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West Michigan Commercial Real Estate Review and Forecast

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Grand Rapids | Industrial Market

Manufacturing activity in 2012 has fueled the fire under the West Michigan economy, bringing forth positive change in the industrial real estate market. While interest in the market continued to escalate, prospective tenants were challenged by a diminishing inventory of upper-tier facilities. The popular perception that there is an abundance of high-quality, low-cost space quickly diminishes upon a close examination of available industrial properties. Finding imaginative alternatives to combat competition for the best space resulted in positive side effects, though. Most notably, West Michigan saw the ground breaking of its first build-to-suit industrial project after a five-year drought.

The driving force behind the West Michigan industrial activity is the Southeast quadrant. This area has a concentration of large, growing manufacturers that needed to consume space for increasing production demands. With few high-quality space options, companies began using alternative approaches to create more room like expanding their current sites or becoming more resourceful with the space that they currently occupy. Plans for speculative construction did not surface during 2012; however, the past year saw the onset of several new construction projects for West Michigan, including a new 85,000-square-foot site for CHEP USA in the Meadowbrook Business Park to be completed in the first quarter of 2013.

As 2013 begins, unresolved issues regarding the U.S. fiscal cliff along with volatile situations in foreign markets continue to leave the market with a fair amount of uncertainty. Eliminating this uncertainty will lead to accelerated growth in the industrial arena which will subsequently boost activity for warehouse facilities. Shrinking available inventory of superior space will make it necessary to get creative on deals for industrial space. Vacancy rates at the end of 2012 have left little room for improvement. However, look for the small amount of remaining coveted space to decrease the vacancy rate modestly.

Expect to see build-to-suit projects play a larger role as the West Michigan industrial market continues to distance itself from the recession. Users with unique and specific facility demands will have very few options aside from new construction.

Manufacturing growth will continue to pull West Michigan through the economic recovery. The industrial real estate climate is favorable stepping into 2013. Activity will slow considerably with the amount of available inventory shrinking. New construction, including speculative projects, will be the theme for manufacturing space throughout the next year.
Grand Rapids | Retail

The overall tone of the retail market in 2012 was more upbeat and optimistic than it has been in years. Propelled by strong tenant activity, West Michigan is well on its way to recovery from the prior years of turmoil. As the market continues to stabilize, we are seeing positive trends and statistics for the upcoming year. Net absorption has increased each of the last three years, each year exceeding the previous. This trend, along with insight from our market experts, suggests that positive absorption will continue to escalate in 2013.

Developers in the downtown retail sector have been fostering growth by transforming outdated historic structures into new mixed-use buildings with loft, office, and retail space. A majority of these developments are a direct result of the various funding incentives that the Downtown Development Authority (DDA) and other organizations have been offering. As these types of tax credits and grants continue to ignite activity, we will see more and more renovations and redevelopments in 2013.

We are starting to see a slight shift in downtown activity with much of it moving south toward the Heartside District where many new apartment developments are in the planning stages. The completion of the “Downtown Urban Market” in 2013 near Wealthy Street will also contribute to absorption and the overall retail presence by reeling in a restaurant, brewery, and a variety of shops.

Over the last year we have noticed new construction starting to reappear in the retail market. Many of the developments that are currently underway are expected to reach completion in the upcoming year. These include Cabela’s new store in the Rivertown corridor, Centerpointe Mall’s transformation into more of a power center design in the 28th Street SE corridor, and a variety of downtown redevelopments into mixed-use space. With new tenants consistently entering the market and vacancy rates contracting, it is only a matter of time before we see supplementary speculative and build-to-suit construction in the retail market.

Compared to last year, the range of asking rents have widened in all of the major retail corridors. Landlords of low-grade, undesirable buildings are continuing to drop their rents as they struggle to find suitable tenants. “Under-demolished” has been an increasingly common term used to

![Asking Rental Rates](chart1.png)

- **General**
- **Flex**
- **Warehouse**

![Asking Rent by Corridor](chart2.png)

- Rivertown Pkwy.
- Plainfield/Northland
- E. Beltline Ave.
- Alpine Ave.
- 28th St SW
- 28th St SE

![Vacancy Percentage of Total Inventory SF](chart3.png)

- 28th St SE
- 28th St SW
- Alpine Ave
- East Beltline Ave
- Plainfield/Northland Dr
- Rivertown Parkway

- **Vacant**
- **Occupied**
describe these corridors with properties that have become physically outdated or functionally obsolete. As the economy improves we should expect even more investor interest in these areas, from investors who are willing to take advantage of the low price and redevelopment opportunity.

Overall, it has been a solid year and we expect more of the same moving forward. It is no longer a secret that Grand Rapids has become one of the most sought-after places in Michigan for its extremely successful Art Prize event to the endless amount of activity coming through DeVos Place and Van Andel Arena. The amount of positive activity we are seeing in the market coupled with steady retailer interest will ensure growth throughout 2013.

