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### Industrial Market Trends

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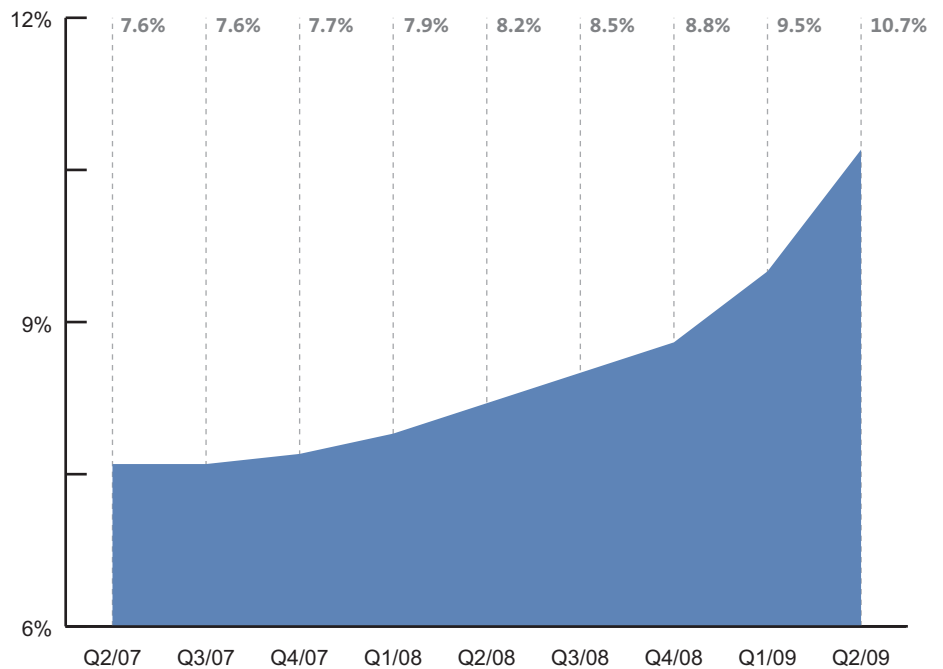
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## Nosebleed Territory...

