MSCI

INDUSTRIAL IN THE LIMELIGHT: SECULAR SHIFT OR CYCLICAL ROTATION?

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July 2018

CONTENTS

EXECUTIVE SUMMARY

In 2017, industrial real estate had a banner year with the highest sector total returns across many global markets. Conversely, the retail sector was frequently the biggest underperformer in the same markets. These diverging trends are often attributed to the growing penetration of e-commerce, but traditionally higher yielding real estate sectors, such as industrial, usually outperform in the later stages of the cycle. So is this just a rerun of industrial's normal cyclical rotation, or are there signs that a secular revolution is starting to impact the real estate sectors?

Given the current competitive real estate landscape, yield-starved investors have undoubtedly turned their attention to industrial real estate in the search for higher income and potential value appreciation. But we also find evidence from many global markets that the demand for industrial real estate has intensified with the growth of e-commerce: The spread in yields between industrial and the other commercial real estate sectors has compressed more over recent years than in previous cycles. In the U.K., the spread between industrial and office yields has even turned negative, an unparalleled event historically.

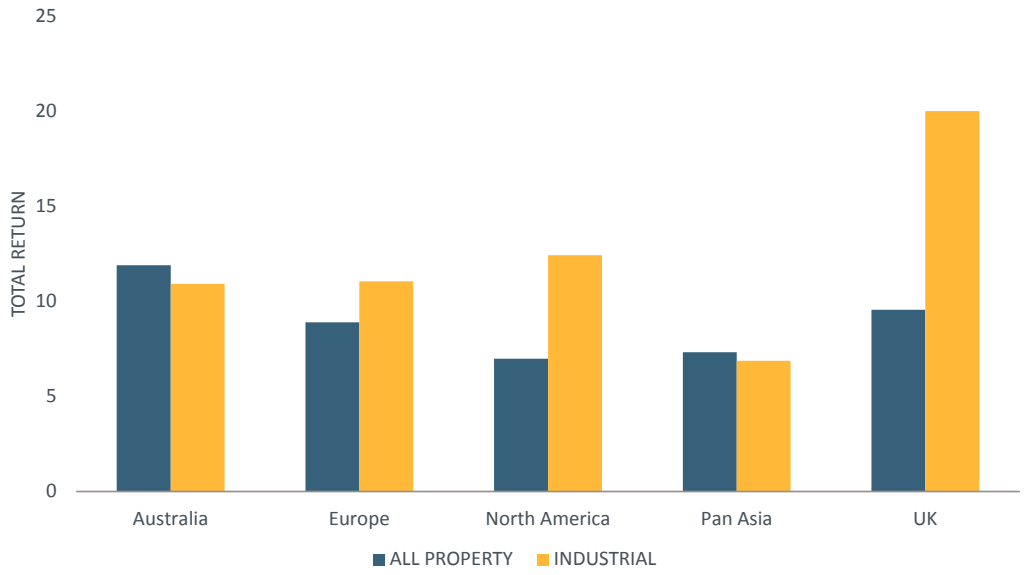
Focusing specifically on the U.K., where industrial outperformance has recently been the most pronounced and e-commerce penetration is particularly strong, it is clear that while a cyclical rotation may be contributing to the increase in investment demand, evidence also suggests secular changes have had an impact on performance. Here the range of industrial asset performance in 2017 was much wider than for other sectors. Most notably, those assets exposed to logistics- and distribution-related tenants, those with multi-tenanted, diversified income streams, and those located in or around London, performed well relative to industrial sector averages.

While retail-related warehousing and distribution has long been a significant component of industrial property demand, the evolution of distribution networks to service e-commerce is having an obvious impact on the quantity and nature of industrial property now required.

GLOBAL INDUSTRIAL PERFORMANCE

In 2017, the industrial sector was the leading performer on a total return basis across the majority of global markets. Comparing industrial performance to the broader market, the margin of outperformance for industrial was greatest in the U.K., at 936 basis points (bps), followed by the U.S. at 524bps. On a regional basis, Europe was the strongest performing region (driven, in part, by the strength of the U.K. industrial market). Europe was followed by North America, with Asia Pacific (APAC) trailing. Industrial outperformance was less pronounced in the APAC region.

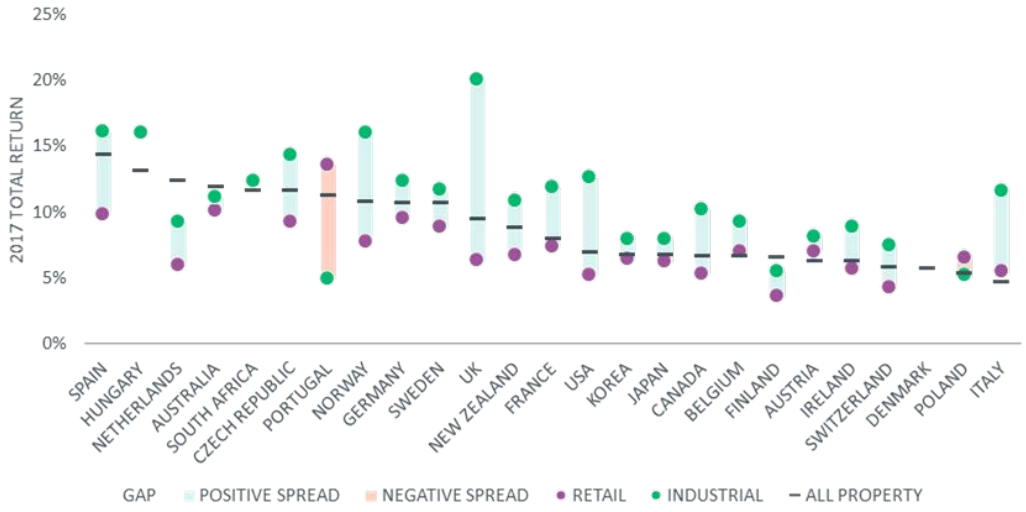
Exhibit 1: 2017 All Property and Industrial Performance by Region



Although the industrial outperformance was a broadly based global trend in 2017, industrial underperformed the wider market in a number of countries. These included the Netherlands, Australia, Portugal, Finland and Poland. Much of the commentary around the strength of industrial returns cites the positive tailwinds associated with e-commerce. While these e-commerce trends have been positive for industrial, they have also been a major driving force behind the relative weakness of the retail sector. Exhibit 2 plots industrial and retail total returns against the all property averages to highlight this tension. Is this a case of retail's pain becoming industrial's gain? The strength of industrial relative to retail is even

starker. Even in markets where industrial has underperformed the broad market average, it still tended to outperform retail. Only in Portugal and Poland was this not the case.

