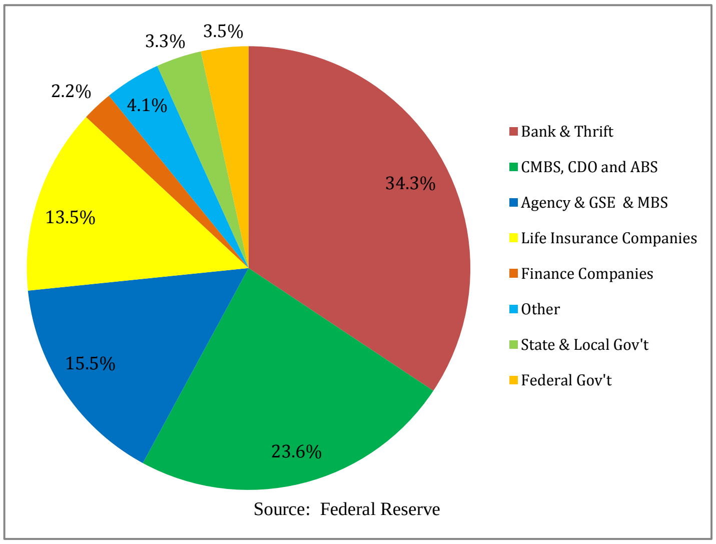
2013 MARKET OUTLOOK
SIOUX FALLS, SD
Presented February 28, 2013

Bender COMMERCIAL

ECONOMIC OVERVIEW
Presented by Michael Bender, CCIM, SIOR

Capital Markets. For the past several years, the need to deleverage the commercial real estate industry has been discussed in Bender Commercial's Market Outlook. The capital markets environment directly influences the commercial real estate market in that they may add a constraint to commercial construction lending. The graph to the right represents the total outstanding debt on commercial and multi-family properties in the United States currently totaling $2.38 trillion in 2012. The industry has witnessed some deleveraging success, with the debt down from $3.4 trillion in 2009, over one trillion dollars in three years. The debt held by commercial banks and other institutions equates to $1.1 trillion in debt maturity over the three years.

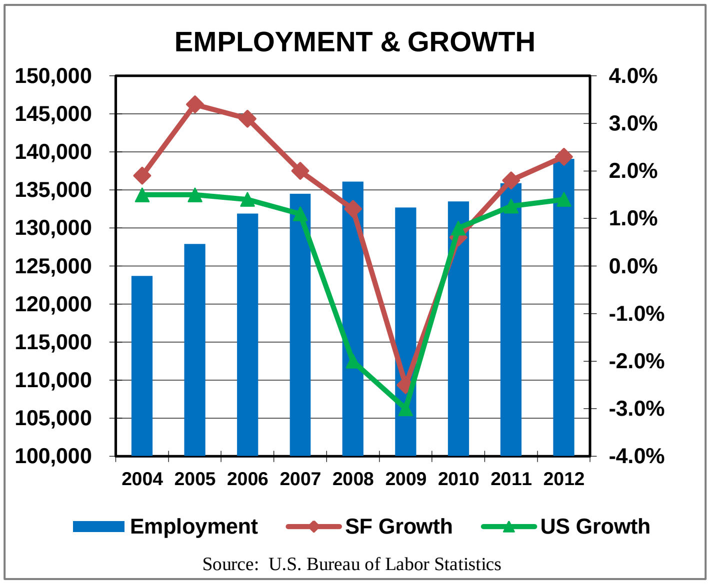


Source: Federal Reserve

Capital Markets Predictions:

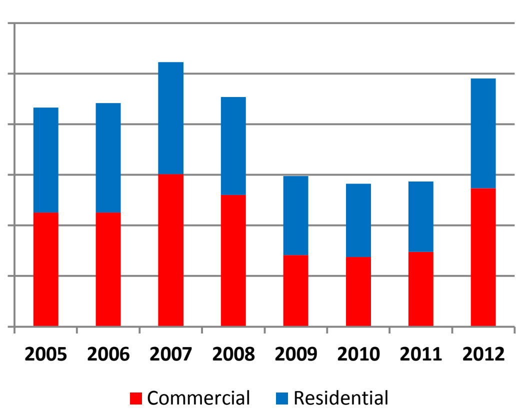
- Deleveraging will continue, though slower through 2014.
- New capital transactions, though modest, will occur in smaller markets since the larger markets have been maximized.

