LEE & ASSOCIATES

COMMERCIAL REAL ESTATE SERVICES

LOS ANGELES - LONG BEACH
INDUSTRIAL MARKET REPORT

3Q 2023

Slow Industrial Market as Inflation Looms

The U.S. economy is facing headwinds as inflation remains a deterrent and interest rates are high. GDP grew by 2.1% in Q2[1], a decline from 2.2% in Q1[2], and it is estimated to grow by 5.1% in Q3 by the Atlanta Fed[3]. In terms of employment, the BLS reports that 336,000 jobs were added in the month of September primarily for leisure and hospitality; government; health care; professional, scientific, and technical services; and social assistance. In September, employment in transportation and warehousing changed little (+9,000). Truck transportation added 9,000 jobs, following a decline of 25,000 in August that largely reflected a business closure. Air transportation added 5,000 jobs in September. Employment in transportation and warehousing has shown little net change over the year.[4] Wage growth declined from a peak of 9.3% in January 2022 to 4.4% in September slightly outpacing inflation[5], and the unemployment rate remained unchanged at 3.8%. With regard to inflation, both headline and core inflation continue to loom. The Consumer Price Index (CPI) rose by 3.7% year-over-year and 0.4% month-over-month in September,[6] representing a slight cooling from August's month-on-month increase of 0.6%. And core inflation, which excludes food and energy prices, for the 12 months ending in September 2023 was 4.1%, compared to the previous rate of 4.3%.[7] According to the U.S. Bureau of Labor Statistics, producer prices for trade services rose 2.3 percent from September 2022 to September 2023, while prices for transportation and warehousing services fell 5.7 percent. Annual decreases in transportation and warehousing prices have occurred in each of the last six months.[8]

Continued slower increases in core prices, combined with a jump in bond yields, may lead Federal policymakers to conclude that further rate increases this year are unnecessary. In fact, significant market actors such as PIMCO anticipate higher bond yields for the next 6-12 months and see core U.S. inflation settling between 2.5%-3% by the end of 2024. Unfortunately, because they anticipate the cost of debt to rise, they also anticipate GDP growth to either slow or stagnate to a mild recession in 2024.[9]

Regardless of one's stance on this issue, it is indisputable that the industrial market relative to other asset classes is in an excellent position to weather any headwind the economy might face. Total retail sales grew by 0.6% from Q2 2022 to Q2 2023[10], and as a percentage of total sales, e-commerce retail sales (one of the key drivers of the industrial sector) now stand at 15.4% – 1.0 percentage points higher than where it stood in Q2 of 2022.[11]

Note regarding lease rates: To give a better perspective on what one can expect to pay within each submarket, we have included both average asking rates as well as average deal rates where pertinent, as we are seeing some transactions with a substantial delta between "asking rate" and actual "deal rate."

1. *BEA: https://bit.ly/46op1uX*
2. *BEA: https://bit.ly/46op1uX*
3. *Atlanta Fed: https://www.atlantafed.org/cqer/research/gdpnow*
4. *US Dep of Labor: https://www.bls.gov/news.release/pdf/empsit.pd*
5. *CNBC: https://www.msn.com/en-us/money/markets/here-s-the-inflation-breakdown-for-september-2023-in-one-chart/ar-AA1i6kjN*
6. *WSJ: https://tinyurl.com/435vw7f2*
7. *US Inflation Calculator: https://www.usinflationcalculator.com/inflation/united-states-core-inflation-rates/*
8. *BLS: https://www.bls.gov/opub/ted/2023/producer-prices-up-2-2-percent-from-september-2022-to-september-2023.htm*
9. *PIMCO Insights: https://bit.ly/3LXpFaw*
10. *Census Bureau: https://bit.ly/41U047S*
11. *St. Louis Fed: https://bit.ly/2r6CLZd*

SOUTHBAY SUBMARKET

3Q Trends At A Glance

▲ **Absorption** 539,763 SF	▼ **NNN Rent Overall** $1.89 / SF	▲ **Sales Transactions** $260,871,801
▲ **Vacancy** 3.8%	▼ **Under Construction** 697,032 SF	▲ **Average Sales Price** $481.41 / SF

