Seidman Business Review

Volume 14 | Issue 1 Article 3

1-1-2008

West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

Gary Albrecht
Grubb & Ellis Company, gary.albrecht@gepc.com

West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

Gary Albrecht, CCIM, Vice President
Grubb & Ellis|Paramount Commerce

Retail:
The expansion of existing users within the marketplace will contribute the most to the growth of the West Michigan retail market.

The West Michigan retail market recovered during the second half of 2007 after a slow first half. Construction continued and rates held firm, as retail moved into the hyper-supply phase of the market cycle. Vacancy rates peaked at 8.1 percent during the second quarter of 2007 and rebounded to 7.8 percent at year-end. A steady increase in occupancy is expected throughout 2008 as more construction projects are completed.

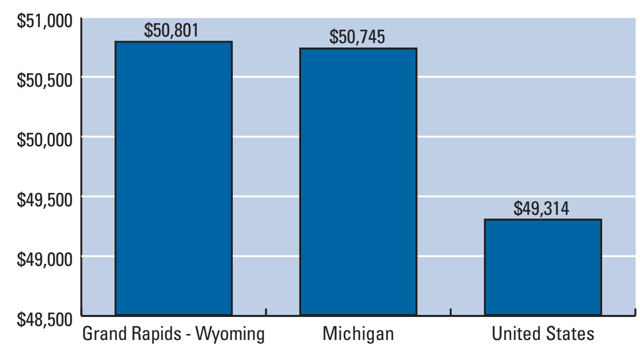
Growth along the M6 South Beltline continues to be one of the strongest retail corridors in West Michigan. Metro Health Village, the first of its kind in the nation, opened in 2007 and national retailers are already looking at Metro Health Village as a place to expand. With limited speculative construction in 2008, we expect vacancy rates to decrease and rental rates to stabilize as the space is absorbed. Similarly, Rivertown Parkway continues to be one of the most desired submarkets in the area due to its accessibility and high visibility. Almost 30,000 square feet was under construction on Rivertown Parkway at year-end with gradual increases in construction during 2008 as space becomes occupied.

2007 came and went with no groundbreaking on the proposed lifestyle centers in Walker or on the East Beltline. There has been a lot of attention on the 450,000 square foot lifestyle center in Walker. Cabela's sporting goods is making a push to add a second franchise in Michigan and JC Penny will look to add one of only five new stores in Michigan. National and local retailers are looking at it as a place to expand or enter the market, and are hopeful the project will get underway in 2008. Additionally, interest in the new lifestyle center proposed at East Beltline and 3 Mile Road gained traction and development looks promising in 2008. It will include retailers such as Barnes & Noble, Talbots, and Anthropologie, and restaurants such as PF Chang's China Bistro.

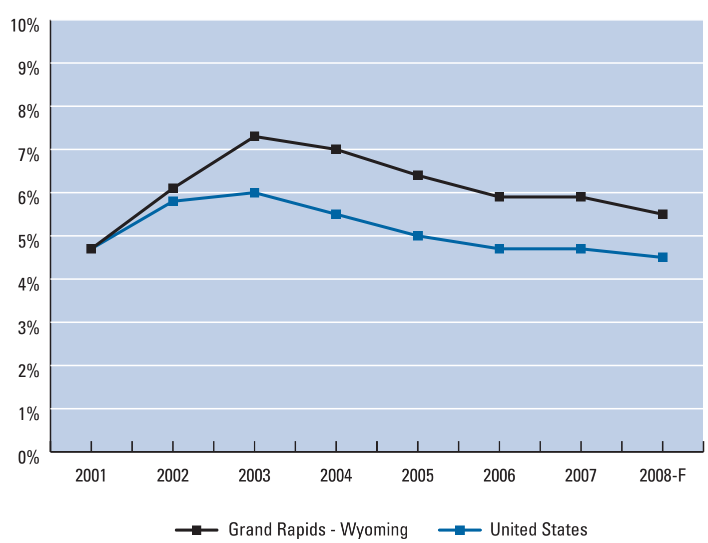
The retail market in downtown Grand Rapids has picked up and will continue into 2008. More local retailers are looking to downtown as a place to expand, which is mainly attributed to the healthcare and hospitality expansions. As there becomes more residential completions, the urban retail market will also help revitalize downtown Grand Rapids. We can expect increased activity with healthier occupancy and rental rates through 2008 downtown.