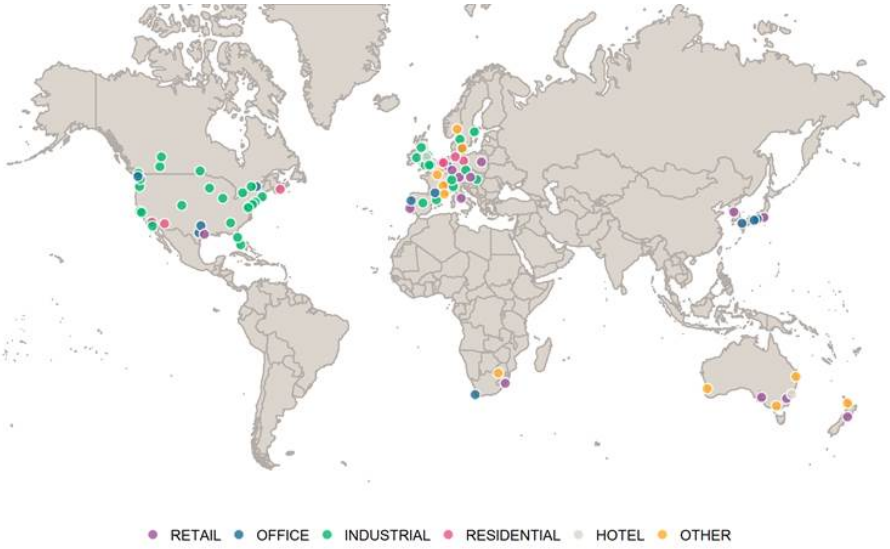
Exhibit 2: Industrial-Retail Total Return Spreads across Global Markets



Source: MSCI Global Intel

Turning to a more granular, city level analysis, Exhibit 3 highlights the best performing sectors by city in 2017. Industrial was a top performer in the majority of North American cities and in many European cities, too. In contrast, industrial was not the top-performing sector in any of the major APAC cities tracked. This was unsurprising for Australia, where industrial lagged the other sectors at a national level. However, in Korea and Japan, industrial was the top-performing sector nationally, but not in any of the cities tracked. This suggests industrial outperformance was an "ex-urban" phenomenon for the assets measured in these countries. This was not the case for North America and swathes of Europe. In the U.S. and Canada, most cities saw strong performance from industrial, suggesting an urban element to the story. We observed this in the U.K. and parts of Europe.

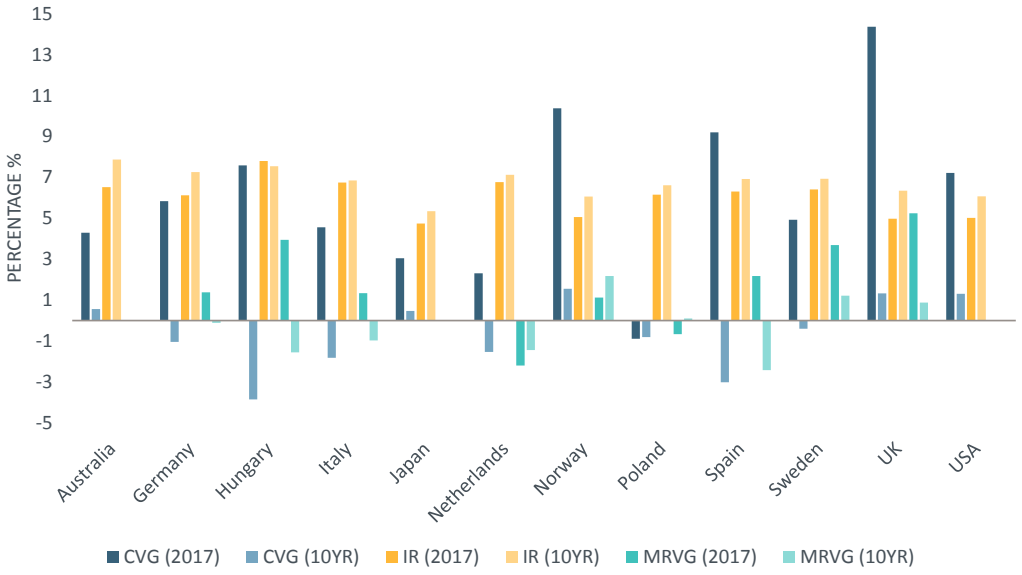
Exhibit 3: 2017 Best Performing Sector by City



Source: MSCI Global Intel

Exhibit 4 illustrates the components of industrial total returns across global markets. For most markets, capital growth was significantly higher in 2017 versus the 10-year average. Meanwhile, income returns were generally lower, indicating that yield compression was a significant driver of growth. In many markets, we can also track market rental value growth, allowing us to gauge how much value appreciation was driven by fundamental demand growth rather than investor sentiment. Industrial property has generally shown lower rates of rental growth due to its relatively elastic supply, the result of easy construction. However, in 2017 we saw meaningful levels of rental growth in some markets, as well as evidence of significant yield compression. The U.K. in particular stands out, but there was also strong rental growth in Sweden, Spain and Hungary relative to their 10-year histories.

Exhibit 4: Global Industrial Market Returns (Income vs Capital Growth)



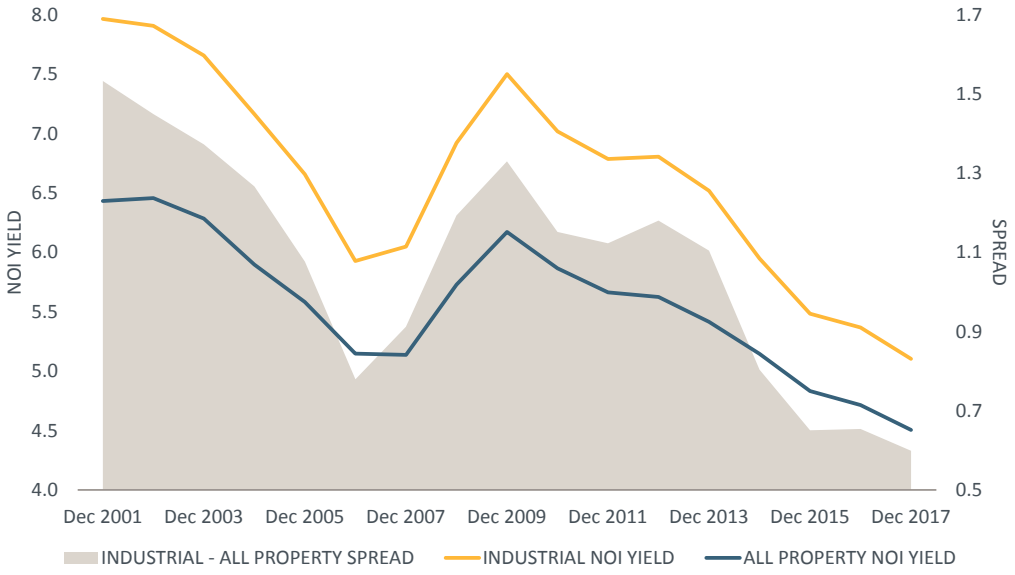
Source: MSCI Global Intel

Focusing on yields in more detail, Exhibit 5 shows industrial net operating income (NOI) yields at an aggregate global level versus the all property average. A steady downward trend in yields is clear across both the industrial sector and the broad all property aggregate. After the repricing that followed the global financial crisis, loose monetary policy across the globe drove interest rates down to record lows with property yields following closely. Given this backdrop, it is unsurprising that NOI yields reached record lows by the end of 2017, irrespective of market or sector.

However, while NOI yields have compressed to historic lows for both industrial and the all property average, the yield spread between them has narrowed further than in previous cycles. The average spread dating back to Dec. 2001 is 107bps. This reflects the relative pricing of the industrial sector versus all property. Typically, industrial property has offered a yield premium to the other property sectors. This may be justified based on risk premium – for example, because industrial property is commonly located in more peripheral locations that may warrant such a risk premium. The spread may also be justified by the traditionally lower rental growth offered by the sector. Industrial property can usually be built more cheaply and quickly than other property types, meaning that supply has been more elastic and has responded more rapidly to rising rents.

