Buffalo Niagara Real Estate Overview and Review of RKG Associates Economic Analysis for the Niagara Opportunity Area

Prepared For: LaBella Associates
300 Pearl Street Buffalo, NY 14202

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Presented by:
Shana Stegner, Managing Director
Robert Starzynski, CCIM, Investment Sales
Sarah Cashimere-Warren, Director, Office Sales & Leasing

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Real Estate Overview & Review of Economic Analysis

INTRODUCTION AND OVERVIEW

CBRE|Buffalo (CBRE) on behalf of the City of Niagara Falls, New York, and as a sub-consultant to LaBella Associates, has been retained to provide commercial real estate market background, analysis and related consulting services for the prospective redevelopment of the Niagara Opportunity Area (NOA).

Part of the CBRE analysis involves a review of economic and market findings of fellow sub-consultant RKG Associates given the realities, including competing elements, within nearby submarkets and the broader Western New York (Buffalo-Niagara) region. Realities is a key word because any development concept needs to relate to conditions that exist and what is likely to succeed.

The CBRE review is based on hard data consistently and systematically accumulated each year over more than a decade for industrial, retail, multi-family, and office uses in Erie and Niagara counties. This data is widely used by CBRE and cited by real estate developers and economic development agencies to assess user as well as investor preferences and needs in terms of location, access, and probability of fiscal success, among other elements. CBRE's review process is also based on ongoing information acquired in day-to-day commercial real estate transaction activities, knowledge of capital markets, and development projects in process including preliminary planning and/or concept stages.

The historical precedents for current economic, demographic, geophysical, and land utilization elements within the NOA and the City of Niagara Falls are already known, and will not be elaborated on in this review except as key impediments or attributes, as the case may be, to realize findings for prospective land uses. It is also important to view the NOA not only in the context of the City of Niagara Falls, but that which has become known as the bi-national "Niagara" region, an area that includes the Niagara Peninsula of Southern Ontario as well as the Buffalo –Niagara region in New York. Cross border facilities for manufacturing, distribution, and retail trade will be of even greater importance in the years to come with the Niagara region border crossings long since established as the second busiest between the US and Canada.

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THE BUFFALO-NIAGARA COMMERCIAL REAL ESTATE MARKET

Over the past decade, the Buffalo-Niagara commercial real estate market vacancy rate has consistently been below the National average year over year. Historically the market has been flat, with rental rates and sale prices holding steady with minor positive and negative fluctuations.

Development is typically tenant driven whereas landlords need to secure a tenant in order to secure financing to get their projects off the ground. Larger users in the market have provided these developers the "kick start" needed for new projects.

The decision made by firms to remain or relocate to the Buffalo-Niagara region are due to, location to the Canadian border, the strong labor pool and cost of living to name a few. Additionally, the industrial market has been experiencing a trend of decrease in available functional space in the market. This is a direct result of the increase in demand over the past several years, but also in large part the reluctance of developers to commit to construction of speculative product in the absence of having a prospective user in hand. Buffalo-Niagara is not a "spec build" market and the severe economic recession of 2008-2011 served to reinforce this trend.

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Office

The Niagara region office market is unique and consists of primarily former industrial/flex and quasi-retail inventory. Past heavy industrial and tourism shaped the built environment today. The tourism roots are apparent as retail inventory is abundant throughout the Niagara area. The retail users are filling former office buildings, while some office users are found in retail strip plazas. Previous buildings offering office space have now been back-filled as seen with the former 80,000 SF TeleTech call center space, now the Smoking Joes Native Center and the former 20-story United Office Building, now The Giacomo boutique hotel and residences. One Niagara Center, formally Occidental Chemical's 186,000 SF headquarters currently services the tourism sector offering souvenirs and dining options. The building offers commercial office space and is currently available for sale and lease. The Niagara region is fortunate to have the retail and tourism draw to absorb limited portions of the vacant office space that had been on the market for some time even if short-term.

The City of Niagara Falls offers smaller on-street office space in a higher density setting, but most of this space consists of older product with vacancies. Former institutional and historic product that now is vacant could potentially house an office component once again through adaptive re-use efforts. The former heavy industrial area is still home to manufacturers that have small office components within their operations. Some of the larger users such as Occidental Chemical Corporation located along Buffalo Avenue could potentially house their office operations within a single consolidated structure once redevelopment occurs. This not only would calm the heavy industrial look along the corridor but could present a reinvestment opportunity and possibly attract additional office users along Buffalo Avenue. The 60,000 SF New York Power Authority's office and warehouse building located on Witmer Road is a great example of a newer flex product design.

