

INDUSTRIAL INDEX

INDUSTRIAL: SECTOR CONTINUED TO BROADLY OUTPERFORM IN 2017

In The dynamics that have supported robust U.S. industrial property market performance in this cycle remain solidly in place. The positive impact from double-digit internet retail sales growth¹ on top of traditional drivers is a key component of the sector's top performance in this cycle and potentially into the foreseeable future. Re-accelerating GDP and income growth, as well as broadly healthy retail sales, trade and industrial production in 2017², bode well for industrial space demand and continued fundamentals strength.

Property market data from CBRE-EA indicate that the year ended with less space demand compared to recent years. Net absorption totaled 178 million square feet, well below the 284 million square-foot annual average recorded during the previous four years. Construction completions surpassed new demand for the first time since 2009, totaling 200 million square feet. The U.S. vacancy rate ticked up 10 basis points to 4.5% during the fourth quarter, but remained well below last cycle's low. Annual rent growth of 5.0% indicates that landlords maintained their advantage in the market. However, rent growth varied widely between markets.³

Investors continued to express interest in the sector, driving prices higher and going in yields lower. According to Real Capital Analytics, Industrial was the only sector to experience year-over-year (YOY) gains in investment volume, up 20% to \$72.2 billion in 2017. All subsectors and market types saw YOY volume increases, including flex (+19%), secondary markets (+20%), and tertiary markets (+22%). NCREIF data seem well aligned with these trends, with current value cap rates drifting lower and 1-year appreciation returns of 7.7% in the fourth quarter of 2017.⁴

Industrial sector returns have outperformed the NPI in each of the past seven years and the performance gap widened in 2017, expanding to 609 basis points. The resilience of industrial sector returns has been supported by healthy market fundamentals, resulting in strong NOI growth (about 6.5% in 2017 and 7.2% annually since 2015).⁵

Investment performance was varied across regions, markets and property segments, with the West being the standout region, posting a 15.1% total return in 2017. The warehouse and R&D segments returned 13.2% and 13.6%, respectively, while the flex and manufacturing segments returned 11.3% and 10.9%, respectively. Strong performance continued across many markets, with only four (Memphis, Minneapolis, Phoenix and St. Louis) underperforming the NPI on a one-year total return basis.⁶

Industrial property market fundamentals are expected continue to support good relative investment performance in the sector in 2018, but the pace of occupancy gain and rent growth is expected to moderate, as are total returns.⁷ There does not appear to be much room for cap rate compression to aid returns. Going in yields are at record lows, and despite strong rent roll-up potential in coming years, the recent upward trajectory of interest rates could dampen the pace of capital appreciation.

Vikram Mehra
Director, Chief Operating Officer of Real Estate, Americas –
Alternatives
Deutsche Asset Management

¹ U.S. Census Bureau, December 2017

² Moody's Economy.com, December 2017

³ CBRE-EA, data as of fourth quarter, 2017

⁴ Real Capital Analytics, US Capital Trends 2017

⁵ NCREIF, data as of fourth quarter 2017

⁶ NCREIF, data as of fourth quarter 2017

⁷ Deutsche Asset Management, PREA Consensus Survey as of December 2017

INDUSTRIAL TOTAL RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
4th Q 2017	1.80	3.28	3.39	3.28	2.30	3.70
3rd Q 2017	1.70	3.29	3.05	2.10	2.34	4.08
One Year	6.96	13.07	12.88	10.33	10.30	15.08
Three Years	9.38	13.41	12.35	11.35	11.53	15.17
Five Years	10.19	13.19	12.27	11.32	12.16	14.46
Ten Years	6.08	7.16	6.98	5.60	6.72	7.84
Twenty Years	9.44	10.01	9.83	7.95	8.59	11.40

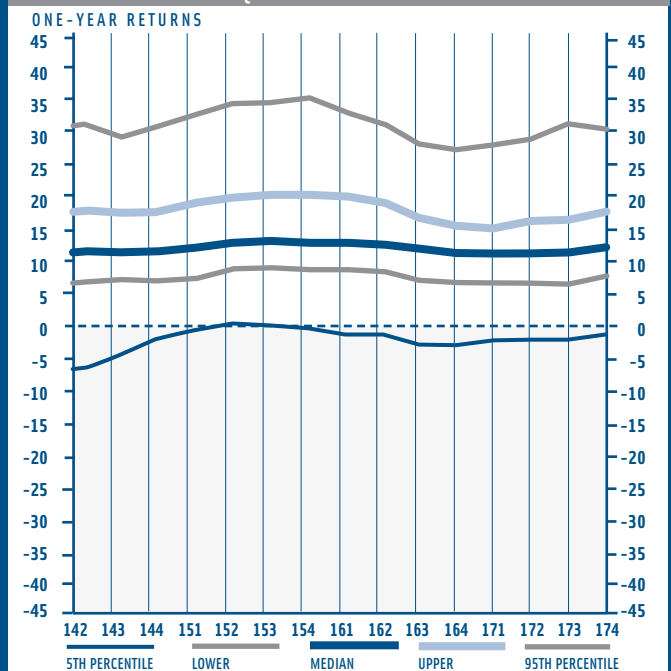
INDUSTRIAL INCOME RETURNS

	Total NPI	Total Industrial	East	Midwest	South	West
4th Q 2017	1.16	1.22	1.25	1.30	1.34	1.13
3rd Q 2017	1.14	1.24	1.29	1.38	1.35	1.14
One Year	4.68	5.07	5.30	5.55	5.53	4.66
Three Years	4.82	5.27	5.52	5.78	5.78	4.83
Five Years	5.08	5.53	5.92	6.02	6.00	5.06
Ten Years	5.54	6.05	6.42	6.47	6.39	5.62
Twenty Years	6.60	7.09	7.43	7.43	7.33	6.76

