Industrial Market Trends Q3 2011
United States

GRUBB & ELLIS
From Insight to Results

In This Issue...

Industrial Market Trends
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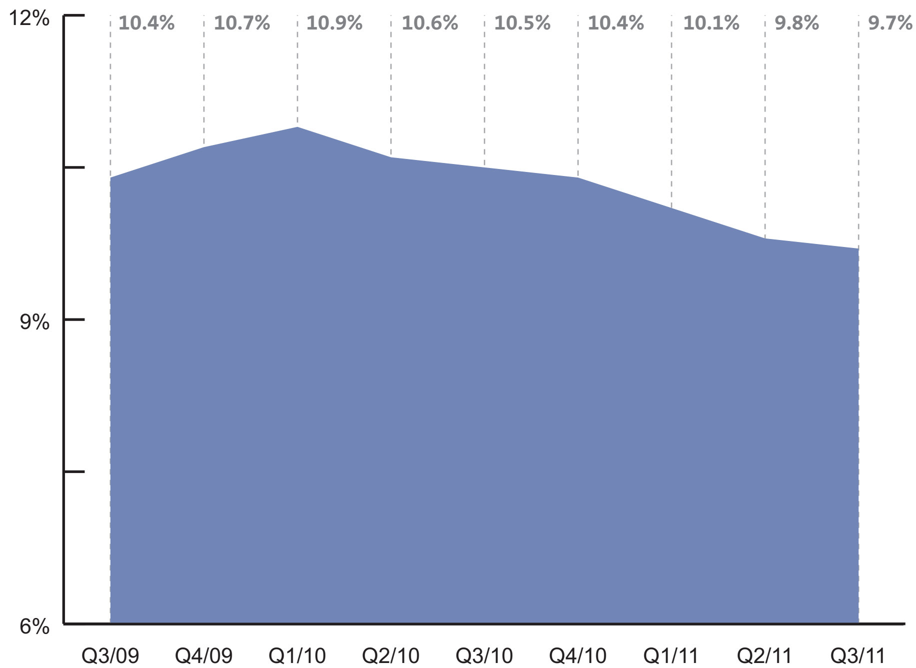
The Market Does Not Pause

US INDUSTRIAL VACANCY RATE*



* All product types

THE BOTTOM LINE

- Demand slowed during the third quarter, reaching 24 million square feet of positive net absorption. Despite this total being 23 percent below levels reached during the first two quarters of 2011, the market is on track to absorb in excess of 100 million square feet this year.
- New supply increased by 53 percent from the second quarter, but 5.3 million square feet of total national deliveries ranks as the fifth lowest quarterly total on record.
- The national vacancy rate declined an additional 10 basis points to 9.7 percent; the national availability rate declined 30 basis points to 13 percent.
- Following three consecutive quarters of flat readings, overall asking net rents increased an annualized 0.6 percent during the quarter. The bottom has been formed and rent increases will accelerate in 2012.
- Increasing speculative new construction will add a new dynamic to the market's recovery in 2012.

