The Lee Industrial Brief

Q4 2015

1 LEE OVERVIEW

2 NATIONAL OVERVIEW

3 KEY MARKET SNAPSHOTS

4 SIGNIFICANT TRANSACTIONS

5 LEE NETWORK

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$10 billion transaction volume 2014

800 agents and growing

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Our agents understand real estate and accountability. They provide an integrated approach to leasing, operational efficiencies, capital markets, property management, valuation, disposition, development, research and consulting.

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PROPERTY MANAGEMENT
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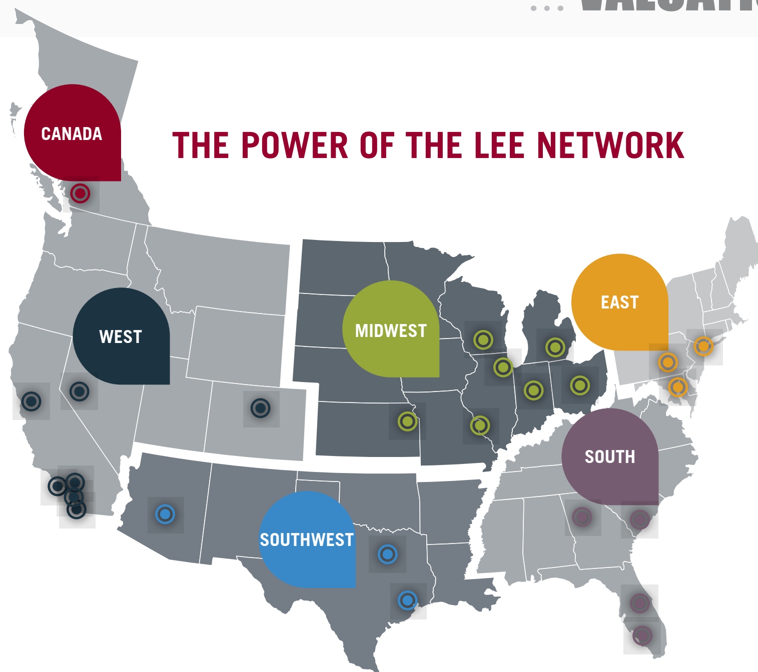
THE POWER OF THE LEE NETWORK



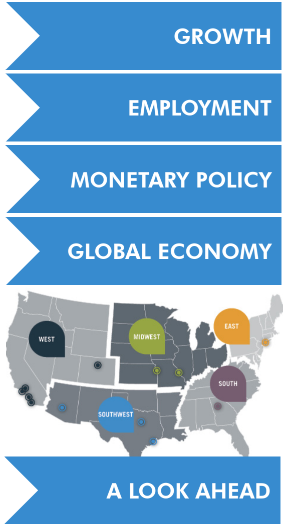
Pasadena, CA • Vancouver, B.C. • Eastern Pennsylvania, PA • Cleveland, OH • Columbus, OH • Houston, TX • Denver, CO • Cleveland, OH • Long Island-Queens, NY • Chesapeake Region, MD • Valuation, Atlanta, GA • Charleston, SC • Edison, NJ • Orlando, FL • Fort Myers, FL • Kansas City, KS • Manhattan, NY • Greenville, SC • Atlanta, GA • Greenwood, IN • Indianapolis, IN • Long Beach, CA • Elmwood, NJ • Boise, ID • Palm Desert, CA • Santa Barbara, CA • Antelope Valley, CA • Dallas, TX • Madison, WI • Oakland, CA • Reno, NV • San Diego, CA • Ventura, CA • San Luis Obispo, CA • Southfield, MI • Santa Maria, CA • Calabasas, CA • St. Louis, MO • Chicago, IL • Victorville, CA • Temecula Valley, CA • Central LA, CA • Sherman Oaks, CA • West LA, CA • Pleasanton, CA • Stockton, CA • Phoenix, AZ • Carlsbad, CA • Industry, CA • Los Angeles, CA • Riverside, CA • Ontario, CA • Newport Beach, CA • Orange, CA • Irvine, CA

US INDUSTRIAL MARKET

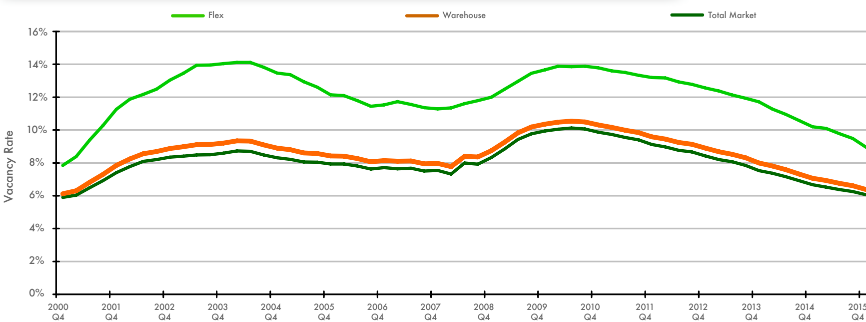
GROWTH ACCELERATES IN Q4

The US industrial property market continued to impress in Q4. Vacancy declined, net absorption rose, rental rates increased, deliveries were up and construction activity accelerated. What's not to like about a market that seems to improve despite economic turbulence both at home and abroad? In 2015, it was another year driven by big deals in big buildings with big tenants in buildings owned by big owners. That all sounds great, but the US economy is not driven entirely by "big business," and in some markets, rent growth has been so steep and vacancy has gone so low that "not-so-big" businesses are unable to compete for the best space. E-commerce, 3PL and the retail giants are dominating the bulk distribution market by taking down space in unprecedented increments at record prices, on long-term leases. Institutional investors love it and many of them are willing to take a pass on solid local players who do business by the million rather than by the billion. In short, landlords want to see the big balance sheet because they can. Quality product is getting harder to find, and those who have it, know it. New deliveries for both speculative and build-to-suit projects for Q4 hit 59.1 million square feet in 463 buildings. That followed a nearly 62.1-million-square foot gain in inventory in Q3. The US now touts an industrial property base of 21.51 billion square feet. Another 207.6 million square feet is still under construction, nearly all of that in the bulk distribution category. However, construction activity has become another case of the haves and the have-nots. Markets with greater land availability like Dallas, Phoenix, Atlanta, and Southern California's Inland Empire are the haves. Vacant land actually exists there and prices are at least somewhat reflective of the rents required to get a ground-up project to make economic sense. Then there's the likes of Los Angeles, New Jersey and New York. They are the have-nots. Land is scarce and prohibitively expensive and mixed-use residential/office/retail projects are the most viable options for ground-up development. The fact is, there is a very real danger of losing industrial inventory in the very markets that need it most. This is no small problem for an established business with a local customer base that needs to expand to remain competitive.

ECONOMIC DRIVERS

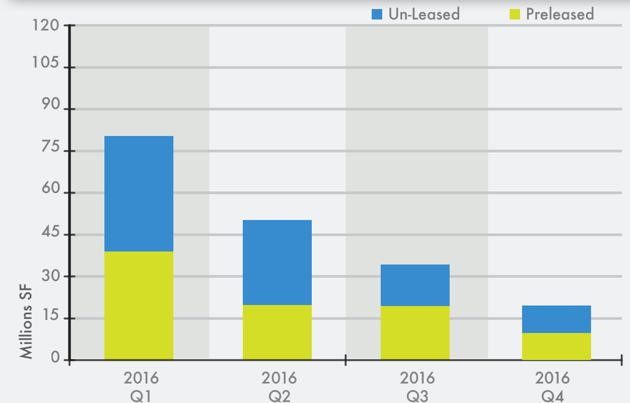


VACANCY RATES BY BUILDING TYPE 2000-2015



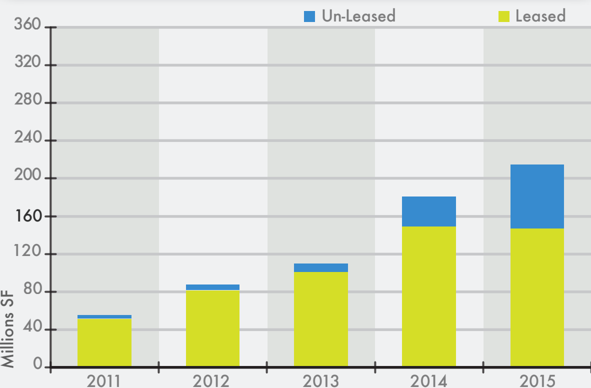
FUTURE DELIVERIES

PRELEASED & UN-LEASED SF IN PROPERTIES SCHEDULED TO DELIVER



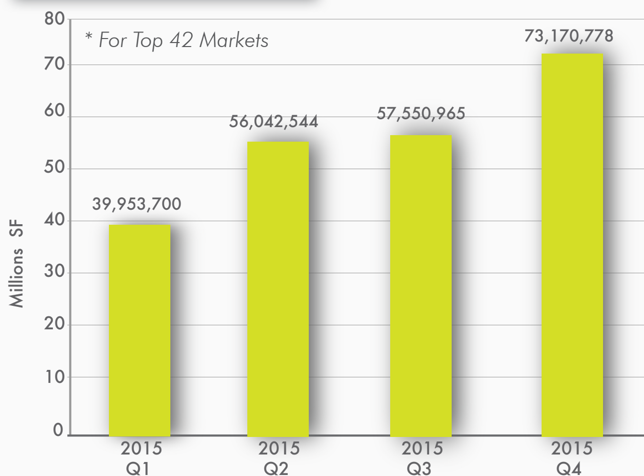
RECENT DELIVERIES

LEASED & UN-LEASED SF IN DELIVERIES LAST 5 YEARS



The national vacancy rate for warehouse and flex space combined has been falling steadily, and that trend continued in Q4, as the amount of vacant space declined by another 20 basis points to finish the year at 6.4%. During 2015, the vacancy rate fell 70 basis points, but several major market areas have reached critically low levels, including Los Angeles and Orange Counties in Southern California, both of which are struggling with vacancy rates in the 2% range. Thin supply means a decline in quality. What's left to choose from is often space with significant elements of functional obsolescence, forcing some users to forego relocation and put up with the inefficiency of the space they have outgrown.

Consistent vacancy declines have caused average asking lease rates to move up. In Q4, rents moved up $.08 to finish the year at $5.76 per square foot. Rents are up across the country, in both primary and secondary markets, but areas with higher levels of construction are seeing the strongest rent growth because tenants remain willing to pay a premium for first generation space that offers greater efficiency.



Net absorption for the overall industrial market for Q4 in all markets tracked by CoStar hit 97.17 million square feet, a significant increase over the 76.65-million-square-foot total in Q3, evidence of consistent demand throughout the country. Just under 311 million square feet of net absorption was recorded in 2015. Large distribution deals continue to account for the bulk of the net gains, with flex activity contributing just 10.5% to that total. E-commerce and 3PL operators continue to make many of the biggest deals around the country. Recent leases signed that reflect that trend include Amazon's 1 million-square foot lease in Boston, Exel Logistics' lease of 987,840 square feet in Atlanta and the 783,407-square-foot lease to Wayfair.com in the Inland Empire.

Demand from owner/users grew throughout 2015, while supplies of small to medium sized buildings shrunk further. That imbalance has sent prices through the roof across the country. Yet, businesses owners are still bullish on the opportunity to fix their occupancy costs for up to 25 years with SBA loans at rates in the 4% range. The Fed's first move on interest rates that came in December had a negligible effect on mortgage rates thus far, as most experts agree that lenders already had the central bank's action factored in. But, if the Fed follows up with regular rate hikes in 2016, mortgage costs are likely to move up and that could put the brakes on runaway price increases.

Investors, both institutional and private, still have a voracious appetite for industrial assets. Cap rates compressed to record low levels in 2015 and there is no clear indication of a change in that trend. However, chatter continues about the market reaching a cyclical peak, especially in the biggest markets that have seen the most competition for product. So, many investors have become more active in secondary markets that offer higher cap rates and the prospect of more rapid rent growth.

A LOOK AHEAD. The US industrial market should continue on its present path into 2016, but the pace of growth could slow, as concerns over the global economy grow. There just isn't a lot of good news coming in from around the world, especially from emerging economies like China, where the all-important manufacturing sector, slowed significantly in 2015. The US economy, while in much better shape than the rest of the world, is also struggling to keep GDP above stall speed. Corporate earnings growth is slowing and capital expense budgets in the energy sector are being slashed. At some point, the industrial market is going to experience a measurable impact of these events. It is important to keep in mind that current levels of vacancy, absorption and rent growth reflect decision making based on past economic conditions. Those conditions have changed significantly in the last year. So, it becomes a question of when and how much the metrics of the industrial market will be impacted going forward. The strong dollar is making our exports more expensive, which will keep the pressure on US manufacturers, especially those who sell their products to customers who don't pay their invoices in US dollars. Fortunately, the US economy outperformed the rest of the world in 2015 and it is likely to do so in 2016, as well. Hopefully, domestic demand for goods and services will keep the US economy growing enough to mitigate troubles from abroad.

Interest from foreign investors should increase in 2016 as they see the US as a safe haven for assets that are at increasing risk in non-dollar-based economies. That should keep the pressure on cap rates, as foreign investors will keep paying more as their focus on capital preservation increases.

Vacancy will continue to decline and more markets will begin to see spot shortages of space, especially those areas that have low levels of construction like Los Angeles where vacancy could go as low as 1% in 2016. Low vacancy will be accompanied by a further decline in product quality, as well. That will pose more of a challenge to tenants that must remain in their immediate areas to keep existing customers.

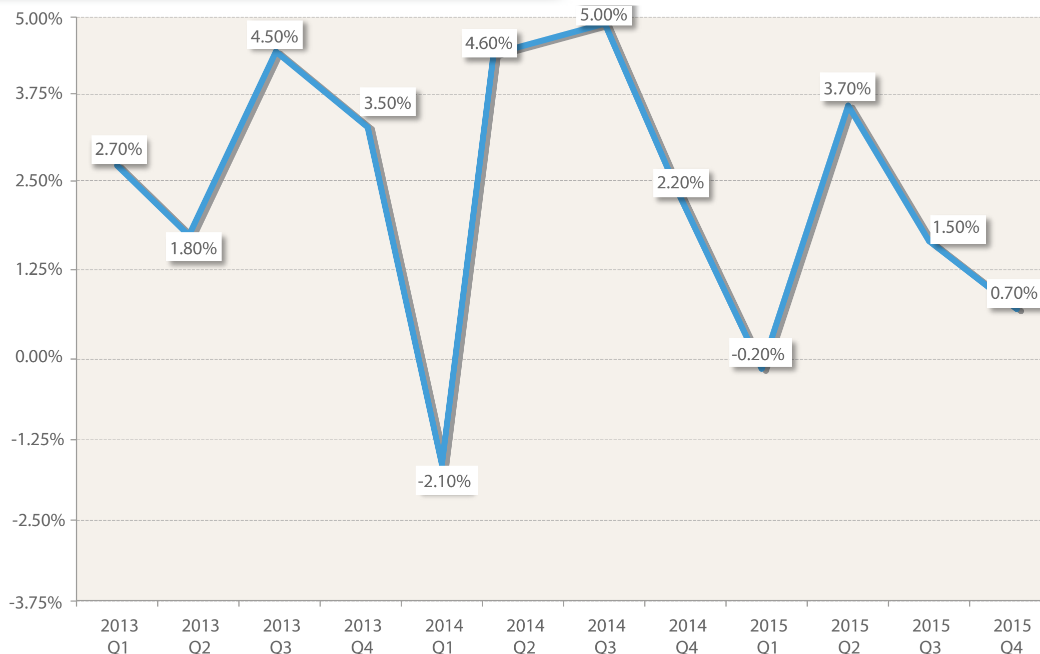
Net absorption should remain well into positive territory in both primary and secondary markets, but will moderate in areas running short on supply. This will force some users to renew in place and forego planned expansion or risk leaving their current markets in order to grow.

Average asking rental rates will continue to rise, especially in those markets with high levels of new construction. Tenants will pay a premium for quality, as the alternative may be to settle for obsolete space and still pay more.

Construction will remain concentrated in large markets that still have land available at a price point that makes sense for industrial development. Even in those markets, construction costs are rising and entitlement is getting more expensive and time-consuming. This will reduce the chances of overbuilding but may also keep developers from being able to build enough product fast enough to capture current demand.

GDP GROWTH

GDP, the key measurement of the total output of US goods and services, continues to disappoint. The list of issues raising concerns for future economic growth is getting longer and that caused another sell-off in the equities markets in the first week of the new year, after nearly recovering from the sell-off in Q3. Volatility in equities has become commonplace as investors react quickly to each bit of bad news. GDP performance hasn't helped to ease those concerns. After sluggish first quarter growth, things picked up in Q2, but slowed again in Q3 to a revised annual rate of 2%. The first estimate of GDP for Q4 came in at just .7%, which will only heighten concerns over further economic sluggishness. In all, the nation's economy muddled through another year, expanding by a lackluster 2.4%.



Consumer spending, which accounts for roughly 70% of GDP has also been weak. Retail sales, a large component of consumer spending, fell by .1% in December, compared to an expected rise of .2%. Persistently weak wage growth may be partly to blame. Income growth is struggling to keep ahead of inflation, which is also running behind expectations. Workers are just not getting ahead, and that has people nervous about making ends meet going forward. Instead of spending their wages on goods and services, many workers opt to pay down existing debt, which does nothing to help current GDP.

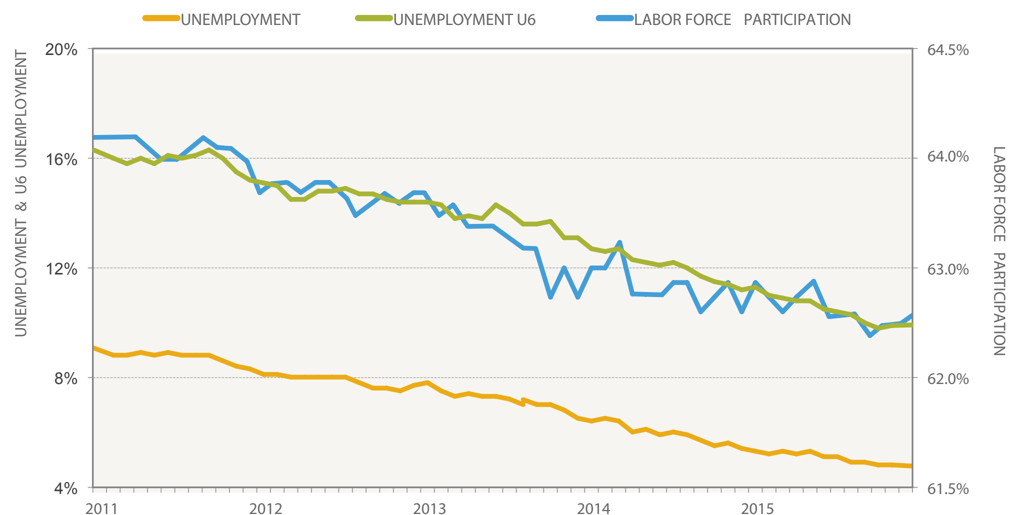
Net exports, another key component of the GDP equation, are also under stress due to the US dollar's strength against other currencies. US goods and services are getting more expensive abroad and the impact to US companies who rely on foreign sales has become clearly evident, and that situation will likely worsen as foreign governments devalue their own currencies to stimulate export activity. As a result, goods imported to the US are getting cheaper, but the trade resulting increase in our deficit puts additional drag on US GDP growth.