Pricing for such traditionally higher yielding sectors has often compressed toward the other sectors in the later stages of the capital markets cycle. As pricing has tightened at the aggregate level, investors have tended to search for higher yielding investments in traditionally "unloved" parts of the market. Ahead of the financial crisis in Dec. 2006, the industrial- all property spread narrowed to 78bps, below the long-run average of 107bps and substantially less than c.150bps and c.130bps recorded in the pricing corrections of 2001 and 2009. At its latest reading in December 2017 the spread had narrowed to just 60bps, 18bps shy of the previous cyclical low. Historical evidence suggests current industrial pricing is tighter relative to other property sectors than in previous cycles and could suggest something more than a simple cyclical rotation.

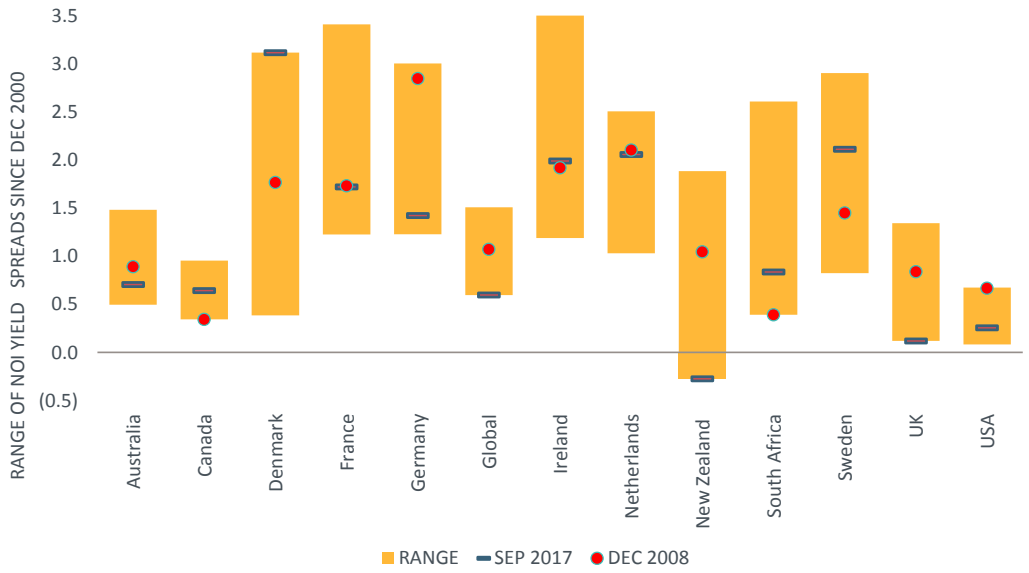
Exhibit 5: Industrial vs. All Property NOI Yields and Spreads - IPD Global Property Index



Source: MSCI Global Intel

Exhibit 6 compares industrial-all property NOI yield spreads with their historical ranges at a national market level. This shows how widespread was the trend toward a narrow yield spread in 2017. The vertical bars illustrate the historical range of the industrial-all property spread for each country, overlaid with the latest reading and the previous cyclical low. While not ubiquitous, the tight relative pricing of industrial has been widespread across major property markets around the world.

Exhibit 6: Range of NOI Yield Spreads Since December 2000



Source: MSCI Global Intel PLUS

While the latest spreads were at the lower end of their historical ranges in most markets, Denmark, the Netherlands and Sweden were notable exceptions. Of these, the Netherlands and Sweden have performed strongly across all sectors in the last couple of years following a period of underperformance, reflecting somewhat delayed cycles relative to their global peers. This in itself may provide some support for the cyclical rotation argument.

High-level trends across global industrial markets do provide some evidence suggesting that recent industrial performance may have been driven by more than regular cyclical sector rotation and the search for yield. The relative pricing of industrial has been tighter than usual in many markets, while rental and income growth have been more prominent contributors to capital growth than usual in a number of markets.

Of all the markets examined, the U.K. stands out for the degree of industrial sector outperformance and its particularly compressed pricing. For that reason, the remainder of this paper will focus on a more detailed analysis of the U.K. market.

THE UK STANDS OUT IN MORE WAYS THAN ONE

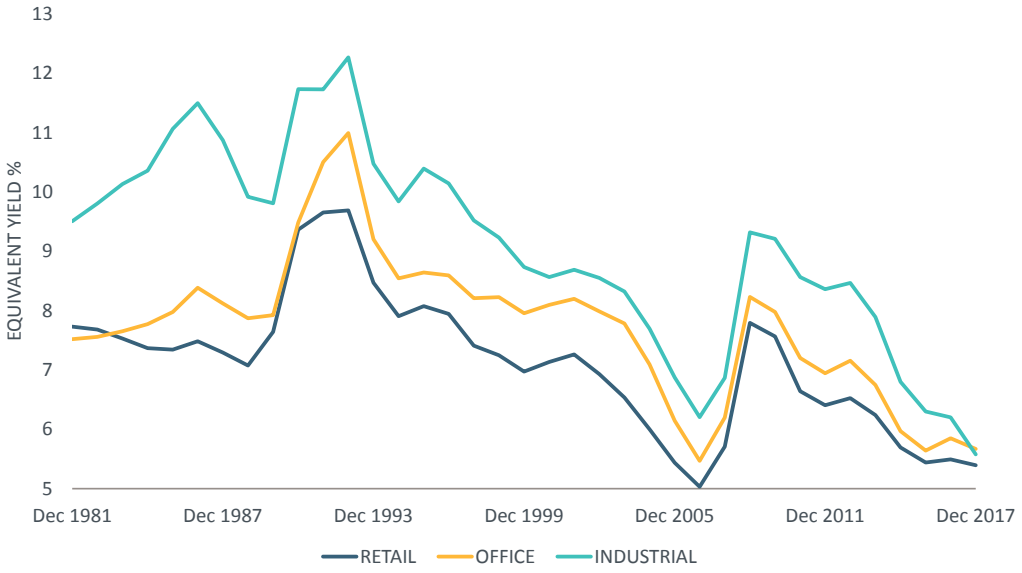
The U.K. market stands out for a number of reasons. First, the U.K. witnessed the strongest industrial performance across all markets, in absolute terms, as well as relative to other property market sectors. And while average U.K. industrial performance was strong, the dispersion of asset returns was far wider than in other sectors. Finally, retail performance in the U.K. has been particularly weak. The divergence between industrial and retail returns has been particularly stark, perhaps unsurprisingly given the relatively deep penetration of online sales in the retail market. For these reasons, the U.K. provides an interesting case study for exploring the extent to which industrial performance is being driven by a structural shift in retail logistics versus a more normal rotation of investment into higher yielding real estate sectors.

PRICING

We already have seen how strong industrial performance was relative to the other property sectors in 2017. But just how unusual was this degree of outperformance for the U.K. market? To explore this further, we turn to time series data of equivalent yields. Equivalent yields are a commonly quoted valuation yield used in the U.K. market. Rather than solely relying on trailing NOI in their numerator, they incorporate a forward-looking element, accounting for the reversionary potential within a property's lease structure.

