Industrial Market Trends Q3 2009
United States

GRUBB & ELLIS.
From Insight to Results

In This Issue...

Industrial Market Trends
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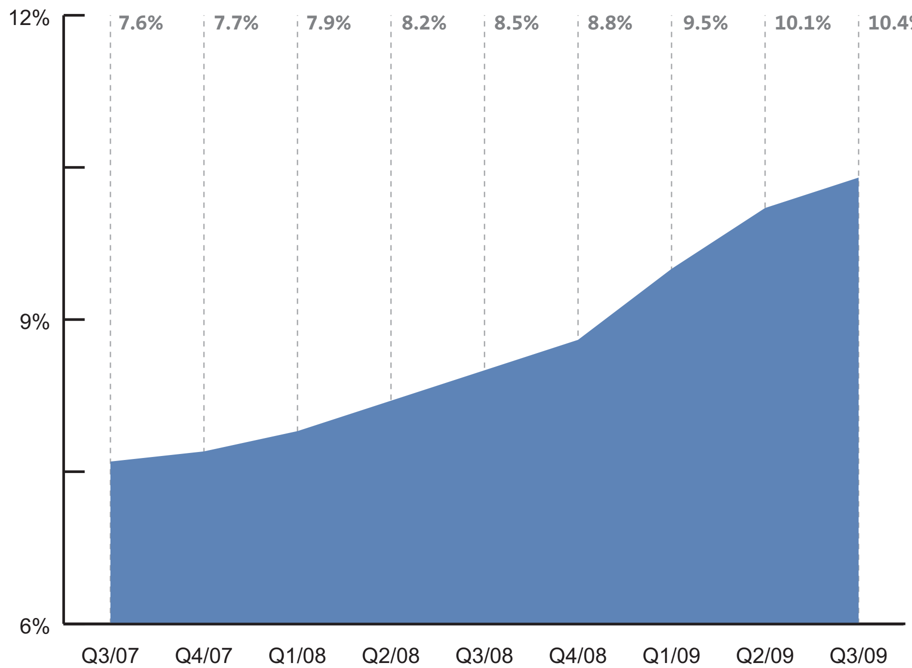
Rising Slower...

