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OFFICE MARKETS HIT THEIR STRIDE

A vibrant CBD marked by mixed-use development is a common thread running through Indianapolis, Chicago and Detroit.

By Kristin Hiller and Matt Valley

The U.S. office market rebounded during the second quarter after a slow start to 2017. Sustained tenant demand and sound economic fundamentals have fueled the upswing, according to brokerage firm JLL.

Average asking rents in the central business district (CBD) nationally have risen by 4.9 percent for Class A space over the past year. In 2018, new supply will likely increase competition among landlords for tenants and help stabilize rents.

While each major metro is unique, today's successful office markets share some common features — a rise in coworking spaces, tech offices, mixed-

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Hendricks Commercial Properties is transforming the old Coca-Cola bottling plant in Indianapolis into a \$260 million mixed-use development, featuring 180,000 square feet of office space, a boutique hotel and food hall.

INDUSTRIAL BUSINESS PARKS EXPAND

Across the Midwest, developers aren't shying away from large-scale, multi-phase construction despite available land drying up.

By Kristin Hiller

It's no secret that the industrial sector is firing on all cylinders across the country. The national industrial vacancy rate stood at 5.4 percent at the end of the second quarter, the lowest rate on record, according to Colliers International.

E-commerce sales, which grew 16 percent in the second quarter on a year-over-year basis, are unequivocally driving the demand. Online sales represent 9 percent of total retail sales, reports Colliers in its latest industrial market outlook.

Developers across the Midwest are

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RGLP Intermodal North 9224 is a 482,220-square-foot bulk warehouse within Duke Realty's Rickenbacker Global Logistics Park in Columbus, Ohio.

BIG FUNDS TARGET SENIORS HOUSING

With REITs temporarily sidelined, private equity takes center stage.

By Bendix Anderson

On Aug. 31, Kayne Anderson Real Estate Advisors acquired Sentio Healthcare Properties Inc. for \$825 million, including all assets and liabilities. The portfolio of 34 properties includes seniors housing communities and medical office buildings in 16 states.

What made this deal unusual wasn't the properties or price tag, but rather the roles of the players involved. Kayne Anderson (KAREA) is a private equity fund manager, while Sentio is a public, non-listed healthcare real estate investment trust (REIT).

In the past, big REITs often purchased portfolios of properties acquired over time by private equity funds. This time the transaction worked in reverse.

In markets across the country, private equity funds have been buying more seniors housing properties as other types of investors buy fewer.

Investors overall spent half as much on seniors housing in the first half of 2017 compared to the peak year of 2015. For REITs and other buyers, the cost of capital has gone up. The yield on seniors housing investments is currently near historic lows, and uncertainty about overbuilding, interest rates and public policy have kept

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OFFICE MARKETS HIT THEIR STRIDE ACROSS THE MIDWEST

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use development and convenient amenities. Read along for further insights into the Indianapolis, Chicago and Detroit office markets to find out what business sectors are driving office demand and how developers are responding.

Indy recycles office space

In Indianapolis, the transformation of the old Coca-Cola bottling plant is generating a lot of buzz. Wisconsin-based Hendricks Commercial Properties acquired the plant site located at 850 Massachusetts Ave. with plans to develop it into the \$260 million mixed-use Bottleworks District. Indianapolis Public Schools had previously owned the site and used it to house the school system's bus maintenance operations.

The bottling plant will soon be transformed into a development that will feature a 150-room boutique West Elm hotel, a nine-screen cinema, 180,000 square feet of office space, a 30,000-square-foot food hall, retail and residential space. The project will be developed over the course of about eight years in three to five phases, starting with the restoration and redevelopment of the historic Coca-Cola

administration building and garages.

HCP will begin the first phase of the Bottleworks project in the spring of 2018, with plans to open the West Elm Hotel, food hall, cinema and more than 70,000 square feet of retail space by the end of 2019. The eight-story office building could be a part of the first phase as well, according to Rob Gerbitz, president and CEO of Hendricks. Much of that will be creative office space.

The vital signs of the downtown Indianapolis office market are quite healthy as evidenced by the decreasing vacancy, says Gerbitz. Substantial positive absorption lowered the vacancy rate in the central business district to 16.9 percent in the second quarter — the lowest level since 2009, according to Colliers International.