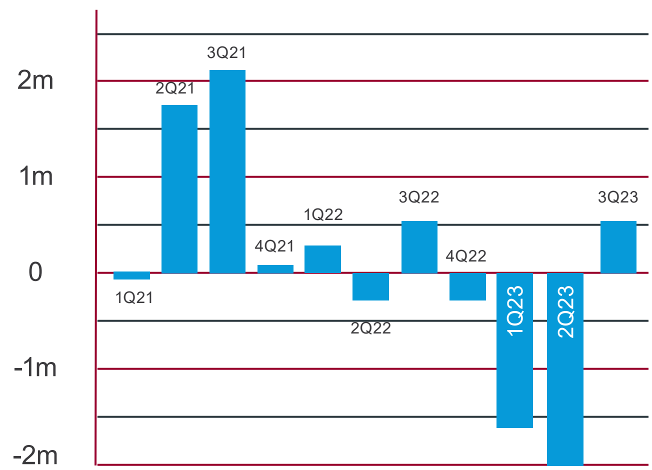
Source: Costar Realty Information Inc.

The vacant-available rate increased to 3.8%, which is 270 basis points above the rate from one year ago. The increase in vacancy in the South Bay can be attributed to the excess inventory levels stabilizing and lower import volumes from overseas. Prior to 2023, industrial tenants acquired additional space to keep up with pandemic induced demand. As the pandemic induced demand has waned, industrial tenants are offering their excess space up for sublease. In fact, vacant-available space now totals over 7 Million Square Feet (MSF) or 0.7%. For comparison, a year ago in Q3 2022, vacant-available space totaled 2 MSF or 0.1%.

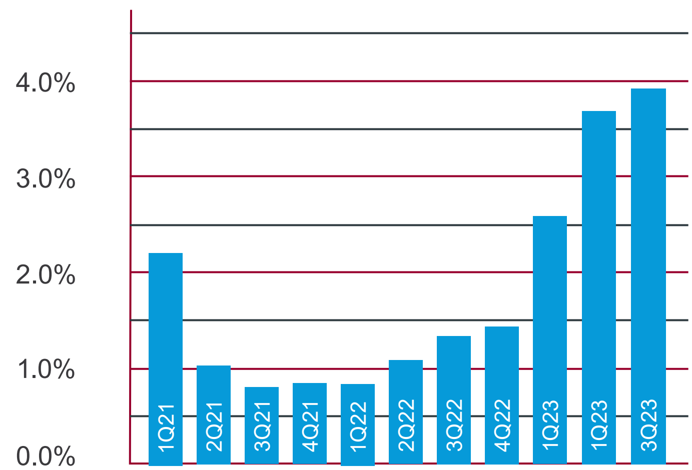
Only 54 deals were transacted this quarter and 11 of them were sublease deals. The decrease in transaction volume is attributed to the prohibitively high asking rates at approximately $2.05 NNN PSF for Class A buildings, despite a quarter-over-quarter decrease of 9.3%. In the prior quarters of 2023, lease comparable rates we on average $2.25-2.35 NNN PSF for Class A industrial space. The South Bay market has had a hindrance resolved with the ILWU labor dispute and continues to be the home of some of the world's busiest container shipping ports in the world. The South Bay market's proximity to the ports of Los Angeles and Long Beach is crucial for logistics and e-commerce tenants and there is a lot of opportunity on the horizon. For the first time in a decade, landlords will need to make favorable concessions and adjustments in rent to attract quality tenants. Throughout the remainder of the year, we expect this trend to continue and now is a crucial time to contact your local market expert to advise on your industrial real estate needs.

Unsurprisingly, capital market activity was subdued this quarter as most commercial real estate investors took a wait-and-see posture toward the economy. There has been a 34% decline in sales prices year-to-date and owner/users are finally in a position to compete with institutional capital. We anticipate investors to start deploying their capital by the middle of 2024, followed by improved leasing activity in the second half of the year.