Employment. Historically, the Sioux Falls employment market has been strong. The Sioux Falls MSA (Minnehaha, Lincoln, Turner and McCook Counties) had its third consecutive year of positive employment growth. According to the U.S. Bureau of Labor Statistics, Sioux Falls had 2.3% growth in employment, totaling 139,100 people, outpacing the national growth rate of 1.4%. The Sioux Falls unemployment rate dropped from 4.3% in 2011 to 4.0% in 2012, while the U.S. rate was 7.8%, also down from 8.5% in 2011. Expect the local unemployment rate to continually be lower than the national rate. Continued job growth and low unemployment are results of a strong community and a healthy government working for the benefit of our city.



Source: U.S. Bureau of Labor Statistics

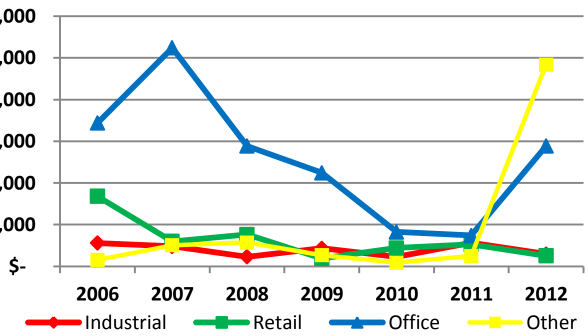
Construction. After three years of low construction, Sioux Falls saw a dramatic increase in 2012 with $490,515,243 in total construction. This is a remarkable 68% increase from 2011. Commercial construction comprised approximately 56% of the total. With this total, Sioux Falls continued to out-build other communities in our region including Rochester, MN; Fargo, ND; Des Moines, IA; and Rapid City. Sioux Falls will continue to see increased construction into 2013.



Source: City of Sioux Falls, Planning

Commercial construction equated to over $273 million of total construction, up 85% from 2011. Most of this increase came in the form of new construction with a total of $165 million, up considerably from $41.6 million in 2011. Addition/Remodel construction remained steady at $108 million. Examples of addition/remodel projects that occurred in 2012 include the $2.6 million Snow Monkey exhibit at the Great Plains Zoo as well as the $1.8 million addition to the Airport.

New Commercial Construction. Typically, the office category leads all new construction due to the medical and financial service industries. However in 2012, “other” category led the way with a significant increase in projects. This category consisted primarily of the $66.1 million Sanford Event Center and the $27.9 million Sanford Sports Complex projects. The office category did increase with over $57 million in new construction with medical and educational projects leading the way.



Source: City of Sioux Falls, Planning

Sioux Falls Economic Predictions:

- Expect continued employment growth in the area of 1.8% - 2.0% - less than 2012 due to the pent up demand in the agricultural market.
- Expect continued new construction, particularly in the residential, retail, medical and manufacturing markets.