US INDUSTRIAL VACANCY RATE*



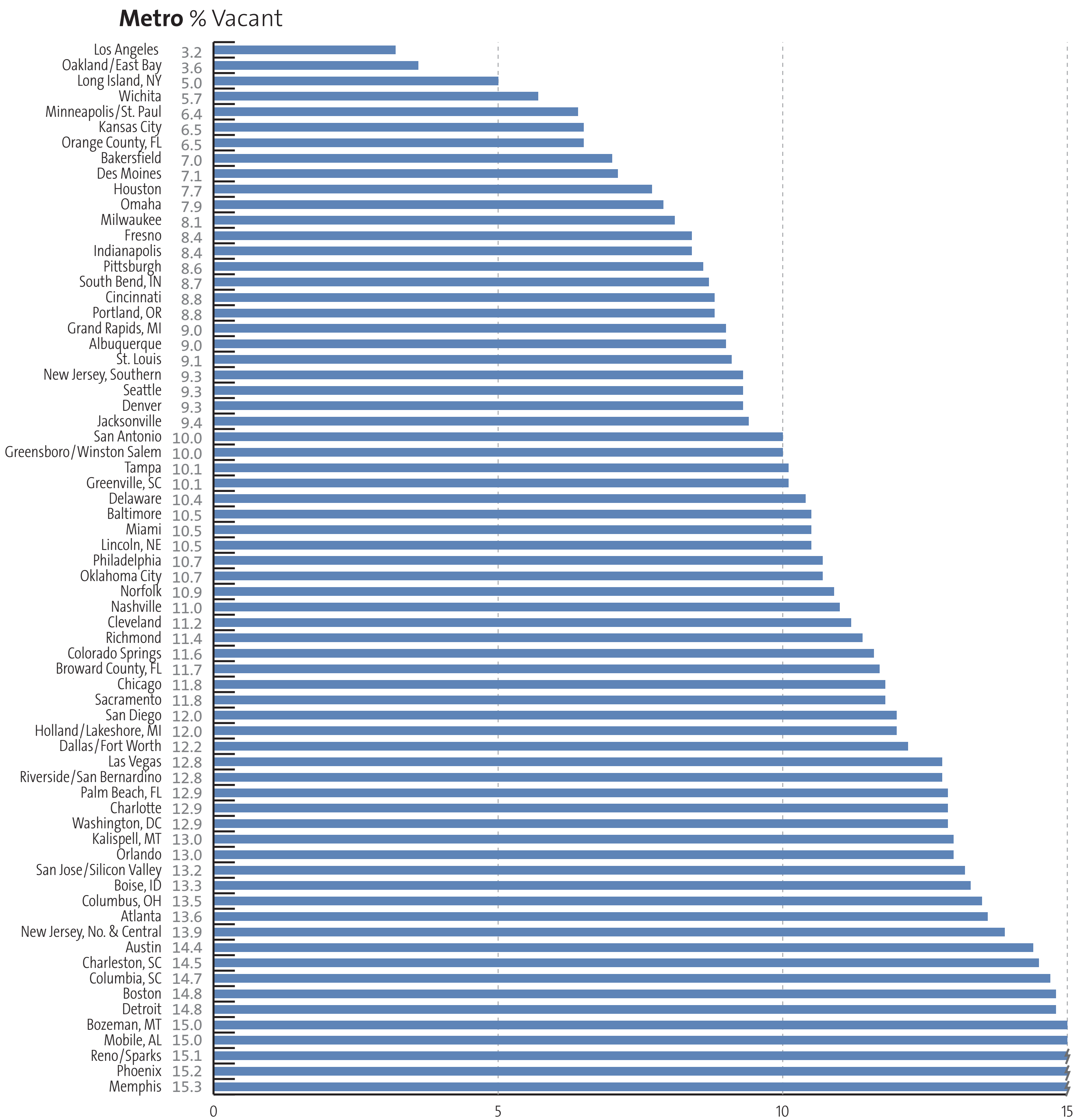
* All product types

THE BOTTOM LINE

The third quarter brought another increase in the vacancy rate, the eighth one in a row, and absorption was sharply negative. But the rate of deterioration in these two variables was slower than in the first and second quarters, which makes sense considering that the economy improved gradually through the spring and summer and now appears to be in the very early stages of a recovery. Global trade, freight shipments, retail sales and manufacturing orders – drivers of demand for industrial space – are showing some improvement although from a very low base. Look for industrial leasing market fundamentals to level out by the middle of 2010 and embark on a slow recovery beginning in 2011.

TOTAL MARKET VACANCY RATES

Note: Vacancy data refer to general industrial, warehouse/distribution, R&D/flex and incubator buildings with size thresholds ranging from 5,000 square feet in smaller markets to 25,000 square feet in larger markets. Inventory includes multi-tenant, single-tenant and owner-occupied space.



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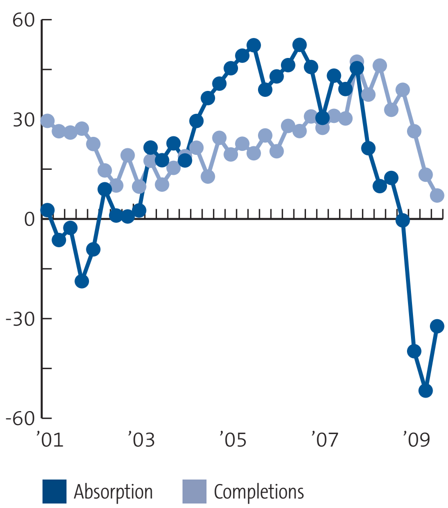
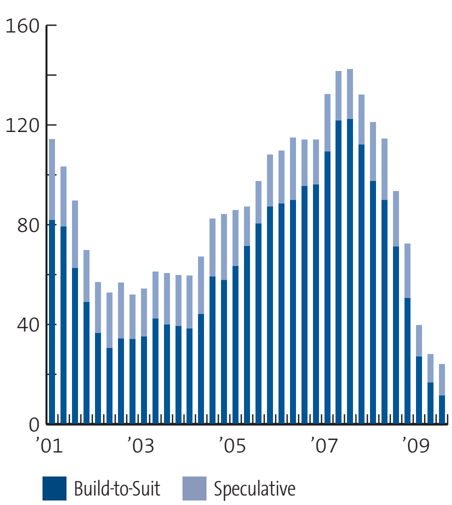
STATE OF THE MARKET

Absorption and Completions
in Millions of Square Feet



Space Under Construction
in Millions of Square Feet



The U.S. industrial vacancy rate increased to 10.4 percent in the third quarter, its highest level since the third quarter of 1994. The good news is that the rate of softening moderated; the quarterly increase was 30 basis points, well below the first and second quarter gains of 70 and 60 basis points, respectively. The slower rate of deterioration was evident as well in the office, retail and apartment sectors.

