

SOME ARE TAKING ADVANTAGE OF DETROIT'S SLOW OFFICE SPACE MARKET



Candice Williams
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Detroit — At the Marko Law office downtown, attorneys are settling into their new office space. The lobby is prepped to receive a Detroit-themed mural and a conference room awaits a Spanish woodworker's large table top that will be delivered through a fourth-floor window.

The company moved this month from a space at 1300 Broadway to a corner office suite more than double the size at 220 W. Congress St. The owner of both buildings, Basco of Michigan, customized the new 7,100-square-foot space for the firm. Other tenants include Tropical Smoothie Café and Venture X co-working space.

"We really wanted to stay in downtown Detroit but were completely out of space," said attorney Jonathan Marko, the firm's founder and principal. "It became a Frankenstein of sorts. Conference rooms were turned into new offices until we had no space left. We were even renting space from the tenants above us and below us, literally bursting at our seams."



Some Metro Detroit owners are renovating their office buildings to attract and retain tenants at a time when there is low demand for office space following the COVID-19 pandemic, with many white-collar employees working remotely part-time or full-time. At the building on Congress, Basco exposed the original wood rafters and brick walls and installed new mechanicals, elevators and windows.

The timing worked out well for the firm, Marko said, because it was difficult and expensive to acquire a new office before COVID-19. Now potential tenants have their pick as companies move to hybrid work, downsize or stay put.

"It was absolute insanity getting any office space," Marko said. "Prices were through the roof. And they were going like hotcakes everywhere. I mean, it was insane. It was insane at the time. The pandemic has changed that. There's more inventory, a lot more inventory. Better pricing. You have room to negotiate. You did not have room to negotiate before the pandemic. It was like take it or leave it."

'Reluctance to relocate'

The real estate office market in Metro Detroit was slow at the start of the year, according to a first-quarter report by real estate firm Savills Detroit.

"As continued economic uncertainty prevailed and hybrid workplace strategies evolved, many occupiers extended the pause in real estate decision making, while some reevaluated the scope of their occupancy requirements," the firm wrote.

"Tenants showed reluctance to relocate, as evidenced by eight of the ten largest lease transactions this period involving tenants that stayed in place and restructured lease terms."

The availability of office space rose 40 basis points from the 24.3% reported in the third quarter of 2022 and was up 160 basis points since the first quarter of 2022, Savills Detroit said. There has been a decline in asking rents, which are off 1.1% since last year. Sublease space was at all-time high of 2.5 million square feet.

A study of 63 North American downtowns by the University of Toronto ranked Detroit 36th in return to pre-pandemic activity, having recovered 57% of its 2019 traffic.

Some Detroit suburbs saw growth in office rental rates from a year ago, most notably the submarket that includes Bloomfield Township, West Bloomfield and Bloomfield Hills, with an increase of 14.9% to \$27.73 per square foot. Birmingham and Ann Arbor remain strong markets for office space, said Greg Bockart, executive managing director for the Savills Detroit office.

"When people are reevaluating what they want post-pandemic, it's amenities, walkability, reasons for people to come back to the office," he said. "So they're either looking for an investment into amenities within their own space or a building that has amenities or a walkable community like Birmingham, Ann Arbor, Royal Oak or Detroit."

Companies are gravitating toward smaller work areas, said Jared Friedman, executive managing director of Friedman Real Estate.

"We don't need as much office space as we used to," he said. "And even ... before COVID, we still had a lot of vacancy in our market. So it's going to take many years to get rid of the excess supply in our market. And it's going to be costly and painful for some owners."

"Friedman said some buildings will need to be repurposed and those that can't be reused will need to be torn down. The former Plante Moran building on Northwestern Highway in Southfield, for example, will become a self-storage container facility. The firm, which previously owned its long-time headquarters, moved to the Southfield Town Center in 2021.

Detroit sites get investment

Elia Group is banking on its location and amenities to draw office tenants at 511 Woodward in downtown Detroit. The firm purchased the long-vacant building in 2019 and has invested more than \$20 million into its renovation, said RJ Wolney, chief investment officer for Elia Group, which also owns four eateries downtown, including PARC.

The building is 50% occupied, Wolney said, but his outlook is optimistic because of its location and features. In addition to having Capital One Cafe as a tenant, Elia Group is constructing and will operate an Asian restaurant called Zuzu on the first floor and a bar called Upstair Bar on the second floor. The company is courting other potential tenants, mostly in professional services.

"They want to be working in a great location with a ton of things around them, amenities in the building or amenities around them," he said. "And that building offers all of those things.

"I'd say the thesis and the idea of the acquisition pre-COVID in 2019 — all those same themes and elements we see as frankly as being even more important now today as far as ... being very well-located, quality experience and environment whether that be for retail and street level activation or office environment. The same necessities are there."

Another office building that has received some investment is Detroit's Fisher Building. The iconic Art Deco skyscraper on West Grand Boulevard recently got a new majority owner when Michigan State University signed an agreement to acquire a 79% stake in the building, a parking garage and two surface parking lots.

The New Center landmark will become home to a business start-up incubator founded by the MSU Research Foundation in a building where the occupancy rate most recently hovered between 65% and 70%. Peter Cummings, executive chairman and CEO of the Platform, the building's part owner, has said he expects the move to increase occupancy.

New spaces on the way

An emerging question: How the office market will fare as new office space comes online with the addition of Bedrock's Hudson's site skyscraper and the District Detroit development? It depends, said Alex Calderone, managing director of the Calderone Advisory Group in Birmingham.

"Everything that I've seen suggests right now that from an office space perspective, Detroit has already been over-built before these new buildings come online," he said. "To a large degree, whether or not the market can accommodate some of the new projects that are coming online without having to cannibalize from existing space is another question. A lot will just depend on where we go, economically. Where the road takes us."

When asked if the new office buildings would have an impact on the Fisher Building, Cummings said that's not a concern.

"The rent that is going to have to be secured to provide a return to those buildings is significantly higher," he said. "Could be twice the rent we think we need to get at the Fisher Building. So I'm sure there will be more competition going forward over the next two to three years than there has been in the past two or three years, but that's healthy in an environment of competition. New space creates excitement in the market, and I'm sure that they'll do well in the central business district."

The Hudson's site will offer something that's not already available in the market, said Brendan George, senior vice president with CBRE. It may cause a "flight to quality" or "flight to experience" among some companies and be strong enough to attract companies not already present in Michigan.

"The obvious one is Chicago," he said. "It's only a four- or five-hour drive away. And if you do have somebody looking for a headquarters-type building and maybe they don't have all their employees yet, those are metrics that they could definitely be looking at. Looking at the labor analytics of what's an example of a Chicago (building) versus a Detroit (building) and looking at that building and saying, you know, that the cost of occupancy there may be lower than what their options are in Chicago. So it is a high-enough-profile-type project that I absolutely think would get looks."



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