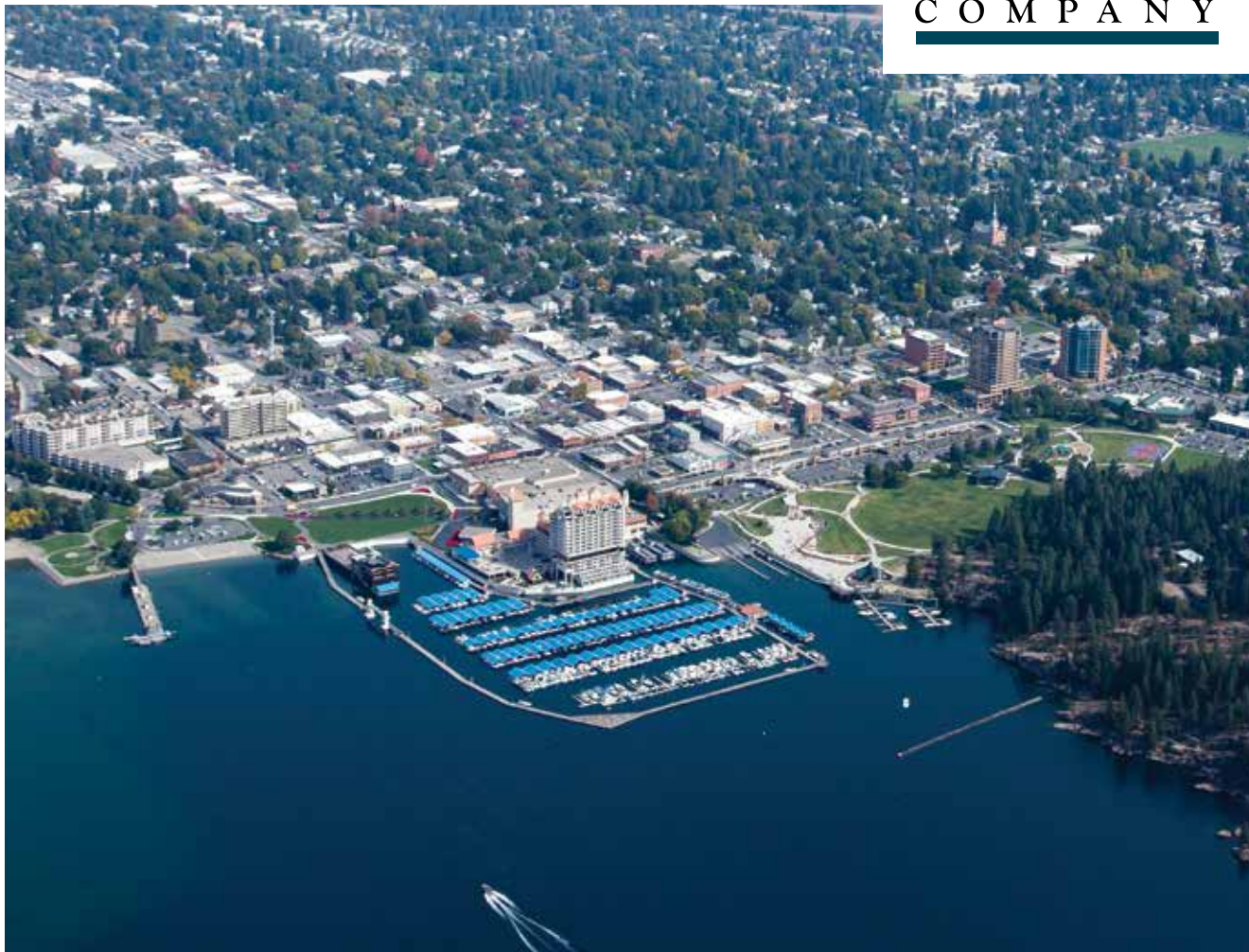


MARKET REVIEW & OUTLOOK



WINTER 2016

**KIEMLE &
HAGOOD
COMPANY**



Published in partnership with



Washington Trust Bank
Member FDIC

TABLE OF CONTENTS

Economic Outlook 3

Office Market 4-5

Retail Market 6-7

Industrial Market 8

Medical Office Market 9

Apartment Market 10

Kootenai County Market 11

**KIEMLE &
HAGOOD
COMPANY**

khco.com

Spokane
509.838.6541
601 W. Main Ave., Suite 400

Coeur d'Alene
208.770.2590
2065 W. Riverstone Dr., Suite 101





The road to economic growth in 2016 will continue to be a bumpy path with several “potholes” impeding growth. Although we are far along in this economic expansion, the economy should be sturdy enough to avoid or absorb these potholes and continue its progress forward. Here is an examination of the potential “potholes” and positives that may influence economic growth in 2016.

POTHOLES

Regulations

Regulations continue to have a negative impact on small businesses, and small businesses are still the engine that drives jobs creation.

Energy prices

Lower energy prices will continue to pressure both the energy sector and the companies throughout the economy who supply goods to the energy sector.

