2015

West Michigan - Grand Rapids Commercial Real Estate Review and Forecast

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Recommended Citation
Available at: http://scholarworks.gvsu.edu/sbr/vol21/iss1/10

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Industrial

The West Michigan industrial real estate market continued to mature in 2014 with landlords, tenants and brokers all adjusting to the reality that demand for quality space has reached an all-time high and supply is struggling to keep up. As the region continues to attract national and international manufacturers, industrial inventory has been stretched near its limit. As forecast last year, we saw the return of construction—albeit modest—and the creative repositioning of functionally obsolete buildings to meet the needs of companies without many options. Whereas in the past, landlords struggled to keep entire buildings full and had to juggle multiple tenants, in 2014 and moving into 2015 we are predicting larger companies entering the market and existing ones expanding within it. This trend is stabilizing these assets for ownership and in turn attracting new investors from all over the country. Subsequently, sale prices are getting closer to cost of new construction according to Colliers International CEO and industrial broker, Duke Suwyn. The market saw positive absorption in three of the four quarters this past year, and we predict a net year-end total of 472,600 square feet absorbed—pushing the overall occupancy rate past 94%. Although absorption was slightly lower than the 2013 total, we had predicted a slowdown due to diminishing available product and the continued need for new facility construction. Rental rates crept higher, and concessions given by landlords again moderately decreased due to competition for space.

It is not much of a secret that manufacturing has buoyed West Michigan in recent years. According to the W.E. Upjohn Institute, during the 12-month period ending in July 2014, manufacturers in West Michigan increased their workforces by 3.4%—outpacing overall area employment growth by 40 basis points. This has had a direct correlation to overall industrial occupancy (see graph below). In addition, the overall unemployment rate in Kent County dropped to a state-low of 4.0%. With strong workforce talent and a desirable geographic location, West Michigan continues to catch the eye of many major companies around the globe. As the trend of on-shoring increases, we have seen major capital investment in the area. Companies like Proos Manufacturing, NOVO 1, INglass S.p.a., Plasan Carbon Composites and others have combined to invest nearly $275,000,000 and create over 2,000 new jobs. Recently, Chinese automotive supplier CITIC Dicastal Co. Ltd. committed $140 million to open production at the former Uni-Solar campus in Greenville. The manufacturer of aluminum wheels plans to add approximately 300 jobs and should be operational by the end of 2015. In Walker, the 700,000-square-foot Avastar Industrial Park is now essentially full due to Profile Industrial Packaging Corp. purchasing a 200,000-square-foot condo section. In Lowell, Brunswick Corporation expanded their footprint at 1016 N. Monroe Street and now occupies 398,387 square feet of the 450,000-square-foot building. Additionally, developer/investor Franklin Partners, LLC acquired nearly 1.5 million square feet previously owned by Steelcase and has since leased nearly half of the space to food processor Roskam Bakery Co.

Despite limited quality supply and large chunks of space being eaten up, 2014 saw an overall increase in both sales and
leasing activity. In 2014, the market executed 123 leases and 101 sales (compared to 108 leases and 75 sales in 2013)—a 12.2% and 25.8% increase, respectively. High demand and healthy activity has pushed us to the brink of full-capacity, and forced brokers and clients to work hard with one another to create solutions. Moving into 2015, we don’t see demand or activity slowing down and will be interested to see how the market reacts to and facilitates this momentum. Build-to-suit construction, speculative construction, and reconfiguration of existing product are all anticipated to be strong considerations. One example of new construction in 2014 was Alliance Beverage’s warehouse on 60th Street, which was completed this past year. The merger of Kent Beverage and B&B Beverage Co. created the need for the new 276,000-square-foot facility, which sits on nearly 32 acres of land.

The industrial market’s last period of considerable growth was spurred by large corporate shutdowns and specific industry consolidations, providing available space. We do not see that being a theme over the next five years. Therefore, we see new construction being the most viable market driver over that period of time. The creation of new space will cause a modest upward adjustment of overall rental rates. It will also increase the rental rate divide as functionally obsolete space becomes even less desirable, and new buildings requiring rates much higher than previously seen. New construction could also cause the creation of a new industrial corridor. As large lots of land will be needed for ground-up builds, historically dense industrial areas might not be the solution. According to our brokers, submarkets with the highest availability of land will see the most interest in 2015 for this reason.

