The Industrial
O·U·T·L·O·O·K

Published Quarterly by ***The Walker Companies***

Vol. 9, No. 3 | 600 W. Peachtree St., Suite 2350, Atlanta, GA 30308 | Fall 2000

Where are You in the Real Estate Cycle?

Is there a real estate asset for all seasons, or is there a season for all real estate assets? To answer this question, every practitioner or investor in real estate must ask the question: W*here am I in the real estate cycle?*

According to industry experts, the concept of market cycles is sometimes oversimplified and used more to support self-serving assertions about probable market recovery than as a guide to investment decisions. The growing body of knowledge on the subject evidences the affirmation that real estate cycles are relevant and will become a more important decision variable for industry practitioners, investors and portfolio managers in the future.

A significant amount of research has been performed to better define real estate cycle lengths since 1919, where repeating cycle lengths of 7 - 8 years, 18 1/3 years and 50 - 60 years have been identified. In 1995,

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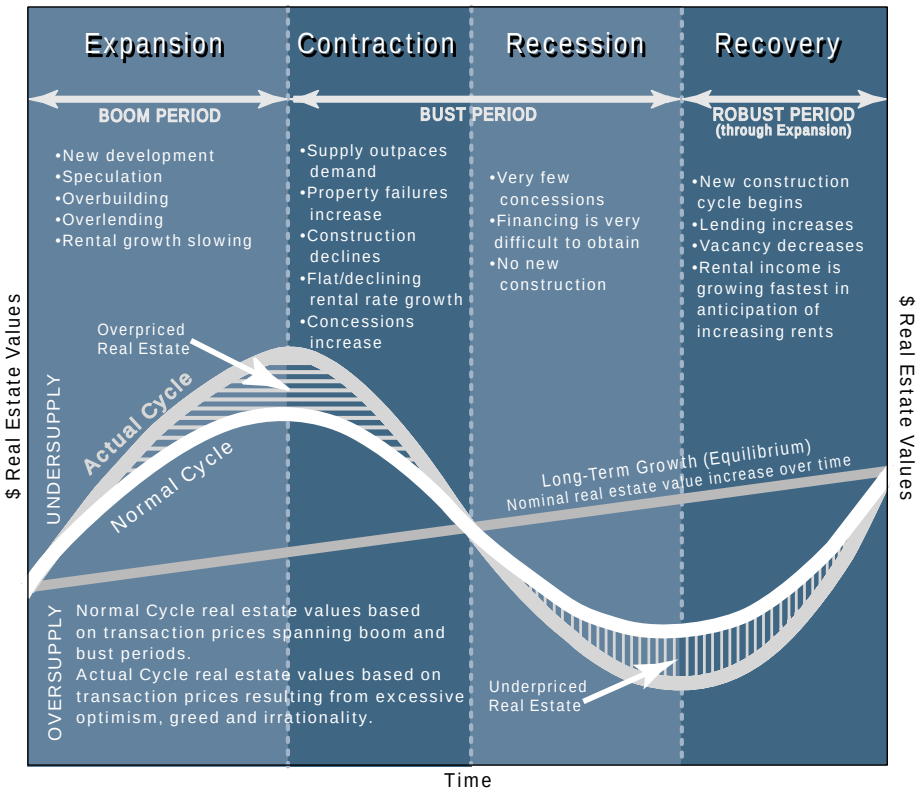

Source: Journal of Real Estate Research, Volume 18, No. 1, 1999; LaSalle Advisors Investment Research, Market Watch 1998

In This Issue

Show Me the Labor

Economic developers, site selectors, and corporate executives agree that finding a quality source of available labor these days is a challenge. National unemployment is the lowest it has been since 1969 (averaging 4% over the last six months), and all U.S. regions [defined by the Bureau of Labor Statistics (BLS)] are currently at or near full employment (see map on page 7). The question among industrial recruiters and employers is how can we locate and tap into already limited sources of labor for a manufacturing or distribution facility?