EMPLOYMENT

Through the first half of the year, the news regarding job creation was looking good, with the US adding an average of well over 200,000 jobs per month. Then things slowed down in the third quarter, raising concerns of an economic stall. But job creation picked back up in Q4, with December posting a gain of 292,000 jobs. As the year ended, the unemployment rate stood at 5.0%, unchanged from the previous month. The biggest job gains in 2015 were seen in professional and business services, construction, healthcare, food service and drinking places. Construction employment was strong throughout the fourth quarter, but manufacturing employment was flat throughout the year.

The proportion of part-time positions remains a problem, but the number of people stuck in part-time jobs who prefer to work full-time decreased by 764,000 in 2015. Despite that improvement, over six million people still fall into this category. Remaining uncertainty about the sustainability of the economic recovery has prompted many employers to hire part-time and temporary workers to enable a quicker response to changing markets. In fact, 34,000 of the 73,000 added jobs in professional and business services for December were hired as temporary employees. For the year, professional and business services added 605,000 jobs, 99,000 fewer than in 2014.

NATIONAL UNEMPLOYMENT



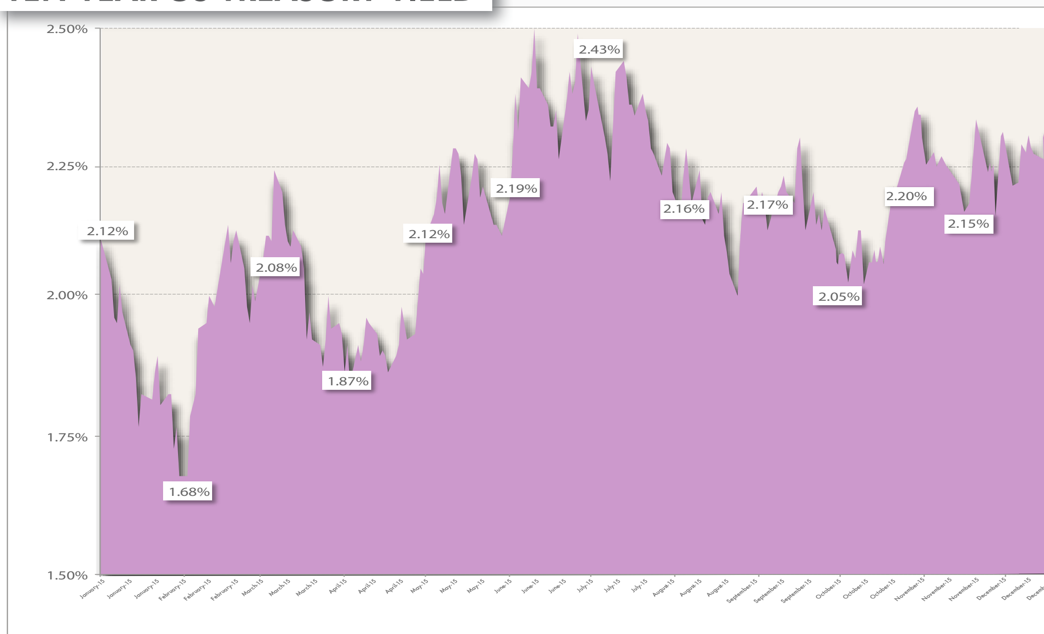
The Labor Participation Rate, which many believe is a more accurate indicator of the true state of the job market, has been declining in recent years. This metric measures the percentage of those eligible for employment between the ages of 16 and 64 who are currently working. Sporadic job growth and the early exit of Baby Boomers, who are retiring at a rate of 10,000 per day, combined to drop this key metric to a four decade low of 62.3% by mid-2015, but it managed to improve slightly in the second half to finish the year at 62.6%.

Wage growth has become a growing concern over the past year even though the unemployment rate has fallen to 5.0%. Too many of the jobs being created are at the lower end of the wage spectrum, while high-paying, full-time openings are either running in short supply or there is not enough qualified candidates to fill the positions. Without an improvement in wage growth, there is little reason to believe that consumer spending, the main GDP driver, will gain momentum. An alarming number of mass layoffs in the energy sector is compounding the problem, as most of the positions being eliminated paid well and tended to be full-time. The oil industry is idling wells, delaying further exploration and slashing capital expenditure budgets, which means that further job losses are likely.

MONETARY POLICY

Fed Chairperson, Janet Yellen and her Board of Governors, finally pulled the trigger on interest rates, making good on their ongoing threat in mid-December. By the time it actually happened, markets seem to have been conditioned to the inevitability of the change and took the rate hike in stride. In fact, there were bigger headlines being made around the globe, and the worsening global economic conditions gave investors something more worrisome to fret over. The Fed's action has at least reduced uncertainty about the central bank's direction and many see that alone as a good thing. While most experts were sure that the first rate hike would come much earlier in the year, the Fed cited concerns over China and other emerging market economies as reason for the delay. Since the move was made, the global economic outlook has worsened, as weakening growth in China touched off another round of hand-wringing.

TEN YEAR US TREASURY YIELD



As of this writing, the price of a barrel of Brent Crude, a major trading classification of sweet light crude oil and the world benchmark, was trading under $30, and stock markets around the globe got a bad start for the year. That will certainly weigh in on future rate hikes by our central bankers, as they have to look at more than US unemployment and inflation numbers for policy guidance, and they have sent a clear signal that further actions will be gradual. Initially, experts were predicting as many as four more rate hikes in 2016, but with inflation and wage growth so low and little hope of major improvement internationally, fewer moves by the Fed this year are expected.

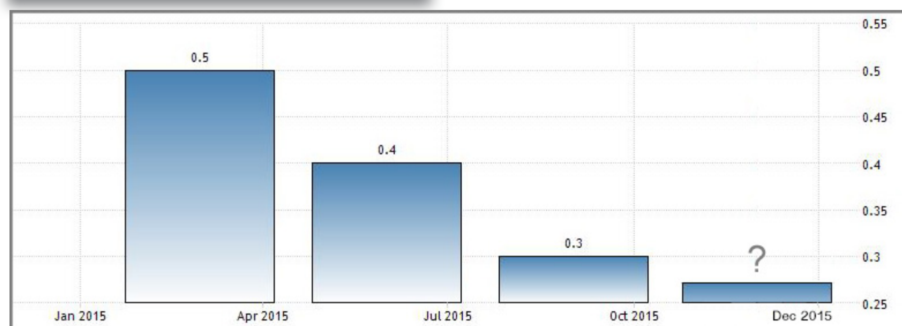
Real estate borrowers have been relieved to discover that the Fed's initial rate hike had little effect on mortgage interest rates. Long-term financing is still cheap and demand to acquire commercial real estate has been unaffected thus far. Cap rates remain compressed with no clear sign of a change in direction, but there is a lot more talk about that now than there was a few months ago. If the Fed follows through with more rate hikes soon, the possibility of higher cap rates will become very real indeed. With cap rates as low as they are, just a 50 basis point move up would have a massive impact on property values. Rents, even in the fastest growing markets are not climbing nearly fast enough to bridge that gap.

The yield on 10-Year Treasuries moved back down late in the year, finishing at 2.2%, but plunged to 1.86% by as of this writing. Many attribute the downward pressure on yields to a "flight to quality", as foreign capital pours into T-bills as a safe haven. This could be a silver lining for borrowers, as most commercial real estate mortgage rates are based on a spread over the 10-Year. So, higher yields that would ordinarily accompany increases in the Fed Funds Rate may be minimized.

GLOBAL ECONOMY

Simply put, the economic outlook is rather bleak when viewed from high altitude. Whether the topic is the European Union, emerging markets, energy-producing states or the manufacturers of the world's goods, the news is mostly bad. Global economic growth has stagnated and many countries are leaning toward or have fallen into recession. Think Russia, Brazil, Venezuela and a growing list of other countries that depend on revenues from the sale of fossil fuels and raw materials they must now sell at a fraction of the market prices of just two years ago. Europe's experiment with a political union is suffering the consequences of not also being a fiscal union, as most of its members are deep in debt, but remain unwilling to submit to fiscal constraints that are a condition of loans from wealthier member nations. Oil-rich Middle-Eastern countries, even Saudi Arabia, are issuing sovereign debt to make up for budget shortfalls occasioned by the falling price of oil. And don't forget China, the manufacturing behemoth that is finally slowing down after decades of prolific and unprecedented economic expansion. It is now struggling to change its economy from one based on the exportation of manufactured goods and the building of massive infrastructure projects to a consumer-based system that can sustain its population of over 1.4 billion people.

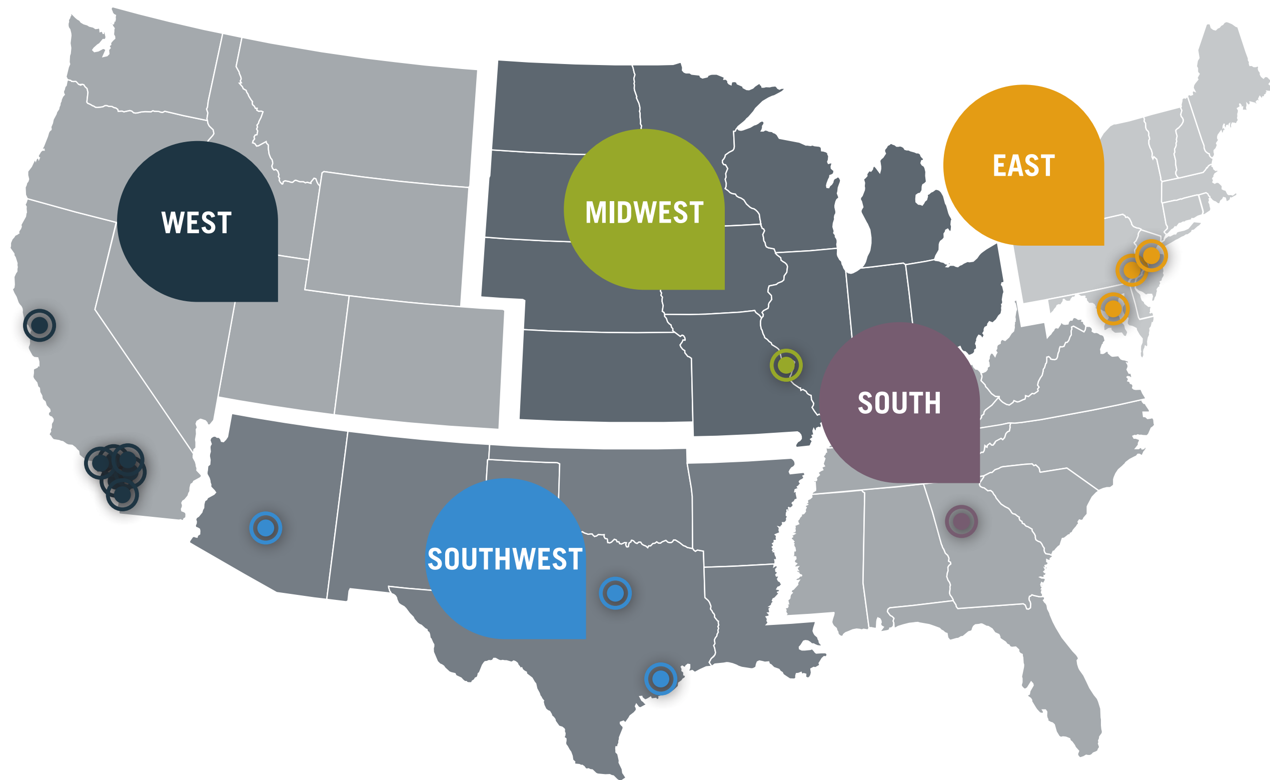
EURO AREA REAL GDP[2]
(QUARTER-ON-QUARTER PERCENTAGE CHANGES)



Economic, political and civil unrest abroad is casting a shadow long enough to cause serious concerns here in the US. The dollar has gotten stronger and that makes foreign goods cheaper, but that also means that our goods and services cost more to foreign trading partners. We already have a trade deficit that runs more than half a trillion dollars a year. Sending empty ships back across the oceans will not serve US interests in the long run. Even our central banks admit that what happens around the world impacts its own actions here at home. The world is getting smaller and struggling economies outside our borders are bound to impact business decisions here at home. Over time, there will be an impact on the commercial real estate market, first in select business sectors and markets, and then the market in general. In the coming year, we will all be hearing more about how international events are impacting business expansion here at home.

Despite all these concerns, the US economy remains in growth mode, albeit at a pace we would all like to see pick up. Industrial real estate markets continue to grow. Rents are rising, vacancy is declining and new buildings are being delivered to businesses expanding to meet anticipated demand. Employment is on the rise, but without the growth in wages we need to get consumer spending moving up fast enough to reach healthier levels of inflation. Rising prices spur production and production generates new jobs. At the moment, we don't see any significant change in economic conditions that would give the economy a needed boost. So, we predict another year of modest economic growth for the US and another year of improving market metrics for industrial real estate. Our exposure to Europe is minimal and we are now producing more of our own energy and have thus become less dependent on oil from volatile areas of the world. If developers are careful not to overbuild, supply and demand should remain in relative balance throughout the year.

Key Market Snapshots



To view a key market snapshot either click on a section of the interactive map above or on the cities below.

OAKLAND
SAN GABRIEL VALLEY
LA NORTH
CENTRAL LA
INLAND EMPIRE EAST
INLAND EMPIRE WEST
ORANGE COUNTY

PHOENIX
DALLAS / FORT WORTH
HOUSTON

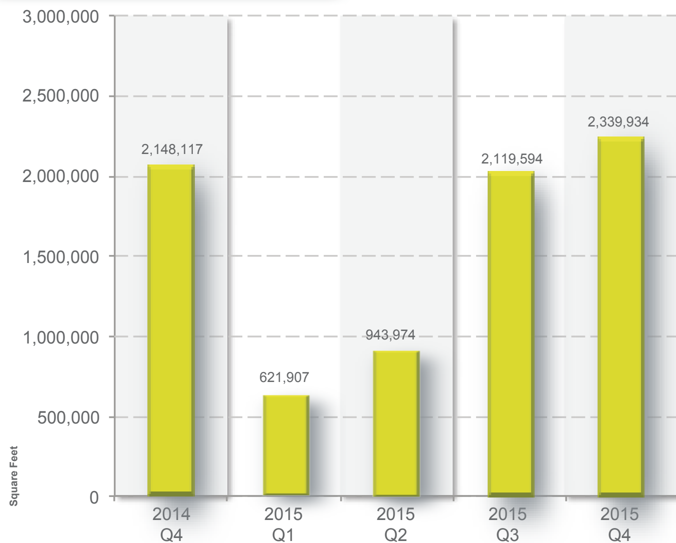
ST. LOUIS

ATLANTA
GREENVILLE /SPARTANBURG

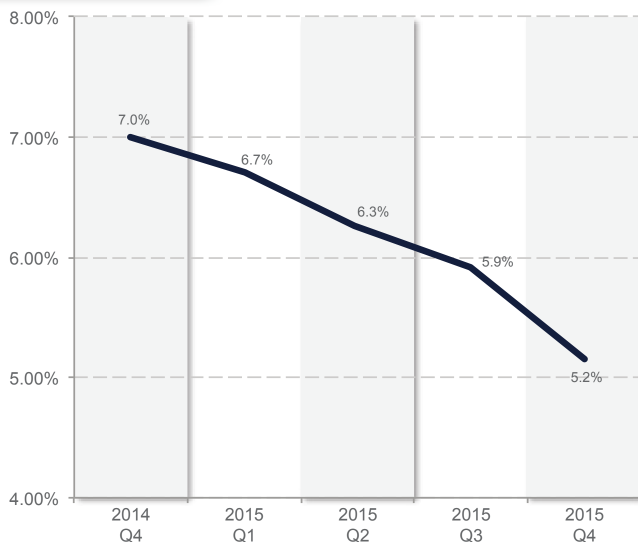
BALTIMORE
PHILADELPHIA
NORTHERN/CENTRAL NJ

OAKLAND

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The entire Bay Area has enjoyed strong economic growth over the past several quarters, mainly due to the resurgence of the tech sector. Rents in all product types have risen, the housing market has rebounded and job growth has run well ahead of virtually all other major metro areas in the country. The East Bay 880 Corridor, located across the bay from San Francisco and the Silicon Valley, has benefited directly from the tech boom, and that has given the industrial market a boost and shifted the balance of supply and demand. In a very real sense, the technology boom has been the tide lifting all boats. Q4 net absorption was up, vacancy went lower and average asking lease rates continue to move higher. Development of speculative industrial space has returned to the region, allowing major users the opportunity to expand without waiting years for build-to-suit space.

Net absorption has been consistently positive, and Q4 posted another gain of 2,339,934 square feet, which followed a 2,119,594-square-foot increase in Q3. Gains in all industrial product types were reported, but large distribution deals are dominating in terms of leasing activity, especially in first generation space, which offers higher ceiling heights and advanced fire suppression capabilities. Noteworthy deals inked in 2015 include Tesla's 504,000-square-foot lease and the 268,800-square-foot lease to CEVA Logistics, both in the 880 Corridor, and the Williams-Sonoma's 252,000-square-foot lease in the 80 Corridor.

With such robust net absorption, vacancy moved sharply lower in 2015. Q4 produced a massive 70 basis point drop, ending the period at 5.2%, which represents a 490 basis point decline since the end of 2012. Landlords now clearly have the upper hand are now demanding longer lease terms and tightening up on tenant concessions and credit requirements.

5.2%	$9.65	2,339,934	263,154,323	2,338,934
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION

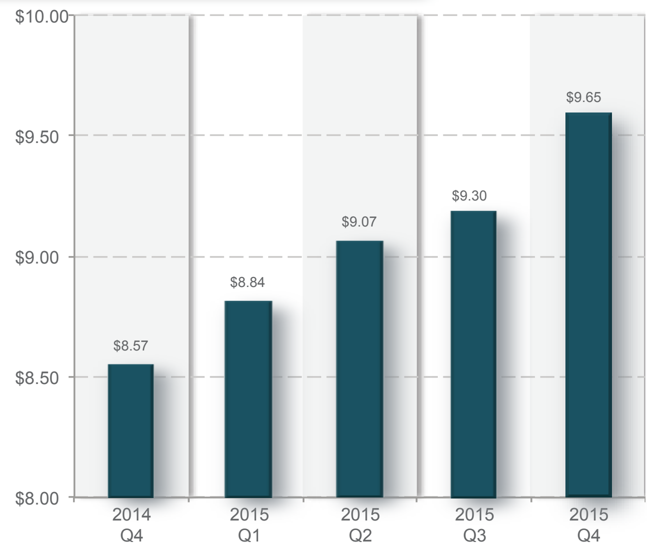
OAKLAND - TRENDING NOW (continued)

These conditions have spurred new speculative and build-to-suit development activity that the area has not experienced since the 1990's. Over 2.1 million square feet of new industrial product was delivered in 2015, and another 2,338,934 square feet was underway as the year ended. Significant deliveries for the year included the 311,469-square-foot building at Crossings@880, 100% occupied by Living Spaces, and the 302,400-square-foot building at 47400 Kato Road, which is fully occupied by Tesla.