### US INDUSTRIAL VACANCY RATE\*



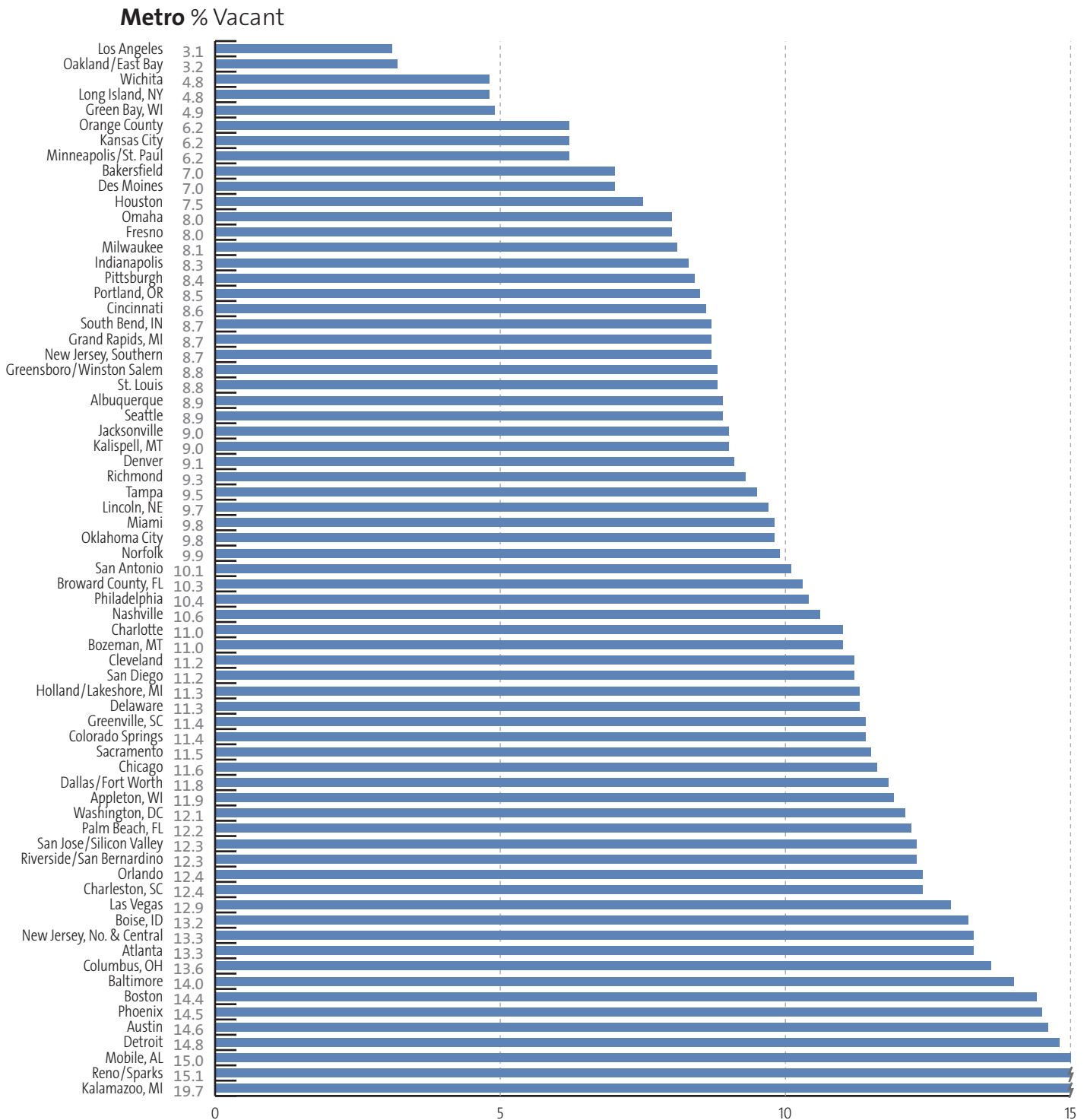
\* All product types

### THE BOTTOM LINE

The industrial market is falling short of its reputation for relatively moderate swings in leasing market cycles. The vacancy rate soared by 120 basis points to end the second quarter at 10.7 percent. This was by far the largest one-quarter gain in the 22-year history of Grubb & Ellis' survey and also the largest vacancy increase among the four core property types during the second quarter. Net absorption has been mired deep in the red so far this year, while effective rental rates are off by 22 percent from a year ago. A rebound in exports to China and other emerging markets could support demand for industrial space, helping to break the negative momentum.

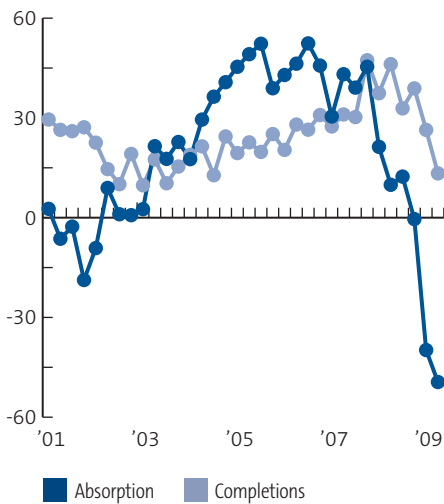
## TOTAL MARKET VACANCY RATES

**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.

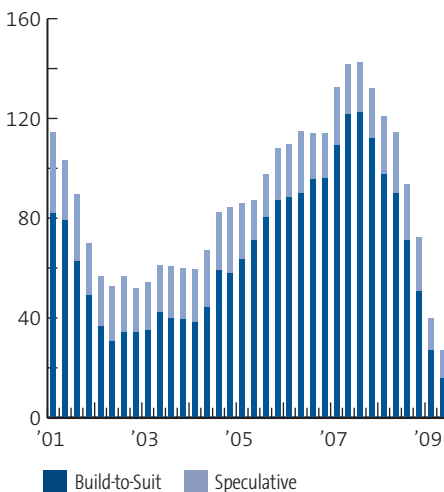


STATE OF THE MARKET

**Absorption and Completions**  
in Millions of Square Feet



**Space Under Construction**  
in Millions of Square Feet



The industrial market softened at an accelerated pace in the second quarter. The vacancy rate soared by 120 basis points to end the quarter at 10.7 percent. This was by far the largest one-quarter gain in the 22-year history of Grubb & Ellis' survey, easily breaking the record of 70 basis points set in the prior quarter. Vacancy has risen most dramatically for warehouse/distribution space, which has also accounted for about three-quarters of all new completions so far this decade. This product type ended the quarter with 12.1 percent of its inventory sitting empty, compared with 13.3 percent for R&D/flex space and 8.0 percent for general industrial space.

