RESEARCH

Newmark Knight Frank

# NATIONAL
## 1Q18 INDUSTRIAL MARKET

# INDUSTRIAL SECTOR MAINTAINS TIGHT MARKET CONDITIONS

The U.S. industrial market recorded rising asking rents and consistent overall vacancy through the first quarter of 2018. Although net absorption decelerated modestly, the industrial asset class continues to attract investor interest, while construction keeps up with strong tenant demand.

### Net Absorption Decelerates

Demand for industrial space leveled off during the first quarter of 2018, posting 45.7 million square feet of net absorption. This was the lowest quarterly absorption total recorded since the third quarter of 2013. Although absorption is down from the 60.3 million square feet recorded at the fourth quarter of 2017 and the 59.0 million square feet recorded one year ago, the vacancy rate held steady at 5.3% for the fourth consecutive quarter. Average asking rents in first-quarter 2018 measured $6.67/SF, the highest quarterly average recorded this cycle. These figures all speak to the overall strength of the national industrial market.

Fourteen of the 49 industrial markets tracked by NKF absorbed 1.0 million square feet or more in the first quarter, led by California's Inland Empire with 7.7 million square feet and Northern New Jersey with 4.0 million square feet. The Chicago, Atlanta, Los Angeles and Indianapolis markets all recorded 2.0 million square feet or more of absorption through first-quarter 2018. Six markets posted declines in occupied space, or negative absorption, through the first quarter, led by the Seattle market.

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. Through the first quarter of 2018, occupied industrial space expanded by 0.3% across the U.S., led by California's Inland Empire at 1.4% and Greenville, South Carolina, at 1.0%. By contrast, the Seattle market saw occupied space shrink by 0.1% during the quarter.

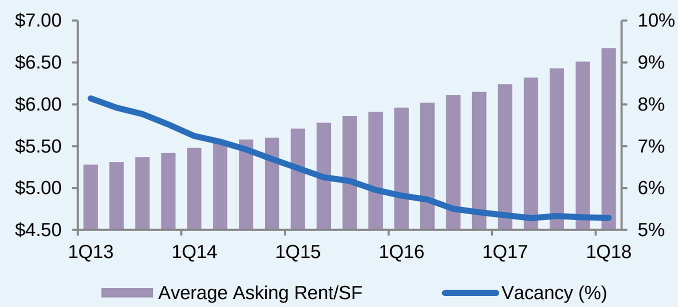
The largest industrial lease of the first quarter was a direct new deal signed by the United States Postal Service for 818,000 square feet in Portland, Oregon. Other large new leases were signed by supply chain service provider Tellworks Communications, for 722,733 square feet in Dallas, and third-party logistics provider Kenco, for 701,228 square feet in Chicago. Two lease renewals were also signed by building products distributor BlueLinx Corporation, one for 585,637 square feet in the Atlanta market, and another for 580,252 square feet in Frederick, Maryland. Mirroring fourth-quarter 2017, when logistics providers were behind the three largest leases of the quarter, two of the largest lease deals signed during the first quarter of 2018 were for third-party logistics and supply chain service providers.

## Current Conditions

- Absorption leveled off from recent quarters, measuring 45.7 million square feet at first-quarter 2018.
- Vacancy remained low, at 5.3% for the fourth consecutive quarter.
- Average asking rents rose 2.5% from last quarter to $6.67/SF, the highest average recorded this cycle.
- Blackstone REIT purchased a 22-million-square-foot industrial portfolio for $1.8 billion in March.

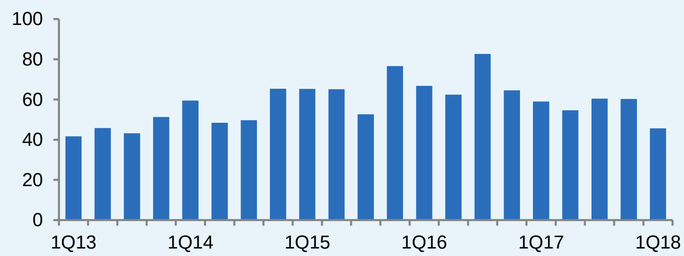
## Market Analysis

**Asking Rent and Vacancy**




**Net Absorption**

Square Feet, Millions




## Market Summary

| | Current Quarter | Prior Quarter | Year Ago Period | 12-Month Forecast |
|---|---|---|---|---|
| Vacancy Rate | 5.3% | 5.3% | 5.4% | ↔ |
| Net Absorption* | 45.7 | 60.3 | 59.0 | ↔ |
| Average Asking Rent/SF | $6.67 | $6.51 | $6.24 | ↑ |
| Under Construction* | 223.7 | 224.4 | 237.6 | ↔ |
| Deliveries* | 44.4 | 62.5 | 56.4 | ↔ |

