SURVEY OF NORTHEAST OHIO’S REAL ESTATE AND CONSTRUCTION INDUSTRIES

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Construction Survey Executive Summary

For the second straight year, there is a tempering of the bright optimism expressed by respondents of the Northeast Ohio construction industry survey in 2015. The tone of 2017 survey respondents appears to be one of cautious optimism—a number of respondents express confidence in continued growth, tinged with a concern about the skilled worker shortage. Still, many of our respondents are optimistic about growth if infrastructure projects and decreased regulation—key cornerstone pledges of the new administration—come to fruition.

Labor and construction materials are vital to the health of the construction market. At a time when material prices had already increased 4.8% from February 2016 to February 2017 (Bureau of Labor Statistics) and are expected to increase further, it’s no wonder that material price volatility is a major concern to survey respondents.

Competition for jobs is at its lowest point since we began asking respondents about it in 2009. The average job size is holding steady, and respondents continue to express optimism about growth opportunities outside Northeast Ohio. Opportunities within the region are lower, but holding steady.

Last year, respondents clearly expressed concern about the lack of skilled workers for their companies. That concern has only grown—this is a challenge that continues to threaten the ability of our respondents’ companies to take on new work and grow their businesses.

Now that the new administration is in place, numerous survey respondents have expressed optimism about action on tax reform, deregulation and a new approach to health care reform. Overall, respondents are feeling good about their industry as they continue to invest in additional opportunities.

As always, we welcome your feedback and questions.

Priorities

For the first time, we asked respondents to list the actions that are among their company’s top priorities. Finding solutions for skilled labor is far and away the number-one answer with 69% of survey respondents choosing this priority. Seeking new markets and strategic planning are other important priorities with more than half (52%) of respondents choosing these priorities. Conversely, seeking new M&A opportunities and getting into new construction trades were the lowest priorities.
Material Price Volatility

For the third straight year, material price volatility is the top political issue on the minds of our construction survey respondents. In fact, this issue has ranked in the top two positions in seven of the last eight years. Much of the concern is likely associated with the increase in demand caused by the uptick in building activity, though the anticipation of higher energy prices is certainly a contributing factor. Concern about tariffs arising from conflicts over trade agreements, plus the new administration’s vow to limit imports, has resulted in the decision by some material suppliers to raise prices, perhaps prematurely. Finally, the skilled labor shortage – a pressing challenge for the industry – can contribute to increased material costs as construction companies are forced to pay higher salaries to attract and keep skilled labor.

Health Care

Health care reform continues to be viewed as one of the top political issues affecting the construction industry—it was ranked by survey respondents as the second-most important political issue this year and has ranked among the top three issues since we began asking this question in 2009. While legislation to repeal and replace the Affordable Care Act faces an uncertain future in Congress, our survey respondents join other business owners as they anxiously await the outcome of a new plan.

Workers’ Compensation

One of the surprises in the 2017 survey is that workers’ compensation jumped five positions to become the third-highest ranked political issue by respondents.
The uptick may be partly anticipatory in nature. First, when the Ohio workers’ compensation program builds up a reserve, refunds go to Ohio employers who are current with their payments to the program and have no lapses in coverage. More than 200,000 private and public employers will get a share of the $1 billion surplus between summer and fall. This is the third rebate since 2013.

Another positive reason for the increased interest in workers’ compensation likely stems from a change in coverage for accidents that occur in vehicles driven on behalf of a business. If the accident is caused by a third party, the Ohio Bureau of Workers’ Compensation will now cover the entire claim of the employee when the worker is hurt through no fault of their own.

Employers should be feeling some relief from bearing a portion of this cost, as they have had to do in the past.

Skilled Labor Remains Top Industry Threat

For the fourth straight year, securing skilled labor is the greatest threat to our construction company respondents, this year by a wide margin. More than half (52%) of respondents find securing skilled labor to be the greatest threat, and no other issue is even close. That’s quite a change from the years of the Great Recession, when lack of work was the greatest threat. Concern about labor costs dropped 10% from 2016, proving that people are willing to spend more money to find the right person.

Lack of work (15%) and tightened bank credit (15%) were the next closest popular choices.
Is your construction company taking advantage of all federal and state tax incentives available to your industry? If not, you could be missing out on considerable tax-savings opportunities. Read our overview of five tax credit and incentive programs that could offer your business valuable tax-savings opportunities.

RESEARCH AND DEVELOPMENT (R&D) TAX CREDITS

Overview
R&D tax credits are available for many activities conducted by contractors and subcontractors in the construction industry, such as those related to system design and development. As architects and engineers have raised the bar on innovation, the construction industry too has developed new processes and engineering solutions that could mean tens of thousands of dollars in tax savings.

Provisions
- Calculation of credits are determined based on the specific industry and qualifying activities
- Includes startups and pass-through entities
- Expenses can include salaries of employees and supervisors who conduct research, supplies and even research contracted out
- Contractors may be eligible to claim the federal R&D tax credit for the prior three years, and the state credit for the prior four years
- Ohio’s R&D Investment Tax Credit equals 7% of the amount of qualified expenses in excess of the taxpayer’s average investment over the three preceding taxable years; it does not require a special application process

How to Qualify
The IRS established a four-part test to determine qualified R&D activity:
- New or improved products, processes or software
- Technological in nature
- Elimination of uncertainty
- Process of experimentation

An R&D tax credit expert can guide you through the application process as well as the documentation you will need to apply.