- Industrial vacancy was lowest in **Los Angeles** at 3.2 percent, although the availability rate of 8.7 percent suggests that vacancy is poised to rise as leases expire. Vacancy was highest at 15.2 percent in **Memphis**, a market where conditions are soft plus the equilibrium vacancy rate tends to be high. Six large markets posted year-over-year vacancy increases of 400 basis points or more, i.e. one percentage point per quarter. Five of the six were in Florida and southern California: **Orlando, Broward County** and **Palm Beach County** in Florida and the **Inland Empire** (Riverside-San Bernardino) and **San Diego** in California. Only two markets recorded year-over-year vacancy decreases: **Oklahoma City** and **Baltimore.**

Absorption was sharply negative for a third consecutive quarter as tenants vacated a net total of 32.3 million square feet. This was a slight improvement from the first and second quarter totals of minus 39.8 and minus 51.7 million square feet. Deliveries were at their lowest level of the decade at just 7.1 million square feet, a sign of how thoroughly developers and lenders have retreated.

- Negative absorption was most pronounced in **Northern and Central New Jersey** where occupiers returned a net total of 3.8 million square feet to the market. This was a vast improvement from the 9 million square feet emptied in the second quarter. Eleven markets recorded positive third quarter absorption. The Greater **Philadelphia** region, encompassing central and eastern Pennsylvania, led with 523,000 square feet.

Space under construction plunged to 24 million square feet at the end of the third quarter, its lowest level since the mid-1990s. The shorter timetables for industrial construction projects mean that construction activity declines more quickly than other property types, which helps keep vacancy increases somewhat manageable when the market turns south.

- **Philadelphia** led all markets with 2.6 million square feet remaining in the pipeline, down from a recent peak of 9.5 million square feet in the third quarter of 2008. The **Inland Empire**, the long-time construction leader, had 1.5 million square feet under way compared with a recent peak of 23.7 million square feet in the second quarter of 2007.

The average asking rental rate for all types of industrial space offered on the market at the end of the third quarter was $5.34 per square foot per year triple net, a decline of 6.7 percent from the year-ago quarter. The average effective rental rate for industrial space year-to-date declined by 12 percent compared with the annual average for 2008, pushed lower by aggressive leasing concessions on offer to tenants.

- There is really no region of the country where demand is strong enough to push rents higher. But some markets are holding up better than others as illustrated by relatively stable asking rates, including several in the central U.S. such as **Minneapolis, Kansas City, Omaha** and **Cleveland.**

The capital markets are on hold right now. The news is all about the lack of debt capital to refinance maturing loans and, on the flip side, the growing pool of equity capital waiting to invest in distressed assets, primarily debt. The standoff is because sellers don't want to sell into the biggest buyers' market since the early 1990s, and they are being enabled by banks (pretend-and-extend or pray-and-delay) and the IRS, which has relaxed the rules for amending the terms of CMBS loans. So the dollar volume of sales remains very low, down 75 percent for all property types year-to-date through August and down 71 percent for industrial properties. Pricing on repeat sales has retreated sharply according to the Moody's/REAL commercial property index, down 40.3 percent over the past two years for all property types and 29.1 percent for industrial properties. Distressed assets continue to pile up, totaling $138 billion at the end of August, of which distressed industrial properties comprise just $3.7 billion according to Real Capital Analytics, a welcome sign of stability relative to other property types. At some point these and many more assets will begin to change hands, but whether that process resembles a dam breaking or a steady flow is uncertain.

FORECAST

There are some signs in the economy and the industrial market itself that this brutal softening cycle could be approaching a bottom.