In the later stages of previous cycles, U.K. industrial equivalent yields compressed toward those of other property sectors in a similar pattern to global NOI yield trends. But astonishingly, U.K. industrial equivalent yields have recently dipped below those of the office sector. While the spread has compressed in the past, it has never reversed. It appears that the traditional hierarchy of sector yields has been disrupted. The acceleration and the collapse of the spread of industrial yields with both the office and retail sectors suggests that a more secular change may have been the catalyst, rather than just investors searching for a yield play.

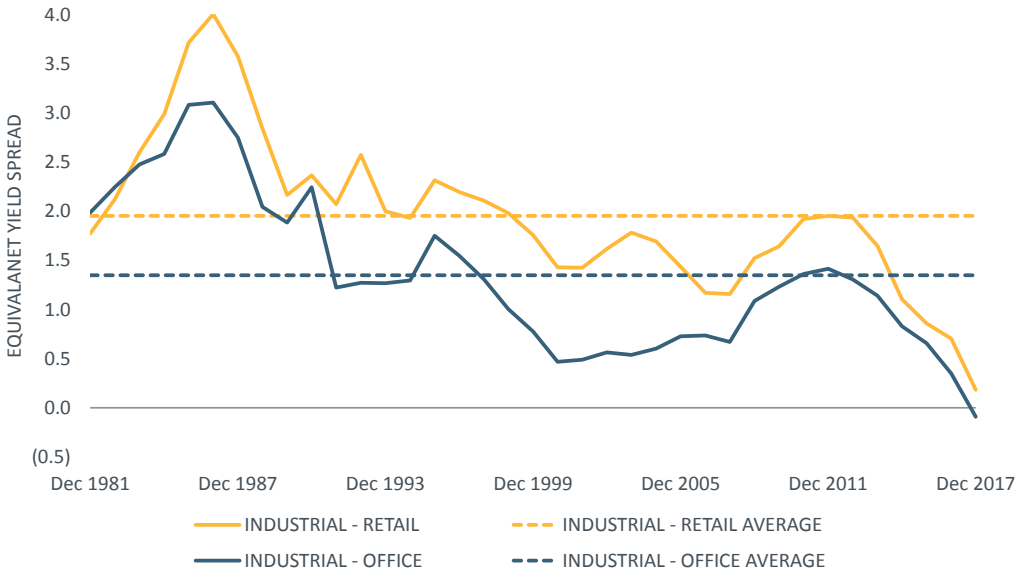
Exhibit 7: UK Equivalent Yields over Time, by Sector



Source: MSCI Global Intel PLUS

This equivalent yield data suggests that there may be more to the current strength of the industrial market than the usual late-cycle search for yield. Putting the sector equivalent yield spreads into their long-term context, Exhibit 9 shows how far industrial-office and industrial-retail spreads have compressed since Dec. 1980, relative to their historical average. The industrial-retail spread has approached zero while the industrial-office spread has reversed.

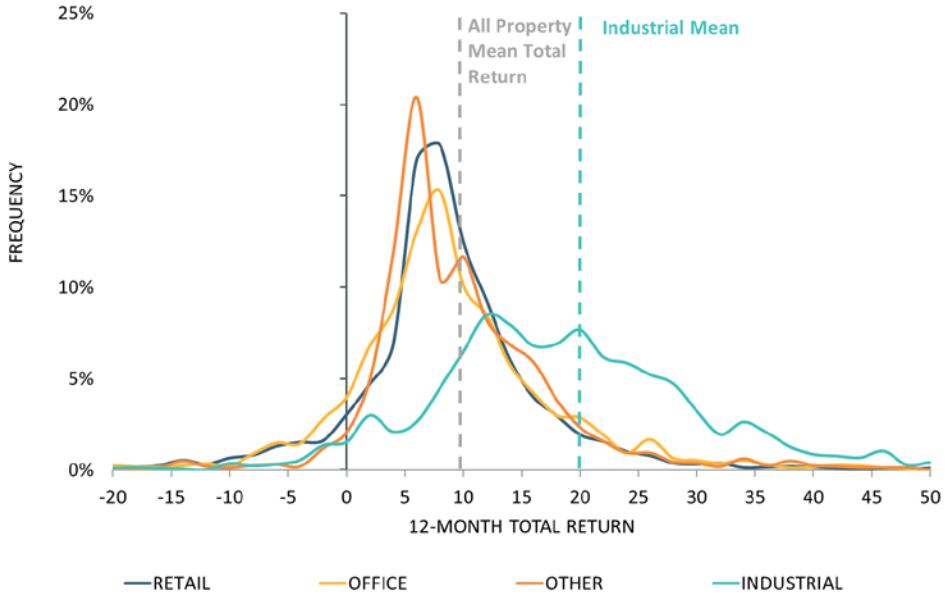
Exhibit 8: Historical and Average Equivalent Yield Spreads



UK INDUSTRIAL PERFORMANCE: OUTSIZED AND DIVERSE

Exhibit 10 compares the performance of the industrial sector with other real estate sectors. Over the 12 months ended Dec. 2017, the U.K. industrial sector was clearly the leading performer, with the average return just under 20%. Performance for all property was close to half that figure at just 10%. The performance of industrial was itself a strong driver of that average, with the other sectors delivering returns in the mid to high single digits. There was a significant positive skew to the industrial performance distribution with 85% of industrial assets (by number) providing double-digit returns. More than 5% of industrial assets provided a return of 25% or higher.

Exhibit 9: Distribution of 2017 Return by Sector – UK Quarterly Index



Source: MSCI Global Intel PLUS

The degree of industrial outperformance is just one interesting feature of the chart above. The shape of the distribution is also significant. The dispersion of returns in the U.K. industrial sector was far broader than for other sectors, which all had similar shaped distributions with a much tighter central tendency around the average performance. The next section of this paper examines industrial performance using a more detailed segmentation with the aim of explaining the range of performance in the sector.

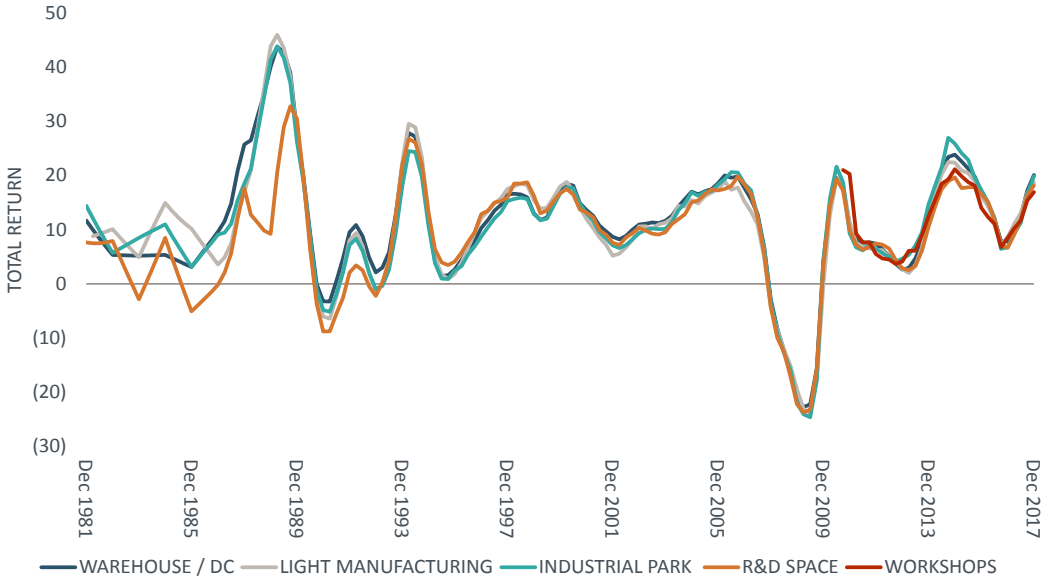
NOT ALL INDUSTRIAL REAL ESTATE IS CREATED EQUAL