INVESTOHIO

Overview
InvestOhio promotes small business investments in Ohio through the purchases of fixed assets; hiring of new employees; and business expansion. The program, which has been renewed through June 30, 2019, provides a non-refundable personal income tax credit to investors that provide new equity (cash) into Ohio small businesses.

Provisions
- Eligible small business is defined as having either total assets of $50 or less, or total sales of $10 million or less
- Provides a 10% non-refundable personal income tax credit equal to up to $1 million to offset Ohio income taxes
- More than 50% of your employees must be located in Ohio, or you must have more than 50 full-time equivalent employees in Ohio

How to Qualify
- Both the investor and the small business must register for InvestOhio through the Ohio Business Gateway
- Once the funds are contributed, they must be spent within six months to qualify for the credit
- The credit is first come, first served, until the credit limit is reached
CONSTRUCTION SURVEY

OHIO SMALL BUSINESS INCOME DEDUCTION (SBD)

Overview
Small business owners can save thousands of dollars and reinvest them in their business through the Ohio SBD, a law that is intended to make Ohio more business-friendly.

Provisions
• Small business owners of pass-through entities can deduct 100% of the first $250,000 of Ohio new business income from the Ohio adjusted gross income (AGI) on their personal tax return
• The deduction is applied at the owner level; multiple owners can claim the deduction
• It includes any interest, dividends or capital gains from the flow-through entities, and if you are at least a 20% owner of the business entity, you can also include your wages from the entity as part of the business income

How to Qualify
• Ohio residents, part-time residents and non-residents are eligible
• Owners and investors in businesses structured as sole proprietorships and pass-through entities (PTEs) qualify

DOMESTIC PRODUCTION ACTIVITIES DEDUCTION (DPAD)

Overview
The DPAD, also known as Section 199, is often called a manufacturing deduction as it allows a 9% tax deduction of income from qualified production activities. However, Section 199 also benefits the construction industry because it allows the deduction for activities constituting the construction of real property.

Provisions
• Deduction applies to activities performed in connection with a project to erect or substantially renovate real property
• Includes activity that materially increases the value of the property, substantially prolongs its useful life or adapts the property to a new or different use
• Companies can receive an up to 9% tax deduction on income earned from qualified production activities; the deduction is limited to 50% of W-2 wages

How to Qualify
• A business can only qualify if it has employees in the U.S.
• If a company is set up as a sole proprietorship, S corporation, partnership or LLC, the deduction is limited to AGI
• The DPAD applies to subcontractors who meet the above definitions

WORK OPPORTUNITY TAX CREDIT (WOTC)

Overview
This federal tax credit, which helps defray the cost for training and development, is available to employers who hire individuals from eligible target groups, such as veterans and felons, with significant barriers to employment. Employers claim approximately $1 billion in tax credits per year under the WOTC program.

Provisions
• Employers that hire military veterans and other qualifying individuals can claim a credit as high as 40% of the first $6,000 of first-year wages
• There is a maximum tax credit that can be earned, which depends on the year and target group

How to Qualify
• There is no limit on the number of individuals an employer can hire to qualify to claim the credit

The Skoda Minotti Construction Group is available to help you navigate these valuable tax credits. For more information, call Roger Gingerich at 440-449-6800.
Taxes

Climate

In an uncertain political climate and a switch of control in the House of Representatives and the White House, it is not surprising that income tax rates and the availability of credit rank among the top political issues that respondents see affecting their business. Perhaps it’s surprising that income tax rates didn’t rank higher than the fourth-most popular political issue given the tax reform proposals being introduced in Congress. It could be that our survey respondents are optimistic that campaign promises of tax reform will benefit their business.

Incentives

We wanted to know whether our respondents are taking advantage of a number of valuable state and federal tax incentives. The answer is surprising. More than two-thirds of our survey respondents are unsure, which tells us there may be a lack of awareness that the tax credits exist, or perhaps whether they are worthwhile to pursue. (See “5 Tax-Savings Opportunities for the Construction Industry” on page 6 for an overview of tax credits and incentives).

Growth Opportunities

The number of survey respondents seeing more growth opportunities in Northeast Ohio peaked at 69% in 2015; that number has now shifted downward to 46% in 2016 and 41% in 2017. In fact, survey respondents are now feeling slightly less optimistic about regional opportunities than they have over the last five years. Still, with 81% of respondents seeing either the same or better opportunities in Northeast Ohio, there is still plenty of work to be done.

Optimism is even brighter when it comes to opportunities outside Northeast Ohio. A combined 92% of survey respondents find either the same or more opportunities outside the region, just slightly under the 96% reported each year since 2014. It is worth noting that 60% of respondents report more opportunities, the most since we began asking this question in 2014.

Competition

After a peak in the average job size in the past two years, the percentage of 2017 respondents who saw an increase in the average size job they bid on in the past year dipped from 52% in 2016 to 47%. However, the news is not all bad—almost half (49%) of respondents indicated that the average job size has stayed the same. Competition among bidders has come down, with 65% of respondents bidding against only one to four bidders—the lowest number of bidders since we began asking this question in 2009.