Dollar strength

A strong dollar will continue to present challenges for the export-oriented portion of the economy.

Labor Shortages

There is growing evidence that points to labor shortages developing in various industries. This may hurt economic growth if businesses are limited due to an inability to find qualified help.

POSITIVES

Consumer Spending

Continued lower energy prices and cheaper imports should support consumer spending. Consumer spending – as measured by Personal Consumption Expenditures – has averaged 3.1% since the recovery and 2016 should see a similar increase.

Housing

Although there are sectors of the country where housing prices are rising so fast that housing affordability has become an issue, as a whole housing should be a positive for the economy.

Government Spending

Increased government spending and potential new tax breaks should add up to a positive contribution to economic growth in 2016. Current projections are an additional 2% - 3% compared to 2015.

CONCLUSION

What could put the U.S. economy at risk in 2016 are: a) a faster-than-anticipated pace of interest rate increases from the Federal Reserve, b) a major economic problem from one of the major international economies (i.e. China, Europe and Japan), c) a negative shock to the financial system via one of the sectors of the financial markets suffering a severe downturn, d) a geopolitical event that disrupts the U.S. or world economy (i.e. terrorism, etc.).

Without one of these factors occurring, the U.S. economy should continue with positive growth in 2016, although with continued “potholes” throughout the year. From a planning perspective, economic growth of 2% - 3% still appears to be the most realistic scenario.

OFFICE MARKET

Market Conditions

- The overall Office Market vacancy increased slightly from 15.7% in the Fall 2014 to 17.0% in Fall 2015.
- Tenants continue to seek high quality office product, creating a tight market for Class A space.
- The Office Market saw minimal sales activity; and, the activity that occurred was mostly tenants seeking to purchase their own facilities.

CBD

Lack of leasing velocity exists in the CBD – Class A market, mainly due to minimal job growth among professional services, rising monthly parking expenses and desire for lower rents.

Close-In

Activity surrounding Spokane’s University District continues to be a draw for tenants, and large space opportunities remain sparse. Both Riverpoint and Iron Bridge Campuses currently have limited vacant space.

Spokane Valley

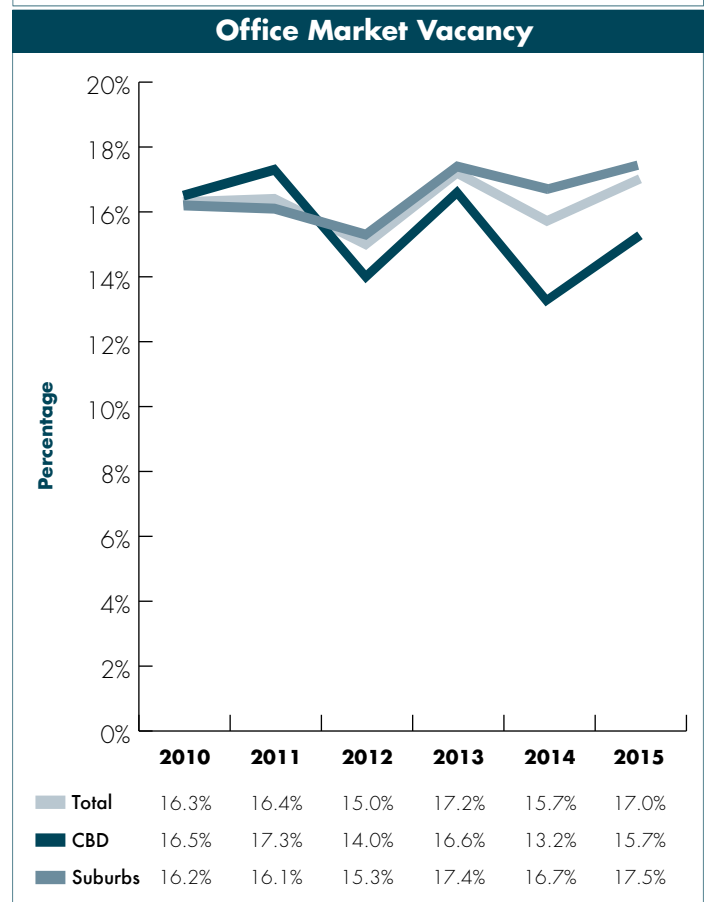
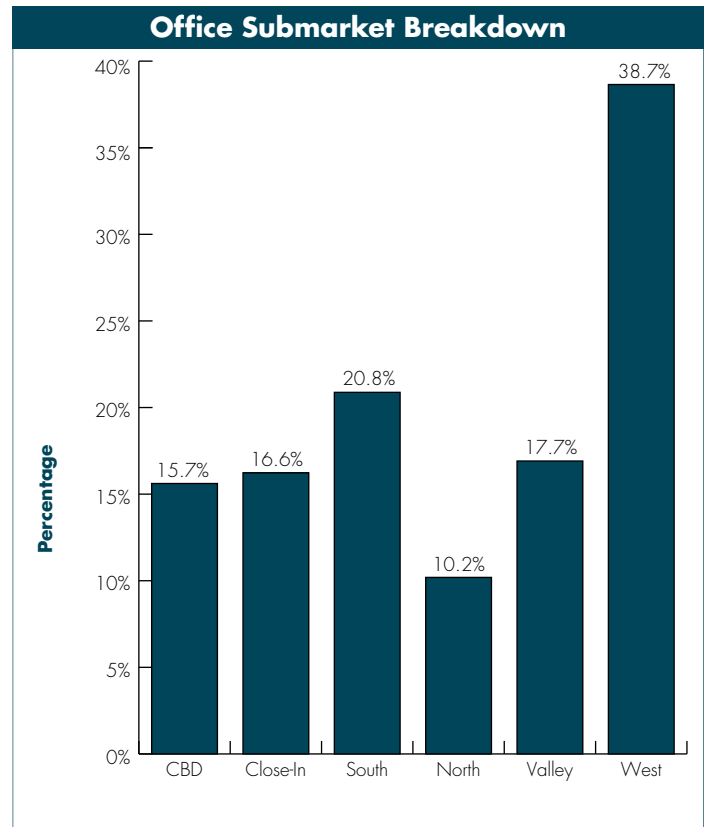
The Valley Submarket experienced an increase in activity during the second half of 2015. As a result, there are limited space options for those looking for quality larger Class A spaces, triggering a demand for new construction.