One tool that can be used to combat this problem is a labor

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Report Card for States

At first glance, the present strength of the national economy appears to be a perfect picture of health, with virtually every state enjoying an abundance of job creation, a low national unemployment rate and consumer price index, real wage growth of 2.6% per year (between 1996 and 1998), and so forth. However, a closer look reveals sharp divergences in resources, policies, and performance that suggest some states could fall increasingly behind as others enjoy rising prosperity in the years ahead.

Each year the Corporation for Enterprise Development (CFED) issues its *Development Report Card for the States*, used to help redefine the concept of business climate, monitor important economic indicators, and measure development strengths and success in each state. To rate the states, the CFED uses three broad indexes: (1) performance, which includes job growth and job quality, income distribution, and efficient use of natural resources; (2) business vitality, which reflects competitiveness, investment, and startups; and (3) development capacity, which weighs human, financial, technological, and physical resources.

The *Report Card* reveals eight states which made As and Bs in all three areas, the most in this decade, with Colorado and Utah leading the nation with a 4.0 grade average. Honorable mentions include Massachusetts, Minnesota and Washington. The poorest performer was West Virginia, the only state to receive all Fs. Other states unable to make the grade include Arkansas, Louisiana, Mississippi and New Mexico.

State	Performance	Vitality	Capacity
Alabama	D	C	C
Alaska	C	F	D
Arizona	D	C	C
Arkansas	D	D	F
California	D	A	A
Colorado	**A**	**A**	**A**
Connecticut	A	B	B
Delaware	B	A	B
Florida	D	C	C
Georgia	C	C	C
Hawaii	D	F	C
Idaho	C	C	D
Illinois	C	A	B
Indiana	B	C	C
Iowa	B	D	B
Kansas	B	B	C
Kentucky	C	C	D
Louisiana	F	C	F
Maine	A	C	D
Maryland	C	A	A
Massachusetts	**B**	**A**	**A**
Michigan	B	B	B
Minnesota	**A**	**B**	**A**
Mississippi	F	D	F
Missouri	B	C	C
Montana	C	F	D
Nebraska	A	D	C
Nevada	C	D	D
New Hampshire	A	A	C
New Jersey	B	B	A
New Mexico	F	D	D
New York	D	C	B
North Carolina	C	B	C
North Dakota	B	D	D
Ohio	C	B	B
Oklahoma	D	C	D
Oregon	B	A	B
Pennsylvania	C	A	A
Phode Island	C	D	B
South Carolina	C	D	F
South Dakota	C	F	D
Tennessee	D	C	C
Texas	F	B	C
Utah	**A**	**A**	**A**
Vermont	A	C	C
Virginia	C	B	B
Washington	**A**	**B**	**A**
West Virginia	F	F	F
Wisconsin	A	C	A
Wyoming	C	D	B

Report Card – *continued*

On a regional basis, the Northeast was clearly the nation's leader, with strong scores in job quality, efficient use of resources, entrepreneurship, and human capital. The nation's heartland (industrial Midwest) continued its strong performance from last year, but was edged out by the Northeast in performance and business vitality.

The South continued to demonstrate its divided character. On one hand, it boasts some of the best numbers (net migration, long-term employment growth, improvements in income distribution). But the region continues to suffer from poor grades for quality of life (low average annual pay, high poverty rates, sparse health coverage).

The Plains states produced strong employment conditions, although their overall Performance earned only an average grade. The Mountain West states scored well on creating jobs, but did not shine as brightly on Earnings and Job Quality (with the exception of Colorado). The Pacific region was once again clearly split between the upper Northwest on the one hand and the rest of the region on the other. While Oregon and Washington were on the honor roll, both California and Hawaii earned a D in Performance.