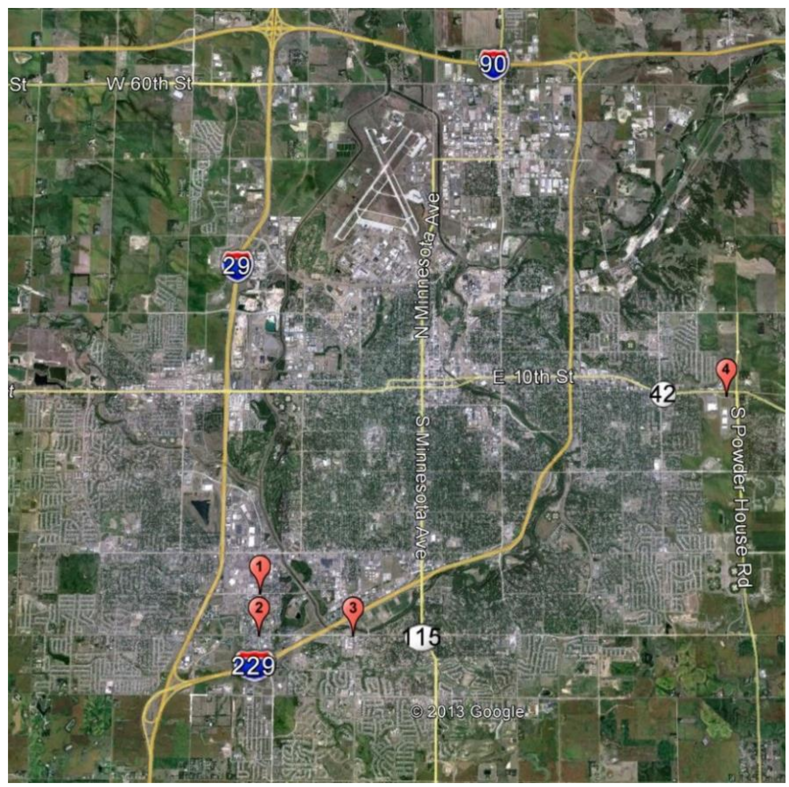
RETAIL MARKET

Presented by Reggie Kuipers

The retail market is the most talked about sector in the commercial real estate world. It is the sector that grabs all the headlines. As a broker, I consistantly get asked “What’s the next big thing?”, “Who’s coming?” and “Where are they going?”. Sioux Falls continues to be a vibrant regional retail hub that attracts local and national interest. When we began to breakdown the almost 12 million square feet of retail space in Sioux Falls, several trends emerged. One major trend is the emergence of smaller, niche neighborhood retail centers and very low vacancy in the core retail intersection in Sioux Falls. To discuss this and other trends, four major retails areas of the city will be examined. For the purpose of this report, only tenant-occupied space will be used, excluding any “big box” users, such as Walmart, Target, Menards and the Empire Mall.

Major Area 1: 41st Street & Louise Avenue

With over a combined daily traffic count of 52,700 vehicles, this intersection continues to be the highest trafficked intersecton in the state of South Dakota. Excluding the big box users, this intersection has 201,140 square feet of tenant-occupied space. At the end of 2012, the vacancy rate was only 1.4% (one vacancy) that consisted of a tuck-behind, second generation space. When space is available, the asking rates are typically $12.00 per square foot triple net for second generation space to $20.00 for newer centers. Since this area is so densely developed, the most likely path to new development will be a developer purchasing an existing building, demolishing it and rebuilding. Expect to see two to three sites redeveloped in the next twelve months.



Major Area 2: 57th Street and Louise Avenue

This area is a prime example of a traditional retail corner with the tenant strip malls on all four corners, featuring the Beacon Center and the Village on 57th Street. This intersection consists of 151,828 square feet of tenant space with no vacancy at the close of 2012. When space does become available in this area, the asking rates range from $16.00 to $18.00 per square foot triple net. One higlight on this intersection will be the addition of Noodles & Co. in 2013.

Major Area 3: 57th Street and Western Avenue

This intersecton features 98,774 square feet of tenant space, primarily locted in The Bridges on 57th. As with the previous area, at the end of 2012, this area was completely full. When space is available, the asking rental rates start at $15.00 per square foot to $17.00 per square foot on a triple net basis. With retail demand in this area so high, when vacant space opens up, it is almost immediately leased by either local or national tenants. The Bridges on 57th Street is an excellent example of the new emerging niche, neighorhood retail center that Sioux Falls will begin to see developing in other areas of the city, potentially at 85th and Minnesota, 69th and Cliff, and other emerging retail trade areas.

Major Area 4: Dawely Farm Village Area

The east side of Sioux Falls is an emerging retail area with past additions of Walmart, Menards, Target and Kohl's. Excluding these "big box" users, this area has 95,873 square feet of tenant space. Unlike the previously discussed area, this area had an 11.03% vacancy at the end of 2012. This space was largely located on the north side of Arrowhead Parkway. When one takes a second look at 11% vacancy, it is only about 10,000 squre feet. A couple of new tenants and the Dawley Farm area will be full. Asking rental rates typically range from $14.00 to $18.00 per square foot. Also unlike the previous area, there is a significant amount of development land in this area, primed and ready for new retail and tenant users alike. Expect several future retail announcements in this area, such as Ashley Furniture or Sam's Club.

