BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

SPECIAL REPORT INDUSTRIAL

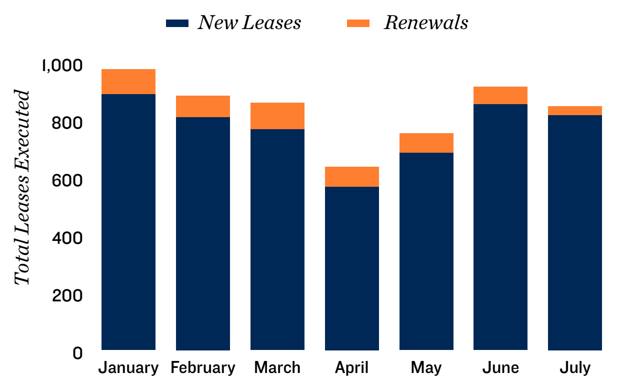
THIRD QUARTER 2020

Health Crisis Bolsters Industrial Outlook; Changing Behavior Accelerates Preexisting Trends

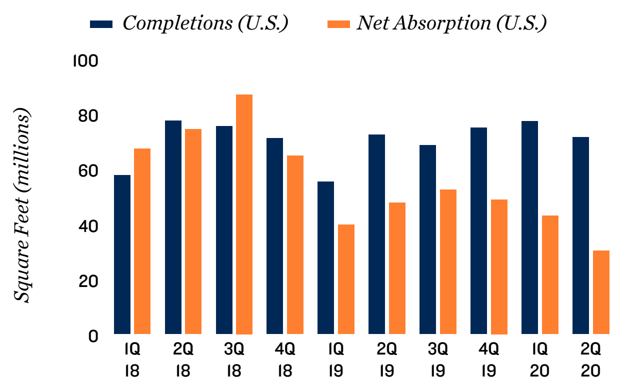
Sector's outlook strengthened. The industrial market enters the second half of 2020 well positioned to record increased demand for available space and inflows of investor capital. Supported by a surge in online spending, renewed factory production and global trade improvements in May and June, the sector registered encouraging performance during the volatile second quarter. Nationwide, roughly 30 million square feet was absorbed during the three-month window, with more than 2,000 new leases executed involving spaces larger than 10,000 square feet. This activity, however, was outpaced by the delivery of more than 70 million square feet of space, equating to a 30-basis-point uptick in quarter-over-quarter vacancy. Still, the vacancy rate ended June 100 basis points below the 10-year average of 6.5 percent, backed by half the nation's major metros recording a decline or nominal gain in second quarter vacancy. The combination of tenant demand for available space, newer buildings entering the market and tight conditions benefited average asking rents in most markets from April to June, pushing the national marketed rate to a record high. Asking rent growth may further elevate during the remainder of the year as preliminary leasing activity for the third quarter suggests industrial tenants are scooping up available square footage at a pre-pandemic pace.

Investors view industrial as a safer option. Bullish on the stability already demonstrated by the sector, investors with a focus on minimizing their risk exposure pursued industrial assets over other property types during the second quarter. Private buyers remained comparatively active across the nation, as most sales fell in the $1 million to $10 million price tranche, netting a mid-7 percent average cap rate. Secondary markets recorded the least fluctuation in quarter-over-quarter closings. Phoenix and Denver, metros slated to benefit from population migration to locales of lower density, registered some of the highest transaction totals among non-primary markets. Minneapolis, home to extremely low vacancy, and life science hub San Diego also accounted for notable percentages of secondary market sales activity. Deal flow in primary and tertiary metros was down by roughly 40 percent in each on a quarterly basis. Top markets for absorption and construction, the industrial hubs of Dallas/Fort Worth, Houston and the Inland Empire continue to garner significant attention, while buyers seeking lower operating costs have targeted smaller Midwest cities along Interstate 70.

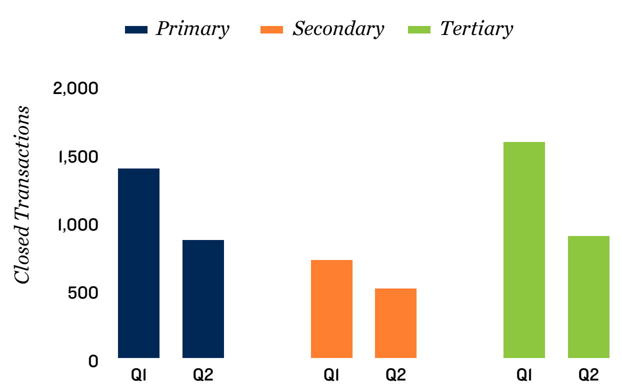
Industrial Leasing Rebounds During Summer*



