OUTLOOK REAL ESTATE

PERSPECTIVE

Real estate is regaining its role as an important tool in our recuperating economy.

BRAD VIRKUS

Real estate is seeing a slow but steady recovery. But the age old saying that real estate is all about location, location, location needs to be updated. It is also about jobs, jobs, jobs and we could go on to list factors like market demographics, a city's economic production, and an area's livability.

Real estate has always been a driver of growth and again is a tool the nation is using as it seeks its equilibrium in the post-recession era.

Look at placemaking. It is an international movement with strong advocates in the United States and has been around for decades, but it's taking on new importance in the post-recession era. The state of Michigan has MIplace, a place-based initiative, as part of its economic development strategy. Placemaking Chicago is so serious about the strategy that it has developed 11 principles of placemaking. Number one is: "The community is the expert."

That could be a warning to leaders who want to cut and paste a bike lane, public art, and a high-tech, cozy coffee shop into a neighborhood in the hopes of reframing it as the next big thing. These additions could signify young, contemporary, urban hipness but they won't last if the community won't support the new image.

Perhaps a family group that is buying up properties in a suburb

NATIONAL CENTER FOR THE MIDDLE MARKET

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that borders on Detroit had that in mind when it began offering rent subsidies to graduate students who rented in a specific district abutting the border. According to reports, the program has been so successful that it tripled projections in the first year. Of the 38 bank-owned or abandoned properties in the neighborhood at the beginning of the year, only three remain.

WHEN IT COMES TO PLACEMAKING, THE COMMUNITY IS THE EXPERT

"In the recession, you could see a downward spiral of property values leads to rentals with bad tenants," the city manager said. "Now we see the opposite of that."

These young professionals who have moved in also will be a good market for the urban, walkable community the family group has in mind. To create that community, their corporation has purchased a thrift store, a church, and a local meat market along with at least seven other buildings. The future could hold a brew pub, an affordable French restaurant, a low-key family restaurant, a wine bar, and a baking company.

Interestingly, the family making these investments is in the health insurance business that expects to grow under the "play or pay" mandate of the federal government's healthcare reform going into effect on Jan. 1, 2014.

With future earning potential in mind, one of the family members told the press, "It's nice, because we're not sitting here trying to make a ton of money off this. Quite frankly we can't, because we're starting these projects from scratch."

We have to wonder if long-term trends like placemaking are a result of the slow growth economy or a right sizing of the real estate market. There will always be pockets of fast growth like that in Williston, N.D., where the city is expecting 800 to 900 new houses coming on the tax rolls by the end of summer. And the price of land has gone from $500 to $180,000 an acre all because of the oil boom.

That extraordinary growth in North Dakota is hard to match, but in general, data indicates markets grounded in energy and high-tech jobs hold the most promise even for cities like San Jose, Houston, and San Francisco. San Francisco is also benefiting from the desire of echo boomers (children of baby boomers) for walkability, good public transit, and easy commutes to work, school, and daily errands. The same goes for New York City and Austin, Tex. The question real estate professionals ask: Will the echo boomers want to stay in the city once children arrive in their lives?

There are many questions to ask about the direction of real estate moving forward. What's going to happen with industrial space? The Urban Land Institute suggests prospects for apartments and industrial space are better than other asset classes. Although the space needs of manufacturing are changing.

Jeff Immelt, CEO of GE Appliances, recently talked about a new approach to producing a dishwasher. Build time was reduced by 68 percent and the required space by more than 80 percent.

REAL ESTATE HAS HISTORICALLY OFFERED BETTER RETURNS THAN BONDS AND CAN BE SAFER THAN OTHER FINANCIAL INSTRUMENTS IN THE CURRENT VOLATILITY.

The International Franchise Association (IFA) and the International Council of Shopping Centers (ICSC) have launched a new online match-making portal designed to connect franchise companies seeking real estate and landlords and brokers looking for retailers to fill open space. But with online sales soaring, what kind of space will retail really need moving forward?

There are questions, but one thing is for sure. Investors like real estate. It offers a better return than bonds and is safer than other financial instruments in the current volatility. If you need to be convinced, in 2012 REITs out-performed other asset classes with returns of 20.4 percent.

