WAREHOUSE / DISTRIBUTION

Metro: Los Angeles

Contents

house/Distribution- Reis Observer

THE ECONOMY

"Los Angeles County lagged its neighbor counties in recovery from the Great Recession over the past two years, but it finally gathered momentum in 2012," reported the Los Angeles County Economic Development Corporation (LAEDC) in its 2012-2013 Mid-Year economic forecast. "The monthly unemployment rate fell by two percentage points in less than a year from the cyclical peak of 13.2% in July 2011 to 11.2% in May 2012. The overall rate of job growth picked up slightly during the second few months of this year, while a number of industries experienced an uptick in activity and more robust job growth." Los Angeles is certainly the economic driver of California, and dominates the southern portion of the state with its huge economy as well as its sheer size. However, as the city struggles to regain its footing, the rest of the state has catching up to do. "California struggles to recover lost jobs," the *Los Angeles Business Journal* reported July 11th. Using seasonally adjusted figures, this source reports that "nine states and the District of Columbia have recovered all of the jobs they lost during the recession, but 41 other states, including the Golden State, still haven't bounced back."

The latest Current Employment Survey (CES) data from the BLS show a small gain, but a gain nonetheless, for seasonally unadjusted non-farm employment. Data from May 2011 to May 2012 show a gain of 42,400 payroll jobs (1.1%) in Los Angeles County. As noted in earlier *Reis Observer* coverage, the self-employed are a large portion of the LA workforce and CES data does not include them. According to household-based data from the BLS, which includes these non-employees, the employment gains are much smaller, with the number of employed residents of Los Angeles County rising by just 24,300 (0.6%) in the year to May 2012, implying that perhaps many of these former free lancers may have finally been taken on as employees. Not many cities can boast of an economy that runs from aerospace to motion pictures, but LA can. According to the LAEDC, "the aerospace and technology sector includes manufacturing and service industries in aerospace, information technology, electronics, and biomedical technology," and these industries accounted for 4.7% of non-farm jobs in Los Angeles County in 2011.

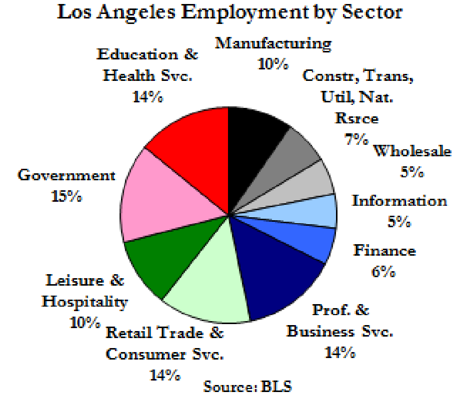
Meanwhile, "activity in the entertainment industry continues to improve," the LAEDC reports. From May 2011 to May 2012, according to CES data, payroll employment increased by 5,100 (2.7%) in the Information Sector, led by a gain of 5,200 (4.3%) in the Motion Picture and Sound Recording industry. It should be noted, however, that FilmL.A—which

- *The BLS reports a seasonally unadjusted unemployment rate of 11.1% in May for the Los Angeles Metropolitan Division, down from 12.0% one year earlier.*

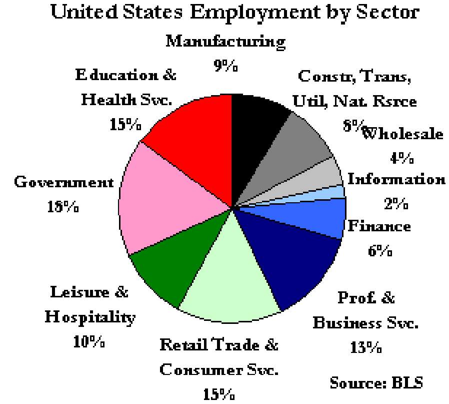
- *Total non-farm employment in Los Angeles was up 1.1% year-over-year in May, according the BLS.*

- *Moody's Economy.com reports a second quarter 2012 average household income of $134,362 for Los Angeles. Average household incomes of $124,481 and $128,541 are reported for the top metros in the nation and West region, respectively.*

