

4Q23

Orange County Industrial Market Overview



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Market Observations

Economy

- U.S. retail sales continue to decelerate as industrial leasing activity slowly moderates.
- Loaded import volume at Southern California’s ports totaled 7.6 million containers in the first 11 months of 2023, slightly higher than the same period in 2016.
- A probable strike by Gulf and East Coast dockworkers, drought-induced restrictions at the Panama Canal and continued ship attacks on the Red Sea suggest significant import traffic gains at Southern California’s ports in 2024.
- A rise in imports does not necessarily portend more demand for local warehouse space. Goods that are “just passing through” to other U.S. markets have a negligible effect on local market dynamics. Severe congestion at the ports (if it happens) will drive up ocean container spot and drayage rates, though.

Major Transactions

- 11 leases over 100,000 SF were signed this quarter compared to six that were signed in the fourth quarter of 2022.
- Garden Communities acquired a 345,000-SF manufacturing center at 1683 Sunflower Ave in Costa Mesa from Formosa, LTD for \$72.0M, in what was the largest industrial sale in Orange County in 2023. Costa Mesa’s city council recently approved the site for redevelopment as a mixed-use project. The facility, constructed in 1975, is located in a mostly residential area.
- Office-to-industrial conversions are still being pursued: Greenlaw and Walton Street announced plans to redevelop a 436,000-SF business park in Santa Ana for industrial use upon sale.

Leasing Market Fundamentals

- A steady trickle of tenant departures and downsizes boosted vacancy to a three-year high of 3.0% and inflicted 2.2 MSF in net absorption losses in 2023.
- Move-outs by Hampton Products (308,000 SF) and Romeo Power (215,000 SF) contributed to net absorption losses in the fourth quarter.
- Available sublease space totaled 2.4 MSF in the fourth quarter, up 13.8% from three months ago. Future sublet availability will likely fluctuate as tenants continue to reassess space needs.
- Lease term lengths are trending down as tenants adopt a more cautionary stance. Some may be biding their time as they wait for rents to further decrease.
- Under-construction activity totals 1.8 MSF; 21.3% has pre-leased to date.

Outlook

- Tenant space reductions will likely continue amid high rents and capital costs.
- Vacancy in the Inland Empire is at an 11-year high, sublet availability has reached 14.0 MSF and rents are steadily falling. A few Orange County tenants may consider relocation-consolidation moves to the market.
- Developers will continue to pursue opportunities to convert infill sites for industrial use in a market where the industrial vacancy rate remains below the historical average.
- A major pullback in U.S. retail sales would further slow industrial leasing activity.
- The SCAQMD has begun to levy fines on industrial occupiers for non-compliance with the [WAIRE Program](#). The program, which will apply to additional property size segments in 2024, is expected to be recognized as federally enforceable.

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 2. Leasing Market Fundamentals
 3. Sales Activity
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Economy



Loaded Imports in the First 11 Months of 2023 Were Slightly Higher than the Same Period in 2016



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West Coast Dockworkers Signed a New Contract in 2023; Their Eastern Counterparts are Next Up...

The ILWU and PMA signed a new labor contract in September, restoring a sense of much-needed stability at U.S. West Coast seaports for the next six years. Longshoremen at East and Gulf Coast ports will soon negotiate their contract, which will expire in late 2024. Import volume will likely shift to West Coast ports until an agreement is reached.

West Coast Ports Agreement Reached...Finally!

- The International Longshore Warehouse Union (ILWU) represents dockworkers at 29 ports from Washington State to California. The Pacific Maritime Association (PMA) represents ocean carriers and terminal operators.
- The prior contract expired on July 1, 2022.
- The ILWU has a history of work disruptions in prior negotiation periods, ranging from strikes, to deliberate work slowdowns to under-staffing shifts.
- These disruptions have cost major retailers billions of dollars in the past.
- In March, for instance, the ILWU did not stagger shifts during meal periods.
- A tentative agreement was reached on June 15, 2023 for what became a new six-year contract. Longshore workers secured a 32% salary increase.
- Many Asian importers pushed inbound goods to East and Gulf Coast ports as talks dragged on. Some of this traffic is returning since stability is now less of a concern.



East and Gulf Coast Ports Are Up Next

- The International Longshoremen (ILA) represents dockworkers at 36 ports from Maine to Texas. The United States Maritime Alliance (USMA) represents ocean carriers and terminal operators.
- Their contract will expire on September 30, 2024.
- Harold Daggett, International President of the ILA, has warned that a strike is likely in 2024.
- Higher pay and job security as it pertains to automating port operations were primary issues for the ILA in 2018/the last negotiation period.



+1.6%
Vs. February 2020

+2.2%

+1.6%

+4.0%
-2.5%

Source: Newmark Research, City of Los Angeles, The Real Deal

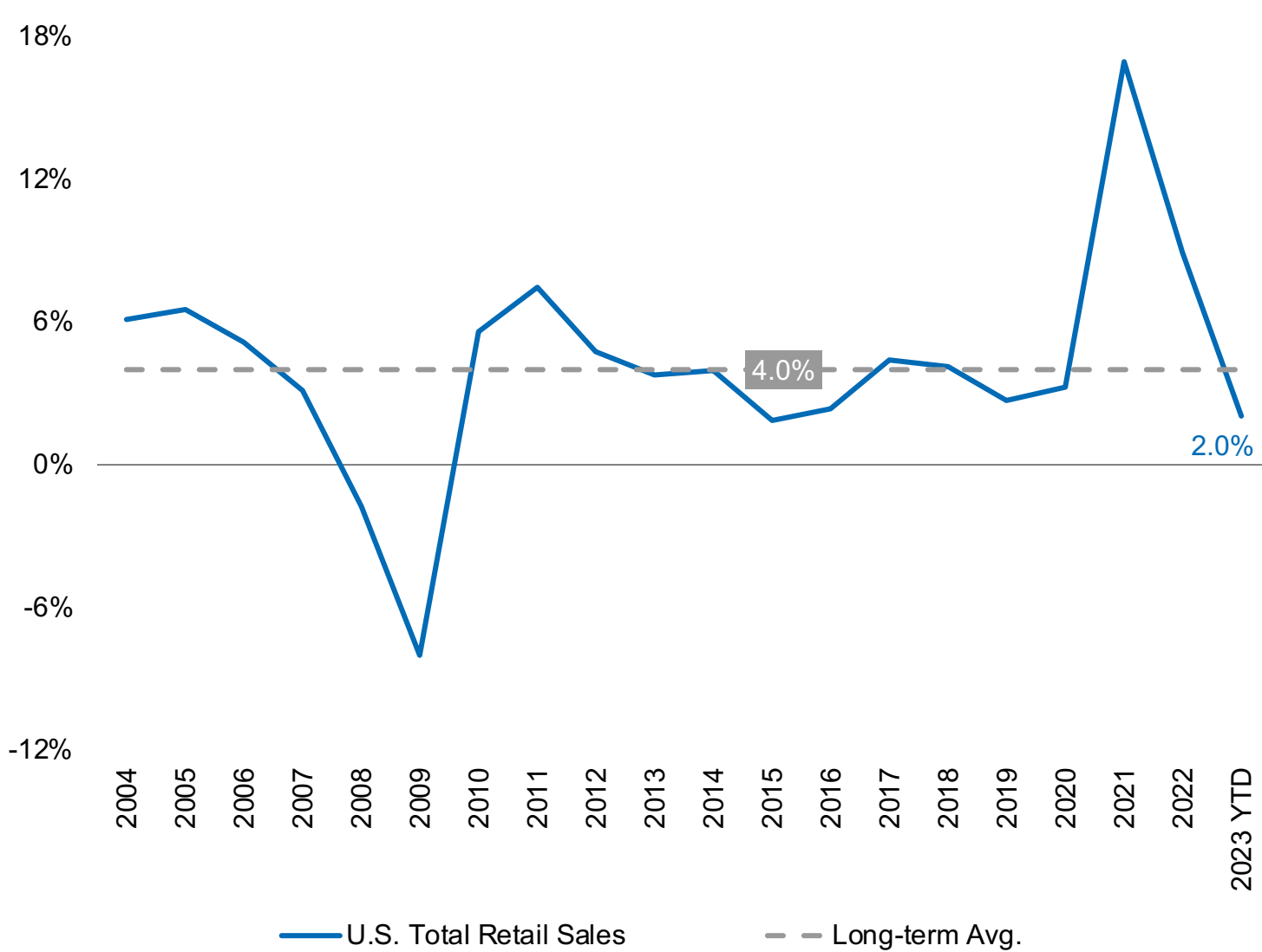
Import Traffic Recently Jumped at Los Angeles/Long Beach