North

The North Spokane Market saw positive absorption in 2015 and remains driven by medical and dental office demand.

West

The West Spokane Market is highly volatile and had a sharp spike in vacancy in 2015. Corporate downsizing and tenant relocations continue to be a driving force.



*Market Data Source: Valbridge Property Advisors

Market Forecast

- Expect to see new construction in 2016 based on need for larger quality office product, especially in the Close-In, Valley, and Liberty Lake Submarkets.
- Rental rates will continue to climb for newer / higher quality office product.
- Office investment sales will be minimal due to lack of product for sale throughout the region.

| Office Submarket Breakdown | | |
|----------------------------|-------------------------|-----------|
| Submarket | Surveyed Inventory (SF) | Vacancy % |
| CBD | 3,099,567 | 15.7% |
| Close-In | 3,103,516 | 16.6% |
| South | 201,840 | 20.8% |
| North | 1,050,853 | 10.2% |
| Valley | 3,458,040 | 17.7% |
| West | 428,873 | 38.7% |

| Leasing Activity Highlights in 2015 | | | |
|-------------------------------------|-----------------------------------|--------|--------------|
| Location | Tenant | SF | Submarket |
| Meadowwood Four | Comcast Cable Communications | 80,000 | Liberty Lake |
| 23321 E. Knox Ave. | f5 Networks | 27,940 | Valley |
| 22528 E. Appleway Ave. | Bank of America Merchant Services | 27,000 | Liberty Lake |
| 627 E. Sprague Ave. | McLeod USA (Renewal) | 18,191 | Close-In |



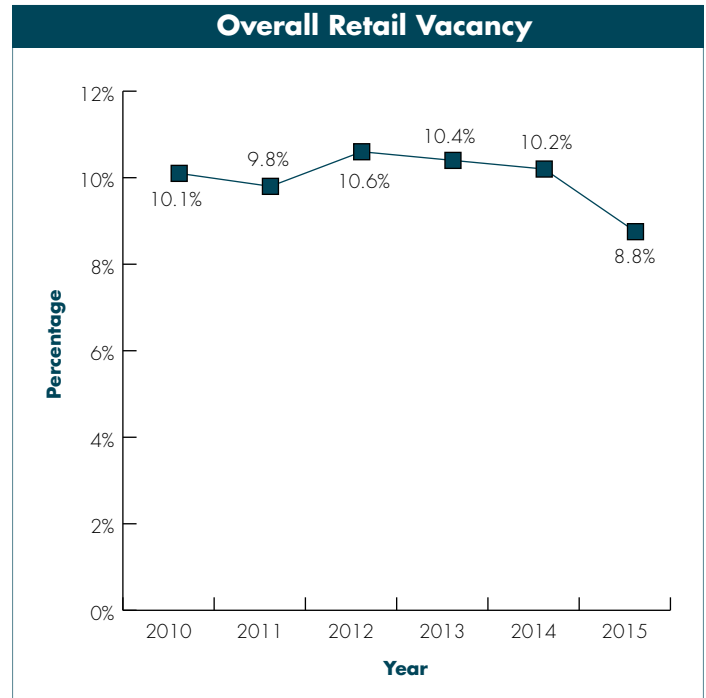
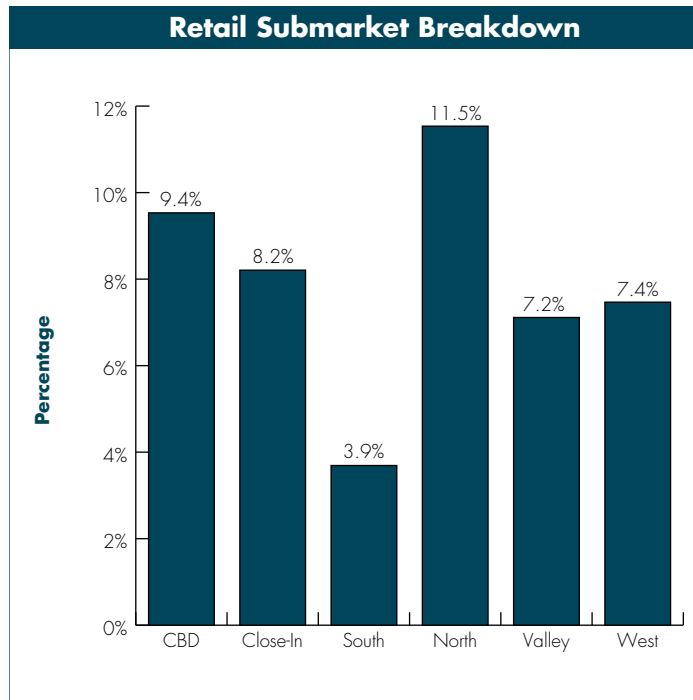
| Sales Activity Highlights in 2015 | | | |
|-----------------------------------|--------|-------------|-----------------------|
| Location | SF | Sale Price | Submarket |
| Trent Plaza | 69,777 | \$6,764,834 | Valley |
| 627 E. Sprague Ave. | 36,000 | \$2,600,000 | Close-In |
| 1328 N. Whitman Lane | 11,939 | \$1,735,000 | Valley (Liberty Lake) |
| Cataldo Place | 17,136 | \$1,690,000 | CBD |
| 8817 E. Mission Ave. | 17,122 | \$1,286,000 | Valley |
| 12309 E. Mirabeau Pkwy. | 5,000 | \$905,000 | Valley |