Conclusions for the Retail Market

- Notable retailers that are expected to enter the Sioux Falls market in 2013 include, Costco, Fairway Foods and AutoZone. Several retails that are already here are expected to expand or open new stores include Scheels, who will be doubling their size, Buffalo Wild Wings and Kum & Go. Walmart is expected to announce a third store, possibly a fourth.
- Downtowners need Downtown. As more people choose to live and work downtown, this area will need amenities to accommodate these people. These include specialty shops, boutiques, restaurants and daycares.
- As discussed, the east side of Sioux Falls will see major momentum.
- Based on the success of the neighborhood retail centers, the market may possibly see new speculative development or build-to-suit options.
- Potentially a record year for retail construction.

OFFICE MARKET

Presented by Andi Anderson, SIOR

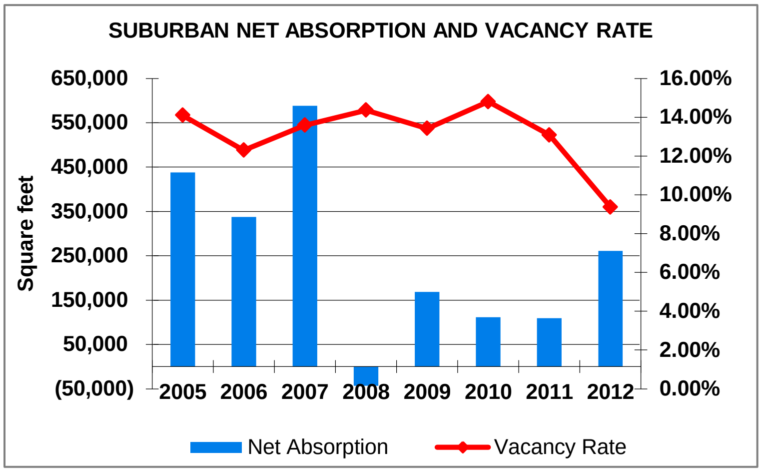
By the end of 2012, Sioux Falls had nearly 13.4 million square feet of office space. This included owner and non-owner occupied buildings. However, 100% owner-occupied buildings do not truly affect the office market's rental rates, hence it is removed when examining the market. The office market is examined through the occupancy and rental rates of all non-owner occupied properties that exceed 1,000 square feet in size. As owner-occupied buildings are converted to non-owner occupied status, they are added to the survey. The Sioux Falls office inventory of non-owner occupied space consisted of nearly 6.8 million feet. This was an increase of 193,387 square feet from 2011. The overall vacancy rate for the city of Sioux Falls in 2012 was 10.56%, down from 13.37% in 2011.

The Sioux Falls office market will be divided into two sectors, the Central Business district, or CBD, and the suburban sector.

Sector	Inventory	Vacancy	Vacancy Rate	Net Absorption	Asking Lease Rate (NNN)
CBD	**2,305,704 SF**	**297,210 SF**	**12.89%**	**95,503 SF**	**$9.65/SF**
Class A CBD	783,576 SF	57,284 SF	7.3%	85,000 SF	$12.20/SF
Class B/C CBD	1,522,128 SF	239,926 SF	15.8%	10,503 SF	$9.00/SF
Suburban	4,483,883 SF	419,940 SF	9.37%	260,751 SF	$10.80/SF
Class A Suburban	1,381,677 SF	144,668 SF	10.5%	129,858 SF	$12.55/SF
Class B/C Suburban	3,102,2016 SF	275,272 SF	8.9%	130,893 SF	$9.90/SF
Total	**6,789,587 SF**	**717,150 SF**	**10.56%**	**135,339 SF**	**$10.32/SF**

Central Business District. The CBD universe in 2012 consisted of 2.3 million square feet. This was an increase of 85,000 square feet, all in the new CNA Building located on the eastbank of the central business district. This building was constructed and completely absorbed in 2012. The CBD had a 4.0% decline in the amount of vacant space available for lease, primarily due to Avera leasing the remainder of the former Midland Building on the corner of 2nd Avenue and 11th Street. This sector had a positive net absorption of 95,503 square feet, up significantly from the 25,836 square feet absorbed in 2011. The decrease in vacancy and significant amount of absorption in this sector resulted in a decline in the vacancy rate from 13.95% in 2011 to 12.89% in 2012.

