Q4 2019
Industrial First Glance

Pre-Release Analysis of Fourth Quarter 2019 Moody's Analytics REIS Findings in the Industrial Sector

TRADE WAR STILL AFFECTING INDUSTRIAL

The Industrial sector decelerated a bit in the fourth quarter as the trade war continued to hurt the sector. Net absorption in warehouse /distribution fell from 18.0 million SF to 14.0 million SF in the fourth quarter. This is was above the average in the first two quarters of 10.9 million SF, but far short of the average quarterly absorption figure of 2018, 26.2 million SF. In flex/R&D, net absorption of 1.4 million SF was in line with last quarter's figure and above the first two quarters' average of 1.0 million SF, and the vacancy rate declined by 0.1% for the second consecutive quarter due to lower construction.

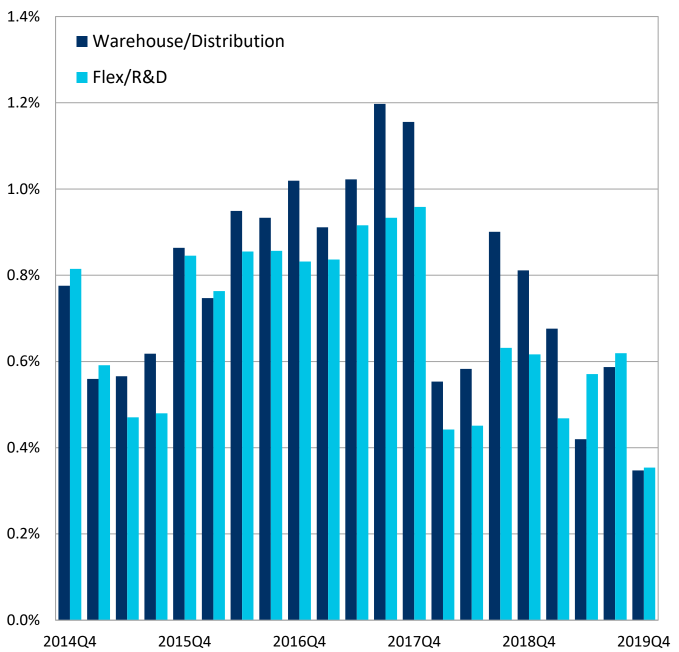
Construction in both warehouse/distribution and flex/R&D was lower in the fourth quarter. The balance in supply and demand for warehouse/distribution kept the vacancy rate steady at 9.9%, though this rate is up from 9.4% a year ago. In flex/R&D, the vacancy rate declined to 9.6% at year-end from 9.7% in the third quarter and is down 20 basis points from 9.8% a year ago as absorption exceeded very low supply growth.

While the national numbers were disappointing, some metros saw significant growth.

WAREHOUSE AND DISTRIBUTION

Net absorption in the warehouse/distribution market was 14.0 million SF in the fourth quarter, well above the nine-year low of 4.3 million SF in the second quarter but still half as strong as the quarterly averages in 2018 and just over one-third the quarterly average of 2017. Construction, meanwhile, saw the weakest quarterly total since the second quarter of 2015. At just 19.2 million SF, completions this quarter fell far below the quarterly average for completions in 2018, 35.8 million SF. Together, the balance of weak demand and supply growth kept the vacancy rate unchanged at 9.9% at year-end but still higher than the fourth quarter of 2018's vacancy rate of 9.4%.

INDUSTRIAL EFFECTIVE RENT GROWTH



Alongside weaker construction this quarter, the average asking and effective rents grew by just 0.4% and 0.3%, respectively, in the fourth quarter, the weakest quarterly growth since 2013. For perspective, the average quarterly asking and effective rent growth in 2018 was 0.7%. For the year, asking and effective rent grew by 2.1% and 2.0%, again falling short of the 2.8% asking rent and 2.9% effective rent growth seen in 2018.

Once again, construction was spread out across a number of metros with seven metros seeing completions of 1 million SF or more –consistent with previous quarters. San Bernardino/ Riverside again saw the highest construction with 3.9 million SF followed by Chicago (2.6 million SF), Atlanta (2.2 million SF), Los Angeles (2.2 million SF) and Baltimore (1.7 million SF). These five metros accounted for 65% of the total completions and 49% of total absorption in the quarter.

