MARKET REVIEW & OUTLOOK

Mid-Year 2018

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OFFICE MARKET

Written By
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Market Conditions

Leasing and sale activity within the Spokane Office Market in 2018 has seen a significant bump over 2016-2017. Office vacancy rates do not reflect the amount of positive absorption in the market because several new projects are expected to come online. Sale activity of raw land, investment, value-add properties and owner/user buildings has been robust. The following is a summary based on submarkets:

Central Business District (CBD)

- A few interesting forces are at play in the CBD and it may take several months for the effects to be felt. First, monthly parking in the CBD is difficult to find, and has resulted in a steep cost increase. Second, additional housing is coming online, the former Macy's building being the best example, with over 100 market rate units being added.

- There were a few notable sales of office buildings in the core. Old City Hall (100,000 SF) sold to local investors who plan to renovate and occupy a portion of the building. The Umpqua Building (110,000 SF) sold to out-of-town investors who plan to reposition the first floor retail space. Both buildings have had long-term vacancy but new ownership is likely to aggressively pursue tenants.

- The Bank of America Financial Center, Spokane's highest profile office product is currently for sale. Unico Properties acquired the building in 2007 and they now seek to capitalize on Spokane's strong market.

Close-In

- The Close-In submarket includes Spokane's University District. With the new, high-profile pedestrian bridge nearing completion combined with plans for development of The Catalyst Project, this submarket is poised for dramatic growth in office, research, and education-related tenancy.

- Leasing activity has been strong resulting in a "landlord's market" characterized by fewer concessions and firming rental rates.

- Wonder Spokane is a 100,000 SF rehab of a historic brick bakery into an office building located adjacent to Riverfront Park on Spokane's North River Bank. The building "shell" is nearing completion and it is expected to absorb new tenants as early as Fall 2018.

Spokane Valley

- The Valley submarket's robust positive absorption over the last few reporting periods is translating into strong demand for new product as evidenced by the sale of the River View Corporate Center (254,000 SF), the acquisition of the Sullivan Business Center (140,000 SF) by a local developer, the completion of the Meadowwood Five Building (60,000 SF) for occupancy by Liberty Mutual, and the development of a new building at Pinecroft (40,000 SF) for 50% occupancy by Northwestern Mutual.

- Sales of raw land and vacant buildings for owner/user occupancy have been especially strong.

Other Submarkets

- The North submarket's second largest office building (100,000 SF), the former Guardian Insurance Building, recently sold to local investors who will be aggressively pursuing tenants.

- The West submarket's vacancy rate dropped from 43% to 30.8% due to a sale and reclassification of the former Bank of America Building (90,000 SF) to industrial. The building sold to U-Haul and will be used for storage.

Market Forecast

- With Spokane's economy growing at a strong and sustainable rate, we believe the market will continue to absorb office space well into 2019. This will translate into development of new projects (both rehab and new construction).