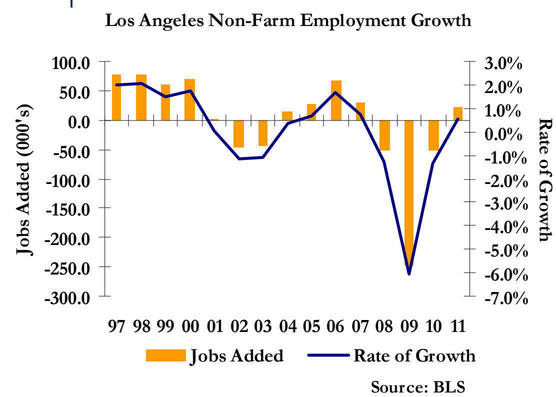
Los Angeles Employment by Sector



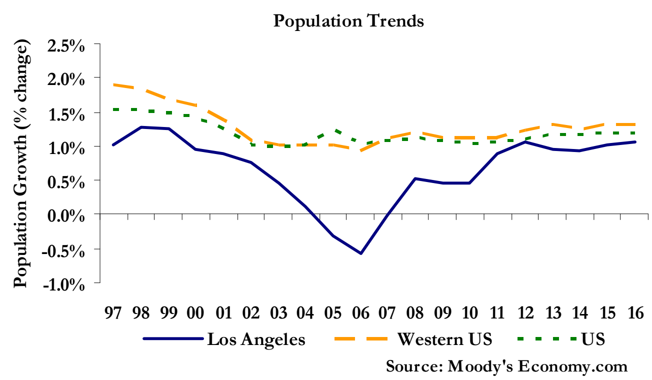
United States Employment by Sector



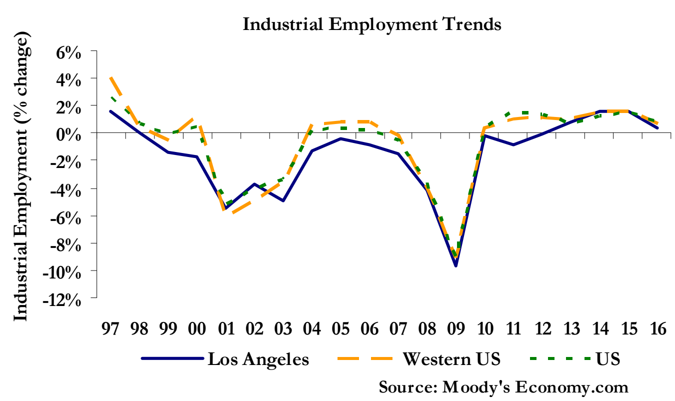
coordinates permits for filmed entertainment shot in the area, announced in early July that "overall on-location production slipped slightly last quarter compared to the same period last year." Even a blip in the entertainment industry can have serious effects in a city like LA.



The Financial Activities sector added 4,900 jobs (2.3%) year-over-year as of May, and Professional and Business Services employment increased by 18,300 (3.4%). The latter includes an increase of 10,300 (12.3%) in the Employment Services industry, which includes temporary workers. Manufacturing continues to lose ground. This sector lost another 5,800 jobs (1.6%) and Transportation and Warehousing was barely positive with 600 (0.4) jobs gained. Wholesale Trade saw a similarly anemic performance, gaining 400 jobs (0.2%) through May 2012. There was welcome news in the Construction sector, however, as 3,100 jobs (3.0%) jobs were added year-over-year in May. Public works have been active, as *The Source* reported in April that the Los Angeles County Metropolitan Transportation Authority certified "the Final Environmental Impact Statement/Report (EIS/EIR) for the $1.37- billion Regional Connector Transit Corridor Project that will connect three light rail lines through downtown Los Angeles." According to *Curbed LA*, once completed, the Connector will allow people "to train travel across the County without transfers," one of the city's long –sought goals On the consumer front, CES data shows an increase of 10,900 jobs (2.8%) year-over-year in May in Leisure and Hospitality, and 4,600 (1.2%) in Retail Trade. Within the latter sector the Food and Beverage Store industry added 3,200 jobs (3.7%) and the big-box General Merchandise Stores industry added 2,200 jobs (3.4%). All in all, total Private Employment increased by 50,600 jobs (1.6%).



