INDUSTRIAL MARKET REPORT: 1Q2012

Fundamentals remain positive, but take a breath.

- **ECONOMY:** Inventory accumulation and auto sales aided moderate 1Q12 GDP growth of 2.2%. PNC Economics reiterated their outlook of 2.4% GDP growth and unemployment gradually decreasing to 7.4% through year-end 2013. Sequentially, key industrial demand indicators (production, trade, inventories, and transport) remained positive; however, signs of a slowdown in late 2012/early 2013 emerged.
- ABSORPTION: Demand remained positive for the eighth consecutive quarter, but the pace decelerated sequentially by nearly 50% to 41.2 msf. Tenant demand remained strongest in intermodal and portoriented markets.
- **SUPPLY:** Limited starts (7.5 msf) and deliveries (7.6 msf) during the quarter will keep new supply near historical lows of existing inventory (0.2%). Pre-leasing for the 44.8 msf underway was 62.6%, down slightly from 4Q11. Speculative construction limited to a few markets, such as the PA I-81/I-78/Lehigh Valley and Inland Empire.
- VACANCY: The national industrial vacancy rate improved 10 bps sequentially to 9.4% and 70 bps annually. Warehouse eased 10 bps to 8.9% from 4Q11, while flex-space was unchanged at 13.3%. At 9.6%, Northern/Central New Jersey remained the only top 10 market with vacancy higher than a year ago, while LA and Houston have the tightest at 4.9% and 5.3%, respectively.
- RENTS: For the first time this cycle, the national industrial rent increased on both an annual (\$0.01/sf) and sequential (\$0.02/sf) basis to \$5.46/sf. Sequentially, warehouse rents remained at \$4.80/sf, while flex-space increased \$0.08/sf to \$10.41/sf. Detroit and Atlanta are the only top 10 markets that did not achieved annual rent gains.
- **CAP RATES:** Transaction volume dropped by roughly 36% from 4Q11 to \$4.8 billion; however, cap rate changes were modest. The average warehouse cap rate rose 10 bps to 7.8%, while the flex-space average improved by 12 bps to 8.2%.
- DISTRESS: Total outstanding distress declined \$1.1 billion from 4Q11 to \$171.4 billion. Industrial properties remain the least distressed property type, representing 7.2% of the total, though CMBS maturity defaults continue to mount.

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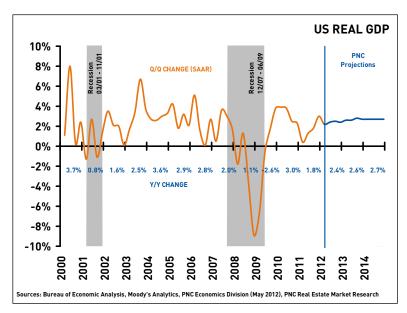
ECONOMY

This section discusses quarterly changes and trends occurring within the economy and supply chain components that influence industrial space demand.

GDP and Employment

The Bureau of Economic Analysis' advance estimate indicated that 1Q12 GDP rose at an annualized rate of 2.2% (below the 2.5% consensus) and slower than 4Q11's 3.0%. While lower government spending (mainly defense and state/local) reduced GDP by 0.6 percentage points, private inventories contributed 0.6 percentage points, resulting in final sales increasing by only 1.6% (a large portion of which was new car sales). PNC Economics' 2012 and 2013 GDP forecast remained at 2.4%, as government budget issues and European recession will prevent stronger growth.

The unemployment rate ended 1Q12 at 8.2%, down 30 bps from year-end 2011 and 90 bps from a year ago. PNC Economics expects

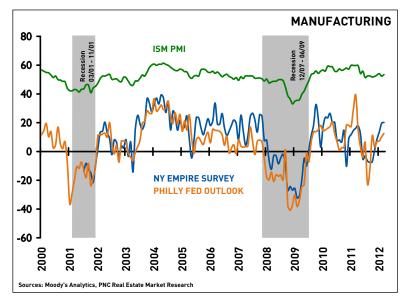


that 2.4% GDP growth will result in job creation slowing from 1Q12's average of 229,000/month to 180,000/month and unemployment ending 2012 at 7.9% and 2013 at 7.4%.

