THE ORANGE REPORT

YOUR SOURCE FOR KANSAS CITY COMMERCIAL PROPERTY INFORMATION

FOURTH QUARTER 2016

The Rising Cost of Construction and Why You Should Care

Industry Thoughts from Mattie Crossland

Whether directly or indirectly, commercial real estate developers live the ups and downs of the construction economy. Accurately forecasting construction costs are paramount to the success of any development project. With the tumultuous year of 2016 and its elections behind us, the CRE industry is on its toes waiting to see how the policies of the Trump administration will affect the US economy, and specifically, construction costs in the coming years.

Many professional organizations who monitor commercial construction believe the industry is on track for continued growth in 2017 following the 2% overall growth experienced in 2016. Despite what many see as an impending downturn in the overall real estate cycle, forecasters believe the effect on the construction economy will be delayed. The gradual increase is expected to continue well into 2018, eventually slowing modestly as the year comes to a close. Robert Murray, Chief Economist for Dodge Data & Analytics, considers the steady growth as a sign of the industry "moving into a more mature phase of expansion," mirroring the slow but steady recovery in the wake of the Great Recession. An anticipated slowing demand for new construction starts will have little immediate effect on construction prices. Developers likely will not see relief from rising costs until late 2018 or 2019, when the overall US economy sees an economic slowdown. Economists are careful to point out that this slowdown will not be as sharp as that experienced in 2009. Coupled with rising interest rates, CRE developers will experience a trying time period characterized by thinning profit margins and higher barriers to entry.

When analyzing construction input pricing, you can plan to see a slight uptick of 0.5-2% across the board in 2017. Associated Builders and Contractors, Inc. (ABC) recently reported that input prices in 2017 have already experienced a higher than normal increase, partly attributable to surging iron and steel pricing, but generally expects the overall trend to even out by the fourth quarter. Asphalt paving, steel, and concrete products pricing should resume growth in 2017. Gypsum products will experience the strongest growth of non-oil dependent materials with an expected 6-7% increase. Gas and petroleum products are expected to make a full rebound from their drop in 2016, with prices stabilizing between $50-60 per barrel. However, there are three vital input prices which have fallen year over year recently, and are expected to do so again this year, including plumbing fixtures and fittings; non-ferrous wire and cable; and prepared asphalt, tar roofing and siding products.

Continued on the next page.

Sources: [1]CoStar: Total existing space, for all retail and office types, including direct and sub-lease. Change for Average Vacancy Rate represents the difference between 2015 & 2016- percentages. [2]Dodge Data & Analytics [3]U.S. Census Bureau: Estimated monthly. [4]Creighton Economic Forecasting Group. Survey ranges from 0-100 with a score of 50 considered growth neutral. Under 50 indicates a contracting economy for the next three to six months. Mid-America survey states are Kansas, Missouri, Arkansas, Iowa, Minnesota, Nebraska, North Dakota, Oklahoma and South Dakota. [5]U.S. Bureau of Labor Statistics. Unemployment rates seasonally adjusted. [6]Kansas City Regional Association of Realtors. Average sales price of new & existing homes. [7]Home Builders Association of Greater Kansas City. Total units YTD as of December 2016.

Article Sources: [a]Associated Builders and Contractors, Construction Economic Update. "Construction Input Prices Plummet in November" (2016). [b]"Construction in Job Growth Accelerates Amid Optimistic Post-election Outlook in November" (2016). [c]"Construction Unemployment Rates Improve in 38 States Year-Over-Year" (2016). [d]Dodge Data & Analytics. "New Construction Starts in 2017 to Increase 5% to $713 Billion According to Dodge Data & Analytics" (2016). [e]Cavalcante, Carolina. "First Look at Construction Costs in 2017" (2016).

Kansas City Sales & Leasing Data

KC MSA Shopping Center Retail[1]

	Q4 2015	Q4 2016	% Chg
Total GLA (s.f.)	113,298,846	113,412,016	0.1%
Avg. Lease Rate	$12.55	$12.95	3.2%
Avg. Occupancy Rate	92.3%	93.8%	1.5%

KC's Largest Lease Signings - 2016[1]

Location	Tenant	Size (s.f.)
South Johnson County	Menards	149,567
BluHawk	Cosentino's Market	55,000
Burlington Plaza	Zone 6 Fitness	48,866

Avg. Total MSA Vacancy[1]

Period	Vacancy Rate	Lease Rate
2016	6.2%	$12.95
2015	7.7%	$12.56
2014	8.0%	$12.24
2013	8.4%	$12.15

Rising Cost of Construction

The Pattern of U.S. Construction Starts[2]

	2014	2015	2016	2017 Projected
Total Construction in Billions Perecent of Annual Total	**$601.0**	**$667.7**	**$676.4**	**$712.9**
Single Family Housing	**$163.8** 27%	**$186.2** 28%	**$203.5** 30%	**$227.1** 32%
Multifamily Housing	**$68.9** 11%	**$84.0** 13%	**$86.8** 13%	**$86.6** 12%
Commercial Buildings	**$83.1** 14%	**$88.0** 13%	**$98.9** 15%	**$105.1** 15%
Institutional Buildings	**$104.4** 17%	**$105.2** 16%	**$108.1** 16%	**$118.5** 17%
Manufacturing Buildings	**$35.6** 6%	**$24.1** 4%	**$17.0** 3%	**$18.1** 3%
Public Works	**$121.3** 20%	**$123.7** 19%	**$120.1** 18%	**$127.5** 18%
Electric Utilities/Gas Plants	**$23.9** 4%	**$56.6** 8%	**$42.0** 6%	**$30.0** 4%