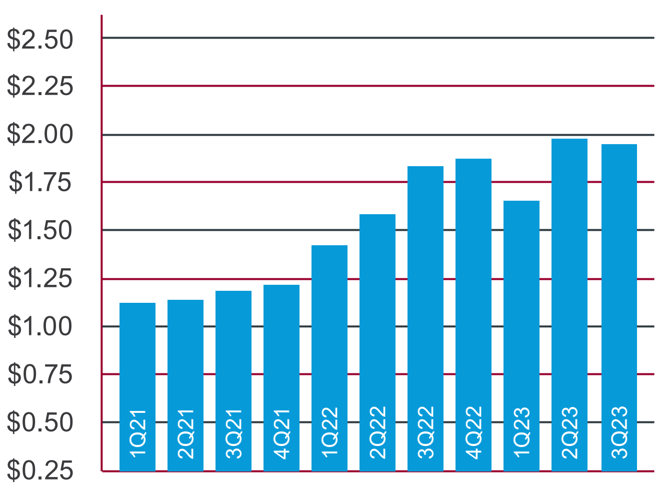
NET ABSORPTION



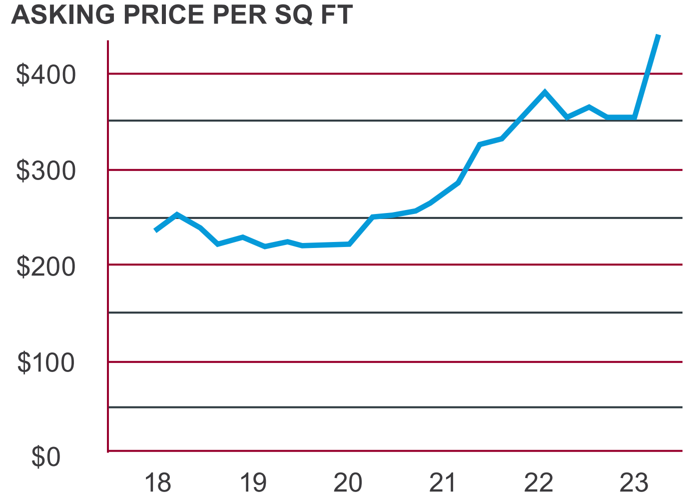
VACANCY

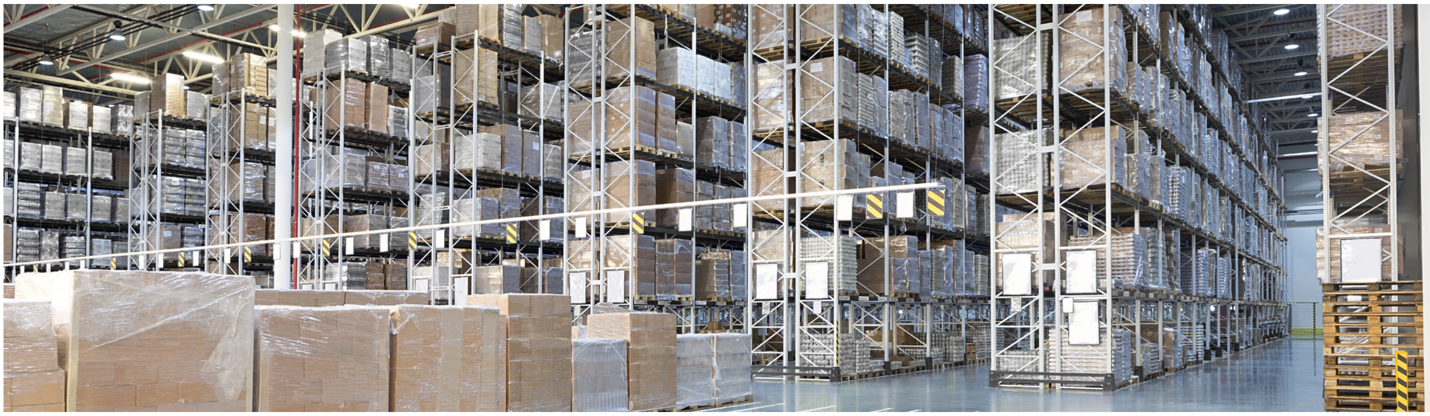


AVERAGE ASKING RENT BY QUARTER



ASKING PRICE PER SQ FT





TOP LEASES FOR 3Q23

Source: CoStar Realty Information Inc & AIR

ADDRESS	CITY	TYPE	TENANT	SQUARE FEET
1452 W KNOX ST	TORRANCE	DISTRIBUTION	NATIONAL ROAD LOGISTICS	442,550
14001-14003 ORANGE AVE	PARAMOUNT	WAREHOUSE	CASTLE METALS	282,000
1001 W WALNUT ST	COMPTON	WAREHOUSE	PINTO EXPRESS INC.	100,000