A project to keep an eye on this year is the Site36 development on 36th Street in Wyoming. The 92-acre site was once home to a two million square-foot General Motors stamping plant, which has since been demolished. Site36 is a public-private partnership between the City of Wyoming, developer Lormax Stern and economic developer The Right Place, Inc. Currently, the partnership has J.O. Galloup, a subsidiary of Kendall Electric, committed to build a $4.5 million, 104,000-square-foot manufacturing and warehouse complex on the site; however, the majority of the site is still available. Developers are hoping that tax incentives and the site’s inherent qualities will attract one or two large-scale manufacturers to make the location home. The site has basically unlimited infrastructure and a community of skilled labor, making for a major story this year if a deal can be struck.

Going forward into 2015, we expect to see employment in the area, specifically manufacturing, have humbled gains. Economist Brian Long, director of Supply Chain Research in the Seidman College of Business at Grand Valley State University, says the region continued to see “modest growth” towards the end of 2014. On a national level, the Business Roundtable’s Fourth Quarter Outlook Index communicated some pessimism for the 2015 economy due to government tax policy and regulatory issues, so it will be interesting to see how that effects overseas investment in the U.S. economy. The West Michigan market has been very strong in the face of some of the adversity of the nation, so we anticipate that any major economic slowdown will not hit home as hard for us as in other places.

INVESTMENT
Sentiment in the investment sector of the West Michigan real estate market remains positive moving into 2015. Steady economic growth and low interest rates continue to be the key forces of increasing investor confidence. Demand for quality opportunities outpaced supply in 2014, causing the market to shift in favor of sellers. Many value-add investors have had to reform their strategy, as most distressed assets have now traded hands. In 2015, competitive debt and equity markets
will continue to make the real estate market a competitive arena to deploy capital in. Debt will continue to be the driving force behind investor activity. Commercial banks have largely finished deleveraging and restructuring legacy loans, investment banks have reemerged as a source of funds, and insurance companies continue their steady disciplined lending. According to Emerging Trends in Real Estate 2015, “the issue for 2015 is not the volume of liquidity supporting the industry… its navigation.” With rising interest rates looming in the future, many investors see now as a great time to lock in debt and strategically leverage it in real estate investments. The combination of available capital and shortage of opportunities in major markets has translated into greater interest throughout the West Michigan market. Traditionally, larger institutional investors have operated in areas of familiarity. We are now seeing a wider array of investors exploring the opportunities available in West Michigan. We expect 2015 to be a continuation of this trend and will be monitoring how this affects competition for assets, cap rates and capital invested by out-of-state investors. While West Michigan cap rates are higher than national averages (lower property value compared to operating income), our market saw a decrease across all property types in 2014 that we anticipate will follow a similar trend throughout 2015.

The retail segment lagged the overall market coming out of 2013; however, our prediction that it would rebound in mid-to-late 2014 was proven correct. Moving into the New Year, we expect the retail sector to continue making strides. As stated in last year’s forecast, we see retail activity as a function of an overall economic cycle that starts with industrial growth and leads to job creation, which spurs consumer spending. The industrial market is now at approximately 94% occupancy with steady manufacturing employment growth of 3.4% year-over-year and an unemployment rate at a state low of 4%. We are clearly now into the pro-retail segment of that cycle. This will translate into new retail developments and additional national tenants wanting to enter the market—all good signs for investors and developers of real estate. The Shops at
Centerpointe on 28th Street SE is a great example of an out-of-town developer/investor coming to the market and successfully executing and repositioning a failing asset. The site has since changed hands to a new investor, completing the investment cycle for this high profile retail location in West Michigan. This project exemplifies the success value-add investors have had across multiple property segments in purchasing a distressed asset, reinvesting in it, and ultimately selling it as a stabilized repositioned piece of real estate.