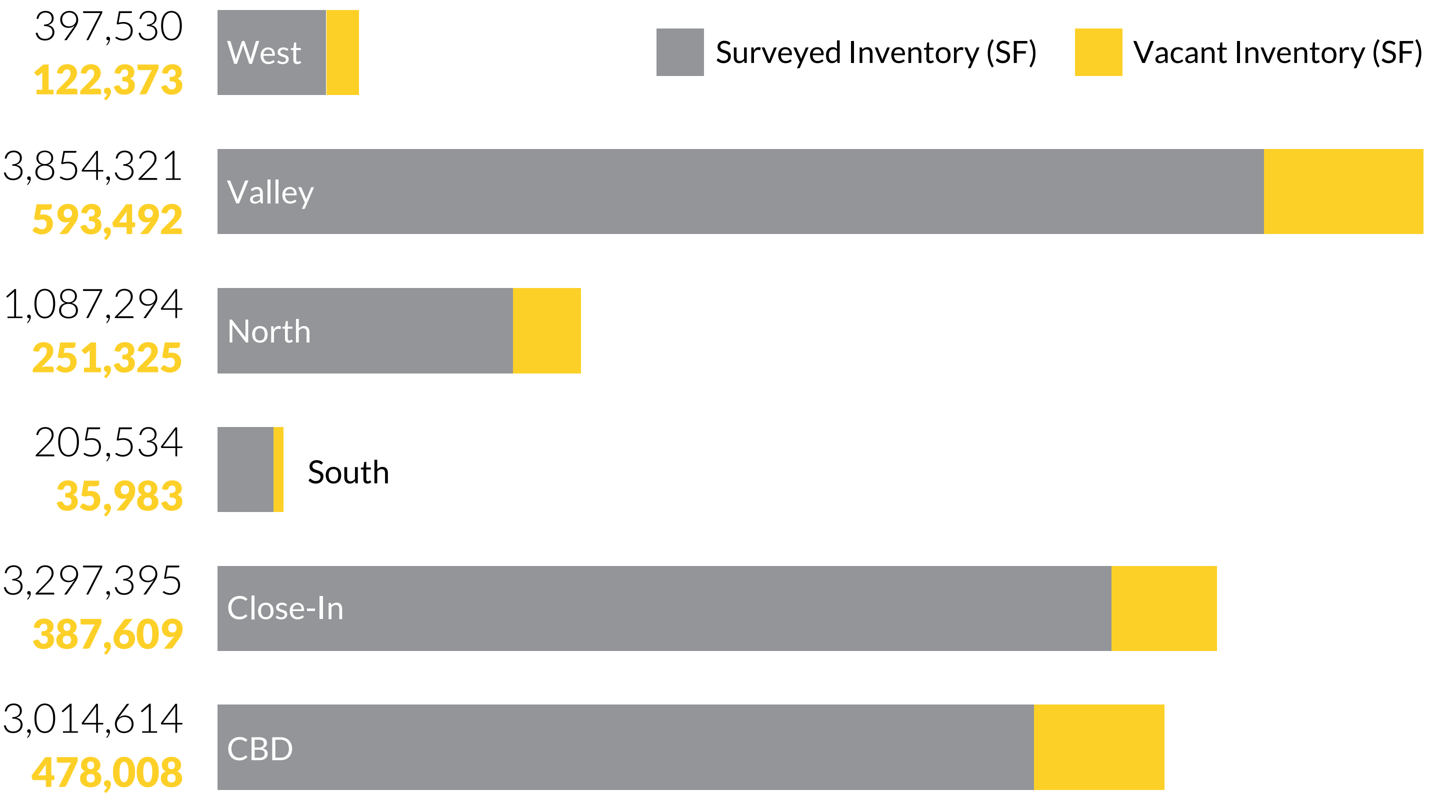
- We expect to see rental rates increase in the near term as construction costs continue to rise, which will drive TI costs and corresponding rents higher. Uncertainty surrounding the cost of steel and aluminum are contributing to a rapid run-up of new construction expenses.

- Since increases in interest rates remain modest, we expect sales to remain strong across all product types (income, owner/user, value-add, land) into 2019.

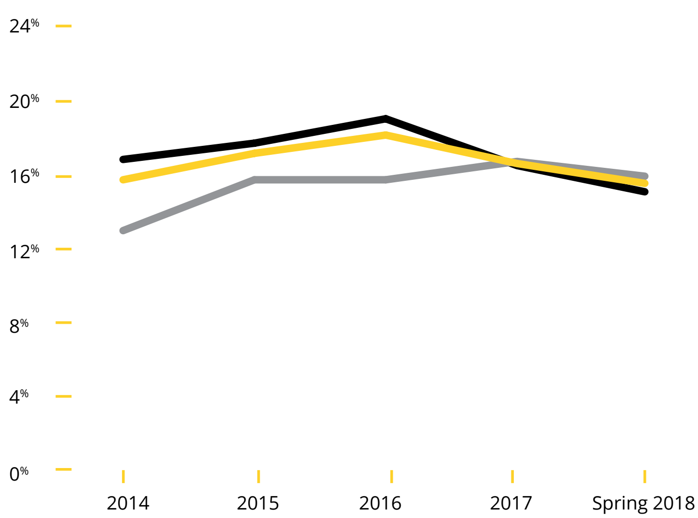
Photo credit: Homes by Eugene, Johanna B. Photography, Isaacson Aerial Photography, Emily Fisher Photography Graphics: Mike Lee

