# 2018 FORECAST

NAI Martens

WICHITA

*Tom Johnson CRE and Steve Martens CCIM, SIOR, CPM*

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# Introduction

Placemaking, the process of vibrant urban space transformation, has come to Wichita and the results have been impressive. The creation of new and vibrant destinations, the repopulation of public space, improvements in the area's versatility and the introduction of character and engagement have all contributed to the community's quality of life.

While the focus of Wichita "placemaking" has been in the urban core areas of the Douglas Design District, Old Town, the CBD and the Delano District, there are scores of other enterprises throughout the community. The results of these efforts are self-evident; they enhance community livability. Who would have thought that Paul McCartney would perform in Wichita or that March Madness would come to Wichita in 2018 and again in 2021!

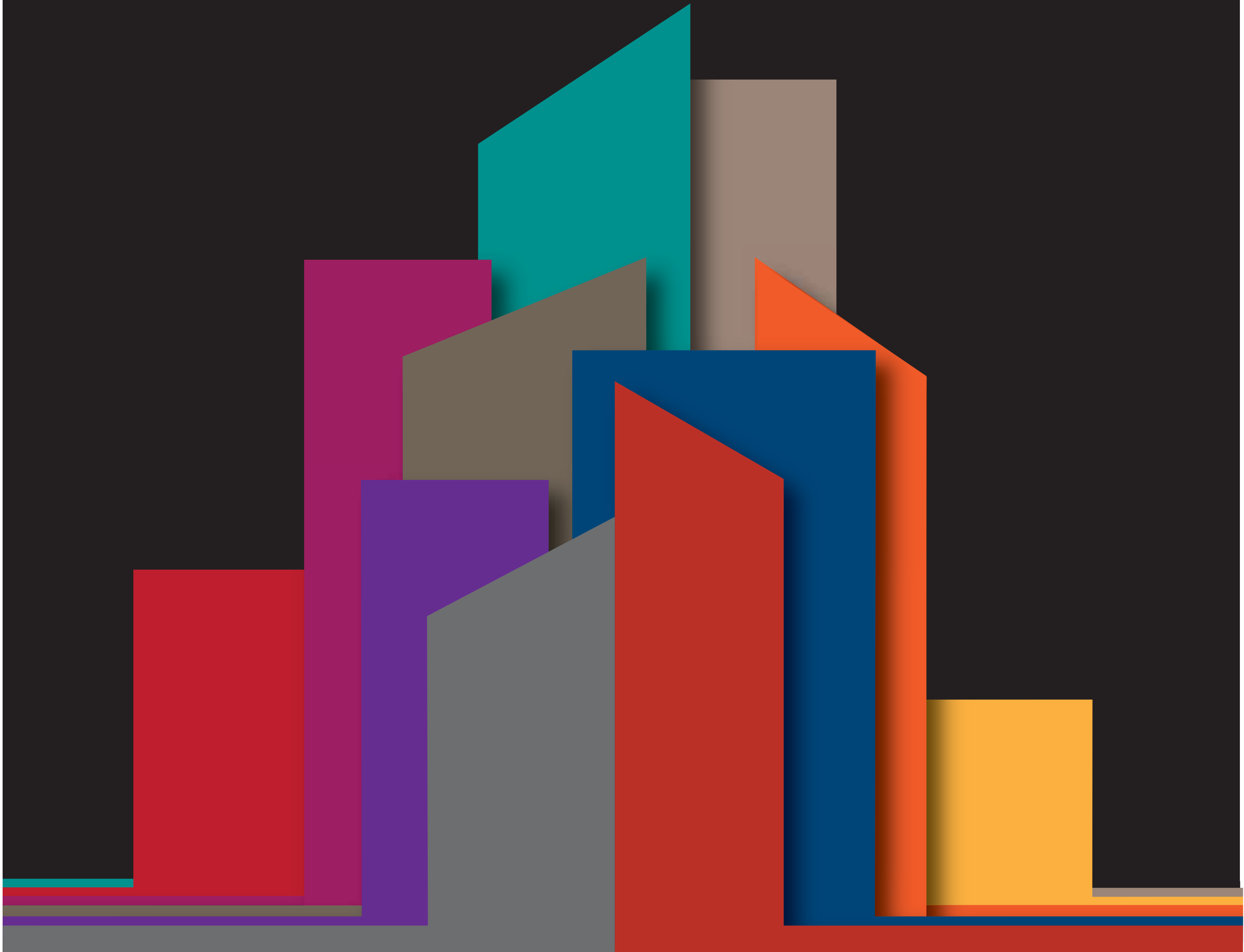
Business activity is strong and investment in new equipment and facilities is expanding. Consumer confidence is high. New out-of-market companies are entering the industrial and service sectors. Regional and national restaurants and an assortment of retailers are continuing to expand into the city and surrounding suburban communities. Just as important, local entrepreneurs and small businesses are growing in the urban core.