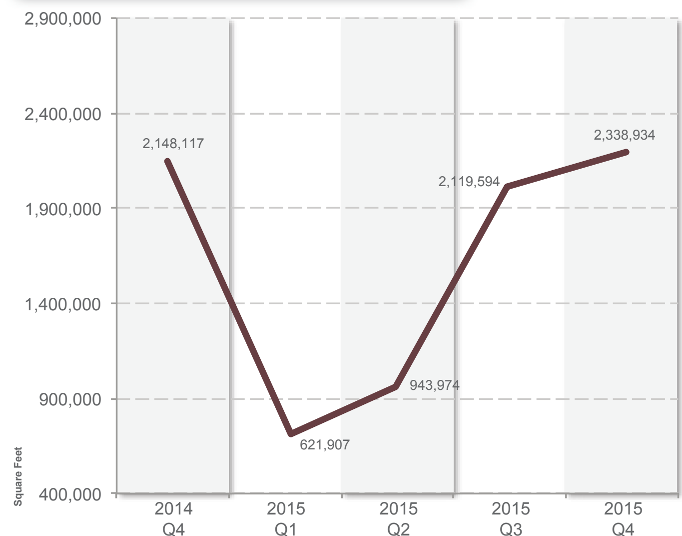
Average asking lease rates continued moving up throughout the year. The combined rate for all industrial product was up $.35 in Q4 to a new high of $9.65 per square foot. Just a year ago that rate was $8.57. The low point in the last cycle was in 2011 when rents bottomed out at $6.93. There is a noticeable sense of urgency from tenants who are growing more concerned that suitable space will not be available when current lease obligations are up.

Those attempting to buy industrial property for their own use are feeling the pinch even more. Availability of product for sale is very thin and prices have been moving up at a double-digit pace. The sense of urgency to acquire owner/user properties is being driven, in part, by the assumption that mortgage rates will rise as the Fed continues to move its Fed Funds rate higher during 2016. Mortgage rates held steady after the central bank's first move, but most believe that the initial increase was already accounted for.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

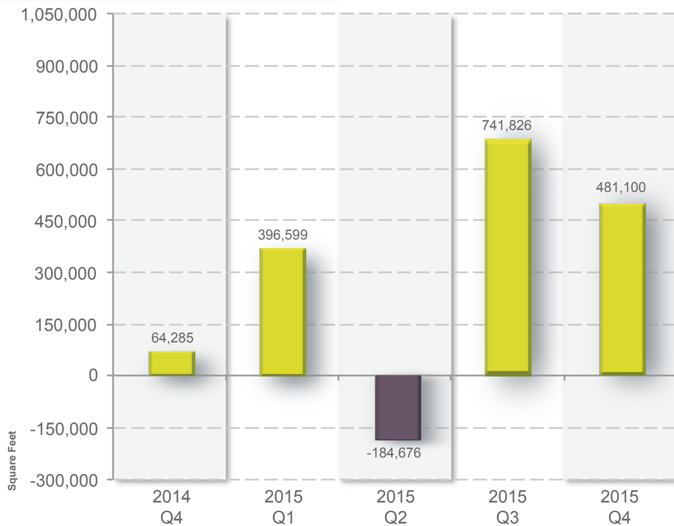


A LOOK AHEAD

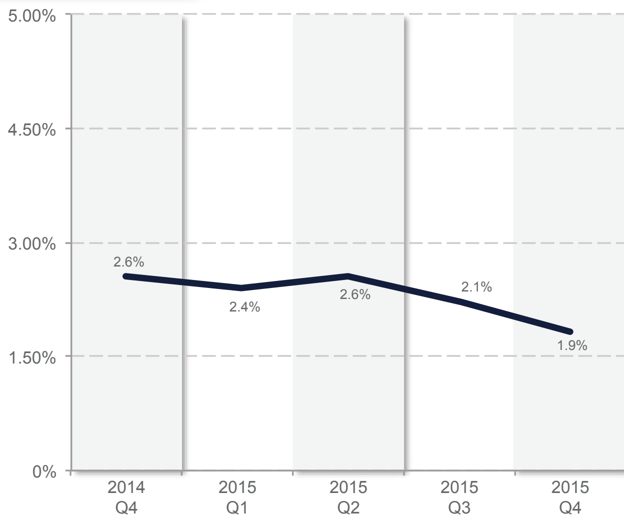
- Lease and Sale activity will remain strong in 2016, as major tenants scramble to secure the limited supply of quality space
- Sales price increases may moderate if interest rates make a significant move up
- Average asking lease rates will move up another 5% in 2016
- Land prices will remain high as the market has few available sites suitable for industrial development
- Vacancy could fall to critically low levels as demand is expected to run ahead of existing supply
- Net absorption will keep pace with 2015 levels

LA NORTH

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The story for North Los Angeles' industrial market was pretty much the same throughout 2015, and it is not expected to change much in 2016. Vacancy was critically low throughout the year and businesses were left with even less quality product to choose from. Leasing activity and net absorption would be much higher if not for the lack of availability that is forcing many tenants to stay where they are, despite inefficiencies within existing locations. Industrial development is at a virtual standstill and sites that could be developed with industrial product pencil better as residential, retail or mixed-use projects. That means that lower wage retail jobs will continue to replace higher-paying manufacturing jobs going forward. While retail brings in substantial sales tax revenues, it's good-paying, full-time jobs that drive net absorption and industrial expansion.

However, business is generally good throughout the region and there is a general sense of optimism about the economy. While there is heavy media coverage related to next year's Presidential election, the potential outcome does not seem to be affecting decision making at this point. The actions of the Federal Reserve Bank are getting more attention, as all eyes are on the frequency of future rate hikes that would impact mortgage rates for owner/user transactions, which have long been a significant component of the North Los Angeles market.

In terms of the actual numbers, the vacancy rate moved down 20 basis points in Q4 to finish the year at a scant 1.9%. Year-over-year, there was a 60 basis point dip. Vacancy that low is disheartening for tenants in need of

1.9%	$8.64	481,100	1,460,400	28,600
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION

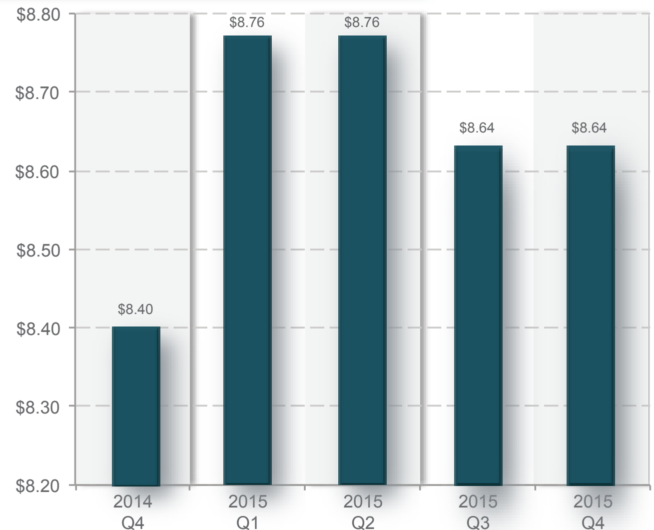
LA NORTH - TRENDING NOW (continued)

space to grow, as what little space there is to choose from has elements of functional obsolescence. In some submarkets, there is literally no vacant space to even take a property tour. However, that has spurred interest from add-value investors to acquire and upgrade existing industrial product. Rexford Properties is rehabilitating a 154,000-square-foot building to add additional loading capability, a new fire sprinkler system and other improvements.

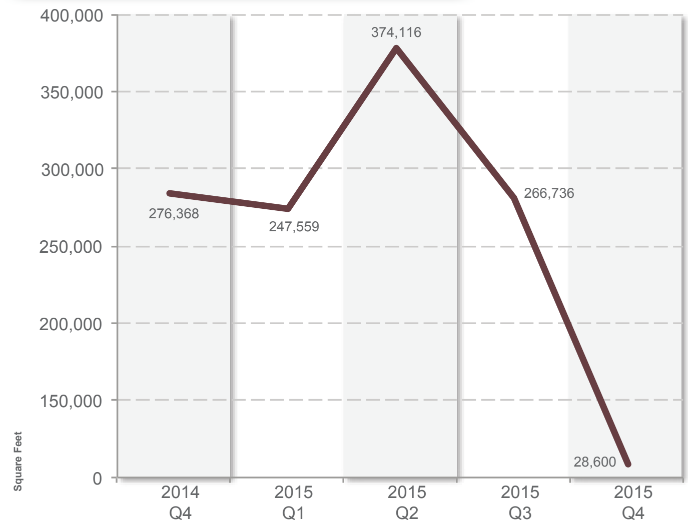
Average asking rental rates kept moving up throughout the year. In Q4, the overall rate was flat at $8.64 per square foot, but actual rates are much higher for well-located, functional buildings. Year-over-year the average asking rate rose by 2.8%. Rates vary significantly by submarket. Net absorption has remained positive, but is limited by low supply, forcing some users to renew in place. The Q4 net gain came in at 481,100 square feet, bringing 2015's total to 1,460,400 square feet. Gains in net occupancy will be hard-fought going forward given the restrictive effect of low vacancy.

The lack of available inventory for sale is another market challenge. Values have escalated as much as 30% in 2015. The sense of urgency to acquire properties became more urgent in December when the Fed made the first of several expected moves to raise interest rates. Since most owner/user transactions are facilitated by 90% loan-to-value loans through the SBA, even a nominal increase in rate can impact occupancy cost significantly. No significant increases in SBA rates have been announced yet, but another Fed rate bump could start the process.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

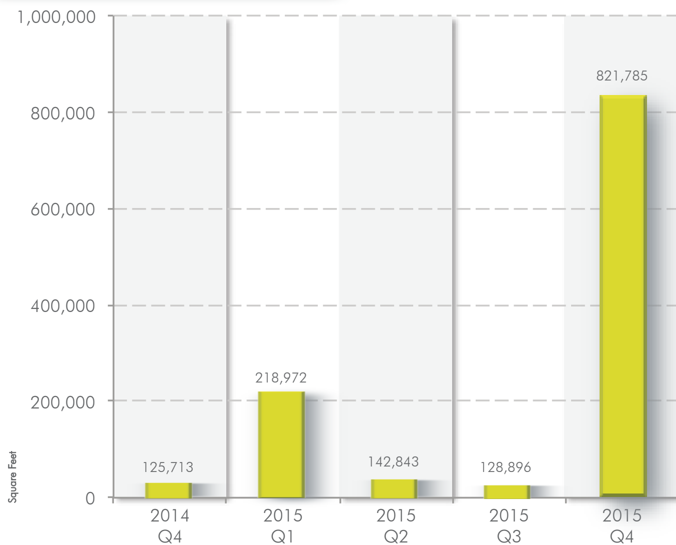


A LOOK AHEAD

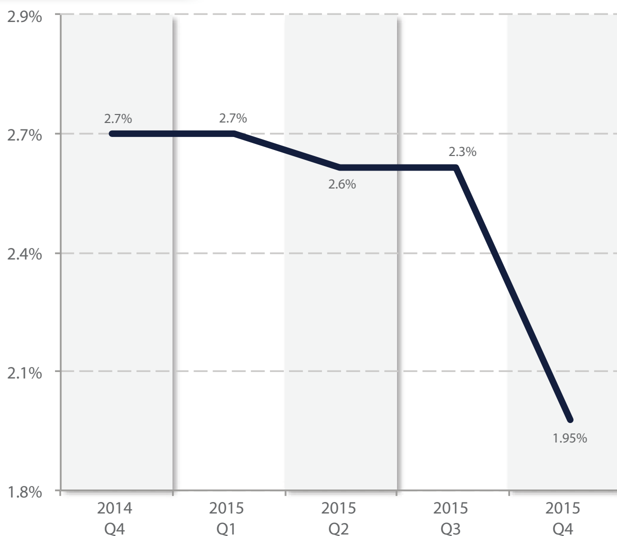
- Leasing activity will continue to slow due to supply constraints
- Interest in owner/user properties will intensify, as buyers scramble to acquire property before interest rates rise
- Net absorption will stay positive, but decrease due to low supply
- Vacancies in many submarkets will remain at sub-2% levels through 2016
- Building sale prices will spike again, and lease rates will continue to move up at current pace
- Development activity will be limited mainly to add-value and redevelopment plays

SAN GABRIEL VALLEY

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The San Gabriel Valley (SGV) industrial market is composed of three major submarkets; West SGV, 60 Freeway Corridor and 210 Freeway Corridor. The highest concentration of industrial space, just over 81 million square feet, is located along the 60 Freeway in the City of Industry. The region has a healthy cross-section of product types and size ranges, and there is a strong international trade component to the industrial business base.

The final quarter of 2015 saw another 35 basis point decline in the vacancy factor, which now stands at just 1.95%. Year-over-year, the rate is down 75 basis points, and the lack of available product is a concern for tenants and even some landlords. For tenants, it means they either pay more to get less or leave the area, which could otherwise negatively impact their businesses. For landlords who own older obsolete product, they face the possibility of significant vacancy and the high cost of retrofitting, including the additional burden of Title 24 energy regulations, in order to make their properties competitive. Landlords who control highly functional buildings have the advantage, as they can expect higher rents and consistent occupancy.

The average asking rental rate continued its steady ascent in Q4, advancing another $.19 per square foot to finish the quarter at $7.83. Landlord concessions have all but disappeared for quality spaces, including tenant improvement dollars that help mitigate the cost of relocation. Tenants are experiencing sticker shock, as a new high water mark is being set as each transaction completes.

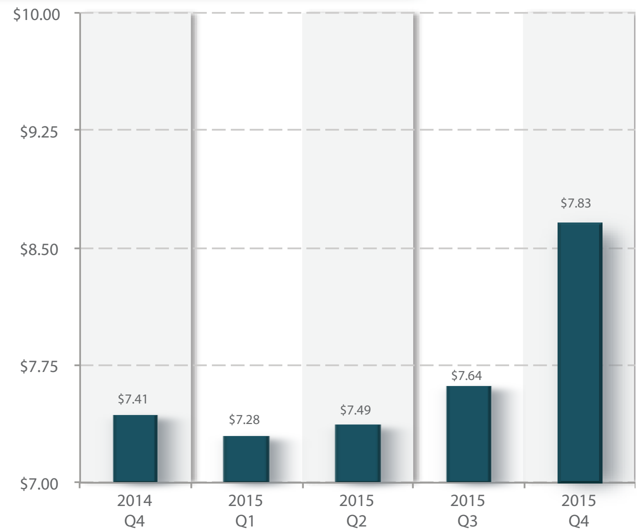
1.95%	$7.83	821,785	182,875,894	1,181,521
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▲

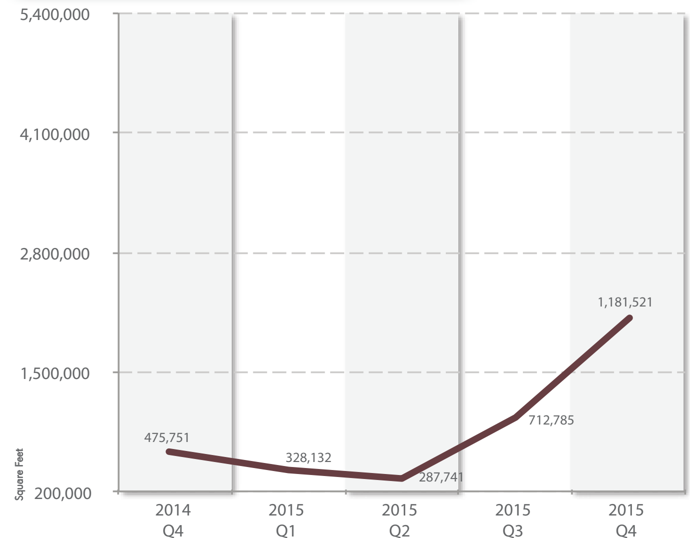
SAN GABRIEL VALLEY - TRENDING NOW (continued)

Net absorption remained positive in Q4, adding another 821,785 square feet to the total of occupied space. However, low vacancy remains a hindrance, as more tenants are renewing existing leases or leaving the area. Distribution users are generating most of the leasing activity throughout the SGV, but space in all size ranges is moving quickly. Gross lease activity, on the other hand, increased from 1.3 million square feet in Q3, to just 1.38 square feet in Q4, largely due to lack of supply in larger buildings.

Development of new product is moving ahead, but well short of the pace needed to satisfy demand for first-generation product. Just 1.2 million square feet of new inventory was under construction as the year ended, and only 520,000 square feet was delivered for all of 2015. Land is scarce and expensive, but developers are willing to risk speculative construction if they can secure the land to build. Fortunately, over 3 million square feet is in the planning stages, but the entitlement process is often frustrating and time-consuming, which only serves to exacerbate the supply problem. It also adds risk to developers who want to take advantage of the current low cost of capital. If the Fed follows through on several intended rate hikes in 2016, it could keep badly needed projects on the drawing board.

Owner/user demand is still high, but skyrocketing prices along with a strong chance of higher rates could dampen the enthusiasm of some user/buyers. Low occupancy cost drives those deals and as those costs move up, the owner/user advantage is diminished.



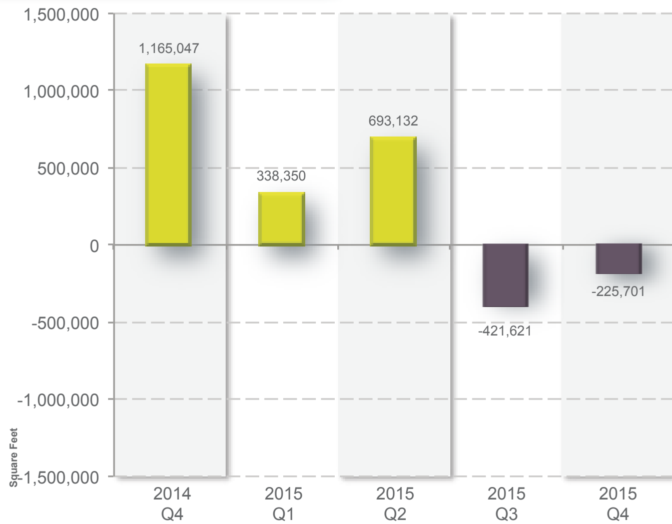


A LOOK AHEAD

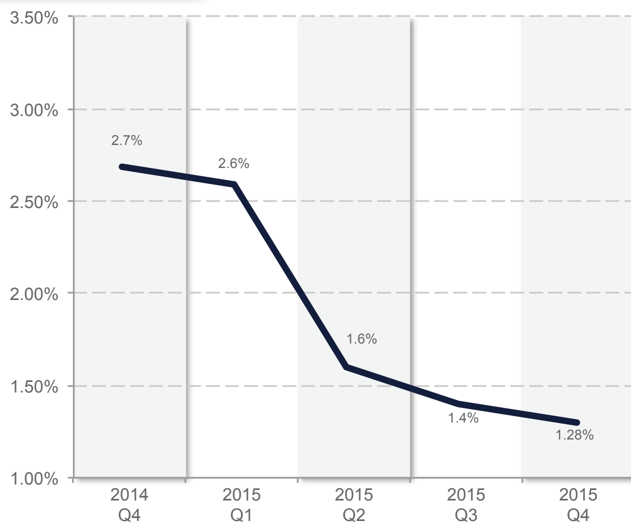
- Gross lease and sale activity will decline slightly due to short supply
- Net absorption will remain near current levels
- Vacancy will remain in the 1% range in 2016
- Owner/user sale prices will set new record highs
- Average asking lease rates will continue to rise at current pace
- Interest rate hike will reduce demand from marginal owner/user buyers
- Construction could increase due to release of Successor Agency properties

CENTRAL LA

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Availability of quality space in the Central Los Angeles industrial market is at an all-time low. The region, which includes Downtown, Vernon, Commerce, and the Mid-Cities, has tightened so much that companies that have expanded into the region are being forced to either choose functionally obsolete product or leave the area. This is particularly problematic for service companies that need to remain in close proximity to existing customers. Rents and sales prices have spiked to levels not seen since the previous market peak.