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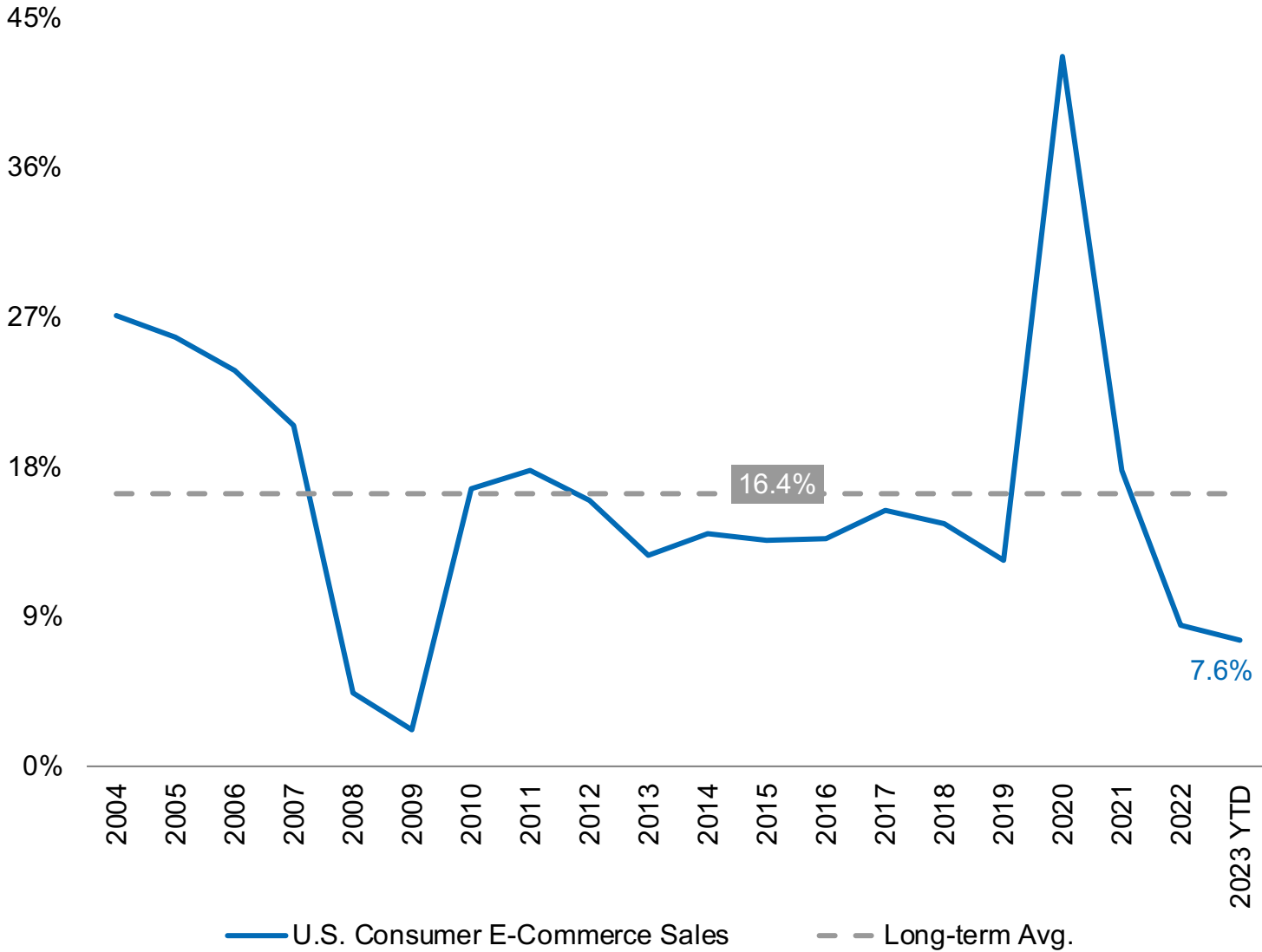
Retail Sales (an Indicator of Warehouse Demand) Continue to Moderate

Consumer e-commerce sales were up 7.6% in the first nine months of 2023 compared with the same period in 2022. Although e-commerce sales growth exceeded total retail sales (+2.0% over the same period), the decline from 2021 onward is noticeable as the macro economy slows.

U.S. Retail Sales Annual Growth



U.S. Consumer E-Commerce Sales Annual Growth



Source: US Census Bureau (consumer adjusted retail sales); most current data available
Note: 2023 YTD encompasses the first nine months of 2023

