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West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

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After a depressing year in 2009, the West Michigan commercial real estate market saw many signs in 2010 to suggest that the long road to recovery had begun. Sales and leasing activity of commercial property has increased and, in general, pricing and vacancy rates are stabilizing. Specifics will vary based on each specialty type (Office, Industrial, Retail, Investment), but there is a positive outlook on the market heading into 2011. As the overall economy and employment rates continue to make gradual improvements, so too will the commercial real estate market.

Industrial

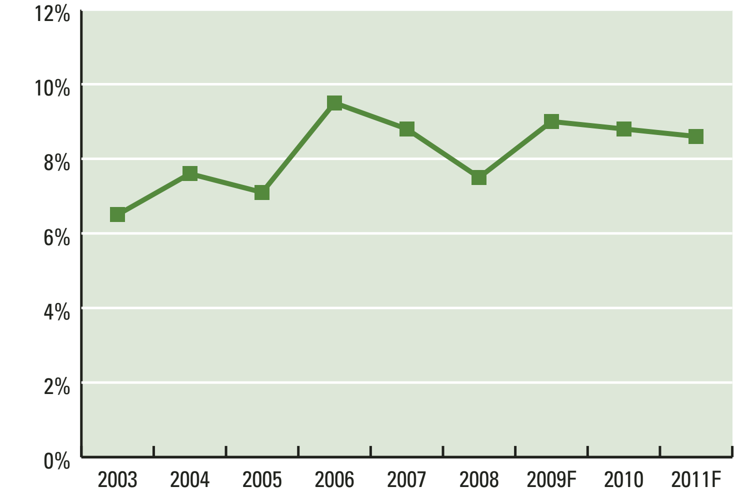
The Grand Rapids industrial market ended 2010 with encouraging statistics compared to the unsightly year of 2009. Year-to-date net absorption for the overall West Michigan industrial market at the end of 2010 was a positive 236,696 square feet. That compares to a negative 1.7 million square feet of absorption in 2009. Last year our forecast predicted the 2010 West Michigan industrial market would again have a negative absorption number so any number above zero comes as welcomed news. For 2011 we foresee continuing positive absorption in all industrial areas, particularly in manufacturing facilities.

As was the case in 2010, do not anticipate any new construction of warehouse or distribution buildings in 2011 as years of supply currently exist for this property type in the Grand Rapids market. The only new construction potentially occurring in the next year would be for user specific manufacturing facilities because of the lack of quality product in West Michigan. Due to the high cost of new construction, another trend that will likely continue is the rehab of existing manufacturing buildings.

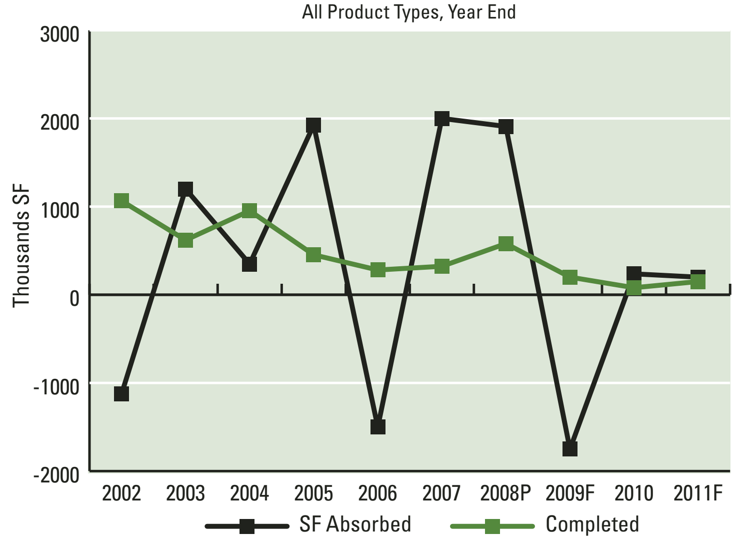
The industrial real estate market in West Michigan ended the fourth quarter of 2009 with a 9.0 percent vacancy rate; that rate decreased over the last year to finish 2010 at 8.8 percent. Along with an overall decrease in vacancy for the market, another positive sign over the past year is rental rates are beginning to stabilize. Leasing activity has improved which helped to drive the average asking rental rate 4.3 percent higher in 2010 compared to 2009. Looking into 2011, expect these statistics to continue to recover, albeit at a measured pace.