The majority of the office users fall into government, healthcare and social services, medical, legal and financial service firms. Seneca Gaming Corp. also has a large office presence in the City of Niagara Falls within the 6th story office building on 3rd Street. Formally the Aerospace Museum, this building now services professional office users.

There has not been large office building construction or speculative builds due to the lack of demand in this area, and the tenant driven nature of the Buffalo Niagara area. The average sized office tenant is under 5,000 SF. With limitations in newer office construction, these tenants have leased space in former strip plazas, and flex warehouse product. Due to the lower amount of inventory, most of the office options that are 8,000 SF and larger have satisfactory occupancy or are fully leased to a single user. Traditional office product that is coming online has been driven by smaller medical users and located throughout the Town of Niagara and Wheatfield.

Historically, Buffalo Niagara's overall vacancy is well below the national vacancy rate; however, the national vacancy has declined to 13.9% as of the second quarter of 2015. Demand for office product continued nationally with 9.5 million square feet of positive absorption. (CBRE Research, 2015). The Buffalo office market currently sits at 14% vacancy, and has an abundance of traditional office building product. The Niagara office market is not positioned currently to present a true representation of office availabilities due to the overall lack of product. Office buildings that were 8,000 SF and up, totaled just over 2 million square feet, and were predominately occupied to some degree. As noted in the Economic and Market Assessment, there has been re-purposing of centers into a mix of retail and office users. The vacant big box stores could potentially be suited for large back office users as well. (Economic and Market Assessment Niagara Falls, NY, 2011)

Absorption in the Buffalo Niagara area has been positive overall but with minimal gains as the market is known for tenants shifting from one building to another leaving vacancy.

Niagara County suburban markets do contain smaller pockets of tenant-driven office parks in areas such as Lockport and Wheatfield, but CBRE's transactional brokerage activities in these areas indicates occupancies and rates similar to those in Erie County. Outside of the aforementioned rental rates are traditionally lower in the Niagara region due to factors such as building classification and demand for product.

Industrial

The industrial product throughout the Niagara region is heavily owner occupied with very little vacancies. The industrial inventory presents a mix of older product specific to its original function or product that is a re-use of former big box retail into warehouse. Transaction activity has been slow without diverse product and developer control. There is however, available industrial land at competitive rates throughout the market.

It is important to look at Erie County's industrial market and the low availability rate that has been trending over the past couple years. The overall availability rate for the Industrial market is 4.5%, down from 5.7%, with 900,984 sq. ft. of positive absorption. This has been the third consecutive year that demand has outpaced supply resulting in a lower overall availability rate. The current lack of supply could prove to be an advantage to Niagara as lease and sale prices increase and users look for competitive rates in neighboring areas.

Nationally, as a result of a rebounding economy and comparatively weak construction activity, the availability rate has fallen as of first quarter 2015 to 10.1%, a post-recession low. Rents have continued their steady growth and consumer consumption is stimulating industrial demand. (CBRE Research, 2015)

As a border city, the status of the Canadian Industrial marketplace is critical to the Buffalo-Niagara region. The Canadian industrial market remained strong in 2014 with the Toronto area at 4.1% availability rate. (CBRE Research, Q3 2014) Regionally, the Buffalo-Niagara market is experiencing the lowest availability rate when compared to the neighboring cities of Cleveland (7.1%), Pittsburgh (7.0%) and Syracuse (17.1%).

Only 88,000 sq. ft. of newly constructed space was added to the total industrial inventory in 2014. Most of the construction demand is anticipated to come from the private sector, owner/occupiers in the form of build-to-suit facilities. Developers in the Niagara area are looking to re-use structures such as former Sam's Club and old Walmart's into industrial product to service demand where new construction is not needed.

Industrial users are paying a premium for "clean" space, ceiling heights, and proximity to the New York State Thruway. In the Buffalo-Niagara market access is important for both the user and its employee base. There is an ongoing preference for existing product over new builds with shorter timelines for the industrial sector due to market demands. Occupiers continue to want to be close the international bridge crossings.

A great deal of the demand for industrial space comes from increased spending on consumer goods. Gas and oil prices contribute to how much disposable income families may or may not have affecting the overall industrial demand.

