

# Seidman Business Review

Seidman College of Business at Grand Valley State University, Grand Rapids, Michigan

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## From the Editor...



**N**o matter what your political views, I think we can all agree that 2016 was a wild, roller coaster ride of a year, full of surprises, twists and turns, and loop-the-loops.

The articles presented in this edition of the *Seidman Business Review* aim to shed light on some of the effects that this tumultuous year has already had on our economy, as well

as effects that are yet to come. The general economic situation is reflected in our yearly reviews and analyses of regional stocks, housing markets, commercial real estate, and our ever-popular annual economic forecast. We also have specialist articles on topics that are relevant to many in the business world – the high cost of prescription drugs, the importance of foreign-trade zones, assessing the needs of small businesses, and a piece by a British economist (yours truly!) on Brexit.

It is my belief that you will find these articles interesting and informative, with the insight and analysis that they provide. As always, I encourage you to look over the list of Seidman Faculty Experts provided on the last page and to contact those whose expertise may be of value to you, as our roller coaster ride continues!

A handwritten signature in dark ink, reading "G. Simons".

*Gerry Simons, Professor of Economics*

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# Grand Rapids Economic Forecast 2017

Paul Isely, Ph.D., Department of Economics, Seidman College of Business

- The Current Business Confidence Index for 2016 is 78.3%, a small improvement over last year.
- The Forecast Business Confidence Index for 2017 is 80.7%.
- Employment is expected to grow by 2.0%-2.2% in 2017.
- Overall nominal sales are expected to increase by 2.8%-3.2% for 2017.
- Export growth in 2017 is forecast for continued weakness; expected growth is between 1.6% and 3.6% during 2017.
- All indicators signal the 2017 economy continuing to grow, but the pace, particularly in employment, will be slower than seen in 2016.



## Introduction

The survey for the greater Grand Rapids economy (Kent, Ottawa, Muskegon, and Allegan counties) was conducted in November and December 2016. A survey was mailed to the CEOs and business leaders for just over 966 organizations based on a representative sample. We tried to ensure that the sample represented different sectors of the regional economy and the geographical diversity of the area. Eventually,

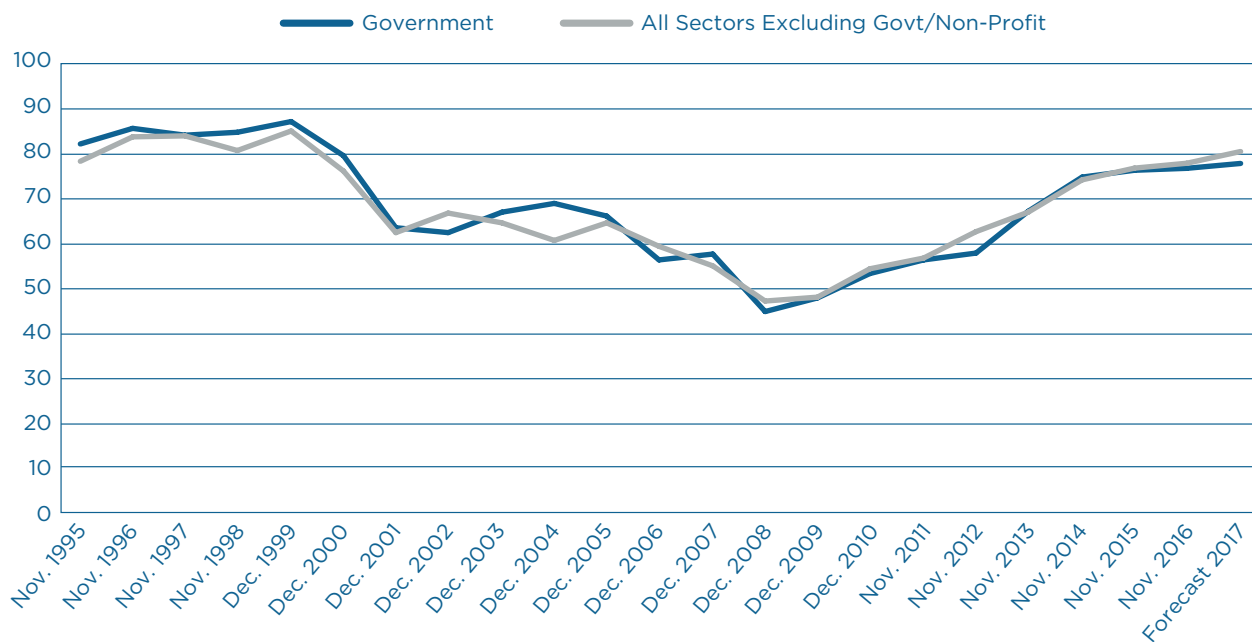
154 organizations responded, resulting in a response rate of 16%, which is a little lower than previous years, but still large enough to make inferences. However, due to possibility of a non-random response sample, the survey should be interpreted with caution. In addition, the survey was delayed two weeks this year to allow leaders more time to digest the results of the presidential election.

A few methodological considerations are in order. Although we discuss the survey results in terms of averages, the data are represented in a histogram format to show the entire distribution of responses. The employment, sales, and export numbers are more volatile as raw averages (when calculated without adjusting for outliers—responses beyond one standard deviation). Since the average of a small sample is significantly influenced by extreme numbers, we use the averages without the outliers to provide more reliable results. The histograms, however, depict all the available observations to show the broad picture.

## Confidence Index

The confidence index has been tracked by researchers at the Seidman College of Business since 1995. A continuing goal of the survey is to historically track the overall business confidence of the Grand Rapids area with a confidence index. The confidence index respondents use a scale from zero percent (no confidence at all) to one hundred percent (complete confidence). In response to the question: **How confident are you in the regional economy?** The average responses for the private sector and the government/non-profit sector over the last 21 years are shown in Figure 1.

Figure 1: West Michigan Confidence Index Forecast 2017



For the last three years, the respondents have underestimated the strength in the coming year. Last year, the private sector confidence index expected for 2016 was 77.6%, but by the end of 2016, survey respondents reported their current confidence at 78.6%, showing firms were positively surprised yet again, but barely. For 2017, private organizations expect an 81.2% confidence level. This brings the confidence index above 80 for the first time since the 1990s. Over the last three years, the confidence level has been basically flat; however, this year the expectation has noticeably improved. This is good news for continued growth in the West Michigan region.

## Employment

For 2016, employment for KOMA was projected to grow at an average of 2.6 – 3.0%. The numbers from the Current Employment Survey indicate that employment in the Grand Rapids area has grown by approximately 2.4% from November 2015 to November 2016 which is consistent with the slight overall estimation seen in the confidence index last year.

The respondents answer the following question: ***What percent change do you expect in employment for the four counties in 2017?***

Compared to 2016, the expectations on job growth have become more muted. The expected job growth has decreased by a third. This is primarily a drop in expectations of the most optimistic survey respondents with those expecting more than 3% growth dropping from 33% of the respondents in 2016 to less than 15% of respondents for 2017. For the first time in several years, the majority of firms see less than 2% job growth

for the coming year. This continues the moderation in job growth that began three years ago. Average employment in the KOMA region is expected to grow at 2.1% which is strongly below last year's expectations and last year's actual employment growth.

Although there is a slowdown in the expected growth in employment, the number of firms expecting to hire this year continues to increase and has reached 85% for 2017, up from 82% last year and 78% the year before. Of those persons being hired, about 75% are expected to be permanent workers, which shows firms' level of optimism for 2017, but it is still below the rate seen in 2015 when 80% of the hires were expected to be permanent.

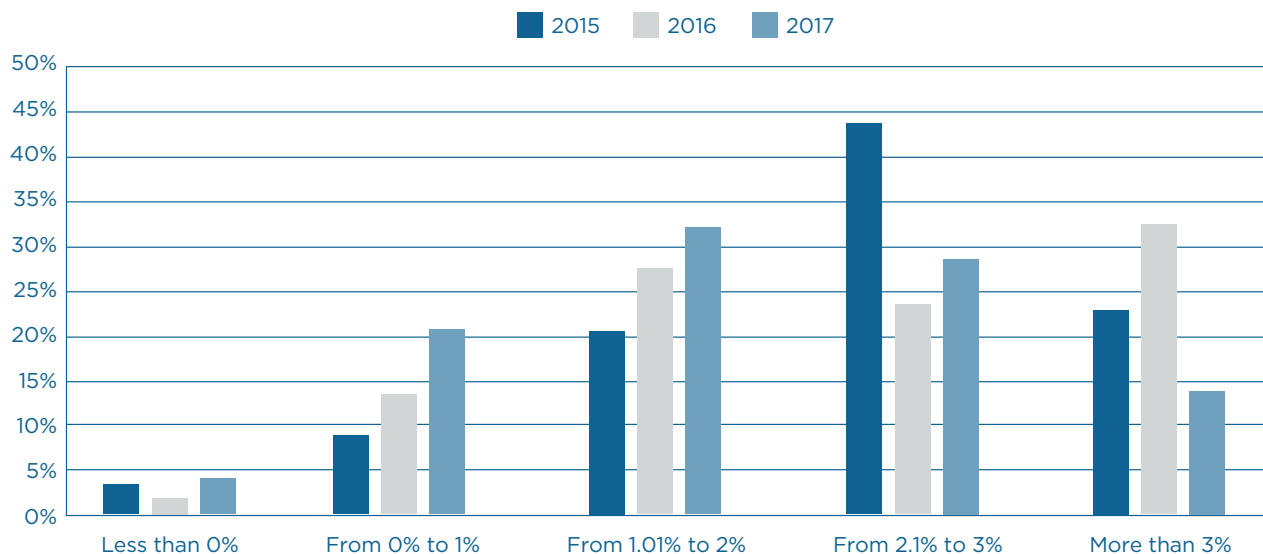
## Sales

For sales, the respondents answer the following question:

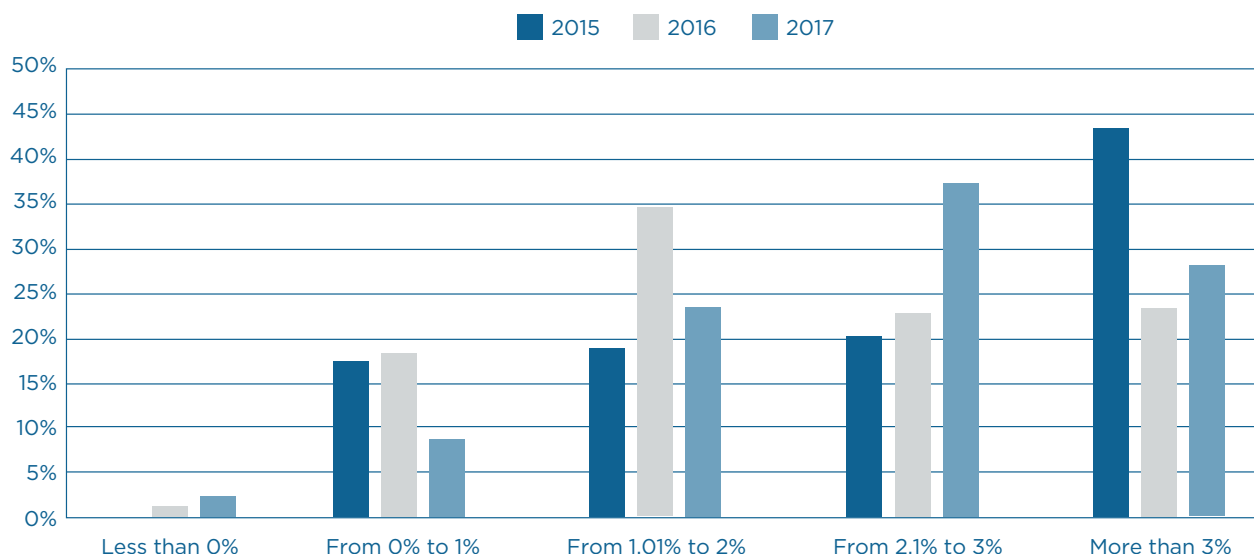
***What percent change in sales do you project for the four counties in 2016?***

During the late 1990s, sales grew at an annual rate of 5%. Last year 23% of respondents were expecting growth above 3%. For 2017, the percent of firms looking for sales growth above 3% has increased to 28%. More striking is the strong increase in firms expecting more than 2% growth, with the number jumping from 46% last year to 65% in 2017. The result is average expected sales growth increases from 2.5% last year to 3.0% in 2017. The increase could be because of an increase in prices and/or quantities. As inflation is expected to grow next year, much of the sales growth is likely a result of price increases, however, this number is strong enough to indicate increases in real output.

**Figure 2: Respondents' Anticipated Change in Employment for 2017 as Compared to Expectations in 2015 and 2016**



**Figure 3: Respondents' Anticipated Change in Sales for 2017 as Compared to Expectations in 2015 and 2016**

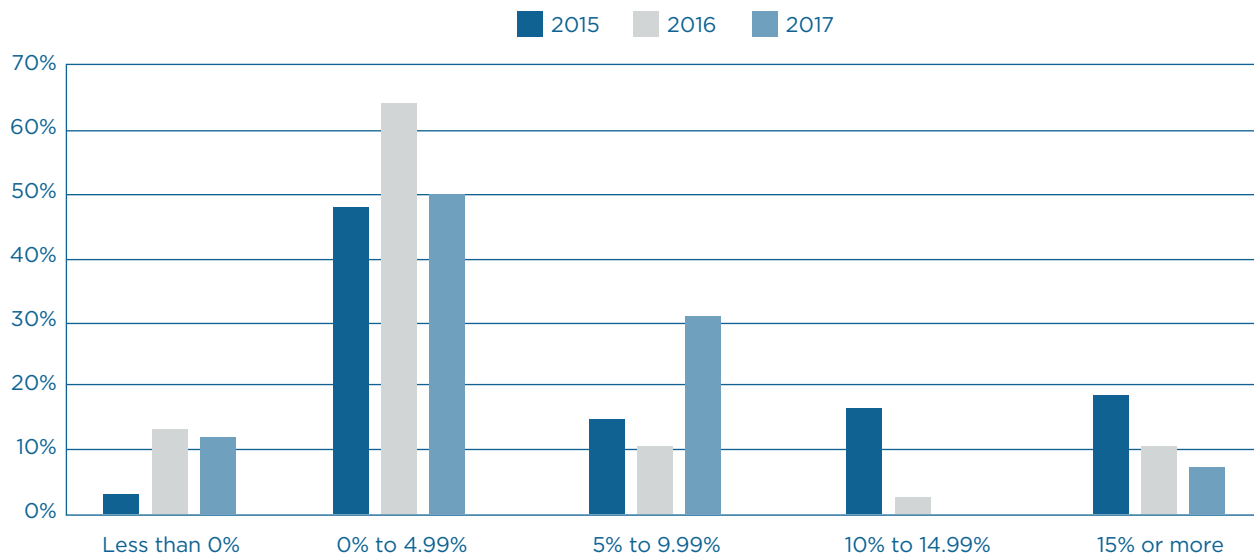


## Export Growth

Exports have traditionally been a bright spot in the West Michigan economy. This year, exports growth is expected to continue a slowdown started two years ago, with expected

growth dropping to 2.6% in 2017. This reflects the slowdown in the rest of the world and the strength of the dollar. However, the numbers appear to be stabilizing with slow growth where few expect large growth.

