Blaine Heck: Thank you all for coming. My name is Blaine Heck. I'm the Office and Industrial REIT Analyst for Wells Fargo. To my left, I'd like to thank them for coming. First is Phil Hawkins, the CEO of DCT Industrial REIT and to his left is Matt Murphy, CFO of DCT. I'd like this to be as interactive a session as possible, so once we get into Q and A, please just raise your hand and we'll get the microphone over to you. To start, I think, I'll turn it over to the guys to go ahead and give a little background on the company. Then we can jump right into Q and A.

Phil: Thanks, Blaine and thanks everybody for sitting in. Some familiar faces and a few not. So, I'll try to give a quick overview, although it's a fairly straightforward company. As the name might imply, DCT Industrial, we are in the business of owning, operating, developing, acquiring warehouses in the U.S. It's a solely U.S. focused strategy and solely a balance sheet strategy. We own our properties. To me, when I think about DCT, it's really about our portfolio, which is a high-quality distribution portfolio. The first thing I think about are people. It's a business where people on the ground matter.

We have built up over the last 10 years, very strong on the ground market teams in the places where we do business. And those teams are responsible for that business. We don't have an acquisition person who flips it over to a leasing person and property management person. It's one team, they're held accountable, they're paid for the performance of the properties in their portfolio whether they build them, buy them or their predecessor did it. They run that business. And that creates an alignment of interest with the company and with the shareholders that I think has transformed the company and translated into great results.

You can't talk about industrial these days without talking about the operating market, the fundamentals. It's a great time to be in industrial. I'd love to say our performance is all due to great people and great real estate, but the fact is, we've got tremendous tail winds that are helping us, soon you may read about and maybe you're here because of e-commerce. "We're not retail" is certainly a fact, but it's not just e-commerce that's driving our business. It's really all aspects of the economy that, at this point, need and are investing in the distribution business network. Housing, manufacturing. Every time you have a manufacturing plant that increases capacity or adds a shift, that has an impact on the supply chain. So many consumer product good companies, they're feeding a lot more of it into e-commerce channels than they were maybe 10 years ago through traditional retail. But the consumer product companies, are clearly ramping up their supply chains and reconfiguring to accommodate an e-commerce world.

So the market's great, supply continues to move up as you would expect, as demand is strong. Vacancy rates are kind of low, single digit, maybe one percent or less. And some coastal markets, five percent and some of the central part of the country, supply has moved up to reflect that, but it's a level that's still very disappointing and frankly still under, on a national level, current levels of demand. So, that creates an environment where we have strong pricing pressure in a positive way for the landlord. Rents are moving up. Probably market rents, 5, 6, 8 percent a year, maybe more than that over certain periods of time. I was asked a question earlier today, "Is that accelerating, decelerating, or flat?" And I think the consensus amongst our team is that, if anything, has accelerated a little bit this year compared to prior years.

So, the rent environment's strong. And as a result of that, we have really focused a lot of our efforts on development. You can still create a lot of value in this world, this business, by building. We're able to build at returns, stabilized yields, several hundred basis points higher than the cap rate in which we would sell that building. Margins in 2016 were 50 percent, meaning the building's worth 50 percent more than our cost. My guess is the margins on the current pipeline is probably 30 percent, if not more. And in almost every case, the actual results have out paced the pro forma meaningfully because of either quicker lease up, almost every time, and higher rents. We've underwritten rents more conservatively than history has turned out to be.

As a result of both internal and external growth, our NAV per share increased 25 percent last year using consensus south side analyst estimates. And it's doubled in the last five years. Assuming a reflection of some cap rate compression, no doubt, but also value creation through value add acquisitions and development. So, that's a somewhat disjointed, but a quick overview of the company. I'd love to get into more. Each of those topics, I'm sure we'll talk about market and strategy and results and all that, and the more questions you ask, the less questions Blaine has to ask, so please if you have a question, just wave your hand and we'll respond to you as quickly as we can.

Blaine Heck: Well I can get the ball rolling. That's a helpful overview. I want to start on the operational front. You guys have done, at DCT, a great job balancing the two growth factors of internal growth, of leasing up and increasing occupancy and increasing rents on both renewals and new leases as much as possible. You guys have had sector leading growth in most metrics. I had a couple questions on that front. Occupancy for you guys now is 97.5%. I think that's the highest in company history. How do you think about maintaining same store NOI going forward without the tailwind from occupancy growth? What do you think is a good range for that metric same store NOI without that, that benefit.

