Deutsche Asset Management

U.S. Industrial Market Snapshot

Fourth Quarter 2016

Marketing Material

— The U.S. industrial market is performing as well as it ever has since the1990's. Broadly across most markets nationally, industrial fundamentals ended 2016 very strongly. Availability rates continued their decline on robust demand that continued to outpace new supply, supporting accelerated rent growth.[1]

— The industrial sector outperformed the NCREIF NPI by a wide margin for the trailing four quarters in 2016 Q4. Its 12.3% total return for 2016 beat NPI by 330 basis points, besting all other sectors and achieving an income return of 5.3%, an appreciation return of 6.8% and NOI growth of 7.4%.[2]

— U.S. average per square foot pricing continue to increase, but total industrial investment volume receded from the 2015 record peak. Average going-in cap rates stabilized during the year about 20 basis points below 2015 levels.[3]

— Average effective rent growth surged to a cyclical high, growing on average 6.6% for the full year 2016, building upon the combined 12% gain achieved in the two years ending 2015.[4]

— Market rent growth has become more varied across markets, as new speculative supply has risen across a greater number of low-barrier Regional Hub markets. Eleven markets posted double-digit market rent gains, while nine markets had either market rent declines or year-over-year growth of 2% or less.[5]

— The U.S. availability rate is at the lowest point since 2000, ending the fourth quarter of 2016 at 8.2%, while the national vacancy rate was just 4.9%, equally historic since 2000.[6] Most markets had single-digit availability rates and nearly all were well below their long term average rate.

— Industrial space demand has been consistently strong since late 2012, with net absorption averaging 264 million square feet per year in the four years ending 2016 [7]. The pace of demand has outstripped its traditional drivers in this period, lifted significantly by e-commerce and rapid fulfillment initiatives currently underway in the retail sector. [8]

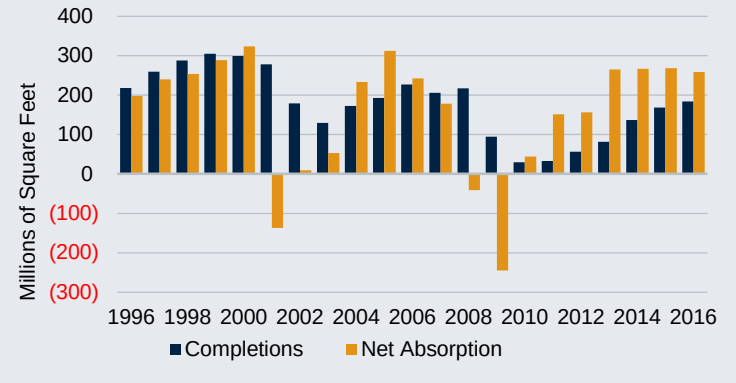
— Construction is ramping up, with deliveries of 184 million square feet in 2016 plus an estimated 200 million square feet underway and potentially deliverable in next 12 to 18 months.[9]

Metro Market Health Indicators by Market Type

Data as of 2016Q4		Availability (%)		Year-to-date	
Market	Type	'16Q4	LT Avg	Demand/ Supply Ratio	% Rent Change
Houston	Gateway	9.3	9.0	0.3	(5.0)
Los Angeles	Gateway	3.9	5.9	1.2	7.9
New York Reg.	Gateway	7.9	10.3	4.9	10.6
Oakland	Gateway	5.8	10.5	1.7	16.3
Orange County	Gateway	4.4	7.4	2.4	13.0
Riverside	Gateway	7.5	10.0	0.8	9.0
Seattle	Gateway	4.3	8.1	2.1	5.7
Atlanta	Nat. Hub	9.7	13.8	1.1	10.3
Chicago	Nat. Hub	10.0	11.3	1.0	3.6
Dallas/Ft. Worth	Nat. Hub	8.8	11.2	1.2	8.5
Allentown	Reg. Hub	7.7	9.7	1.1	11.8
Cincinnati	Reg. Hub	9.0	9.0	0.9	3.1
Columbus	Reg. Hub	8.2	11.7	1.8	1.6
Indianapolis	Reg. Hub	7.8	9.9	2.4	0.7
Kansas City	Reg. Hub	8.4	8.2	0.7	(1.7)
Memphis	Reg. Hub	11.3	16.8	3.1	11.6
Philadelphia	Reg. Hub	10.1	11.7	2.6	5.6
Harrisburg	Reg. Hub	7.3	11.0	2.7	11.8
Austin	Local	7.6	11.3	0.7	5.3
Baltimore	Local	11.9	13.8	3.5	2.7
Boston	Local	11.3	13.5	3.6	3.5
Charlotte	Local	6.3	11.2	2.1	(0.2)
Denver	Local	7.1	9.9	0.4	4.8
Fort Lauderdale	Local	7.2	9.4	3.2	11.4
Miami	Local	7.3	9.0	0.9	24.8
Minneapolis	Local	6.9	7.9	2.1	(2.3)
Orlando	Local	8.3	10.6	4.4	2.0
Phoenix	Local	11.6	12.3	1.5	6.8
Portland	Local	4.8	8.0	2.1	2.0
San Diego	Local	8.0	10.4	1.0	6.5
San Jose	Local	8.3	11.1	(0.7)	11.5
Washington, DC	Local	11.3	12.0	1.3	1.5
US Total		8.2	10.4	1.4	6.6