In summary, after a slow start in 2007 the West Michigan retail market rebounded, and as there are more healthcare completions we can expect that 2008 will pick up drastically. Interest will be focused around the two proposed lifestyle centers in Walker and on the Beltline. Expansion of existing users within the marketplace will contribute the most to the growth in the area. The attraction of new retailers to West Michigan will be contingent on the lifestyle centers developing and beginning construction in 2008.

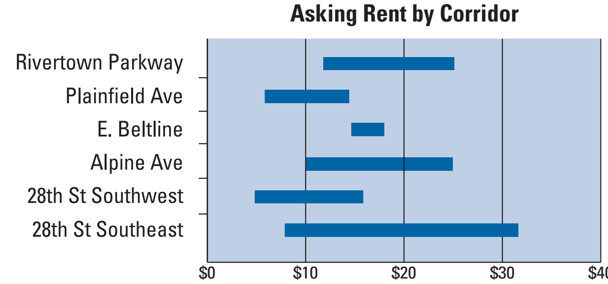
Median Household Income 2007



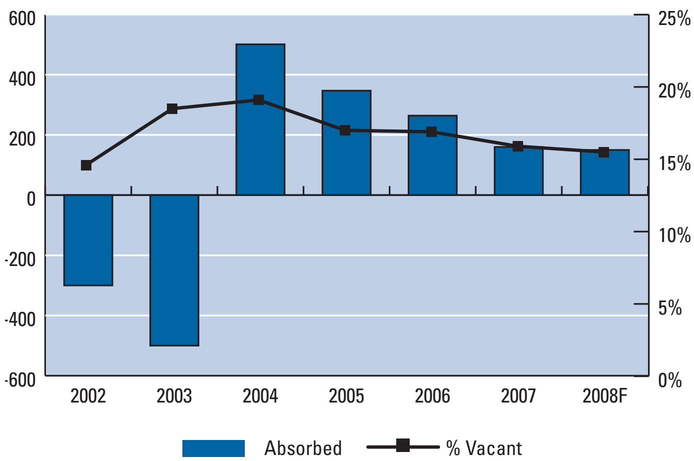
Unemployment Rate
Grand Rapids - Wyoming Metro vs U.S.
Not Seasonally Adjusted



