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2018

West Michigan- Grand Rapids Economic and Commercial Real Estate Forecast

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Industrial

The industrial market seems to continue to grow tighter, with continued absorption and positive but modest new construction over the last year. In 2018, we anticipate the theme of this property type will be off-market transactions and creativity by brokers, developers, landlords, and tenants.

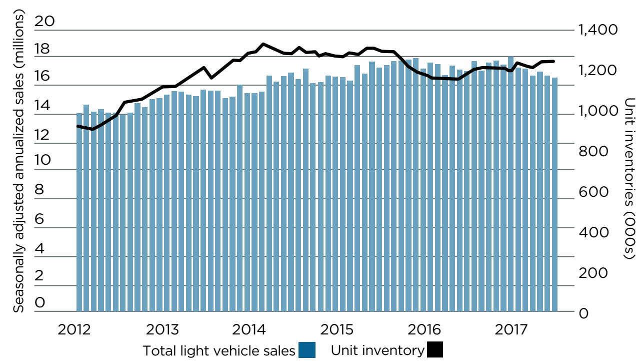
The West Michigan industrial market has a number of demand drivers, including furniture manufacturing and food processing; however, one driver we expect to have an impact on the region in 2018 is the automotive industry. With a number of OEMs (original equipment manufacturers) and Tier 1, 2, and 3 part suppliers in the region, any change in the automotive industry is sure to be felt. The paradigm shift in the auto industry is complex and there are a number of factors that influence the industry. Vehicles themselves are more intricate and advanced than ever, with on average more than 30,000 individual parts per vehicle. Technology within vehicles is rapidly increasing as well, so manufacturing for these components has become more sophisticated. We see that continuing into 2018, especially with Tesla, Ford, and Volkswagen aggressively pursuing market share in the up-and-coming electrical vehicle (EV) market.

In addition, it will be interesting to watch how autonomous vehicles progress in 2018. As this type of technology advances, fundamentals of how a car operates will change. This is likely a few years away, however, prudent auto parts manufacturers are thinking about these changes now. What this will mean for West Michigan's industrial market in 2018 and beyond is yet to be seen, but we expect new companies that specialize in autotomizing cars to enter the market.

The demand for vehicles will also play a role in real estate decisions in 2018. Many experts think total vehicles produced nationwide and automotive employment will plateau if not drop in 2018, but that will be coming down off near record highs. We forecast that 2017 would be the leveling off year, after a very strong 2016 in which more than 18 million vehicles were produced, however, manufacturers in the auto industry have largely had a great year. The national long-term average is just under 17 million vehicles produced, and gas prices have been favorable to production of some of the bigger and more expensive vehicles recently, so a modest correction is not something that should take too many by surprise.

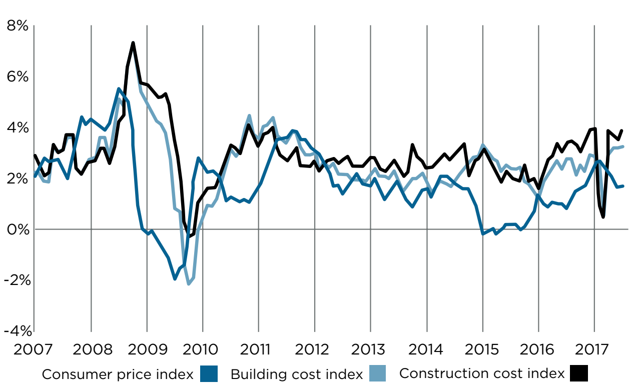
Access to skilled labor continues to be a constraining factor in not only the automotive industry, but also across most of West Michigan's manufacturing industry. Even while demand is present, production has been a challenge recently and it's also affecting real estate decisions. Many people growing up and newer to the labor force were told that the traditional college route was the best way to earn gainful employment. Now, companies in West Michigan are trying to shift that way of thinking. Skilled trades are more in-demand than ever and are garnering salaries above what many jobs that require a four-year degree can offer. Demand for skilled labor is so high that many companies are paying individuals to undergo training and apprenticeships. This will be a theme in 2018.