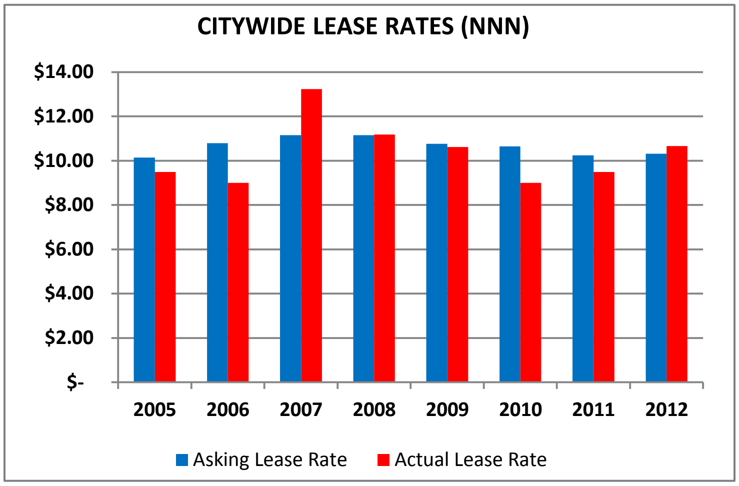
Suburban Sector. The suburban sector's inventory increased by 24%, or nearly 110,000 square feet in the last year. This increase was due to primarily built-to-suit construction projects and occupant conversions of other buildings. The suburban sector had a nearly 27% decrease in the amount of vacant space available from 2011, while it absorbed over 260,000 square feet. This sector absorbed more space than it added causing the vacancy rate to dramatically decrease from 13.1% in 2011 to 9.4% in 2012.



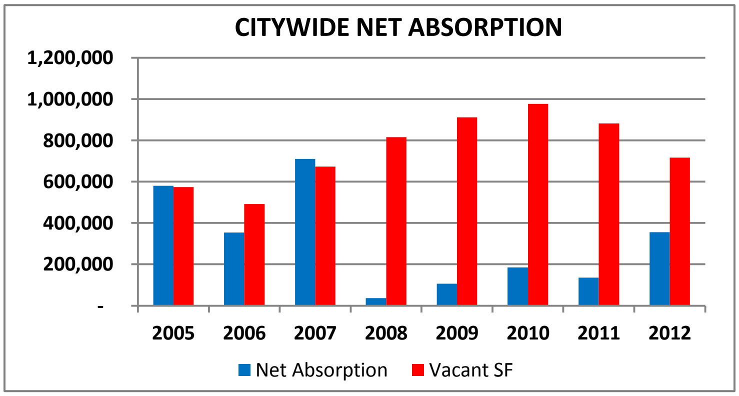
Conclusions for the Overall Sioux Falls Office Market

Vacancy Rate. After several consecutive years of increasing vacancy rates, the city's overall vacancy rate decreased for the second consecutive year from 13.4% in 2011 to 10.56% in 2012. Even in the period when Sioux Falls had increasing rates, its vacancy rate was below the national average, which was 15.5% in the fourth quarter in 2012.

Rental Rates. Asking lease rates have been consistently trending downward since 2007, but in 2012 these rates stabilized and actual signed lease rates have increased for the second consecutive year. In 2007, landlords were willing to spend the money to finish out spaces to tenant's requirements and amortize this tenant improvement into the lease rates, hence the higher actual rates. Starting in 2009, the opposite has been occurring, beginning the correction in the office market. Landlords don't have the excess cash for build-outs, so tenants are taking spaces "as is". Landlords are also willing to accept a lower rental rate to simply fill their vacant spaces. With the decrease in vacancy rates and increase in net absorption, additional money for build-outs will be available, resulting in higher asking and actual lease rates in 2013.

