

Issue Date: May 2006 Issue, Posted On: 4/28/2006

A Changing Landscape

Retail, urban housing and suburban office space top the growth areas in Northeast Ohio's real estate market.

Christopher Johnston

When the going gets tough, the tough, apparently, do go shopping. With manufacturing-sector layoffs continuing to hit the headlines and corporate office space still primarily in a holding pattern, retail and residential projects continue to dominate commercial real estate development in Northeast Ohio.

All the buzz downtown, for example, is about The Wolstein Group's \$230-million Flats redevelopment and Zaremba's \$200-million Avenue District project east of the Tower at Erieview, according to Dave Browning, managing director, CB Richard Ellis, Cleveland.

Both projects are a mix of residential and retail, with The Wolstein Group attempting to create a new downtown neighborhood as soon as the firm can acquire all of the parcels it seeks on the East Bank of the Flats, while Zaremba plans to construct condominium and townhouse units combined with retail and parking.

"At least in the downtown environment, none of the big projects are a major office development," Browning says. "The office market downtown still has a long way to go before someone would think about building a new multi-tenant office building."

For the past several years, retail development has seen the emergence of "lifestyle centers" such as Hudson and Main in Hudson, Legacy Village in Lyndhurst, Crocker Park in Westlake and the expanded Eton Collection in Woodmere.

"Combining retail, office and sometimes living space within the same development is a mega trend in real estate nationally and locally," observes Mara Cushwa, chair of the Real Estate Practice Group for Calfee, Halter & Griswold LLP in Cleveland.

Northeast Ohio's significant retail trend continues now in the rise of "power centers." Historically, retail shopping centers and malls had a couple of large anchor stores connected by a series of in-line shops and boutiques. The power centers are designed to drive traffic to a series of big box stores with some in-line ones.

Currently, the definitive power center for the region is Steelyard Commons, an approximately 1 million-square-foot facility not far from downtown Cleveland that will feature the first Wal-Mart in the city proper, Home Depot, Staples and Target when it is completed in 2007.

Several other power centers are now in different stages of design and construction, including City View Center, a 600,000-square-foot center in Garfield Heights; Harvard Crossing, a 200,000-square-foot facility in the Chagrin Highlands area off of Interstate 271 and Harvard Road in Beachwood; and the 450,000-square-foot Meadowlands Town Center in Chardon.

Additionally, the Jacobs Group and the New Plan Excel Realty Trust are transforming Westgate in Fairview Park from an enclosed mall into an 850,000-square-foot open-air power center. Kohl's will remain, while Lowe's and Target will be added to the mix.

On the office space side of commercial real estate, Class A office space is tight in Cleveland's Central Business District, which means that Class B space is loosing up, says Michael Cantor, principal, Allegro Realty Advisors Ltd., Cleveland. While Class A vacancy rates are hovering around 10 percent, Class B vacancy levels are closer to 30 percent.

"Basically, that means we'll see a lot of competition this year, with rates coming down or staying low," Cantor says. "Also, the newer Class B buildings will compete with downtown's Class A spaces and with some suburban office space."

William Cunningham, vice president of asset management for the American National Group in Cleveland, sees another trend in the downtown office market: an increasing interest in leasing rather than renting.

As an indication, Cunningham says his company's lease equity program for its three mixed-use properties in Playhouse Square has been gaining popularity. By signing a 10-year lease, tenants can receive an equity position in the property.

"The changes I see downtown are that people want space that is going to be more efficient for their business needs and allow them to utilize the latest in technology," Cunningham says. "They also love the opportunity for an equity position."

The East Side office space market along the Chagrin Boulevard corridor is just as tight as downtown, according to Cantor. With vacancy rates at roughly 11 percent, there are few large blocks of space available. One of Cantor's clients has experienced difficulty in identifying a 40,000-square-foot space on the East Side, with no more than 10,000 square feet typically available, especially along Chagrin Boulevard.