Figure 1: Light Vehicle Sales and Inventories



Source: Bureau of Economic Analysis (BEA)

Figure 2: Change In Construction Costs



Sources: Engineering News-Record; Bureau of Labor Statistics

Because of this, we still see construction costs being prohibitive to many. In 2017, we saw more than 2 million square feet of new space delivered to the market, however, with an overall industrial vacancy rate around 5 percent, the market is demanding more. Long lead times and high costs will still make companies consider becoming more efficient with space, tempering production goals or just building onto existing buildings rather than constructing new. Speculative building has taken place, such as 5300 Broadmoor Avenue SE, which started as a 50,000-square-foot Class A facility and was completely leased to two 25,000-square-foot tenants by the end of the year. The site has additional room to add onto, and we expect to see some movement at that site in 2018. Additionally, Robert Grooters Development Company has been working on their speculative development project near the Gerald R. Ford international Airport, dubbed "Area 52" and is actively building speculative warehouse space.

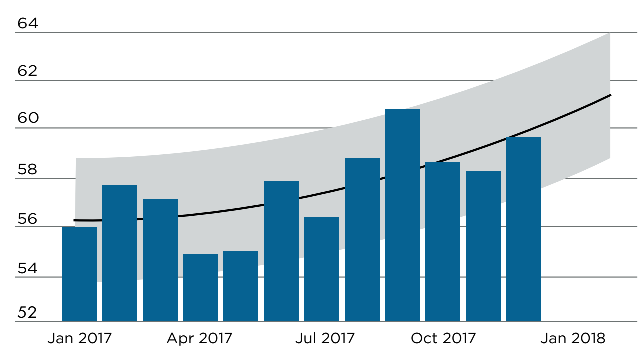
As we see a shift towards more efficient use of space, automation has been a solution many are turning to. Rather than invest in new real estate, some are investing in machines that can be more productive, for longer hours, in the same amount of square footage. Mark Ermatinger, Vice President of Sales at Zeeland-based Industrial Control Services Inc., a provider of automation equipment, expects upwards of a 300 percent increase in automation investment in 2018 from clients. We have seen technology and its effects on all industries grow exponentially, so we expect this to play a major role in the coming year.

Although we have a long lineage of manufacturing in West Michigan, as the industry becomes more advanced, we will need to continue to not only retain companies we have currently, but attract new, and innovative ones as well. That is precisely what is happening at Site 36 in Wyoming, former home to the General Motors Stamping Plant. Although the site was demolished and sat vacant for a number of years, the City of Wyoming, development partner Franklin Partners and Colliers brokers are actively looking for the next "advanced manufacturer" that will not only occupy real estate, but will also bring in new, high-paying jobs. In 2018, we expect to see some traction on this site as conversations with companies increase in intensity, and both the City of Wyoming and Grand Rapids' local economic development firm, The Right Place, continue to scout and create incentive packages that make a deal of that magnitude worthwhile.

Other themes that will shape 2018:

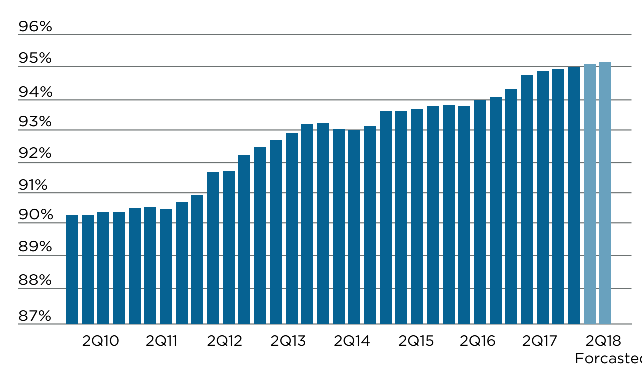
- The gap between in-place rents and market rents continues to grow. Companies that were able to lock in rates a decade ago, some with renewal options, are well-positioned relative to those looking for new leases right now. Rental rates have grown by more than 25 percent since the beginning of 2016 alone.
- With talent attraction at the forefront across all industries, we expect to see manufacturers become willing to pay a premium for space. Despite the trend mentioned above, a slight increase in real estate costs is a small price to pay in order to have the best talent available in a space that is suited well for efficient operations.
- The Michael A. Dunlap & Associates Furniture Index continues to point to modest growth. This has been a staple in our market for a long time, and we anticipate this will continue into the near future.
- Fulfillment centers to satisfy the "last mile" of e-commerce distribution operations will increase in prevalence.
- Investment in industrial space has been the favored sector for a long time. Opportunities continue to be scarce, as many buildings are owned by the operator. As the market continues to increase in value, we can expect not only more active buyers, but more willing sellers. While capitalization rates are being compressed across the board and investment yields are being cut thin, Grand Rapids offers some opportunities if you can find them.

Figure 3: Purchasing Manager Index



Source: Institute of Supply Management (ISM)

Figure 4: Grand Rapids Industrial Occupancy Rate



Source: Colliers International | West Michigan Research Department

Office

The attraction and retention of quality talent continues to be a motivating factor in real estate decisions by local employers. Providing spaces and amenities that appeal to employees has become as important as ever.

The Grand Rapids office market continues to show momentum heading into 2018 after yet another year of growth. In each quarter for the past seven years we have seen positive office space absorption and rental rates have steadily pushed upwards as the market continues to mature and expand.

Once known as a region in which people leave to find better jobs, Grand Rapids has seen a reversal in that trend, with many now migrating back home or deciding not to leave in the first place. While wages are still lagging in many comparable cities, opportunities for employment and quality of life are high, and cost of living is relatively low.

The office sector houses a large and growing part of the U.S. economy. Office job growth is strong, expanding by 2.2 percent on average in this recovery as compared with 1.6 percent total job growth. In a battle for talent, office space is now a key tool for tenants to attract and retain employees.

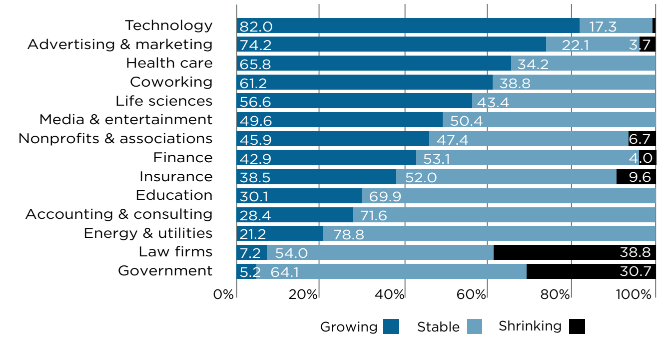
Moving into 2018, land acquisitions for new office development should increase, however construction costs and available labor will continue to be constraining factors this year. Despite these, new office construction continues downtown. Orion Construction is working on building a new home for law firm Warner Norcross & Judd and Chemical Bank at 150 Ottawa Avenue NW in the heart of the city, and Rockford Construction is set to deliver a mixed-use building at 234 Market Street SW, which will include approximately 30,000 square feet of ground floor office space.

The 171,000-square-foot Calder Plaza Building at 250 Monroe Avenue NW has undergone significant upgrades as well, which resulted in the commitment of Bank of America to consolidate a number of offices into the building. Additionally, 330,000-square-foot 111 Lyon Street NW is slated to undergo a similar transformation, and the currently-vacant 50 Monroe building will be split and converted into an AC Hotel and renovated office building. 50 Monroe was one of four local properties recently approved for Brownfield tax credits.

