INDUSTRIAL

Minneapolis/St. Paul • Midyear Towle Report 2003

HIGHLIGHTS

- Direct vacancy dropped to 12.7% from 16.8%.
- With sublease space, the combined vacancy is 13.7%, down from 19.8%.
- Over 2.4 million sq. ft. of absorption.
- 51,200 sq. ft new construction.
- Tenants remain in control of the market.
- Rents are still soft.

MARKET OVERVIEW

This Midyear Report covers the 12-month period from Second Quarter 2002 to Second Quarter 2003.

Fast Facts:

- 924 buildings
- 77.3 million leaseable sq. ft.
- 728,130 sq. ft. sub lease space
- 12.7% direct vacancy rate
- 13.7% combined vacancy rate
- 2,479,883 sq. ft. annual net absorption

It was possible to feel a breeze as the pendulum swung in the Twin Cities industrial market this past year. After seeing record levels of negative absorption at the end of Q2 2002 (-873,481 sq. ft.), the market reported an amazing 2,479,883 sq. ft. in *positive* absorption for the period ending Q2 2003.

The Northwest sector alone accounted for approximately 42% of this total (1,041,894 sq. ft.), most of which can be traced back to the O/W category. The Southwest sector followed closely at 32% (807,922 sq. ft.), with the majority of its absorption seen by the OS/BC market. Even the addition of 728,130 sq. ft. in sublease space was not enough to dampen the good news, bringing the total combined vacancy rate down 6.1 percentage points over Q2 2002 (19.8%) to 13.7%.

Looking strictly at the numbers, it would appear as though a recovery has begun. Or has it? The results of the past year beg the question - is this a sign of true absorption and growth, or just a market correction, with occupancy rates playing catch-up?

Realistically, it's both.

That being said, in order to understand the past and future implications of this dynamic, it's important to view the overall market performance in context.

The industrial real estate market as a whole is driven by the state and health of the manufacturing industry. And, according to the June 2003, Minnesota Department of Economic Security, *Minnesota Trends* publication, "Minnesota's manufacturers benefited from the nation's longest expansion during the 1990s. U.S. manufacturing began to falter in the second quarter of 2000, while manufacturing in Minnesota [sic] started slipping in the fourth quarter. Minnesota's manufacturing woes....have wiped out roughly 47,000 jobs or about 12 percent of peak factory employment."

In addition, permanent, commodity-type manufacturing migration to overseas markets and business-friendly incentives offered by competing states, continued to adversely affect the vitality of the Minnesota manufacturing sector, and by default, the industrial real estate market.

In response, Twin Cities' property owners and landlords took a good, hard look at the realities facing them, and went on the offensive.

Sale price reductions (10% on average), long-term leases containing generous concessions (some up to 18%), the development of plans to convert vacant loft industrial properties into luxury residential space, and the conversion of

Towle Industrial Market Outlook

Looking ahead to the next 12 months, the industrial real estate market will continue to face a number of challenges.

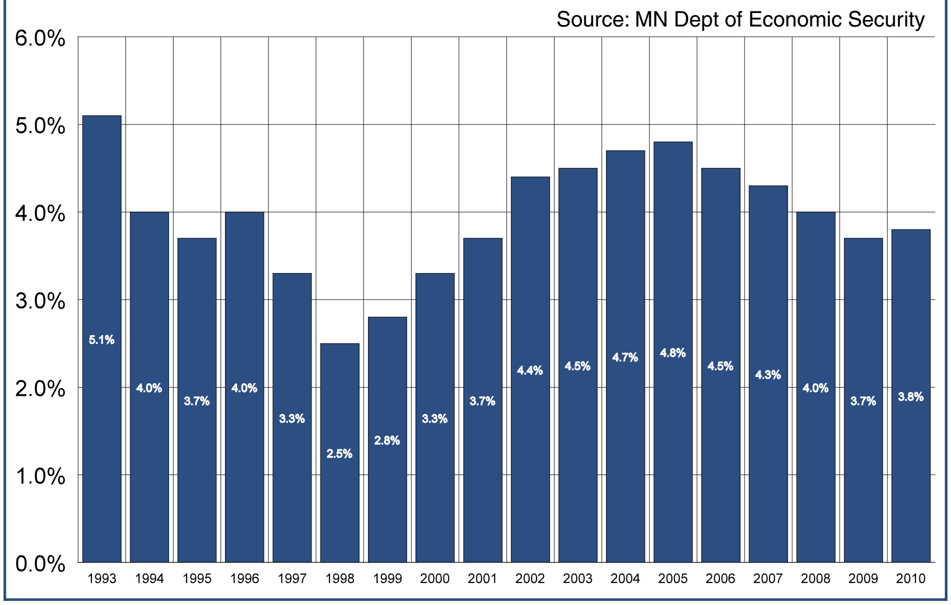
According to the Minnesota Economic Trends, June 2003 publication, "the recent declines in the indexes hint at more factory contraction down the road and suggest that no quick, robust rebound in manufacturing will happen either nationally or in Minnesota." Further, "the economic ripple from the downturn in manufacturing in Minnesota hasn't been fully felt yet. On the back side of the economic production chain are the businesses that supply manufacturing goods and services. These businesses have also been hurt by the manufacturing slump, but have probably been hanging on, waiting to see if their customers can recover."

Excess plant capacity, already a measurable consequence of reduced demand, is also expected to increase over the next year, driving projected unemployment rates in this market even higher.

So, what does this mean for the Twin Cities industrial real estate market?

- Property owners and brokers will continue to offer creative incentives to attract and retain tenants.
- Single-user property sales will continue to be an active segment of the industrial market.
- New construction will remain on hold, pending significant pre-leasing.
- Expansion and growth in the medical device/bio-tech areas will continue to play an important role in square footage absorption.
- Job growth in the industrial sector will remain a critical indicator of space demand in 2004.

Minnesota Past & Projected Unemployment Rates



INVESTMENT & USER SALES

There will be more investment property coming on the market. Buyer appetite is strong, and sub-9% cap rates are probable for the best properties.

There are more than 110 industrial buildings on the market for sale at the current time. Two-thirds of them are less than 100,000 sq. ft. in size. 20% are between 100-200,000 sq. ft. and the balance (14%) are over 200,000 sq. ft. For the user/buyer, market conditions are excellent. There is great property availability and attractive financing is readily accessible. For the investor, many of these properties are divisible and could become good investments. They just need to be leased!

As mentioned above, many user buildings are for sale including (clockwise from top left): FEC building in Plymouth (121,000 sq. ft.), 6021 Broadband Blvd. in Shakopee (490,000 sq. ft.), Worldwide Distribution in Bloomington (389,000 sq. ft.) and Gen-X Sports Facility in Anoka (208,000 sq. ft.)