The Warehouse Sector

STATE OF THE NATIONAL WAREHOUSE MARKET: THIRD QUARTER 2002

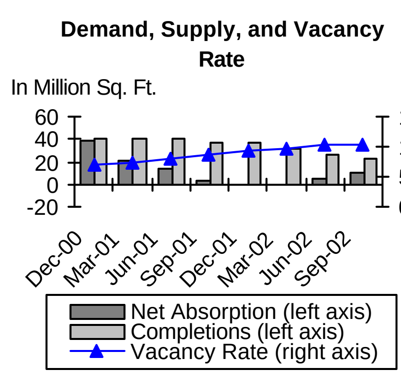
Vacancy. Recovery in the warehouse sector continued to advance in the third quarter of 2002. Resilient consumer demand induced retailers and wholesalers to cautiously lift their inventories, and an import buildup provided an unexpected boost to inventories. Factories continued to fill orders from inventories so that industrial production was up at an annual rate of 3.5 percent from the second quarter, and 0.8 percent from the third quarter 2001. Moreover, U.S. companies ordered imports in anticipation of a longshoremen strike –- and some of that import buildup went into inventories, especially at retailers and wholesalers.

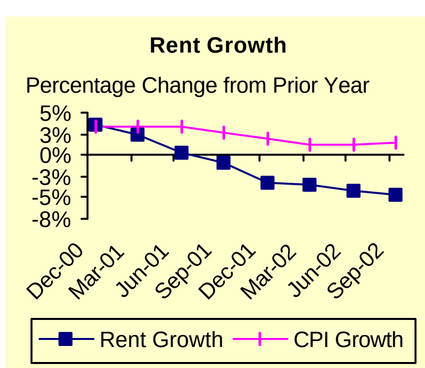
Inventory gains allowed leasing activity to expand modestly in the 54 markets tracked in the third quarter of 2002. Though still low compared to the 20-year quarterly average of 23 million sq. ft. (msf), net absorption doubled last quarter's total to 9.9 msf. Super-regional distribution centers including Inland Empire, Dallas-Fort Worth, Los Angeles, Chicago, and Atlanta topped the 45 markets that recorded positive absorption in the third quarter of 2002. Year-to-date, approximately 14 msf has been absorbed in the 54 markets, particularly in Inland Empire, Phoenix, Chicago, Dallas-Fort Worth, Charlotte, Fort Lauderdale, Indianapolis, and Atlanta. Only 24 markets continued to report languishing demand for warehouse space, compared to 31 markets in the previous quarter.

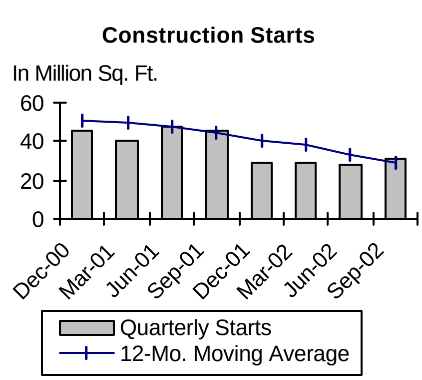
Developers were cautious, and new warehouse space completions declined for a third straight quarter in the 54 markets. Approximately 22.3 msf of new projects were completed in the third quarter of 2002, down from the 26.7 msf posted in the second quarter of 2002 and off from the 37.4 msf posted in the third quarter of 2001. Year-to-date, only 79.6 msf of new warehouse space was added to the 54 markets, compared to 118.3 msf in the same period in 2001. Still, the amount of new and sublease space was copious relative to absorption so that the average vacancy climbed from 8.6 percent in the third quarter 2001 to 10.4 percent in the third quarter of 2002. Palm Beach County was the only market that experienced improvement in occupancy on both a yearly and quarterly basis.

Rent. Rising vacancies, coupled with the availability of sublease space, eroded rents of warehouse properties for the fifth consecutive quarter and spruced up leasing incentives in the summer of 2002. Average rent in the 54 markets was down 4.6 percent compared to that of the third quarter of 2001. Still, three markets –- San Diego, Honolulu, and Kansas City –- managed to eke out rent gains of 1-2 percent from the third quarter in 2001. On a quarterly basis, the average rent in the 54 markets was off just 1.3 percent from the previous quarter.

Construction Starts. Inventory rebuilding efforts propped up development of new warehouse properties in the 54 markets. Thirty markets reported a pickup in development activity from the second quarter of 2002. Over 31.5 msf of new space broke ground or was under construction in the third quarter compared to 28 msf of building projects underway in the last quarter. Still, aggregate starts remained well below 45.6 msf that was under construction in the third quarter of 2001. Likewise, year-to-date starts of 88.3 msf remained substantially below the 132.9 msf that was in the pipeline for the nine months ending September 2001. Top super-regional distribution centers including Inland Empire, Chicago, Dallas-Fort Worth, Los Angeles, Atlanta, Houston, and Northern New Jersey accounted for half of total year-to-date starts.







