

## ROBUST MARKET CONTINUES TO PRESENT REWARDS & CHALLENGES.

The Inland Empire market continues to be one of the most dynamic industrial markets in the country, with its high concentration of modern “Class A” space above 200,000 square feet. The market continued its record run as we entered the 100th month of our overall economic recovery. Third quarter posted positive absorption, record high asking lease rates and an even tighter vacancy rate, despite having the most active development pipeline in the nation (over 28 million square feet under construction). The market is still heavily dependent on the twin ports of LA and Long Beach. With land cheaper than neighboring infill markets and excellent access to the most influential population centers of Southern California, the Inland Empire offers a strategic advantage for today’s retailers, distributors and logistics providers.

As consumption levels increased this quarter aided by record highs on most major stock indexes, local port traffic increased 9% from its previous high—water mark set in 2016. Retailers with emerging e-commerce platforms continue to compete for expansion space in this vibrant market. Capital infusion from investment funds, both foreign and domestic, is up significantly compared with 2016, and this competition has now driven investor pricing above user pricing in certain segments of the market. This tight market has given landlords the leverage—with very few alternatives to choose from at expensive rates, tenants are having to get creative to find real estate solutions, particularly in smaller blocks of space (100,000 square feet and below). The Inland Empire still provides one of the only relief valves for tenants from Orange County and Los Angeles who are searching for larger, more modern blocks of space at significantly lower rents. A 30-mile drive east could result in 20–30% savings in rent in many cases. The debt markets are still attractive, fueling more investment and user activity, but expect construction financing to tighten up given where we are in the cycle.

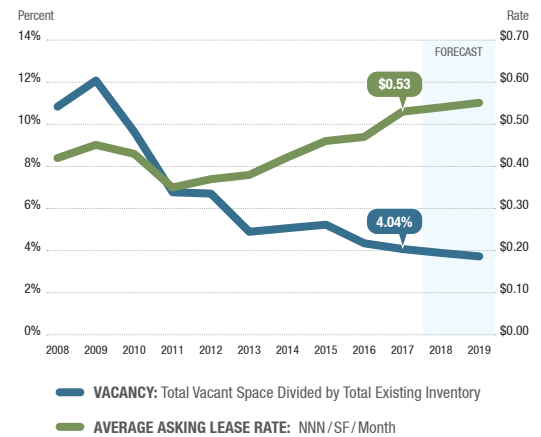
**VACANCY.** The vacancy rate has dropped to 4.04% from 4.89% in the second quarter and an already low 5.1% a year ago. This represents a 21% drop in a market whose historic vacancy rate over the past 10 years is close to 6.9%. As e-commerce continues its dominance as a market driver, industrial as an asset class is stealing market share from bricks and mortar retail, as warehouses are becoming points of sale themselves. The Inland Empire’s West submarket boasts the lowest vacancy rate for the region at 2.94%.

**LEASE RATES.** Average asking lease rates are now at \$0.53 NNN for the third quarter of 2017, up an average of four cents per square foot (8.16%) from the same quarter last year and one cent per square foot over second quarter figures. Rents are up 20% on average since 2010. Even with new supply coming online, expect lease rates to continue their climb as pent-up demand from retailers and transportation/logistics sectors remains at peak levels.

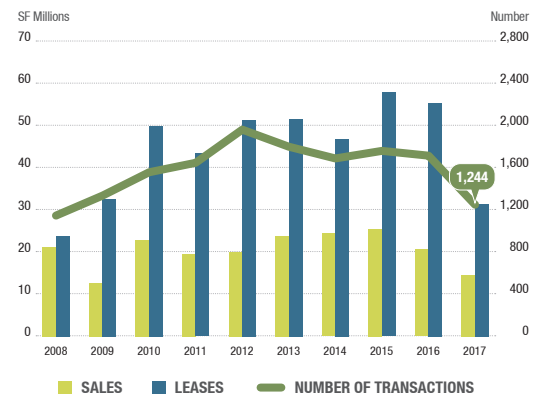
**TRANSACTION ACTIVITY.** Large blocks of Class A space continue to be in high demand by tenants and investors alike. Third party logistics and e-commerce/retail-related uses were the most active sectors of the market in the third quarter. High ceiling clearance (36–40’), expanded truck courts and well designed office areas emerged as the most desirable features tenants are evaluating. Increased efficiency, improved function and access to labor are at the core of most real estate decisions at the moment. Inland Empire’s sale and leasing activity in the third quarter totaled 15.6 million square feet, up from 13.8 million square feet in the second quarter, a 13.5% increase. Notable lease transactions for the third quarter include:

- Amazon’s lease of 649,800 square feet at SE Renaissance Parkway in Rialto
- States Logistics Services Inc.’s lease of 627,464 square feet at 5500 E. Francis Street in Ontario
- Best Buy’s lease of 573,899 square feet at 2104 Jay Street in Ontario
- Topson Downs’ lease of 442,920 square feet at 8986 Remington Avenue in Chino

### VACANCY vs. AVERAGE ASKING LEASE RATE



### TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



## Market Statistics

	Change Over Last Quarter	3Q 2017	2Q 2017	3Q 2016	% Change Over Last Year
Total Vacancy Rate	▼ DOWN	4.04%	4.89%	5.10%	(20.78%)
Availability Rate	▼ DOWN	5.43%	6.00%	7.58%	(28.36%)
Average Asking Lease Rate	▲ UP	\$0.53	\$0.52	\$0.49	8.16%
Sale & Lease Transactions	▲ UP	15,682,173	13,821,749	17,800,521	(11.90%)
Gross Absorption	▲ UP	12,407,291	11,241,388	17,714,518	(29.96%)
Net Absorption	▲ POSITIVE	6,832,822	6,724,504	8,065,210	N/A

**LEASE RATES.** Though rents in the Inland Empire are still far cheaper than neighboring infill markets by comparison, they're rising just as fast as Los Angeles and Orange Counties. Anticipate asking rents to increase by an annualized average of 3% to reach a level of \$0.56 per square foot by the end of the first quarter of 2018.

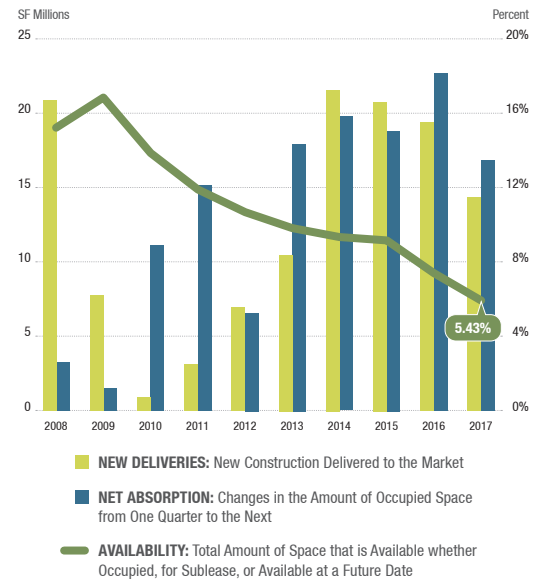
**VACANCY.** While annual deliveries have grown every year since 2010, demand continues to outpace supply. Although the overall vacancy rate will temporarily increase as new construction comes online, we anticipate demand to keep up with these new deliveries, keeping vacancy rates in the 3.9–4.0% range over the next three quarters.

**OVERALL.** The fundamentals of the Inland Empire market are as sound as they have been in several years and we expect them to continue into 2018. With consumer spending up, tenant demand at a peak and a flood of investment capital targeting the region, we anticipate a healthy but competitive market. Landlords will have the upper hand and tenants will need to start making expansion or relocation plans further in advance as available options become even more scarce. Lease renewals will become more common. Exchange buyers (private investors / family offices) who have recently sold assets will continue to be aggressive and pay up for infill industrial product. Capital markets and investment activity should remain strong, but rising interest rates should slow the double-digit year-over-year growth in sale prices.

**CONSTRUCTION.** At the conclusion of the third quarter, the Inland Empire had 28.5 million square feet under construction, leading the nation in this category. By comparison, the Los Angeles market had roughly 4.5 million square feet under construction. Of the 28.5 million square feet under construction, 50% is for buildings over 500,000 square feet and a sizable portion is speculative. With tight vacancies overall and strong rent growth, developers don't appear to be pulling back yet. Third quarter figures show that 17% of the new construction coming online is pre-leased. The largest development projects in the pipeline include a 1,558,992 square foot speculative building at Rialto Fulfillment Center in Rialto, a 1,412,000 square foot speculative building at 6720 Kimball Avenue in Chino and a 1,388,210 square foot speculative building at 24385 Nandina Avenue in Perris.