As these buildings downtown get redeveloped and filled, options for new companies will grow increasingly limited. The downtown office vacancy is approximately 5 percent, while suburban vacancy continues to lower, now around 14 percent.

Along with limited available office space, limited parking has been a much-discussed topic with tenants and landlords downtown. Recently, the City has become engaged, holding community feedback forums and working on alternative mobility and efficiency options. As new development occurs downtown, the city is hopeful that added parking components will help satisfy some of the demand. Some skeptics believe this will only address the new demand

Figure 5: Survey Of Expected 2018 Leasing Activity



ULI's Emerging Trends in Real Estate 2018

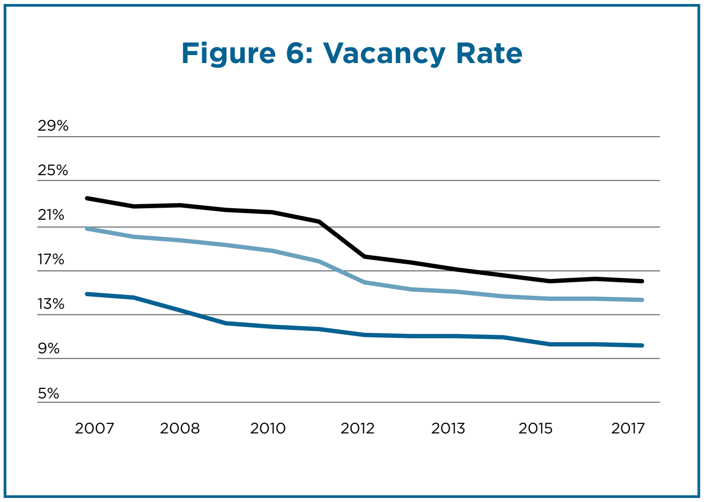
Most industries expect to see growth or at least stability in real estate leasing in 2018, with the technology sector not surprisingly leading the way.

created by the associated development. The planned Studio C! entertainment/commercial mixed-use project downtown is in the center of this situation. The development is planned on land that is currently 300 city-owned surface spaces, and although the project calls for a 900-space ramp, there is question as to whether this will be a net gain or loss for day-time employee parking. The project has evolved recently, with updates to project partnerships as well as its planned use. Once slated to contain 187 apartment units, developers have amended plans to include hotel and office space instead.

Suburban office buildings are seeing a lot of attention, and will again in 2018, as space and parking downtown remain tight. 1925 Breton Road SE is undergoing renovation by ownership and has attracted a new government agency that will be moving out to the suburbs during 2018. In addition, a notable company that made a move from the downtown area to the suburbs recently is Advantage Sales and Marketing, who moved nearly 400 employees out of 56 Grandville Avenue SW downtown into the former Klingman's Furniture building on 28th Street SW.

The Atrium Building at 3351 Claystone Street SE underwent a major renovation in 2017, and saw SalesPad expand into a new 30,000-square-foot space after taking an ownership interest in the building. They moved out of approximately 17,000 square feet on the East Beltline. Additionally, First Companies announced the purchase of four acres to continue to expand their Heritage Pointe office campus on East Paris Avenue near Cascade Road. We expect to see the medical office market continue to expand and grow in 2018.

Employment trends continue to be positive. Unemployment reached a resistance point around 3 percent and has bounced back up slightly, however most economists consider 3 percent to be "full employment". Labor participation in Kent County is over 70 percent, compared to a national average of 62.8 percent. These numbers show that not only does our



Source: Colliers International | West Michigan Research Department

region have among the lowest unemployment in the nation, but that we have among the highest amount of people trying to find work as well. Both signs of a very healthy economy.

We predicted the downtown market would feel pressure around $20 per square foot (Modified Gross) in 2017, however, we are seeing that being tested and expect 2018 to see many office spaces, especially downtown, break through that number.