Source: Property and Portfolio Research, Bureau of Labor Statistics

KEY MARKET TRENDS: THIRD QUARTER 2002

Markets with Highest Occupancy

Market	Vacancy Rate	Change from Prior Year
Palm Beach County, FL	5.6%	-30 bps
Milwaukee, WI	7.0%	120 bps
San Francisco, CA	7.3%	140 bps
Los Angeles, CA	7.5%	220 bps
Seattle, WA	8.0%	190 bps
Jacksonville, FL	8.1%	90 bps
Oklahoma City, OK	8.2%	250 bps
Kansas City, MO-KS	8.4%	230 bps
St. Louis, MO-IL	8.5%	180 bps
Denver, CO	8.6%	160 bps

Source: Property & Portfolio Research

Palm Beach County once again boasted the lowest vacancy rate in the third quarter of 2002, after sustaining positive absorption while the availability of industrial land dwindled. Overall, 29 markets reported above-average occupancies despite significant increases in warehouse space relative to absorption. Among the four regions, the West was tightest with just 9.2 percent of available warehouse space as most major markets reported occupancies higher than the national average. The Midwest followed with a vacancy rate of 10.1 percent; occupancy decline in this region was moderate compared to the rest of the regions. Lackluster demand in the Northeast, and high supply growth in the South pushed down occupancies in these regions. The Northeast posted a vacancy rate of 10.9 percent and the South posted a vacancy rate 11.5 percent.

Markets with Highest Rent Growth

Market	Rent Growth
San Diego, CA	1.9%
Honolulu, HI	1.6%
Kansas City, MO -KS	1.0%
Stamford, CT	-0.5%
Long Island, NY	-0.9%
Oklahoma City, OK	-0.9%
Northern New Jersey, NJ	-1.1%
Houston, TX	-1.7%
Ft. Lauderdale, FL	-1.7%
San Antonio, TX	-1.7%

Source: Property & Portfolio Research

The lack of strong demand for warehouse space made landlords in the 54 markets more willing to continuously lower rents. As a result, average rent growth has been non-existent or marginal at best since the second quarter of 2001. To date, the average rent in the 54 markets is off 6.3 percent from its peak level in 2000. In San Jose, East Bay, and San Francisco, average rents for warehouse space have dipped over 20 percent since 2000. Sizeable declines were also noted in Phoenix, Orange County, Detroit, Jacksonville, Salt Lake City, Philadelphia, Honolulu, St. Louis, Columbus, and Dallas-Fort Worth.

Markets with Highest Construction Starts

Market	Percentage of Total U.S. Starts
Inland Empire, CA	12.3%
Dallas - Fort Worth, TX	10.8%
Chicago, IL	9.0%
Los Angeles, CA	6.8%
Northern New Jersey, NJ	5.0%
Houston, TX	3.8%
Atlanta, GA	3.3%
Portland, OR	2.7%
Las Vegas, NV	2.6%
Cleveland, OH	2.5%

Source: Property & Portfolio Research

Construction in the third quarter 2002 was once again concentrated in the seven largest warehouse markets –- Los Angeles, Northern New Jersey, Atlanta, Chicago, Dallas-Fort Worth, Inland Empire, and Houston. Those markets accounted for more than 50 percent of new projects in the third quarter. The combination of a large population base and physical accessibility is instrumental in driving development activity in these markets. Regionally, the South and West had the most construction activity, each with 11.4 msf of new warehouse space under construction. The Midwest and Northeast reported construction pipelines of 5.5 msf and 3.2 msf, respectively, in the third quarter of 2002.

THE WAREHOUSE OUTLOOK

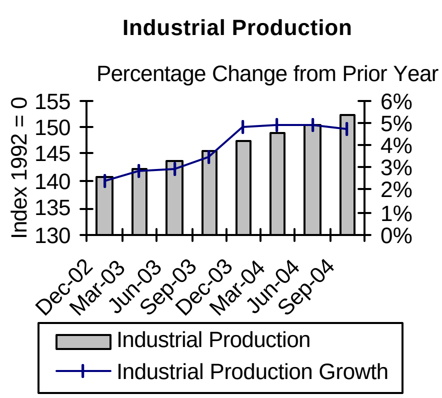
Even though recent data show manufacturing continues to struggle, there are signs of future improvement. Consumer spending on items other than autos has not fallen off. Businesses have also begun to spend a bit more on equipment and other productivity-boosting tools. In addition, the ratio of overall business inventories to sales for September was far below its long-run trend. All these indicate the need to build up inventories and set the manufacturing recovery back on track. However, with the national mood of waiting and worrying about both economic and security issues, a manufacturing upturn is still at risk.

