Bender
COMMERCIAL

MID-2017
SIOUX FALLS, SD
MARKET OUTLOOK REPORT

Bender Commercial Real Estate Services

122 South Phillips Avenue, Suite 350

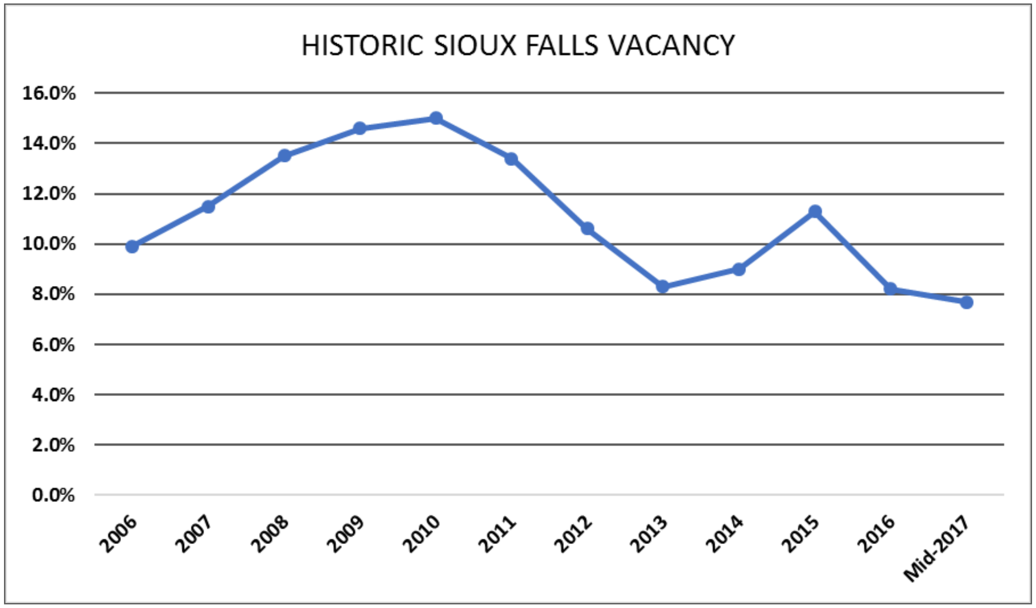
Sioux Falls, South Dakota 57104

(605) 336-7600

www.benderco.com

Bender
COMMERCIAL

OFFICE MARKET
ANDI ANDERSON, SIOR



By midyear of 2017, Sioux Falls entire office market consisted of approximately 14,460,989 square feet of space. This figure includes both owner and non-owner-occupied buildings. However, buildings that are entirely leased by an owner do not truly affect the market's rental rates, hence it is removed in this report when examining the market. This criteria left 7,774,359 square feet of tenant-occupied space, an increase of over 45,000 square feet in the past six months. The overall vacancy of the Sioux Falls office market decreased from 8.2% at the end of 2016 to 7.7% by mid-2017.

Central Business District. The CBD added 23,000 square feet to it's inventory due to the availability of new lease space in the Argus Leader building. This segment did see over a percentage point decrease in its vacancy rate, from 6.8% to 5.7%. The asking lease rates in this market remained steady at approximately $12.00 per square foot triple net.

Suburban Market. The suburban market's inventory increased by approximately 23,000 square feet. Seven newly constructed buildings ranging from 3,000 to 10,000 square feet were responsible for 75% of this increase with the remaining caused by two conversions from owner-occupied to tenant-occupied. The conversions brought with it new vacant space, however this segment still had a slight decrease in its vacancy rate from 8.9% to 8.5%. The average asking rate for Class A space remained consistent at $13.00 per square foot triple net, while the Class B/C space increased slightly from $11.00 to $11.35 per square foot triple net.

