

U.S Industrial Markets Are Poised for Long-Term Growth



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Perhaps we are wrong, but we do not believe we are in a recession. Real GDP grew by 2.7% in 2007, though the fourth quarter was much slower. We believe the first quarter's annualized growth rate was 0.9%, although year-over-year growth will be closer to 2%, as we predict that GDP growth will modestly improve through the second and third quarters.

The modest job losses in January and February do not reflect systematic reductions, but rather the fact that employee attrition is not fully replaced. Our airports, hotels, conferences and restaurants are too full for the U.S. to be in a recession.

What we are experiencing is a capital strike. Beginning in the mid-January 2008, consumers and businesses collectively decided to "sit on their hands," choosing not to do anything for the next few months until conditions become clearer (for better or worse). This is what has brought economic growth to a grinding halt. We are not moving forward or backwards; we are just sitting dead in the water.

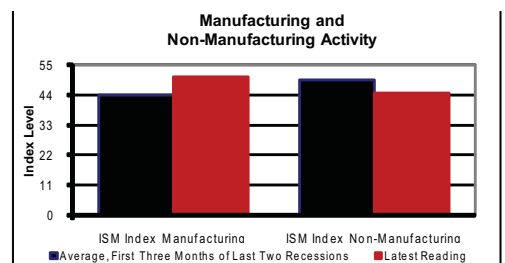
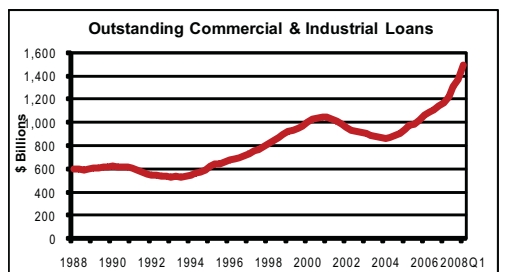
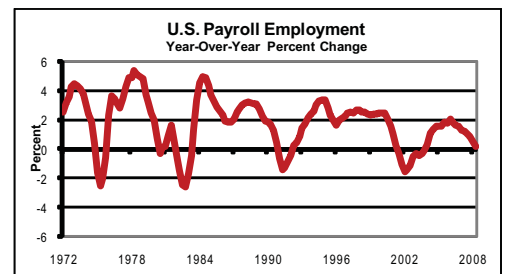
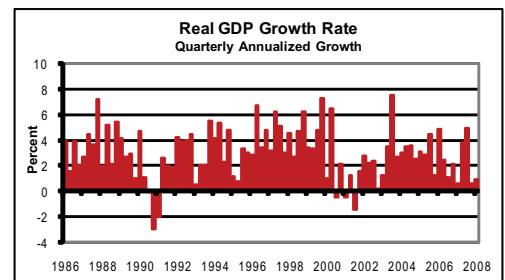
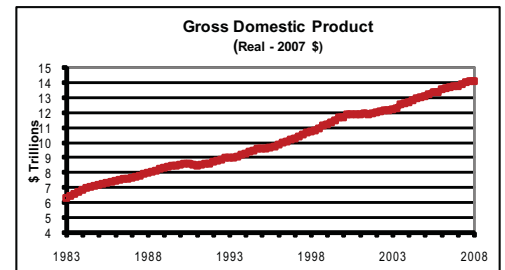
As a result, the economic plateau we foresaw for 2009 seems to be taking place now. Interest rate cuts and aggressive government spending will probably see us through 2008. We still anticipate 2% real growth and 1 million new jobs in 2008. But if this growth occurs, we still foresee a recession in 2009 as political uncertainty takes hold.

But we may be wrong, and the recession of 2009 may have arrived six to nine months early. There are regions (especially Ohio and Michigan) and sectors (housing, construction and financial services) that are clearly in a serious recession. But there also are regions (the Mountains, the Northwest and Texas) and sectors (healthcare and travel/leisure) that are doing quite well. Thus, depending on where you live and what you do, these are either the better of times (for even those regions and sectors doing well have had even better times in recent years) or the recent worst of times.