The Pandemic Accelerated E-Commerce Sales Growth and Adoption Rates

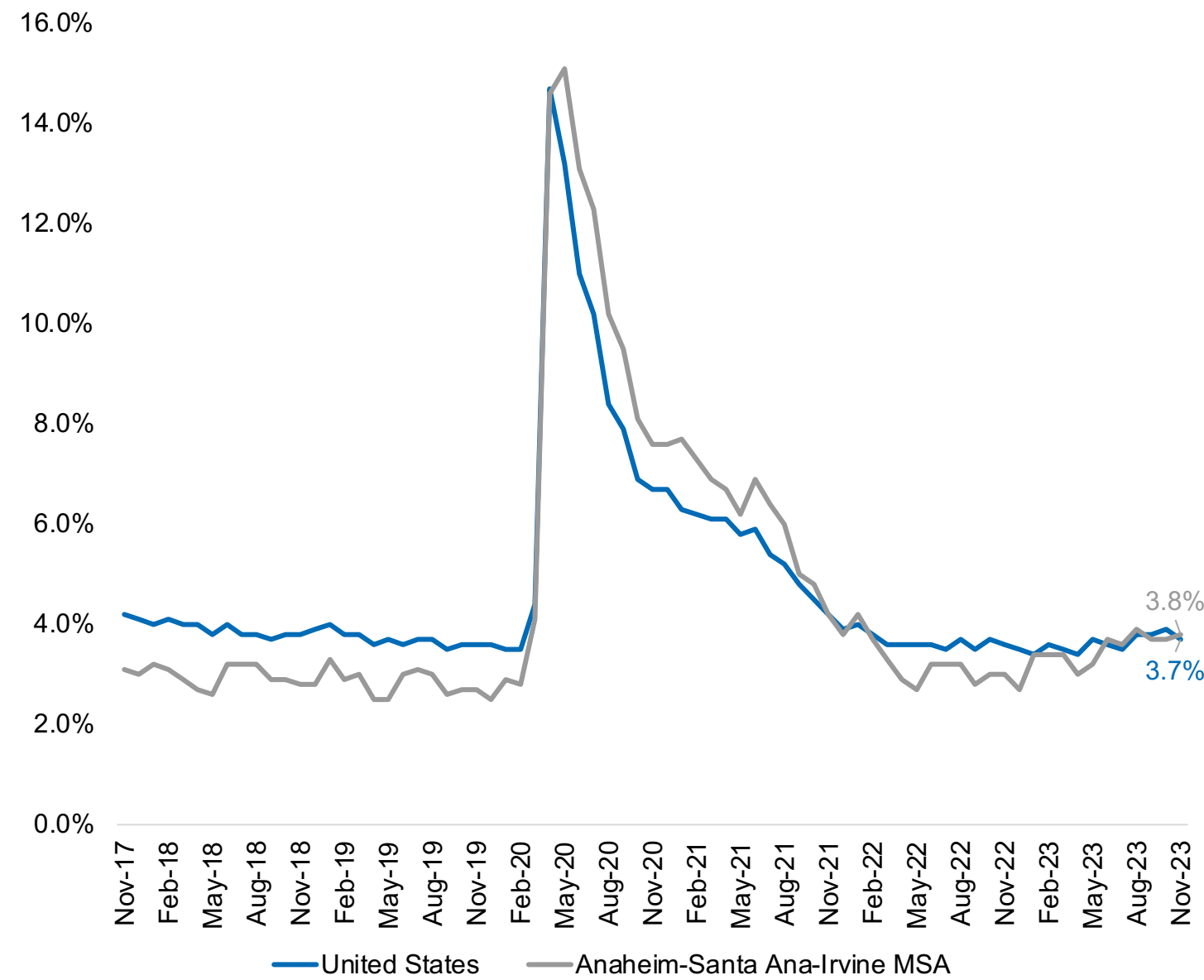


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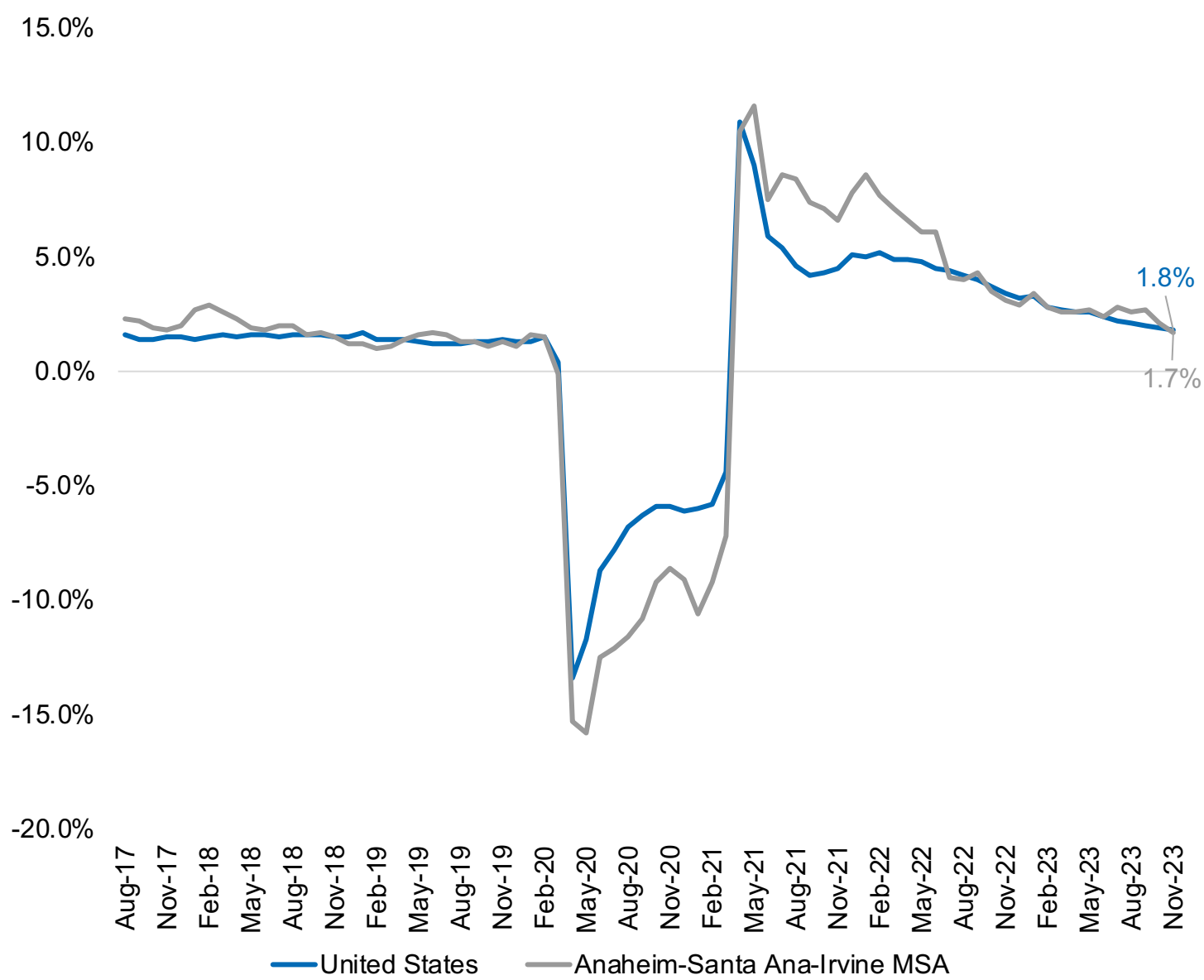
Local Unemployment Stabilizes Amid Declining Job Growth

Orange County unemployment has remained elevated – albeit stable – in recent months. The trajectory of the local unemployment rate, which has roughly fallen in line with the national average over the past half year, depends on both the continued strength of the economy and the Fed’s level of commitment to interest rate cuts over the next year.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change

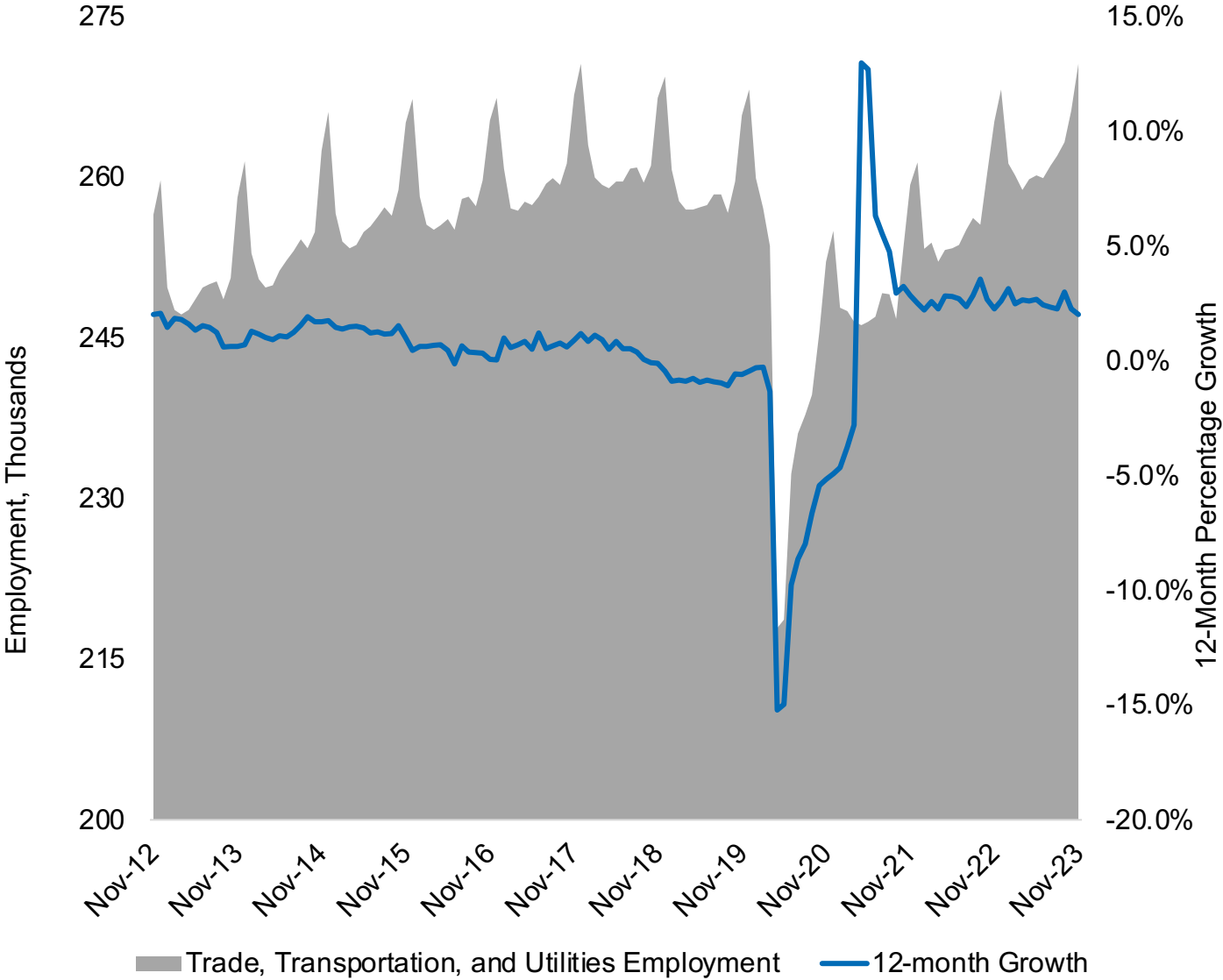


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA

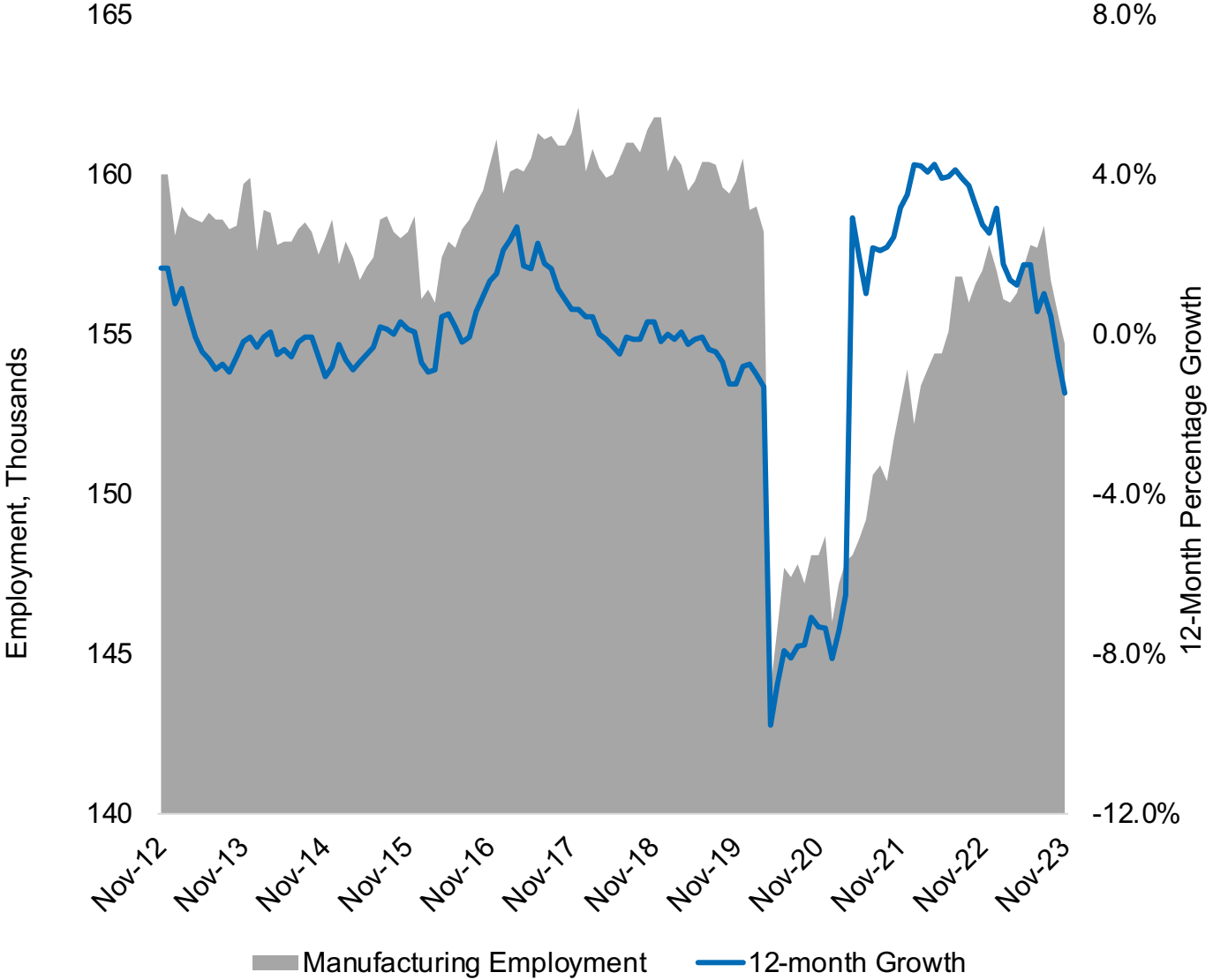
Mixed Signals for Industrial Employment Growth

Local employment in the trade/transportation/utilities sector reached an all-time high in November as the holidays fueled seasonal job gains. A spate of plant closures in the past quarter has contributed to a marked decline in countywide manufacturing employment. Given the regionally disadvantageous costs of doing business in California, it is unlikely that the county will recoup these job losses anytime soon. With that said, EV-related production in the southern reaches of the market remains a bright spot.

