

DETROIT & WASHTENAW COUNTY OFFICE

Quarter 1 2015

BIG DEALS ARE BACK

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For Detroit's Office Market, the first quarter of 2015 was one for the history books. With the sale of One Detroit Center to Dan Gilbert's Rock Ventures, along with the inking of a lease with Ally Bank, the market's largest investment sale and potential tenant came off the books in one deal. For Dan Gilbert, the deal all but cements his status as the undisputed King of Downtown Detroit's office market. From Jefferson Avenue to Grand Circus Park, there is not a single block along Woodward Avenue without a building tied to Dan Gilbert. For Downtown Detroit stakeholders, retaining a major corporate headquarters such as Ally Bank is a coup as well, proving that the city can still compete against the now bargain-priced suburbs of Southfield and Farmington Hills.

Stepping out of Downtown, Metro Detroit's office market began the year on a strong note. The overall market reported positive absorption of 451,713 SF, a decrease in the vacancy rate from 15.5% to 15.3%, and a modest rise in quoted rents—from \$17.80 to \$17.99 per SF. Throughout the market, a lack of new construction since 2008 has given Metro Detroit's landlords some breathing room.

A further sign of stability in the market is the refinancing of stabilized assets, both in the city and suburbs. A number of Detroit's Class A Office properties have secured non-recourse CMBS financing, with values continuing to climb as the market improves. With major banks refinancing large office properties again, Detroit's office market is finally showing signs of a true recovery.

Market Indicators

	Quarter 4 2014	Quarter 1 2015
VACANCY	↓	↓
NET ABSORPTION	+	+
CONSTRUCTION	↓	↑
RENTAL RATE*	↑	↑

*Asking Rents

Notes on the Market

CLASS A RENTS GROW

In the Metro Detroit market area, the average quoted rental rate for available office space, all classes, was \$17.99 per SF at the end of the fourth quarter of 2014. This represents a solid increase from the previous quarter's quoted rent of \$17.80.

The average Class A quoted rental rate was \$20.62 per SF, a slight increase from \$20.51 in the previous quarter. Quoted rents in Detroit's CBD increased to \$23.42 per SF. Class A suburban markets quoted \$20.28 per SF, an increase from the previous quarter's \$20.08.

VACANCY DECREASES

The overall office vacancy rate in the Metro Detroit market decreased by twenty basis points, reporting 15.3% at the end of the first quarter. The vacancy rate has continuously improved since 2010, with the exception of a small aberration for the second quarter of 2014.

Across the market, Class A performed well in the first quarter. Class A space reported a vacancy rate of 13.7%, down sixty basis points from 14.3% at the end of the fourth quarter of 2014. In Metro Detroit's larger office markets, the highest vacancy rates were reported in the suburban submarkets of Troy North (33.6%), Farmington Hills (28.2%), and Southfield (23.8%). Across all classes, a total of 29,866,401 SF of space remains available.

NOTABLE LEASES AND ABSORPTION

Net absorption for the overall Metro Detroit office market was strong in the first quarter. 451,713 SF was absorbed across all classes in the market, which complements the 505,842 SF absorbed in the previous quarter. This not only represents a nice rebound from the slow second quarter, but a strong addition to the yearly trend. For 2014, YTD total absorption, across all classes, is 1,688,395 SF. Notable leases for the quarter include the blockbuster 321,000 SF Ally Bank deal for One Detroit Center, and Truven Health Analytics 134,000 SF lease in the Wickfield Center of Ann Arbor.

MAJOR TRADES ON THE MARKET

Investment sales dominated the headlines for the second quarter in a row. Last quarter, the Compuware Building came off the market. This quarter, Dan Gilbert bought another \$100,000,000 dollar building down the street--the Philip Johnson designed One Detroit Center. With both properties off the market, look to the Fisher and Kahn Buildings in Detroit's New Center to become the latest source of rumors and intrigue.

LITTLE HEADWAY IN CONSTRUCTION

Metro Detroit's office market continues to lack the fundamentals for new construction. Just 47,000 SF of office space was delivered in the first quarter of 2015.

Key Takeaways

- > Rent growth is modest, but it is still good news. Modest growth is better than no growth.
- > Vacancy is down, especially in top-quality multi-tenant buildings.
- > It was a quarter of big-name leases, with Ally Bank and Truven leading the way.
- > Market still not strong enough for new construction, let alone speculative construction.

Looking Forward

- > First quarter was a headline quarter for Detroit. Do not expect as much fireworks for the second quarter.
- > Fundamentals of the market remain strong. Expect absorption and rental rates to trend upward in 2015.
- > New construction might finally be in play, especially in tighter markets like Ann Arbor
- > With One Detroit Center, Compuware Building, and Ally Bank off the market, all eyes turn to the Fisher and Kahn Building

