West Michigan-Grand Rapids Economic and Commercial Real Estate Forecast

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2019 Industrial Forecast
The manufacturing sector of the West Michigan region has been a driver that has kept unemployment low relative to other markets, has helped mitigate economic downturns, and has been a catalyst for economic recovery. The diversity of industries creates synergies between local and regional companies, and with the prime logistical location between Chicago, Indianapolis, Detroit, and even Toronto, West Michigan is an ideal manufacturing and distribution market. Industries such as Aerospace, Tier II and III Automotive, Food Processing, and Medical Device Manufacturing have all thrived in the region. Even retail giant Amazon took notice this year and has since opened an 850,000-square-foot fulfillment center in Gaines Township, its first such building in West Michigan. Amazon, with various facilities on the east side of the state, however, saw an opportunity in West Michigan and moved quickly to take advantage.

Amazon opening distribution and fulfillment centers around the country is a result of the proliferation of online shopping. As e-commerce continues to grow, logistics of quick and efficient delivery of packages to their destinations has become a focal point. The "last mile distribution" model is built in a way that fuels the demand from two different angles. As the internet makes purchasing items easier with factors like revolutionary payment processing, improved web design, reduced overhead, and wider access, the need for distribution subsequently grows. Yet at the same time, as distribution gets more efficient, the appeal of online ordering also grows. These factors working simultaneously have made this trend increase in a hurry.

Not every company, however, has the means to distribute their own product throughout their territory. This is where third party logistics (3PL) companies come into play. West Michigan is home to a number of these, and we see the 3PL industry growing in 2019. In 2017, FedEx built a new 340,000-square-foot distribution center and warehouse at 3466 Shipper Drive NW in Walker. In the spring of 2018, Same Day Delivery leased space at 3378 3 Mile Road (a former FedEx facility. At the end of 2018, Surface Logistics leased 74,000-square-feet at 5738 Eagle Drive.

The industrial real estate market currently has a historically low vacancy rate, under 5 percent, and the unemployment rate in the Grand Rapids-Wyoming metropolitan statistical area was a mere 2.6 percent in the fourth quarter of 2018. This means companies are operating at near-maximum capacity, while at the same time the labor pool is stretched thin. This shortage of warehouse labor is raising the competition to retain employees, with firms raising wages as well as building warehouses with more amenities. Labor shortages will also increase the usage of automation in distribution in the coming years, and developers will need to be cognizant of automation machinery requirements when building new distribution centers.

The labor shortage isn’t limited to warehouse workers. As automation increasingly fills voids left by lack of basic labor, skilled labor to operate and maintain technology becomes necessary. Companies in other countries have launched dual-training programs, where the apprentice splits time between the classroom and the workplace. A number of organizations in West Michigan have begun a serious push to educate the next generation of workers about the opportunities available and have initiated training programs prior to entering the workforce; however, there is still a serious talent gap that needs to be addressed in order for manufacturers in the region to grow.

A national theme, which will eventually trickle into the West Michigan market, is international trade. While the apparently successful United States/Mexico/Canada Agreement (USMCA) negotiation is welcomed news, the escalating trade disputes between the United States, China and Europe remain a concerning headwind. Any growth in domestic manufacturing from the USMCA could be mitigated or even overtaken by increased tariffs on products manufactured in the U.S. This could shift some foreign automaker manufacturing away from the U.S. to Asia, which could eventually make its way down the pipeline and affect Tier II and Tier III suppliers in West Michigan. In addition, as GM and Ford shift their business models away from the traditional automobile to autonomous and electric vehicles, they have threatened to close a number of existing plants and eliminate more than 38,000 salaried jobs between the two companies in order to restructure. Suppliers who have preemptively adapted to this paradigm shift and have invested in technology and skilled labor to provide new-age parts will have an advantage over those who haven’t. These shifts in the automotive industry will likely have an impact on industrial real estate in West Michigan in 2019.
With such low available inventory, **new construction has increased**. However, making the financial numbers work has been a real challenge for companies. Input prices continue to rise and have been impacted by international trade. Lack of construction workers is creating a shortage of available contractors and sub-contractors, which is driving up prices. New energy efficiency regulations are adding to the price-per-square-foot construction cost. When looking at replacement costs, the sticker-shock of new construction has been prohibitive to companies in many cases. Companies are often times opting to make the best of the space they have, moving to whatever other space they can make work, or in many instances, just adding onto their existing building. Investment in automation rather than real estate is also something that companies are doing in order to grow production without an increase in space demand. Any construction that does happen will likely be build-to-suit for these reasons, rather than speculatively built. When new construction does happen, a theme we have seen this year and will likely see going forward is building not only to fit a company’s needs but also creating space for future expansion. This allows for short-term landlord flexibility while reaping the benefits of construction economies of scale.

