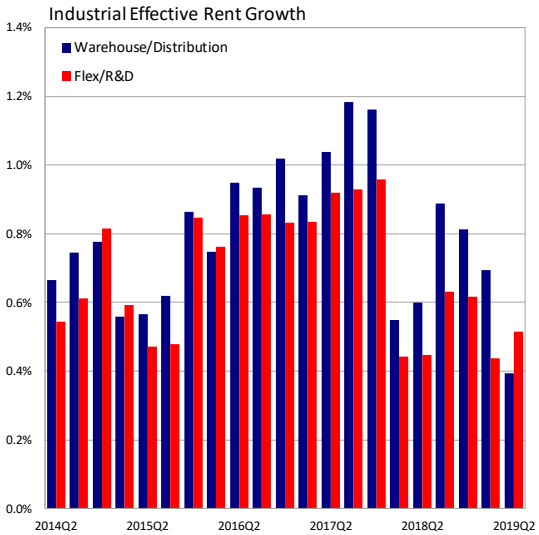
Warehouse and Distribution



Construction in the warehouse/distribution market was 26.5 million SF in the second quarter, up from 17.4 million SF in the first quarter of 2019. The second quarter figure still falls below the average of 35.1 million SF added each quarter in 2018. Net absorption of 3.1 million SF in the quarter was well below the 16.0 million SF absorbed in the first quarter. In the second quarter of 2018, net absorption was 12.2 million SF.

Rent Growth Slows As Well

Consistent with generally slower growth, the average asking rent grew by 0.5% in the second quarter, down from a rate of 0.6% in the first quarter. In 2017, the warehouse/distribution asking rent increased 1.0% per quarter, on average. The effective rent increased 0.4% in the second quarter, down from 0.7% in the first quarter. The annual growth rates for asking and effective rents were 2.7% and 2.8%, respectively, similar to the annual rates at the end of 2018.



Construction was spread out across a handful of metros as eight saw completions of 1 million SF or more – consistent with previous quarters. San Bernardino/Riverside had the most growth with 3.7 million SF followed by Atlanta with 3.6 million SF, Houston (2.7 million SF), Dallas (1.9 million SF) and Chicago (1.7 million SF). These five metros accounted for 51% of the total completions but two of the five saw negative absorption in the quarter.

Atlanta and Chicago were two of the 22 metros that saw negative net absorption in the quarter, up from 14 metros last quarter. The declines in occupancy were led by Chicago (-1.1 million SF), Columbus (-725,000 SF), Sacramento (-715,000

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

	Absorption		Occupancy		Effective Rent	
Q2 2019	25 +	22	13↑	34	40↑	7
Q1 2019	33 +	14	22↑	25	43↑	4
Q4 2018	34+	13	20↑	27	46↑	1
Q3 2018	41 +	6	27↑	20	47↑	0
Q2 2018	33 +	14	16↑	31	43↑	4

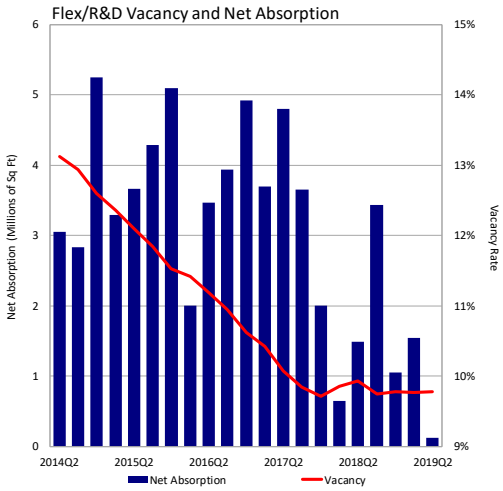
Figures are based on 47 metro markets per subsector.

SF), Atlanta, (-591,000 SF) and Orange County (-388,000 SF). Metros with the largest increase in vacancy, however, included these along with San Jose, Houston and Cincinnati. With little to no new construction, Suburban Virginia, Kansas City, Fort Worth, Fort Lauderdale and Boston all had the biggest drop in vacancy in the second quarter.

Most metros saw positive rent growth in the quarter, led by Charlotte, Jacksonville, Orlando, Dallas and Fort Lauderdale that saw effective rent growth of 1.0% to 1.4%. Metros that saw a rent decline include Memphis, Cincinnati, Philadelphia, Raleigh-Durham and Portland. No metro incurred a rent decline over the year. Metros with the highest annual effective rent growth were San Bernardino/Riverside, Orlando, Fort Worth, Chicago and Miami, with growth rates of 3.9% to 5.1% for the year.

Flex/R&D

New completions of flex/R&D space was 378,000 SF, lower than last quarter's 1.5 million SF. This quarter's added inventory is the lowest since the second quarter of 2013. Likewise, net absorption was weaker in the quarter at 126,000 SF. On the plus side, though both numbers were weak, the balance between supply and demand kept the vacancy rate at a steady 9.8% where it has remained for three consecutive quarters.



Rent growth in the flex/R&D space was higher than last quarter at 0.6% (asking) and 0.5% (effective). At $10.17 and $9.16 per SF, respectively, both the average asking and effective rents were 2.2% higher than in the second quarter of 2018.

New completions were counted in four metros in the second quarter including Boston (205,000 SF), Baltimore (124,000 SF), Phoenix (34,000 SF) and Central NJ (15,000 SF). At the same time, all of these saw negative net absorption. In total, 24 metros saw negative net absorption led by Cincinnati, Oakland-East Bay, Central NJ, Cleveland and Boston. Metros with the highest net absorption were Chicago, San Francisco, Philadelphia, San Antonio and Austin.

Metros that saw the biggest increase in vacancy include Cincinnati, Cleveland, Long Island, Oakland-East Bay and Central NJ. Metros with the biggest decline in vacancy were San Francisco, San Antonio, Austin, Richmond and Chicago.

Ten metros had effective rent growth of 1% or more in the quarter led by Jacksonville, Palm Beach, Phoenix, Nashville and Houston. At the same time, six metros saw a rent decline in the quarter, led by Columbus, St. Louis, Cincinnati, Boston and Long Island. No metro has a rent decline for the year, however.

Outlook

The employment statistics show that the warehouse and storage industry continues to add jobs every month. Year to date, the industry has added 19,900 jobs, a growth rate of 1.7%. Moreover, a look at the trade statistics shows that goods imports in the first five months of the year have risen 0.8% over the same period in 2018, while goods exports have risen 0.2%. In short, the threat of a continued trade war is still real, but these numbers suggest that the current tariffs have not hurt trade as significantly as the media has portrayed.

Second quarter numbers were lackluster, but in line with the first quarter of 2019 when the sector may have stalled in response to the trade war threat. With so little construction, however, the market remains in a balanced state as occupancy gains kept pace with new completions, at least in the flex/R&D space. There is no evidence of widespread contraction or negative effective rent growth. Although the trade picture continues to look cloudy, e-commerce growth has been a perennial constant—a bane for retail, but generally a boon for warehouse/distribution specifically.

Thus, our outlook for both warehouse/distribution and flex/R&D remains favorable, but the continued uncertainty from the trade war should keep occupancy growth at a slow pace.