Vacancy fell again in Q4 of 2015 to a new low of 1.28%. While this is welcome news to landlords, even those tenants willing to pay a premium for space, are unable to find properties that are suitable for their needs. With vacancy so low, more tenants are renewing in place, but an increasing number are being forced to leave the area for the Inland Empire where vacancy is also falling sharply. A decline in quality has accompanied the decrease in availability, as the best spaces are snapped up quickly, many on an off-market basis. The cost to retrofit older space for new tenants is much higher, and landlords are able to pass more and more of it onto tenants. California's new Title 24 energy regulations exacerbates this problem. The law drives construction cost up based on the extent to which the electrical system is changed. Landlords of significantly obsolete facilities face the biggest challenge from the new law, as they are being forced to make more upgrades to remain competitive and meet new building codes. Even with such low vacancy, there is still a real danger for long term vacancy for the least functional buildings.

There is virtually no vacant land for the development of modern facilities and what few parcels do become

1.28%	$7.56	-225,701	271,259,802	1,224,181
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION

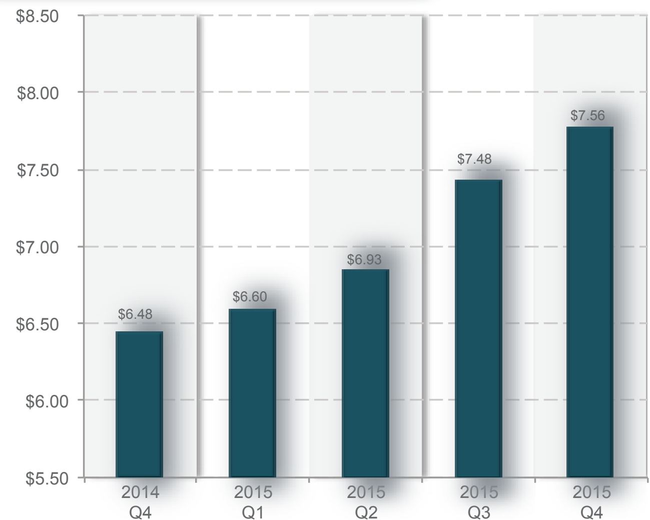
CENTRAL LOS ANGELES - TRENDING NOW (continued)

available are at prices that don't justify the construction of traditional industrial product. Older industrial product is being purchased for redevelopment to higher uses including multi-family and mixed use retail-office-residential projects. Thus, the base inventory is shrinking, while concurrently becoming more obsolete. Compare that to Dallas, Chicago and Atlanta, markets that are adding tens of millions of square feet of state-of-the-art industrial product every year.

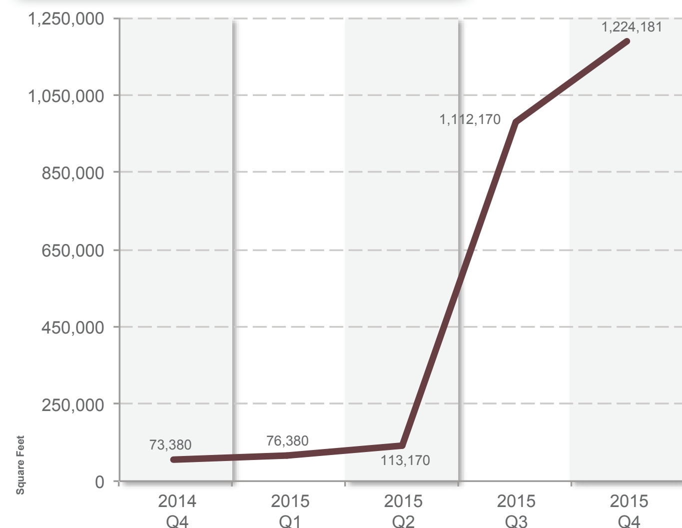
Net absorption is severely impacted by the lack of supply. Q4 saw a decline in occupied space of 225,701 square feet, following Q3's gain of 421,000 square feet. Average asking rental rates moved up throughout the year, posting another increase of $.08 in Q4. Year-over-year, rents moved up by 17%. Sale prices are also up, but available product is scarce. Users remain motivated to find product to occupy before SBA rates start moving up as a result of Fed action. Over 60% of the owner/user sales involved SBA financing. With the Fed indicating the likelihood of more rate hikes in 2016, user demand may ease up, but given the lack of supply, prices could keep moving up even if mortgage rates rise.

Cap rates remain compressed to historic lows, as institutional demand for product in Central Los Angeles continues to strengthen. Add the owner/user demand for small to medium sized buildings, and it's clear that Sellers have a big upper hand in any negotiation. However, the tables are turned, as those same sellers seek properties to acquire to complete 1031 exchanges. The alternative to exchange is to cash out, and most owners are unwilling to suffer the massive tax consequence.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

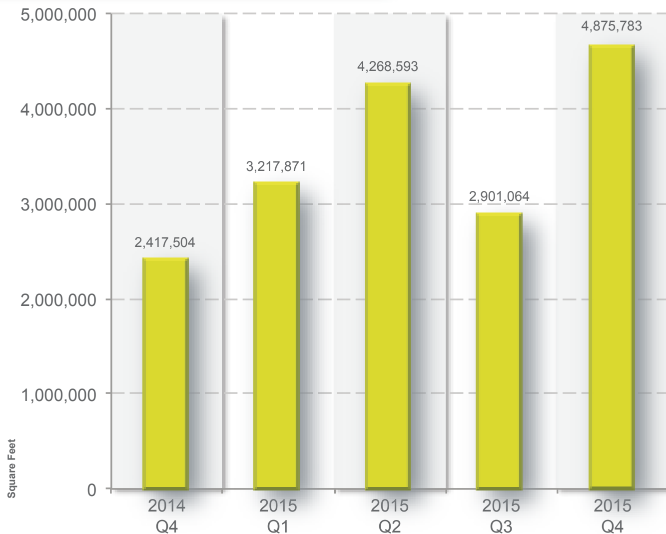


A LOOK AHEAD

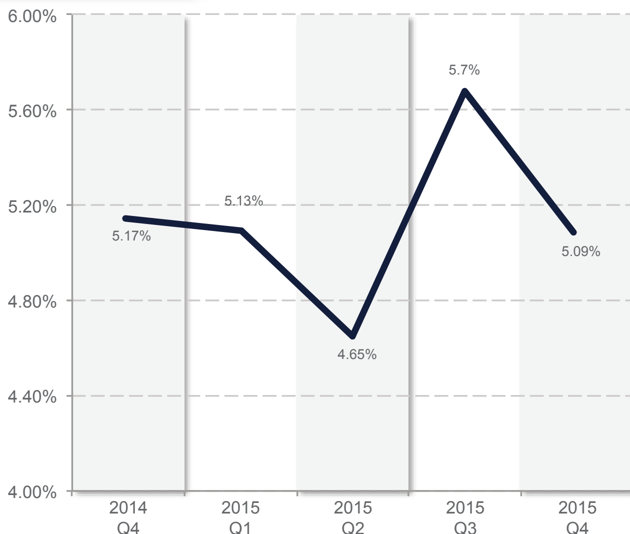
- Gross activity will remain strong, as users scramble for limited supply of quality space
- Lease rates will rise another 5% in 2016
- Development of new industrial product will be nominal
- Net absorption will stay in positive territory, but restricted by tight supply
- Vacancy will stay under 2% in 2016
- Industrial-zoned land, if sold, will likely be developed as mixed-use projects including multi-family, retail and office product

INLAND EMPIRE-EAST

GROSS SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Inland Empire-East (East Valley) industrial market includes the cities of Colton, Grand Terrace, Moreno Valley, Perris, Loma Linda, Mentone, Redlands, Yucaipa, Bloomington, Rialto, Riverside, Jurupa Valley (Portions), Highland, San Bernardino, Banning and Beaumont. The area is served by Interstates 10, 15, 215 and the 60, 71, and 91 Freeways, which makes it one of the largest distribution hubs in the US when combined with the Inland Empire-West market.

Industrial lease and sale activity continued to run hot in the final quarter of 2015, as savvy tenants in all size ranges have a sense of urgency over finding space under tight market conditions. Landlords are pushing for simple deal structures and longer term leases from tenants with solid credit. Users without good financials are finding themselves at a distinct disadvantage if they have to compete for the best quality product. Marketing time for smaller spaces is being measured in weeks now rather than months, and it's hard to image that vacancy, which settled at 5.09% in Q4, ran as high as 19% just six years ago. Year-over-year, the vacancy rate has decreased by 8 basis points, but it fluctuates quarter to quarter due to the high volume of new deliveries.

Large lease transactions, some over 200,000 square feet, are driving absorption, but supply is running short in all size ranges, especially for properties offered for sale. Gross absorption for Q4 hit almost 4.9 million square feet, bringing total gross absorption for the year to just under 15.3 million square feet. With such strong momentum, gross absorption should remain at least at current levels, but landlords with functionally obsolete space may see longer lease-up times and be forced to settle for weaker credit.

5.09%	$6.69	4,875,783	183,110,180	10,338,507
VACANCY	AVG. SF RENTAL RATES	GROSS SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▼

INLAND EMPIRE (EAST) - TRENDING NOW (continued)

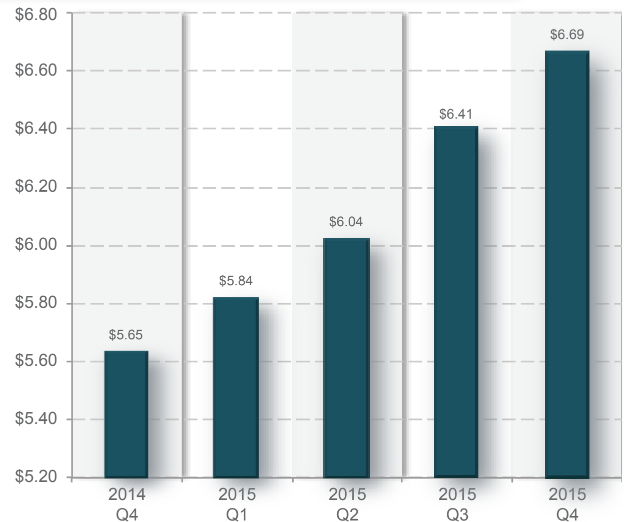
Would-be owner/users are competing aggressively to secure limited inventory before the Fed's recent shift in monetary policy triggers a bump in SBA mortgage rates. For the moment, qualified users can still secure fully amortized, fixed rate loans under 5% for 90% of appraised value.

Sellers, who know supply is short, stubbornly push prices higher each quarter, making buyers reach to record-high pricing levels to get deals done. But, even at today's elevated pricing levels, the opportunity to fix occupancy costs for up to 25 years is compelling.

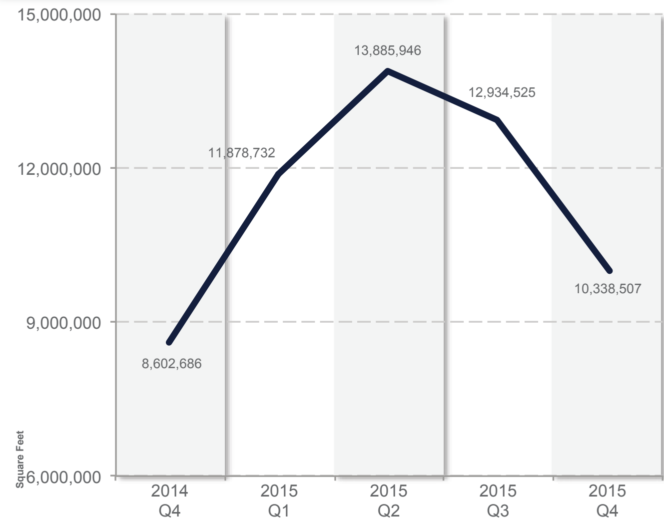
Average asking rental rates for manufacturing and distribution space combined, moved up $0.28 to $6.69 GRS by the end of Q4. Year-over-year GRS lease rates have climbed by 18.4%, another good reason for tenants to become owners. Construction kept a brisk pace in the final quarter of the year. Almost 4.6 million square feet of new space was delivered, bringing total base inventory up to 183 million square feet.

Another 10.3 million square feet of space is still underway, some of it now in smaller buildings that appeal to a wider variety of industrial uses. Some developers are taking on more risk of late by pursuing sites with significant environmental, soil and political issues. Projects under construction are seeing high levels of interest, many leasing up or selling out by the time they are completed.

AVERAGE GROSS SF RENTAL RATES



SF UNDER CONSTRUCTION

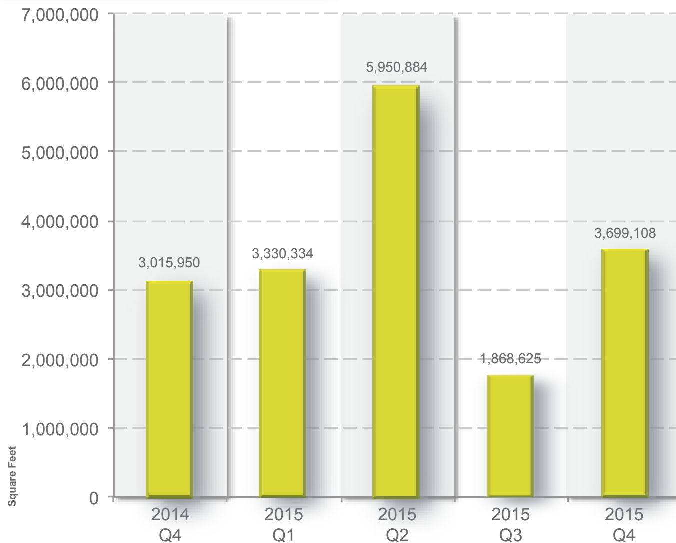


A LOOK AHEAD

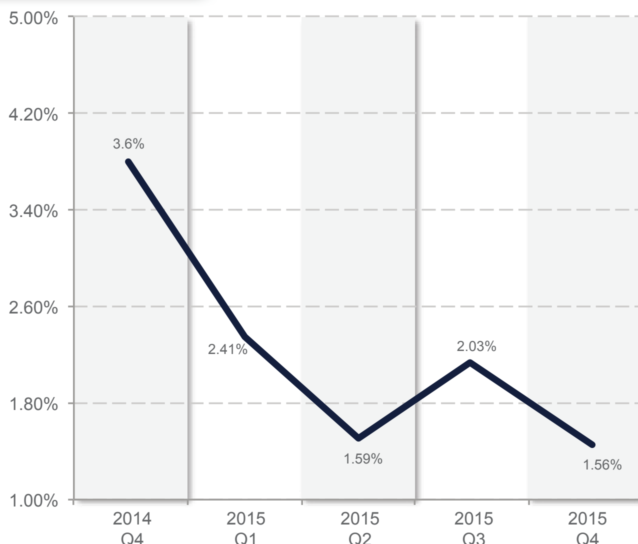
- Gross leasing activity will remain strong in the short term
- Absorption will be positive but tempered by limited supply
- Sales prices will continue to move up, especially for smaller buildings
- Vacancy will remain stable going forward
- Higher lease and sale prices will shift construction activity to smaller size ranges
- Limited supply of land and a protracted entitlement process will slow new deliveries going forward
- Renewals-in-place will increase due to "sticker shock" and limited choice of quality properties

INLAND EMPIRE-WEST

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Inland Empire West (IE West) industrial market includes the cities of Chino, Ontario, Rancho Cucamonga, Fontana and Mira Loma. Together, these cities contain 290 million of the over 500 million square feet of existing industrial space in the Inland Empire market. IE West is one of the largest industrial markets in the United States, and serves as a key distribution hub for the Western states.

Located within an hour's drive of the ports of Long Beach and Los Angeles where up to 40% of the goods entering the US arrive each year, IE West is served by several major highways including Interstates 10, 15 and 215, with easy access to the 57, 60, 91, 210 and 605 Freeways. Bulk distribution product makes up the vast majority of the industrial space, with a high concentration of buildings in excess of 500,000 square feet each.

Quality is also a differentiating factor for IE West, as the region is the most active in the US in terms of construction of state-of-the-art distribution facilities with high ceiling clearance and the latest in fire and life safety systems that allow large distributors to operate with greater efficiency. By the end of Q4, over 9.3 million square feet of Class A distribution space was under construction and over 9.1 million square feet delivered in 2015. A good portion of that space has been preleased, but speculative development is also a big factor in terms of construction, which gives expanding major retailers, e-commerce companies and 3PL operators the opportunity to quickly expand their capacity within the region.

1.56%	$5.27	3,699,108	290,368,387	10,150,138
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▼

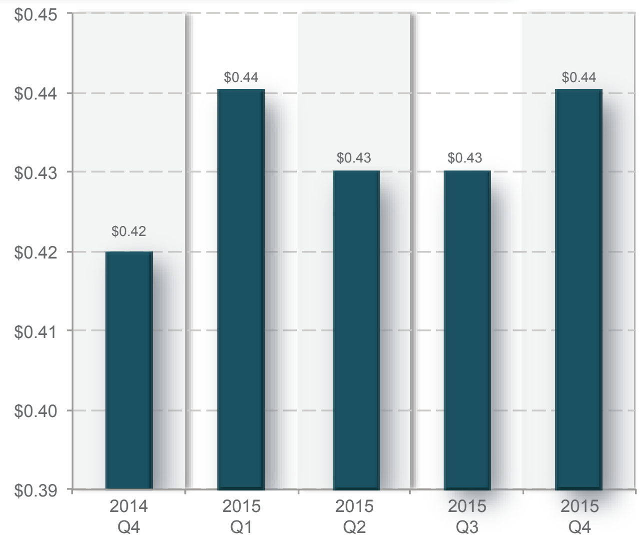
INLAND EMPIRE (WEST) - TRENDING NOW (continued)

Despite high levels of new construction, demand is still so strong that supply constraints have become a problem, especially for buildings under 300,000 square feet. That could be more of an issue going forward, as land availability in the IE West is declining, which makes good sites more expensive. Also, political resistance to bulk distribution projects is on the rise in some jurisdictions, which complicates an already slow and complex entitlement process.