Phil: Let me start and let you talk about where you see the range happening. A couple years ago, where same store results for us and our peers were driven by occupancy. I think, investors and management teams were probably a little bit nervous about what same store looked like in that environment. Where rents were growing but not accelerating. Today when you've got rent spreads and the cash rent spreads in the high single digit numbers and in some quarters even higher than that, gap run spreads, double digits. In the twenties. Rent has become, I think all of us underestimated the power of rent growth. Because none of us, no matter how long you've been in this business, have been in this environment. Where market rents were this low and quality portfolio occupancies were this high.

I've been in the real estate business 35 years, 37 years actually. I joined LaSalle Partners in 1980. So that's easy to do the math, 37 years ago, and if you would've told me that i were to have a 6.5 billion dollar company, 97.5% leased, that would've been a dream. So I don't think any of us understood what that does to rent growth. And we've underestimated rent growth a number of years in a row. We're not sandbaggers. We have simply underestimated as we've given out guidance, what the power of rent growth can be. Some people say, "Well, gee, we're gonna hit equilibrium in 2018." Well, they've been saying that for five years. They may be right. Some day they will be right 'cause market occupancy is not gonna go up above 100%. At some point supply will equal demand. And maybe even exceed it.

But to me, the most important aspect of where we are right now, is where market vacancies are low rising cost of new supply, which means in order to meet new demand, in order to achieve equilibrium, you've got to build buildings that cost 5-7% more than the ones that were delivered last year. Assuming you're in a rational world, which you will be in a period of low vacancies, rents are gonna go up at least that much. And there's nothing wrong with margins expanding and landlords making a little bit more money.

So that's the kind of environment we're in which I think drives. So high occupancy no longer the negative that people feared three years ago. "Wow, you're at getting at 95%." I think at this point rent growth has taken over. Matt can translate it to his thinking in terms of what that might mean for the industry.

Matt: Yeah. To talk about, it's hard for me, probably not necessarily appropriate for me to get into specifics about where I think the future's gonna go, but if you think about what the market does today. If you take changes in occupancy out of the equation, what can sustainable same store growth. To me, I have to look at it in terms of the progression of embedded rent bumps in our leases. Which are getting pretty close to 3% as a normal average number. That's a starting point. And then, on top of that if you're looking at where releasing spreads will be, I think, you're looking at the current momentum will lead you to something in the range of 4-5% if you take out occupancy out of the equation.

If I look back in the first quarter at DCT, we had same store NOI growth. It was double digit on a cash basis, but 5% of that was a growth of 5% was strictly attributable in change in rental rates. Both bumps in our existing leases and the rollover of new leases. And the environment that Phil just described is such that it's gonna take a change to change that trajectory as opposed to just it running out of gas because the environment that we're in today is pretty fertile to maintain that.

Blaine Heck: That's helpful. The question comes to, if you've got the steady bumps that you're planning on in [inaudible 00:10:46] embedded in your portfolio. The main variable is going to be those rent spreads. So you guys have done great on the rent spread side for the past few years you've had high single digit cash rent spreads. Even higher on the gap basis. Do you think that's sustainable. Given where you think rents are growing and then also factoring in where you think expiring rents are going.

Phil: Hard question. Go to Matt. If it's simple come to me. It's real simple.

Matt: I do feel like it's sustainable. It's not a guarantee. There's no question that the comps, the expiring leases that we will face going forward are a tougher comparison than the one's that have been for the last few years. Majority of the leases that we've signed in the last three years, probably, have been compared against trough recession rents. Having said that, market rent growth over ... Let's say we're at average 5 year lease term, which is the easy way to think about it and pretty close to the truth. Rent growth, market rent growth in the last five years has really been phenomenal. It's been much better than what it was in '12 and '13, even '14.

Yeah. Do I think it would be optimistic or aggressive of me to say that I think the next two years will be as good from a releasing spread as the last two years because they've been the highest two years any of us have ever seen? But again I think the environment is such that I think the forward momentum that we have is absolutely sustainable.

Blaine Heck: Okay. Shifting gears a little bit. Development, obviously, also been a major driver of your earnings growth. You guys have a little bit of a different view than other companies. Other REIT peers with respect to investing in and holding land on the balance sheet. Can you just talk through your strategy in that regard.