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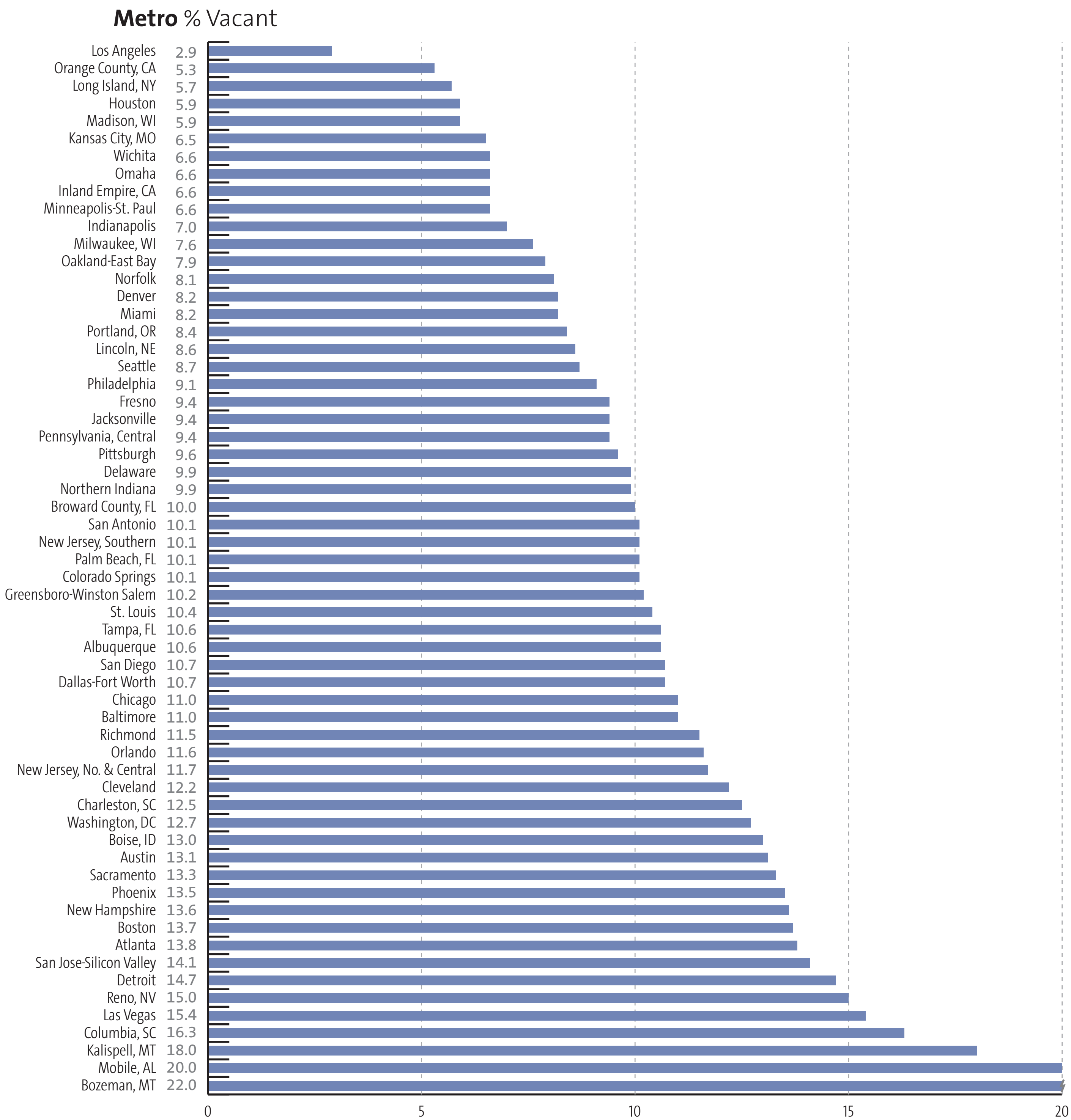
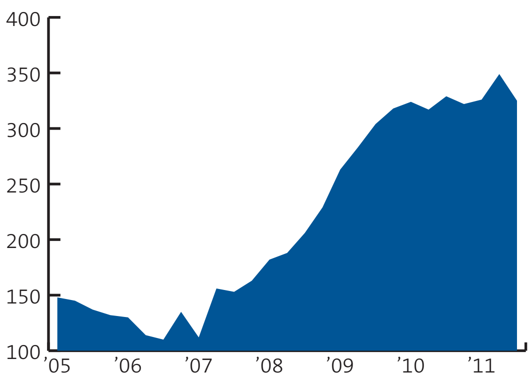
TOTAL MARKET VACANCY RATES

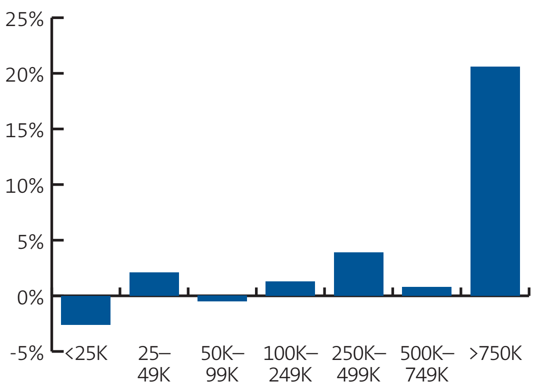
Note: Vacancy data refer to general industrial, warehouse/distribution, R&D/flex and incubator buildings with size thresholds ranging from 5,000 square feet in smaller markets to 25,000 square feet in larger markets. Inventory includes multi-tenant, single-tenant and owner-occupied space.