- Vacancy was lowest in **Los Angeles County** at 3.1 percent, although this was a 130 basis-point increase from the year-ago quarter as demand shriveled. With an availability rate of 8.3 percent, L.A.'s vacancy rate is likely to climb as leases expire. Vacancy was highest at 19.7 percent in **Kalamazoo, Mich.**, a region that is working hard to shore up its industrial base.

Net absorption was mired deep in the red for a second consecutive quarter, registering negative 49 million square feet on top of the 40 million square feet vacated in the first quarter. Only 13 million square feet was completed in the second quarter, the lowest level in nearly five years. The depth of this downturn is evident by comparison with the 2001-02 softening cycle, during which negative net absorption totaled just -37 million square feet and was spread out over four quarters.

- Tenants and owner-users in **Northern and Central New Jersey** gave back nearly 9 million square feet of space in the second quarter, far ahead of second-place **Atlanta** where just shy of 6 million square feet was returned. Ten of the 58 markets tracked by Grubb & Ellis did manage to stay in the black, led by **Denver** with 813,000 square feet absorbed.

Space under construction plunged to 27 million square feet at the end of the second quarter, its lowest level since at least the early 1990s.

- The Greater **Philadelphia** region, encompassing Central and Eastern Pennsylvania, led all markets with 4.1 million square feet yet to be completed, followed by second-place **Houston** with 2.6 million square feet. Southern California's **Inland Empire**, a longtime hotbed of new construction where nearly 22 million square feet was delivered in 2007, ended the most recent quarter with just 1.6 million square feet in the pipeline.

The average asking rental rate for all types of industrial space offered on the market at the end of the second quarter was \$5.40 per square foot per year triple net, a decline of 4.8 percent from the year-ago quarter. Asking rents fell by 4.7 percent for warehouse/distribution space, 6.3 percent for R&D/flex space and 0.6 percent for general industrial space (primarily manufacturing and light assembly). The average effective rental rate for industrial space (all types combined) declined by 22 percent over the past four quarters, driven lower by gener-

ous periods of free rent and other concessions given to tenants.

- For warehouse/distribution space, asking rates are highest in land-constrained **Long Island** and lowest in land-rich **Columbus**, Ohio where generous tax abatements in some communities permit landlords to charge lower rental rates. For R&D/flex space, **San Diego** and **San Jose/Silicon Valley** landlords are able to charge the most for their space, while rents for this property type are least expensive in **Grand Rapids** and **Oklahoma City**. General industrial space is most expensive in San Jose/Silicon Valley, while tenants in search of a bargain are advised to look in **Greenville**, S.C. and **western Michigan**.

Sales of industrial properties greater than \$5 million totaled \$2.2 billion through May of this year, down 81 percent from the same period in 2008 according to Real Capital Analytics. The average cap rate for industrial transactions year-to-date was 8.1 percent, up from 7.4 percent in 2008 and 6.9 percent in 2007. Sales activity for all commercial property types remains practically non-existent because buyers are waiting on the sidelines or out raising capital in anticipation of a wave of distressed assets coming to market. Nearly \$500 billion in commercial real estate loans are expected to mature in 2009 and again next year, and it is unclear how these loans will be refinanced. At the peak of the market, CMBS, Wall Street firms and international banks provided 60 percent of the financing used to acquire properties. Since September 2008, they have financed just 2 percent of acquisitions. Although the TALF (Term Asset-Backed Securities Loan Facility) and PPIP (Public-Private Investment Partnership) programs have been extended to CMBS, they are unlikely to lure enough investors to stem the tide of foreclosures. Expect sales activity to begin to pick up in the second half of 2009, fueled by an increase in distressed sales. Cap rates are likely to rise consistently through next year.