OUTLOOK

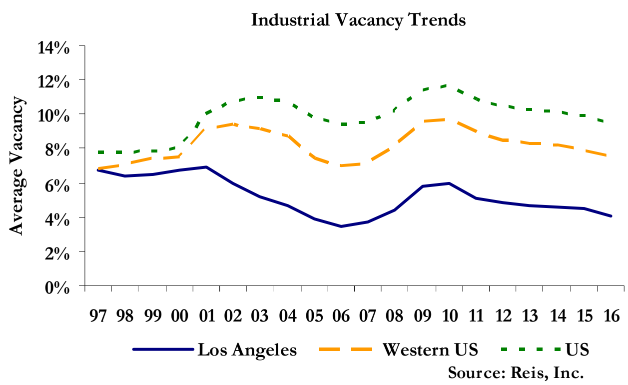


Moody's Economy.com predicts a slight increase of 31,000 jobs (0.8%) in 2012 but a better showing in 2013. The LAEDC maintains the position it held in earlier reports, noting that "it will take several years to return to the job levels that preceded the recession, but most industries are expected to add jobs this year and next, the exceptions being Government and Manufacturing."

THE REAL ESTATE MARKET

The Los Angeles industrial market is on the upswing. "Performing better than expected, the perception that industrial real estate in the region hit bottom in 2011 is gaining traction," according to the according to the 2013 International Trade Outlook by the Los Angeles County Economic Development Corporation (LAEDC). "Vacancy rates are declining across much of Southern California and rental rates appear to be stabilizing" and "a few markets are even starting to see an increase in rental rates."

OCCUPANCY



Reis reports a second quarter 2012 vacancy rate of 8.5% for 444 million square feet of multi-tenant warehouse/ distribution space in Los Angeles County, down 40 basis points from the prior quarter and 120 from the second quarter of 2011. The rate had peaked at 10.5% in the third quarter of 2010. For 38.7 million square feet of multi-tenant Flex/R&D space, Reis reports a vacancy rate of 6.0%, down 60 basis points from the prior quarter and down 260 basis points year-over-year.

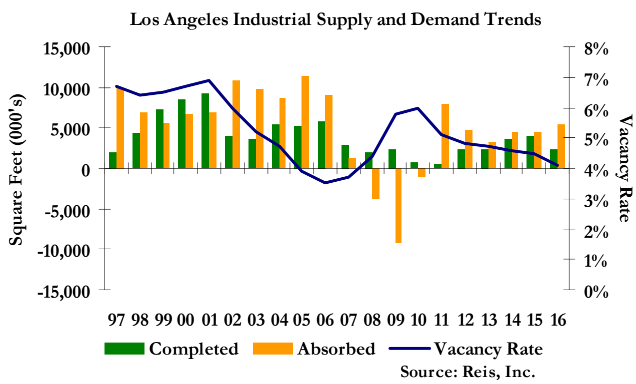
Colliers reports a total vacancy rate of 4.5% for 882 million square feet in Los Angeles County, down 30 basis points from the prior quarter. Strong demand during the quarter was concentrated in Central Los Angeles according to this source, which puts the average asking rent at $6.00 psf. "Market fundamentals for the region continue to improve," according to Cushman & Wakefield, "dropping the overall vacancy rate to 4.6%, the lowest since 2009." "The marketwide vacancy rate will fall 60 basis points to 7.6%, after a 30-basis-point rise in 2011" according to Marcus & Millichap. Reis forecasts vacancy for multi-tenant warehouse/distribution space will finish 2012 at 8.5%, and then change little through 2015. For Flex/R&D space, Reis forecasts a year-end rate of 6.5%, with little change the next few years.

Special Real Estate Factors:

- *"Cargo volumes at the ports of Los Angeles and Long Beach rose in June, though the two ports continue to see disparate trends," the LA Business Journal reported July 18th. "About 9.0% more cargo containers passed through the Los Angeles port last month than in the same month a year ago, thanks in part to a big increase in the number of empty containers bound for Asia. The port handled about 697,000 containers, up from 641,000 in June of last year," this source reports. "For the year, cargo volumes at the port are up 6.5%. But at the neighboring Port of Long Beach, despite solid growth of imports and exports, the total container count grew just two-tenths of a percent due to a 10.0% dip in the number of empty containers leaving the port. Still, any growth is good news for Long Beach, which has seen its cargo numbers drop in most months this year. For the first half of the year, cargo traffic is down 5.0%. Taken together, the two ports show a relatively flat year so far, with cargo up just 1.4% through June. And officials at the Los Angeles port say they don't expect a big change in the second half of the year."*

- *Western Real Estate Business reports that the "Ports of Long Beach Los Angeles Keep Industrial Developer Active." This source notes that "the Southern California industrial product type continues to be a highly resilient market and one of the most desirable industrial places to invest in across the nation. The ports of Los Angeles and Long*