The Corporation for Enterprise Development concludes that the U.S. is approaching a time when the distribution of development resources will be severely polarized, as noted by the increasing concentration of venture capital and R&D in fewer states. Further concentration of resources will limit the development potential of those states that are left out. The CED further maintains that strong resources, maintained or improved over the years, are typically a key to good economies. ❑

The Site Selection Process: It's not all on the Internet

The Internet is a technology that is being utilized more by economic developers and site selectors. From the user side, the Internet empowers corporate site selectors with greater access to larger amounts of data and information. From the provider side, websites such as The American Community Network [www.acn.net], the Tennessee Valley Industrial Development Association [www.tvida-siteselector.com], and The Walker Companies [www.walkerco.com] are examples of what site selection could be on the Internet. TVIDA's site offers topical information via a sophisticated GIS interface that includes proximity to highways, rail, and water. ACN's site offers approximately 200 variables on every MSA and county in the United States. The Walker Companies' site allows users to query our database of more than 1,500 available industrial buildings and will soon have a GIS interface to allow users to query our proprietary site selection model, WISER.

However, there are two primary limitations of the Internet as a site selection and economic development tool. First, site selection data on the Internet runs wide, but not deep. For example, The American Community Network provides estimates of manufacturing employment at the MSA and county levels, but the user cannot break down employment further, for instance, by 3-digit North American Industry Classification System (NAICS) subsector. If a manufacturer of Transportation Equipment wanted to draw from an existing pool of experienced workers in Transportation Equipment Manufacturing (NAICS 336), they would have to identify the location of that pool themselves (highly unlikely), or utilize WISER, which has been fully converted to the NAICS standard (Unveiled in 1997 by the Clinton Administration, the NAICS system replaces the Standard Industrial Classification System (SIC) that has been used since the 1930s. The system enables the North American Free Trade Agreement (NAFTA) part-

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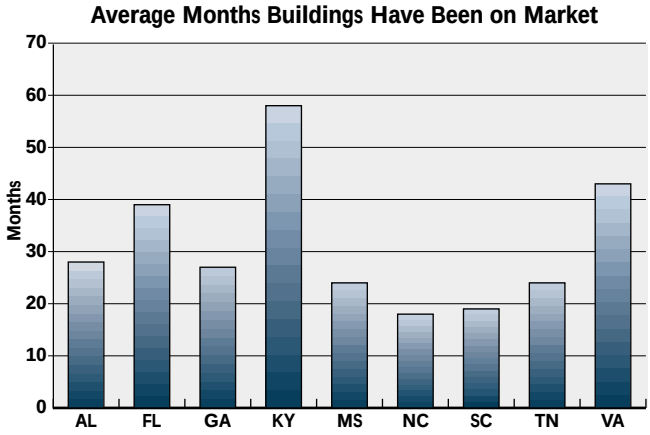
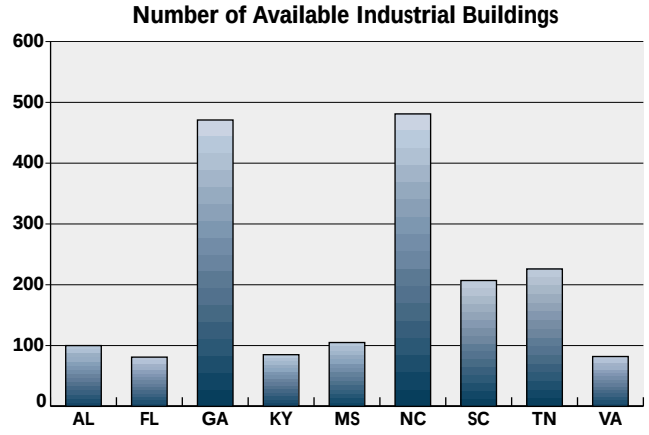
The Southeastern Industrial Real Estate Market