RETAIL MARKET

Market Conditions

- The overall Retail Market saw a significant decrease in vacancy from 10.2% in Fall 2014 to 8.8% in Fall 2015.
- The demand for Class A retail space remains high with limited opportunities in existing centers.
- Class B retail locations experienced a tightening this past year; however, Class C centers continue to be extremely competitive for landlords searching for tenants.
- New construction on smaller retail strip centers occurred. New sites at 3rd Avenue & Division Street and Newport Highway and Holland Avenue are part of this trend.



Sales Activity Highlights in 2015

| Building/Land | SF | Sale Price | Submarket |
|----------------------|--------|--------------|-----------|
| 4515 S. Regal St. | 99,168 | \$10,534,246 | South |
| 9520 N. Newport Hwy. | 94,069 | \$10,132,452 | North |
| 9420 N. Newport Hwy. | 44,000 | \$1,200,000 | North |
| 8702 N. Division St. | 10,597 | \$2,640,000 | North |
| 8014 N. Division St. | 8,545 | \$2,965,206 | North |
| 9208 E. Sprague Ave. | 7,496 | \$1,750,000 | Valley |

Leasing Activity Highlights in 2015

| Location | Tenant | SF | Submarket |
|-----------------------|------------------|--------|-----------|
| 13112 E. Sprague Ave. | PF Spoval | 24,000 | Valley |
| 15224 E. Sprague Ave. | Home Goods | 24,000 | Valley |
| 15530 E. Sprague Ave. | DeLeon Foods | 17,000 | Valley |
| 4511 N. Division St. | Natural Grocers | 16,000 | North |
| 9412 N. Newport Hwy. | Sherwin Williams | 4,000 | North |
| 9405 N. Newport Hwy. | MOD Pizza | 2,500 | North |
| 707 W. Main Ave. | MOD Pizza | 2,376 | CBD |

*Market Data Source: Vallbridge Property Advisors

Market Forecast

- Expect to see continuing demand for new shopping center developments and Class A retail space within the South and West Submarkets.
- New retailers entering the market in 2016 will include Natural Grocers, Carhartt, Urban Outfitters, and a new North Spokane Trader Joe's.
- Cap rate compression should hold throughout the year for quality retail investment sales regardless of the Federal Reserve's recent action to raise interest rates.