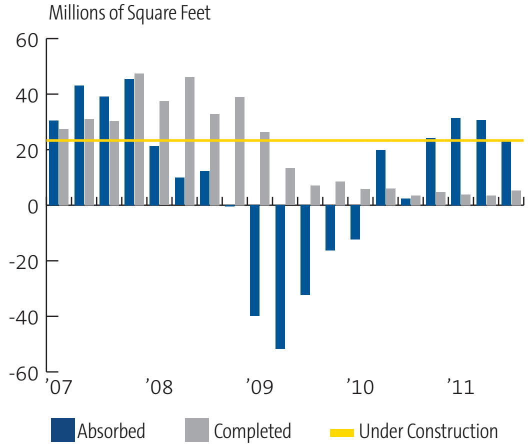
Vacancy & Availability Spread
(BPS)



3Q Annualized Rent Growth
By Market Segment (Square Feet)



Construction Will Accelerate
Millions of Square Feet



STATE OF THE MARKET

The U.S. economy grew at an annualized rate of less than 1 percent during the first half of 2011. During the third quarter, growth accelerated to 2.5 percent, a rate that is still well below the pace needed to improve the struggling labor market. The ongoing economic slowdown, however, did not penetrate into all drivers of industrial demand. While the ISM manufacturing index declined from 55.3 in June to 51.6 in September (but only after an August reading of 50.6), industrial production growth accelerated from 0.1 percent in the second quarter to 1.3 percent in the third. Also, while year-over-year containerized imports growth turned from positive 2 percent in the second quarter to negative 4 percent in the third, total retail sales excluding food remained strong, growing on a year-over-year basis 8.2 percent in the third quarter, 10 basis points faster than during the previous quarter. Nevertheless, monthly job creation of 95,000 jobs and consumer confidence at recessionary levels are both headwinds that temper demand for industrial space.

Net absorption performed better during the quarter than some of the drivers were suggesting, totaling 23.7 million square feet. Despite the slowdown, the recovery continues to be nationwide.

- Of the 49 markets tracked in detail by Grubb & Ellis, 34 had positive net absorption during the third quarter, which was five fewer than during the second quarter and on par with first-quarter performance. The aggregate negative net absorption of negative 4.4 million square feet came in between the first quarter's negative 5.8 million and second quarter's negative 2.8 million.
- The national industrial market is just one quarter away from reabsorbing all the space that went vacant during the last recession. In total, 153 million square feet was vacated over a six-quarter period, of which 132 million has been reabsorbed over the subsequent six quarters. Given the severity of the decline, the current recovery is progressing slightly ahead of the one that followed the 2001 recession.
- Inland Empire continues to outperform. Big-box tenants absorbed an additional 4.1 million square feet during the third quarter, bringing the year-to-date total to 17.1 million square feet. This one market, which represents less than 4 percent of total national stock, has contributed 20 percent of total national demand in 2011. Local net absorption is likely to slow in the coming quarters, as imports and the overall economy play catch-up to the space that has been absorbed here.
- With the exception of Atlanta, where demand slowed from a quarterly average of nearly 2.5 million square feet during the first two quarters to just 360,000 square feet in the third quarter, all national distribution markets saw strong demand, especially for large blocks of distribution space. Chicago led the way with 2.5 million square feet, followed by Dallas/Fort Worth with 2.3 million square feet and Northern/Central New Jersey with 2 million square feet. Phoenix, which historically acted as a local distribution market, has been attracting retailers from California, resulting in quarterly net absorption of 1.7 million square feet.
- Negative demand was mostly concentrated in local markets that are more reliant on smaller businesses which are not yet participating in the recovery. Top-

ping the chart in this category was Albuquerque with negative 470,000 square feet, Boston with negative 460,000 square feet and Minneapolis with negative 280,000 square feet. The two notable exceptions, which were also the two worst-performing markets of the third quarter, were Columbus (negative 1.4 million square feet) and Memphis (negative 600,000 square feet). Both of these markets are distribution markets, often targeted by large third-party logistics providers (3PLs).

New deliveries bottomed in the second quarter at 3.4 million square feet. The third-quarter total of 5.3 million square feet is still just the fifth lowest quarterly total on record, but it also marks the quarter during which new deliveries started to accelerate into the foreseeable future. Only 427,000 square feet, or 8.1 percent of total, was delivered as available.

- New buildings were completed across 10 markets, but two markets, Inland Empire (1.8 million square feet) and Chicago (1.7 million square feet) accounted for two thirds of total deliveries.
- A built-to-suit for Skechers USA in the Inland Empire market was the largest completion at 1.8 million square feet. The buildings will serve as a national distribution center, reaching customers across the U.S. and Canada.
- A Clorox built-to-suit in the Chicago market totaling 1.35 million square feet was completed during the third quarter. The company has not moved in yet, so the building is artificially increasing the market's vacancy rate and understating net absorption. Both of these statistics will be impacted at the beginning of 2012, when the company moves from Minooka to University Park at a net gain of 500,000 square feet.
- The third largest completion of the quarter took place in Atlanta, where Sany America moved into its built-to-suit. The facility is a 409,000-square-foot corporate headquarters and manufacturing facility.
- CenterPoint Properties completed the largest speculative building of the quarter. The 109,000-square-foot flex building is located in the I-81 Corridor in northeastern Pennsylvania and was 100 percent vacant at completion.
- The remaining 1.6 million square feet, of which 319,000 square feet is available, was delivered in 19 buildings.