The more troubling finding was that 16 metros saw negative

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net absorption in the quarter, although this was down from 18 metros last quarter. The declines in occupancy were led by Detroit (-707,000 SF), Kansas City (-586,000 SF), Seattle (-552,000 SF), Fort Lauderdale, (-362,000 SF) and Philadelphia (-291,000 SF). Metros with the largest increase in vacancy, however, included these along with Fort Worth, Oakland and San Jose. With no new construction at all, Richmond, Central New Jersey, Charlotte and Columbus had the biggest drop in vacancy in the fourth quarter, but metros with the largest occupancy growth included these as well as Baltimore, Chicago and Dallas with net absorption of 2.1 million SF to 2.3 million SF in the quarter.

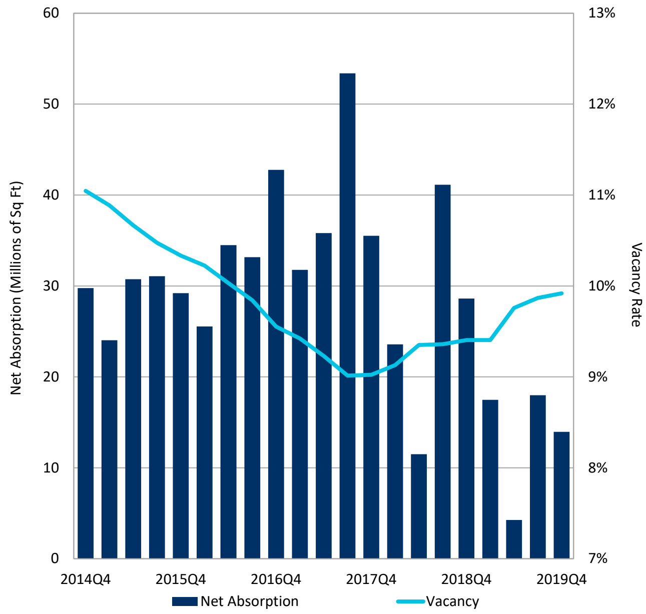
Most metros saw positive rent growth in the quarter, led by Memphis, Central New Jersey, Seattle, Austin and Sacramento where the effective rents grew 0.9% to 1.2% in the quarter. Five metros saw a rent decline in the quarter: Columbus, Cleveland, Denver, Palm Beach and San Jose with negative growth of 0.1% to 0.3%. For the year, metros with the highest rent growth were Sacramento, Orlando, Indianapolis and Tampa-St. Petersburg and Baltimore with growth rates of 3.2% to 4.2% for the year.

FLEX/R&D

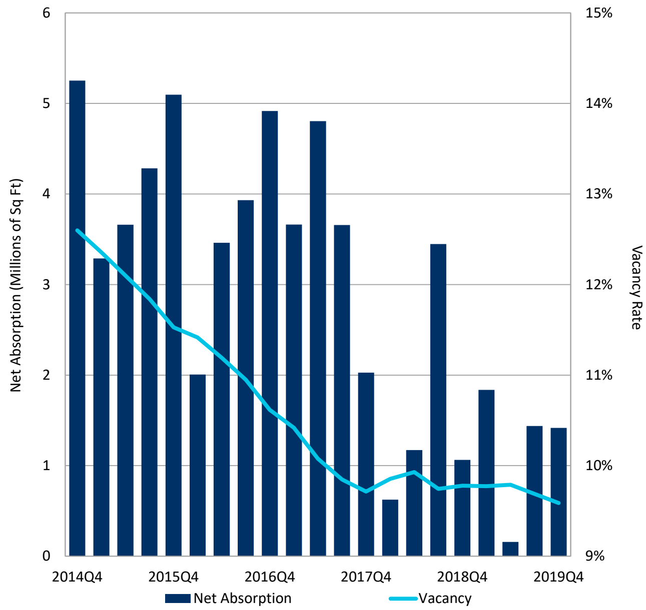
New completions of flex/R&D space measured a scant 229,000 SF, lower than last quarter's already weak 251,000 SF. In 2018, construction averaged 2.0 million SF per quarter but averaged only 0.7 million SF per quarter in 2019. Net absorption was 1.4 million SF in the quarter, in line with last quarter's figure but below the average quarterly absorption of 1.6 million SF in 2018. In 2017, net absorption averaged 3.5 million SF per quarter. The combination of moderate absorption and weak completions pulled the vacancy rate down to 9.6% in the fourth quarter from 9.7% in the third quarter. The vacancy rate has changed little more than 0.2% over the last two years.