SUPPLY AND DEMAND



Warehouse/distribution net absorption continued to be strong in the second quarter at 1.6 million square feet, after a slightly smaller amount was recorded for first quarter. A substantial 6 million square feet were absorbed in 2011, after a completion total of 587,000 square feet, according to Reis' latest construction data Thus far in 2012, 812,663 square feet of such space has been completed. Reis tabulates 1.7 million square feet under construction in various warehouse/distribution projects, and well over 2.5 million in the planning stages. Reis estimates just less than 2 million square feet will complete in 2012, while net absorption will reach a remarkable 4 million square feet. Demand is forecast to keep a slight edge over new supply from 2013 to 2016, but not quite as much as the current dynamic scenario.

The second quarter saw a pickup in Flex/R&D net absorption, as the first quarter's total of plus 47,000 square feet was a notably outpaced by the second quarter's 242,000 square feet. Construction for this property type has been light, with no completions in 2011, but 250,000 square feet is forecast to complete in 2012. Reis predicts net absorption will reach 318,000 square feet. From 2012 to 2016, Reis predicts new construction will total 1.7 million square feet, or about 335,800 per year on average, while net absorption will all but mirror those amounts. Thus vacancy is expected to remain with 50 basis points of the current rate for the rest of the forecast period.

"In 2012, additions to supply will total 840,000 square feet, down from more than 900,000 square feet last year," according to Marcus & Millichap. "There is currently 1,511,500 square feet of industrial space under construction as developers remain optimistic about the prospect of future rental rate increases," according to Colliers. Cushman & Wakefield reports year-to-date overall net absorption at 1.3 million square feet, with a lack of available quality space suppressing leasing.

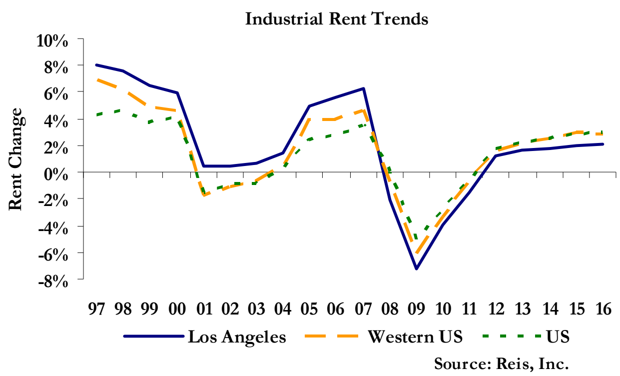
Special Real Estate Factors:

Continued

Beach are the drivers for the region, as the industrial vacancy rate is one of the lowest not only nationally, but worldwide. For example, the South Bay industrial market experienced positive absorption during the fourth quarter of 2011 and the first quarter of 2012 as the direct vacancy rate decreased to 5.0%. This was welcomed news by property owners who had not seen two straight quarters of positive signals from the marketplace since 2007," this source reported in July. "The fundamentals of supply and demand have also encouraged developers to get back into building Class A properties as they are so high in demand in this area. According to our tracking, there is more than 10 million square feet of speculative Class A construction in the South Bay, Mid Counties, Orange County and the Inland Empire markets. This accounts for just less than a 1.0% increase in new base inventory." Sale transactions have also increased according to this source, "as buyers are taking advantage of historic low interest rates and SBA financing. Investment sales have also increased and should continue with the low interest rates. Investors know that real estate is a great hedge against inflation, and many foresee inflation and higher interest rates in the near future."

- *"Boeing prepares for U.S. defense pending cuts," Los Angeles Business reported May 16th. "Boeing Co.,*

RENTS



Warehouse/distribution rents are edging up, with the average asking rent rising 0.5% in the second quarter to $6.01 psf and the average effective rent up 0.7% to $5.53 psf. The year-over-year gains are 0.3% and 1.5% respectively, and Reis predicts rents will rise by 1.5% asking and 2.0% effective for all of 2012. For Flex/R&D space, the average asking rent increased 0.4% to $11.01 psf in the second quarter, with the average effective rent up 0.5% to $9.87 psf. The year-over-year changes are negative 0.3% and positive 0.3%. Gains of 1.4% asking and 1.7% effective are forecast for this property type for 2012. Reis' forecast calls for improving rent increases over the forecast period, but to no more than 2.5% in any year through 2016.

