

UNITED STATES INDUSTRIAL MARKET REVIEW AND OUTLOOK

By Hugh F. Kelly, CRE

Harry S. Truman had a famous plaque on his White House desk: “The Buck Stops Here.”

Ronald Reagan used that space for a reminder that, “There Is No Limit To What a Man Can Accomplish If He Doesn’t Care Who Gets the Credit.”

Every market analyst ought to have a poster hanging in the office with the advice, “Don’t Start Any Research Project Unless You Are Willing To Be Surprised.”

The whole point of research is discovery. Why bother, if you already know all the answers? At the end of a study, if the only thing that has happened is to confirm one’s previous opinions, there is a real danger that investigator bias has focused on just what one expected to find, and ignored or minimized the importance of data that challenges preconceptions.

Sir Arthur Conan Doyle, author of the Sherlock Holmes mysteries, understood how assumptions could keep us from noticing things that become obvious once they are pointed out. His story, “The Adventure of Silver Blaze,” has Holmes conversing with one Inspector Gregory, who asks, “Is there any other point to which you would wish to draw my attention?” Holmes replied, “To the curious incident of the dog in the night-time.” Gregory: “The dog did nothing in the night-time.” “That was the curious incident,” remarked Sherlock Holmes.

In the common realm of real estate commentary, the conventional wisdom at the end of 2003 is that the industrial property markets are in terrible shape. In November, the respected Torto Wheaton Research firm states, "It is widely accepted in the real estate investment community that the industrial market is cause for alarm." Pension fund managers at SSR Realty Research believe occupancy in the sector to be in long-term decline "in part explained by the gradual migration of domestic manufacturing jobs outside the U.S. ... We forecast recovering NOI (net operating income) growth to be in the range of one to two percent per annum." Bob Bach, Grubb & Ellis' national research director, is a bit more sanguine, "The industrial market is stirring, but a recovery worthy of the title awaits a more robust economy. Net absorption has been low, but positive for five consecutive quarters... but rental rates remain soft and the mood of the market is tentative."

So it was something of a surprise to uncover comments from the SIOR professionals around the country such as the following:

"2004 will see the renewal of speculative Class A product with at least two 60,000 to 80,000 square foot buildings breaking ground... The overall market is expected to show significant movement during 2004." J. Earle Furman, SIOR, Greenville, South Carolina.

"2004 forecast: Increased activity for sale-leaseback and build-to-suit facilities is expected. Some speculative construction will commence. The marketplace is balanced overall. The local economy will track the national economy." Mike Ullian, SIOR, Melbourne, Florida.

"Absorption was positive during second quarter 2003 at 2.2 million square feet, up from 580,700 square feet in the first quarter... The market is projected to remain generally healthy. Demand from users and investors for the purchase of industrial buildings is expected to remain strong." Paul A. Sablock, SIOR, Central Los Angeles.

"Demand (in 2004) will continue strong for well-located high bay warehouse/distribution facilities and industrial buildings less than 60,000 square feet available for sale. It is expected that the leasing market will stabilize by the third quarter." Michael H. Monks, SIOR, Nashua, New Hampshire.

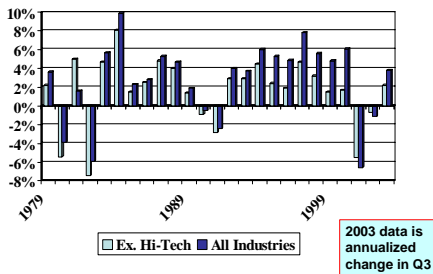
"All areas of the industrial market will continue to improve in 2004. As there was very little spec space completed in 2002, and none in 2003, absorption will improve with pressure on lease rates increasing toward the end of 2004." Robert C. Glaser, SIOR, Tucson, Arizona.

When there is such startling variance in perspective, the need to look closely at the numbers becomes all the more pressing.

Forces Affecting the Industrial Economy

Trends in Industrial Production

1979 – 2003 (q3)



Source: Federal Reserve System: Dec. 16, 2003

The statistical measures of goods production and distribution functions of U.S. business took a sudden, steep turn in 2003. One of the most basic measures is the Industrial Production Index maintained by the Federal Reserve. This index plummeted in 2001, and gave ground further in 2002. But, by the third quarter of 2003 industrial production had broken back into positive territory. All manufacturing output was up 3.8 percent on an annualized basis, and manufacturing, excluding the high-tech sector, grew at a 2.2 percent pace. A technology revival is underway, great news for many parts of the nation that have suffered grievous blows since the dot-com collapse.