Leasing velocity has increased over the past year as well as the average size of each transaction. According to our data, the average size of an industrial lease in 2009 was 8,129 square feet, and in 2010 that number increased to almost double at an average of 16,045 square feet per lease. Some of the largest lease transactions that took place in the market include the 164,349 square foot lease signed by Gilson Graphics at 2000 Oak Industrial Drive NE in Grand Rapids and 224,000 square feet leased at 4247 Eastern Avenue SE by Undercar Products.

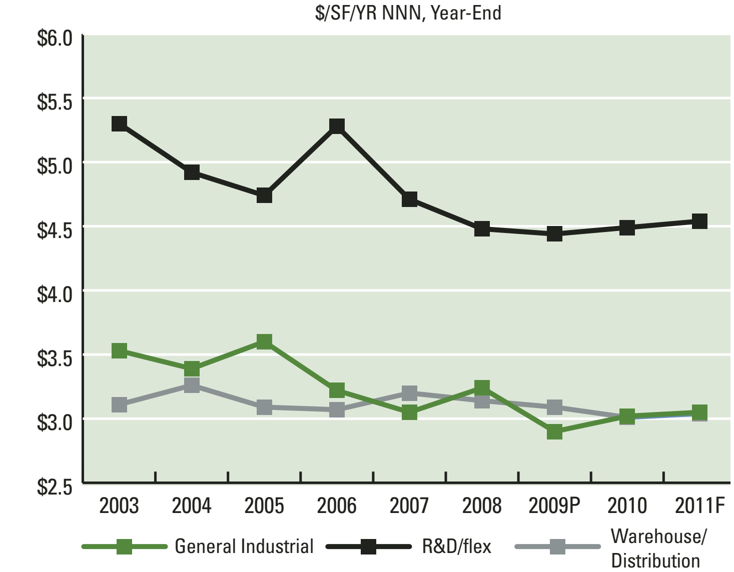
Vacancy Rates
All Product Types Year End

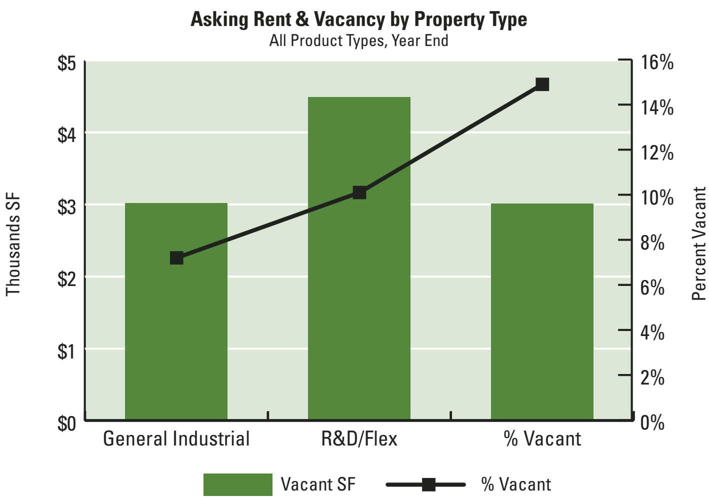


Absorption vs. Completions
All Product Types, Year End



Asking Rental Rates
$/SF/YR NNN, Year-End





In 2011, lease prices will remain stable but tenant directed incentives will begin to decrease. Also expect to see leases slowly progress to longer term lengths in the next year as business confidence increases.

From a sales perspective, our professionals are seeing well located Class A industrial properties with solid infrastructure selling at improved pricing. A great example of this is the sale of 5801 Clay Avenue SW in Wyoming which is a 53,472 square foot building that sold for $25.70 per square foot. On the other hand, distressed buildings that are outside of the major industrial hubs are selling for dramatically decreased prices. The declined pricing caused for some noteworthy deals that took place in 2010 including the 222,800 square foot user purchase of the former Nicholas Plastics building at 11700 48th Avenue in Allendale that sold for $15.91 per square foot. Other examples of this trend are 870 74th Street SW in Byron Center which is a 48,575 square foot building that was purchased for $18.53 per square foot, as well as the 53,000 square foot building at 2310 Breton Industrial Park Drive SE in Kentwood that sold for $7.26 per square foot.

Expect to see sale prices of quality product rise to “normal” highs comparable to that of 2005, but not to the unusually high levels of 2007. We predict that banks will continue to dispose of Real Estate Owned (REO) properties on their books and will take a significant loss on anything besides their Class A assets. For 2011, it will seem as almost two separate markets exist as the Class A asset market improves and REO and Class C properties continue to struggle.