- Many economists including Federal Reserve Chairman Ben Bernanke think the recession is over, although a majority thinks the recovery will be very sluggish, particularly in the labor market.
- Both imports and exports are on the rise as global trade resumes following precipitous drops last fall. The increase in imports is vital for port-adjacent industrial markets such as the Inland Empire while the increase in exports will support manufacturing-oriented markets such as parts of the Midwest.
- Retail sales have posted modest increases in recent months, which is significant for markets where retailers locate their distribution centers.
- The Freight Transportation Services Index (TSI) rose 0.7 percent in August compared with July, the second consecutive monthly increase according to the U.S. Department of Transportation's Bureau of Transportation Statistics. The index has increased four consecutive months although it remains well below its year-ago level. This is a sign that retailers, wholesalers and manufacturers are restocking depleted inventory levels and that demand for business capital goods is beginning to recover.
- Even the long-suffering labor market is showing some signs of life as weekly jobless claims, though still elevated, have fallen through most of the year.

Commercial real estate usually is the last industry to recover from a recession, but the slower pace of deterioration in the third quarter raises hope that a market bottom is not too far off. Look for industrial leasing market fundamentals to level out by the middle of 2010 and embark on a slow recovery beginning in 2011.

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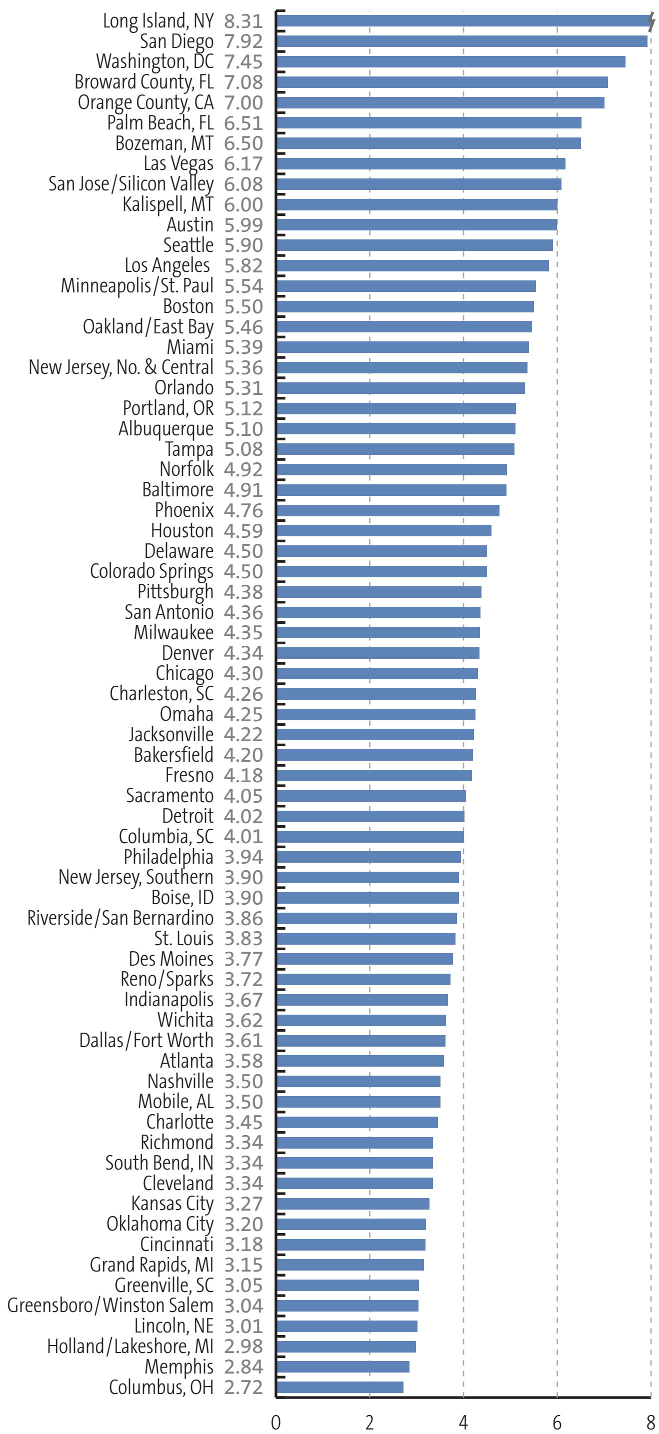
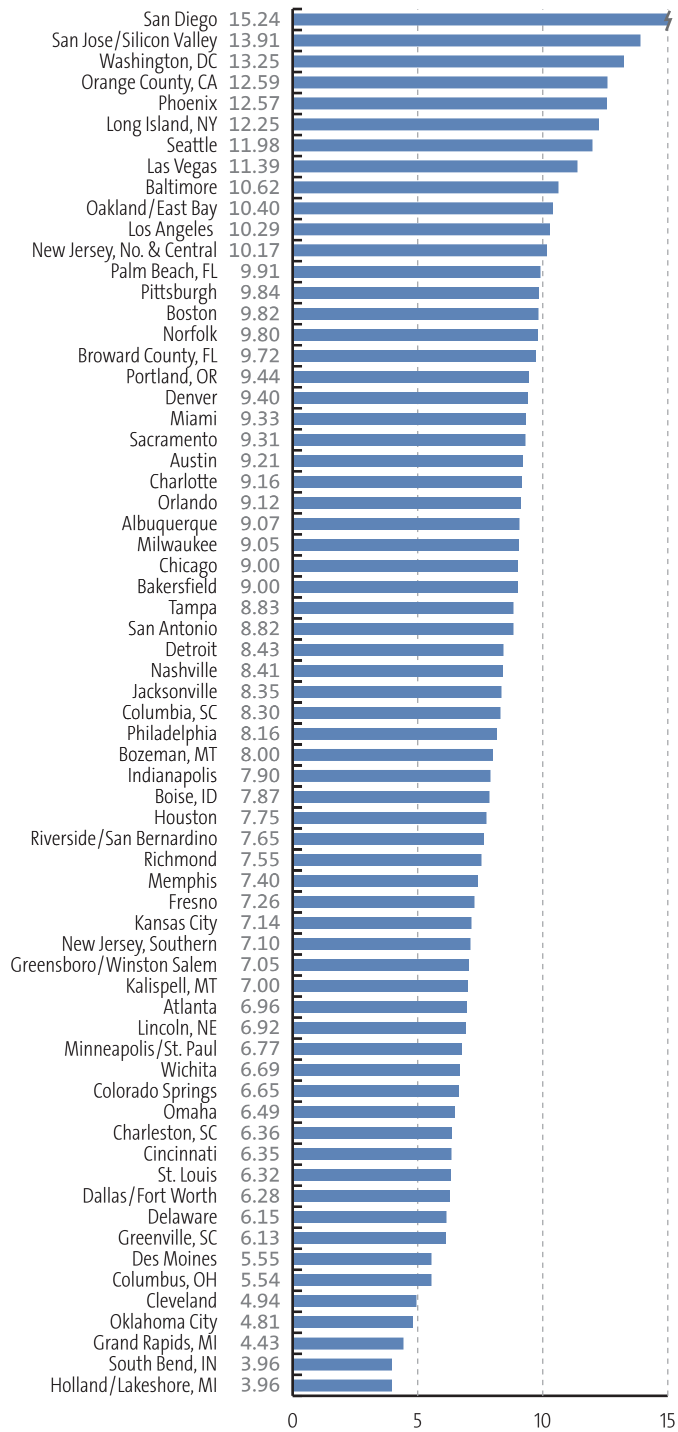
ASKING RENTAL RATES

Note: Rental rate data refer to space that is available on the market at the end of the quarter. Rates are per square foot, quoted on a triple net basis. Rates for each building are weighted by the amount of available space within the building.

Warehouse/Distribution $ Asking Rent



R&D/Flex $ Asking Rent



NORTHERN CALIFORNIA/ PACIFIC NORTHWEST

Fresno: Vacancy is expected to rise through year-end... **Oakland-East Bay:** Whipple Business Park in Hayward saw approximately 132,000 square feet come back on the market due in part to UPS vacating 48,000 square feet at 1063 Whipple Rd... **Portland:** Tenant and user activity has started to pick up with the hopeful economic signs. DP Partners recently announced a 100,000-square-foot build-to-suit for Morgan Distributing at Riverside Parkway Corporate Center... **Sacramento:** Nestle Waters took occupancy of its facility on Younger Creek, bringing new jobs to the area as well as contributing to positive net absorption in the Power Inn submarket... **San Jose-Silicon Valley:** Emerging clean technology tenants have begun to look for deals on manufacturing and storage space. In the largest transaction this quarter, eco-friendly Tesla Motors nabbed a portion of the Agilent Technology building in Palo Alto... **Seattle:** AFL-CIO Building Investment Trust sold the Renton Commerce Center to Bertch Company for $11,350,000.

