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Colliers International | West Michigan

Industrial Market

West Michigan's industrial sector is driving the region's economic resurgence to new heights. "West Michigan's economic recovery is leading the state of Michigan, which is running ahead of the nation's economic recovery," said Paul Traub, a Detroit-based economist with the Federal Reserve Bank of Chicago. Attributed to strong growth by many of the area's auto suppliers and an overall uptick in industrial production, we are seeing businesses expanding and creating new jobs like never before. The industrial real estate market's unprecedented low vacancy rates and increased level of construction offer proof that West Michigan has made major strides over the past year.

Vacancy rates dropped 65 basis points throughout the year reaching a new low of 6.62%. Additionally, both sale volume — dropping from 187 in 2012 to 133 in 2013 — and lease volume — dropping from 248 in 2012 to 177 in 2013 — took a hit compared to last year due to lack of inventory available in the market. Transaction velocity will continue this downward trend until more quality space is added to the market. Rental rates are gradually increasing, although we haven't yet experienced that necessary bump to the next tier of pricing. As a result, many developers are hesitant to construct new speculative projects based on the current market rates. This situation is posing a problem for many users who demand new quality space, unable to find a location to secure. Demand will continue to outweight supply until action is taken to equalize the scale. This is why we anticipate a surge in speculative construction throughout 2014 as developers respond to this economic imbalance.

Some companies like Franklin Partners, based out of Naperville, IL, have found their own solution by purchasing older industrial buildings and repositioning them into high-quality manufacturing and warehouse space. Their latest project includes the purchase of a 400,000-square-foot industrial and office building at 5300 Patterson Avenue SE. They intend to split the building into two separate buildings — office and warehouse — to appeal to a wider range of users.

Though speculative construction is lacking, we are experiencing an increase in build-to-suit projects. CHEP Pallets recently moved into a brand new 85,000-square-foot building in the Meadowbrook Business Park. Within months, they were forced to add a 65,000-square-foot expansion to account for increased demand and production requirements. Gordon Foods is experiencing similar conditions adding a 94,000-square-foot freezer facility at 651 50th Street, down the road from their distribution center on Clay Avenue. If they have extra land, building expansions are the next best option for many of the growing companies who are unable to move. New construction will continue to be clustered around manufacturers that need space and have very few options in existing buildings that meet their specifications.

The state of Michigan currently leads the nation with the most manufacturing jobs added over the last three years. Strong auto sales and the resurrection of the “Big Three” can be credited for a large portion of this growth but other factors are bringing jobs back to the state. Attractive tax credits offered by the state, labor costs increasing overseas, and the low cost of natural gas is making it cheaper to manufacture on our own soil. Such high levels of growth are encouraging as we move into 2014 where we will continue to notice the ripple effects in other industries. With more jobs available, consumers will have more money in their pockets to spend on goods and services. As demand increases, production
levels for manufacturers will follow suit. This important cycle influences the entire economy, and we expect it to carry West Michigan through 2014 with confidence and success.

INVESTMENT

The investment sector of the West Michigan real estate market experienced very strong activity in 2013, with transaction velocity nearing historic highs from 2007. There certainly has been more demand than supply for quality investment real estate deals. Investors remain focused on assets that include some level of value add, or projects that have long-term leases in place. Increasingly, the vast majority of transactions in the market are arms-length transactions, with the percentage of distressed assets falling from a post-recession high of 70% to below 20%. Most local lenders have seen their balance sheets shored up considerably, and the volume of distressed properties coming to the market exemplifies this.