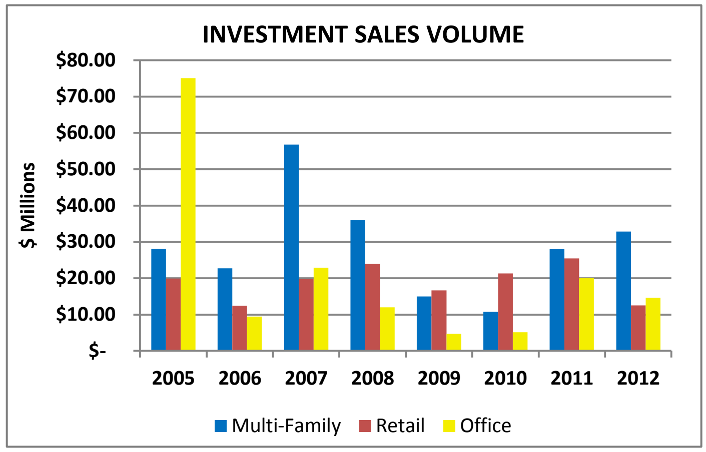


Absorption. Citywide, Sioux Falls had another year of positive net absorption. In the 16 years that Bender Commercial has surveyed the office market, there has never been negative net absorption citywide. In 2012, the market absorbed an average of 958 square feet per day. With nearly 720,000 square feet of vacant space, this absorption rate represents a two year supply. This is significantly down from over a six year supply in 2011. With this amount of supply, Sioux Falls may begin to see a minimal amount of speculative construction.



INVESTMENT MARKET

Presented by Nick Gustafson



The investment market in Sioux Falls can be comprised of many types of assets, however for the purpose of this report we are going to focus on the multi-family, office sales and retails sales, as these are the most commonly occurring asset transactions.

Multi-Family Market. There are many inputs affecting the multi-family investment market. The first is the supply of multi-family units. 2012 witnessed its second year of increased construction with a total of 485 new units. Since mid-2011, the multi-family market has had record low vacancy rates, currently at 3.79%. Our market's vacancy rate can be volatile, since it is still a small market, and factors such as the recent recession, unit overbuilding and job uncertainty can have a significant effect. The multi-family market improved in sales volume with 24 transactions. However approximately 65% of the total value was in one sale, the Donegal Point and Centre located on West 57th Street, that sold for $21,550,000. Fundamentals will continue to improve leading to more sales in 2012. The multi-family market is currently in the expansion portion of the commercial real estate market. Note to developers, be cautious not to overbuild in our market in 2013. Capitalization rates will stabilize in the 7.0% to 8.5% range.

Retail Sales Market. Unlike the multi-family market that is almost always considered absolute investment transactions, retail sales include some owner-occupied transactions. Surprisingly, retail property transactions, primarily owner-occupied, has maintained a consistent sales volume through good and poor times. The 2012 retail sales volume was lower than in years past, but this is not an indication of poor conditions. The market simply didn't have a large property change hands as typically seen in the past. Into 2013, expect retail sales to trend up with capitalization rates to improve and be in the 7.5% to 8.5% range.

Office Sales Market. The office sale market had a 38% decrease in sales volume in 2012. While office fundamentals have improved with lower vacancies, the market did not see many sales. Like the retail sales market, there were very few true investment transactions in 2012. Capitalization rates in this category will remain in the 8.0% to 8.5% range. With continued improving fundamentals in the office market, expect to see an increase in sales volume in 2013.

LAND MARKET

Presented by Rob Fagnan

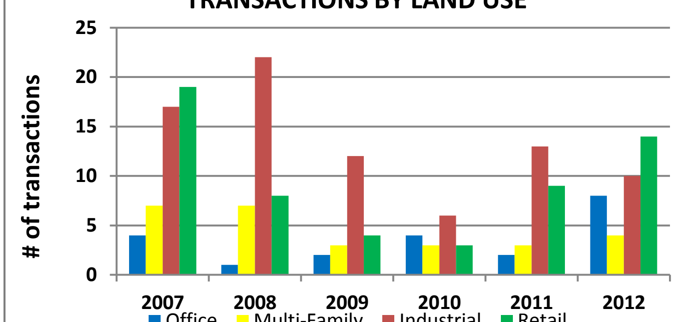
By definition - for this report - the land market consists of five property types. It all begins as unimproved land, or the farm ground that surrounds the city. This type of land is sold on a per acre basis. When basic services, such as curb, gutter, water and sewer, are added it becomes improved land used for the other four basic property types: retail, office, multi-family and industrial. These lots are typical sold on a per square foot basis.