**Grand Rapids | Office**

The Grand Rapids area has made healthy strides on the path to economic recovery over the course of 2012. According to The Brookings Institution, Grand Rapids metro area ranked eighth strongest-performing in recovery from the recession. The ranking is based on quarterly indicators including employment, unemployment rate, gross metropolitan product (GMP), and housing prices. This is a stark contrast to the same report in 2011 that labeled the market as one of the 20 weakest performing areas with respect to economic recovery. Additionally, the *Forbes Magazine* honor of “Best Metro Area to Raise a Family” was bestowed on Grand Rapids early in the year.

The past year saw the West Michigan office market firm up. While deals were not as luxurious as in the past, the Grand Rapids area was still able to offer space at a tremendous value to buyers and tenants. Tenant incentives are still on the table but have decreased through less available free rent and improvement allowances. Rental rates began to see a shift with slight increases as competition increased for premium space, especially in central business district properties. Tenants aware of these emerging trends reacted by shoring up longer-term deals to avoid larger increases in the future.

Sales activity for the year was highlighted by several major downtown assets changing hands. Most notably 50 Monroe Place, 99 Monroe Avenue, and McKay Tower were sold, totaling almost 700,000 square feet of office real estate. These transactions brought several ambitious ownership groups looking to revitalize previously less attractive tenant offerings. Many of these buildings are undergoing a facelift to both their internal structure and outside appearance to reinvent the office space.
Overall occupancy experienced a modest increase for 2012 and finished the year with an eighth straight quarter of positive absorption. The downtown and southeast submarkets garnered most of the attention of Grand Rapids office space users, keeping in line with historical trends. The suburban office scene benefited from improved growth but waned in comparison to the level of the CBD.

Medical use played a major role in lease activity. The Medical Mile had a strong year bringing occupancy to almost 100%. In addition, Spectrum Health continued to be active in the market, inking several major leases.

Construction over the next year should remain minimal. The downtown area will continue to see the majority of interest but development opportunities for new space are scarce in this area. Health care may be the anomaly of office users, with several big players positioned to tackle new projects. With an almost 20% vacancy rate, there is still plenty of usable space elsewhere that makes construction a less appealing option. With many renovation projects completing during the year, owners can anticipate slightly higher rates than similar unimproved properties in their vicinity.

New tenants to the market will see a quite different landscape than what was presented in the past few years. The options for high-quality inventory, especially downtown, have dramatically decreased compared to recent times. Also, lease terms will become less negotiable with respect to free rent and concessions, both of which were previously used to lure in occupants. From a landlord perspective, the trend of increasing rental rates will provide faster payback for improving office space and common areas.

The availability of distressed office properties will become less frequent as banks back away from their fire sale approach to offloading this inventory. Financial institutions are taking a more conservative and orderly approach to
selling their foreclosed properties. Opportunities will still exist for investors that have done their homework and have no barriers to financing. The market will continue to offer great deals on these assets for those that are patient and willing to strike quickly.

**Grand Rapids | Investment**

In 2012, the market saw positive absorption and rising lease rates which contributed to lower cap rates (meaning higher values). This valuation improvement continues to be driven in large part by historically-low interest rates. Additionally, competition among local lenders remains strong, allowing well-funded investors the opportunity to finance at historic low levels. Cap rates have fallen approximately 100 basis points over the last year, resulting in higher value of many quality assets. There remain a larger proportion of distressed properties in the market; however, we are witnessing a decline of distressed inventory as banks continue to dispose of distressed assets and the pipeline of new distressed activity slows. The cumulative effect is that a significantly lower proportion of sales is of distressed nature, which is allowing prices to continue an upward trend.

Similar to last year, the multi-family market continued to show the strongest increase in property values. This sector has shown the most consistency and improvement with increasing rental rates, increasing occupancy rates, and high buyer interest. There is currently a shortage of multi-family inventory as demand outweighs quality supply. With low interest rates and favorable financing conditions, investors are actively seeking opportunities to purchase; however, there have been few opportunities offered to the market.

In 2012, the suburb office market has been relatively quiet with a tremendous amount of activity occurring instead in the downtown marketplace. The office market saw several key assets trade hands in the Central Business District (CBD) over the past year. These include 99 Monroe (Former Campau Square Plaza), 50 Monroe (Huntington/TGIF), 146 Monroe Center (McKay Tower), 125 Ottawa (Ledyard Building), and 50 Louis (Trade Center Building), and soon to be followed by Bridgewater Place. We anticipate these purchases to be long-term holds, which are driven by both the stability of our urban core and the ability to achieve very attractive long-term financing. The current interest rate environment is allowing investors to pursue projects that may be in need of significant updating and rehabilitation. Many recent transactions in the CBD are being closely followed by significant property improvements. By giving a new look and upgrading amenities at some of these properties, owners are beginning to drive rent growth as well as appeal to new tenants which otherwise may have overlooked these opportunities.

The fundamentals of the retail market, such as vacancy rates and rents have steadily improved in major retail areas. Despite this improvement, there has not been a great deal of investment activity. There were less than a dozen arms-length retail investment transactions and only a handful of retail strip center transactions. Due to the lack of activity in retail investments we anticipate that this segment will see the greatest increase in activity over the next couple years.