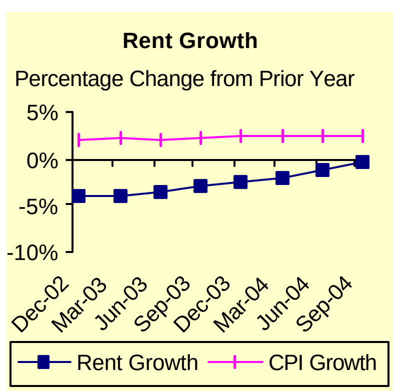
With current inventories exceptionally lean, businesses will inevitably have to expand output –- a situation that bodes well for the warehouse sector. Increased output should spur leasing activity in all 54 markets except San Francisco, Tampa, and San Jose –- and translate into a net absorption of 10.4 msf in the fourth quarter this year. However, net absorption should only reach 24.4 msf for all of 2002, down from the 36.5 msf absorbed in 2001.

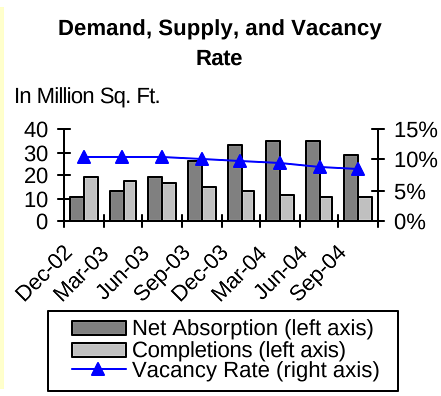
Construction starts of warehouse space have tapered off noticeably from last year in 42 of the 54 markets so that completions are expected to fall from 154.9 msf in 2001 to 98.9 msf for 2002. However, there is more building activity than is warranted so that the average vacancy rate is expected to edge up to 10.5 percent by year-end 2002 from 9.3 percent in 2001. Approximately 26 markets are expected to post vacancies higher than the national average by year-end. Hence, landlords are likely to slash rents to induce tenant renewals and fill up empty warehouse buildings. The average rent in the 54 markets is thus expected to drop 3.8 percent from 2001. Only San Diego and Honolulu are likely to post modest rent appreciation from their 2001 levels.

As long as overall demand keeps growing –- even modestly –- chances are good that businesses will gear up production in the next two years. This should stimulate leasing activity in the 54 markets, and help keep net absorption rising to 91.4 msf and 123.1 msf in 2003 and 2004, respectively. Much of the demand strength is likely to occur in the large warehouse markets of Los Angeles, Northern New Jersey, Atlanta, Chicago, Inland Empire, and Dallas-Fort Worth. Declining construction starts will continue to temper increases in warehouse space across the 54 markets, with completions of 60.8 msf in 2003 and 43.6 msf in 2004. When demand growth picks up beginning in 2003, 41 of the markets could strengthen occupancies. However, sizable advances are more likely to happen in 2004: the average vacancy rate should dip to 8.2 percent in 2004 from 9.8 percent in 2003. With vacancy rates in the 54 markets still higher than the 20-year average, landlords are likely to wield weak pricing power. As a result, the average rent is expected to drop again 2.5 percent in 2003, and level in 2004.

Hot Markets. Approximately 26 markets are expected to be the frontrunners as above-average occupancies gain from healthy employment growth and controlled development activity in the next two years. Palm Beach County, Milwaukee, Oklahoma City, San Francisco, and Honolulu will lead those markets with less than 60 msf of warehouse space. Seattle, Jacksonville, Kansas City, Denver, Ft. Lauderdale, Cincinnati, Miami, Detroit, Orange County, Indianapolis, Tampa, Salt Lake City, San Diego, Phoenix, and Las Vegas are poised to recover the fastest among warehouse markets with size ranging from 60 msf to 100 msf, while Los Angeles, St. Louis, East Bay, Chicago, Houston, and Dallas-Fort Worth are expected to dominate those with warehouse space exceeding 100 msf.







Source: Property and Portfolio Research, NATIONAL ASSOCIATION OF REALTORS®

The markets covered in this report include the following:

Atlanta, GA	Minneapolis, MN-WI
Austin, TX	Nashville, TN
Baltimore, MD	New Orleans, LA
Boston, MA	New York City, NY
Charlotte-Gastonia, NC-SC	Norfolk, VA
Chicago, IL	Northern New Jersey
Cincinnati, OH-KY-IN	Oklahoma City, OK
Cleveland, OH	Orange County, CA
Columbus, OH	Orlando, FL
Dallas-Fort Worth, TX	Palm Beach County, FL
Denver, CO	Philadelphia, PA-NJ
Detroit, MI	Phoenix, AZ
East Bay, CA (Formerly Oakland)	Pittsburgh, PA
Fort Lauderdale, FL	Portland, OR
Hartford, CT	Raleigh, NC
Honolulu, HI	Richmond, VA
Houston, TX	Sacramento, CA
Indianapolis, IN	Salt Lake City-Ogden, UT
Inland Empire (Formerly Riverside, CA)	San Antonio, TX
Jacksonville, FL	San Diego, CA
Kansas City, MO-KS	San Francisco, CA
Las Vegas, NV	San Jose, CA
Long Island, NY	Seattle, WA
Los Angeles, CA	Stamford, CT
Memphis, TN	St. Louis, MO-IL
Miami, FL	Tampa-St. Petersburg, FL
Milwaukee, WI	Washington, DC-MD-VA

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