* Square feet, millions

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### Deliveries Stabilize

Developers delivered 44.4 million square feet of new space during the first quarter of 2018, stabilizing after the third and fourth quarters of 2017 posted totals of 69.4 million and 62.5 million square feet respectively, the largest delivery totals recorded so far this cycle. Industrial space under construction during first-quarter 2018 measured 223.7 million square feet, down from 224.4 million square feet recorded for the fourth quarter and 237.6 million square feet recorded one year ago. The volume of space under construction has been fairly stable since the fourth quarter of 2016. Developers continue to break ground on new projects to meet the growth demand for distribution space.

As in the previous three quarters, six major distribution hubs accounted for nearly 100.0 million square feet of the first quarter's construction total, led by Dallas with 24.0 million square feet and California's Inland Empire with 21.2 million square feet. Atlanta, Chicago, Northern New Jersey and Pennsylvania's I-81/78 Corridor rounded out the top six, with all markets but the I-81/78 Corridor posting more than 12.0 million square feet of industrial space under construction as of first-quarter 2018.

Industrial space under construction during first-quarter 2018 comprised 1.5% of total inventory. Based on this metric, the supply was growing most rapidly in Charleston, South Carolina, at 6.9%, California's Inland Empire at 3.7% and Baltimore at 3.6%. Markets that serve as major distribution hubs and are near large seaports and metropolitan areas, such as the ones listed above, will continue to require more new supply in the coming years, especially as the e-commerce and logistics sectors continue to thrive. As seen in recent quarters, several of the largest leases signed during the first quarter were for supply chain and third-party logistics providers, industries that will continue to seek space in gateway markets to manage expanding global trade flows and the increase in e-commerce.

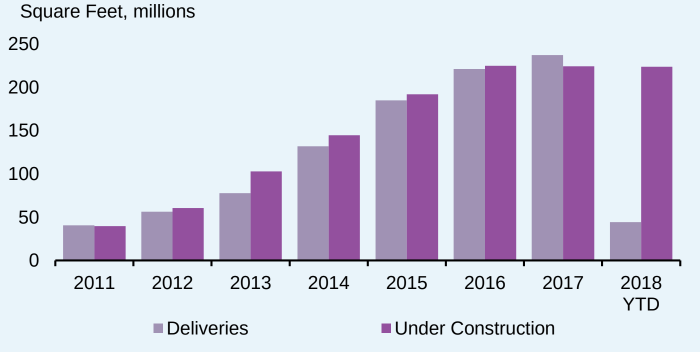
### Vacancy Remains Low and Little-Changed

The vacancy rate remained low through the first quarter of 2018, at 5.3%, identical to the rate recorded over the past three quarters and 10 basis points lower than the 5.4% recorded at first-quarter 2017. Vacancy is very tight in several major markets, notably Los Angeles at 1.1%, Orange County at 2.2%, Long Island at 3.1%, Cincinnati at 3.2% and Seattle at 3.4%. Southern California's access to the ports of Los Angeles and Long Beach make the regional industrial markets there highly desirable for the distribution of exports and imports, particularly with regard to Asia-Pacific trade, and continue to keep the vacancy rate at a low level.

None of the 49 markets tracked by NKF had a double-digit vacancy rate as of first-quarter 2018. This speaks to the overall strength of the national industrial market. It also helps to explain why investors have become keen on this product type. According to the National Council of Real Estate Investment Fiduciaries (NCREIF), U.S. industrial was the only core property sector to achieve a double-digit unlevered total return during 2017, at 13.1%. Industrial outperformed the second-best performing sector, apartments, by 691 basis points during 2017.