Trade/Transportation/Utilities Employment and 12-Month Growth Rate



Manufacturing Employment and 12-Month Growth Rate



Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine MSA
Note: November 2023 data is preliminary

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Leasing Market Fundamentals



Unprecedented Rent Growth Decelerating After Two Years

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Tenants Opting for Short-Term Leases as They Wait for Rents to Moderate

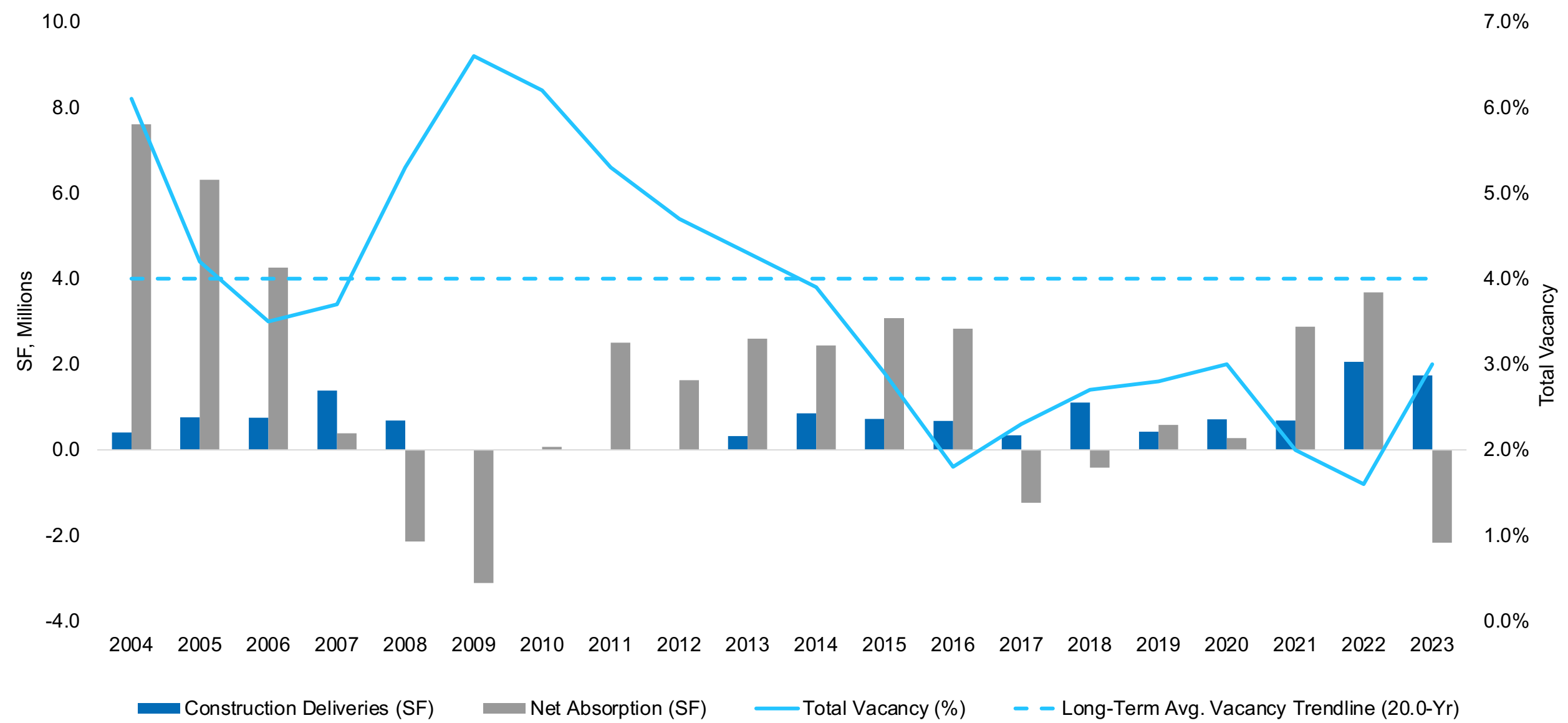


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Vacancy Remains Below Historical Average Amid Sustained Absorption Losses

Net absorption was negative for the fourth-straight quarter, yielding 2.2 MSF in net absorption losses in 2023, a 14-year low. Total vacancy increased but remains a full percentage point lower than the 20-year average.

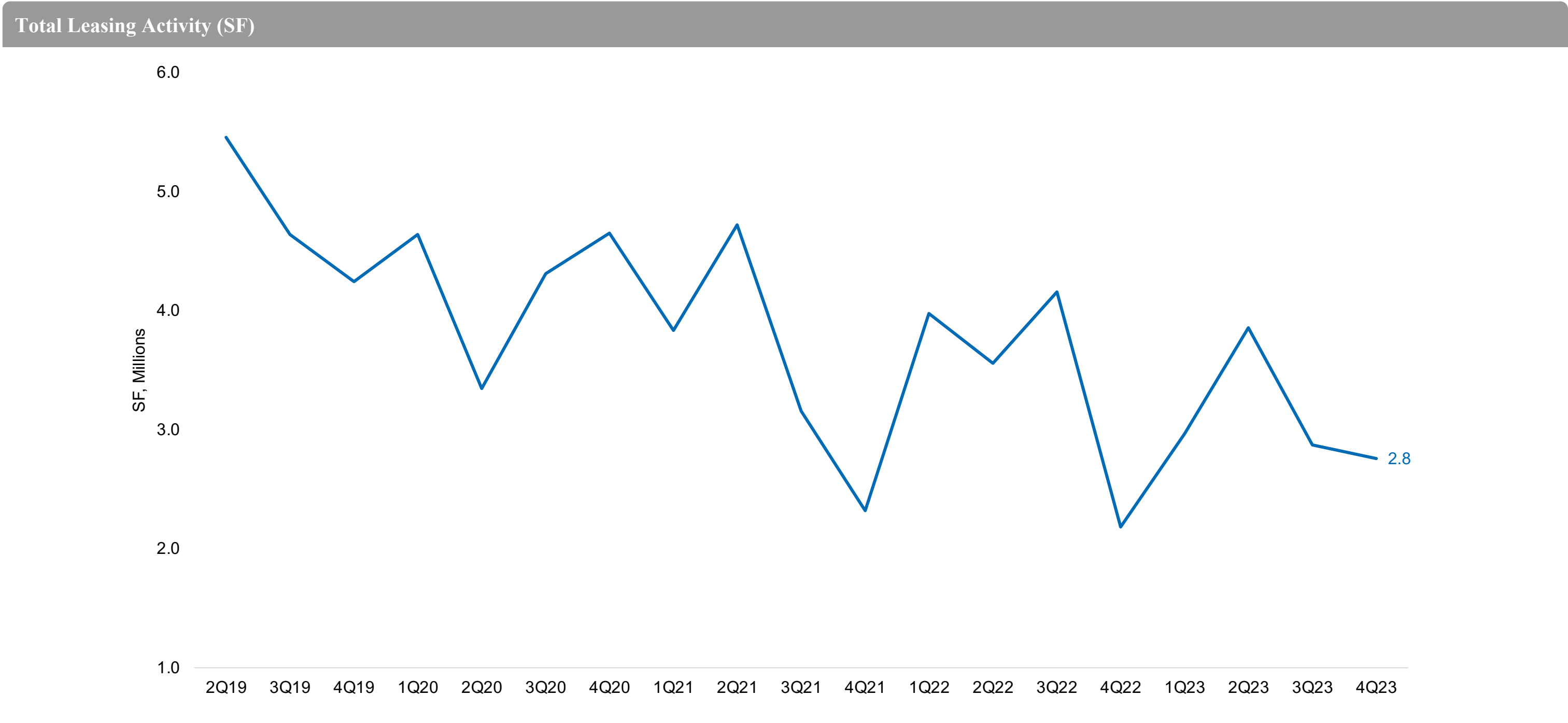
Historical Construction Deliveries, Net Absorption, and Vacancy



Source: Newmark Research

Overall Leasing Activity Healthy Despite Downturn, on Par with 4Q21 and 4Q22

Landlords are beginning to lose the upper-hand in leasing negotiations amid cooling demand, which will lead to lower leasing figures in the quarters ahead. A slowing economy is keeping retail sales in check, while most occupiers are trying to shed overcapacity in their networks to reduce costs. Both have implications for future leasing activity.