“I believe that now is the time to grow and the biggest hurdle to that is a pipeline of qualified field personnel.”
- Survey respondent
We also note a drop-off in the number of respondents bidding against five to nine bidders, a decline of 12% since last year.

What these numbers tell us is that the average job size is more than holding steady and there is still plenty of work out there. The lower number of bidders will hopefully help companies improve their margins and maintain profitability.

Financial Update

Credit Availability

Much in line with respondents in recent years, survey respondents feel good about their ability to secure financing. Almost 90% of survey respondents found their ability has increased (23%) or stayed about the same (66%), right in line with last year’s numbers. While still a consideration, only 11% of survey respondents saw their ability to secure credit over the past year decrease.

Bonding

Over the years, we have asked survey respondents about the percentage of their work that requires bonding. Between 2008 and 2017, that number has held fairly steady, with only slight fluctuations. Forty-three percent of 2017 survey respondents report that less than 20 percent of their work requires bonding, the lowest number of respondents with work meeting the minimum requirement since we began asking this question in 2008. In fact, almost a quarter (22%) of respondents report that greater than 80% of their work requires bonding, an increase of 8% from just two years ago. One of the reasons may be the increase in the number of projects being done outside the state.

At the same time, our survey respondents don’t seem to be worried about their ability to obtain bonding—in fact, 92% of respondents don’t feel the ability to obtain bonding will remain unchanged (82%) or improve (10%) in the near future.
Expenditures

The trend in companies investing in more overhead expenditures that began in 2011 spiked more than 15% in 2017 over the previous year. This exceeded the expectations of our 2016 survey respondents who were more conservative in their estimates. Seventy-one percent of survey respondents say their overhead expenditures increased versus the 53% estimated by our 2016 respondents. Further, 55% of our current respondents expect their budget to increase over the next 12 months. While cautiously optimistic, it is clear they are not afraid to spend some money.

Environmental Update

After jumping from tenth to fourth place as an important political issue in 2016, environmental regulation has leveled off a bit as the sixth of 10 most important political issues likely to affect our respondents’ businesses in the coming year. On the LEED front, not much has changed. There is a decrease in the number of respondents seeing greater than 10 jobs with a LEED-certified component, and one-quarter of respondents seeing none at all. Fifty-six percent of respondents saw two or fewer LEED jobs come across their desk.

Ohio Construction Reform: The Last Word

It is interesting to note that Ohio Construction Reform dropped sharply, from being ranked the third most important political issue by past survey respondents to the seventh in 2017. While comments continue to reflect some unhappiness in the wake of reform, we most likely have reached a point of resigned acceptance of the changes.

The very objectives of reform – increased transparency and fairness – have been consistently countered by respondents. This year we asked respondents for final thoughts on reform. While some acknowledge that reform has benefitted a select few, most respondents find reform to be more detrimental to Ohio businesses than advantageous.

“Ohio Construction Reform has pushed out small businesses or forced them into joint ventures and allowed for more opportunities for foreign (to Ohio) corporations to enter the marketplace and drive cash out of the state.” – Survey respondent

Post-Election Viewpoint

With this year’s survey coming on the heels of a presidential election, we asked respondents to share one construction hot topic they would most like to see addressed. Given the change in power, it is not surprising that tax reform, deregulation and union issues were the top three topics among all responses.

Overall, many respondents express optimism based on pledged infrastructure improvement initiatives while others seek answers to the need for skilled labor, a theme that resonates consistently throughout the survey results. 😊
## Results

1. Please classify the type of construction work that you perform. (check all that apply)

<table>
<thead>
<tr>
<th>Service Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>General contractor</td>
<td>46%</td>
</tr>
<tr>
<td>Sub-contractor</td>
<td>37%</td>
</tr>
<tr>
<td>Construction management</td>
<td>20%</td>
</tr>
<tr>
<td>Design/build</td>
<td>21%</td>
</tr>
<tr>
<td>Federal government contractor</td>
<td>7%</td>
</tr>
<tr>
<td>Service provider</td>
<td>15%</td>
</tr>
<tr>
<td>Other</td>
<td>16%</td>
</tr>
</tbody>
</table>

2. Please indicate your company’s annual revenue.

<table>
<thead>
<tr>
<th>Revenue Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $1 million</td>
<td>14%</td>
</tr>
<tr>
<td>$1 million to $4.9 million</td>
<td>20%</td>
</tr>
<tr>
<td>$5 million to $9.9 million</td>
<td>8%</td>
</tr>
<tr>
<td>$10 million to $20 million</td>
<td>20%</td>
</tr>
<tr>
<td>More than $20 million</td>
<td>38%</td>
</tr>
</tbody>
</table>

3. Please indicate the number of employees at your company.

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 10</td>
<td>21%</td>
</tr>
<tr>
<td>11 to 50</td>
<td>36%</td>
</tr>
<tr>
<td>51 to 100</td>
<td>17%</td>
</tr>
<tr>
<td>More than 100</td>
<td>26%</td>
</tr>
</tbody>
</table>

4. Do you use union or non-union labor?

<table>
<thead>
<tr>
<th>Labor Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Union</td>
<td>15%</td>
</tr>
<tr>
<td>Non-Union</td>
<td>60%</td>
</tr>
<tr>
<td>Both</td>
<td>25%</td>
</tr>
</tbody>
</table>

5. What political issues will most impact your business in 2016? Please rank 1-11 with 1 the most impact and 11 the least impact.