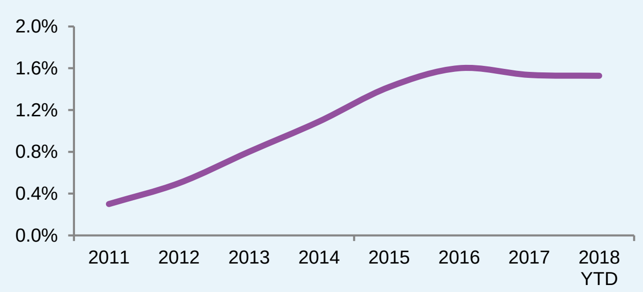
No industrial markets posted a first-quarter vacancy increase of 1 percentage point or greater. The largest increase occurred in Charleston, where vacancy increased by 90 basis points from the fourth quarter of 2017 to 9.3%. Twenty other markets posted a smaller rise in vacancy for first-quarter 2018. Twenty-two of the 49 markets covered in this report posted vacancy declines relative to figures from fourth-quarter 2017, led by Las Vegas, where vacancy fell by 80 basis points to 6.8%. Vacancy was unchanged in six markets during first-quarter 2018. On balance, vacancy remained low enough in most markets to drive rent increases during the quarter. Only nine markets nationally posted rent declines relative to fourth-quarter 2017 totals.

#### Construction and Deliveries




Source: CoStar, NKF

#### Construction as a Share of Inventory




Source: CoStar, NKF

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### Average Asking Rents Up 6.9% Year-Over-Year

Average asking rents across the U.S. at first-quarter 2018 measured $6.67/SF triple net, up 2.5% from the fourth quarter and up 6.9% from the first quarter of 2017. Notably, the first-quarter average is the highest recorded this cycle and reflects the overall strength of the national industrial market. Modern distribution centers that meet the needs of e-commerce tenants, offering higher ceiling heights and automated warehouse management systems, have seen strong national rent growth because of consistently robust demand. In denser, urban markets such as New York City and Seattle, developers are planning multi-story warehouses that will offer truck ramps to second-floor loading bays. Although cost estimates for multi-story facilities are sometimes 50.0% greater per square foot than single-story product, rising rents allow the projects to pencil out on a cost-per-square foot basis. The concept of rapid last-mile delivery—the delivery of goods to customers within hours—continues to proliferate in dense urban environments across the United States. The desire to reduce delivery times, along with increasing rents, will continue to push industrial developers to innovate their product even further in order to remain competitive.

### What to Expect

As of the first quarter of 2018, the current U.S. economic expansion is tied for the second-longest growth cycle post-World War II. The Federal Reserve's latest GDP growth forecast of 2.8% for 2018 suggests that the expansion is likely to continue beyond this year. The industrial market's appeal to investors continues to grow—2017 annual total returns eclipsed 13.0%, per NCREIF, far outperforming other sectors. Although industrial absorption decelerated during the first quarter, vacancy remained low, and asking rents jumped 2.5% from last quarter—both signs that the industrial market remains healthy in early 2018.

E-commerce, along with related industries such as supply chain management and third-party logistics, has continued its rapid growth into 2018. Consumers across demographic and economic spectrums are demanding rapid product delivery, which has led developers to innovate their product and offer more highly efficient space in urban markets. The boom in e-commerce has led to high construction levels and increasing asking rents, which reached their highest level recorded this cycle during the first quarter. The growth in e-commerce has pushed institutional investors to purchase more warehouse and distribution facilities to capitalize on ever-increasing demand: In March, Blackstone REIT purchased a 22-million-square-foot portfolio concentrated around urban centers nationwide for $1.8 billion.

The first quarter of 2018 saw Congress pass a $1.3 trillion omnibus spending bill guaranteeing government funding through the fiscal year. Both the spending bill and the 2017 Tax Cuts and Jobs Act are expected to benefit the U.S. commercial real estate industry overall. The new tax law is also likely to benefit the national industrial market, as businesses are now able to immediately expense several types of asset purchases, encouraging more owner-user transactions. However, the Trump Administration's willingness to begin a "trade war" with China by imposing steep tariffs on Chinese imports may negatively affect the national industrial market due to its impact on gateway markets. Markets supporting importers have seen the strongest demand for industrial product—Los Angeles has the lowest vacancy rate nationally as of first-quarter 2018, measuring 1.1%.