Phil: Love to 'cause I have pretty strong views. We're not believer's in land banking. What we've proven to ourselves and believed going into the last 10 years has been, with good people on the ground, we can find, assemble, and create land opportunities that are profitable. To own land ... And what we're doing is we're trying buy land that we believe is ready to go now. We're prepared to build on it now. Today's market building. At today's market pricing. And in this environment there's still risk premium spreads we're able to make, as I described the margin's earlier.

The benefit of that is, clearly, you do not have a drag of non-income producing assets in your balance sheet for very long. We're gonna have a developmental pipeline of, I don't know, two starts this year have caught 250 million dollars a year. Maybe it's 300. We have land on the balance sheet today at 35 million dollars. That's a fraction of other peers. The positive to that is clearly we are buying land and building a set of building in today's market. In a six month construction window, you have as much visibility as possible, but the flip side of that is we're starting speck.

The alternative is you have more that which you need to then use to go pursue builder suits. And the builder suits come with lower risk, lower returns, but you have a longer duration of land itself. So I would rather take more leasing risk in today's market over a more land risk over a five or seven year period of time. There's not a right or wrong. It's chocolate and vanilla. We don't have and not invested in the infrastructure necessary, I think, to be a really great build-to-suit player. We've got several public peers who are really good at it. To me, what we're really good at is assembling land, solving problems, wetlands issues, environmental issues, zoning issues, entitlement issues, multiple sellers, and creating tracks that are usable. That's where we invest our time as opposed to trying to convince a tenant to let us build their building.

And then we'll build our building, a market building at market returns, which are far higher than if you have a lower risk builder suit tenant. As an example why that's the case, if I have a spec building, I have DCT has the capital to build it. But to go out and get a non-recourse construction loan on a spec building is very difficult if not nearly impossible unless you don't really need the money.

Anybody can go out and take a credit tenant and go finance that construction loan. As a result, the risk and the costs of just the capital are lower. You'll see more specs starts from us. We'll do build-to-suits where we control the tenant and the relationship, for sure. Or where the site is ... Obviously, we'll get a tenant that comes to us early and they'll track it and we'll pre-lease. But for the most part, hate land sitting on our balance sheet idle. The flip side of that is we're prepared to put our money where our mouth is about our confidence in the market and build building without pre-leasing. Yes ma'am.

Lady asking Q: If your tenants we're expecting that 2017 and 2018 could see water tariffs and all kinds of increased costs to importing, would they not stack every heave of foot full of goods. And do you think any of that could now be happening and that's the reason why your occupancy is already pushing 98%?

Phil: I think it's too early to be able to say that tenants have reacted. It doesn't appear to be the case. Assuming the likelihood of that happening is lower today than it would've been four months ago or November. It doesn't seem, when you look at inventory levels in the tenants that we're dealing with, that's the driver of demand. It's been more e-commerce, housing, manufacturing, things that are not driven by imports. In fact, if you look at import levels they're up a little bit year over year, but not dramatically. So, it doesn't appear that companies are behaving in a way that's accelerating future imports to today. I'm saying it's not happening, I don't see it. It's not in the numbers yet. It's probably too early to have that reaction.

I would think that, if i was a company that was an importer, it seems if the anti-border tax crowd has weighed in pretty effectively. Maybe DC has proven to be more dysfunctional than we ever would have expected with one party controlling all three branches of the government. I'm not anybody's putting too much money on anything coming out of DC right now

Lady asking Q: Are there good industry sources on not the commerce department import, but not just the air freight but cargo shipments, volume.

Phil: The ports themselves publish it. If to aggregate it, a number of firms do that. And so TEU volume which is not air cargo it's coming from the ports itself is up modestly. It's been pretty anemic actually if you think about over the last three years, it's probably lagged. It would not explain why our business is doing so well. If you go back five years ago, ten years ago, several companies, and maybe some sell-side analyst, not you. It's a global business. It's driven by global trade. And really it's driven by consumption, regardless, of where that product comes from and how it's delivered. Right now, consumption is being, more often than not, delivered by FedEx or UPS via e-commerce and being purchased in the store. There is more manufacturing than ever in the US.