Production Activity

Positive momentum from 4Q11 extended into 1Q12. While the forward-looking components of the manufacturing surveys remain optimistic, they indicated a potential slowdown in activity.

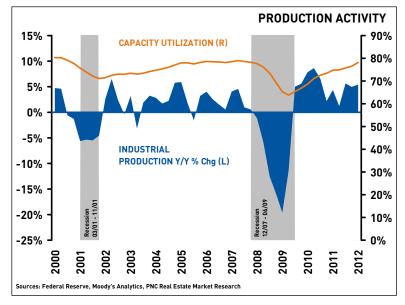
The Federal Reserves regional surveys, Empire State (blue line) and the Philadelphia Business Outlook (orange line) continued 4Q11's positive momentum, expanding at a moderate pace finishing the quarter at 20.2 and 12.5, respectively. New orders, shipments, and employment remained positive during the quarter. Increased input costs were somewhat offset by rises in prices received.



The Institute of Supply Management's

Purchase Managers Index (green line) provides a national overview of manufacturing activity. It ended the quarter at 53.4, marking 32 uninterrupted months of expansion (> 50) and was broad based with 15 of the 18 industries reporting increased activity, compared to 8 in December. A review of the PMI's components revealed that employment, inventories, order backlogs, and prices paid increased from year-end 2011, while new orders and production softened, which suggests that there is a slight weakness in demand.

The Fed's Industrial Production Index (shaded blue area) grew at an annualized rate of 5.4% during 1Q12. Manufacturing capacity utilization (orange line) continued to increase, reaching 77.6%, and approaching its long-term average of 78.8%. PNC Economics predicts that slack will continue to shrink through year-end 2013, though the annualized growth will slow to 4.2%.



Trade

Over the past year, trade activity has grown at a moderate pace with export (blue line) growth trailing imports (orange line) by roughly one percentage point. Consequently, the monthly trade deficit (green line) has widened by 12.5% to \$51.8 billion from a year ago (second highest reading since October 2008).

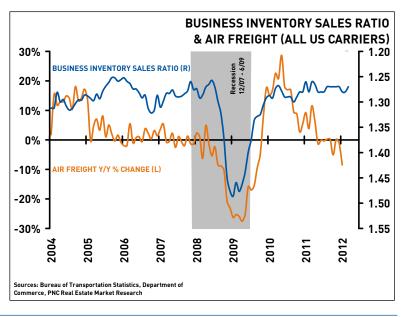
PNC's Economics Division indicated that despite a European recession, exports to the eurozone rose during the quarter. However, they noted that export growth would slow, due to Europe's continued recession and China's slower growth trajectory.

US TRADE Billions (\$) 250 200 **EXPORTS** 150 100 50 0 -50 -100 TRADE BALANCE -150 **IMPORTS** -200 -250 -300 Source: U.S. Commerce Department, BOC, Moody's Analytics, PNC Real Estate Market Research

Inventory and Transport

Inventories increased by \$69.5 billion, contributing 0.6 percentage points to 1Q12 GDP; however, stronger consumer demand maintained the Business Inventory to Sales ratio (blue line) at 1.27. Over the past year, the ratio has shown very little movement (1 – 2 bps).

While official air freight figures are only available through January, airlines and freight forwarding companies indicated that volume remained even to slightly up, due in part to new Apple products. Stronger cargo volumes transported by less costly surface-based shipping (ports/railroads/trucking) indicate that retailers anticipate having a good year. The National Retail Federation projected a 3.4% annual sales increase.



INDUSTRIAL MARKET FUNDAMENTALS Absorption

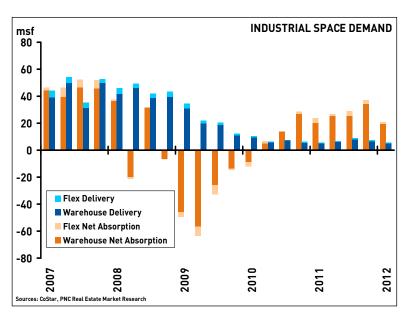
As discussed in the Economy Section, changes in key industrial space demand drivers (production, trade, inventories, and transport) remained positive; however, they exhibited signs of a potential slowdown later in the year. Please refer to the Appendix for additional details on PNC's 22 Footprint Markets, which represent approximately 41% of the nation's industrial space.