**ABSORPTION.** The Inland Empire industrial market posted nearly 6.8 million square feet of positive absorption for the third quarter of the year, giving the market a net total of more than 15.7 million square feet of positive absorption over the last three quarters. Over the last four years, the market has averaged a staggering 5.1 million square feet of positive absorption per quarter. Absorption and activity levels are expected to improve as new deliveries come online in late 2017 and early 2018.

**NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE**



**Significant Transactions**

**Sales** \* Voit Real Estate Services Deal

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
9363 Lucas Ranch Rd. – 5 Properties	Rancho Cucamonga	1,537,530	\$172,000,000	Property Reserve, Inc.	TIAA-CREF
17791 Perris Blvd.	Moreno Valley	794,581	\$111,850,000	Duke Realty	Sares Regis
6207 Cajon Blvd.	San Bernardino	830,750	\$60,229,500	Westcore Properties	Black Creek Capital
22705 Newhope St.	Moreno Valley	366,698	\$30,710,000	Westcore Properties	JW Mitchell Company *
4697–4701 Brooks St. – 12 Properties	Montclair	119,199	\$9,400,000	Montclair Business Park, LLC *	4747 Holt Investments, LLC *

**Leases** \* Voit Real Estate Services Deal

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
20801–20901 Krameria Ave.	Riverside	1,000,000	Aug-2017	Amazon	Invesco
657 Nance St.	Perris	864,000	Aug-2017	NFI	Industrial Property Trust
6207 Cajon Blvd.	San Bernardino	830,750	Sep-2017	LG	Westcore Properties
8985 Merrill Ave.	Chino	725,160	Sep-2017	Caleres	Watson Land Company
1990 S. Vintage Ave.	Ontario	195,780	Aug-2017	Pacific Urethanes *	Vintage Sterling Company, LLC