Asking Rent by Corridor

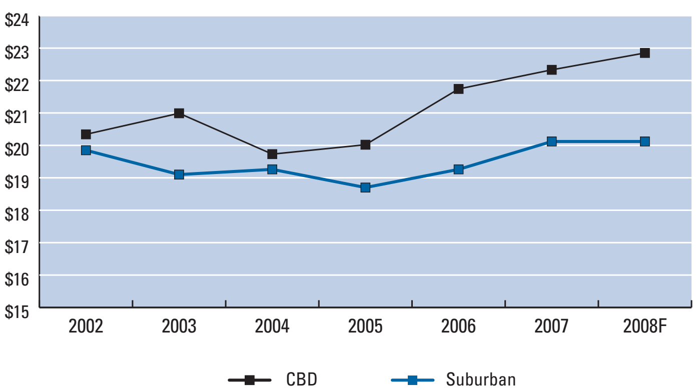


Vacancy and Absorption



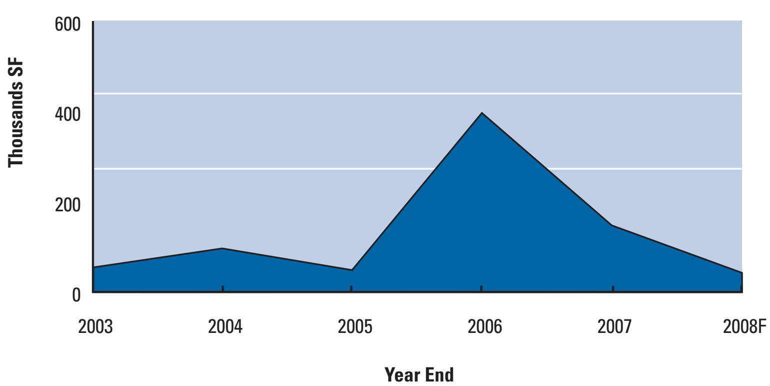
Class A Asking Rental Rates

$ / SF /Yr. Full Service, Year End



SF under Construction

Year End



Office:

Despite uncertainty created by the state budget and taxation changes, continued modest growth is expected in 2008.

The Grand Rapids office market experienced modest improvement in 2007 as overall vacancy rates dropped from 16.2 percent in the first quarter to 15.9 percent year-end. This accounts for nearly 160,000 square feet of positive absorption, despite new construction completions and new vacancies resulting from the closing of mortgage companies throughout the area. We expect gradual improvement in 2008 with several major projects coming to fruition and little new construction speculated.

Highlights for downtown included the openings of the new Grand Rapids Art Museum (GRAM) and the JW Marriott, which is one of only three of the "luxury-brand" hotels to open worldwide and the only one in the U.S. in 2007. The 24-story structure adds a strong presence to the downtown skyline and the GRAM brings to the area the world's first LEED certified art museum.

The downtown market maintained healthy occupancy rates with slight increases in rental rates. Discussions of a new Class A tower have quieted as prospective tenants renewed and extended their existing leases. There is surprisingly little Class A product offering 30,000-plus-square-feet of contiguous general office space in the central business district (CBD). As a result, we expect to see moderate rent increases in Class A and B office rates downtown.

The suburban markets remained soft with some tenants looking at the CBD as a place to expand operations. Much of this attention is attributed to the medical and hospitality development. During the second half of 2007, Metro Health Village welcomed the opening of Metro Health. Their unprecedented move to the 170-acre campus, which consists of a hospital, support services, retail, and restaurants, will have a major impact on the suburban market. We expect rental rates to hold and net absorption to be marginal as the suburban office market begins to absorb the glut of space vacated by the mortgage company operations.

The rapid development of "Medical Mile" along Michigan Street is scheduled to bring over 450,000 square feet of medical related space online in 2008. The announcement of MSU relocating its College of Human Medicine further demonstrates Grand Rapids as an emerging leadership in the life sciences. However, second-generation medical office space vacated will create a new set of market challenges. Landlords will have to upgrade or reposition their assets to remain competitive and maintain occupancy.

In summary, 2007 witnessed major downtown openings, continued boom of the medical sector, and an overall healthy market. Looking to 2008, we eagerly anticipate the market reaction to the nearly two billion dollars in downtown development, as years of investment and construction finally come online. The uncertainty in the business community created by the new Michigan Business Tax and shaky state budget will likely result in shorter term leases, as companies wait cautiously to determine the real impact on their operations. However, bioscience and healthcare industries will continue to play a vital role in the growth of West Michigan.

Investment:
Overall demand is expected to remain strong while tightening financial markets will have a tempering effect on prices.

2007 saw the culmination of a number of major construction projects and civic investments in the greater Grand Rapids area. Downtown was host to the opening of the Grand Rapids Art Museum, the only LEED® certified art museum in the world, as well as the only new J.W. Marriott hotel in the nation. Medical expansion continued downtown and the relocation of Michigan State's medical school was announced. These projects highlight the region's ability to create strong, positive, and sustainable growth. Significant out-of-state interest was the trend during 2007 and should continue into 2008. Unprecedented investment demand from around the country, along with a large pool of quality investment properties, were taken to market by long term local investors seeking to capitalize on the strong demand and steady pricing, which contributed to a very positive; active year.

