West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

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The Grand Rapids industrial market started slow and steady in the first quarter of 2008 but made up for lost time during the remainder of the year. The vacancy rate decreased from 9.4 percent during the first quarter of 2008 to 7.5 percent at year-end. The consolidation, relocation, and expansion of three companies in the Grand Rapids area, which absorbed nearly 2.5 million square feet, significantly impacted the overall vacancy rate during 2008. One of the companies consolidated their operations from multiple West Michigan locations, while the second company relocated operations from three locations outside of the market and the state indicating that Grand Rapids continues to be a viable destination for out of state industrial users to locate. The third, a locally based company, has been taking large blocks of space off the market for the last few years, and continued this trend in the fourth quarter of 2008. Although we expect continued interest from out of market companies looking at Grand Rapids, the amount of space taken off the market in 2009 will almost certainly be much less than it was in 2008.

As forecasted, new speculative construction was almost nonexistent during 2008. This was primarily due to higher construction costs, lower than needed demand, depressed lease rates, and more recently, increasingly stringent financing requirements. Redevelopment of older manufacturing sites continues to offer more economically feasible alternatives when compared to new construction, and consequently, new construction in 2009 will be limited to owner-built properties and expansions, as it has been for the last several years.

The Grand Rapids industrial leasing market had steady rental rates, static concessions, and favorable options for short and long-term leases. Tenants are still favoring short-term leases and managing to secure lease rates that are more typically in-line with long-term leases. Uncertainty about the economy and the tighter credit markets have and will continue to keep leasing activity balanced well into 2009 as users wary or unable to purchase will continue to lease space until they feel more optimistic about the future and are able to secure financing for a purchase.

Although leasing was typically the more viable option for users in 2008, the industrial market did have multiple user sales of every size, including three over 400,000 square feet. Interestingly, even with the uncertainty in the market, approximately one million more square feet was purchased by users in 2008 than in 2007. As anticipated, the Grand Rapids industrial market saw a marked decrease in all types of leased, cap rate investment sales, especially compared to the banner year of 2007. In 2009, although sellers and buyers will have adjusted expectations relative to pricing and financing.
from those they previously held, we expect leased, cap rate type investment activity to only slightly increase from 2008 levels.

**Grand Rapids Office**

With dramatic fluctuations in capital markets, the stock market and state tax law, it is difficult to anticipate what the coming year will bring for the Grand Rapids office market. But it is with cautious optimism that we are forecasting a slight, positive absorption for 2009.

The skyline of the Medical Mile continues to be filled with cranes as medical construction moves forward. The Lemmen-Holton Cancer Pavilion was the first building on Medical Hill to come online in June of 2008 and has already garnered recognition for its LEED certification from the United States Green Building Council. Construction on the 240,000 square-foot expansion of the Van Andel Institute is well underway and scheduled for a 2009 completion date.

The Helen DeVos Children's Hospital consisting of 440,000 square feet, broke ground early 2008 and is expected to be completed in 2010. Also underway is the construction of the new location of the Michigan State Medical School that is scheduled for occupancy in the year 2010.

The downtown market maintained steady occupancy rates in 2008. Tenants continued to follow the national trend of short-term leases or lease extensions in their existing spaces. Interestingly there are very few options available for large Class A users looking to lease space in the central business district (CBD), which under normal market conditions would prompt the development of a new Class A tower. Tenants repositioning themselves within the CBD in 2008 have kept occupancy rates constant, and Grubb & Ellis expects the same trend to continue into 2009.

The suburban markets saw some activity of medical users relocating downtown, which has made available second generation medical office space. As a result, new speculative construction has become almost non-existent. Landlords are able to sign short-term deals at great rental rates without renewal options, which allow landlords to be well positioned for anticipated future increases in rental rates. Absorption in the suburban markets is expected to be much of the same as it has in the past three year.

**Grand Rapids Retail**

Although the retail sector is feeling the pinch like other sectors, West Michigan’s diverse economy and the substantial number of new construction projects for medical use have proven to be somewhat stabilizing forces. As a general rule, stores are showing a decline in retail sales compared to last year, which is causing most retailers to be more cautious about expanding and a smaller group is concerned about survival. New construction has slowed, but currently planned developments continue to draw the interest of several national tenants. The second half of 2008 brought the anticipated slowdown in consumer spending, which resulted in slower, more cautious growth from large retailers and limited expansion for most small retailers and quick service restaurants. As a result, vacancy rates increased slightly. 2009 will be the year of uncertainty in the West Michigan retail sector due to the current economic crisis.