Steady Completions Outpace Positive Absorption



Health Crisis Alters Deal Flow Across Markets



** Leases for 10,000-plus square feet*
Source: CoStar Group, Inc.

Industrial Property Performance in the Second Quarter

Region	Metro	Vacancy Rate (Q2)	Q-O-Q BPC	Net Absorption (Q2)	Average Asking Rent (Q2)	Average Price/ Sq. Ft. (T12-Q2)	Average Cap Rate (T12-Q2)
West	Los Angeles	3.4%	50	-2,551,000	$12.48	$280.26	5.3%
	Oakland	6.4%	30	-2,800	$14.52	$247.51	5.4%
	Orange County	3.4%	20	-282,000	$12.15	$256.44	4.8%
	Portland	4.2%	10	1,293,000	$8.92	$180.06	5.6%
	Riverside-San Bernardino	4.1%	-50	4,096,000	$9.01	$181.16	5.4%
	Sacramento	4.5%	0	642,000	$7.23	$129.15	6.4%
	San Diego	5.7%	20	-280,000	$15.64	$227.48	5.9%
	San Francisco	5.0%	0	883,000	$22.89	$520.21	5.0%
	San Jose	5.9%	-20	346,000	$28.03	$373.54	6.0%
	Seattle-Tacoma	5.4%	40	-1,067,000	$9.82	$258.40	5.6%
Mountain	Denver	5.9%	40	543,000	$8.60	$182.08	6.6%
	Las Vegas	6.1%	100	-770,000	$8.45	$155.73	6.2%
	Phoenix	7.8%	20	3,376,000	$7.43	$132.13	6.4%
	Salt Lake City	4.0%	20	-235,000	$6.50	$108.90	6.3%
Texas	Austin	8.0%	-10	308,000	$10.73	$136.74	6.5%
	Dallas/Fort Worth	6.9%	50	6,015,000	$5.98	$89.05	7.1%
	Houston	8.1%	30	4,363,000	$7.48	$90.05	7.1%
	San Antonio	7.4%	30	-43,000	$5.88	$101.02	7.3%
South	Atlanta	7.1%	-10	4,464,000	$4.84	$96.09	7.0%
	Charlotte	7.4%	50	-69,000	$4.83	$114.24	6.6%
	Fort Lauderdale	7.0%	70	-234,000	$9.63	$164.34	6.0%
	Miami	5.1%	60	264,000	$10.66	$177.54	6.0%
	Nashville	3.4%	50	-651,000	$5.92	$165.45	6.9%
	Orlando	7.1%	30	-136,000	$6.95	$119.64	6.8%
	Tampa-St. Petersburg	5.0%	0	1,427,000	$6.09	$88.05	7.1%
	West Palm Beach	3.9%	0	-4,100	$10.57	$175.24	6.6%
Midwest	Chicago	6.4%	10	2,939,000	$5.86	$93.61	7.1%
	Cincinnati	5.8%	50	-1,037,000	$4.39	$61.44	7.6%
	Cleveland	4.5%	20	-781,000	$3.70	$50.05	8.5%
	Columbus	7.0%	110	-124,000	$3.88	$65.05	7.8%
	Detroit	3.8%	10	-376,000	$5.99	$68.02	7.9%
	Indianapolis	4.3%	-30	2,689,000	$4.51	$69.03	7.3%
	Milwaukee	5.0%	40	-51,000	$4.52	$63.31	8.7%
	Minneapolis-St. Paul	3.8%	30	-71,000	$5.68	$88.40	7.1%
	St. Louis	5.5%	20	-364,000	$4.71	$69.14	7.4%
Northeast	Baltimore	9.7%	150	-1,300,000	$5.91	$108.15	7.4%
	Boston	5.3%	-20	1,608,000	$8.45	$163.53	7.0%
	New York City	5.1%	30	-383,000	$25.02	$441.22	4.7%
	Northern New Jersey	4.4%	0	306,000	$9.74	$153.03	6.2%
	Philadelphia	5.2%	0	540,000	$6.44	$84.21	6.9%
	Washington, D.C.	6.6%	100	-275,000	$8.69	$196.59	7.6%
	United States	**5.5%**	**30**	**30,190,000**	**$7.35**	**$96.25**	**6.9%**