The national vacancy rate decreased 10 basis points to 9.7 percent during the third quarter, making it the smallest quarterly decline this year. However, it is the elevated availability rate that has been having the larger impact on the national industrial market. In 2007, the spread between vacancy and availability averaged 150 basis points. This spread increased to 325 basis points by the time vacancy peaked at 10.9 percent during the first quarter of 2010. During the first stage of the recovery, this spread continued to widen, as tenants were concerned about the possibility of a double-dip recession. During the third quarter, availability fell by 30 basis points to 13 percent, reducing the spread by 25 basis points. The spread between these two metrics is a measure of market uncertainty and until it compresses to normalized levels, market rents will continue to struggle.

During the quarter, net asking rents rose an annualized 0.6 percent. While the market remains in recovery, it is not insightful to focus on overall rents, because not all segments are performing identically. While most markets are seeing absorption in the large-block segment, smaller tenants are mostly making lateral moves in search of lower rents. Focusing on just the 750,000-plus-square-foot blocks, rents during the third quarter rose an annualized 21 percent. On the other hand, spaces smaller than 25,000 square feet saw their average rents decrease by 3 percent. The 250,000-to 500,000-square-foot segment was also a strong performer with annualized rent increases of 4 percent. Big-box, Class A rents are likely to increase further as their existing supply diminishes and new supply is just now starting to be contemplated.

FORECAST

Speculative new construction will be the story of 2012. While in 2011 the news was the commencement of construction of the first, large speculative building since the beginning of the recession, the focus of 2012 will shift to the depth and breadth of the construction market. The Grubb & Ellis Third Quarter Industrial Broker Sentiment Survey identified 16 markets where speculative construction is already occurring, or is to commence in the immediate future. Currently, there is 23.3 million square feet under construction, of which nearly 10 million square feet is speculative. The Inland Empire alone is likely to have as much as 7 million square feet of speculative construction underway by 2012. The lack of new developments has been of tremendous help to the recovering market to date. Although rents in many markets are still well below where they were in 2007, capitalization rates have fallen 25 percent in 2011, increasing values correspondingly and making new construction more economically feasible, even at the current depressed rent levels. With increased construction activity, market demand will need to accelerate if vacancy is to continue falling at the rates seen since the second quarter of 2010.

