

MARKET OVERVIEW. The story of industrial real estate centers around compressing cap rates and the steady stream of capital flowing into the sector. After adding another 9.69 million square feet to the industrial base in 2Q 2018, the Inland Empire industrial market has seen a large increase in the volume of construction over the past year and a half, having delivered 22 million square feet of industrial product in 2017, a 22% increase over the total space delivered during the previous year and leading the national average. With industrial rents, tenants have been faced with sticker shock when looking to renew leases in recent years, with rent prices continuing to soar in Southern California amid tight occupancy and robust demand, much of it from e-commerce. Still, asking rents for bulk-distribution properties remain 40% lower than in Los Angeles and Orange County.

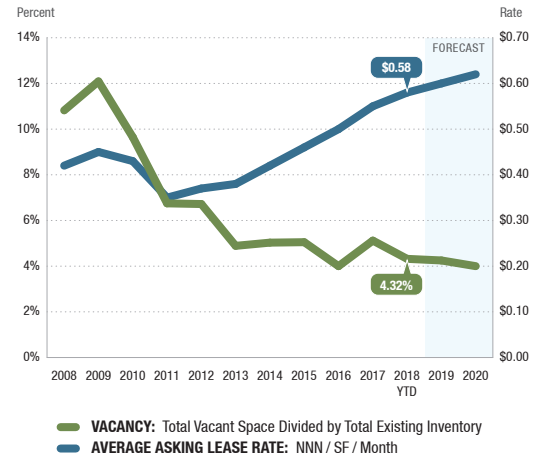
VACANCY. Vacancy rates continued a downward trend in 2Q 2018 across all property types. With demand for space advancing, tenants shifted their focus toward larger footprints. Vacancies have held a steady path since the start of 2013, with absorption levels capped by the limited new supply. The vacancy rate decreased in 2Q to 4.32%, down from 1Q 2018 rate of 5.11%. And from a historical perspective, the second quarter vacancy rate was lower than the 5.29% average recorded since the beginning of 1Q 2007. The Inland Empire's West submarket boasts the lowest vacancy in the region at 2.98%.

LEASE RATES. Despite the introduction of new supply, demand has been consistently strong, keeping vacancies low for the past three years and yielding rent growth in the market. However, over the past four quarters, rent growth has started to level out—registering 9.43% per year. While asking rents in the Inland Empire stand at an all-time high for the market, the region remains more affordable than neighboring infill markets Los Angeles and Orange County. Average asking lease rates are now at \$0.58 for 2Q 2018, up an average of three cents per square foot (11.54%) from the same quarter last year and six cents per square foot over 4Q 2017 figures. Expect further rent increases of at least 3–4% on an annual basis throughout the year.

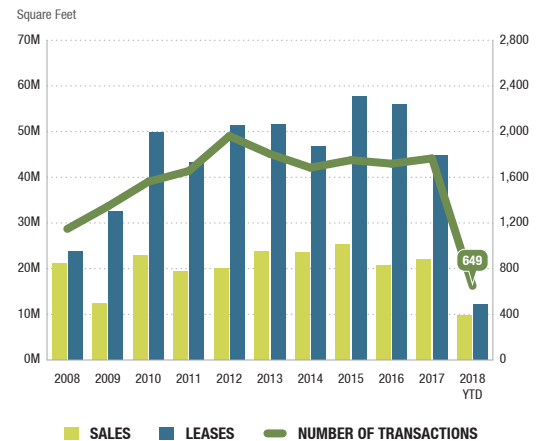
TRANSACTION ACTIVITY. Market demand has continued to grow in the Inland Empire with increased tenant activity from small / mid-sized tenants and the rebirth of the 100,000 square foot tenant. Due to its access to the ports of Los Angeles and Long Beach, and the related trade links to the east, the Inland Empire will continue to take advantage of good economic conditions across the country. The sale and leasing activity in 2Q totaled 10.6 million square feet, down from 11.2 million square feet in 1Q 2018.

AVAILABILITY. Direct/sublease space being marketed in 2Q is now at 5.28%, down from 6.24% in 1Q. We expect availability to continue to compress with a possible uptick in later quarters when new, speculative projects are delivered to the market.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	2Q 2018	1Q 2018	2Q 2017	% Change Over Last Year
Total Vacancy Rate	▼ DOWN	4.32%	5.11%	4.62%	(6.49%)
Availability Rate	▼ DOWN	5.28%	6.24%	7.16%	(26.26%)
Average Asking Lease Rate	▲ UP	\$0.58	\$0.55	\$0.52	11.54%
Sale & Lease Transactions	▼ DOWN	10,618,828	11,236,889	14,739,271	(27.96%)
Gross Absorption	▼ DOWN	10,462,039	11,879,913	11,181,945	(6.44%)
Net Absorption	▲ POSITIVE	5,701,106	6,627,562	7,116,770	N/A

LEASE RATES. The Inland Empire industrial market currently boasts one of the fastest rent growths in the nation. Anticipate asking rents to increase to an annualized average of 3% to reach a level of \$0.60 per square foot by the end of 2018.

