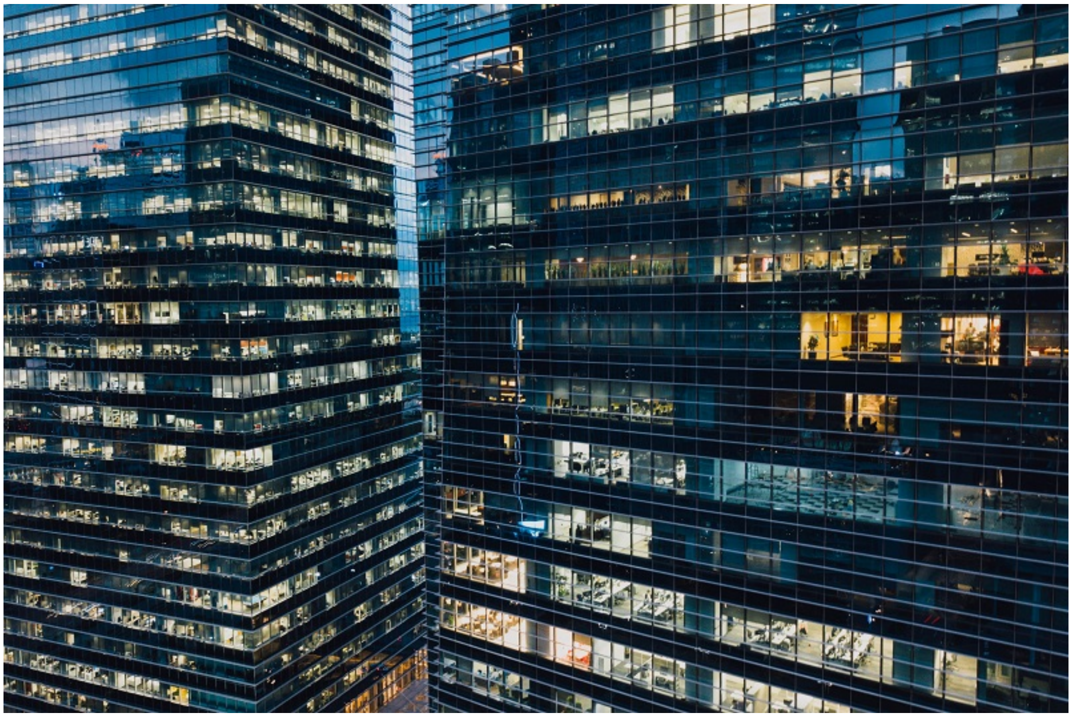
ILLINOIS | MICHIGAN OFFICE

Ripe with opportunities: Midwest's office market is on the rebound

WILLIAM BUBNIAK | MARCH 21, 2022



With the Omicron wave receding and the prospect of a spring and summer where COVID is less of a disruption than at any time since the start of the pandemic, commercial real estate professionals are enjoying a period of optimism and opportunity. The office sector has been slower to recover than the surprisingly resilient retail and restaurant sectors, but there are signs that office leasing and investment activity is picking up.

The Midwest, where office sales are rebounding in an encouraging way, mirrors some of the patterns we are seeing nationally. Understanding the Midwest office market dynamics is instructive, not just as a snapshot of where the sector stands today, but what might be in store in the months and years ahead.

Disruption and opportunity

It's clear that a great deal of disruption and uncertainty remains in the office market now. There are very real questions about what comes next, and because virtually every tenant's space needs are in play and few office tenants really know how much (or what kind of) space they will need in the future, some hesitancy is understandable.

Some prominent brands and businesses that had moved to a virtual or hybrid model have been bringing their people back to the office, while others have remained more cautious. For all the excitement about newly flexible remote operational models, the overwhelming consensus seems to be that in-person office remains enormously valuable. Most decision-makers believe that getting your people back in the office will fuel greater ingenuity, creativity and productivity.

Industrial and multifamily may be dominating commercial real estate headlines, but we are also seeing growing numbers of investors taking advantage of market conditions by buying a sizable number of office assets—and looking to buy more.

Market headlines

While there are clear differences from one Midwest market to the next, there are some key themes that show up across the region:

Chicago

Chicago still faces some high-tax headwinds, along with safety and security issues and political challenges. Foreclosures of office deals in Chicagoland are at their highest point in some time. Judging by the enthusiasm with which investors are pursuing deals right now, there is widespread confidence that Chicago is going to come back.

Recent highlights of noteworthy office transactions include the sale of the controlling interest in the Bank of America tower at 100 N. Wacker Drive. With the building valued at around $1 billion, that makes it one of the biggest office transactions in Chicago history. Two other downtown towers also recently sold, including the 64-story Wacker drive building next to the iconic Willis tower, in transactions approaching $400 million.

Fulton Market is a particularly hot area of the city, sapping some of the energy from the fabled Loop, where activity has been more sluggish. However, the Loop isn't going away. As the Chicago office market rebounds, there will be an inevitable flight to quality, and betting against Chicago and The Loop is a sucker's bet.

While leasing activity is still gathering steam, we are starting to see more law firms, financial services and tech companies signing downtown deals. From an investment perspective, the market seems to be at a place where if you buy now, you will capture a lot of opportunity with upcoming leasing.

Detroit

In Detroit, we are also seeing a relatively modest uptick in leasing. On the investment side, many investors are still being quite selective about what opportunities to pursue and are taking advantage when they can get a deal with favorable basis points. Detroit isn't flashy, but savvy investors have recognized for several years that it is a city on the rise.

A market that was already amid a significant civic renaissance before the pandemic, Detroit is still in a strong place in its broader economic and civic revival. Square footage remains more affordable, the auto industry looks poised for growth with the advent of the electric vehicle market and we are already seeing money invested across Southeast Michigan.

Challenges and priorities

We are already seeing lots of first-time investors coming to the Midwest to tap into buying opportunities that simply don't exist on the coast. Given the still-somewhat uncertain state of the market, the most promising opportunities are perhaps best suited for investors who are not looking for safe returns but are willing to take on a little more risk for a potentially significant up-side in the not-too-distant future.

It's not hyperbole to suggest that investors might make more money in office than in any other commercial real estate sector during the next several years. While sectors like industrial remain hot, so much of the value is already priced into the asset that genuinely lucrative opportunities can be tougher to come by.

In other words: If you have the equity resources, now is a great time to invest. That said, the near- and mid-term will not be without challenges, and all investors should be cognizant of what lies ahead. Owners and operators will have to be more hands-on and expect to spend more time and resources taking care of their tenants. For all the recent optimism, COVID remains a wildcard—and current and prospective tenants are understandably nervous.

Smart landlords will consider designing and retrofitting buildings with high-quality air filters, extra janitorial services and other health and safety benefits that could help them stand out in what seems likely to be an increasingly competitive market in the near future. They will also need to be flexible when it comes to redesigning or renovating spaces.

Some up-front investment now in helping tenants adjust to their new operational needs and priorities could pay real dividends in the long run. Those that can most effectively balance running properties aggressively while keeping tenants happy throughout the ups and downs will find themselves positioned for sustainable success, regardless of what the future holds.

William Bubniak is executive vice president of investment sales at Midwest commercial real estate firm Farbman Group. To reach him directly, email ***bubniak@farbman.com****.*

TAGS

CHICAGO FARBMAN GROUP