Almost 2 percent of the over 114 million square feet of industrial property in West Michigan may soon cease to exist as the former GM Metal Fabrication Division at 300 36th Street SW in the Wyoming could possibly be torn down for redevelopment. The plant has produced stamped-metal parts since 1935, until its closing in May of 2009. The Obama administration proposed a trust fund of more than $800 million to pay for the clean-up and potential demolition of several closed General Motors sites in 14 states which includes the plant on 36th Street in the Grand Rapids area. It has not yet been determined whether the plant will be knocked down but it is highly unlikely someone will want the nearly 2 million square foot building in its current configuration. A number of redevelopment possibilities remain as the City of Wyoming continues to work with consultants on a reuse plan; however, it is anticipated that the site will remain primarily industrial.

West Michigan is widely viewed as having the best combination of access to manufacturers, labor aptitude and cost, as well as entrepreneurial talent to support the next decade of production. Because of this positive outlook of our area, we anticipate that insourcing will be a trend for West Michigan going forward. Expect the Grand Rapids industrial market to be driven by the manufacturing of automotive, medical, office furniture, food and other consumer products in 2011.

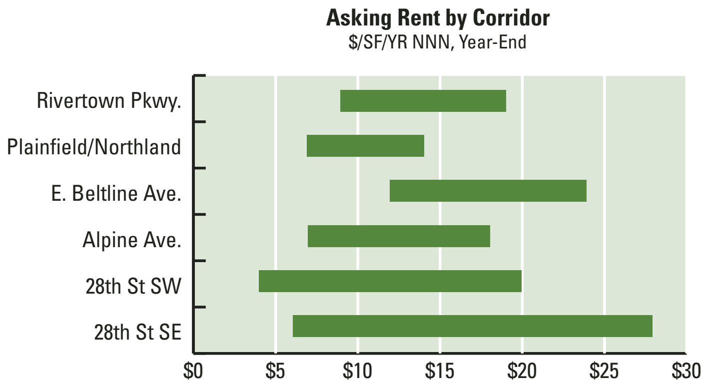
While the industrial real estate market in West Michigan continued to languish during 2010, increasing evidence does suggest that the worst is over. Businesses were still largely wary of taking additional space, but the move by tenants to vacate space has mostly dissipated. The key industrial economic measures are still in expansion mode, although at a slow rate of growth. The local economy will push ahead with the national economy into 2011 in a positive, yet restrained direction. We will see vacancy rates as well as asking rents stabilize and the intense competition for tenants will continue.

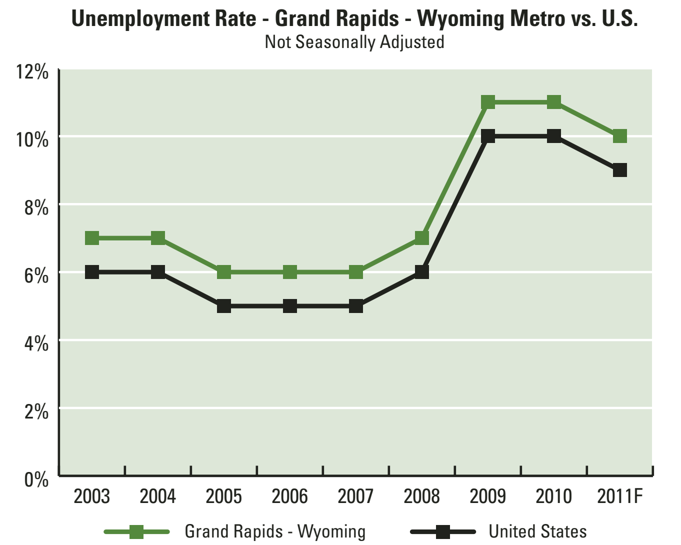
Retail

The West Michigan retail market has taken a hit recently due to decreased consumer spending over the last few years. The current economic recession had 8.4 million jobs lost nationally versus the 1.6 million lost in the recession of the early 1990s. However, economists see light at the end of the tunnel; national unemployment at the end of the third quarter was at 9.6 percent and many expect that to be reduced to 8.8% by 2012. Even with the struggling economy, the overall retail market in the Grand Rapids area saw encouraging signs as the total vacancy rate dropped from 12.6 percent in 2009 to 11.5 percent in 2010. It will remain a slow recovery for the local retail market but the statistics at the end of the year show positive momentum going forward.