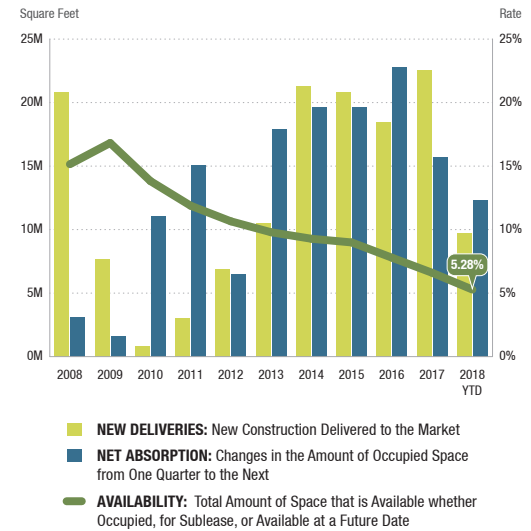
VACANCY. Due to the growing needs of e-commerce and traditional retailers to fulfill increasing consumer demand, we are forecasting that vacancy will continue to trend downward in 2018 based on the continuing economic growth. Although the overall vacancy rate could temporarily increase as new construction comes online, we anticipate demand to keep up with these new deliveries, keeping vacancy rates in the 4.1–4.5% range over the next two quarters.

OVERALL. The Inland Empire’s manufacturing sector has grown for 17 consecutive months. The production index was virtually unchanged month-over-month, while new orders increased slightly. Combined, those two factors mean purchasing managers in the area expect to keep filling orders. Inventories were also up slightly last month, and the employment index was 57.6, the 17th consecutive month that number has been above 50. Inland Empire employment continues to show strong growth, outpacing other areas of Southern California, with added jobs driving the region’s unemployment rate to new lows. As the industrial market continues to tighten in Inland Empire, we are experiencing an abundance of tenant and buyer interest, and developers are vying to deliver buildings to meet market demand.

CONSTRUCTION. With demand outpacing supply and rents continuing to rise, developers remain motivated to get speculative projects off the ground and delivered as soon as possible. Even with the hurdles of increasing construction costs (up 6% from 2016) and the presence of public labor agreements, construction is at an all-time high in this region with 93 buildings under construction, totaling nearly 21.9 million square feet. The largest development projects in the pipeline include a 1,388,210 square foot building at 24385 Nandina Avenue in Moreno Valley, a 1,039,898 square foot building at 4100 N. Webster Avenue in Perris and a 1,022,680 square foot building at 6720 Kimball Avenue in Chino.

ABSORPTION. Net absorption for the Inland Empire industrial market was 5.7 million square feet in 2Q. Due to solid fundamentals, some of the most recent leasing activity involved already occupied or recently vacated buildings. Absorption will continue to pick up in the second half of 2018 when a few large buildings deliver. While overall economic growth and improved manufacturing mean a diverse array of companies need more space, the market has primarily expanded due to e-commerce and retailers. In 2Q, 54% of the market’s absorption was in buildings 500,000 square feet and larger. Primary contributors to this trend in 2Q include: Harbor Freight Tools (601,810 SF), Ingram Micro (468,682 SF) and Mattel (414,020 SF).

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

* Voit Real Estate Services Deal

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
3343 S. Lena Rd.	San Bernardino	476,632	\$44,573,500	Trader Joe’s Company	Hillwood
9150 Hermosa Ave.	Rancho Cucamonga	407,074	\$36,850,000	General Motor, LLC	Todd Interests
2000 W. Baseline Rd.	Rialto	176,000	\$22,000,000	Liberty Property LP*	Shaw Properties / Penwood RE*
6340 Providence Way	Eastvale	85,453	\$11,514,500	WH88 Property, LLC	Orbis Real Estate Partners
345 Adams Cir.	Corona	21,713	\$2,600,000	R&J Material Handling Inc.	Duct-O-Wire Corporation

