Industrial Real Estate Gaining Positive Momentum

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While things have been looking up for the U.S. industrial markets steadily over the past year, it is now clear that our recovery is picking up momentum. National industrial market statistics heading into the second half of 2011 - including vacancy, leasing and absorption rates - provide reason for guarded optimism.

Perhaps most notably, the United States' overall vacancy rate, a key indicator of real estate performance, had declined to a two-year low of 9.7 percent at mid-year 2011. This is down from 10.6 percent at mid-year 2010. This also represents an 0.5 percentage point drop from the first quarter of 2011 - the biggest quarterly decline in the U.S. industrial vacancy rate since the first quarter of 1997.

Additionally, U.S. industrial leasing activity totaled 144.8 million square feet at mid-year 2011, a 14 percent increase from the 126.6 million square feet leased in the first half of 2010. Within this context, all first-tier industrial markets reported improved leasing activity during the second quarter.

This includes a number of hubs -- such as Chicago, New Jersey, Dallas, Houston and even Atlanta -- that had remained very soft over the past few years. Markets with the largest increases included Inland Empire, Calif. (up 4.5 million square feet), Dallas/Fort Worth (up 3.5 million square feet) and Central New Jersey (up 3.0 million square feet).

That good news, combined with minimal new construction, is creating significant momentum. Generally speaking, because little industrial inventory is being added, every square foot leased is improving our absorption rates.

Year to date in 2011, 38.1 million square feet has been absorbed. This is up from the negative 12.9 million square feet at this time last year. During the second quarter alone, tenants absorbed 30.3 million square feet of industrial space, making it the third straight quarter of positive absorption.

Though some new construction projects have been delivered, the majority has been on a build-to-suit basis, and strong leasing activity has demonstrated that the demand is there. Year-to-date, 8.9 million square feet of new industrial space was added to the U.S. market, up slightly from 8.2 million square feet in the first half of 2010. However, compared to 2010, when 30.1 percent (or 2.5 million square feet) of that space was built on spec, only 11.2 percent (or 1.1 million square feet) of the new space added in 2011 has been speculative.

Our research, however, indicates the emergence of some new and planned speculative development. This is especially true in Southern California, which is the largest industrial market in the world. Always a good region from which to gauge forward-looking fundamentals, Southern California generally is among the first to soften in a faltering economy and to improve in a rebound.

Within this context, we are seeing robust activity there. In addition to the buzz about construction, rental rates are on the rise, and investors and developers are looking for opportunities to acquire properties and land sites. This all bodes well for other markets, which we expect will follow in Southern California's footsteps in the near term.

Perhaps one of the most interesting aspects to watch as the industrial sector continues to rebound will be the acute shortage of big-box distribution buildings available for lease in the country's top industrial hubs. As demand grows to outpace supply, we expect to see a jump in rental rates as well as stepped up activity among developers and investors looking to launch spec projects.

In short, things are headed in the right direction. With rents either stabilized or rising, and the supply/demand equation for big-box space in major market shifting in favor of landlords, this positive trajectory should continue through the remainder of the year. Of course, several critical drivers - including jobs growth, economic improvement and global conditions - remain volatile and could impact the rate of our progress significantly.