## California Split Roll Tax — The First Real Challenge to Proposition 13

**by Bryson Llyod**
SENIOR ASSOCIATE, IRVINE
714.935.2312 · bllyod@voitco.com · Lic. #01958158

As we have been reporting for the past several years, the Mid-Counties industrial market continues to move higher in terms of sale prices and asking lease rates. This is mainly due to high demand from growing businesses and a lack of construction of much needed inventory. Vacancy has bottomed out in the 3% range and much of what is available is older, less functional product.

Strong economic growth in Southern California should keep the market on its present course for the meantime, but there is a looming threat to property owners and occupiers that will be decided in 2020's General Election. Voters will be weighing in on the first real challenge to Proposition 13 in more than 40 years. Specifically the California Schools and Local Communities Funding Act, if passed, would effectively split the property tax roll and strip Proposition 13 protection for most commercial properties statewide.

Currently, the base levy for all real property in California is set at 1% of market value as determined by the sales price each time a property is sold. Annual tax increases are limited to 2% of the base levy or the rate of inflation, whichever is less. This protects property owners from steep tax hikes each year, especially in real estate up-cycles like the one we are experiencing now. It also protects the state from sharp property tax declines in a real estate down-cycle. On average, property tax revenues have climbed 7% per year since Proposition 13 passed back in 1978.

If this new proposition becomes law, all but the smallest commercial properties will be subject to reassessment to full market value every 3 years, which could double or triple the base levy for long term property owners. This would be detrimental to both landlords and tenants depending on the type of lease being used. In a gross lease, property taxes are included in the lease rate for the 'base' year, with increases passed along to the tenant in subsequent years. In a net lease, the tenant pays the entire property tax bill from day one. The new law would have a major impact on this traditional arrangement and is certain to put downward pressure on asking lease rates. Lower rates mean lower net operating income (NOI) and lower NOI would lower property values even if cap rates remained at their current levels. Owner/users could really get hit, as they have no one to pass the higher cost along to.

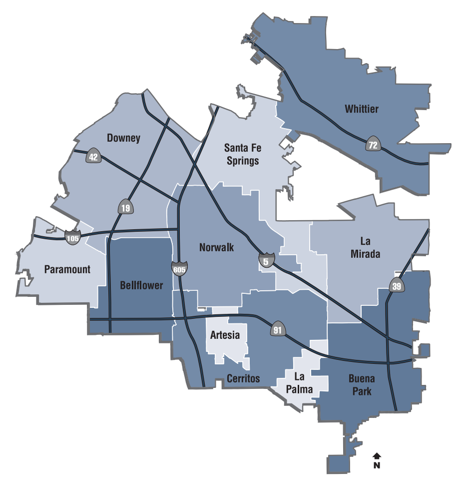
As we get closer to the election, this issue is expected to get a lot of media attention. Proponents claim the law, if passed, would raise up to $11 billion per year in new tax revenue, every penny of which would come from the pockets of property and business owners.

## Product Type

**MFG./DIST.**
Manufacturing / Distribution / Warehouse facilities with up to 29.9% office space.

## Submarkets

**MID COUNTIES**
Artesia / Cerritos, Bellflower / Downey, Buena Park / La Palma, La Mirada, Norwalk, Paramount, Santa Fe Springs, Whittier




**Please Contact Us for Further Information**

**Tony Tran**
Regional Director of Research
ttran@voitco.com

Anaheim, CA 714.978.7880
Carlsbad, CA 760.517.4000
Inland Empire, CA 909.545.8000
Irvine, CA 949.851.5100
Los Angeles, CA 424.329.7500
San Diego, CA 858.453.0505







MC3Q19 THIRD QUARTER 2019 MARKET REPORT
MID COUNTIES INDUSTRIAL
Voit REAL ESTATE SERVICES

**MARKET OVERVIEW.** Demand for industrial property in Mid Counties continues to show remarkable strength. This need for space continues to be driven by e-commerce and last-mile logistics as retailers seek supply-chain efficiencies. The Mid Counties' strong tenant demand has resulted in industrial vacancy rates hitting historic lows, hovering around 2% in the third quarter of this year. The Mid Counties market boasts a number of strategic advantages and as the demand for space continues to grow expect the vacancy rate to drop even further, any new supply to be quickly absorbed, and lease rates to continue their climb.

