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West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

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West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

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Retail:
The West Michigan retail market is poised to expand in 2007, gaining in strength and popularity.

The West Michigan retail market was virtually unaffected by the slowdown of the State economy in 2006. Retail is still well positioned in the expansion phase of the market cycle. This is expected to continue throughout 2007 as absorption remains positive, construction continues, and rates slowly tick up.

Growth within the healthcare industry continued to bring jobs into the economy in 2006, drawing attention to the Greater Grand Rapids retail market, particularly along the M-6 South Beltline where St. Mary’s and Metro Health Hospital have been under construction. This area has been a major draw for new and expanding retailers seeking to position themselves in a high growth area and within proximity of the workforce living in outlying areas. New projects were started for Metro Health Village at the corner of Byron Center Avenue and 54th Street SW in Wyoming. The 170-acre development will include 200,000 square feet of medical, office, retail, and residential space. The new Metro Health Hospital is expected to open in fall 2007.

A lot of attention in 2007 will be focused on two proposed lifestyle centers:

- Orchard Park Lifestyle Center, a $340 million project, will cover 220 acres of land in Walker Township. The 450,000 square foot retail component has plans for a number of restaurants, a movie theater, a book store, Cabela’s sporting goods, and two junior anchor stores. If the project is constructed at this site, it will be one of more than a hundred lifestyle centers built across the United States.

- Robert B. Aikens & Associates have proposed The Village of Orchard Hills in Plainfield Township. The vast majority of the 400,000 square foot, 60-acre project will have a heavy dose of high-end retailers, nationally known anchors, a book store and an upscale grocer. In addition, the developers are considering incorporating second-floor residential units to soften the contrast with the existing neighborhood. With nearly 50 retailers, 150 to 175 condominiums, and two restaurants proposed, The Village will be the first of its kind in West Michigan.

Construction in the downtown area added a new art museum, a medical complex, significant residential activity, and the first new office buildings in almost 20 years. As the downtown area expands across a wide spectrum of industries in 2007, the retail market is poised to follow suit gaining in strength and popularity.

Limited speculative development will take place in 2007 centered primarily around strip malls. The majority of construction activity will be the expansion of existing users within the marketplace, primarily in auto-related industries, fast food restaurants, Starbucks, Dollar Stores, and banks. In 2007 the level of new speculative development will be contingent on rising land and construction costs, as well as interest rates.
Office:
A year of consolidation and medical expansion will lead the West Michigan office market to a future of sustainability for 2007 and beyond.

The Grand Rapids office market improved in 2006 as many businesses considered leasing over buying. Increased occupancy rates, absorption, and the boom in medical construction all helped to firm the market. Landlords provided fewer concessions in the way of free rent and tenant improvement allowances, a significant shift from a couple of years ago, when they were more aggressive with rental rates and incentives.

There was incredible downtown investment (both public and private) in 2006, a trend expected to continue in 2007. The new investments, including the art museum, expansions at Spectrum and St. Mary’s Hospitals, new residential construction, and the JW Marriott Hotel, are playing a pivotal role in the revitalization of downtown. Private office investment is evident in the addition of the first new Class A office properties since 1990 with the construction of 70 Ionia and the Riverfront Plaza expansion. Together, they total nearly 100,000 square feet.

Ownership among downtown office properties underwent consolidation in 2006 primarily from buyers outside the market. Investors included an Ann Arbor group that bought over 500,000 square feet of Class B space, a Kalamazoo investor that acquired 400,000 square feet of A and B space, and a Holland investor that purchased three quality office buildings totaling over 200,000 square feet. This consolidation of over 1 million square feet, making up 20 percent of the downtown office space, should contribute to higher rental rates in the future. Additionally, two new mid-rise office projects are considered for the Central Business District (CBD). We believe there is a good chance of at least one of the projects breaking ground in 2007.

Rental rates in the suburbs are forecasted to remain steady in 2007 with slight improvement toward year-end. Concessions are expected to level off in 2007 for suburban Class A properties; however, landlords of Class B and C office buildings must continue to offer aggressive incentives to fill space. With a surplus of available inventory, the suburban markets remain flat.