## FORECAST

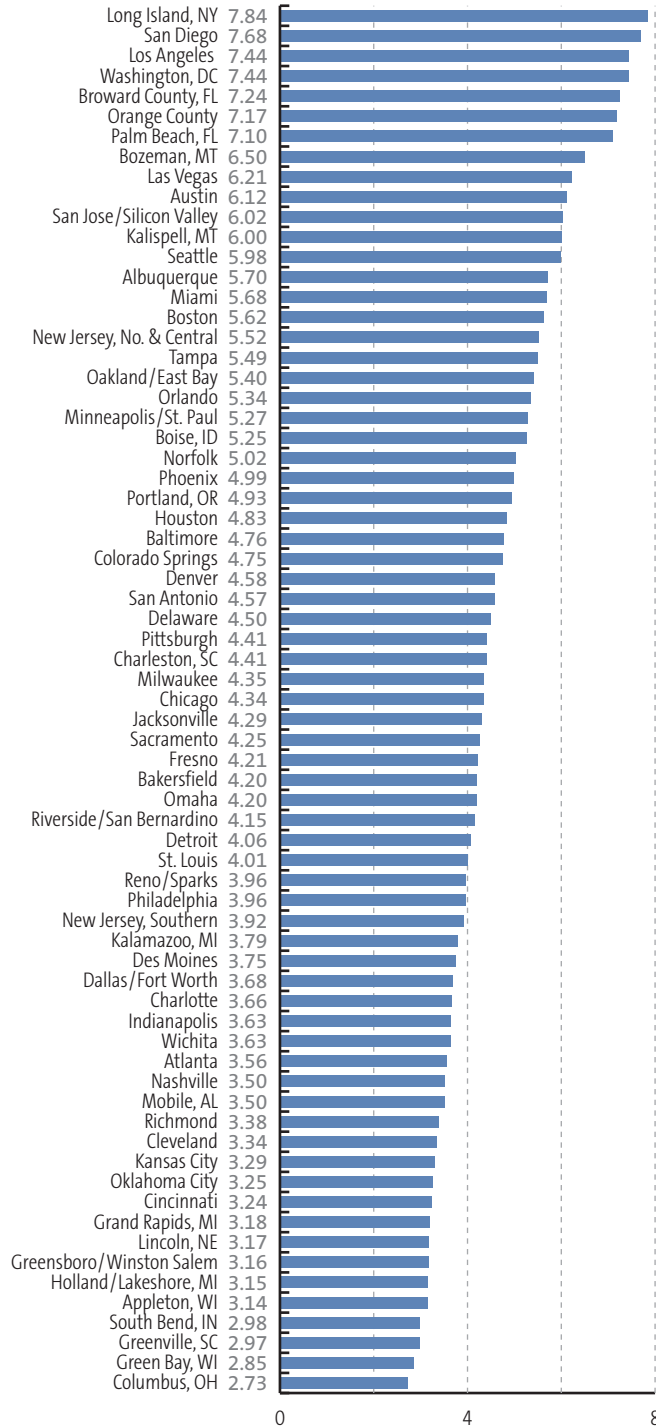
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The industrial market is not living up to its reputation for relatively moderate swings in leasing market cycles. The 120 basis-point increase in the vacancy rate during the second quarter was the fastest pace of softening among the four core property types. The drivers of demand for industrial space—retail sales, logistics, global trade and the construction industry—all have taken big hits in the current recession. The sharp increase in the second quarter vacancy rate to 10.7 percent raises the possibility that the market may come close to the previous record of 13.7 percent posted in the first quarter of 1992. Ironically, given the rapid pace of deterioration, the industrial market could be the first to turn around. China's efforts to rescue its economy—a \$586 billion stimulus package (larger as a share of GDP than the U.S. stimulus) and a robust expansion of credit by the state-controlled banking system—appear to be putting the country on track to achieve its GDP growth target of 8 percent this year. This is a hopeful sign for U.S. exports and, by extension, demand for light assembly and warehouse/distribution space.