Many tenants have decided to exercise renewal options rather than relocate due to recent increases in market rates. With the cost of construction still high and demand for modern spaces pent-up, we expect rental rates to remain firm in the near-term.

In 2018, we see the office market continuing to grow and attract business. Parking will continue to be a concern downtown, while the suburbs will look to take advantage of this trend. Drawing talent back to the region is also paramount in 2018. Companies will look to create work environments that help grow and retain the best talent.

Retail

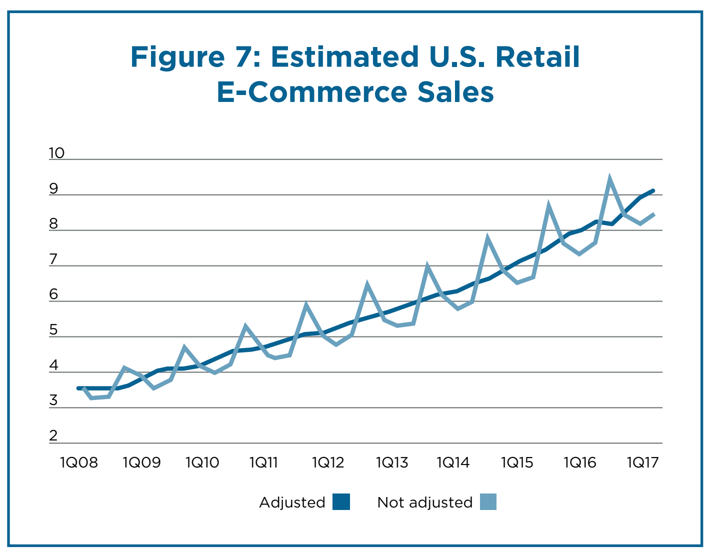
The past year was predicated on some fundamental shifts in the way retailers do business. In 2018, the landscape will continue to evolve, with retailers continuing to find ways to make physical stores relevant in an increasingly digital era.

Over the past year, the West Michigan retail market has undergone some significant changes. We saw local retail notables such as MC Sports, Family Christian Bookstores, and Sears all close locations. However, with change comes new opportunity. How bricks-and-mortar stores are utilized has begun to change, and that shift will be a driving force in the 2018 real estate market. Many retailers are focusing on omni-channeling, which refers to increasing brand accessibility and awareness by attracting customers, using multiple distribution avenues, including both online and physical stores. This is a trend we saw take form in 2017 and one we see continuing into 2018.

Part of this shift has seen large big-box stores shrink their footprint or close all together. The approximately 313,000-square-foot Sears anchor store at Woodland Mall is now being turned into a new mall wing comprised of multiple smaller-footprint retailers. Part of this is due to over-building in the past. In fact, the United States averages 24.5 square feet of retail space per capita, compared to just 4.5 square feet per capita in Europe.

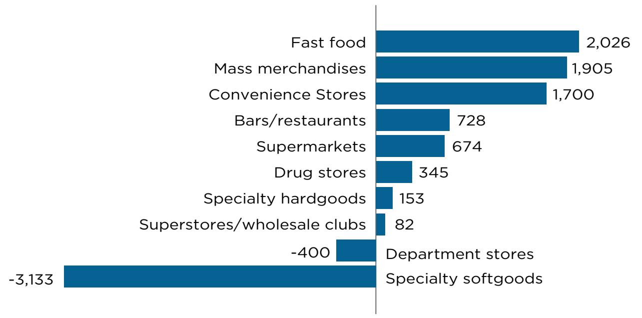
The successful de-malling of Centerpointe Mall in Grand Rapids and Westshore Mall in Holland has proven that accessibility and convenience is as valued as ever, and a trend to be continued. Retailers who are not ready to adapt to a shifting consumer paradigm are feeling pressure; however, the demise of physical retail has been largely over-dramatized. In 2018, we expect to see further shifts in the retail landscape, yet according to the International Council of Shopping Centers (ICSC), there are projected to be more retail establishments opened in the United States in 2018 than closed. A stark contrast to what is generally reported. Additionally, according to the U.S. Census Bureau, e-commerce only accounts for about 8.5 percent of total retail and food service sales, and about 11 percent if you include cars and auto parts; showing that while online sales continue to grow, they still only represent a fraction of all retail purchases.