The office market continues to be divided into two segments—the downtown Central Business District and the suburbs. The downtown district has experienced significant ownership consolidation over the past 36 months, with many buildings being purchased by firms with a local presence. New owners are well capitalized with multi-year repositioning strategies focused on adding amenity packages, updated common areas and building exteriors. The result is rental rates that have risen by approximately 25% since 2011. Twenty5 (25 Ottawa Avenue), the Trust Building (40 Pearl Street), Calder Plaza (250 Monroe Avenue), 99 Monroe, Bridgewater Place (333 Bridge Street), and the Waters Building (161 Ottawa Avenue) are all examples of assets that have changed hands during the last three years. Suburban office buildings will begin to see the trend taking place downtown of ‘acquisition to reposition,’ as limited inventory of downtown will push investors to the suburban market.

The industrial market remains one of West Michigan’s most active property types for investors. There is virtually no availability of quality, heavily infrastructured industrial buildings. Investors who can identify opportunities to create space for tenants will be able to improve their asset’s value through tenant lease-up. This past year, Franklin Partners, LLC, an Illinois-based investor, purchased 1.5 million square feet of Steelcase’s campus on Broadmoor Avenue. They have since leased nearly half of the building and have the remaining space in the building and approximately 35 acres of vacant land on the market. Other notable transactions include national REIT, ARC Global Partners’, purchase of the 281,715-square-foot GE Aviation building at 3290 Patterson Avenue for $138/square foot. Finally, New York-based Praedium Group purchased the 434,000-square-foot, single tenant building at 4247 Eastern Avenue. In 2015, we predict increased activity from out-of-market investors actively seeking industrial investments as the West Michigan market continues to grab the national spotlight for its economic stability.

Multi-family apartment projects have been the most actively traded asset in our market. With a growing workforce and the rising popularity of West Michigan, occupancy rates are at record highs. New multi-family developments are underway or in the planning stages throughout West Michigan. With over 1,300 units delivered, under construction, or planned, the downtown Grand Rapids market will see increased investor activity continue to pressure cap rates lower. Notable transactions include the sale of a 222-unit property known as Richmond Hills Apartments, and 306-unit Oxford Place. Both properties should see investors increase rents through strategic unit upgrades. A New York-based investor, The Embassy Group, had a big year with acquisitions that included the Cambridge Partners six-property portfolio that consisted of over 1,000 units, as well as the 144-unit Glen Oaks East Apartments.

A market driver affecting all property types in 2015 will be increases in new construction. Fundamentals have continued to improve, and the increased demand for quality space
will lead to the new construction. The positive economic environment of West Michigan will continue to attract investors seeking real estate investment opportunities, although shortage of inventory will be a barrier to entry in our marketplace throughout 2015. The basic “principle of anticipation” states that any investment is priced based on the anticipated benefits of future ownership. We believe the West Michigan market has a stable and bright future and expect that investors will continue to experience this as West Michigan continues to receive accolades for entrepreneurship, growth, hospitality and sustainability.

OFFICE

In 2014, the West Michigan office market was shaped by a few key factors—continued job growth, evolution of the way office space is used, transportation logistics, and repurposing/repositioning of office buildings. We saw unemployment in West Michigan drop 180 basis points to 4.9%, and private sector employment grow 320 basis points with the addition of 17,300 jobs as companies continue to expand. (Compare this to a state unemployment rate of 7.1% and a private sector employment growth of only 50 basis points). While companies make strategic moves to accommodate this growth, they are engaging space planners to incorporate design efficiencies and collaborative work environments. Tenants and landlords alike have largely embraced this and in turn have seen some major repositioning and repurposing of a few marquee office buildings in the market, specifically downtown. Companies looking for a new office are prioritizing the look and feel of space over other factors now more than ever. This sentiment was echoed by the recently-held Commercial Construction & Development Roundtable, in which 10 executives from the industry discussed trends they are seeing in the market. Finally, the investment and growth of our public transportation system has helped alleviate some of the growing parking concerns and enabled workers to sprawl while still having efficient access to downtown workplaces and mobilization during the workday. The Rapids launched the $40 million Silver Line Transit system this past fall, which is a 9.6-mile route that connects the city’s core to the Medical Mile, Wyoming and Kentwood. Supporters say the route can cut an average commute by approximately 40%. This ability has added to the allure of making downtown a place to call home.

