RESEARCH

Newmark Knight Frank

NATIONAL
2Q17 INDUSTRIAL MARKET

HEALTHY DEMAND DRIVES RENTS HIGHER

The U.S. industrial market experienced healthy demand during the second quarter, which drove rents to another record high for the cycle.

Demand Remains Strong

Net absorption totaled 46.7 million square feet in the second quarter of 2017. While demand remained strong, it fell short of the 52.9 million square feet absorbed in the previous quarter and the 60.3 million square feet absorbed in the second quarter of 2016.

Seventeen of the 46 industrial markets tracked by NKF absorbed 1 million square feet or more in the second quarter, led by Dallas with 5.9 million square feet and Atlanta with 5.4 million square feet. The Inland Empire and Columbus also posted strong totals. Eight markets experienced drops in occupied space, i.e., negative absorption, led by Nashville.

NET ABSORPTION REMAINED STRONG, WITH 17 MARKETS ABSORBING ONE MILLION SQUARE FEET OR MORE

Another way to measure demand for space is to divide absorption by total occupied space, which shows how rapidly the occupied base is growing regardless of a market's size. In the second quarter, occupied industrial space expanded by 0.3% across the U.S., led by Columbus at 1.3%. Atlanta and Cincinnati also achieved a rate of 1.0% or greater. At the other extreme, Nashville saw occupied space shrink by 0.5%.

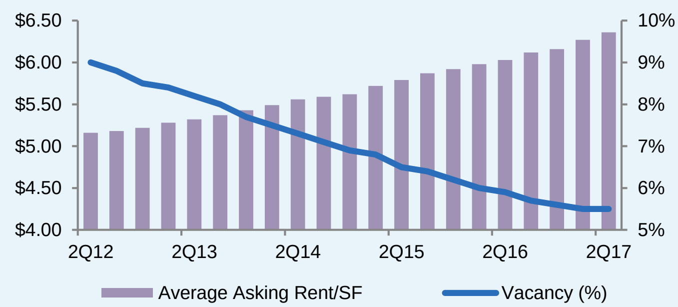
The largest lease of the quarter was signed by Owens Corning, a fiberglass and insulation company, for 1.0 million square feet in Palmetto, Georgia, in the Atlanta market. Other large leases signed during the second quarter included one by Amazon for 992,043 square feet in Cranbury, New Jersey; one by Ace Hardware for 874,126 square feet in Fredericksburg, Pennsylvania; one by SWS Re-Distribution Company for 702,000 square feet in Plainfield, Indiana; and one by GEODIS for 624,150 square feet in Edwardsville, Illinois. In short, a cross-section of various company types took down large blocks of industrial space during the period, from manufacturing firms to retailers to distributors.

Current Conditions

- Absorption remained robust during the second quarter, at 46.7 million square feet.
- Vacancy remains very low, at 5.5%, and is particularly limited in several California markets.
- Average asking rents rose 5.5% over the past year.
- The industrial market is benefiting from the shift in consumer behavior toward convenience, manifested through home delivery.

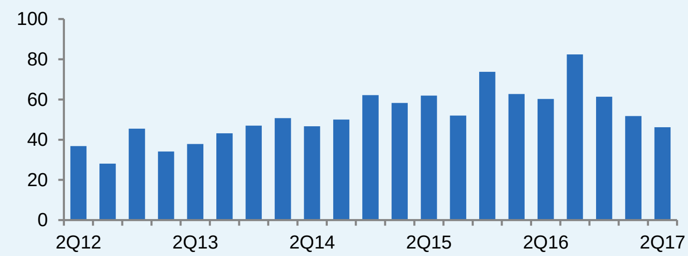
Market Analysis

Asking Rent and Vacancy



Net Absorption

Square Feet, Millions



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Vacancy Rate	5.5%	5.5%	5.9%	↓
Net Absorption*	46.7	52.9	60.3	↔
Average Asking Rent/SF	$6.36	$6.27	$6.03	↑
Under Construction*	227.5	228.9	205.7	↔
Deliveries*	45.8	50.0	51.6	↔

* Square feet, millions

Supply Still Trails Demand

Developers delivered 45.8 million square feet of new space during the second quarter, the least in two years. However, space under construction at the end of the quarter remained near recent highs at 227.5 million square feet. The volume of space under construction has been fairly stable during the past year; this was the fourth consecutive quarter with the total exceeding 220 million square feet.

