Commercial Real Estate
Office sector reinventing itself; multifamily and industrial sectors thrive

In this week’s Thought Leadership Roundtable, executives from Ambrose Property Group, Business Furniture + Co., Cushman & Wakefield and Gray Capital cover a wide range of commercial real estate topics, from the importance of quality, in-person office experiences to the robustness of the Indianapolis industrial market.

**Q:** Which sectors of the commercial real estate market have performed well during the pandemic, and which ones are poised to do well in the future?

**SPENCER GRAY:** Multifamily and industrial significantly outperformed other types of commercial real estate during the pandemic and will continue to do so.

Regarding multifamily, it’s truly a perfect storm of factors. Record-high demand for housing, both single-family homes for sale as well as rentals, has continued to drive prices and rents higher. We simply haven’t built enough housing over the last decade to keep up with growth. For example, in Indianapolis in 2021, new supply was only about half of what it needed to be to keep up with demand. While single-family home prices and rising interest rates make homeownership unattainable to many, others are choosing to rent for convenience, flexibility, and the perception of viewing a home as more of a liability than an asset or investment.

Similarly, health care investment and demand will remain robust, and for obvious reasons. Indianapolis is a regional health care hub for the state, and, whether they like it or not, Baby Boomers aren’t getting any younger. Those two factors alone are enormous demand drivers for health care services, of course, but also for new development, especially around our hospital systems.

**TIM MICHEL:** You hear a lot about “sheds, beds and meds,” and that certainly applies to Indianapolis. Our industrial sector (“sheds”) is among the strongest in the U.S., with tenants absorbing more than 16.3 million square feet of space last year, a record exceeding the previous record in 2019 by more than 4 million square feet. Demand, increasing rents, and lower vacancy remain in the forecast for the foreseeable future, even with back-to-back record years for construction deliveries.

As for multifamily (“beds”), we’re seeing remarkable mixed-use product delivered and absorbed, like The Mark at Fishers Landing, and record investment in all types of apartment properties from a variety of local, regional, and national buyers. A dearth of new residential construction drives increased demand for apartments, too. With capital markets, our multifamily investment sales team closed nearly $2 billion in apartment sales last year, a record on top of a record 2020. Rent growth was 8.8% in 2021, well above the five-year trend of between 4% and 5%. Rent growth is expected to be well above the norm this year, too. Exceptionally high rent growth has helped propel apartment prices to record highs.

“**We see Indy as being undervalued compared to many of our peers and even some larger markets with less desirable fundamentals.**”

**SPENCER GRAY, Gray Capital**

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Q: What are the prospects for people returning to their offices in both the Central Business District and suburban office markets in the next 12 months?

**MARY BETH OAKES:** Our clients have returned to their offices or are...
well on their way to having their employees coming back. What’s driving them to return is not just because it’s safer from a post-COVID standpoint, but because organizations have found that their employees must have face-to-face, in-person time to maintain a healthy culture and team collaboration. Everyone felt the weight of the time apart and their cultures have been negatively impacted. Not being able to get together in person makes mentorship and organic connection nearly impossible. According to most CEOs, having everyone work from home doesn’t work well. So, our clients are anxious to have everyone back, but they are finding that their employees want to return to something better than before COVID. After working from home for the last two years, when given the option, employees welcome “touches of home.” Office spaces need to offer the things employees liked about working from home, like soft sofas, and provide what home might have lacked, like focus rooms (without the dog barking). We are finding that leaders must reimagine what the office means to their teams and how the office fits their culture. While change can be uncomfortable for some, there’s no better time to look at how we can work better.

TIM MICHEL: The office market’s recovery has been slowed by uncertainty around the pandemic, but the recovery hasn’t stopped. We actually expect it to accelerate going into 2023 and into the next several years. Occupiers will drive performance as economic activity, office-using job growth and a focus on talent and innovation accelerate the imperative to get real estate right, resulting in renewed demand, rent inflation and further disparity between good and average assets. We’ll see continued growth and commercial/office development in the northern suburbs, especially in Hamilton County.