**Figure 4: Respondents' Anticipated Change in Exports for 2017 as Compared to Expectations in 2015 and 2016**



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## General Outlook

At the national level, expected growth indicated by the major economic surveys and the Federal Reserve (in December of 2016) will average between 2.2% and 2.5% for 2017. The economy will continue the slow growth seen recently. Nationwide employment will continue to improve in 2017. Full-time hiring will continue to increase, but not at the rate seen over the last year in West Michigan. In addition, tightness in the labor markets already are leading to increases in wages in almost all sectors.

At the regional level, the economy continues to improve slowly. Overall confidence is expected to remain above 80%. Employment will grow by approximately 2.1%. Nominal sales will increase by 3.0%. In spite of its volatility, exports have always been a bright spot, but this engine of growth is expected to continue the recent slowdown and grow at only 2.6%.

Public policy will generate major uncertainties for 2017. The incoming presidential team is looking to change many longstanding policies. These changes have both positive and negative potential, but it will take some time to understand what will get changed and how this will affect the economy. The biggest downside concern to economists is the anti-trade and anti-immigration rhetoric. The United States has benefited greatly from trade over the last 50 years by keeping costs down and increasing choices. Moving away from trade will likely generate more inflation. In addition, there are skilled labor shortages around the United States. The ability to increase production will be constrained if skilled labor cannot be imported. The unknowns surrounding the policies being proposed make it harder to plan for 2017 and 2018 which will likely slow the US economy in the short run until the effects can be understood.

Finally, with the projected growth in GDP, the US economy will likely cross potential GDP sometime in the next 18 months. Potential GDP is the maximum level of output that can be sustained for long periods of time. Historically, when this happens, a recession follows in two to three years. However, this will not affect 2017, so the US and West Michigan economies will end 2017 better than they started them.

## Acknowledgments

This study could not be completed without the assistance of the SBDC West Michigan Region staff. We are very grateful to all the organizations that participated in the survey. ■

# What Does Brexit Mean for West Michigan?

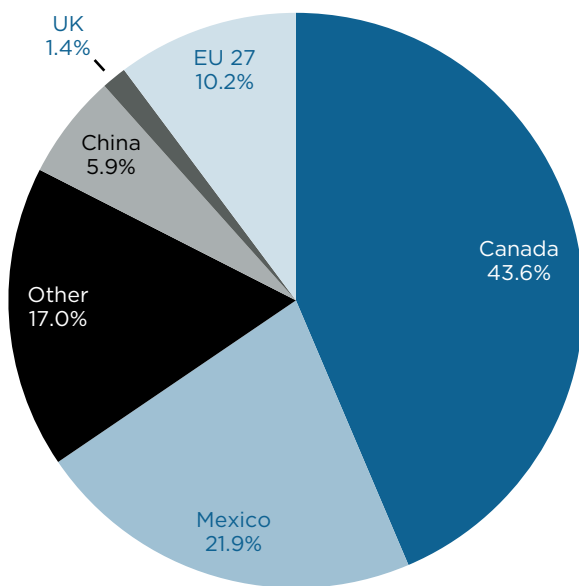
**Gerry Simons, Ph.D., Department of Economics  
Seidman College of Business**



On June 23, 2016, British voters passed a referendum 52-48% in favor of the United Kingdom (U.K. – England, Northern Ireland, Scotland, and Wales) leaving the European Union (E.U.). Although the referendum is not legally binding, the British government has announced that it will abide by the people's wishes and begin the process of "Brexit" – a British exit from the 28-country E.U.

As Figure 1 shows, about 1.4% of Michigan exports in 2015 were to the U.K. and another 10.2% to the remaining 27 E.U. nations, for a combined value of about \$6.3 billion. Comparable data for West Michigan are not available, but figures from the U.S. International Trade Administration indicate that around 23% of West Michigan's exports are to the E.U. as a whole. For the Grand Rapids-Wyoming Metropolitan Statistical Area, exports to the E.U. in 2015 amounted to about \$1.1 billion.

**Figure 1: Michigan Export Markets, 2015**



Source: International Trade Administration, U.S. Department of Commerce

Note, however, that the above data underestimate the full extent to which area companies sell products in the E.U., as these statistics only count the movement of goods from Michigan to Europe and do not include, for example, a West Michigan company's production of goods *within* Europe.

So, what does the Brexit vote and process mean for West Michigan? Here, I try to address some of the main areas of concern. Be aware, though, that no individual country has ever left the E.U., and that the interpretation of some of the laws governing the process are being questioned, with their outcomes still to be determined. I will also not cover everything – the U.K. and E.U. laws, regulations, and economies are so intertwined that disentangling them will be extremely complex.

## When will the U.K. actually leave the E.U.?

If you had asked me this a few months ago, I would have said, "Probably in March 2019." That is because British Prime Minister Theresa May has said that the U.K. will initiate the formal process for leaving the E.U. by the end of March 2017. At that point, the clock starts ticking – E.U. rules (Article 50 of the Treaty of the European Union) give the E.U. countries two years to negotiate the withdrawal agreement once the formal process has been initiated. However, in November 2016, the British High Court ruled that the Prime Minister cannot initiate the formal process without an act of Parliament. At the time of printing, this ruling hasn't been overturned by the British Supreme Court, and it is unclear if Theresa May will be able to start the formal process by her desired date.

Whenever the formal process is initiated, it is unlikely, though theoretically possible, that the negotiations will take less than two years. Nevertheless, the U.K. will be out of the E.U. once the two years are up, whether or not the countries have reached an agreement. (It is possible for the remaining 27 members of the E.U. to grant an extension to this two-year process, but that too is unlikely).

## What trading arrangements will the U.K. have with the U.S.A.?

As long as the U.K. is part of the E.U., it must abide by the E.U.'s trade policies with respect to the U.S.A. (and other non-E.U. countries). After Brexit, the U.K. and the U.S.A. would be free to negotiate a trade deal independently of the E.U.

The tricky part is that the E.U. says that its rules prohibit the U.K. from officially engaging in any trade negotiations until Brexit is complete. However, some constitutional specialists argue that E.U. law does not actually prohibit negotiations during the two-year withdrawal phase. If any agreements are negotiated prior to Brexit, they could then be signed into law as soon as the Brexit process is finalized.

All of this means that the U.S. and the U.K. could enter into a preferential trading arrangement. In light of the recent floundering of talks for the U.S.-E.U. Transatlantic Trade and Investment Partnership (TTIP), it is even conceivable that a trade deal with the U.K. is reached before an agreement is reached on the TTIP. However, this is all speculation. Although Australia and the U.K. have informally expressed an interest in a joint free trade agreement, no public statement has been made concerning a possible U.K.-U.S. trade deal.

## How will this affect business trips to the U.K.?

Until Brexit actually happens, nothing will change in this regard, and it is likely that things won't be any different than now for American business people even after Brexit – no visa requirement for business visits of up to six months for U.S. citizens. Once the U.K. leaves the E.U., it is free to change its rules regarding visa requirements. However, it is extremely unlikely that it will add restrictions for U.S. business visitors.

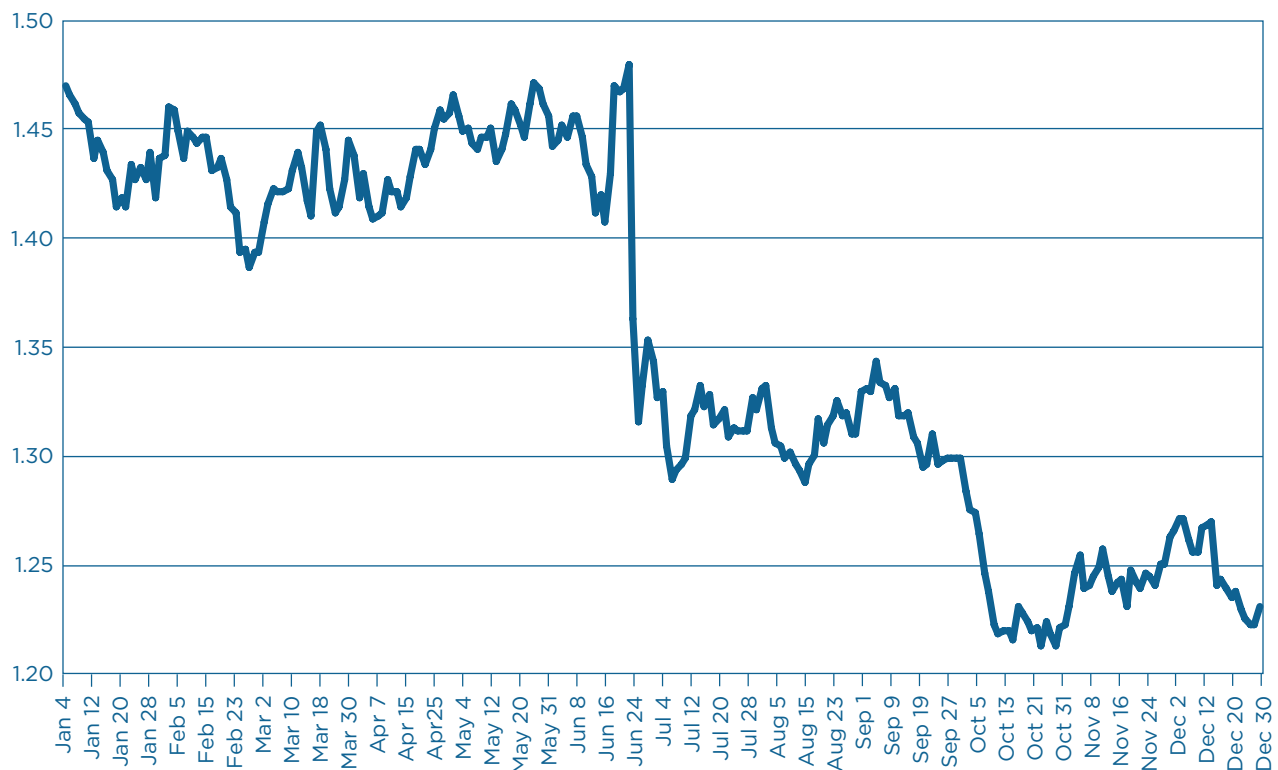
If your employees are citizens of E.U. countries who will be traveling in and out of the U.K., then they might face new restrictions on the duration of visits to the U.K. once Brexit is complete, as the U.K. will no longer have to abide by the E.U.'s "free movement of people" principle. Also, if your employees are British citizens, then they are likely to incur additional fees to visit Schengen Area countries. The U.K. is not part of this bloc, for which there are no border controls between the 26 E.U. and non-E.U. members. The E.U. is considering a program similar to the U.S.'s E.S.T.A. (Electronic System for Travel Authorization) for non-E.U./non-Schengen citizens who want to enter the Schengen Area. This would involve an online visa waiver application process as well as payment of a fee. If adopted, this would mean that a British

employee on a business trip to Germany, for example, faces no restriction while the U.K. remains part of the E.U., but would have to pay the fee and use the E.U.'s E.S.T.A. once Brexit is complete.

## What about exchange rates?

As Figure 2 shows, there was a tremendous drop in the value of the pound following the Brexit referendum on June 23rd. The pound fell by 10% against the U.S. dollar in the three trading days after the referendum. Subsequent concerns about the impact of Brexit and the uncertainty about the trading relationship between the U.K. and the E.U. post-Brexit have pushed the pound lower. The relative strength of the U.S. economy compared to the U.K. (and the impact on Federal Reserve and Bank of England policy) has also dampened the pound and strengthened the dollar, with the pound falling by about 17% against the dollar from the time of the referendum to the end of 2016. It is likely that the pound will remain below its pre-referendum levels for some time. This, of course, is bad news for American businesses – British products will have a competitive edge, sales of American products in Britain will be hurt, and the dollar value of the profits of American subsidiaries in the U.K. will also drop.

**Figure 2: 2016 Daily Exchange Rate: U.S. Dollars per British Pound**



Source: Bank of England

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## How will Brexit affect intra-European trade?

The U.K. will have the same business rules and regulations as the rest of the E.U. until Brexit actually takes place. Some fear, though, that once the U.K. leaves, it would be free to change regulations, including industry standards. An American business which is currently selling the same product across the E.U. might then face the problem and cost of having to satisfy different standards for selling to the U.K. However, the U.K. is a member of C.E.N – the European Committee for Standardization, which creates standards and specifications across 33 European nations. As it is not an E.U. organization, British entities will continue to be subject to C.E.N standards even after Brexit.

The problem is not a change in standards, but rather a change in the bureaucracy concerning the shipment of goods into and across the E.U. If you transport British-made products from the U.K. to France and from there through Germany and into Poland, you currently have relatively little bureaucracy to deal with. After Brexit, though, the bureaucracy could increase substantially, with added costs and delays at ports of entry. To get around the issue of border checks, Britain would need to have a Mutual Recognition Agreement on conformity assessment with the E.U. as well as an agreement on Customs cooperation. These might or might not be negotiated during the two-year withdrawal period.

You will likely face additional problems if your business involves the import or export of goods between Britain and the E.U. Britain's post-Brexit trading relationship with the E.U. will be part of the negotiations taking place during the two-year withdrawal phase. The best case scenario for the U.K. is that it will continue to have free trade with the E.U. (for example, by joining the European Free Trade Association). However, some E.U. leaders have threatened a “hard Brexit” – not agreeing to free trade with the U.K. In that case, the most likely (and worst case) scenario would be that the trade relationship would be as Most Favored Nations under World Trade Organization rules. So, for example, your business might then face tariffs on raw materials that you are buying from Germany for your production plant in England, or on finished goods that you manufacture in Scotland and sell in Italy.

## Speaking of Scotland, will it also leave the E.U.?

Yes, but... As part of the U.K., Scotland will leave the E.U. along with the rest of the country. However, there has been a growing push in Scotland for it to leave the U.K. and be an independent nation. In 2014, a referendum in Scotland resulted in a 55-45% vote to stay in the U.K. Ironically, one of the reasons for voting to stay was so as to not jeopardize E.U. membership. Of course, that is now changed with the Brexit referendum, in which the majority of Scots voted to remain in the E.U. In October 2016, the Scottish government published its plans for a second independence referendum. If it takes place, it would likely be held after Brexit. The independence vote has a greater likelihood of passing the second time around. If it does, it will lead to a whole host of other issues. How will a split from the rest of the U.K. actually happen? What would it involve? How long would it take? Would Scotland be able to get fast-track entry into the E.U. as an individual member, or would it have to go through the lengthy application process? There are just too many unknowns at this point.