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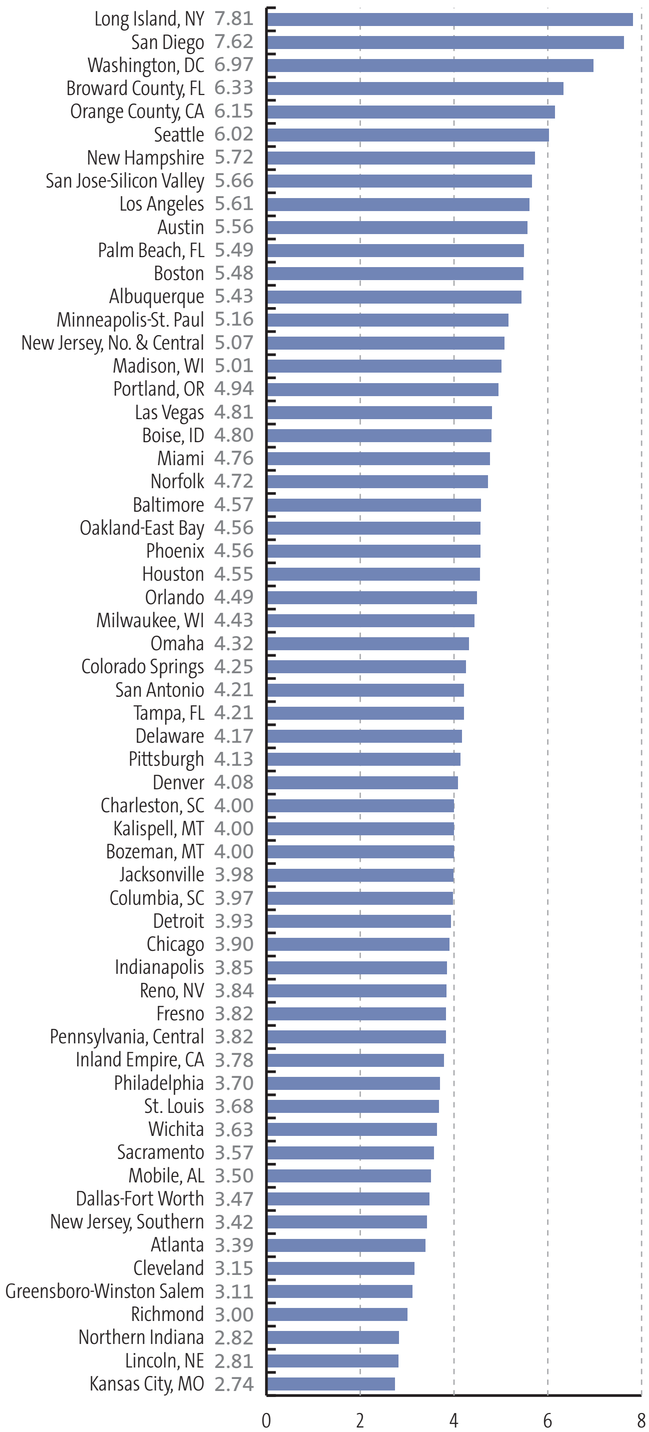
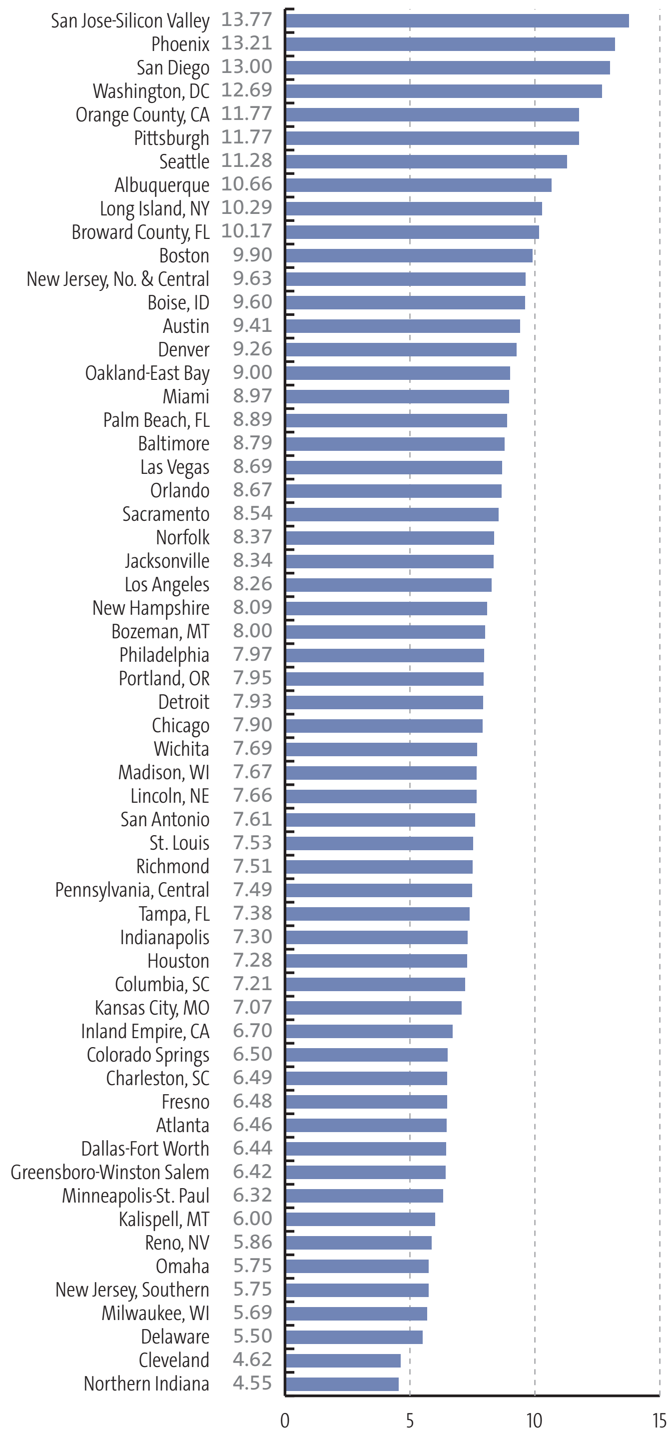
ASKING RENTAL RATES

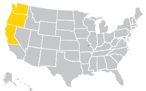
Note: Rental rate data refer to space that is available on the market at the end of the quarter. Rates are per square foot, quoted on a triple net basis. Rates for each building are weighted by the amount of available space within the building.