DELIVERIES TOTALED THE LEAST IN TWO YEARS

Six major distribution hubs accounted for nearly half of the construction total, led by the Inland Empire with 31.0 million square feet and Dallas with 23.3 million square feet. Chicago, Atlanta, Northern New Jersey, and the I-81/78 Corridor in Pennsylvania rounded out the top six, all with at least seven million square feet underway.

THE VOLUME OF SPACE UNDER CONSTRUCTION HAS BEEN FAIRLY STABLE

Industrial space under construction at the end of the quarter was 1.6% of total inventory. Based on this metric, the supply was growing most rapidly in the Inland Empire at 5.7%, Baltimore at 4.0%, and Nashville at 3.6%. Markets that serve as major distribution hubs, and which are proximate to sizeable metro areas, are the ones likely to require the greatest amount of new supply in the coming years, as e-commerce firms seek solutions to their delivery needs.

Vacancy Remains Very Low

The vacancy rate was unchanged during the second quarter, at 5.5%. The rate is down 40 basis points over the past year. Vacancy is very tight in several major markets, notably in Los Angeles at 0.9%, Orange County at 1.9%, Seattle at 3.3%, the Inland Empire at 3.4%, and Oakland/East Bay at 3.8%. Southern California's access to the ports of Los Angeles and Long Beach make these industrial markets highly desirable for the distribution of exports and imports.

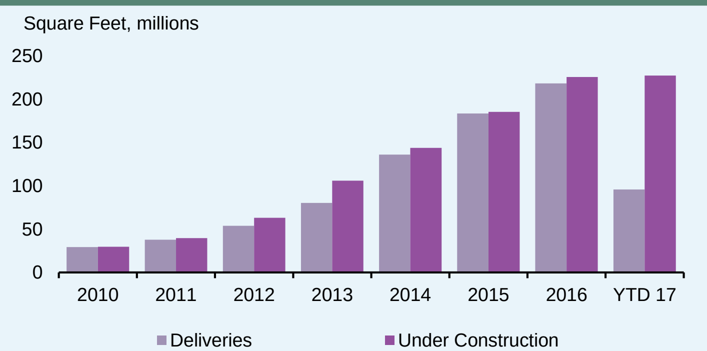
NONE OF THE 46 MARKETS HAD A DOUBLE-DIGIT VACANCY RATE

None of the 46 markets tracked by NKF had a double-digit vacancy rate as of mid-year 2017. This speaks to the health of the market. It also helps to explain why investors have become keen on this product type. According to NCREIF, the five-year average total return for U.S. industrial assets was 12.8% as of the first quarter, leading all five major asset classes.

Columbus and Cincinnati posted second-quarter vacancy declines of at least one percentage point; 23 others posted a lesser decline in vacancy. Conversely, seventeen of the 46 markets covered in this report posted vacancy increases. On balance, vacancy remains low enough in most markets to drive rent increases.

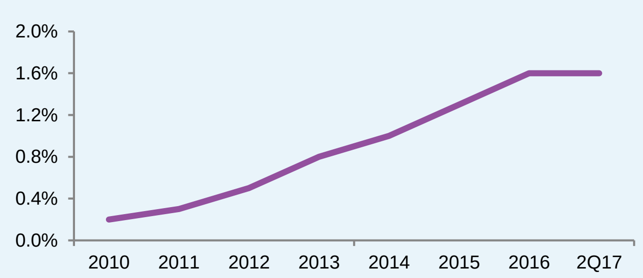
VACANCY REMAINS LOW ENOUGH TO DRIVE RENT INCREASES

Construction and Deliveries



Source: CoStar, NKF

Construction as a Share of Inventory



Source: CoStar, NKF

Rents Continue Their Methodical Rise

The average asking rent across the U.S. ended the second quarter at $6.36/SF triple net, up a stout 1.4% from the first quarter and up 5.5% from a year ago. Rents are rising especially rapidly for modern distribution centers that meet the needs of online retailers.