Office Market Inventory

**Market Data Source: Valbridge Property Advisors*

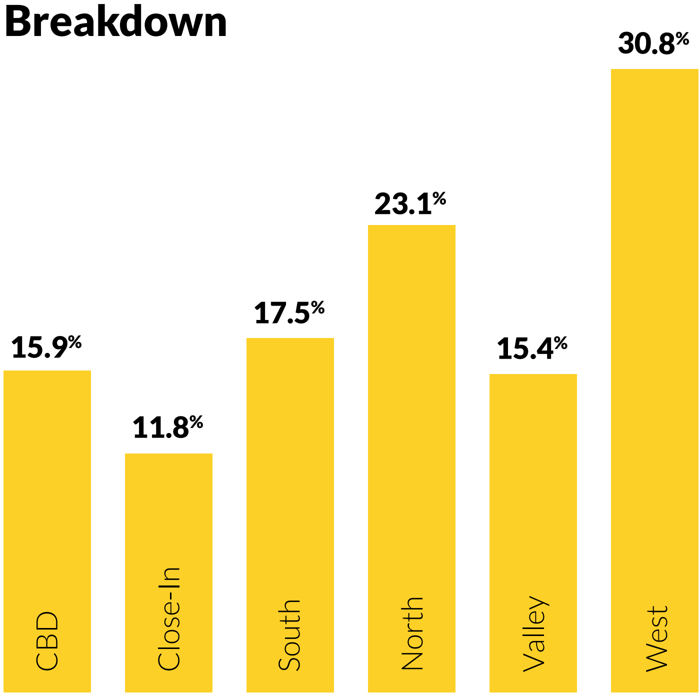


Office Market Vacancy



	2014	2015	2016	2017	Spring 2018
Total	**15.7%**	**17.0%**	**17.9%**	**16.5%**	**15.8%**
CBD	**13.2%**	**15.7%**	**15.7%**	**16.6%**	**15.9%**
Suburbs	**16.7%**	**17.5%**	**18.7%**	**16.4%**	**15.7%**

Office Submarket Vacancy Breakdown



RETAIL MARKET

Written By
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Market Conditions

- The Spokane Valley currently has a 4% retail vacancy rate. In mid-2013, Spokane Valley's vacancy rate had hit a post-recession high of 12.6%. Regardless of this increased absorption, the average rental rate for Spokane Valley continues to be less than $13.00/SF, which is the lowest in the county.

- The South Spokane submarket enjoyed a long span of low vacancy rates, but continues to experience a climb in this area. A shift has occurred in this submarket, as the vacancy level has increased from 4% in Fall 2017 to 6% in Spring of 2018. South Spokane continues to be a challenge for national and regional retailers to enter. Rental rates continue to be at high levels, the highest per average in the county.

- In summary smaller retail projects have come online in North Spokane and Spokane Valley, as new South Spokane projects struggle to gain traction.

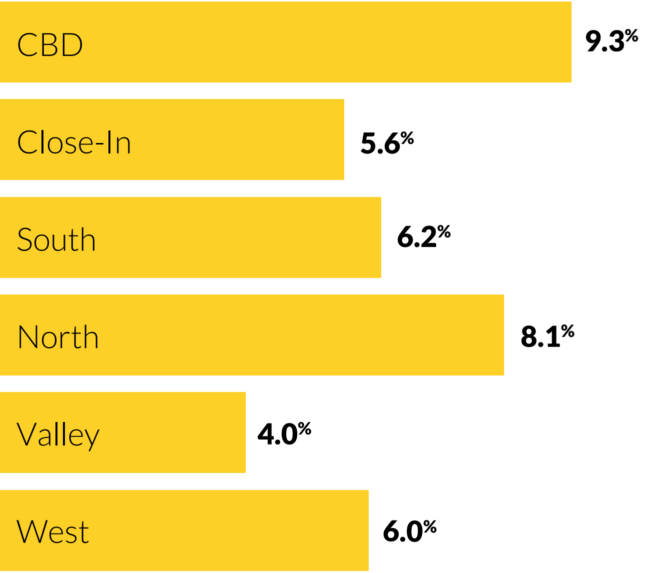
Market Forecast

- The seller's market in investment sales continues at a rapid pace. The lack of available product and access to available cash has kept pressure on the market, regardless of rising interest rates. Sellers continue to demand low cap rates, compressing the margin between interest rates.

