

2016

West Michigan- Grand Rapids Commercial Real Estate Review and Forecast

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West Michigan - Grand Rapids Commercial Real Estate Review and Forecast

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INDUSTRIAL

The West Michigan industrial real estate market was healthy and balanced, but tight in 2015. Continued demand pushed supply to record lows after another four quarters of positive absorption totaling 509,827 square feet. As a result, the long-awaited arrival of new construction finally occurred.

In early 2014, as we saw the market break the 7.0% vacancy threshold, we predicted that new construction was the most viable and likely solution to the problem of lack of supply. Over the course of the year, construction was not as prevalent as foreseen—despite demand—and vacancy dipped to 6.15%, as those needing space settled for what was still left on the market.

At the beginning of 2015, the market climate seemed even more likely to produce new space, and it finally did.

With property values increasing and becoming closer to replacement costs, and quality available space being extremely scarce, those sitting on the sidelines waiting for the market to produce a solution started to take action.

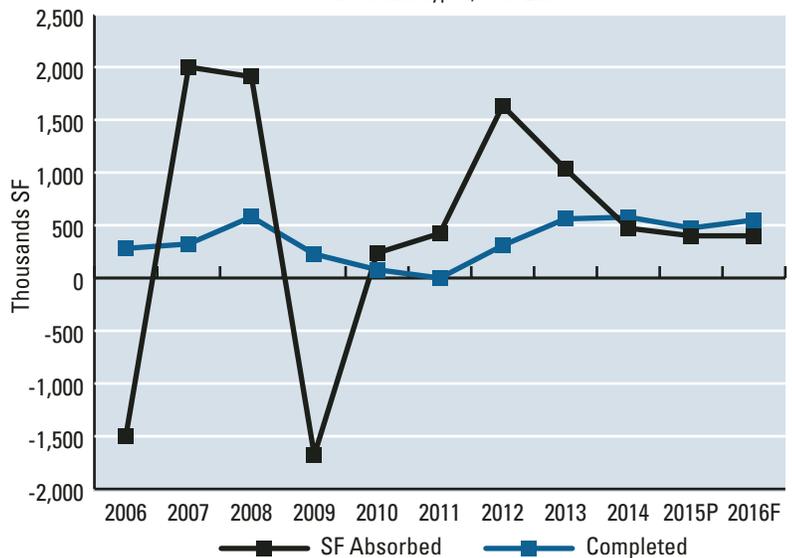
We have seen numerous additions, speculative builds, and build-to-suit construction projects break ground over the past year. Weeke North America built a new 100,000-square-foot facility at 4577 44th Street in the Aerotech Industrial Park. Automated Machine Systems Inc. broke ground on a new 41,250-square-foot plant in Jenison. Notions Marketing announced a \$33-million, 80,000-square-foot expansion to its current facility, which will add nearly 250 jobs. And speculative industrial park Area 52 broke ground on the first of a three-phase, 700,000-square-foot complex. Speculative buildings of that size are a positive indicator, showing confidence in the long-term health of the market and exhibiting the feasibility of undertaking such a project.

Redevelopment projects have also breathed new life into centers that in the recent past were viewed as undesirable or functionally obsolete, and created new spaces to absorb. One example is the Grand

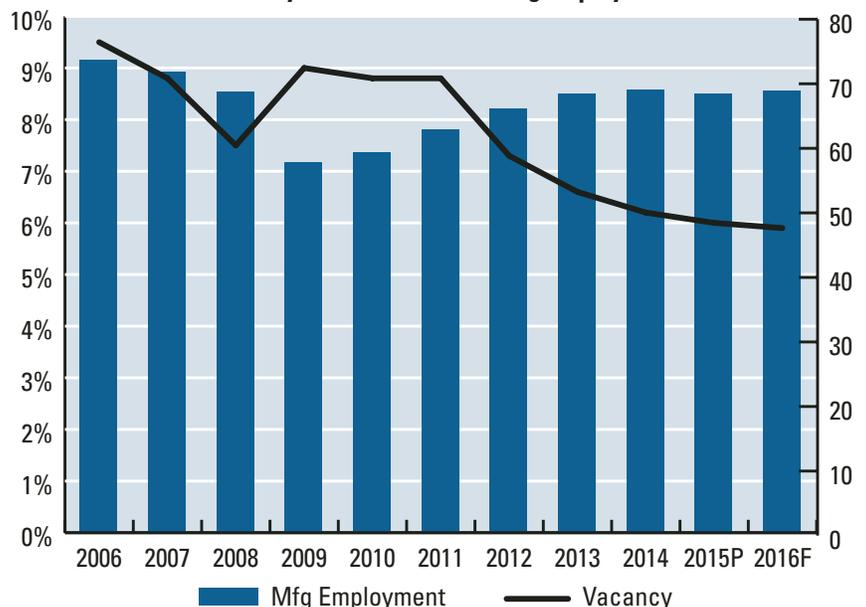
Rapids Corporate Center on Roger B. Chaffee Memorial Drive. In less than nine months after a new owner invested capital to reposition it, a team of Colliers International advisors was able to take the center from roughly two-thirds vacant to close to two-thirds occupied.