Warehouse/Distribution $ Asking Rent



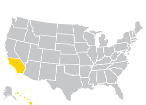
R&D/Flex $ Asking Rent





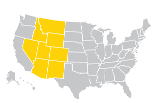
NORTHERN CALIFORNIA/ PACIFIC NORTHWEST

Fresno: Overall activity has slowed since the second quarter. There were more showings and tours in the first half of the year with companies indicating interest to lease or buy. As the year progressed, most companies put their projects on hold or canceled them... **Oakland-East Bay:** Third quarter was slower than the previous two. Businesses have been taking advantage of depressed prices and favorable financing and purchasing their own buildings instead of leasing them. The investment market remains strong with cap rates as low as 6 percent... **Portland:** There is a high level of uncertainty in the market and landlords continue to offer strong packages to attract tenants. Larger blocks of space are becoming harder to find as large corporations are locking in low rates, while local businesses are still focused on cutting costs and not adding more space... **Sacramento:** Local market is stabilizing, but there is still a lot of uncertainty in the market. Short-term leases are still in demand and concessions remain at one month of free rent per year of term... **San Jose-Silicon Valley:** Technology companies such as Google, Apple and Facebook continue to drive the market. Rents are on a rise and owners are starting to pull back on concessions. In Palo Alto, Mountain View and Sunnyvale, free rent is generally no longer being offered... **Seattle:** The market recovery continues and rents have stabilized. Large blocks will see significant increases in rents due to lack of available space. The 50,000- to 70,000-square-foot segment is the weakest with large vacancies and very competitive landlords still offering low introductory rents.



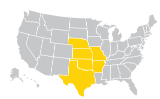
SOUTHERN CALIFORNIA/ PACIFIC SOUTHWEST

Bakersfield: Low rents are starting to generate increased inquiries in the market. However, tenants are very aware of the market's state and demand rents that many landlords are not willing to offer. Landlords are looking for three-year terms as they do not want to lock in today's low rates for extended periods... **Honolulu:** The market remained soft during the third quarter. Rents have stabilized. Users/buyers remain active in the market... **Inland Empire:** Activity moderated during the quarter. The big-box segment remains extremely active with rising rents and speculative construction. The smaller-block segment has an oversupply of space, but rents have stabilized for now... **Los Angeles:** Lease and sale activity slowed nearly 30 percent from the second quarter. There has been a flight-to-quality with lack of Class A space available. The investment market remains very strong with prime cap rates at 5.25 percent... **Orange County:** Market velocity does not correspond to the 5.3 percent vacancy rate. While leasing demand has been sluggish, user-sales have been active. Landlords are still offering one month of free rent for each year of term to credit tenants... **San Diego:** The market is stabilizing, but continues to underperform its neighbors. Downward pressure on rents remains as it still takes 15 months to lease a building, on average.



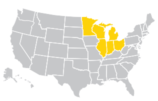
MOUNTAIN/SOUTHWEST

Albuquerque: The stalled new single-family housing construction market is still driving vacancy up and absorption negative. Non-traditional industrial users such as trade and charter schools are discovering great values across all property types... **Boise:** The market turned stagnant and most tenants are taking a wait-and-see attitude on relocating or expanding. Rents have stayed flat and landlords are offering some free rent and minimal tenant improvement packages... **Bozeman:** New warehouse product absorption is very slow with the downturn of the construction-related companies. The next few quarters will continue to be slow with no new development or significant absorption... **Colorado Springs:** The market continues to struggle. Distress sales are commonplace and causing overall values and rents to decline. Landlords are eager to attract any deal in the market by offering incentives and tenant improvements... **Denver:** The market slowed considerably in the third quarter. Class A properties are attracting attention at the expense of Class B and C product. Large-block speculative construction is being proposed, but rents need to rise another 10 to 15 percent... **Kalispell:** Warehouse product absorption has slowed in the market with rates starting to move down slightly. Although development has been strong previously, it is now non-existent. The market is not terribly over built... **Las Vegas:** Activity picked up in the third quarter. Large levels of foreclosures continue to put downward pressures on rents and values... **Phoenix:** Big-box tenants continue to drive the market. Only few large vacancies remain and speculative new construction will be starting within a few quarters... **Reno:** Rents have stabilized, but are down 35 percent below 2006 levels. No large blocks of space remain as companies such as Toys"R"Us, Diapers.com and Urban Outfitters leased the remaining space.