OFFICE MARKET SURVEY RESULTS

	CBD	CLASS A CBD	CLASS B/C CBD	SUBURBAN	CLASS A SUBURBAN	CLASS B/C SUBURBAN	TOTAL
INVENTORY	**2,349,937**	691,399	1,658,538	**5,424,422**	1,616,419	3,808,003	**7,774,359**
VACANT SPACE	**134,238**	5,660	128,578	**461,115**	155,463	305,652	**595,353**
VACANCY RATE	**5.7%**	0.8%	7.7%	**8.5%**	9.6%	8.0%	**7.7%**
NET ABSORPTION	**46,409**	(5,660)	52,069	**40,755**	24,870	15,885	**87,164**
ASKING AVERAGE RENTAL RATE (NNN)	**$12.00/SF**	$16.00/SF	$12.20/SF	**$11.30/SF**	$13.00SF	$11.35/SF	**$11.40/SF**

Bender COMMERCIAL

RETAIL MARKET

REGGIE KUIPERS, SIOR

At year end, I predicted the retail sector was at its peak. We sensed we were pushing in to hypersupply in the economic cycle but hadn't seen the fundamentals to back that up. At mid-year 2017, the metrics of the fundamentals show we are now in the beginning stages of hypersupply. We have high new construction, rising vacancy rates, and low rental rate growth. The last time we were here was 2007. If the fundamentals hold true, we should experience an economic correction in the next few years in the retail sector.

Retail remains in transition. Most retailers are focusing on experiential shopping, giving the consumer something unique to sway them from purchasing on-line. Many investors in the retail sector are focused on products, services and market segments that Amazon and other online retailers will have difficulty disrupting.

Areas to watch:

Lake Lorraine: WOW, did that development take off fast! In the last year, senior housing, office and several junior box retailers have been constructed. Furthermore, Sioux Falls Ford has opened. Tires, Tires, Tires and SilverStar Car Wash have purchased land from St. Michael's Catholic Church and will open for business in the next year. The retailers simply prefer the infill sites as opposed to the suburban sprawl developments. I'd look for additional construction and activity at Lake Lorraine in the next 12 months. At our Market Outlook event, we warned that the 18.1% vacancy rate wasn't telling the entire story. It was simply a new development in transition and six months later, Lake Lorraine (26th and Marion) is at 13.4% vacancy.

Dawley Farm. Dawley Farm remains an attractive option for a suburban sprawl retail development. Many retailers are waiting for additional residential housing to surround (and support) the new retail. With the opening of PetSmart, the development is still adding junior box users and is poised for continued growth.

85th & Minnesota. New construction in 2017 includes the Sioux Falls Specialty Hospital and Valvoline. Hardee's purchased land in early 2017, but has recently decided against the site and has put it back on the market. Due to the Walmart effect of driving traffic, I'd look for more announcements in the area in the next 12 months.

Predictions:

- Retail investment transactions will increase in the next 12 months The developers and owners (smart money) sense some oncoming headwinds and will take some money off the table while the interest rate environment is low and the demand for retail is still high.
- More Big Box Availability? In the latest announcements of closures, Sioux Falls escaped losing JCPenney, Sears and Macy's. However, I wouldn't be surprised to see one or two of them vacant in the next 12 months.
- Vacancy will continue to increase. Since year end, we've seen vacancy spike up from 5.8% (year-end 2016) to 9.0% in mid-2017. A slight economic correction would spur several more vacancies across the retail sector.

RETAIL MARKET SURVEY RESULTS

SECTOR	TOTAL SF	VACANCY RATE	ASKING PRICES (NNN)
Mall Area	562,154	11.8%	\$12.00 - \$30.00/SF
57th Street & Louise Avenue	164,328	3.1%	\$17.00 - \$24.00/SF
57th Street & Western Avenue	92,774	9.%	\$15.00 - \$17.00/SF
Dawley Farm / East Sioux Falls	187,389	4.0%	\$14.00 - \$24.00/SF
69th Street & Western Avenue	53,985	13.6%	\$14.00 - \$16.00/SF
69th Street & Minnesota Avenue	64,462	-	\$14.00 - \$16.00/SF
26th Street & Marion Road/Lake Lorraine	112,471	13.4%	\$12.00 - \$17.00/SF