Looking forward into 2016, we expect construction to continue. Projects now underway or completed in 2015 should stimulate further development. In Hudsonville, one site is already priming for a big development splash this year.

Absorption vs. Completions
All Product Types, Year-End



Vacancy Rate vs Manufacturing Employment



The Jamestown Commerce Center, a 250-acre industrial/residential site located at the 32nd Avenue and I-196 interchange has already sold multiple parcels to various developers and users who will begin building this year.

“To be able to watch a large tract of land in your backyard be converted and developed into a new and vibrant industrial park is extremely motivating and exciting. Projects like this ripple excitement and encouragement throughout the entire community, and restore confidence and motivation for both extrinsic and intrinsic growth, which are evident in all segments of the market,” said Trent Wieringa, Colliers International industrial advisor who is helping broker the site.

So what will drive the industrial market in 2016?

Manufacturing continues to show strength in West Michigan, with an approximately 1.0% per quarter average job growth over the past year.

We expect to see this trend remain positive in 2016. However, the talent pool and wages are again topics of conversation.

Much of the population entering the workforce has grown up around a negative manufacturing job stigma, and subsequently avoided the skilled training necessary to be qualified for numerous positions. As a result, many of those being hired are entry-level and inexperienced. This trend is decreasing overall average wages, which will need to increase to keep our community competitive for hiring. Some manufacturers in the community are taking a proactive approach to combat this. Primera Plastics, for example, has started its own talent pipeline by reaching out to current high schoolers and mentoring them with on-the-job training while monetarily compensating them for their time as well. Creative solutions to a dried up talent pool will be imperative to continue to grow the manufacturing industry.

Automotive manufacturing and sales have long been a staple in Michigan. This past year saw a return to some of the historically high automotive sales numbers that we last saw in the early 2000s. According to the University of Michigan’s Research Seminar in Quantitative Economics, the country is projected to produce 18 million automobiles in 2016, up from approximately 17.7 million in 2015. This continued growth bodes well for many West Michigan manufacturers who supply parts to the auto industry, although Dr. Paul Isely of Grand Valley State University sees the auto industry flattening out.

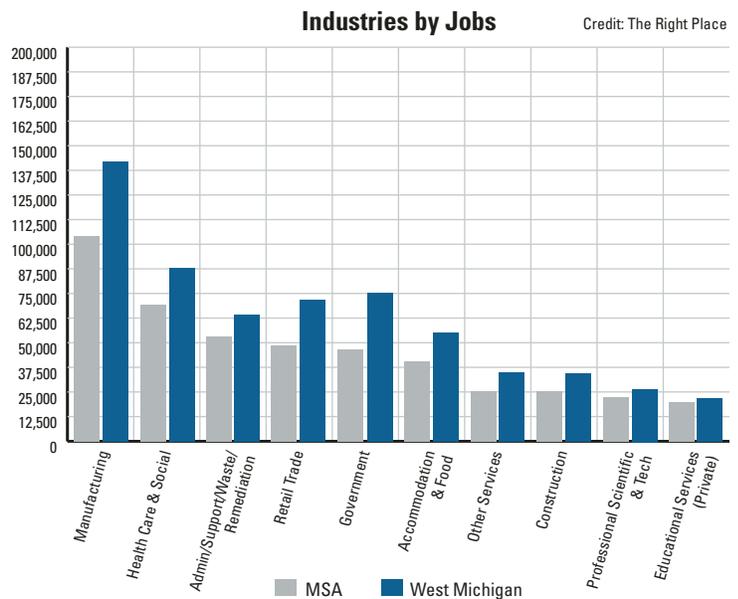
The office furniture industry is also a historical benchmark metric for the West Michigan manufacturing economy. According to the Michael A. Dunlap & Associates (MADA) office furniture index, the industry is continuing to grow and is currently above historical averages. The MADA Personal Outlook index is also well above a normal level

and suggests an optimistic attitude about the future. Grand Rapids-based Business and Institutional Furniture Manufacturers Association (BIFMA) reported a 4.0% increase in office furniture shipments from a year ago. They project an approximately 2.0% increase in 2016.

In December, lawmakers approved a pair of tax break bills that paved the way for Nevada-based data center company Switch to select West Michigan as its new home. Switch plans to build a 2-million-square-foot campus surrounding the existing iconic 600,000-square-foot Pyramid building, adding new infrastructure on the 100-acre site. **The project is estimated to bring more than \$5 billion to the local economy and create 1,000 new jobs over 10 years.** It is still yet to be seen how this will affect the industrial real estate market, but it will be a topic of focus going forward.

In 2016, we expect to see continued advancement, however at a slightly slower pace across the board. Much like the rest of the economy, we have seen several years of impressive growth that is now reaching a plateau.

Unemployment in West Michigan has reached 3.1% and likely doesn’t have much room to push lower. While demand for industrial space continues to be solid, it is inevitable that the undulation of the economic cycle will take its course. New construction will meet some of the space demand, although transaction velocity will likely level off. New absorption is estimated to be approximately 350,000-square-foot for the coming year, down slightly from this past year, yet still positive. Rental rates are also likely to remain steady, as landlords have mostly adjusted to the market. We anticipate creative solutions being what drives an already very healthy market forward, and with stabilized assets and strong fundamentals in place, investment interest in industrial product should also remain strong.