It is still taking longer to lease vacant retail space in West Michigan because many smaller tenants are in a holding pattern due to the economy, and several national retailers remain concerned about the Michigan market. In order to secure tenants, owners are still offering several months of free rent as well as reduced rent. One bright spot is that a number of lower price point retailers are leasing space in stronger retail areas because they can now afford the improved location with the lower rents being offered, thus reducing the vacancy rates. In West Michigan, as well as nationally, leasing is still being dominated by discount retailers. In 2010 some of the most active companies in the retail market were Dollar Tree, Big Lots, Dollar General, Goodwill Industries and Family Dollar. Dollar General planned to complete 600 new stores nationally in 2010 alone, while Dollar Tree had estimated their 2010 total national units at 235 before the end of the year. In aggregate, we saw dollar store chains add close to 1,500 new stores nationwide in 2010.

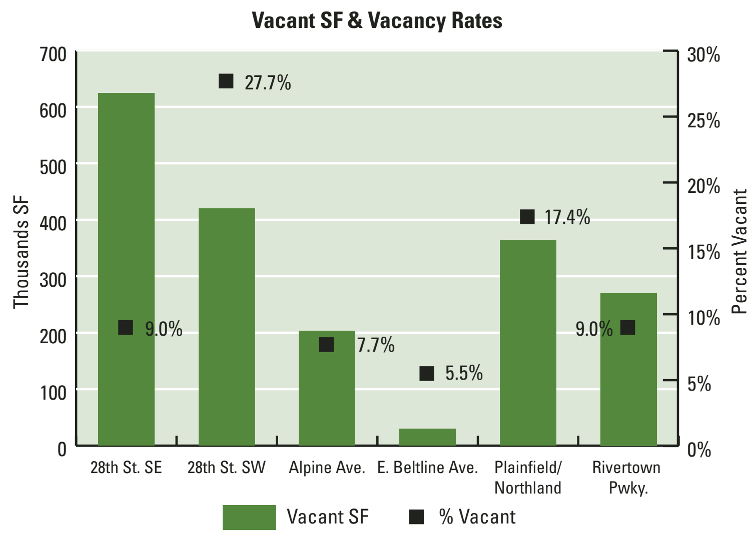
Auto parts stores are also strong locally with stores like AutoZone and O’Reilly Auto Parts signing new leases and



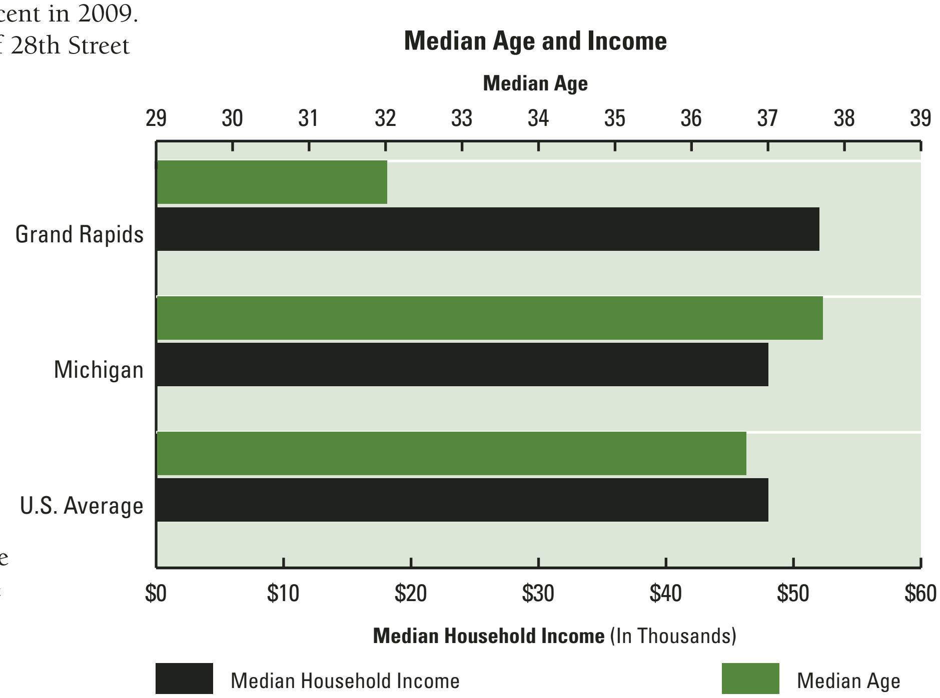


purchasing sites in the West Michigan market in 2010. The cell phone boom is another segment that continues to do well in this economy as providers such as Sprint, Verizon Wireless, Metro PCS and AT&T Wireless grow their presence in our area.