Ten markets posted double-digit rent gains over the past four quarters, led by Seattle with a strong 20.5% increase. Austin, Northern New Jersey, Long Island, and Oakland/East Bay rounded out the top five gainers. Only seven of 46 markets experienced declines in the average asking rent over the past four quarters.

What to Expect

The economy is entering its ninth year of expansion, making this the third-longest of the 12 post-World War II expansions. Indicators generally suggest that the expansion will continue into 2018 and perhaps beyond, although the Federal Reserve recently lowered its growth forecast. Unlike the office, retail, and apartment markets, the industrial market appears to be in the prime of its run. Office absorption has receded gradually since 2014, but industrial absorption has accelerated every year since 2009. Demand for industrial space will be hard-pressed to match 2016's total absorption of 266.9 million square feet, but the first-half tally for 2017 was still an impressive 99.6 million square feet.

E-commerce, the economic driver that has catalyzed demand for industrial space, continues to grow at a double-digit pace every year, pressuring brick-and-mortar retailers to invest more in their online strategies and supply chains to avoid being "Amazoned." In fact, Amazon has been the biggest occupier of new distribution and fulfillment centers in recent years. The company's purchase of Whole Foods was driven in large part by Amazon's desire to acquire the grocer's distribution network and storage facilities.

Global trade has been another important demand driver for industrial space. Trade volumes have been weak in recent years, restrained by slower growth in China and widespread economic softness outside the U.S. But the global economy is firming, and the Trump administration appears to be backing away from its campaign rhetoric advocating tariffs and trade restrictions, prompting importers and exporters to sigh with relief. The brightening trade picture bodes well for industrial demand.

Look for the industrial market to sustain its above-trend growth for at least another year. Construction and absorption are both near record highs, but the latter is still winning the battle, at least for the time being. If the economy continues to grow, it will become the second-longest post-war expansion by early 2018, and the longest ever in the summer of 2019. That is not out of the realm of possibility, and the industrial market stands to be one of the greatest beneficiaries of the shift in consumer behavior toward convenience, manifested through home delivery of goods.

Select Lease/User Transactions

Tenant	Market	Building	Type	Square Feet
Owens Corning	Atlanta (Palmetto), GA	8095 McLarin Road	Direct Renewal	1,044,288
Amazon	Cranbury, NJ	2 Brick Yard Road	Direct New	992,043
Ace Hardware	Fredericksburg, PA	139 Fredericksburg Road	Direct New	874,126
SWS Re-Distribution Company	Plainfield, IN	3375 Plainfield Road	Direct New	702,000
GEODIS	Edwardsville, IL	624 Gateway East	Direct New	624,150

Select Sales Transactions

Building/Portfolio	Market	Sale Price	Price/SF	Square Feet
1040 North Las Palmas Avenue	Los Angeles, CA	$200,000,000	$542	369,000
2020 Lynx Trail	Ontario, CA	$141,200,000	$124	1,140,000
2635 South Western Avenue	Chicago, IL	$82,400,000	$325	253,153
2405-2505 Trade Center Avenue	Denver (Longmont), CO	$69,600,000	$62	1,130,000
696 East Trimble Road	San Jose, CA	$62,000,000	$300	206,642