Despite this slow growth environment, it is important that the real estate profession take time to investigate cloud computing, adjust to the increased use of mobile devices, and engage social media as well as understand the trends like placemaking and the evolving needs for office and industrial space.

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THANK YOU

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Will placemaking bring people back to the city to work and live?

CITIES THAT EXCEL IN THE ART OF PLACEMAKING TOP THE CHARTS FOR REAL ESTATE INVESTMENT AND JOB GROWTH

Placemaking is about making memorable places that people like to visit and where people want to live. It can be called redevelopment or urban revitalization. It can mean leveraging a waterfront location, a sports stadium, or a farmers' market, but cities that excel in the art of placemaking top the charts for real estate investment and job growth.

It is like the chicken and the egg for cities like San Francisco and New York City. Can they predict job growth because of their economic production, or are they expecting job growth because employers know they can attract the desirable, skilled young professionals they need? Austin, Tex., which boasts a good work-play-live environment, is expecting a 2.3 percent increase in population this year.

There are commonalities among cities that can offer the living experience that the echo boomers (children of baby boomers) are looking for. They are drawn to cities that are pedestrian friendly and offer convenient mass transit. Cities serious about placemaking need to be human focused rather than auto focused, academics like to say.

Many factors must come together to get to the point where cities can offer human-focused environments. Population density is a major factor. For success, an area needs to have enough people to support mass transit. It also needs diversity. To provide the appealing work-play-live environment, it needs businesses to employ people, places to socialize, entertainment venues, and service providers to help with everything from the dinner menu to the laundry.

Project for Public Spaces (PPS), a nonprofit based in New York City and dedicated to creating and sustaining public places that build communities, often refers to the "Power of 10."

This is the way PPS describes the synergy that comes with placemaking. A park is good.

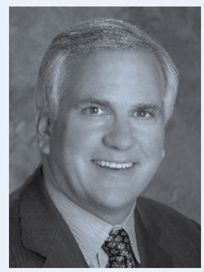
A park with a fountain, playground, and food vendor is better. If there's a library across the street, that's better still, even more so if the library offers storytelling hours for kids and local history exhibits. If there is a sidewalk café nearby, a bus stop, a bike path, and an ice cream stand, then you have what most people would consider a great place.

The goal for a city is to develop 10 great places and link them so residents and tourists alike can become immersed in the life of the city for days at a time.

Real estate pundits also suggest that investment is drawn to areas like these. And even conservative investors are beginning to look outside core districts that are becoming too pricey. They're looking for the next hip area.

ANOTHER VOICE

PLACEMAKING CAN BE A LIGHTER, QUICKER, CHEAPER APPROACH TO REVITALIZING DOWNTOWNS



MATT CULLEN

The following are excerpts from a conversation with Matt Cullen, president and CEO of Rock Ventures, an umbrella entity that provides operational coordination, guidance, and integration for Dan Gilbert's portfolio of companies and investments. He also has responsibility for Gilbert's high profile "Opportunity Detroit." Long involved in the revitalization of downtown Detroit, Cullen was the chief architect of General Motors' $500 million acquisition and development of the Renaissance Center as the automaker's global headquarters and the $1 billion redevelopment of the city's international riverfront.

A Cincinnati publication recently called Dan Gilbert the "downtown magic man." How do you respond to that?

We love Cincinnati. The people there are tremendous. The business community is great, the community leaders are great. They have already gone a long way in revitalizing the downtown. We just want them to know that we're committed to being a part of that revitalization and using the Horseshoe Casino to help connect the downtown to developing neighborhoods like Over the Rhine.

We see endless opportunities in downtowns and we want to collaborate, connect, innovate, and activate in downtowns like never before.

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According to reports, Rock Ventures is heavily invested in sparking downtown revivals in several cities. In Cleveland you are renovating the historic Higbee's department store. It will include pedestrian-friendly features such as windows to the outside, an easily accessible entrance, and street level restaurants. This sounds a little like placemaking.

I think it is. Placemaking is all about connectivity and bringing people together and that can be done by how you activate the buildings and public spaces. And there is proof that the principles of placemaking work.

We've been closely watching Rock Ventures' investments in Detroit, your biggest project. At first it seemed as if you were concentrating your activity on the main street, that spoke through downtown that connects the river with the entertainment district, but recently you've made some changes.