Wichita has a great story to tell. As the leader in commercial real estate services and the market knowledge pacesetter, NAI Martens is committed to helping tell that story as we work in new and innovative ways to support our clients and the business community in their efforts to "expand, locate, hire and succeed!"

Wishing you continued success…

Steven J. Martens CCIM, CPM, SIOR
CEO – The Martens Companies

J. Thomas Johnson, CRE
President – NAI Martens



*Wanda Whitworth, Commercial Advisor and Patrick Ahern, CCIM, SIOR*

*Tom Moses, CCIM (Topeka Office)*

# Office

The agonizing slow growth of office user jobs has the Wichita office market experiencing tepid absorption and little to no increases in occupancy and rental rates.

Deal flow has been significant over the last year and there have been several high profile moves and announcements. The flight to quality has benefitted several properties to the detriment of those that can't compete on rental rates, parking, location, space layout or amenities. The inventory in the CBD and throughout the primary suburban sub-markets is aging. Regrettably, overall demand and current rental rates do not support the construction of replacement properties on any significant scale.

The northeast has been, and continues to be, a solid sub-market. Discounting lease up space in Class A properties, the vacancy rate is as a low as it has been in recent years and rents are gradually increasing. The Class B sector is holding its own despite a couple of vacant buildings in transition. Well-located, well-maintained smaller single and multi-tenant properties are fully occupied. There has been little to no new construction in the northwest, southwest and southeast quadrants has kept vacancy and rental rates steady.

The CBD vacancy rate is climbing for Class A properties as a couple of major tenant losses to suburban locations and one significant out-of-market headquarters move has freed up a significant amount of space. The transition of older office buildings to alternative uses has reduced the inventory of available space but has done little to enhance absorption. Current rental rates are too low to support the elevator, mechanical or structural renovations required by many tenants to make these properties competitive.

Given the momentum generated by placemaking activities in the CBD, the office environment downtown is much improved and makes for a much more conducive market. Investor confidence has improved as several CBD properties have sold over the last couple of years. As the economy improves and office user jobs increase, we will see gradual improvement throughout the market.

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# Office Market Trends

- The "out of office" workplace is a new reality as the number of employees who are remote working, teleworking and telecommuting is increasing. Floor plans with nontraditional spaces and a walkable live/work/play environment remain desirable. These design and utilization standards have resulted in less space needed per worker.

- Hinkle Law Firm has moved into their new space on three floors of the Murfin, Inc. built office building in the Waterfront development. Additionally, Grant Thornton will be taking 9,429 sq. ft. and Morgan Stanley will downsize and consolidate its two offices into 12,000 sq. ft.

- There have been a significant number of office leases completed between 1,000 and 5,000 sq. ft. A large percentage of these tenants were in the TAMI (technology, advertising, media, and information) sector supplemented by legal, accounting and financial services.

- Cargill's new ground up 200,000 sq. ft. headquarters for its protein division, Meritrust Credit Union's purchase of Cargill's former building and the Wichita Eagle's move to their 24,000 sq. ft. headquarters in Old Town Square are all game-changer for the CBD

## Forecast

| | |
|---|---|
| *Absorption* | ▲ |
| *Vacancy Rate* | ▼ |
| *Asking Rent* | ▶ |

### Office Market Overview

| | | Vacancy Rate | Asking Rent |
|---|---|---|---|
| CBD | Class A | 19.6% | $17.25 |
| | Class B | 19.9% | $11.84 |
| Northeast | Class A | 13.9% | $22.19 |
| | Class B | 20.6% | $14.26 |
| Northwest | Class A | 10.4% | $19.20 |
| | Class B | 11.9% | $12.81 |
| Southeast | Class A | NA | NA |
| | Class B | 29.4% | $10.30 |
| Southwest | Class A | NA | NA |
| | Class B | 14.2% | $12.95 |
| Overall | | 19.6% | $14.29 |
| | Class A | 16.2% | $19.45 |
| | Class B | 21.2% | $12.25 |

*Note: 357 properties and 8.6 million sq. ft. in database. Rents are generally full service.*

### Office Building Sales (Sedgwick County)

| | Transactions | Square Feet | Valuation (Millions) |
|---|---|---|---|
| 2011-15 (Avg) | 31 | 897,806 | $35.1 |
| 2016 | 33 | 603,334 | $32.3 |
| 2017 YTD | 20 | 498,930 | $25.3 |