- Speculative building is beginning to re-emerge within the marketplace. The lack of available product to purchase and low vacancy rates are driving some developers to put projects on the books without pre-leased tenants. Planned developments in Spokane Valley display this example most clearly.

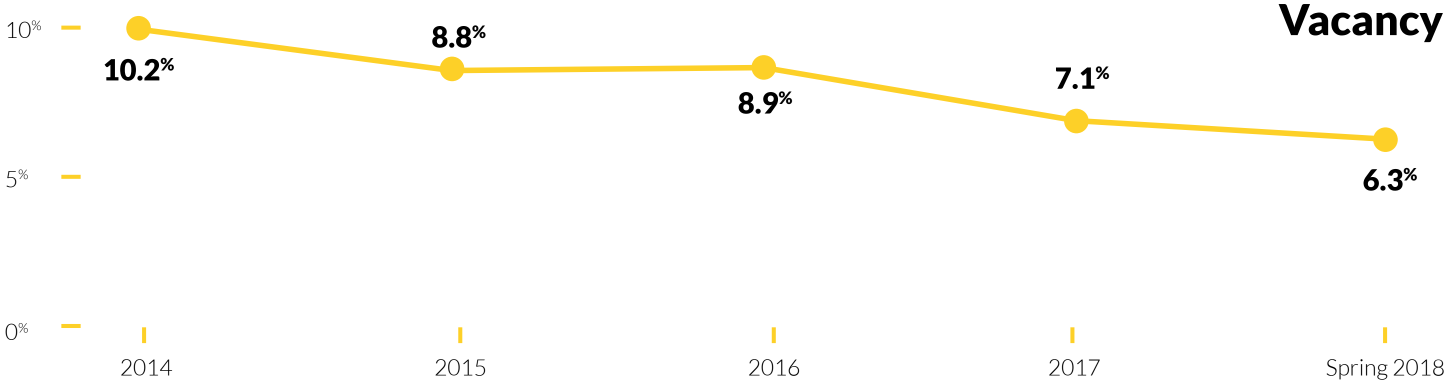
- With consumer confidence at a high, expect to see strong retail spending to continue for the remainder of the year.

Retail Submarket Vacancy Breakdown



Market Data Source: Valbridge Property Advisors

Overall Retail Vacancy



INDUSTRIAL MARKET

Written By
Mark Lucas, SIOR , Tracy Lucas and Tracy Poff – Kiemle Hagood

Market Conditions

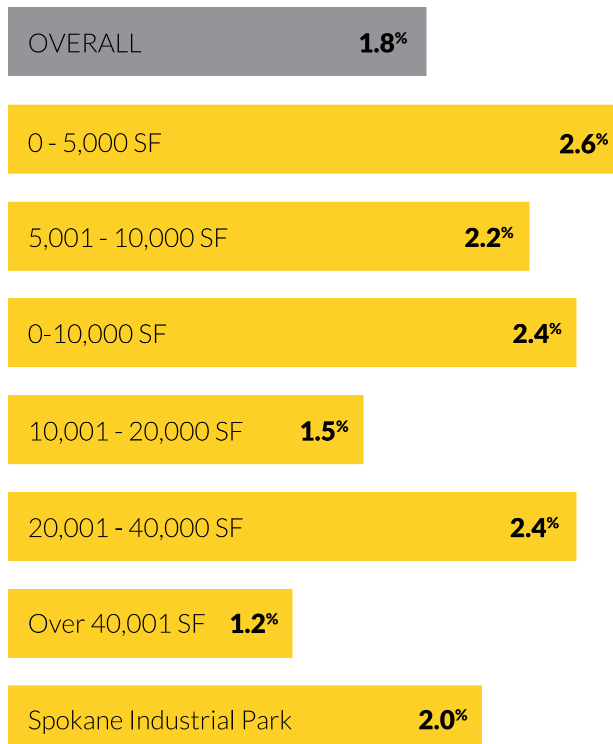
- Spokane's Industrial Market saw another drop in vacancy levels during the second half of 2017. Vacancy rates remain historically low as the overall level dipped just below 2%.
- Demand for industrial space continues to grow throughout the region, and only 638,134 SF of new space was built in 2017, while 1,024,544 SF was absorbed.
- With constricted options, tenants within the region have seen an increase in rental rates.