OFFICE

The West Michigan office market continued to grow in 2015, led by the continued expansion of the downtown Grand Rapids Central Business District. For the 20th consecutive quarter, we saw positive absorption to end the year, with a market total of approximately 468,478 net square feet of newly occupied space in 2015. Quality of office space continues to drive transactions as companies build on the theme of talent attraction and retention.

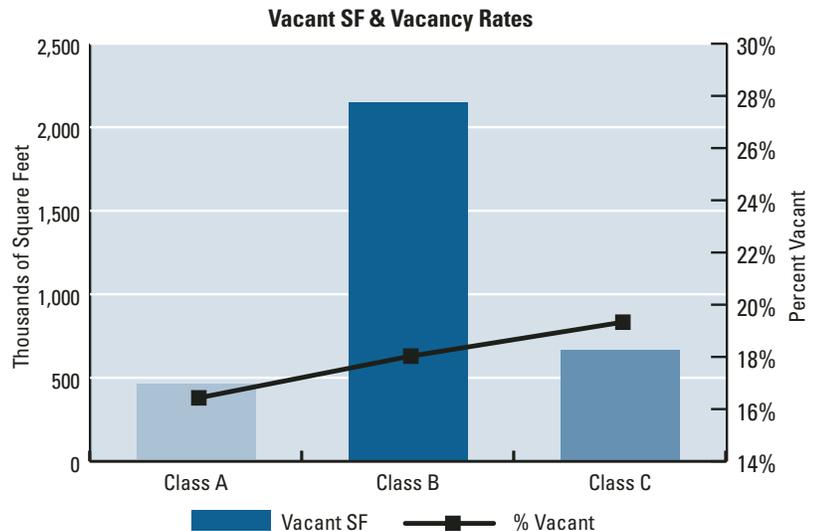
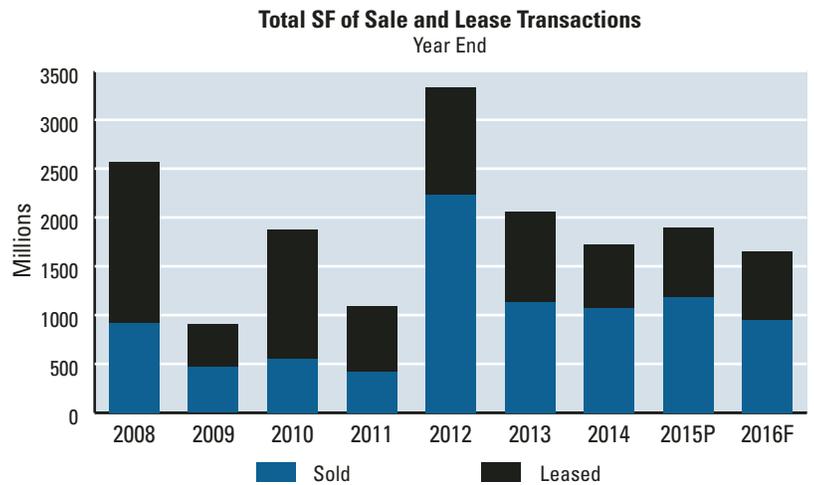
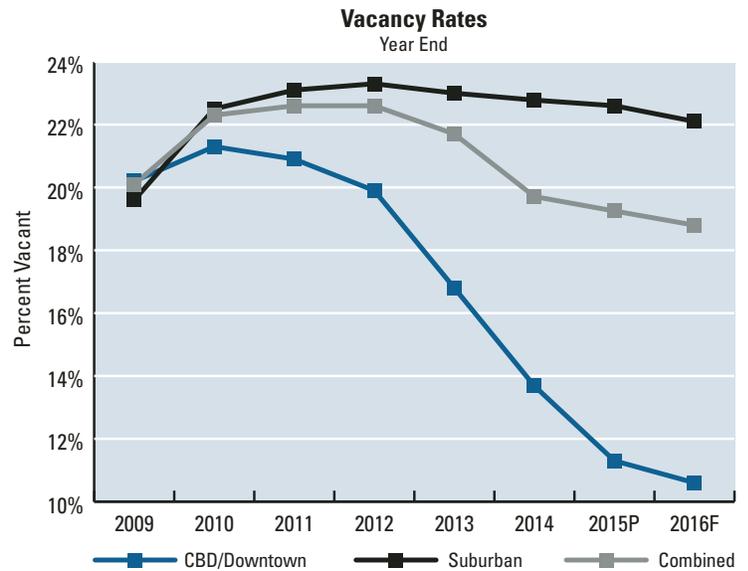
Building ownership groups have embraced this with renovations and new construction that include tenant amenities and common areas designed to foster more than just a work environment. **Physical fitness facilities, retail establishments, and comfortable common areas are now the norm.**

Now rebranded Twenty 5, 25 Ottawa Avenue is finishing up renovations that completely overhauled the building. Spectrum Health leased more than 75,000 square feet of the building to house training and information technology staff, with new restaurant concept "IRON" taking up the nearly 6,000 square feet on the ground floor. Building owners felt it was imperative to bring in a new and exciting restaurant concept to continue with the mixed-use formula they utilized by bringing Panera Bread to 99 Monroe. In today's modern office building, tenants are finding it increasingly appealing for their office building to include extra-curricular components.