A closer look at the Industrial Production Graph shows how much the tech sector has contributed to U.S. production gains over the past decades. Typically the darker bars, which include high-tech, have faster growth during an expansion and less decline in a recession, than the lighter bars (representing more traditional industries). This past recession, of course, was very different. But in the new expansionary cycle, it looks like technology will reassert itself as an important driver. This affects not only tech industries themselves (such as computer and telecommunications equipment, instruments and scientific devices, semiconductors, and other electronic components), but all other industries because technology is the key to productivity gains. Since the United States grows its labor force only one to two percent per year, it is up to improved productivity to provide the difference in a presumed sustainable rate of GDP growth in the three to four percent range.

The Institute of Supply Management’s Purchasing Managers Index (PMI) is a widely respected gauge of the industrial economy and its relation to business conditions as a whole. Data collected in November 2003 showed economic activity in the manufacturing sector strengthening for the fifth consecutive month, and the PMI well advanced into levels suggesting a very vigorous expansion in 2004. In fact, according to the survey, manufacturing posted its greatest advance since December 1983. New orders and production are at very lofty levels, and momentum is strong. The relative optimism of our SIOR survey respondents begins to fit into the context outlined in the table below. ISM summarizes the results as follows: “The recovery is gaining momentum. Indications are that the manufacturing sector is ending 2003 on a very positive note, and all the indexes support continued strength into 2004.”

Institute of Supply Management's Manufacturing Survey at a Glance

Variable	November Index	Direction Nov. vs. Oct.	Rate of Change Nov. vs. Oct.
PMI	62.8	Growing	Faster
New Orders	73.7	Growing	Faster
Production	68.3	Growing	Faster
Employment	51.0	Growing	From Contracting
Supplier Deliveries	56.0	Slowing	Faster
Inventories	50.0	Unchanged	From Contracting
Customers' Inventories	39.5	Too Low	Slower
Prices	64.0	Increasing	Faster
Backlog of Orders	59.0	Growing	Faster
New Export Orders	57.9	Growing	Slower
Imports	62.4	Growing	Faster

The Economy

Overall Economy	Growing	Faster
Manufacturing	Growing	Faster

Index values of 50 or higher indicate expansion.

Indications of a broad-based recovery in the economy is the best possible news for the industrial real estate sector, which is very closely tied to national economic cycles. This makes considerable sense, as GDP is a measure of goods and services output. The goods production end is easy to understand, but many of the services measures also have a direct effect on industrial real estate. For example, consumption activity at the retail level is highly correlated with the movement of products through the warehouse and distribution system that accounts for two-thirds of the nation's stock of industrial properties. Housing, which is measured in the investment tables of GDP, stimulates demand for furniture, appliances, and even the raw material for home construction, all of which flow from and through industrial properties.

Some Historical Statistics

All Cycles	Expansion	Contraction	Full Cycle
32 Cycles 1854-2003	38 months	17 months	55 months
15 Cycles 1919-2003	49 months	13 months	62 months
10 Cycles 1945-2003	71 months	10 months	81 months

If the mounting evidence that we have reached a sustainable expansion is to be believed, the consequences for an extended industrial market recovery are profound. That is because, over time, the U.S. business cycle has been changing structurally. We remain a cyclical economy, and that is probably an unalterable feature of free markets responding to supply and demand impulses. But cycles are getting longer, with *all of the lengthening in the expansionary phase*. As the table on the previous page strongly indicates, we have learned to mitigate downturns quite effectively, especially through the use of monetary policy and, to a lesser extent, through the blunt instrument of fiscal policy. Businesses, too, have taken to adjusting rapidly at the first sign of contraction, this is apparently limiting the duration of recessions. If we are in recovery, this is going to last for a long time. It is not out of the question to expect that the entire balance of the decade will be a period of growth for the United States. In that case, the outlook for the industrial real estate sector is particularly bright.