UNIMPROVED LAND SALES – 2012

Unimproved Land. In 2010, there was a 100% increase in unimproved land sales from one sale in 2009 to two in 2010. In 2011, the market "doubled-down" again with four bulk land sales. However, in 2012, there was lateral movement, with four bulk unimproved transactions. Two of the four sales were for residential developments and sold between $33,571 and $43,311 per acre. The third was a bank-owned commercial tract that sold for $33,016 per acre on the east side of Sioux Falls and will be used for commercial development. The final was a $50,000 per acre transaction for the University of Sioux Falls future expansion. An interesting note to add to the land market was the emergence of an additional three transactions of bulk improved land, including two residential developments (Prairie Hills and Arbor's Edge) and the $13.5 million purchase of 85 acres by Avera at 69th Street and Louise Avenue.

One factor that significantly influences bulk land sales is the residential market. Over the past several years, Sioux Falls has had an average of 3,000 build-ready residential lots. When these 3,000 are compared to the 884 building permits that were issued in 2012 for single-family residential homes, there's a 3.5-to-1 ratio of available lots to permits issued. The 2011 market had a 6-to-1 ratio and in good economic years, the ratio was 4-to-1. The 2012 land market has continued to correct itself and has reached equilibrium. As a result, in 2013, expect four to six bulk unimproved land transactions.

TRANSACTIONS BY LAND USE



Improved Land. The number of improved land transactions increased 33% from 27 sales in 2011 to 36 in 2012. The majority of these purchases were by owner-occupant users. In years past, the industrial market has led the way, but in 2012, the retail land sector had a breakout year. There was also a small surge in the office land sector after several years of little action. With the majority of these transactions being owner-occupant users, 2013 will see similar numbers.

Land prices for improved land vary depending on their use. The largest margin occurs in the office and retail land markets, due to the users desire to be in a certain area of the city with visibility. Industrial and multi-family users typically have less desirable locations. In 2013, expect land prices to increase slightly.

2012 Land Prices	Low	High
Office	**$4.00/sq. ft.**	**$8.00/sq. ft.**
Retail	**$7.00/sq. ft.**	**$15.00/sq. ft.**
Industrial	**$1.80/sq. ft.**	**$2.25/sq. ft.**
Multi-Family	**$2.00/sq. ft.**	**$2.25/sq. ft.**

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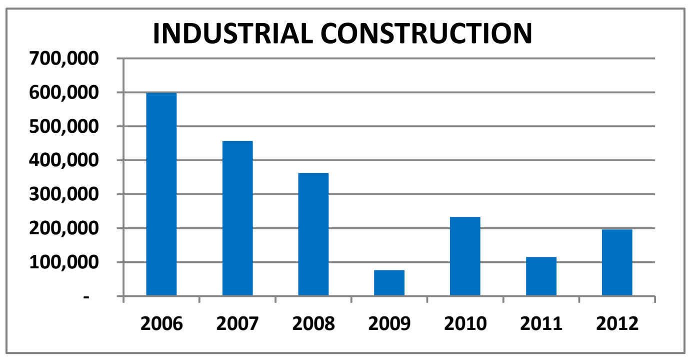
INDUSTRIAL MARKET

Presented by Doug Brockhouse, CCIM, SIOR

By definition, the industrial market is made up of those properties used for manufacturing, warehousing, distribution, transportation, and a large part in this area, contractor shops. Our survey encompassed 740 properties equating to 14.8 million square feet of space in Sioux Falls and 309 buildings making up 2.3 million square feet in Tea. In contrast to the office market, both owner and tenant-occupied space is included. Of the 14.4 million square feet in Sioux Falls, 69% are owner-occupied. The remaining is either tenant-occupied or vacant. In Tea, this ratio is 80/20. The economics of the Tea market make it easier to own your own building. To determine the health of the industrial market, several factors need to be analyzed starting with the total available space for the year, the vacancy at the end of the year and the net absorption, as well as rental rates and sales prices. These factors will gauge the market's health.