As we look ahead, the short-term forecast for industrial real estate is robust, thanks to a strong economy and e-commerce trends. Further out, trade disputes and growing labor shortages represent rising headwinds. The U.S. and local economies continue to fire on most cylinders, despite mounting headwinds. Economic growth for the year should again be strong, though the recent pace will not be sustained much longer. Job growth remains very strong but continues to ease as we are nearing full employment and wage growth is reaching its targets, and the Federal Reserve Board will continue its pace of moderate hikes through next year in its quest for a soft landing in 2020 or 2021.

**Office Forecast**
As the national economy has continued a slow but steady recovery over the last eight years, West Michigan’s office market has steadily grown as well. Each quarter has seen positive net space absorption while vacancy has decreased by more than 10 percent during that time. The downtown office market continues to see both development and redevelopment with the city’s core expanding in all directions. The suburban medical office market continues to thrive as well. Heading into 2019, it is expected that the market will continue to stabilize and face some economic uncertainty, but largely continue its positive momentum. As West Michigan builds its reputation nationwide, we expect national companies to grow their presence in the area, while regional companies also make decisions to position themselves for the future.

Despite a slow start to the year, Gross Domestic Product (GDP) growth for the United States throughout all of 2018 is expected to reach more than 3 percent, which would be the highest rate since 2004. Meanwhile, the economy continues to create new jobs at a healthy rate — averaging just under 200,000 nonfarm payroll jobs per month over the past year. Grand Rapids has benefitted from this more than most metropolitan areas in the state and now has an unemployment rate of approximately 2.5 percent. As we move into 2019, we expect job growth to slow slightly, however, it is expected that growth will still be positive. Although we are nearing full employment, the labor...
Office space as an investment has always been risk and reward. As trends of open-office, coworking, evolving retail co-tenancy, and increasing amenities start to characterize office buildings, functional obsolescence has become a reality. Some building owners have invested in updating buildings to meet current demands, but not all are able to do so. In this competitive landscape for working talent, companies are increasingly interested in space that will differentiate themselves and be more attractive to employees. In 2019, we see this movement continuing to increase.

Coworking is another trend to keep an eye on in 2019. On a national level, an estimated 55 million square feet of space is occupied by coworking space. Coworking space is office space that is leased out to individuals or a small group who desire a small or flexible space, often on a short-term basis, without signing a larger master lease. There are currently at least 10 coworking locations in Grand Rapids, and this number could grow in 2019.

Five Coworking Trends for 2019

- Technology – access cards, space management software, room booking systems, time trackers, and lower staffing overhead allow for almost full-time access in some cases.
- Coworking Programs – multiple coworking companies participating to allow users to subscribe to and utilize various companies at various locations.
- Space Design – design continues to become more engaging and inviting, adding to the allure of these spaces.
- Additional Services – babysitting, dog-sitting, yoga classes, and relationships with other providers like banks and accounting firms increase the benefit.
- Corporate Buy-in – Coworking had been primarily used by freelancers, solo entrepreneurs, and start-ups, but now larger corporations are exploring coworking spaces for their employees to offer flexibility.

There has been some tenant movement over the past year, and we expect a continuation of this theme in 2019. Companies like Chemical Bank and Van Wyk Risk Solutions – both joining law firm Warner Norcross and Judd, LLP in the new Warner Building at 150 Ottawa Avenue NW – as well as insurance company Acrisure, and accounting firm BDO all made notable moves in 2018. Law firm Bodman PLC secured a long-term residence at 99 Monroe Avenue NW and Lighthouse Insurance leased 30,000 square feet on Grandville Avenue downtown. In the suburbs, Keller Williams Realty East moved their headquarters from 630 Kenmoor Avenue SE to 1555 Arboretum Drive SE in Cascade. Many companies are looking for space, but quality options are becoming somewhat limited. New construction is a natural solution. However, cost of construction continues to climb, so while many office users desire to own, building new has become a challenge. We continue to benefit from investment and commitment to the community, something that helped insulate us from the previous downturn, and something that has propelled us to where we are now.