Demographic Overview of the Inland Northwest

| | 2015 Estimated Population | 2020 Projected Population | 2010 Census Population | Projected Annual Growth (2015-2020) | 2015 Estimated Households | 2015 Estimated Median Household Income | 2015 Estimated Median Age |
|------------------------|---------------------------------|---------------------------------|------------------------------|---|---------------------------------|--|---------------------------------|
| Spokane County | 492,304 | 518,394 | 471,221 | 1.1% | 198,049 | \$51,831 | 37.3 |
| Spokane, WA | 220,124 | 230,982 | 209,752 | 1.0% | 93,233 | \$45,070 | 35.8 |
| Spokane Valley, WA | 93,825 | 98,878 | 89,657 | 1.1% | 38,413 | \$50,915 | 37.4 |
| Liberty Lake, WA | 7,784 | 8,791 | 7,591 | 2.6% | 3,085 | 76,957 | 38.6 |
| Airway Heights, WA | 6,432 | 6,625 | 6,114 | 0.6% | 1,729 | \$37,907 | 33.2 |
| Kootenai County | 146,742 | 157,052 | 138,494 | 1.4% | 58,809 | \$50,818 | 39.2 |
| Coeur d'Alene, ID | 47,608 | 50,689 | 44,096 | 1.3% | 20,317 | \$44,108 | 36.6 |
| Post Falls, ID | 29,446 | 31,497 | 27,642 | 1.4% | 11,206 | \$49,202 | 34.3 |
| Rathdrum, ID | 7,173 | 7,698 | 6,935 | 1.5% | 2,599 | \$50,086 | 34.6 |
| Hayden, ID | 13,943 | 14,908 | 13,294 | 1.4% | 5,522 | \$54,352 | 40.7 |

*Data Source: U.S. Census Bureau/Sites USA

Northtown Square



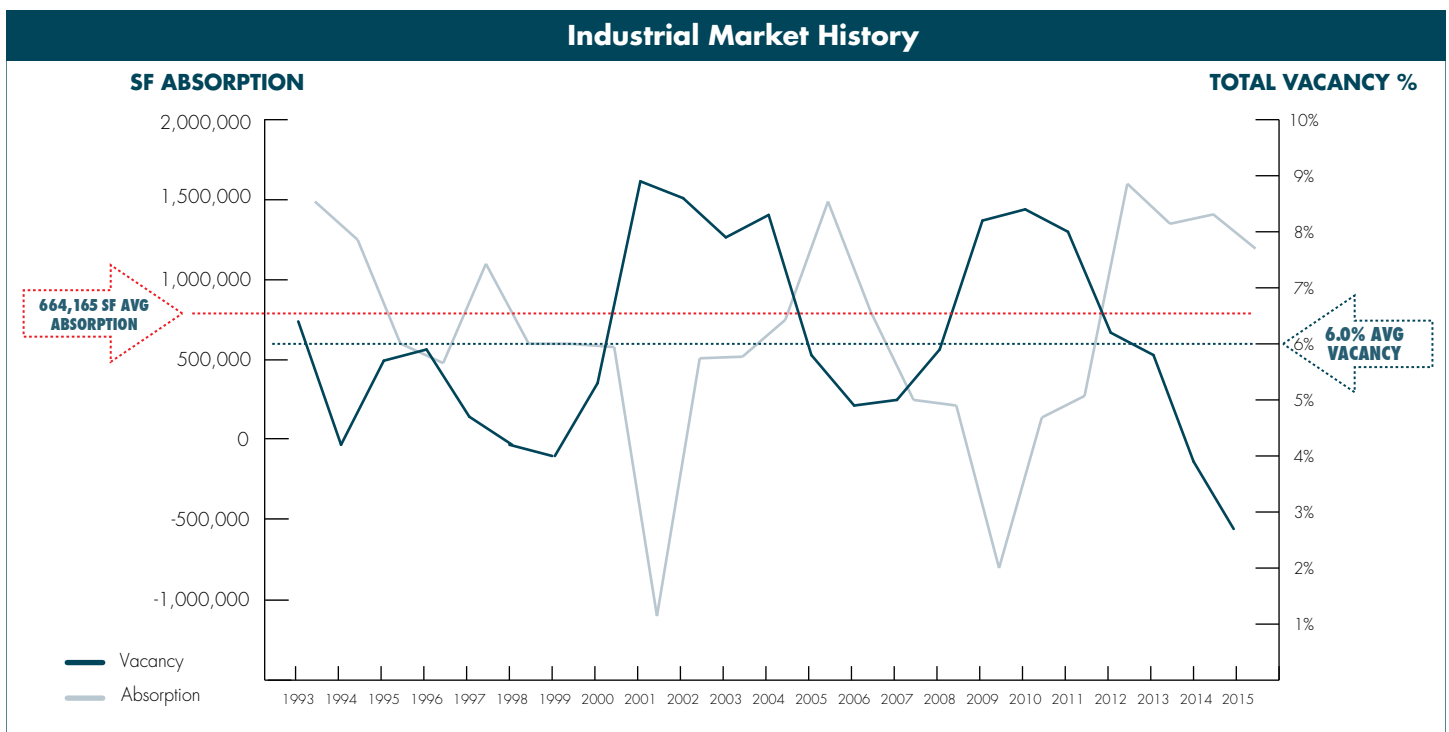
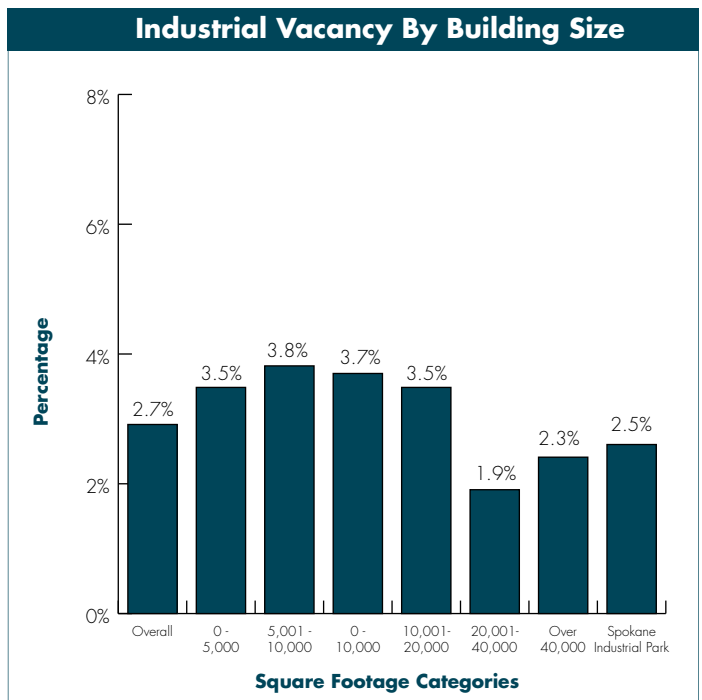
Market Conditions