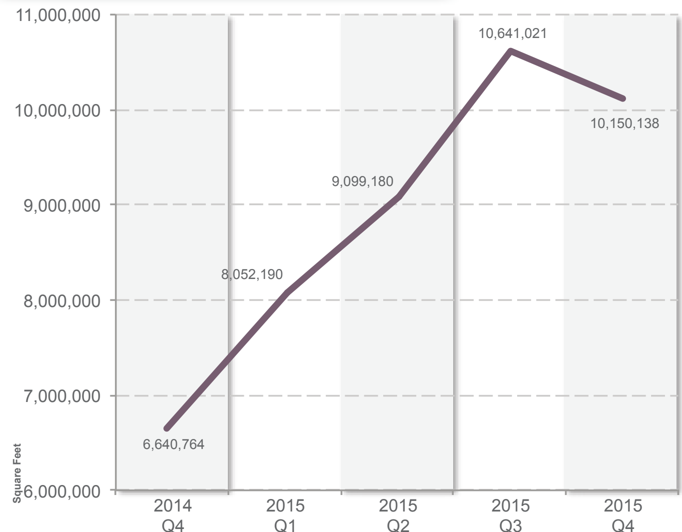
Average asking lease rates for Q4 moved up $0.12 to finish at $5.27. Year-over-year, an increase of $0.22 was recorded. The bigger story in the IE West market is about vacancy. In Q4, the vacancy rate stood at just 1.56%, perhaps the lowest of the nation's major distribution hubs. Under such tight conditions, it appears quite likely that rates will move up in the coming year, as demand remains strong and the delivery of new Class A space, that rents at a premium, is delivered. Low vacancy and higher rents have emboldened landlords to demand stronger credit and longer lease terms. Concessions like free rent are quickly becoming a thing of the past.

If they can find it, institutional investors are buying distribution product throughout the Western Inland Empire. They like doing the big deals and most of the region's base inventory is in large scale projects. Large investment transactions in 2015 included the 609,888-square foot property on N. Locust Ave in Rialto, acquired by Madison Core Property Fund, LLC from CapRock, and TIAA-CREF's purchase of 398,471 square feet in Fontana from Oakmont Industrial Group.

NNN AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

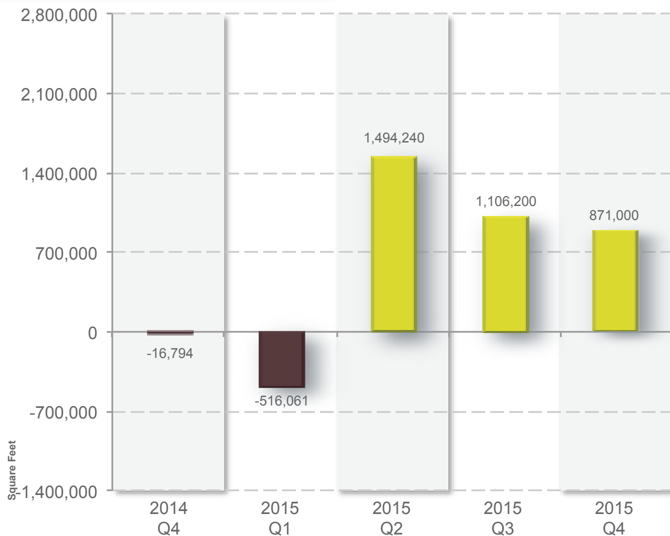


A LOOK AHEAD

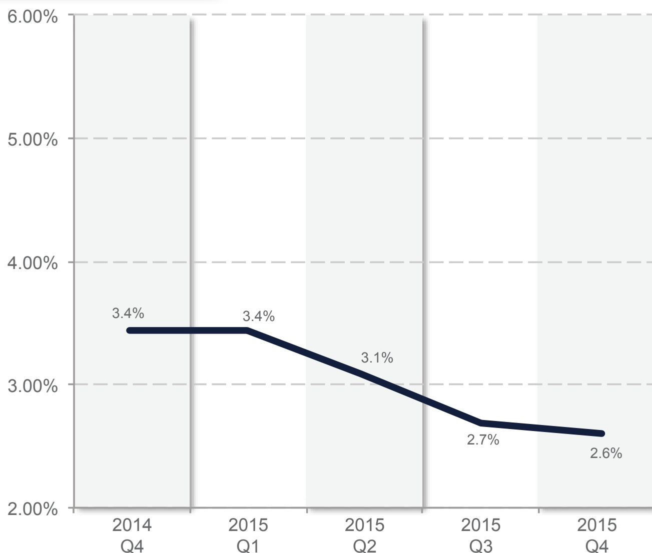
- Overall gross leasing activity should remain strong in 2016 as large users continue to expand
- Limits on net absorption will be precipitated by record-low vacancy rates
- Supply constraints will continue for space under 300,000 square feet, especially if home building improves in 2016
- Lease rates will rise another 3% - 5% over the next year
- Vacancy will remain near current low level, as new deliveries will keep pace with demand
- Construction will increase by as much as 10% in 2016

ORANGE COUNTY

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Industrial businesses throughout Orange County are still growing, hiring and acquiring space, but vacancy remains critically low and strong demand pushed sale prices and lease rates sharply higher in 2015. Development activity is at a virtual standstill and quality space is getting harder to find by the day.

Landlords with vacant space are calling the shots for new leases and renewals. Current conditions are forcing some tenants and would-be owner/users to look to neighboring Riverside and San Bernardino Counties to find space, but those markets have their own low vacancy to contend with.

The likelihood of measurable industrial construction is low. Land is just too expensive to justify building traditional industrial product, even at today's elevated price points. Projects offering buildings for sale will be comprised of larger units to keep construction costs down. Gone are the days of projects offering buildings under 30,000 square feet, even though the demand for small buildings has never been stronger. That's good news for those who own the many thousands of small buildings throughout the county.

Demand for these properties is and will remain very strong. In fact, in many submarkets pricing for top quality buildings has eclipsed the previous market peak. Only a significant increase in SBA lending rates could put the brakes on the rise in property values, which have been running at a double digit pace for several years.

2.6%	$9.57	871,000	301,946,508	595,927
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▼	▲	▼

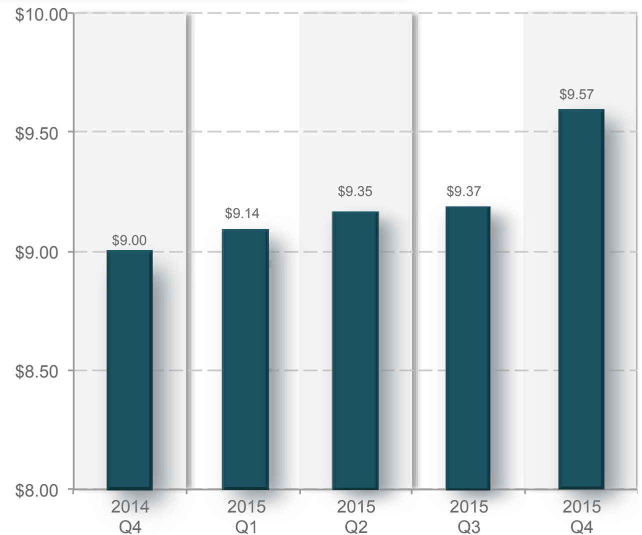
ORANGE COUNTY - TRENDING NOW
(continued)

Just 2.6% of the industrial base was vacant as the year ended, a decline of 10 basis points for the quarter. With such low vacancy comes poor quality, as the best space is either occupied or snatched up as soon as it hits the market. Competition for space is common, and the winning bidders are feeling lucky even if they end up paying more the asking rate. The possible exception to this trend will be manufacturing properties in West County, as manufacturing across the US struggled through the last half of 2015.

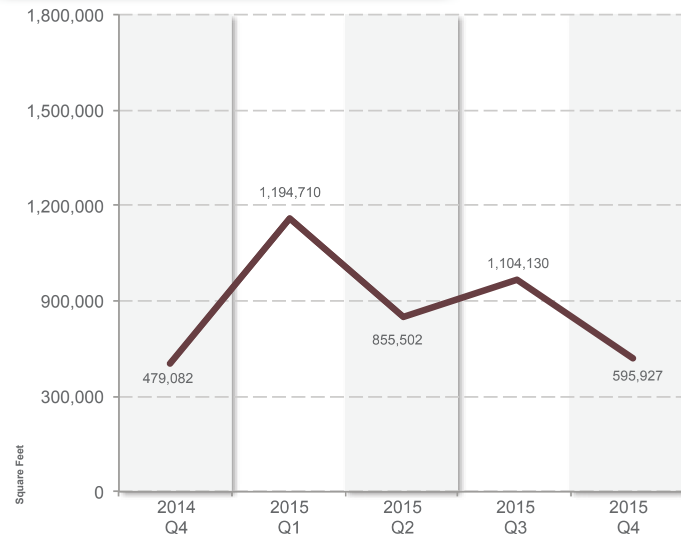
The lack of supply is also having a negative impact on net absorption. For many tenants and would-be user/buyers, there is simply no place to go. The net gain in occupied space totaled 871,000 square feet in Q4 as compared to 1,106,000 square feet in the previous period. Inventory under construction offered little relief. Only 508,203 square feet was delivered in Q4 to a market with 302 million square feet of industrial product. Redevelopment plays like Turner Development's Anaheim project of 14,000 to 43,000 square-foot buildings in Anaheim, are seeing high activity, especially from owner/users looking to secure a facility before SBA mortgage rates go up.

Average asking rental rates moved up again in Q4, rising another $.20 to $9.57 per square foot. Landlords have tightened up on leasing concessions and credit strength. Title 24, the new California energy conservation regulation, is driving up the cost of tenant improvements, and landlords are successfully passing those costs along to tenants who are increasingly desperate for space.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

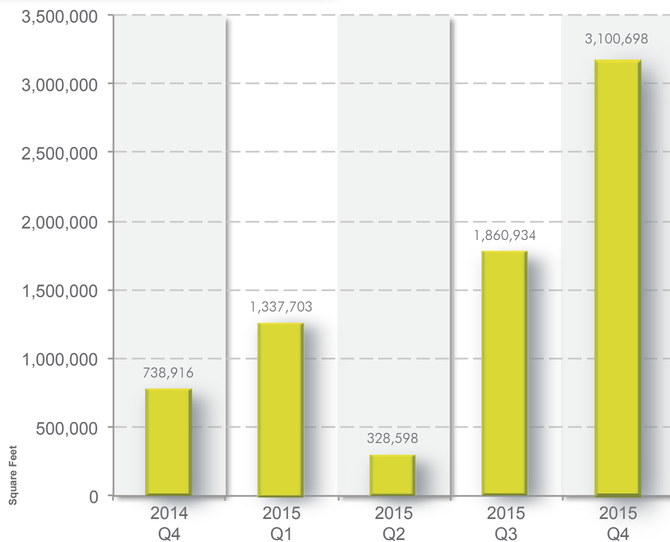


A LOOK AHEAD

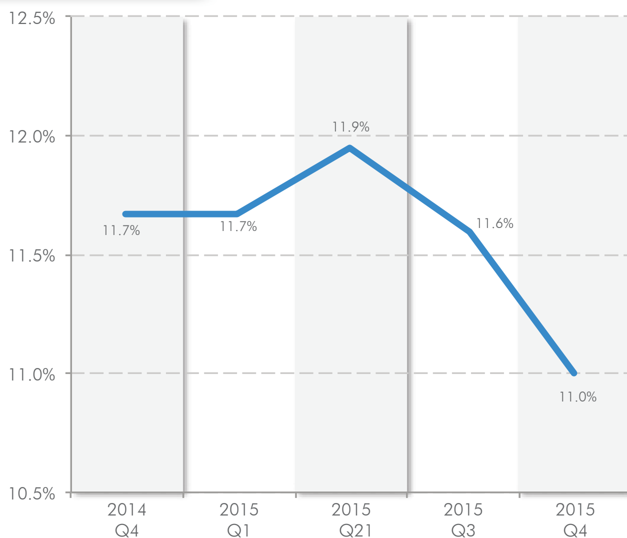
- Competition for sale and lease product will only get more intense in 2016
- Transaction volume will decrease going forward due to supply constraints
- Lease rates for 2016 will rise by as much as 10% depending on quality and functionality
- Tenants without strong credit will have to settle for inferior product in secondary locations
- Construction of industrial inventory will remain nominal
- Vacancy in manufacturing buildings could tick up unless that sector rebounds in 2016

PHOENIX

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Phoenix industrial market is still in expansion mode. The area continues to attract major users, in part because city and state government agencies are aggressively recruiting businesses from other states to the area with tax incentive programs based on new job creation.

Business growth means new jobs and new jobs drive the construction and absorption of industrial space. The unemployment rate in the Phoenix area fell 60 basis points in 2015 to 5.0%, bringing it very close to the current US rate of 4.8%.

In Q4, another 657,834 square feet of new product was delivered, bringing the base inventory total up to 293.1 million square feet overall. The bulk of new construction has been largely on a build-to-suit basis, but speculative development is on the rise, mostly in multi-tenant product. Another 3,454,000 square feet is currently under construction.

The addition of all the new inventory is keeping vacancy at fairly high levels in the Greater Phoenix area compared to infill markets like Central Los Angeles, the Inland Empire-West, and Orange County where vacancy rates are running in the 2% range. Leasing activity is not quite to the point where it can easily absorb all the space being vacated by tenants moving to new buildings. Still, the vacancy rate managed to decline by 80 basis points in Q4, to end the year at 11.0%.

11.0%	$6.48	3,100,698	293,121,023	3,454,071
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▼

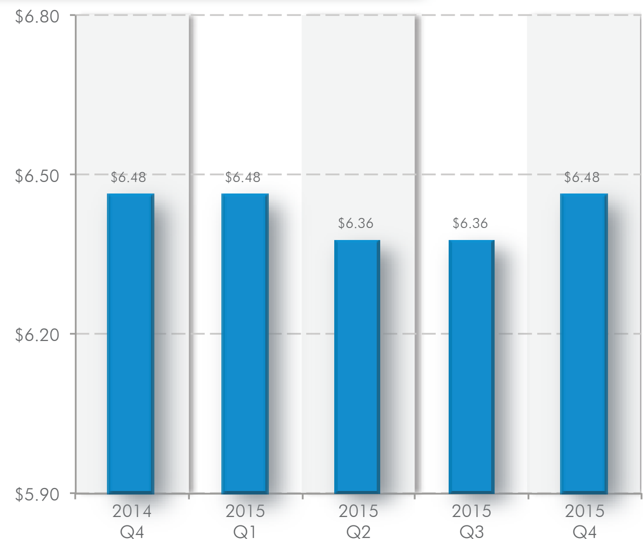
PHOENIX - TRENDING NOW (continued)

There was great news in terms of net absorption in the final quarter of 2015. The period ended with a net gain of 3,100,698 square feet, the biggest jump in six quarters. That strong performance brought net gains in occupied space up to 7,083,096 square feet for the year. Large distribution deals are still the big story in the Southwest, which accounted for 38% of the overall net absorption in 2015, while large manufacturing, flex and multi-tenant distribution product sees more action in the Southeast Valley. Demand is still strongest for distribution product, but activity in high-tech manufacturing space is also a big contributor to overall market activity.

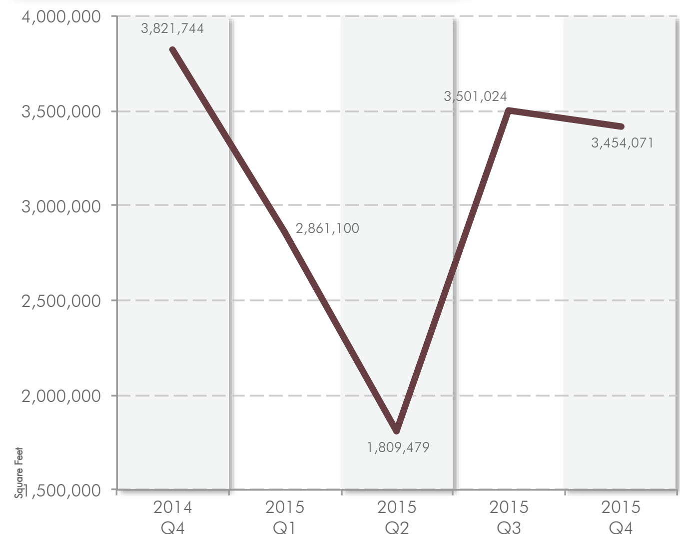
Average asking rental rates in Q4 increased slightly to $.54 per square foot on a monthly basis in Q4, which represents a 1.9% increase in just one quarter. Though, there has been no sustained increase in overall average asking rental rates since 2010, something major users eying the area for future expansion take note of. Phoenix offers existing and potential employees a good quality of life and a relatively low cost of living compared to major metro areas on both coasts.

Investors chasing higher yields than they can get in other major metro areas, continue to have strong interest in acquiring industrial product in Phoenix. Cap rates remained compressed throughout the US, but investors, big and small, see Phoenix as an area with good upside rent growth potential over time. There is also a significant amount of new construction, which offers investors the opportunity to acquire first generation space at a better price point than older product in infill markets that offer lower returns.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

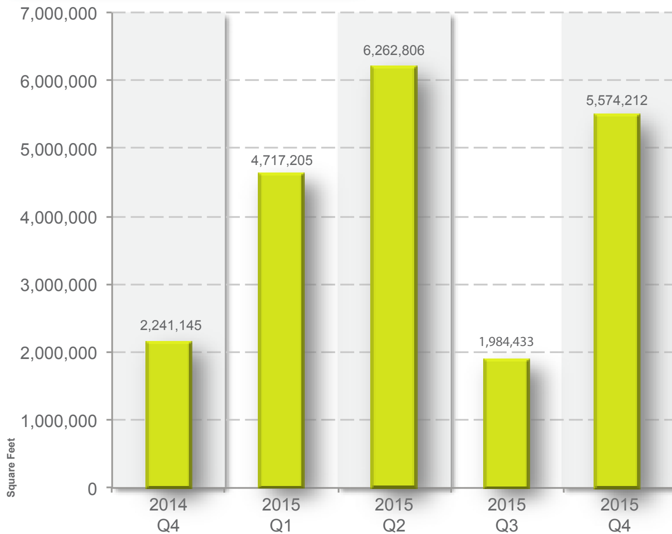


A LOOK AHEAD

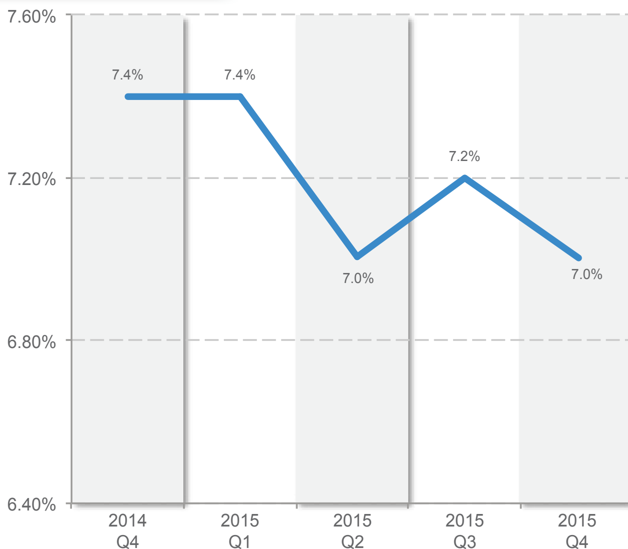
- Gross activity should remain at current levels, driven by a move-up in quality to first generation space
- The amount of functional obsolete product offered for lease is rising
- Vacancy will move up and down for the next several quarters in-sync with new deliveries
- Lease rates will move up slightly over the next year
- Construction activity will remain at the current pace, with emphasis in mostly 40K to 80K multi-tenant distribution buildings
- Owner/user demand will stay strong until interest rates make a significant move up

DALLAS / FORT WORTH

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Dallas/Fort Worth (DFW) industrial market is still one of the nation's hot spots in terms of new construction. New deliveries for the year hit 17.2 million square feet by the end of Q4 and another 20.6 million square feet of space remained under construction going into 2016. Developers have been bringing just enough new product to the market to keep from overbuilding, but there is increasing concern that supply might get out in front of demand going forward.