Investment has been seen throughout the industrial market in Niagara County, and it is expected that redevelopment of the Niagara Opportunity Area (NOA) will only attract more interest such as the Yahoo and Greenpac Mill projects.

Retail

CBRE|Buffalo's Retail Market View looks at (6) trade areas identified as: City of Buffalo, Boulevard, Eastern Hills, Galleria, McKinley, and Niagara Falls, accounting for over 26 million sq. ft. of retail space. For the third consecutive year, Buffalo-Niagara's retail market experienced a decrease in vacancy in 2014 to 10.3%. The 1.3% decrease in vacancy now puts the region at 1.2% under the U.S. Retail vacancy rate of 11.5%. (CBRE Research, 2014) The Buffalo-Niagara retail market was very healthy in 2014, with new inventory added and coming online fully occupied totaling 361,534 sq. ft. of positive net absorption.

The U.S. markets continue their trend of decreasing vacancies and increasing rental rates. Much like Buffalo-Niagara, the vast majority of projects being developed nationally tend to be primarily pre-leased, with only a limited amount of speculative space being added to the market.

The Niagara Falls trade area accounts for over 4 million square feet. The Fashion Outlets of Niagara, completed their expansion in 2014 with most of the new space pre-leased to a diverse mix of 35 tenants. This activity resulted in a reduction of retail vacancies from 11.7% in 2013 to 11.2% in 2014. The Fashion Outlets is one of the top three performing outlet malls in terms of per. square foot sales. (Economic and Market Assessment Niagara Falls, NY, 2011)

There has been continued improvement and new construction of retailers surrounding The Fashion Outlets of Niagara and the crowds it draws. The national retailers are demographic and traffic driven and as the area grows we continue to see development. Area developers have not seen any signs of saturation surrounding this trade area as new projects with speculative space have been filling up as seen with Benderson Developments LaSalle Center.

Although, this area has been successful, not far in the City of Niagara Falls development has been slower with small private retailers and tourist shops dominating the area. Old Falls Street has been an important success with the addition of 14,000 SF Rain Forest Café, TGI Fridays, Starbucks and Barnes and Noble at the Niagara Culinary Institute. The proposed redevelopment of the former Rainbow Center Mall by Uniland could potentially create waves of new development into the area as seen in downtown Buffalo.

We will revisit this trade area later in our review, particularly as relates to the topic of NOA retail leakage and recapture.

Multi-Family

The CBRE|Buffalo Multi-Family report looks at the Buffalo-Niagara area in terms of sales transactions of Multi-Family product across the region. In 2014 sales remained strong with 3,168 apartment units sold, an 18% increase over the number of units sold in 2013. Total sale transactions for 2014 were 146 a decrease from 2013, but nonetheless exceeded the 140 transaction average from the previous five years. The total consideration for all transactions was $152.9 million. This is a nearly 45% increase over the 2013 total of $105.6 million.

The 2014 average sale price per unit was $48,258, approximately $9,000 more than the average sale price per unit for both 2013 and 2012. The total dollar consideration, number of units sold, and average price per unit all point to the overall strength of the apartment sector of the commercial real estate market in Buffalo-Niagara. However, it is also important to note that in a smaller market such as Buffalo-Niagara, relatively few sales can and often will skew the annual averages from year to year.

Overall, new construction as well as adaptive reuse and refurbishment of older, existing properties in Buffalo-Niagara has continued to accelerate over the past four years as the U.S. continues to recover from the severe economic recessionary period of 2008-2010. Additional impetus for developers and investors in general has been provided by an interest rate environment at or near all-time historic lows. This continues to provide a compelling opportunity for new equity to enter the real estate investment market.

Multi-Family housing has been commercial real estate's strongest sector over time for the U.S. as a whole for decades, and demographic projections suggest continuous growth. Younger adults coming into the housing market are trending toward longer periods as renters, and older adults are trending away from the responsibilities of home ownership.

Niagara County displayed a decrease in year-over-year results in number of transactions at 35, and an almost 50% decrease in the number of units sold. However, average sales price per unit increased by more than 11% from $31,384 in 2013 to $34,927 in 2014. The Niagara area has not seen the momentum of multi-family redevelopment as the Buffalo area and the multi-family product is not abundant. The Economic and Market Assessment notes "Only 8.3 percent of the City of Niagara Falls units are in multifamily buildings with ten units or more, and many of these are subsidized housing properties serving low-income families and especially seniors." Due to the low overall rents, the report points out that "it would be difficult to develop new rental units without some type of subsidy or government assistance". (Residential Market Analysis Niagara Falls, NY, 2011)

Through continued redevelopment and revitalization efforts the City could potentially draw more businesses to want to locate downtown and thus attract the millennial population looking to live closely to where they work. The area also is home to Niagara University, where the options for student housing are limited, especially for the graduate student base.