As the market continues to traverse its natural cycle, it is important to keep expectations in perspective. The West Michigan office market has experienced unprecedented growth since recovering from the trying times of the late 2000s, where in 2010, the office market lost nearly 600,000 square feet of occupancy.

Creative solutions and investment in the market and the community have brought positive results. Nevertheless, market experts are starting to see a plateauing of activity. **This is not to say the market is declining, simply a normal adjustment that should be expected.** Rental rates are strong and firm, with downtown Class-A modified gross rates averaging \$20.75 per square foot and suburban Class-A averaging approximately \$18.75 per square foot. These numbers show continued strength overall, and are likely to stay relatively consistent throughout 2016.

Downtown, Fusion Education Group signed a 15,000-square-foot lease at 72 Monroe Center after an exhaustive search. The construction of **Twelve Weston** is planned for the upcoming year at the corner of South Division Avenue and Weston Street SW. SIBSCO, LLC is the ownership group behind the project and Rockford Construction will be the contractor, however, they are still attempting to overcome some hurdles. Landowners had to gain approval from the Heartside Neighborhood Historic Preservation Commission before the 150,000-square-foot project would be green-lit. In addition, Orion Real Estate



Solutions has announced a partnership with Midtown Properties, Pearl & Ottawa, LLC, and DTN Management to construct two new towers at the intersection of Lyon Street and Ottawa Avenue. Law firm Warner Norcross & Judd has committed to be a lead tenant, and will be moving from its

current office in 111 Lyon Street NW. Building owner of the firm's current location, Fifth Third Bank, has publically expressed interest in selling the building which creates a new opportunity for investment downtown in 2016.

Suburban office buildings continue to try to attract the tenants that desire some of the higher profile spaces of the downtown area. Many buildings have deferred maintenance that has been long overdue, and thus have failed to garner the attention and rental rates of buildings that have benefited from long-sighted investment. Second- and third-generation medical space will likely continue to struggle in 2016 as those seeking space are likely to invest in new construction or retrofit quality buildings to pave the way for their future. Many of our experts feel that the coming year will be difficult to convince tenants to lease space that has been neglected.

A theme we saw emerge in 2015 that will likely continue in 2016 is companies purchasing suburban office buildings rather than leasing space within them. Applied Imaging, Andrews Hooper Pavlik PLC, Hungerford Nichols CPAs + Advisors, and Compliance Systems, Inc. all recognized the opportunity to own their building and executed purchases in 2015. Legal Copy Services, Inc. purchased land on East Beltline to construct a new two-story building to move from its currently leased home at 1555 Arboretum Drive SE. These suburban purchases are spurred by opportunity to improve buildings to fit specific needs as well as to ensure ample parking options that may not be available in the central business district.

The former Steelcase Pyramid changed hands in 2015, with investment firm Norman Properties realizing the potential it has. After weeks of discussion, new tax incentive legislation from the state finally paved way for Las Vegas-based data center company Switch to select West Michigan as its new home and rename the building to the Switch Pyramid. Switch plans to build a more than 2-million-square-foot campus surrounding the existing iconic 600,000-square-foot pyramid shaped building, by adding new infrastructure to the site. **The project is estimated to bring more than \$5 billion to the local economy and create thousands of new jobs over 10 years.**

In all segments of the market, we have seen a lack of quality supply and an increasing need for new construction. 2015 was a year of continued positive momentum, but 2016 will be shaped by how tenants and building owners adjust and adapt to a market that is now competing on a national stage with the likes of Chicago and Detroit. In order to become a major market, growth has to push through barriers, and 2016 will be a great litmus test to see where we stack up.

2016 will likely be another year of overall growth for the office market. New construction will be seen in areas of the suburban landscape, and downtown will continue its transformation into a mixed-use development community. Downtown office space is in high demand, and those who desire to be in the central business district will remain a

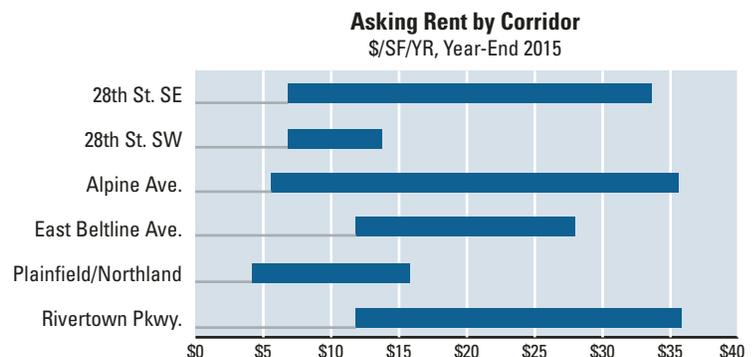
presence, despite cost concerns. Those looking for space at a discounted rate will still certainly find options in the suburbs. The West Michigan office market should remain positive in 2016, with **modest but steady growth.**