However, because leasing momentum has been maintained thus far, actual evidence of a slowdown in construction or absorption has yet to materialize. Pre-leasing of space under construction remains strong, as well, pointing to the continuing health of the industrial sector.

DFW continues to attract distribution users rather than manufacturers because of its infrastructure and hub location, which has construction focused on product with high clearance and state-of-the-art fire suppression technology. Until recently, most of the construction was in buildings over 350,000 square feet, but recent deliveries have also included buildings in the 120,000 to 250,000-square-foot range. E-commerce operators have been the most active business sector.

The overall industrial vacancy rate declined another 20 basis points in Q4 to finish the year at 7.0%. A year ago, vacancy stood at 7.4%. Variations up or down are influenced by the timing of new deliveries, but vacancy is holding steady in the 7% range, which has landlords taking a bullish stance in their negotiations for new leases and renewals.

7.0%	$5.22	5,574,212	820,798,391	20,581,854
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▲

DALLAS / FORT WORTH - TRENDING NOW (continued)

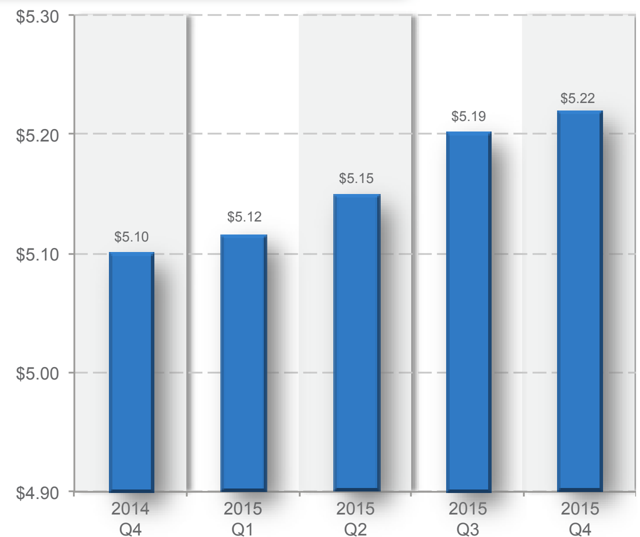
The good balance of leasing activity and development should keep vacancy from falling too low to accommodate the growth plans of expanding distribution operators. This is not the case in more mature markets like Los Angeles that have vacancy rates under 2% with nominal construction activity.

Net absorption for Q4 came in at 5,574,212 square feet, bringing 2015's net gain in occupied space to over 18.5 million square feet. Big box users continue to pay more for quality and that has kept average asking rental rates trending up. In Q4, the overall rate moved up another $.02 to $5.22.

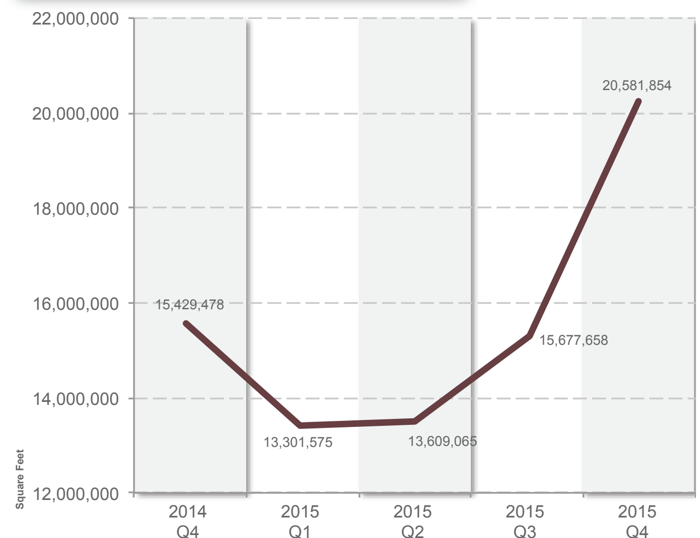
The inner loop submarkets are still experiencing more rent growth than outlying areas, allowing tenants willing to move 5-10 miles to lower occupancy costs. Notable move-ins during 2015 included the 1,394,109-square-foot lease to Procter & Gamble at Dalport Trade Center and the 667,635-square-foot deal lease for General Motors on W. Marshall Drive.

Since state-of-the-art distribution product is the preferred industrial asset class for institutional investors, DFW is still a prime target for those investors. Supply is scarce and cap rates kept compressing throughout the year. Bigger deals backed by stronger credit, which are characteristic of recent activity, keeps the region at the top of the list with the institutional investor crowd.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

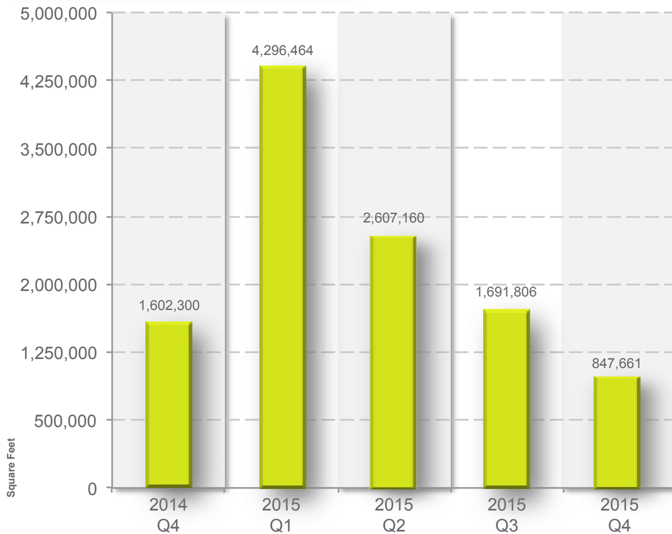


A LOOK AHEAD

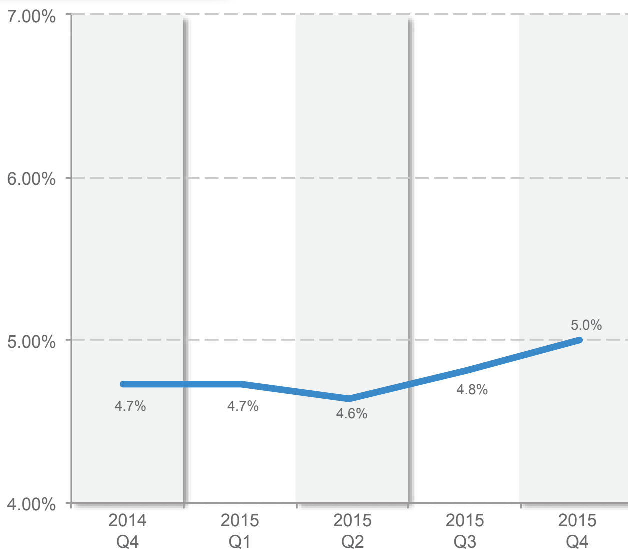
- Leasing activity should remain steady through the end of 2016
- Net absorption in 2016 should keep pace with 2015 totals
- Vacancy will remain near current levels, keeping balance with new deliveries
- Lease rates will continue to rise for existing and new inventory in 2016
- Construction will remain strong, but will keep in sync with current demand
- 36 foot clear heights will become more of a priority for tenants above 100,000 square feet

HOUSTON

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

For the past year, the Houston economy has been under the microscope, as the price of oil tumbled starting in Q3 of 2014. To be sure, the industrial market has been affected, but Houston is not just about oil extraction and the impact of the energy sector problem is being felt to varying degrees in terms of submarket and use type. Houston is a massive market with good population growth, a major port, two large airports and a diversified economy, all of which go a long way in terms of softening the blow of sharply lower oil prices. Hardest hit have been those companies that are involved in exploring for and extracting crude oil and natural gas. Operating budgets have been slashed, capital expenditures are down and wells have been idled, all in response to failure of the market to rebound based on economic conditions around the globe.

However, many are benefiting from lower oil prices, especially for those downstream from the oil producers. The petrochemical industry has reduced production costs and increased profitability due to the lower cost of feed stock. The entire transportation industry is also getting a boost from lower fuel prices, and every worker that drives to work has increased his take-home pay by paying less at the pump. Panama Canal widening is nearing completion, which is certain to boost activity at the Port of Houston, already an economic force by itself. Demand for rail-served, distribution buildings over 250,000 square feet is on the rise in anticipation of higher TEU traffic.

Houston's industrial market is really a tale of two cities, as activity has been declining in the West/North/Northwest submarkets and increasing in the East/Southeast submarkets. Demand for freestanding, crane-served manufacturing buildings long popular

5.0%	$6.48	847,661	553,607,613	9,713,178
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▲	▲	▼	▲	▼

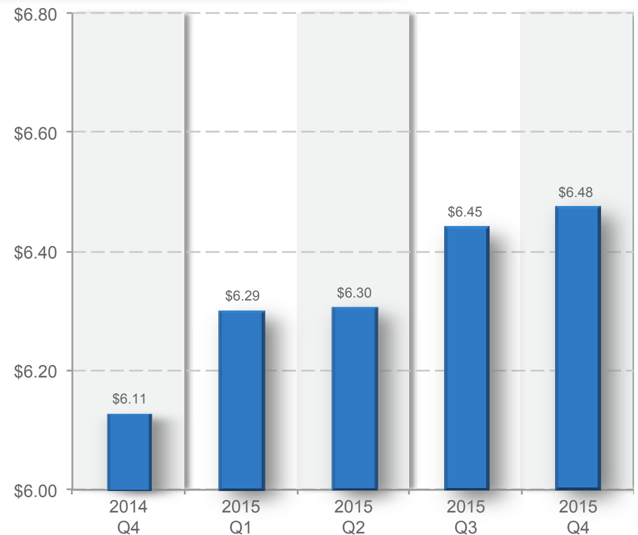
HOUSTON - TRENDING NOW (continued)

with upstream energy companies, has softened. But, a price correction there may actually serve to increase sales in the coming quarters, as prices have moved so high as to be out of reach for other user types. Tenants on the East side of Houston, by contrast, are having to compete for limited supply and have to settle for reduced concessions.

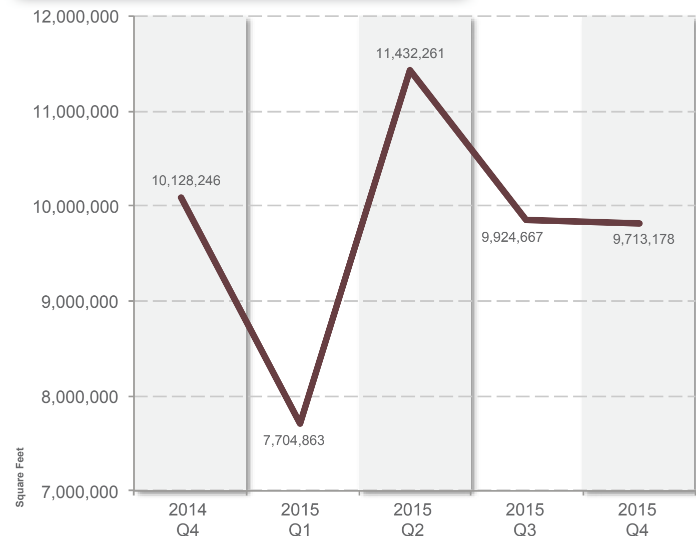
Average asking rental rates for the overall market finished the year at $6.45, a $.03 increase for the quarter and a 6% increase compared to Q4 of 2014. Though, rates vary widely by submarket. Net absorption for 2015 stayed in positive territory at just over 9.4 million square feet, although just 847,661 square feet of that was recorded in Q4. Vacancy, which stood at 4.7% a year ago, inched up throughout 2015 to finish at 5.0%.

Developers, who have been busy for the last several years delivering new inventory, are making big adjustments in terms of timing, size range and product type. In the Northwest/North, construction activity had been quite strong due to demand from oil companies, low vacancy and the announcement of major campuses for Exxon/Mobil FMC, Daikken and Nabors Drilling, among others. However, new fears of overbuilding have developers modifying layouts and, in some cases, placing projects on hold. West Houston industrial construction remains very strong, as developers try to keep pace with current demand. However, land prices as high as $6 per square foot are limiting construction activity. Overall, almost 12 million square feet of new industrial space was delivered in 2015, and another 9.7 million square feet was still under construction as the year ended.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

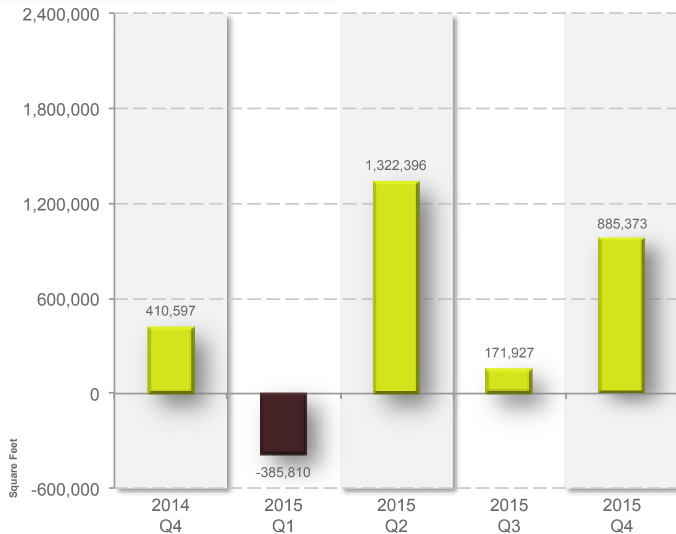


A LOOK AHEAD

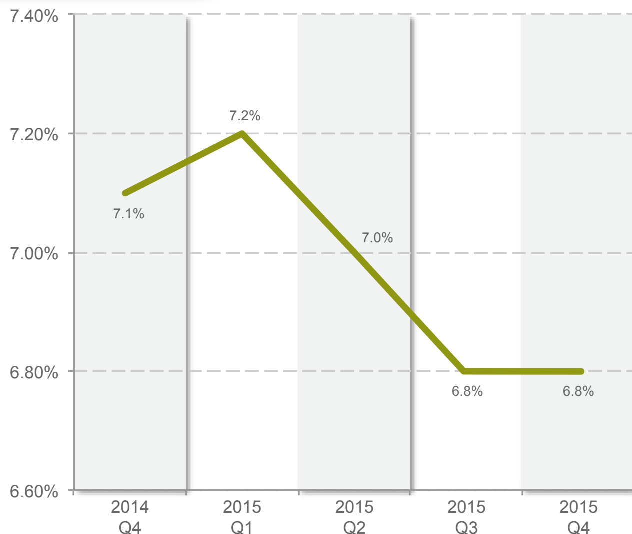
- Gross leasing activity will be strongest in the East submarkets, especially for rail-served buildings
- Net absorption will be high in the East and lower in the West/Northwest/North submarkets
- Vacancy will move up slightly in the Northwest and North, but decline in the East by as much as 150 basis points
- Rents in the Northwest/North submarkets will decline by as much as 5%, but may increase by the same margin in East submarkets
- Land prices on a NET basis will range from $3.50 to $5.00 depending on location and size of tract
- Decreased cost of feed stock will boost profitability and growth plans for the petrochemical industry

ST. LOUIS

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The industrial base for the St. Louis region swelled to over 263 million square feet in 2015, but much of that space lacks the high ceiling clearance and fire suppression systems preferred by today's expanding businesses. Therefore, the new spec space being developed is leasing well and at higher rates. That strong activity has caught the attention of institutional investors who are increasingly attracted to the quality and rent growth associated with new bulk distribution facilities.

Cap rates have compressed, but yields in St. Louis, along with other Midwest metro areas, are still higher than bigger markets on both coasts. At the end of the year, 3,704,865 square feet of industrial space in nine different projects was still under construction, with much of that total being built on a spec basis. Another 997,275 square feet was delivered in Q4, compared to just 162,843 square feet in Q3.

For the year, net absorption came in just shy of 2 million square feet, and 44% of that total came in the final quarter of 2015. Auto industry vendors in need of space for just-in-time delivery to GM's Wentzville facility, continue to figure heavily into the absorption picture.

Overall average asking lease rates moved up another $.03 in Q4 to finish the year at $4.18, after a $.04 increase in Q3. Year-over-year, the rate has risen by 4.5%, but fell well short of the rent growth in much tighter markets like Los Angeles that have record low vacancy rates.

6.8%	$4.18	885,373	263,178,363	3,704,865
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION

ST. LOUIS - TRENDING NOW (continued)

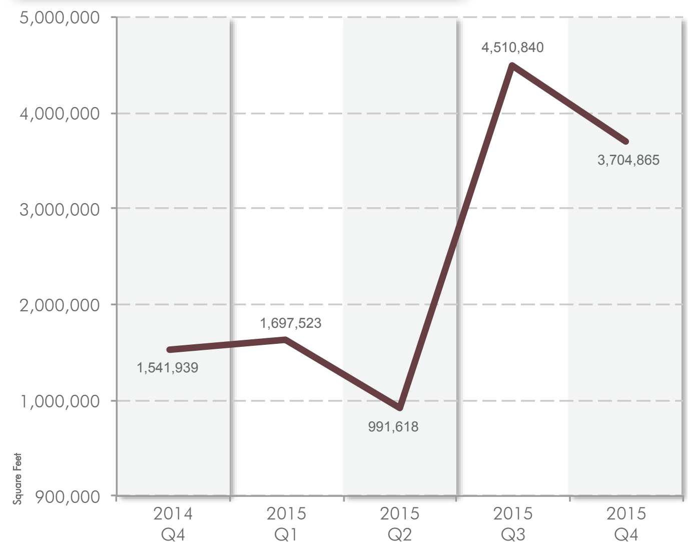
The vacancy rate finished the quarter at 6.8%, unchanged for the period. Year-over-year, vacancy fell by 30 basis points. Bulk distribution space in the Metro East and St. Charles submarkets have both contributed heavily to the decline, as absorption was strongest there throughout the year. Significant move-ins for 2015 included the Saddle Creek Corporation's 673,137-square-foot deal at Gateway 673 and World Wide Technology's move to a 410,000 square foot facility at Lakeview Commerce Center III.

Investment activity was particularly strong in 2015, as institutional players looked to St. Louis for quality product at slightly higher yields than can be achieved in larger metro areas. They like the location and the prospects for more growth in the automotive sector. As a result of that interest, tenants in Class A projects, along with their broker representatives, have new landlords to build relationships with, which could complicate negotiations for new deals as well as lease renewals going forward.