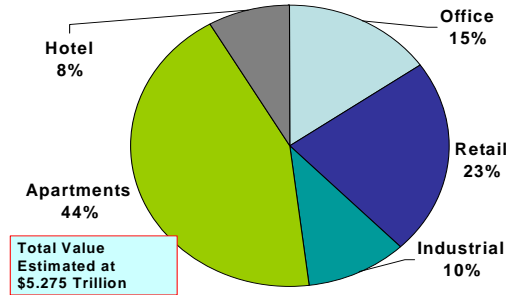
National Statistics in Brief

In terms of sheer physical space, industrial properties are substantially greater in magnitude than the other components of the commercial market. The *SIOR Comparative Statistics* annual survey covers a much broader range of markets than is typical of real estate reports and therefore captures a substantially greater stock of market-oriented industrial properties. Large, single-purpose manufacturing facilities like auto assembly plants, semiconductor production operations, foundries, and heavy equipment factories are excluded from our review. But typically if the space can be leased or generally adapted for use by firms for warehousing, light manufacturing, or R&D work, we attempt to include it in our market analysis.

We find the inventory of industrial property to be little changed in the past year, at 13.3 billion square feet. This compares with approximately four billion square feet of office space (see the following chapter of this report for details), about nine billion square feet of store area, 4.4 million hotel rooms, and 33 million square feet are rental apartments in the United States. The income structure of industrial real estate, however, is much more cost sensitive than other forms of investable property, as any expenses associated with occupancy must be passed through to final consumers. As such, rental rates and sales prices per square foot for industrials are far lower than for other property types. Consequently, functionality (including the appropriateness of location) is the key factor in evaluating industrial property.

While there is no general agreement about the overall value of U.S. commercial real estate, inventory and pricing data are becoming sufficient to make very supportable estimates of its extent. To put the estimate of \$5.275 trillion into context, recall that the Gross Domestic Product of the United States is approximately \$10 trillion. That is also the approximate capitalization of the listed firms on the New York Stock Exchange. Real estate is in the big leagues as an economic force. Industrial properties account for approximately 10 percent of that value, somewhat more than \$530 billion.

Estimated Share of Real Estate Value by Property Type



The 2004 edition of *Comparative Statistics* contains data and commentary on 135 U.S. industrial markets, and seven international markets. Although markets in Canada, Mexico, Brazil, and the United Kingdom are included in this year’s research, we focus on U.S. markets in this commentary. Insights into offshore markets can be gleaned by examining their individual report pages, which contain both the statistical information and the expert commentary of the Society of Industrial and Office REALTORS® member or members in each locality. For further information on specific markets, contact the contributing SIOR member whose contact information is located at the bottom of each individual market page.

Our U.S. inventory figures are within 0.2 percent of the 2002 tally, indicating remarkable stability in the nation’s stock of industrial properties. Of course, our market sample does change a bit from year to year, and we have five fewer reporting markets this year compared with last. So we might infer that some growth has occurred that might not be reflected in the numbers. Nevertheless, at a 13 billion square foot base, it takes 133 million square feet to move the totals one percentage point. The median market size in our sample is 49 million square feet and some of the missing markets are quite small. There is ample statistical reliability in the database from national and regional comparisons year to year. A rough equality in year-to-year inventory is plausible in years, such as 2003, when construction volumes were relatively low, since obsolescence probably claims at least one percent of the market per year.

INDUSTRIAL MARKET SIZES IN SIOR SURVEY

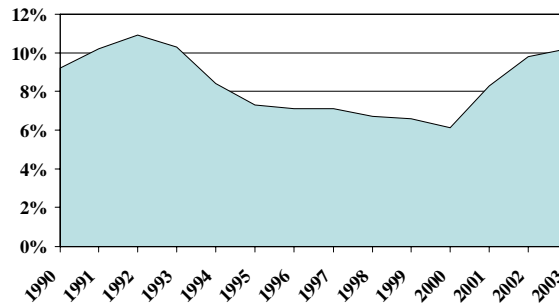
Millions of Square Feet

Largest Markets	Inventory	Smallest Markets	Inventory
Chicago, Illinois	1,036.8	Lake Charles, Louisiana	2.3
Dallas, Texas	467.0	Gainesville, Florida	3.3
Atlanta, Georgia	430.5	Lansing, Michigan	5.9
Houston, Texas	365.1	Marin County, California	6.4
Boston, Massachusetts	364.3	Batavia, New York	7.2
Northern New Jersey	357.0	Wichita, Kansas	8.7
Philadelphia, Pennsylvania	353.0	Des Moines, Iowa	8.8
Detroit, Michigan	344.5	Portland, Maine	10.2
Central New Jersey	334.7	Medford, Oregon	11.0
Cleveland, Ohio	318.3	Melbourne, Florida	11.8