TOP SALES FOR 3Q23

ADDRESS	CITY	TYPE	SALES PRICE	SQUARE FEET
2500 E THOMPSON ST	LONG BEACH	WAREHOUSE	$20,300,000	174,691
20100-20200 S WESTERN AVE	TORRANCE	WAREHOUSE	$88,000,000	116,433
1210 KONA DR (PART OF A 3 PROPERTY SALE)	COMPTON	WAREHOUSE	$21,714,433	51,669

MID COUNTIES SUBMARKET

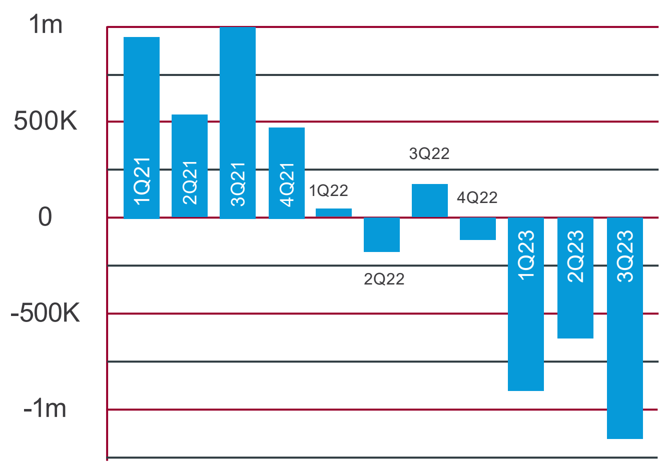
3Q Trends At A Glance

Absorption	(1,257,544)	▼
NNN Rent Overall	$1.65 / SF	▼
Sales Transactions	$264,243,620	▲
Vacancy	1.9%	▲
Under Construction	486,868	▲
Average Sales Price	$350.28 / SF	▲

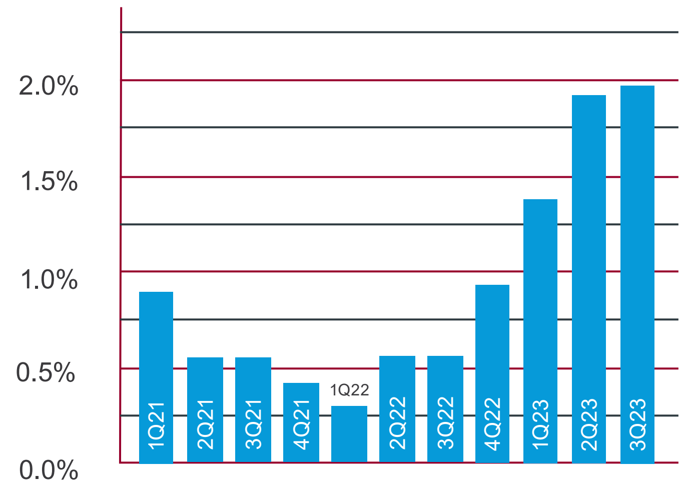
Source: Costar Realty Information Inc.

Mid-Counties continued to have the lowest vacancy rate of any major industrial submarket within Los Angeles at 2.8%. There is only about 2.0 MSF of direct vacant-available space on the market. As small as that number is, it represents an increase in vacancy for the submarket. Since Q3 2022, vacant-available space increased by over 2.4 MSF. One new building delivered this quarter, totaling over 23,000 SF, and seven buildings totaling over 486,000 SF are under construction. Overall asking rents increased to $1.67 NNN PSF, a year-over-year increase of about 8.4% from Q2 2022's rate of $1.54 PSF. Prepare renewing tenants for sticker shock as rents have nearly tripled over the past 10 years. Because of these tight conditions, buildings remain on the market for longer periods. Moreover, the financial strength of many prospective tenants in the market for buildings is not exceptionally strong. Unless they lower their prices, landlords will have to be more patient in leasing these buildings. Even with all these challenges facing the Mid-Counties, it remains a market industrial tenants want to occupy. For any industrial tenant looking for an alternative to the South Bay, they will most likely turn to either the Inland Empire or Midcounties.

