KIEMLE & HAGOOD COMPANY

Market Review & Outlook

2017-MID YEAR

OFFICE MARKET

Market Conditions

- In general, leasing activity remains moderately strong throughout the market. Demand continues for higher-quality space while the number of options for space greater than 10,000 square feet is limited.
- While rental rates have not appreciated for existing office product, prices for office development sites have escalated making build-to-suit options increasingly expensive.
- The Greater Spokane area continues to see inbound migration, job growth, and employment growth. All bode well for office space absorption.
- Spokane has seen an increase in interest from technology-oriented companies.
- Investment sales remain robust and are limited only by a lack of supply.

VACANCY ↑

RENTAL RATES ↑

NET ABSORPTION +

Market Forecast

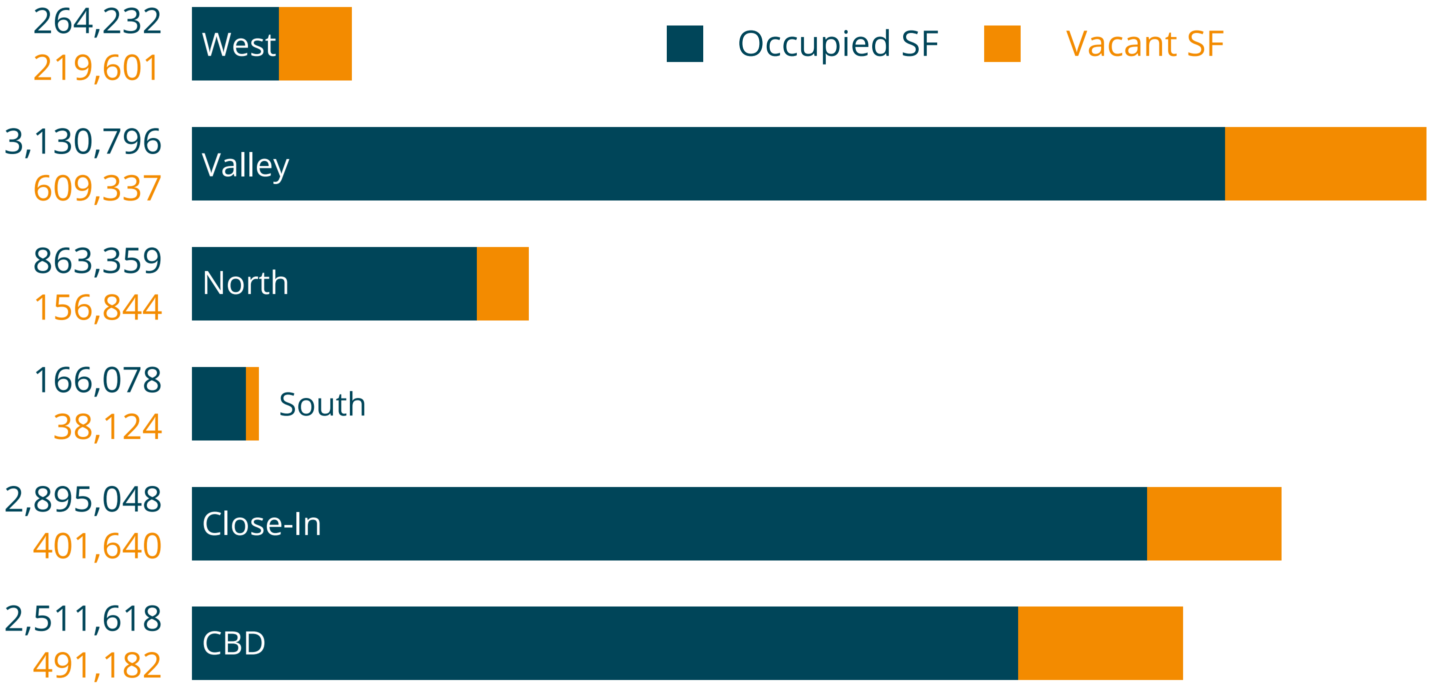
- A number of projects currently under construction will have positive implications for the downtown office marketplace. These include the conversion of the 375,000 square foot former Macy's building to market-rate housing, the $64 million renovation of Riverfront Park, and the construction of the Gateway Bridge in the University District.
- A number of medical related uses have sought space in conventional office buildings in the Close-in and U-District submarkets. This combined with Washington State University's new Elson Floyd Medical School should result in construction of new office/medical office projects in the near future.


