DETROIT INDUSTRIAL MARKET IS ONCE AGAIN FIRING ON ALL CYLINDERS

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Considering the city's recent negative press, as well as the government loans that General Motors and Chrysler both required in order to manage their way through structured bankruptcies nearly five years ago, it is understandable why one would question the economic vibrancy of Detroit and the surrounding region. However, the much-maligned Motor City is actually a lot healthier than the view projected by the city's high-profile bankruptcy status.

The Michigan jobless rate is hovering near 9 percent. While still high compared to other states, the unemployment rate is the lowest it has been since mid-2008. Since March 2012, the state has gained more than 18,000 manufacturing jobs and over 20,000 jobs in other sectors. The U.S. energy boom is making it more cost effective for factories to operate, and Michigan's manufacturing base is directly benefitting from lower energy costs.

In addition to the automotive sector, Michigan industries that thrive include advanced manufacturing, defense, information technology, water technology, medical devices, food processing and logistics and supply-chain management.

The rebound in manufacturing has cut metro Detroit's overall industrial vacancy rate by 400 basis points since the peak of the recession, falling from approximately 14 percent in mid-2010 to 10 percent at the end of the third quarter of 2013, according to CoStar Group. This was an extremely rapid rate of recovery aided by a great deal of positive net absorption in 2012 and 2013.

Most recently, positive net absorption for the 12-month period Oct. 1, 2012 through Sept. 30, 2013 totaled 7.2 million square feet, according to CoStar.

Leasing, Sales Rev Up

Since the recovery locally began in earnest in early 2011, we've burned through the majority of troubled assets and bank-owned property deals. We benefited from this flurry of activity as sale prices and lease rates spiked in late 2012 and 2013.

However, it is important to note that it was extremely difficult to manage the sale of these troubled assets in a normal fashion. Many bank-owned properties had a long shelf life due to the fact that the banks did not want to realize massive losses on their troubled loans right out of the gate. Some transactions were also subject to bankruptcy court approval, or approval by a court-appointed receiver.

The most common variable was the recurrence of a short sale. Although short sales are not as common today, they still played a role in our market in 2013. Furthermore, on the purchasing and leasing side, it was difficult at times to successfully negotiate a transaction (most notably sale transactions) due to the lack of financial viability.

Tenant credit ratings deteriorated during the recession to the point that it made it difficult for some companies to qualify for lease terms or to borrow funds to acquire commercial property. At the peak of the recession, it was common to see a reputable and profitable manufacturing company fail to secure a loan commitment simply because the bulk of its business was automotive-related.

This, in essence, froze the industrial market in 2009 and much of 2010. Thankfully, as financing became more accessible, and troubled assets and bank-owned properties traded, our market became less complicated.

Consequently, we have returned to near normalcy and once again can negotiate third-party transactions without the need to collaborate with a bank or special servicer to get deals done. Today, brokers can work with their respective clients — building owners and tenants — to negotiate simple lease and sale agreements.

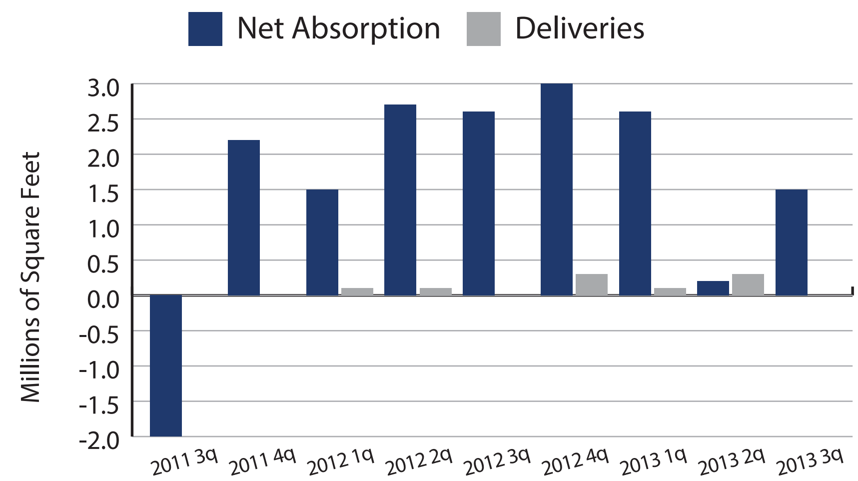
As the recession wore on and the American automotive industry struggled to remain viable, lease and sale prices dropped dramatically and made the Detroit area a clear buyer's market in lease and sale situations up until the beginning of 2013 as the market swung closer to equilibrium. The combination of a market that favored tenants or buyers with an improving economy and recovering automotive industry led to two years of strong absorption.