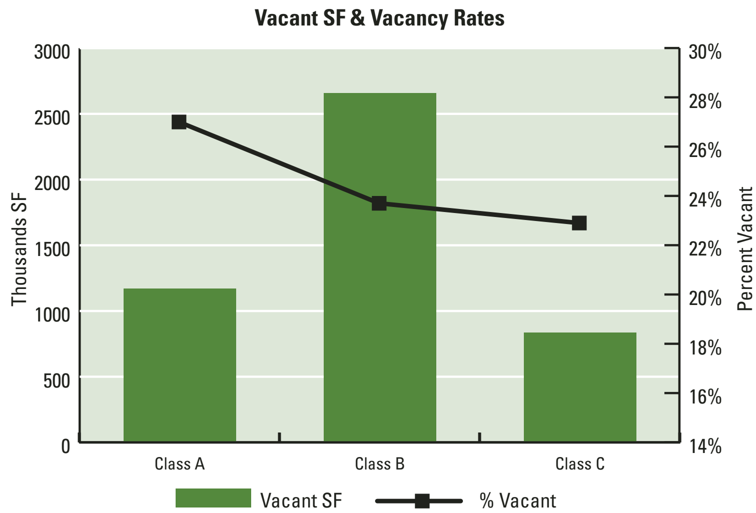
Growth is also coming from retailers who are increasingly willing to experiment with their footprint templates to take advantage of deals and to cash in on more vibrant urban markets. Meijer, Walmart, Cabela's, Costco, Petco, Target and numerous restaurant chains are all experimenting with smaller footprints. From a restaurant perspective, there is increasing activity in the fast food/fast casual restaurant arena. One example in West Michigan is Brann's Restaurant & Sports Grill that has approved its first franchise location on M-37 in Caledonia. Nearly every major operator in this field is counting on franchise growth to fuel expansion plans in the coming years. To accomplish this, many chains are dropping their initial capital requirements to attract new franchisees, as the biggest hurdle continues to be acquiring financing.