Iron Bridge


Downtown Spokane

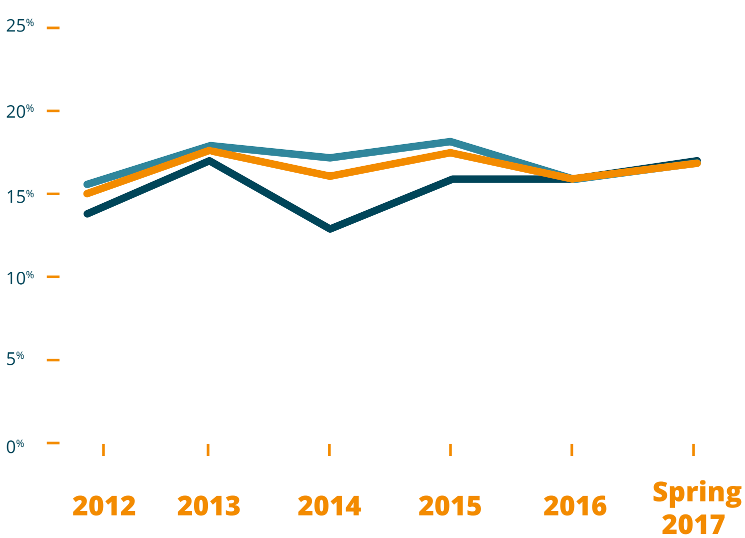
Information provided by
Mike Livingston, Craig Soehren and Erik Nelson – Kiemle & Hagood Company

OFFICE MARKET INVENTORY



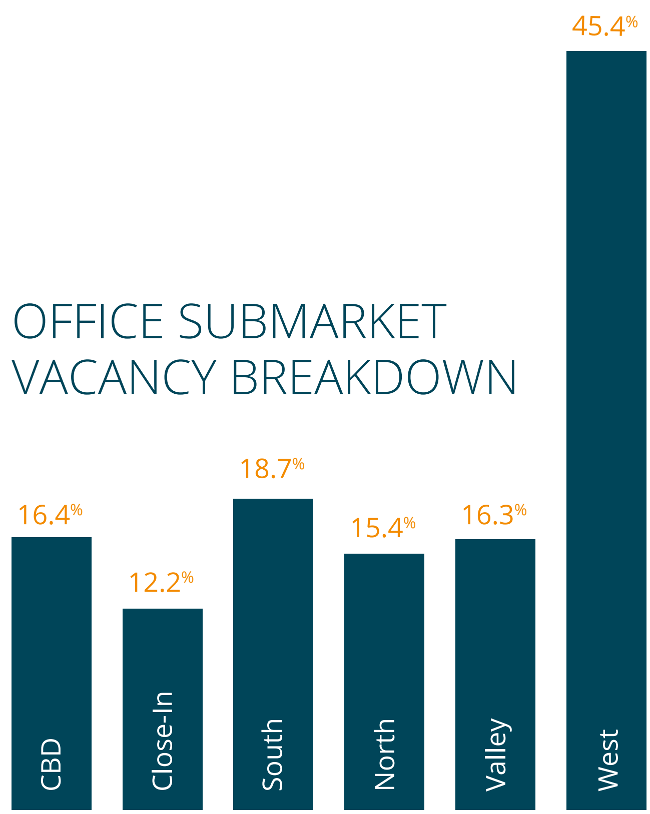
**Market Data Source: Valbridge Property Advisors*

OFFICE MARKET VACANCY



	2012	2013	2014	2015	2016	Spring 2017
Overall	15.0%	17.2%	15.7%	17.0%	15.8%	16.3%
CBD	14.0%	16.6%	13.2%	15.7%	15.6%	16.4%
Suburbs	15.3%	17.4%	16.7%	17.5%	15.8%	16.3%

OFFICE SUBMARKET VACANCY BREAKDOWN



RETAIL MARKET

Information provided by
Colin Conway, Chad Carper and Carl Guenzel – Kiemle & Hagood Company