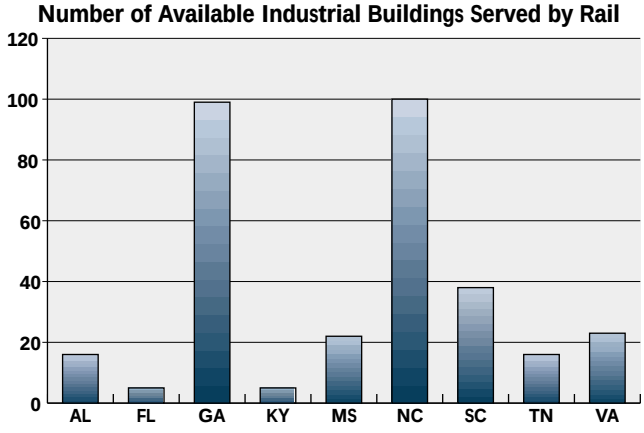
The Southeastern Industrial Market is defined as functional and available manufacturing and distribution facilities, 50,000 sq. ft. and larger, typically located in non-metropolitan/secondary markets. There are currently 1,838 available buildings totaling 275,811,190 square feet. The average building is 150,060 square feet and has been on the market for 31 months. Rail service is in place or available for 18% of the buildings and 10% have at least one overhead crane. The following are state-by-state summaries highlighting various building attributes. ❑

State	# Buildings	Available SF	Avg Building SF	% of Market
GA*	471	78,376,826	166,405	28%
NC	481	59,974,772	124,688	22%
TN	226	34,007,547	150,476	12%
SC	207	25,842,439	124,843	9%
MS	105	15,211,022	144,867	6%
AL	100	15,378,867	153,789	6%
KY	85	15,211,022	178,953	6%
FL	81	18,273,712	225,601	7%
VA	82	13,534,983	165,061	5%
Total	1,838	275,811,190	150,060	100%

* Includes buildings in Atlanta 100,000 square feet or larger.







Real Estate Cycle – *continued*
from page 1

Mueller and Laposa cited the 7 - 8 year cycle as being most common and useful in the timing of purchases and sales, but very limited in deciding how to allocate the real estate asset class in a portfolio of properties. In 1996, Pyhrr and Roulac found that longer cycles, including the Wenzlick 18 1/3 year cycle, provide a better explanation of the behavior of the real estate markets. More recently, in 1997, Kaiser identified the presence of a 50 - 60 year boom/bust real estate cycle, which is comprised of three Wenzlick 18 1/3 year cycles.

Wherever you identify yourself in the short or longer cycles, one thing is clear. Your real estate asset(s) are likely to experience the same ride through four distinct phases: expansion, contraction, recession and recovery. According to Pyhrr, during the expansion phase many real estate professionals ignore their position on the real estate cycle because they are making extraordinary income from commissions, fees and profits. They act as if the boom will never end, because it is in their economic self-interest to do so. In the recovery and expansion phases, "overpriced" real estate is produced because the cycle usually goes up faster and higher than is anticipated by market participants. "Underpriced" real estate is produced during the contraction and recession phases and is the result of the cycle going down faster and lower than is expected.

Keep in mind that different assets perform differently during the various phases of a real estate cycle. In particular, there is a property-type (apartment, single family, suburban office and industrial, retail, raw land, and CBD office) lead-lag sequence over the composite real estate cycle. This lead-lag period, where different property types pass through the trough (bottom) of the real estate cycle and through the recovery phase, transpire over a period of years. Also affecting real estate performance at the national, regional and submarket levels are many different types of interdependent cycles (e.g., economic, financial, physical, political, social, cultural, international, and project/portfolio, etc.).

"In an effort to take advantage of constantly changing property and market conditions, most average investors guess wrong a large percentage of the time because they gallop with the herd and follow conventional crowd wisdom. In contrast, successful investors and industry practitioners are willing to follow a path contrary to that of the masses. In other words, investments must be bought and sold before cyclical trends are fully reflected in real estate prices and activity. An investor must forecast cycles and act ahead of popular opinion – buying when popular opinion is still negative and most investors are trying to sell; and selling when popular opinion says the boom is on and speculative investor buying causing asset prices to increase beyond economic reason."