CANADIAN INVESTMENT

The Buffalo-Niagara region has benefitted tremendously from bordering Canada. The region has seen the impacts of Canadian shoppers year after year as shoppers travel to the Fashion Niagara Outlets, Galleria Mall and now smaller niche retail neighborhoods. Canada has faced unique challenges trying to retain consumers and adjust to shifting market conditions. (Shopping Center Business, July 2015)

Canadians travel to the region for a variety of reasons stemming from "bang for their buck," variety and selection, to gas and groceries. To many the short drive has become routine and almost habit no matter what the Canadian Dollar is doing. Shopping Center Business reported in July, 2015 that due to the recent decline in the Canadian Dollar, a 14% drop in cross border shopping in the past year had occurred, however this has not been the case in the Buffalo-Niagara region, where daily Canadian shoppers and tourists flood the area for what is known as an easy day trip or weekend getaway.

In May of 2015, a Canadian competitor to the Niagara, NY Fashion Outlets shopping mall opened in Niagara-on- the- Lake. This however, did not impact the Niagara Fashion Outlets which had previously added an additional 175,000 SF and 35 stores in 2014. The activity has continued and has spurred several national chain restaurants to pop up surrounding the shopping district. The consumer impact although strong, is certainly contained within an isolated area and there is not much spill over into the City of Niagara Falls, NY.

The City of Niagara Falls and nearby suburban towns on the US side have historically been known for their tourist population, but this had changed drastically through the years as tourists shifted to the Canadian falls attractions. While a majority of the current cross-border travelers come for the retail experience, tourism is growing throughout Buffalo due to numerous new developments that have occurred.

Manufacturing is another sector where the Buffalo-Niagara region has benefitted from Canadian investment. The local economic agency, Buffalo Niagara Enterprise, has helped over 70 Canadian companies expand into the region since 1999. (Buffalo Niagara Enterprise, January, 2015). These companies look to the Buffalo Niagara region for numerous reasons including: reduced shipping costs, experienced labor pool, reduced border crossing, lower real estate costs, and the "Made in America" stamp. The reduction in real estate costs represents 68% in savings when comparing industrial sales prices in Toronto to Buffalo. (Buffalo Niagara Enterprise, 2015).

BUILDING ON STRENGTHS

Comparisons are often drawn regarding economic development in other US metro areas, or for that matter with other municipalities within one's own Metropolitan Statistical Area (MSA). For many years one mantra when comparing the Buffalo Niagara area with other areas was "why can't we be like Pittsburgh." The simple answer of course is that Buffalo Niagara is not Pittsburgh. The more involved comparison has to do, among many other factors, with population size, geographic location, history, economic development incentives, collaboration between private and public sectors, tax structures, presence of foundation dollars, concentration of higher education/research resources. Success in economic development is in large part playing to strengths.

Looking within the Buffalo-Niagara region, the economic development successes include: light industrial development in Lakeside Commerce Park off of Route 5 in South Buffalo; new higher end mixed uses in Larkinville in a formerly downtrodden industrial area with large, mostly empty buildings; and; the new Solar City manufacturing plant currently being built on what were abandoned former steel plant lands. Coincidentally, all three of these redevelopment areas are within about two miles or less of one another, comparable in overall square mileage to the City of Niagara Falls own Niagara Opportunity Area (NOA). Buffalo Niagara's success has been the result of building on strengths such as location, proximity to existing transportation infrastructure, economic development incentives, collaboration between private and public sectors, and last but not least a tremendous amount of private capital willing to take risks. The afore-mentioned developments now performing or being built are the result of more than a decade of effort.

New industrial development, which often creates synergies for other types of peripheral and nearby development are achievable within the NOA over the longer term. The strengths are: major transportation infrastructure; abundant power; overall location, including easy access to Canada; and, initiative in the form of the developing NOA master plan. The main task will be to continue to play on these, among other strengths, to build confidence and interest among sources of private capital once the key strategic sites for redevelopment within the NOA are identified and actively promoted.