We originally thought we'd build up Woodward from the Detroit River at the south end to the entertainment district at the north. The city has a very popular park that runs along the banks of the river and approximately 12 blocks away a vibrant entertainment district with three major theaters; stadiums for the Tigers baseball team and the Lions football team; an opera house; restaurants; and bars. We wanted to develop a creative and distinctly Detroit corridor that would bring together those assets and in the process create a world-class downtown.

To make that happen, however, our consultants – Shook Kelley, North Carolina; TerreMark Partners, Georgia; Project for Public Spaces, New York; and Gibbs Planning Group, Michigan – helped us to realize we needed to develop one or two blocks east and west of Woodward to support the retail we planned.

We've taken it even further. We now have six districts. Our goal is to make each of the districts into hubs with multiple things to do, then connect those districts so we offer a depth of experience.

Connectivity seems to be the pivotal issue here. How important is mass transit to your project?

We think it is essential and we have been a part of bringing together the resources to make a light rail system happen. The M-1 Rail is a 3.4 mile light rail system that connects downtown with the Midtown section and its hospitals, university, and museums. We've raised $100 million philanthropically from the private sector and recently the federal government kicked in $25 million.

After you announced extensive plans for retail in downtown Detroit, one of your consultants compared your vision to two Middle Eastern cities that built downtowns almost from scratch – Abu Dhabi and Dubai.

He did that, but you missed what he added: In Detroit we already have an infrastructure. We also have enormous support. The City of Detroit, the Detroit Planning Commission, Downtown Detroit Partnership, Detroit Entertainment District Association, Detroit Economic Growth Corporation, Ilitch Holdings, and the M-1 Rail are all involved. We've also held workshops to engage people who live, work, and play in the targeted areas.

Everyone who knows Dan Gilbert says patience is not in his dictionary.

No question! We are moving on the long-term plan, but right now our focus is about lighter, quicker, cheaper. We are talking about activating space with more outdoor furniture, better lighting, wider sidewalks, and pop-up retail. People will begin experiencing a big difference this summer.

The trend is toward **a more collaborative approach to office space.**

COMPANIES HAVE BEGUN FOCUSING ON LARGE OPEN AREAS WHERE MULTIPLE DISCIPLINES CAN COME TOGETHER TO INNOVATE

There are predictions that commercial real estate will gain momentum this year, but building owners should be prepared for a new set of demands from prospective tenants.

There is a trend toward more open, collaborative office space. The office design that included a cubicle equipped with desk, PC, and phone for each worker surrounded by a few meeting rooms is no longer working for many companies, especially those with global footprints.

A global workforce and customer base can mean transacting business at any time, not just the 9-5 traditional work day. Audio and video conferencing, interactive white boards, instant messaging, email, and voice mail also bring exceptional connectivity to the office. Field offices and customers can join meetings with ease.

Companies seeing these changes also found that their cubicles were empty 65 percent of the time and their meeting rooms were always overbooked. In response, they have begun focusing on large open areas where multiple disciplines can come together to innovate and offering space that employees can reserve if they want to have a workstation.

The goal is to break down silos and encourage integration. Emphasis is being put on office design as well as technology because companies have

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decided that to shift behaviors, it is best to have people live the change, not just be told about it.

According to McKinsey researchers, workplace collaboration technologies are underutilized with just 3 percent of organizations getting it right. But there's good news: when companies begin to better use technology, they could see a 20 to 25 percent increase in productivity.

WHEN COMPANIES BEGIN TO BETTER USE TECHNOLOGY, THEY COULD SEE A 20 TO 25 PERCENT INCREASE IN PRODUCTIVITY

What do these collaborative spaces look like? In an article for Harvard Business Review, a software company described the collaborative space in one of its offices this way:

"Physically, it's a 2,000 sq. ft. open and sunlit space with large windows that frame the beautiful mountain views. Everything in the space is on wheels and is configurable by teams as they need it. They can move tables and whiteboards around to create mini-collaboration spaces."

Besides facilitating collaboration, this new open office layout reduces real estate costs. The company now can assign 140 people to the same space that would accommodate only 88 when it was configured the traditional way. Also cutting down the walls and going wireless means fewer wall jacks which cost $200 each.

For those that think this is only for technology companies, Stanford University is introducing the concept to executives as part of its class designed to help organizations create a culture of innovation.