<table>
<thead>
<tr>
<th>Issue</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material price volatility</td>
<td>1</td>
</tr>
<tr>
<td>Healthcare reform and insurance rates</td>
<td>2</td>
</tr>
<tr>
<td>Workers’ compensation</td>
<td>3</td>
</tr>
<tr>
<td>Income tax rates</td>
<td>4</td>
</tr>
<tr>
<td>Availability of credit</td>
<td>5</td>
</tr>
<tr>
<td>Environmental regulation</td>
<td>6</td>
</tr>
<tr>
<td>Ohio Construction Reform</td>
<td>7</td>
</tr>
<tr>
<td>Union issues</td>
<td>8</td>
</tr>
<tr>
<td>Sustainability/energy-efficient initiatives</td>
<td>9</td>
</tr>
<tr>
<td>MBE/WBE contract requirements</td>
<td>10</td>
</tr>
<tr>
<td>Project labor agreements</td>
<td>11</td>
</tr>
</tbody>
</table>

6. What percentage of your work requires bonding?

<table>
<thead>
<tr>
<th>Bonding Percentage</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 20%</td>
<td>43%</td>
</tr>
<tr>
<td>21 to 40%</td>
<td>19%</td>
</tr>
<tr>
<td>41 to 60%</td>
<td>14%</td>
</tr>
<tr>
<td>61 to 80%</td>
<td>2%</td>
</tr>
<tr>
<td>Greater than 80%</td>
<td>22%</td>
</tr>
</tbody>
</table>

7. What is the current outlook on your bonding capacity?

<table>
<thead>
<tr>
<th>Bonding Capacity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>It will be significantly more difficult to obtain bonding</td>
<td>2%</td>
</tr>
<tr>
<td>It will be somewhat more difficult to obtain bonding</td>
<td>6%</td>
</tr>
<tr>
<td>It will be neither more nor less difficult to obtain bonding</td>
<td>82%</td>
</tr>
<tr>
<td>It will be somewhat less difficult to obtain bonding</td>
<td>5%</td>
</tr>
<tr>
<td>It will be significantly less difficult to obtain bonding</td>
<td>5%</td>
</tr>
</tbody>
</table>
8. In the next three years, do you see your business having:
More opportunities in Northeast Ohio ......................... 41%
Less opportunities in Northeast Ohio ........................... 19%
The same amount of opportunities in Northeast Ohio .... 40%

9. In the next three years do you see your business having:
More opportunities outside Northeast Ohio .................. 60%
Less opportunities outside Northeast Ohio ..................... 8%
The same amount of opportunities outside Northeast Ohio 32%

10. Which of the following actions are among your company’s top priorities?
Cutting operational costs ............................................ 41%
Getting into new construction trades .......................... 16%
Organizational planning ............................................. 48%
Managing your material vendors ................................ 23%
Restructuring the company to position for growth ....... 29%
Seeking M&A opportunities ....................................... 15%
Seeking new markets .................................................. 52%
Strategic planning ....................................................... 52%
Finding solutions for skilled labor ............................. 69%
Other .......................................................................... 7%

11. Over the past 12 months, has the average size job that you bid on:
Increased .................................................................... 47%
Decreased ..................................................................... 4%
Stayed the same ......................................................... 49%

12. What is the average number of bidders that you compete against?
1-4 bidders .................................................................. 65%
5-9 bidders ................................................................. 30%
10-15 bidders ............................................................... 2%
16 or more bidders ....................................................... 3%

13. What do you see as the biggest threat to your business over the next 12 months?
Banking (tightened credit) .......................................... 14%
Increased difficulty in securing bonding ................... 1%
Labor costs ................................................................. 3%
Securing skilled labor ................................................ 52%
Lack of work .............................................................. 15%
Material costs ............................................................ 17%
Other .......................................................................... 8%

14. Have you taken advantage of any of the following tax incentives?
InvestOhio ................................................................. 7%
Work Opportunity ....................................................... 4%
R&D tax credit ............................................................ 7%
Ohio Small Business Deduction ................................. 11%
Domestic Production Activities Deduction .............. 10%
Don’t know ................................................................. 67%
None .......................................................................... 8%
Other .......................................................................... 2%
15. Over the past year, your company’s overhead expenditures have:
Decreased ................................................................. 8%
Increased ................................................................. 71%
Remained relatively flat ........................................... 21%

16. In the future (next 12 months), your company’s budget for overhead expenditures will:
Increase ................................................................. 55%
Decrease ................................................................. 7%
Remain relatively flat .............................................. 38%

17. Are you familiar with Thomas Schleifer, Ph.D., and his construction industry theory of Flexible Overhead?
Yes ................................................................. 14%
No ................................................................. 86%

18. Do you feel that over the past year the ability to obtain financing has:
Increased ................................................................. 23%
Stayed about the same ........................................... 66%
Decreased slightly .................................................... 8%
Decreased significantly ........................................... 3%

19. How many jobs did you review or perform over the past year that had a material green or LEED-certified component?
0 ................................................................. 25%
1-2 ................................................................. 31%
3-5 ................................................................. 22%
6-10 ................................................................. 11%
Greater than 10 ........................................................ 11%

One respondent commented, “Acquisition opportunities exist although many sellers have unreasonable valuations.”
Welcome to the 10th annual Northeast Ohio real estate industry survey report. The best way to summarize the views and outlook of the 2017 survey respondents is positive—just less so than in recent years. The cautious optimism expressed by 2016 survey respondents continues into this year. The survey was completed just as the new administration took office, so some of the reservation can mean that respondents are waiting to see whether campaign pledges become new policies.

