

INDUSTRIAL INDEX

INDUSTRIAL'S OUTPERFORMANCE CONTINUES

Sustained demand from both tenants and investors led to another quarter of strong performance for the NPI Industrial. Industrial once again led all property types in the third quarter, with a total return of 3.36% and a one-year return of 14.17%. The quarterly return was slightly lower than Q2's 3.58%, but higher than the previous ten quarters. In comparison, office had the second highest returns of the four major property types at 1.69% (-167 bps) for the quarter and 6.85% (-732 bps) for the past year.

Industrial has now led all property types in total return in every quarter since Q1 2016 when industrial was ironically beat by retail! How the times have changed over those two and a half years. Retailers have been rushing to compete with their E-Commerce counterparts, resulting in retailers reallocating space usage from stores to warehouses. Investors, seeing industrial as the new retail, have followed suit and are rebalancing portfolios towards higher industrial exposures.

The West (3.94%) led all regions for the 7th quarter in a row. Three of the top four markets during the quarter hailed from the West, including Portland (7.24%), Seattle (6.03%) and San Francisco (5.45%). The South region (3.03%) eclipsed the East region (2.88%) in total return this quarter for the first time since Q2 2016. The slowdown in the East was primarily driven the New York City market, where the quarterly return fell to 2.83% from a 4.45% average over the previous four quarters. The South benefited from a surge in returns in South Florida where the Miami (3.51%), Fort Lauderdale (3.56%), and West Palm Beach markets (12.21%) all saw quarterly returns at or near cyclical highs. The slower growth Midwest (2.21%) region continues to lag the other regions. Cincinnati (5.03%), benefitting from excitement around the forthcoming Amazon Prime Air Hub, was the one bright spot for the Midwest. Minneapolis was the worst performing market nationally, and the only market to see a negative appreciation return during the quarter.

Over the past year, the implied cap rate based on the quarterly industrial income return has fallen from 5.05% to 4.85%. The East region saw the largest decrease (37 bps), falling from 5.26% to 4.89%. Compared to the other property types in the NPI, industrial's implied cap rate is still relatively high. Given industrial's perceived income durability and growth prospects, especially in the types of locations owned by NCREIF contributors, it's not a stretch to expect further cap rate compression for industrial relative to the other property types.

When will industrial's outperformance relative to other property types come to an end? According to recent surveys by PREA and ULI, investors expect industrial to remain the top performing property type for the foreseeable future. While there has been a pickup in supply in selective markets, absorption and rent growth have been keeping up. Investors remain under-allocated to industrial, leading to robust competition and pricing for assets. Barring an exogenous event, industrial appears poised to continue its relative outperformance over the upcoming quarters.

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INDUSTRIAL TOTAL RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
3rd Q 2018	1.67	3.36	2.88	2.21	3.03	3.94
2nd Q 2018	1.81	3.58	3.76	2.38	3.24	3.95
One Year	7.16	14.17	14.23	11.03	11.87	15.96
Three Years	7.75	13.15	12.46	10.14	11.00	15.13
Five Years	9.57	13.49	12.74	11.04	12.17	14.96
Ten Years	6.42	7.98	7.86	6.25	7.31	8.77
Twenty Years	9.09	9.91	9.77	7.92	8.57	11.24

INDUSTRIAL INCOME RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
3rd Q 2018	1.11	1.19	1.20	1.32	1.31	1.10
2nd Q 2018	1.14	1.21	1.22	1.37	1.33	1.13
One Year	4.62	4.93	5.00	5.39	5.45	4.57
Three Years	4.70	5.13	5.32	5.61	5.62	4.71
Five Years	4.92	5.36	5.65	5.88	5.85	4.91
Ten Years	5.50	5.97	6.32	6.41	6.32	5.56
Twenty Years	6.44	6.92	7.25	7.29	7.18	6.58

INDUSTRIAL APPRECIATION RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
3rd Q 2018	0.56	2.17	1.68	0.90	1.72	2.83
2nd Q 2018	0.67	2.37	2.55	1.01	1.91	2.82
One Year	2.46	8.91	8.90	5.42	6.17	11.02
Three Years	2.95	7.73	6.87	4.35	5.16	10.06
Five Years	4.49	7.82	6.81	4.95	6.05	9.69
Ten Years	0.88	1.91	1.46	-0.16	0.93	3.07
Twenty Years	2.53	2.84	2.39	0.60	1.32	4.43

INDUSTRIAL INDEX—QUARTILE RANGE OF RETURNS