Market Statistics

Market	Inventory (SF)	SF Under Construction	SF Absorbed This Quarter	SF Absorbed YTD	% Vacant	Average Asking Rent/SF
Atlanta	615,006,368	13,574,947	5,424,534	12,710,113	7.6%	$4.75
Austin	82,513,011	1,426,967	-241,942	-370,683	7.2%	$10.79
Baltimore	171,888,619	6,903,664	1,348,693	1,921,456	8.2%	$5.12
Boston	220,172,154	619,382	74,229	514,180	6.9%	$7.76
Broward County, FL	105,590,372	703,680	267,149	702,300	4.6%	$9.28
Charlotte	358,095,605	5,767,918	2,069,798	4,634,039	5.7%	$4.21
Chicago	1,115,916,246	18,128,520	2,577,433	6,155,024	7.7%	$5.29
Cincinnati	296,787,607	6,120,149	3,016,447	3,952,864	3.7%	$3.74
Cleveland	293,994,123	439,188	-43,802	725,339	6.5%	$4.25
Columbus	274,012,058	4,894,459	3,296,032	3,203,769	4.6%	$3.73
Dallas	823,438,745	23,292,750	5,898,901	10,712,608	6.7%	$5.26
Denver	188,380,752	3,720,252	917,716	1,011,094	4.8%	$8.43
Detroit	382,034,347	6,298,800	1,296,441	2,925,846	5.3%	$4.89
Houston	542,896,838	3,720,924	-23,938	2,989,044	5.5%	$6.80
Indianapolis	315,362,796	4,369,014	-44,336	350,765	5.9%	$3.68
Inland Empire, CA	543,003,157	30,983,376	4,123,887	8,499,447	3.4%	$6.21
Jacksonville	121,665,884	4,145,726	1,084,280	705,916	5.5%	$4.30
Kansas City	321,463,198	6,715,611	-114,910	1,503,633	6.3%	$4.63
Las Vegas	106,646,304	3,325,663	556,148	589,190	7.1%	$6.93
Long Island	157,341,773	306,274	52,484	-192,593	3.4%	$10.97
Los Angeles	985,034,460	7,980,928	241,110	574,989	0.9%	$9.04
Memphis	247,297,896	2,398,570	1,328,978	884,723	7.6%	$3.13
Miami	210,772,862	2,399,180	-37,250	544,276	4.4%	$7.84
Milwaukee	229,637,893	1,130,918	375,512	886,713	4.7%	$4.62
Minneapolis	374,153,101	1,673,000	352,819	-37,985	4.3%	$6.46
Nashville	224,177,535	7,971,815	-977,817	-278,780	4.7%	$4.95
New Jersey Northern	728,741,233	12,179,028	683,547	2,753,409	5.3%	$7.52
Oakland/East Bay	250,404,459	1,692,123	1,600,081	1,415,791	3.8%	$12.14
Orange County, CA	258,149,611	144,008	44,524	19,863	1.9%	$11.86
Orlando	181,368,662	238,338	487,578	1,746,898	4.7%	$5.89
Palm Beach	48,042,505	166,392	182,727	454,775	4.3%	$9.11
Penn. I-81/78 Corridor	328,148,658	7,930,750	2,740,518	6,791,123	6.4%	$4.43
Philadelphia	498,193,572	2,503,752	539,785	2,268,541	7.1%	$5.07
Phoenix	280,894,634	3,914,359	1,154,463	4,109,151	9.8%	$7.13
Pittsburgh	134,306,874	465,500	38,731	377,766	7.6%	$4.39
Portland	216,383,181	3,152,234	855,410	1,270,796	3.6%	$8.38
Raleigh/Durham	116,844,009	2,139,662	198,881	441,351	5.9%	$6.96
Sacramento	166,917,123	1,333,355	575,826	2,130,695	7.4%	$5.48
Salt Lake City	215,144,046	4,087,431	1,780,217	2,624,171	3.7%	$5.57
San Antonio	111,352,668	1,102,013	211,738	63,492	6.7%	$5.68
San Diego	168,470,483	490,689	101,606	-278,571	4.6%	$11.15
Seattle	301,835,601	3,386,861	1,218,536	2,665,048	3.3%	$8.98
Silicon Valley	189,540,349	857,936	621,222	958,326	5.9%	$21.91
St. Louis	280,872,754	3,085,428	1,576,537	2,335,230	6.0%	$4.48
Tampa/St. Petersburg	254,258,062	2,720,672	67,132	782,145	5.7%	$4.64
Washington, DC	285,513,196	6,871,245	-785,054	834,755	7.3%	$8.20
National	**14,322,665,384**	**227,473,451**	**46,712,601**	**99,582,042**	**5.5%**	**$6.36**