The medical community on East Paris, informally known as “Medical Mile East”, has continued to grow. The three-building Heritage Pointe development has been completed within the last few years and was leased to Mercy Health, Foot and Ankle Specialists, West Michigan Eye Care Associates, and Total Health Chiropractic. A fourth medical building nearby will house Bengtson Center, which is moving from the Woman’s Health Center in 555 MidTowne Street, near downtown.

Also taking place in 2019 on the city’s west side is the construction of a new $20 million Consumers Energy building at 501 Alabama Street just off Bridge Street. The six-story building will house more than 275 employees, and according to a company press release, “shows continued commitment to a prosperous, growing Grand Rapids and West Michigan region.” The building is expected to be completed by early 2020.

West Michigan Center for Arts and Technology has also moved from 98 Fulton Street E to 614 First Street NW, part of the new Rockford Construction development that includes the Bridge Street Market. In 2019, we look to see who will fill the balance of the office portion of that development, which still has nearly 30,000 square feet available.
The overall vacancy and absorption trends in Grand Rapids are very similar to what we are seeing nationwide. We predict 2019 will show similar signs of growth albeit at a slightly slower rate. As companies continue to ride out the positive economic wave, office real estate should reap some benefits this year, despite some challenges and a bit of potential economic uncertainty. Regardless of some obstacles, we envision 2019 being a prosperous year and foresee the West Michigan office market continue to mature and compete with larger regional cities.

**Retail Forecast**
The retail landscape has recently been stigmatized by big-box store closures and the increased popularity of online shopping. Many have predicted the demise of brick-and-mortar and have seen store closures as a sign of physical locations becoming less relevant. In West Michigan, Sears, MC Sports, and Family Christian Bookstores have closed, yet retail vacancy has dropped below 8 percent. This past year was characterized by creativity and finding new ways to utilize old space. As the retail landscape changes, prime locations still remain a vital component to retail placement.

In 2018 many of the historically active retail corridors experienced growth, notably Alpine Avenue, East Beltline, and 28th Street SE with Woodland Mall continuing its $100 million renovation. New retailers include department store Von Maur, Black Rock Bar & Grill, Urban Outfitters, Altar’d State, and a new 20,000-square-foot Recreational Equipment, Inc. (REI). Woodland Mall has been a staple in the community, and as The Shops at CenterPoint have undergone its transformation, the mall has re-imaged itself as well as a way to compete.

As large retail stores vie to stay relevant, we are also seeing smaller, newer stores – many of whom started online – step into physical space. Last year we talked a lot about physical stores gaining an online presence, however, we are now seeing that trend reverse. **For retailers, an omni-channel approach is vital.** This allows customers to experience the brand via multiple avenues, which includes a digital and physical approach. According to the International Council of Shopping Centers (ICSC), when a company opens a new physical store, it equates to a 37 percent increase in online traffic for the brand within the market, something referred to as the “Halo Effect.” ICSC also reported that almost 70 percent of shoppers who purchased items online to pick up in-store, ended up purchasing at least one more item at time of pick-up. As many brands started with the less-overhead route of e-commerce, several have quickly realized the importance of a physical presence and have supplemented with actual stores. According to Colliers retail advisor Chris Prins, “Brick-and-mortar stores are more essential today than ever before. A lot of people can sell a product online. ‘Brands’ are built by being able to touch, and feel, and experience. It’s about identity.”