MSCI provides a more detailed standard segmentation of industrial assets across global markets, splitting it into six segments: warehouse/distribution centers, heavy manufacturing, light manufacturing, research and development (R&D) space, industrial parks and workshops.[1] Ignoring the early years of the time series when sample sizes were

[1] Detailed definitions can be found on page 66 of MSCI Global Data Standards for Real Estate Investment, available on msci.com

small due to limited investment in the sector, total returns to these segments were largely in line throughout the late 1990s and early 2000s. Their performance was very similar through the global financial crisis and the initial recovery, when correlations across most asset classes spiked due to the nature of the crisis. Only since 2010 has more performance variation started to appear. A bifurcation emerged in 2011/2012, with warehouse/distribution centers and industrial parks outperforming all other industrial subtypes. These are the segments most associated with the changes that have occurred in retail distribution driven by the growth of e-commerce.

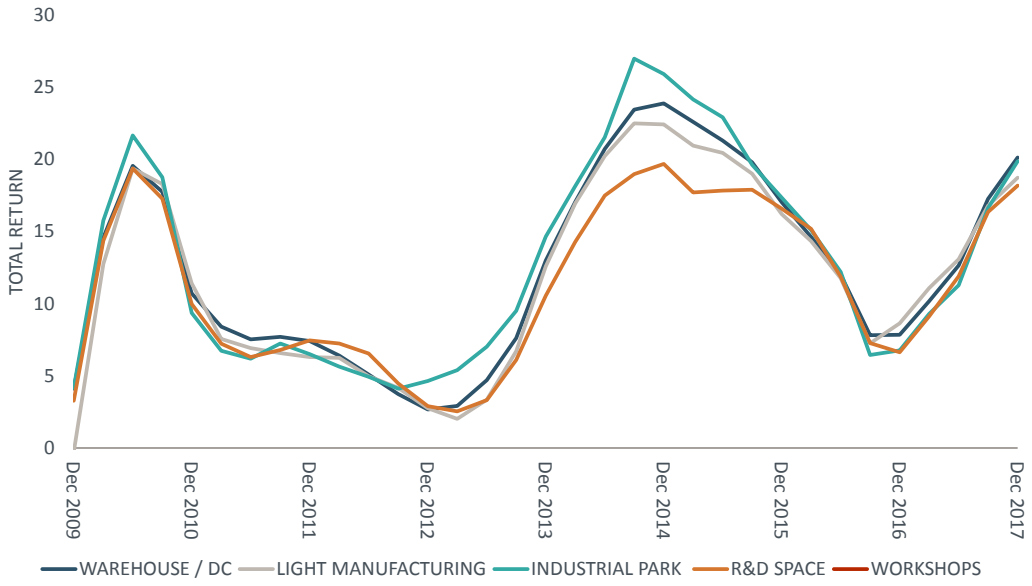
Exhibit 10: U.K. Industrial Total Return by Subtype since December 1981



Source: MSCI Global Intel PLUS

A closer look at U.K. industrial performance by subtype since Dec. 2009 shows outperformance by both warehouse/distributions centers and industrial parks over R&D space and manufacturing.

Exhibit 11: U.K. Industrial Total Return by Segment since December 2009



Source: MSCI Global Intel PLUS

Although there were some significant differences in performance between the industrial segments, the degree of this variation was much more limited than was seen in the 2017 asset-level return distribution described above. While the outperformance of warehousing and distribution centers points toward e-commerce as a potential driver, the extent of variation in asset performance warrants more explanation. Before we investigate this in more detail, the next section provides some context around the role of e-commerce in the demand for industrial real estate.

E-COMMERCE AS A DEMAND DRIVER

E-commerce fulfillment utilizes distribution centers and warehouses more than any other type of industrial space. As retailers' business models evolve and adapt to the challenges and opportunities of online retail, the quantity, quality and location of the distribution facilities they require may also change.

A traditional, bricks and mortar supply chain model involves picking products at a warehouse or distribution center and shipping them in bulk to the store network. But when shipping goods directly to consumers rather than retail stores, the process requires picking

individual items in the warehouse/ distribution center, implying a much more flexible operation than the predictable patterns of sales to traditional bricks and mortar retailers, which have only fluctuated slightly to accommodate peak times.

To satisfy e-commerce distribution requirements, new warehouse layouts generally require larger footprints, higher ceilings and more loading docks in close proximity to large population centers. The need to store large and fast-moving inventories has created demand for larger and taller warehouses. Ceiling heights have increased to allow for mezzanine levels and racking systems. New industrial buildings may also require thicker concrete floors to support the heavy machinery used to automate some warehouses. As a result, older warehouse stock risks becoming obsolete.

Consumers generally behave differently when shopping online than they do in retail stores, particularly in terms of the much higher return rate. Items bought online are returned at a significantly higher average rate compared to items purchased in bricks and mortar stores. Accommodating for increased returns requires a reverse supply chain with additional storage space.

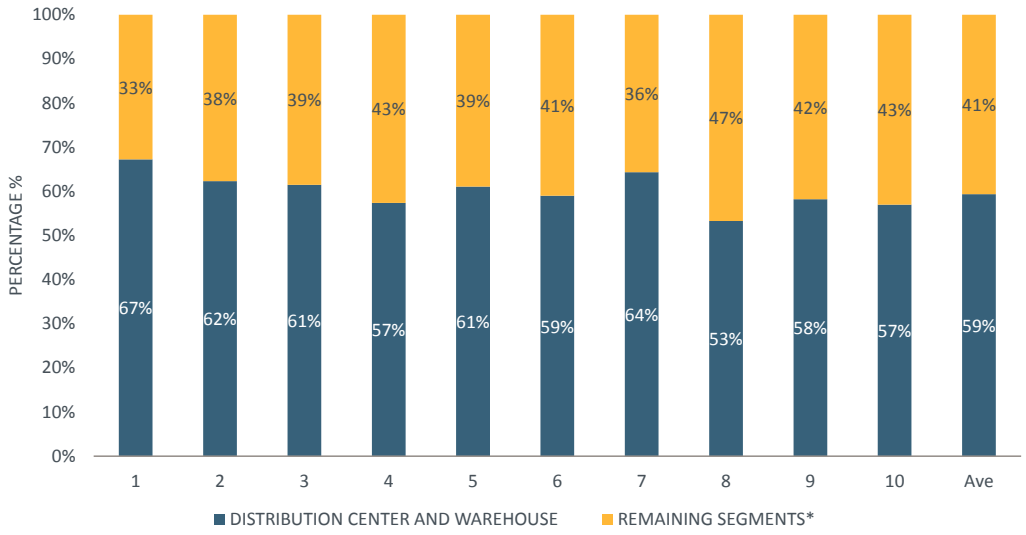
DRIVERS OF INDUSTRIAL DIVERSITY

The exhibits that follow rank U.K. industrial assets in order of 2017 total return from best to worst. This distribution of returns is then split into ten groups containing an equal number of assets (deciles). The characteristics of each of these deciles can then be examined in relation to a number of risk factors such as size, location or type of tenancy. In this way we can investigate which characteristics top-performing assets share and how they compare to underperforming assets.