SPENCER GRAY: It’s been interesting to see the difference between industries in how quickly they have returned to the office or not. Tech companies and law firms have largely been working remotely, which led to downtown being pretty empty most of 2020 and 2021. It seems, however, that many downtown employees have been returning over the last few months. We’ve also seen a recovery of downtown apartment occupancy and rents, although rents have grown only around 5% compared to the mid-teens in the suburbs.

Q: Will we ever see office occupancy return to pre-pandemic levels, and does that matter?

TIM MICHEL: It absolutely matters. Office occupancy is a driver for the broader economy, and certainly for the ancillary businesses surrounding office properties, whether in the CBD or suburbs. We do anticipate office-using job growth to accelerate in the next few years, which will bring office occupancy back to pre-pandemic levels and exceed pre-pandemic levels eventually.

MARY BETH OAKES: We may never see the office as it was pre-pandemic, and we think that’s good news. Hybrid is not a new concept; it’s a dialogue leaders and employees began long before COVID. Now it’s top of mind, and here we all are, adopting new models to make it work for both the employee and the company. Most employees want the option to work both from home and office. We help our clients reimagine what the office looks like to fit their needs, reconfigure spaces, and create something that is hybrid-friendly.

Q: Industrial seems to be Indy’s strongest sector. What is driving demand there?

SPENCER GRAY: The industrial sector was performing well pre-pandemic due to a steady increase in ecommerce sales as a percentage of overall retail sales. Then the pandemic came along, and compounded this trend, leading to an increase in demand for industrial space. Further, the pandemic highlighted the tightness of U.S. supply chains. Companies both large and small are adding warehouse space to their supply chains to add resiliency, to onshore products, and to mitigate upstream risks. Demand has been especially strong in locations, such as Indianapolis, that provide users access to a large percentage of the U.S. population within a one- or two-day drive. Indianapolis’ industrial sector has also benefited greatly from FedEx’s Industrial hub, which continues to serve as an additional demand driver for our market.

SPENCER GRAY: Indianapolis has been a major logistics hub for some time, and as e-commerce continues to grow and evolve, demand will continue. Abundant and relatively cheap developable land, an international airport that already serves as the world’s second largest FedEx hub with ample room to expand, and a location and interstate system that have earned Indy the title of “Crossroads of America” will make Indianapolis an attractive market for warehouse and industrial developers and users for some time.

TIM MICHEL: We’re seeing a shift in strategy where tenants need to have more product on hand, vs. a “just-in-time” strategy that we’ve seen increasingly in the past few decades. Supply disruptions and product-availability delays have motivated users to increase supplies-on-hand for both materials and finished products. The other big driver of demand is e-commerce. It was a growing demand driver already, but the past two years have accelerated that trend, to say the least. Given our central location in the U.S. supply chain, we don’t see that abating any time soon.

Q: Is the industrial sector here overbuilt?

TIM MICHEL: Given demand and low vacancy, it simply makes sense for there to be this much construction—nearly 50 million square feet—right now. Vacancy is below 4%, and we had 21 million square feet of leasing activity in 2021. Industrial demand in central Indiana has never been greater, and we’re seeing a great deal of construction, especially in bulk properties, as a result.

SPENCER GRAY: There is more than 21 million square feet of industrial in the construction pipeline; however, we’re also seeing record demand and low vacancy. There seems to be a near-unending appetite from not only the Amazons and Walmarts of the world but also a wide variety of demand from logistics-oriented users.

STEPHEN LINDLEY: After a record-breaking year in 2021 in terms of net absorption, overall vacancy rates below 4.5%, and a 2022 that is off to another strong start from a demand standpoint, I find it hard to argue that the industrial sector is overbuilt in Indianapolis. In the Indianapolis area, Ambrose has six speculative bulk industrial projects under construction totaling more than $230 million in total investment, and all are either leased or under negotiation.
have significant tenant demand. While Indianapolis has a robust pipeline of new construction, there’s an equally robust backlog of users looking to occupy warehouse space.

