The Industrial
O·U·T·L·O·O·K

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SAT Scores: What You Don't Know

Does the Score Really Mean Anything?

Q. What did the politician get on his SAT test?

A. Drool.

The third rail of American politics is Social Security reform, but school funding is a close second, and nothing is more sacred to the school-funding warriors than (*drum roll, please…*) test scores.

A high score on the Scholastic Aptitude Test (SAT) is the Holy Grail for high school seniors, politicians and economic developers anxious to tout their community or state based on the quality of its school system. But without context, does the SAT score mean anything?

If an analysis of test scores tells us anything, it's that the quickest way to increase scores is to reduce the number of students taking the test. "Exhibit A" in support of this

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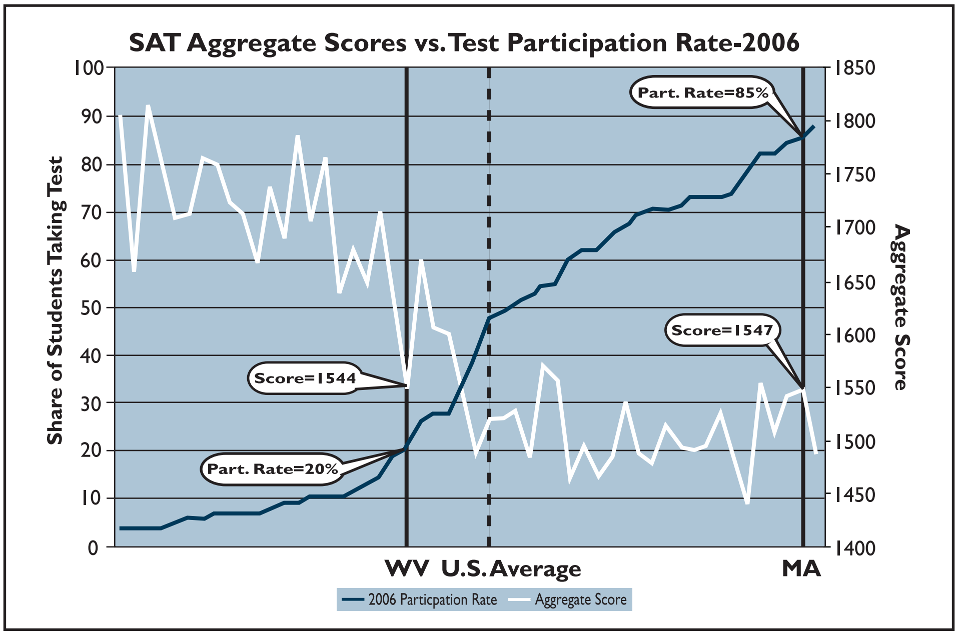

In This Issue

Health Care Mandates

This Will Make You Sick

You may have been following the State of Maryland's assault on Wal-Mart, wherein the legislature passed a law over the Governor's veto, mandating that the company make expenditures on health benefits equal to 8% of total compensation paid to its employees. Of course, Wal-Mart was not named in the legislation; it's just the only company in the state that would be impacted by the law.

This "model" legislation, which has "organized labor" written all over it, required employers with 10,000 or more workers in Maryland to spend at least 8% of their payroll on health insurance, or pay the difference into a state Medicaid fund.

Three other Maryland employers exceed the 10,000-employee threshold, but escape the requirement because they already spend at least 8% of compensation on employee health care. It's interesting to note one of these companies, Giant Food, competes directly with Wal-Mart's food retailing operations and endorsed the legislation, as did Giant's union. (If you can't compete on price, drive up your competitor's costs!) As a reward for the legislature's efforts, Wal-Mart has pulled back on plans to