Leases

* Voit Real Estate Services Deal

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
1686 W. Baseline Rd.	Rialto	758,940	Jun-2018	Kellogg Sales Company	IDI Gazeley, LLC
23450 Brodiaea Ave.	Moreno Valley	601,810	Apr-2018	Harbor Freight Tools	Prologis
2255 W. Lugonia Ave.	Redlands	601,287	Jun-2018	Kuehne + Nagel	TH Real Estate
9050 Hermosa Ave.	Rancho Cucamonga	468,682	Jun-2018	Ingram Micro	TH Real Estate
5401 E. Jurupa St.	Ontario	142,404	May-2018	Idea Nuova, Inc.	Wescove Medical Enterprises*

INVENTORY

VACANCY & LEASE RATES

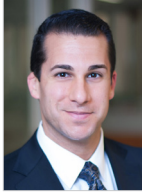
ABSORPTION

	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2018	Square Feet Available	Availability Rate 2Q2018	Average Asking Lease Rate	Net Absorption 2Q2018	Net Absorption 2018	Gross Absorption 2Q2018	Gross Absorption 2018
West													
Chino / Chino Hills	898	48,209,174	4,032,019	1,002,135	594,690	1.23%	1,568,442	3.25%	\$0.70	399,940	1,158,163	1,528,617	2,317,345
Fontana	712	61,661,401	668,227	2,057,373	2,400,391	3.89%	2,351,650	3.81%	\$0.66	564,375	806,103	1,329,547	2,383,914
Mira Loma / Eastvale / Jurupa Valley	354	40,904,075	746,236	2,421,078	1,485,159	3.63%	1,384,582	3.38%	\$0.78	(46,724)	1,669,252	238,892	2,024,729
Montclair	200	3,490,837	0	83,942	65,810	1.89%	97,510	2.79%	\$0.00	76,269	41,632	105,855	122,039
Ontario	1,462	107,338,871	191,777	390,661	2,803,284	2.61%	3,622,972	3.38%	\$0.68	706,281	639,029	1,894,052	3,472,737
Rancho Cucamonga	715	38,908,192	950,783	1,720,780	1,606,629	4.13%	2,767,085	7.11%	\$0.52	96,700	(13,910)	526,885	1,068,482
Upland	254	4,046,994	0	209,182	129,249	3.19%	147,409	3.64%	\$0.76	46,785	100,867	75,156	175,882
5,000-24,999	2,717	32,684,263	24,360	518,860	589,122	1.80%	939,691	2.88%	\$1.00	31,627	(48,149)	439,476	823,612
25,000-49,999	705	24,660,198	178,289	1,265,211	1,027,269	4.17%	1,427,190	5.79%	\$0.73	184,247	417,192	685,173	1,175,757
50,000-99,999	436	30,311,121	1,044,108	836,897	1,160,021	3.83%	1,506,103	4.97%	\$0.67	557,516	641,847	715,293	1,511,529
100,000-249,999	422	64,399,744	2,036,208	1,279,522	2,153,306	3.34%	3,264,772	5.07%	\$0.56	442,173	466,166	1,511,625	2,699,792
250,000-499,999	214	76,085,765	2,745,723	3,494,159	2,504,054	3.29%	2,880,925	3.79%	\$0.00	314,228	916,094	808,372	1,959,712
500,000 plus	101	76,418,453	560,354	490,502	1,651,440	2.16%	1,920,969	2.51%	\$0.00	313,835	2,007,986	1,539,065	3,394,726
West Total	4,595	304,559,544	6,589,042	7,885,151	9,085,212	2.98%	11,939,650	3.92%	\$0.64	1,843,626	4,401,136	5,699,004	11,565,128
East													
Banning	49	1,028,267	0	2,546,920	55,120	5.36%	55,120	5.36%	\$0.59	15,108	15,144	15,108	15,144
Beaumont	43	3,817,154	0	2,002,096	0	0.00%	0	0.00%	\$0.00	10,000	12,665	10,000	12,665
Bloomington	93	4,586,326	556,212	6,975,993	63,520	1.38%	163,579	3.57%	\$0.54	10,988	52,589	12,588	184,322
Corona / Norco	958	30,995,690	491,664	599,316	734,072	2.37%	1,054,094	3.40%	\$0.64	484,499	1,001,760	618,632	1,388,869
Colton / Grand Terrace	168	10,002,669	808,500	427,903	895,400	8.95%	968,910	9.69%	\$0.55	(19,480)	171,458	24,090	365,119
Moreno Valley	80	23,603,830	3,355,646	43,232,990	1,979,536	8.39%	2,099,637	8.90%	\$0.95	1,305,098	1,509,418	1,310,593	2,058,204
Perris	192	23,054,351	3,750,095	8,192,634	1,279,661	5.55%	1,374,052	5.96%	\$0.68	185,164	1,146,819	240,254	1,354,957
Redlands / Loma Linda	229	27,876,775	0	686,630	2,883,700	10.34%	3,506,819	12.58%	\$0.48	1,055,988	1,281,128	1,134,655	1,474,141
Rialto	167	25,442,720	1,610,248	1,099,523	1,011,550	3.98%	607,937	2.39%	\$0.68	38,844	1,147,352	81,621	1,418,840
