Economic core eroding, but long-term growth potential still exists

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Each year, Grubb & Ellis ranks major U.S. apartment, industrial, office and retail markets against a set of criteria important to the performance of real estate investments.

The criteria are specific to the type of real estate being evaluated and include demographic, economic and real estate indicators.

This type of analysis does not consider the objectives, strategies and return targets of specific investors, nor does it consider differences in performance by submarket, which can vary greatly within a particular metropolitan area. The analysis is meant to highlight markets that offer the potential for good investment returns, whether debt or equity, over a five-year time horizon and may warrant further attention by investors.

Despite the seismic shifts in the economic and financial landscape surrounding commercial real estate, the market rankings changed surprisingly little from last year. This is because the time horizon for this exercise is five years, by which time, fingers crossed, the financial crisis and recession will be an unpleasant memory and commercial real estate will be entrenched in its next expansion cycle.

Here is a summary of the outlook by property type and the markets scoring high on our list for good long-term investment prospects:

Office Market

The construction pipeline will continue to deliver the 80 million square feet still under development even as tenants shrink their space requirements, pushing vacancy higher. Negotiating leverage will shift in favor of tenants with concessions packages looking more generous as the year progresses.

Washington, D.C. took top honors in our ranking, moving from third place last year. The expansion of government authority over the financial industry alone will be enough to propel leasing activity through the recession.

Portland, Los Angeles and the San Francisco Bay Area benefit from diverse economies, educated workforces and high barriers to entry. Austin, Raleigh-Durham and Boston are state capitals graced with leading universities and technology industries. Houston and Dallas will benefit from their rapidly expanding workforces and energy-driven economies when global demand begins to grow again.

Industrial Market

Businesses look at industrial space as a productivity enhancer, an integral part of their supply chain strategies. The relentless quest for cost-saving efficiencies by businesses should put a floor under demand for industrial space in 2009, even in a weak economy.

Nevertheless, vacancy is expected to rise gradually as absorption dips into the red and the construction pipeline delivers the 72 million square feet of space still under way.

Led by land-constrained Los Angeles, seven of the 10 top industrial picks are driven by proximity to seaports – Houston, Oakland, Seattle, Miami, Portland and New Jersey. The other three in the top 10 list are major inland distribution hubs: Atlanta, Dallas-Fort Worth and Chicago.

Retail Market

Shopping centers are in the crosshairs of the consumer-led downturn. Expect higher vacancies and softer rental rates by year-end.

Los Angeles took the top slot in the list of retail markets with good long-term potential for investors with Orange County, San Francisco and San Diego also making the top 10. These markets offer growing industries, high incomes and barriers to entry.

Strong population growth projections will boost the prospects for Houston, Dallas-Fort Worth and Austin. Rounding out the list are Washington, D.C., (high incomes), Atlanta (strong population growth) and Portland (urban growth boundary).

Apartment Market

Recessions are not kind to apartments because younger people facing unemployment will move in with a roommate or relative. Further, many of the houses and condos lost in bankruptcies are coming back as rentals.

On the other hand, most former owners who have lost their homes will end up as renters, and a portion of them will rent apartments as opposed to condos or single-family homes.

Against this backdrop, supply-constrained markets occupy all 10 slots, led by Los Angeles. The five other coastal California markets also made the list as well as three East Coast markets and Portland. ■

Robert Bach is senior vice president and chief economist for the commercial real estate brokerage Grubb & Ellis. He has 30 years of professional experience in real estate market research, consulting and city planning. At Grubb & Ellis, he prepares the firm's national market publications, speaks at industry events and is widely quoted by media outlets such as the *Wall Street Journal*, The *New York Times* and *National Real Estate Investor*.

Market Strength Forecast 2009-2013

Top Ten Markets

Rank	Office	Industrial	Retail	Apartment
1	Washington, DC	Los Angeles	Los Angeles	Los Angeles
2	Portland	Houston	Washington, DC	San Francisco
3	Los Angeles	Atlanta	Houston	Orange County
4	San Francisco	Oakland-East Bay	Dallas-Fort Worth	Oakland-East Bay
5	Austin	Seattle	Atlanta	Washington, DC
6	Dallas-Fort Worth	Dallas-Fort Worth	Orange County	San Diego
7	Houston	Chicago	San Francisco	New York
8	Raleigh-Durham	Miami-Dade	Austin	San Jose
9	Boston	Portland	San Diego	Long Island, NY
10	Oakland-East Bay	New Jersey, No. & Central	Portland	Portland

Note: Markets were ranked from 0 to 100 against 13-17 property, economic and demographic variables.
Source: Grubb & Ellis