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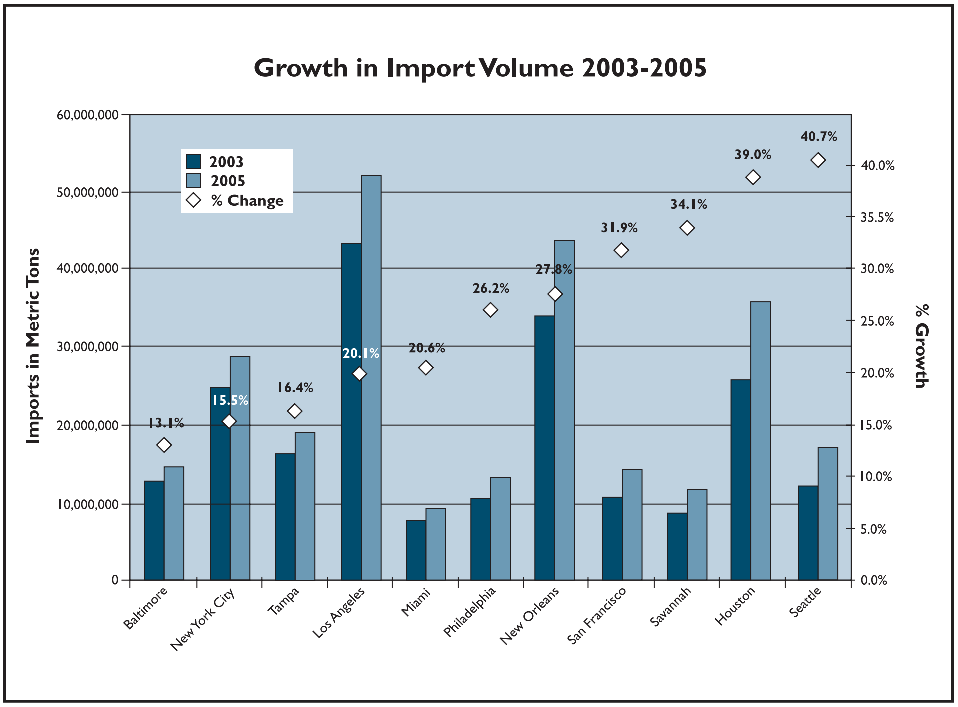
Globalization-Impact on U.S. Ports and Supply Chain

The dramatic growth of international trade has had a profound impact on U.S. ports, our transportation infrastructure and industrial real estate trends. These changes will continue over the next 25 years, and possibly beyond. The greatest cause of these changes is the emergence of Third World countries as reliable sources of manufactured goods, at prices well below what can be produced domestically.



In 2005, the value of U.S. imported goods reached $1.5 trillion. A third of these goods came from the Pacific Rim, with China accounting for approximately half or almost $250 billion. Only Canada exceeds China on the value of imports by the U.S., but China is expected to become the leader in the next two years.

The size of oceangoing vessels has increased steadily in efforts to improve efficiency and reduce costs for intercontinental shipping. From a capacity of 1,500 to 2,000 TEUs (20-foot equivalent units) in the 1970s and 80s, the ships increased to 4,500 to 5,000 TEUs in the 1990s. By 2006, container ships were being built that are 1,000 to 1,300 feet long and hold 10,000 to 14,000 TEUs.

The dramatic increase in ship size is creating new logistics problems, including longer loading and unloading times, inadequate overhead crane capacity and staging/scheduling delays for other shippers.

Only Los Angeles/Long Beach, Oakland, Seattle/Tacoma, and Norfolk have adequate channel depth to handle these state-of-the-art vessels. However, Savannah, Charleston, and New York/New Jersey have major capital improvement programs underway to accommodate these large ships.

Other important trends to meet greater container volumes are the use of rail, intermodal hubs, and re-packaging shipments in "over the road" truck trailers. Rail transport of containers or land-bridging has dramatically increased, thus providing more efficiency getting goods from West Coast ports to the population centers east of the Mississippi River.

Some companies are obtaining facilities near the ports specifically to take imported goods from the ocean-going containers and immediately repackage them into 53-foot truck trailers. The most obvious down-stream impact on industrial real estate trends: demand for distribution rather than manufacturing capacity, since the majority of manufacturing is done offshore. Virtually all speculative buildings constructed by developers are a cross-dock configuration with loading on both sides, have large designated areas for trailer storage and high ceilings for maximum storage volume. There has also been strong growth of those real estate markets adjacent to the largest container ports.

Average distribution facility sizes have increased from 200,000 to 300,000 square feet to 400,000 to 600,000 square feet; and one million square foot facilities are now commonplace in larger markets. These facilities are often located near interstates outside the major metropolitan areas where labor force characteristics are more desirable, taxes are lower, and communities are more aggressively seeking new industry with meaningful incentive packages. ❑

The Cost of Electricity is Shocking

Watts going on?

If recent trends are any indication, hold on to your wallet and break out the kerosene lanterns…the cost of electricity is going up fast.

In 2005, the average cost of power for industrial customers in the U.S. was 5.73 cents per kilowatt hour (kWh). This represents a 9.1% increase over the 2004 cost of 5.25 cents per kWh. Texas leads all states with a 21.6% year-over-year increase in the average cost of a kilowatt hour.