Riverside	1,027	44,548,970	2,930,502	4,153,143	3,539,825	7.95%	3,746,641	8.41%	\$0.51	65,409	269,038	608,011	1,233,220
San Bernardino / Highland	571	37,318,905	1,863,196	2,454,042	1,685,635	4.52%	2,836,604	7.60%	\$0.62	705,862	1,320,161	707,483	1,271,343
5,000-24,999	2,302	27,075,630	295,134	386,240	956,700	3.53%	1,284,747	4.75%	\$0.71	(49,987)	(129,491)	404,785	804,440
25,000-49,999	536	18,696,953	222,073	691,878	481,225	2.57%	834,880	4.47%	\$0.86	49,365	145,790	181,117	598,858
50,000-99,999	310	21,136,206	1,826,047	3,286,082	527,108	2.49%	878,072	4.15%	\$0.57	105,462	301,927	354,109	719,087
100,000-249,999	216	32,369,732	4,563,106	5,630,010	2,433,406	7.52%	2,771,615	8.56%	\$0.52	735,656	1,427,793	1,220,060	2,421,943
250,000-499,999	96	35,158,548	8,099,136	61,122,862	2,883,013	8.20%	3,525,702	10.03%	\$0.31	943,335	2,335,891	529,315	2,386,874
500,000 plus	117	97,838,588	360,567	1,254,118	6,846,567	7.00%	7,118,377	7.28%	\$0.00	2,073,649	3,845,622	2,073,649	3,845,622
East Total	3,577	232,275,657	15,366,063	72,371,190	14,128,019	6.08%	16,413,393	7.07%	\$0.54	3,857,480	7,927,532	4,763,035	10,776,824
Inland Empire Total	8,172	536,835,201	21,955,105	80,256,341	23,213,231	4.32%	28,353,043	5.28%	\$0.58	5,701,106	12,328,668	10,462,039	22,341,952
5,000-24,999	5,019	59,759,893	319,494	905,100	1,545,822	2.59%	2,224,438	3.72%	\$0.78	(18,360)	(177,640)	844,261	1,628,052
25,000-49,999	1,241	43,357,151	400,362	1,957,089	1,508,494	3.48%	2,262,070	5.22%	\$0.77	233,612	562,982	866,290	1,774,615
50,000-99,999	746	51,447,327	2,870,155	4,122,979	1,687,129	3.28%	2,384,175	4.63%	\$0.59	662,978	943,774	1,069,402	2,230,616
100,000-249,999	638	96,769,476	6,599,314	6,909,532	4,586,712	4.74%	6,036,387	6.24%	\$0.53	1,177,829	1,893,959	2,731,685	5,121,735
250,000-499,999	310	111,244,313	10,844,859	64,617,021	5,387,067	4.84%	6,406,627	5.76%	\$0.31	1,257,563	3,251,985	1,337,687	4,346,586
500,000 plus	218	174,257,041	920,921	1,744,620	8,498,007	4.88%	9,039,346	5.19%	\$0.00	2,387,484	5,853,608	3,612,714	7,240,348
Inland Empire Total	8,172	536,835,201	21,955,105	80,256,341	23,213,231	4.32%	28,353,043	5.28%	\$0.58	5,701,106	12,328,668	10,462,039	22,341,952
High Desert													
Adelanto	143	3,928,124	120,000	532,000	305,009	7.76%	337,530	8.59%	\$1.16	545,155	632,910	568,155	682,910
Apple Valley	74	2,491,388	1,350,000	0	39,024	1.57%	48,224	1.94%	\$0.71	18,000	15,350	32,000	44,500
Barstow	53	1,083,008	0	0	330,987	30.56%	190,804	17.62%	\$0.22	0	(12,071)	0	425
Hesperia	189	3,210,731	0	107,980	301,704	9.40%	344,343	10.72%	\$0.90	(6,912)	28,250	14,690	74,752
Victorville	131	7,794,567	76,410	9,991,933	442,699	5.68%	533,115	6.84%	\$0.36	(16,451)	(33,771)	7,334	9,759
High Desert Total	590	18,507,818	1,546,410	10,631,913	1,419,423	7.67%	1,454,016	7.86%	\$0.42	539,792	630,668	622,179	812,346
Temecula Valley													
Hemet	84	1,458,253	0	0	36,402	2.50%	51,544	3.53%	\$0.88	(4,550)	(4,150)	338	738
Lake Elsinore	165	2,496,490	0	8,358	43,017	1.72%	31,770	1.27%	\$0.67	76,164	155,714	120,378	232,187
Menifee	20	404,015	72,835	129,306	39,148	9.69%	49,066	12.14%	\$0.00	(14,230)	(14,230)	9,918	15,803
Murrieta	232	3,738,237	274,977	27,988	62,955	1.68%	121,579	3.25%	\$0.00	2,782	11,941	42,494	106,894
San Jacinto	60	1,035,680	0	109,948	33,650	3.25%	50,830	4.91%	\$0.00	(16,950)	(6,950)	0	10,000
Temecula	331	10,753,184	109,211	20,000	204,394	1.90%	806,927	7.50%	\$0.70	117,176	281,901	206,741	433,902
Wildomar	12	324,860	0	0	4,115	1.27%	37,474	11.54%	\$0.83	(4,115)	363	0	13,542
Temecula Valley Total	904	20,210,719	457,023	295,600	423,681	2.10%	1,149,190	5.69%	\$0.71	156,277	424,589	379,869	813,066