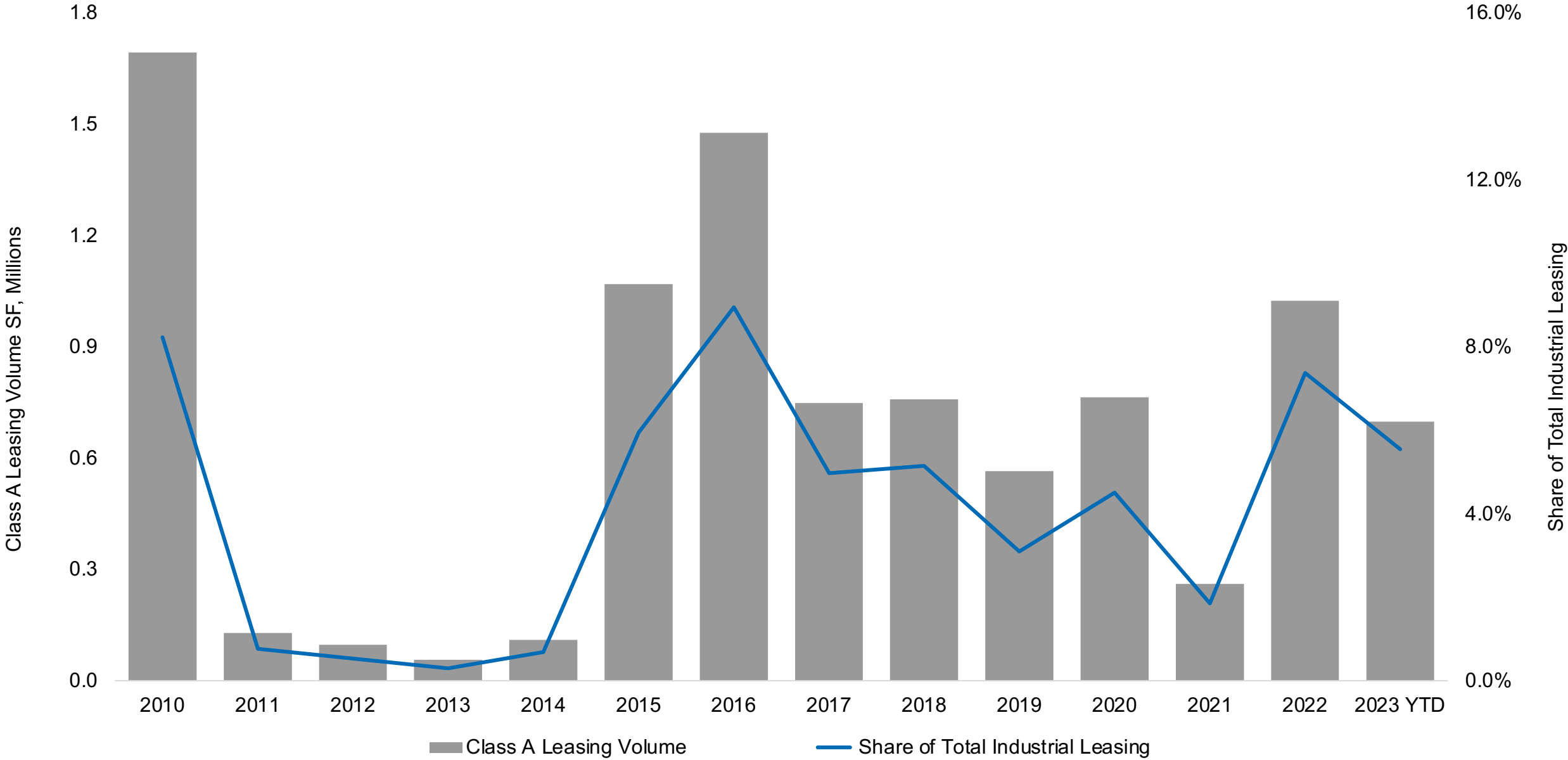


Source: Newmark Research, CoStar

Class A Warehouse Leasing Activity Trends Down

High rents and a cost-cutting focus among most occupiers explain the decrease.

Industrial Class A Leasing Volume and Percentage of Total Industrial Leasing Volume

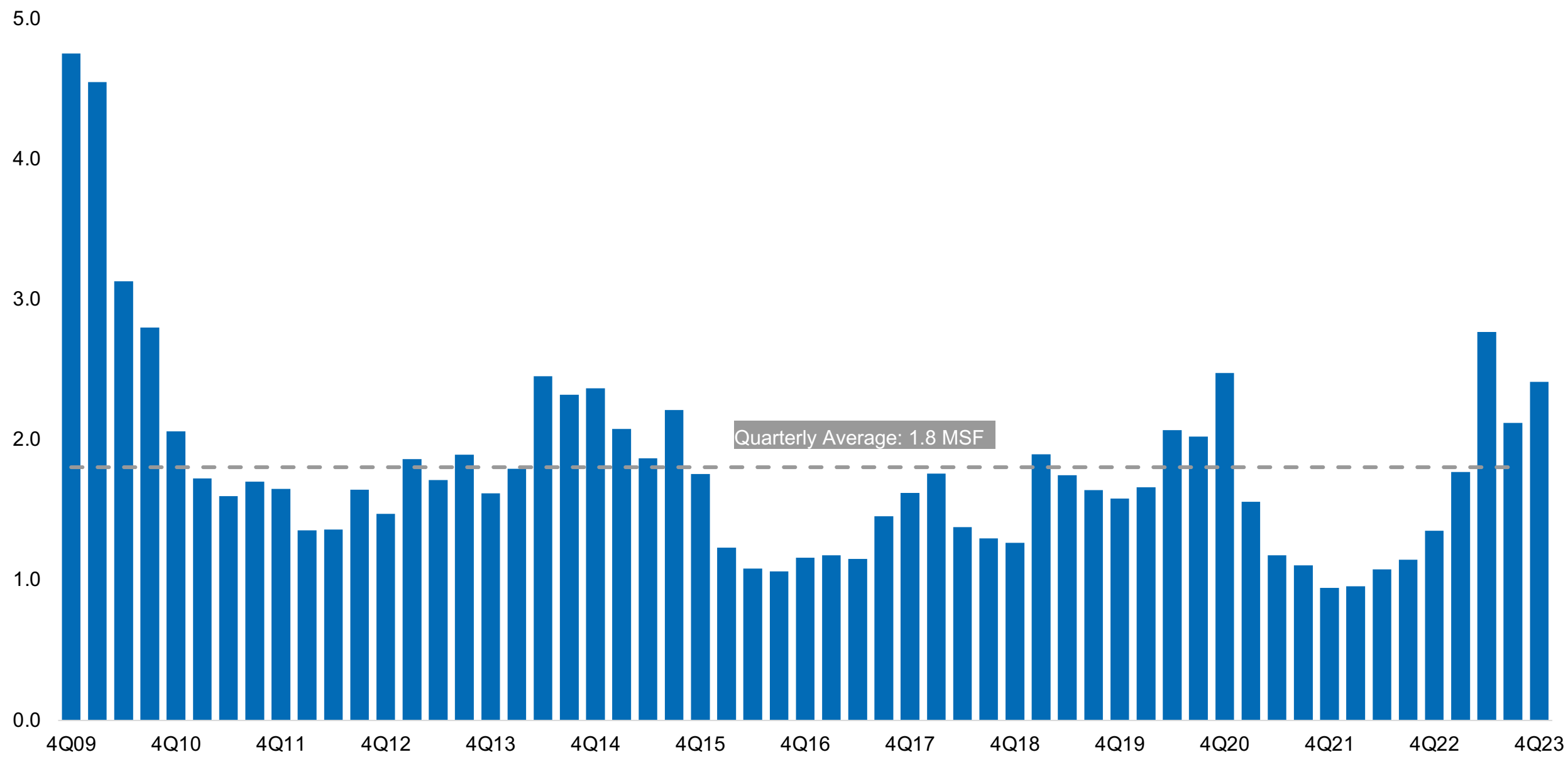


Source: Newmark Research, CoStar

Sublease Availability Edges Upward

New sublease offerings from Crane Worldwide Logistics (375,000 SF at 1515-1517 E Winston Rd in Anaheim), Allen Packaging (87,000 SF at 1150 Valencia Ave in Tustin) and 3PL Fulfillment (75,507 Sf at 19531 Pauling in Foothill Ranch) increased the overall sublease pool. This increase was tempered by de-listings from Hayes Company (126,681 SF at 1225 W Imperial Hwy in Brea) and Brentwood Home LLC (123,972 SF 2009 Raymer Ave in Fullerton)—spaces that found sublessees.