Based on the Household Survey, the U.S. added only 300,000 jobs in 2007, while the Payroll Survey indicated about 1 million new jobs. So job growth in 2007 was disappointing, at roughly 600,000-700,000 new jobs. In the first quarter of 2008, job growth will be less than 200,000, and maybe zero. Yet the unemployment rate continues to hover around 5%, though we expect it to rise over the next two months as forestalled job entry expands.

In 2007, jobs were lost in manufacturing, construction and financial services, but added in education, healthcare, leisure/hospitality, professional services (just what we need—more accountants!) and wholesale trade. Manufacturing employment declined by 1.3% year-over-year and construction lost 3% of its job base, but professional and business services gained 2% and leisure/hospitality gained 2.8% during that period. This pattern has continued into early 2008. We expect notable declines in financial services, which has been stunningly slow to reduce staffing. This will hit New York City particularly hard.

Real personal consumption expenditures for gasoline remained flat in 2007 and early 2008. In the face of exploding lending spreads and tightening loan standards, real personal expenditures on durable goods fell by 1.7% in 2007 and continue their downward drift in early 2008. This is in large part attributable to flat auto sales and reduced auto prices, as U.S. auto companies burn off excess inventories. But this durable consumption decline fueled a 5.5% real increase in non-durable consumption as consumers substituted one type of spending for the other. For example, real spending on furniture rose 8% in 2007, even as





home purchases plunged. Real medical expenditures by consumers rose 2.8% in 2007. We anticipate that these spending patterns will continue until the Great Capital Strike ends. At that point, there will be a reversal in favor of durables. Real disposable personal income rose by 2.2% in 2007, and continues to rise slowly in early 2008. We expect further growth of 1-2% in 2008.

Bright spots are business investment in equipment and software, which experienced 3.9% real growth in 2007. Software alone had a 17% growth rate. Hence the resurgence of Silicon Valley office space demand. This expansion will slow in the first half of 2008, as firms monitor economic growth.

But venture capital spending remains high and is growing, reflecting a belief that such investments must be fed when the moment is ripe and capital is available.

Market conditions are likely to fluctuate with current uncertain economic conditions, but the major U.S. industrial markets are stable and well-positioned for long-term growth.

In the first quarter of 2008, the U.S. industrial vacancy rate was up slightly, from 10.2% in the previous quarter to 10.5%. The national industrial vacancy rate had not broken the 10% threshold since 2005. It had previously peaked in the second quarter of 2004, at 11.3%. The U.S. industrial vacancy rate as reported by NCREIF (for institutional quality properties) was 6.7% in the first quarter, representing a flattening trend after decline from a high of 10.6% in the first quarter of 2004. The two data series moved in lockstep from 1987 to 2004, but then the NCREIF series began to trend downward more sharply. This divergence indicates that the institutional-grade properties in the NCREIF survey are enjoying greater demand than the overall market.

For 2008, we foresee 23 markets improving, 9 declining and 2 remaining flat. By the end of 2008, the biggest improvements will be seen in Westchester County, Washington D.C., Seattle, and Minneapolis. Las Vegas' vacancy will increase by 3%. Over the next three years, 28 of out of the 34 markets we cover are projected to improve. Seattle, Minneapolis, and Washington D.C. will show the greatest improvement, while Las Vegas will show the biggest increase in vacancy rate at 11%, followed by St. Louis at 2%, and then Nashville at 1.8%.