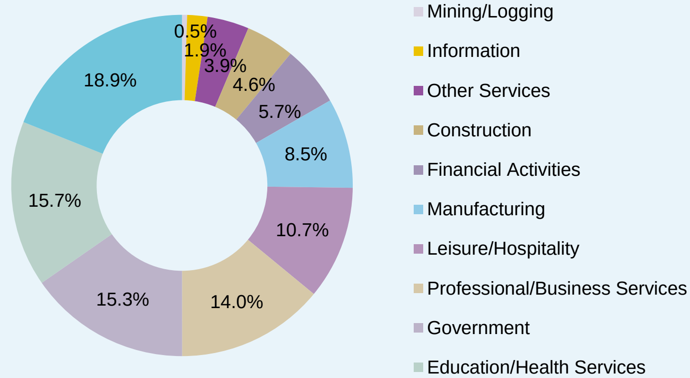
Note: Absorption reflects change in occupied space for the specified period of time. Rents are quoted in triple net terms.

ECONOMIC CONDITIONS

The economy grew at an annual rate of 1.4 percent in the first quarter of 2017 according to the Bureau of Economic Analysis's third estimate, released in June. This rate is down from 1.6% for all of 2016. Despite sluggish GDP growth, hiring has been brisk considering the expansion is now eight years old. The jobless rate, 4.4% in June, reflects an economy near full employment. Employers added 222,000 new jobs in June and an average of 180,000 per month during the first half of 2017, on par with last year's pace of 187,000. Fed officials felt confident enough to raise short-term interest rates by a quarter-point in March and by another quarter-point in June. However, inflation remains weak, which may forestall additional rate increases this year. The stock market has continued to rise, notwithstanding downgraded economic growth estimates by the Federal Reserve and a lack of action by the Congress on tax reform and infrastructure spending. The issue of whether the Affordable Care Act will be repealed, replaced, or patched also remains unresolved.

Employment By Industry

United States, 2016 Annual Average

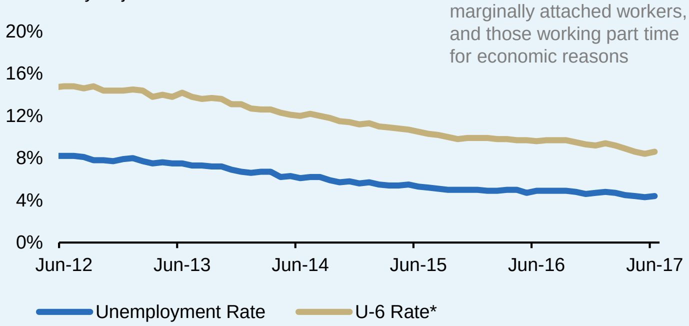


Source: U.S. Bureau of Labor Statistics

Unemployment Rate

Seasonally Adjusted

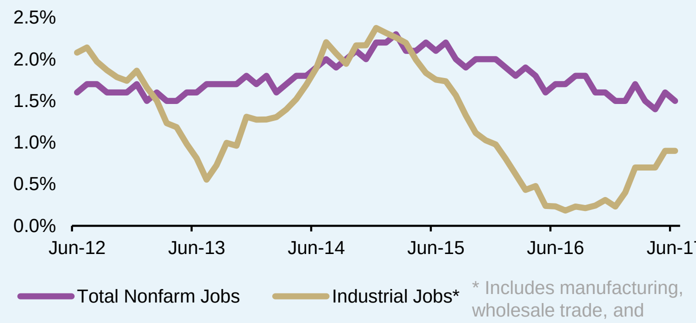
* Includes total unemployed, marginally attached workers, and those working part time for economic reasons



Source: U.S. Bureau of Labor Statistics

Payroll Employment

12-Month % Change, Not Seasonally Adjusted



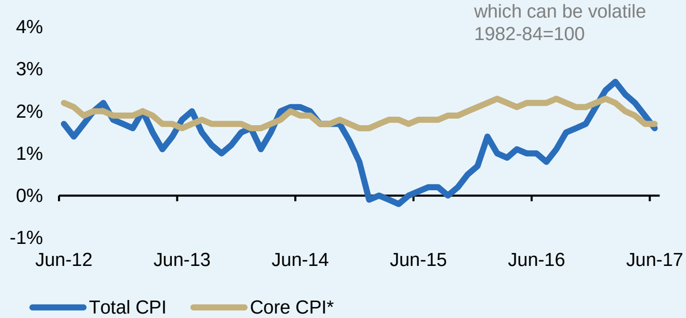
* Includes manufacturing, wholesale trade, and transportation and warehousing