## What's the bottom line?

The bottom line is that there is a lot of uncertainty about what a British exit from the E.U. will involve. But what we do know is that this is not just a “British problem” or even a “European problem.” Businesses in the U.S. must keep up with the changing landscape and evaluate and respond to the uncertainty as best as they can. ■

# Prescription Drug Prices Will Drive Health Insurance Premium Increases in 2017

**Jeff Rubleski, MBA, Director, Sales Strategy, Blue Cross Blue Shield of Michigan  
Adjunct Faculty Member, Seidman School of Business**



The top driver of rising health insurance premiums for 2017 is the cost of prescription drugs. Medical inflation for health insurance premiums is measured by a term referred to as “trend.” In 2017, the prescription drug trend is projected to be 11.6 percent, up from 11.3 percent in 2016<sup>1</sup>. The annual prescription drug trend is alarming, considering that it is almost a 7x multiple of general inflation in our economy, represented by the Consumer

Price Index (CPI).<sup>2</sup> Based on a host of factors, including individuals being treated at an increased rate for chronic conditions and diseases, aggressive pharmaceutical price increase policies for existing drugs and the introduction of new and very expensive drug therapies, it appears that annual drug price trend increases will continue at a pace that widely exceeds the CPI for years to come.

The single largest factor behind the year-over-year increase in prescription drug trend involves what are labeled as specialty drugs, which treat complex conditions such as cancer, hepatitis C, arthritis, multiple sclerosis, and a multitude of other chronic and debilitating medical conditions and diseases. Advances in complex genetic research over the past decade have served as the catalyst for the development of these drugs. Pharmaceutical companies collectively spend billions of dollars to develop specialty drugs that have a high risk of failure, as most specialty drugs do not pass stringent Food and Drug Administration (FDA) testing that is required before prescription drugs are approved to go to market. However, the relatively few specialty drugs that do pass FDA testing once introduced to consumers can produce “lottery ticket-like” revenues and profits for pharmaceutical companies. To put into context the cost impact of specialty drugs, consider that they account for less than 1 percent of all prescribed medications, yet they account for about 35 percent of total prescription drug cost trends for 2017!<sup>3</sup>

For pharmaceutical companies, the high risk and correspondingly high return nature of specialty drug development make them a top priority for market introduction. It appears that this trend will continue to accelerate in future years with scores of promising new specialty drugs in the pipelines of many pharmaceutical

companies. All of this translates into continued development of new specialty drugs that can treat and cure debilitating and even terminal conditions, yet at a cost that is increasingly becoming a financial burden for both consumers who use and pay more to acquire the medications and businesses that pay most of the cost of prescription drugs through company-sponsored health insurance programs. In a 2016 health care tracking poll, The Kaiser Family Foundation discovered that one in four people in the United States have trouble paying for their medication.<sup>4</sup> Expect affordability issues to increase in future years as businesses and consumers are forced to absorb the increasing cost of the ever-growing list of specialty drugs.

## Specialty Drugs—the “Silver Lining” for Consumers

Specialty drugs produce powerful life-enhancing and sometimes life-saving results for consumers who need them. They can deliver rates of cure from disease and long-term relief from chronic health conditions that just a decade ago would have been impossible to treat with traditional drug therapies. For example, hepatitis C is a terrible disease that afflicts an estimated 3.5 million Americans. In 2014, the Centers for Disease Control (CDC) documented 19,659 deaths from hepatitis C, making it the leading cause of death of Americans from infectious disease.<sup>5</sup> In 2013 and 2014 the specialty drugs Sovaldi and Harvoni received FDA approval as a cure for hepatitis C. These drugs provide a cure of hepatitis C for over 90 percent of the patients who receive treatment. But the cost of both drugs is staggering and out of financial reach for those who do not have some form of insurance coverage or external subsidy. The average cost for Harvoni is \$94,500 for a 12 week treatment program, resulting in a cost of over \$1,100 per pill! (Note that a 12 week treatment of Sovaldi is about \$84,000 or around \$1,000 per pill.)<sup>6</sup> These drugs are often combined with other drug therapies when treating hepatitis C, resulting in a total price tag that often exceeds \$100,000 to treat and cure hepatitis C.

Naturally health insurance premiums are directly impacted by rising prescription drug costs. Figure 1 shows the breakdown of key components that factor into the pricing of health insurance premiums.<sup>7</sup> Note that prescription drugs represent the largest component of the total premium expenditure for health insurance, accounting for 29% of total health insurance premiums.

Just a few years ago, prescription drug spending accounted for less than 20% of the total health insurance premium

<sup>1</sup> Segal 2017 Health Plan Cost Trend Survey, September 27, 2016, [www.segalco.com](http://www.segalco.com).

<sup>2</sup> Bureau of Labor Statistics, September 2016 CPI Detailed Report, [www.bls.gov](http://www.bls.gov).

<sup>3</sup> Segal 2017 Health Plan Cost Trend Survey, September 27, 2016, [www.segalco.com](http://www.segalco.com).

<sup>4</sup> Kaiser Family Foundation Health Tracking Poll, September 2016, [www.kff.org](http://www.kff.org).

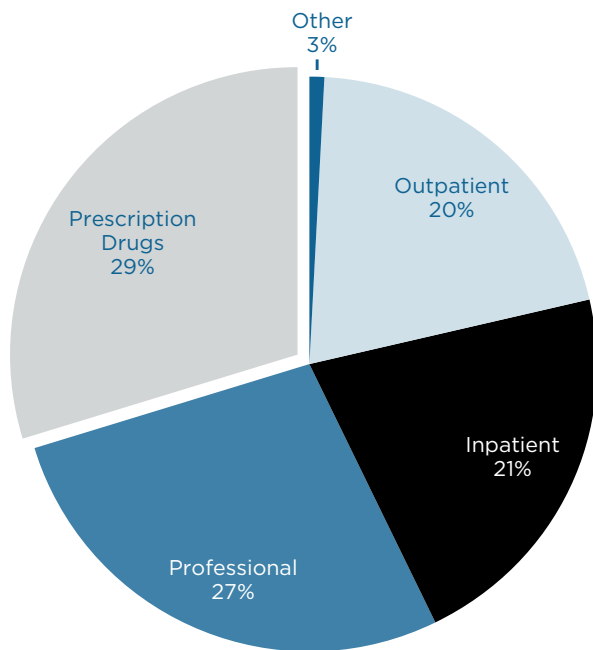
<sup>5</sup> Centers for Disease Control, Clinical Infectious Diseases online publication, May 4, 2016.

<sup>6</sup> Hepatitis C Society, 2016.

<sup>7</sup> Blue Cross Blue Shield of Michigan Book of Business Analysis 2015.

expenditure, so rapidly growing prescription drug spending is a concern for both employers who continue to pay for a majority of health insurance premiums and for employees, who likely are now paying much more in out-of-pocket expenses to obtain necessary pharmacy benefits than they did just a couple of years ago.

**Figure 1: Medical Service Costs As A Percentage of Total Health Insurance Premiums**



Source: Blue Cross Blue Shield of Michigan 2015 Book of Business Analysis

### Four Actionable Strategies for Controlling Rising Prescription Drug Costs

With drug costs continuing to rise, there are a number of strategies businesses can take to control cost and to encourage employees and their covered family members to utilize the lowest priced prescription drug therapy to treat a diagnosed condition. Here are four strategies to consider when managing the rising cost of prescription drugs:

1. Consider adopting or modifying any existing multi-tier prescription drug benefit. Insurance carriers and pharmacy benefit managers now offer a variety of prescription drug tiers in an effort to direct covered members to the lowest cost drug therapy. The most common multi-tier formats offer 4 to 6 tiers, with each tier representing a higher out-of-pocket drug cost for the member. Specialty drugs are represented in the last tier and carry the highest out-of-pocket cost. Be sure to understand the likely wide spectrum of multi-tier options available, including deductibles linked to prescription drug spending, fixed copayment, and coinsurance payments per drug tier. Making thoughtful adjustments to your pharmacy benefit can save significant premium dollars.
2. Educate employees on the cost of prescription drugs through targeted communications. With more employers introducing multi-tier prescription drug benefits that shift cost to members for higher tier drug use, it is important for your employees and their covered family members to understand why the sometimes confusing multi-tier approach is necessary and how they can lower their out-of-pocket costs by asking their health care provider to prescribe generics whenever possible. Your insurance company or pharmacy benefit manager should have a number of turn-key communications available to help you to communicate with employees and covered family members.
3. Work with a good health benefits agent or consultant to help you to navigate your prescription drug options and to recommend options that make the most sense for your organization. A good agent should present a number of viable prescription drug options for consideration and should also provide guidance on how to communicate coverage changes to employees and family members. Also seek the input of your current insurance carrier or current pharmacy benefit manager for their insight on what your organization can do to control rising costs while still providing a solid prescription drug benefit for your employees and their covered family members.
4. If your group is self insured or is experience rated for medical and prescription drug claims (typically if your group insures more than 50 employees, your plan will be experience rated), consider purchasing stop-loss coverage for prescription drug costs that exceed a designated level at the employee contract level (referred to as specific stop-loss coverage) and for the total amount of group pharmacy expenses (referred to as aggregate stop-loss coverage). For many companies, this extra form of risk reduction stop-loss coverage will be a good decision, as specialty pharmacy costs can exceed over \$100,000 for just one treatment regimen.

The cost of prescription drugs will continue to rise, and understanding the factors that are driving these ongoing increases will allow you to take proactive steps to keep pharmaceutical premium increases in line with your health insurance budget. The decisions you'll need to make are by no means easy, but will be necessary to keep health insurance a viable option for your organization. Commit to understanding the factors driving your organization's pharmacy drug costs and take advantage of plan design and strategies to keep the rising cost of your pharmacy benefits in check. ■

# Housing Market Trends in the Grand Rapids Area

**Laudo M. Ogura, Ph.D., Associate Professor of Economics**  
**Paul Isely, Ph.D., Professor of Economics**  
**Seidman College of Business**



Laudo M. Ogura



Paul Isely

Housing prices, sales, and construction activities continued to rise in 2016 as overall economic and credit market conditions in the U.S. have improved, with lower unemployment and lower mortgage delinquency rates (see Table 1). Due to the slow recovery of the global economy, interest rates are still very low, helping to fuel the housing market. In Michigan, the homeownership rate actually increased from 2014 to 2015, from 73.8% to 74.6%, while it continued to decrease in the nation as a whole. This reflects the faster recovery of the Michigan economy and housing market. In the Kent County area, the number of employed workers has steadily increased from 280,000 to 331,000 from 2009 to 2015, with the unemployment rate staying around 3% in the past 12 months.

**Table 1: Economic and Housing Market Conditions**

	2005	2015	2016	2015-2016 change
US unemployment rate (%)	5.1	5.3	4.60 (November)	- 0.7
Kent County unemployment rate (%)	5.8	3.6	3.20 (October)	- 0.4
30-year fixed mortgage rate (%)	5.9	3.9	3.80 (November)	- 0.1
Home mortgage delinquency rate* (%)	1.6	6.4	4.90 (3rd quarter)	- 1.5
S&P/Case-Shiller 20-city (Jan-2000 = 100)	190.3	179.8 (September)	189.0 (September)	+ 5.1%
Consumer Price Index CPI (Jan-2000 = 100)	113.4	140.8 (November)	143.10 (November)	+ 1.7%
New private housing starts (annual rate, in millions)	2.07	1.10	1.14 (3rd quarter)	+ 3.6%
NAR Existing Home Sales (annual rate, in millions)	N/A	5.23	5.38 (3rd quarter)	+ 2.8%
Michigan homeownership rate (%)	76.4	74.6	N/A	N/A

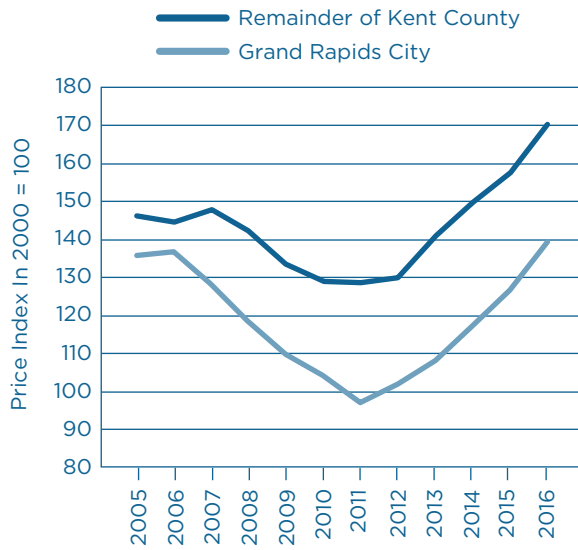
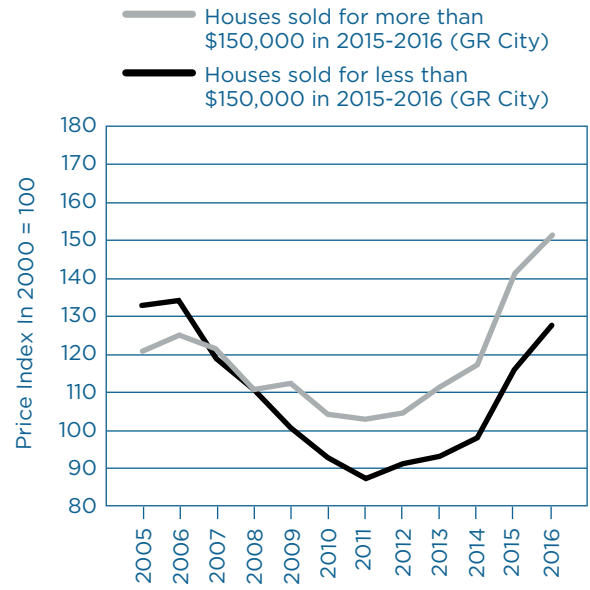
\* Single family residential mortgage delinquency rate in the top 100 banks.

Annual data are averages or total for the year. Non-annual data are seasonally adjusted, except for the unemployment rate in Kent County.

Source: Data was retrieved from the FRED Economic Data database provided by the Federal Reserve St. Louis.