One of the principal reasons for the sharp increases nationally, especially in Texas, is the growing reliance on natural gas to fuel generating plants. From 1994 to 2005, U.S. electricity production using natural gas as a fuel increased by 65%, three times the rate of growth of any other fuel source.

Coupled with the growing use of natural gas is a sharp increase in gas prices. In 1994, natural gas cost for electricity generators was slightly over $2.00 per million BTUs. Last year, it was $8.21 per million BTUs. Over the same time span, the cost of coal remained flat and was only $1.54 per million BTUs last year.

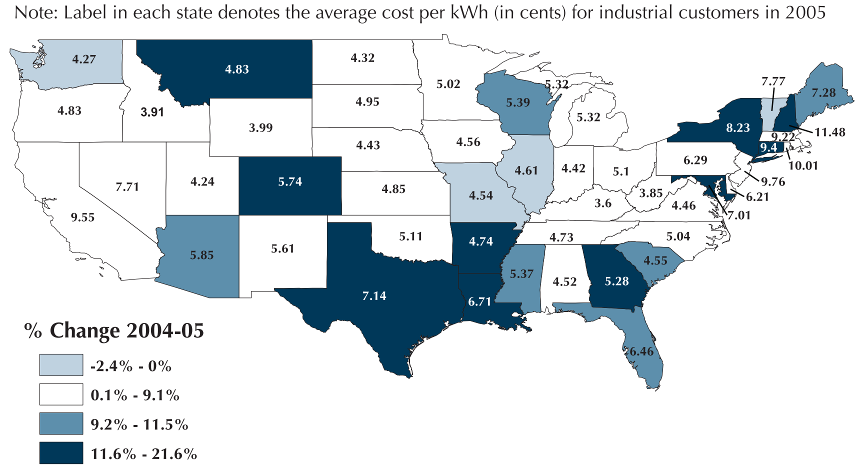
Since natural gas is the primary source of generation in Texas, it stands to reason the Lone Star State would experience sharp increases in retail prices for power. Deregulation of energy markets in Texas has produced few price benefits, since the state is largely isolated from the rest of the power grid in the U.S., and importing cheaper electricity is constrained.

Industry can expect further increases. According to the North American Electric Reliability Council, demand for electricity in the U.S. is expected to increase by 141,000 megawatts over the next ten years, but electric utilities plan to increase capacity by only one-third that amount. The resulting reduction in capacity margins could increase rates and reduce reliability.

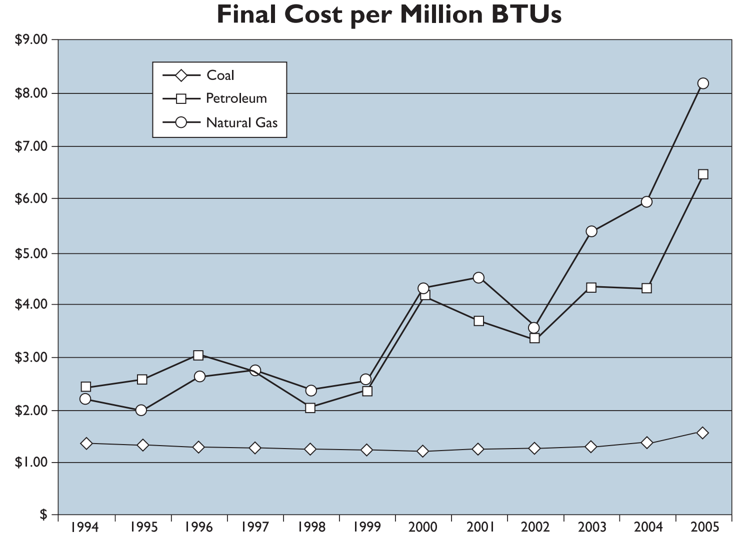
Texas is viewed as particularly risky, with capacity margins expected to fall over the next three years. Supply-Demand margins of 15% are generally viewed as necessary to maintain reliability, but growth of demand in Texas is expected to reduce the margin to 11%. Transmission constraints limit the ability to move power into Dallas and Houston, placing operations in these cities at risk in the event of a system emergency. ❑

Cost of Electricity for Industrial Users

Note: Label in each state denotes the average cost per kWh (in cents) for industrial customers in 2005



Final Cost per Million BTUs



I'll Gladly Pay You Tuesday, but I'm Filing Bankruptcy Today.

Tougher bankruptcy laws may not deter consumers from this financial solution of last resort.