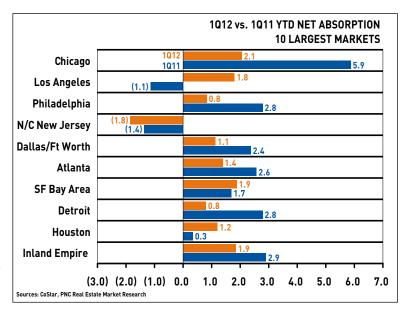
Although net absorption slowed by nearly 50% sequentially to 20.9 msf and is down 15.7% from a year ago, it has been positive for the past eight quarters, averaging 23.3 msf.

During 1Q12, the top 10 markets accounted for just over a third of the nation's net absorption, down from 45.5% in the prior quarter. Northern/Central New Jersey remains the only major market that continues to struggle with net absorption and is down 1.8 msf from a year ago. The other top 10 markets experienced positive absorption during the quarter; however, only Los Angeles, San Francisco Bay Area, and Houston registered year-over-year gains, while the pace slowed considerably in Chicago, Philadelphia, and Detroit.

Net absorption among the industrial markets tracked by brokers Cushman & Wakefield and Cassidy Turley also reflected a slowdown from 4Q11. Cushman & Wakefield reported that 65% of its 72 markets had positive net absorption in 1Q12, down from 86% in 4Q11, while Cassidy Turley indicated that it slowed from 88% of its 67 markets at year-end 2011 to 76% during 1Q12.

The majority PNC's footprint markets began 2012 with positive net absorption and accounted for slightly less than 20% of net absorption during 1Q12. Atlanta, Charlotte, and Chicago recorded the largest gains, each with more than 1.0 msf. Central New Jersey continued to struggle, losing nearly 2.0 msf, as did the Ohio markets (Cincinnati, Cleveland, Dayton, and Columbus), which shed almost 1.2 msf collectively.





A few markets will potentially benefit from transportation network changes. Atlanta and Charlotte are likely to experience increased freight volumes with Norfolk Southern and Kansas City Southern railroads expansion of intermodal service to facilitate near-sourcing between Mexico and the US. Warehouse space demand will likely shift within the Seattle/Puget Sound, as the Grand Alliance shipping consortium will relocate from the Port of Seattle to Tacoma.

Supply

At just 0.2% of inventory, the construction pipeline remains at a historical low. Among the 142 markets that we monitor, only 73 had any construction activity in 1Q12, unchanged from the prior quarter. During the quarter, starts decreased from 10.1 msf in 4Q11 (prior estimate was 5.4 msf) to 7.5 msf. Based on the pipeline, new supply is expected to total approximately 40 msf in 2012, up 8.4 msf from 2011.

The top 10 industrial markets accounted for 39% of the square footage underway, up from 33% a year ago, while over the same period mid-sized markets (>100 msf) declined from 56% to 50% and small markets (<100 msf) increased from 12% to 13%. Within PNC's footprint markets, new supply underway totaled 13.6 msf, accounting for roughly 30% of the square footage underway.

Deliveries during the quarter totaled 7.6 msf, up slightly from a year ago. Mid-sized buildings (100,000 – 499,999 sf) represented the majority (61.8%) of the completed space. The only large completion (> 500,000 sf) was First Industrial's 692,000 sf spec distribution center in the Inland Empire's Moreno Valley submarket.

Sequentially, the leasing pace slowed across all sizes of newly delivered industrial buildings (except for 50,000 – 99,999 sf) to 66.9%. Leasing remained weak for the smallest (< 50,000 sf) at 52.3% and strongest among mid-sized buildings at 75.3%.