Available Industrial Sublease Volume (MSF)



Source: Newmark Research

North County Comprises the Bulk of Today's Sublease Availability

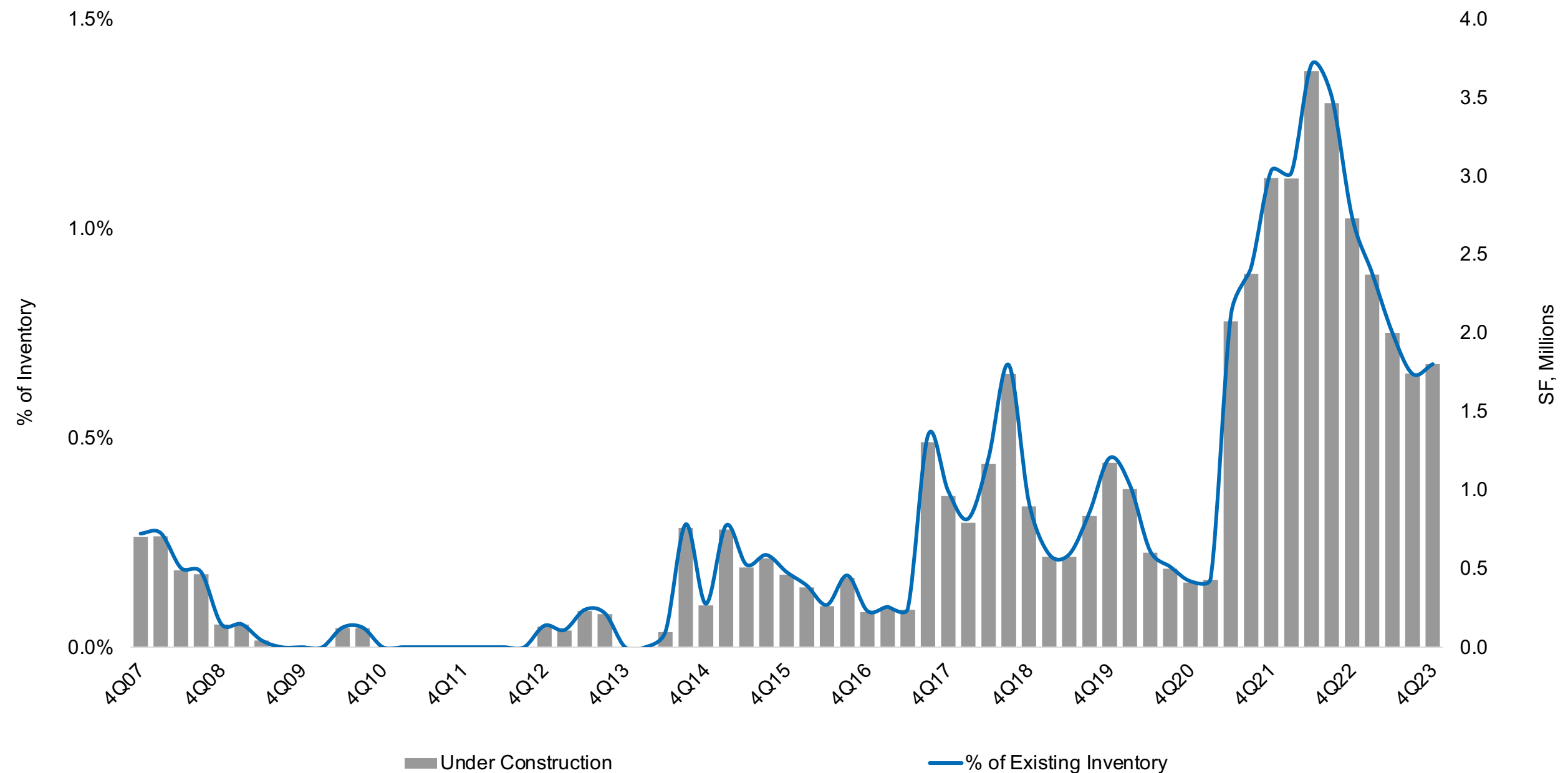


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Under-Construction Space Declines Amid Low Pre-leasing Activity

Just under 1.0 MSF of under-construction industrial product is scheduled to deliver in the first quarter of 2024. 28.6% of this space has been pre-leased; market vacancy will increase if this figure does not improve.

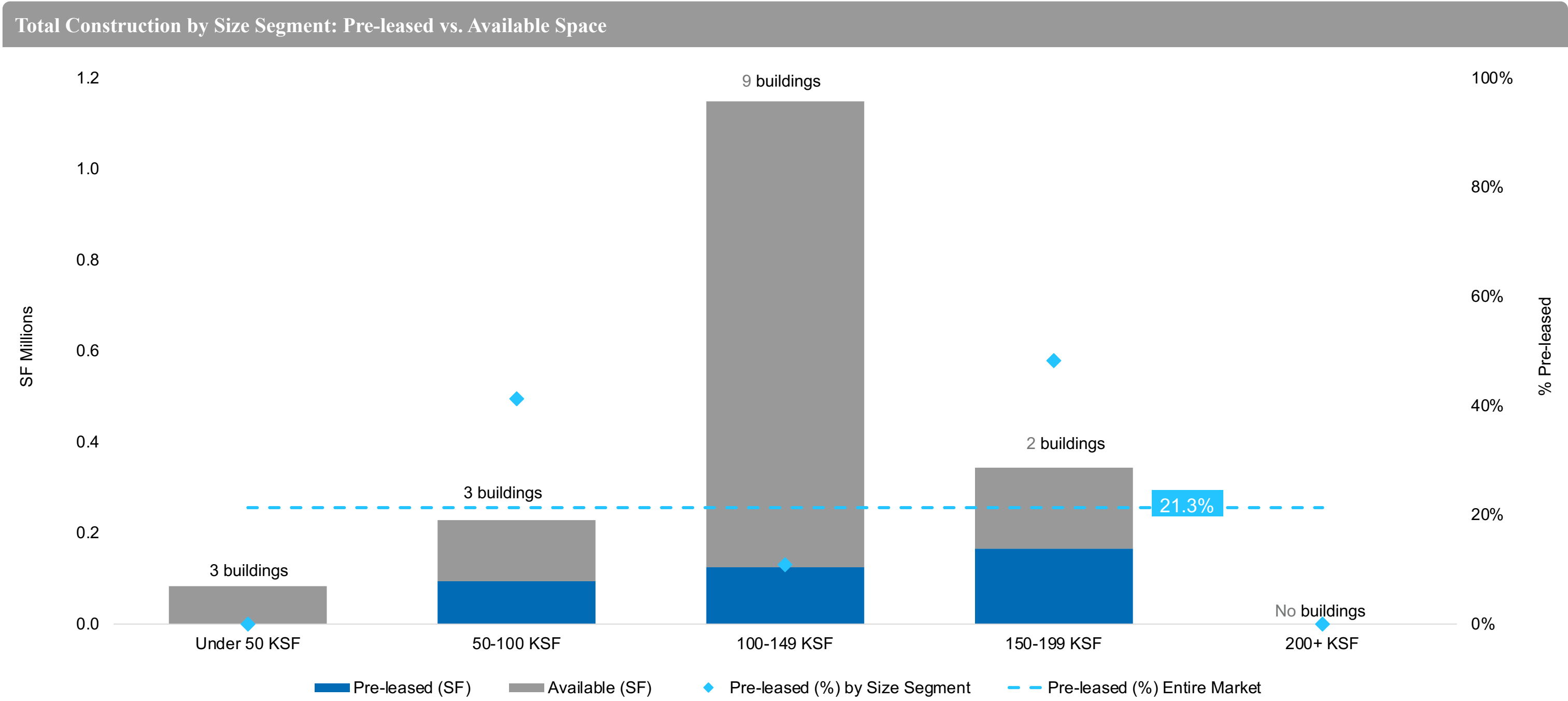
Industrial Under Construction and % of Existing Inventory



Source: Newmark Research

Pre-leasing Activity Limited as Tenants Seek to Avoid High Rents

Of the 17 buildings currently under construction, three have been pre-leased. The bulk of under-construction activity is based in the 100,000 to 149,999-SF size segment where a mere 10.9% of product has leased to date. Low pre-leasing levels are not a reflection of market demand, but rather a result of price-conscious tenants waiting for the high rents of new construction to moderate.



Source: Newmark Research

Healthy Leasing Activity Still Ongoing

A healthy mix of direct leases and renewals were signed during the fourth quarter of the year. A single pre-lease was signed, suggesting a declining tenant interest in brand-new construction.

Select Lease Transactions				
Tenant	Building	Submarket	Type	Square Feet
3PL Global	2501 E Orangethorpe Ave	North County	Lease Renewal	229,422
Tenant has leased property since 2013. Lease term expires in 4Q33.				
Raymond West Intralogistics	5560 Katella Ave	West County	Direct Lease	215,000
The Santa Fe Springs-based logistics company will expand operations into Orange County when it takes occupancy of the entire building in June 2024. Lease term expires in 3Q34.				
Home & Body Company	5800 Skylab Road	West County	Direct Lease	167,788
Company will expand footprint within McDonnell Centre Business Park in Huntington Beach when it take occupancy in early-2024. Lease term expires 1Q29.				
Sunrise Produce	1215 Van Buren St	North County	Pre-lease	165,850
Produce wholesaler will expand operations into Orange County when it takes occupancy of the entire building when it delivers in early-2024.				
P&P Imports	17352 Derian Ave	Airport	Lease Renewal	132,545
Tenant has leased property since 2019.				