So how can you track, comprehend and act upon your position in the real estate cycle? Although finding a real estate asset for every season is a difficult task, if not impossible, the following basic principles identified by Kaiser should help: (1) *Identify critical cycles* – focusing on those that will have the greatest impact on rents, vacancies, capitalization rates and property values), (2) *Pay careful attention to the leads and lags and research the critical cycle's effects on your most important investment variables* – cash flow, rates of return, and risk parameters, and (3) *Develop an investment strategy to take advantage of cycles* – measuring impact on cash flows, IRRs and risk parameters under different acquisition/disposition and market/economic scenarios.

"Assuming cycle lengths repeat, with the last real estate boom/bust period peaking during the years 1985 - 1990, we will not likely see the next Wenzlick 18 1/3 - year cycle correction until after 2003 - 2008." So in finding a season for all real estate assets, might a patient investor with capital to place in the middle of this decade prudently wait until the cycle correction presents a new wave of buying opportunities? ❑

How Low Can You Go?

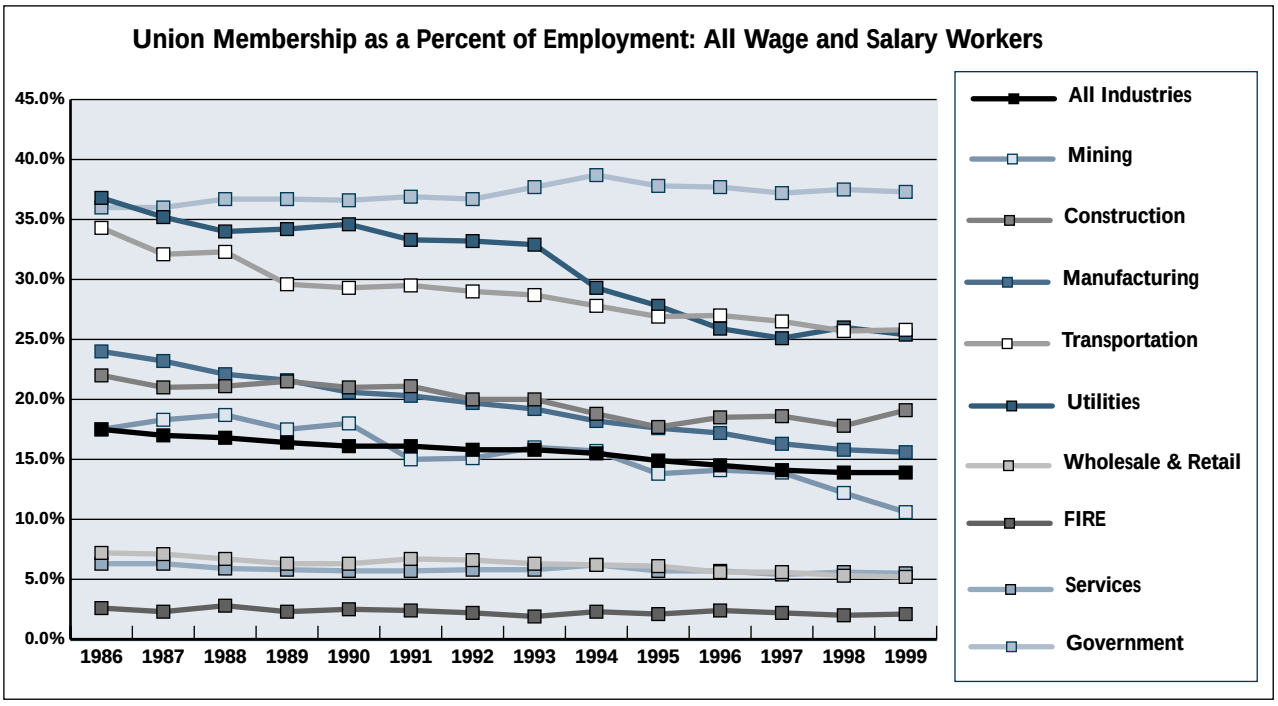
Labor union membership has been in a long state of decline. The latest data on membership shows that, with few exceptions, the trend continues.

