

ORANGE COUNTY

Industrial Q2 2023

	YoY Chg	12-Mo. Forecast
2.1% Vacancy Rate	▲	▲
-579.1K Net Absorption, SF	▲	▼
\$1.71 Asking Rent, PSF	▲	▲

Overall, Net Asking Rent

ECONOMIC INDICATORS Q2 2023

	YoY Chg	12-Mo. Forecast
1.7M Orange County Employment	▲	▲
3.2% Orange County Unemployment Rate	▲	▬
3.6% U.S. Unemployment Rate	▬	▲

Source: BLS

ECONOMIC OVERVIEW

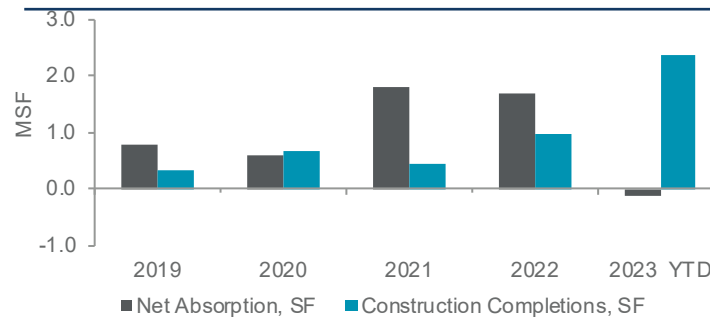
Between May 2022 and May 2023, nonfarm employment in Orange County (OC) grew by 45,600 jobs, representing a year-over-year (YOY) increase of 2.7%. The trade, transportation and utilities sector fueled job growth, adding 6,800 jobs (+2.7% YOY), followed by the manufacturing sector with a gain of 2,800 jobs (+1.8% YOY). The monthly unemployment rate in OC increased from 2.7% in the previous year to 3.2%, aligning with the Q2 2023 average of 3.2%.¹ The 272,300 nonfarm jobs lost between March and May 2020 at the onset of the pandemic have been fully recovered as of May 2023. Since June 2020, OC has added 305,000 jobs. Looking ahead, all employment sectors in OC are projected to experience growth. Combined, these sectors are expected to grow at a rate of 2.5% in 2023 and 0.9% in 2024, surpassing the five-year historical average of 0.6%. The unemployment rate is also forecasted to increase slightly from 2.7% in 2023 to 3.0% in 2024, remaining below the five-year historical average of 4.8%.²

Through May 2023, the Port of Los Angeles and the Port of Long Beach accounted for 3.2 million Twenty-Foot Equivalent Units (TEUs) combined of loaded imports, a 27.2% drop YOY.³ Part of the decline in imports can be attributed to the ILWU-PMA labor contract negotiations. Once the tentative agreement is ratified, there may be a return of diverted TEU volume to the ports. Until then, uncertainty and the threat of stoppages will continue to loom over the San Pedro Ports. Advance estimates of U.S. retail and food services sales for May 2023 were \$686.6 billion, up 0.3% from the previous month and up 1.6% YOY. E-commerce sales totaled \$272.6 billion, an increase of 3.0% quarter-over-quarter (QOQ) and 7.8% YOY, with the e-commerce share of total retail sales declining from its peak of 16.5% in Q2 2020 to 15.1% in Q1 2023.⁴ Consumer spending habits may shift downward as economic uncertainty impacts the broader region and nation.

SUPPLY AND DEMAND

The overall vacancy rate in the OC industrial market increased for the second consecutive quarter, rising by 40 basis points (bps) quarter-over-quarter (QOQ) and 80 bps YOY to 2.1%. This was the first time in 11 quarters in which the overall vacancy rate exceeded 2.0%, dating back to the height of the COVID-19 pandemic in 2020. In Q2 2023, tenants returned a total of 579,106 square feet (sf) to the market. This was the highest negative quarterly amount since Q1 2020, indicating a softening in demand for industrial space. The largest vacancy of the quarter was attributed to Cloud Mountain Inc., which filed for Chapter 11 bankruptcy and vacated 246,622 sf in Santa Ana, located in the Greater Airport Area. This example highlights the impact of significant occupiers on the market's vacancy rate. Tenants occupying less than 100,000 sf vacated almost the same amount of square footage as tenants greater than 100,000 sf, indicating that occupancy losses were driven by companies of all sizes. Also contributing to the increase in the vacancy rate were vacant construction completions. The OC industrial market registered 611,157 sf of construction completions in Q2 2023, of which 83.7% or 511,519 sf was delivered vacant.