Source: Newmark Research

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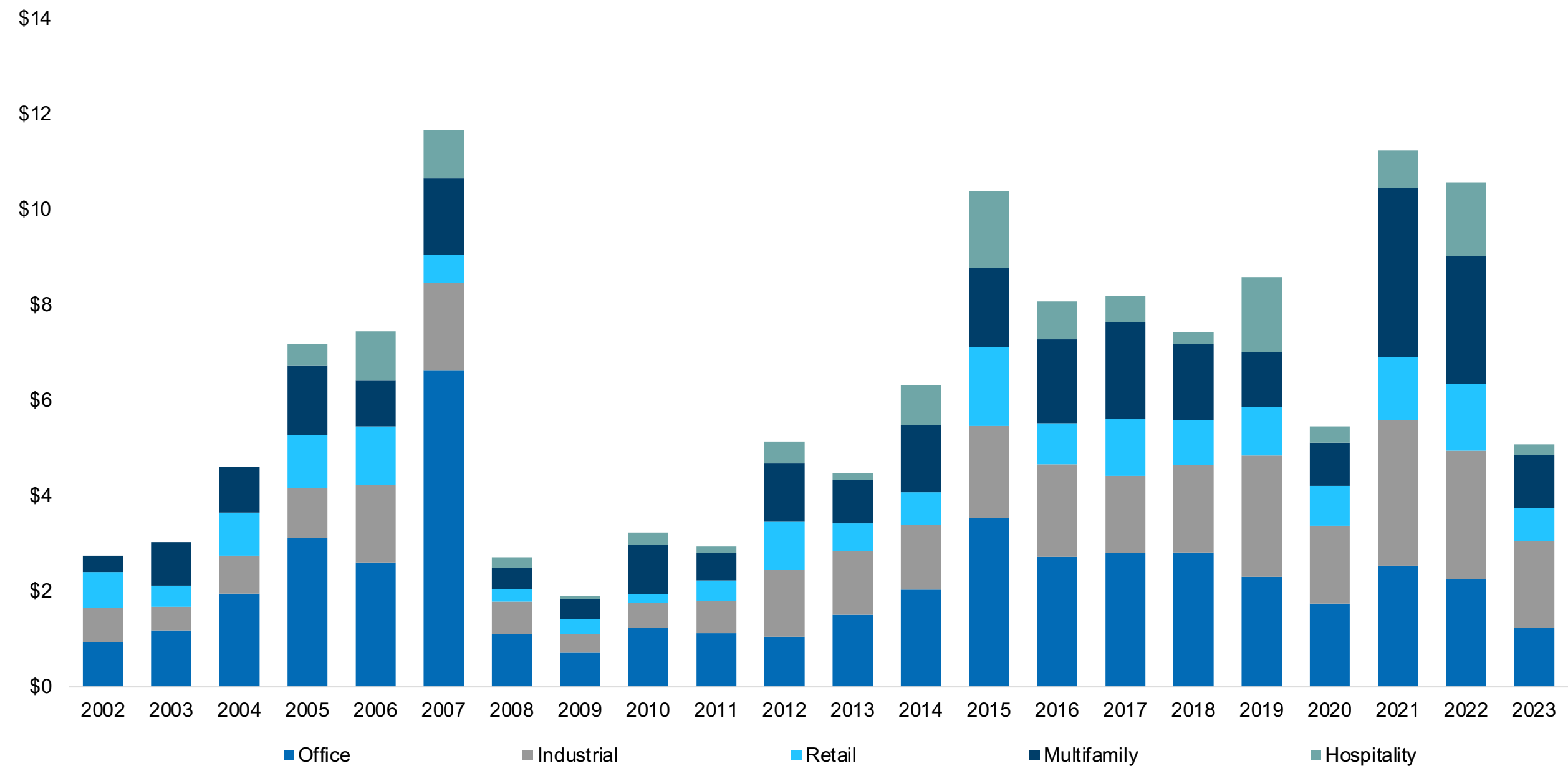
Sales Activity



Industrial Comprised 35.4% of Total Sales Volume in 2023

This figure is significantly higher than the 22-year average (2002 to 2023) of 23.2%. Low vacancy and heated rent growth in recent years favor the segment, with many investors targeting desirable buildings with credit tenants whose leases are up for renewal. What the tenant was paying (\$\$) is different than today's rent averages (\$\$\$\$).

Orange County: Sales Volume Across Commercial Property Segments (\$ in Billions)

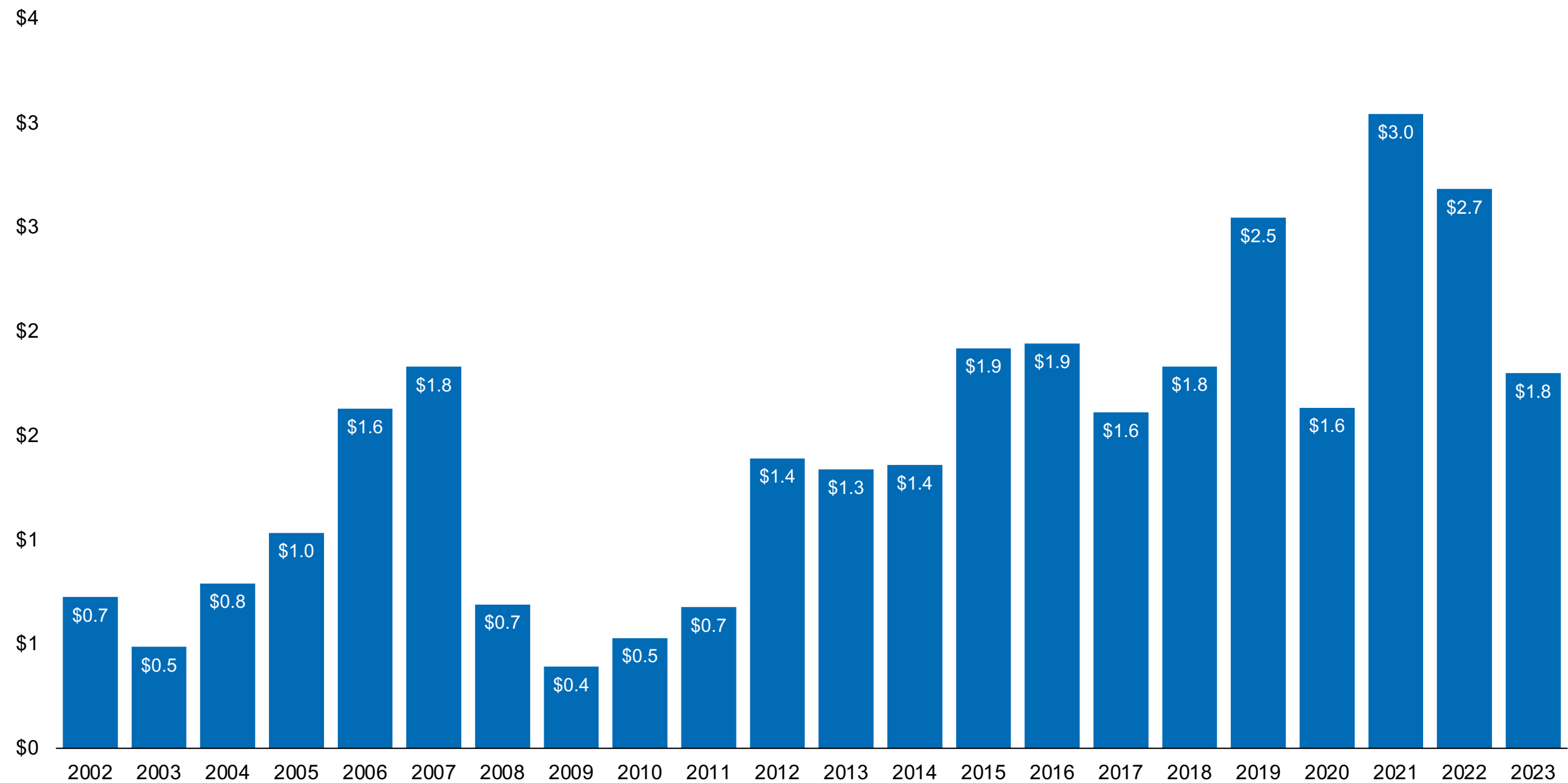


Source: MSCI Real Capital Analytics, Newmark Research
Note: Preliminary data is cited for the fourth quarter of 2023

Industrial Sales Volume: Up Close

Industrial sales volume totaled \$1.8 billion in 2023, adding up to 67.1% of 2022’s total. The higher cost of capital following multiple interest rate hikes is crimping momentum in addition to cooling but still healthy leasing fundamentals. Both will add downward pressure to pricing.

Orange County: Industrial Sales Volume (\$ in Billions)



Source: Newmark Research, MSCI Real Capital Analytics
Note: Preliminary data is cited for the fourth quarter of 2023

Pricing has Started to Fall, While Cap Rates Are Rising

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Private Buyers Are Active



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Appendix



A low-angle, upward-looking photograph of a modern building's interior or exterior steel framework. The image shows a complex network of dark blue steel beams and girders forming a grid-like structure. The perspective creates a sense of height and architectural scale. The background is a clear, light blue sky. A semi-transparent blue horizontal band is overlaid across the middle of the image, containing white text.