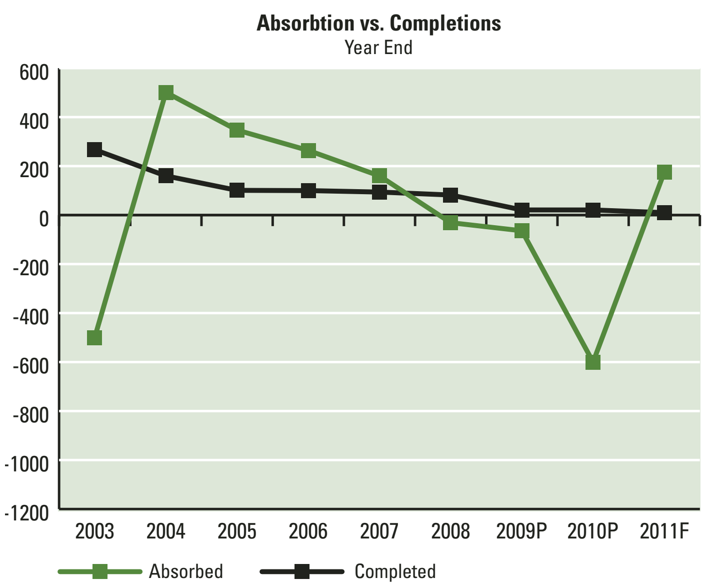


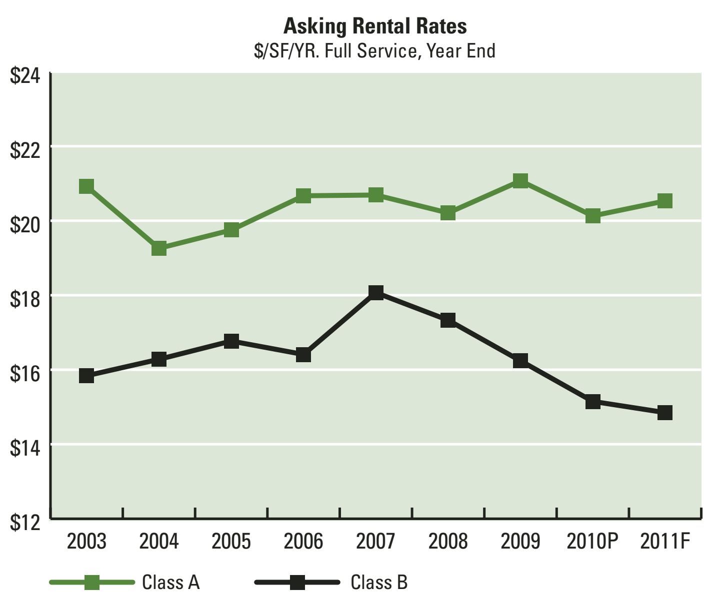
It remains to be a tale of two cities for 28th Street in the Grand Rapids area. The typically strong Southeast corridor of 28th Street saw a decrease in vacancy over the year as the rate dropped 9.0 percent compared to 11.3 percent in 2009. On the opposite end, the Southwest corridor of 28th Street saw its vacancy rate increase even further from its 2009 figure of 25.7 percent to 27.7 percent at the end of 2010. The two large closings that hurt the vacancy rate dramatically last year, Studio 28 and Classic Chevrolet, remain vacant and have not finalized any plans for reuse. Additional big box vacancy was caused by the closing of Klingman's Furniture and the continual struggles of Rogers Plaza.



By far the largest improvement in overall activity was in the East Beltline corridor as the area saw its retail vacancy rate drop by 4.2 percent compared to 2009. The Rivertown corridor and Alpine Avenue, two other major retail areas in Grand Rapids, saw slightly mixed results over the past year. Rivertown saw its vacancy rate increase from 8.5 percent in 2009 to 9.0 percent in 2010, while the Alpine corridor had a decrease in vacancy of 1.6 percent dropping it to 7.7 percent at the end of 2010. The Plainfield Avenue/







Northland Drive submarket remained the same as in 2009 at a 17.4 percent vacancy rate.

With the beginning signs that the retail market is firming up, landlords will not be as desperate as they have been in recent years. The sole focus on maintaining occupancy at any cost is waning, and short term deals are becoming more rare. Department store sales are increasing which will cause more traffic in the centers they anchor and help non-anchor retailers that may be struggling as a by-product. The success of junior retailers is on a case-by-case basis as some increase their market share and others close their doors.

Expect to see the 2011 retail vacancy rate improve slightly in West Michigan. After a flurry of retail tenants closed their doors and left vacant space in West Michigan, the bleeding is beginning to subside. The big black X's are finally lifting off of the State of Michigan for many retailers, but there will be little to no new retail development in 2011 and most likely into 2012. The majority of new tenants will be backfilling currently existing vacancies in the market and there will be a slight upward pressure on lease rates.

The long-term future of retail remains bright due in part to the age of our area's population. The median age for a Grand Rapids resident is 32 years old, which compares to a median age of 38 for the entire State of Michigan and 37 on a national basis. This means that West Michigan will have a larger number of shoppers in their prime spending years for a longer period of time.

Office

The West Michigan office market saw some positive signs in 2010 after a few dismal years caused by the struggling economy. Without raising expectations to unrealistic levels, the results over the past year suggest the office market has begun what will almost certainly be a very long and slow road to recovery. Even though the market saw an overall increase in vacancy, the data alone can be misleading. As confidence in the economy began to increase slightly, leasing activity in 2010 increased as well. The increase in vacancy can be attributed to large blocks of space that became vacant in 2010 like the Israel's campus, as well as many occupiers using office space more efficiently. With the local economy posting reasonable growth and the addition of more private sector jobs, the West Michigan office market is expected to improve in 2011, albeit only in small increments with no sudden surge anticipated.

Suburban office buildings have been hit the hardest with occupancy not supporting the mortgage values. Some building owners have lost their equity and their passion for maintaining the asset leading to the negative values seen in the less than desirable locations. A number of examples exist where the value of the property is no greater than the land it is setting on. These tend to be Class C properties, but the general trend in the Suburban market is sub replacement value. This affords new owner users the opportunity to acquire property, upgrade it to fit their needs, and secure financing as the banks are still favoring these types of loans.

Rental rates for the suburban office market have not yet bottomed out, and it is expected that rates will continue to decrease slightly into 2011. Landlords of these properties continue to provide larger tenant improvement packages and other incentives to lease up their buildings. These outlying submarkets have been hurt by tenants leaving the suburbs to take advantage of attractive rates in Central Business District (CBD) office properties. However, a positive sign for the suburban office market is that tenants are beginning to sign longer term leases instead of short-term or month-to-month leases. It is anticipated that the suburbs will lag behind the stronger CBD market.