- Spokane's Industrial Market continued to see a decline in vacancy in 2015, as overall vacancy fell from 3.9% in December 2014 to 2.7% in December 2015.
- New industrial space grew slightly by 706,103 SF, and net absorption decreased to 1,232,969 SF. Much of the newly constructed space occurred in the new Playfair Commerce Park located in Spokane's Close-In market.
- Marijuana businesses continue to make an impact on the Industrial Market. Options are limited as tenants seek to lease space for their production and distribution facilities.

Market Forecast

- Historically, Spokane's Industrial Market vacancy levels tend to rise after a four to five year decline. Expect to see this trend continue, as vacancy will gradually rise with rental rates to remain stable over the next few years.
- Sales activity within the region will remain steady for facilities that are competitively priced.

*Market Data Source: Mark Lucas, SIOR and Tracy Lucas





Holy Family Central Medical Office Building

Market Conditions

- Consolidations continue to be the driving force in the medical market today. The purchase of smaller medical system operators are providing larger healthcare systems the opportunity to expand and extend their operations into secondary markets.
- The local market is seeing some absorption with vacancy rates having dropped 2.5 percentage points from the previous survey to 10.2% in the most recent Spokane County survey.
- Lease rates are in the low to mid \$30's PSF for modern, flexible, well-located spaces that facilitate collaboration with other providers. Older buildings in less desirable locations will need to be aggressive in attracting and retaining tenants. Regional and national medical office buildings are increasingly attractive purchase opportunities by REIT's.

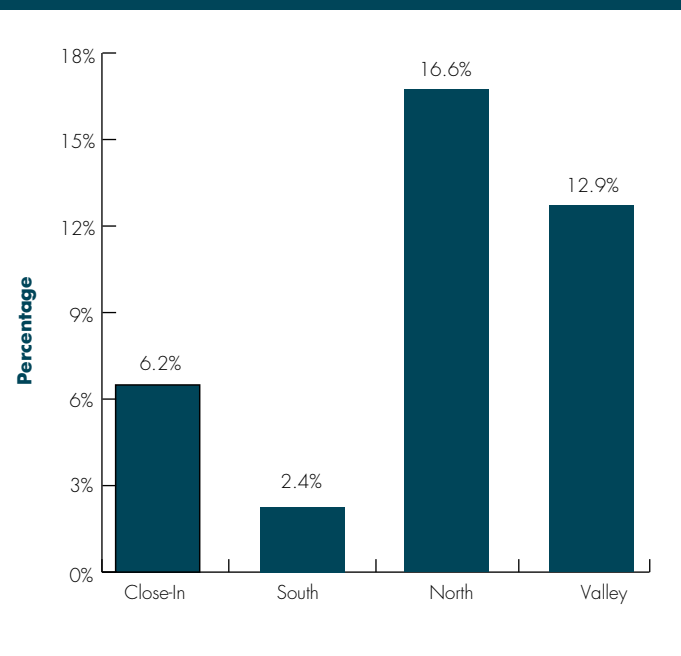
Sales Activity Highlights in 2015

| Location | SF | Sale Price | Submarket |
|---------------------|--------|-------------|-----------|
| 510 E. Holland St. | 10,765 | \$3,150,000 | North |
| 510 S. Crowley St. | 18,515 | \$2,075,000 | Close-In |
| 1414 N. Vercler Rd. | 8,068 | \$1,250,000 | Valley |