With record-high asking rents, low vacancy and consistent tenant demand, the industrial market should sustain its above-trend growth at least through 2018. As consumers continue to demand rapid deliveries, e-commerce tenants will require more innovative space nationwide.

### Select Lease/User Transactions

| Tenant | Market | Building | Type | Square Feet |
|---|---|---|---|---|
| USPS | Portland, OR | 7007 NE Cornfoot Road | Direct New | 818,000 |
| Tellworks Communications | Dallas, TX | 4101 Research Drive | Direct New | 722,733 |
| Kenco | Chicago, IL | 5800 West Industrial Drive | Direct New | 701,228 |
| Bluelinx Corporation | Atlanta, GA | 200 Hosea Road | Direct Renewal | 585,637 |
| Bluelinx Corporation | Washington, DC | 4300 Georgia Pacific Blvd | Direct Renewal | 580,252 |

### Select Sales Transactions

| Building/Portfolio | Market | Sale Price | Price/SF | Square Feet |
|---|---|---|---|---|
| Cabot Canyon Industrial 2018 | IL, KS, CA, TX, MD, CO, NJ, FL | $1,800,000,000 | $83 | 21,718,000 |
| 3053 Arden Road | Oakland/East Bay, CA | $93,500,000 | $395 | 237,000 |
| L&B Warehouse Acquisition 2018 | Boston, MA | $72,700,000 | $99 | 737,810 |
| Sitex Group NJ Industrial Portfolio 2018 | Northern New Jersey | $65,000,000 | $173 | 375,182 |
| 2652 Long Beach Avenue | Los Angeles, CA | $57,821,000 | $217 | 266,396 |