SPACE DEMAND / DELIVERIES



OVERALL VACANCY / ASKING RENT



In Q2 2023, 2.5 million square feet (msf) of available space was added to the market from the previous quarter, bringing the total available space to 8.4 msf. Most of the added space (2.2 msf) was on a direct basis, while the remainder was added for sublease. The amount of sublease space available at the end of Q2 2023 was just over 1.9 msf, which is 1.5 msf more than a year ago (+330% YOY).

New leasing activity continued to slow in Q2 2023, with just under 1.5 msf leased during the quarter. This represents a 2.4% decrease QOQ and a significant drop of 43.8% YOY. At mid-year 2023, YTD leasing reached its lowest level in five years, totaling just under 3.0 msf. While new leasing activity declined, there was an increase in renewal activity. The three largest leases of the quarter were renewals, resulting in a 153% increase in QOQ renewal activity. The North County market, which normally drives leasing activity in OC, experienced the largest decrease in new leasing activity, down 38.7% QOQ. With an inventory of 109.5 msf, North County recorded the lowest amount of new leasing activity compared to other OC markets, totaling just 349,018 sf.

PRICING

After the first rent decrease in nine quarters during Q1, rents recovered throughout the second quarter. The overall average asking rate in OC increased to \$1.71 per square foot (psf) per month on a triple net basis. This represented a QOQ increase of \$0.15 psf or 9.6% and a YOY increase of \$0.22 psf or 14.8%. In 2023, 2.4 msf of new construction was added to the market – the highest level on record – leading to a notable increase in average rent. For warehouse and distribution buildings, which make up the majority of industrial inventory in OC, the average asking rate rose by \$0.32 psf or 20.9% QOQ, jumping from \$1.52 to \$1.84 psf. This is also a \$0.31 increase from a year ago (+20.9% YOY). The large increase in the asking rent over the past quarter is due to a combination of expensive space becoming available as well as new construction delivering vacant.

FUTURE INVENTORY

At the end of Q2 2023, there were 17 buildings under construction in OC, totaling just under 1.9 msf. All these buildings are being constructed on a speculative basis with only one building pre-leased so far, bringing the overall pre-leasing rate to 5.1%. However, as the completion of these buildings draws nearer, it is expected that more pre-leasing activity will occur.

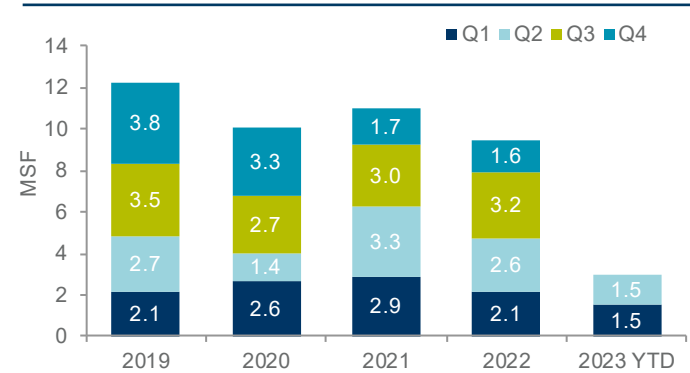
SALES ACTIVITY

Sales activity continued to slow in Q2 2023, dropping 60% QOQ and 68% YOY to \$185 million. Consequently, the average price psf decreased 3% QOQ but stayed close to even YOY only dropping \$1, from \$330 to \$329 psf in Q2 2023. The average capitalization rate increased by 30 bps QOQ and 100 bps YOY to 4.7%.⁴ The interest rate hikes from the Federal Reserve and continuing economic uncertainty have had a material impact on sales volume.

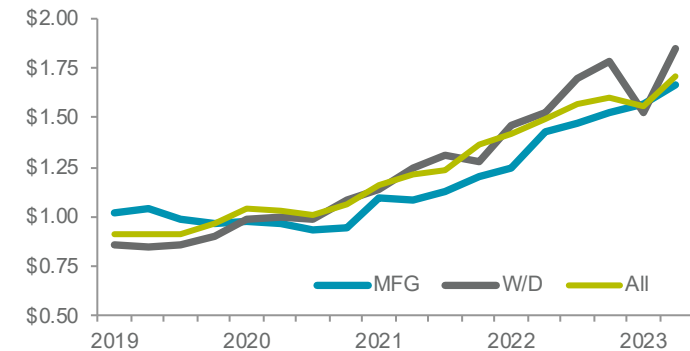
OUTLOOK

- The fact that the ILWU and the PMA have reached a tentative agreement is indeed a positive development in the ongoing negotiations between the two unions. If approved, the return of some TEU volume that was diverted to other ports over the past year can benefit the OC industrial market as demand by occupiers who want to be port-proximate could once again increase.
- As more space comes to the market and new products sit vacant, it is probable that the vacancy rate continues to climb. This in turn may finally have a cooling effect on the growth of the average industrial rental rate which would come as a relief to tenants who have witnessed eye-popping rent increases over the past few years.