There are many key indicators that support the view that the CBD office market has hit bottom and is improving. Downtown tenants are also executing longer term deals compared to the last two years where a majority of the leases executed or renewed were short-term leases; there has been a sharp uptick in five, seven, and ten year terms. Tenants are taking advantage of the low lease rates, and the belief that over the next year and a half rental rates will rise as the economy strengthens and more office space is absorbed. There is a definite upsurge of confidence in the long-term success and growth of downtown, spearheaded by the philanthropic nature of our Grand Rapids community and its leaders.

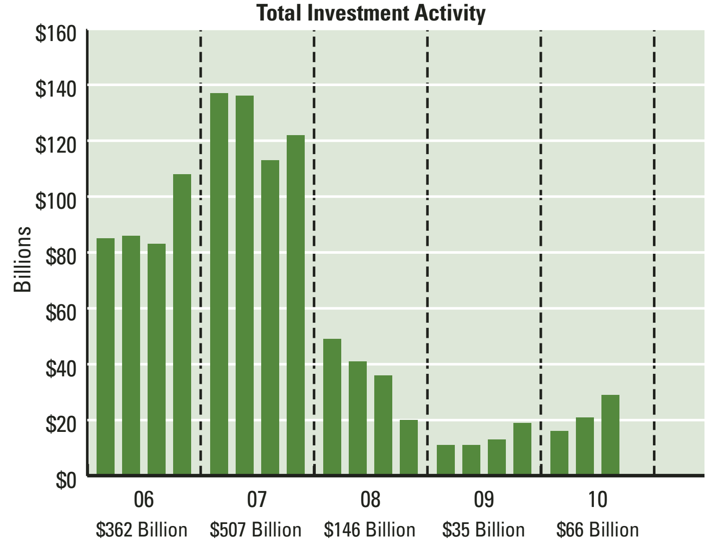
In general, downtown companies have downsized and reevaluated how they do business and how to utilize their office space. Companies have been able to upgrade to newer, less costly, and superior located space. Several well located office buildings south of the entertainment district are at 100 percent occupancy. This encouraging sign reinforces the fact that demand is increasing, and buildings are once again beginning to fill up.

The success of new construction projects like 38 Commerce gives additional hope that the worst of the economy is behind us. The idea that new development is happening is a great sign that the market has hit bottom and the office market is improving. There has recently been an increasing market presence in the downtown area from key companies like Meijer, Amway, Steelcase, Wolverine World Wide, and universities such as Michigan State, Davenport, GRCC, Grand Valley, Ferris State, Kendall and Western Michigan. Restaurants and other entertainment venues have continued to expand downtown and that should be the harbinger to more people living downtown.

Empty-nesters and young professionals are actually creating waiting lists at some of the apartment and condominium projects in the downtown area. Leading the way in filling downtown housing are healthcare professionals, drawn to downtown by the recent medical development, and college students, who are attending one of the various universities. Many Class C office buildings have been converted to residential, eliminating functionally obsolete office space and providing for a more attractive urban core going forward. Many people are taking advantage of the live, work, play environment that downtown provides.

Expect rental rates for downtown office space to stabilize in 2011, while the suburban market will continue to decrease slightly for the next year. Overall, the number of transactions will increase with users realizing that the market has bottomed out and that now is the time to act before prices increase. Landlords will begin to tighten up and hold their ground on incentive packages as the demand for space increases.

Total Investment Activity

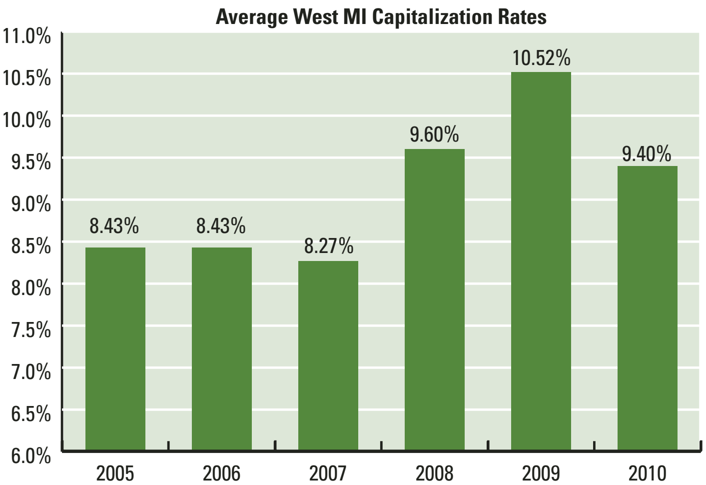


Source: Real Capital Analytics, www.rcanalytics.com

Investment

West Michigan commercial real estate investors began the year still facing headwinds from the recent recession. As the year progressed, investors became more certain that the recovery had begun to take hold. As forecasted last year, this rising confidence lead to increased transaction volumes, and transaction momentum continued to increase throughout the year. As we look towards 2011, we anticipate a continued increase in investment sales, particularly by opportunistic buyers.