It is no secret that Grand Rapids has put itself on the map in recent years, with a hot housing market, low cost of living, and record low unemployment and vacancy rates across the board. As we expect to see many of these trends continue in 2018, we also anticipate the retail real estate market to continue to thrive as well. At the beginning of 2017, we had "cautious optimism" for the year ahead. In 2018, we have "optimism."



Quarterly as a percentage of retail sales

Figure 8: Store Growth



Source: IHL Group

Location has always been a driving force in the retail world. Many retailers are willing to pay a premium for premier location. However, this usually manifests itself more apparently in large markets. Grand Rapids, however, is entering that realm, with desirable locations leasing at rental rates that our region has never seen before. In the popular retail corridors, we are seeing and anticipating rental rates to push towards $40 per square foot (triple net), while even tertiary locations see increased interest, although not at the same lease rates.

This past year, we saw the long-time vacant former-Roger's Department Store and Klingman's Furniture building on 28th Street Southwest re-imagined into the new home for Advantage Sales and Marketing, which moved out of downtown Grand Rapids. One major reason being parking. As numerous large retail tenants move out of big footprints, we are interested to see how these spaces are utilized going forward. Gyms, grocery stores, and call-centers are all options on the board.

A project that has garnered a lot of interest is the Bridge Street Market development on the corner of Bridge Street and Stocking Avenue on the city's northwest side. For a long time, those living in and around downtown have wondered when a neighborhood urban grocery store would be built. Rockford Construction has partnered with Meijer Corporation to bring a scaled-down grocery concept to the area, which should spur further momentum in the corridor. The development will include additional retail, office space, apartments and parking. The project will be delivered in phases, with parts of the project complete near the end of 2018 and a final product early in 2019.

Also undergoing significant change is downtown Ada. We saw a great deal of progress made in the village in 2017, and look to see that continue in 2018. Recently, Kingma's Market opened a second location and Vitale's Pizza built a new building and relocated just west up Fulton Street.
In addition to witnessing areas re-invent themselves, we also expect to see new retail corridors start to emerge in the coming year. One area to keep an eye on is the east M-6 freeway area. As data server provider Switch continues to build-out the former Steelcase Pyramid building, we expect activity to increase in the surrounding area. Multiple hotels and apartments are planned nearby, and as daytime population increases, retail will follow. Davenport University and Farmers Insurance also have a large presence in the area and will help drive retail demand as well.

The retail market is not without headwinds, however. To be sure, we are seeing change. In 2018, we expect to see further advancements in e-commerce and delivery automation, and retailers adjusting to new patterns in the way people shop.

The acquisition of Whole Foods by Amazon is a major move that will affect the way people shop in 2018, and we expect Amazon to both continue to evolve, as well as announce the location of the much-anticipated "HQ2".

Beyond shopping habits shifts, we have also seen a number of retailers struggle with over-leveraging themselves on balance sheets. Over the past decade, we have seen an abundance of leveraged buy-outs of retailers by private equity firms, creating a massive debt burden. At the same time, lenders are becoming more and more weary of helping to refinance loans for these companies, which could create some turmoil for some retailers in 2018.

All told, we expect the West Michigan retail market to remain positive this year. 2017 was unique, as demand remained high, yet we experienced some significant announcements and closings. In 2018, we predict national brands will continue to consider West Michigan and find creative ways to penetrate the market. Restaurants will see demand, and downtown retail will continue to evolve and mature.

Apartment

Is Grand Rapids' Apartment Market Reaching its Peak?