## Market Statistics

| Market | Inventory (SF) | SF Under Construction | SF Absorbed This Quarter | SF Absorbed YTD | % Vacant | Average Asking Rent/SF |
|---|---|---|---|---|---|---|
| Atlanta | 608,313,497 | 16,365,055 | 2,832,957 | 2,832,957 | 7.9% | $4.96 |
| Austin | 90,317,020 | 1,666,597 | 243,390 | 243,390 | 7.7% | $10.64 |
| Baltimore | 174,422,226 | 6,280,958 | -47,073 | -47,073 | 9.2% | $4.98 |
| Boston | 221,359,300 | 388,700 | 839,622 | 839,622 | 6.3% | $8.30 |
| Broward County, FL | 105,191,697 | 1,248,382 | 102,688 | 102,688 | 4.3% | $8.96 |
| Charlotte | 373,079,950 | 3,889,823 | 1,425,737 | 1,425,737 | 5.6% | $4.23 |
| Charleston, SC | 67,759,399 | 4,681,728 | 121,934 | 121,934 | 9.3% | $5.55 |
| Chicago | 1,129,042,600 | 13,715,968 | 3,237,198 | 3,237,198 | 8.1% | $5.30 |
| Cincinnati | 305,120,670 | 4,051,676 | 1,709,465 | 1,709,465 | 3.2% | $4.00 |
| Cleveland | 284,048,222 | 1,999,628 | -96,545 | -96,545 | 5.8% | $4.34 |
| Columbia, SC | 58,391,433 | 1,029,657 | 185,728 | 185,728 | 8.3% | $4.02 |
| Columbus | 276,822,033 | 5,576,305 | 1,400,338 | 1,400,338 | 4.1% | $3.85 |
| Dallas | 838,804,753 | 24,046,978 | 1,796,972 | 1,796,972 | 6.2% | $5.29 |
| Denver | 189,148,459 | 6,383,208 | 165,234 | 165,234 | 4.7% | $7.42 |
| Detroit | 388,601,699 | 5,904,627 | 746,740 | 746,740 | 5.0% | $5.05 |
| Greenville, SC | 200,674,164 | 3,414,460 | 1,926,501 | 1,926,501 | 5.4% | $3.49 |
| Houston | 515,404,027 | 6,719,658 | 979,339 | 979,339 | 5.1% | $6.38 |
| Indianapolis | 316,984,288 | 4,253,101 | 2,411,017 | 2,411,017 | 5.3% | $3.76 |
| Inland Empire, CA | 568,101,758 | 21,208,768 | 7,688,877 | 7,688,877 | 3.7% | $6.98 |
| Jacksonville | 126,008,832 | 368,205 | 671,791 | 671,791 | 3.5% | $4.60 |
| Kansas City | 283,261,116 | 2,416,841 | 928,300 | 928,300 | 6.0% | $4.89 |
| Las Vegas | 110,662,833 | 181,442 | 358,563 | 358,563 | 6.8% | $8.12 |
| Long Island | 158,426,223 | 217,875 | 116,043 | 116,043 | 3.1% | $11.27 |
| Los Angeles | 992,204,255 | 2,822,154 | 2,414,074 | 2,414,074 | 1.1% | $9.40 |
| Memphis | 252,638,153 | 5,114,441 | -267,976 | -267,976 | 6.5% | $3.08 |
| Miami | 212,705,320 | 1,910,757 | 676,347 | 676,347 | 4.4% | $7.28 |
| Milwaukee | 230,814,520 | 847,800 | 62,453 | 62,453 | 4.1% | $4.41 |
| Minneapolis | 378,257,958 | 1,066,250 | 1,621,704 | 1,621,704 | 4.0% | $6.64 |
| Nashville | 232,795,404 | 5,249,656 | 462,737 | 462,737 | 4.1% | $5.65 |
| New Jersey Northern | 633,829,484 | 12,348,160 | 3,988,396 | 3,988,396 | 4.8% | $8.25 |
| Oakland/East Bay | 249,909,101 | 2,568,891 | 334,270 | 334,270 | 3.8% | $13.59 |
| Orange County, CA | 258,861,045 | 793,138 | 151,398 | 151,398 | 2.2% | $12.84 |
| Orlando | 182,254,443 | 773,712 | 461,939 | 461,939 | 4.1% | $6.16 |
| Palm Beach | 48,208,897 | 0 | -66,364 | -66,364 | 3.6% | $9.27 |
| Penn. I-81/78 Corridor | 334,586,953 | 8,881,210 | 225,875 | 225,875 | 6.8% | $4.44 |
| Philadelphia | 500,094,417 | 4,897,156 | 491,625 | 491,625 | 6.2% | $5.37 |
| Phoenix | 284,821,150 | 7,314,039 | 669,598 | 669,598 | 8.4% | $7.46 |
| Pittsburgh | 134,844,946 | 100,000 | 197,845 | 197,845 | 7.6% | $4.52 |
| Portland | 219,132,693 | 2,837,909 | 281,295 | 281,295 | 4.4% | $8.04 |
| Raleigh/Durham | 117,350,485 | 1,937,346 | 535,485 | 535,485 | 5.9% | $6.92 |
| Sacramento | 156,345,033 | 754,576 | 966,085 | 966,085 | 5.7% | $6.24 |
| Salt Lake City | 221,268,193 | 3,798,101 | 473,315 | 473,315 | 3.8% | $6.21 |
| San Antonio | 114,997,141 | 718,457 | 42,966 | 42,966 | 6.4% | $5.89 |
| San Diego | 168,150,355 | 2,375,677 | -168,244 | -168,244 | 4.1% | $11.81 |
| Seattle | 302,835,892 | 6,089,949 | -429,097 | -429,097 | 3.4% | $9.76 |
| Silicon Valley | 215,657,251 | 606,519 | 1,238,417 | 1,238,417 | 7.9% | $22.32 |
| St. Louis | 263,842,939 | 5,525,081 | 488,205 | 488,205 | 5.0% | $4.74 |
| Tampa/St. Petersburg | 257,111,677 | 1,841,842 | 73,014 | 73,014 | 5.5% | $5.43 |
| Washington, DC | 292,033,630 | 6,564,125 | 1,002,058 | 1,002,058 | 6.6% | $8.52 |
| **National** | **14,645,497,534** | **223,746,586** | **45,672,236** | **45,672,236** | **5.3%** | **$6.67** |