Vacancy. The first step in determining the health of the industrial market is to examine its vacancy. At the beginning of 2012, there was 604,840 square feet of vacant space and the market was absorbing space at the rate of 1,284 square feet per day. This was approximately a 471-day supply. At the end of 2012, the city's vacancy rate was 4.02% or 596,796 square feet, down from 4.18% in 2011. Tea's industrial market had slightly over 101,000 square feet of vacant space, a vacancy rate of 4.4%.

New Construction. Sioux Falls had only $6 million of new industrial construction in thirteen projects equating to 196,542 square feet. Of that nearly 200,000 square feet, the majority of that construction was in mini-storage projects, leaving only 90,800 square feet in for true industrial construction.



Existing Space Turnover. Normally, the largest contributor to available space throughout the year is the turnover of existing space. That held true once again. During the year, 546,897 square feet of existing space hit the market. This amount was up 82% from the previous year.

Net Absorption. To determine the market's net absorption, the market's current vacancy needs to be subtracted from the total of the previous year's vacancy, new construction and existing space turnover (See Table at right). Sioux Falls had a positive net absorption of 751,510 square feet in 2012, approximately 60% more than in 2011. Based on our current rate of absorption (751,510 square feet equals 2,058 square feet per day), our current vacancy of 596,769 square feet should be absorbed in less than one year (290 days) if there is no new space added. In 2012, most of the underutilized available space was used up. That and the fact that Sioux Falls has less than one year of supple, 2013 should see several expansion or new construction projects.

Vacant January 1, 2012	604,840 sq. ft.
New Construction in 2012	196,542 sq. ft.
Existing Turnover	546,897 sq. ft.
Vacant January 1, 2013	(596,769 sq. ft.)
Net Absorption	**751,510 sq. ft.**

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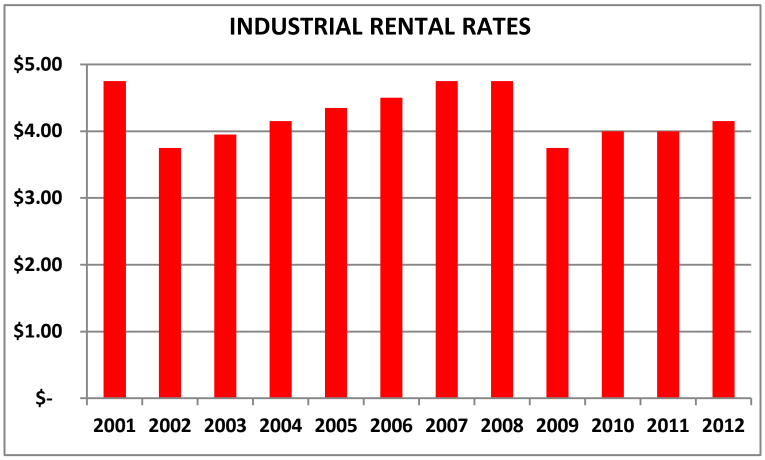
Industrial Sales. In 2012, there were 20 industrial property sales that generated prices ranging from $13.00 per square foot to $65.00 per square foot for all building types/classes. On average, industrial sale prices near $40.00 per square foot. However, for a well-maintained, metal building in Sioux Falls, the average sale price is $45.00 per square foot.

Industrial Rental Rates. Rental rates increased slightly in 2012 to $4.15 per square foot triple net with the slight drop in the vacancy rate of existing space. Sioux Falls saw leases ranging from $3.00 to $4.25 per square foot triple net. The average, however remained near $4.00 per square foot.

Industrial Market Predictions. By definition, recovery includes decreasing vacancy rates, low new construction, moderate absorption and low rental rate growth. Based on this definition, the industrial market is in recovery. As previously stated, with only a 290-day supply of space, expect some new construction in 2013. Also with supply, tenant may look to surrounding towns, such as Tea, Harrisburg, Hartford or Brandon for space. Recognizing that the market is in recover, landlords may hold out for higher rental rates and longer lease terms.



SIOUX FALLS COMMERCIAL REAL ESTATE CYCLE