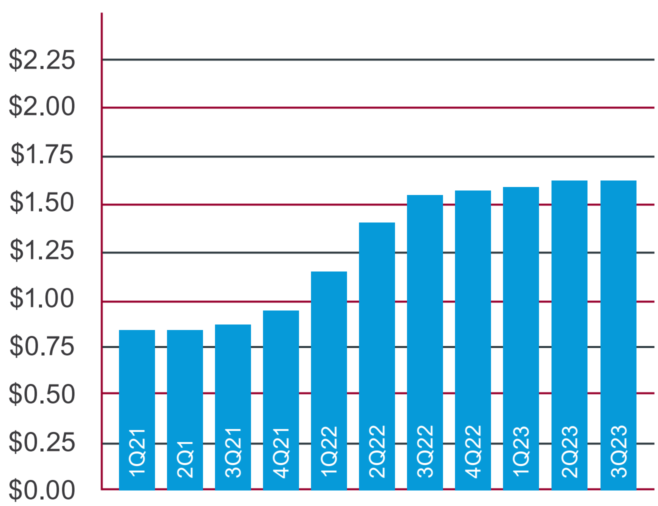
NET ABSORPTION



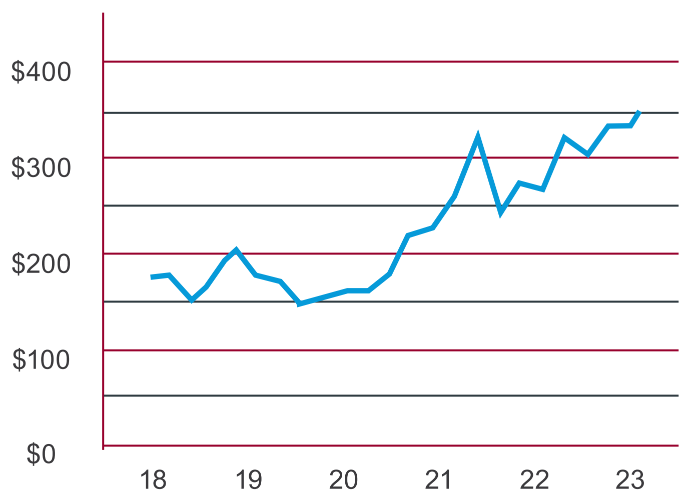
VACANCY



AVERAGE ASKING RENT BY QUARTER



ASKING PRICE PER SQ FT



CENTRAL SUBMARKET

3Q Trends At A Glance

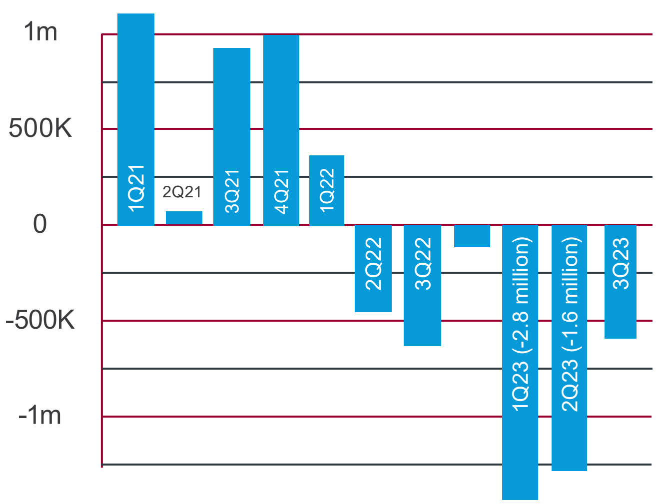
Absorption (568,287)	**NNN Rent Overall** $1.63 / SF	**Sales Transactions** $267,169,000
Vacancy 4.5%	**Under Construction** 778,050 SF	**Average Sales Price** $190.59

Source: Costar Realty Information Inc.