The region offers expanding businesses a good balance of location, value and expansion capability. There is ongoing speculative development to meet immediate needs for efficient space. The automotive industry remains firmly entrenched in the region, which attracts a wide variety of industrial users. The unemployment rate has fallen 80 basis points year over year to 4.6% and that could boost wages and bump up consumer spending in 2016. However, the loss of the Rams looms large for the local economy, particularly in the CBD and Riverfront areas.

AVERAGE SF RENTAL RATES

SF UNDER CONSTRUCTION

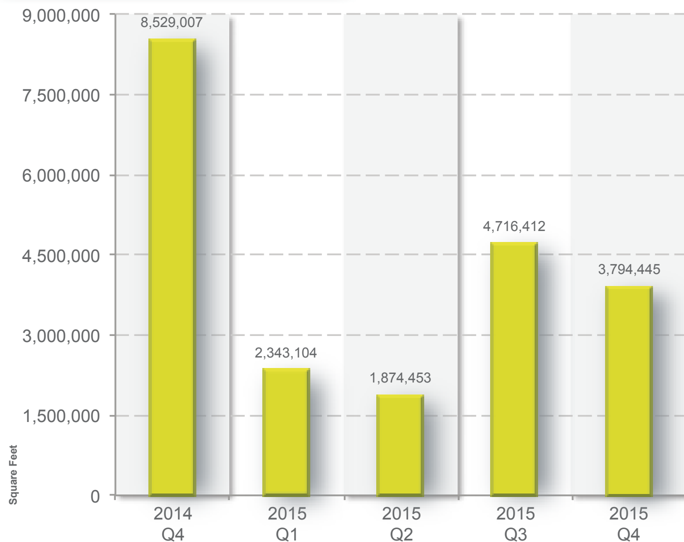


A LOOK AHEAD

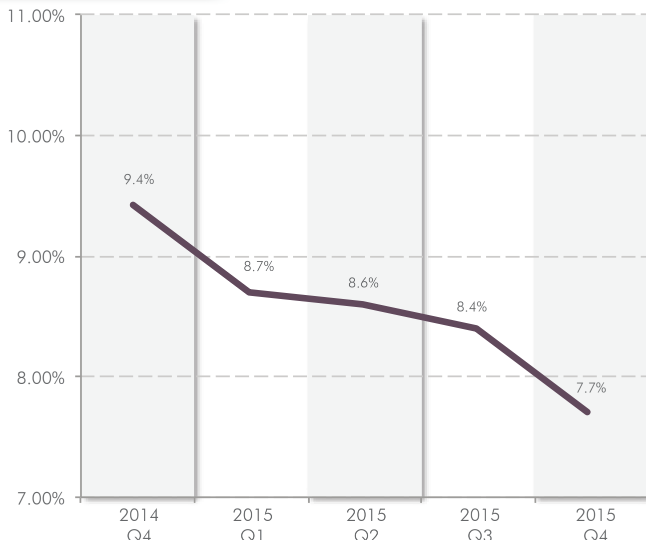
- Leasing activity will be flat for the next quarter, and then increase as spec product is delivered
- Sale activity in the short term will decrease due to lack of supply
- Vacancy will continue its decline through Q2 of 2016, and then stabilize in the 6% range
- Average asking lease rates will rise10% in 2016
- Construction activity will increase by 15% - 20%
- The GM plant will continue to attract new businesses to the region
- Older product in St. Louis will be redeveloped into more efficient space

ATLANTA

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Atlanta's industrial-based businesses continued its expansion to meet steady demand for products and services. The Atlanta region's overall workforce expanded by 3.4% in the 12 month period ending November 15, 2015, which equates to over 90,000 new positions. The resulting economic activity has fueled strong growth in the industrial sector. Demand for bulk distribution space still dominates market activity, boosting positive net absorption for industrial product to 3,794,445 square feet in Q4. Bulk distribution space accounted for 83% of that total. Net absorption for the overall market in 2015 was just over 13.5 million square feet, with 11.7 million of that in the warehouse sector.

Development activity was robust throughout 2015. Over 7.4 million square feet of industrial space was delivered, with 624,250 square feet of that completed in Q4. A whopping 17.1 million square feet that remained was still under construction heading into the New Year. Large distribution users remain eager to expand in the Atlanta area, as a ready supply of quality space has been sustained by the addition of new inventory. Good balance exists between speculative and build-to-suit projects, so the possibility of overbuilding the market remains low. Demand for local fulfillment centers from internet-based retailers is the main contributor to the warehouse market. Also, "rapid delivery" is an emerging trend that should positively impact absorption looking ahead. The concept calls for smaller transfer facilities or trailer lots with each trailer serving as a mini-warehouse. Amazon opened up two small distribution centers in the Atlanta area in Q4 to enhance its "rapid delivery" capability.

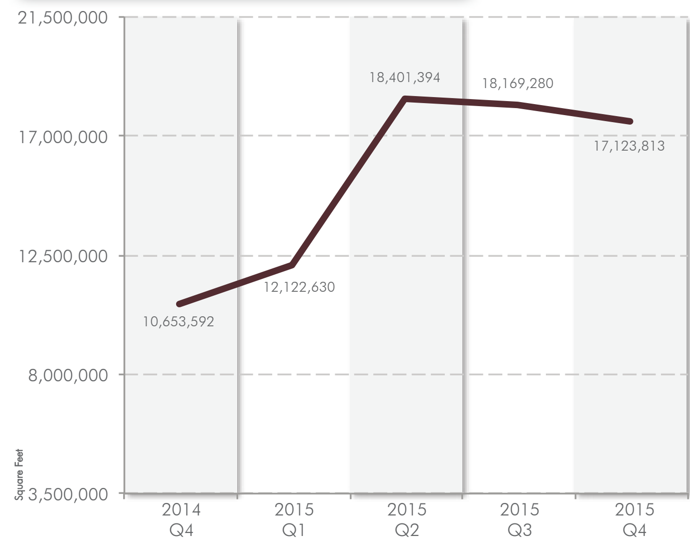
7.7%	$4.24	3,794,445	597,173,264	17,123,813
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION

ATLANTA - TRENDING NOW (continued)

Vacancy moved again in Q4, falling 60 basis points to 7.7%. Year-over-year vacancy is down by 140 basis points despite high construction activity. New product, offering greater efficiency, higher clear height and more advanced fire suppression technology remains the key driver of leasing activity. Despite tightening conditions, landlords of second generation buildings are still motivated to renegotiate lease renewals at competitive rates to maintain current occupancy levels by encouraging tenants who would otherwise move into first generation space. Those tenants who do choose to move up to more functional product are faced with longer lead times, as competition for new inventory is strong.

Investor demand for quality industrial product in the Atlanta area has been steadily rising all year, and competition for quality assets shows little sign of abating. As a result, cap rates have compressed for all industrial product types, and available capital for further investment is still on the rise. Large bulk distribution product remains the favorite of institutional investors. They like the absorption numbers and strong rent growth that Atlanta's industrial market has been experiencing over the past several years.

Low cap rates have existing owners re-evaluating exit strategies, but the lack of product to trade into will force many to hold for a while longer. Rumblings about cap rate decompression due to the projected increase in interest rates are on the rise now that the Fed finally made its move on the Fed Funds rate in December.

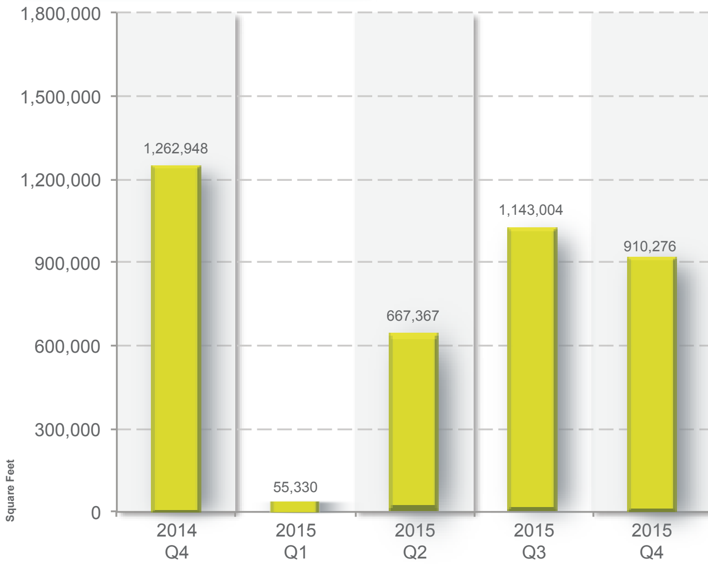


A LOOK AHEAD

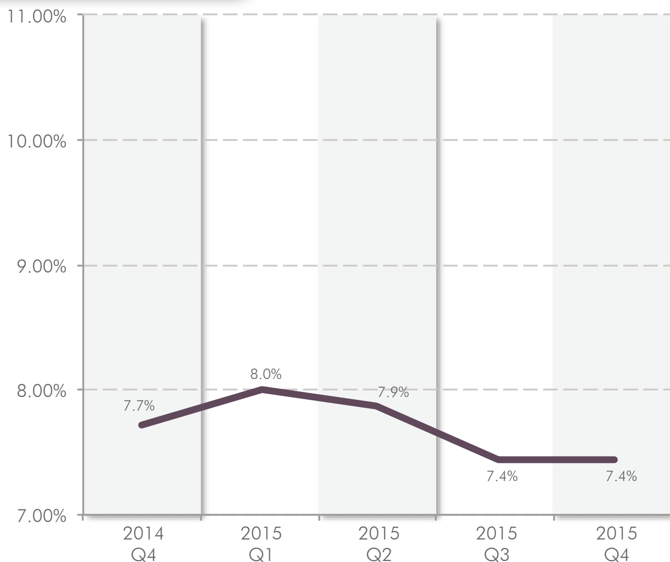
- Net could reach 15 million square feet in 2016
- Vacancy will stabilize in the 8% range due to steady flow of new inventory
- Average asking lease rates will stabilize near current levels in 2016
- New deliveries will spike in Q1 of 2016, due to weather-related delays in Q4
- Look for more divisible buildings from 20K to 200K range to be constructed
- Energy efficiency and land for trailer storage will remain a priority for tenants

GREENVILLE/SPARTANBURG

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Greenville/Spartanburg area is strategically located between the larger markets of Atlanta, GA and Charlotte, NC. Interstate highways 26 and 85 cross in the center of the region which also has easy access to the deep water Port of Charleston that can handle 8,400 TEU vessels drafting up to 48 feet.

To extend the reach of the port and boost efficiency for the movement of international freight, the South Carolina Inland Port was opened in 2013. Use of the facility by companies like BMW, Michelin and other international manufacturers has exceeded expectations and continues to draw new businesses to the region.

Greenville/Spartanburg has become known for its exceptional business climate. The automotive, aviation/aerospace, advanced materials and bioscience sectors are in expansion mode, as these businesses need the well-trained, highly educated workers that are attracted to the area for its affordability and quality of life. Local and state government agencies are aggressively recruiting new businesses through a variety of incentive programs that reward job creation.

While manufacturing has grown exponentially in recent years, the area is also becoming a cutting-edge innovation center, and there are numerous organizations active in advanced technology education. The International transportation Innovation Center focuses on leading-edge automotive research. Other innovative resources include Greenville Works, NEXT, Greenville Forward and Ten at the Top, among others.

7.4%	$3.62	919,276	197,025,063	3,090,090
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION

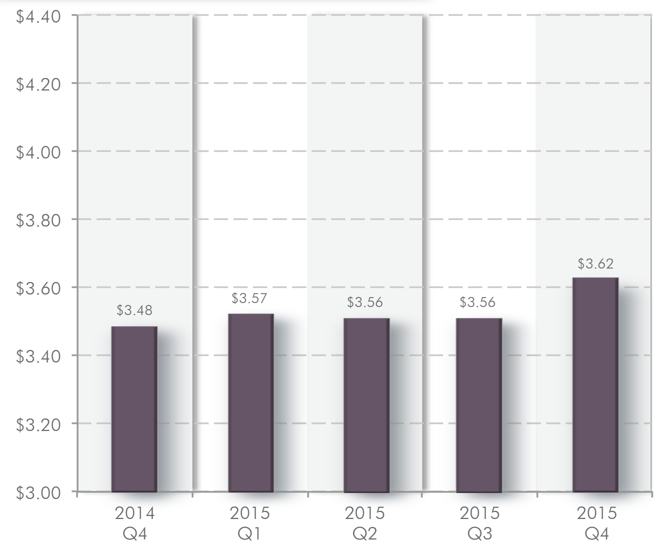
GREENVILLE / SPARTANBURG - TRENDING NOW (continued)

All this innovation and business growth has put strain on the availability of quality industrial space. Vacancy held steady at 7.4%, but has fallen 30 basis points since the end of 2014. Larger tenants looking for space in the region have a particularly difficult time, as the development of new product is lagging well behind demand. In 2015, 2,320,370 square feet of new space was delivered, with 910,170 square feet of that total completed in Q4. Spec development is limited, but space is being absorbed as fast as it can be built. At the end of Q4, another 3,090,090 square feet was still under construction. Competition amongst developers is on the rise, as several new players have come to the area to pursue new projects.

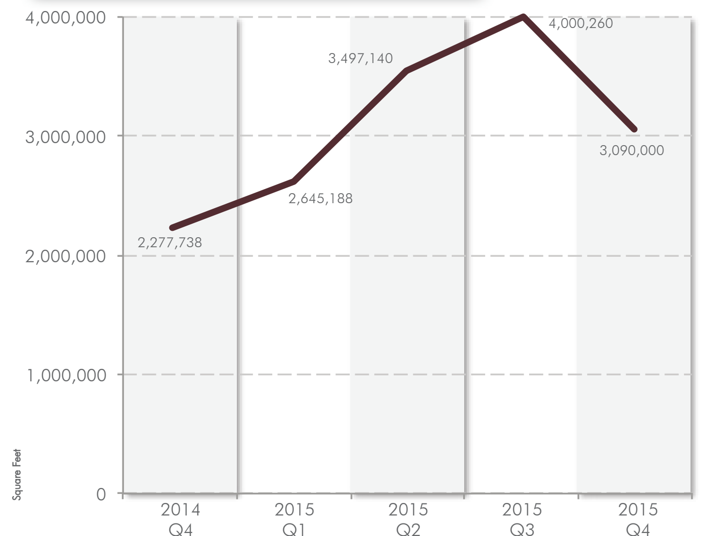
Average asking rents have been moving up, as well. By year's end, the overall asking rental rate stood at $3.62, up $.06 for the quarter and $.14 year-over-year. With land and construction costs moving up fast, tenants can expect rents to rise accordingly going forward. To this point, tenants have shown a willingness to pay more to secure the space needed for growth, and that is reflected in the net absorption numbers for the year.

In 2015, just under 2.8 million square feet of positive absorption was recorded, with 900,000 square feet of that occurring in Q4. Activity hotspots include Greenville County and the Highway 101 and 290 segment of Spartanburg County, as these areas have a high concentration of larger operations that stimulate growth from companies who supply and support them.

AVERAGE SF RENTAL RATES



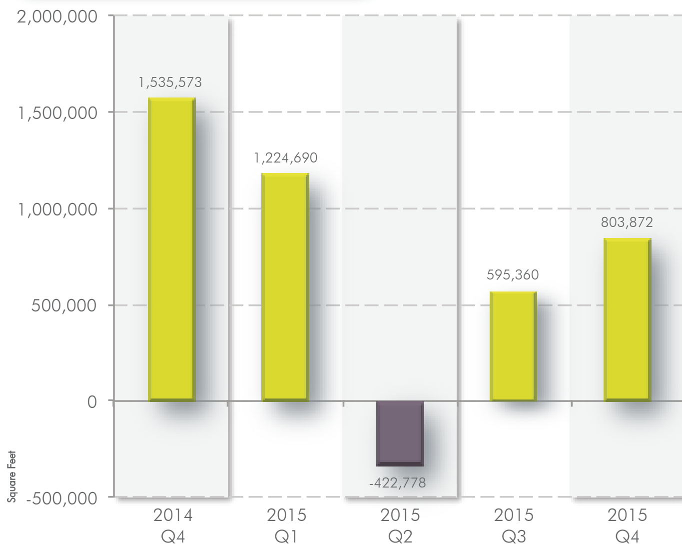
SF UNDER CONSTRUCTION

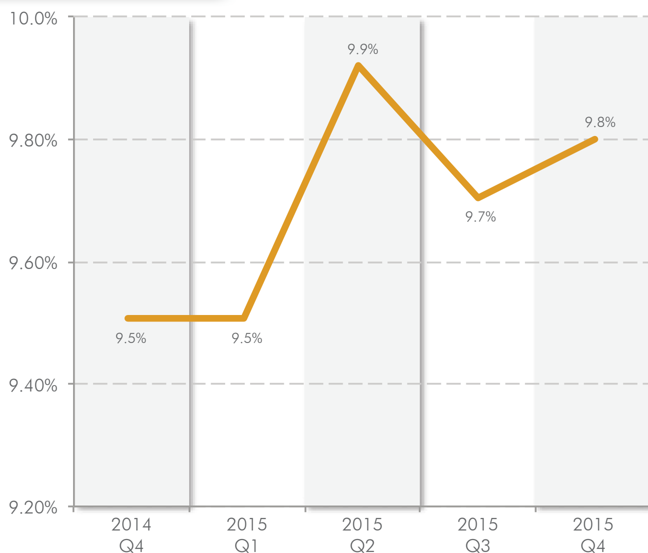


A LOOK AHEAD

- Lease and sale activity will increase in 2016
- Net absorption will remain positive, but low supply could hinder growth in occupied space
- Vacancy will continue to decline throughout the year
- Lease rates will keep moving up, especially for first generation space
- Land prices will spike again in 2016, as more developers compete to secure prime sites
- Construction costs could move up another 20% to 30% in 2016

BALTIMORE





TRENDING NOW

The Baltimore area's industrial market is moving along at a steady, if tepid pace. The total base inventory has grown to almost 236 million square feet, after recording 3.1 million square feet of new deliveries in 2015. Significant projects delivered for the year include a 1,017,000-square-foot building at 2010 Broening Highway that is now a fully occupied fulfillment center for Amazon and a spec building totaling 571,500 square feet at 610 Chelsea Road, which was still vacant as the year ended. Nearly 1.4 million square feet was still under construction by the end of Q4.

Primary areas of activity include the eastern part of Baltimore City, in and around the Port, along I-95 in Harford County and the I-95 corridor between the two Beltways in Baltimore and Washington. Big box deals at or above 500,000 square feet have been stronger than the bread and butter deals under 75,000 square feet. Larger users are attracted to the strong demographic profile of the region, including its proximity to multiple large population centers up and down the Atlantic coast, the Amazon deal being a prime example. The new facility speeds up delivery times and lowers distribution costs, key drivers of profitability in an increasingly competitive sector.

The region recorded positive net absorption of 2,185,400 million square feet in 2015, 803,872 square feet of that coming in the final quarter. The annual total represents a significant decline compared to 2014's net gain of 4,877,937 square feet. The vacancy rate increased 10 basis points in Q4 to 9.8%, as compared to 9.5% in the final quarter of 2014. The trend toward lower federal government spending has definitely influenced the industrial market recovery, as the public sector has always been a key economic driver of business growth.