Among leading companies that showcase their collaborative workspaces are Haworth in Holland, Mich., and Procter & Gamble in Cincinnati, Ohio.

ANOTHER VOICE

AN OFFICE NEEDS TO PROVIDE SPACE TO CONCENTRATE, COLLABORATE, AND EXCHANGE

ANGIE LEE

The following are excerpts from a conversation with Angie Lee, leader of SmithGroupJJR's National Workplace Practice. She is often quoted in design publications and is passionate about people, performance, and the power of design.

How do you stay on top of trends in the use of office space?

SmithGroup has a client advisory round table that we tap into for hot button issues and what the workplace of the future is going to look like.

They tell us that the business model has changed over the last five to eight years. Most firms have multiple locations in the United State and some activity in the global marketplace. The challenge is to design offices that are consistent with the firm brand, but also reflect the local culture.

And flexibility in the office space is pivotal. We see office buildings with a longevity of more than 50 years. Interior spaces have an 18+ year life before they get tired. But technology changes dramatically in 18 to 24 months. And we need office space that can accommodate that evolution.

Tablets have changed the office. But we're soon going to have technology that is wearable. Nike is already out with its FuelBand, Apple is coming out with its wrist-mountable iPad, and there are 3D printers that will allow us to produce product on site; when you input a drawing of a chair, the 3D printer will produce that chair. On a smaller scale, dentists are already using 3D printing to create crowns for your teeth while you wait.

Demographics are another shift in the marketplace. Baby boomers right now are still the majority, but research shows that by 2016 the millennials will take over and they are going to bring different habits and expectations to the workplace.

One thing the younger generation expects is a healthy, green environment.

Oftentimes when they describe a green workspace, they talk about a wall of windows looking out on a vista from National Geographic. How can offices in cities replicate that kind of scenery?

In an urban area, the window wall could look out on another building, but it's direct access to natural daylight that is important. We design to keep interior walls low to allow more access. It is part of LEED certification or a movement toward more environmentally friendly buildings. It is also healthy for people inside to see the rain, the snow, or the beautiful sunny day.

We're talking about flexibility in the workplace, but recently, Yahoo! put out a call to all of its workers to return from their homes and work in the office. How does this fit with what we hear about the move to telecommuting?

Yahoo!'s request to have everyone move back into the office seemed extreme, but they must have their reasons for it. Today's work environments are about choices; there are times when people need to work in an office to collaborate, whereas other times they have to focus and might be better off working from somewhere they can concentrate.

I like to say that offices must offer options for their employees to work: one where people can concentrate, one where they can collaborate, and one where they can exchange ideas informally.

The office of the future seems to require less square footage. Does this mean a cost savings for companies?

They can probably lease a smaller space, but the cost of technology and the labor to support the technology oftentimes will negate that savings.

How do you gain acceptance for a new approach to offices?

Support from the top is very, very important. It also requires a champion. Just as important is a well-designed change management program that uses all kinds of communications to involve the people who will be working in the new space.

When job growth picks up, real estate will follow. **There are positive signs.**

It wasn't any surprise when the Urban Land Institute (ULI) reported that respondents to its annual survey rated jobs as the single biggest factor affecting real estate in the coming year. On a scale of 1 to 5, respondents rated job creation 4.73, down slightly from last year, but still higher than any other single factor.

The stories from North Dakota, however, are a strong reminder of what jobs can mean to the real estate market. There are questions about whether the oil boom there can sustain the enormous growth in that area, but for now 800 to 900 homes will go on the tax rolls of Williston, N.D, this year and an acre of land that sold for $500 10 years ago is going for $180,000 this year.

Those are startling numbers for the councilmen in the town of 12,500 and they can't avoid feeling a little antsy. They remember the last boom that dried up and the housing developers bailed, leaving them with a $23 million bill for streets and sewers.

This is a dramatic story, but it does speak to the strong connection between jobs and real estate. Right now industry pundits indicate that markets grounded in the energy and high-tech industries show the most near-term promise while places anchored by major education and medical institutions should perform better over time.

THE MIDDLE MARKET IS PREDICTED TO ADD ONE MILLION JOBS THIS YEAR

Drilling down on statistics collected by the National Center for the Middle Market (NCMM) at the end of 2012, it seems that expectations for employment growth are stronger among all industries. The top four being services, construction, health care, and manufacturing.