Market Conditions

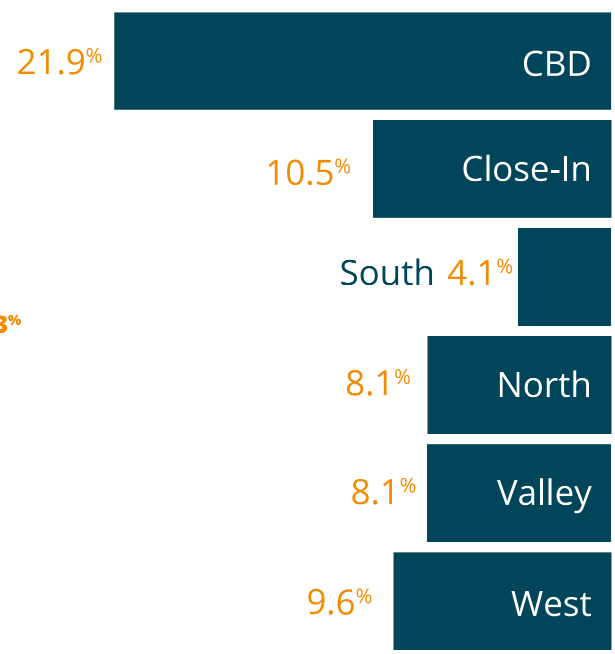
- The overall Retail Market vacancy rate rose slightly from 8.9% at the end of 2016 to 9.3% in Spring 2017. This could be attributed to a harsh winter throughout the Inland Northwest region.
- There are little to no vacancies in Class A locations, forcing the Class B and C market to tighten over the past year.
- A limited number of available investment retail properties have led to a seller's market, lowering cap rates and driving prices up.
- Smaller retail strip centers are being built in North Spokane and Spokane Valley, some of them with less than 50% occupancy at the time of construction. This type of speculative building has not occurred since 2008. With construction prices on the rise, rents in these new buildings are at an all-time high.

Market Forecast

- The South Spokane Market saw a spike in vacancy as it rose from 1.3% in Fall 2016 to 4.1% in Spring 2017. Expect to see vacancy continue to increase as new projects come online within the next 24 months.
- Expect interest rates to rise slightly in the coming months as the market continues to adjust. Significant capital is still available for investment properties, which will hold cap rates at low levels.

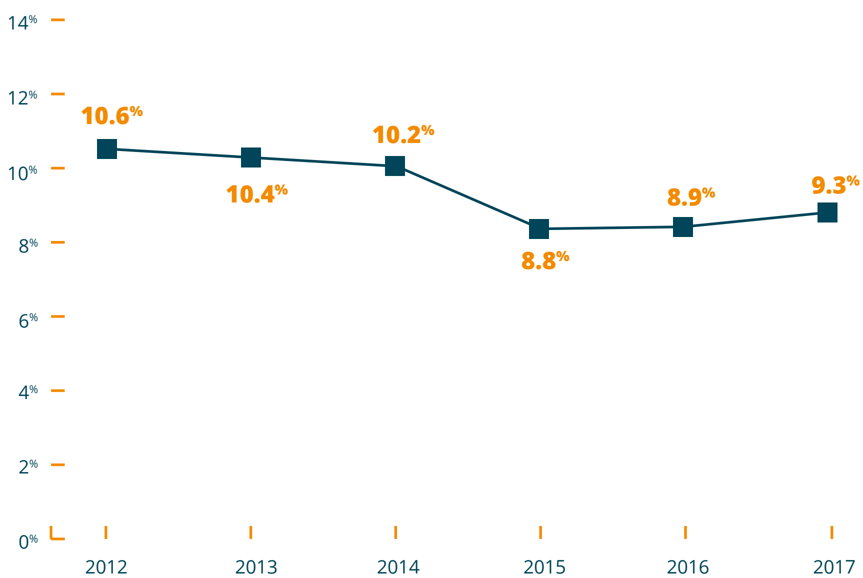
- Spokane's restaurant market has hit an oversaturation point. This combined with the state's minimum wage increase has affected local operators. We anticipate additional closures especially for mom and pop businesses that have felt the greatest impact.
- With recent bankruptcy rumors surrounding some large national retailers, the expansion of new concepts into the market will be limited over the next year.

RETAIL SUBMARKET VACANCY BREAKDOWN



**Market Data Source: Valbridge Property Advisors*

OVERALL RETAIL VACANCY



INDUSTRIAL MARKET

Information provided by
Mark Lucas, SIOR, Tracy Lucas and Tracy Poff – Kiemle & Hagood Company

Market Conditions

- Spokane's Industrial Market vacancy continues to be extremely low at 2.6% overall, with limited space availability throughout most submarkets.
- New industrial space grew marginally by 222,050 square feet and a positive net absorption of 286,552 square feet.
- Only a few new projects came online in 2016, which included the McKinzie Business Park in Liberty Lake, an additional building at Playfair Commerce Park in the Close-In submarket and a few smaller multi-tenant buildings in the North submarket.