The 28th Street SE corridor will see the most new construction for this market in 2009. There are several developments scheduled to be completed in the 28th Street SE submarket next year. They include a 10,000 square foot center just east of the East Beltline Avenue corridor, which will include a new Chipotle Mexican Grill; a 28,000 square foot center at Kraft and 28th Street SE, which is a Meijer out lot, with tenants Qdoba and AT&T; and the redevelopment of the former Ethan Allen furniture store into a Jared’s Jewelry with adjacent 20,000 square foot center. The closing of the Linens N Things store at Centerpointe Mall resulted in a large vacancy, but that is expected to be filled when a Jo-Ann Fabrics Superstore moves into the space in early 2009.
The biggest development for West Michigan, the proposed lifestyle center to be located at East Beltline Avenue NE and 3 Mile Road, has been pushed out. Construction is not expected to begin until 2010, which means this development will have little impact on the retail market for 2009. The proposed 450,000 square foot shopping center in Walker, anchored by Cabela's and JC Penney, is also on hold.

In summary, despite the economic crisis, most of the West Michigan retailers have been able to maintain their place in the marketplace. Some attrition is to be expected, but to date it has been less than predicted. While the outlook for 2009 may be less positive than we would like to see, there are still enough bright spots in the region that will keep interest focused on West Michigan for a long time to come.

Grand Rapids Investment

West Michigan has continued to diversify its economic base helping to present a more stable environment for real estate investors. The medical expansion in downtown Grand Rapids remains at the center of this diversification and growth. The medical investments into Grand Rapids indicate the area's ability to utilize a highly skilled and educated work force to retain sustainable growth in the healthcare industry.

2007 was a record year for investment activity, especially from out-of-state investors. This trend has slowed during 2008, primarily due to the lack of available capital. The first half of 2008 saw average deal momentum as credit continued to tighten and capital became harder to obtain. The second half of 2008 proved to be more difficult, as the capital markets froze and investors fled to the sidelines or sought extremely aggressive value-add transactions. As predicted, underwriting requirements for all financing tightened as the psychological effects of the subprime lending crises created strain on lending practices. While financing became more difficult in 2008, it has created attractive pricing for opportunistic buyers. In 2009, buyers will find more opportunity in under-performing assets and certain sellers will become more motivated. Financial institutions and investors will explore more creative ways to get deals completed such as assumability of debt and land contracts.

The West Michigan Industrial market tempered during 2008 after a record year in 2007. As predicted, there was less industrial activity in 2008. Less available product and lender requirements made it very difficult for investors to achieve their required returns. West Michigan's strong manufacturing background will continue to drive investment activity in 2009, as we expect more activity from local investors.

Retail investment sales have been affected as lower consumer confidence levels have led to a loss in revenue for the majority of retailers, impacting their sustainability and ability to pay continuous higher rents. Investors have been significantly more cautious regarding retail investments and have significantly increased their underwriting standards for this asset type causing it to be the least sought after asset in 2008.
Office investment sales in West Michigan remained slow in 2008. In downtown Grand Rapids, the trend of consolidation of properties to fewer owners slowed as investors worked to stabilize their investments before taking on new projects. Investors will take a wait-and-see approach in 2009, as they determine exactly what effect the medical expansions will have on medical office space in the suburban markets.

The West Michigan multi-family market remained strong in 2008 primarily due to rental rates increasing and the availability of financing. The downtown housing market continues to be fueled by student housing. The sub-prime challenges will remain the focus of apartment activity in 2009. We expect that activity will remain strong, rental rates will hold firm, and financing will still be available to qualified buyers.

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*Projected Average Capitalization Rates*

2009

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<thead>
<tr>
<th>Category</th>
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<tbody>
<tr>
<td>CBD Office</td>
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<tr>
<td>Suburban Office</td>
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<tr>
<td>Industrial</td>
<td>9.0%</td>
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<tr>
<td>Garden Apartment</td>
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<tr>
<td>Retail Strip</td>
<td>10.0%</td>
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<tr>
<td>Net Leased Retail</td>
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</tbody>
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*Averages – It is important to note that individual cap rates vary based on a number of factors including property quality, tenants, length of lease and location. These cap rates should be considered overall averages and may vary greatly depending on any of the above qualities.*

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*Total National Investment Activity*

<table>
<thead>
<tr>
<th>Year</th>
<th>Billions</th>
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<tbody>
<tr>
<td>2005</td>
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<tr>
<td>2006</td>
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<tr>
<td>2007</td>
<td>$426 Billion</td>
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<tr>
<td>2008</td>
<td>$111 Billion</td>
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*Source: Real Capital Analytics, Grubb & Ellis*