As the recovery has regained a foothold, we are now seeing enough confidence to explore the market and its possibilities. As Grand Rapids continues to grow as an urban destination, building owners have to progressively plan to keep up with the shifting paradigm. New owners of Arena Station at 25 Ottawa Avenue have rebranded it “Twenty5,” which at the time of acquisition was roughly 40% occupied. Repositioning this asset will include new common areas and the addition of various tenant amenities. Other buildings in the market have begun the repositioning process as well. The Waters Building at 161 Ottawa Avenue was purchased by Waters Building, LLC. Plans for this historic 290,000-square-foot office building include office, retail, residential and hotel space. The renovation is scheduled for completion in late 2015 with an estimated cost of $35 million.

Arena Place, located at 45 Ottawa Avenue SW, broke ground in 2014. It will be a mixed-use building anchored by law firm Miller Johnson, who will occupy 54,000 square feet, as well as restaurant operator Meritage Hospitality Group and brand agency Domoregood/Hanon McKendry. The 11-story building located just west of the Van Andel Arena is scheduled for completion in late 2015. Arena Place Development, LLC is teaming with Concept Design and Orion Construction to design and construct the building. Other repositioning projects to occur in the CBD are The Ledyard Building (125 Ottawa Avenue), The Trust Building (40 Pearl Street), and The Trade Center Building (50 Louis Street). In a number of situations, building owners were able to work with the Downtown Development Authority for façade grants, Brownfields Tax Incentives, Tax Increment Funding (TIF), and the Michigan Strategic Fund (MSF) for assistance.

The suburban office market is primed to shift, as well. As the downtown office market becomes increasingly tight, tenants will begin to seriously look at alternative options in the suburbs. With an emergence of call-center type users, as well
as a shift toward collaborative work environments, the number of workers occupying space has grown. This will increase the demand for on-site parking, and users demanding a higher ratio of spaces will be intrigued by the suburbs due to the lack of availability and cost of downtown parking. Additionally, owners of suburban office buildings will be put under pressure to upgrade their buildings, to meet expectations of tenants who know about the quality of buildings downtown. Because the cost of redevelopment of outdated or obsolete product can be cost prohibitive, we expect the reemergence of new suburban office construction in the near future.

One example of new construction is the three new medical buildings planned to be completed in 2015 on East Paris as Phase II of the existing Heritage Pointe Center, which will total approximately 80,000 square feet of new space. Currently, the suburban office market is largely built-out but not repositioned in the main corridors such as East Paris, Cascade Road and the East Beltline. We expect to see some creativity in construction and even the possibility of a new suburban corridor emerge south near M-6.

Looking forward into 2015, we expect to see the trend of repositioning continue downtown and begin in the suburbs. As competition for tenants force ownership groups to get creative with their buildings, we predict more reimaging and more multipurpose building configurations. We will also see the downtown market begin to develop north and south as the core becomes increasingly tight. The office market has maintained steady absorption for the past 16 quarters and, despite planned additions to market inventory, many tenants looking to expand or upgrade will be left with fewer and fewer quality options. Tenants looking for new offices are beginning to fall into two distinct camps—those willing to pay a premium for the amenities and prestige of a Class A building, which have exhibited increasing rental rates due to investment into them, or those shopping for value in suburban or Class B/B- downtown space. Because of this, some of the Class B+ space is being caught in the middle. Landlord concessions will continue to fall as they gain more leverage against tenants and lease terms will increase as the market continues to stabilize. We foresee 2015 being another successful year for the office market, granted the maturity of trends we saw in 2014 and the shifts we predict moving forward. We also expect positive absorption for each of the next four quarters, and as Grand Rapids continues to gain national recognition for talent, opportunity and entrepreneurial spirit, we see no signs of it reversing course anytime soon.

**RETAIL**

Many Grand Rapids retail market historical trends of the past continued into 2014. New marquee transactions or projects and big name tenants entered or expanded within the market as well. West Michigan continues to gain significant interest from national retailers as the region continues to lead as one of the most successful recession recoveries in the nation. The area has received numerous awards and recognitions from national publications and, due to its increased attention, major retailers have started exploring the opportunities that exist. In addition to individual retailers gaining interest in the market, large investment groups are also figuring out ways to put down roots in the area. We have seen a number of large-scale renovations and ground-up builds started or planned for in the market. This year initiated a lot of momentum, and we expect some of these big name projects and tenants to continue to drive activity into 2015.