Location and history have favored a variety of markets that have become the nation’s principal industrial hubs. Seaports, rail centers, and markets with excellent access to the network of interstate highways dominate the list, with some of the nation’s historic manufacturing cities represented as well. But there are many smaller markets serving local niches as well. Many of them are in agricultural areas or near smaller manufacturing centers that cater to special industry clusters.

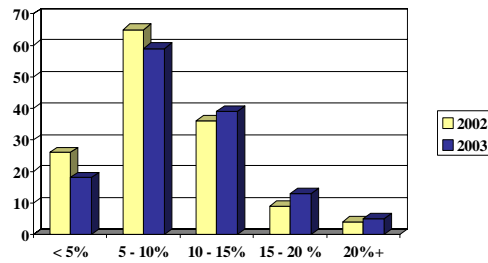
The data indicates that vacancy has stabilized in the industrial markets, and the national vacancy rate was tallied at 10.2 percent, up six-tenths of a percentage point from 2002. The range of vacancy, however, swings very widely. A few markets are exceptionally tight, such as some of the nearby suburbs of New York City; the sprawling warehouse markets in the Riverside-San Bernardino MSA; and some of the smaller Florida cities. Others, like Allentown, Austin, Des Moines, and Raleigh, have 20 percent or higher vacancy in industrial inventories of considerable size. In each case, the local economy has a much more immediate influence on the market than broad macroeconomic variables.

Industrial Vacancy Rates Edge Above 10 Percent in 2003



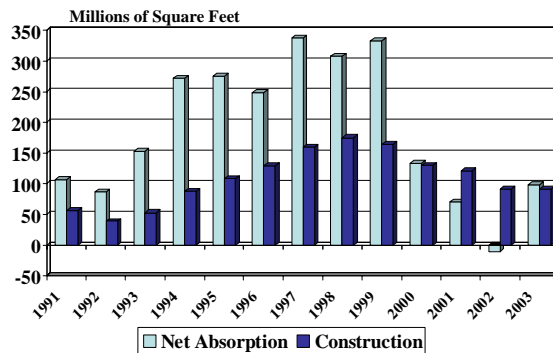
Arraying the 135 markets according to their vacancy rates on the histogram on the next page, we can see how a moderate shift in occupancy conditions has made more markets a bit more vulnerable than they were just a year ago. Markets with single-digit vacancy rates are fewer in number than in 2002, and each category from 10 percent up has added to its count of reported vacancy. The commentators who have been focusing on the challenges facing industrials no doubt have this in mind. And a review of the SIOR market commentaries from many of these areas will show that the local professionals do not dismiss the requirements of a recovery effort. There is no point in shying away from market realities in this business.

Histogram of Vacancy Rates



Nevertheless, our statistics demonstrate that a rebound is not merely coming around the corner, but is underway in late 2003. The industrial markets have bounced back from the negative net absorption we registered in the previous edition of *Comparative Statistics*, and have posted a net take-up of 98.7 million square feet, or 0.7 percent of the existing inventory. This is slow growth, to be sure, but growth it is. Meanwhile, construction has been even more moderate, at just 90.6 million square feet—virtually unchanged from a year ago. By the standards of the past decade, neither number is especially high. What is important is that they are well balanced. These figures reinforce the vacancy rate message that the industrial sector stabilized from 2002 to 2003.

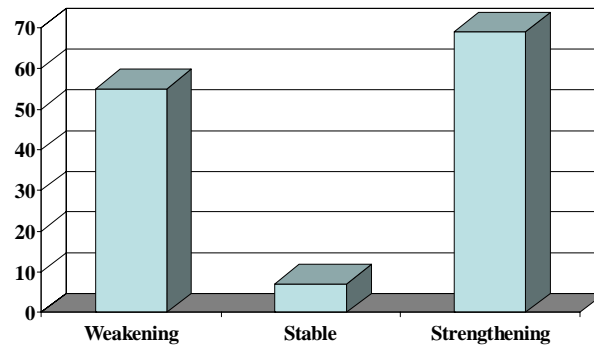
First Sign of a Turnaround:
Construction Flat; Absorption
Improving in 2003