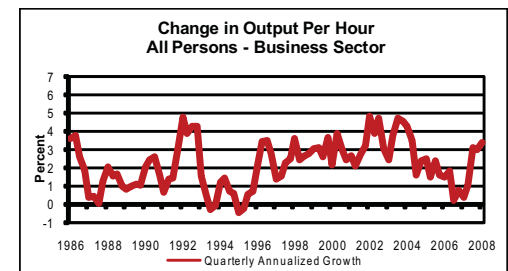
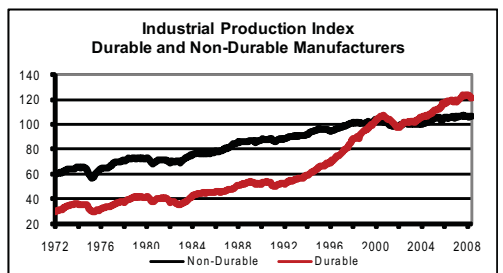
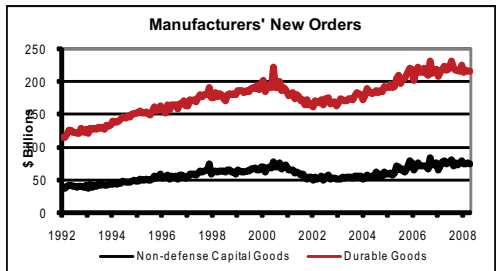
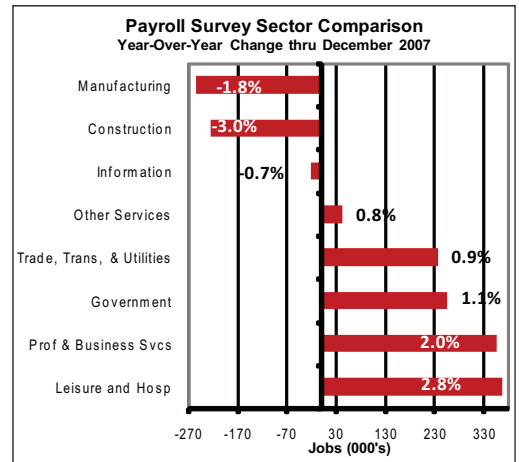
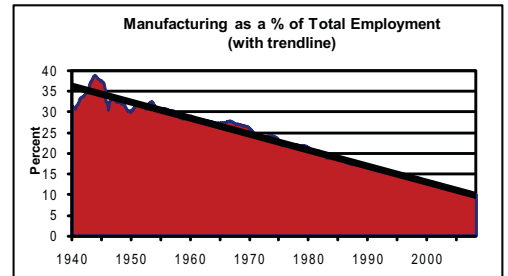
Using a 6% benchmark vacancy rate to proxy supply demand balance for industrial markets, only two markets were in balance at year-end 2007, and only one market is expected to be in balance by the end of this year, Tampa Bay. By the end of 2011, 12 of the 34 markets are projected to achieve balance. Atlanta, Austin, St. Louis and Las Vegas are projected to have the highest vacancy levels in 2011 while Fort Lauderdale, Minneapolis, Seattle and Long Island are projected to have the lowest.

CHICAGO

As the nation's third largest intermodal center, Chicago's diverse industrial space demand remains relatively solid during national downturns. At a time when the nation is faced with a housing market slump, rising oil prices, tightening credit conditions and recessionary concerns, the city's resilience is an asset. The outlook for industrial properties nationwide is softening, as manufacturing activity declined in December and January for the first time in 11 months.

Employment conditions in Chicago rose 40 basis points from the end of 2007 at 4.8% to 5.2% at the end of the first quarter 2008, marking the highest first quarter rate of unemployment in Chicago since 2005. Net absorption was posted at 2.6 million square feet, up from last quarter. The overall vacancy rate was 10.5% and rental rates rose slightly to \$4.82 per square foot, from \$4.77 per square foot last quarter.

Leasing activity declined significantly to 1.3 million square feet, from the 6.8 million square feet posted in the fourth quarter last year. There were five major lease transactions this past