TRENDS TO WATCH

RENTS ↔

CONSTRUCTION ↑

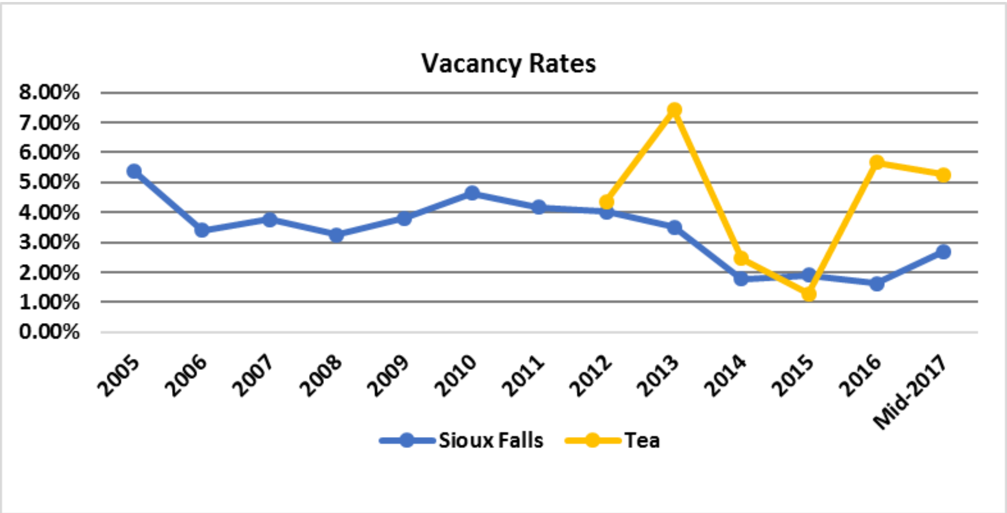
VACANCY ↑

SALES ↑

INDUSTRIAL REPORT
ROB FAGNAN, SIOR

By definition, the industrial market is made up of those properties used for manufacturing, warehouse, distribution, transportation, and a large part in this area, contract shops. Our survey encompassed 791 properties equating to over 16.8 million square feet of space in Sioux Falls and 328 buildings making up nearly 2.69 million square feet in Tea. In contrast to the office market, both owner and tenant-occupied space are included in our survey. Of the nearly 16.8 million square feet in Sioux Falls, 67% is owner-occupied. The remaining is either tenant-occupied or vacant. In Tea, owners occupy approximately 70% of the 2.69 million square feet. The economics of the Tea market make it easier to own your own building.

Vacancy. At the beginning of 2017, the Sioux Falls industrial market had 273,813 square feet of vacant space. At the time, the market was absorbing space at a rate of 1,452 square feet per day, which equated to about a 6-month supply. At midyear, the Sioux Falls vacancy rate was 2.7% (454,564 square feet), up slightly from 1.64% at year-end. Tea's industrial market had 141,584 square feet of vacant space equating to a vacancy rate of 5.26% at midyear, slightly down from 5.6% at the beginning of the year.



Industrial Sales. There has been a total of ten (10) industrial building transactions recorded at Minnehaha County during the first six months of 2017. These ten (10) sales are down about 30% from 2016's midyear report. Watch for these sales to finish the year with 18-20 total transactions. The big sale thus far has been the $18,730,490 sale of the Amesbury Truth's new property to Cole Capital.

Lease Rates. Lease rates have remained stable throughout the first half of the year. New construction asking rates increased by about $0.25 per square foot. Class B and C rates have leveled off as the supply of available space increases. I predict this trend will continue throughout the remainder of the year.

PROPERTY CLASS	LOW ASKING RATE (NNN)	HIGH ASKING RATE (NNN)
Class A	$5.75/SF	$7.00/SF
Class B	$4.50/SF	$5.50/SF
Class C	$3.25/SF	$4.25/SF

New Construction. 2017 is off to a great start. The total number of new building permits issued by midyear is up to thirty-eight (38), five of which are additions. This is more than double the number of permits for the entire year of 2016. This adds a significant amount of square feet to the market. The major project to be constructed this year is Gage Brothers' new $40 million state-of-the-art manufacturing facility near the intersection of I-229 and Benson Road. This 210,000 square foot facility will be situated on 45 acres.