As noted above, traditional financing for real estate transactions started to come back in 2011. However, the same cannot be said for investment transactions. Traditional lending institutions will not provide a loan unless the site, at a minimum, is 51 percent owner-occupied. Thus, a true income-producing investment property that is occupied by third-party tenants will most likely not qualify.

Ironically, there appears to be a shortage of quality investment opportunities on the market. Risk has moderated and capitalization rates have come down to the 8 to 10 percent range for industrial product.

Area investors recognize that the market is changing rapidly. Henceforth, many of them are paying cash, or seeking financing through non-traditional lending institutions such as private equity firms or credit unions.

Solid Net Absorption Curbs Supply



One of the notable deliveries in 2013 was 36320 Eureka Road, a 250,000-square-foot industrial facility in Romulus, Mich., that delivered in the second quarter. There was 356,960 square feet of industrial space under construction at the end of the third quarter of 2013.

Source: CoStar Property

Automotive Leads the Way

The clear driver of the region's recovery is the automotive industry. Simply put, car sales are the best they have been since before the recession. In fact, U.S. consumers bought 15.6 million vehicles last year, up 7.6 percent from 2012, according to market researcher Autodata Corp.

That's the strongest volume in sales since 2007. U.S. auto sales averaged 16 million between 1998 and 2007 and bottomed out in 2009, when 10.4 million cars were sold. The industry buzz is that 16 million cars will be sold in America in 2014.

In addition to the big automakers of General Motors, Ford and Chrysler, Michigan is home to 61 of the top 100 automotive suppliers in this sector. The automotive suppliers are largely responsible for the positive net absorption during the past two years.

The recovery in heavy manufacturing came first, followed by companies that build high-tech prototype components and parts. Now we're in the beginning of the third phase of this cyclical environment as auto suppliers' start retooling their facilities to meet new manufacturing and production demands that are spurred by new car designs.

With positive net absorption in eight consecutive quarters (since the second quarter of 2011), values have appreciated quickly. Rental rates for manufacturing space have recovered to a range of $4.50 to $5 per square foot on a triple net basis compared with three years ago when similar space was leasing between $3 and $4 per square foot.

The second largest submarket in Detroit is the East Suburban Area with approximately 115 million square feet of industrial space. As of the third quarter of 2013, the East Suburban Area had the lowest vacancy rate of all the major submarkets at 3.6 percent, according to CoStar.

The submarket is primarily made up of Macomb County and eastern Oakland County. Three of the top five employers in Macomb County are the Big Three automakers. In addition, automotive suppliers such as Faurecia Corp., U.S. Manufacturing, U.S. Farathane Corp., Kuka Systems North America LLC, Comau, and Magna International Inc. all have a presence in the area.

As for the city of Detroit's bankruptcy and its impact on the industrial market, it's business as usual. Don't get me wrong, a healthy Detroit benefits the region. Yet so much commerce is conducted in the suburban markets that it more than cushions the blow from our much-maligned city.

With the fundamentals of the industrial market in metro Detroit returning to normalcy, we expect to see some speculative development this year, in large part because the market is starved for new product.

Even with spec development imminent, we expect the vacancy rate to decline further with rents and sale prices climbing too, but at a much more moderate pace than we experienced in 2012 and 2013 when there was a heavy surge in demand for space and Detroit industrial real estate was on sale. Moving forward in 2014, demand will be slightly stronger than supply.