

INDUSTRIAL INDEX

INDUSTRIAL RETURNS AND FUNDAMENTALS REMAIN STRONG DESPITE CHALLENGING MACROECONOMIC CLIMATE

The U.S. economy remains fundamentally sound with a tight labor market, healthy household balance sheets, and a high level of job openings creating competition for workers and placing upward pressure on wages. However, the current economic environment is one that is exposed to multiple risk factors. Given the risk of runaway inflation, the Fed has shifted its monetary policy stance and committed to bringing prices under control at all costs while geopolitical turmoil and lingering supply-chain issues are having an impact on the U.S. economy and the industrial sector.

Second quarter industrial returns reflected the current macroeconomic environment. Albeit historically strong, index returns eased from their recent meteoric levels. Total returns moderated to 5.9% this quarter, but the sector could still achieve a stellar calendar year return far above historical norms at this pace. Quarterly income returns have trended downwards over the prior few quarters, demonstrating the sector's value growth over the past couple years. Current value cap rates continued to compress as the market anticipates substantial NOI growth.

Sector fundamentals remain solid spurring the impressive rent growth we've seen during this cycle. Industrial demand continues to push rents to new levels as users seek more functional and productive spaces that fit their needs. NCREIF industrial NOI increased by more than 40.0% over the prior five years while vacancy rates are at an all-time low at 1.7%. The pace of rent growth means that in-place rents for leases are well below market, and attractive mark-to-market opportunities remain for landlords in the future despite an anticipated rent growth slowdown.

YTD total returns are strong at 17.5% while the 1-year return is a remarkable 47.7%, doubling the nearest sector, apartments, at 24.4%. It should be noted that the size and demand seen in LA, Inland Empire, NYC & New Jersey do have an overweight effect on aggregate dynamics. Supply constraints, proximity to crucial distribution infrastructure and major population centers, and a massive weight of capital generated geographic concentrations of extreme outperformance.

Against the current economic backdrop, we still expect the industrial sector to outperform the other sectors. Sector tailwinds remain robust and should continue to buoy returns. Tenant demand for well-located, modern industrial space that can also focus on sustainability measures should endure through the cycle, although supply risks in some markets will become more apparent in a weaker demand environment. Higher construction financing costs and softening rent growth should slow supply, bringing the market to a more sustainable growth equilibrium. Cap rates are expected to expand somewhat as rate hikes cause capital markets to re-price assets and re-evaluate risk profiles, increasing deal flow and generating interesting investment opportunities for well capitalized investors.

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INDUSTRIAL TOTAL RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
2nd Q 2022	3.23	5.86	5.35	3.91	4.68	6.95
1st Q 2022	5.33	10.96	9.38	7.08	9.92	12.85
One Year	21.45	47.67	45.20	27.95	39.94	56.65
Three Years	10.22	26.04	26.87	16.68	21.84	29.68
Five Years	8.86	21.07	21.67	14.01	17.73	23.92
Ten Years	9.67	16.85	16.64	12.39	14.84	18.85
Twenty Years	8.98	12.14	11.88	9.00	10.67	13.74

INDUSTRIAL INCOME RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
2nd Q 2022	0.97	0.78	0.78	1.00	0.90	0.69
1st Q 2022	0.99	0.84	0.81	1.05	0.97	0.75
One Year	4.10	3.57	3.54	4.37	4.00	3.24
Three Years	4.23	4.19	4.24	4.89	4.57	3.85
Five Years	4.37	4.47	4.54	5.10	4.87	4.12
Ten Years	4.78	5.05	5.30	5.62	5.48	4.64
Twenty Years	5.65	6.04	6.30	6.50	6.35	5.68

INDUSTRIAL APPRECIATION RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
2nd Q 2022	2.26	5.08	4.58	2.91	3.78	6.26
1st Q 2022	4.34	10.13	8.57	6.03	8.95	12.10
One Year	16.85	43.01	40.64	22.86	34.94	52.22
Three Years	5.81	21.19	21.94	11.37	16.69	25.11
Five Years	4.35	16.07	16.57	8.57	12.40	19.21
Ten Years	4.72	11.36	10.89	6.49	8.99	13.73
Twenty Years	3.20	5.81	5.31	2.37	4.11	7.71

INDUSTRIAL INDEX—QUARTILE RANGE OF RETURNS

