West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

Matt Abraham
Grubb & Ellis, matt.abraham@gepc.com

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West Michigan has endured and persevered through a considerable economic hardship throughout the past several years. Despite the odds, even the most troubled sectors of the commercial real estate industry have slowly recovered and are showing signs of further growth in the coming year. The following article will give a depiction of how the market has performed and where the recent trends are heading in the coming year. All information is based on a compilation of data collected for each division of commercial real estate for the 2005 year.

Grand Rapids Industrial
2006 will demonstrate that West Michigan’s resilient industrial marketplace offers opportunities for local companies engrained with the region’s well-known entrepreneurial spirit.

The industrial market remains in a recovery phase with a sense of optimism for 2006. A continued up-tick in the economy is expected, as several local companies expand and additional governmental incentives become available. The pace of the local recovery will be restrained with few companies consolidating or sending their operations offshore. This mature market will recover with stability and health, drawing further interest from investors who have focused their attention in West Michigan.

Lacks Enterprises, an automotive supplier, continues its expansionary plans. Phase-one of its project was completed this past summer adding a 156,400 square-foot plating facility in Kentwood at an estimated cost of $17.5 million. Over the course of the next few years, the total project is poised to add approximately 420 jobs directly to the community with a ripple effect of about 820 jobs to the State of Michigan.

Additionally, the manufacturing sector may receive a lift from the passage of recent legislation in the U.S. House of Representatives on a bill now being reviewed by the Senate. This bill would provide grants, encouraging research, establishing scholarships, and strengthening the Manufacturing Extension Partnership (MEP) to help small and medium-sized manufacturers. MEP funding will be $110 million in fiscal year 2006, increasing by $5 million per year until fiscal year 2008.

The redevelopment of the 915,000 square foot Bosch facility in Kentwood reinforces the ability of the market to retain and attract advanced manufacturing firms. X-Rite, a hardware and software leader, is investing $24 million to refurbish 350,000 square feet saving over 400 West Michigan jobs and recruiting over 313 new high-paying jobs over the next five years.

Foreign competition and technological advancements are driving many domestic manufacturers to consolidate and go abroad to manufacture products competitively. Steelcase, a global furniture manufacturer, announced plans to downsize their North America operations by closing some of their new facilities in Grand Rapids over the next two years. Nearly 206 acres and approximately 5 million square-feet of existing buildings will be shutdown with potential plans for redevelopment.

Many companies are beginning to rethink lease-versus-own scenarios, due to increasing land costs and the abundance of available product with infrastructure in place. Leasing concessions are expected to decline in 2006 with the tightening of inventory. Notable increases in rental rates are not foreseen, as rents will remain relatively flat.
In 2005, SVN Equities sold a 1.86 million square-foot portfolio, to an out-of-state investor for $56 million, which indicates that investors see value in the Grand Rapids industrial market. This was in part due to lower prices, allowing a greater return on investment, and less competition than in major markets, making transactions easier to complete.

**Grand Rapids Office**

*Regional planners are looking forward to very exciting times in 2006 with accelerated investment in the West Michigan office market.*

The Grand Rapids office market straddles the cusp between recovery and expansion. Higher-than-usual vacancies in all submarkets have fostered tremendous opportunities for tenants to shop space or renegotiate existing lease contracts. In suburban markets, Class B vacancies prevail as landlords compete to fill buildings and retain existing tenants. However, well-financed owners are passing on the most aggressive tenants in lieu of offering lower rents or concessions.

In 2006, health care will be the hottest sector for growth in downtown Grand Rapids. Van Andel Institute will commence Phase II of its $120–$150 million medical research and education facility, creating 400 new jobs and adding approximately 280,000 square feet of space. Spectrum Health will construct the $78 million, 200,000-square-foot Lemmen-Holton Cancer Pavilion at the Butterworth Campus and the new $190 million DeVos Children’s Hospital.

With the community’s one billion dollar investment in this cluster of health and medical facilities and its new research and development in biotechnology and life sciences, will serve to promote new commercial and residential development in the urban core and help build the City’s reputation as a world-class medical community.

The 2005 completion of the M-6 Beltline connecting the I-96 and I-196 freeways along the southern portion of Grand Rapids sparked the growth of the next major office corridor creating new jobs and development. Metro Health is moving rapidly to complete its new hospital at Byron Center and M-6 while Saint Mary’s Health Care has followed suit and broken ground on a new 86,000-square-foot outpatient campus just north of 64th Street at Byron Center Avenue. Spectrum Health will anchor the new project at Wilson and M-6. The Beltline has also spawned an increase in owner-built projects and speculative development.