Exhibit 12 shows the level of exposure to warehouse space across return deciles. At first glance, there may not appear to be a high degree of variation in exposure across the return deciles, ranging as it does from 53% to 67%.

However, Exhibit 13 examines this variation in more detail, focusing on the center of the chart. The top decile had the highest concentration of warehouse and distribution center space at 67%, significantly higher than the 59% average across the whole sample. More broadly, the top three deciles were over-exposed to warehouse and distribution, while the bottom three were under-exposed.

Exhibit 12: UK Industrial Subtype Breakdown by Decile



*Remaining segments include heavy manufacturing, light manufacturing, industrial park, R&D space, workshops and other

Source: MSCI PAS, based on 2017 returns

Exhibit 13: Percentage of Distribution Centers and Warehouses by Decile

Source: MSCI PAS

INDUSTRIAL LOCATIONS

The push toward same-day and next-day delivery is increasing pressure to reduce drive-times to consumer catchment areas and thus to locate distribution centers and warehouses closer to large populations. Many of these may be smaller facilities built in dense urban areas to enable the delivery of goods to customers within short timeframes. These are often existing developments that have fallen vacant but can now be re-purposed. Some speculate that demand for this kind of property is driving exceptional industrial performance. To test this hypothesis, we examine performance across U.K. cities and regions.

While London has the largest inventory of industrial assets in the U.K., these made up an even greater proportion of the top-performing deciles. Conversely, Aberdeen, with a much smaller population also has a correspondingly smaller inventory, while its asset return distribution skewed toward lower return deciles, as seen below.

Exhibit 14: Industrial Asset Decile Distribution by City

City	Decile										Population
	1	2	3	4	5	6	7	8	9	10	Millions
ABERDEEN	0%	0%	0%	0%	0%	1%	1%	2%	8%	7%	0.2
BIRMINGHAM	1%	1%	1%	1%	2%	3%	2%	2%	2%	0%	1.1
BRISTOL	1%	4%	4%	4%	2%	3%	2%	2%	3%	3%	0.4
LEEDS	1%	1%	1%	2%	3%	4%	2%	1%	2%	2%	0.7
LONDON	13%	11%	12%	7%	3%	5%	5%	2%	2%	1%	8.8
MANCHESTER	1%	2%	2%	2%	2%	3%	2%	3%	4%	3%	2.6
NORTHAMPTON	1%	2%	2%	2%	2%	2%	3%	1%	1%	1%	0.2
NOTTINGHAM	1%	0%	0%	1%	1%	1%	2%	3%	1%	0%	0.3
READING	1%	2%	1%	2%	1%	1%	0%	1%	2%	0%	0.3
SOUTHAMPTON	1%	1%	1%	1%	1%	1%	2%	0%	1%	1%	0.2

Source: MSCI Global Intel PLUS; UK Office for National Statistics. Based on 2017 returns.

Breaking out performance by region shows Outer London had the largest proportion of assets in the top deciles. In second and third place came the Rest of South East and Eastern regions, both of which border the Greater London metropolitan area, with many assets close to its borders.

Exhibit 15: Industrial Asset Decile Distribution by Region

Region	Decile										Population
	1	2	3	4	5	6	7	8	9	10	Millions
East Midlands	5%	3%	5%	7%	7%	9%	13%	10%	7%	7%	4.5
Eastern	14%	13%	13%	13%	11%	11%	9%	10%	10%	9%	5.8
Inner London	2%	0%	0%	0%	0%	0%	1%	0%	1%	1%	3.5
Northern Ireland	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1.8
Outer London	**32%**	**28%**	**21%**	**20%**	**13%**	**15%**	**12%**	**8%**	**8%**	**6%**	**4.9**
Rest of South East	29%	29%	30%	25%	26%	22%	16%	13%	15%	21%	8.8
Scotland	3%	3%	2%	2%	3%	3%	5%	5%	13%	14%	5.3
South West	3%	7%	8%	8%	7%	9%	12%	11%	9%	8%	5.3
The North East	0%	1%	1%	1%	4%	2%	0%	3%	5%	3%	2.6
The North West & Merseyside	4%	4%	5%	9%	8%	9%	10%	16%	11%	15%	8.4
Wales	1%	2%	1%	0%	3%	3%	2%	2%	3%	1%	3.1
West Midlands	8%	7%	10%	10%	10%	10%	13%	17%	9%	7%	5.7
Yorkshire and The Humber	1%	2%	4%	4%	8%	9%	7%	6%	9%	7%	5.3

Source: MSCI Global Intel PLUS; UK Office for National Statistics. Based on 2017 returns.

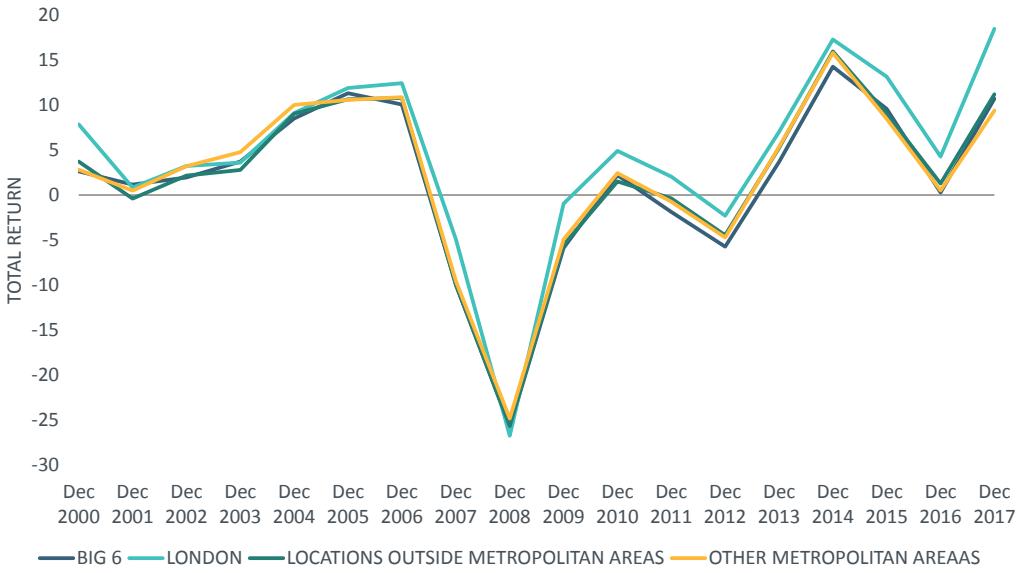
Looking at this urban/ex-urban performance differential a little more closely, Exhibit 16 plots total return time series for a number of custom segmentations defined in MSCI's Global Intel Plus product. Industrial assets are split into four segments: London, the Big 6 (Bristol, Birmingham, Manchester, Leeds, Glasgow and Edinburgh), other metropolitan areas (including all other cities and towns across the U.K.) and finally assets outside of metropolitan areas.