Investment sales activity was significantly higher than that of both 2008 and 2009. Investors were focused on core assets with strong tenants and long term leases as well as distressed



Reflects average cap rates for all investment property sales completed by Colliers International In West Michigan

assets with noticeable upside potential. We've referred to this trend as "Trophies and Train Wrecks." While there is confidence that the recovery has taken hold, this "Trophies or Train Wrecks" philosophy leaves investors focused almost exclusively on either the most secure or value-add based transactions.

One of the biggest themes of the last two years has been the challenges of the financing market. While financing remains challenging for investment real estate, those investors with strong balance sheets and liquid capital are once again able to find competition among financing sources. Financing for recent transactions has come from local West Michigan banks as well as national life insurance companies, and there have even been early signs of a return of the CMBS (Commercial Mortgage Backed Securities) market. Underwriting criteria remains stringent, and loan-to-value levels remain well below those found in peak years. Interest rates, however, remain at historic lows and it appears will remain at these low levels well into 2011. We expect financing options and terms to continue to improve into 2011.

As previously mentioned, the most active investors have been focused on distressed real estate across all property types. Investors are seeking opportunities that can be purchased well below replacement cost yet still allow potential for increasing leasing activity to drive superior returns. In reviewing these distressed opportunities, investors are very focused on basic real estate fundamentals. Lease rates must be at or below current market levels and there must be an opportunity to reposition the property positively compared to the competition. Those distressed property types seeing the most activity include multi-family and office properties.

In addition to these distressed real estate investment sales, there was much activity focused on class A opportunities which offered a very stable cash flow. Class A properties either had a superior location, superior tenant, and typically a long-term lease in which an investor could rely upon. Activity for these property types came from both local real estate investors as well as national real estate investors. Interest from national investors is again increasing, particularly for those investors who have already invested in West Michigan and view the community favorably.

Cap rates have shown an improvement trend throughout 2010. We began the year with cap rates averaging 150 to 250 basis points higher than 2007 levels (the market peak). Throughout the year, increasing competition and improving financing conditions saw cap rates move lower, subsequently increasing the values of real estate investments. In some instances the premier properties saw a 10 to 15 percent increase in property values in 2010 alone, although property values remain between 15 percent and 30 percent below peak levels. In 2011 we expect continued improvement in real estate investment values, with value appreciation greatest in stable properties with long term leases in place.

Retail

The retail investment market seems to be one of extremes. One example is net leased single tenant buildings, where competition for such assets remains particularly strong. Cap rates seemingly improve by the month, and for the very best, assets are nearing values seen at the peak. On the other extreme are multi-tenant retail buildings. In such buildings, income has deteriorated, and there has been very little investor demand with values remaining well below their peak. As fundamentals continue to improve, we do expect well located strip centers to begin to trade again.

Industrial

Investment in West Michigan industrial real estate was virtually non-existent in 2009. In 2010 however, investor activity significantly increased and investors were very focused on superior assets with long term tenants. Warehouse distribution investment remained tempered, but competition existed for single tenant net leased industrial assets. With the manufacturing sector leading the country out of the recession, we expect the industrial segment to continue to be an active market in 2011.

Office

As was the case in 2009, investors were focused on distressed office properties in 2010. Multiple class C office portfolios sold in 2010, as investors sought to take advantage of pricing well below replacement cost. We expect investor interest in 2011 to be focused on the downtown core, which has seen the most stable occupancies and shows the greatest potential for growth. Additionally, we expect investors to continue to show interest in medical office buildings and distressed assets.

Multi-Family

The multi-family market continues to show strength and reliability throughout 2010. Occupancy rates have been steady, and some owners have successfully managed to raise rents. There is active competition amongst investors to locate distressed multi-family opportunities.

In summary, we expect the improvement trend begun in 2010 will continue into 2011. We expect investors to remain focused on distressed assets as well as class A stable opportunities. Cap rates will continue a slow moderating improvement trend; financing availability will continue to improve, and interest rates will remain low throughout 2011. ■