THE NUMBERS > QUARTER 1 > OFFICE

Class A	Existing Inventory		Vacancy			YTD Net	YTD	Under	Quoted
Market	# Blds	Total RBA	Direct SF	Total SF	Vac %	Absorption	Deliveries	Const SF	Rates
CBD	15	7,213,794	758,047	818,507	11.3%	78,678	0	0	\$23.42
Suburban	196	38,822,876	5,418,582	5,501,890	14.2%	150,208	0	340,000	\$20.28
Totals	211	46,036,670	6,176,629	6,320,397	13.7%	228,886	0	340,000	\$20.62
Class B	Existing Inventory		Vacancy			YTD Net	YTD	Under	Quoted
Market	# Blds	Total RBA	Direct SF	Total SF	Vac %	Absorption	Deliveries	Const SF	Rates
CBD	77	15,669,451	2,048,615	2,048,615	13.1%	125,804	0	0	\$18.59
Suburban	3,013	86,795,767	15,738,453	15,899,175	18.3%	(54,491)	47,000	233,890	\$17.75
Totals	3,090	102,465,218	17,787,068	17,947,790	17.5%	71,313	47,000	233,890	\$17.82
Class C	Existing Inventory		Vacancy			YTD Net	YTD	Under	Quoted
Market	# Blds	Total RBA	Direct SF	Total SF	Vac %	Absorption	Deliveries	Const SF	Rates
CBD	70	3,276,095	1,110,231	1,110,231	33.9%	12,224	0	0	\$18.87
Suburban	5,805	43,304,649	4,498,083	4,507,983	10.4%	139,290	0	0	\$14.44
Totals	5,875	46,580,744	5,608,314	5,618,214	12.1%	151,514	0	0	\$14.81
Totals	Existing Inventory		Vacancy			YTD Net	YTD	Under	Quoted
Market	# Blds	Total RBA	Direct SF	Total SF	Vac %	Absorption	Deliveries	Const SF	Rates
CBD	162	26,159,340	3,916,893	3,977,353	15.2%	216,706	0	0	\$20.07
Suburban	9,014	168,923,292	25,655,118	25,909,048	15.3%	235,007	47,000	573,890	\$17.78
Totals	9,176	195,082,632	29,572,011	29,886,401	15.3%	451,713	47,000	573,890	\$17.99

Source: CoStar Property®

THE NUMBERS > HISTORIC > OFFICE

	Existing Inventory		Vacancy			Net Absorption	Deliveries		UC Inventory Total RBA	Quoted Rates
	# Blds	Total RBA	Direct SF	Total SF	Vac %		Deliveries	Const SF		
2015 1q	9,176	195,082,632	29,572,011	29,886,401	15.3%	451,713	2	47,000	573,890	\$17.99
2014 4q	9,174	195,035,632	30,017,625	30,291,114	15.5%	505,842	1	8,696	620,890	\$17.80
2014 3q	9,174	195,076,976	30,412,321	30,838,300	15.8%	628,852	1	10,000	582,586	\$17.73
2014 2q	9,176	195,117,585	31,150,506	31,507,761	16.1%	(171,765)	4	80,852	207,124	\$17.55
2014 1q	9,172	195,036,733	30,891,299	31,255,144	16.0%	930,890	0	0	94,280	\$17.55
2013	9,174	195,071,933	31,862,494	32,221,234	16.5%	1,263,548	6	67,351	70,820	\$17.53
2012	9,174	195,665,798	33,522,427	34,078,647	17.4%	1,031,830	13	504,959	61,351	\$17.75
2011	9,168	195,572,256	34,344,619	35,016,935	17.9%	1,397,071	9	308,919	443,406	\$18.23
2010	9,163	195,334,843	35,275,158	36,176,593	18.5%	(803,156)	14	368,060	506,798	\$18.80
2009	9,157	195,293,742	34,043,648	35,332,336	18.1%	(2,557,972)	21	341,011	508,768	\$18.83
2008	9,141	195,034,333	31,331,564	32,514,955	16.7%	(542,702)	35	817,335	314,438	\$19.48
2007	9,110	194,224,473	30,117,677	31,162,393	16.0%	1,483,131	74	1,807,032	856,569	\$20.05
2006	9,044	192,438,440	29,944,698	30,859,491	16.0%	373,409	89	2,359,976	1,979,501	\$20.40
2005	8,957	190,086,939	28,110,210	28,881,399	15.2%	(248,697)	100	2,062,676	2,810,378	\$20.45
2004	8,858	188,074,263	25,539,033	26,620,026	14.2%	2,252,827	113	3,609,326	2,116,195	\$20.54
2003	8,747	185,227,509	24,246,762	26,026,099	14.1%	1,394,306	93	3,251,406	3,766,918	\$21.15

Trend to Watch: Is the market back?

> Return of the Investment Sale

Big deals, big trades, and big buyers. Are things really heating up?

Dan Gilbert's purchase of One Detroit Center, along with the complementary lease of the property to Ally Bank has capped a busy year in Metro Detroit. Starting with the sale of Southfield Town Center to New York City's 601 W Properties in Spring 2014, the market has seen a number of large investment sales, including the sale of the Compuware Building to a joint venture between Dan Gilbert and Meridian Healthcare, and finally the One Detroit sale. This marks three \$100,000,000 deals within the span of year. All three properties secured non-recourse CMBS loans as well.

Dan Gilbert's downtown deals are particularly intriguing. The deals mark a shift in strategy for Rock Ventures, who previously focused on purchasing distressed assets for low prices, not performing, investment-grade properties. The shift in strategy marks a shift in the market. Recall, just a few years ago, this market dynamics would have seemed impossible, with buildings frequently trading under \$20 per SF. Now, thanks to the market Dan Gilbert has created, Dan Gilbert is forced to pay higher prices. In any event, the Gilbert organization now controls over 3,000,000 SF of Class A space on Woodward alone.

Long term, while the healthy trade prices indicate that Downtown's investment market is heating up, it is a little early to call Detroit's investment market "back." After all, the only person buying the big properties is the local player, Dan Gilbert, who partnered with the Detroit-based Cotton family of Meridian Health for Compuware, and beat out two other local firms in REDICO and the Hayman Company for One Detroit Center. Time will tell if institutional buyers from out of state or out of the country are willing and able to make a deal in Detroit.

TIMING IS EVERYTHING: PRICES PER SF SKYROCKET



In 2013, the Penobscot Building, (in the immediate foreground with the red ball on top) a 1,000,000 SF office tower, traded for just \$5,000,000, or \$5 per SF. Fast forward two years, and One Detroit Center (with the blue accents on the roof) traded for over \$100,000,000, 20 times the price of the Penobscot.

FOR MORE INFORMATION

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