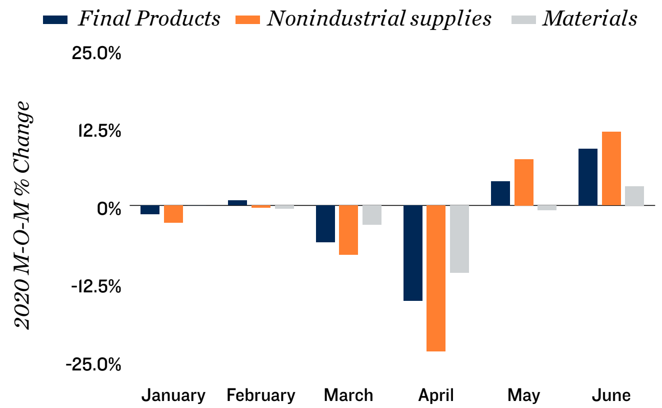
Storage and Manufacturing Demand Gain Momentum as Health Crisis Extends

Demand for supplies and finished goods storage preserved amid downturn. Manufacturers, retailers and merchant wholesalers maintained comparably sized inventories during the second quarter when compared with the same period last year, supporting demand for warehouse space. Subdued retail sales, factory closures and reductions in orders for finished products at the onset of the pandemic forced these groups to hold onto portions of these inventories longer. In June, industrial production rose across the board as did retail sales, translating to a reduction in stored up inventories. However, the widespread rise in COVID-19 case numbers recorded during July and the escalation of U.S.-China tensions may hold factory orders below pre-pandemic levels and stall short-term increases in retail sales, potentially increasing the length of time goods and supplies are stored. Additionally, panic buying recorded at the onset of the health crisis highlighted the limitations of just-in-time inventory. Retailers and suppliers have since established larger inventories of essential goods and medical products, an adjustment that will aid long-term demand for industrial space.

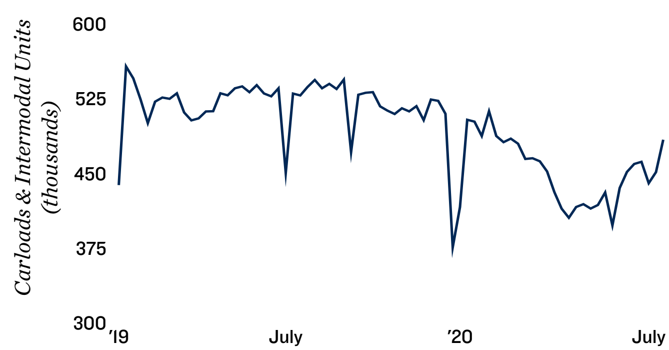
Improvements in export/import volumes and rail traffic a boon for logistics firms. After declining on a month-over-month basis during April and May, exports jumped by 9.4 percent in June and imports rose for the first time this year, by 4.7 percent. Although volumes remain significantly lower than a year ago, the increase in both categories may signal a starting point of global economic recovery. This rehabilitation could increase domestic storage demand for imported consumer goods and the warehousing and production of automotive vehicles set for export. The increase in trade volumes and domestic manufacturing production has coincided with a rise in rail carloads and intermodal unit originations. As rail traffic returns to a traditional level, logistics-related demand for warehouses near intermodal yards may improve.

Increased focus on domestic manufacturing to impact industrial sector long term. While U.S. export and import volumes were encouraging in June, the global supply-chain disruptions that emerged at the beginning of the second quarter accelerated organizations' reshoring plans. The growing number of companies considering this supply-chain realignment indicates rising user demand for automated production space may be on the horizon. Investors may respond by acquiring facilities or land zoned for this type of development. Secure supply chains in communications infrastructure, packaged food production, defense-contract applications and pharmaceuticals are logical next reshoring opportunities; however, relocating operations is a longer-developing trend that will take years to realize.

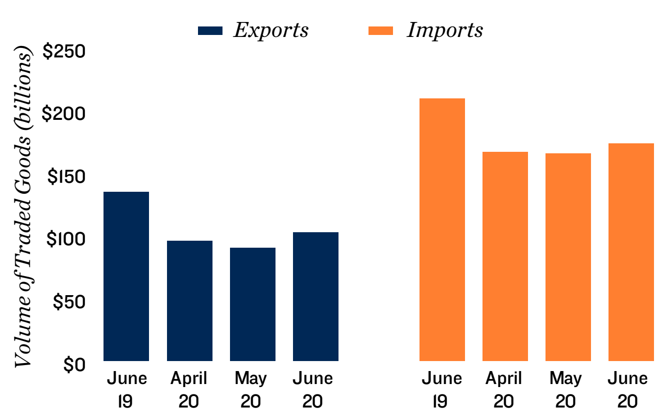
Production Rises Among Major Market Groups