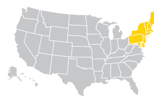
TEXAS/GREAT PLAINS

Austin: Market recovery continues to accelerate. Five consecutive quarters of positive net absorption have brought vacancy down 180 basis points since it peaked at 14.9 percent... **Dallas-Fort Worth:** Despite Dallas showing strong quarterly net absorption, the market still has a long way to go before rents can start climbing. At the end of the quarter, there were 54 buildings that could accommodate a 200,000- to 300,000-square-foot user... **Houston:** Strong levels of activity continued to push vacancy down to 5.9 percent. Crane-served buildings are in strong demand from oilfield servicers... **San Antonio:** Vacancy started to decline and rents have stabilized. The oil and gas industry is active, but smaller tenants remain cautious, expecting rent reductions and shorter leases at renewals... **St. Louis:** While the local market continues to struggle to gain traction, negative net absorption totals over minus 1.5 million square feet during the past two quarters, the local vacancy rate at 8.8 percent is better than the nation's.



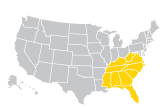
GREAT LAKES/ OHIO VALLEY

Chicago: Activity slowed during the summer, but picked up again in September. Overall rents have stabilized, but landlords of small blocks of space remain aggressive, offering above standard improvement and abatement packages... **Cleveland:** Market velocity slowed during the quarter. Rents are yet to stabilize... **Detroit:** Activity is gaining momentum and Detroit continues to outperform. Rents, however, are at 1980s levels. Users/buyers are active... **Elkhart/Goshen:** The market has seen an uptick in investments during the quarter. Kiel N.A. LLC, an international seat-manufacturing firm, is investing $3.79 million, Lippert Components, a supplier to the manufactured housing industry, is investing $35 million in a new aluminum extrusion plant, Lake Copper Conductors, a manufacturer of bare copper wire, is investing $3.4 million in a new 90,000-square-foot facility and Wieland Designs' plans to nearly double its work force by the end of 2015 after investing $1 million to improve its 210,000-square-foot facility... **Milwaukee:** Activity picked up in all size ranges. Small users, 5,000 to 10,000 square feet, have been noticeably active. Activity extended to additional submarkets: Airport, NW Side... **Minneapolis:** Activity has increased and several deals that had been in the pipeline closed. There has been an increase of new deals and expansions in the market at low rents and concessions... **South Bend:** One of the challenges of this area continues to be a limited supply of high-quality, new generation space. Companies are looking to upgrade their space, which continues to leave the older buildings vacant. Organizations are also continuing to look at downsizing their operations and are investing in equipment to provide better efficiencies in a smaller footprint.



