The momentum in the industrial market slowed a bit as demand growth decelerated. Nevertheless, vacancy held steady in the warehouse and distribution sector as net absorption exceeded new construction by a small margin. Vacancy declined in the Flex/R&D subsector largely due to a sharp drop in new construction. Net absorption slowed somewhat but remained positive. Market rents increased but also at moderate rates, similar to the second quarter. Once again, every metro posted positive rent growth for the quarter, although some outperformed others.

Although the industrial sector has outperformed other property types in terms of occupancy growth, the downshift observed in the third quarter puts the asset class on par with office and retail which followed a similar pattern. Still, the outlook on industrial remains more favorable as the e-commerce industry is still evolving. Amazon’s latest announcement suggests that they are planning a roll-out of a new food store concept which should boost demand for warehouse and distribution space.

Warehouse and Distribution

Net absorption fell to 14.7 million SF in the third quarter, down from 21.8 million in Q2. A year ago, net absorption was 28.9 million SF. While demand in 2016 continued to decelerate from 2015, new construction has slowed as well, falling to 13.4 million SF in the third quarter, down from 19.6 million SF in the second quarter and an average of 18.2 million SF in the five previous quarters.

Once again, much of the new construction, 52%, was concentrated in five metros: Chicago (2.2 million SF), San Bernardino/Riverside (1.5 million SF), Atlanta (1.4 million SF), Houston (1.0 million SF) and Denver (740,000 SF). Of this, 30% was preleased. These metros posted some of the highest net absorption numbers with a combined 6.3 million SF, or 43% of the national total.

Of the 47 metros that Reis tracks, 35 or 75% posted positive net absorption in the third quarter. However, as many as 16 saw a rise in vacancy as new construction exceeded net absorption.

Metros posting the highest vacancy increases were Cincinnati, Richmond and Fort Worth. All of these markets had new construction that was only partially preleased in one case (Richmond). Metros that saw the strongest declines in vacancy rates were Columbus, Orange County, Dallas, and Atlanta.

Rent growth was mixed in that the top performing metros included those that added new supply as well as a few that did not. San Bernardino/Riverside, Fort Lauderdale, Denver, San Antonio, San Jose and Oakland all had a rent growth of 0.6%. As mentioned above, all the metros saw positive rent growth, those with the lowest growth include Pittsburgh, Cleveland, Richmond and Indianapolis which all had growth of 0.2% for the quarter.

Flex / R&D

The Flex/R&D market saw a more robust decline in vacancy rate from 11.6% in the second quarter to 11.4% in the third. At 366,000 SF, the third quarter’s new construction was the lowest quarterly level since the first quarter of 2014. New construction had averaged 1.1 million SF in the four previous quarters. Net absorption held steady at 2.6 million SF in the third quarter, down slightly from 2.8 million SF in the second quarter. In the third quarter of 2015, net absorption was 3.9 million SF.

The conflicting trends in the two industrial types demonstrate once again that tenants’ demand for Flex/R&D space has not abated, yet developers have been less eager to build smaller buildings, opting for larger warehouse space instead. Only
seven of the 48 metros saw new construction in Q3 led by Denver with 110,000 SF and Fort Lauderdale with 103,000 SF. Of the seven metros with new construction, only three had pre-leasing: Denver, Raleigh-Durham and Indianapolis. Metros that saw the strongest net absorption and vacancy decline had no new construction. These include San Jose (456,000SF), Chicago (263,000 SF), Oakland (235,000 SF), Minneapolis (215,000 SF) and St. Louis (199,000 SF) that together accounted for 52% of the national Flex/R&D net absorption.

On the other end of the spectrum, 17 metros posted negative net absorption – up from 15 metros last quarter – that corresponded to slight increases in vacancy rates. Metros that saw the highest increase in vacancy include Jacksonville, San Antonio, San Diego and Richmond.

Similar to the warehouse/distribution numbers, no flex/R&D metro had a rent decline in the third quarter. Most metros saw very low rent growth. Markets with the highest rent growth rates include St. Louis, Charlotte, San Bernardino/Riverside, Denver and Minneapolis. Metros with the lowest growth include Kansas City, Suburban Virginia, Memphis, Phoenix and Palm Beach.

The tepid pace of growth in the industrial market was in line with national economic statistics; however, some statistics related to industrial demand have improved of late. Aggregate trade numbers (goods exports plus imports) increased to an average of $308 billion from June through August, up from an average of just under $300 billion in the prior three months. Also the Institute for Supply Management’s purchasing managers’ index (PMI) climbed to 51.5 in September, down from 53.2 in June, but any index above 50 indicates that economic activity in the manufacturing sector expanded. The PMI has expanded every month this year except August. Finally, new orders for manufactured durable goods fell 0.4% in August. New durable goods orders have declined three of the last four months and are down 0.9% year to date. The retail statistics were generally positive in the quarter, although e-commerce growth was not as healthy as in previous quarters.

On the more positive side, national employment growth in the warehousing and storage sector has grown by 3.8% thus far in 2016 after growing by 8.4% in 2015, making it the fastest grow-

### Number of Metros with Improving/Flat or Declining Fundamentals

<table>
<thead>
<tr>
<th>Combined Distribution-Warehouse and Flex-R&amp;D</th>
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<tbody>
<tr>
<td><strong>Absorption</strong></td>
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<tr>
<td>Q3 2016</td>
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<td>Q2 2016</td>
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<td>Q1 2016</td>
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<td>Q4 2015</td>
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<td>Q3 2015</td>
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Figures are based on 47 metro markets per subsector.

Outlook

Echoing the sentiment we expressed last quarter, the slow but steady rate of growth should continue going forward as most metros continue to see demand growth for industrial space. With limited new construction in most markets, vacancy should hold steady and continue to decline for Flex/R&D. Still, rent growth should stay low unless international trade and other statistics as well as absorption levels start to accelerate. The news from abroad has settled somewhat following the Brexit vote in June but the outlook for the EU is still cloudy which suggests that the slow growth we have seen over the last few quarters should continue headed into 2017.