Many landlords are also evaluating the identity of their shopping center. With record-low vacancy near eight percent in our main corridors, owners are now concerned with creating the right tenant mix to enhance their center and the shopper’s experience. Where in the past, landlords were welcoming of almost anyone who was willing to sign a lease, now we see groups of tenants coming together that complement each other. The Village at Knapp’s Crossing is a development we saw take shape this year with a tenant mix that has grown to have a common theme. Orangetheory Fitness, Clean Juice Organic Juice Bar, Neurocore, and Woodhouse Day Spa have helped create a wellness dynamic that customers identify with.
The holiday shopping season is always an indicator of consumer confidence and a sign of retail market health. This past shopping season was, by initial indications, the strongest in more than six years. On average, more than 30 percent of overall retail sales occur over the November and December months. It has been estimated by accounting firm Deloitte that this season of spending grew by as much as 5 percent from last year, whereas online shopping grew by approximately 20 percent. While the online percentage grows, much of this shopping is still done in stores.

Logistics of delivering packages to consumers is a new challenge that many online retailers are tackling. Amazon opened a new fulfillment center in West Michigan, and other third-party logistics companies are following suit.

Discount stores are also heating up. Aldi, Dollar General, TJ Maxx, and Marshalls have all made moves, and we expect more of this to occur within the product type. Luxury is doing well, too. It’s the middle companies that are more commoditized due to lack of specialty products that are facing a fierce competition for market share.

Construction activity should remain positive in 2019, despite costs. The value of locations at “the corner of Main and Main” is at a historical high, yet availability of these sites remains low. Downtown, the Bridge Street and Stocking Avenue development has broken ground on a 9,000-square-feet retail addition, and Studio Park will continue work on its mixed-use development.

Creativity by landlords, tenants, and advisors is at a premium. Outlots have grown in value, and the value of splitting off parcels for retail use should remain a growing trend. We saw this with Chick-fil-A opening a location in March on an outlot in front of the former Toys-“R”-Us at 3445 28th Street SE, and recently, Christian Brothers Automotive purchasing an outlot in front of Kmart at 4111 Plainfield Avenue NE.

We look for 2019 to be a plateau of the retail market. As big box stores fill, others will start to see their demise. Local stores will continue to thrive, while national brands continue to look into our market for the first time.

Multi-Family Forecast
Limited product seemed to be the main theme in 2018, leading to increased competition with deals that were available. It has been a seller’s market as there have been far more interested buyers than sellers, allowing sellers to keep pricing and terms firmly in their favor. Multi-family units in Grand Rapids recorded a rolling 12-month average sale price of $69,430 per unit as of November 2018. Just 12 months prior, the average was $95,405 per unit, though this number was bolstered by the outlier of The Ridges of Cascade transaction. Without that outlier in the data set, the average price per unit in 2017 was $61,585.

The average interest rate for recorded transactions in West Michigan was 4.63 percent in fourth quarter 2018 - compared to 4.09 percent just a year prior - a 13 percent increase. Interest rates are relatively low compared to historical rates, but they have been showing a gradual upward trend in our local market these last five years. These rising interest rates have an impact on home affordability, which can be beneficial to apartment demand. As the cost of borrowing goes up, prospective single-family home buyers can afford less, so may elect to remain renters for longer.

We will likely see the conditions of 2018 recur in 2019. Pricing may temper off a bit, however, buyer demand will persist as companies from the coast and major metros chase higher yields in markets such as West Michigan, relative to their own backyards.

Between this year and last, apartment sales made up one-third of all investment sales in West Michigan with $141 million in sales volume reported from Real Capital Analytics. There have been a number of prominent multi-family investment sales in the region this past year. One of the largest transactions in West Michigan was that of the combined purchase of Ramblewood Apartments and Woodlake Apartments for $144 million by New York-based Torchlight Investors. Additionally, Waters House Apartments at 500 Fulton Street E in Grand Rapids was closed by Colliers’ very own Matt Jones, Associate Vice President of Multi-Family Investments. This property sold for $10.25 million.
and consists of 107 apartment units, common areas, a pool, and 125 parking spaces on-site.

On the development front, just south of Waters House Apartments is the site of the newly completed Heritage Place at 50 College Avenue SE. This $14 million four-story development brings 86 units of apartments to the downtown area. 601 Bond is also nearing completion as a 16-story, 202-unit building in the North Monroe neighborhood. On-site amenities will include the Skyview Club with a rooftop deck, fitness center and lounge, and 220 parking spaces.

West Michigan’s multi-family market has been quite active in 2018, with more than 1,500 units completed throughout the year. More than 2,500 units are planned or currently under construction.