The real estate lending market remains very positive with the majority of respondents seeing reasonable lending requirements. However, when it comes to redevelopment projects, some respondents see financing as a barrier to growth. More respondents are utilizing tax credits and incentives to help finance their projects.

While rents continue to increase across the residential, commercial and industrial sectors, they are not increasing at the same rate as they have in previous years. Similar to last year, more respondents see growth opportunities outside Northeast Ohio than within the region, but the number of respondents who see growth in either category has decreased.

In 2016, the availability of inventory was a top barrier for development in Northeast Ohio. This year, property valuations was the topic most respondents see as the chief barrier. It appears that the more favorable climate our respondents see in the lending environment is not always congruent with rapidly escalating market values.

Our respondents also weigh in on the real estate hot topics they want the new administration to address in the coming months and years.

We welcome your feedback and thoughts about this year’s survey.

Lending

The lending environment for the real estate market continues to improve. According to 30% of survey respondents – almost triple the number from just three years ago – banks are asking just 20% or less in equity requirements for new projects. In fact, 80% of all respondents are seeing requirements of 30% or lower. There could be two factors at play. First, banks could simply be loosening requirements, or they are financing projects with higher property values. According to respondents in our 2015 and 2016 surveys, regional
banks overtook national banks as the chief source of funding for new development and acquisitions. This year, national and regional banks tied as the most popular source for our respondents to fund development with both an option for 50% of our respondents. The percentage of respondents tapping private equity as their source for financing decreased from 48% last year to 37% in the 2017 survey.

It is interesting to note the steady climb over the past five years of those respondents relying on tax credits to finance new development and acquisitions. As more and more property is redeveloped, historic tax credits have grown in importance as a significant source of financing.

**HVCRE**

In 2016, we surveyed respondents about their awareness of high-volatility commercial real estate (HVCRE) loans. Only 19% of respondents were aware of the loans, which were put into effect in 2015 for regulated financial institutions to offset potential losses from failed construction loans. Perhaps more lending institutions fully enforced the loan requirements because the number of respondents aware of HVCRE loans has increased to 33%. Almost one-half of respondents aware of HVCRE perceive a negative effect on financing opportunities.

### Barriers

#### Development

This is the fifth year we asked real estate survey respondents to rank barriers for development. Property valuations jumped from being ranked last by respondents just two years ago to being ranked as the greatest barrier to development by 2017 respondents. The sizeable increase in the importance of property valuations indicates a dichotomy of perceived value by the seller, and the ability to finance a property on that perception, not necessarily supported by rental rates.

A seller’s market still requires the collateral value to finance a high-potential property, whether residential, industrial or commercial. Varying cap rates have not been the best indicator of the seller’s perceived value, especially in the residential arena. A majority of our respondents continue to see opportunity in our region, but much of that opportunity is in underserved or unserved markets. The potential is high, but the collateral value is low.

It is also interesting to note that availability of inventory, which was the top barrier for development in 2016, moved down five notches to sixth place.

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One respondent commented, “The greatest challenge is adding an addition to an existing building and having it appraised at an amount that can be financed.”
REAL ESTATE SURVEY

Have efforts by the city of Cleveland and Cuyahoga County to combat urban blight freed up available land for development? We believe that these efforts, coupled with developers’ optimistic assessment of available inventory (think Hingetown and Cedar Lee), have created less of a supply crunch.

We also asked respondents to tell us the greatest challenge their company faces. Finding skilled labor and the ability to secure financing topped the list, followed by the availability of good inventory and concerns about competition and a potential economic slowdown. Equity demands are low; however, it is clear that some of our respondents have concerns about the stability of the lending environment going forward.

**Redevelopment**

For the first time, we asked survey respondents to rank the greatest barriers to the redevelopment of their existing properties. Just over one-half of all respondents redevelop, and of those, a significant 71% of them view financing as their greatest barrier. Zoning and market pressures were each the second-greatest barrier to redevelopment (47%). At a time when deregulation is front and center on the political stage, it is interesting to note that only 29% of survey respondents who redevelop see regulation as a main barrier to redevelopment—perhaps indicating optimism about the deregulation political agenda.

We also asked respondents about funding sources for redevelopment, including the use of tax credits and incentives. The majority of respondents who are redeveloping utilize direct bank financing (86%) and current cash flow from their property (79%). It is encouraging to note that historic tax credits (71%) and New Markets Tax Credits (64%) closely follow as ways to fund redevelopment. Approximately 43% of respondents are also using tax-increment financing (TIF).

“Financing has to be in place before opportunities arise, but lenders won’t make it available until there’s an opportunity and by then it’s too late.” – Survey respondent
Cybersecurity Considerations for the Real Estate Industry

Cyberthreats have become a growing concern for just about every business, and the real estate industry is no exception. When asked about expenditures for IT costs, almost all of our survey respondents plan to maintain or increase their budgets, and certainly cybersecurity is driving that action.