"There are some opportunities in the Landerhaven/Landerbrook area," Cantor says. "But if you want to be on Chagrin, it's pretty tight right now."

Several major unknowns in the market are preventing new speculative office development, as well, Cantor believes. Specifically, developers and commercial real estate experts are waiting for OfficeMax's decision about its building in Shaker Heights, since the company is relocating to Chicago, and MBNA's substantial corporate facility in Beachwood is also in question. The company was recently acquired by The Bank of America.

Moreover, Progressive Insurance continues to consolidate its diverse operations in buildings throughout the area into its headquarters campus in Mayfield Village. To the south, the Rockside Road corridor, where vacancy rates are around 22 percent, might benefit from the restricted availability of office space on the East Side, Cantor adds.

Despite the ongoing layoffs, the industrial market in Cleveland is "very healthy," according to Cantor, with vacancy rates of 7 percent. The most popular spaces are located in modern, efficient buildings, while older facilities, especially around downtown Cleveland, have higher vacancy rates. However, the entire region continues to hold its breath as the American automotive industry navigates its way through a significant period of retraction due to increasing global competition.

"Our big question in industrial real estate relates to some of the changes in the automotive industry," Cantor says. "The other thing that's plagued new development over the last couple of years is rising construction costs."

A slow economic recovery in the region, however, has led to a healthier corporate environment for many companies, which means fewer office and industrial properties are available, says CB Richard Ellis' Browning.

"We're seeing an actual increase in rental rates, especially in the east suburban office markets," he says. "It's the strongest activity we've seen in 10 years."

Local commercial real estate professionals are also looking to another major trend affecting the region's market: the substantial trading that is occurring as a result of two major property owners selling off their Northeast Ohio assets.

In November of 2005, Duke Realty announced its strategic decision to gradually exit the market over the next few years. The Indianapolis-based Real Estate Investment Trust (REIT) plans to invest the proceeds from the sale of its approximately 4 million square feet of industrial and office properties located between Strongsville and Hudson in growth markets, such as Denver, Las Vegas and Phoenix.

In addition, John Dellaganese, owner of John Dellaganese & Assoc., which held the largest office building portfolio in Akron, has decided to sell off his company's assets.

"Nationally, we've seen historic pricing in terms of high prices versus the net income for properties," Browning says. "So it will be very interesting to see when all of these assets close whether we're going to hit some of the historic high-pricing levels that other markets have achieved."

Ongoing public improvement initiatives to reenergize Northeast Ohio such as the Euclid Corridor Transportation Project and lakefront redevelopment projects will also have a far-reaching influence on commercial real estate in Cleveland, says Calfee's Cushwa.

The removal and replacement of dilapidated properties, the enhanced connectivity between downtown and University Circle because of the dedicated bus lanes, beautified streetscapes and the installation of new utility infrastructure such as wireless communications technology, will make properties more attractive throughout the lakefront and Euclid Corridor areas, Cushwa says.

"These are projects of a scale that requires some patience and a lot of diligence," she says. "So, it's a long process, but

it's underway, and together, these projects will have a great impact on the area."

Looking even further down the road, the commitment by local community colleges and universities to technology transfer and the construction of technology parks and business incubators will also have a significant impact on commercial real estate by launching, ideally, an ongoing stream of new small companies that will need space in the future, Cantor says.

These facilities include a new technology park in Medina County that is being planned by the University of Akron and the Great Lakes Technology Park developed by Lorain County Community College. Additionally, Kent State University is planning to create technology incubator space for businesses launched by its Liquid Crystal Institute.

Along with The Cleveland Clinic Foundation and University Hospitals Health System, Case Western Reserve University is also involved in the development of the new biotechnology center on the former Mt. Sinai Medical Center in University Circle.

"One of the best trends in our economy right now," Cantor says, "is that all of the higher education institutions seem to be focusing not only on technology transfer, but on how you start up these businesses and help them grow and stay in the region."