Market Forecast

- Expect to see the continuing trend of minimal industrial product availability throughout much of 2017, as limited new projects are currently planned or scheduled.
- As a result of low inventory, we anticipate that rental rates will remain at higher levels.

The industrial market report is offered on a yearly basis.
Data included in this report was completed in December 2016.

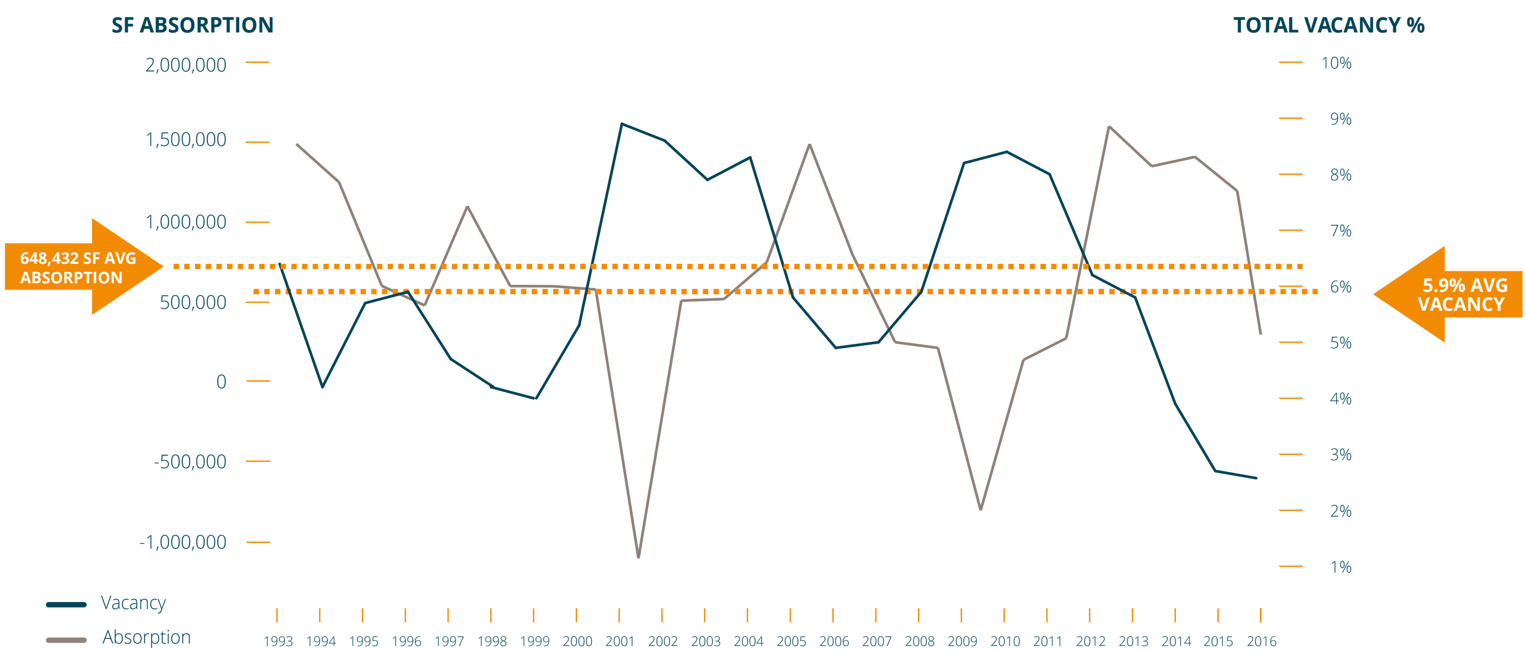
**Market Data Source: Mark Lucas, SIOR and Tracy Lucas*


International Gateway Park

INDUSTRIAL VACANCY BY BUILDING SIZE

Total Industrial Market	2.6%
0 - 5,000 SF	3.5%
5,001 - 10,000 SF	2.2%
0-10,000 SF	2.7%
10,001 - 20,000 SF	3.3%
20,001 - 40,000 SF	2.9%
Over 40,000 SF	1.9%
Spokane Industrial Park	3.0%

INDUSTRIAL MARKET HISTORY



MEDICAL OFFICE MARKET

Information provided by
Ron Horton – Kiemle & Hagood Company

Market Conditions

- The Medical Office Market saw an increase in overall vacancy rates. Vacancy rose from 9.4% in Fall 2016 to 10.2% in Spring 2017. New construction and the uncertainty of the Affordable Care Act (ACA) are factors. Not all market segments are seeing increases. Both the North and the Valley/Liberty Lake submarkets have seen vacancy rates drop in the last few months.