	INVENTORY				VACANCY & LEASE RATES				ABSORPTION				
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2017	Square Feet Available	Availability Rate 3Q2017	Average Asking Lease Rate	Net Absorption 3Q2017	Net Absorption 2017	Gross Absorption 3Q2017	Gross Absorption 2017
<b>West</b>													
Chino / Chino Hills	891	47,907,803	2,932,687	2,130,008	755,747	1.58%	1,834,398	3.83%	\$0.63	696,895	1,088,553	1,948,575	2,898,835
Fontana	706	60,170,009	1,670,326	692,648	2,623,037	4.36%	3,765,398	6.26%	\$0.66	1,782,400	3,230,315	2,610,747	6,573,418
Mira Loma / Eastvale / Jurupa Valley	336	38,034,710	3,210,971	910,688	741,026	1.95%	741,109	1.95%	\$0.65	434,104	668,623	43,728	714,325
Montclair	197	3,416,791	0	30,000	47,179	1.38%	194,295	5.69%	\$0.52	10,416	165,741	58,925	326,377
Ontario	1,439	106,041,348	1,323,188	358,778	2,682,667	2.53%	3,717,608	3.51%	\$0.64	1,483,740	3,596,428	2,102,327	5,949,834
Rancho Cucamonga	714	38,714,114	387,022	2,276,124	1,624,917	4.20%	1,841,933	4.76%	\$0.50	31,731	(29,091)	829,782	1,744,502
Upland	252	4,003,675	88,338	209,182	294,556	7.36%	259,490	6.48%	\$0.80	(67,539)	(137,117)	61,800	123,288
5,000-24,999	2,705	32,510,354	161,083	217,050	619,045	1.90%	859,796	2.64%	\$0.84	16,888	165,141	512,619	1,522,243
25,000-49,999	688	24,054,307	1,118,384	1,125,069	918,704	3.82%	1,535,154	6.38%	\$0.66	(114,117)	405,593	558,415	1,826,440
50,000-99,999	420	29,317,919	1,461,618	681,771	637,745	2.18%	1,215,354	4.15%	\$0.64	2,652	336,318	955,264	1,778,029
100,000-249,999	417	63,571,132	1,810,401	1,867,080	2,758,996	4.34%	3,830,296	6.03%	\$0.55	934,096	1,460,960	1,566,444	4,748,327
250,000-499,999	207	74,693,365	1,371,966	1,317,320	2,257,803	3.02%	2,049,235	2.74%	\$0.47	846,086	1,022,738	1,629,822	3,317,983
500,000 plus	98	74,141,373	3,689,080	1,399,138	1,576,836	2.13%	2,864,396	3.86%	\$0.46	2,686,142	5,192,702	2,433,320	5,137,557
<b>West Total</b>	<b>4,535</b>	<b>298,288,450</b>	<b>9,612,532</b>	<b>6,607,428</b>	<b>8,769,129</b>	<b>2.94%</b>	<b>12,354,231</b>	<b>4.14%</b>	<b>\$0.59</b>	<b>4,371,747</b>	<b>8,583,452</b>	<b>7,655,884</b>	<b>18,330,579</b>
<b>East</b>													
Banning	49	984,827	0	2,600,895	77,439	7.86%	80,264	8.15%	\$0.66	27,249	(70,122)	41,657	61,573
Beaumont	43	3,817,154	0	1,997,424	0	0.00%	446,738	11.70%	\$0.31	0	1,489,240	0	1,495,740
Bloomington	93	4,673,601	0	5,735,358	3,500	0.07%	264,003	5.65%	\$0.68	97,644	203,204	97,644	210,304
Corona / Norco	953	31,437,608	27,713	1,236,403	986,293	3.14%	1,940,747	6.17%	\$0.59	79,958	450,082	938,530	1,800,476
Colton / Grand Terrace	164	8,767,414	926,013	615,995	320,581	3.66%	428,346	4.89%	\$0.63	(10,380)	140,380	19,125	238,260
Moreno Valley	79	21,194,730	3,848,301	14,694,261	1,062,834	5.01%	1,850,470	8.73%	\$0.79	(5,736)	4,160	4,133	26,358
Perris	185	20,862,075	1,767,410	12,917,796	861,322	4.13%	255,309	1.22%	\$0.43	501,485	2,004,635	520,035	2,152,096
Redlands / Loma Linda	223	26,680,175	1,204,048	532,636	3,405,809	12.77%	4,161,915	15.60%	\$0.67	727,433	734,337	782,238	2,199,774
Rialto	159	22,579,170	5,544,677	1,086,223	1,203,420	5.33%	1,309,457	5.80%	\$0.44	461,935	460,101	468,519	1,019,719
Riverside	1,016	43,902,974	4,175,478	5,425,438	2,417,551	5.51%	2,763,934	6.30%	\$0.59	140,565	642,600	352,295	1,619,372
San Bernardino / Highland	562	36,346,056	1,469,152	1,604,717	1,886,922	5.19%	2,335,289	6.43%	\$0.45	440,922	1,107,834	1,527,231	1,681,880
5,000-24,999	2,278	26,731,647	85,190	443,647	563,995	2.11%	1,203,036	4.50%	\$0.69	26,396	117,983	324,956	1,138,708
25,000-49,999	528	18,430,402	151,013	770,417	528,394	2.87%	790,065	4.29%	\$0.62	159,852	110,600	371,448	676,178