CYBERATTACKS: IS YOUR COMPANY AT RISK?
Real estate developers, appraisers, brokers/agents, property managers and title agents hold a significant amount of confidential third-party information. This can include personally identifiable information and confidential corporate information stored in leases and rental agreements, rental applications and credit reports—the very information cybercriminals target.

Over the past decade, we have witnessed an unforeseen level of data breach incidents, including a rampant increase in ransomware, by which hackers gain access to a company’s hard drive and encrypt it until a ransom payment is made. When a security breach occurs, business interruption costs can take a huge toll on a real estate firm and cause great damage to the firm’s reputation. Think about theft of valuable digital assets, including customer lists, business trade secrets and other electronic business assets.

With the increasing number of “smart” connected buildings, commercial real estate firms in particular also need to consider the potential for cyberattacks to shut down building systems, resulting in anything from business interruption to serious physical harm. Hackers can also introduce malware, worms and other malicious computer codes. So what should real estate companies do to 1) protect themselves, and 2) mitigate risks should a breach occur?

IT DEFENSE: HOW TO PROTECT YOUR COMPANY
Protecting against cybercrime incidents, breaches and privacy issues calls for a smart, defensive IT strategy. For example, putting measures in place for the careful maintenance and destruction of confidential records—all in compliance with data protection and privacy laws—goes a long way to ensuring that data is only held for as long as justifiably required. Other steps include:

- Making the right level of IT investments to protect information, including firewall, virus protection and monitoring software
- Securing laptops and all mobile technology with encryption software
- Establishing strong passwords
- Limiting employee access to sensitive information
- Backing up data regularly to an external drive
- Educating employees about the importance of protecting all data and the consequences of a breach

Not sure where to start? The first step often entails an assessment of your company’s IT protection needs. DataServ, a Skoda Minotti Technology Firm, provides strategic, integrated IT safety and security solutions to protect your company. For more information, visit www.dataservtech.com to download our free e-book, “Unveiling Your Security Nightmares” and to learn more about our services. You may also reach us at 440-892-2555.
Less than 15% of respondents take advantage of rebate plans, such as solar, windows or water.

As redevelopment continues to escalate by utilizing tools like historic tax credits and easement deductions, we also note a surge in multi-family and mixed-income new residential construction.

**Expenditures**

Our respondents have more or less held the line on company expenditures with a slight downward trend in certain areas. While payroll and employment expenses have remained status quo, there is a tightening in discretionary spending and marketing from 2016 numbers. In light of rapidly increasing cyber-threats and attacks, we are not surprised that 97% of respondents are either maintaining (60%) or increasing (37%) current IT costs. With the need for data security at an all-time high, businesses across all industries should be reviewing the company protection they have in place. (See the sidebar article on cybersecurity considerations on page 17 for a full explanation).

**Rents**

This is the sixth year we have asked respondents about past and projected rents in three industry sectors. While the real estate industry remains healthy, we are seeing less optimism than the previous two years.

In addition to getting an idea of economic indicators, we are able to see how closely last year’s respondents tracked with actual performance over the past year. We found last year’s respondents to be right on the money with most of their predictions.

**Residential**

Our 2016 survey marked three straight years of less than 10% of respondents experiencing a decrease in residential and apartment rents; in fact, no decreases were reported by 2016 respondents whatsoever. This year, 15% of respondents noted a slight decrease in rents over the past 12 months. Overall, the markets are still strong—one-quarter of respondents report no change in rents, and 60% saw an increase. While the news is still good, the increase is far less than
the 82% of respondents who predicted growth in the next 12 months in our 2016 survey. A more moderate optimism prevails for the immediate future, with 48% of respondents expecting rents in the residential real estate market to slightly increase in the next 12 months.

**Commercial**
The commercial real estate market appears to be rather flat, with 100% of respondents reporting that rents held steady (48%) or only slightly increased (52%) over the past 12 months. Our prognosticators from 2016 did a great job of predicting this scenario. If our 2017 respondents are as accurate, 21% expect rents in the commercial real estate market to decrease. The balance of respondents predict commercial rents to remain stable (46%) or slightly increase (33%).

**Industrial**
Similar to the commercial market responses, respondents’ answers regarding the industrial real estate market closely aligned with the commercial sector in a fairly flat performance over the past 12 months. Again, 100% of respondents report that rents remained stable (38%) or slightly increased (62%). What’s more, 2016 survey respondents were equally as accurate in predicting 2017 performance. Looking ahead to the next 12 months, respondents see these numbers holding steady.

**Opportunities for Growth**

Less than half (48%) of 2017 real estate survey respondents see more opportunities over the next three years in Northeast Ohio; 42% of respondents see the same amount of opportunities. Only 10% of respondents are seeing less opportunities for growth.

Respondents are slightly more optimistic when it comes to opportunities outside Northeast Ohio in the next few years. More than half (55%) see growth outside the region, but this percentage is much lower than last year’s number of 74% and more in line with 2015 figures.

*One respondent commented, “Opportunities are better outside Cuyahoga County; land and building values are more affordable in other counties.”*

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### Barriers for development in Northeast Ohio. Rank 1-9 with 1 being the most significant and 9 being the least significant.

