Reis Observer

LOS ANGELES INDUSTRIAL MARKET

Published August 9, 2011

THE ECONOMY

The Los Angeles County (Los Angeles Metropolitan Division) economy may be in a double-dip recession, according to the latest employment data. According to Current Employment Survey (CES) data from the U.S. Bureau of Labor Statistics (BLS), total non-farm employment was 10,000 jobs (0.3%) lower in May 2011 than it had been in May 2010. A big loss in Government employment, of 26,700 jobs (4.4%) could be partially explained by the loss of 2010 federal census jobs, while private sector employment is up by 16,700 jobs (0.5%) year-over-year. But a look at the data for individual sectors shows a very limited turnaround, with the entertainment and tourism industries doing well, and just about everything else continuing to lose jobs. The Motion Picture and Sound Recording industry was up by 18,100 jobs (15.6%) year-over-year in May, and Leisure and Hospitality was up by 6,900 (1.8%). The only other sector with significant employment gains was the substantially government-funded Education and Health Services sector, at plus 8,700 jobs (1.6%).

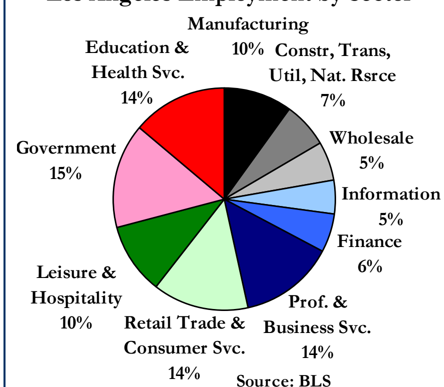
Employment in office-based sectors continues to be weak, with the Financial Activities sector down by 2,900 jobs (1.4%) year-over-year in May according to CES data, and Professional and Business Services up by just 1,300 jobs (0.2%). That gain is almost entirely explained by an increase of 1,100 jobs (1.4%) in the Employment Services industry, which includes temporary workers. While strong gains in this sector often preceded a shift to growing permanent employment, weak gains are not a good sign. And in fact, as noted by the previous *Observer*, year-over-year job gains in Professional and Business Services and Employment Services were much stronger in the year to February 2011.

The same may be said of the industrial sectors, now set in the employment loss category year-over-year. CES data show Manufacturing employment down by 1,100 (0.3%) in the year to May, Wholesale Trade down by 2,300 (1.1%), and Transportation and Warehousing down by 3,700 jobs (2.7%). This was despite a slight increase in the Air Transportation industry. The Construction sector lost another 5,800 jobs (5.5%) during the period. The consumer-based sectors, with the exception of Leisure and Hospitality, also remain weak. The Retail Trade sector lost 1,100 jobs (0.3%) in the year to May, despite a gain of 1,500 jobs (1.7%) in the Food and Beverage Store industry. And Other Services, which includes industries such as Dry Cleaners, Beauty Parlors and repair shops lost 1,800 jobs (1.3%).

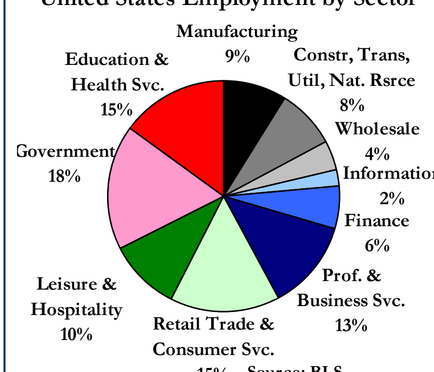
Employment:

- *BLS reports a seasonally unadjusted unemployment rate of 11.8% in May for the Los Angeles Metropolitan Division, down from 12.2% one year earlier.*
- *Total non-farm employment in Los Angeles was down 0.3% year-over-year in May, according the BLS.*
- *Moody's Economy.com reports a second quarter 2011 average household income of $131,104 for Los Angeles. Average household incomes of $122,167 and $125,445 are reported for the top metros in the nation and West region, respectively.*