### Office Construction (WAMPO))

| | Permits | Square Feet |
|---|---|---|
| 2009-15 (Avg) | 19 | 242,906 |
| 2016 | 17 | 221,125 |

# Retail

*John O'Rourke, Commercial Advisor, Nathan Farha, CCIM, and Troy Farha, Commercial Advisor*

*Ryan Hubbard and Grant Glasgow, Commercial Advisors*

From the recent headlines referencing a "retail apocalypse" you might assume that brick and mortar stores are in their death throes. If so, you'd be wrong. Yes, e-commerce is growing at a much faster rate, but revenues in most physical stores remain positive. Even with a dramatic share shift, e-commerce represents some 13 to15 percent of total retail sales and is expected to remain below 20 percent five years from now.

If brick and mortar is dying, somebody should tell retailers like Aldi, Apple, Costco, T.J. Maxx, Dollar General, Dollar Tree, Nordstrom, H&M, Ulta and Sephora. Collectively, they have announced plans to open about 3,000 stores. Newer brands such as UNTUCKit, Bonobos, Casper, Warby Parker, Fabletics and thredUP, who got their start online, are now opening dozens of physical stores. It is clear that the failure to innovate, shifting customer preferences and market-share grabs from transformative new models have had an adverse impact on the part of many traditional retailers.

While this transformation has touched all classes of retail, it has had the most profound effect on big-box retailers; many of whom are in the process of downsizing their store counts and footprints. Others have remained immune to date, including off price chains, warehouse clubs, dollar stores, home improvement, fitness, beauty and grocery stores. These seem to be thriving but are all looking at their e-commerce approach. Grocery online purchasing is already here and Amazon's purchase of Whole Foods will alter the way business is done.

The restaurant segment, retail's major player, continues to evolve. While some of the more traditional chains are struggling and closing locations (Logan's Roadhouse, Outback, Chili's, Joe's Crab Shack, Applebee's, IHOP, TGI Fridays, to name a few), the fast casual segment is expanding from creative alternatives to burgers and pizza to new innovations in farm fresh and grab n' go offerings.

The changes taking place are geared toward one objective; providing the best shopping experience. Consumer spending and e-commerce will maintain healthy growth rates in 2018. Rent and occupancy increases will be dependent upon job growth. Retailers and landlords will continue to innovate in their efforts to attract customers; particularly in delivering shopping experiences centered on entertainment concepts, dining and technology.

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# Retail Market Trends

- Greenwich Road, between 21st St. N. and K-96, remains the epicenter of retail activity. The frontage is essentially built out and all out parcels have been sold. Restaurants dominate the tenant mix.
- Pottery Barn has opened at Bradley Fair and Athleta is moving into space next to the Gap. The Rock Road corridor is still attractive with activity stretching from the AMC Theaters' renovation of the former Northrock 14 theater on 32nd St. N. to the introduction of H&M at Towne East Square.
- Initial phases of the 34 acre Cadillac Lake development at 29th St. N. and Maize Road are underway. The first new tenants are moving into the Tyler Pointe development and there are many new and expanding retailers in the northwest sub-market.
- The long dormant Slawson land at 21st St. N. and Webb Road will soon see a new free-standing, full-service Emergency Center, Opti-Life Center, a 35,000 sq. ft. fitness center and strip center development.
- Activity is brisk in Derby. Several national retailers have opened locations in the last couple of years. Don Hattan Chevrolet is nearing completion of its new location and Field Station: Dinosaurs is scheduled to be complete by summer 2018.
- Union Station now houses several new restaurant concepts in the kiosks along Douglas Avenue including Funky Monkey Shaved Ice, Noodles to Go, 8 Below (a rolled ice cream shop) and Douglas Street Tacos. Delano continues to evolve as homegrown retail and restaurants are flourishing.