At Ambrose, we believe there to be quite a bit of runway left for Indianapolis’ industrial sector. In addition to the six projects under construction, we intend to start at least four more projects later this year in metro Indy.

Q: What trends are we seeing emerge in multifamily development and investment?

SPENCER GRAY: Indianapolis has become a major target for investment from both local and out-of-state groups, especially as elevated prices in sunbelt markets are leading to lower returns for investors.

One of the largest shifts from both renters and investors has been away from downtowns and the central business district and into the suburbs. Residents are seeking more space, an extra bedroom, and a discount from higher-on-average downtown rents.

“Build-to-rent” communities, where all the homes are built as rentals, are another trend that will see significant growth over the next decade. The millennial generation will continue to settle down and start families, albeit later than earlier generations, and many will prefer to live in a single-family home for more space and privacy. But many millennials either can’t afford to own a house or prefer to rent. What we’re seeing is a decoupling of the “American Dream” and the 30-year fixed mortgage.

TIM MICHEL: Multifamily development continues to be very active. Strong demand dynamics push the need for additional housing. Cost challenges continue as development costs have skyrocketed. Fortunately for developers, rent growth has increased to support the increasing cost of new product. Many towns around Indiana are pushing for higher density, walkable, mixed-use product in their downtowns. Cities are offering incentives, such as Tax Increment Financing bonds, to fund certain costs, and they’re asking for real estate tax abatement.

Multifamily sales continue to be very robust. There is a continuous flood of new investor capital looking to buy in Indianapolis and throughout Indiana. Cap rates continue to decline, as low as the low 3% range for the best locations. Most properties are trading at cap rates in the 3.7% to 4.3% range.

Q: What changes or improvements need to be made to foster commercial real estate growth here in the various sectors?

SPENCER GRAY: Indianapolis is a highly sought-after region for construction. Franklin, Greenwood, and Whiteland are increasingly seeing new projects as development pushes further south of Indianapolis. The northwest and southwest submarkets have seen significant construction activity over the past several years and are poised for further growth as well.

TIM MICHEL, Cushman & Wakefield

“Generally, we’re seeing a flight to quality with office tenants. They may be taking less space, overall, but they’re taking higher-quality space as part of broader talent strategies.”

MARY BETH OAKES: It’s important that employees be able to find enjoyment in their work environment. Employees who enjoy their workspace are more engaged, less likely to leave and are more productive. Leaders are focused on creating more flexible policies, but hybrid models alone do not address other important factors, such as a desire for control, a sense of belonging, and a need for privacy. In surveys, it is surprising to see just how strongly many people feel about having some level of control over their space at work. If leaders intend to entice people back to the office, they need to give employees access to private spaces. Employees are unlikely to collaborate all day long. Three of the top four elements people value now are related to access to private spaces. Employees have a stronger voice than ever. Leaders have to consider how employees’ needs are being met, especially those returning to the office after an extended time away, and they need to recognize that leaders’ experiences likely don’t match the experiences of the majority of their employees. Leaders should consider changes to the workplace that support a larger group of employees.

STEPHEN LINDLEY: Labor continues to be a consistent theme and pain point for users across the United States. One of the ways Indianapolis can continue to foster a strong industrial sector and related job growth is by creating a compelling labor story relative to our peer markets. Encouraging the city and state to continue to invest in training for warehouse laborers and supply chain experts will continue to put Indianapolis at the forefront of geographically options for users. Investing in public transportation linking population hubs in Marion County with jobs in surrounding counties will also help Indianapolis maintain its competitive position. Finally, continuing to promote Indiana’s national reputation as a “State that Works” will help to keep Indiana and Indianapolis on the map as quality, national and international companies search for new locations.

Q: Across all sectors, what parts of Indianapolis are expected to see the most commercial real estate growth in the next several years?

TIM MICHEL: For industrial, every corner of the region is poised for growth. From the northwest and southwest to the south and east submarkets, we’ve seen historic growth and development over the past 24 months, and that will continue.