U.S. Rail Traffic Impacted by Health Crisis



U.S. Trade Improves, Still Down on Y-O-Y Basis



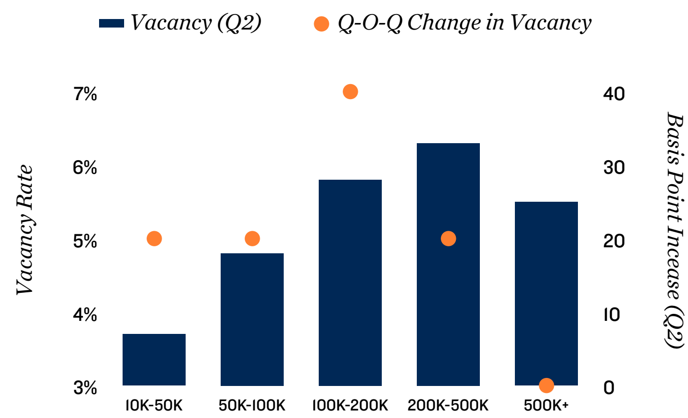
Sources: Board of Governors of Federal Reserve System; Association of American Railroads; U.S.. Census Bureau

Retailers Upgrade Rapid Delivery Capabilities, Lifting Demand for Limited Inventory of Smaller Warehouses

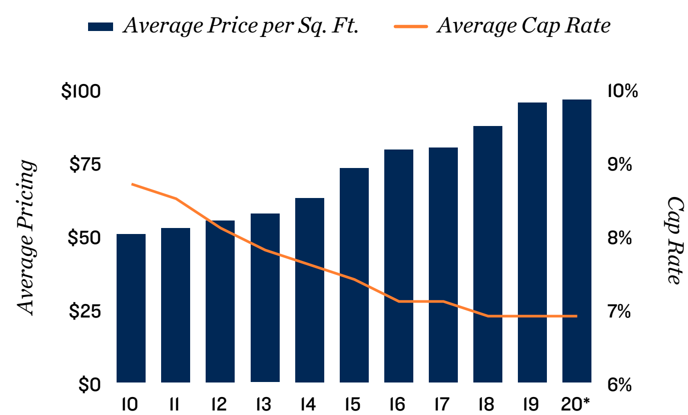
Grocers and discount stores bolster distribution presence near households. The increasing usage of online platforms for shopping during the second quarter has expedited consumers' order processing expectations. In response, grocers and other necessity-based retailers with an omnichannel presence have begun to lease supplementary last-mile facilities in both urban and suburban settings, allowing these companies to shorten the order-to-delivery window. Properties near population centers able to handle high volumes of perishables have seen rising demand from grocers and discount retailers. Dollar General recently announced plans to expand its distribution presence by leasing three cold-storage facilities. Albertsons, Shoprite and other regional grocers are turning to highly automated, micro fulfillment centers that accelerate the order picking process. Similar last-mile warehouses could be leaned on by Walmart and other large retailers that plan to offer subscription-based models guaranteeing same-day delivery.

Smaller facilities become a rarity. As the year progresses, competition for smaller warehouses will intensify as nonessential retailers attempt to secure space near population centers prior to the holiday shopping season. Additionally, brick-and-mortar shops processing a higher number of in-store and curbside pickup orders may require nearby storage to quickly replenish stock when spikes in purchases occur. The expected surge in demand for last-mile facilities is likely to shrink what is already a limited volume of vacant, smaller warehouse space. Entering the second half of 2020, vacancy in the 10,000- to 100,000-square-foot segment was sub-5 percent on a national level, with properties in this size range accounting for more than 10 billion square feet of industrial inventory. While the construction of smaller facilities appears warranted, in many cases a lack of available land in population centers will prevent this from occurring, creating potential opportunities to convert office or retail properties into single and multi-tenant industrial facilities.

Vacancy Adjusts Minimally Across Property Types



Pricing Rises, Cap Rates Adjust Nominally in Q2



*Trailing 12 months through second quarter
Source: CoStar Group, Inc.

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Sources: Marcus & Millichap Research Services; Association of American Railroads; Board of Governors of Federal Reserve System; CoStar Group, Inc.; Real Capital Analytics; U.S.. Census Bureau