In the Grand Rapids region, home prices also continued to rise. Figure 1 shows home price indexes (HPI) for the Grand Rapids city and the remainder of Kent County. These indexes were calculated using arms' length sales only, which better reflect market conditions for non-distressed properties. The estimation of these indexes is discussed in a technical note at the end of the article. Based on the Grand Rapids city's HPI, sale prices in 2016 were on average 12% higher than in 2015, reaching levels seen during the peak of the housing boom in 2006. This large price growth is a result of a rising demand not matched by growth in the number of homes for sale. During the first nine months of 2016, the Grand Rapids Association of Realtors recorded 3.7% more closed sales than in the same period in 2015 in their region of activity, while inventory-to-sales ratio

went down to an average of 1.6 months' supply during 2016 (the average in 2015 was 2.5 months' supply). As a result of this low supply, construction of new housing units has risen significantly in Grand Rapids in the last two years (see Table 2). For the remainder of Kent County, home prices had already recovered and surpassed the 2006-2007 peak levels earlier in 2014. In fact, home prices in richer communities did not drop much during the crisis, so prices are now at much higher levels than in 2000. On the other end of the market, lower and mid-income communities had home price trends similar to the Grand Rapids city. Even within Grand Rapids, high priced homes were less affected by the crisis, with prices rising fast in the past two years (see Figure 2).

**Figure 1: Housing Price Index****Figure 2: Housing Price index**

See Technical note at the end of the article for details. Source: Indexes computed using data from Kent County-MI.

**Table 2: Building Permits and Household Income**

Area	Building permits				Median household income
	2005	2014	2015	2016*	2014
Grand Rapids City	318	203	455	904	\$39,913
Kent County	2,941	1,711	1,838	N/A	\$52,713

\*Permits data until October 2016. Median household income comes from the American Community Survey 2010-2014 estimates. Source: US Census Bureau.

### Foreclosure Crisis

In recent years, mortgage foreclosures have heavily impacted many homeowners and neighborhoods in the region. Based on a recent study by the Community Research Institute at Grand Valley State University, we can identify the neighborhoods that had the highest rate of foreclosure activities. Table 3 shows the zip code areas with high foreclosures per 1,000 houses

in the Grand Rapids area. Neighborhoods in Grand Rapids city (49503 to 49508) and Wyoming city (49509, 49519, and 49548), characterized by lower income of residents compared to other places, were the most affected. While some states are still suffering with high foreclosure rates, Michigan foreclosure activities have subsided to pre-recession levels. Table 4 shows the decrease in foreclosures per month in Kent County in recent years.

**Table 3: Foreclosure Rates by Zip Code Area (2005-2015\*)**

Zip code	Foreclosures	Housing units	Foreclosures per 1000 houses
49507	2,403	13,750	174.8
49509	1,419	10,408	136.3
49504	1,776	17,516	101.4
49505	1,108	13,795	80.3
49548	988	12,565	78.6
49503	1,241	16,355	75.9
49506	865	12,710	68.1
49519	722	11,624	62.1
49508	906	16,243	55.8

\* Based on data available until June 2015. Foreclosures were measured as transfers to lenders.

Source: Housing units from American Community Survey 2010-2014. Foreclosures from Ogura, L. and Pyne, J. (2016), based on data from RealtyTrac.

**Table 4: Foreclosures per month in Kent County (2005-2015\*)**

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
33.9	71.7	124.3	186.5	202.7	192.0	155.8	149.6	90.2	59.3	54.3

\* Based on data available until June 2015. Foreclosures were measured as transfers to lenders.

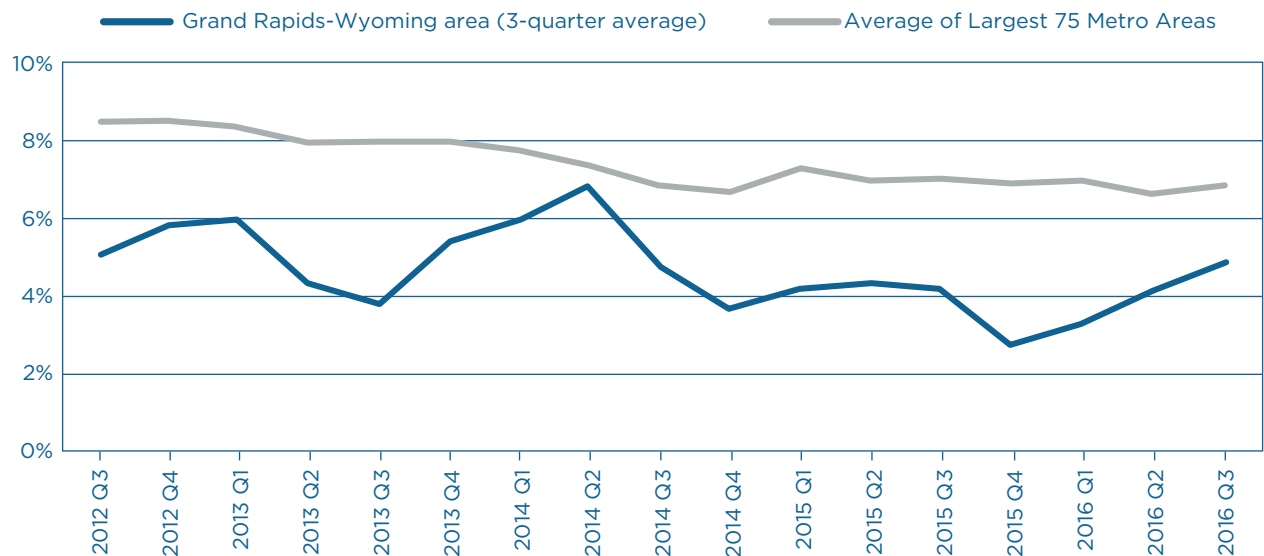
Source: Ogura, L. and Pyne, J. (2016), based on data from RealtyTrac.

## Rental market

The alternative to purchasing a house is renting. Therefore, the rental property market provides useful information in gauging home sales. Grand Rapids has seen substantial growth in multi-family housing units over the past two years, which is evidenced by the number of cranes in downtown Grand Rapids. If this market is overbuilt, then rental rates will drop relative to home prices, leading some people to rent instead of purchasing

a house. However, if the market is underbuilt, rental rates will rise. In the Grand Rapids region, the vacancy rate has been below the average of other regions over the past four years. There was an increase in the vacancy rate in the region from 3% to 5% during 2016 as new units opened, but this is still well below the 7% rate observed nationally (see Figure 3). Therefore, there should still be an upward pressure on rental prices in 2017, inducing greater demand for home purchases.

**Figure 3: Rental Vacancy Rates in the Grand Rapids-Wyoming Metro Area**



The counties included in the Grand Rapids metro area changed in 2015. Source: Data from U.S. Census Bureau.

## Conclusions

With the improved economic and housing market conditions in the region, demand for housing has continued to rise, especially in the mid-to-high end of the market. Supply of homes for sale has not responded accordingly yet, but increased construction activity should help to slow down the rise in home prices in the next few years. Mortgage rates are also expected to rise as the overall economy improves, which should also reduce the growth in housing demand.

## Technical note

The repeat-sale housing price index shown in Figure 1 is set at 100 in 2000, so it can be interpreted as the amount of money needed to buy a house for every \$100 that was needed to buy the same house in 2000. The index is computed by comparing sales prices of the same houses over time. The use of repeat-sales is a way to control for variation in quality across houses. Thus, the estimation does not include prices of houses that were not resold during the period analyzed and disregards the impact of renovation or deterioration of houses. Nonetheless, it is a widely accepted method to measure the average changes in prices in a broad housing market. Our indexes were computed using arms' length sales from 2000 to October 2016, with prices as low as \$10,000 and as high as \$1,000,000 to better reflect changes in the prices of typical homes in the market. ■

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# West Michigan Stocks Again Led the Way in 2016

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Once again stocks of West Michigan-headquartered publicly traded companies outperformed the major national stock market indexes. The West Michigan Index increased 18.6% in 2016, marking the seventh annual increase in the eight years since financial markets bottomed out in early 2009.

Table 1, Stock Market Returns, shows how the West Michigan Index has performed compared

with the major indexes over the past three years.

As shown in Table 2, the stock prices of eleven out of the fourteen companies comprising the Index increased, and most of the eleven rose more than the Index. How is that possible? It's because each company's importance to the Index is weighted by its total market capitalization, that is, the market value of all outstanding shares. The more shares a particular company has and/or the greater the number of shares, the more the influence its price change has on the Index. For example, Perrigo Corporation has nearly nine times the number of shares outstanding as does Mercantile Bank, making Perrigo's 43.2% price drop nine times as important as Mercantile's 53.6% rise. All by itself, Perrigo's price drop lowered the Index's gain by 4%.

**Table 1: Stock Market Returns<sup>1</sup>**

	2016	2015	2014	3-Year Cumulative
West Michigan Index	18.6%	- 6.5%	17.4%	30.2%
NASDAQ Composite Index	7.5	5.7	13.4	28.9
S&P 500 Index	9.5	- 0.7	11.4	21.1
Dow Jones Industrial Average	13.4	- 2.2	7.5	19.2

<sup>1</sup>The West Michigan Index consists of 14 publicly traded companies headquartered in West Michigan. Each company's return is weighted by its market value — the number of shares of common stock outstanding multiplied by the company's stock price. The index matches the weighting methodology used by both the S&P 500 Index and the NASDAQ Composite Index. The Dow Jones Industrial Average is price weighted.

**Table 2: West Michigan Company Returns**

	2016 Prices		2016 Price Change
	Closing	Opening	
SpartanNash Company	\$39.63	\$21.64	82.7%
Macatawa Bank Corporation	10.50	6.05	72.1
Mercantile Bank Corporation	37.78	24.54	53.6
Universal Forest Products, Inc.	103.82	68.37	49.5
Independent Bank Corporation	21.95	15.23	42.5
Wolverine Worldwide, Inc.	22.02	16.71	31.4
Stryker Corporation	120.52	92.94	28.9
Gentex Corporation	19.96	16.00	23.0
Steelcase Inc.	17.90	14.90	20.1
Herman Miller, Inc.	34.60	28.70	19.2
Community Shores Bank Corporation	2.30	2.18	5.5
ChoiceOne Financial Services, Inc.	23.75	23.80	- 0.2
Meritage Hospitality Group Inc.	11.30	11.25	- 0.9
Perrigo Corporation PLC	82.31	144.70	- 43.2

The 2016 performance of each of the companies in the Index is described below. Most of the discussion is based on year-to-date performances as reflected in quarterly earnings reports through the third quarter.

## SpartanNash Corporation

SpartanNash's stock was the top performer in 2016, rising nearly 83%. That follows a 17% price decrease in 2015. In fact, the company's price at the end of 2015 was its lowest year-end price in four years, suggesting there was unfounded investor pessimism late in 2015. The company's price held fairly steady at around \$30 per share for most of the year, but jumped up nearly \$10 after the presidential election.

The company owns 159 supermarkets across 47 states, Europe, and several countries. Supermarket banners include Family Fare Supermarkets, Family Fresh Markets, D&W Fresh Market, Econo Foods, and SunMart. The company also is the leading distributor of grocery products to military commissaries in the US, and operates as a grocery distributor.

## The Banks – ChoiceOne, Community Shores, Independent Bank, Macatawa Bank, and Mercantile Bank

In general, 2016 was a very good year for banks across the US, and that certainly includes West Michigan banks. Many investors believe rising interest rates are good for bank earnings. The rationale is that banks raise their loan interest rates more quickly than the rates on their deposits which fund those loans. Although many economists disagree with that rationale, as long as investors continue to believe it's true, bank stocks will rise when interest rates rise. The Federal Reserve raised rates in December and suggested it would do so as many as three more times in 2017.

Perhaps more important than rising interest rates is the belief that President-elect Donald Trump will stimulate the economy with tax cuts, infrastructure spending, and with other business-friendly policies. If so, bank loan demand will increase, leading to higher bank profits. Bank stock prices shot up after it became clear that Trump would be the next president. Here's a look at West Michigan bank stock performance:

### ChoiceOne Financial Services, Inc.

Sparta-based ChoiceOne's stock barely changed during 2016, falling 0.2%. Its revenue and earnings per share have been stuck in a rut for two years, and compared with its peer banks, its performance metrics are about average. The good news is the company opened a loan office in downtown Grand Rapids during the summer, and indications are that it will contribute significantly to ChoiceOne's future profitability.

ChoiceOne has 3.3 million shares of stock outstanding, the least of any of the fourteen companies in the West Michigan Index and about one-hundredth of the number of Stryker shares. Its influence on the Index is small.

### Community Shores Bank Corporation

The year began with some good news. The Bank learned that both the FDIC and Michigan's Department of Insurance and Financial Services terminated the Consent Order which had been effect for five years. That action reflected the bank's stronger financial position after it raised \$5 million

from a stock offering and used \$3.7 million of it to increase bank capital. The Bank's regulatory expenses will decrease now that the Order has been lifted.

Its stock rose 5.5% in 2016 on top the previous year's 45% gain. While that sounds good, you need only look at these 2016 end of year price-earnings ratios of West Michigan banks to recognize a potential problem:

ChoiceOne.....	14.6
Mercantile Bank .....	20.4
Independent Bank .....	21.2
Macatawa Bank.....	22.9
Community Shores.....	121.1

Community Shore's stock price is way too high relative to its earnings – about six times too high -- and as such, represents considerable risk to its owners, and suggests owners are extremely optimistic about the bank's future. While the bank has come a long way since its 2010 problems, it still struggles to consistently earn a profit from quarter to quarter.

Community Shores Bank Corp. serves the Muskegon and Norton Shores area.

### Independent Bank Corporation

Ionia-based Independent Bank Corporation's stock price held nearly steady at \$15 per share during the first half of 2016, then jumped to around \$16.75 during the third quarter. The Trump effect drove the price to nearly \$22 by the end of the year, making for a 42.5% annual increase. Earnings increased sharply in the second quarter, and near the end of the third quarter, two events added to the Bank's stock price: a 25% increase in the dividend in October (following a 33% increase a year earlier) and the Trump effect. Overall, a great year for Independent Bank.

### Macatawa Bank Corporation

Stock of the Holland-headquartered bank rose nearly 74% in 2016. The rise continued throughout the year, but as with most banks, accelerated after the election. Investors found plenty to like about Macatawa's performance. Through the first nine months of 2016, revenue, loan growth, and capital strength all increased while non-interest expenses stayed the same. Investor optimism remains high.

### Mercantile Bank Corporation

Grand Rapids-based Mercantile Bank also had a great 2016. Its stock price began the year at \$24 per share, began increasing in June, reaching almost \$28 in early November, and then added \$10 more per share due to the Trump effect and great third quarter earnings. Third quarter consensus income was \$30.7 million, but the Bank reported \$35 million, a nice surprise. Overall, the stock price rose nearly 54% during the year.