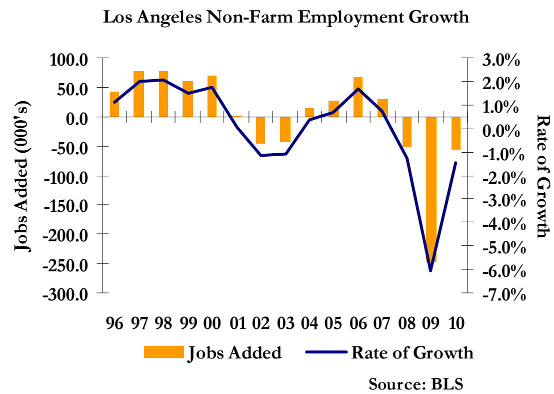
Los Angeles Employment by Sector



United States Employment by Sector

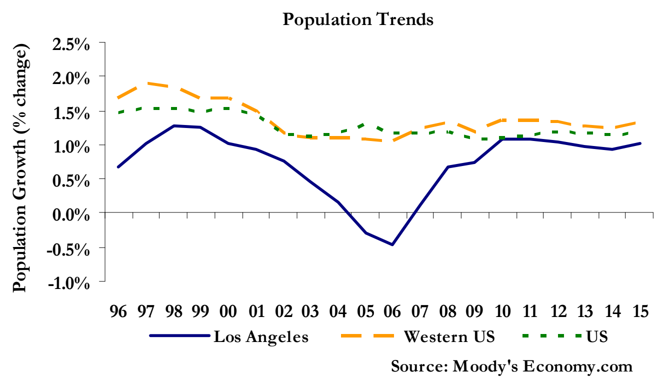


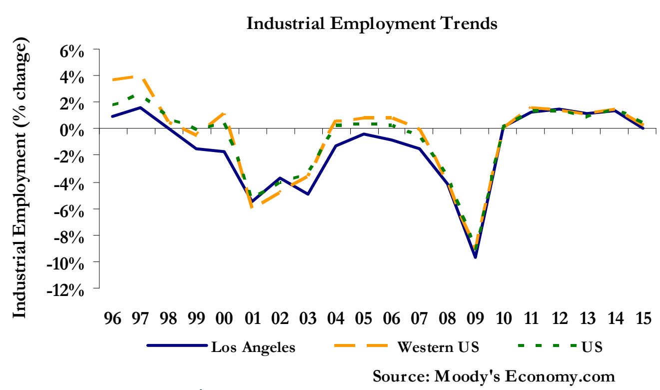
The best news was recorded by household-based data from the BLS. During the mid-2000s boom, many of the employment gains in Los Angeles did not show up in CES payroll employment data, because much of the additional work was going to “freelancers” and “independent contractors” who were being hired to avoid employer taxes and non-wage benefits. Household-based data on the number of employed residents of the county (whether employees or self-employed) showed greater gains than the establishment-based CES. During the bust, the household-based data showed greater losses, and a large number of self-employed workers lost their sources of employment. Now there has been another turnaround, with the number of employed residents of Los Angeles County up by 23,300 (0.5%) in the year to May 2011. It remains down by 321,900 (6.9%) since May 2007.



OUTLOOK

Despite the recent wobble, Moody’s Economy.com forecasts an increase of 38,500 jobs (1.0%) in Los Angeles County for 2011, down from the previous quarter’s forecast but still significantly positive. Strong gains of around 100,000 (2.5%) are expected in some of the latter years of the forecast period as the economy finds its footing, and population growth is expected at or just below the U.S. average after having been far below that average during the 2000s.