Over the years we have found that the measure we call the Demand Ratio has acted as a very reliable short-term indicator of the direction of vacancy rates. The Demand Ratio simply divides current net absorption by construction underway. When the ratio is below 0.85, there is significantly more development than absorption, and it is likely that vacancy will rise in the short run. When the ratio works out to 1.15 or higher, the opposite is the case, and we expect improved occupancy a year from now. In between, we regard things as “too close to call,” but find that it is very infrequent that many markets fall in this “Goldilocks” range (not too big; not too small; just right!). Last year, we

concluded that “the risk is that industrial markets will be softer once again this year” based upon a 2002 count of 85 weakening markets versus 55 strengthening markets. And so it was. Based upon this year’s reports, 69 markets had strengthening demand ratios, including 14 markets in which no construction at all was underway. Fifty-five markets were in the weakening category, including 13 with negative net absorption in 2003. Seven were in that rare “steady state.” This leads us to two related predictions. First, that the national industrial vacancy rate will trend downward in 2004. Second, the histogram of market vacancies will be shifting to the left next year as we break into single-digit industrial vacancies once again.

Demand Ratio



New England

(Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont)

The northeast corner of the country found itself with another year of erosion facing its industrial market. Vacancy climbed 1.2 percentage points to 11.3 percent, the second highest regional rate in the nation. The 10 markets in this six-state cluster have widely varying experiences, though. Boston and nearby Nashua (NH) bore the brunt of negative net absorption, although the Hartford market also saw occupancy suffer real decline. But all seven of the other markets were in positive territory.

It is remarkable that three of the region's markets—Providence, Portland (ME), and Bridgeport/Stratford (CT)—qualified on the list of 10 lowest vacancies in the country. Providence reports brisk sales activity for turn-of-the 20th century mill buildings being rehabbed or developed to adaptive re-use. Portland has seen very little development in the past two years, keeping vacancy around three percent. In southwestern Connecticut, demand is shifting from traditional industrial tenants to wholesalers and service industry firms like landscapers and contractors, who can afford higher rents.

The technology downturn hit the Boston area very hard, and once again vacancy in the 13.5 percent range has put downward pressure on lease rates. Nashua is coping with some large corporate consolidations and downsizing, and Hartford continues to watch its manufacturing base shrink. It was better just to the north, as Springfield (MA) reported a full percentage point drop in vacancy by late 2003, with major retailing chains the major impetus for absorption.

Middle Atlantic

(New Jersey, New York, and Pennsylvania)

Like New England, the Middle Atlantic Region saw a moderate increase in vacancy since 2002, up 0.3 percentage points, to 9.9 percent. But unlike its neighbor to the north, the 15 markets reporting from New York, New Jersey, and Pennsylvania could boast of net take-up of 19.8 million square feet of space in 2003, and a regional Demand Ratio that predicts strengthening during 2004. Three markets posted vacancy of less than five percent, a claim that only 17 markets nationwide could make. One of these, Westchester County in New York, had the nation's tightest market, at 1.6 percent vacancy. The others were the Bronx (yes! The Bronx) and Syracuse. Storage companies have been gobbling up older industrial space in Westchester for retrofitting, and the county also saw cost sensitive office tenants eyeing facilities suitable for "flex" use. The Bronx is also benefiting from displaced demand from the other boroughs of New York City, where land is fast becoming prohibitively valuable for industrial users.

At the other end of the spectrum are the old steel areas of Pennsylvania, most notably Pittsburgh, with 15.7 percent vacancy and Allentown, whose slack is more than 21 percent. Corporate consolidation afflicted Pittsburgh, but there are some signs already that 2004 could be its turnaround year. Allentown also expects to see some of its space fill in the coming year, but obviously has a long way to go.

The giant industrial concentrations in the Middle Atlantic, though, are in New Jersey, both of which make the grade of the nation's 10 largest markets (as does Philadelphia).

Northern New Jersey has a strong 6.2 percent vacancy rate, and active construction in Central New Jersey has its vacancy at 8.2 percent. Investor interest, primed by low interest rates, was avid for modern buildings in these markets.