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

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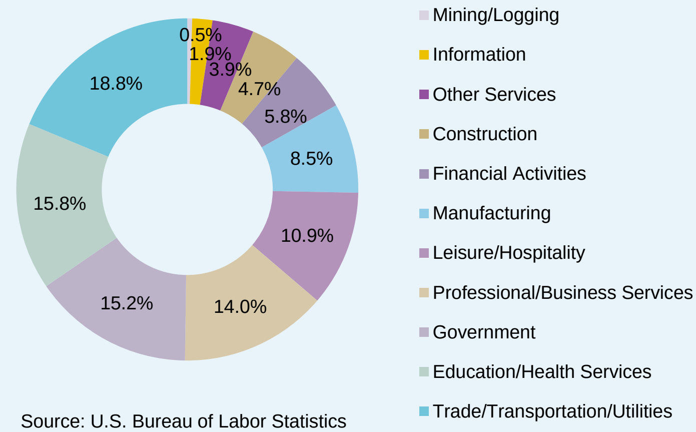
## ECONOMIC CONDITIONS

The U.S. economy grew at an annual rate of 2.9% during the fourth quarter, according to the Bureau of Economic Analysis' third estimate, released in March. While imports outpaced exports, the cost of goods increased 2.5% during the fourth quarter—though the inflation rate was just 2.0% (not seasonally adjusted) for the 12 months ending in February. GDP continues to make solid gains, consistent with steady job growth. The unemployment rate has held steady at 4.1% since October 2017, reflecting an economy near full employment. Employers added an extraordinary 326,000 new jobs in February 2018, although that number normalized to 103,000 new jobs in March 2018, with mining/logging and construction among the notable growth sectors. Although consumer and business confidence has increased with the passage of the Tax Cuts and Jobs Act, the full effect of tax reform will not be felt in the near term. Also, two key macroeconomic trends bear monitoring: the Fed's continued interest rate hikes, which may curtail consumer and business spending as lenders tighten standards, and the threat of trade-hampering tariffs.

### Employment By Industry

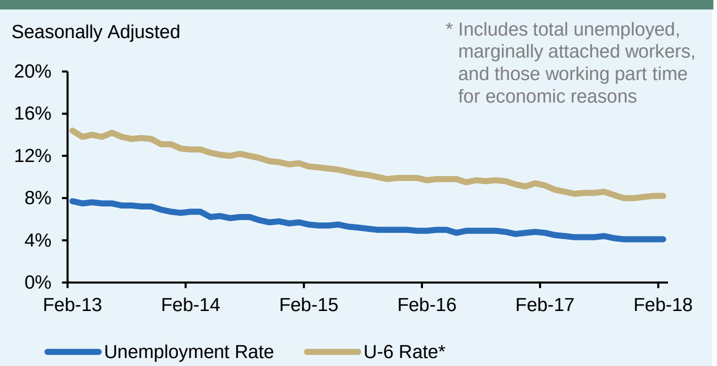
United States, 2017 Annual Average




Source: U.S. Bureau of Labor Statistics

### Unemployment Rate

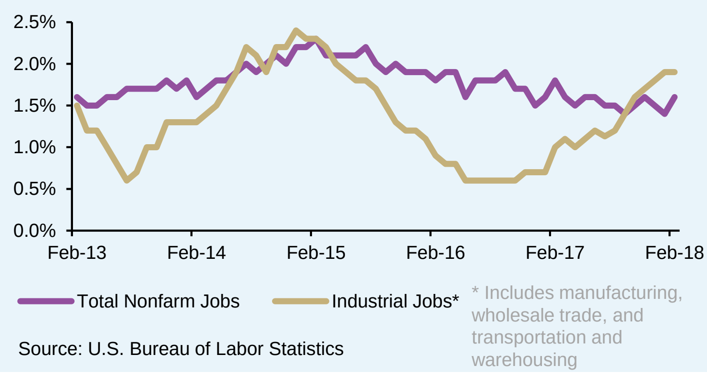
Seasonally Adjusted




Source: U.S. Bureau of Labor Statistics

### Payroll Employment

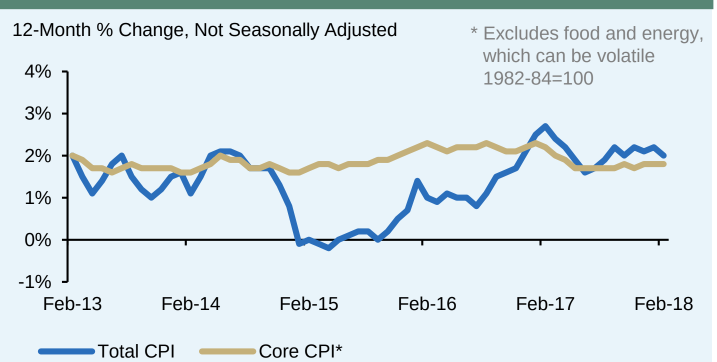
12-Month % Change, Not Seasonally Adjusted