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A low-angle, upward-looking photograph of a modern building's structural steel framework. The image shows a complex network of dark steel beams and girders forming a grid-like pattern against a bright blue sky. The perspective creates a sense of height and architectural scale. A semi-transparent blue horizontal band is overlaid across the middle of the image, containing white text.

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Some Underperforming Office Properties Will Find New Life

A low-angle, upward-looking shot of a modern building's exterior. The image features a complex network of dark steel beams and glass panels, creating a geometric pattern. The sky is visible through the glass, appearing as a bright, hazy blue. A semi-transparent blue horizontal band is overlaid across the middle of the image, containing white text.

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WAIRE: Program Summary and Implications for Industrial

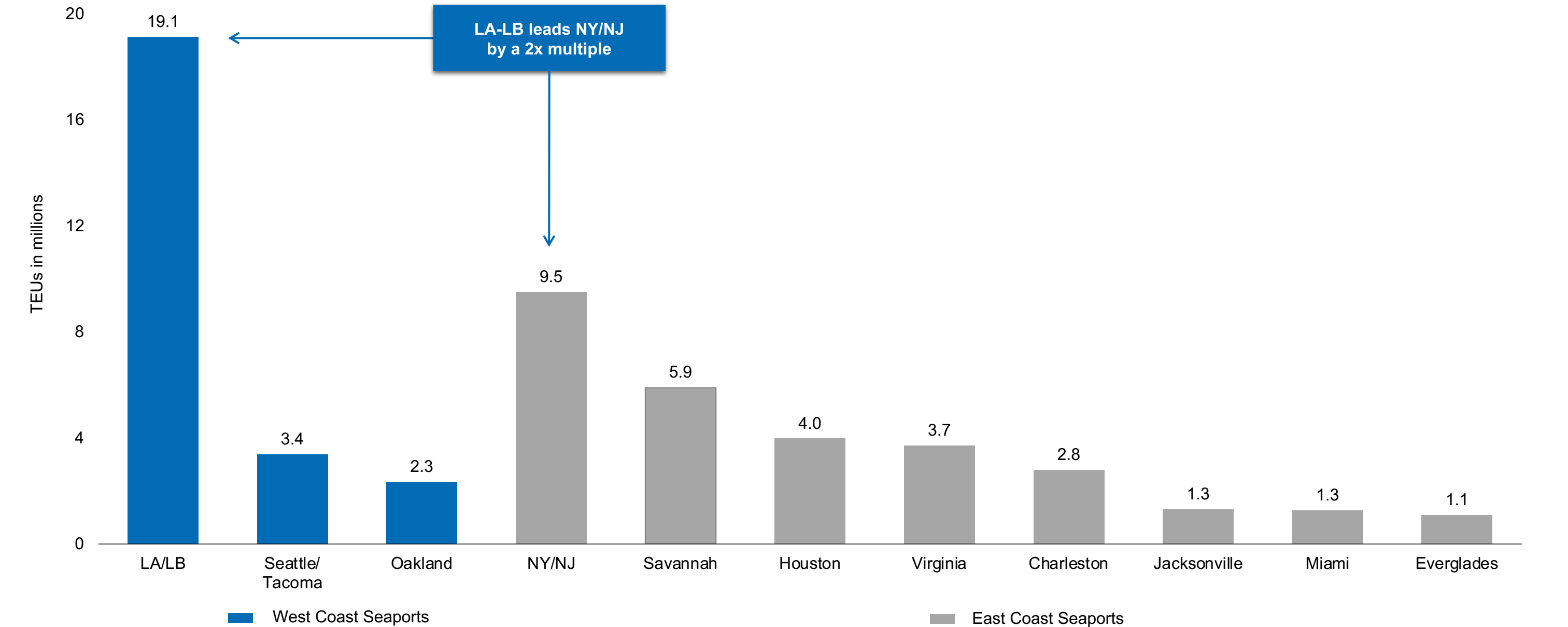


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Los Angeles-Long Beach Is the Nation’s Dominant Port System

Los Angeles-Long Beach can accommodate 18,000 TEU vessels, which are too wide to traverse the new Panama Canal. Additionally, both ports have Class 1 freight rail connectivity to the nation’s major population centers.

Major U.S. Seaports: 2022 TEU Volume (All Containers: Loaded and Empty)



Source: Newmark Research, Individual Seaports
Note: Data is through February 2023 and is not adjusted for seasonality. Shaded areas indicate U.S. recessions

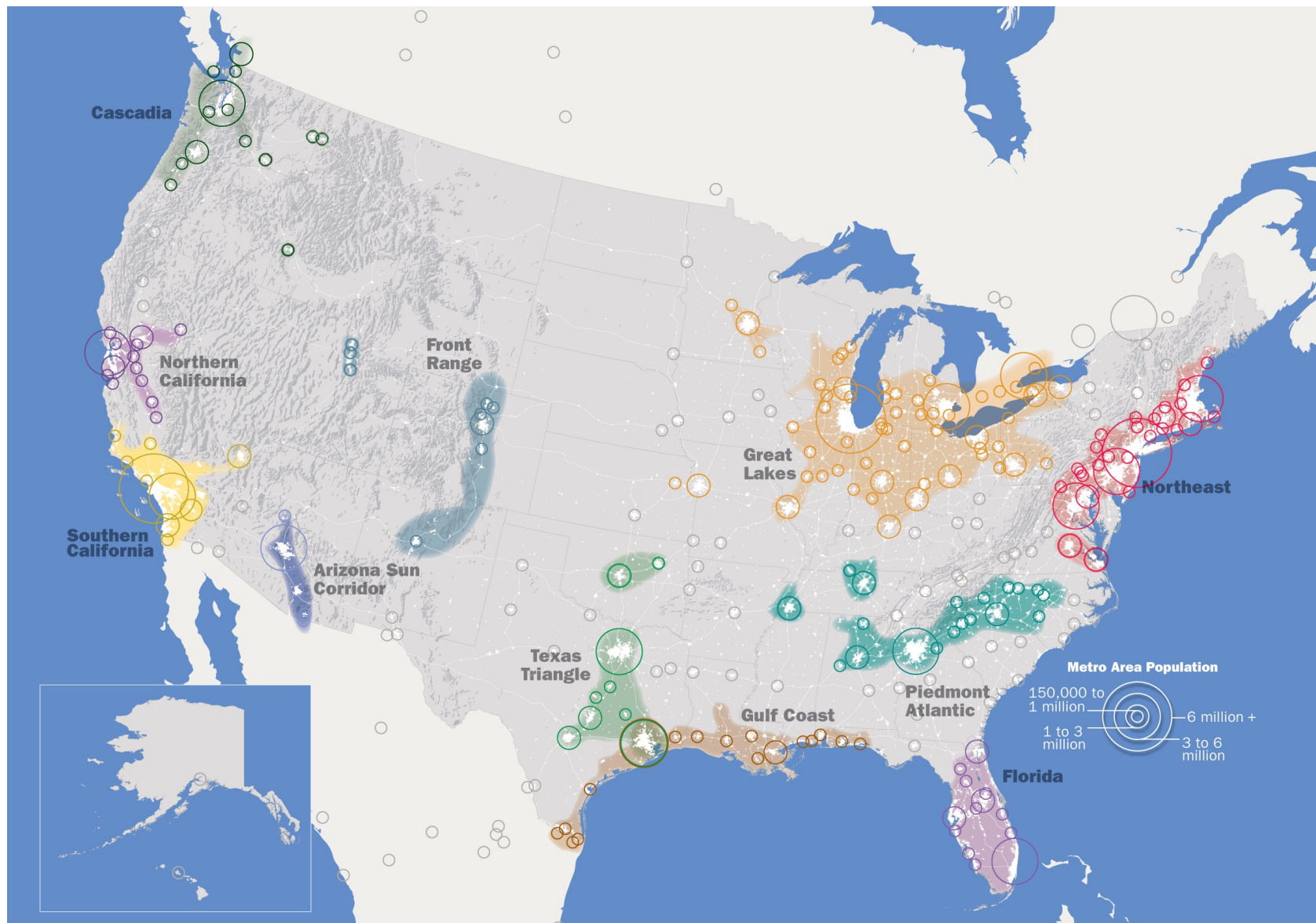
Why Los Angeles-Long Beach?

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Population of Megaregions: Past and Projected

Southern California benefits from its consumer base, ports and rail connectivity.



Megaregion	2010 Population	2025 Pop. Est.
Arizona Sun Corridor	5.7M	7.8M
Cascadia	8.4M	8.8M
Florida	17.3M	21.5M
Front Range	5.5M	7.0M
Great Lakes	55.6M	60.7M
Gulf Coast	13.4M	16.3M
Northeast	52.3M	58.4M
Northern California	14.0M	16.4M
Piedmont Atlantic	17.6M	21.7M
Greater Southern California	24.4M	29.0M
Texas Triangle	19.8M	24.8M

Source: U.S. Census Bureau

Transport Costs Are the Biggest Expenditure for Most Warehouse Occupiers



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Transport Costs per TEU Container

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