The only region that showed significant outperformance was London, which has substantially outperformed since the global financial crisis. Before the crisis, there was only modest variation in performance between London and the other segments, but the gap has widened significantly in the last three years. However, perhaps rather surprisingly, the performance of assets located within the next six largest U.K. cities has not diverged from the broader U.K. So far, the urban industrial narrative seems to have been concentrated on London and its environs rather than being a broader- based trend across other major cities in the U.K.

The scale and population density of London, along with the associated traffic congestion, perhaps, requires a more intensive logistics network with sites located closer to the urban centers to allow the reach and coverage required by ecommerce tenants. In other parts of the U.K., lower density and freer flowing roads can allow urban conurbations to be serviced from further away using more traditional industrial and logistics locations. This provides two potential explanations for the more limited performance in U.K. regional cities. The first is that the e-commerce related industrial properties are not captured by these urban segments outside of London. The second is that the elasticity of supply tends to be more elastic in such ex-urban locations when compared to London and that any strength in

demand doesn't translate as robustly into rental growth and returns as it does in the areas in and around London.

Exhibit 16: U.K. Industrial Total Return Performance by Custom Urban Segmentation



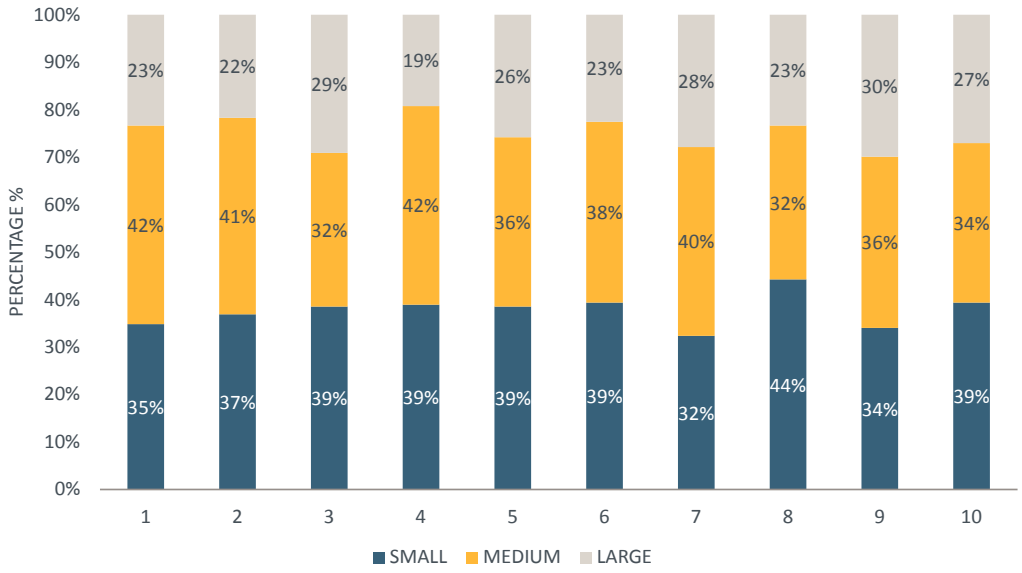
DOES SIZE MATTER?

In the following analysis, we examine how asset size varies across the industrial return distribution. To do so, we categorize the industrial assets in our dataset into three distinct size categories:

- Small: Less than 65,000 square feet (19,800 sq. meters)
- Medium: 65,001 – 175,000 square feet (19,800 – 53,340 sq. meters)
- Large: More than 175,001 square feet (53,340 sq. meters)

Exposure to the small segment was fairly consistent across the return distribution and averaged 38%. The top-performing decile's exposure to small assets was 35%, three percentage points lower than average. There was a somewhat greater variation in exposure across the distribution among the medium and large assets. In particular, better performing assets had a lower exposure to the large warehouses.

Exhibit 17: Exposure to Size Groups by Decile Ranking



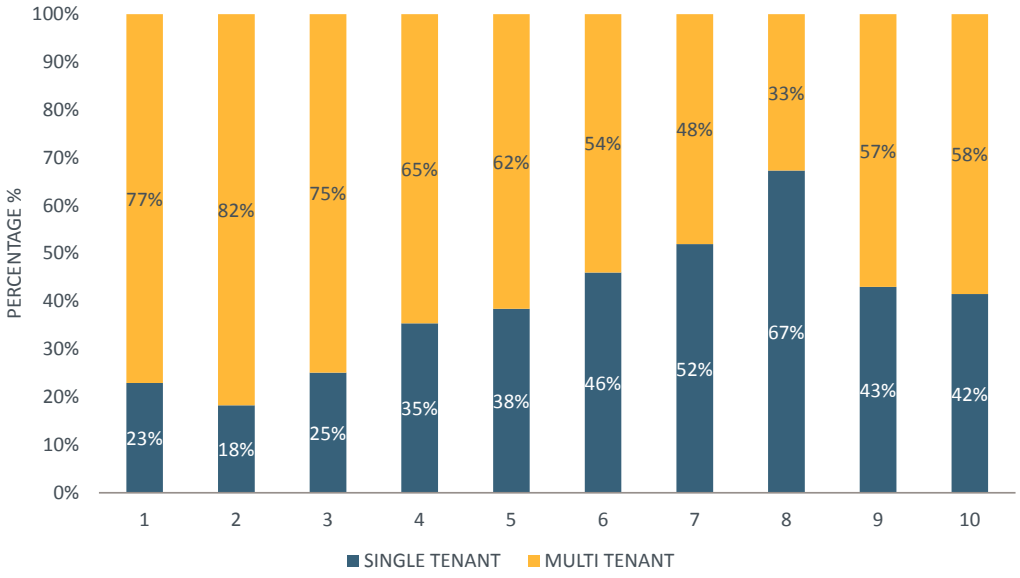
Source: MSCI Global Intel PLUS. Based on 2017 returns.

TENANT DIVERSIFICATION

Thus far we have examined relative performance segmented by physical asset characteristics: size, location and format. We can also segment performance based on tenant exposure, leveraging the lease and income information in our dataset. A key source of potential difference in performance was whether the asset has a single tenant or a more diversified income stream across multiple tenants.

This segmentation produced a relatively strong pattern of performance differentiation. The higher performing deciles had a significantly higher exposure to assets with multiple tenants compared to the lower deciles. While the average split across the performance distribution was 39% single tenant to 61% multi-tenant, 77% of the top-performing three-tenths of assets were multi-tenanted.

Exhibit 18: Multi-tenant vs. Single-Tenant Distribution across Decile Ranking



Source: MSCI Global Intel PLUS. Based on 2017 returns.

TENANT EXPOSURE

Exhibit 19 shows the top 20 industries in the dataset in terms of total tenant revenue, based on U.K. Standard Industrial Classification (SIC)[2] coding. Business services was the largest industry represented in terms of rental income, and includes wholly online retailers such as Amazon.com Inc. The next most prevalent industry group was "trucking operator-nonlocal," which includes many third-party logistics providers such as DHL, UPS, FedEx Corp., DPD Group and Track & Trace. The other top-20 industries were dominated by those involved in general warehousing, distribution and logistics, and also those in the wider retail business, whether selling wholesale or direct to the consumer.

[2] Source: Office of National Statistics © Crown copyright 2009. Contains public sector information licensed under the Open Government Licence v3.0.