## Universal Forest Products, Inc.

UFPI is a well-run company in the right place at the right time. Its sales, earnings, and stock price have boomed over the past two years, rising almost 50% in 2016 following a 28.5% gain in 2015. The company continued its long-term trend of acquiring other firms in the industry during 2016, adding customers and new products. It also is benefiting from

continued strengthening in demand in the US construction industry. Stock analysts are optimistic these factors will carry over into 2017. Compared with the company's major competitors, UFPI's stock trades at a lower price/earnings ratio. That's another indication the company's stock price may increase further.

Those of you who have followed UFPI's performance over the years likely remember when its stock price was stuck around \$6 per share. That was in the mid-1990s. At the closing 2016 price, that represents a 17-fold increase and a compound annual rate of return of around 14%.

Universal designs, manufactures, and markets wood and wood-alternative products to retail, construction, and industrial customers.

### **Wolverine Worldwide, Inc.**

Rockford-based Wolverine-Worldwide is a world leader in designing, manufacturing, and marketing of branded casual, active lifestyle, work, outdoor sport, athletic, children's, and uniform footwear and apparel. Its stock price increased 31.4% in 2016 representing a nice rebound from 2015's more than 43% decline.

Wolverine's third quarter sales fell 11% as analysts expected, but the announcement combined with the September stock market swoon knocked down Wolverine's stock price by 12%, and the lower price held throughout the remainder of the year. Investors in WWW should be aware of the company's high exposure to fluctuations in the strength of the US dollar. When the dollar is high, as it is now, Wolverine's products cost more to customers outside the US, and the company's sales and profits suffer. The strong dollar reduced third quarter earnings by 18 cents, or by about 12%.

Optimism among Wolverine's executives is high for 2017 and 2018. The company is making progress with a major multi-year initiative to diversify its manufacturing base, lower production costs, close brick and mortar stores while expanding e-commerce, divest non-performing brands, and implement a more flexible debt structure. These actions will increase profitability. Executives describe Wolverine's 2016 progress toward achieving these goals as "tremendous."

### **Stryker Corporation**

At the beginning of 2016, the focus was on the decrease in Stryker's price-earnings ratio from 57 at the beginning of 2015 to 30 at the beginning of 2016, even though the company's price remained nearly unchanged. Earnings had increased substantially, but the stock price hadn't. That reflected reduced investor optimism about Stryker's future. In a way, that trend continued in 2016. While the company's stock price rose 28.9%, the P/E ratio fell to 27.3. To put this in perspective, had the 57 P/E ratio from 2015 held, Stryker's price today would be well over \$200 per share.

Perhaps the 57 value was too high, but the 27.3 P/E seems too low. Through the first nine months of 2016, sales were up 13% while net earnings were up 25%. Reflecting its strong growth, Stryker increased its dividend 12% in December. Most analysts expect double digit revenue and earnings growth to continue. Stryker is known for its product innovations,

strategic acquisitions, strong sales force, and diversified revenue base. Further, if changes to Obamacare eliminate the 3.8%-of-sales medical device tax – a proposition for which there is considerable support on Capitol Hill – Stryker will be a major beneficiary.

### **Gentex Corporation**

The stock of Zeeland-based Gentex closed the year at nearly \$20, a price representing a 23% increase in 2016. Long-time investors in Gentex remember when the price peaked at \$37 a little more than two years ago, but that was before a 100% stock dividend in December 2014, reducing the effective price to \$18.50. In fact, the stock is now at an all-time record high price. That's attributable to the auto industry's record vehicle sales and further auto industry adoption of Gentex's main products – automatic-dimming rearview mirrors and other automotive industry electronics.

The company's stock rose throughout 2016. Sales rose about 10% through the year's first three quarters, but the pace of earnings increases accelerated in the third quarter: Net income increased 18% while earnings per share increased 19%. Company guidance for 2017 is for revenue to increase 6-10%.

### **Herman Miller, Inc. and Steelcase Inc.**

Herman Miller's stock had an up and down year, but ended the year rising \$5.60 due to the Trump effect. That gain was just about equivalent to the company's entire 19.2% stock increase for the year. The same can be said for Steelcase: an up and down year followed by a sharp increase after the election.

Both companies began the year expecting to perform better than they did in 2015. The optimism didn't last long. Both companies disappointed investors when they failed to meet analysts' earnings expectations in the second half of 2016. They blamed lower than expected North American demand and uncertain geopolitical risks. A strong US dollar also took its toll on foreign sales.

Steelcase is a case in point for a lesson in investing: Never invest in an IPO. Sure, now and then someone makes a fortune, but that's not typical. Most individuals who manage to buy IPO shares wish they hadn't. With Steelcase, the company's price on the day of its 1998 IPO was \$36.30. Six months later it had fallen to under \$20 per share, and has varied between \$10 and \$20 in the 18 years since. Here's the lesson: Wait at least six months after an IPO before buying shares of the company. Shares will more accurately reflect the fair price, not the price trumped up by accounting manipulations made in preparation for the IPO and investor over-confidence.

### **Meritage Hospitality Group Inc.**

Meritage Hospitality Group's stock fell slightly in 2016 after outperforming all other West Michigan companies in the Index in 2015, when it rose 115%. The company, headquartered in northeast Grand Rapids, operates 183 quick service and casual restaurants in eight states and has approximately 330 full-time employees and 6,300 total employees. Meritage recently announced a new five-year plan covering years 2017 through 2021 including continued high growth in revenue and sales, renovations of existing restaurants, and continued acquisition of new restaurants. Over the past five years the

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company's stock price more than quadrupled, and the number of restaurants doubled. The company's net income plateaued in 2016, but perhaps offsetting the lack of good news about earnings, the company increased its dividend from three cents semi-annually to two cents each quarter, a 33.3% increase. It should be noted that seven officers and directors own almost 88% of Meritage's stock. Such concentration of ownership usually is a red flag for potential investors.

### **Perrigo Company PLC**

2016 was a most memorable year for Perrigo. Problems for the country's leading manufacturer and seller of over the counter healthcare products and generic prescription drugs began in April 2015 when Mylan N.V. made an unsolicited tender offer bid to acquire Perrigo for \$204 per share. Perrigo's price quickly rose to near the bid price, but the company fought the bid, spending over \$100 million fighting the tender offer, successfully convinced enough shareholders to reject the bid, and caused Mylan to withdraw its offer. Perrigo promised shareholders dramatic increases in both earnings and the stock price if they rejected the offer. That was in November 2015, and by then, Perrigo's price had dropped more than \$50 per share to \$146. On January 11 last year, the company increased its earning guidance for 2016.

A month later, the fourth quarter 2015 earnings report was released, showing record earnings, and a full-year 2016 earnings per share estimate of \$9.50 to \$9.80. Then things went south. Joseph Papa, who had served as CEO for ten years and was widely credited with Perrigo's incredible growth, abruptly left to become chairman and CEO of Valeant Pharmaceuticals. Further, earnings guidance for 2016 was lowered by 13%, and then lowered another 17% in August. Not only did 2016's third quarter have no earnings, but the company lost \$8.86 per share — not the dramatic increase investors had been promised.

Starboard Value LP and its affiliates — Perrigo's single largest stockholder with 4.6% of Perrigo's shares — accused Perrigo of mismanagement and asked company executives what their plans are to turn around the company's fortunes. And the price is now down to \$82. Only time will tell. ■

# Michigan Companies Growing Exports Through Foreign-Trade Zones

**Sonja Johnson, B.S., Executive Director  
Van Andel Global Trade Center**



The ever-changing global marketplace brings both potential increases in competition and provides many additional opportunities for Michigan businesses looking to diversify and tap into the over 95 percent of global consumers who reside outside U.S. borders.

In 2015, Michigan exports totaled nearly \$54 million and imports totaled approximately \$124 million.

In a state so actively involved in foreign trade, it is important for businesses to take a look at where the best opportunities lie, including utilizing the programs available to help them stay competitive in global markets.

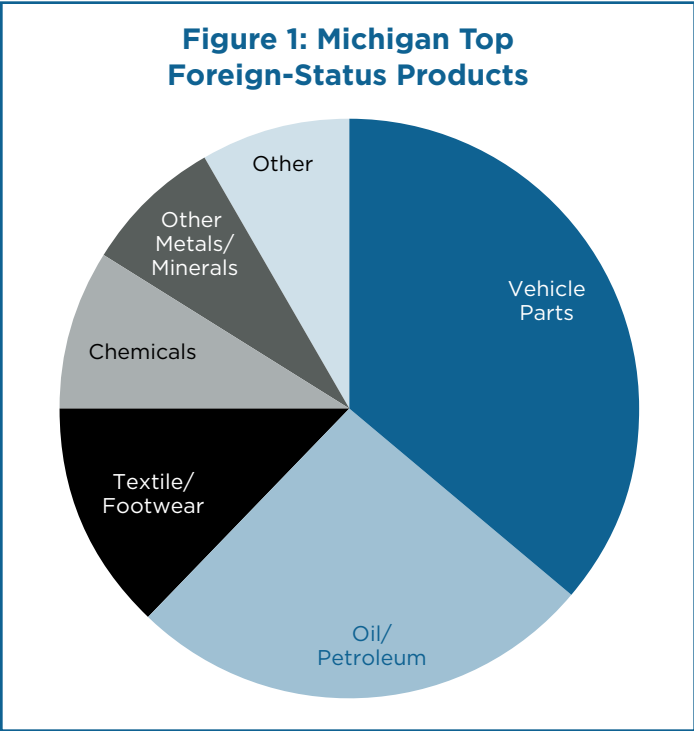
A valuable tool available to Michigan businesses is the U.S. Foreign-Trade Zone (FTZ) program. Michigan is fortunate to have seven zones located across the state, one of which is located at the Seidman College of Business's Van Andel Global Trade Center (VAGTC).

The Center has been supporting the Kent-Ottawa-Muskegon Foreign-Trade Zone since 1999 through a public-private partnership capitalizing on the unique services available through the trade center at Grand Valley State University.

FTZ	GRANTEE
FTZ 16, Sault Ste. Marie	Economic Development Corp. of Sault Ste. Marie
FTZ 43, Battle Creek	City of Battle Creek
FTZ 70, Detroit	Greater Detroit Foreign-Trade Zone, Inc.
FTZ 140, Flint	City of Flint
<b>FTZ 189, Kent/Ottawa/Muskegon Counties</b>	<b>KOM Foreign Trade Zone Authority</b>
FTZ 210, St. Clair County	Economic Development Alliance of St. Clair County
FTZ 275, Lansing	Capital Region Airport Authority

## What Is A Foreign-Trade Zone?

A foreign-trade zone is a designated location in the United States where companies can use special procedures that help encourage U.S. value-added activity with domestic and foreign inputs. Zones are considered outside the customs territory of the United States for the purposes of duty payment. See Figure 1.



## Benefits of using an FTZ include:

- Defer duties until the merchandise leaves the FTZ and enters U.S. for consumption
- Store, distribute, manufacture, repackage and exhibit products without paying duty
- Inspect imported products for quality
- Combine foreign merchandise with domestic products and materials to create a new product which may then qualify for lower duties when exiting the zone to the U.S. marketplace
- Duty avoidance if merchandise is exported out of the zone to a foreign destination
- Zone-to-Zone transfers allow for movement of products closer to final customer without payment of duty until leaving the last zone
- Potential reduction in merchandise processing fees

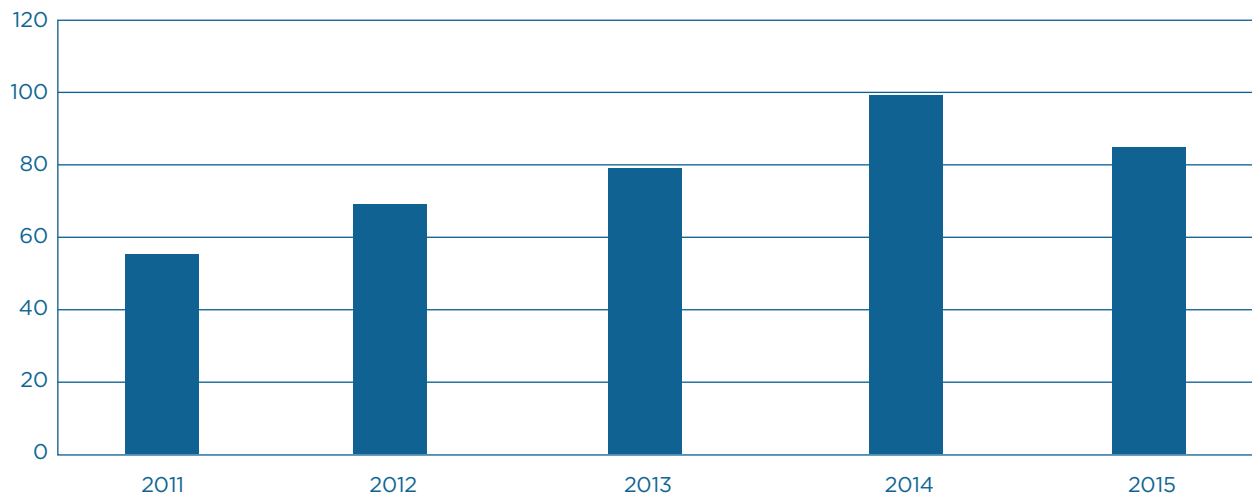
## 2015 U.S. Foreign-Trade Zone Report Data

- During calendar year 2015 according to the 77th annual U.S. FTZ Board Report to Congress, exports of goods through the zone program totaled USD 84 billion.
- There were 186 active Foreign-Trade zones during 2015, with a total of 324 active production zone operations.
- 65 percent of the goods received by the program through a production zone were valued at USD 431 billion.
- Zone warehouse/distribution of merchandise through the program totaled nearly USD 228 billion. (Any goods not exported from a U.S. zone are either consumed in production or come into the U.S. market after completion of the value-added activity often reducing the amount of duty which has to be paid.)