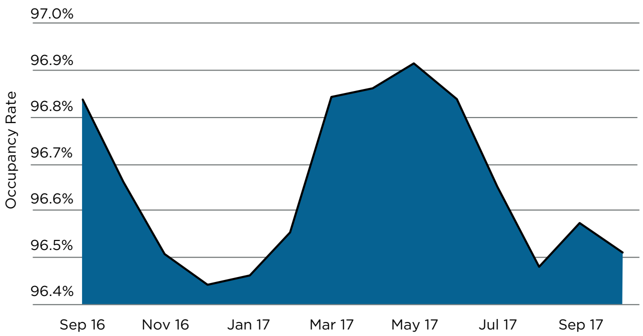
Those who live in Grand Rapids know that there has been an abundance of apartment development over the past few years. As of the fourth quarter of 2017, there were 1,025 units under construction, 776 prospective units (announced but no specific documents or government filings), and 642 units planned (documents already filed with the city or county).

Occupancy rates peaked in early 2017 at about 96.8 percent. We are currently reporting an occupancy rate of 96.5 percent. This is still extremely strong. This slight decrease is largely due to new supply on the market, not a decrease in demand.

Because of this activity, the question looming is when the market will become saturated? While we don't have a definitive answer to the question, we expect 2018 to continue to be a growth year.

Grand Rapids continues to accumulate accolades, most recently and notably ranking as the top large metropolitan area in the country for job growth, with 4.4 percent growth in 2016. Add that to being ranked 4th Best City to Start a Career by WalletHub and 2nd Best City to be a Millennial by Trulia, it is no wonder demand for apartments has been growing.

Figure 9: Occupancy Rate Trends



Source: Occupancy data derived from USPS records

Millennials continue to drive much of the demand, with approximately 78 percent of downtown Grand Rapids renters being between the ages of 22 and 39. In addition, we are seeing empty nest baby-boomers grow increasingly interested in trading in the responsibilities of homeownership for the opportunity to live in an apartment in or around our vibrant downtown.

Amenities

As competition for tenants continues to grow, landlords must find ways to differentiate their complexes and the units within. According to Apartment Guide research, renters are generally more interested in individual unit amenities, however complex amenities are important too.

Popular complex amenities:

- Washer/Dryer
- Workout Facility
- Air Conditioning
- Pet Friendly
- Furnished
- Laundry Facility
- Modern Finishes
- Covered Parking
- Balcony
- Wireless Internet Access

Rental Rates And Unit Mix

Average rental rates for Grand Rapids apartments continue to rise. The overall market average for all types currently is $1.33 per square foot, however there are numerous unit mixes that factor into that. $2.00 per square foot has been seen as a barrier in the past, however, many of the new construction apartment units are north of that. The Downtown submarket has a unit average of $1.92 per square foot, which is the highest submarket in the market. Developers are building a mix of unit types, however, the most popular tend to be the studio and 1-bedroom. Renters are using their apartments less and less and therefore don't require as much space. The trend is also towards flexibility, so we are seeing less renters who desire to have a roommate.

Parking continues to be of utmost importance. Despite the efforts/hopes that GR can become a more mobile community, many renters still prefer close parking. Price of parking does not seem to be as big of a problem as availability. This then becomes an amenity that attracts renters to certain communities.

The downtown parking system is at more than 95 percent capacity, and the average reserved parking space is $134 per month. Additionally, metered parking has seen an increase in price, with an average price range between $1.00 and $1.50 per hour depending on the location. So many renters are looking for a complex that either has it included, or at least can pay significantly less than if they were to have to find parking on their own.

One metric to keep an eye on is the 'length of stay', meaning the average amount of time renters are staying in their units. Often rental complexes have high turnover, so when deciding whether or not to build new, it is important to not only look at current demand, but to look at predicted demand in the next cycle, whenever that may be. Currently we are seeing about a 1.5-year length of stay cycle. As that number fluctuates, developments become more and less stable. ■