RETAIL

Historically, the retail segment of the commercial real estate market has slightly trailed overall economic trends. Over the course of the last five to seven years, we have seen the retail market exhibit strong fundamentals but generally lack the resiliency that the office and industrial markets have displayed. However, as those markets are peaking and preparing for a plateau, the retail market is again booming. **Market cycles are inevitable. Nevertheless, the strength that West Michigan commercial real estate has shown over the past few years has brought with it a very healthy retail demand for the foreseeable future.**

Over the past year, we saw a number of key retail locations make news, with more to come. Tanger Outlet Mall opened in Byron Center, which brought to the community more than 1,000 full-time jobs as well as more than 300 temporary construction jobs. It has been heralded as a resounding success. Located in a less-than-traditional retail location, the mall created a destination that has positively impacted the surrounding community and validated the strong retail demand that West Michigan has. Trader Joe's, a grocery chain long desired but historically found only in larger markets, opened a location at 3684 28th Street SW in September. More than 300 people showed up for the grand opening. Detroit-based Slows BBQ also opened a new storefront in the Grand Rapids Downtown Market while Leo's Coney Island, another east-side concept, also open their first West Michigan location.

The Shops at CenterPoint is another success story, completing an unprecedented "de-malling" and not only adding full out-let retail buildings, but bringing the existing mall to nearly 100% occupancy. Advisors from Colliers were confident in the de-malling plan when they advised the center's owners, and have now brought the strategy to the Holland area. They have already been successful in implementing the same strategy at the former Westshore Mall, which is being rebranded and de-malled similar to Centerpointe Mall, and will be called Shops of Westshore. Existing anchor tenants Younkers, JCPenney, Dunham's Sports, and GNC continue to operate, though much of the rest of the mall was vacated before



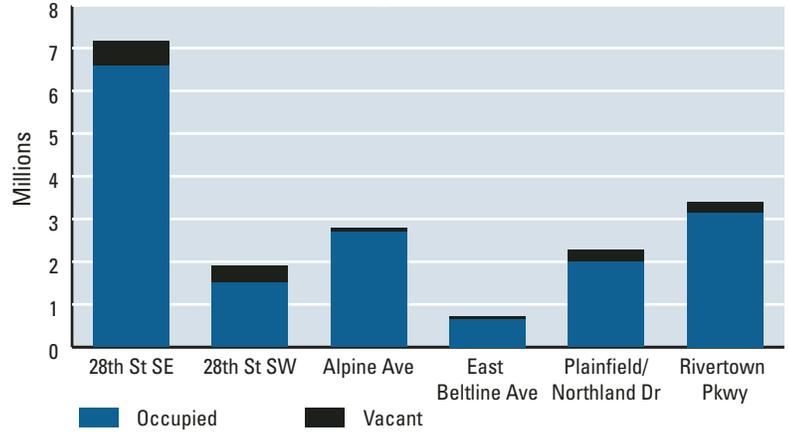
construction began. New ownership was eager and excited to revamp the struggling center, investing more than \$25 million and hiring a group with experience to breathe new life into it. In a matter of months, creative marketing (including a “Shark Tank”-like competition in which the winning concept received \$10,000 in marketing and free rent for a year) has brought in a host of new tenants, utilizing the strategy of out-lot buildings and a similar de-malling of interior space. Restaurants Anna’s House and On the Border have both committed to expand to the site. Ownership and the team of brokers have worked diligently to create a mix of both local and national retailers.

2015 saw approximately 50,800 square feet of retail absorption, with vacancy dropping to 9.0%. Alpine Avenue remains the corridor with the lowest vacancy at less than 3.8%. Overall, transaction velocity was about the same as 2014, with sales decreasing by 19.6% but leases increasing 2.6%.

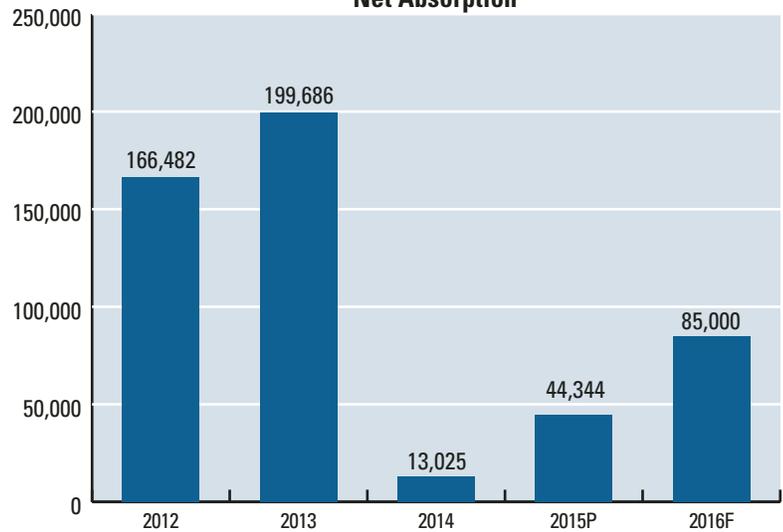
2016 looks to increase in sales and leases signed, as continued interest pushes transactions to the finish line. Additionally, we expect rental rates to remain strong and even increase in some of the marquee locations. As demand continues to outpace solid supply, landlord lease concessions also will remain minimal.