The high levels of investor demand are being driven by a diverse range of buyers actively seeking stable real estate projects as a diversification tool while simultaneously hedging against inflation. We have also seen a marked increase of confidence in the overall real estate market as the number of 1031 transaction needs has risen dramatically over their post-recession lows. Investors are looking toward the additional benefit of interest rates that remain at or below historic levels over the past year distributed toward all of the property sectors. West Michigan is now viewed in a very positive light compared to prior years when poor conditions stifled local investment exploration. Being a smaller market has its benefits as investors can quickly distinguish the value light compared to prior years when poor conditions stifled local investment exploration. Being a smaller market has its benefits as investors can quickly distinguish the value

1.5 million square feet by a new investor out of the Chicago market, CrossLake Partners. The portfolio consisted of 7 multi-tenant properties totaling $29.3 million or $19.24 per square foot. Other notable investment transactions include the $5.6 million sale of a fully-leased 197,220-square-foot manufacturing facility at 3195 N. Wilson Dr. to an out-of-state investor from Tennessee and the $6.17 million sale of an 88,000-square-foot fully-leased manufacturing building at 4070 East Paris to a national REIT. Multiple sale and leaseback transactions also occurred between local manufacturing companies and various national REITs.

Out-of-state investor interest has reached exceedingly high levels over the past year distributed toward all of the property sectors. West Michigan is now viewed in a very positive light compared to prior years when poor conditions stifled local investment exploration. Being a smaller market has its benefits as investors can quickly distinguish the value of lower price points and higher cap rates compared to the larger markets like Chicago or Atlanta. California-based Hertz Investment Group made its first purchase in Grand Rapids earlier in 2013 with the acquisition of one of West Michigan’s most recognized office towers, Bridgewater Place. Bridgewater Place was approximately 70% occupied at the time of sale, and represented an opportunity with a solid mix of long-term tenants, and a value add component through additional leasing. The next largest office deal consisted of a 53,000-square-foot fully-leased medical building occupied by Spectrum Health
until 2022. Acquired by another out-of-market REIT, the hefty $16.4 million ($309/per square foot) price tag illustrates just how much investors value long-term, triple net leased facilities with quality rated tenants. The health care field is expected to outpace the rest of the office property subtypes as investors compete to find the most secure and rewarding opportunities to place their money.

The retail market has made solid gains in the past year but continues to be the lagging segment of the West Michigan market. Historically, this trend is the product of an economic cycle that starts with industrial growth, job creation, putting money in the hands of the consumers, and ending with strong retail performance. This cycle is progressing nicely and the proof is in the increased industrial activity and corresponding decrease in unemployment in the area. As a result, retail investment opportunities have increased in activity and interest over the past year. One of the first major retail center transactions since the downturn was completed in February when a buyer out of Ohio invested $4.2 million into the 60,876-square-foot Rivertown Center in Grandville. Activity has remained very strong for single-tenant net leased retail operations, with cap rates continuing to fall as investors search for long-term stable assets. The 1031 exchange market has been very active, with many investors in this sector driven to retail in search of long-term net leased assets.

Some of the major deals in the pipeline for the year ahead include a 14-story 108-unit mixed-use apartment building at 20 E. Fulton, a 7-story 48-unit mixed-use apartment building at 240 Ionia Avenue SW, and a four-story 54-unit mixed use development at 740 Michigan Street NE. In addition to these urban based projects, there are also a number of suburban apartment projects that have been announced or are in the works. These projects will prove to be the first delivery of new suburban multi-family of any magnitude in the last five years.

Looking forward, we expect apartments to reign as the dominant player in the investment market. Healthy demand, low vacancy rates, and the young work force entering the market will drive new developments and additional investment activity in the year to come. Manufacturing and warehouse space will benefit from the local production increases as well as the e-commerce trend that is forcing online retail operations to expand their back-end storage
requirements. Lastly, retail and office investment properties will reach attractive occupancy levels as the economy gets stronger with each quarter.