It's been slightly more than a year since a tough bankruptcy law, Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), took effect on October 17, 2005.

The first revision to the U.S. bankruptcy laws since the 1970s, the BAPCPA was enacted by Congress to eliminate or minimize the misuses that crept into the system under the previous Bankruptcy Code.

The most sweeping changes in the bankruptcy process require:

- **Implementation of a "means test."** Is the debtor's average income for the last six months less than the median income in his/her state? If yes, the debtor may be eligible to file under Chapter 7 (liquidation). If no, the debtor may be required to file under Chapter 13 (wage-earner repayment plan).
- **Mandatory credit counseling from certified agencies.** A requirement of all debtors both before and after filing a bankruptcy case.
- **Supervised random audits and targeted audits** to determine whether a Chapter 7 debtor's bankruptcy documents are accurate.

In 2005, there were a record 2.04 million bankruptcy filings, or ***1 in every 60 U.S. households,*** as consumers rushed to file before the new law imposed tougher bankruptcy restrictions. In 4Q 2005 alone, there were a staggering 654,633 bankruptcy filings.

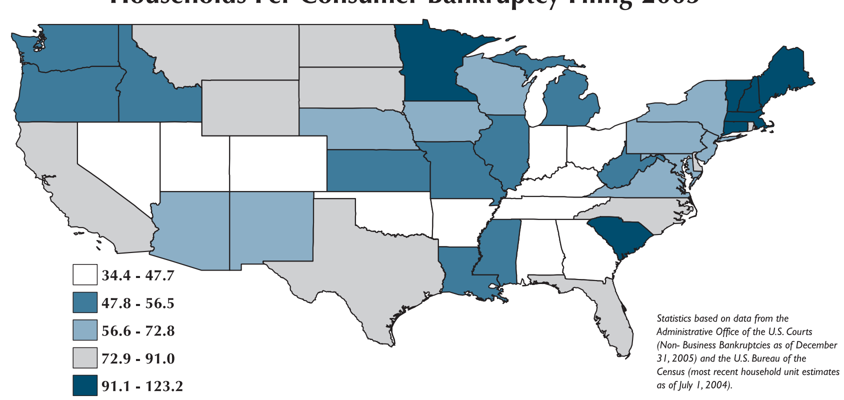
After the surge in bankruptcy filings as a result of the BAPCPA effective date (October 17, 2005), U.S. personal bankruptcies fell to their lowest figure since year ending June 30, 2001.

In 1Q 2006, there were only 112,685 bankruptcy filings. By 2Q 2006, however, the number jumped to 150,975, a 34% increase over the previous quarter. While both figures are well below the number of bankruptcies reported just before the passage of the new law, some economists predict that BAPCPA may have only temporarily slowed (not cured) a bankruptcy epidemic.

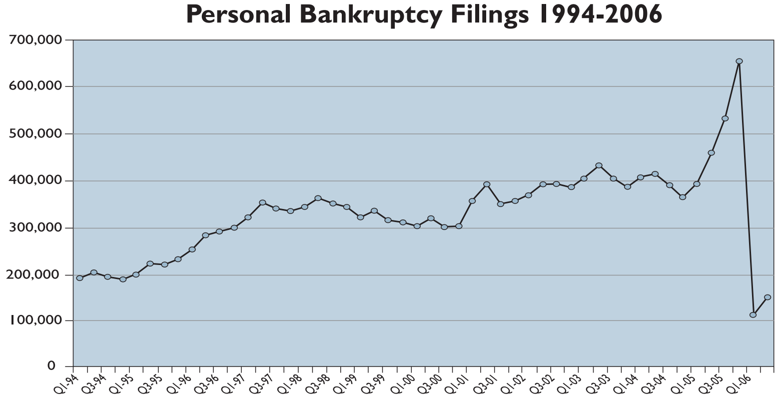
Why? Because the causes that fueled the bankruptcy boom still exist. These causes include increasing credit limits offered by the lending industry, interest rates with no caps, financial mismanagement by consumers, and a growing number of people who are uninsured or underinsured against skyrocketing health care costs. In addition, high fuel prices and adjustable-rate mortgages (ARMs) reset to high interest rates may send more consumers into bankruptcy court in the months ahead.