SOUTHERN CALIFORNIA/ PACIFIC SOUTHWEST

Bakersfield: The industrial market remains fairly stagnant with most activity consisting of local users relocating to take advantage of reduced rates. Corporate users are in the market but are taking a long time to make a decision to ensure the best deal. Sales remain slow due to the lack of available credit... **Los Angeles:** Tenants appear to have finally been enticed by lower rates and are taking the opportunity to lock in longer-term deals before the eventual economic turnaround... **Orange County:** Limited user demand coupled with tenant move-outs pushed vacancy lower and rents higher across most submarkets... **Riverside-San Bernardino:** Walnut-based Peng Cheng Aluminum purchased a 1.1 million-square-foot facility in Fontana, previously occupied by Galleria Furniture, for just under $45 per square foot... **San Diego:** Absorption for the third quarter of 2009 was minus 1.1 million square feet, bringing the total year-to-date loss to 3.3 million. Effective rents continue to decrease.

MOUNTAIN/SOUTHWEST

Albuquerque: Sublease space has grown substantially compared to a year ago, increasing by over 350,000 square feet. Falling rates are beginning to spur a small uptick in market activity... **Boise:** The industrial market has remained fairly active. Landlords are offering more in tenant improvement allowances than in the past... **Bozeman:** There is currently a significant amount of new product within the Four-Corners submarket with rental rates falling and vacancies increasing... **Colorado Springs:** Investors are finding opportunistic buys in distressed properties... **Denver:** While some pockets of activity persisted, namely in the northern suburbs where renewable energy tenants remain active, by and large submarkets experienced a net loss of tenants over the quarter... **Kalispell:** Warehouse product absorption has slowed with rates starting to move down slightly... **Las Vegas:** Development has come to a standstill with an overabundance of existing product... **Phoenix:** Negative net absorption is expected to set a new record this year. Expect asking rents to fall even further if distressed assets trade... **Reno/Sparks:** Absorption was negative for two of the last three quarters. Speculative building has virtually shut down, and there has been just 34,000 square feet of build-to-suit construction year-to-date. Several large tenants are interested in northern Nevada but have not yet committed to space.

TEXAS/GREAT PLAINS

Austin: Dell Financial vacated 185,485 square feet of R&D/flex space at Plaza 35 Business Park. Further contraction among industrial tenants pushed the city-wide absorption level deeper into the red... **Dallas-Fort Worth:** The recession plus an abundance of new product in the market has triggered a sharp decline in speculative development this year... **Des Moines:** The decline has been slow and gradual compared to other areas of the country, however, improvement is not expected any time soon... **Houston:** The trend of rising vacancies will continue for the remainder of 2009 as over 1.5 million square feet of new construction delivers into a market with diminished leasing demand... **Kansas City:** Short-term renewals have become more common as companies are uncertain about their future... **Oklahoma City:** Business owners have focused on current operations instead of expansion while property owners' focus has been on maintaining their portfolios rather than growth... **Omaha:** With a lid on new and planned construction, vacancy is expected to decrease going forward... **San Antonio:** A recent surge of activity around Port San Antonio has set the stage for an expansion of businesses in South San Antonio... **St. Louis:** Larger owner-users such as Holt Electric are taking advantage of the weak economy to purchase space rather than leasing... **Wichita:** The market retains one of the lowest vacancy rates in the U.S. despite an increase in the third quarter from the completion of vacant spec buildings.