Market Forecast

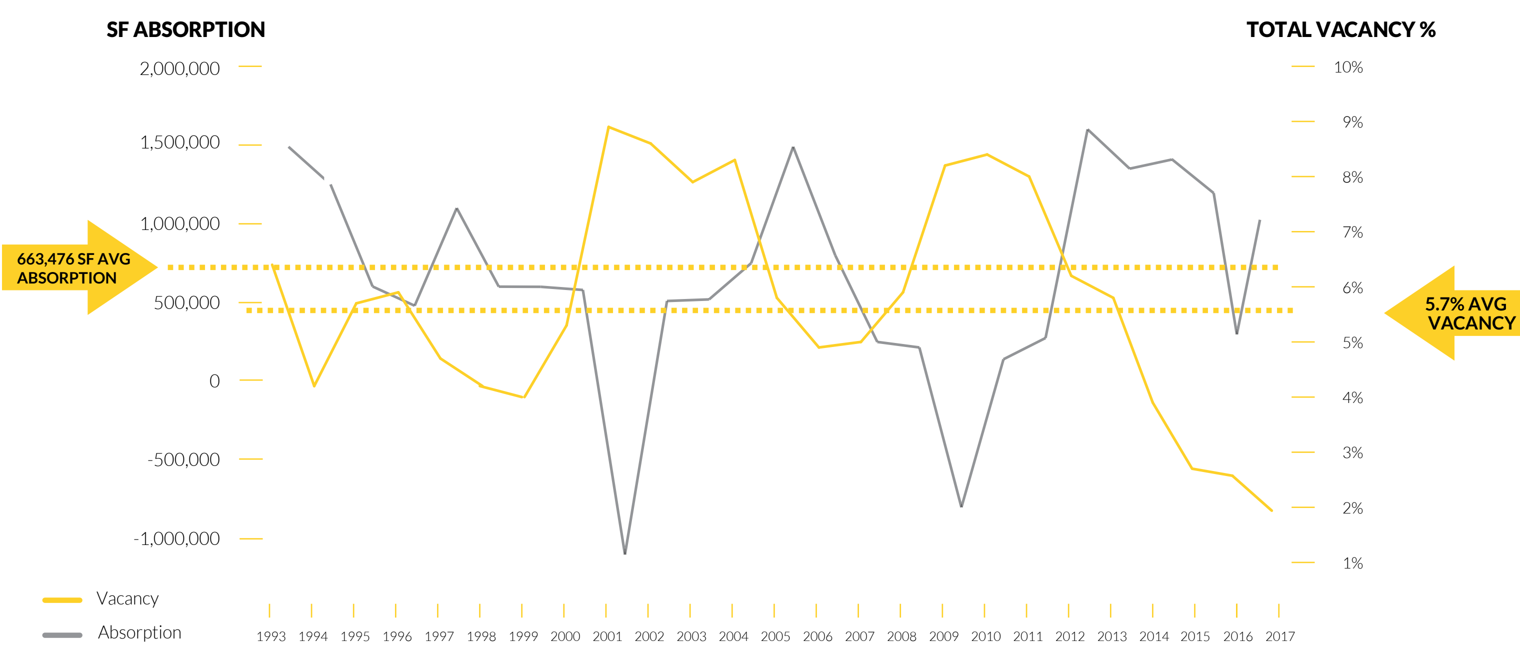
- Several new projects will come online in 2018. As these projects are completed, expect to see a slight rise in vacancy and more options for tenants.
- Historically, the Industrial Market tends to have a five year vacancy level incline and decline. Movement towards a small vacancy level rise is expected to occur in 2018.