Although the national average for bankruptcies in 2005 was one in every 60 U.S. households, some states had much worse ratios. Where did your state rank? (See map.) ❑

Households Per Consumer Bankruptcy Filing-2005



Personal Bankruptcy Filings 1994-2006



Source: American Bankruptcy Institute

"Change to Win" Union Coalition Achieves Success

Early Results May Spell Danger for Industry

In September 2005, a handful of labor unions disgruntled with the AFL-CIO's stance on and funding for organizing, bolted from organized labor's parent body and formed Change to Win, an affiliation of seven unions bent on securing new members.

The unions which set out on this course are the Teamsters (IBT), Laborers (LIUNA), Service Employees (SEIU), Carpenters (CJA), Food and Commercial Workers (UFCW), UNITE HERE, and the Farm Workers (UFW).

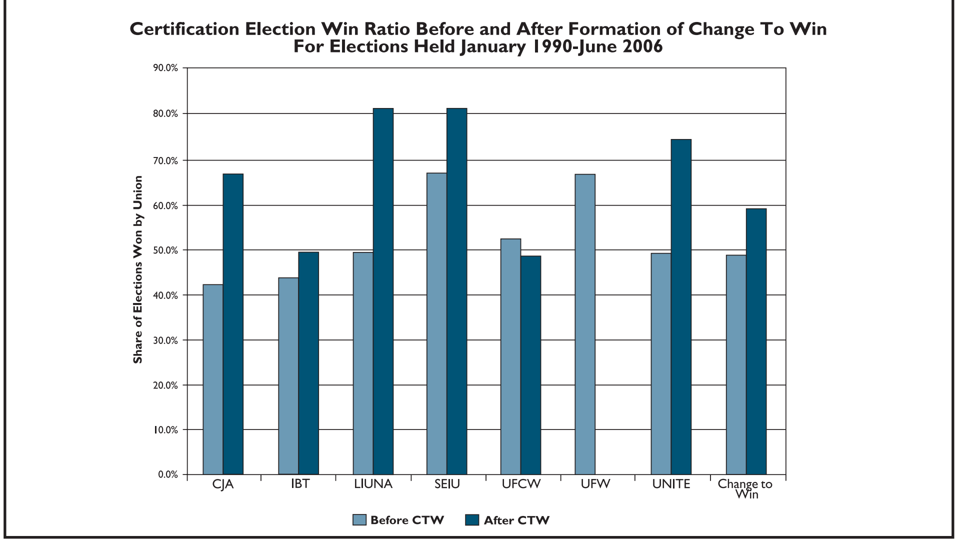
So how have they done? Early indications are…pretty well. The accompanying chart shows the certification election win ratio for each of the seven unions, pre- and post-CTW formation. The pre-formation election data covers a significantly longer period of time, January 1990 to August 2005, while post-formation elections cover the period September 1995 through May 2006. Nonetheless, nearly 1,200 certification elections have been held by CTW unions over the post-formation timeframe, a good indication of the direction this effort has taken.

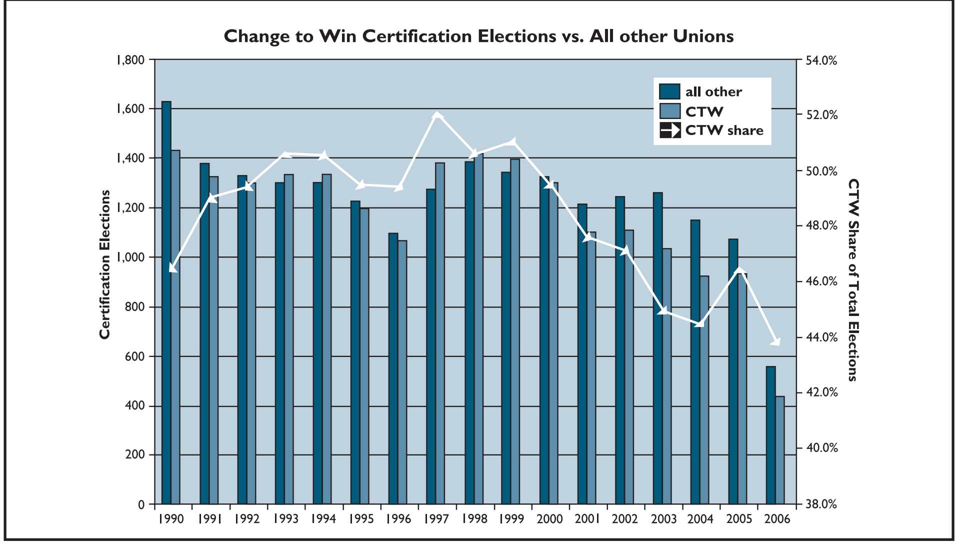
Election activity involving the UFW, CJA and UNITE HERE is modest, but the IBT, LIUNA, SEIU and UFCW have had decent election volume, all with at least 68 certification elections post-CTW formation.