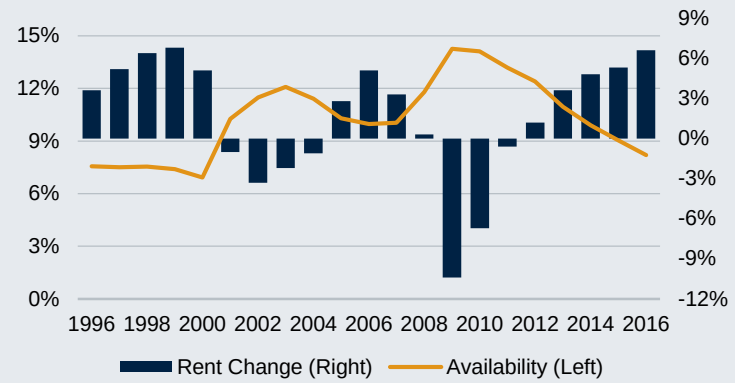
Sources: CBRE-EA, and Deutsche Asset Management
Color indicators: Green – Strong; Orange – Moderate; Red – Weak

U.S. Demand and Supply Trends are Healthy



Sources: CBRE-EA and Deutsche Asset Management. As of December 2016. Forecasts are based on assumptions, estimates, opinions and hypothetical models or analysis which may prove to be incorrect.
Past performance is not indicative of future returns.

Effective Market Rent and Availability Trends



Sources: CBRE-EA, and Deutsche Asset Management. As of December 2016.

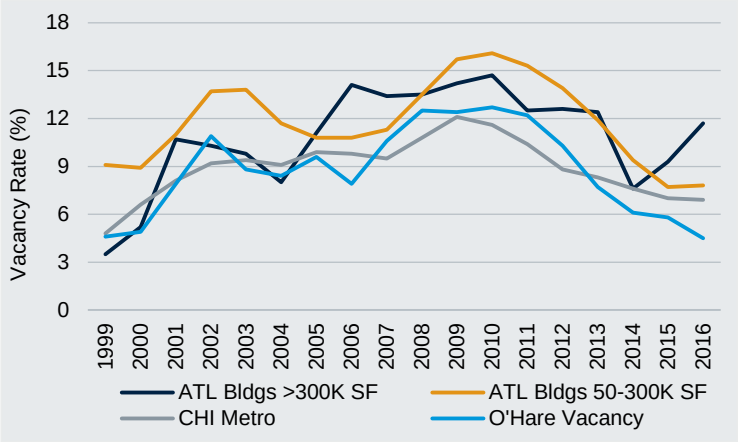
The Implications of a Deepening Development Cycle

— New speculative supply changes landlord/tenant leverage. As speculative construction rises a typical dynamic emerges: moderating vacancy declines and rent growth in low-barrier markets, and lower vacancy rates and higher rent growth in high-barrier markets.[10] This dynamic began to take shape in 2016. Even so, some low-barrier markets posted high rent growth during the year, including Atlanta, Dallas and Allentown/Harrisburg.

— Infill locations and smaller buildings should outperform. Not all property type segments and submarkets are experiencing elevated new supply. Small-bay warehouse (less than 200,000 square feet) and infill submarkets have not had as much construction in the past two years, resulting in lower vacancy rates and potentially better rent growth dynamics.[11]

— Case in point: Chicago and Atlanta segments. The following chart exhibits vacancy trends in Atlanta for smaller versus larger buildings. Robust development of large-bay warehouse buildings has lifted vacancy in the past year. Conversely, relative supply constraints and strong demand in Chicago's O'Hare submarket has allowed it to outperform average metro vacancy.[12]

Vacancy Trends in Atlanta and Chicago



Sources: CoStar Analytics and Deutsche Asset Management. As of December 2016.