- Rents need to rise to recover increases in operating costs. Class A properties continue to demand top rates, while Class B and C properties struggle to attract credit tenants. Landlords will need to be aggressive by offering attractive tenant improvement allowances and other amenities in the future.

Market Forecast

- The potential repeal of the ACA, and the uncertainty surrounding that is casting a large cloud over the health care sector at this time. Regardless, the real estate fundamentals of the medical office market will remain strong due an aging demographic.

- The implementation of the Site Neutral Payment Rule on January 1, 2017 reduced the payment rate that Medicare & Medicaid pay providers at off-campus sites that started billing after November 2, 2015. This could have a significant impact on health care providers plans for additional off-campus locations.

- Investors will need to understand more than the standard considerations of building class, occupancy and locations. They will need to understand their tenant's future source of payment and how that will impact building cash flows.

- The nature of health care is one of constant change and innovation to meet demands. Properties that align with this evolution should be successful in attracting solid tenants and investors.

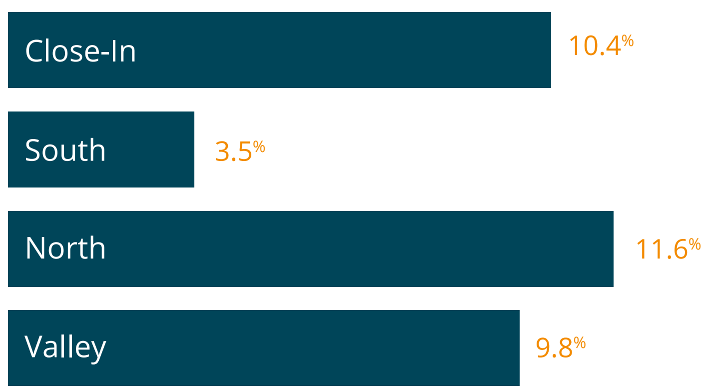
Providence Medical Park

MEDICAL OFFICE MARKET BREAKDOWN

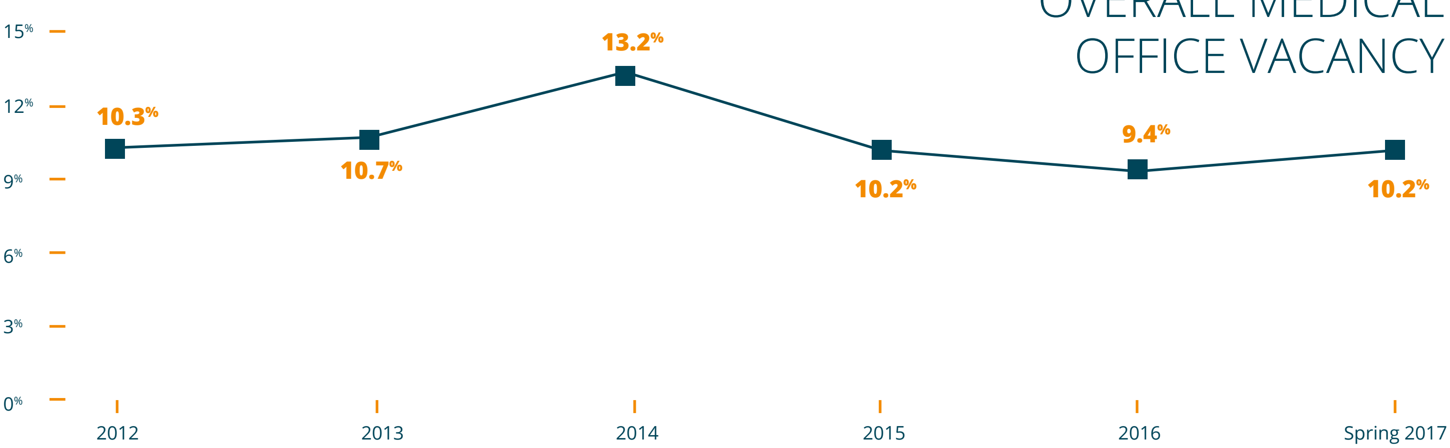
Submarket	Inventory (SF)	Vacant Inventory (SF)	Vacancy
Close-in	1,056,138	110,253	10.4%
South	127,700	4,491	3.5%
North	585,375	67,620	11.6%
Valley/Liberty Lake	710,836	69,821	9.8%