Source: U.S. Bureau of Labor Statistics

Consumer Price Index (CPI)

12-Month % Change, Not Seasonally Adjusted

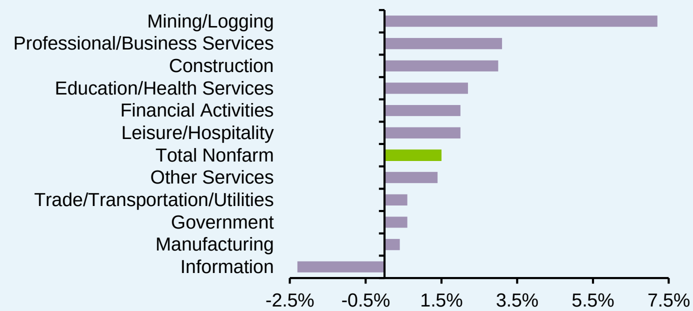
* Excludes food and energy, which can be volatile
1982-84=100



Source: U.S. Bureau of Labor Statistics

Employment Growth by Industry

June 2017, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

RESEARCH

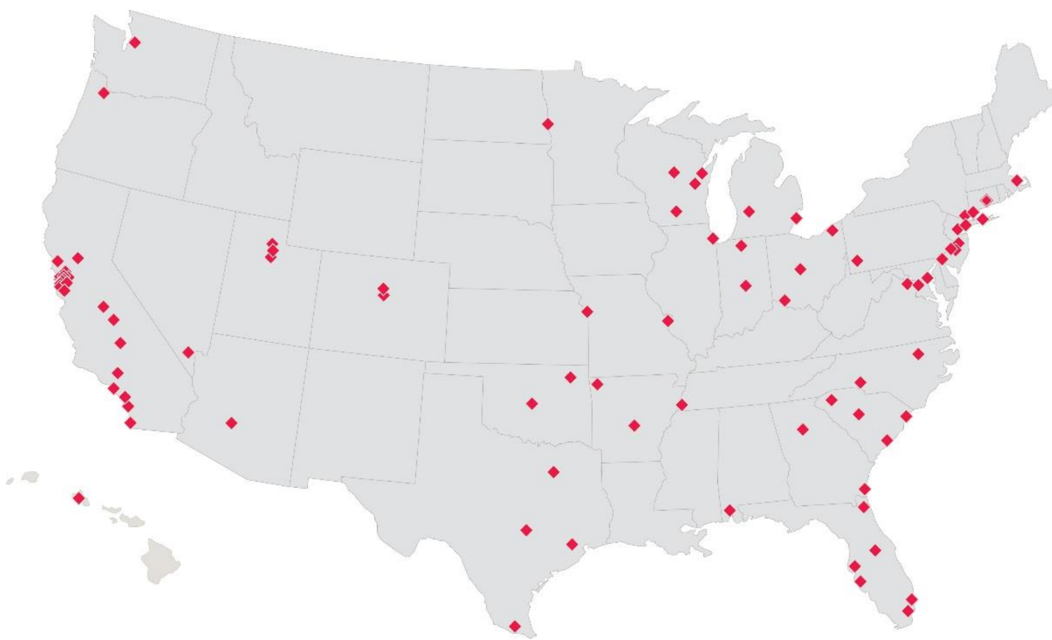
Newmark Knight Frank

New York Headquarters
125 Park Avenue
New York, NY 10017
212.372.2000

Jonathan Mazur
Managing Director
212.372.2154
jmazur@ngkf.com

Alexander (Sandy) Paul, CRE
Managing Director
202.312.5783
apaul@ngkf.com

Newmark Knight Frank United States Office Locations



Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents.

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