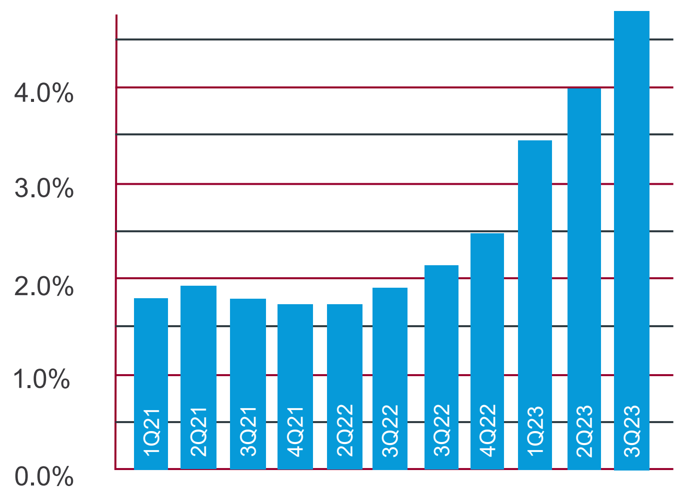
The vacancy rate in Central LA ended the quarter at 4.5%. There is now over 10.4 MSF of vacant-available space in Central LA. Contrary to what used to be the case for the past decade, Central LA has one of the highest vacancy rates among all the submarkets in the LA Basin now. One new building totaling over 40,000 SF was delivered this quarter, and eight buildings totaling over 778,000 SF are still under construction. Like nearly all the submarkets across the L.A. basin this quarter, net absorption was negative as occupiers shed excess space they acquired during the pandemic boom. As a result, the amount of sublease space increased dramatically this quarter. Year-over-year, sublease vacancy increased by 60 basis points from 0.1% in Q3 2022 to 0.7% in Q2 2023. In terms of square footage, there is now over 1.53 MSF of vacant and available sublease space on the market.

Net absorption numbers notwithstanding, the demand for functional industrial space is nearly insatiable in the Central submarket, and asking prices are now extremely high – although they are easing up a bit. Average asking rental rates are now $1.63 per square foot (PSF). This represents a quarterly decline of $0.07 or 4.1%. Industrial demand is heavily concentrated in the Vernon and Commerce submarkets, where food production and apparel manufacturing are the top industries. Commerce has a large concentration of food manufacturing tenants. The spaces these tenants occupy come at a premium and will continue to drive up asking rents. Although landlords have started to reduce their asking rents to placate occupiers who cannot afford to lease at current prices, the pace of reduction has been slower than expected. Nonetheless, expect the reduction in asking rents to continue over the next 18 months.