The Industrial Market Report is offered on a yearly basis. Data included in this report was completed in December 2017.
**Market Data Source: Mark Lucas, SIOR and Tracy Lucas*

Industrial Vacancy by Building Size



Industrial Market History



MEDICAL OFFICE MARKET

Written By
Ron Horton – Kiemle Hagood

Market Conditions

- The Spokane Medical Office Market has been somewhat flat over the last 6 months with vacancy creeping back over 10% according to the most recent survey. A conservative, careful approach has become the new norm for tenants and landlords in the market as uncertainty over the Affordable Care Act (ACA) continues.
- Rents will need to rise to recover increases in operating costs, which show no signs of slowing. Class A properties will continue to demand top rates, while B and C class properties will struggle to attract good tenants. Landlords will need to be aggressive by offering attractive tenant improvement allowances, flexible lease terms and other incentives.

Market Forecast

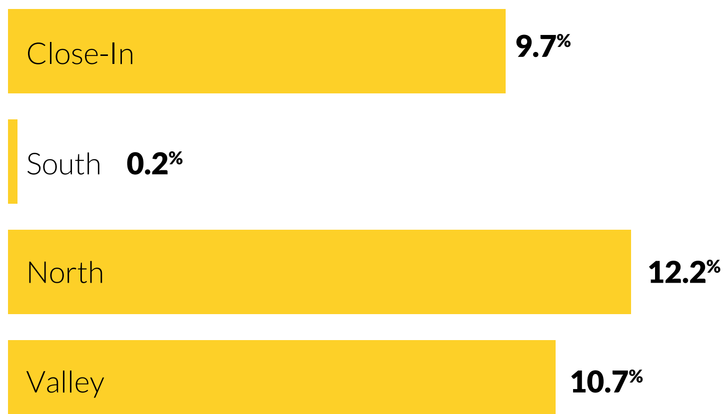
- Healthcare demands will continue to soar as an aging population demands more services and doctor visits.
- Non-medical real estate properties will continue to become important elements of a hospital's comprehensive network approach. Spaces and pad sites within well situated retail centers are increasingly becoming health system brand centric, public facing facilities.
- Healthcare will continue to move toward a convenience – based model. Health care organizations will continue to move to population centers where their customer base is located and operational costs are lower than on hospital campuses.
- New rules implemented by the Financial Accounting Standards Board will impact how health care providers account for long-term leases, which currently allow sale leaseback arrangements. Under the new rules, leases will be classified as financing leases, which are treated as debt by the lessee. These changes will force a fundamental rethinking of whether providers want to own or lease their facilities. Developers will need to offer credit-leasing where a provider gets the benefit of ownership following lease expiration.

MEDICAL OFFICE MARKET BREAKDOWN

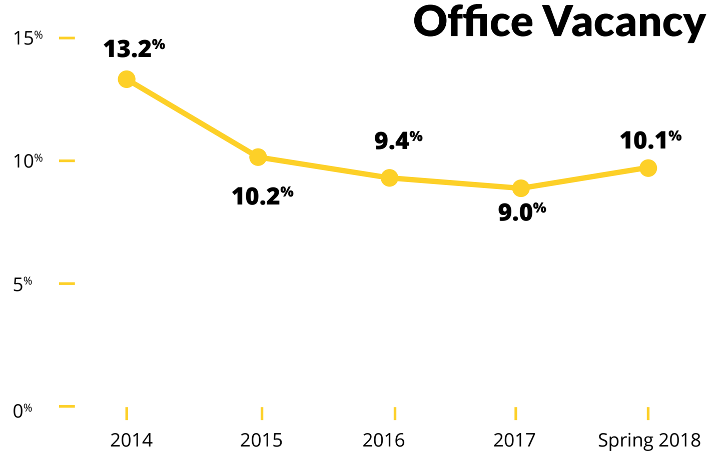
Submarket	Surveyed Inventory (SF)	Vacant Inventory (SF)	Vacancy
Close-in	1,083,008	105,500	9.7%
South	127,700	214	0.2%
North	590,454	71,853	12.2%
Valley	710,836	76,077	10.7%