East North Central

(Illinois, Indiana, Michigan, Ohio, and Wisconsin)

The Great Lakes States held their vacancy rate rock solid at 9.7 percent between 2002 and 2003, a tremendous accomplishment as this region had the most devastating employment losses of any region during the past year. The historical center of manufacturing in America's Industrial Age, the East North Central states have the greatest concentration of inventory of any region, 3.1 billion square feet. Remarkably, the 21 markets in this region had an aggregate 26.7 million square feet of positive net absorption. But this was largely dissipated as 22.5 million square feet of new construction was tallied.

Only Youngstown (OH) reported a vacancy rate less than five percent, unchanged from a year ago at 4.9 percent. Milwaukee had a stunning 9.4 million square feet of positive absorption, with vacancy peaking at eight percent early in 2003 and dropping to 6.6 percent by autumn. Chicago, the nation's largest industrial market by far, registered 6.8 million square feet of net absorption, about 0.7 percent of its inventory base.

Distribution hubs such as Columbus and Indianapolis anticipate strong recoveries during 2004, but the outlook for cities with heavy manufacturing dependence like Dayton, Cleveland, and Detroit look ahead more cautiously. Troubled Lansing (MI), with 23.9 percent vacancy, is not expecting recovery to be swift.

West North Central

(Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota)

The Great Plains States retained the laurel for the lowest regional vacancy rate at 8.8 percent vacancy across its seven markets. Though the region is 1.4 percentage points stronger than the national average, its total vacancy is up from 7.6 percent a year ago. The reason for the regional softening is ironically its prior success. Last year's Demand Ratio detected higher levels of construction than absorption, as builders look at the region's relatively strong occupancy. That hasn't changed much, as we find 2003 net absorption of less than 150,000 square feet, versus construction of 5.4 million square feet. Things could get worse before they get better out on the prairie.

The economic difficulties in the market run along an east-west corridor from St. Louis through Kansas City to Wichita, all of which saw reduced occupancies in 2003, more than a million square feet apiece in the cases of St. Louis and Kansas City. A corporate exodus from a single 835,000 square foot user hammered Kansas City, while the other markets had to cope with the downturn in aircraft production. Des Moines has the unenviable title of the highest industrial vacancy in the nation, at 27.8 percent.

Omaha, on the other hand, led the region with 1.8 million square feet of net absorption, although this market admitted coping with tenant migration issues. Minneapolis also reported a year in which absorption exceeded expectations, partly because landlords so

aggressively wooed businesses with attractive leasing terms. They have a saying out here: If you don't like the weather, stick around an hour or two and it will change. With less than 775 million square feet of inventory, the West North Central has one of the smallest industrial market bases in the nation. That makes the area prone to statistical swings, and it is in the middle of one right now.

South Atlantic

(Delaware, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, and West Virginia)

For the third consecutive year, the South Atlantic Region has the highest vacancy rate in the U.S., rising from 12.1 percent a year ago to 12.2 percent in our present compilation. Unoccupied space grew from 197 million square feet to 229 million square feet in just a year's time. That's what happens when you build four times as much as you absorb, the situation diagnosed by the Demand Ratio last year, when we warned that development volumes "virtually guarantee continued high vacancy."

Well, things appear to be changing. Between 2002 and 2003, net absorption along the Atlantic Seaboard accelerated from 3.9 million square feet to 10.9 million square feet. Meanwhile, construction underway geared down from 13 million square feet to just about 10 million square feet. So the region is in that "sweet spot" of equilibrium, predicting a relatively stable year going forward. Of course, giving the starting point, it will have to do better than that if it hopes to see real improvement in industrial rents and prices.

The weakness is widespread. Raleigh (24.1 percent vacancy) and Northern Virginia have been clobbered in the tech wreck. Textile and furniture troubles plague Greensboro. Atlanta saw positive absorption in 2003's third quarter, but that followed nine consecutive quarters of losses. And in Orlando, "tenants are happily experiencing the lowest lease rates in more than 10 years." And so it goes.

Here's the good news. No state matched Florida for steady employment gains in the recent economic downturn. It is no accident that Gainesville and Ocala are in our "top 10" markets for occupancy. Georgia saw a stunning turnaround in employment as 2003 wound down, and Atlanta's positive absorption is not likely to prove a fluke. The demand side of the warehouse/distribution markets will do just fine in this region. The only question is whether developers will have the discipline to allow absorption to bring vacancy back to the single digits in 2005 through 2006. That's a "maybe."