Despite the rhetoric in DC, the manufacturing index has been really strong for a long time. One of the largest drivers of our growth is not e-commerce, it's manufacturing. Not manufacturing, the use itself, but the supply chain going through our warehouses. Every time a car gets sold or maintained or an air conditioning unit gets made, or anything that's getting built here, the amount of warehouse space required to feed that manufacturing plant is pretty substantial.

Anyway, that's a long answer and maybe not even an answer to your question. Air cargo is negative. The air freight business, I can tell you I'm glad we don't have a lot of exposure to traditional air freight. In fact, I'll give you another example. We have a warehouse in LA that was leased to an air cargo facilitator, and they moved out and Amazon took the space right away. The location was important, not the airport itself. So air cargo goes away, e-commerce steps in. Air freight has been a tough business for a while.

Back to you.

Blaine Heck: So it sounds like on the demand side, obviously, things have definitely kept up from what I can draw from your commentary. We have heard from some competitors of yours, that we are seeing a little bit of an increase in supply. Is that your experience as well and are there any specific markets where you're concerned about supply catching up.

Phil: I think, supply has moved up rationally in response to strong demand and low vacancy. It's been my view in every market, rational, prudent. The fact that there's more supply in southern California inland empire makes sense. It's 1% vacancy. Now, some of that supply is being built further out, and I'm not necessarily a fan personally in investing in those further out locations, but that product will lease. Dallas and inland empire are the two largest volume supply markets. Both markets are also very strong from a demand perspective. And both markets those supply numbers are influenced, at least partly, by further out locations. In the case of California, it would be the inland empire east, and the case of Dallas, south Dallas, large boxes.

Our response to that is to stay more infill. In the case of Dallas, north. In the case of California, west. And not build as many big boxes, but more of the small-medium sized. Where our pipeline is predominately 100,000 to 500,000 foot buildings, we got a couple of buildings bigger than that, maybe one or two a little smaller than that. Smaller markets that we're not developers in but Indi, Louisville, the two markets I see flag in a percentage basis. They're not markets that we're active in, harder for me to comment.

But Dallas, 22 million square feet in Dallas, I think similar to that in inland empire, that's a lot of space. Demand has been strong and so I don't think it's irrational. I wish there was less, but we're not gonna slow down. So, I'm not surprised other's won't either.

Blaine Heck: Running a bit low on time, but I did want to touch on asset pricing. I think that's been another aspect of this cycle where it's been a little bit surprising to investors and participants. There's been a lot of demand for industrial real estate. It seems like its institutions have been underweight this sector for quite a while right now. Is that still the case? Is there anything? Are there any signs that point to any sort of softening in pricing?

Phil: Yeah.

Blaine Heck: For industrial kind of near to midterm?

Phil: Well, the short answer would be no.

Blaine Heck: Yeah.

Phil: Cap rates. Boy, every time I do these types of panels, three or four times a year, and when your panel in February, and everyone was saying, "Well cap rates can't come down any further." Three months later and you say, "Well they've come down a little bit further." They're probably down 20 basis points in the last six months. That's pretty meaningful if you're talking about cap rates of five.

Every major market, now, cap rates are sub five. Atlanta was the last market. And I shouldn't say ... That's not a generic all assets of five. Class A, well leased assets, sub five. And in California, even potentially sub four if the rents are materially below market.

What I think though, it's also important to understand is there's another side of that coin. It's a very differentiating market. It's a bifurcated world. Investors really want what tenants want, functional, well located real estate. Secondary markets, yes, but as soon as you get too far out or you go from a basic level of function, and that's somewhat judgemental if you next to LA or LA airports, San Francisco airport, the definition of function maybe a little different than if you're in Dallas or Houston, but as soon as you drop off a little bit of the quality spectrum, you drop off the cliff from a demand perspective. Invested demand perspective. I think, in some ways, when I look at public re-pricing, for example, I think of lower quality portfolios as being treated almost in a continuum with the higher quality portfolios. And it doesn't work that way.

There's certainly some adjustment that cap rates as quality as markets change. But at some point there's one level where all of a sudden you lose all buyers. You could give it away and it's not saleable. But if you've got decent quality product, you've got investors calling on you looking for assets to buy. Foreign and domestic, we've got a number of packers out there on the street right now, some are in contract, some are hard, one recently closed. It's international. It's public right and it's pension fund and then it's also private, local investor depending on the asset and the quality. The whole gambit.

Blaine Heck: We've got a question over here.

Phil: Yes ma'am.