Of the four most active unions, only the UFCW has posted a lower union win ratio (i.e., share of certification elections won by the union) since the CTW was formed. All others are up sharply, most notably the LIUNA, which has exhibited a 60% improvement in its win ratio.

The IBT, typically a laggard among major labor unions in organizing success, has shown measurable improvement, increasing its win ratio from 44% to 50%.

Perhaps these unions are being more selective in the companies they target. A retrospective analysis of organizing activity back to 1990 shows the unions comprising the CTW have accounted for a smaller and smaller share of total certification activity over time. Since its peak in 1997, when the share of certification elections accounted for by these seven unions was 52%, the CTW share of all elections has dropped to 43.8%. ❑





If You Like What You're Spending on Health Care…

…You'll Love What You Pay in Taxes

Politicians love a good sound bite, and few issues resonate more with the electorate than the cost of health care. It's a rallying cry for the Democrats, and it's the weapon of choice for organized labor as it attempts to bludgeon large employers, especially Wal-Mart, into submission.

But for the average American, health care costs pale in comparison to taxes as an expense item. In 2006, Americans worked 52 days to pay for health care, but a whopping 116 days to pay their federal, state and local tax bill. That's right…for the average American, tax expense is more than twice what is paid for health care.

The federal tax bite alone is greater than health care spending, as it takes us on average, 77 days of work to pay Uncle Sam. State and local taxes require 39 days.

Avoiding federal taxes is a challenge, at best. Aside from using Willie Nelson or Wesley Snipes to prepare your federal income tax return, there is little you can do to reduce this expense. But state and local tax burden varies considerably across the U.S., as illustrated in the accompanying map.

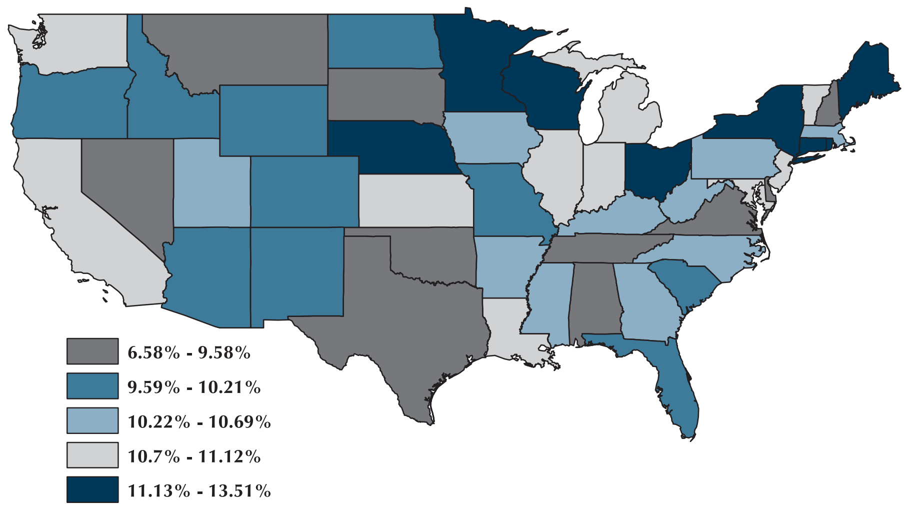
Which state has the highest state and local tax burden? New York? (No…they're #2). Connecticut? (Not even close!) California? (Fuhgetaboutit!).

The dubious honor goes to the Pine Tree State…Maine. The average state and local tax burden in Maine is 13.5% of income. New York, Ohio, Minnesota and Hawaii round out the top five. With Ohio's recent decision to abolish its personal property tax, this ranking may change in the future.

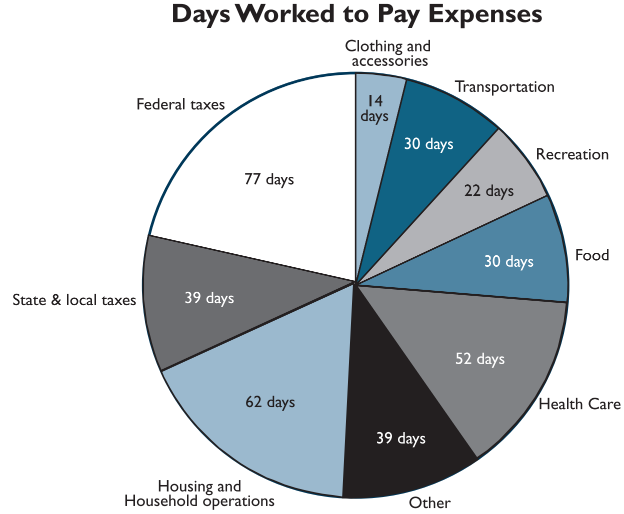
For all you Maine residents, if you want to skinny-down this tax bite, move next door… to New Hampshire. It has the second lowest burden, at 7.34%. Only Alaska is lower (6.58%), but then you would have to, well, live there.