East South Central

(Alabama, Kentucky, Mississippi, and Tennessee)

The Mid-South is another region where a troublesome Demand Ratio a year ago predicted an increase in vacancy in 2003. Availability rose from 10.6 percent to 11.0 percent over the course of 12 months. What a difference a year makes, though. Birmingham is humming with the spin-off effects of automotive expansions led by Honda, as is Jackson with Nissan. This region has become the growth corridor for the car manufacturers, and industry has a significant multiplier effect. Both Birmingham and Jackson posted net absorption figures in excess of three million square feet. Knoxville, Huntsville, Louisville, and Memphis are also in the plus column, albeit at more modest figures.

If there is still a major trouble spot it is Nashville, which saw several business closures put a significant volume of inventory back on the market. Nashville's vacancy is still not extreme, at 8.7 percent, but its negative net absorption of 1.6 million square feet is disturbing. Several other markets also gave ground this year: Montgomery, Chattanooga, and Mobile.

As the national pattern of employment expansion works its way north and east, this region is primed for recovery. This is one area where low cost competition from abroad could hinder the pace of growth, since it was exactly on the basis of cost that the Dixie states set the terms of competition with the industrial North a generation ago.

West South Central

(Arkansas, Louisiana, Oklahoma, and Texas)

Austin has a 20.7 percent vacancy, and anticipates that rents will rise when equilibrium is reached—at 15 percent. Dallas had 1.5 million square feet of negative absorption, yet asserts, "Given its central location, the pro-active development community, and quality of life, Dallas will often defy the perceived market conditions." Ft. Worth also saw significant occupancy loss, 1.4 million square feet, but that market is clear-eyed about its difficulties for 2004.

Here are the regional figures. Over the past year, a 10 percent vacancy stepped up to 10.8 percent of a 1.4 billion square foot inventory. Net absorption, a negative 1.6 million square feet in 2002, worsened to negative 3.5 million square feet in 2003. Yet we find 11.2 million square feet under construction here, not much of a correction from 12.1 million square feet a year ago. Guess what? Vacancy is going up again in 2004.

Where are markets improving in the Oil Patch states? New Orleans has a 7.9 percent vacancy and posted net positive absorption of 462,800 square feet. Tulsa has a 6.0 percent vacancy, and saw a half-million square feet of occupancy improvement in 2003. Baton Rouge's vacancy is 10.1 percent, even with 544,000 square feet of net absorption in the past year. Tellingly, all three of these markets offer a cautious outlook for 2004 in their local commentaries.

The turnaround doesn't look to be arriving in 2004. Someone should tell the developers.

Mountain

(Arizona, Colorado, Idaho, Montana, New Mexico, Nevada, Utah, and Wyoming)

The nine markets reporting from the Mountain Region held their aggregate vacancy just less than 10 percent in 2003, as their 2002 Demand Ratio of 1.07 might have suggested. And if the reliability of this indicator proves sound, that vacancy rate could be much improved by 2004. Current absorption in the region is computed at 11.8 million square feet, but only 6.8 million square feet of development is reported.

Demand has come back decisively. The employment figures for all states in the region have trended up on a year-over-year basis, with one exception—Colorado. Nevada has achieved the distinction of being the first state in this recovery to see a greater than three

percent annual employment gain. Viva Las Vegas! That city saw 3.5 million square feet of net industrial absorption in 2003 and lease rates are poised to move upward in 2004. Phoenix had even greater industrial absorption, 4.1 million square feet. And yet both these markets are on the high side of the regional vacancy.

Albuquerque's 7.6 percent vacancy has been elevated 1.5 percentage points by a technology closure. This market still saw more than 450,000 square feet of net absorption and is taking a slow, but sure approach to growth in 2004—"slightly better" is the outlook. Denver is on the plus side of the ledger with nearly 700,000 square feet of absorption and a vacancy rate of 9.4 percent, yet is conservatively planning for a bottoming out of rents by mid-2004. Tucson has the region's lowest vacancy rate at 5.1 percent, and it absorbed 346,000 square feet of space in 2003, yet is building only 74,000 square feet.

As the national economic recovery matures, and particularly if the technology sector strengthens, many of the Mountain markets should do very well in the coming year.