In 2014, we saw a full range of retail activity—continued development of the new Bucktown Shopping Center in Grandville, reconfiguration of the former Centerpointe Mall on 28th Street Southeast, the addition of Tanger Outlets to the market, and planning for The Village at Knapp's Crossing—all noteworthy projects to keep a close eye on. We expect these centers to aggressively drive retail commerce in their respective areas moving forward.

Anchored by Target and Cabela's, Bucktown Shopping Center has further plans to expand in 2015 and recently attracted new tenants such as Panda Express and Tom+Chee, a restaurant concept featured on television shows like ABC's “Shark Tank” and the Travel Channel’s “Man vs. Food.” Furthermore, after more than $50 million in investment into the de-malling of Centerpointe Mall, previous owners sold the site for $68 million to an investment firm out of New York this past summer. The new owners plan to continue the progress already started and position it as one of the most prominent retail locations in West Michigan. The center has been rebranded The Shops at Centerpointe and, with the help of the leasing team at Colliers International | West Michigan, owners are currently in negotiation with tenants to continue making a dent in the vacancy rate. The mall, once considered all but dead, is inching closer to becoming fully leased. In addition to traditional mall retailers, food concepts such as Potbelly, 5 Guys Burgers & Fries, Saladworks and Red Olive have recently come to newly created outlots in front of the center, and we expect to see the remaining vacant space fill up quickly. Additionally, Tanger Outlets has begun construction at their newly acquired site south of Grand Rapids at US-131 and 84th Street, attracting tenants such as Nike, Polo Ralph Lauren, H&M, Old Navy, Under Armour, Banana Republic and many more. Finally, plans to revitalize the retail project at Knapp and...
Asking Rent by Corridor
$/SF/YR, Year-End

Vacancy Percentage of Total Inventory SF
(by submarket)

Net Absorption
East Beltline are regaining steam as well. Detroit-area investor Lormax Stern, who started the Centerpointe Mall renovation, is currently in the planning stages of development and will be announcing more formalized plans early in 2015. Currently, the center is home to D&W Fresh Market and P.F. Chang’s.

The historically active retail corridors continue to garner much of the tenant interest; however, as these available spaces become absorbed, rental rates will continue to rise, lease term length will continue to grow, and new construction/renovation will likely be common. Landlords in tertiary retail corridors still struggle with attracting quality tenants, which has historically been the case, and 2014 was no different. These landlords must offer additional concessions and be willing to be flexible with tenants’ situations in order to fill space. Moving into 2015, this trend will continue. Rental rates will grow slightly in sought-after retail areas while rates in secondary corridors are unlikely to make any significant progress. Prominent tenants coming into the market will likely seek prime location and will have to pay a premium for it as inventory declines. These tenants are less likely to settle for unimpressive retail centers, which will in turn keep those centers searching for occupants.

In 2015, we will be interested to see how the activity downtown will affect the retail market. With an increasing commitment to downtown residential living, we expect to see that translate into growth within the downtown retail scene. Many large residential projects are underway or planned in the Central Business District, with a current projection of doubling residential units within the next few years. As more and more people decide to live downtown, retailers will follow that demand. In addition, with the reimaging and repurposing of some of the major downtown office buildings, the increased workforce activity will likely factor into retailers’ decisions to possibly locate downtown as well. Office space has been positively absorbed for the past 16 quarters, so retailers will be looking to take advantage of the demand that creates. Furthermore, with New Holland Brewing and Harmony Hall set to open new locations on Bridge Street and the Michigan Street Corridor Planning Initiative underway to decide how to modernize Michigan Avenue, we will likely see an expansion of the downtown retail market in both east and west directions.

The upcoming year is expected to bring more growth. It can’t be overstated how well West Michigan has rebounded since the recession or how well consumer confidence in the region has driven retail expansion. The area is not only a bright spot for the State of Michigan, but for the Midwest and the nation as a whole. Local entrepreneurial-focused ‘seed funds’ like Start Garden continue to gain momentum and publicity and we foresee continued interest from all types and sizes of retailers and expect 2015 to introduce even more new-development and redevelopment ideas. As always, absorption and rental rates will reflect demand, and we see demand continuing to grow. It is an exciting time to be in Grand Rapids.