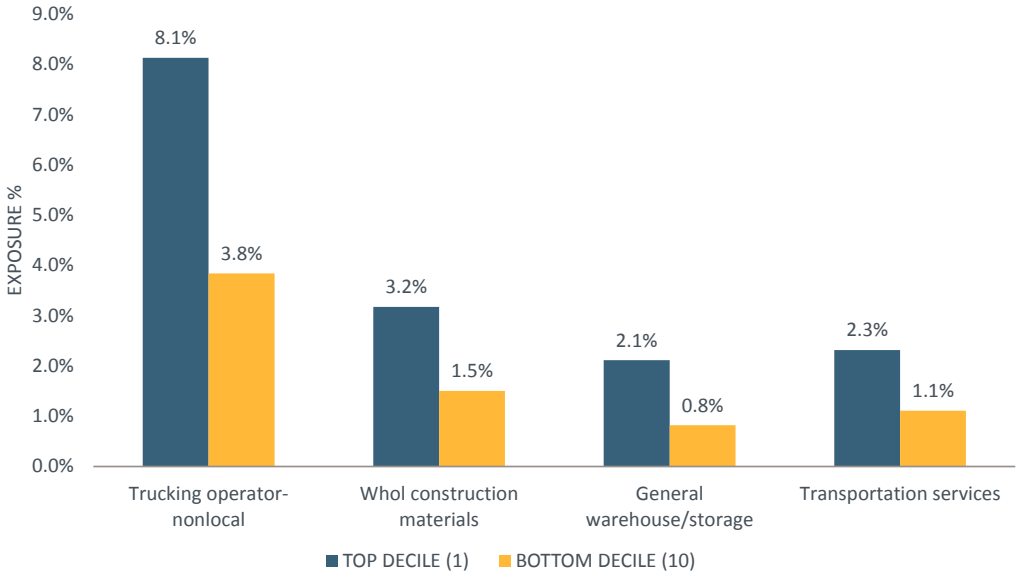
Exhibit 19: Top 20 Tenant Industries in U.K. Industrial Properties

	Tenant Industry	Concentration
1	Business services	9.6%
2	Trucking operator-nonlocal	6.5%
3	Whol nondurable goods	3.9%
4	Holding company	3.8%
5	Ret groceries	3.6%
6	General warehouse/storage	2.1%
7	Postal Service	2.0%
8	Whol construction materials	2.0%
9	Transportation services	1.8%
10	Mfg misc products	1.7%
11	Ret misc general merchandise	1.7%
12	Ret misc merchandise	1.6%
13	Ret new/used automobiles	1.6%
14	Eating place	1.6%
15	Ret paint/glass/wallpaper	1.4%
16	Subdivider/developer	1.4%
17	Equipment rental/leasing	1.3%
18	Ret family clothing	1.2%
19	Engineering services	1.1%
20	Department store	1.1%

*Industry definitions are based on UK SIC codes

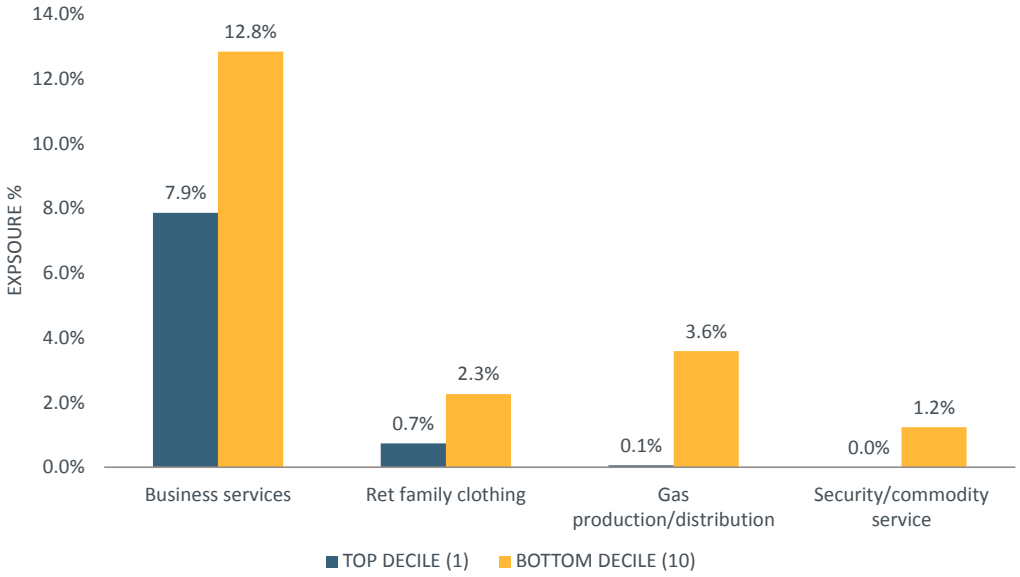
How did exposure to these different tenant types vary between the best-performing and worst-performing assets? Exhibit 20 shows that top performing assets derived a relatively large share of revenue from industries involved in transportation and storage. Trucking operations exposure in particular, including third-party logistics operators, was associated with higher asset performance. Conversely, Exhibit 21 indicates that industries related to consumer and commodity businesses were more prevalent in the bottom decile. Notably, business service operators comprised a relatively large proportion of tenants in bottom-decile performing assets, despite the presence of Amazon in this tenant type.

Exhibit 20: Industries where Above Average Exposure was Associated with Outperformance



Source: MSCI IRIS, PAS.

Exhibit 21: Industries where Above Average Exposure is Associated with Underperformance



Source: MSCI IRIS, PAS.

CONCLUSION

Industrial investors enjoyed strong returns in 2017 across nearly every global real estate market. The sector's performance was particularly strong when viewed relative to that of the retail sector. Many commentators have cited structural shifts in e-commerce and their impact on retailers' distribution networks as the main driver of these performance trends.

However, we have seen industrial real estate outperform before. Historical evidence shows that higher yielding sectors have often performed well in the later stages of a cycle, as investors rotated into these assets in search of yield. Indeed, until recently a significant yield premium was evident between industrial and the broader market, as seen in previous cycles. But this yield spread has compressed to new lows, both in aggregate globally and in many national markets. For the U.K. in particular, the average equivalent yield for industrial assets has fallen below that of offices, an unparalleled market development. This suggests something more than normal cyclical rotation may be at play.

Data from the U.K. tells us that the old adage that a rising tide lifts all boats has not been entirely true for the industrial sector: The range of industrial asset performance in 2017 was much wider than for other sectors. Most notably, those assets located in or around London, those with multi-tenanted, diversified income streams and those exposed to logistics- and distribution-related tenants performed well. Size had a less-clear impact on performance. These findings suggest that the e-commerce narrative may carry some weight in explaining industrial outperformance, but there is likely to be potential value in further analysis.

The ability to create detailed custom segmentations by location or physical asset characteristics has allowed investors to refine this kind of analysis and uncover more tailored insights. The penetration of e-commerce has varied substantially by country, as has the nature of distribution networks. For example, the U.K. is an island nation that imports a large share of goods from overseas and has a well-developed retail and e-commerce market, while the Netherlands is the entry point for distributing goods across much of continental Europe. Such differences imply very different demands for industrial real estate, and may make the ability to segment market performance flexibly to reflect the myriad of underlying property characteristics increasingly important, particularly should secular shifts, such as e-commerce, have had a growing impact on the performance of real estate assets.

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