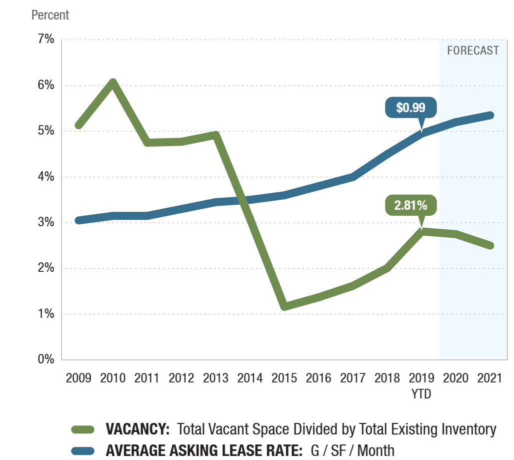
**VACANCY.** The demand for warehouse and distribution space shows no signs of diminishing. In addition to low unemployment, the economy is thriving with corporate tax cuts, low interest rates, and overall good financial health of the market's tenant base. The Mid Counties industrial market is as healthy as it has ever been, despite steep barriers to entry. As tenant demand remains consistent among a diverse pool of tenants, vacancy rates will remain low and rents will stay high. Vacancy in the Mid Counties region was 2.81% at the end of the third quarter of 2019, down 54 basis points compared with the prior quarter, and 16.12% compared with the previous year.

**AVAILABILITY.** Direct / sublease space being marketed in the third quarter came in at 4.64%, up from 5.44% from the third quarter of 2018. Due to the difficulty in developing new, modern buildings, much of the Mid Counties industrial inventory tends to be in properties that are smaller and older than might be considered normal for such a distribution market.

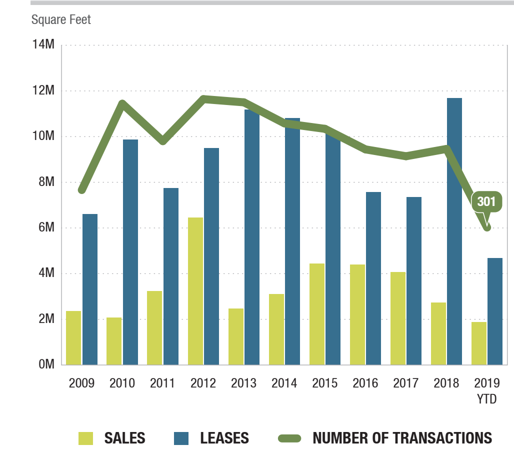
**LEASE RATES.** The average asking lease rate is $0.99 IG per square foot per month, a $0.11 per square foot increase from a year ago (12.50% annual increase). While uncertainty (e.g. escalating U.S. / China trade war) typically reduces expectations, which could reduce growth, consumer sentiment appears to be forward-looking, focusing on long-term expansion plans. Vacancies in many markets are at or near historic lows and are likely to remain low in the near term.

**TRANSACTION ACTIVITY.** We are seeing significant drops in vacancy and availability coupled with overall increases in net occupancy. As we progress into the last quarter of 2019, positive absorption and higher occupancy costs should continue. A lack of product available for lease or sale in some size ranges is causing an increase in prices and a drop in transaction volume. Sale and leasing activity for the Mid Counties industrial market checked in at just over 2,034,947 square feet this quarter, compared with 3,097,745 square feet in the third quarter of 2018. The slowdown in transaction volume can be attributed to a lack of supply in the marketplace.

### VACANCY vs. AVERAGE ASKING LEASE RATE




### TRANSACTION VOLUME & NUMBER OF TRANSACTIONS




## Market Statistics

| | Change Over Last Quarter | 3Q 2019 | 2Q 2019 | 3Q 2018 | % Change Over Last Year |
|---|---|---|---|---|---|
| Vacancy Rate | DOWN | 2.81% | 3.17% | 3.35% | (16.12%) |
| Availability Rate | DOWN | 4.64% | 5.44% | 5.28% | (12.12%) |
| Average Asking Lease Rate | UP | $0.99 | $0.94 | $0.88 | 12.50% |
| Sale & Lease Transactions | DOWN | 2,034,947 | 2,334,971 | 3,097,745 | (34.31%) |
| Gross Absorption | UP | 1,785,917 | 961,779 | 1,377,265 | 29.67% |
| Net Absorption | POSITIVE | 274,076 | 752,091 | 269,249 | N/A |

## Forecast

**OVERALL.** The Los Angeles labor market has been extremely tight since mid-2016 and the unemployment rate reached 4.4% in July 2019—creating challenges for many firms trying to expand. As we head into 2020, we are forecasting strength in the region. The Mid Counties industrial market continues its positive momentum, surpassing pre-recession highs in just about every metric (lease rates, sale prices & land values). We believe this trend will continue for the foreseeable future (6–12 months) given the continued growth of the e-commerce sector.