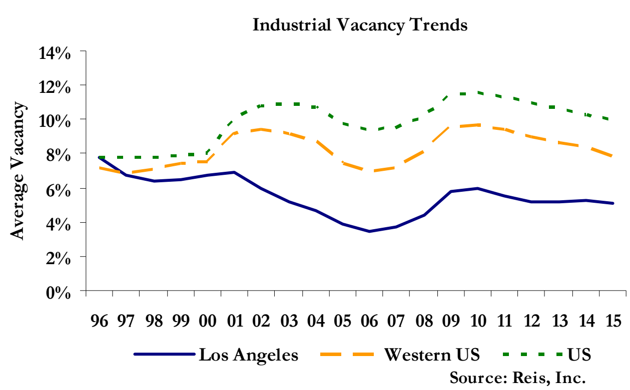


THE REAL ESTATE MARKET

The recovery of the Los Angeles industrial market stalled in the second quarter of 2011, according to several market watchers. Grubb & Ellis called the setback a "speed bump," Cushman & Wakefield noted a "slight slowdown" and Colliers observers that "demand is starting to wane for infill markets and may continue to taper off in future quarters." This sourced called the recovery of the Los Angeles basin as a whole "mixed," but no market watcher has indicated a renewed downturn. The 2011 forecast from Reis, on an 812 million-square-foot multi-tenant, non-manufacturing Los Angeles industrial market continues to call for recovery this year.

OCCUPANCY

"After making a gradual but steady decline throughout 2010, the vacancy rate stalled at 3.1% for the second consecutive quarter," according to Grubb & Ellis, which reports on 1 billion square feet including single tenant and owner occupied space. The vacancy rate is still falling, according to Colliers, but by only 20 basis points from the previous quarter to 5.2%. The rate is 4.8%, according to Cushman & Wakefield, down 10 basis points from the quarter before and 40 from a year earlier. The availability rate is down 30 basis points from a year earlier according to this source due to "fewer properties brought to market."



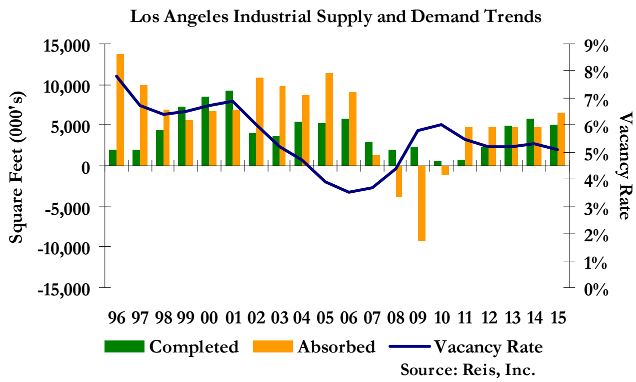
The vacancy rate has not reached 10.0% in the Los Angeles industrial market since 1994, according to annual data from Reis, and has not exceeded 6.0% since 2001. During the mid-2000s, the negative effect of industrial space scarcity on the economy was a major issue, as the local vacancy rate hit a low of 3.5%, and industrial development shifted to the Inland Empire. Although Reis predicts the vacancy rate will shed 50 basis points in 2011, the lows of the mid-2000s are not expected to recur. Instead, the rate is forecast to fall to 5.2% in 2012, and then level off.

Special Real Estate Factors:

- *Los Angeles, not Detroit, was the biggest loser of factory jobs from 2008 to 2011, according to MSNBC. In absolute numbers, not percentage. "Not surprisingly, the big losers are also some of the biggest markets, including Los Angeles, which was the biggest loser with a net loss of 89,900 manufacturing jobs since 2008. L.A. was followed by New York City, Chicago and Detroit. The recession has exacerbated a long-term loss of manufacturing jobs in America, with more companies replacing workers with technology or moving production work overseas."*

- *Los Angeles is looking Green for a turnaround, according to a new report from the Los Angeles Economic Development Corporation. The size of the "green" market in Los Angeles is expected to be the key magnet for "green jobs." With a population of more than 10 million, Los Angeles County presents a large market for green goods and services and, by itself, can create enough demand to influence greening trends. The L.A. region's general prosperity means that it is better positioned than many emerging economies to afford the often more expensive up-front costs associated with greening." The culture and politics is supportive to absorbing those costs for long term gains. "The state of California places a high priority on 'greening' relative to other regions. Several pieces of*

SUPPLY AND DEMAND



Although Cushman & Wakefield took note of a second quarter slowdown, this source reports net absorption for the first half of 2011 at plus 1.7 million square feet, with direct net absorption at plus 2.1 million square feet. Colliers finds a similar pattern, with 4.6 million square feet of positive net absorption year-to-date, but only 1.3 million of that in the second quarter. According to Grubb & Ellis, net absorption actually shifted in to the red in the second quarter at minus 690,000 square feet, with the year-to-date total at plus 1.7 million square feet.