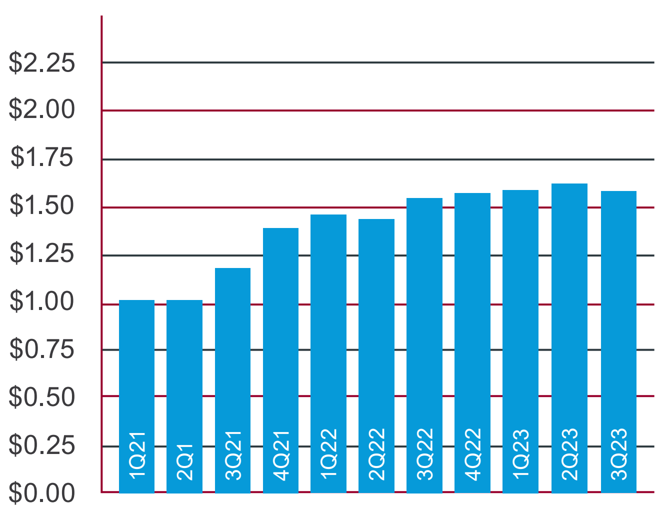
NET ABSORPTION



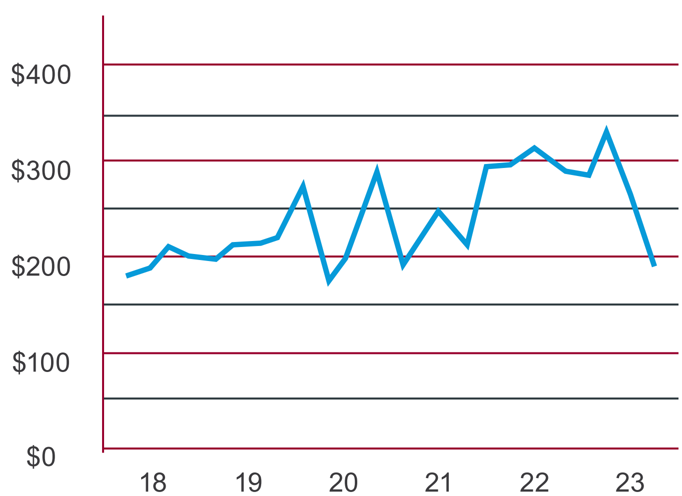
VACANCY



AVERAGE ASKING RENT BY QUARTER



ASKING PRICE PER SQ FT



INLAND EMPIRE SUBMARKET

3Q Trends At A Glance		
▲ **Absorption** (6,264,006)	▼ **NNN Rent Overall** $1.27 / SF	▼ **Sales Transactions** $723,740,356
▲ **Vacancy** 4.8%	▲ **Under Construction** 39,143,438 SF	▲ **Average Sales Price** $300.54

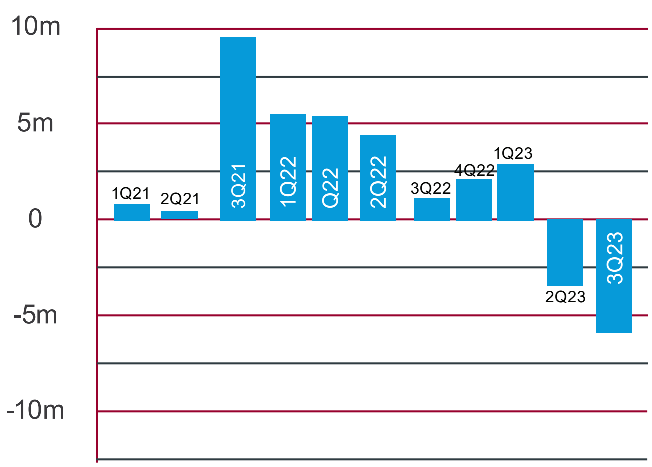
Source: Costar Realty Information Inc.

Like all the other submarkets in the LA Basin this quarter, the vacancy rate increased in the Inland Empire. By the end of Q3, more than 27.6 MSF of space was vacant and available. Compared to last quarter, the vacancy rate grew by more than 100 basis points to reach 4.1%. That the vacancy rate increased by so much is unsurprising given that 89 new buildings totaling over 13.9 MSF were delivered over the past three quarters. A significant plurality of these buildings were not pre-leased. In the pipeline there are 158 buildings totaling over 39.1 MSF under construction.

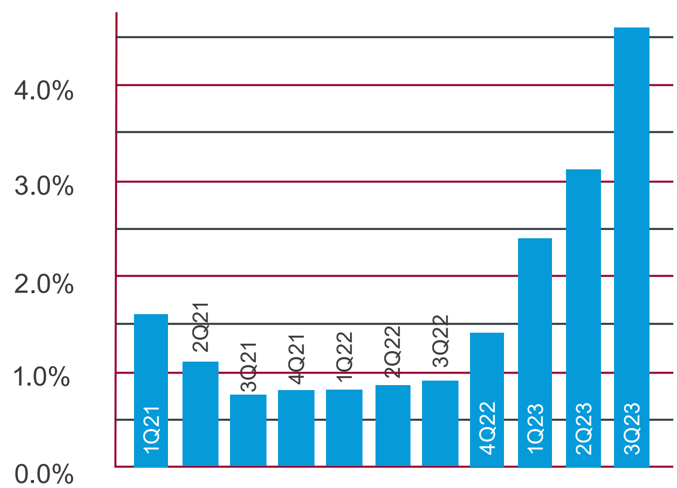
Net absorption for the quarter totaled was negative, as industrial occupiers continued the process of "right-sizing." Companies that expanded their warehouse/distribution space during the pandemic to keep up with the pandemic-fueled e-commerce boom have started to reduce excess space. The shedding of excess space is evident from the amount of industrial space placed on the market as available for sublease. Approximately 2.3 MSF of additional sublease space was put on the market in the second quarter, more than double the amount of sublease space vacant and available just a year ago. We anticipate that net absorption for the year will be positive as Amazon will occupy over 4 MSF in Q4 at 4707 Baker, the development Prologis custom-built for Amazon.