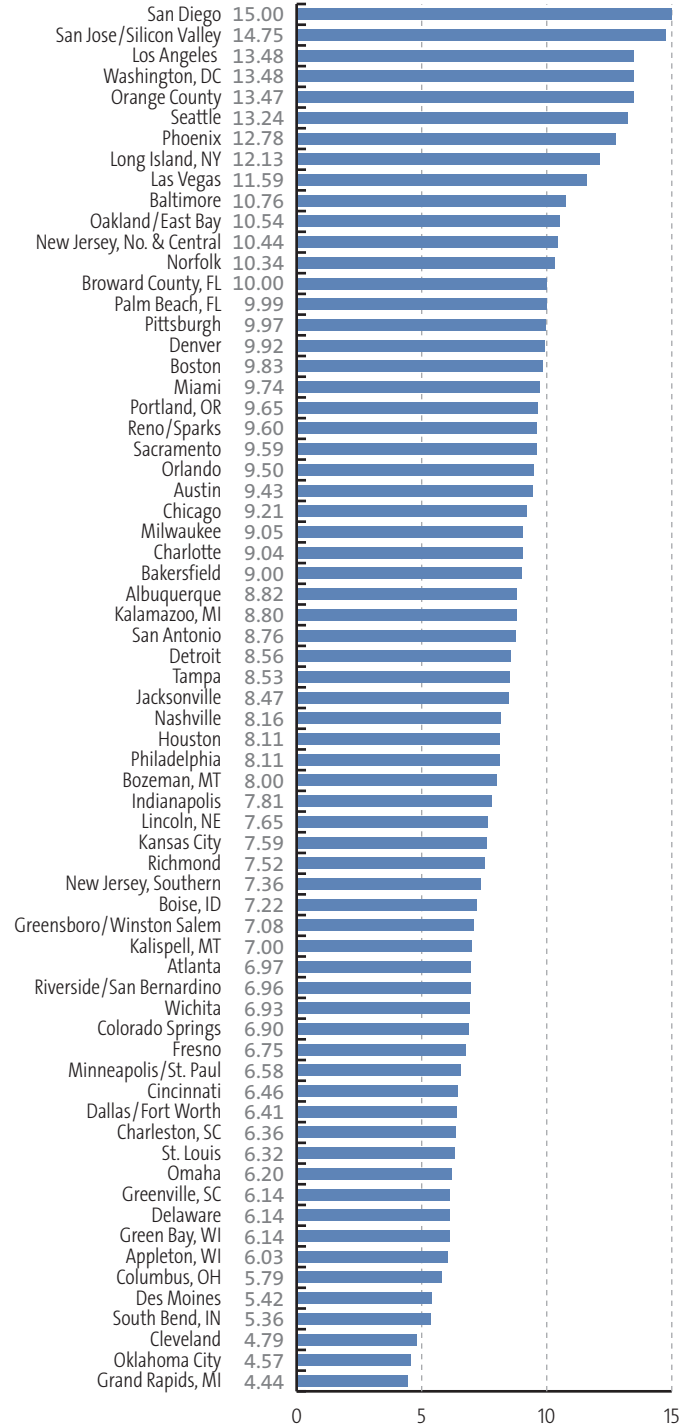
## ASKING RENTAL RATES

**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





## PACIFIC

**Bakersfield:** Aggregate demand continued to slide, but there has been a slight increase in smaller users looking to relocate or downsize... **Fresno:** Many sellers will contemplate an installment sale to circumvent traditional lenders, thus offering buyers the chance to purchase property at the lowest prices in recent memory...

**Los Angeles:** Tenants know there is a glut of available space and are negotiating aggressively. Price will be the main driver of activity for the foreseeable future as businesses are focused on their occupancy costs...

**Oakland-East Bay:** Recent notable transactions included a 200,000-square-foot warehouse sale in Richmond and an 89,000-square-foot warehouse lease in Hayward...

**Orange County:** Medical device manufacturers and food and beverage companies are expanding... **Portland:** The demise of Wilsonville-based Joe's Sports and Outdoors put 170,000 square feet back on the market, helping pump the vacancy rate in the I-5 Corridor to its highest level in 10 years... **Riverside-San Bernardino:** Cargo moving through Los Angeles' dual port system is expected to drop by 13.5 percent in 2009, impacting demand for industrial space throughout the region... **Sacramento:** The average size of industrial leases executed in the second quarter fell by 30 percent compared with the first quarter. The lack of large deals combined with tenants' need to downsize is expected to keep absorption in the red through year-end...