NORTHEAST/ MID-ATLANTIC

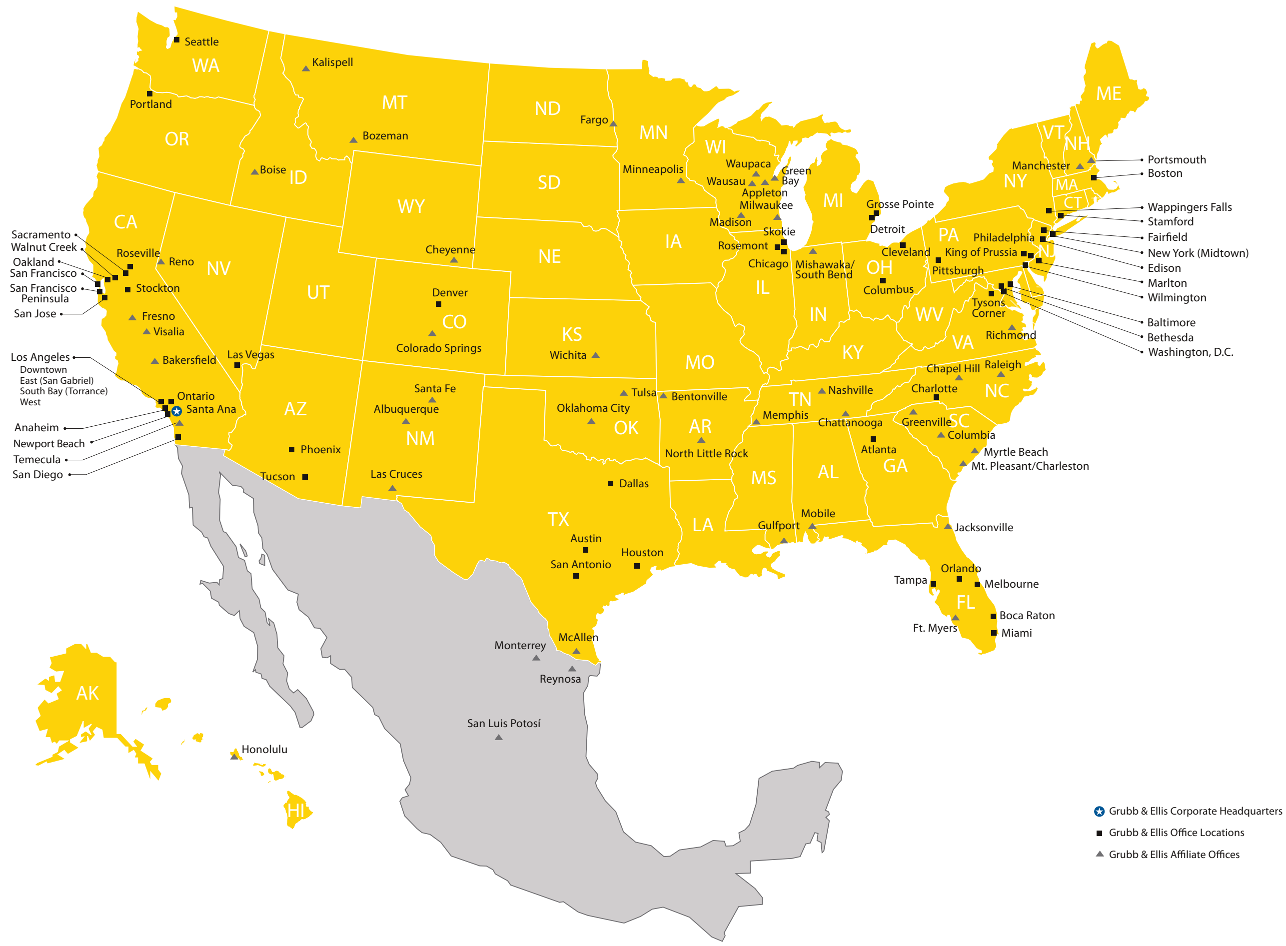
Boston: The market slowed in the third quarter. Life sciences and clean energy companies are driving absorption. Boston is one of the few markets where the smaller segment of the market is more active than the big-box segment... **Central Pennsylvania:** The market continues to recover and Class A, large blocks of space are in short supply. Liberty Property Trust broke ground on a 972,000-square-foot speculative building. Landlords are very aggressive in leasing small-block and second-generation space... **New Hampshire:** Activity picked up with the 25,000-to 40,000-square-foot size range being most active. Currently, there are several 100,000-plus requirements touring the market... **Northern/Central New Jersey:** Activity is predominantly driven by national 3PLs with food and pharmaceutical companies as their end users. There are minimal large blocks available in the northern part of the market, but in central New Jersey, they are still available... **Philadelphia:** The market is slow and landlords once again are starting to become more aggressive with concessions. Net effective rents could start to decline again... **Pittsburgh:** Activity increased in the third quarter. Vacancy declined 500 basis points and there is a shortage of Class A space in the market. New construction is being announced.



SOUTHEAST

Atlanta: Third quarter activity slowed with just one 400,000-plus-square-foot deal signed, while there was additional second-generation space coming on the market. Rents have stabilized, but they are still 25 percent below their last peak... **Charleston:** After a slow summer, demand picked up in September. Landlords are offering reduced concessions and prefer free rent to tenant improvement packages, especially to weaker-credit tenants... **Columbia:** The market slowed in the third quarter. Asking rents continue to overstate the condition of the market, as effective rates stand considerably below the face value. User/sales have been more active than the leasing side of the market... **Jacksonville:** Market showed a lot of momentum at the beginning of the year, but slowed considerably since. No new vacancies are coming onto the market, but space is also not being absorbed. Rents have stabilized, but at decade lows... **Memphis:** There has been an increase in activity in the large segment of the market. Currently there are just five blocks over 500,000 square feet and this total is going to three by the end of the year... **Miami:** Class A market is performing well and rents are rising to pre-recession levels. Class B space is soft with rents 60 percent of Class A rents. Most notable third-quarter deals were renewals... **Mobile:** Market slowed considerably. There is some activity for smaller office/warehouse properties, while large blocks are not moving at any price... **Nashville:** The big-box segment of the market continues to recover. During the quarter, Griffin signed a 518,000-square-foot lease and Amazon.com signed a 445,000-square-foot lease... **Orlando:** Activity was double that of second quarter. Rents have stabilized, but concessions remain elevated. The most active segment is within the 15,000-to 50,000-square-foot range... **Raleigh-Durham:** The market is struggling to gain traction. Rents are flat and concessions are highly negotiated. With vacancy rates over 20 percent, tenants have a great opportunity for low occupancy costs.... **Richmond:** Activity was slower than in the second quarter and was limited to lateral moves driven by lower rates. Rental rates continue to decline with ample abatements being offered.

GRUBB & ELLIS OFFICE LOCATIONS



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