Most Class A properties in the suburbs command five-to-ten year lease terms, with occasional 15-year terms for anchor tenants. Class B and Class C property lease terms typically averaged three to five years. National companies attempt to negotiate five-year terms with a kick-out clause after three years to either reposition for growth or exit the market. In 2006 more users were inclined to lease, as opposed to purchase or build, as interest rates, land prices, and construction costs increased. If interest rates hold steady or fall, leasing could slow in 2007.
In summary, 2006 investors from outside the market place invested significant dollars in the future of the Grand Rapids CBD. Institutional, medical, and hospitality continue to lead the parade of cranes across the skyline. The growing demand for medical office space and other service users in medical research should generate demand for office space and residential product in 2007 and beyond.

**Investment:**
Interest rates will be closely monitored in 2007, and will be a primary issue impacting investors throughout the year.

The skyline of downtown Grand Rapids is silhouetted with cranes, representing over $1 billion of new construction. In addition to the large visible investments, significant acquisitions of real estate by local investors and an influx of regional capital highlighted 2006. As was forecasted in 2005, there was a marked increase in interest rates throughout 2006. It was projected that this increase would temper investor demand, particularly in Michigan where the effects of a recession are still being felt across all sectors. Despite rising rates in 2006, there was strong pricing, high demand for investment-type properties, and a general lack of quality in the investment properties offered. Private capital has come to West Michigan from Chicago, Detroit, New York, and California with investors seeking better yields.

Capitalization rates trended upward in 2006 and were primarily impacted by rising interest rates. In late 2006, the Federal Reserve initiated a series of interest rate pauses. Interest rates will be closely monitored in 2007, and will be a primary issue impacting investors throughout the year.

![Projected Average Capitalization Rates* 2007](chart)

**Industrial:**
Grand Rapids is the hub of Western Michigan and, based on investor demand, is rapidly being viewed as an extension of the Chicago Market.

Grand Rapids, synonymous with the furniture and auto industry for decades, is becoming more reliant upon technologically advanced industries that are developing and expanding here. Industries such as medical, food manufacturing and processing, and life sciences are rapidly becoming foundations that West Michigan is able to rely upon. These growing industries are adding to the industrial diversity of the market, which is the backbone of the West Michigan economy.

The growing presence of the healthcare/bioscience sectors spawned limited industrial inquiries in 2006 for small-scale lab and incubator space. We expect that as the healthcare/
bioscience industry flourishes, it will contribute to the overall health of the industrial market. With the development of this industry, many current manufacturers are looking to further diversify their product lines.

Demand for owner-occupied industrial space less than 25,000 square feet remained moderate in 2006. Tenant demand remained fairly strong with smaller multi-tenant buildings holding onto higher occupancy levels. The demand from buyers in this size range has slightly lessened as interest rates have risen. In 2007, demand from tenants and buyers in this segment will increase as smaller entrepreneurial companies begin more aggressive growth.

The Southeast Submarket saw the greatest absorption across the board in 2006, driven by users requiring 50,000 plus square feet of space with specific heavy infrastructure requirements. However demand for warehouse/distribution (W/D) space in every submarket remains soft with three to five years of available inventory. This will hold rates and terms down for the foreseeable future. New construction in the Southeast Submarket doubled since the fourth quarter of 2005 with nearly 665,000 square feet or 84 percent of total marketplace construction.

Lease terms ranged from three to five years in 2006, with a few at the outer range of 10 years. Landlords were aggressive on their terms and were eager to add annual rental increases into their leases. Concessions are expected to slowly decline toward year-end 2007 with landlords offering fewer months of free or reduced rent, move-in allowances and build-out options with W/D space as an exception. As this occurs, tenant opportunities will weaken in 2007 in those submarkets with a smaller supply of available inventory.

To encourage growth and redevelopment, state and city government continue to provide programs geared toward economic expansion. The state plans to invest $2 billion over the next 10 years to spur job growth. The fund is aimed at life sciences, advanced automotive and manufacturing, alternative energy and homeland security. The creation of renaissance zones, provide exemptions on most city and state taxes. Many West Michigan companies have used this program to improve and grow their businesses and will move forward with it into 2007.