**San Diego:** Manufacturing space has been more resilient than other industrial product types... **San Jose-Silicon Valley:** Rising unemployment coupled with a drop in manufacturing inflated vacancy this quarter... **Seattle:** In the largest transaction of the quarter, IKEA purchased two Renton warehouses that it had been leasing from AMB Institutional Alliance Fund. The transaction totaled 760,000 square feet with a sales price of \$32.8 million (\$43 per square foot).

This is emblematic of the deals on offer for tenants with cash reserves.



## MOUNTAIN/ SOUTHWEST

**Albuquerque:** In the quarter's largest lease transaction, a growing food bank teamed up with other non-profits to take 166,000 square feet of warehouse space. New owner-user projects totaling 240,000 square feet were completed during the quarter, shoring up occupancy... **Boise:** The rising unemployment rate carries a silver lining for businesses moving into the region; they can tap into the growing pool of educated workers...

**Bozeman:** A significant amount of new product in the Four-Corners submarket caused market conditions to soften... **Colorado Springs:** Both leasing and sales transactions are down by 30 to 40 percent from normal levels. Landlords are cutting rents and offering incentives to attract the few tenants looking for space... **Denver:** ProLogis signed leases totaling 303,000 square feet during the quarter, comprising one-third of the positive absorption for the entire market. Acquisitions by owner-users will continue to dominate the sales market...

**Kalispell:** Warehouse product absorption has slowed, pushing rental rates down slightly. Development is non-existent... **Las Vegas:** The number of distressed sellers and bank-owned properties continues to grow. Sale prices and lease rates are expected to reach pre-2001 levels by year-end... **Phoenix:** Despite plummeting occupancy, the construction level actually increased by roughly 500,000 square feet this quarter... **Reno:** Landlords are writing aggressive leases with free rent and tenant improvements, rewarding businesses willing to sign for new space.



## CENTRAL/GREAT PLAINS

**Austin:** A wave of business closures and consolidations has forced landlords to reduce asking rents in order to retain tenants... **Dallas-Fort Worth:** Vacancy reached its highest level this decade. Sublease space rose, and new construction deliveries met with sluggish demand... **Des Moines:** The vacancy rate is creeping up, but overall the market continues to fare better than the national average. A new 10-year deal for nearly 123,000 square feet at an effective lease rate of \$2.25 per square foot NNN was completed this quarter... **Houston:** Tenants are showing little interest in preleasing the 2.5 million square feet of new product under construction... **Kansas City:** Harley Davidson eliminated another 460 local positions on top of the 85 jobs axed earlier this year... **Oklahoma City:** Producers' CoOp, which recently took 1 million square feet of the former Dayton Tire space, returned 750,000 square feet back to the market... **Omaha:** Users have absorbed 66,500 square feet year-to-date, a sign of the recession's muted impact thus far on Nebraska and the Great Plains... **San Antonio:** A recent surge of activity around Port San Antonio has set the stage for business expansion in the vicinity... **St. Louis:** Several large warehouse users closed or consolidated operations in the second quarter, including Serta Mattress, which vacated 90,000 square feet, and Miller Multiplex, which moved out of 97,000 square feet... **Wichita:** The Center of Innovation for Biomaterials in Orthopedic Research was awarded a \$21.7 million grant to develop artificial hips and other medical devices from composite materials. The impact of Cessna's decision to cancel the Columbus Jet project will begin to impact tenant demand for space.