## Forecast

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|---|---|
| *Absorption* | ▲ |
| *Vacancy Rate* | ▼ |
| *Asking Rent* | ▲ |

### Retail Market Overview

| | Vacancy Rate | Asking Rent |
|---|---|---|
| Power Center | 1.6% | $12.00 |
| Hybrid (Lifestyle/Power) | 7.4% | $24.58 |
| Lifestyle | 14.9% | $17.22 |
| Community | 12.2% | $16.06 |
| Neighborhood | 21.1% | $10.44 |
| Regional | 13.3% | $10.37 |
| Strip | 12.7% | $10.62 |
| Urban Retail | 7.5% | $10.33 |
| Overall | 12.0% | $11.82 |
| Derby Submarket | 6.3% | $13.86 |

*Note: 510 properties and 13.1 million sq. ft. in database. Rents are generally triple net*

### Retail Building Sales (Sedgwick County)

| | Transactions | Square Feet | Valuation (Millions) |
|---|---|---|---|
| 2011-15 (Avg) | 53 | 832,559 | $62.7 |
| 2016 | 45 | 853,568 | $51.7 |
| 2017 YTD | 30 | 375,279 | $29.8 |

### Retail Construction (WAMPO)

| | Permits | Square Feet |
|---|---|---|
| 2009-15 (Avg) | 44 | 459,996 |
| 2016 | 47 | 549,696 |

# Industrial

*David George and Glenn Cox, Commercial Advisors and Scott Salome SIOR*

*NAI Martens brokerage support team members Ryan Moyer, Marketing Specialist, Erika Huntley, Administrative Manager, Katie Martin, Marketing Specialist and Drew Gannon, Research and GIS Specialist.*

The industrial sector remains the prime beneficiary of the numerous technological shifts occurring throughout the economy. E-commerce continues to fuel demand for distribution and warehouse space and Wichita's aerospace cluster, advanced manufacturing and the growing advanced materials sector are considerably healthier.

Going forward, the supply pipeline is poised to remain about the same as it has over the past couple of years and absorption rates are expected to be steady; resulting in lower vacancies. Rent growth will accelerate further as the market continues to tighten through the end of 2017 and into 2018. The growth in employment has not been reflective of renewed vigor in the industrial sector highlighting the contribution of technological trends as they drive the industry forward. The industrial sector boasts a bright outlook as technological shifts show no sign of abating.

Of more importance, is the availability of buildings that meet the requirements of today's users. The overall vacancy rate is just 7.9 % which has historically been influenced by less desirable and functionally obsolete property in several sub-market areas. Options are limited for companies requiring more modern facilities that support today's user requirements of higher ceilings, more efficient lighting and mechanical systems, and more accommodating dock configurations, truck court depths and turning radiuses.

Speculative development remains challenged as construction costs are still disproportionate to achievable rents. Even though rental rates have been trending upward, they remain significantly below a level that supports new construction. Historically, owners have been reluctant to push rents and it has taken a while for tenants to accept rental rates of over $5.00 per square foot. These triple net rents on speculative projects are only possible given the City of Wichita's property tax abatements.

Recent speculative development, supported by tax abatement, has been substantially absorbed demonstrating both the markets growing demand and an increased willingness to pay higher rent for quality facilities. Tenants are reluctant to wait for build-to-suits, thus having inventory ready to lease is vital to the market. Overall, the inventory to buy or lease will remain low as companies are expanding and new business creation is on the upswing. Most new construction will be driven by owner occupied properties.

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# Industial Market Trends

## Forecast

| | |
|---|---|
| *Absorption* | ▲ |
| *Vacancy Rate* | ▼ |
| *Asking Rent* | ▲ |

- The areas of industrial market influence remain north along I-135 in Park City, along the K-96 corridor, in the Bel Aire and Maize industrial parks with an effort to shift supply to south Wichita through speculative development.

- Even though speculative construction remains challenged, owner-occupied new construction and expansion over the last three years has been two and a half times the average of the previous five years.

- Lou Robelli is building a 500,000 sq. ft. warehouse for the Coleman Company at 71st St. N. and I-135 and Epic Sports is building a 125,000 sq. ft. warehouse and distribution facility in Bel Aire's Sunflower Commerce Park.

- Kyodo Manufacturing, in a joint venture with Lubrication Engineers, announced plans for an 80,000 sq. ft. facility in the Maize Industrial Park and Cox Machine is adding 52,284 sq. ft. to its operations on 21st St. N.

- B G Products announced the construction of a 30,000 sq. ft. addition to their headquarters and will be adding 120,000 sq. ft. to their El Dorado distribution center while Dold (Hormel) is investing $50 million in a 153,000 sq. ft. expansion of it's Wichita facility on 31st St. N.