Rent growth in flex/R&D space was again low at 0.4% (both asking and effective rates). Last quarter, both asking and effective rents grew 0.6%. At $10.27 and $9.26 per SF, respectively, the average asking and effective rents grew 2.1% and 2.0% over the year.

WAREHOUSE / DISTRIBUTION VACANCY AND NET ABSORPTION



FLEX / R&D VACANCY AND NET ABSORPTION



New completions were counted in three metros in the fourth quarter including Chicago (187,000 SF), San Francisco (22,000 SF) and Detroit (20,000 SF). Chicago, saw negative net absorption, but San Francisco and Detroit saw some

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of the highest absorption figures, 433,000 SF and 262,000 SF, respectively. Altogether, 18 metros incurred negative net absorption in the quarter down from 23 metros with that distinction in the third quarter.

Six metros saw a rent decline in the quarter: Northern New Jersey, Orange County, St. Louis, Columbus, Memphis and Suburban Virginia. However, four metros had effective rent growth of 1.0% or more in the quarter led by Minneapolis, Fort Worth, Phoenix and Indianapolis. Metros with the highest year-over-year rent growth include Fort Lauderdale, Jacksonville, Phoenix, Minneapolis and Pittsburgh. Only Columbus had a rent decline for the year, with rents falling 0.2%.

OTHER INDUSTRIAL MEASURES

The Institute for Supply Management's recent reading on manufacturing activity, the Purchasing Managers Index (PMI), fell to 47.2 in December, the lowest reading since June 2009. It was 48.1 in November. This is surprising given that market expectations were at 49. Any reading below 50 represents a contraction in manufacturing activity and this is the fifth consecutive month of decline in manufacturing activity. The contraction in the sector reflects the ongoing trade war with China.

Separately, the aggregate trade data on goods exports and imports declined near the end of 2020. For the three-month period of September to November, goods exports plus goods imports totaled $1.02 trillion, down $27.4 billion from the prior three-month period (-2.6%) and down $47.2 billion from the same period in 2018, a decline of 4.6%. Goods imports fell more than goods exports in the most recent period. Aggregate goods trade had increased steadily in 2017 and 2018 which had fueled demand for warehouse and distribution centers. Together with e-commerce, trade in goods had contributed to strong rent growth and low vacancy rates in the industrial sector, but as trade slowed in 2019, so too did occupancy and rent growth for warehouse/distribution and flex/R&D space.

On a positive note, the warehouse and storage industry added 52,300 jobs in 2019, a growth rate of 4.6%. In 2018, the industry added 113,000 jobs, a growth rate of 11%.

INDUSTRIAL OUTLOOK

The fourth quarter numbers were disappointing but not surprising as many lessors had been concerned about the future of trade and the overall health of the economy following the yield inversion in August of 2019.

That said, the U.S. and China are expected to sign "phase one" of a trade war that settles a number of tariffs at lower rates than those threatened over the course of the last two years. The mere announcement of this signing was a relief to Wall Street as stock indices soared in the last few weeks of 2019 and early 2020. Leasing activity in warehouse/distribution and flex/R&D is likely to accelerate a bit now that the trade war threats have subdued.

Consumption growth remained healthy as was job growth at the end of 2019. Thus, our outlook remains favorable for 2020 as occupancy growth should keep pace with supply growth and rents should see slightly higher growth rates in 2020.

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

	Absorption		Occupancy		Effective Rent	
Q4 2019	31+	16	22 ↑	25	41 ↑	6
Q3 2019	30+	17	18 ↑	29	47 ↑	0
Q2 2019	26 +	21	11 ↑	36	40 ↑	7
Q1 2019	33 +	14	21↑	26	42 ↑	5
Q4 2018	35 +	12	20 ↑	27	45 ↑	2

Figures are based on 47 metro markets

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