REVIEW OF RKG ASSOCIATES ECONOMIC AND MARKET ANALYSIS FINDINGS

As mentioned in the Introduction and Overview section, CBRE's scope of work for the NOA includes a review and analysis of RKG's own analysis (Working Draft of July 13, 2015).This is an important element of NOA for future development concepts, which CBRE will also be tasked with providing assistance in further analyzing alternatives, and making recommendations as part of a sustainable Master Plan containing strategies for selected sites. The following is a brief summation of some of the key findings of RKG's analysis, and CBRE's support thereof, or observations and challenges for further consideration given the realities, including competing elements within submarkets in closer proximity to the NOA as well as the broader Buffalo-Niagara region.

Economic Indicators

- RKG indicates "annual demand in some sectors is nominal at less than 2000 SF, suggesting that speculative development (without tenants in hand) could present a financial risk many developers are unwilling to take." This is a true statement and a very key point for NOA development as it mirrors the reality of recent decades throughout the Buffalo-Niagara region and is likely to be the reality for the foreseeable future.
- "The ten year demand" as noted in RKG's report for Accommodations/Food Services exceeds 225,000 SF, suggesting that a hospitality venue may be supported pending other considerations. CBRE observes that the other considerations include; unattractive locations for hospitality sites/food services within the NOA beyond those which have already been developed at or near the Route 62 interchange of Interstate 190; newly built or proposed hospitality locations outside NOA in downtown Niagara Falls in close proximity to the Falls; and, two new hotels planned or under construction, totaling approximately 170 rooms in Grand Island within less than five minutes drive time of the NOA.

Retail Indicators

- CBRE would concur with the RKG observation that retail sales leakage for the City of Niagara Falls represents about 35% of local consumer demand. There is good reason for this as a large portion of the huge concentration of retail in the Niagara Falls Boulevard/Military Road area, is actually located in the Town of Niagara.
- RKG conservatively estimates that a 5-25% recapture of sales leakage could result in the development of 25,000-125,000 SF of new retail city wide. Given the City's population decline, long established existing consumer shopping patterns, and well established Niagara Falls Boulevard/Military Road retail concentrations, there may not be realistic demand to support the stated level of new retail development.
- CBRE supports RKG's opinion of additional retail in the NOA likely being of smaller scale and neighborhood convenience oriented.

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Residential Indicators

- CBRE observes RKG's statements with regards to decline in number of households, age demographic shifts, decline in rental households in the NOA, and median owner household values and gross rents in the NOA and the City are true representations.
- The challenge for maintaining the strength of existing residential neighborhoods as well as development of new residential product within the NOA is the presence of surrounding, often adjacent heavy industrial facilities.
- RKG's conversations with local officials indicate that over the 2001-2013 period there were over 360 residential permits for new construction in the City. We question the definition of "new" because our observation is that new single and multi-family residential construction has been negligible if indeed it has occurred at all.
- CBRE's observation is that the aging population within the NOA and the City suggests that new senior housing could be the most economically viable form of residential development.

Employment and Estimated SF Demand

- The projection in RKG's Employment and Estimated SF Demand Chart is for the period of 2014-2024 for all of Niagara County. What is difficult to project is the impact on demand specific to NOA. For example, CBRE does not envision a demand over the next decade for office space related to sectors such as finance, insurance, real estate, or professional services. There may however, be a demand for healthcare and human services given the lower income demographics and aging populations within the NOA. Industrial demand may in fact increase within the NOA despite a very significant projected drop in Niagara County as a whole.
- The SF demand based on per person within the Employment and Estimated SF Demand Chart is observed by CBRE to be high, as ongoing right-sizing, and shifts within the traditional office and manufacturing environments reflecting increased technology may mean significantly less SF per employee.

Estimated Retail Sales, Leakage and Recapture

- CBRE, based on comprehensive knowledge of retail markets with the Buffalo Niagara region, question the validity of any recapture of retail sales leakage for the categories of: electronic and appliance stores; building material and garden equipment; sporting goods; hobby; book; music stores; and, clothing and clothing accessories stores. All of these categories are already well represented within the nearby Niagara Falls Boulevard/Military Road retail concentration of local, regional, and national retailers.
- CBRE's observation of the table titled Typical Retail Site Location Criteria supports our previous point by recognizing that retailers follow set standards with regard to desired populations within certain polygon areas, traffic counts, and co-tenants where desired.