During the quarter, Richmond, Atlanta, Memphis, Columbus, and Birmingham joined the ranks of metros with more than 1.0 msf of industrial space under construction, raising the total from 17 last quarter to 20.

Although the amount of new supply underway remains at historically low levels, build-to-suits represent the majority of new construction; however, speculative construction continued to increase. As of 1Q12, pre-leasing was 62.6%, down from 65.8% in 4Q11 and 84.2% a year ago.

Markets where speculative development represents the majority of space under construction include PA I-81/I-78/Lehigh Valley, Inland Empire, Dallas/Ft Worth, Memphis, and Los Angeles.

CONSTRUCTION ACTIVITY (> 1.0 MSF)								
Market	# Bldgs	MSF UC	% of Inv.	% Leased				
PAI-81/I-78/Lehigh Valley	5	4.5	1.0%	30.3%				
Phoenix	8	3.4	1.2%	92.9%				
Inland Empire	14	3.3	0.7%	0.2%				
Houston	37	3.1	0.6%	53.6%				
Portland	5	2.2	1.2%	98.9%				
Richmond	6	2.2	1.9%	97.5%				
Atlanta	n/a	1.8	0.3%	n/a				
Dallas / Ft Worth	15	1.6	0.2%	17.4%				
Kansas City	4	1.5	0.6%	100.0%				
Albany	2	1.5	1.7%	95.8%				
Salt Lake City	8	1.3	0.6%	80.3%				
Baltimore	n/a	1.3	0.7%	n/a				
Cincinnati	n/a	1.3	0.5%	n/a				
Memphis	3	1.3	0.6%	31.5%				
Los Angeles	19	1.3	0.1%	28.3%				
Nashville	4	1.3	0.6%	97.8%				
Chicago	6	1.2	0.1%	78.9%				
Columbus	n/a	1.2	0.5%	n/a				
Birmingham	2	1.0	0.8%	100.0%				
Youngstown	1	1.0	2.0%	100.0%				
US TOTAL	307	44.8	0.2%	62.6%				

Source: Cassidy Turley; CoStar; Cushman & Wakefield; PNC Real Estate Market Research

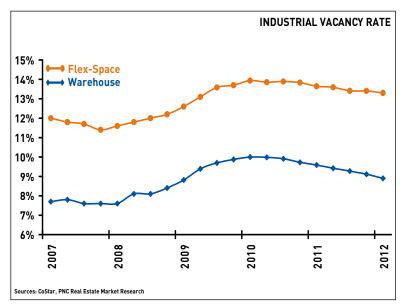
Vacancy

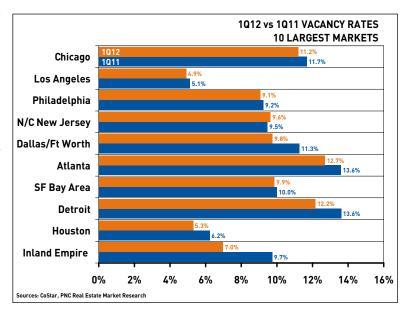
The national industrial (warehouse and flex-space) vacancy rate continued to improve. It moved 110 bps below this cycle's peak of 10.5% in 2Q10 to 9.4%, down 10 bps sequentially and 70 bps annually. CoStar reported vacancy in improved in 64 of its 142 industrial markets (compared to 68 a year ago), while Cushman & Wakefield reported that vacancy declined year-over-year in 54 of its 72 markets. Vacancy is predicted to decline by approximately 75 bps by year-end 2012

As shown in the adjacent chart, the warehouse vacancy rate (blue) continues to experience a slow, but steady decrease from 2Q10's high of 10.1% to 8.9% in 1Q12. Meanwhile, the flex-space vacancy rate (orange) has persistently remained above 13.0%, down only 60 bps from its 3Q10 high of 13.9%.

During 1Q12, Northern/Central New Jersey was the only industrial market among the nation's ten largest with a vacancy rate higher than a year ago. Los Angeles and Houston continue to report the tightest vacancy rates at 4.9% and 5.3%, respectively. The Inland Empire experienced the largest year-over-year improvement, decreasing 270 bps to 7.0%, as demand for large distribution center space remained strong.