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

No Longer the “Low Cost Alternative...”

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If you blinked, you missed it. Rental rates for mid-sized industrial space (defined as 50,000 SF–150,000 SF) in the Inland Empire West have continued to skyrocket. Every day the IE West becomes more “infill” and less like the “low cost alternative” it used to be. Here are the major takeaways from last quarter:

- Recently Purchased, Immediately Leased.** Many newly constructed buildings in the 50,000 SF–90,000 SF range have delivered and closed over the past six months, with a large majority trading to investors. The lion’s share of those properties leased almost immediately, or shortly after their delivery date. Some of these buildings, including 560 S. Magnolia Avenue in Ontario and 9500 Feron Boulevard in Rancho Cucamonga, were pre-leased in escrow prior to closing. In most other cases, the timeline for leasing up the properties ranged from two to four months. The average rental rate for these newly constructed, newly leased transactions has ranged from \$0.60–\$0.66 NNN (triple net), and in one case, up to \$0.70 NNN on a pre-lease once the “teaser rate” concession burns off after the initial twelve months of the lease term.
- Net-to-Gross — The Operating Expenses Behind the Comp.** Rental appreciation is expected in an up market. Dating back to the first two quarters of 2017, typical starting rental rates for deals between 50,000 SF–150,000 SF would range from low to mid \$0.50s NNN. Fast forward twelve months, and those same deal sizes now range from low to mid \$0.60s NNN, and in some cases high \$0.60s NNN to low \$0.70s NNN in markets like Chino. What may surprise some is how many tenants have been willing to absorb a landlord’s new property tax basis on a recently acquired building in the form of increased triple net operating expenses. While typical triple net operating expenses in the Inland Empire West range from \$0.09–\$0.14 / SF, operating expenses on these recently acquired buildings range from \$0.17–\$0.20 / SF, with a majority of the expense coming from the new property tax basis of the recent acquisition.
- What About the B Squad?** In typical “flight to quality” fashion, tenants have historically paid more for the newest buildings with state-of-the-art features. But what about the Class B buildings (Class “B” indicating buildings with less than 28’ minimum clearance, with sprinkler systems below ESFR calculations, or more than 20 years old). In most cases these “now considered vintage” properties are achieving high \$0.50s to low \$0.60s NNN rents, and in some cases mid \$0.60s NNN on buildings under historic long-term ownership and relatively low triple net operating expenses. Those same landlords with lower operating expenses have been striking gross leases in the mid \$0.70s, which once the operating expenses are included, equate to the same or similar low to mid \$0.60s NNN base rate the new construction buildings have been achieving.
- Remember Free Rent? Most Landlords Don’t.** As the rental market has tightened, the willingness of landlords to provide rental abatement and tenant improvement allowances has diminished. On average, only one month of rental abatement is granted, and many recent deals have included no free rent and an immediate occupancy date. In some cases, landlords will grant rental abatement in the form of early occupancy for a portion of the month, depending on the date the transaction is executed. But more often than not, there is less than 30 days between transaction execution date and rent commencement.

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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