Structure and Economic Drivers

— The economic drivers of space demand remain supportive of the industrial sector. Although U.S. GDP has been relatively weak in this growth cycle, averaging just 2.3% from 2013 through 2016,[13] other factors have lent meaningful support to space demand. The rapid growth of online retail sales, 15.7% YOY through the third quarter of 2016,[14] has stimulated warehouse demand. The need to ramp up rapid fulfillment and reverse logistics capabilities has increased need for warehouse space at closer in locations of major metropolitan areas as well as at national and regional hubs. Recent forecasts estimate that online retail sales may continue to capture a growing share of total retail sales,[15] so this dynamic of robust demand will likely be a durable one.[16]

— In the four years ending 2016, the U.S. industrial market has absorbed more than one billion square feet of industrial space, about 260 million square feet per year.[17] During the same period the U.S. has added about 10 million new jobs and U.S. personal incomes have risen about 13%, and median home values are up about 30%. U.S. consumer confidence is at cyclical highs.[18] All of these factors plus the structural shift taking place in the retail sector point to favorable conditions for the industrial sector.[19]

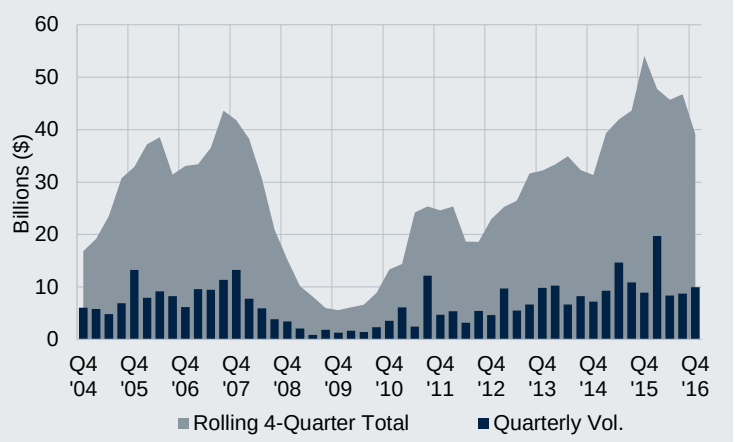
Capital Markets Activity

— The industrial sector continued to attract intense interest among investors, although the volume of sales has eased compared to 2015. Recent data from RCA reflect industrial investment sales activity of $39.1 billion in 2016. Although this is well below 2015's record $54 billion, when several large portfolios transacted, it is 25% higher compared to 2014 and above the $36 billion annual average since 2012.[20]

— Prices continued to rise in 2016, as investors drove per square foot prices higher and going-in cap rates lower. Average sale prices in 2016 for transactions larger than $10 million reached $82 per square foot for warehouses (up 8.5%) and $93 per square foot for all industrial properties. [21] The trends (below) reflect robust price gains since the very early stages of recovery.

— Average warehouse cap rates began to stabilize in 2016, settling 20 basis points lower than in 2015, around 6.3% for the past four quarters. However, the top quartile of transactions reflected a much lower average cap rate of 5.5% in the 12 months ending December 2016. [22]

Capital Markets Pricing and Volume



Sources: Real Capital Analytics and Deutsche Asset Management As of December 2016.

Warehouse Price/SF and Cap Rates (quarterly averages)

Sources: Real Capital Analytics and Deutsche Asset Management. As of December 2016. Forecasts are based on assumptions, estimates, opinions and hypothetical models or analysis which may prove to be incorrect. Past performance is not indicative of future returns.

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[1] CBRE-Economic Advisors data as of 9/30/16 and Deutsche Asset Management
[2] NCREIF, 4Q 2016
[3] Real Capital Analytics Trends and Trades Report, 4Q2016
[4] CBRE-Economic Advisors, 12/31/2016
[5] CBRE-Economic Advisors, 12/31/2016
[6] CBRE-Economic Advisors, 12/31/2016
[7] CBRE-Economic Advisors, 12/31/2016
[9] Deutsche Asset Management
[9] CBRE-Economic Advisors, 12/31/2016
[10] Deutsche Asset Management
[11] CoStar data as of 12/31/16 and Deutsche Asset Management
[12] CoStar data as of 12/31/16 and Deutsche Asset Management
[13] Moody's Economy.com data as of December 2016
[14] Department of Commerce and Internet Retailer, Third Quarter 2016
[15] Internet Retailer, Third Quarter 2016 and Deutsche Asset Management
[16] Deutsche Asset Management
[17] CBRE-Economic Advisors, 12/31/2016
[18] Moody's Economy.com data as of December 2016
[19] Deutsche Asset Management
[20] Real Capital Analytics Trends and Trades and US Capital Trends, 4Q2016
[21] Real Capital Analytics Trends and Trades and US Capital Trends, 4Q2016
[22] Real Capital Analytics Trends and Trades and US Capital Trends, 4Q2016

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