National & Regional Trends

U.S. Food & Retail Sales[3]

Period	In Billions
'16 - Q4	$1,400.6
'15 - Q4	$1,345.7
'14 - Q4	$1,319.3
'13 - Q4	$1,263.6

Business Conditions Index[4]

2016	Oct	Nov	Dec
Missouri	41.6	55.1	57.1
Kansas	43.7	44.4	51.1
Mid-America	43.8	46.5	53.1

Unemployment Rate[5]

December	'15	'16
Midwest	4.7	4.7
U.S.	5.0	4.7

Consumer Price Index[5]

2016	Oct	Nov	Dec
Midwest	227.4	226.7	226.8
U.S. City Avg	241.7	241.4	241.4

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Despite a general increase in input pricing, the most immediate problem for developers and contractors (and perhaps what is felt the hardest here in the KC Metro) is the extreme labor demand and simultaneous shortage. Labor demand was strong pre-election in 2016, and the need is only becoming magnified due to planned infrastructure improvements and increase in domestic production sought after by the Trump administration. Though the construction industry employment is up compared to the overall economy's job growth rate, the construction unemployment rate remained at a stable 5.7% at the close of 2016 despite increasing demand. The problem exists in the gap between available work force and skilled laborers. "Construction industry employment growth would likely be much sharper if more suitably skilled or trainable workers were available to fill the job openings," according to ABC, who sites the shortage of skilled labor vs. general labor as the real problem. The competition for skilled labor has created significant wage pressure that is fast outpacing historical inflation rates. "Construction firms in the nation's hottest markets report that in certain occupational categories, compensation is rising at a 10% per annum pace or more." A severe shortage is also being recognized for construction superintendents and managers qualified to keep up with industry growth.

For commercial real estate, all of the above statistics indicate one thing: rapid growth in building costs. Contractors are being cautioned to conservatively bid projects, especially large projects whose schedules are expected to span years, in order to avoid financial downfall. Post-recession, contractors have been more nimble in reacting to market pressures to avoid reiterating past mistakes and are intentionally refraining from taking undue risks as this upcoming slowdown continues to unfold. With the Federal Reserve expected to continue raising interest rates in 2017, I expect to see a growing number of developers grappling with both the increased cost of development and higher exit cap rates. Prudent developers will avoid aggressive cost per square foot budgeting and prepare for how construction cost increases will affect their later performance.

***Mattie Crossland**, Project Manager*

Giving Back

LANE4 continues to support Harvesters Community Food Network every year. In December, the LANE4 team participated in our Annual Volunteer Day at Harvesters' main facility in KCMO and claimed the record of food boxes packed for the elderly – 597 boxes!

Harvesters is a registered 501(c)3 nonprofit organization committed to finding long-term solutions to hunger by spreading awareness to communities throughout Kansas and Missouri. Harvesters began operations in May 1979 and now feeds more than 141,500 people in 26 countries each month. For more information about Harvesters and to learn how you can help, please visit **www.harvesters.org**.

About LANE4 Property Group

LANE4 provides its clients the best position from which to succeed. The firm offers an advantage in tenant representation, project leasing, property management, investment sales, receivership, project management, and development. These comprehensive services allow our clients to streamline their time and optimize their investments. From the initial market analysis through the grand opening and operation, the team at LANE4 executes each step of the process with skill and professionalism.

Our team has forged strong relationships with our constituents: tenants, investors, municipalities, architects, engineers, attorneys, contractors, and developers. This experience, dedication, and focus – combined with creativity and passion – is the LANE4 formula that maximizes our partners' results.

Kansas City Housing

Average Home Price[6]

County	Dec '15	Dec '16	% Chg
Cass County, MO	$209,302	$193,842	-7.4%
Clay County, MO	$181,851	$196,446	8.0%
Jackson County, MO	$165,129	$170,474	3.2%
Platte County, MO	$249,379	$254,972	2.2%
Johnson County, KS	$290,848	$301,304	3.6%
Leavenworth County, KS	$179,567	$214,638	19.5%
Miami County, KS	$185,211	$221,468	19.6%
Wyandotte County, KS	$111,248	$127,137	14.3%
Kansas City Region	**$204,792**	**$213,467**	**4.2%**

Residential Building Permits-YTD[7]

County	Dec' 15	Dec '16	% Chg
Cass County	320	598	87%
Clay County	1,722	1,548	-10%
Jackson County	2,392	2,311	-3%
Platte County	501	962	92%
Johnson County	3,262	3,461	6%
Leavenworth County	218	246	13%
Miami County	104	260	150%
Wyandotte County	176	272	55%
Kansas City Region	**8,695**	**9,658**	**11%**

For. Your. Information.

LANE4 Continues to Grow

Welcome Alex and Rita

LANE4 recently welcomed two new employees to its team, **Alex Howe** and **Rita Burke**.

Alex joins the LANE4 sales team as an associate broker. Alex is a bright mutli-family agent in the KC market and brings passion, creativity, and drive to the team.

Rita is the latest addition to the LANE4 Property Management department. As an assistant property manager, Rita assists the senior managers on LANE4's quickly expanding portfolio of management assignments.

X TEAM