Pacific

(Alaska, California, Hawaii, Oregon, and Washington)

Arriving at the West Coast, we finally reach this year's standout region. Not only did the Pacific have the lowest vacancy at 9.4 percent, but also posted 37.6 million square feet of positive absorption, or 1.2 percent of its 2.5 billion square foot inventory. Four markets can claim occupancies greater than 95 percent, led by Marin County, and including most of the Inland Empire in Riverside-San Bernardino, the San Fernando Valley near Los Angeles, and even Honolulu. The vast majority of Pacific markets can boast single-digit availability rates. There are certainly some exceptions, though, many with a high-tech flavor: San Jose, Seattle's Eastside, Portland (OR), and Orange County.

Southern California has been generating stunning absorption numbers, especially around the Ontario Airport and throughout the Inland Empire. The eastern portion of San Bernardino has seen rents rising 10 percent over the year, and the only complaint is that infrastructure is starting to constrain the market's ability to accommodate demand. Lots of markets would like to have this problem. Los Angeles' South Bay was deeply affected by slowing trade during the recession but now reports that rents have climbed back to levels not seen for more than a year. Orange County is the exception. Net occupancy dropped more than 800,000 square feet, and rental concessions became ever more generous. Given this market's history, tenants should probably grab the deals.

Further north, Seattle just received the excellent news that Boeing will keep production of its new jetliner, the 7E7, at its Puget Sound facilities. That is a very significant, and long-term, boost to the economic base and, of course, to the industrial market. Implementation of this decision cannot come too soon: Seattle lost more than two million square feet of occupancy in 2003. That's not as bad as the battered Silicon Valley, where San Jose lost another three million square feet of industrial tenancy after dropping 1.8 million square feet in 2002. Portland's vacancy is up—greater than 15 percent, but this market did see an increase in occupied space of about 850,000 square feet and hopefully is embarked upon a sustainable recovery.

If it takes patience, so be it. Ask Honolulu, which struggled with a statewide economic slump for nearly the entire decade of the nineties, ever since the Nikkei bubble burst in Tokyo. Now Honolulu's vacancy is down near four percent, net absorption is 457,000 square feet (that's 2.2 percent of its inventory), and no large scale industrial construction is planned to address a space-short market. No wonder that major owners who have held on through the bust are now looking for buyers of industrial portfolios. Unless one is willing to concede that we've had our last technology boom, a similar trajectory could be ahead for the Bay Area and the Pacific Northwest.

INDUSTRIAL SUMMARY TABLE

(Millions of Square Feet)

Region	Number of Markets	Inventory	Vacancy	Vacancy Rate	Net Absorption	Construction
New England	10	626.0	70.9	11.3%	-1.7	3.3
Middle Atlantic	15	1,631.9	161.3	9.9%	19.8	6.5
East North Central	21	3,112.0	302.6	9.7%	26.7	22.5
West North Central	7	773.1	67.8	8.8%	0.1	5.4
South Atlantic	24	1,877.0	229.0	12.2%	10.9	10.0
East South Central	10	603.0	66.0	11.0%	5.6	4.6
West South Central	14	1,404.2	151.8	10.8%	-3.5	11.2
Mountain	9	779.5	76.9	9.9%	11.8	6.8
Pacific	25	2,468.7	231.5	9.4%	29.0	21.0
U.S. Totals	135	13,275.5	1,357.8	10.2%	98.7	90.6

INDUSTRIAL MARKET VACANCY CONDITIONS IN SIOR SURVEY

Highest Vacancy	Vacancy Rate	Lowest Vacancy	Vacancy Rate
Des Moines, Iowa	27.8	Westchester County, New York	1.6
Raleigh, North Carolina	24.1	Ft. Smith, Arkansas	1.9
Lansing, Michigan	23.9	Marin County, California	2.2
Allentown, Pennsylvania	21.1	Providence, Rhode Island	2.9
Austin, Texas	20.7	Gainesville, Florida	3.1
Atlanta, Georgia	19.1	Portland, Maine	3.2
Greensboro, North Carolina	18.6	Bridgeport/Stratford, Connecticut	3.5
Lake Charles, Louisiana	18.3	Ocala, Florida	3.7
Louisville, Kentucky	18.0	Inland Empire, California	3.9
Dayton, Ohio	16.5	Fargo, North Dakota	4.0