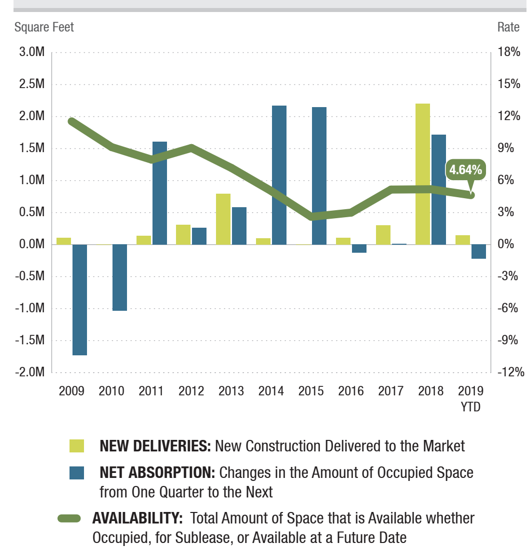
**LEASE RATES.** Rental rates are expected to increase at a moderate pace in the short run and rents in the "last mile" markets near critical population centers will experience the most aggressive growth. Tenant concessions like free rent, moving allowances and specific tenant improvements will remain minimal as the market stays tight and favors landlords. We expect 3–4% annualized growth in the coming year.

**VACANCY.** While hard to predict a drop in an already low 2.81% vacancy rate, we expect to see this figure dip below 2.50% by the end of first quarter 2020.

**CONSTRUCTION.** In almost all the Mid Counties submarkets, development opportunities are hard to come by. It is considered an infill market with very little land still available for development, and this is pushing industrial demand into adjacent areas. Construction could begin soon on a last-mile logistics hub on a 10-acre lot with a history of environmental problems in Santa Fe Springs, a sign of just how rare desirable industrial sites have become for the e-commerce industry. Industrial real estate developer Xebec Realty plans to build a 234,330 square foot facility at 8201 Sorensen Avenue in Santa Fe Springs. At the end of the third quarter of 2019, there was only one building under construction in Mid Counties, totaling 17,338 square feet.

**ABSORPTION.** The trend of positive net absorption for the Mid Counties' industrial market continues despite the drop in overall transaction volume due the lack of available product. The Mid Counties industrial market has benefited from a number of economic shifts that have led to an increase in demand for warehouse space, including the rise of e-commerce and manufacturing. The Mid Counties industrial market posted 274,076 square feet of positive net absorption in the third quarter, rebounding back from 1,247,799 square feet of negative net absorption in the first quarter of 2019. Primary contributors to this trend include: County of Los Angeles (215,462 square feet), Innovel (146,640 square feet) and Aramsco, Inc. (84,651 square feet).

### NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE








| | INVENTORY | | | | VACANCY & LEASE RATES | | | | | ABSORPTION | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Number of Bldgs. | Net Rentable Square Feet | Square Feet U / C | Square Feet Planned | Square Feet Vacant | Vacancy Rate 3Q2019 | Square Feet Available | Availability Rate 3Q2019 | Average Asking Lease Rate | Net Absorption 3Q2019 | Net Absorption 2019 | Gross Absorption 3Q2019 | Gross Absorption 2019 |
| **Mid Counties** | | | | | | | | | | | | | |
| Artesia / Cerritos | 278 | 13,164,186 | 0 | 0 | 382,937 | 2.91% | 457,891 | 3.48% | $0.67 | 152,514 | 444,350 | 352,513 | 1,029,411 |
| Bellflower / Downey | 195 | 5,539,507 | 0 | 0 | 114,597 | 2.07% | 334,145 | 6.03% | $0.83 | (21,078) | 129 | 31,438 | 106,420 |
| Buena Park / La Palma | 232 | 15,083,192 | 0 | 0 | 1,175,177 | 7.79% | 1,654,953 | 10.97% | $0.67 | 199,584 | (755,834) | 474,780 | 1,067,884 |
| La Mirada | 183 | 12,976,445 | 0 | 0 | 461,920 | 3.56% | 605,532 | 4.67% | $0.92 | (339,319) | (206,266) | 64,174 | 401,679 |
| Norwalk | 87 | 2,911,788 | 0 | 0 | 28,587 | 0.98% | 28,587 | 0.98% | $0.00 | (228) | 78,704 | 2,940 | 52,359 |
| Paramount | 377 | 8,744,375 | 0 | 0 | 149,936 | 1.71% | 356,381 | 4.08% | $0.92 | (6,337) | (114,234) | 29,601 | 119,280 |
| Santa Fe Springs | 1,347 | 52,683,817 | 17,338 | 801,144 | 859,022 | 1.63% | 1,515,694 | 2.88% | $0.99 | 108,431 | 215,182 | 815,544 | 1,744,929 |
| Whittier | 161 | 3,872,607 | 0 | 0 | 60,571 | 1.56% | 378,039 | 9.76% | $0.94 | 180,509 | 116,337 | 14,927 | 57,005 |
| **Mid Counties Total** | **2,860** | **114,975,917** | **17,338** | **801,144** | **3,232,747** | **2.81%** | **5,331,222** | **4.64%** | **$0.99** | **274,076** | **(221,632)** | **1,785,917** | **4,578,967** |
| 5,000-24,999 | 1,795 | 23,885,975 | 17,338 | 0 | 362,686 | 1.52% | 589,245 | 2.47% | $1.09 | (99,631) | (1,450) | 199,816 | 675,886 |
| 25,000-49,999 | 485 | 17,219,775 | 0 | 87,980 | 229,592 | 1.33% | 654,986 | 3.80% | $0.99 | 41,931 | 78,234 | 130,293 | 519,201 |
| 50,000-99,999 | 308 | 21,182,090 | 0 | 0 | 424,999 | 2.01% | 985,539 | 4.65% | $0.89 | 140,936 | 305,201 | 203,303 | 776,342 |
| 100,000-249,999 | 214 | 31,533,737 | 0 | 713,164 | 788,580 | 2.50% | 1,555,619 | 4.93% | $0.67 | (211,926) | (382,939) | 805,450 | 1,776,340 |
| 250,000-499,999 | 51 | 16,663,874 | 0 | 0 | 349,711 | 2.10% | 468,654 | 2.81% | $0.75 | 402,766 | 883,987 | 447,055 | 831,198 |
| 500,000 plus | 7 | 4,490,466 | 0 | 0 | 1,077,179 | 23.99% | 1,077,179 | 23.99% | $0.00 | 0 | (1,104,665) | 0 | 0 |
| **Mid Counties Total** | **2,860** | **114,975,917** | **17,338** | **801,144** | **3,232,747** | **2.81%** | **5,331,222** | **4.64%** | **$0.99** | **274,076** | **(221,632)** | **1,785,917** | **4,578,967** |

This survey consists of buildings greater than 5,000 square feet. Lease rates are on an industrial-gross basis.

## Significant Transactions

### Sales

| Property Address | Submarket | Square Feet | Sale Price | Buyer | Seller |
|---|---|---|---|---|---|
| 11811–11831 E Florence / 10510–10702 Hathaway Dr. | Santa Fe Springs | 543,161 | $101,000,000 | PS Business Parks | Westcore Properties |
| 9339 Ann St. | Santa Fe Springs | 52,000 | $8,350,000 | M-Kourosh, LLC | McLellan Estate Co. |
| 11770–11780 Slauson Ave. | Santa Fe Springs | 29,927 | $5,331,000 | Terreno Realty Corporation | Western Screw Products Inc. |
| 12250 Coast Dr. | Whittier | 20,717 | $4,350,000 | HAI Top Properties, LLC | Soon A. Chang10020 |
| 10020 Freeman Ave. | Santa Fe Springs | 18,200 | $3,760,000 | Att Capital, LLC | JR Group Freeman |

### Leases

| Property Address | Submarket | Square Feet | Transaction Date | Tenant | Owner |
|---|---|---|---|---|---|
| 12100 Rivera Rd. | Whittier | 215,462 | Jul-2019 | County of Los Angeles | Exeter Property Group |
| 13415 Carmenita Rd. | Santa Fe Springs | 200,068 | Aug-2019 | County of Los Angeles | Golden Springs Development Co. |
| 17817 Valley View Ave. | Cerritos | 146,640 | Jul-2019 | Innovel | Kareny Management |
| 16201 Commerce Way | Cerritos | 71,712 | Aug-2019 | Grimco Inc. | Global Logistic Properties |
| 12995 Marquardt Ave. | Santa Fe Springs | 68,640 | Jul-2019 | Maintenance Supply Headquarter | Golden Springs Development Co. |