<table>
<thead>
<tr>
<th>Answer Options</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property valuations</td>
<td>N/A</td>
<td>4th</td>
<td>9th</td>
<td>8th</td>
<td>1st</td>
</tr>
<tr>
<td>Lending environment</td>
<td>1st</td>
<td>1st</td>
<td>1st</td>
<td>2nd</td>
<td>2nd</td>
</tr>
<tr>
<td>Cost of construction</td>
<td>6th</td>
<td>5th</td>
<td>7th</td>
<td>3rd</td>
<td>3rd</td>
</tr>
<tr>
<td>Equity environment</td>
<td>3rd</td>
<td>2nd</td>
<td>3rd</td>
<td>4th</td>
<td>4th</td>
</tr>
<tr>
<td>Regulation</td>
<td>5th</td>
<td>3rd</td>
<td>4th</td>
<td>5th</td>
<td>5th</td>
</tr>
<tr>
<td>Availability of inventory</td>
<td>2nd</td>
<td>6th</td>
<td>2nd</td>
<td>1st</td>
<td>6th</td>
</tr>
<tr>
<td>Environmental issues</td>
<td>8th</td>
<td>7th</td>
<td>6th</td>
<td>7th</td>
<td>7th</td>
</tr>
<tr>
<td>Cost of land</td>
<td>7th</td>
<td>8th</td>
<td>5th</td>
<td>6th</td>
<td>8th</td>
</tr>
<tr>
<td>Lack of local economic incentives</td>
<td>4th</td>
<td>9th</td>
<td>8th</td>
<td>9th</td>
<td>9th</td>
</tr>
</tbody>
</table>
When asked to list growth opportunities in 2017, responses ranged from "We see plenty of growth opportunities—this is our kind of market," to "There’s less opportunity than last year." One comment directly addresses lenders: “Consistent underwriting required to maintain growth in a downturn and real estate is due for a correction in the next few years.” One residential developer sees short-term opportunities for improved lot sales, but sees mid-term stagnation due to the financial slowdown in the next two or three years.

**Leaner Green**

Following trends from previous years’ surveys, more than one-half (53%) of respondents do not have a LEED-certified building in their portfolio. And sharply down from 50% of respondents in 2015, only 12% of 2017 respondents see improved value with LEED certification.

**Post-Election Viewpoint**

Last year, we asked real estate survey respondents to share their views on the upcoming general election with regard to its impact on their industry. Respondents were mainly concerned about the retention of beneficial tax credits and incentives and burdensome lending regulations.

With the new administration and party in place, we were curious to repeat the same question. The majority of respondents are concerned about two challenges: taxes and regulations. It is also interesting to note that several respondents commented about the importance of making historic tax credits permanent.

One respondent offered a different perspective on the impact of the new administration: "I don’t believe that a “new” administration and party has any more or less responsibility for what happens in our market. The real estate market growth is based on supply and demand. We do not have a supply problem."
## Results

1. How would you describe your involvement in the real estate industry?

<table>
<thead>
<tr>
<th>Type of Involvement</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>32%</td>
</tr>
<tr>
<td>Management</td>
<td>29%</td>
</tr>
<tr>
<td>Commercial development</td>
<td>24%</td>
</tr>
<tr>
<td>Residential development</td>
<td>12%</td>
</tr>
<tr>
<td>Service provider</td>
<td>44%</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>24%</td>
</tr>
</tbody>
</table>

2. Please indicate your company’s annual revenue.

<table>
<thead>
<tr>
<th>Revenue Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $1 million</td>
<td>15%</td>
</tr>
<tr>
<td>$1 million to $4.9 million</td>
<td>12%</td>
</tr>
<tr>
<td>$5 million to $9.9 million</td>
<td>20%</td>
</tr>
<tr>
<td>$10 million to $20 million</td>
<td>12%</td>
</tr>
<tr>
<td>More than $20 million</td>
<td>41%</td>
</tr>
</tbody>
</table>

3. Please indicate the number of employees at your company.

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 10</td>
<td>21%</td>
</tr>
<tr>
<td>11 to 25</td>
<td>6%</td>
</tr>
<tr>
<td>26 to 50</td>
<td>23%</td>
</tr>
<tr>
<td>More than 50</td>
<td>50%</td>
</tr>
</tbody>
</table>

4. In today’s lending climate, what type of equity demands are lenders making on new projects?

<table>
<thead>
<tr>
<th>Equity Demand Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 20%</td>
<td>30%</td>
</tr>
<tr>
<td>21 to 30%</td>
<td>50%</td>
</tr>
<tr>
<td>31 to 40%</td>
<td>3%</td>
</tr>
<tr>
<td>Greater than 40%</td>
<td>0%</td>
</tr>
<tr>
<td>Don’t know – unable to secure credit</td>
<td>17%</td>
</tr>
</tbody>
</table>