The economic impact of the 2005 hurricane season will bring an anticipated rise in utility costs and construction materials, requiring overall higher rents. In 2006, rents are expected to increase 5–10% for Class A product and 2–3% for Class B and C products.

**Grand Rapids Retail**

*Opportunities abound for developers of power centers, grocery-anchored centers, high-end retailers and restaurants.*

The West Michigan retail market is thriving, largely due to impressive economic growth statistics seen over the past 30 years. Large national retailers continue to be attracted to the Grand Rapids area because of its strong demographic profile of more than 1.3 million people in the four surrounding counties of the Combined Statistical Area (C.S.A.).

Retail vacancies hover in the single digits with high land prices and product demand exceeding construction resulting in escalating rents. Rental rates for Class A product is expected
to increase 5% in 2006, while Class B rents will remain steady. Rents have increased even more drastically in some newer developments.

Although downtown redevelopment has favorably impacted local retail markets, the strongest growth corridor in 2006 will be along the newly completed M-6 Beltline south of Grand Rapids. Numerous restaurant chains (i.e., Logan's, Applebee's, Panera Bread, Pizzeria Uno, Steak 'n Shake) and big box retailers (i.e., Meijer, Target, Staples, and Celebration Cinema Theatre) have already targeted this prime area for development. Further, all three regional hospital groups are planning future corridor expansion and that is likely to entice new retailers into the area.

New retail projects will continue to be developed well into 2006. From the expansion of Rivertown Parkway in Grandville to a potential lifestyle center, there are enormous opportunities for power centers, grocery-anchored centers, high-end retailers, and restaurants in West Michigan.

Landlords are currently reaping a good return on investment by refurbishing older shopping malls with offers of expanded build-out. Tenants will capitalize on opportunities in the south end of the market, specifically along M-6 and the older strip centers where lower rents are still available.

Investors are bullish over retail opportunities with demand for product exceeding supply in 2006. Strip centers will remain the hot product type for 2006. Conversely, sellers are comfortably positioned in the driver's seat as they weigh offers from local investors.

**Grand Rapids Investment**

Despite rising interest rates overall, capitalization rates remained low in 2005 but are expected to move upward approximately 25 to 50 basis points during 2006.

The West Michigan investment community will confront recurring patterns of prior years: a limited supply of quality opportunities in 2006 coupled with aggressive demand for strong real estate investments. The one main difference impacting the investment arena in 2006 is upward-trending interest rates. The changing financial markets could transform the real estate investment landscape in West Michigan and throughout the nation. A cautious investor will be focused on rising interest rates. As the rates spiral upward, it will be interesting to note how investors evaluate their overall returns. Although increasing interest rates will affect cash flow, the net effect on cap rates may be tempered by a high level of demand for quality investment product.

Despite rising interest rates, overall capitalization rates remained low in 2005 but are expected to move upward approximately 25 to 50 basis points during 2006. This economic scenario clearly presents a prime opportunity for owners to consider selling while interest and cap rates are at relatively low levels. Though no immediate changes should be expected, the long-term expectations are that prices may be at their peak and in some segments may have already topped off.

Investor interest is strong in larger, more-stable investment properties. Out-of-state investors, considering adding to their portfolios from lower-tier markets like Grand Rapids, are adding to the demand for quality projects. This was the case when a California buyer utilizing a tenants-in-common (TIC) ownership strategy paid $56 million for the SVN Equities portfolio sale. TICs are increasingly being marketed as an alternative to the traditional 1031 exchange.

The Grand Rapids Central Business District (CBD) also attracted strong investor interest with the sale of three prominent office buildings in 2005: 50 Monroe Place, The Campau Building, and the Ledyard Building. All three high-profile property sales demonstrate and solidify the consensus that Grand Rapids is a viable market allowing investors a greater return on their dollar. As more out-of-state investors begin to consider alternatives to upper markets, Grand Rapids will emerge as a competitive and respected investment market.

The multi-family housing market is showing signs of recovery. Concessions are stabilizing, occupancy is rebounding, and there is no notable construction in the pipeline. With the continued growth in college and university satellite facilities, coupled with expansion at the Van Andel Institute, the Lemmen-Holton Cancer Pavilion, and the DeVos Children’s Hospital in the medical corridor, the increased demand for housing may add to the vibrant CBD housing market. The economic impact of these developments will create a ripple effect in job creation and demand for retail amenities. Rising home mortgage interest rates will increase construction of rental housing projects in the community.

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