Construction remains limited. Grubb & Ellis puts the under construction total at 446,000 square feet. Colliers reports 1.3 million square feet under either construction or renovation, and 4.2 million square feet planned or proposed including projects without planning approval or financing. Cushman & Wakefield reports 610,000 square feet completed in the first half of 2011 with 1.55 million square feet under construction. It isn't just weak demand that constrains development. According to Cushman & Wakefield, "with limited supply of land for new development, developers must rely on redevelopment and repurposing of existing properties." This means that new supply may go hand in hand with inventory losses due to demolition.

The 521,000 square feet of new supply recorded by Reis in 2010 was the least the firm had tabulated in its 31 year history here, and just 635,000 square feet is forecast to come on line in 2011. This a reaction to 14 million square feet of negative net absorption during the 2008 to 2010 period, a more severe retrenchment for demand than even the crushing early 1990s recession (when vacancy rose higher due to greater construction in the late 1980s). Net absorption had been in the vicinity of 10 million square feet per year during the 2003 to 2007 boom, but Reis forecasts net absorption at a more modest 4.6 million square feet in 2011 and each of the following three years. From the lows of 2010 and 2011, new supply is expected to gradually ramp up and balance the market.

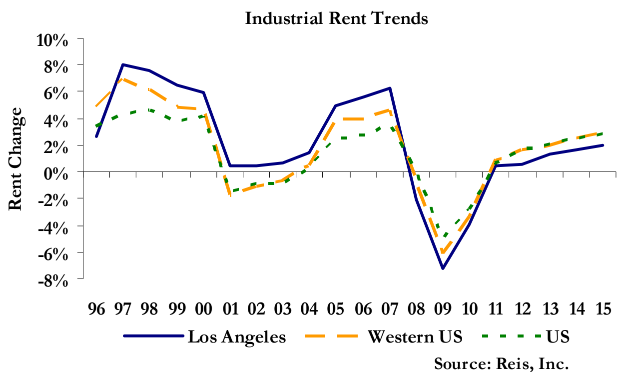
Special Real Estate Factors:
Continued

legislation, executive orders, and administrative rules from the past five years convey the State's commitment to greening the economy…There is a broad commitment to green policies in the state as Californians have consistently supported efforts to clean up and protect the environment. Likewise, business leaders have typically shared those commitments and/or pursued greening for the potential cost savings."

- *The green economy, according to this source, will be like information technology – not just an industry in itself, but a new way of doing things in the full range of activities. "The largest impact of greening the Los Angeles County economy, measured by the number of businesses and jobs affected, will come from existing firms in multiple industry clusters adapting to regulatory requirements; higher costs for transportation and power; and new market opportunities. The job impact will not necessarily be high, since all major industry clusters in Los Angeles can adopt cost-effective greening practices that have been successfully adopted by similar firms and organizations." Attracting new firms in the "green" category from outside Los Angeles will be difficult according to this LAEDC "and intense global competition will make it*

RENTS

The average asking rental rate was $5.64 psf in the second quarter, according to Grubb & Ellis, "up just slightly from the prior quarter and well off the high ($7.32 psf) last seen at the peak of the market in 2008." "While the market hovers near bottom, tenants continue to benefit from renewal packages, including free rent," according to this source. "This practice is already starting to diminish, as market fundamentals are improving." "With improved fundamentals, there was a slight uptick in the region's asking rent," according to Cushman & Wakefield, which records a $6.12 psf figure. The weighted average asking lease rate is "steady" according to Colliers, at $5.64 psf.



The average asking rent and average effective rent began 2011 at $5.93 psf and $5.48 psf, according to annual data from Reis. Strong gains from 2005 to 2007 were reversed—to within a penny for the effective average—by steep declines from 2008 to 2010. This six-year whipsaw, however, had followed a decade of steady gains, leaving Los Angeles with a rent level appropriate for one of the tightest industrial markets in the country. Reis predicts small but improving rent increases for the 2011 to 2015 period, starting with an increase of 0.4% by both rent measures this year, and reaching gains of 2.0% asking and 2.4% effective in 2015.