Cushman & Wakefield reports a 1.9% increase in direct asking rents year-over-year, to $6.36 psf. This source reports a direct weighted average rate of $6.24 psf for warehouse/distribution, and $9.12 psf for office/service. "Looking ahead to the rest of 2012," according to the LAEDC, Los Angeles County will "see increases in rental rates accompanied by longer lease terms." Reporting on the Los Angeles section of the greater LA Basin industrial market, Colliers reports a weighted average asking lease rate of $6.00 psf. According to Marcus & Millichap, "asking rents will increase 1.8% to $6.32 psf this year as effective rents rise 2.6% to $5.91 psf. Last year, losses of 0.8% and 0.3% were recorded for asking and effective rents," this source notes.

Single property industrial sales volumes and prices dipped slightly in the second quarter, according to Reis Transaction Analytics. There were 57 deals totaling $371 million at a mean price of $92 psf. The quarterly sales volume is consistent with the quarterly values recorded in 2011 and 2010, according to Reis. The mean sale price of $6.5 million is up only slightly from first quarter's $6.1 million.

Special Real Estate Factors:
Continued

which has operations from its Defense, Space and Security division throughout Southern California, said it is preparing for the 'distinct possibility' that U.S. defense spending will be cut by a total of $1 trillion over the next decade." The defense division has laid off about 8,000 of 60,000 jobs over the past 18 months according to this source, "but most of those positions have been shifted to other departments inside the company, such as the commercial sector. If $500 million in spending cuts took effect in January as planned, Boeing is expected to see about double the impact, the company said. More than 2,300 workers in the aerospace and defense sector lost their jobs in April, bringing the total number of workers to 10,102, according to data complied by Challenger, Christmas & Gray, a Chicago-based consulting firm."

- *The Associated Press reported in May that Federal environmental regulators say they have "reached a deal with four companies to build a groundwater treatment system at two Superfund sites in southern Los Angeles County." The Environmental Protection Agency said "the $14 million settlement is the first step in cleaning up contaminated groundwater at the Montrose and Del Amo Superfund sites in Torrance. For three decades, the Montrose site made the chemical DDT. The nearby Del Amo site made synthetic rubber. The EPA said groundwater contamination from both sites has mixed and will be treated by the proposed plant. The*

SUBMARKETS

The South Bay area is the home of the ports of Los Angeles and Long Beach, and the key to the region's economic prosperity, although distribution centers are located throughout the county and further inland, particularly in the Mid Cities submarket. The San Gabriel Valley contains more traditional manufacturing, along with high-tech and distribution space while the San Fernando Valley is more tech-and local-market oriented. Labor-intensive light manufacturing, including apparel and toys, clusters in central areas.

San Fernando Valley

- Reis reports a vacancy rate of 18.8%, highest among eight submarkets, and an average asking rent of $8.63 psf, also the highest countywide, for 6.6 million square feet of warehouse/distribution space in the San Fernando Valley West submarket.
- The vacancy rate is down 770 basis points year-over-year including 230 in the second quarter. Rents are up again, although not as much as first quarter, with the average asking rent up 0.5% for the quarter and the average effective rent up 0.8% to $7.77 psf. The year-over-year increases are 7.5% and 9.7%, respectively.
- For 22.2 million square feet of warehouse/distribution space in the San Fernando Valley East submarket, Reis reports a vacancy rate of 7.7%, and an average asking rent of $7.23 psf.
- There the vacancy rate is down 30 basis points from the prior quarter and 210 from a year earlier. The average asking rent is up 0.4% from the prior quarter and down 1.4% year-over-year, but the average effective rent is up 0.6% for the quarter and 0.3% year-over-year to $6.68 psf.
- A 240,000-square-foot FedEx facility is under construction in San Fernando Valley East, according to Reis.
- Reis reports a vacancy rate of 8.6% and an average asking rent of $12.32 psf for 3.1 million square feet of Flex/R&D space in the San Fernando Valley West submarket.

Special Real Estate Factors:
Continued

settlement is subject to a final court approval. Construction is expected to take 18 months. Once built, it will treat about a million gallons of contaminated water a day," according to this source.