OFFICE
Sales activity for the year was highlighted by the culmination of several significant investment deals. The first of which, occurring at the beginning of the year, was the purchase of Bridgewater Place at 333 Bridge Street NW for $26.5 million. This was an REO sale of a 70% occupied Class A building to an out-of-state investor making its first purchase in Grand Rapids. Another noteworthy transaction transpired in the Southwest corridor where a public REIT named American Realty Capital purchased the Spectrum Health West Pavilion building for $16.4 million. This is a triple net leased investment to an Aa3 Moody’s rated tenant (Spectrum Health) with nine years remaining on the lease, hence the hefty sale price. An alternate investment approach was applied to the 395,689-square-foot building at 5300 Patterson Avenue SE. The buyer plans to split the office and warehouse portions of the building into two separate sections to give a clear distinction between the uses. The repositioned office building will offer around 100,000 square feet of space designed for large suburban users with sizeable floor plate requirements.

Overall, construction is making a comeback in the market and the office sector is no exception. A new 24,631 square foot Class A office building was erected at 4362 Cascade Road, marking one of the first partially speculative developments arising in the last 5 years. Just under half of the building was pre-leased before construction leaving two available units totaling 13,549 square feet. The aforementioned Spectrum build-to-suit on 3 Mile will be a large addition to the area drawing more attention to the East Beltline corridor. There is a vast number of project proposals in the pipeline moving forward including an office complex on East Paris with one 40,000-square-foot two-story building and another two 10,000-square-foot buildings. Downtown Grand Rapids also has a variety of projects in the pipeline for this year including a $28 million mixed use development in the parking lot behind Van Andel Arena. The proposal calls for a 200,000-square-foot structure including office, retail, market rate apartments, and underground parking to offset the spaces taken away.

The updating and upgrading of older historic downtown buildings is reaching an all time high as landlords lure tenants to their space by adding value and amenities. The 186,597-square-foot office building at 99 Monroe, built in 1985, recently underwent a repositioning effort that added a modernistic new interior, a fitness center, and a contemporary conference room. Another local real estate firm announced that it will spend a total of $6.7 million updating two other downtown buildings originally built in the 1890s. The firm plans to rehabilitate the exterior façade, update the lobby/common areas, and modernize the existing office suites. With intentions of increasing overall profits in the long run, landlords know that these structural improvements are necessary to raise rents and stabilize the urban core. These tactics have proven successful throughout the past year as we witnessed the Downtown/CBD vacancy rate drop 3.71%. This trend
is expected to continue moving forward with increased absorption levels projected as the year progresses.

Overall, companies are doing much better today propelled by the dynamic economy of West Michigan. The office sector will be a major beneficiary of these positive conditions as growing companies demand larger real estate requirements. The influx of new companies capitalizing on the abundant workforce of Grand Rapids will also benefit landlords and sellers in the market. The many new construction projects planned for 2014 will offer some excitement for tenants wishing to occupy the latest and greatest space.

Landlords must continue to be mindful of this fact by further strategizing how to maintain strong occupancy levels in such a competitive market.

RETAIL

As we look back on the real estate market in 2013, it is apparent that West Michigan is robust and alive with retail activity. Picking up steam from last year's strong performance, we experienced improving conditions on all fronts including absorption, activity, and new construction. Net absorption has increased each of the last four years, each year exceeding the previous. Already surpassing last year's absorption projections with over 180,000 square feet of newly occupied space, we expect more of the same moving forward especially with many new construction projects making room for the growing demand. New and existing tenants are stimulating the market by opening new stores and further expanding their brand presence in the major submarkets. Quick service restaurants have been particularly busy deploying growth strategies and opening new locations.

Prospective buyers have also made moves during the busy year as both owner-user and investment activity increased. One of the first investment grade shopping center transactions occurred in the first quarter of the year when the 60,876-square-foot Rivertown Center Building at 3845 Rivertown Parkway SW sold to an out-of-state investor. This imperative transaction boasted confidence to new investors who were previously weary to invest in the West Michigan marketplace. Since then we have witnessed an influx of out-of-state investor activity resulting in more deals coming to a close. Two notable deals include a triple net leased Walgreens on Plainfield Avenue and a triple net leased Applebee’s on Alpine Avenue, each selling for over $2.5 million.