The industrial market was very healthy in 2012 with significant interest exhibited by out-of-market investors.
A number of quality assets with long-term leases in place traded to out-of-market investors. Interest is expected to remain steady into 2013 as the local industrial market continues to exhibit strength. Investors remain focused on quality buildings, strong tenants and longer term leases. The demand from investors in this segment has seen steadily rising prices. In 2013 we expect to see several build-to-suit “new construction” projects surface in the market.

In 2013, we anticipate an increase in arms-length transactions, as distressed opportunities continue to decline. Transaction volume should continue to increase in all sectors, with retail and multi-family experiencing the biggest upswing. Net leased single tenant properties demonstrating stable and predictable cash flows will remain the focus of many investors. The buyers of the high-profile downtown transactions will conclude their renovations and upgrades resulting in elevated rents. Buyer activity will remain strong as buyers seek to take advantage of low interest rates that will allow them to pursue properties with a long-term hold in mind. Overall activity should escalate as long as the economic conditions cooperate, interest rates remain at historic lows, and sufficient financing options are available.

Kalamazoo | Office
The Kalamazoo office market can be summarized by slow, but steady, growth. Contributing to the overall growth of the area is the anticipated completion of the Western Michigan University School of Medicine. This downtown project is a $68-million renovation of a 320,000-square-foot former Pfizer building donated by MPI Research, with a 30,000-square-foot building addition. The development promises to attract new retail and service uses, while creating new jobs.

The purchase of the 130,000-square-foot former Kalamazoo Gazette building by a local development group is anticipated to create new multi-use options in the downtown area. In addition, the approximately 46,500-square-foot PNC Bank building in the 100 block of W. Michigan Avenue will be 100% vacant by 2013 due to the relocation of the retail branch to the newly renovated Kalamazoo Metropolitan Center across the street, and the relocation of corporate offices to the Varnum Building on N. Rose Street. PNC’s move creates a unique opportunity for a large user in the downtown office market.

The overall office market in Kalamazoo continues its uphill climb at a modest rate, with the demand for suburban office space remaining flat. However, continued redevelopment activity in the downtown area is expected to have owners looking to acquire new assets, encourage corporate expansions, create longer-term deals for tenants, and increase the demand for downtown residential properties in 2013.

Kalamazoo | Industrial
Kalamazoo’s industrial economy continues to focus on attracting high-technology, life science and research-intensive industrial applications, including pharmaceuticals. This initiative is supported by the community’s strong partnership between public and private entities.
Although the Kalamazoo area experienced the closure of International Paper in mid-September, displacing seventy-seven workers, new tenants entered the market and existing tenants showed signs of growth by upgrading space, expanding and signing longer-term deals.

Janesville Acoustics opted to relocate to a 308,000-square-foot facility in Battle Creek after its former Ohio location was destroyed by fire late last year, and Mueller Industries recently announced its plan to invest $26.5 million in its Portage facility/equipment as a result of a 2011 fire at an Arkansas site. In addition, Hark Orchids, a German company that cultivates orchids, broke ground on a new $5 million facility in Midlink Business Park, and Imperial Beverage Company absorbed over 500,000 square feet with its relocation from Manchester Road to the former American Greetings/DesignWare building on Emerald Drive.

Reinventing the area as a destination for high-tech and life science users will prove to be the path to industrial strength in the Kalamazoo market. This, coupled with core manufacturing companies, will ensure the longevity of industrial real estate use in the area.

**Kalamazoo | Retail**

Retail activity in Kalamazoo has been driven by a tight market and limited availability in the primary retail corridors. While there is a growing number of national retailers seeking entry into the main retail corridors, adequate sites are at a premium. Expect interest in this area to continue to be strong as we enter 2013. Landlords are benefitting from this piqued interest by upgrading tenants and improving rental rates.

The main retail corridors of W. Main Street, S. Westnedge Avenue and Gull Road continue to see positive absorption. This last year saw the introduction of many new retailers to the S. Westnedge Avenue corridor, including Tim Horton's, Dunkin’ Donuts, Five Guys Burgers & Fries, Five Below, Planet Fitness, and while the coming year will bring several new tenants to this much sought-after corridor, including Dick's Sporting Goods and Hobby Lobby, which will absorb 100,000 square feet in the former Kmart Plaza.

The W. Main Street corridor gained several new tenants in 2012, including Chipotle, Let's Swirl Frozen Yogurt, Niskers Char-Grill, Lumber Liquidators, Wild Bill's Tobacco, Taste of Heaven, Tim Horton's and Huntington Bank. In addition, Maple Hill Pavilion is currently constructing 20,000 square feet of new retail space for occupancy in the first quarter of 2013.

The Gull Road corridor remained steady in 2012. The coming year will bring the addition of a new AutoZone in front of Walmart, as well as the ground-up construction of the area’s third Menards store at the former Kmart site.

Moving into 2013, the Kalamazoo retail market is poised to continue the trend of decreasing vacancies. Competition for quality locations will remain high, especially along S. Westnedge Avenue, while new retail space opportunities are also expected to emerge in downtown Kalamazoo as development of the new medical school campus nears completion.