### Industrial Market Overview

| | Vacancy Rate | Asking Rent |
|---|---|---|
| Hyde Park | 7.2% | $7.21 |
| Northeast | 8.5% | $5.14 |
| Northwest | 6.1% | $4.91 |
| Southeast | 14.4% | $4.33 |
| Southwest | 4.5% | $4.46 |
| Overall | 7.9% | $4.71 |

*Note: 1,153 properties and 40 million sq. ft. in database not including aircraft campuses. Rents are generally modified gross.*

### Industrial Building Sales (Sedgwick County)

| | Transactions | Square Feet | Valuation (Millions) |
|---|---|---|---|
| 2011-15 (Avg) | 69 | 1,610,973 | $57.5 |
| 2016 | 73 | 1,587,267 | $66.2 |
| 2017 YTD | 34 | 763,795 | $19.4 |

### Industrial Construction (WAMPO)

| | Permits | Square Feet |
|---|---|---|
| 2009-15 (Avg) | 45 | 848,788 |
| 2016 | 47 | 1,134,128 |

# Investment

*Nathan Farha CCIM, Jeff Englert and Trent Garmon, Commercial Advisors*

*Ryan Hubbard, Trent Garmon, Wanda Whitworth and John O'Rourke (l to r), along with Patrick Ahern and Tom Johnson, earned the Masters in Commercial Property (MICP) designation from the Lipsey School of Real Estate at the NAI Global University in Chicago.*

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**Commercial real estate has a long history of being an attractive investment during both up and down-market cycles. Secondary markets such as Wichita are favored by local and regional buyers as institutional investors have generally focused on gateway and first tier markets.**

**Industrial** - Local opportunities are limited by a lack of property with credit based long-term leases. Solid performance has owners holding on to assets resulting in a shortage of suitable properties to buy. Cap rates have compressed in major metro areas, motivating buyers to move capital into secondary and tertiary markets.

**Multifamily** - Many investors continue to favor apartments as a relatively safe investment and they have had a long run of success. It will continue to outperform most other sectors given a stable supply and steady job growth. A shortage of available product on a local and regional basis will impede deal flow.

**Hospitality** - The lodging segment has seen considerable new construction activity. In many markets, room supply has caught up with demand and in the oil patch it has exceeded it. Budget, economy and midscale brands are slowing while upper scale properties are expanding. Short-term stay alternatives, such as Airbnb, are competing for market share.

**Office** - The office sector is less in favor as it is more sensitive to job numbers. New development remains challenged and requires substantial preleasing. Older urban office buildings with a lot of character gather interest from users and redevelopers. Assets with solid long-term tenant rosters and on-site amenities are in demand.

**Retail** - Investors are focusing on smaller centers, lifestyle/entertainment, grocery-anchored, and even niche power centers. Overall pricing and cap rates have surpassed pre-recession levels. Many secondary and tertiary markets offer unique opportunities as prices remain below the prior peak and these markets are eliciting interest from investors.

**Self-Storage** - Underlying demand for storage continues to strengthen given positive demographic trends, the strength of the multifamily market and households moves and downsizing. Rental and occupancy rates are quite healthy. New supply has not overwhelmed demand and opportunities exist for small to mid-size investors to explore secondary markets and older properties.

**Manufactured Housing** - Investor demand for mobile home communities has continued unabated and cap rates in the region are comparable to those enjoyed in recent years. Small to medium sized private investor groups are the leading buyers for properties in the Midwest although there are interested buyers across the spectrum.

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# Investment Market Trends

- Thirteen hotel properties with a total of 1,328 rooms were sold over the last year. Several non-flagged properties were sold to investors planning to rebrand the assets to nationally flagged hotels.

- Investor activity has ramped up over the last few months led by Birds Eye Holdings LLC and Murfin, Inc.'s purchase of the Farm Credit Bank Building and the sale, at auction, of Brittany Place I & II.

- In the Wichita MSA, there have been no manufactured housing communities developed for at least five years and only one operator is planning an expansion. Regionally, nine communities, comprising 476 spaces, have sold in the last year.

- The self storage inventory has been relatively stable. Only one small development has been completed in the recent past and there are two projects, one west and one northeast, currently under construction.

- Over the last year, 14 multifamily properties comprising 1,619 units with a total value of almost $70 million were sold to local and out-of-market investors. Major properties traded included Sundance, Falcon Pointe, Mt. Carmel Village, Twin Rivers and Hearth Hallow.

## Investment Prospects for Major Property Types

| | |
|---|---|
| Industrial/Distribution | 3.61 |
| Multifamily | 3.52 |
| Hotels | 3.29 |
| Office | 3.26 |
| Retail | 2.93 |

Scale: 1 Poor – 2 – 3 – 4 – 5 Excellent


*The NAI Martens Third Quarter 2017 Wichita Multifamily Report, an in-depth overview of the market, has just been released.*

MARTENS COMPANIES

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Sources: Forbes, John Gehl, NAIOP, JLL, Urban Land Institute, CBRE, Marcus Millichap, NAI Martens Research, TenX, REIS Reports, GlobeSt.Com, WSU CEDBR