

METRO DETROIT COMMERCIAL REAL ESTATE VALUE UPDATE

Many of the bankers with whom we associate share a new, optimistic view of the commercial real estate market. Signs of the recovery seem to be everywhere: new construction can be seen, businesses are profitable and expanding, and there is less news of layoffs/shutdowns, etc.

But what is really going on with the commercial real estate market here in Metro Detroit?

To gain better insight, we asked Gary Goodman, Managing Director, Brokerage Services of Friedman Integrated Real Estate Solutions and Eric Banks, Executive Principal, Partner of CORE Partners, both of whom are experts on the local commercial real estate market. Both firms have focus and experience with the REO departments of banks and welcome any opportunities to work with you on any CRE services you may need. Their contact information is below.

1. *How is the overall health of the commercial real estate landscape here in Metro Detroit?*

Eric Banks: Generally speaking, we are seeing continued improvement in the market pretty much across the board; of course some sub-markets, and product sectors are faring much better than others. Generally, there is sustained growth, and positive net absorption. Landlords need to give overly generous leasing concessions; incentives are diminishing and rental rates and sale prices are rising, albeit slowly.

Gary Goodman: Things are improving fairly rapidly. Our brokers are very busy, deals are being done, and values and lease rates are coming up across the various property segments. I think the overall sentiment in the market is that of cautious optimism.

2. *We are still an automotive manufacturing town. How's industrial doing as far as vacancy, values, new construction, etc.?*

Gary Goodman: Industrial is our strongest segment by a long shot. As the autos go, so goes Detroit, and that still holds true. But what's interesting is that the traditional image of industrial is being turned on its head. It's no longer about these giant, dirty, featureless buildings...it's a whole new ballgame. Sure, the tool and die shops still exist and companies are busy making brake components, but there is a whole new shift to high-technology automotive. I'm talking about the companies making the software and hardware for the new interior 'infotainment' systems. Audio systems, touch-screen interfaces, connected vehicles, self-driving cars...

Eric Banks: Yes, we are still an automotive town. The auto manufacturers are selling lots of units, definitely helping to make Industrial CRE Metropolitan Detroit's hottest sector. We are now looking at 9 consecutive quarters with positive net absorption. Detroit's last negative absorption quarter was back in 2011. Since then, more than 17 million sq. ft. has been absorbed, with 1.4 million feet in the last quarter of 2013. We are seeing some build to suits coming back. Both rental rates and sale prices are on the rise. There were 162 industrial leases signed in the fourth quarter of 2013. In some sub markets like Troy, it can be hard to find your client a building to lease or buy and you better not play around with your negotiations too much when you find the right property or you lose the property to someone else.

3. *What are the worst performing building types?*

Gary Goodman: Retail is still lagging, but we hope it picks up as the economy strengthens and consumer confidence starts to stabilize. However there are pockets where developers are taking older infill locations and creating new retail that is commanding strong rental rates. For example, the AF Jonna development on Big Beaver just east of Somerset comes to mind.

4. *How is net absorption looking on say office, retail and industrial?*

Eric Banks: The metro office market continues to show signs of sustained recovery. Fourth quarter absorption was positive by almost 500,000 SF, and last year we saw about 1.5 million feet absorbed across all markets. Tenants will likely see fewer landlord concessions coming their way on new leases in the coming year. Again, some sub-markets are doing much better than others. There will be a couple of announcements made very soon on large Office Property trades including Arboretum Office Park (approximately 450,000 SF) in Farmington Hills, the Southfield Town Center (approximately 2.2 million square feet) is on the market and rumored to be under contract. On the leasing side, Federal Mogul Corp. took 180,000 SF of space at the former Southfield headquarters for Blue Cross Blue Shield. That building has been essentially moth balled since BC/BS moved out. We are seeing more big tenants in the market now than we have seen in 4 or 5 years. We discussed Industrial & Flex R&D. As for the retail sector in Detroit, it showed slightly positive net absorption last quarter with 183,000 SF which was the result of 161 leases completed in that same period. Retail rental rates are flat or down slightly. Having said that, there are some bright spots. For example, A.F. Jonna Company seems to be doing very well with their retail developments with something like 9 very nice development projects currently in process.

Gary Goodman: Office absorption is up. Industrial absorption is up significantly. Retail is still slow. Significant new deals are happening, such as: (i) the 250,000 square foot relocation of Magna International's HQ in North Troy, Denso adding 140,000 square feet of office property in Southfield, (ii) North American Lighting taking 75,000 square feet along 12 Mile in Farmington Hills, and (iii) the aforementioned lease by Federal Mogul at the former Blue Cross Blue Shield complex in Southfield. Much of the movement in offices is driven by companies that were sitting on the sidelines evaluating their strategy as the economy improved, and were ready to make a move when the timing made sense. The large moves we've seen are companies that are either optimizing their footprint, moving to more modern facilities, consolidating operations for efficiency, and even preparing for growth.

5. *How quickly are properties now being sold/leased?*

Gary Goodman: The pace is increasing for sure. There is more deal volume, and deals are closing. As always, when coming out of a period of distress, there is still some disconnect between some buyers who think values should still be at the very bottom, and some sellers who think their property is now at the top of the market. Our job is to help buyers and sellers understand where the market is today, and where we think it's going so they can make informed decisions.

6. What are the strongest sub markets here in town?

Gary Goodman: Most people outside of our State would never guess, but the downtown Detroit CBD is booming. Dan Gilbert's investment in the downtown is well publicized, and his success in buying, renovating, and filling up significant properties downtown has increased values and the demand for surrounding real estate. Companies like Lowe Campbell Ewald are moving downtown, and residential demand is dramatically outpacing supply.

7. Any bold predictions for 2014?

Eric Banks: Well, I suppose I have two. First, keep an eye on the walkable communities, those with an urban core. I am referring to Birmingham, Royal Oak, Plymouth, Ann Arbor, Pontiac and so forth but of course the City of Detroit. This is where the growth and energy will be. There is not only a great deal of interest in these communities, some obviously are historically strong like Birmingham, but there is also a lot of momentum in the City of Detroit and Pontiac. Lots of projects in the pipeline. Lots of interest from both local developers and in the case of Detroit, there's of course the force of Dan Gilbert, but also the bankruptcy filing, placement of the Emergency Manager, a new mayor, approved M-1 light rail, new hockey arena etc., coupled with real investment money flowing in with interest from out of state and international investors. We have had a dozen out of state investors, funds, hotel operators and others tour with us in the last 3 months. It's very exciting and we have not seen this kind of momentum - well, ever in my lifetime! Pontiac also has the attention of developers, the County Executives and has a recently elected and well regarded new mayor, who came in on the heels of a departing Emergency Manager. Watch these markets. Second, I think we will see momentum continue for CRE construction and development projects in 2014.

Gary Goodman: I think what's happening downtown is nothing short of amazing. I like to say that in the future, the urban planning programs at major universities across the country will be doing case studies on the remarkable 'rebirth of Detroit', despite the seemingly insurmountable odds against it. I guess it echoes that Detroit mentality...'Detroit hustles harder'. I know we, like you, are out hustling and trying to help our clients in the marketplace. I think 2014 will be a very busy year!

Thank you Eric Banks of CORE Partners and Gary Goodman of Friedman! We appreciate your time and insight. We value your opinions here at RMA.

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