- *"Ace Canopy is leaving Palmdale due to high state tax rates and will head to Taylor, Texas," Los Angeles Business reported June 11th. "Ten percent of Ace Canopy will remain in California but 90% of the canopies will be distributed from Taylor, company officials said Monday. Ace Canopy is a division of Abadak Inc., a supplier of outdoor products and camping gear. Abadak is also based in Palmdale. Ace Canopy officials couldn't be reached for comment. The company sells a variety of products that include outdoor canopies, party tents, shade canopies, carports and instant shelters."*

- The vacancy rate is up 50 basis points from the prior quarter, and up 150 year-over-year. The asking average fell 0.6% during second quarter, with the average effective rent down 1.1% to $11.09 psf. The year-over-year increases are 1.7% and 2.8%, respectively.

- The vacancy rate for 2.1 million square feet of Flex/R&D space in the San Fernando Valley East submarket is 6.7% according to Reis, while the average asking rent is $8.59 psf

- Flex/R&D vacancy is down 300 basis points from a year earlier including an 80-basis-point second quarter decrease. The average asking rent is down 0.2% for the quarter and 2.7% from a year earlier, but the average effective rent is up 0.3% during the quarter to $7.71 psf. It remains down 1.2% year-over-year.

- For a 222 million-square-foot LA North submarket that also includes the Los Angeles County portion of the Inland Empire, Cushman & Wakefield reports an overall vacancy rate of 4.7% and a direct weighted average net rental rate of $6.96 psf for warehouse/distribution space and $10.20 psf for office service.

- "In terms of net demand, the North Los Angeles is the healthiest market of the greater Los Angeles region," according to Cushman & Wakefield. "After a net loss of 2.2 million square feet in occupancy in 2010 when it overall vacancy rate climbed to 5.8%, the market has been slowly recovering. This quarter's occupancy gain of 137,901 square feet brought the overall vacancy down to 4.7%, marking the sixth consecutive quarter of positive growth for this market."

San Gabriel Valley

- In the San Gabriel Valley, Reis reports a second quarter vacancy rate of 9.8% and an asking rent of $6.21 psf for 16 million square feet of multi-tenant warehouse/distribution space.

- The vacancy rate is unchanged over three months and down 90 year-over-year. The average asking rent and the average effective rent were unchanged over the quarter, the latter at $5.69 psf. Rents are down 1.3% and 0.4% from a year earlier.

- This is one of Los Angeles County's largest industrial markets according to other sources, but the Reis inventory is small. This implies that a large share of the space is single-tenant, owner-occupied or general industrial space. The square footage per building in the Reis inventory is less than 38,000 square feet.

- Moreover, Reis breaks out some of the more prominent industrial areas, such as City of Industry, in its separate and adjacent E. Los Angeles/Covina/Pomona Corridor submarket, which has 83.9 million square feet of warehouse/distribution space. Here Reis reports a vacancy rate of 9.0% and an average asking rent of $6.06 psf.

- For 2.4 million square feet of multi-tenant Flex/R&D space in the San Gabriel Valley, Reis reports a vacancy rate of 6.2% and an average asking rent of $10.96 psf.

- The vacancy rate decreased 40 basis points in the second quarter, and is down 40 from a year earlier. The average asking rent and the average effective rent increased 0.6% and 0.8% in the second quarter, the latter to $9.88 psf. The year-over-year decreases are 3.0% and 2.5%, respectively.

- Cushman & Wakefield reports an overall vacancy rate of 4.7% and a direct weighted average net rental rate of $5.40 psf for warehouse/distribution space and $13.68 psf for office/service in the San Gabriel Valley. This source gives an inventory of 192 million square feet.

- This market has been "relatively stable," according to this source. "The largest deal of the second quarter was Evike.com's seven-year lease for 106,266 square feet in Alhambra. Investment activity remains strong with 18 sales totaling 1.4 million square feet."

- Colliers reports the San Gabriel Valley vacancy rate "has remained flat over the quarter, at 4.1% which is the lowest the vacancy rate has been since" the first quarter of 2009. "The largest new lease of the quarter was National Distribution Centers moving into 300,000 square feet of space also in the City of Industry," according to Colliers, which reports a weighted average asking lease rate of $5.28 psf.

South Bay

- The South Bay submarket is home to the Ports of Los Angeles and Long Beach. There Reis reports a second quarter vacancy rate of 9.0%, and an asking rent of $6.43 psf for 100 million square feet of multi-tenant warehouse/distribution space.

- The multi-tenant inventory here, according to Reis, is the second largest among the submarkets behind the adjacent Mid-Cities submarket.