GREAT LAKES/ OHIO VALLEY

Chicago: World's Finest Chocolate executed a 436,000-square-foot sale-leaseback deal for an 18-year lease term with AIC Ventures. Freudenberg Household took occupancy of its 525,000-square-foot North American headquarters facility in Aurora, making it the largest completed project this quarter... **Cincinnati:** Smurfit relocated to 321,000 square feet at Duke Realty's World Park @ Union Centre #12... **Cleveland:** It appears that occupancy is stabilizing after a recent slide. The defense, aeronautical and bio-med/healthcare sectors have been expanding...**Columbus:** The market remained flat with no rebound likely until 2010... **Detroit:** Xtreme Power Inc and Clairvoyant Energy announced investments of up to $1.3 billion to convert Ford Motor Company's Wixom Assembly plant into an alternative energy park that will produce solar panels and renewable electrical energy storage systems in 2011... **Elkhart/Goshen:** There has been an economic resurgence with over $105 million of new investment and approximately 2,600 new jobs added in 2009. Elkhart County's jobless rate fell from 18.9 percent in March to 16.0 percent in September, helped by a rebound in the RV industry... **Grand Rapids/West Michigan:** The vacancy rate increased 30 basis points to 9.0 percent, most of which is attributable to the continued weakness in the warehouse/distribution sector... **Indianapolis:** Construction activity is declining while vacancy is going up... **Milwaukee:** The velocity of transactions for small industrial users has been brisk... **Minneapolis:** The amount of negative net absorption was significantly less than in past quarters... **South Bend:** Property prices are continuing to trend downward. Properties that are priced right are better positioned to get offers. Price discounts are sometimes as great as 30 to 40 percent below recent values.

NORTHEAST/ MID-ATLANTIC

Baltimore: Low consumer demand and a decrease in warehouse usage caused leasing activity to decline significantly... **Boston:** FedEx expanded into the entire 343,000-square-foot building at 1 Beeman Road in Northborough... **Long Island:** With minimal demand, space remains on the market an average of 13.4 months. Vacancy increased by 20 basis points to 5 percent, while the availability rate increased more rapidly by 130 basis points to 11.7 percent—the highest rates in four years... **New Hampshire:** Leasing activity picked up in the last quarter, particularly for R&D/flex properties... **New Jersey:** Rental rates are not anticipated to stabilize until a rebound in demand can absorb the significant availabilities currently impacting the market... **Philadelphia:** Church & Dwight moved into 1.1 million square feet in the Central PA submarket of Thomasville. The Visteon plant on Morris Road in Lansdale and the Graham Packaging facility on Bristol Pike in Levittown were shuttered... **Pittsburgh:** The existing inventory is well positioned to accommodate small to medium-size users, but for larger projects in excess of 200,000 square feet, the only viable option is new construction.

SOUTHEAST

Atlanta: Duluth-based AGCO Corporation is eyeing a Georgia factory that could employ up to 2,000 workers. Shaw Industries is consolidating its operations in Ringgold and is expected to hire 400 additional workers... **Broward County:** Tenants downsizing before their leases expire along with new construction deliveries contributed to the steepest quarterly rise in vacancy since 2003... **Charleston:** TBC Corp has chosen Berkeley County for a 1.1 million-square-foot distribution center... **Greenville-Spartanburg:** Lockheed Martin leased the 210,000 square-foot David Poole Building, and General Electric Aviation took a 155,000-square-foot building previously occupied by Grammer Industries... **Jacksonville:** Jaxport continues to improve infrastructure at all of the marine terminals to prepare for increased shipments... **Memphis:** Nike leased 817,274 square feet in the Southeast market... **Miami:** Demand for small-bay space remains relatively healthy compared with demand for medium to large blocks of space... **Mobile:** With warehouse vacancies rising and rents declining, there are no plans for new construction at this point... **Orlando:** Vacancy increased for the 10th consecutive quarter... **Palm Beach County:** Vacancy has soared 410 basis points this year while average asking rents for the three industrial product types have dropped 11 to 15 percent... **Raleigh-Durham:** Warehouse vacancy rose above 20 percent in the third quarter driven largely by space returned to the market by Stock Building Supply. The market's saving grace at the moment is an ongoing lack of new construction, which will keep vacancy from reaching levels seen during the last softening cycle... **Richmond:** Qimonda closed its 1.3-million-square-foot plant in eastern Henrico County, which was constructed for the manufacture of computer chips and, as such, will attract few users. Liberty Property Trust completed a 220,800-square foot lease with American Red Cross at Fairgrounds Distribution Center... **Tampa:** Activity is limited to smaller deals. Vacancy rates are still increasing but in smaller steps than earlier in the year.

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