Northpointe Medical Building

Medical Office Submarket Vacancy Breakdown



Overall Medical Office Vacancy



**Market Data Source: Valbridge Property Advisors*

APARTMENT MARKET

Written By
Tim Kestell and Cody George – Kiemle Hagood

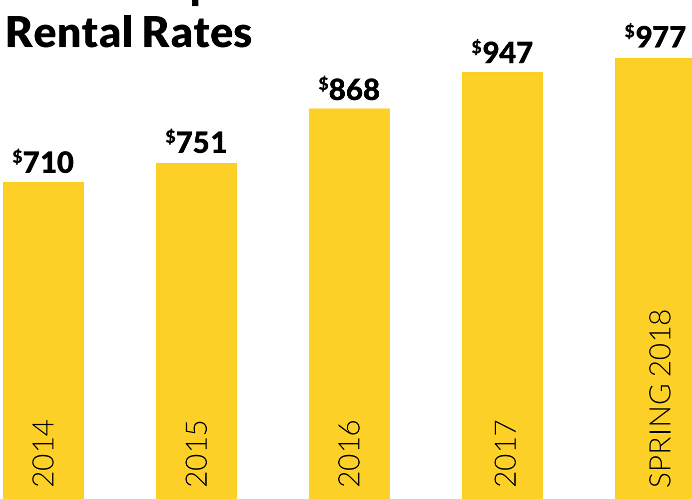
Market Conditions

- Expectedly, the average apartment vacancy rate for the overall Spokane market has decreased from 2.9% in late 2017 to 1.3% in early 2018. Overall absorption rates are strong and are anticipated to remain strong through all new multi-family projects in the local markets. The Spokane market has felt increased demand for quality multi-family projects as new businesses emerge in our market and the local economy continues to thrive. The average rental rate has increased nearly $100 per month to a new record of $977 per month. The highest average rental rate is in South Spokane at $1,315.
- The residential housing market remains highly competitive, which has forced many "would be" home buyers into apartments while they regroup and methodically seek out opportunities for ownership. We anticipate several new home developments throughout the region; however, we do not anticipate a vacancy rate increase in the multi-family sector due to expected population growth.

APARTMENT MARKET BREAKDOWN BY SUBMARKET

Submarket	Vacancy %	Average Rental Rates
North	0.9%	$785
Central	1.1%	$624
Valley	1.3%	$933
South	2.6%	$1,315
West	0.7%	$1,033
OVERALL	**1.3%**	**$977**

Overall Apartment Rental Rates

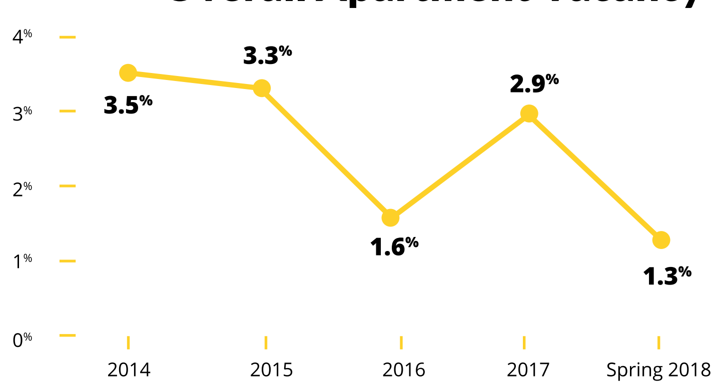


**Data Source: Runstad Center for Real Estate Studies/University of Washington*

Market Forecast

- Vacancy rates will remain low throughout 2018 into 2019.
- The new "M" apartment building in Downtown Spokane is projected to be 100% occupied in 2018 which will spark interest for other Downtown or Close-In multi-family projects.
- Multi-family land will remain high demand and fetch record sale prices.
- Existing multi-family investment projects will remain hard to find. If listed for sale, existing projects will be at low capitalization rates due to the limited inventory and upward pressure on interest rates.
- Look for smaller unit size (studio and 1 bedroom) multi-family projects coming out of the ground in neighborhood markets and close to amenities. The smaller unit options are becoming more desirable to younger generation tenants as well as empty nesters.

Overall Apartment Vacancy



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