Much of that absorption stems from Salesforce occupying its namesake tower. Based in San Francisco, the cloud computing company opened a new regional headquarters in Indianapolis this year. The 49-story office building is the tallest building in Indiana. Salesforce is also credited with kicking off the growing tech community within Indianapolis. Like other



Bottleworks District in Indianapolis will be developed over the course of about eight years. Phase I is slated to open by the end of 2019.

downtown areas, incubators and start-ups are growing at a good clip within the city, says Gerbitz.

The north corridor and downtown are the hot spots where millennials want to be, according to Joseph DiSalvo, vice president of investments in the Indianapolis office of Marcus &

Millichap. He credits Super Bowl XLVI, hosted by Indianapolis in 2012, for triggering development and revitalizing the downtown area. Today, areas such as Massachusetts Avenue are thriving with retail, restaurants and bars.

"Almost every buyer is chasing the Indianapolis market because it's tough to find this stability and yield in other markets," says DiSalvo.

What's notable about the Indianapolis office market is its lack of new construction. There hasn't been any new speculative office construction for about 10 years, according to DiSalvo, which has helped keep the city's vacancy rate in check.

Minnesota-based Onward Investors took on a major office redevelopment at 130 E. Washington St. downtown. The project included adding a retail storefront, outdoor seating, enlarged windows and a lower level amenity area that features the transformation of a 1920s bank vault into a game room. The 200,000-square-foot property sits along the Indianapolis Cultural Trail, an eight-mile bike and pedestrian path that connects several neighborhoods.

Walkability is certainly something many of today's office workers look for in a workplace location.

"Companies that plan appropriately can use their office space to gain an edge in recruiting," says Brian Askins, senior vice president at Colliers International in Indianapolis. "Amenities that attract employees — walkability, connection to nature, wellness, collaboration and mobility — transcend all generations of employees."

Askins says that attracting employees is an important issue locally amid such a tight labor market. The unemployment rate in Indianapolis-Carmel registered 2.8 percent in April compared with 4.4 percent nationally.

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"This talent competition has driven companies to look at real estate for the value it provides rather than simply looking at it as another expense item," says Askins.

Coworking spaces are also gaining momentum within the office market. The Union 525 is a 122,000-square-foot, four-story tech hub. Tenants can lease 5,000-square-foot office suites that feature conference rooms, data connections and movable walls. Industrious, a coworking space company with locations across the country, is opening an Indianapolis office on Massachusetts Avenue in November. The space will feature conference rooms, common areas and private phone rooms.

Sources are excited about future growth opportunities in the Indianapolis office market due to the strong real estate fundamentals, a diverse economy and the area's relatively low cost of living, which helps attract workers.

"I think Indianapolis has just started to scratch the surface on what the downtown community is going to be," says Gerbitz. "It's a great city. It has a lot to offer and a very long runway for growth in my opinion."

Chicago looks to rezone

The big news in the city of Chicago is the changing of long-established zoning policies limiting development within the industrial corridors, according to Michael Drew, founder of Chicago-based Structured Development. The city passed a new ordinance this summer that unlocked approximately 760 acres of land in the North Branch Industrial Corridor, which stretches from Kinzie Street to Fullerton Avenue. This has opened up large sections of land for mixed-use development, including light manufacturing, office and residential.

"The city has taken a more proactive role in recognizing that yesterday's smokestack industries are not returning," says Drew. "In fact, by restricting the land they were holding development back substantially. Today's manufacturers are the Googles, Amazons and information logistics-type companies. They're the job creators of today."

This development opportunity will further entice corporate users to take a look at Chicago's office advantages, including good access to fiber connections, transportation and the airport. Chicago's number one asset is its workforce, says Drew.

Currently within Structured's pipeline is a 200,000-square-foot mixed-use property comprising office and retail space. Structured purchased a 40,000-square-foot loft office building earlier this year that is adjacent to another building the firm owns in Chicago's Lincoln Park. Together, the sites will be redeveloped as The Shops at Big Deahl, with construction slated to begin in early 2018. There is potential

for a residential component as well.