Industrial Vacancy Rates

Market	1Q08 Act.	YE 2008	YE 2009 Est.	YE 2010 Est.	YE 2011 Est.
Atlanta	18.7%	18.0%	16.8%	15.3%	13.8%
Austin	19.4%	19.5%	19.6%	19.7%	19.7%
Baltimore	15.3%	14.6%	13.5%	12.4%	11.2%
Charlotte	10.0%	8.9%	7.4%	5.8%	4.3%
Chicago	10.5%	10.3%	9.6%	8.9%	7.9%
Cincinnati	7.0%	6.7%	5.9%	5.1%	4.3%
Cleveland	8.6%	8.7%	8.3%	7.6%	6.8%
Columbus	15.0%	14.5%	13.5%	12.4%	11.4%
Dallas-Fort Worth	10.9%	9.8%	8.5%	7.5%	6.5%
Denver	10.7%	9.9%	8.7%	7.3%	5.9%
Detroit	12.2%	13.0%	13.3%	13.0%	12.3%
Fairfield County	14.8%	14.3%	13.2%	12.1%	11.0%
Fort Lauderdale	7.4%	7.3%	6.2%	4.3%	2.3%
Houston	7.8%	7.2%	6.6%	5.8%	5.1%
Indianapolis	11.0%	11.1%	10.8%	10.4%	10.1%
Inland Empire*	13.6%	13.6%	13.1%	12.5%	11.9%
Las Vegas	8.3%	11.5%	14.7%	17.3%	19.5%
Long Island	6.7%	6.0%	5.0%	3.9%	2.8%
Los Angeles	8.5%	8.2%	7.9%	7.5%	7.2%
Miami	8.6%	8.0%	7.2%	6.5%	5.8%
Minneapolis	8.5%	7.5%	5.6%	3.2%	0.6%
Nashville	10.1%	10.7%	11.1%	11.5%	11.9%
North & Central NJ	9.4%	9.3%	9.2%	9.1%	9.0%
Orlando	8.3%	7.8%	6.8%	5.7%	4.6%
Philadelphia	9.9%	9.7%	9.2%	8.6%	7.9%
Phoenix	16.3%	16.3%	15.2%	13.4%	11.5%
Portland	7.1%	6.8%	6.2%	5.3%	4.4%
St. Louis	12.4%	12.8%	13.3%	13.8%	14.2%
San Diego	12.4%	12.5%	12.5%	12.4%	12.1%
San Francisco	10.7%	10.5%	10.6%	10.7%	10.8%
Seattle	8.8%	7.6%	5.5%	3.1%	0.5%
Tampa Bay	5.7%	5.8%	5.6%	5.2%	5.0%
Washington, D.C.	14.4%	13.3%	11.5%	9.6%	7.7%
Westchester County	11.3%	8.0%	7.9%	7.9%	7.6%

Highlighted entries indicate market at supply-demand balance, or better.

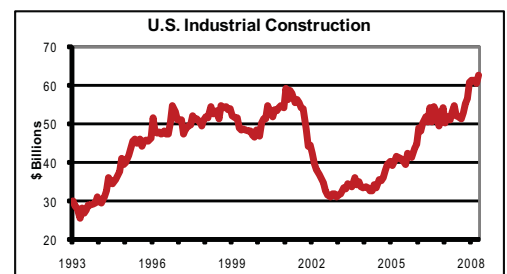
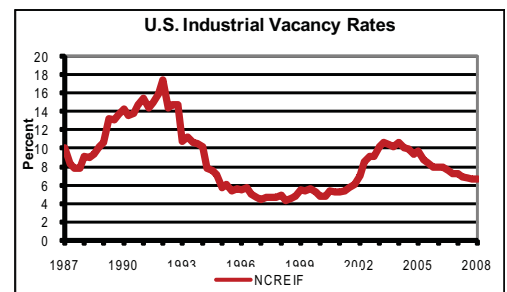
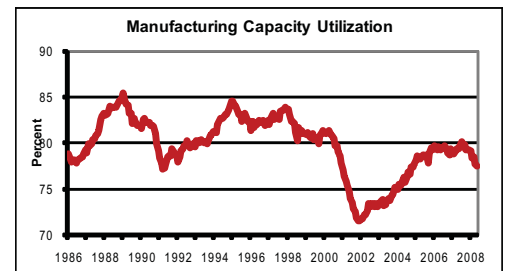
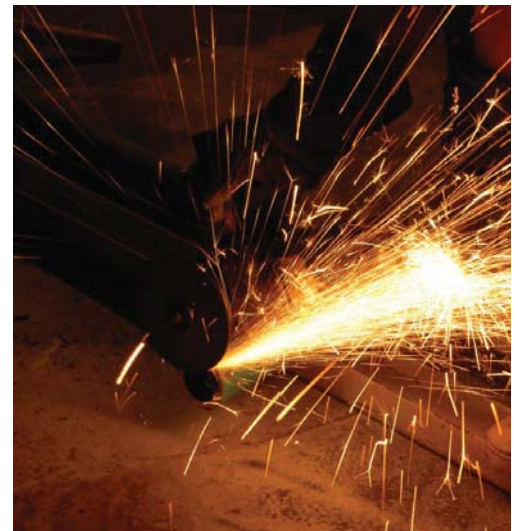
* Inland Empire = Riverside/San Bernardino Metropolitan Area