Further, in 2016, we will see the Village at Knapp’s Crossing continue to grow and expand on the popular retail corridor of East Beltline Avenue. Bagger Dave’s Burger Tavern has already opened its doors after

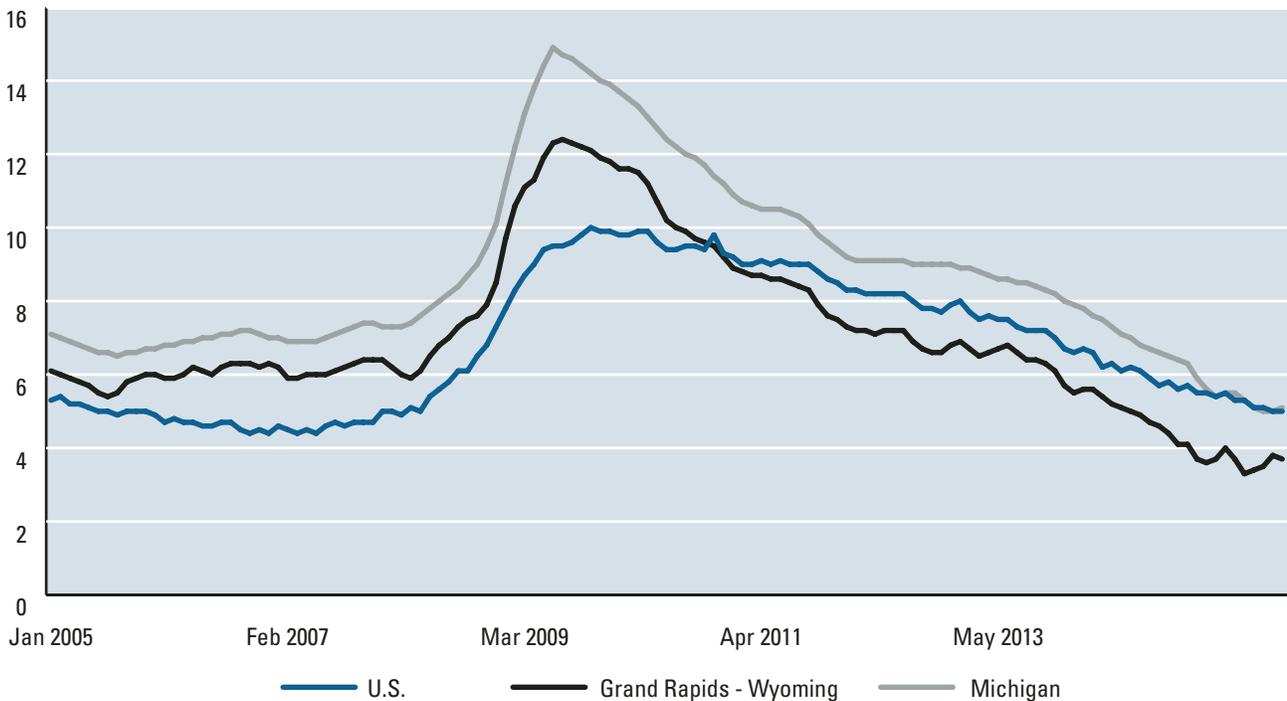
Vacancy Percentage of Total Inventory SF
(by submarket)



Net Absorption



FRED Unemployment Stats



Source: U.S. Department of Labor: Bureau of Labor Statistics/US. Bureau of Labor Statistics/FRED

building its restaurant, and BRAVO! Cucina Italiana, Menchie's Frozen Yogurt, Pieology Pizzeria, Potbelly Sandwich Shop, PNC Bank, and Rx Optical have all committed to the new center as well, which will join existing retailers D&W Fresh Market and P.F. Chang's. The site was purchased by Detroit developer/investor Lormax Stern, the same company that initiated the Centerpointe Mall reconfiguration. Lormax Stern is partnering with Visser Brothers Inc. on the development of the site.

Continuing the theme of the office and the industrial markets, quality retail space is at a premium. In 2016, we expect historically active retail corridors continue to see rates increase and any free space, utilized with urgency. Regional and national retailers looking to enter or expand within the market will do so with key locations in their sights. **As we have seen over the past few years, undesirable retail locations will continue to face challenges despite demand.** Property owners will be tasked with finding ways to incentivize tenants, although they will not be able to collect the rates that 28th Street, Alpine Avenue and East Beltline will get.

Many new retailers to the market are now looking at West Michigan as the entry point to the state, with eventual expansion east. In the past, we have seen the opposite, where companies look to the east side to establish a brand and then move west. A number of new national retailers will look to enter the West Michigan market for the first time in 2016.

In addition to new retailers, existing brands have decided to expand as well. Jimmy John's, Subway, Taco Bell, Potbelly Sandwich Shop, and AutoZone all have searched for and found new locations. Finding the right location is always the difficulty in retail—which has recently kept some searching, rather than executing. We expect to see more solutions in 2016.