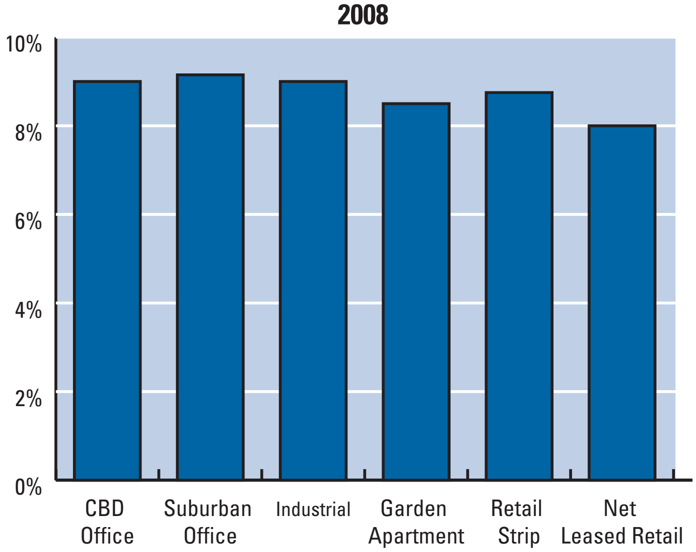
The second half of 2007 witnessed an overall tightening in the financial markets, not only in West Michigan but around the nation. As of August, top financial lenders became much more cautious and are addressing financing with more scrutiny, leading to higher interest rates for the majority of long-term financed deals. This credit tightening is expected to have a tempering effect on prices as we enter 2008. Expect to also see tightening from local lenders; however, short-term rates should continue to remain at historical lows. Overall, financing remains available and rates remain near historic lows.

The Grand Rapids Industrial market was the most active investment sector during 2007 with a significant number of single-tenant transactions and a variety of large portfolio sales. Although the region has lessened its dependency on manufacturing, West Michigan's manufacturing community continues to be a leading economic indicator based on the area's large population of skilled labor.

Retail strip center sales were driven by 1031 exchanges during 2007, which buoyed prices more than anticipated. A slight decrease in leasing activity in the West Michigan retail market has led to an overall increase in vacancy. Occupancy and location will be the two primary factors impacting retail investors in 2008.

The consolidation in Grand Rapids' central business district slowed; and, as forecasted, office transactions slowed overall in 2007. The transactions that did trade were primarily long-term, single-tenant transactions or were associated with the medical expansion. We expect 2008 to be a similar year with focus on acquisitions of medical properties and value-add opportunities of large projects experiencing vacancy issues. Multifamily housing sales were limited in 2007, but student housing remained strong and continues to attract a variety of investors. The downtown rental housing market was fueled primarily by student housing, which can be expected throughout 2008. Although activity was less than anticipated in 2007, rental and occupancy rates have stabilized, which should create stable investment activity in 2008.

Projected Average Capitalization Rates*
2008



*Averages — It is impotant to note that individual cap rates vary based on a number of factors including property quality, tenants, length of leases and location. These cap rates should be considered overall averages and may vary greatly depending on any of the above qualities.

2007 Major Transactions

Address/Name	Size	Property
900 Brooks	310,000 SF	Industrial
4701 E. Paris	152,000 SF	Industrial
Single Tenant Portfolio	230,000 SF	Industrial
Multi Tenant Portfolio	570,000 SF	Industrial
Grand Central Plaza	93,000 SF	Retail
Cherry Valley Retail	57,000 SF	Retail
1515 Arboretum	63,000 SF	Office
Millbrook Apartments	73 Units	Apartments

Industrial:

A diverse, creative, and flexible supply base remains a significant factor in the overall health of the industrial market.