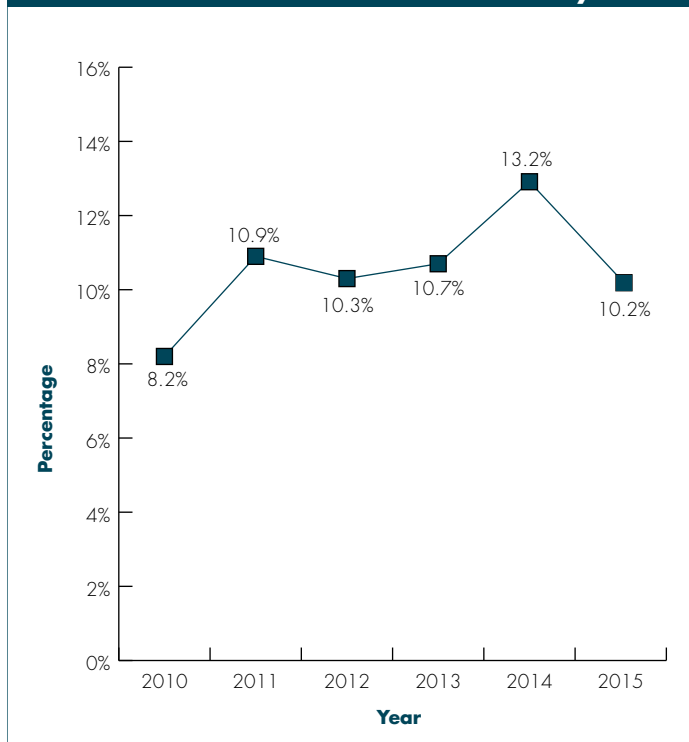
Leasing Activity Highlights in 2015

| Location | Tenant | SF | Submarket |
|--------------------|------------------------------|--------|-----------|
| 9919 N. Nevada St. | Providence Health & Services | 14,257 | North |
| 2020 E. 29th Ave. | Providence Health & Services | 10,413 | South |
| 9631 N. Nevada St. | Jamison Family Medicine, LLC | 3,880 | North |

Medical Office Submarket Breakdown



Overall Medical Office Vacancy



*Market Data Source: Valbridge Property Advisors

Market Forecast

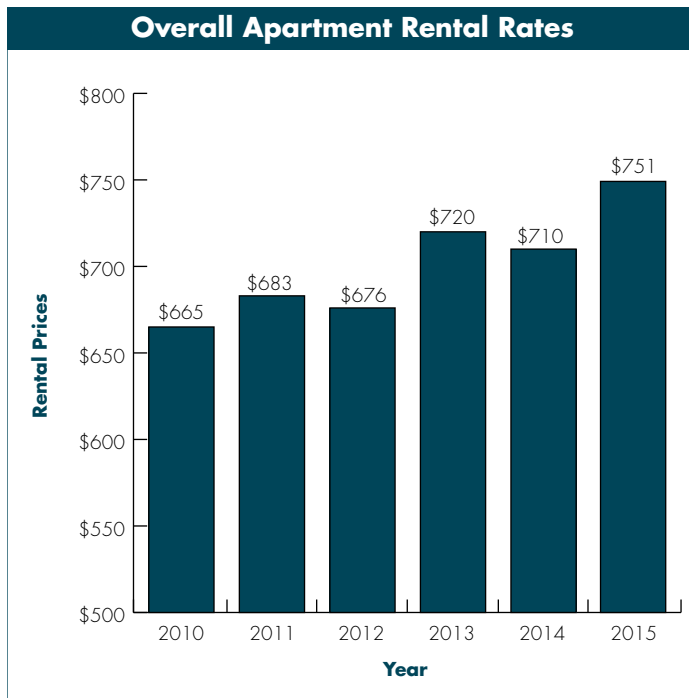
- The increased number of people now insured through the Affordable Care Act (ACA), and the growing number of baby boomers reaching retirement age will continue to increase demand for healthcare real estate. This trend will provide opportunity for land owners and brokers able to provide assistance with site analysis and acquisition. Savvy hospital executives will need real estate advisors that are knowledgeable about the markets, traffic issues, zoning, land values and lease rates.

Market Conditions

- Overall apartment vacancy rates dropped slightly from 3.5% in 2014 to 3.3% in 2015.
- The 2015 average combined rental rates across Spokane's submarkets is up to \$751 per month, and that represents a \$41 per month increase over 2014 average rental rate.
- Multi-Family building permits were at an all-time low in 2012 with only 287 units authorized. Since then the market has recovered with 853 units approved during the first three quarters of 2015.

| Apartment Market Breakdown by Submarket | | |
|---|-----------|----------------------|
| Submarket | Vacancy % | Average Rental Rates |
| North | 2.3% | \$721 |
| Central | 2.8% | \$689 |
| Valley | 6.3% | \$751 |
| South | 1.6% | \$1,067 |
| West | 1.3% | \$704 |
| Overall | 3.3% | \$751 |