Another trend that we have seen is a retail component to residential and office development. Specifically downtown, we have seen projects such as Arena Place at 45–55 Ottawa Avenue, Eastown Flats, The Rowe, and Twenty 5 at 25 Ottawa Avenue all include ground-floor retail. In 2016, we expect many of the new developments to continue to incorporate and drive retail locations.

INVESTMENT

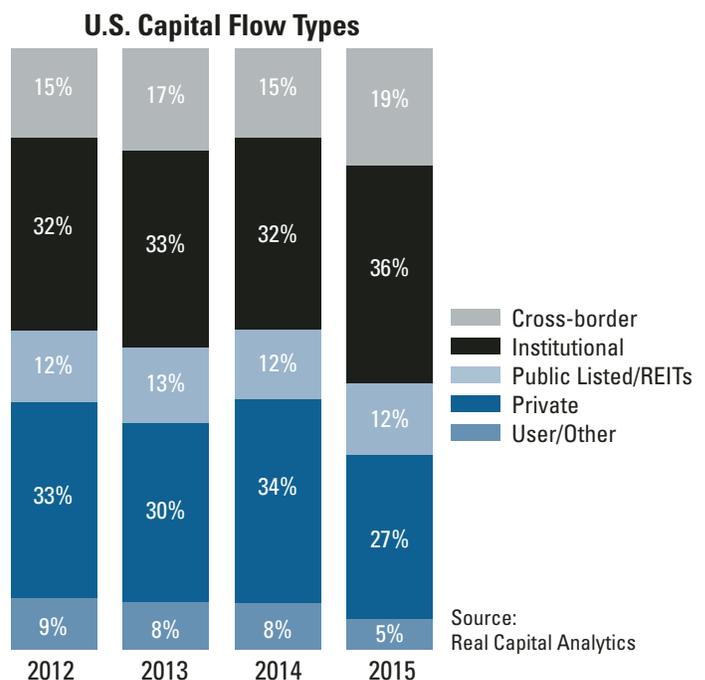
The West Michigan investment market remains strong. Nevertheless, a lack of supply is drastically reducing opportunities for those looking to invest in commercial real estate—a theme we saw across all property types for both users and investors.

In 2015, our forecast indicated a tightening of supply spurring new construction, and we began to see that this past year. **Market conditions in the region continued to improve,** with unemployment below 3.5% for both the Grand Rapids-Wyoming and Holland-Grand Haven metropolitan statistical areas, attracting a great deal of investor interest to the area from all around the country.

Nevada-based Norman Properties, which previously invested in the Kalamazoo-Portage region, invested heavily in the area in 2015 by purchasing the former Steelcase Pyramid building. The investment firm quickly attracted Switch, a data center company that plans to invest nearly \$5 billion, including a \$400-million initial construction to expand the campus and create the largest data center campus in the eastern United States.

“We look forward to working in partnership with Michigan to attract the largest companies in the world to the Switch ecosystem here in the Great Lakes State,” Adam Kramer, Switch executive vice president of strategy, said in a statement. Norman Properties and Switch collaborated on the company's flagship location in Reno, Nev., as well. Franklin Partners disposed of two assets in 2015, with 5010 52nd Street in Kentwood being sold in June at an 8.38% cap rate, and 4147 Eastern Avenue in Wyoming selling at an 8.70% cap rate. Both properties were 100% occupied. An investment firm from New York purchased the pair – one for office use and the other for industrial use. The two buildings together totaled more than 250,000 square feet of space.

The Grand Rapids Central Business District will continue to excite, as plans for an arena expansion and a mixed-use development anchored by Loeks Theaters Inc. continue to work through the planning process. Few assets actually traded in the CBD in 2015. However, the sale of the student housing property located at 5 Lyon to a New York investor showed the competitiveness of the market, commanding a \$12.5-million purchase price, representing a 6.10% cap rate at the time of sale. The property is slated for renovations to the ground floor retail and conversion of the top floors into market rate apartments. **With a sizable pipeline of projects breaking ground or scheduled for groundbreaking in early 2016, Grand Rapids' downtown landscape will see significant change throughout the year.**



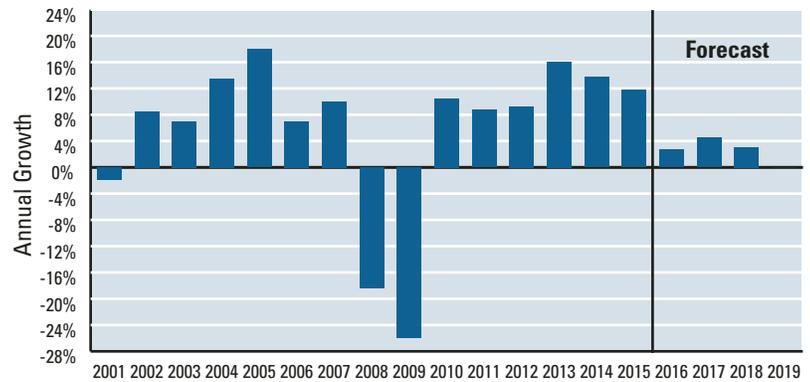
We saw 1031-exchange activity increase over the past year as investors realized the gains from early recession investing. As all asset classes benefit from increased tenant activity, 1031-exchange activity will continue to be prevalent through 2016. A San Diego-based investment company triggered a reverse exchange by purchasing a three-property portfolio of multi-family complexes in West Michigan. In January 2015, the 160-unit Wyndtree Townhomes in Springfield, 100-unit Tree Top Ridge Apartments in Battle Creek, and 136-unit Forest Hills Apartments sold with an 8.44% cap rate.