Developers are well aware of the rising demand and diminishing vacancy in the main retail corridors. This has resulted in a long awaited surge of new retail construction that has played a crucial role in providing space to new entrants to the market. The majority of the developments are fueled by prospective tenants pre-leasing space before the structure is built to ensure the developer's interests are protected. The “Bucktown” development on the corner of 44th Street and Ivanrest Avenue is a perfect example of how investors are applying this method. Capitalizing off of the flood of consumers Cabela’s has attracted since its opening in March, there have been multiple new buildings constructed surrounding the outdoor goods giant and its fellow anchor tenants Target, Ulta, and Maurice’s. These buildings are 100% full with a strong mix of quality tenants. They will be joined by an additional 35,000 square foot development in this coming year. The recently built retail center in Forest Hills will be a major beneficiary of these positive conditions as surrounding the outdoor goods giant and its fellow anchor tenants Target, Ulta, and Maurice’s.

Rental rates in the main retail corridors have returned to pre-recession prices in the $20–$26/square foot range while new construction is demanding even higher figures in excess of $30/square foot. Landlords of these high quality buildings are demanding top dollar for their remaining space and holding firm on the price as they now have options to choose from. Free rent and tenant improvements in these scenarios are nonexistent and overall they are less common than years before. Still, rates starting as low as $6/square foot do exist in the struggling areas where properties suffer from poor location and deferred maintenance.
The East Beltline/Knapp’s Corner area is projected to be the next retail hot spot in the upcoming year. Already boasting one of the lowest vacancy rates at 4.50%, this area will surely see a surge in new development. Driven by very strong neighborhood demographics and the surplus of vacant land nearby, tenants will be fighting for space once they discover there is little else to choose from in the other submarkets.

The three key takeaways from the 2014 forecast equate to an increase in construction activity moving forward, new entrants prospecting in the market, and very tight vacancy rates pushing rental rates upwards.

Property Management

The spring of 2013 brought heavy rains, flash flooding and enough water-related issues throughout our region to make the record books. The Grand River peaked in downtown Grand Rapids around 21.85 feet, the highest it has been in years, affecting many commercial and residential buildings in the Greater Grand Rapids area. It was preventative measures and immediate emergency management that kept our heads above water.

Emergency management is the process of preparing for, responding to and recovering from any unplanned event that could have a negative effect on your tenants and/or your property. The goal is to establish a strategic plan which provides uniform standard operating procedures for response to emergency conditions within owned or managed buildings. An emergency plan should take into account various tenant profiles within each property to address their specific needs and risks. The property type and use has a direct bearing on the types of risks inherent to it. Residential, office, industrial, hospitals, medical office, theatres, retail centers and shopping malls all offer different challenges based on varying factors specific to their occupancy: the number of hours per day the property is occupied, occupant load, building height, security levels, building contents, presence of hazardous materials, and nature of activities are factors that must be taken into consideration. We are constantly adjusting our emergency plans and procedures, but used the months after the flood to especially evaluate other potential risks and situations for our clients and their properties.

While emergency plans were a big part of the beginning of 2013, the rest of the year brought many new projects and acquisitions, including two residential complexes.

Icon on Bond, a well-known apartment building in downtown Grand Rapids, was acquired by a New York investment firm in July of this year, and our team was awarded management of the nine-story building by the new ownership group. In addition, Glen Oaks East is a 144-unit multi-family housing complex located in the Southeast market of Greater Grand Rapids that we began managing this year with the addition of a few more team members.

One of the largest new management projects this year was a portfolio totaling over 1.5-million square feet. A partnership based out of the Chicago area named CrossLake Partners purchased the seven former Centerpointe properties for a total of $29.3-million and engaged our team to manage them.

We anticipate continued growth of our management portfolio and of our team, as more and more buildings are built or change hands throughout the upcoming year. The current property management portfolio totals 5,194,240 square feet of over eight property types.