Note on Negative Vacancy: In order to calculate estimated vacancy rates, we adjust beginning inventory for new construction completions and compare that to net absorption (including sublease space). If we show negative vacancy rates, it simply means that given the scheduled supply and growth in expected demand, sufficient demand pressure exists to more than absorb all available space. Of course, negative vacancies cannot occur, as in the face of such demand pressure additional development will occur and rents will increase in order to dampen demand. Therefore, forecasts of negative vacancy should be viewed as a strong excess demand indicator.

quarter mostly on the Interstates, I-55 and I-88. Sales in Chicago totaled about 2.2 million square feet, rising 18% from last quarter.

The Chicago industrial market is revealing an interesting trend regarding construction – speculative buildings continue to increase in size and frequency, with new buildings larger than 1 million square feet. Construction totaled more than 12 million square feet for the first quarter of 2008.

The economic outlook in Chicago looks relatively strong for the near future. Proponents believe that the completion of the I-355 South extension will give a much needed boost to the market, specifically to the area directly surrounding the expressway. We anticipate that job losses will end, and the metro area job base will increase steadily over the next several years, despite the economy continuing to weaken. Barring a recession, we forecast that the market will add 31,000 jobs in 2008, with an additional 45,000 new jobs in 2009. From 2010





through 2012, we estimate that the Chicago region will add approximately 177,000 new jobs in total. We also project that absorption will remain steady and vacancy rates will decline to 8.6% by 2010.

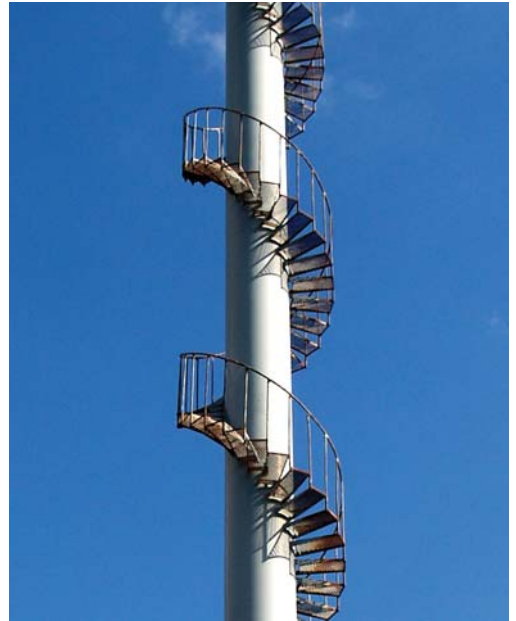
DETROIT

Detroit's industrial market continues to soften as the U.S. automotive industry re-positions itself in the world market. Detroit's unemployment rate at the end of the first quarter of 2008 was 7.4%, compared to 4.8% for the U.S. However, the Detroit metro area posted a positive net absorption of 167,000 square feet. in the first quarter of 2008 The Detroit industrial market has experienced a steady increase in vacancy rates climbing to 12.3% this quarter.

Leasing activity increased due to a steady influx of military work in the area. The military contracts are also expected to generate ancillary business in the area. Asking average rental rates also rose slightly from last quarter in order to stay competitive with Ohio's and Indiana's rates. Major lease transactions occurred mostly in the suburbs of Wayne County with nothing larger than 350,000 square feet. Mid-sized leases were more common.

With 394,000 square feet already delivered in the first quarter of 2008, another 205,000 square feet are currently under construction.