The average vacancy rate across PNC's footprint markets was 10.2% during 1Q12, down 27 bps sequentially and 69 bps annually. Footprint markets with the biggest sequential improvements include Baltimore, Birmingham, Chicago, Cleveland, and Indianapolis, while Central New Jersey, Cincinnati, Mobile, Nashville, and St. Louis worsened.





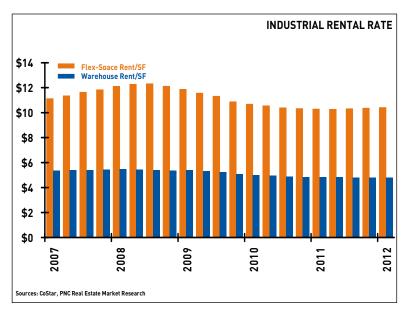
Rents

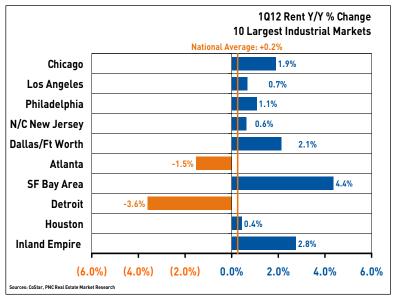
Based on CoStar data, the national industrial (warehouse and flex-space) rent registered annual and sequential gains for the first time this cycle. The national average rent was \$5.46/sf, up \$0.01/sf from a year ago and \$0.02/sf from 4Q11. Rents are expected to registering low, single digit gains in 2012.

Although flex-space represents less than 12.0% of industrial space nationwide, flex-space rent increases outweighed warehouse's slight decline. Flex-space rent (orange bar) is up \$0.10/sf to \$10.41/sf from 1Q11 and \$0.06/sf from 4Q11, while the average warehouse rent (blue bar) is \$4.80/sf, down \$0.01/sf from a year ago and unchanged from 4Q11.

Improvement in rents continued to mount, as eight of the nation's 10 largest industrial markets achieved annual rent growth. Detroit and Atlanta continued to struggle with weakening rents on both an annual and sequential basis, while California's Inland Empire and San Francisco Bay Area reported the strongest rent gains.

As of 1Q12, the average rent across PNC's footprint markets was \$4.35/sf, up \$0.02/sf from 4Q11 and even with a year ago. Compared to 4Q11, Pittsburgh and Cleveland achieved the highest gains at 6.1% and 5.4%, respectively, while Cincinnati and Columbus each declined by approximately 2.0%.





Cap Rates

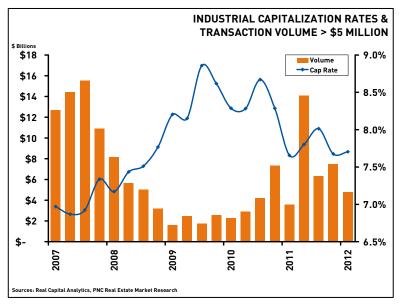
Transaction volume for institutional quality industrial properties trended lower in 1Q12, decreasing \$2.7 billion in 4Q11 to \$4.8 billion; however, volume remains above 1Q11's \$3.6 billion. At 7.7%, cap rates are relatively unchanged from a year ago and remain approximately 75 bps to 100 bps above their lows. According to Real Capital Analytics (RCA), distressed industrial assets represented just 5.0% of 1Q12's total industrial volume, down from 11.0% in 1Q11.

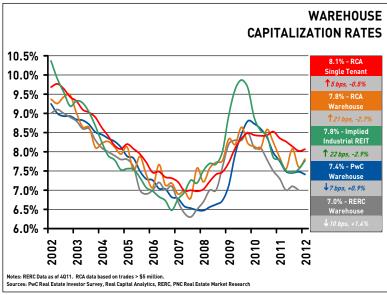
Over the past year, investor interest pushed cap rates down 71 bps to 7.1% in major markets and expanded to secondary markets, which declined 42 bps to 7.9%, while tertiary markets backed-up 18 bps to 8.6% as sales volume retreated.