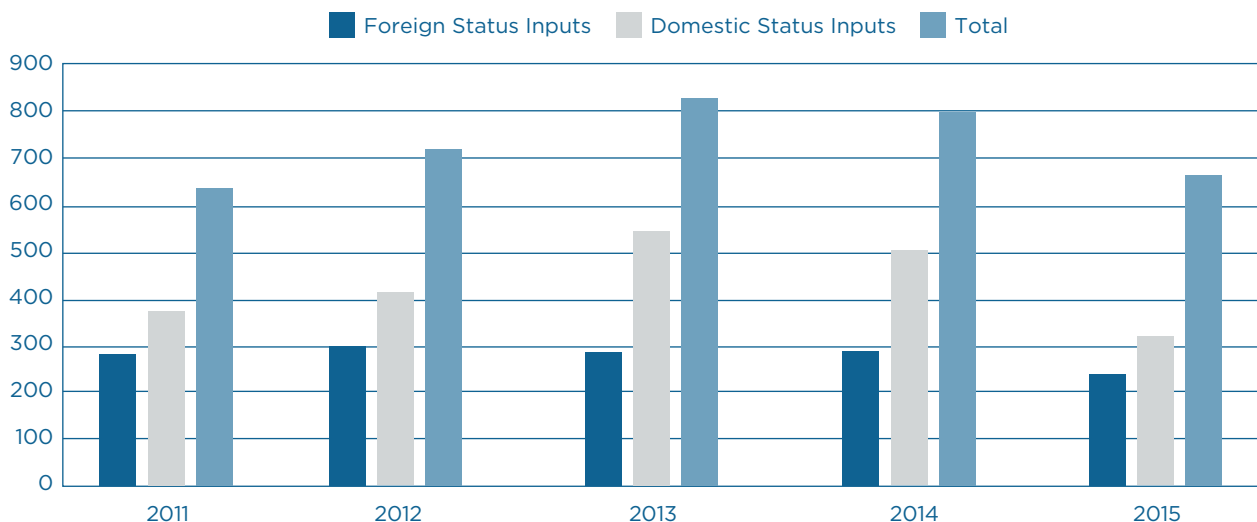
Foreign-Trade Zones are one of the many beneficial resources available to Michigan businesses looking to expand their operations into international markets. If you're interested in learning more about the FTZ program or want to speak to a current user, contacting Van Andel Global Trade Center is a good place to start.

Van Andel Global Trade Center (VAGTC) is located within the Seidman College of Business on the Pew Campus of Grand Valley State University. VAGTC has impacted over 22,000 business professionals through its research, educational training, and consulting supporting more than 7,400 Michigan businesses to expand in the global marketplace! Contact VAGTC to see how they can assist with your imports and exports and get you connected to resources to grow globally. ■

**Figure 2: FTZ Exports (In Billions)**



**Figure 3: FTZ Merchandize Received (In Billions)**



# West Michigan - Grand Rapids Economic and Commercial Real Estate Forecast

**Jeff Hainer, Research Analyst**  
**Colliers International, West Michigan**



## Industrial

*With an industrial market near capacity, building new seems to be the logical next step. However, high new construction costs and more efficient operations are resulting in many companies making do with what they have or paying a premium for additional space.*

Historically, West Michigan has not been a market where developers build large amounts of speculative space. It has been

one, however, where companies move around the market, nestle into pockets that fit their needs, and expand on existing buildings when necessary. Generally, growth is fairly conservative. But now that market vacancy is down near five percent, moving around in existing inventory has become difficult. This has fueled more creativity in non-listed properties as well as new build-to-suit projects.

At the beginning of 2016, as many industries continued showing strength, we predicted land sales to increase in anticipation of an expanding market. The 140-acre Jamestown Commerce Center, the 92-acre Site 36, and the 250-acre Walker Ridge development were sites we were eager to keep an eye on for industrial activity due to their accessibility and infrastructure. However, many tenants have been hesitant to be first in, and developers have waited for tenants to sign pre-construction leases rather than building speculatively. In 2017, we look for all three sites to gain momentum.

Some hesitation has come from high construction costs and long lead times for completion due to building company constraints. Those looking for new space are usually in need of it immediately, and waiting 12-18 months for a new building is often less than ideal.

Those who have planned, started or finished new construction in 2016 include Lacks Industries, Gourmet International, Laminin, Kent Quality Foods, RT Baldwin, Tesa Tape, FedEx, Viking Products, Laserone and ETO Magnetic to name just a few. At year-end, we were tracking 26 construction projects totaling more than two million square feet. However, this represents less than two percent of the current market inventory.

The Grand Rapids economy has largely rebounded from the recession, with annual Gross Metropolitan Product now nearly 30 percent higher than it was in 2010. Industrial rental rates are consequently 23 percent higher as well. In addition, approximately 100,000 jobs have been added to the workforce over that period of time, back to a level greater than what we saw before the downturn. Much of that employment and production has come from the manufacturing sector. Twenty years ago,

manufacturing employment made up more than 25 percent of the Grand Rapids economy, however, an economy that relies so heavily on one sector is more susceptible to feel fluctuations in the economy, so during the recession the region lost a lot of its strength – creating a large hole to dig itself out of.

This is precisely what we have been doing for the past six years. Manufacturing job growth has been positive at a rate of roughly 34 percent annually, and as industrial production has built back up, more than half a million square feet of industrial space has been absorbed. Over that time, transaction velocity has also remained strong. However, heading into 2017 we are largely out of room for companies to grow into. As mentioned, construction is occurring, but is expensive and only done out of complete necessity; transaction activity has slowed two years in a row; rental rates are strong, but for the most part plateauing; and the Purchasing Managers Index shows the industry is still growing, but at a slowing pace. So what does this mean going forward? Does this mean we are at the end of an expansion phase, that we are done recovering? Or are we so pent-up that something will inevitably have to give?

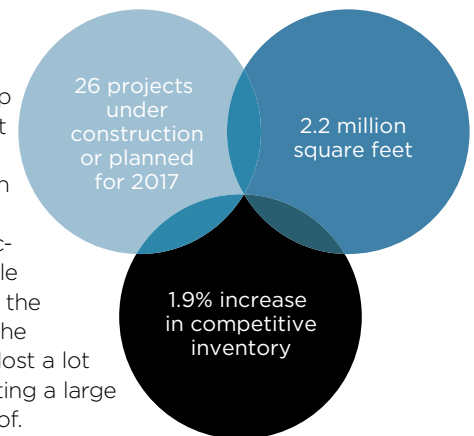
Well, the answer isn't so simple. Industrial users have adapted and the way they utilize space has changed. It is possible that we can both continue to see positive production and industry growth without an equal increase in space demand. Automation is creating efficiencies that allow companies to produce in less space with better quality and fewer people.

The small amount of spec construction that is taking place is designed based on flexibility and efficiency. Both 5300 Broadmoor Avenue SE and 3833 Soundtech Court SE were built with this in mind and saw leasing activity in 2016, despite above market rental rates. Companies are coming to grips with the fact that in order to position themselves in space for the future, it will cost them more than it does currently.

Local economic development organization, The Right Place, is reporting record amounts of capital investment, but the investment is largely in equipment, not personnel. This is causing management and technical positions to gain value, yet entry level jobs are seeing wage stagnation, making it much harder to attract the new wave of workforce. Many industrial businesses who are hiring are complaining about a drained talent pool as a result.

To fill the talent pipeline, new education programs are being developed to teach youth about the benefits of a career in manufacturing. Schools are also making professionals available

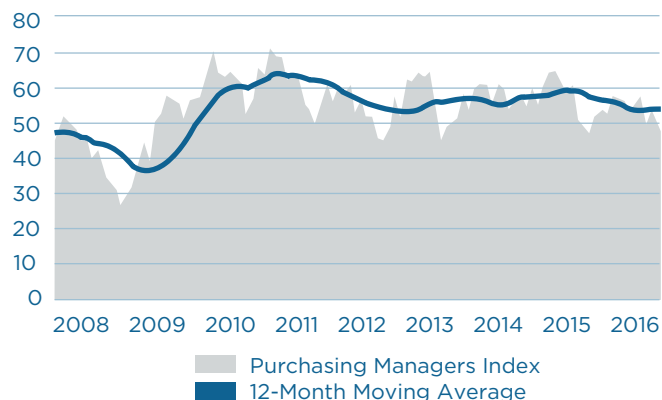
## Industrial Construction Kent & Ottawa Counties



to answer questions and share successful career stories of the past. West Michigan is a community in which much pride is taken from the products we produce, so in order to allow companies who are wanting to expand the ability to do so, this issue will need to be continually addressed in 2017.

Many questions remain for 2017 across the entire regional and national economy, but balancing a new paradigm of how companies operate with an aging workforce and depleted employee pipeline will be key to sustaining the growth we have seen over the past half-decade.

**Figure 1: Purchasing Managers Index (PMI)**



The PMI is an indicator of the economic health of the manufacturing sector. It is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. An index reading above 50 indicates positive growth.

### Investment

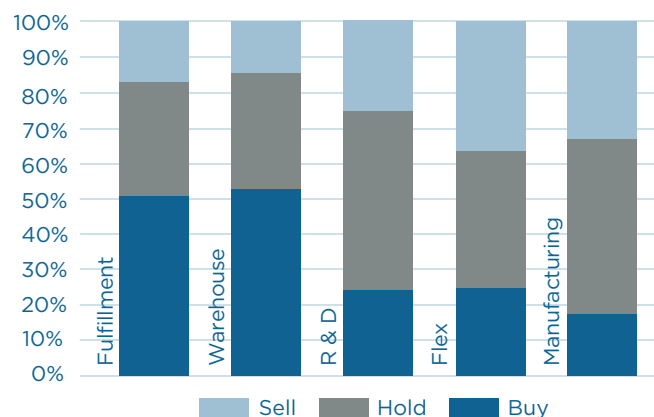
Industrial property has been a favored sector for investors and developers in West Michigan and, according to The Urban Land Institute's 2017 Emerging Trends in Real Estate survey, it is again the favored sector heading into 2017. This is largely due to being lower risk relative to the other property sectors.

In 2016, West Michigan saw a large industrial portfolio change hands when the 1.1-million-square-foot Crosslake Portfolio was sold to an out-of-state investor. Previous owners had purchased the six-building portfolio in 2013 with various short term and rolling leases resulting in about 70 percent occupancy. This created an opportunity to add value. Sellers spent time and money to stabilize the asset, bringing it to 95 percent occupancy, and sold it this past September. This was the largest transaction of the year in the region and represented a 9.46 percent cap rate.

This year we saw a 10.7 percent difference between average listed for-sale price and final transaction price in our market, 190 basis points less than in 2015.

Going forward, we see investment opportunities still available in the industrial market. Smaller R&D/Flex space recovered slower from the downturn, so cap rates still remain inflated. Additionally, some opportunities exist to repurpose functionally obsolete buildings, as submarket vacancies rates across the region are at historical lows and users are hungry for space and are willing to be creative.

**Figure 2: Sell/Hold/Buy Industrial Investment Recommendations**



Source: Emerging Trends in Real Estate 2017 Survey (based on U.S. respondents only)

### Office

*Office buildings offering amenities, quality design elements, and parking are having little trouble attracting tenants at premium rates. Outdated and neglected buildings, however, are struggling to keep up.*

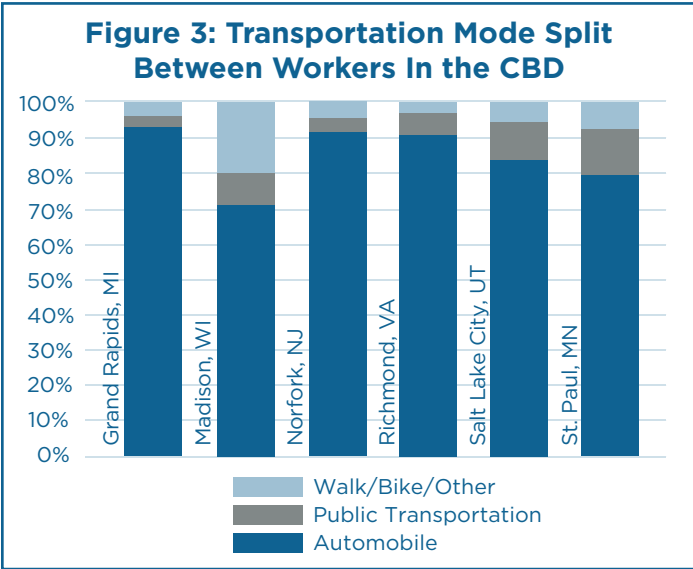
### Downtown

At the beginning of last year, one of the biggest questions we posed looking forward was how the region would start to measure up against major markets given the trajectory we were on. Was our weathering of the recession and subsequent growth a nice local story, or was Grand Rapids really on its way to the national conversation? After years of being one of the stronger performers in the low-to-middle market categories, we wondered how we would compare when stacked up next to the likes of Chicago, Detroit, and Atlanta.

To find the answer, we had to look past the differences in physical size. Throughout the past year we tracked and reported on a number of indicators such as new construction starts, transaction velocity, vacancy, list/sale price differential, and investment cap rates – and compared them to trends we saw in major cities. By most accounts, the office sector has shown us that despite our smaller population, we are beginning to act like a major market. However, we are not at the adult table yet.

A basic, yet meaningful indicator that helps show we are on our way is rental rates. Rental rates are the product of a supply and demand equilibrium, and show where the market's ceiling and floor are. Increasing top-end and submarket averages reflect growing space quality and tenant appetite. A year ago, we saw the downtown Class-A average listed rental rate finally cross the \$20.00 per square foot (modified gross) mark for the first time and wondered if leases would be executed at that level in 2016 or if it would serve as a mental barrier. We opined that tenants would have to justify crossing this threshold by comparing our market to larger markets. If talent and client attraction was really paramount, we predicted this mark would be breachable and sustainable. By the end of 2016, after four more positive quarters of growth, the Class-A downtown average asking rate stood at a record \$22.44 per square foot, showing that our market continues to exhibit strength at resistance points and desire to break through the middle-market classification.

Much of the reason rental rates and occupancy continue to climb downtown is the realization of the need to reposition. After years of relative stagnation downtown, we continue to see the city's skyline significantly change. Franklin Partners' acquisition and reposition of 99 Monroe Avenue NW really started the ball rolling in 2013. Since then we have seen TWENTY 5 at 25 Ottawa Avenue SW undergo considerable redevelopment and subsequent lease-up, improvements to 200 and 300 Ottawa Avenue NW and 250 Monroe Avenue NW, new construction such as Arena Place at 45 Ottawa Avenue SW, and a transition of ownership in 111 Lyon Street NW. Some of those buildings have had to endure temporary vacancies in order to accomplish this, however, we expect the downtown Class-A vacancy rate to drop under 10 percent in 2017 (currently approximately 15 percent), with a total downtown vacancy below 7 percent (currently approximately 9 percent).