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

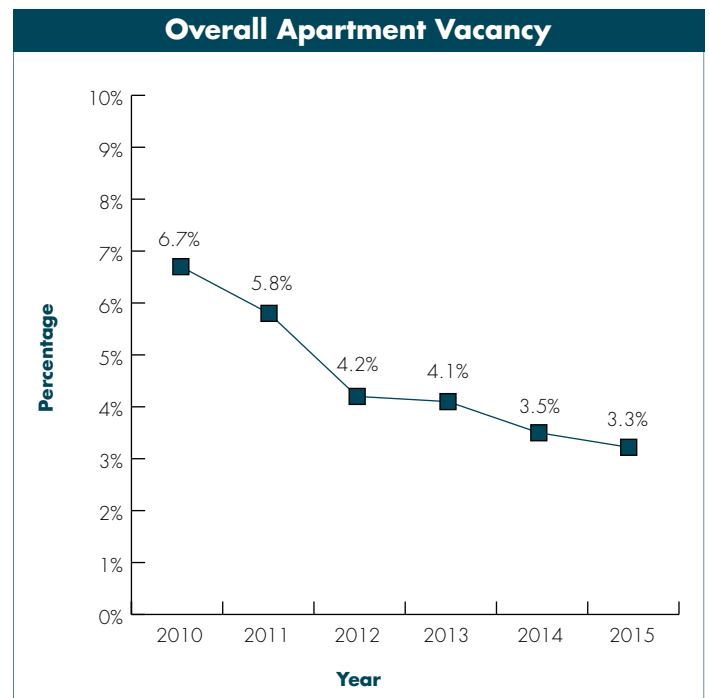


Liberty Park Apartments



Market Forecast

- Many new apartment communities were constructed in 2015 and more are expected in 2016, including a 114 unit low income apartment community in South Spokane.
- Interest rates have risen slightly as projected. This could cause a slight increase in apartment vacancy rates if tenants try to capitalize on the favorable interest rates and purchase their own homes.



Market Conditions

Office:

- The Kootenai County Office Market vacancy dipped below 10% for the first time since 2009 according to the latest survey.
- Based on nearly four million square feet of office product surveyed, 2015 saw roughly 48,000 square feet of positive absorption from 2014.
- Further absorption is needed. However, as positive absorption continues expect to see an increase in rents, and less TI allowances and free rent concessions offered by landlords.
- New office construction continues to be controlled by owner-users, which alleviates some concerns regarding speculative new lease product coming online. This trend will provide some second generation space availability from relocating office professionals.

| Office Market Breakdown | | | |
|-------------------------|------------------|-----------------------|-------------|
| Submarket | Inventory (SF) | Vacant Inventory (SF) | Vacancy |
| Coeur d'Alene | 3,011,748 | 296,938 | 9.9% |
| Post Falls | 553,090 | 71,242 | 12.9% |
| Rathdrum | 24,915 | 0 | 0% |
| Hayden | 367,413 | 24,394 | 6.6% |
| Dalton Gardens | 14,712 | 0 | 0% |
| Totals | 3,971,878 | 392,574 | 9.9% |



Retail:

- New local, regional and national retailers including restaurants and banks continue to show interest within Kootenai County for expansion and relocations.
- Vacancy indicators seem to show a stabilized retail market with consistent positive absorption of 2.2% from 2014 to 2015.
- Market rents continue to fluctuate between newer and/or grocery anchored projects and older retail strip centers (\$8.00-\$24.00, NNN).

| Retail Market Breakdown | | | |
|-------------------------|------------------|-----------------------|-------------|
| Submarket | Inventory (SF) | Vacant Inventory (SF) | Vacancy |
| Coeur d'Alene | 5,096,735 | 227,102 | 4.5% |
| Post Falls | 1,856,107 | 233,116 | 12.6% |
| Rathdrum | 219,649 | 2,000 | 0.9% |
| Hayden | 858,576 | 27,999 | 3.3% |
| Dalton Gardens | 163,627 | 2,000 | 1.2% |
| Totals | 8,194,694 | 492,217 | 6.0% |

Industrial:

- With an already limited county wide supply of product, the Industrial Sector saw positive absorption of roughly 1% in 2015.
- Industrial lease vacancy in Kootenai County has been cut in half since its peak in 2011 and 2012.
- Overall Kootenai County Industrial vacancy is sub 5%, which has led to limited options for interested tenants thus placing landlords in control of seeking upward pressure on rents.
- Well positioned industrial projects with quality amenities and professional management could expect rent bumps in 2016.

| Industrial Market Breakdown | | | |
|-----------------------------|------------------|-----------------------|-------------|
| Submarket | Inventory (SF) | Vacant Inventory (SF) | Vacancy |
| Coeur d'Alene | 1,717,722 | 84,449 | 4.9% |
| Post Falls | 2,708,814 | 137,403 | 5.1% |
| Rathdrum | 422,632 | 35,920 | 8.5% |
| Hayden | 1,243,068 | 41,356 | 3.3% |
| Dalton Gardens | 187,434 | 6,000 | 3.2% |
| Totals | 6,279,670 | 305,128 | 4.9% |

*Market Data Source: Valbridge Property Advisors

LEADERSHIP

Leadership has kept Washington Trust a strong local bank,
anchored in the Inland Northwest since 1902.
It's what makes us the right bank for your business.

watrust.com/business



left to right:
Jack Heath, President & COO
Peter Stanton, Chairman & CEO