Since 1986, union membership as a percent of wage and salary employment in the U.S. has fallen from 17.5% to 13.9%. Over this 14-year period, the only sector of the economy in which union membership as a percent of employment has actually increased is government employment, which has grown from 36% to 37.3%.

The construction trades, though showing a decline over the 14-year period, have actually shown an increase in union concentration since 1994. In that year, union membership stood at 18.8% of total employment, which increased slightly to 19.1% in 1999.

The steepest decline in union share of total employment has been seen in mining and manufacturing. In these two sectors, labor unions' share of total employment has fallen by more than one-third. ❑

Union Membership as a Percent of Employment: All Wages and Salary Workers



The Sun Belt Shines

The heavily industrialized states in the Northeast and upper Midwest continue to be union strongholds, while the Southern tier offers employers the allure of very low levels of union membership.

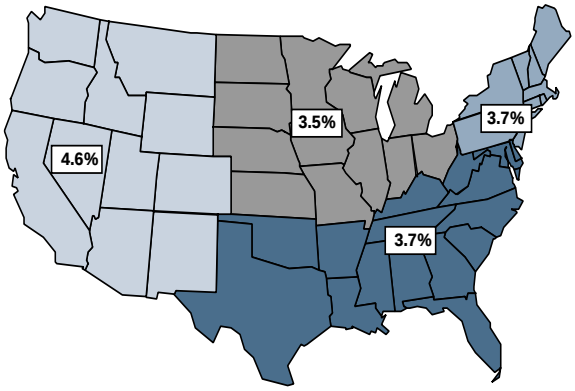
With the lone exception of Alabama and Kentucky, all states in the Southeast and Gulf coast area show union membership levels at or below 8.1% of total employment. In contrast, most of the heavily industrialized states show levels of at least 17.7%. The five states with the highest level of union membership as a percent of total employment are New York (25.3%), Hawaii (22.3%), Michigan (21.5%), Washington (20.7%) and New Jersey (20.5%).

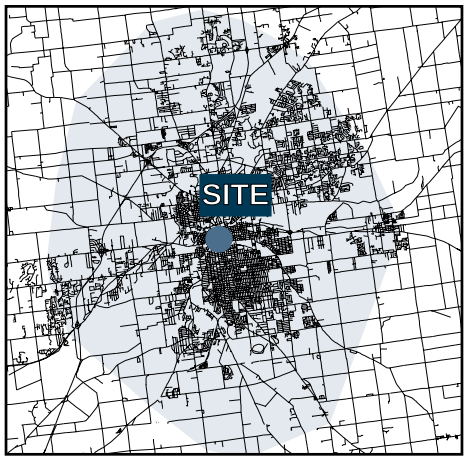
At the opposite end of the continuum, the states with the lowest concentration of union membership (6.2% or below) are Mississippi, South Dakota, Texas, South Carolina, and North Carolina. North Carolina enjoys the distinction of having the smallest share of union membership, estimated at 3.2% in 1999. ❑

Show me – *continued from page 1*

commute analysis completed with WISER, the Walker Companies site selection model. As an example, depicted in the graphic below is the geographic area within a **10-minute drive** of a site. Powered by network modeling software and national transportation databases that contain distances and speed limits for streets, roads, and highways, travel times can be calculated to illustrate a commuting snapshot of a potential workforce. Using demographic databases "layered" underneath a commute analysis, economic developers, site selectors, and corporate executives can get a feel for the workforce and see—for example—how many people 16-30 years old live within a 10 minute drive of a prospective facility.