The slowdown seen in demand in the second quarter extended to industrial property sales, which makes sense because owner-user purchases have been prominent during the recession. Reis Transaction Analytics data show just four deals for $19.9 million during the quarter, by far the least in any quarter going back to the start of the database in 2005 (although additional sales may still be uncovered). The mean price was $91 psf, similar to most recent quarters – it has been below $100 since second quarter 2009 after having been above that level the prior three years. C&W notes few quality assets are being put on the market.

Special Real Estate Factors:
Continued

harder still to develop a new export-oriented industry cluster based on green products and services."

- *"A $15 million deal to sell a huge parcel owned by the Community Redevelopment Agency has fallen through, Los Angeles Downtown News has learned. It marks the third time in less than three years that a project involving the site, envisioned as the jobs-generating Cleantech Manufacturing Center, has been scuttled." The buyer backed out after finding site pollution. "Our independent consultant's analysis of the Cleantech campus determined there are ongoing environmental issues at the site that require additional remediation…While the city invested in a remediation effort of the property, environmental issues persist at the Cleantech site and adjoining areas. We remain very interested in this property but to date have not come to a resolution on how to address the environmental issue and have terminated our escrow on the property." The property had been used as a rail yard and repair facility by Amtrak and its predecessor railroads, and by Crown Coach Company as a manufacturing plant. "According to the CRA, there was a rail car spill in the late 1970s or early '80s. Other pollutants came from the repair work." The damage will cost up to $2.5 million to clean, up according to an estimate. "The dissolution of the Genton deal is the latest stumble for a property that has been nothing but trouble for the CRA," with prior deals having*

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. The San Gabriel Valley contains more traditional manufacturing, along with high-tech and distribution space while the San Fernando Valley is more technology and local-market oriented. Labor intensive light manufacturing, including apparel and toys, clusters in central areas.

San Fernando Valley/Ventura County

- "At mid-year 2011, the San Fernando Valley & Ventura County industrial market experienced negative net absorption (-343,900 square feet again," according to Colliers. "After a decline in total vacancy seen last quarter, the total vacancy rate increased 30 basis points from last quarter to 5.4%." This source put the weighted average asking rent for 176 million square feet at $6.36 psf.

- The vacancy rate in its 221 million-square-foot North Los Angeles submarket fell 20 basis points to 5.4%, according to Cushman & Wakefield. While this source reports positive net absorption, which is only due to the inclusion for Santa Clarita Valley in the LA County portion of the Inland Empire. Overall rental rates are "flat" at $7.20 psf, and down 31.0% from the peak, according to C&W.

San Gabriel Valley

- "Industrial real estate demand has been positive for the last three quarters and the San Gabriel Valley industrial market continues to improve throughout 2011," Colliers reports. This source put the vacancy rate for 142 million square feet at 5.4%, down 30 basis points from the prior quarter, and the average asking rent at $5.04 psf.

- Cushman & Wakefield reports a renewal for 250,050 square feet of warehouse/distribution space by Dura Freight Lines at 20275 Business Parkway. In a new warehouse/distribution lease, Carryland Company signed for 145,800 square feet at 19301 E. Walnut Drive.

- This source reports net absorption at plus 100,000 square feet for the quarter, along with a vacancy rate of 4.3%, the same as a year earlier.

Special Real Estate Factors:
Continued

featured an electric car battery manufacturer and an Italian rail car manufacturer.

- *"We are entering peak season for the port of Los Angeles/Long Beach and companies will begin stocking their shelves and warehouses for the holiday season" according to Colliers. "Port activity has steadily risen for the past six quarters, albeit at a decreasing rate. Retailers have been more optimistic in their holiday orders after continued underestimating during the recession, and this will benefit large industrial distribution centers in Southern California."*

- *"The Wilmington Waterfront Park opened earlier this month after decades of wrangling between the Port of Los Angeles and the neighbors," according to CurbedLA. "Starting in the eighties, the Port had plans to build a 20 foot high barrier between Wilmington's houses and the waterfront, but by 2001, neighbors were pushing for a buffer park instead, according to the LA Times. Construction finally began in 2009. The 30 acre park covers nine blocks of formerly vacant land and has a huge lawn, a splash fountain, a promenade, a playground, barbecues, and a 16 foot high sound-blocking hill on its southern border."*

- C&W reports some development and sales action in the San Gabriel Valley. In the second quarter, "Majestic Realty broke ground on its first new construction since 2008 with a new 300,000-square-foot building in its Grand Crossing Industrial Center in the City of Industry." A 655,000-square-foot building for Huy Fong Foods had broken ground previously in the San Gabriel Valley. Both are due on line in the first quarter of 2012.