The economic outlook in Detroit is modest, but positive for the near future as it continues to establish itself as a new leader in the progressive industries. The industrial market is primed for growth with the addition of new technology and military work. We anticipate that job losses will end and the metro area job base will increase steadily over the next several years. We forecast that the market will add an additional 42,000 new jobs in 2008. If a recession occurs, more jobs will be lost. We expect the Detroit industrial market to experience some softening in the first half of 2008, but to show modest improvement thereafter. We anticipate that overall vacancy rates will rise slightly in the near term, and then flatten as demand catches up to supply. Construction starts are expected to decrease and absorption to increase. With the market's favorable leasing terms, we expect leasing and sales activity to follow the positive trend and continue to improve through 2010.



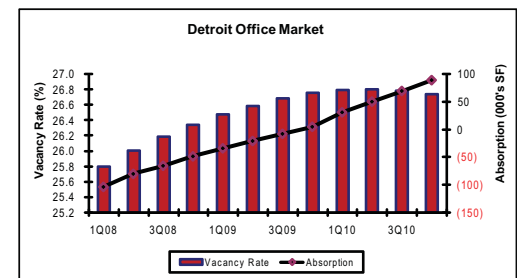
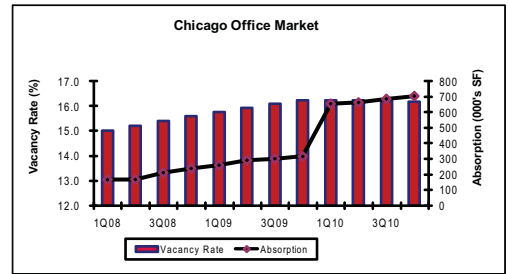
NORTHERN AND CENTRAL NEW JERSEY

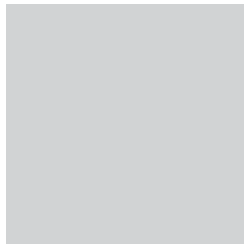
For the past several years, Northern and Central New Jersey's industrial market has been propelled by a solid economy. However, in keeping with the times, Northern and Central New Jersey is seeing slight modest market fluctuation, but no substantial impact so far. Little has changed in the industrial market as compared to last year's statistics.

Unemployment rose to 4.8% by the end of the first quarter 2008, compared to 4.3% in 2007 and 4.6% in 2006. The first quarter of 2008 saw positive net absorption of 1.5 million square feet, representing a 266% decrease from 2007. Overall vacancy rates increased 0.7% from the end of 2007 to 9.1%. The average lease rate rose 3.1% to \$6.67 in the first quarter of 2008 from \$6.47 at the same time last year.

The first quarter of 2008 saw a spike in sales activity for Northern and Central New Jersey. About 5.1 million square feet of sales occurred early this year, of which 3.5 million square feet were purchased by investors. Twelve new buildings totaling 1.6 million square feet were delivered during the first quarter of 2008. This was a 50% increase over the number delivered last year, and accounted for significantly larger buildings as well. Currently 6.2 million square feet are under construction.

According to "Forecasting MSA Population Growth Through 2020," an article co-written with my Wharton colleague Albert Saiz in 2006, the population in Newark (the largest city in North/Central New Jersey) is expected to grow to 2.5 million by 2020, a 25% increase over 2000. We expect employment in the North/Central New Jersey area to grow by approximately 1.0% in 2008. An aggregate of another 122,000 jobs is projected to be added to the





region between 2009 and 2011. Demand for high-quality warehouse and distribution spaces in prime locations around seaports and airports will remain strong. The area should see solid growth for the next five years. We anticipate that vacancy rates in the North/Central New Jersey will remain relatively flat for the next three years, and begin to fall toward the latter half of 2010. Absorption will remain strong through 2011, despite minimal fluctuation throughout the year.

DALLAS/FORT WORTH

Along with Chicago and Memphis, the Dallas/Fort Worth (DFW) industrial market has developed into one of the U.S.'s main inland industrial hubs. DFW's proximity to large markets and superior access to freeways, rails and a major U.S. air transport hub has fueled this development. The core fundamentals of the market, although slightly weaker than last quarter, remain favorable and are near their healthiest levels since early 2001.