In the industrial sector, construction activity is concentrated in key areas around the region. The east submarket has the most space under construction, totaling over 9.5 million square feet, primarily in the Mount Comfort area. The south submarket also has emerged as a construction hotspot, with 6.5 million square feet of space under construction. Franklin, Greenwood, and Whiteland are increasingly seeing new projects as development pushes further south of Indianapolis. The northwest and southwest submarkets have seen significant construction activity over the past several years and are poised for further growth as well.

SPENCER GRAY: Multifamily development will continue to be concentrated in the northern suburbs in Hamilton and Boone counties as well as in and around downtown. The lack of development and the growing pipeline of available jobs on the far east, south, and west sides of town (largely attributed to the industrial sector and related job growth) will cause those submarkets to continue to see high occupancy for the foreseeable future.

The new industrial pipeline on the east side near Mount Comfort and along all interstate corridors will continue to expand.

Q: How is real estate performing here relative to our peer markets?

SPENCER GRAY: In multifamily, Indianapolis performed exceptionally well during the pandemic. In fact, it was one of only a few markets to see positive multifamily rent growth in 2020. Like other markets around the country, Indianapolis has seen significant price appreciation since 2020, and we’re about on par with most of the nation. Our incredibly low unemployment rate compared to the national average, diversified economy, and more stable growth makes Indy an attractive market for the foreseeable future. We see Indy as being undervalued compared to many of our peers and even some larger markets with less desirable fundamentals.

STEPHEN LINDLEY: Speaking for the industrial sector, our peer markets have experienced similar success, as the Midwest remains a highly sought-after region for...
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STEPHEN LINDLEY, Ambrose Property Group

warehouse space. According to CBRE’s market research, Chicago, Columbus, Indianapolis, and Cincinnati were all within the top 10 nationally in 2021 for bulk transactions, defined as 100,000 square feet and greater. Some of our peer markets, including Louisville and Columbus, finished 2021 with vacancy rates below 2.5%, making it extremely difficult for users to find space in those markets and therefore pushing those users to look elsewhere, most commonly in neighboring markets. New construction remains robust in each of these markets, like Indianapolis, with developers starting to look at the “next exit out” to find new development opportunities as land in historically proven submarkets becomes more difficult to find.

Q: What’s the biggest trend in the sector that you’re most familiar with?

MARY BETH OAKES: There is no one-size-fits-all solution for the future of where we work. The pandemic has completely revolutionized how we think about offices and employee workplace needs. There is no longer a standard way of working. Hybrid has a unique definition for each company. There isn’t one paradigm.

STEPHEN LINDLEY: Similar to many other industries, rising construction costs and supply chain constraints continue to present challenges for industrial development projects from a budgetary and timing perspective. Lead times for steel, precast, and roofing are upwards of 10-12 months. On the cost side, building shell prices increased more than 50% over the past 12 months. This trend is, in turn, pushing rental rates across the Indianapolis market to record levels. Additionally, land is becoming increasingly scarce and more expensive, particularly in proven submarkets.

Taking all of these trends into consideration, it is critical for developers to find a way to differentiate their buildings and create competitive advantages via location, cost, product, and client flexibility. With our clients, which include the biggest and most sophisticated users in the world, returning to trusted development partners to navigate the challenges of 2022 is more important than ever.

As president of Gray Capital, Spencer Gray focuses on investment strategy and driving forward the vision of the firm, a multifamily real estate investment collective. Since founding Gray Capital with his wife, Alex, Spencer has been involved in over $1.5 billion in transactions, and controls over $500 million of multifamily real estate. Spencer is also CEO of Gray Properties, LLC, a commercial real estate-focused family office.

Mary Beth Oakes is CEO and owner of Business Furniture + Co., which was founded in 1922 and was the first Steelcase furniture dealer in the world. Oakes believes that values rooted in innovation, relationships and doing the right thing have given BF+C the opportunity to celebrate a century of success. A graduate of DePauw University, Oakes has spent the last three decades living out those values and engaging with clients to envision and implement their ideal work environment.

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