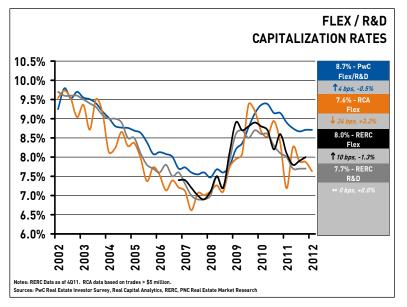
RCA reported that industrial portfolio transactions accounted for roughly 25% of volume this quarter. Two large southern California warehouse portfolios traded during 1Q12, NY State's Retirement Fund purchased a 50% interest in a 6.8 msf Prologis portfolio and Verde Realty acquired a 4.0 msf one from UBS/AEW for \$290 million.

Warehouse cap rates diverged, with RCA and the implied rate for industrial reits backing up approximately 20 bps to 7.8%, while PwC eased 7 bps to 7.4%. This widened the spread between the various series from 54 bps to 66 bps.

Due to high profile trades, such as Beacon Capital Partners' acquisition of the San Diego Tech Center for \$152.5 million (\$236/sf) and BioMed Realty's purchase of Cambridge Place for \$119 million (5.5% cap rate), the average flex cap rate moved down 12 bps to 8.2%.



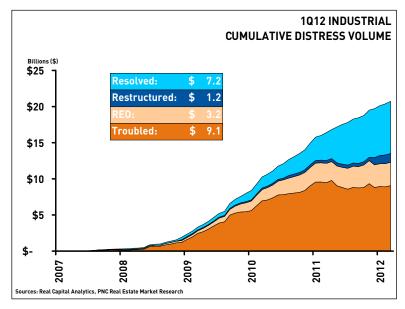




Distress & Delinquencies

Across all property types, the amount of outstanding commercial real estate distress (Troubled and REO) continued to decline. As of 1Q12, approximately 52% of the cumulative distress had completed workout (Restructured and Resolved). During 1Q12, workouts exceeded new additions by \$1.1 billion, lowering the cumulative amount of distressed assets from 4Q11's \$172.6 billion to \$171.4 billion in 1Q12.

By property type, industrial properties represent the least amount of distress (7.2%); however, it has been the slowest at resolving distress, with approximately 41% completing workout. During 1Q12, the amount of distressed industrial loans increased by \$362.8 million to \$12.3 billion, as the pace of workouts lagged new additions (primarily CMBS maturity defaults).



Geographically, the Northeast, Mid-Atlantic, and West regions have made the most progress in resolving distressed industrial situations, with nearly 50% of the \$11.1 billion in cumulative distress worked out. With the exception of Cleveland, Dallas, and Houston, distressed industrial assets are likely to linger in the Midwest, Southeast, and Southwest regions, as only 36% of the \$9.8 billion in cumulative industrial distress has been completed workout. According to RCA data, recovery rates have been lower in these regions, averaging 67% compared to 72% in the other three regions.

Based on Trepp data, the overall CMBS delinquency rate fluctuated 21 bps during 1Q12, before ending the quarter at 9.6%, up 10 bps sequentially and 26 bps from a year ago. While the 30+ days delinquency rose 2 bps sequentially, composition of the overall delinquency rate in 1Q12 changed as more properties moved into the foreclosure and REO categories, which increased 22 bps to 3.0% and 25 bps to 2.8%, respectively. Las Vegas (22.0%) and Atlanta (20.0%) remained at the top of MSA's with the highest CMBS delinquency rates, while Inland Empire (21.7%) traded places with Phoenix (14.7%) for the number three spot.

At 12.5%, the 30+ days delinquency rate for CMBS loans secured by industrial properties was second only to multifamily's 15.4%. However, the industrial rate is still climbing, it is up 51 bps sequentially, and 229 bps annually, while multifamily has declined 18 bps and 82 bps over the same periods. Securitized industrial loans represent approximately half of the outstanding distress, of which 30% have been resolved compared to US banks, which account for 25% of distressed industrial loans and have resolved 50%.