In general, the highest tax burden states are in the Northeast and upper Midwest, while the lowest are clustered in the Plains states and Southeast. ❑

State and Local Tax Burden-2006



Days Worked to Pay Expenses



Health Care – *continued from page 1*

locate an 800-employee distribution center in Maryland's economically depressed Somerset County.

The madness doesn't stop in Maryland. Similar legislation has been introduced in over 30 states. Mercifully, no other states have passed it. But it does send a signal about the influence of organized labor and its ability to get legislation introduced that is clearly anti-business.

Most initiatives mirror the "model" legislation introduced in Maryland, in that only very large employers are targeted, typically those with at least 8,000 workers in the state. The spending mandate usually is pegged at 8% of compensation. The accompanying map denotes the states in which legislation has been drafted, and the spending mandate.

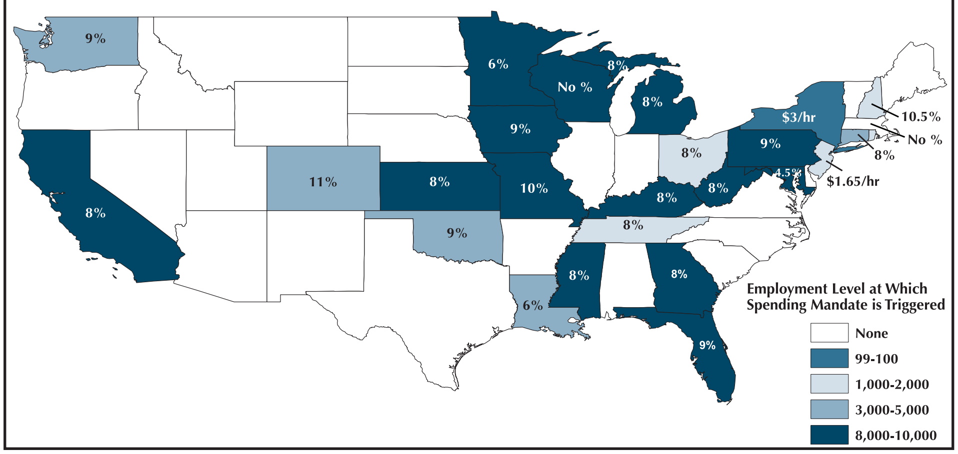
A legal challenge to Maryland's law resulted in a court ruling that the legislation conflicted with a little ol' federal law known as ERISA, which allows employers to offer uniform benefits coverage free from conflicting state regulations.

Let's recap: organized labor, which has a beef with Wal-Mart, drafts legislation to punish the company and gets it passed by the Maryland legislature; the Governor vetoes the bill, and his veto is overridden, but the law is subsequently overturned; Maryland is tagged with a label as "anti-business;" and Wal-Mart "delays" a decision to locate a major distribution center in Maryland's poorest county, costing the county 800 jobs. In short, no one got what they wanted.

This gives me a headache. ❑

States Considering Health Care Spending Mandates for Major Employers

Note: State labels indicate spending mandate as a percent of payroll



SAT Scores – *continued from page 1*

proposition is the graph on page 1, in which the average aggregate test score (math+critical reading+writing) for each state is plotted against the share of seniors taking the test. Clearly, the more people that take the test, the lower the average score.

The national average score in 2006 was 1518 out of a possible 2400, and the test participation rate was 48%. Twenty-seven states had participation rates below average, and 26 of these states recorded an aggregate score above the national average.

Twenty-three states and the District of Columbia have participation rates above the U.S. average, and 15 had below average test scores.

Of course, there are exceptions to this "rule." West Virginia's participation rate is a very low 20%, with an average score of 1544. Massachusetts is at the opposite end of this continuum. The Bay State's average score is about the same as West Virginia's, at 1547, but the participation rate is over four times as high, at 85%.