Question Lady 2: Obviously that history has some great [inaudible 00:26:05] e-commerce was [inaudible 00:26:08] manufacturing. Have you seen growth in [inaudible 00:26:13] or acceleration this quarter on this side of e-commerce as we go [inaudible 00:26:18]

Phil: I think we've seen acceleration for two reasons. One is, it's still in the early infancy of building out and clearly Amazon is as busy as ever. But forget Amazon. Everybody else is trying to catch up to Amazon. And second, as I said, we're for a build-to-suit company. We're not trying to go out and build whatever tenants want. We want to build what the market wants in the locations we want. As so then that quote, "Last Mile" has come to us and we're much more of a beneficiary of that. So what we're seeing is, Amazon two years ago was not on top 10 list. Probably not on our top 50 list. Today they're number one. It's not because we went out and built build-to-suit, we didn't do any build-to-suits with Amazon. They leased either first generation spec development buildings or second generation. I mentioned LAX, second generation buildings. We've done, I don't know, seven or eight leases with them in the last year, two year.

That's just an example, but I think we're still early days. It's not the only story out there. I hate ... If all you think about is e-commerce, it's probably not enough of a reason to buy into the industrial story, but it's certainly a nice ... I'd rather be in our shoes than retail. I'm not bold statement.

Blaine Heck: We've got a couple more minutes.

Phil: And I may need you to use the mic. Is there a ... I can't hear you back there.

Man asking Q: [inaudible 00:27:53] national trade.

Phil: Somewhere to the border tax question, no. We've actually done, at least, one lease with a very major off shore manufacturer of consumer products. Very well known name, and they're clearly building out a US infrastructure more than, I think, I would've expected. I don't think it's a response to more recent political discourse, but more a function of trying to control their, and diversify their supply chains. And if you're wholly dependent on importing from Asia into the US, that can be disrupted fairly easily. It can be disrupted from a supply chain perspective, costs are changing. Exchange rates are changing. Cost of energy is changing. So a lot's going on besides just taxation and/or anti-trade rhetoric.

There's been, I think, an on shoring phenomenon, maybe even a near shoring phenomenon with Mexico that is shifted some market share from Asia to North America. So the US and Mexico. I'm not sure about Canada. I think it's still way too early to read into the political discourse and how companies ... I don't know how you ... I don't run a Fortune 50 manufacturing company. I don't know how I would deal with what I'm listening to right now. It's just so much noise and so much static that it would probably drive me nuts.

It's hard to take a position on something that's indecipherable.

Yes sir.

Blaine Heck: One more quick one.

Question Man 2: [inaudible 00:29:48]

Phil: You know, we've had this discussion a fair amount. I don't have a view. To me, I think, I still focus our investment strategy or philosophy on assets that are more irreplaceable than not. I gotta believe that location and function will matter no matter how product is delivered. I think you could argue a number of different ways. I think, driverless vehicles could increase the need for more trailer storage 'cause you got fewer constraints on the drivers. So you can get more trailers moved through, but then can you really unload them fast enough.

That's been a trend we've already been building into anyway. Maybe you have fewer car parking spaces, but I'd rather have a building that has too much parking than the market wants. Because that's just simply an economic, at the margin an economic issue, than a building with too little parking, and you can't fix it.

I had a conversation with an individual who actually, now, very senior at a large financial institution, we sit on a common board together. And his comment was everyone's talking about we're the technologist when it comes to this, but the political side of this has not weighed in that much. And when you see what Uber's done to some communities, and how they've reacted and many others, I think that the political discussion of automation, driverless vehicles, robotics, whatever, I'm not sure the politics is gonna be a non event. I could be wrong.

And I also think, until you believe there's such a dominant market share of driverless vehicles and traffic's no longer an issue, location will still matter. Even if you don't have a driver in it, until you get rid of the traffic on 95 or on 5 on the west coast or where ever you might live, I don't care if you got a driver in there or not, location will matter a lot. And I don't believe in a foreseeable future a whole period of 10 years that traffic should be taken out of the equation.

But we'll find out. I still would rather invest in non commodity in fill locations and take my chances than believing that I'm gonna go buy the next corn field out and be a leader in what is now almost worthless land.

Blaine Heck: So with that, that's our time. I want to thank Phil and Matt for coming. Thank you all for your interest.

Phil: Thanks. Appreciate your staying in.