Retail properties benefited, with growing tenant activity increasing investment activity in the market. Investment firms like Lormax Stern are realizing the opportunity through development. After an extremely successful investment into the repositioning of Centerpointe Mall, the Detroit-based investment firm is now heading the development of the Village at Knapp's Crossing, constructing a number of new retail buildings for a group of tenants that has already committed.

We saw a number of office tenants purchase the building they were leasing, with the knowledge that options for relocation are scarce. Landlords are finally filling vacancies that have not been occupied since the Great Recession. Downtown, many of the investment opportunities have already transpired over the past few years. However, we expect creativity will drive new projects. With a handful of redevelopment and ground-up projects nearing the end of the planning stages, 2016 will usher in new construction of mixed-use buildings anchored by office tenants and supplemented with residential and retail components.

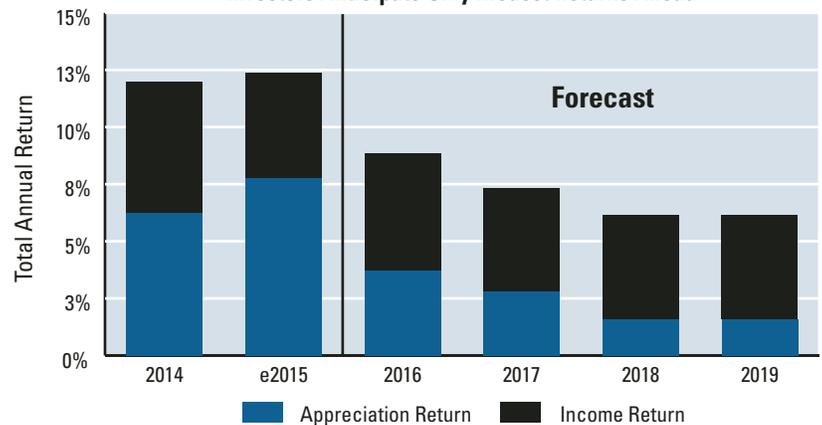
For 2016, the lack of quality opportunities will continue to be the biggest challenge in the marketplace. Developers may be more selective when deciding on projects to fill the 2017 pipeline, as the cost of short-term debt financing increases due to the Federal Reserve's decision to raise short-term interest rates. With the majority of the investor market seeking assets secured by long-term fixed-rate debt, investors are likely going to see yield compression as cap rates resist pressure to move upwards.

Growth in Commercial Property Prices Forecast to Slow



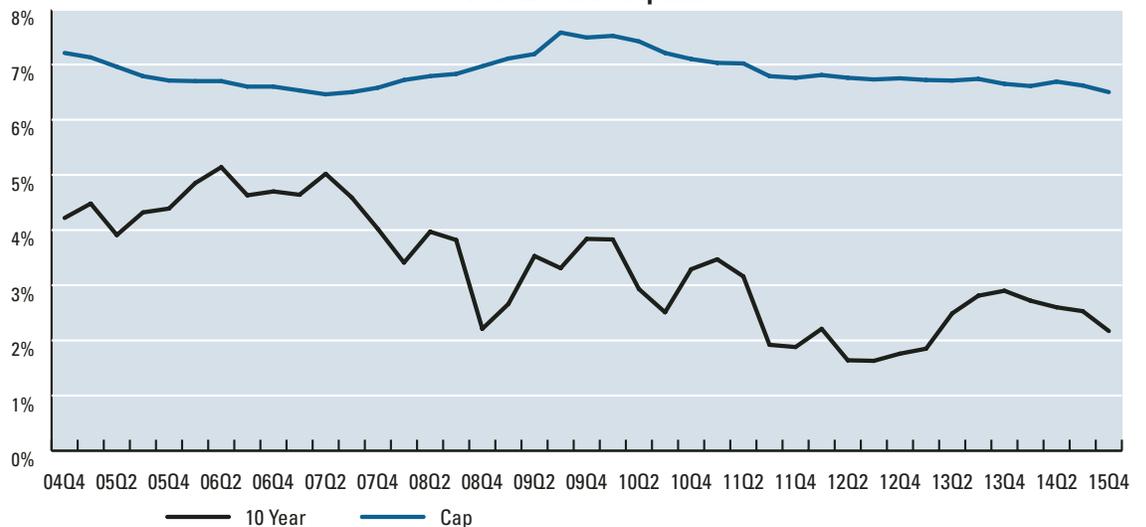
Source: Moody's Analytics, November 2015 Forecast

Investors Anticipate Only Modest Returns Ahead



Source: PREA Consensus Survey, Q4'15

10 Year U.S. vs Cap Rate



In summary, the economy of the greater Grand Rapids area will continue to grow and diversify, creating a desirable market for long-term investors. ■