- In addition, as reported by this source, Exxel Outdoors purchased a 155,679-square-foot building at 341-345 Baldwin Park Boulevard for $8.2 million ($52.60 psf), and JP Original purchased a 131,420-square-foot building at 19161 Walnut Drive for $9.1 million ($69 psf).

South Bay

- "Sales and leasing activity has declined over the past year as the large Class A industrial space that Fortune 500 companies find desirable have largely already been leased," according to Colliers. "To demonstrate this point, OHL has pre-leased a 224,600-square-foot Class A building being constructed by Watson Land Company."

- This source put the vacancy rate for 213 million square feet at 5.3%, down 10 basis points for the quarter, and the asking rent at $6.24 psf, unchanged from the prior quarter.

- The largest transaction of the quarter, according to Grubb & Ellis, "was a direct lease in which AZ West signed a 72-month direct lease on a 302,400-square-foot warehouse in Carson" at $6.12 psf. "The building is currently occupied by Boeing until the end of July. AZ West will take possession on November 1st; the deal extends through the end of October 2017" and "includes one 5-year option at market rent."

- Cushman & Wakefield reports a renewal for 273,000 square feet by Ernest Packaging Solutions at 5777 Smithway Street in the Commerce/Vernon area. In the largest new lease, Herbalife took 148,900 square feet at 18431 S. Wilmington Avenue. Also reported by this source was the purchase of a 310,000-square-foot building at 2001 East 57th Street in the Commerce/Vernon area by owner-user CR Laurence.

- This source puts the South Bay vacancy rate at 5.1% for 230 million square feet, unchanged from the prior quarter, and the direct weighted average net rental rate at $6.24 psf, a slight increase.

- "Owner/user purchases constitute the lone bright spot and the most prominent trend," in the South Bay/Long Beach industrial market according to *Western Real Estate Business*. "In Rancho Dominguez in March, F.C.C. Logistics' $5 million purchase of a 71,360-square-foot industrial facility was a significant South Bay transaction of this kind. Sparking the owner/user acquisition trend are low property valuations, low interest rates and the availability of SBA financing. A prime example is a local auto-parts aftermarket company, which is currently in escrow for 19,000 square feet of space in north Long Beach."

- "Though new development has been absent, value-added projects featuring the renovation of existing facilities are happening," according to this source. "One significant new project on the horizon is a 200,000-square-foot distribution building that will be built by Alere Property Group LLC on 12.4 acres in Long Beach."

Central Los Angeles

- Colliers reports a vacancy rate of 4.6% for 245 million square feet in Central Los Angeles, down from 4.9% one quarter earlier, and the asking rental rate at $5.16 psf, the same as the prior two quarters.

- "Unlike last quarter where leasing activity was concentrated on a few large deals, sales and leasing activity this quarter was spread more evenly across all size ranges, with the majority of deals occurring in small and mid-sized buildings" according to this source.

- Cushman & Wakefield reports only nine deals over 50,000 square feet, none of which was large enough to make its list of major leases. This source reports a 30-basis-point decrease in the vacancy rate to 3.9%, and a slight uptick in the asking rent to $5.28 psf.

OUTLOOK

"While it appears that the recovery has slowed, it is important to keep in mind that with a vacancy rate of 3.1%, Los Angeles is unquestionably the tightest market in the country," according to Grubb & Ellis. "Its proximity to a large population center, the country's two largest container ports and lack of developable land consistently make it one of the best performing markets in the country."

Reis believes the market has entered an extended recovery, with the vacancy rate falling to a moderate level and rents starting to rise. It will take three years for occupancy to recover the losses of the recession, and more than five years for a full recovery in rents. But Los Angeles was in a position of strength to start, and remains so today.