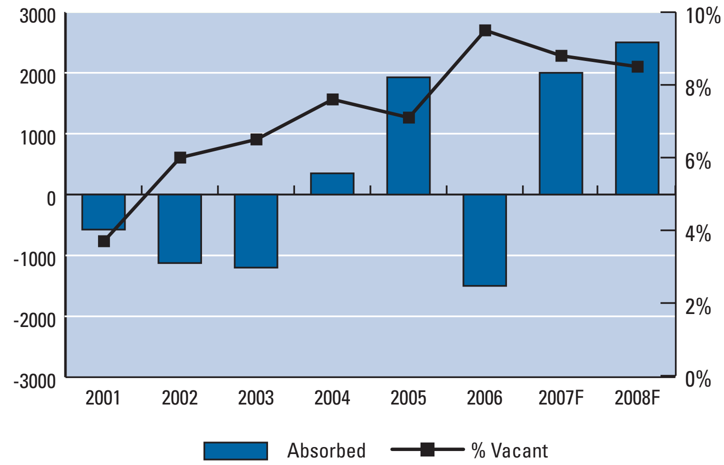
Corporate downsizing and plant shutdowns slowed in 2007, having a positive effect on the Grand Rapids industrial market. The vacancy rate decreased from 9.8 percent during the first quarter of 2007 to 9.5 percent year-end. While large plant closings and layoffs make headlines, much of the occupancy growth has been local, incremental, and somewhat behind the scenes. However, in contrast to the last seven years, we are finally witnessing companies based outside the area seriously consider Grand Rapids as a viable place for new or relocated operations. This renewed interest is due to the presence of our highly skilled and competitive-wage work force, the vast intellectual capital of our local supply base, and the availability of large manufacturing facilities featuring heavy infrastructure at prices found almost nowhere else in the nation. Several companies are currently under contract to take sizeable spaces off the market while many others have shown serious interest. We expect this trend to continue in 2008, as word travels about the opportunities that exist in West Michigan.

There was approximately 750,000 square feet of new construction in 2007, almost all of which was built specifically for an end user. We expect speculative construction to be almost non-existent, at least throughout 2008. Current lease rates, combined with high construction costs and tighter lending practices, make it difficult for developers to make industrial speculative construction a profitable enterprise. New construction has been triggered by users unable to find existing facilities to meet their needs. In addition, redevelopment of older manufacturing sites continues to offer affordable alternatives to those considering new construction.

The leasing market remained favorable to tenants, as it has been for the past seven years. Many leases trended toward shorter terms during 2007, as the current rates for short and long term leases have become almost identical. Tenants are choosing to minimize their risk by committing to shorter terms while betting that long-term rates will not be higher than they presently are. As a result, overall occupancy levels improved even though lease terms were shorter than most landlords desired. Landlord concessions remained static, but as occupancy increases, we expect to see a slight shift in 2008 toward a more landlord-friendly environment.

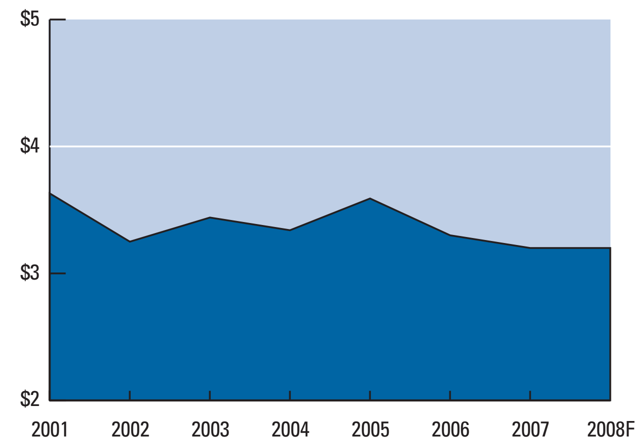
The locally-based manufacturing sector continues to be the most critical component of the Grand Rapids industrial market. These companies occupy the majority of the existing inventory and drive demand for bulk warehouse space. Many local companies have survived and adjusted to the new realities of the domestic auto and office furniture industries. They have branched out and started to apply their expertise toward new markets such as medical devices, defense industries, and various high tech, low volume manufacturing niches. As more locally based companies delve into these growing markets, they will contribute to the continuing diversification of the supply base that has been essential to the overall health of the region.

Vacancy and Absorption



Asking Rental Rates

$ / SF / Yr. NNN, Year End



SF in Thousands