The health of the apartment market is important to monitor as it impacts other sectors of development. A pilot program beginning in November will incentivize the development of 1,000 affordable housing units on the Near North and Near West sides, and along Milwaukee Avenue. Mayor Rahm Emanuel announced the three-year initiative, which will target areas experiencing gentrification pressures.

"Residential encourages more pedestrian traffic, more use of public transportation and a more vibrant

community," says Drew.

Monitoring the apartment market is important when looking ahead for future office development, according to John Dempsey, principal of Chicago-based CA Ventures' office division, because that's where the desired employee base is housed.

"To the extent that the apartment market is strong and continuing to be strong, that's a good forward-looking indicator of the employee base that's coming into Chicago," he says.

As millennials become more prominent in the workforce, they are shap-

ing the future of the office market. Resistant of the suburbs, most have flocked downtown, and several corporations have followed.

Google's Midwest headquarters now sits in a former cold storage warehouse in Chicago's Fulton Market, a Sterling Bay development. McDonald's is also moving to Fulton Market from suburban Oak Brook upon completion of a loft office building in 2018.

More recently, advertising giant WPP Group unveiled plans to move its Chicago offices to the Fulton Market in 2020. The former meatpacking

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district has become one of Chicago's hottest neighborhoods.

"We will continue to see some major headquarters relocations to the city, but the real story is the small satellite offices sprouting up all over from suburban-based companies who are 'dipping their toe' downtown," says Jon Milonas, a first vice president with CBRE in Chicago.

Every large or growing suburban company is contemplating a downtown presence, he believes.

One way to attract these new tenants is with the latest and greatest amenities. A move toward more communal office space is also resonating with businesses.

"You're seeing more amenities, recreational facilities and features that replicate young millennial habits," says Drew. "Progressive companies recognize that it's much easier to keep their workforce long-term with amenities and services that help increase their productivity."

Dempsey echoes the sentiment regarding today's workforce.

"Where skilled labor is, that's where the corporations want to be," he says. "At the end of the day, an employer wants to be able to recruit and retain effectively."

In Chicago's West Loop, CA Ventures is developing a 438,000-square-



CA Ventures is developing 625 West Adams, a 20-story office building that sits atop a 400-car parking garage in Chicago.

foot, 20-story office building known as 625 West Adams. On schedule for delivery in early 2018, the speculative project features a 400-car parking garage and 2,500 square feet of retail space on the main floor. The developer has not yet disclosed the names of the tenants at the property, but Dempsey says it's fully available for an anchor

tenant's occupancy.

Speculative development was the right move, according to Dempsey, because downtown Chicago doesn't lend itself to large build-to-suit type office buildings.

"Everyone's needs are immediate," he says. "Businesses are now making moves earlier and expecting early re-

sults. They're not going to wait for a typical 24-month construction period."

Despite businesses flocking to downtown, vacancy rates for the Chicago office market have been on the rise. The vacancy rate stood at 12.3 percent at the end of the second quarter, according to CBRE. In comparison, the vacancy rate was 10.3 percent at the end of the fourth quarter of 2016. Milonas attributes the spike in the vacancy rate to large tenant consolidations and downsizing. The rise in vacancies may also encourage tenants to wait for leasing rates to ease before inking a deal in hopes of a more affordable price.

As far as attracting companies to the market, the biggest advantage for Chicago is its commuter rail system, according to Dempsey.

"Every city is getting more congested because of urbanization, but most don't have the infrastructure to support that," Dempsey points out. "With the train system and the Chicago River, it's almost embarrassing the advantages that Chicago has."

Detroit ratchets up building

When Bob Kraemer looks under the hood of the Detroit office market, he finds space conditions downtown much tighter than the metro area's overall second-quarter vacancy rate of 16.5 percent as reported by CBRE.

The principal of Kraemer Design Group (KDG), a high-end architecture and interior design firm that specializes in adaptive reuse projects, says that the vacancy rate for "move-in-ready" Class A and B office space in downtown Detroit is under 10 percent.