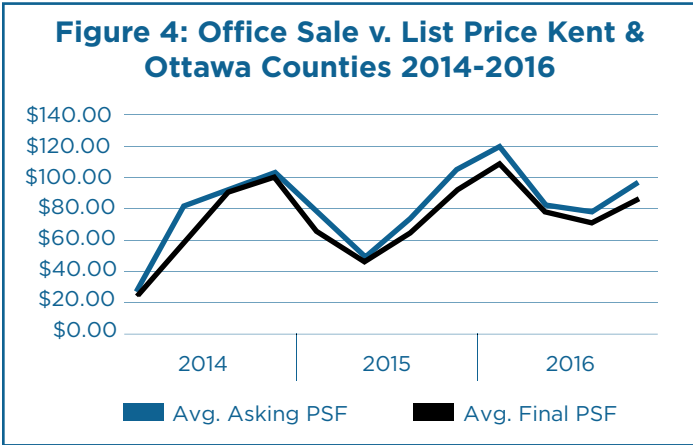
Relative to peer cities, Grand Rapids has room to grow its alternative transportation usage.  
Source: GR Forward Parking Study

Repositioning a building is not cheap, however, and is part of the reason rental rates have climbed. Exterior changes are what is visible, but within those buildings, physical layout of office space has changed as well. A newer generation of workforce is disrupting the status quo and traditional work environments are being transformed into culture and collaboration facilitators. This is key in the battle for talent. Companies are investing significant capital into finishes and amenities, and landlords who do the same are finding significant success compared to those who are not.

Tenants who renewed low rates during the downturn are now forced to face realities of a much higher market, and many are doing whatever they can to extend longer. This is part of the cause for a decrease in overall completed new transactions in 2016.

Furthermore, parking downtown continues to be a concern for many. However, as previously mentioned, part of acting like a major market is finding solutions to this problem. We are far below our peer cities (Madison, WI; Norfolk, NJ; Richmond, VA; Salt Lake City, UT; and St. Paul, MN) in terms of public transportation usage by residents and workers downtown. So emphasizing alternatives to driving will be key going forward. Almost all new office development contains a parking

component, however, for rehabilitations like TWENTY 5 in which no new parking could be added, a creative parking stipend program was implemented for Spectrum Health's nearly 400 staff members who now occupy the building. Further programs like this will also be instrumental in absorbing continued demand to locate businesses downtown.



10.7% difference between list and final sale price in 2016



Source: Burning Glass International Inc. (2016)

### Suburbs

In West Michigan, 2016 will be remembered as the year data server-provider Switch started its multi-billion dollar investment in the West Michigan region. Leasing the former Pyramid-shaped Steelcase headquarters building in Gaines Township, the company committed to contributing more than 1,000 new jobs to the region over the next decade. More than half of those jobs are expected to be with companies other than Switch. This means that Switch and economic development organization The Right Place, who helped bring Switch to the area, are planning on more than 500 jobs to come from companies Switch provides its services to.

We expect this to have a massive impact on the suburban office market. While 2017 might be too early to see many of these jobs come to fruition, we expect a number of companies to locate workers in West Michigan on a co-location basis initially, with eventual permanent locations established in the future. Ancillary benefits of more office workers being in the area will be more retail, hoteling, and residential rooftops. As mentioned, the downtown office market has seen a renaissance over the past decade, however, the suburban market has seen far less capital investment in updating and building new space. Heading into 2017 we see significant

opportunity in peripheral office submarkets for developers and owner-users to create high-quality office spaces. Access to parking gives suburban buildings an advantage over their downtown counterparts, so those who build great space to couple with ample parking should see significant interest. We have seen suburban development such as Heritage Pointe on East Paris Avenue fill up quickly, and we expect future development to have similar success.

A number of smaller office users who have been patiently waiting and searching for a new home purchased land south of Grand Rapids and began construction knowing the area is primed for expansion. Medical practices are especially active, and in 2017 we forecast further movement of medical users from tenancy in neglected buildings to owning or being a tenant in a new medical development. However, construction costs will continue to be prohibitively high in some instances.

In 2016 we saw a 9 percent difference between average listed for-sale price and average final transaction price, compared to 12.9 percent in 2015.

### Investment

Currently, much of the Grand Rapids office investment inventory is owned by smaller local investors. However, as we progress into the national picture as an overall market, it is important to be aware of investment trends on a national level.

Office product is often a popular category for larger institutional investors for a number of reasons. Central Business District office product has generally been an easy way to scale up a portfolio and is often favored by foreign investors who prefer high value transactions. Because of this, office product weathered the recession relatively well considering the hurt they feel with lost occupancy. In 2016 office portfolio sales were down according to Real Capital Analytics and according to the 2017 Emerging Trends Report by the Urban Land Institute, many investors feel that 2017 could be the peak of the office investment market. Because the office market historically reacts harshly to a downturn, many investors are taking their returns now and de-risking their portfolios.

Suburban office investment has fallen distinctly out of favor due to deferred maintenance and other operational issues in many cases. High capital outlays to attract tenants are scaring away investors. In addition, maturing debt is expected to bring a number of underwater assets to market in 2017. Because of this, opportunistic investors might find opportunity.

### Retail

*West Michigan has become a melting pot of retailers, attracting companies of all shapes and sizes to the market. As room to accommodate demand dwindles, creativity has become key.*

By almost all accounts, 2016 was a great year for retail real estate in West Michigan. Unemployment for the Grand Rapids-Wyoming Metropolitan Statistical Area (MSA) has hovered around 3 percent, which most economists consider full employment. A year ago we predicted the retail market would show strength while other sectors started to slow, and that rental rates in marquee locations would continue to push higher. Although deal velocity across all property types slowed, retail performed the best with just a 1.3 percent year-over-year decline

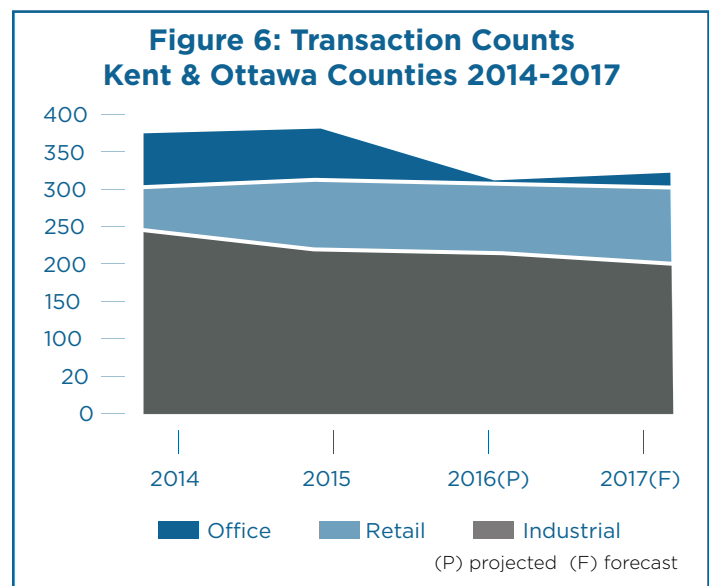
(compared to a 17.8 percent decline in industrial, for example). Rental rates in power corridors like 28th Street SE and Alpine Avenue are seeing asking rates as high as \$38.00 per square foot triple-net, which reflects high demand and low well-located supply – yet prices some tenants out of those markets.

In most cases, creativity is key to finding great locations for tenants who demand them. In 2016 we saw a number of key deals happen in the marketplace at sites that were not previously considered available. In order to find locations for Chick-fil-A in West Michigan, this is precisely what needed to be done. Brokers and tenants continue to work with landlords to utilize out-lots and parking areas to build standalone retail buildings. Spots like downtown Ada and Gaines Township have seen creative re-use of sites as well as new ground up retail construction.

Downtown continues to see activity, as mixed-use development has created new opportunities for retailers. As the city's core expands in all directions and more residents live closer to downtown, we anticipate companies previously hesitant to enter or expand downtown will consider doing so.

### Centers

Last year we saw the relatively new retail center Village at Knapp's Crossing add three out-lot buildings, creating 10 new retail suites. By the end of the year we saw 9 of those 10 filled. In 2017, we expect the next phase of this development to break ground and for the center to see a high level of interest from well-known national retail brands.



Retail centers outside of key corridors and ones that have been neglected are having trouble capitalizing on the high demand for space in the region. Prime locations are all but full, yet tenants are so eager to locate there that they are finding ways to squeeze in – thus driving rates up. In order to stay relevant, retail centers like the Cascade Center at 6250 28th Street SE, which was purchased by investment firm Great Lakes Capital earlier in the year, invested significant money into renovating the exterior façade, parking lot, and landscaping. Since then, a number of leases have been signed including The Blue Moose Sports Pub, which will fill the anchor space vacated by Cascade Sports Bar & Grill.

We expect to see other centers with growing vacancies address similar issues with similar capital improvements. As these centers gain strength, landlords will become more selective with tenant mix. Credit-worthy tenants who complement each other are preferred, and with a retail market that is growing competitive for space, landlords will look to assemble the right roster of tenants for their centers.

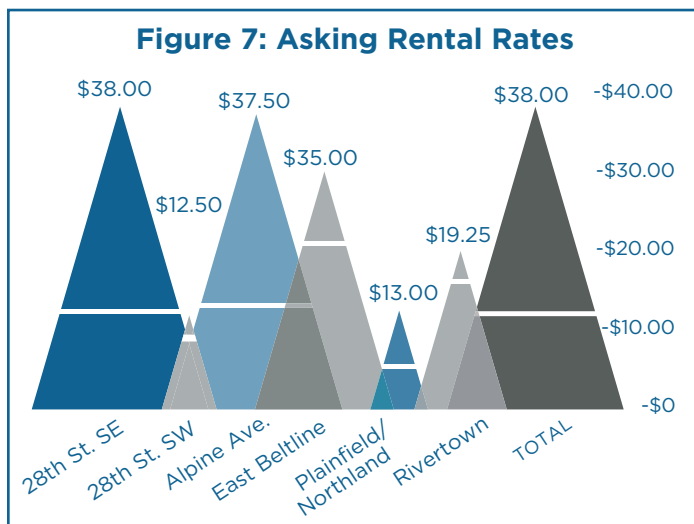
## Malls

Traditional shopping malls and their big box anchors have been seemingly under siege over the past few years. However, despite mass-closure announcements made by companies like Macy's and K-Mart, in general we are seeing landlords who are willing to be flexible survive this shift in retail paradigm. Some malls have pivoted away from interior space, and in some instances creative repurposing of big boxes have saved the center they're in.

Recently, we saw Centerpoint Mall undergo a "de-malling" which resulted in an increased occupancy of approximately 35 percent, as well as the addition of numerous new out-buildings.

Westshore Mall followed suit and has subsequently signed more than a dozen new tenants. Now, Breton Village Mall is undergoing the same type of reconfiguration. The upper story and roof will be removed and storefronts will be added for all tenants. Additionally, out-buildings are being built to provide more street presence. This work is in response to the overwhelming success of Centerpoint and Westshore, and the reaction to changing consumer preferences and tendencies. Across the street, Breton Village South has been designed and partially built with the same plaza-style site design.

In 2017, we very well could see other malls like Woodland and RiverTown Crossings undergo changes as well, as some of the big box tenants consider their future at the sites. While this could potentially represent change, it also could represent opportunity.



Maximum and average asking rates for 6 main corridors, with the average asking rate represented by each shape's white line.

## E-commerce

One phenomenon that has been cutting into physical store sales is the proliferation of e-commerce. Cost effectiveness of selling products online make it hard to justify overhead costs like utilities, staffing, and rent that are associated with

bricks-and-mortar locations. According to Forrester Research, online sales in the United States are expected to grow 56 percent between 2015 and 2020 to more than \$523 billion. We are currently in the middle of that acceleration. However, it is possible that a physical presence has become even more important since the dawn of the internet shopping era. More than ever, retailers desire to approach consumers from a number of angles. While online shopping offers efficiency, physical stores offer the brand experience, which is an important differentiator considering the amount of competition in the marketplace. In our estimation, this is a large reason why shopping malls will remain relevant.

In 2017, we anticipate getting closer to a resolution on a tax reform bill requiring online retailers to pay state sales tax. Currently, a loophole exists that allows online shops to avoid this collection cost, making it hard for physical stores to compete and causing states to miss out on the additional tax revenue. It is estimated that this loss in revenue is costing states more than \$23 billion annually. The new White House administration campaigned for e-fairness, so it will remain to be seen if any changes are enacted.

## Investment

Nationally, the retail sector of the investment market was relatively sluggish in 2016. Investment sale transactions were down 23 percent across the country through the first three quarters, largely due to slow consumer recovery and negative headlines regarding shopping malls and big box tenants. New retail development was also slow in 2016 for many of the same reasons, and some retail-focused developers have even been seeking alternative project categories. According to the Emerging Trends 2017 report by The Urban Land Institute, retail came in last for overall investor sentiment heading into 2017.

Feelings about retail remain diverse, however. Retail properties have historically been appreciated by public REITs and foreign investors, but in a market our size, we do not see much activity from those groups. One positive to retail investments is the ability to pass through costs to tenants, relative to other property types. This makes owning retail property less capital-intensive.

As mentioned previously, de-malling has been a strategy deployed that has added value to three different malls in the region. Creative repurposing of mall space will be an opportunity for investors to add value and re-stabilize failing assets.

## Multi-family

*Favorable conditions have led to recent growth in the multi-family market and we expect this to continue into 2017, with numerous projects underway or planned. Yet many feel they are in a race to be built and filled before we reach a saturation point.*

## Apartments

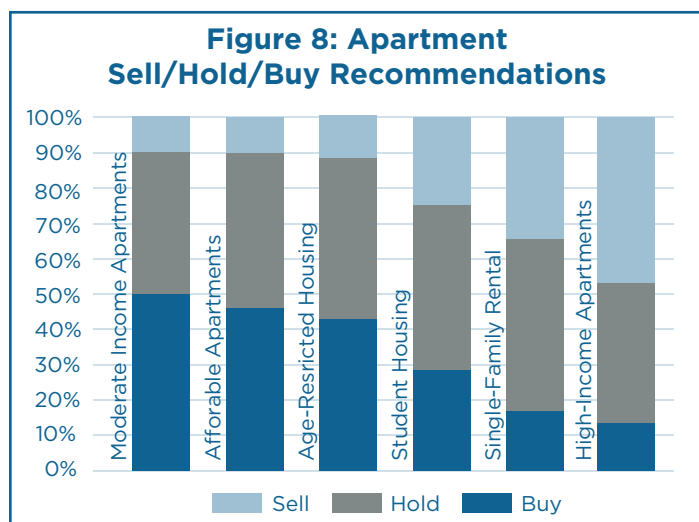
The multi-family investment sector has been a steady performer due to its relatively inelastic demand and consistent cash flow. Management of these properties can be consolidated and streamlined as assets are accumulated, and value can be added easily. Today, the sector is as popular as ever as the large millennial generation changes the way home-owning was previously viewed.

Since the recession, the share of 18- to 34-year-olds who own a home has fallen to a 30-year low. Millennials have less desire to be anchored to a particular asset or location and are far more likely to change their work and living environments than prior generations. Credit issues caused or compounded by student debt are keeping many in this generation from even having the choice to buy a house. Additionally, lessons seemingly learned by their parents through the housing crisis have soured the notion that purchasing a house will always result in positive return on investment. As a result, renting a residence has become popular and investors in the multi-family market have consequently reaped the benefits.