50,000-99,999	312	21,297,980	260,204	1,409,991	834,728	3.92%	1,143,526	5.37%	\$0.57	315,201	593,221	552,486	1,445,097
100,000-249,999	208	30,894,076	1,853,240	3,619,594	1,922,659	6.22%	2,571,327	8.32%	\$0.46	194,015	537,777	396,017	1,439,445
250,000-499,999	93	33,865,886	2,326,290	5,845,304	2,849,241	8.41%	4,806,105	14.19%	\$0.31	142,096	418,084	652,235	1,860,125
500,000 plus	107	90,025,793	14,286,855	36,358,193	5,526,654	6.14%	5,322,413	5.91%	\$0.38	1,623,515	5,388,786	2,454,265	5,945,999
<b>East Total</b>	<b>3,526</b>	<b>221,245,784</b>	<b>18,962,792</b>	<b>48,447,146</b>	<b>12,225,671</b>	<b>5.53%</b>	<b>15,836,472</b>	<b>7.16%</b>	<b>\$0.48</b>	<b>2,461,075</b>	<b>7,166,451</b>	<b>4,751,407</b>	<b>12,505,552</b>
<b>Inland Empire Total</b>	<b>8,061</b>	<b>519,534,234</b>	<b>28,575,324</b>	<b>55,054,574</b>	<b>20,994,800</b>	<b>4.04%</b>	<b>28,190,703</b>	<b>5.43%</b>	<b>\$0.53</b>	<b>6,832,822</b>	<b>15,749,903</b>	<b>12,407,291</b>	<b>30,836,131</b>
5,000-24,999	4,983	59,242,001	246,273	660,697	1,183,040	2.00%	2,062,832	3.48%	\$0.87	43,284	283,124	837,575	2,660,951
25,000-49,999	1,216	42,484,709	1,269,397	1,895,486	1,447,098	3.41%	2,325,219	5.47%	\$0.61	45,735	516,193	929,863	2,502,618
50,000-99,999	732	50,615,899	1,721,822	2,091,762	1,472,473	2.91%	2,358,880	4.66%	\$0.55	317,853	929,539	1,507,750	3,223,126
100,000-249,999	625	94,465,208	3,663,641	5,486,674	4,681,655	4.96%	6,401,623	6.78%	\$0.53	1,128,111	1,998,737	1,962,461	6,187,772
250,000-499,999	300	108,559,251	3,698,256	7,162,624	5,107,044	4.70%	6,855,340	6.31%	\$0.35	988,182	1,440,822	2,282,057	5,178,108
500,000 plus	205	164,167,166	17,975,935	37,757,331	7,103,490	4.33%	8,186,809	4.99%	\$0.29	4,309,657	10,581,488	4,887,585	11,083,556
<b>Inland Empire Total</b>	<b>8,061</b>	<b>519,534,234</b>	<b>28,575,324</b>	<b>55,054,574</b>	<b>20,994,800</b>	<b>4.04%</b>	<b>28,190,703</b>	<b>5.43%</b>	<b>\$0.53</b>	<b>6,832,822</b>	<b>15,749,903</b>	<b>12,407,291</b>	<b>30,836,131</b>
<b>High Desert</b>													
Adelanto	134	3,259,376	120,000	600,000	365,966	11.23%	453,861	13.92%	\$2.14	(167,892)	(137,920)	98,726	223,974
Apple Valley	75	249,638	0	1,847,530	43,067	17.25%	56,707	22.72%	\$0.71	3,500	(169)	8,000	26,531
Barstow	52	1,071,920	0	0	156,633	14.61%	189,291	17.66%	\$0.00	0	(13,708)	196	11,005
Hesperia	187	198,667	0	2,271,490	326,925	164.56%	374,345	188.43%	\$0.00	(11,407)	(248,200)	35,278	104,506
Victorville	130	7,777,031	0	991,938	1,549,503	19.92%	418,593	5.38%	\$0.80	(1,005,794)	(411,365)	9,278	649,062
<b>High Desert Total</b>	<b>578</b>	<b>12,556,632</b>	<b>120,000</b>	<b>5,710,958</b>	<b>2,442,094</b>	<b>19.45%</b>	<b>1,492,797</b>	<b>11.89%</b>	<b>\$1.09</b>	<b>(1,181,593)</b>	<b>(811,362)</b>	<b>151,478</b>	<b>1,015,078</b>
<b>Temecula Valley</b>													
Hemet	84	1,458,065	0	0	76,928	5.28%	80,628	5.53%	\$0.00	(41,778)	(43,033)	6,250	9,550
Lake Elsinore	162	2,421,045	74,800	95,350	108,774	4.49%	133,355	5.51%	\$0.67	49,146	170,716	112,983	319,432
Menifee	20	403,975	0	0	26,018	6.44%	79,166	19.60%	\$0.00	(1,100)	(8,315)	0	11,297
Murrieta	233	3,745,861	22,064	27,988	63,835	1.70%	113,536	3.03%	\$0.00	(23,048)	(14,270)	45,805	124,231
San Jacinto	60	1,034,157	0	109,948	44,872	4.34%	61,572	5.95%	\$0.00	(23,272)	(4,172)	0	27,500
Temecula	331	10,781,527	204,618	129,211	254,839	2.36%	575,699	5.34%	\$0.66	(11,748)	(47,450)	42,781	177,807
Wildomar	12	324,860	0	0	14,656	4.51%	14,656	4.51%	\$0.80	(8,386)	(10,177)	6,270	32,944
<b>Temecula Valley Total</b>	<b>902</b>	<b>20,169,490</b>	<b>301,482</b>	<b>362,497</b>	<b>589,922</b>	<b>2.92%</b>	<b>1,058,612</b>	<b>5.25%</b>	<b>\$0.67</b>	<b>(60,186)</b>	<b>43,299</b>	<b>214,089</b>	<b>702,761</b>