The unemployment rate in DFW is between 4% and 5% for the second year in a row, putting DFW exactly at the average for Texas and slightly below the national average of 5.2%. While the majority of this employment growth rests in the professional and business services, nearly 14,000 jobs are expected to be created in the trade, transportation and utility sectors. Ninety-one new jobs have already been added to the North Texas economy, according to the U.S Bureau of labor Statistics. Continuing the four-year trend of positive absorption, the metro area posted a positive net absorption of 8.4% in the first quarter of 2008. Vacancy rates for bulk warehouse were 7.7%, manufacturing posted 9.7% and high tech/R&D posted 9.0%. Asking rates remained stable.

Approximately 4 million square feet of new industrial space is now either available or currently under construction.

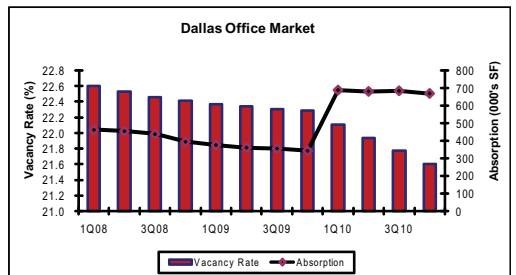
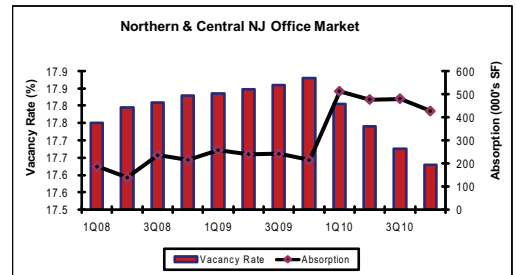
With a strong economy in the near future, the industrial market is expected to remain stable with slow growth. Due to the metro area's large handling capacity, enormous business base and access to various transport infrastructure, the DFW industrial real estate market will grow. We anticipate that job growth will increase steadily over the next several years, adding 80,000 new jobs forecasted for 2008. From 2009 through 2011, we estimate that the DFW region will add approximately 150,000 new jobs in total. The outlook for the DFW industrial market remains positive, particularly for developers. We anticipate that overall vacancy and availability will decline over the next several years. As construction completions come to market, we expect leasing and sales activity to follow the positive trend and continue to improve for the duration of our forecast.

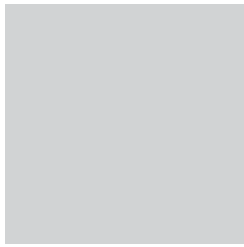
LOS ANGELES

The Los Angeles industrial market is the tightest market in the U.S., but amidst a slowing economy, the Greater Los Angeles area faced troubled conditions in the first quarter of 2008.

Unemployment levels in the Greater Los Angeles area increased 30 basis points to 5.3% at the end of the first quarter 2008. Net absorption was negative 2.4 million square feet down from a positive 4 million square feet posted for the fourth quarter of 2007. The L.A. market has experienced a steady decline in availability since 2005. Overall vacancy rates increased to 3.1% in the first quarter of 2008 from 2.9% at the end of 2007. However, when accounting for sublease space, the availability rate jumps to 7-8%.