According to the U.S. Census Bureau, the population of Grand Rapids grew by 1.3 percent between 2016 and 2017. The demand for apartment development is due in part to this rapid population growth. Downtown is becoming “the” trendy place to live with its growing number of amenities. A strengthening economy and the development of nicer, newer apartment units is the source of rising rental rates. The average monthly rental rate in Grand Rapids at the end of 2018 was around $940 and has been showing an average escalation of 4.1 percent annually over the last three years.

**Figure 7: West Michigan Average Rental Rates Per Unit**

Six low-income housing projects scattered throughout Grand Rapids are planned to break ground in 2019 after the state of Michigan approved $5.9 million in state tax credits. The tax credits will help finance the projects and allow developers to offer qualifying tenants below-market rental rates. The six projects are: Franklin Apartments and Grandville Apartments, part of the Plaza Roosevelt project, being built by Dwelling Place; Edge Flats on Seward, being built by Wisconsin-based Common Wealth Development Corporation; Tapestry Square Senior Living Center being built by the Inner City Christian Federation on South Division; West Garfield Apartments, being developed by LINC UP; and Ferguson Apartments, a restoration and renovation project being done by Dwelling Place.

Along with these new apartment developments comes a new residential rental application ordinance in the City of Grand Rapids. The new ordinance intends to improve application affordability for residents and deter predatory collection of application fees. Any property owners with units in Grand Rapids who charge an application fee should familiarize themselves with this new ordinance, if they haven’t already.

Living downtown means close proximity to businesses and entertainment. Accessible parking is an especially valuable amenity downtown that many developers are incorporating into their projects. We are seeing more mixed-use projects assembling downtown as developers seek a competitive edge to draw occupancy. One example of this is the much-anticipated Studio Park development, scheduled to open this fall on the city block between Oakes Street SW, Ionia Avenue SW, and Cherry Street SW. The $140-million project will feature a nine-screen movie theatre, 138-room hotel, 230 residential units, 40,000 square feet of retail and office space, and a 750-space parking ramp. On the Westside, The Hendrik is now leasing 116 market-rate apartments above the Bridge Street Market. At the same development, ICCF is also partnering with Rockford Construction to provide 64 additional apartments, 51 of which will be affordable-rate. Despite all the new supply coming online downtown, we still feel like there is room to grow.

The downtown hotel market is one potential bubble we could see forming in 2019, with many being built at the same time. This was sensed when Hinman Company’s development plans for 10 Ionia Avenue NW were scaled back from a 42-story hotel and apartment complex to a 13-story building featuring first-floor retail and a 12-story Marriot Residence Inn. Other developments include Embassy Suites by Hilton at 710 Monroe Avenue NW, Staybridge Suites by Holiday Inn at 942 Front Avenue NW, a 130-room AC Hotels by Marriott at 50 Monroe Avenue NW, a 160-room Hyatt Place Hotel at 710 Monroe Avenue NW, and Studio Park’s 155-room Canopy by Hilton. There has also been a proposed 24-story hotel tower development between the Windquest Building at 201 Monroe Avenue, and Studio Park’s 155-room Canopy by Hilton. This was sensed when Hinman Company’s development plans for 10 Ionia Avenue NW were scaled back from a 42-story hotel and apartment complex to a 13-story building featuring first-floor retail and a 12-story Marriot Residence Inn. Other developments include Embassy Suites by Hilton at 710 Monroe Avenue NW, Staybridge Suites by Holiday Inn at 942 Front Avenue NW, a 130-room AC Hotels by Marriott at 50 Monroe Avenue NW, a 160-room Hyatt Place Hotel at 150 Ottawa Avenue, and Studio Park’s 155-room Canopy by Hilton. There has also been a proposed 24-story hotel tower development between the Windquest Building at 201 Monroe Avenue NW and DeVos Performance Hall next door at 303 Monroe Avenue NW, which would bring an additional 400 rooms downtown.

A lack of new development will continue to keep pricing in the landlord’s favor. While there are some development deals that will be completed, current construction costs are prohibitive to consummate new deals, which may keep rents steady or even improve them. Demand will continue to be steady on the rental side and there is not a massive pipeline to offset the current supply and demand curve. New inventory that does come to the market this year will not hinder demand, which should continue to bode well for landlords throughout the year.