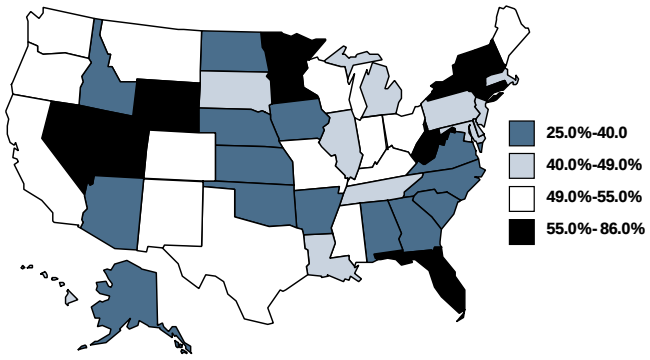
As location decisions become increasingly complex, site selectors have to go beyond the traditional "macro" analysis, and utilize methods, such as commute analyses, in the "micro" world to understand a potential labor force's accessibility to a site. Operational risk due to shortages of labor can be minimized by using commute times to intelligently determine proximity to sources of seasonal labor, such as colleges or universities, or sources of temp-to-perm employees, such as retired military personnel residing near a base or military installation.



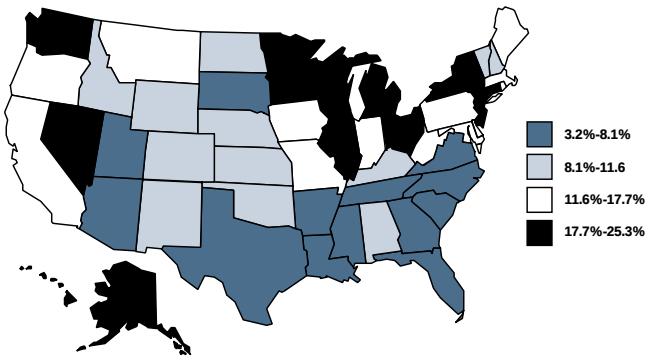


Commute analyses can also compare and contrast the available workforce of multiple sites that are within close proximity of one another. During a new facility search, a commuting analysis could show a site selector the optimal location for a new facility, that would not "cannibalize" the workforce of the existing facility. ❑

Union Win Ratio in Certification Elections: 1999



Union Membership as a Percent of Total Employment



Site Selection – *continued from page 3*

ners—the United States, Canada, and Mexico—to compare economic statistics and to attempt to keep better pace with "new economy" changes).

A "site selection" website would not tell you that, going forward with the 1998 reporting year, data in the widely used *County Business Patterns* (U.S. Census Bureau) product is tabulated by industry as defined by NAICS only. Perhaps the biggest limitation of relying on the Internet is its lack of data that is most germane in selecting a site. . . operating costs and operating environment. Data on power costs, tax rates, wage rates, union membership, and others are not universally available at the city or county level, except in the Walker Companies' WISER model.

The other primary limitation of the Internet in site selection and economic development is the ability to discern—at the end of the day—what it all means. The American Community Network and Tennessee Valley Industrial Development Association are mentioned above, but for each of these sites, there are ten others that also provide variables and/or some form of quasi-analysis tool, either through a GIS map or on-line table. But what does it all mean?

The Internet adds value in providing data and processed information in a raw format that can be viewed or downloaded to a site selector's personal computer. Mapping sites, such as TVIDA, provide a topical way to browse through general areas for site selection, also offering valuable information on areas such as environmental contamination or tax rates by site. However, these applications are simply tools that only add value to the "tool kit" of a professional site selector who serves the client most effectively by exploring options and advising based on the client's needs. ❑

Memphis Office Opens

This past July, the third office of The Walker Companies opened in Memphis, Tennessee. The Memphis office increases Walker's presence in the western portion of the southeastern industrial market. Four new employees, Jim Cole (Managing Broker), Chris Brown (Associate Broker), Tony Argiro (Associate Broker), and Donna Christy comprise the Memphis team.

THE WALKER COMPANIES provide location consulting, brokerage, and facility development services for industrial corporations throughout the United States. For additional information on our services, or to comment on ***The Industrial Outlook,*** please contact:

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