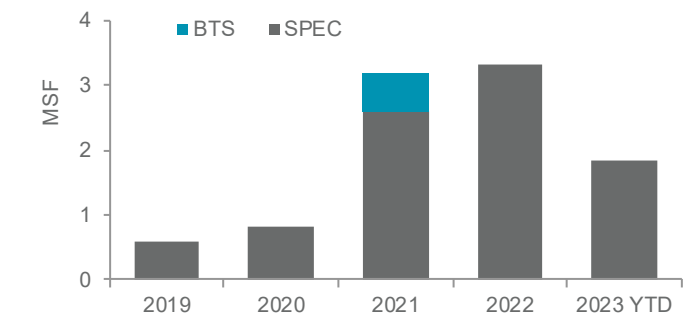
NEW LEASING ACTIVITY



AVERAGE MONTHLY ASKING RENT \$PSF MONTHLY NNN



UNDER CONSTRUCTION BY SF



MARKET STATISTICS

SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	UNDER CNSTR (SF)	YTD CNSTR COMPLETIONS (SF)	AVERAGE ASKING OVERALL RENT (MFG)	AVERAGE ASKING OVERALL RENT (W/D)	AVERAGE ASKING OVERALL RENT (ALL TYPES)*
North County	109,521,560	926,194	2,034,273	2.7%	-530,217	-15,047	328,471	1,949,678	\$1.77	\$1.89	\$1.77
West County	38,728,121	84,385	581,105	1.7%	147,559	349,227	584,809	331,601	\$1.66	\$1.58	\$1.62
Greater Airport Area	72,015,269	20,508	1,169,018	1.7%	-280,978	-440,815	706,215	0	\$1.57	\$1.75	\$1.63
South County	35,279,460	198,654	468,167	1.9%	84,530	-32,026	230,503	99,638	\$1.72	\$1.51	\$1.67
R&D	22,329,034	184,081	778,163	4.3%	-34,679	-209,598	0	0	N/A	N/A	\$1.56
MFG	86,250,737	93,874	1,308,253	1.6%	-276,636	-625,337	0	0	\$1.66	N/A	\$1.66
FLEX	17,818,627	1,494	394,182	2.2%	-39,110	105,587	0	0	N/A	N/A	\$1.65
W/D	129,146,012	950,292	1,771,965	2.1%	-228,681	590,687	1,849,998	2,380,917	N/A	\$1.84	\$1.84
OC TOTALS	255,544,410	1,229,741	4,252,563	2.1%	-579,106	-138,661	1,849,998	2,380,917	\$1.66	\$1.84	\$1.71

*Rental rates reflect weighted triple net asking \$psf/month. **Renewals not included in leasing statistics.

Flex/R&D, MFG = Manufacturing, W/D = Warehouse/Distribution

KEY LEASE TRANSACTIONS Q2 2023

PROPERTY	SUBMARKET	TENANT	SF	TYPE
3310-3320 Miraloma Av e.	North County	Bunzl Distribution	319,174	Renewal**
566 N. Gilbert St.	North County	Cargill Inc.	301,470	Renewal**
3454 Miraloma Av e.	North County	Freeman Expositions	300,000	Renewal**
12821 Knott St.	West County	Harbinger Motors, Inc	165,171	Direct
5665 Corporate Ave.	West County	Bar Bakers	159,943	Direct