MEDICAL OFFICE SUBMARKET VACANCY BREAKDOWN

**Market Data Source: Valbridge Property Advisors*



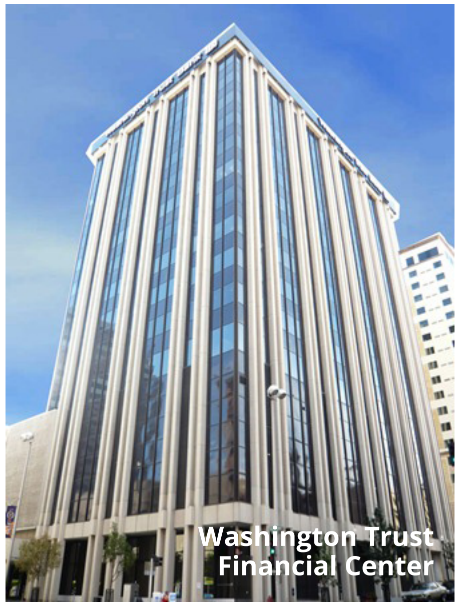
OVERALL MEDICAL OFFICE VACANCY



IMPROVING THE BOTTOM LINE

By Gordon Hester, Vice President

There are a myriad of ways that good property management can improve the financial return on a real estate investment. Providing building tenants with exceptional service can have a significant effect on lease negotiations and improving tenant retention. A deep understanding of the real estate market is equally important when establishing rental rates that are not overpriced to an extent that discourages tenants from leasing opportunities. An evaluation of these items can be subjective, but should be routinely discussed between owners and property managers. A recent assessment of managed industrial properties by our brokerage and management team indicated rents to be 10% lower than the market average. By adjusting rents to the appropriate market level and ensuring common area costs were properly accounted for and recovered, net income to these clients increased by $22,500 annually, while property values increased by $321,000 (a 7% investment return utilized for calculation).



Washington Trust Financial Center

North Town Office Building

Another vital piece to a successfully managed property is controlling operating costs. One important aspect of controlling these costs is through properly managed utilities that take advantage of various technologies and incentives. A good property management company will understand that technology and incentives change frequently and ideas that did not make sense one year could be great opportunities the next. Over the last 18 years, we have worked closely with Avista Utilities to maximize project incentives and energy savings to clients. To date, we have reduced our electricity usage by over 100,000,000 kilowatt hours, saving over $7,000,000 in electrical charges. Kiemle & Hagood also works closely with Resource Synergy to evaluate refuse costs and recycling opportunities. This partnership has resulted in reducing our refuse cost by $145,746 per year, reduction of 44% on average across our management portfolio. The revenues gained by implementing this program has increased their property values by $2,082,000, using a 7% investment return.

Understanding vendor contracts can also make a large impact on the success of a real estate investment. As an example, janitorial contracts should be managed to a proper cleaning specification that ensures quality and appropriate pricing. In a recent review of cleaning specifications for four managed buildings, we were able to reduce the janitorial expense by $42,930 per year, while also improving the cleaning schedule to enhance tenant satisfaction.

Good management also focuses on curb appeal, preventive maintenance, capital planning and meeting the owner's investment needs. Consistent oversight of all facets of the property and good communication with the client is the highest priority for Kiemle & Hagood Company.

Flour Mill

We welcome the opportunity to discuss your property management needs. For more information, please visit

khco.com/property-management

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CUSTOMER DRIVEN.
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K&H FACILITY SERVICES

Our Mission is to provide comprehensive facility operation, maintenance and repair to all types of properties through professional technicians, efficient and cost-effective operations and comprehensive maintenance, which will enhance the value of the property owner's investment.

Our List of Services

- Comprehensive Preventative Maintenance Programs
- On-Site Facility Technicians with Internet Based Work Order Dispatch
- System Life Cycle Management/ Planning and Energy Management Systems
- HVAC System Management
  Full Service and Repairs on all Types of Equipment
- Consulting & Analysis
  Mechanical System Re-Commissioning, Energy Audits, Energy Efficient Systems
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- Indoor Air Quality
  System Evaluation, Management of Industrial Hygienists, Planning & Prevention
- Control Systems
  Direct Digital Control (DDC), Pneumatic Controls, Calibration and Repairs, Upgrades and Integration
- Life Safety
  Oversight and Maintenance

Office Locations

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