INDUSTRIAL APPRECIATION RETURNS

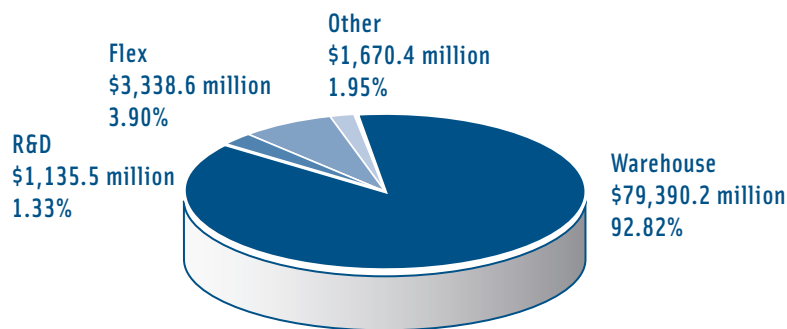
	Total NPI	Total Industrial	East	Midwest	South	West
4th Q 2017	0.63	2.06	2.14	1.98	0.96	2.57
3rd Q 2017	0.56	2.05	1.76	0.72	0.99	2.94
One Year	2.20	7.71	7.29	4.59	4.59	10.07
Three Years	4.41	7.83	6.56	5.35	5.52	9.98
Five Years	4.92	7.36	6.08	5.07	5.90	9.05
Ten Years	0.52	1.05	0.52	-0.84	0.31	2.12
Twenty Years	2.71	2.77	2.28	0.49	1.19	4.42

INDUSTRIAL INDEX—QUARTILE RANGE OF RETURNS



INDUSTRIAL SUB-TYPES INDEX

TOTAL INDUSTRIAL



Industrial Properties	3,273
R&D Properties	34
Flex Space Properties	231
Other Properties	82
Warehouse Properties	2,926
Total Market Value	\$85,534.7M

* Other includes manufacturing and office showroom. Other categories are not included in the subtype property returns below due to the small sample size.

WAREHOUSE TOTAL RETURNS

	Total NPI	Total Industrial	Total Warehouse
4th Q 2017	1.80	3.28	3.27
3rd Q 2017	1.70	3.29	3.35
One Year	6.96	13.07	13.19
Three Years	9.38	13.41	13.67
Five Years	10.19	13.19	13.46
Ten Years	6.08	7.16	7.44
Twenty Years	9.44	10.01	10.09

WAREHOUSE INCOME RETURNS

	Total NPI	Total Industrial	Total Warehouse
4th Q 2017	1.16	1.22	1.21
3rd Q 2017	1.14	1.24	1.23
One Year	4.68	5.07	5.02
Three Years	4.82	5.27	5.24
Five Years	5.08	5.53	5.49
Ten Years	5.54	6.05	6.01
Twenty Years	6.60	7.09	7.05

WAREHOUSE APPRECIATION RETURNS

	Total NPI	Total Industrial	Total Warehouse
4th Q 2017	0.63	2.06	2.06
3rd Q 2017	0.56	2.05	2.13
One Year	2.20	7.71	7.88
Three Years	4.41	7.83	8.12
Five Years	4.92	7.36	7.66
Ten Years	0.52	1.05	1.35
Twenty Years	2.71	2.77	2.88

R&D TOTAL RETURNS

	Total NPI	Total Industrial	Total R&D
4th Q 2017	1.80	3.28	7.14
3rd Q 2017	1.70	3.29	1.61
One Year	6.96	13.07	13.60
Three Years	9.38	13.41	11.92
Five Years	10.19	13.19	11.49
Ten Years	6.08	7.16	6.29
Twenty Years	9.44	10.01	9.54

R&D INCOME RETURNS

	Total NPI	Total Industrial	Total R&D
4th Q 2017	1.16	1.22	1.34
3rd Q 2017	1.14	1.24	1.48
One Year	4.68	5.07	5.66
Three Years	4.82	5.27	5.09
Five Years	5.08	5.53	5.51
Ten Years	5.54	6.05	6.12
Twenty Years	6.60	7.09	7.20

R&D APPRECIATION RETURNS

	Total NPI	Total Industrial	Total R&D
4th Q 2017	0.63	2.06	5.80
3rd Q 2017	0.56	2.05	0.13
One Year	2.20	7.71	7.62
Three Years	4.41	7.83	6.58
Five Years	4.92	7.36	5.75
Ten Years	0.52	1.05	0.17
Twenty Years	2.71	2.77	2.22

FLEX SPACE TOTAL RETURNS

	Total NPI	Total Industrial	Total Flex
4th Q 2017	1.80	3.28	2.71
3rd Q 2017	1.70	3.29	2.69
One Year	6.96	13.07	11.35
Three Years	9.38	13.41	10.83
Five Years	10.19	13.19	10.65
Ten Years	6.08	7.16	4.71
Twenty Years	9.44	10.01	8.93

FLEX SPACE INCOME RETURNS

	Total NPI	Total Industrial	Total Flex
4th Q 2017	1.16	1.22	1.36
3rd Q 2017	1.14	1.24	1.39
One Year	4.68	5.07	5.79
Three Years	4.82	5.27	5.89
Five Years	5.08	5.53	6.08
Ten Years	5.54	6.05	6.45
Twenty Years	6.60	7.09	7.32

FLEX SPACE APPRECIATION RETURNS

	Total NPI	Total Industrial	Total Flex
4th Q 2017	0.63	2.06	1.35
3rd Q 2017	0.56	2.05	1.30
One Year	2.20	7.71	5.34
Three Years	4.41	7.83	4.74
Five Years	4.92	7.36	4.37
Ten Years	0.52	1.05	-1.67
Twenty Years	2.71	2.77	1.53