APPENDIX

Market	Existing Inventory Vacancy					YTD Net Absorption	YTD Deliveries	U/C	Rent			
	Total RBA (msf)	Direct (msf)	Total (msf)	1Q12 %	Q/Q bps A	Y/Y bps A	(msf)	(msf)	(msf)	1Q12	Q/Q % A	Y/Y % Δ
Atlanta	643.6	78.4	81.8	12.7%	-18	-90	1.4	0.2	0.9	\$3.84	-0.5%	-1.5%
Baltimore	224.5	21.9	23.0	10.2%	-50	-70	0.8	0.0	0.2	\$5.50	1.7%	4.8%
Birmingham	126.7	10.5	10.7	8.4%	-31	-50	0.4	0.0	1.0	\$3.46	0.9%	1.5%
Central New Jersey	287.9	30.7	32.5	11.3%	66	-36	-2.0	0.0	0.1	\$4.47	n/a	n/a
Charlotte	290.1	35.4	36.4	12.6%	-3	-100	1.2	0.5	0.4	\$3.84	2.1%	1.6%
Chicago	1,148.2	123.5	128.6	11.2%	-26	-50	2.1	0.3	1.2	\$4.90	0.6%	2.1%
Cincinnati	296.4	26.9	28.7	9.7%	33	80	-0.7	0.0	0.6	\$3.36	-2.0%	-0.9%
Cleveland	417.8	35.4	36.0	8.6%	-107	-90	0.0	0.0	0.2	\$3.70	5.4%	0.3%
Columbus	266.5	27.3	27.8	10.4%	-33	-110	-0.2	0.0	0.8	\$3.05	-2.2%	-7.9%
Dayton	114.7	14.6	15.0	13.1%	12	-100	-0.3	0.0	0.0	\$3.24	1.3%	-3.9%
Detroit	571.4	68.5	69.6	12.2%	-26	-140	0.8	0.0	0.6	\$4.29	-1.2%	-3.6%
Indianapolis	301.1	19.3	19.9	6.6%	-76	-190	0.9	0.0	0.1	\$3.91	2.4%	4.3%
Louisville	178.4	17.3	17.8	10.0%	-28	-190	0.2	0.1	0.0	\$3.52	0.0%	1.1%
Milwaukee	308.6	22.7	22.9	7.4%	0	-30	0.1	0.2	0.2	\$4.18	0.2%	-0.5%
Mobile	23.4	3.1	3.1	13.3%	45	-90	-0.1	0.0	0.0	\$3.92	0.8%	-4.4%
Nashville	193.8	18.5	19.4	10.0%	31	-70	0.2	0.0	1.3	\$3.98	-1.0%	3.4%
Northern New Jersey	525.0	43.8	46.0	8.8%	-23	20	0.1	0.1	0.6	\$5.40	n/a	n/a
Philadelphia	995.4	87.5	90.3	9.1%	-7	-13	0.8	0.2	4.7	\$4.49	0.4%	1.1%
Pittsburgh	167.5	12.8	13.0	7.8%	46	60	0.0	0.1	0.1	\$5.21	6.1%	7.0%
Raleigh	115.0	12.4	12.8	11.1%	-11	-80	-0.1	0.0	0.1	\$4.89	-0.8%	-1.0%
St. Louis	262.9	24.2	24.6	9.3%	30	130	-0.3	0.2	0.0	\$4.01	-1.0%	-4.5%
Washington DC	207.7	22.9	24.3	11.7%	-43	-110	0.7	0.2	0.7	\$8.97	-1.5%	-2.9%
PNC FOOTPRINT TOTALS / WTD AVGS	7,666.5	757.6	783.9	10.2%	-27	-69	6.0	2.2	13.8	\$4.44	2.6%	2.0%
US TOTALS / WTD AVGS	20,522.2	1,847.4	1,903.7	9.3%	-19	-60	30.7	7.3	44.8	\$5.12	0.2%	-0.4%

Note: Due to differences in CoStar's methodology, national figures differ from long-term historical ones presented in this report. Sources: CoStar; PNC Real Estate Market Research