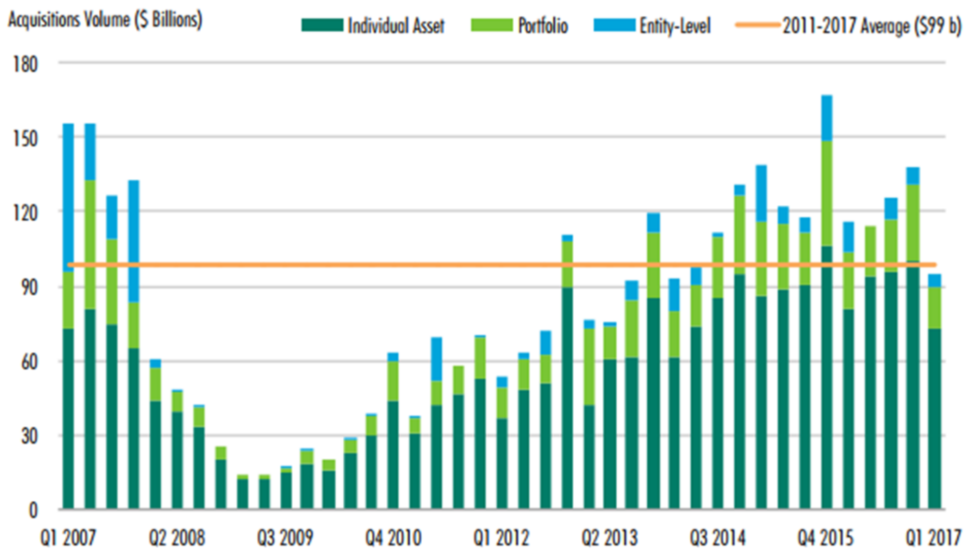
The speculative market had positive absorption in 2016. Due to increased activity and the limited supply of space, investors are adding additional supply to the market in 2017. Thus far, four (4) buildings - ranging from 6,000 to 12,000 square feet - are being built on spec, which is the most the market has seen in over ten years. A similar trend is taking place in the Tea market, with six (6) new spec buildings being added in that market. As supply continues to increase, watch for new construction projects to slow by year's end.

INVESTMENT REPORT
NICK GUSTAFSON, CCIM

Macro Conditions

Investors have been on a wild ride so far in 2017. Despite political dysfunction in Washington and a general sense of increasing geopolitical instability, equity markets have been on a tear. The Dow Jones Industrial Average and the S&P 500 are firmly into double digit percentage returns for 2017 at the time of this report. It appears that interest rates will continue a slow, steady march upwards but will remain in a historically low interest rate environment for the next several years.

Figure 2: Historical U.S. Commercial Real Estate Acquisitions Volume



Source: CBRE Research, Real Capital Analytics, Q1 2017.

Global commercial real estate investment was down 9.8% in Q1 of 2017 and U.S. Commercial real estate investment transactions were down 18.3% as well. Pricing has remained stable. While these declines are somewhat concerning they are well above long-term historical averages and reflect a repricing of risk rather than a true drawback in investor appetite.

Sioux Falls Conditions

Investor demand continues to outstrip supply in our market. Very few investments appear on the open market at market prices. Many properties are sold quickly off-market after being listed and sellers are often approached by able and willing buyers unsolicited. This environment has had a downward pressure on capitalization rates and has pushed asset prices higher than the previous market peak in 2007.

Two emerging trends are starting to appear in spite of the conditions outlined above:

1) Investment property owners sense that we are at an inflection point in asset valuations and investor demand. I predict over the next year we will see an increasing number of investment property transactions as property owners look to take profits at a perceived market peak.

2) Investors remain bullish but are becoming wary of overpaying for assets. Local investors continue to be well capitalized and are taking advantage of historically low interest rates. However, there is a general sense that asset pricing is nearing a top and this is fueling a greater sense of price sensitivity.

Transaction volume will increase substantially, while pricing will remain relatively stable over the next 12-18 months.

Multi-Family. Developers have aggressively developed new multi-family properties in Sioux Falls since 2011, far exceeding previous development records. Earlier this year in our annual Market Outlook, we reported that this aggressive building was finally starting to have upward pressure on vacancy rates. Over the next six months we will have clarity on this trend and investor reaction. Currently, Sioux Falls is on target for similar transaction volume as in 2016.

Office. The office market is lagging 2016 in sales volume, pacing at a notable rate. At mid-year, we are approximately at 30% of 2016 year-end transactions. I predict there will be a healthy surge of year-end transactions, but it will fall short of the average 2013-2016 volume.

Retail. Retail transactions are on a healthy pace and are on point to top 2016. It will likely be the second highest year on record. Development and leasing fundamentals continue to give investors confidence.