- This submarket posted 413,000 square feet of positive net absorption in the warehouse/distribution category in the second quarter, right after 910,000 was absorbed in the first quarter. The vacancy rate is down 40 basis points for the quarter and 200 year-over-year.

- The average asking rent rose 1.3% during second quarter and the average effective rent rose 1.5% to $5.94 psf. The asking average is up 1.4% year-over-year, and the effective average is up 3.1%.

- Nearly 1.2 million square feet of warehouse/distribution space is under construction in the South Bay submarket.

- For 9.0 million square feet of multi-tenant Flex/R&D space in South Bay, the most among the submarkets, Reis reports a vacancy rate of 6.4% and an average asking rent of $10.46 psf.

- The vacancy rate decreased 10 basis points in the second quarter on 8,000 square feet of net absorption, and is down 150 from a year earlier. The average asking rent is up 0.6% for the quarter and down 0.1% from a year earlier. The average effective rent increased 0.8% and 1.7% respectively to $9.50 psf.

- Colliers reports a weighted average asking lease rate of $6.48 psf and a total vacancy rate of 4.8% for the South Bay.

- According to Colliers, the largest lease deal of the quarter was Amerifreight taking 237,800 square feet of space in Rancho Dominguez. Other deals included Fujitsu Ten Corp. moving into 56,500 square feet of space in Torrance and Ryan's Express leasing 44,700 square feet of space, also in Torrance.

- According to Cushman & Wakefield, "the South Bay industrial market remained relatively healthy with a 5.1% vacancy rate." With the large number of move-ins this quarter, the occupancy gains of 621,076 square feet "offset last quarters' negative net absorption." This source reports a direct weighed average net rental rate of $6.60 psf for warehouse/distribution and $10.56 psf for office service.

Central Los Angeles

- In Central Los Angeles, the older but intensely-used industrial submarket surrounding Downtown Los Angeles, Reis reports a vacancy rate of 7.4%, lowest among the submarkets, and an average asking rent of $5.90 psf, for 77.3 million square feet of multi-tenant warehouse/distribution space.

- The vacancy rate is down 40 basis points for second quarter and 60 from a year earlier on 309,000 square feet of net absorption for the quarter, a very solid performance. The average asking rent is up 0.7% over three months and 1.2% over twelve months. The average effective rent is up 1.1% and 2.2%, respectively, to $5.47 psf.

- For 8.2 million square feet of multi-tenant Flex/R&D space, Reis reports a vacancy rate of 4.4%, and an average asking rent of $14.31 psf.

- The vacancy rate plunged 380 basis points in the second quarter on 315,000 square feet of positive net absorption, more than reversing out the 51,000 square feet of negative net absorption recorded in the first quarter. The average asking rent increased 0.1% for the quarter, with the average effective rent up 0.8% to $12.65 psf. The year-over-year gains are 0.4% and 0.7%, respectively.

- Colliers reports a vacancy rate of 4.1%, down 50 basis points from the prior quarter, and a weighted average asking lease rate of $5.76 psf for 245 million square feet in Central Los Angeles.

- Underlining Reis' observation regarding heavy demand, Colliers reports that second quarter "saw a huge increase in industrial activity, both leases and sales. Sales and leasing activity totaled 5,480,700 square feet" according to this source, "double the 2,637,300 square feet reported in the previous quarter."

- "The Central Los Angeles market began to show signs of life in 2011 with positive gains and at mid-year 2012, the market remained relatively stable with an overall vacancy rate of 3.9%," according to Cushman & Wakefield. This source reports a direct average weighted rental rate of $6.48 psf for warehouse/distribution space.

OUTLOOK

"Local industrial companies are already benefitting from the metro's improving economic climate, and many are buying additional space to meet growing needs," according to Marcus & Millichap. "As the demand for multi-tenant space heats up, and a dearth of listed inventory remains, investors will bid aggressively to purchase the sought-after space." "Looking ahead to the rest of 2012, Los Angeles County will hang on to its high occupancy rates and see increases in rental rates accompanied by longer lease terms. As demand increases and vacancy rates fall, tenants will start to lose some of the negotiating advantages they have enjoyed over the past several years," according to the LAEDC.

Reis expects generally positive performances for both the warehouse/distribution and Flex/R&D sectors. Neither property sector is forecast to see major rental increases the next few years, but gains are forecast nonetheless and occupancy should remain steady.