"There are a number of buildings that may be for rent, but are really not move-in ready, meaning that the landlord has a lot of work to do just to get the building ready, whether it's the elevators or the mechanical systems that

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need to be modernized," says Kraemer, whose 21-year-old firm is based in the heart of the city. "The tenants are becoming astute that there are some buildings below par that landlords just haven't made improvements to, so tenants are skipping over them."

Kraemer has his pulse on market conditions. His firm is especially adept at the conversion of old office and other buildings to mixed-use with a heavy emphasis on multifamily.

Given the dearth of available quality Class A and B space in the city's financial and entertainment districts, coupled with the strong tenant demand from start-ups and established companies across a variety of industries, the downtown office market is ripe for new development, emphasizes Kraemer.

WeWork, a provider of coworking space for entrepreneurs and companies, serves as an example of the growing demand for office space. The company opened two locations downtown this year. WeWork occupies seven floors at 1449 Woodward Avenue in the Merchant's Row district, and three floors at 1001 Woodward Avenue in Campus Martius, for a total of 82,000 square feet. Both buildings are owned by Detroit-based Bedrock.

"We're going to start to see new office buildings being built because what's left just really is not going to be good stock, so you're seeing that it's now worth it to develop new [product]," says Kraemer.

Enter Bedrock, which in September unveiled plans for \$2.1 billion in new development projects downtown that are expected to create up to 24,000 jobs, including 15,000 construction jobs and 9,000 permanent jobs.

Each of the four projects — The Hudson's Site, Monroe Blocks, Book Tower and One Campus Martius — includes a major office component. Collectively, they will create a five-year construction pipeline.

All totaled, the developments will add approximately 3.2 million square feet and over 2,000 parking spots to downtown Detroit, according to Bed-

rock, the real estate arm of the family of companies owned by billionaire Dan Gilbert, founder and chairman of Quicken Loans.

"Detroit is going vertical," remarked Gilbert in a press release detailing the four projects. "In fact, that is the only way to create any type of significant expansion in the city because we are virtually at full occupancy for residential and commercial space in both downtown and Midtown."

Here are some of the highlights of the four projects:

1. The Hudson's Site: Slated for groundbreaking by the end of this year, the proposed \$909 million tower at the site of the former J.L. Hudson department store will rise 800 feet in the air and be the tallest building in Detroit since the Renaissance Center was built in the 1970s. (The highest tower in the Renaissance Center is 727 feet).

Plans call for the 1.3 million-square-foot skyscraper to be completed by December 2020 and include office, retail and event space and a 68-floor residential tower. Atop the tower will be an observatory and skydeck. The J.L. Hudson department store was a block-long building on Woodward Avenue that closed in 1998. The building was imploded in 1998.

2. Monroe Blocks — The \$830 million transformation of the Monroe Blocks between the Greektown district and Campus Martius Park will deliver a 35-story, 814,000 square-foot office tower to attract companies and jobs to Detroit, as well as 482 residential units, restaurants and retail space and three public plazas.

3. Book Tower — The \$313 million rehabilitation of the Book Building and Tower will be one of the most significant historic rehabilitation projects ever undertaken in Detroit, according to Bedrock. The project will feature a combination of 95 residential units, 180,000 square feet of retail and office space and a planned hotel.

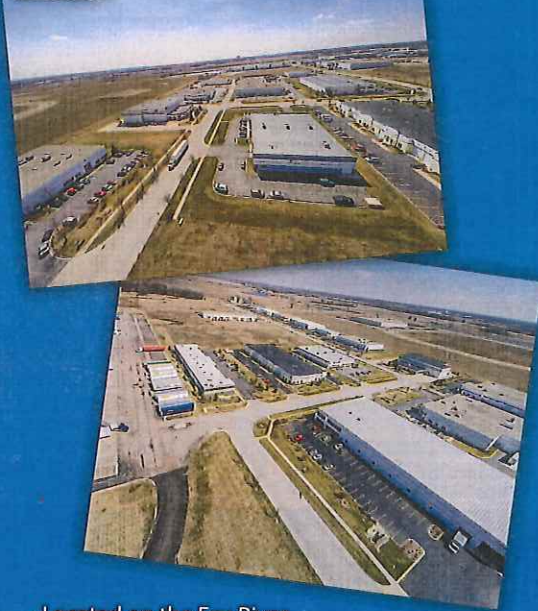
4. One Campus Martius — The \$95 million expansion of the One Campus Martius site will provide 310,000 square feet of office space.