Coming in first was the service industry with an expected mean total workforce growth of 4.0. Coming in second with a 3.5 mean total growth in employment was the construction industry, up 6 points from the third quarter. Health care came in third with a 2.5 mean total growth rate in jobs, up just three points from the third quarter. Manufacturing came in fourth with a predicted 2.1 mean total growth in jobs, up seven points from the third quarter.

Middle market experts who looked at the fourth quarter results point out a gap between job growth and revenue growth which suggests that companies are increasing overtime rather than adding people, signaling even more job growth potential.

In which areas will the growing companies hire? According to statistics, they will be hiring in operations, followed by marketing and sales. Technology comes in a distant third.

Among the companies reporting expected job growth there was only a 5 percentage point difference among regions. The south was strongest at 44 percent. The northeast was the weakest with 39 percent and the west and midwest were in the middle, both at 40 percent of respondents expecting jobs growth.

To put it into perspective, the middle market is predicted to add one million jobs this year. Perhaps job growth won't be as tepid as the ULI predicts and income growth will pick up, which means better times for real estate.

BRIGHT FUTURE FOR REAL ESTATE DEPENDS ON UNEMPLOYMENT RATE GOING DOWN

ITZHAK BEN-DAVID

The following are excerpts from a conversation with Itzhak Ben-David who has been called a prophet by Freakonomics columnists for his prediction of the subprime crisis based on his research into cash-back transactions. He is currently on the faculty of the Fisher College of Business at The Ohio State University.

Predictions for 2013 are that activity in hotels will surge and there will be gains in leasing, rents, and pricing. What do you see as a major trend in real estate?

Actually I look to the past to put the present into perspective. Real estate depends on employment. When unemployment goes down, the trend in real estate is positive. I'm not saying real estate prices will jump to 2006 levels, but they will go up. As the market works, prices will stabilize and we'll see an average of up to 1 percent annual growth over inflation.

The real estate you are talking about seems to be housing. Isn't there a trend away from home-ownership?

Absolutely. Homeownership peaked at 70 percent during the housing boom and now it has slipped to a 15-year low: somewhere around 64/65 percent. Basically people are deleveraging and they want to remain mobile. They look at the cost of home-ownership and they realize that renting is cheaper. I rent.

Can you talk about commercial real estate?

The demand for office space is more delicate. It isn't just about employment. It's about how well the firms that require the space are doing. It's more about the state of the economy and how well the businesses are performing.

Also, building owners have to be aware that the office layout is changing and the square footage per person is changing.

Actually there is a downsizing in general. Improved processes are demanding less industrial space, and there is a shift in retail to a "showroom" type space and less need for inventory.

It seems as if when we begin talking about the economy, we begin figuring in disposable income and confidence as factors?

Of course these are huge factors especially when we talk about asset classes like hotels and retail.

Retail reflects a blend of employment and disposable income. There is also the confidence factor. Confidence is important for retail and even more important for hotels. For hotels to thrive people have to have disposal income and they have to have a general confidence. They have to be willing to dip into their savings to travel and vacation. We're seeing that shift toward confidence and that is reflected in a growing interest in hotels. People are feeling a little more comfortable. They are not so afraid of getting laid off.

It's all about location as well for both hotels and retail. A strong market is essential.

Retail is really in transition. Retail and outlets overbuilt up until 2006 when the strong trend toward online began to emerge. I have no idea of the magnitude of online sales, but I do see online stores looking for brick and mortar locations. The stores are more like showrooms with fewer clerks and less inventory. I think we could be reaching a time where we have big box stores and these high tech showrooms with little in between.

They are talking about energy and technology leading job growth. How do you see it?

There might be an explosion of jobs in those areas, and it will be reflected in employment, but we have to look at overall employment rates. We need the unemployment rate to go down by 1 percent and then we will be looking at a brighter future for real estate.

Real estate is being touted as a good investment. Some even point out that it is a good option to bonds. Is it really safe?

Real estate is not safe. It's a risky asset. Just talk to a homeowner who lost half of the value of his house. REITs are the darling of investors right now. They are a substitute for corporate bonds and they offer relatively good yields, but that doesn't make them safe. They offer a steady flow of income, but the capital value isn't there. Their popularity is one of the mysteries of human psychology.

INDEX

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