Politicians clamoring for more school funding (and more votes for themselves) are quick to use test scores as a hammer, but rarely does the share of students taking the test enter into the discussion when comparisons of state rankings are thrown about.

It's politically incorrect to delve into it, but there are also significant differences in performance along ethnic lines. In 2006, the highest scoring groups which took the SAT were Asians, with an average combined score for the three tests of 1600, followed by Caucasians, at 1582. Mexican Americans and Puerto Ricans nearly tied at 1371 and 1363, respectively. The lowest scoring ethnic group was African-American, with an average combined score of 1291.

Perhaps the funding discussion would be more productive if the shotgun approach, in which money is thrown at all schools, was replaced by a rifle-shot funding mechanism which directs funding at the groups with the greatest need based on performance. ❑

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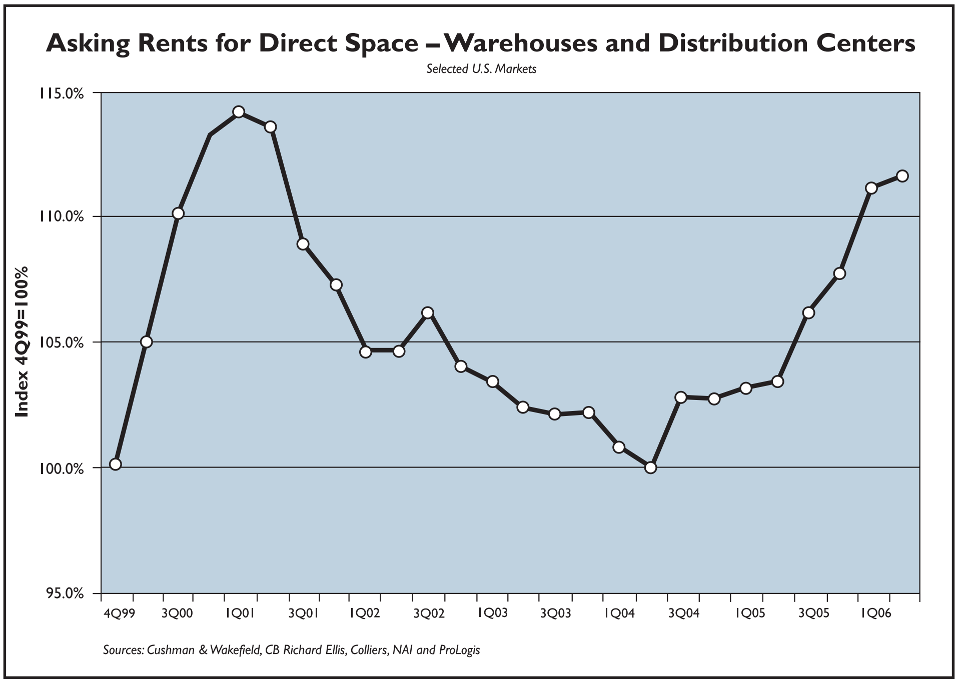
Good Times or Risky Times for Industrial Property Developers?

New construction activity is booming in the industrial property market. Bulk distribution and warehouse projects exceeding 150 million square feet are expected to be completed this year according to industry surveys.

Most noteworthy is the overwhelming percentage of these projects being built on a speculative basis. By some estimates, fully 80% of all new bulk distribution projects currently in the construction pipeline are being built "spec." While market fundamentals in general have certainly improved over the past couple of years and some markets (primarily in the western U.S.) have exploded, the scale of speculative development may be a dicey proposition for industrial developers if an economic slowdown is upon us.

Meanwhile, another spike in the price of materials has pushed shell construction costs up at least 35% over the past 2$^1/_2$ years. With higher land costs and no more room for cap rates to drop, new projects are largely dependent on market rent growth to maintain their profit margins. That could prove to be problematic as any significant slowdown in demand will magnify the competitive advantage held by owners of second generation buildings which were constructed at much lower costs. This market dynamic didn't exist in other cycles, as building costs had remained virtually constant for many years.

It will also be interesting to see what effect rising rents have on demand. That envelope really has not been pushed as real asking rents are still lower than they were six years ago (*see Chart*) despite the huge run-up in construction costs. ❑



THE WALKER COMPANIES provide location consulting, real estate, 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:

John Warden, Executive V.P.

THE WALKER COMPANIES
2100 RiverEdge Parkway
Suite 425
Atlanta, GA 30328
Phone: 404/892-1600
Fax: 770/541-6150

THE WALKER COMPANIES