As architect for the new home of Gas Station TV, Kraemer Design Group last year converted three floors of the Kresge Building at 1201 Woodward Ave. in Detroit into a naturally lit command center with clean lines and large wood timbers.

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The package of proposed projects will now go before the Detroit Brownfield Redevelopment Authority as the first step toward the approval of new state financing under the Michigan Thrive Initiative (MIthrive) program enacted into law earlier this year.

The State of Michigan, specifically the Michigan Strategic Fund, is ultimately responsible for approving all proposals applying for the MIthrive tool.

For its part, Bedrock will invest equity and potential outside debt totaling \$1.9 billion (or 88 percent of the project costs) while securing approximately \$250 million in bond funding (or 12 percent of the total cost) through the MIthrive program. If approved, Detroit will be the first city to put this new state-financing tool to work.

Tale of two submarkets

The vacancy rate in Southfield — metro Detroit's biggest suburban office submarket with an inventory of nearly 16.5 million square feet — stood at 24.9 percent in the second quarter, according to CBRE. In stark contrast, the vacancy rate in the much smaller Birmingham/Bloomfield submarket, which totals 4.3 million square feet, was 6.9 percent.

"Because it was one of the first suburbs developed in metro Detroit,

Southfield has an older stock of office buildings," says Andy Gutman, president of the Farbm Group, a full-service real estate firm based in Southfield. That older stock includes many buildings constructed in the 1970s and early 1980s.

"You see a lot of those buildings being repositioned now, and they are starting to gain some traction," says Gutman, adding that the city is pursuing public/private partnerships to redevelop the city center to make it a more walkable, bustling area.

What's more, earlier this year the city of Southfield and the Michigan Economic Development Corp. (MEDC) launched a crowdfunding campaign to create an interactive art installation, located along the new Northwestern Highway Pathway and Greenway, known as Red Pole Park. Tall poles, painted red, will be installed along the greenway.

Because the campaign met its crowdfunding goal of \$50,000, the project will receive a matching grant with funds from MEDC's Public Spaces Community Places program.

Southfield's redevelopment as a pedestrian-friendly community began with converting an old goat path into a brand new bike-walk accessible greenway to join a growing network of trails and new sidewalks throughout



The \$95 million expansion of the One Campus Martius site in Detroit will provide 310,000 square feet of office space. This is one of four developments totaling \$2.1 billion in new investment that Bedrock unveiled in September.

Southfield, according to the city's website. The greenway will include a series of outdoor "rooms" or art installations that residents and visitors will experience when using the path, of which Red Pole Park will be the first.

Southfield has built a network of about nine miles of paths and sidewalks over the past five to six years, according to *Crain's Detroit Business*.

Some of the office buildings in Southfield look tired and are located in a sea of parking, a turnoff for many space users today, says Kraemer. The thought of walking to their vehicle to drive to a limited number of restaurants for lunch a mile or two down the road and then driving back isn't terribly appealing to millennials, in particular. Conversely, downtown office workers generally have many food options available to them within a short walking distance.

One solution to a struggling suburban office building is to re-examine and possibly rebrand the property, says Kraemer. Among the salient questions: What enhancements can be made to the property to make it a neighborhood of its own? (That possibility involves studying the parking lots). Can outlots be created? Is there an opportunity to convert some portion of the property to mixed-use such as multifamily to bring some vibrancy to the property?

It's no accident that the Birmingham/Bloomfield office submarket is outperforming the market as a whole. For starters, downtown Birmingham is highly walkable and offers plenty of retail and restaurant options, says Farbm Group's Gutman.

"The city has a huge stock of very attractive upscale housing. You have a lot of decision-makers who want to live there, and therefore they want to work there so they can walk to work," explains Gutman. "I wouldn't say it's recession-proof, but it holds its value during every down cycle. A lot of it has to do with the fact that you can live, work and play in that city." ■

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