## GREAT LAKES

**Appleton:** There were no major new leases or new vacancies in the first half of 2009... **Chicago:** Gordon Food Services' 587,000-square-foot build-to-suit in Kenosha is the largest project under construction... **Cincinnati:** Only two significant projects have been completed this year: IDI's 720,135-square-foot Building A at Monroe Logistics Center, and Blue Star's 150,000-square-foot corporate headquarters in Hebron, Kentucky. The construction pipeline is now completely empty, and developers have put all planned projects on hold... **Cleveland:** Sale transactions are down significantly; however, some users and opportunistic investors are capitalizing on weak pricing... **Columbus:** Many retailers have closed, ceasing their associated warehouse and shipping operations... **Detroit:** General Motors eliminated four brands, cut dealerships by nearly half and reduced production facilities by 25 percent while Chrysler and Ford instituted similar measures. The new vacancies were offset somewhat by battery maker A123's 291,000-square-foot lease at the I-275 Corporate Center in Livonia... **Grand Rapids/West Michigan:** General industrial buildings have held their occupancies better than warehouse/distribution properties. For the first time in over 10 years, there are no new buildings under construction... **Green Bay:** Vacancy declined slightly as the market absorbed over 180,000 square feet in the first half of the year. This was enough to vault tiny Green Bay into the rarified band of markets that have weathered the recession without a decline in occupied space... **Indianapolis:** Build-to-suit completions have kept net absorption in the black while helping to stabilize the vacancy rate... **Milwaukee:** GE Healthcare moved into the newly constructed 486,000-square-foot distribution center in Muskego. Redevelopment of outdated multi-story industrial buildings downtown continues with Towne Realty's

project at the former Pabst Brewery... **Minneapolis-St. Paul:** Many companies are moving into more efficient space or reorganizing their current space to maximize efficiency, which may mean returning space to the landlord or subleasing some of it... **South Bend:** Defying the challenging economic conditions in northern Indiana, industrial vacancy has stayed in a tight, single-digit range since 2004.



## SOUTHEAST

**Atlanta:** Public storage facilities, which are considered recession resistant, have taken a direct hit in the current recession due to the decline in consumer spending... **Broward County:** Mohawk Industries vacated 258,270 square feet at Seneca Industrial Park. The company had moved into an adjacent build-to-suit facility last year, having intended to occupy both buildings... **Charleston:** Defense contractors continue to absorb space... **Greenville-Spartanburg:** Strong build-to-suit activity was not enough to keep the vacancy rate from rising... **Jacksonville:** Northeast Florida absorbed more than 370,000 square feet in the second quarter... **Miami:** Paper products distributor LagasseSweet moved into the newly built, 328,000-square-foot Flagler Station Building 33, leaving 88,000 square feet in the project unoccupied. The company vacated 302,000 square feet at its former site in East Hialeah... **Memphis:** Vacant sublease space increased to 2.1 million square feet at mid-year. Only 421,000 square feet is under construction... **Mobile:** The market is beginning to see warehouse vacancies and declining rents with no prospective plans for expansions... **Nashville:** Recent manufacturing layoffs include Gibson, Unipres and Quality Industries. The latter is a Peterbilt supplier that eliminated 111 positions in June after Peterbilt closed its Madison facility, laying off 390 and moving operations to Texas... **Or-**

**lando:** In the largest lease transaction of the quarter, Kenco Logistics took 22,720 square feet at the Airport Distribution Center, but it was more than offset by the 120,000 square feet returned to the market by Master Tile in the Southeast Orange County submarket... **Palm Beach County:** The market's vacancy skyrocketed by 230 basis points to a record high of 12.2 percent... **Richmond:** GPM Investments (FasMart) leased 25,600 square feet in Windsor Business Park while HD Business renewed a lease on 33,182 square feet on Lewis Road... **Tampa:** Landlords are getting more space returned to them at a time when prospect lists are growing shorter.



## NORTHEAST/ MID-ATLANTIC

**Baltimore:** The market absorbed 171,000 square feet in the second quarter... **Boston:** Thanks to a large roster of technology tenants and a limited supply of new product, the market is positioned for an early recovery... **Long Island:** There were seven leases signed above 25,000 square feet including two over 50,000 square feet... **New Jersey:** The availability rate has been stuck in the double digits for the past four quarters... **Philadelphia:** The southeastern part of the region was hit the hardest as manufacturers and distributors alike downsized or closed... **Pittsburgh:** The market has been relatively stable, having benefited from almost non-stop restructuring of its manufacturing sector over the past two decades... **Washington, DC:** Vacancy moved higher by a full percentage point during the quarter.