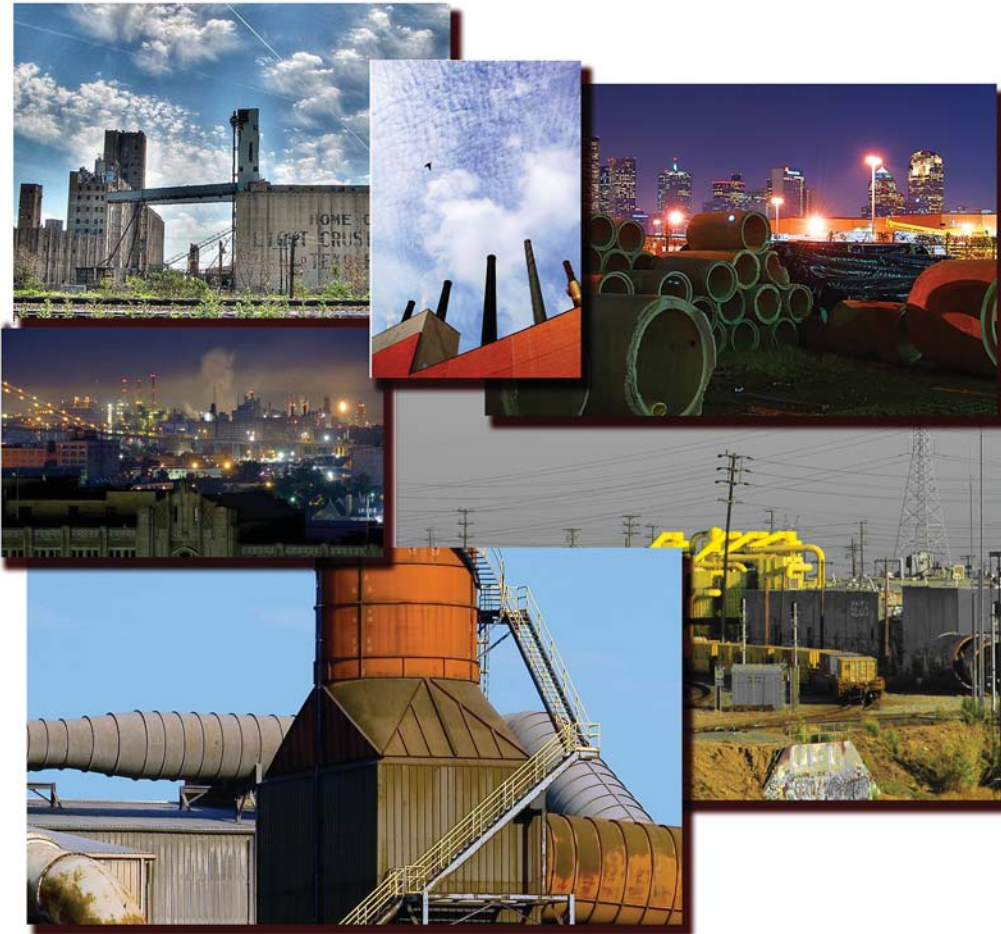
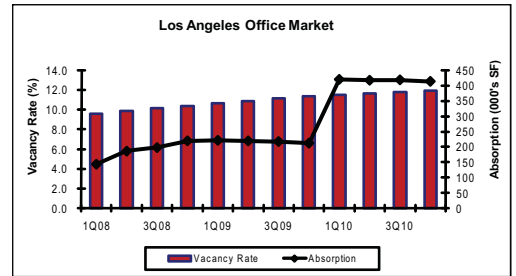
Vacant sublease space increased to 2.8 million square feet at the end of the first quarter 2008 up from 2.7 million square feet at the end of 2007. The average leasing rate increased 1% from \$8.68 at the end of 2007 to \$8.77 at the end of the first quarter of 2008. Tenants are facing the current tight market conditions by renewing or signing long-term leases, as opposed to buying.






Construction activity continued to decrease this quarter with eight buildings completed totaling 212,000 square feet as compared to last quarter's 26 completed buildings totaling 1.9 million square feet. Approximately 2.8 million square feet were under construction at the end of the first quarter 2008. New development is becoming relatively non-existent due to lack of vacant land and high land prices.

The outlook for the Los Angeles industrial market remains positive, and we predict that the fundamentals will improve for most submarkets. We anticipate that job growth will increase steadily over the next several years with the market adding about 40,000 jobs each year through 2011. We anticipate that overall vacancy rates will continue to fall as demand continues to outpace supply. Construction is expected to increase, especially in inland areas where land is more abundantly available. Absorption will remain high as almost all usable industrial space becomes occupied, but is expected to level off as the availability of infill and redevelopment opportunities decrease. As new construction spurs increased activity, we expect leasing and sales activity to follow the positive trend and continue to improve for the duration of our forecast. The L.A. industrial market is a landlord's market, as tenants compete for the use of the scarcely available space.





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