Source: U.S. Bureau of Labor Statistics

### Consumer Price Index (CPI)

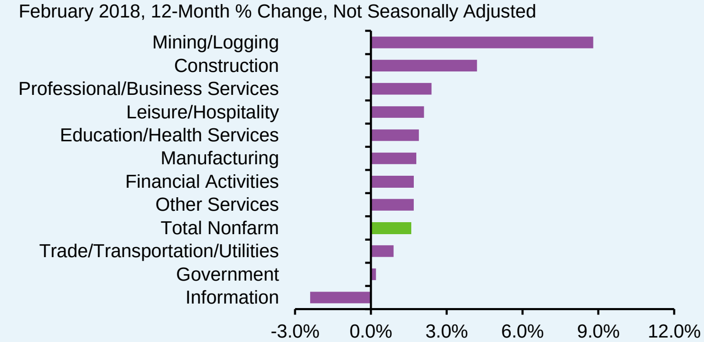
12-Month % Change, Not Seasonally Adjusted




Source: U.S. Bureau of Labor Statistics

### Employment Growth by Industry

February 2018, 12-Month % Change, Not Seasonally Adjusted



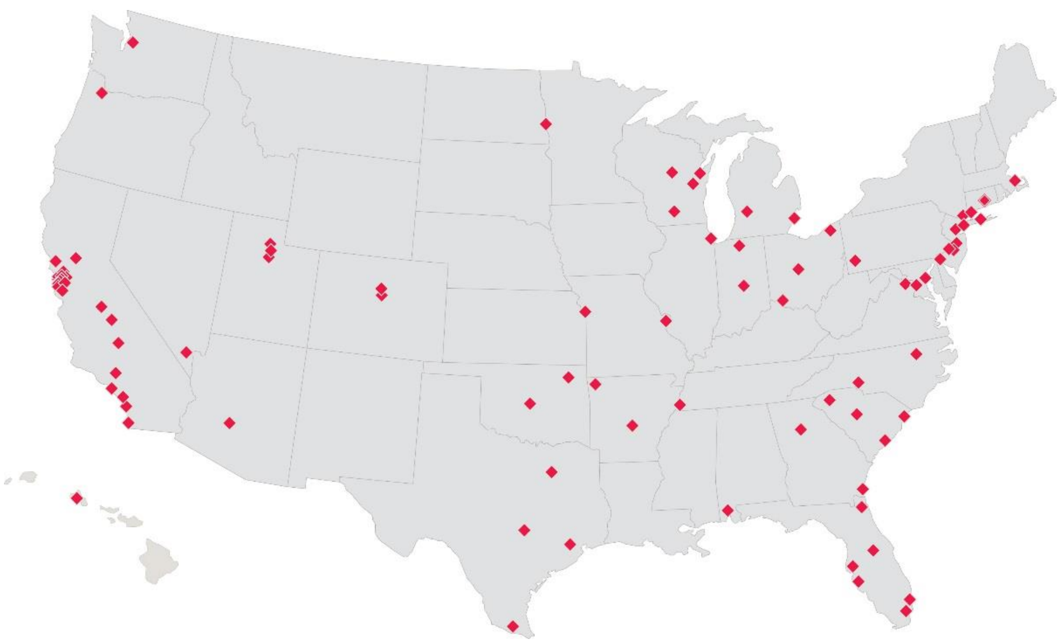

Source: U.S. Bureau of Labor Statistics

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

**Jonathan Mazur**
Senior Managing Director
212.372.2154
jmazur@ngkf.com

**Alexander (Sandy) Paul, CRE, LAI**
Senior 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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