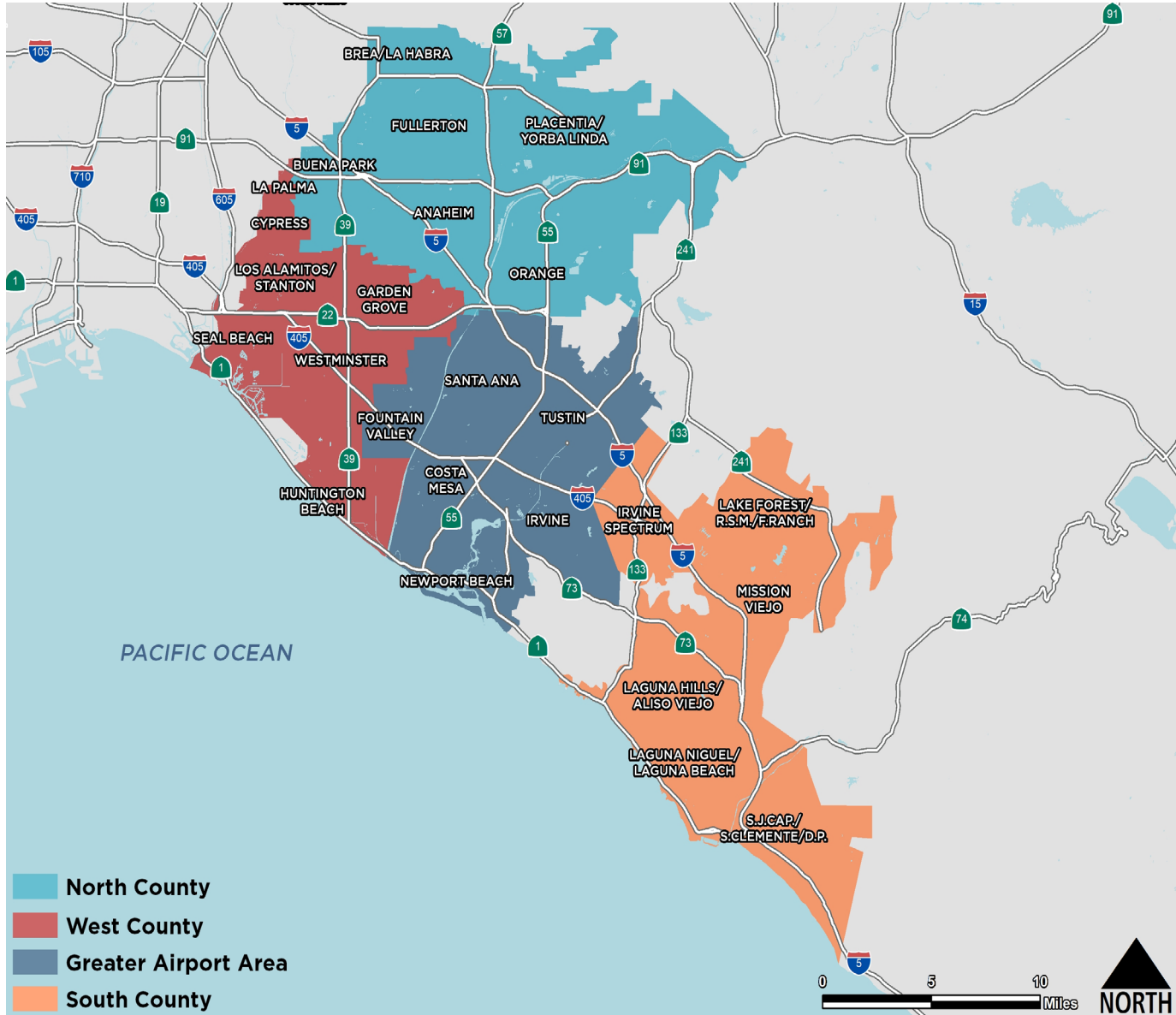
KEY SALES TRANSACTIONS Q2 2023

PROPERTY	SUBMARKET	SELLER / BUYER	SF	PRICE / \$ PSF
1400 Allec St.	North County	Bixby Land Company / LaSalle	121,225	\$28.2M / \$232
1340-1400 State College Blvd.	North County	JP Morgan / Dalf en Industrial	102,800	\$37.3M / \$363
2000 Winston Rd.	North County	JP Morgan / Dalf en Industrial	80,000	\$27.7M / \$346
650 Freedom Av e.	North County	Vu Family Trust/ AlemiProperties	30,863	\$12.0M / \$387
1820 S. Santa Fe St.	Greater Airport Area	Limpus Prints / STSU LLC	19,152	\$7.1M / \$371

KEY PROJECTS UNDER CONSTRUCTION Q2 2023

PROPERTY	SUBMARKET	MAJOR TENANT	SF	OWNER
LogistiCenter at 55	Greater Airport Area	N/A	178,094	Dermodity Properties
LBA Logistics Center	North County	N/A	165,850	LBA Realty
Prologis West Orange Counter Logistics Center	West County	N/A	149,335	Prologis

INDUSTRIAL SUBMARKETS



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