Although large occupiers receive most of the attention in the submarket, smaller properties under 50,000 SF have been doing remarkably well. Their vacancies are low and their lease rates are considerably higher than pre-pandemic levels.

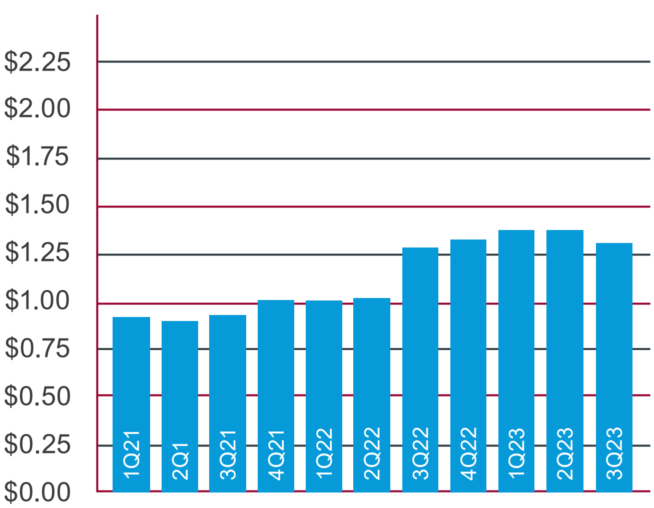
NET ABSORPTION



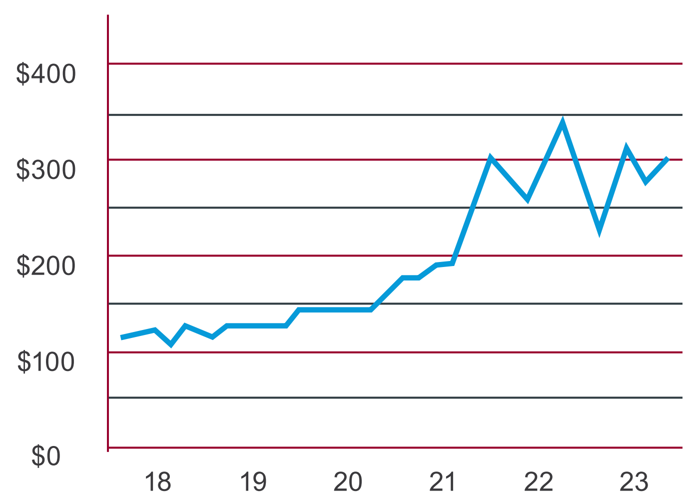
VACANCY



AVERAGE ASKING RENT BY QUARTER



ASKING PRICE PER SQ FT



3Q 2023 Looking Ahead

Investment activity in the industrial sector came to a halt in Q1 2023 after three years of record volume. Due to a 40-year high in inflation rate, interest rate levels not seen in two decades, and overall economic uncertainty, investors exercised caution and took a “wait-and-see” approach throughout 2023. We anticipate capital market investment in commercial real estate to proceed in a similar fashion in Q4. However, because of all the key indicators of the macro-economy still holding up – GDP is up, workers are at full employment, and both headline and core inflation is trending downward – expect capital market activity to resume by around Q2 of 2024, especially in the greater Los Angeles area. Even with the currently high cost of debt, the industrial market of the L.A. Basin remains a highly competitive and prized market for investors. That is especially so for the major players looking to expand their industrial portfolio in Southern California, since vacancy levels remain historically low and rent growth continues its positive momentum.

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