5. How are you funding new construction and acquisitions? (Check all that apply)

- Seller financing                       | 20%        |
- Conventional bank (national)           | 50%        |
- Regional bank                          | 50%        |
- Private equity                         | 37%        |
- Individual investment/private placement| 33%        |
- Tax credits, TIF and other public funds| 30%        |
- Insurance companies                    | 10%        |
- Pension funds                          | 7%         |
- Other institutional funds              | 7%         |
6. If your current cash flow is not sufficient to support existing properties and projects, what actions are you taking? (check all that apply)
- Attempting to sell assets: 72%
- Accessing existing liquidity: 17%
- Borrowing: 22%
- Adjusting rents to increase occupancy: 11%
- Current cash flow is sufficient to support existing properties and projects: 17%
- Surrendering properties back to lender: 6%

7. What are your barriers to the successful redevelopment of existing properties (check all that apply)
- Financing: 71%
- Zoning: 47%
- Regulation: 29%
- Market pressures of current use: 47%
- Other (please specify): 6%

8. As a funding source for redevelopment, do you utilize the following (check all that apply)
- Current cash flow from property: 79%
- Direct bank financing: 86%
- Historic tax credits: 71%
- New markets tax credits: 64%
- Enterprise zone incentives: 21%
- Tax-increment financing (TIF): 43%
- Rebate plans, such as solar, windows or water: 14%
- Other (please specify): 7%

9. Are you aware of High-Volatility Commercial Real Estate (HVCRE) loans?
- Yes: 33%
- No: 67%

10. If so, have they had a negative impact on any of your financing opportunities?
- Yes: 45%
- No: 55%

11. In the following areas, how have your company expenditures changed in the past 12 months?

<table>
<thead>
<tr>
<th>Expenditure</th>
<th>Increased</th>
<th>Same</th>
<th>Decreased</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discretionary expenses</td>
<td>20%</td>
<td>53%</td>
<td>27%</td>
</tr>
<tr>
<td>Payroll</td>
<td>50%</td>
<td>43%</td>
<td>7%</td>
</tr>
<tr>
<td>Professional services</td>
<td>37%</td>
<td>57%</td>
<td>6%</td>
</tr>
<tr>
<td>Marketing</td>
<td>30%</td>
<td>57%</td>
<td>13%</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>33%</td>
<td>50%</td>
<td>17%</td>
</tr>
<tr>
<td>IT</td>
<td>37%</td>
<td>60%</td>
<td>3%</td>
</tr>
</tbody>
</table>

12. In the past 12 months, how have rents in the apartment and residential markets been affected by the economy?

- Rents have significantly decreased: 0%
- Rents have slightly decreased: 15%
- Rents have remained stable: 25%
- Rents have slightly increased: 45%
- Rents have significantly increased: 15%

13. In the past 12 months, how have rents in the commercial market been affected by the economy?

- Rents have significantly decreased: 0%
- Rents have slightly decreased: 0%
- Rents have remained stable: 48%
- Rents have slightly increased: 52%
- Rents have significantly increased: 0%

14. In the past 12 months, how have rents in the industrial market been affected by the economy?

- Rents have significantly decreased: 0%
- Rents have slightly decreased: 0%
- Rents have remained stable: 38%
- Rents have slightly increased: 62%
- Rents have significantly increased: 0%
15. In the next 12 months, how do you foresee rents in the apartment and residential markets being affected by the economy?
Rents will significantly decrease ........................................4%
Rents will slightly decrease ...........................................8%
Rents will remain stable ................................................40%
Rents will slightly increase .........................................48%
Rents will significantly increase ...................................0%

16. In the next 12 months, how do you foresee rents in the commercial market being affected by the economy?
Rents will significantly decrease ...................................0%
Rents will slightly decrease ..........................................21%
Rents will remain stable ...............................................46%
Rents will slightly increase ...........................................33%
Rents will significantly increase ...................................0%

17. In the next 12 months, how do you foresee rents in the industrial markets being affected by the economy?
Rents will significantly decrease ...................................0%
Rents will slightly decrease ...........................................5%
Rents will remain stable ...............................................36%
Rents will slightly increase ..........................................59%
Rents will significantly increase ...................................0%

18. In the next three years in Northeast Ohio, do you see your business having:
More opportunities ..................................................48%
Less opportunities .....................................................10%
Same amount of opportunities .................................42%

19. In the next three years outside of Northeast Ohio, do you see your business having:
More opportunities ..................................................55%
Less opportunities .....................................................0%
Same amount of opportunities .................................45%

20. Rank the barriers for development in Northeast Ohio. Rank 1-8 with 1 being the most significant and 8 being the least significant.
Property values .........................................................1st
Lending environment ...............................................2nd
Cost of construction ...............................................3rd
Equity environment ..................................................4th
Regulation .................................................................5th
Availability of inventory ..........................................6th
Environmental issues ................................................7th
Cost of land ...............................................................8th
Lack of local economic incentives ............................9th

21. Has LEED certification improved either the actual or perceived value of your buildings?
Yes ................................................................................12%
No ...............................................................................35%
There are no LEED-certified buildings in our portfolio ..53%
“Agresta has been a Skoda Minotti client since the firm first opened its doors in 1980. Their professionals have worked closely with us in identifying, negotiating and structuring business transactions. Our company has saved a significant amount of money thanks to their strategic tax planning. I find their expertise invaluable.”

John Agresta
President
C.A. Agresta Construction Company

How Can We Help Your Business Grow?

The Real Estate and Construction Group at Skoda Minotti brings a depth of industry knowledge, experience and designations, such as CCIFP, CCA and GACP, to help guide your success.

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