In addition to millennials, empty nest baby boomers have been increasingly interested in luxury urban apartments.

Debt and equity have become more readily available, so although construction costs are currently high, strong demand is allowing developers to build in occupancy projections that satisfy lenders and allow a high percentage of projects to be green-lit.

New residential projects in West Michigan are aplenty. Seemingly every week we hear the announcement of a new project. While many are ground-up, the redevelopment of functionally obsolete buildings is popular as well. Currently there are nearly 1,000 market-rate units under construction and an additional 1,545 units proposed or approved within the Grand Rapids area. There are also 658 units of income-restricted housing in the pipeline.



Source: Emerging Trends in Real Estate 2017 Survey Based on U.S. respondents only.

The current residential occupancy rate remains above 97 percent in the area, gradually coming down off its peak of 98.6 percent at the end of 2013. Annualized apartment rent growth in Grand Rapids has been between 7 and 8 percent over the past two years, but this is forecast to slow as more units come online and as inflation remains tempered. Since rates are at such high levels, many are having to sacrifice size for location because they can't afford both. To maintain affordability for the largest portion of the population, we anticipate rates to plateau and for some developments to aim at capturing parts of the market that rates have passed by.

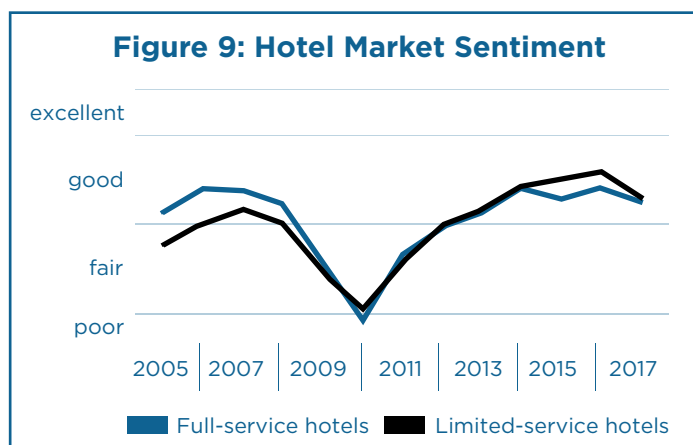
In 2017 we will look to see if planned unit rate continues at the levels we saw in 2015 and 2016, or if it starts to slow or even drop off significantly. Delivered units will likely be strong in the upcoming year, however, new projects are anticipated to slow as developers watch the wave of new units hit the market and measure the effect on occupancy and rent.

## Hotels

West Michigan experienced a healthy level of hotel activity in 2016, mainly in well-trafficked retail corridors such as 28th Street SE, East Beltline Avenue, and Rivertown Parkway. Also, the addition of Switch to the market has spurred future hotel plans south of Grand Rapids in Gaines Township – as evidenced by two parcels of land sold for that purpose.

Additionally, Grand Rapids-based Grand Action, a business-based nonprofit, recently released findings from a local asset study and revealed in their findings a need for expanded hoteling downtown to accommodate a proposed increase in convention space. In 2017, we expect some decisions to be made in response to the study and for more rooms to potentially be planned in the city's core.

Despite strong demand locally, national investment experts are growing bearish on the hotel market and are concerned that the sector has hit its peak. This is noteworthy because the hotel market is often looked to as a leading indicator for the rest of the commercial real estate market, as room demand essentially refreshes daily. Room-sharing concepts like Airbnb have cut into hotel demand (as much as 10 percent in New York City), and as businesses have become more technologically interconnected, corporate travel has dropped. In West Michigan's case, with strong tourism and economic growth, we seem to still be in good shape and growing, however, it will be a key indicator to keep an eye on in 2017. ■



Source: Emerging Trends in Real Estate 2017 Survey.

# Small Business Needs Assessment

**Jennifer M. Deamud, M.P.A., M.S., COO/Associate State Director**  
**Michigan Small Business Development Center**



Small businesses are expanding and thriving in Michigan, but increasingly they find they need assistance in managing their growth and success.

This article highlights some key findings of a recent statewide project focused on small business growth, challenges and how to help Michigan small businesses prepare for future success. It has been twenty-five years since a comprehensive small business

needs assessment of this depth was conducted in the state by a combination of partners.

The study was designed to answer the following questions:

- What are the key barriers and challenges that impede the survival and growth of small firms? What are the key service needs that arise from them?
- What beliefs do business owners have about the most effective means of delivering business services?
- How can providers of business services apply their services and resources to better meet the needs of small businesses?

## Key Findings

- Diversity among small business owners is increasing. The proportion of businesses owned by racial minorities and women is on the rise.
- More than two-thirds of the businesses surveyed indicated that they have a “strong desire and take steps to scale up the company.”
- Nearly all businesses experience challenges, but relatively few seek outside help to address those challenges. Almost 90 percent of respondents noted one or more challenge areas, and 45 percent identified two or more areas as challenging. However, only 50 percent of those experiencing challenges indicated that they had ever sought outside assistance to address those challenges.
- Decisions to seek outside assistance and experiences with outside business services are influenced by the nature of

the challenges small businesses are seeking to address. Respondents were most likely to seek outside help for challenges related to defining and serving a market and accessing capital.

- The extent of small business challenges and access to outside assistance vary by region within the state.
- In-person methods of delivering small business services and support were perceived as more effective than other methods.

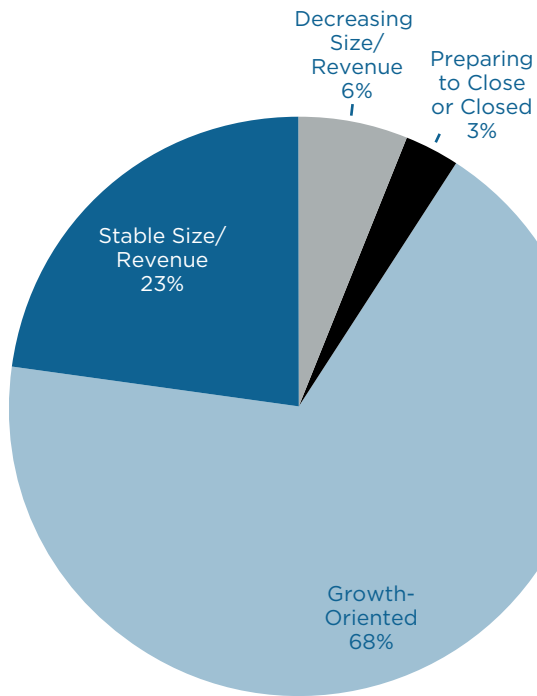
## Lessons and Implications

- It is increasingly important to tailor approaches to outreach and service delivery in order to meet the needs of more diverse business owners.
- Outreach and service-delivery strategies that emphasize positive impacts on sales growth may help convince more small businesses to engage outside help.
- Firms might value advice in deciding whether to seek outside assistance and in locating appropriate help. Firms may need to be more aware of available resources.
- Considering the volume of small firms and variety of challenges facing small businesses, the data in this report may provide some basis for targeting services in challenge areas where firms are looking for outside help and struggling to find it.
- In regions with lower perceived levels of access to needed assistance, additional assessment of service availability and barriers to access may be necessary in order to develop effective strategies to better connect small businesses with high-quality service providers.
- When designing and delivering small business services, efforts to increase efficiency and convenience should be balanced with an emphasis on relationship-building and face-to-face contact with customers.

## Growth Orientation

Nearly 70 percent of respondents indicated that they would describe their businesses as growth-oriented, meaning they have a “strong desire and take steps to scale up [the] company” (Figure 1). An additional 23 percent of respondents described their businesses as stable in size and annual revenues, with only nine percent indicating that their businesses were downsizing, preparing to close, or closed.

**Figure 1: Self-Reported Growth Orientation of Small Businesses**



Among growth-oriented businesses, sales were, by far, the most frequently identified target for business growth. Proportion of businesses seeking to grow sales, market share or headcount:

- 57.1 % seeking to grow sales
- 12.2% seeking to grow market share
- 10.7% seeking to increase headcount

### Small Business Challenges

Small businesses face a myriad of challenges that can impact growth and/or stability. Survey respondents were asked whether the stability or growth of their companies was limited by challenges. Nearly all businesses experienced challenges. The proportion of respondents who selected each area as a challenge were:

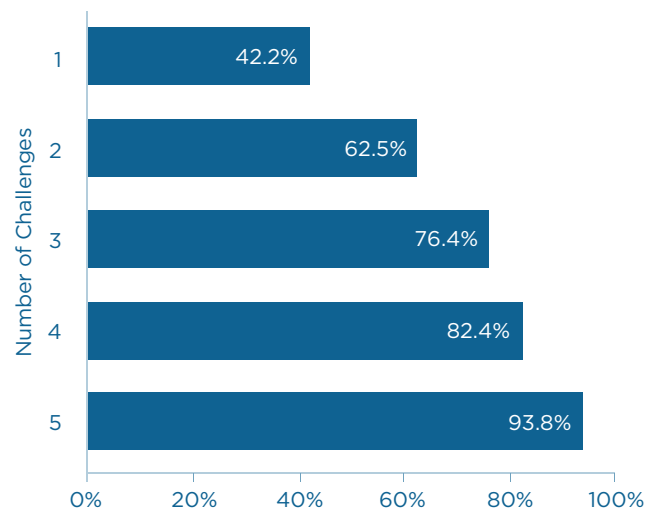
- 36.9 percent in defining and serving a market
- 35.6 percent accessing capital
- 29.2 percent in workforce or talent development
- 20.2 percent in operations and technology
- 13.5 percent in management or administration

While no single area was identified as a challenge by more than 37% of respondents, almost 90% of respondents indicated that they experienced challenges in at least one of the areas. Forty-five percent identified two or more areas as challenging.

### Small Business Assistance

Half of the small businesses facing challenges sought outside assistance. Although 9 out of 10 small businesses indicated that they experienced challenges in at least one of the areas listed, only 50% indicated that they had ever sought outside assistance with addressing any of those challenges. As illustrated in Figure 2, though, the likelihood of a small business deciding to seek outside help increased as the number of identified challenges increased.

**Figure 2: Proportion of Businesses That Sought Outside Help for Any Challenge, by Number of Challenges Identified**



## Communication Channels for Delivering Information Needed by Small Businesses

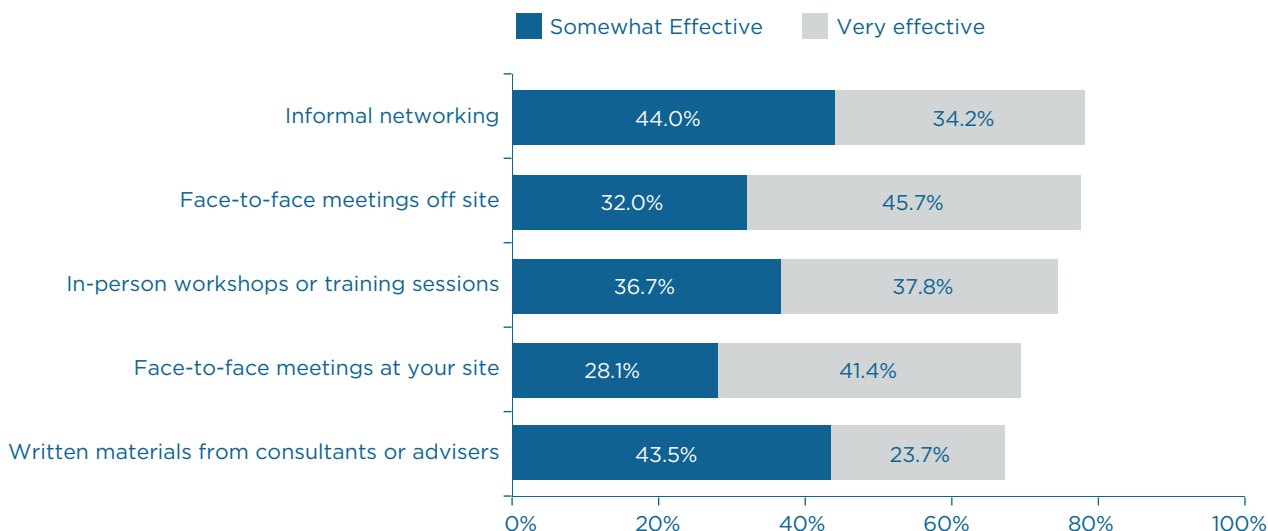
Survey respondents were asked to rate the effectiveness of various communication channels in delivering the information needed to run a successful business. The majority of respondents perceived nearly all of the options presented below to be somewhat effective or very effective. The communication channels rated as effective by the highest proportion of respondents, though, tended to be the options that involved in-person interaction (i.e., informal networking, face-to-face meetings, and in-person workshops or training sessions). On the other hand, the options least likely to be rated as effective were those that often require sorting through a wide variety of content in order to find specific and relevant guidance (i.e., e-mails; Twitter, Facebook, or other social media; and newspapers).

## Michigan SBDC and the PINE Consortium

The Michigan SBDC is funded by a combination of federal, state and local funding to provide business counseling, training, secondary market research assistance and technology commercialization services to existing and startup businesses. The Michigan SBDC guides small business as well as keeps a pulse on small business needs all across Michigan to ensure the right services and tools are available to help small businesses succeed. For sixteen years, the Lead Center of the Michigan SBDC has been hosted by Seidman College of Business, Grand Valley State University.

Both the Michigan SBDC and SBAM are part of the PINE Consortium, an international collaboration of business, government and university members helping to better align public and private entrepreneurial support with the priority needs and interests expressed by small and medium-size enterprises. ■

**Figure 3: Most Effectiveness of Means for Delivering Assistance**



## In Summary

There are a significant number of small businesses in Michigan that are positioned for growth. These small businesses plan to, and in many cases will, encounter a number of challenges. The results and the information gathered by the Michigan Small Business Needs Assessment will provide guidance on how to better serve Michigan's small businesses to help foster their economic growth.

## Acknowledgments:

The Michigan Small Business Development Center (Michigan SBDC) would like to thank the Small Business Association of Michigan (SBAM) for collaborating on this joint research project, the expertise of Public Policy Associates (PPA) and Neil Sheridan who facilitated the project collaboration with PINE and fielded the survey.

## Methodology

The research team at PPA used an online survey tool and e-mail invitations to engage potential respondents. The target audience included Michigan firms with fewer than 500 employees. The pool of invitees was assembled from multiple business lists, including a subset of Michigan SBDC clients, current SBAM members and a proprietary list of Michigan businesses. A total of 1,186 usable responses were completed. These responses were then weighted according to sector, age of business, and number of full-time employees, to permit results that represented the full spectrum of Michigan businesses.

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