9.8%	$5.90	803,872	235,905,080	1,138,094
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▲	▲	▲	▲	▼

BALTIMORE - TRENDING NOW (continued)

However, the potential for stronger growth in the region is looking up now that Congress and President Obama have agreed to a $1.8 trillion spending bill that calls for bigger operating budgets for multiple agencies in and around the DC area.

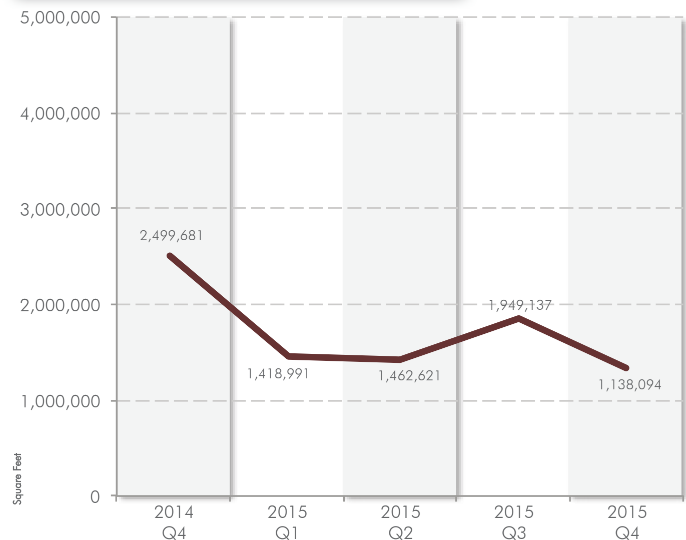
Average asking rental rates remain relatively stable, moving up by just $.14 in 2015 to $5.90, a 2.43% gain for the year. Regional distributors continue to drive industrial activity, but the construction of new speculative space that generally drives rates higher, has yet to materialize in a significant way. Lack of land sites and rising construction costs have combined to keep spec building from taking off. So, unless tenants are willing to wait for build-to-suit facilities, they are forced to choose from existing, less efficient space.

Interest from users to purchase their own facilities is still strong, but too few facilities reach the market. Much of the user sale activity is still in off-market opportunities, and sellers continue to hold out for higher prices. The long-anticipated move by the Fed to raise interest rates is now a reality, but long term interest rates have yet to move up in response. That could change soon if the central bank makes good on its intentions to raise rates several times in 2016. For now, user/buyers can still take advantage of fully amortized loans at fixed rates under 5%.

Investor interest is also strong and cap rates for quality industrial investment property have compressed as a result. Institutions are particularly interested in placing capital in the Baltimore area, as they see the entire region as a safe bet for long-term investing.

AVERAGE SF RENTAL RATES

SF UNDER CONSTRUCTION

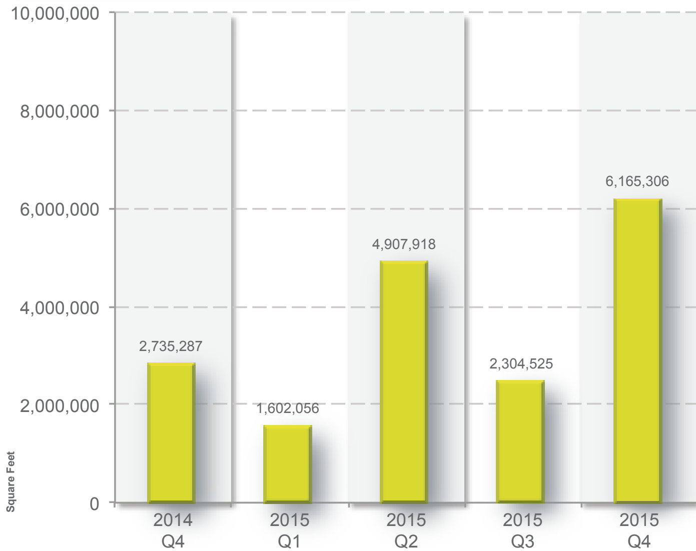


A LOOK AHEAD

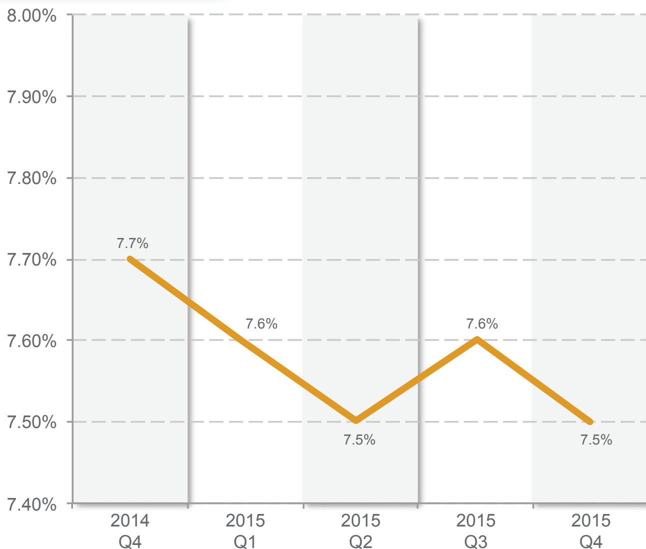
- Aggressive institutional buyers will continue to drive the investment sale market
- Net absorption will remain positive but will moderate due to lack of quality product
- Vacancy rates will steadily increase as vacancy declines
- Speculative development will be limited by high land prices and higher construction costs
- Increased government spending will reduce uncertainty in the private sector
- A strong housing market, especially in high-income areas, will boost the regional economy

PHILADELPHIA

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Philadelphia industrial market boasts an existing building inventory of over 1.05 billion square feet, making it one of the nation's largest industrial hubs. The region is characterized by strong road, rail, and parcel infrastructure along with reliable same-day access to the dense population centers of the Northeast and Mid-Atlantic United States. This rapidly growing market is among the strongest in the country, and falling vacancy, strong positive absorption, and steady ongoing demand continue to drive widespread investment appetite.

The overall vacancy rate for industrial product in Q4 fell 10 basis points to 7.5%. Year-over-year, vacancy is down by 20 basis points, despite record levels of new construction. Flex vacancy finished the quarter at 8.9%, down 50 basis points while warehouse vacancy dropped another 10 basis points to 7.4%. Central Pennsylvania and the Lehigh Valley remain two of the most active submarkets, while Southern New Jersey saw a noticeable increase of activity during 2015.

Bulk warehouse and distribution space continues to generate most of the leasing activity in the region, especially across 3PL, consumer product, e-commerce and food & beverage companies. Notable occupancies in 2015 included Georgia Pacific (1,495,720 square feet), Zulily (800,000 square feet) and H+M (545,000 square feet) along with expanded operations by 3PL operators such as Allen Distribution, Exel Logistics, and DB Schenker. Perhaps even more importantly, as much as 35% of Philadelphia's total leasing activity is tied to inventories which are new to the market.

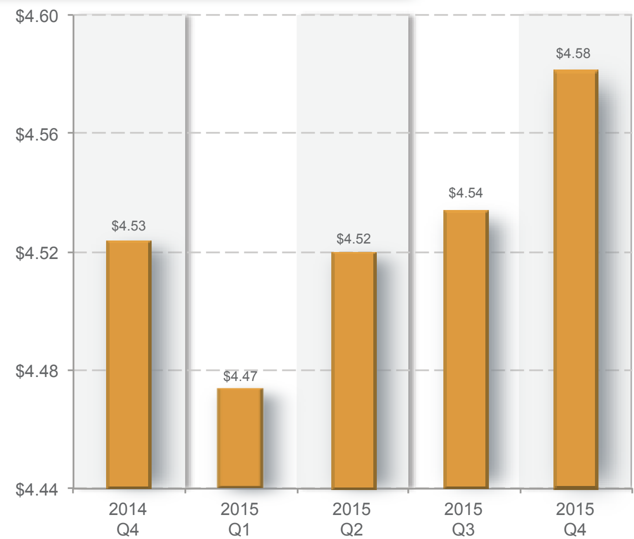
7.5%	$4.58	6,165,306	1,051,297,922	14,648,185
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▼

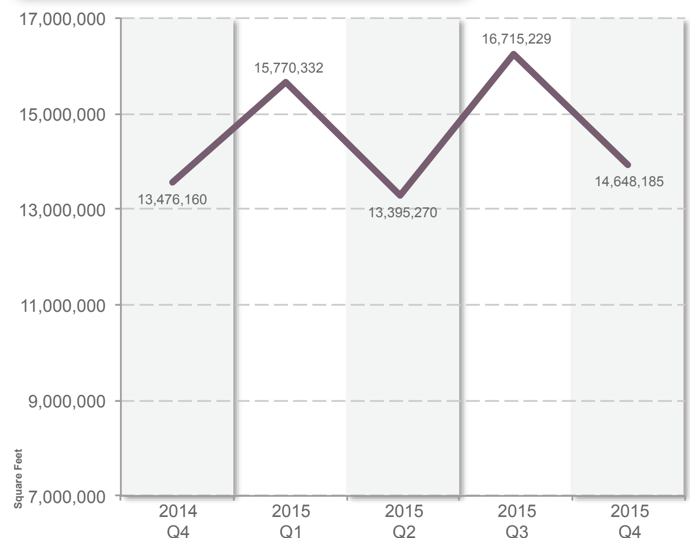
PHILADELPHIA - TRENDING NOW (continued)

The steady flow of new requirements from outside the market has kept net absorption positive, encouraging developers to continue the pipeline of new inventory flowing. In Q4, 24 new buildings were delivered, adding some 6 million square feet to the base. Another 12 million square feet remained under construction as of the end of Q4.

Notably, the majority of the projects – both those delivered in Q4 and those still under construction – represent speculative development of larger distribution centers. However, desirable land sites are increasingly in short supply across the market, especially in primary submarkets like the Lehigh Valley and Central Pennsylvania. In response, 2015 saw developers exploring redevelopment plays as well as peripheral land sites in an effort to get vertical.

While the region has not seen the prolific rent growth that other national markets have, rents are nonetheless growing. Looking forward, realized rates (market-wide) are expected to remain stable or grow moderately for the next four quarters, reflecting general equilibrium between net absorption and new development.



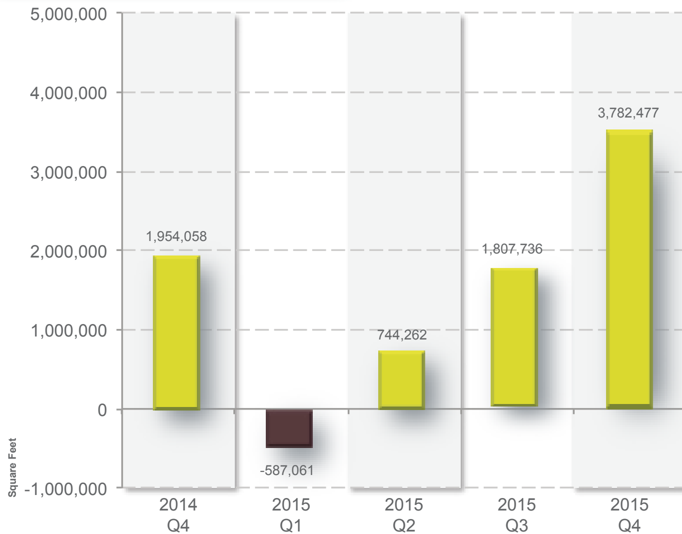


A LOOK AHEAD

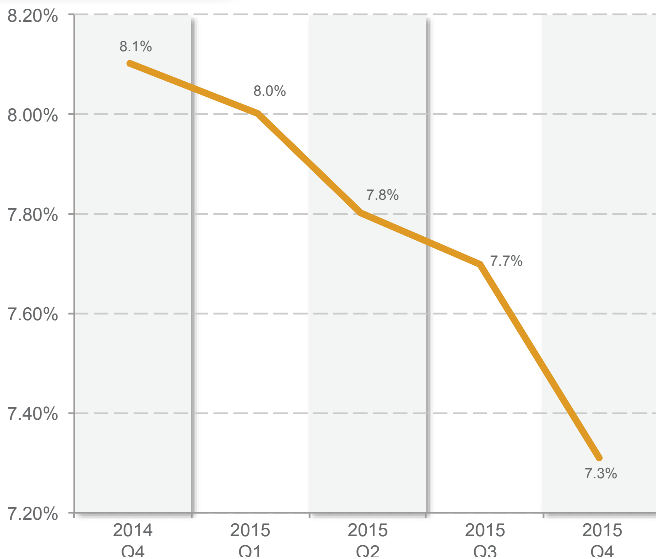
- Across the larger Bulk Warehouse assets, overall vacancy rates and net absorption will remain flat year over year, notwithstanding some quarter-to-quarter volatility as new product is delivered and leased
- Primary submarkets like Central Pennsylvania, the Lehigh Valley, and Southern New Jersey will continue to experience dynamic activity due to their desirable location
- Demand levels are expected to remain consistent, and absorption should follow at levels similar to those experienced over the last 2-3 years. Investment sale activity may taper due to limited core acquisition opportunities

NORTHERN/CENTRAL NJ

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Northern/Central New Jersey industrial market, like most major hub locations across the country, remains in growth mode. The region's proximity to dense population centers continues to attract major distributors, especially e-commerce users looking to reduce shipping times. The State of New Jersey government is in an ongoing battle with Pennsylvania, New York and Connecticut to recruit job-creating companies to the state. The Grow New Jersey Assistance Program offers up to 10 years of tax credits to companies for creating new jobs.

Vacancy moved lower again in Q4, falling another 40 basis point to 7.3%. Year-over-year, the vacancy rate has declined by 80 basis points. Class A product continues to see the most leasing action, but supply is getting tight and landlords are demanding stronger credit and offering less in tenant improvement dollars to get it. This has really put the squeeze on small and mid-sized tenants, who are having trouble competing for quality space in good locations. Their only options are to accept inferior locations, pay for their own improvements or leave the region altogether. Availability is drying up even in Class B and C product, and that has rents moving higher across all building classes. In Q4, the overall average asking rental rate rose by $.05 to $6.29. Net absorption moved up again in Q4, posting a 3,782,477-square-foot increase in occupied space. For the year, net absorption hit 5.75 million square feet. Notable move-ins for the year included Amazon's 1,064,515-square-foot lease at 8003 Industrial Ave, and Ferguson Enterprises, Inc.'s lease of 450,318 square feet at 50 Meadowlands Prkwy.

Demand for owner/user product continues to run well ahead of supply. In fact, prices are rising so fast that getting properties to appraise at the contract price is becoming difficult.

7.3%	$6.29	3,782,477	804,891,880	3,885,323
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INDUSTRIAL SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▼

NORTHERN/CENTRAL NEW JERSEY - TRENDING NOW (continued)

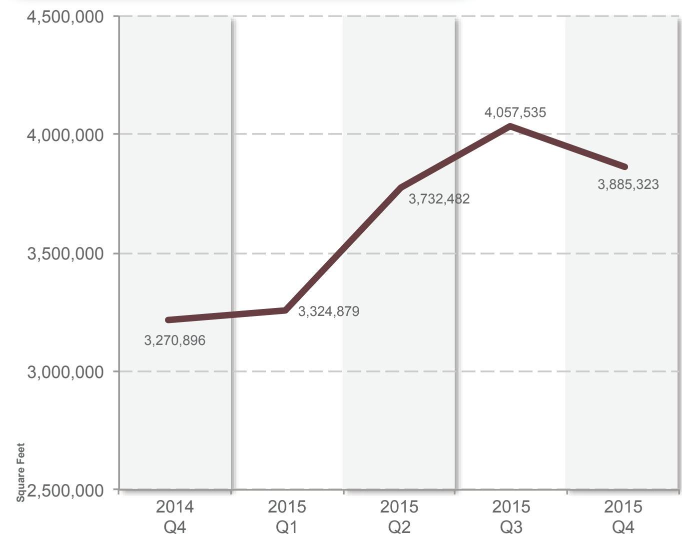
This ongoing trend is putting the pressure on investor/buyers of industrial product to outbid users, and that's no small task, as SBA loans are still readily available and rates have held steady despite the Fed's first move to raise the cost of capital in December. Unsuccessful bidders are frustrated by the short supply, and unless interest rates move up significantly in response to subsequent Fed increases, they won't get much relief in the coming year.

Developers are in a tough spot. The demand for quality space is there, but the cost of land in proximity to the Port, where demand is highest, reached as high as $50 per buildable square foot in 2015, which requires very high rents to justify new construction. That increases the risk of longer lease-up times, as the pool of potential tenants who can afford to pay those rates gets smaller. Tenants who can't pay that premium because of lower profit margins are effectively pushed out of the market. Another hurdle for developers and users is the protracted entitlement process for new development and the Certificate of Occupancy process tenants must go through to occupy existing buildings. In Q4, nearly 588,000 square feet of space was delivered in eight buildings, and another 3.9 million square feet was under construction.

Institutional investors still favor the region because of its strong fundamentals. Foreign investors do the same, but they also like the relative safety of investing in a region known throughout the world as a thriving metro area. Through the first three quarters of 2015, just over $1 billion changed hands in 191 industrial sale transactions, keeping pace with 2014's total for the same period.

AVERAGE SF RENTAL RATES

SF UNDER CONSTRUCTION



A LOOK AHEAD

- Overall sale and lease demand will remain strong
- Net absorption could slow down due to lack of available space options
- Development on leased land will become more prevalent in 2016, as some landowners refuse to sell outright
- Delivery of new inventory will drive overall average asking lease rates up further in the near term
- Construction activity will slow down due to lack of available land
- Average asking sales prices for new product will keep escalating unless interest rates spike

SELECT TOP INDUSTRIAL LEASES Q4 2015

BUILDING	MARKET	SF	TENANT NAME
Amazon	Boston	1,000,000	Amazon.com
Union Station Business Center	Atlanta	987,840	Excel Logistics
Prologis Park	Inland Empire (California)	882,230	Amazon
Duke Perris Logistics Center - Bldg II	Inland Empire (California)	783,407	Wayfair.com
5635 NE 14th St	Des Moines	600,000	Monsanto
Monsanto Expansion - Phase 1	St. Louis	590,000	Monsanto
75 Mill Rd	Northern New Jersey	571,000	List Logistics
5220 Robert J Mathews Pky	Sacramento	555,219	DST Output
Whirlpool Bldg	Nashville	505,000	Sinomax
Hermosa II	Inland Empire (California)	468,682	Amaxi Nutrition
Buford Logistics Center II - Building B	Atlanta	461,700	Best Buy

SELECT TOP INDUSTRIAL SALES Q4 2015

BUILDING	MARKET	SF	PRICE PSF	CAP RATE	BUYER	SELLER
The Crossings @880	East Bay / Oakland	690,796	$195.43	4%	BlackRock Realty	Overton Moore
Moffett Business Park	South Bay	457,760	$291.50	4.75%	CBRE	Prologis
Prime Industrial	Chicago	1,995,150	$49.57	7.27%	AEW Capital Mgt.	TA Realty

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The Lee Industrial Brief

Q4 2015

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