This survey consists of industrial buildings greater than 5,000 square feet. Lease rates are on a triple-net basis.



## Lease Renewals: Facts Are Open to Interpretation

by **Walt Chenoweth**

EXECUTIVE VICE PRESIDENT / PARTNER, ONTARIO

Over the past seven years, industrial real estate markets across the country have seen continuous improvement as they have recovered from the “Great Recession.” The Inland Empire industrial market has led the way in this recovery, given its high concentration of modern “big box” distribution facilities. With the emergence of e-commerce as a market driver and continued demand above 200,000 square feet, the market has shifted to favor landlords. Lower vacancy rates, stronger gross and net absorption, and rising lease and sale prices across all market segments are now the “new normal.” Does this refrain sound familiar? This is how the majority of real estate brokers, developers and investors have characterized market conditions. What if you are a tenant in these same markets? Are things really better? You see less space to choose from, more occupiers competing for fewer spaces and market rents 30–40% higher than a lease negotiated several years ago. This is the predicament that faces the two sides of any current real estate negotiation. The facts are open to interpretation.

This is especially true in the lease renewal arena that has become a majority of the real estate transactions in our market, given the limited number of choices available to a tenant. No matter which side of the table you find yourself on (Landlord or Tenant), it is critical to try to put yourself in the shoes of the other party. What is truly important to them? For a tenant, what is their “ceiling?” In other words, how much of an increase can they justify in their current space before it makes financial sense to relocate, incurring costs for moving and improving the new space, and potentially losing key employees?

There is another view to consider. Landlords need to be concerned about potential down time, with an interrupted income stream and the risk of incurring substantial costs to improve or to bring a property back to a “market ready” condition. Before a landlord gets too aggressive and turns away an existing tenant, it needs to determine its “floor.” In other words, what is an acceptable rent that would help the landlord achieve a rate close to market and would improve their position by not incurring improvement costs, risking any downtime or paying the higher brokerage commissions on a new lease?

There are mutual benefits to both the landlord and the tenant from a renewal. Most importantly, each takes less risk by relying on their shared experience from the previous lease term. Hopefully it was a good experience, but either way the comfort of the known is usually preferred to the uncertainty of the unknown. The old saying “time is money” is true here too. A renewal is substantially less complicated and less time consuming for both parties. The landlord avoids the process of finding a new occupant and the out-of-pocket costs of new improvements to the space. The tenant avoids an exhaustive search for a new building and the startup costs associated with relocating.

In summary, everyone in a real estate transaction should strive for a “Win-Win” outcome. It becomes much easier to achieve this result if both parties are willing to consider each other’s perspective. A good practice is to try to quantify these different perspectives, model them, and compare them with each other through the negotiation process. You might be surprised to find that both parties are closer to each other than they originally perceived.

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This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a triple-net basis. The information contained in this report is gathered from sources that are deemed reliable, but no guarantees are made as to its accuracy. This information is for Voit Real Estate Services’ use only and cannot legally be reproduced without prior written consent from the management of Voit Real Estate Services.

### Product Type

#### MFG./DIST.

Manufacturing / Distribution /  
Warehouse facilities with up to  
29.9% office space.

### Submarkets

#### WEST

Chino / Chino Hills, Fontana,  
Mira Loma / Eastvale / Jurupa  
Valley, Montclair, Ontario,  
Rancho Cucamonga, Upland

#### EAST

Banning, Beaumont,  
Bloomington, Corona / Norco,  
Colton / Grand Terrace, Moreno  
Valley, Perris, Redlands /  
Loma Linda, Rialto, Riverside,  
San Bernardino / Highland

#### HIGH DESERT

Adelanto, Apple Valley, Barstow,  
Hesperia, Victorville

#### TEMECULA VALLEY

Hemet, Lake Elsinore, Menifee,  
Murrieta, San Jacinto,  
Temecula, Wildomar