CRE: What's the Big Picture?

We examine the commercial real estate market in Phoenix

by RaeAnne Marsh

Interest in Metro Phoenix's commercial real estate industry

spans not only all its segments but naturally draws in most of the rest of the business community as companies need space for their operations. Perspective on the state of the market and its future varies by the angle from which involvement stems, and *In Business Magazine* explores those viewpoints of investors, whose capital infusions power the industry, developers, who create the products, and lessees, whose needs inform the direction of the industry.

Photo courtesy ViaWest (Central Logistics)

Phoenix CRE from an Investor's Perspective

"There is no doubt that industrial and multifamily — including single-family for rent product — are driving the activity in the market right now both from a tenant demand standpoint and a capital investment standpoint," says Steven Schwarz, founding partner of ViaWest Group, a Phoenix-based, full-service commercial real estate investment, development and property management firm.

Explains Dave Kotter, principal of Scottsdale-based commercial mortgage broker Integrity Capital, "Manufacturers are coming here in droves because there has been an increased need for production. Apartments are of great interest because they are a safe bet." Noting a huge influx of people coming to the Valley, all of whom need a place to live, he adds, "It is easier right now to fill an apartment building over an office space."

Observing that many office, retail and hotel developers have transitioned their business plans to incorporate or refocus entirely these product types, Schwarz says, "In Phoenix, we not only have new entry into the market from developers seeking these product types but also from out-of-state developers who now have a strong desire to be in the Phoenix market." In fact, he says that "industrial and multifamily in Phoenix are as 'hot' as they have ever been."

Andrea Davis, principal of Scottsdale-based brokerage firm Andrea Davis CRE, illustrates the strength of the industrial market by describing a recent transaction: "A recent very strong local warehouse client toured a 35,000-square-foot facility that fit their requirements nicely. We quickly negotiated the letter of intent and proceeded to reviewing a lease." With both parties understanding time was of the essence, lease comments were emailed back to the landlord within a week ("This dance in CRE often takes four to six weeks," says Davis). The transaction was tracking quickly on two weeks, but the day after the tenant's lease comments were received by the owner, the landlord's broker called Davis to let her know a national credit tenant wanted the space at full asking lease rate, for five years and no tenant improvements. "Even if my client met the terms, the landlord had made its decision — the national tenant was less of a risk and added value to their property."

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In this space, Davis points out logistics and distributions are on the rise and the demand is thriving. "Phoenix is poised for growth and a major boom," she says. "Employment base, water, power, IT and connectivity to other locations and proximity to Mexico are key for industrial sustainability. Phoenix has it all."

Schwarz describes interest in industrial and multifamily as at all-time high from existing investors and developers as well as those who are new to the Phoenix market, noting that while tenant demand for office has been slow over the past year and the sector has its issues and concerns, it has not stopped capital investment in Phoenix. "Many investors believe that the Phoenix office market will perform well in the foreseeable future due to a movement out of higher-cost, regulated and dense environments to this market with lower costs of doing business and living, quality lifestyle and less regulation.

"Interestingly," he adds, "there is not much office product on the market for sale as most landlords are waiting for the leasing situation to improve before considering selling, and to date there has been very few distressed situations."

Davis sees activity among Arizona investors adding to their commercial real estate portfolios. "Some are riding the wave of influx of out-of-state investors and selling their investments at a profit. Most are reinvesting back into the Arizona market, banking on continued growth and lack of product, which drives up pricing." For example, Sunrise Preschool is a local investor who annually acquires at least one investment. "Unable to find his desired

return, we ventured into Las Vegas for a peek." However, they found Arizona product had more stability and potential growth. "We found the perfect acquisition to diversify his portfolio — a longer-term absolute triple net lease asset with the desired return." Opportunities, she says, "are here for the persistent patient investor."

While Kotter believes that, from an Arizona perspective, prices have gone up and those who have been in the Phoenix market for a long time have the mindset of not wanting to pay these high prices, those from California or New York looking to get into business here see significantly lower prices to build in Arizona. In fact, he says, "New investors and developers are coming to Phoenix in droves." Specifically, he says, Phoenix is becoming a major place for people who want to develop multifamily properties. "Strong employment, pro-business policies, increasing rents, and great weather in Arizona all come together to make the Valley a popular destination."

Says Davis, "Investors are searching anywhere in Arizona that meets their criteria for their ideal return on an investment. A 1031 tax deferred exchange client wanted an 8% cap rate absolute triple net lease investment. To satisfy our client's return requirement, we ventured into strong tertiary markets such as Prescott and Buckeye and accomplished their net return goal."

So, some corners and corridors are hotter than others, of course. Kotter sees Scottsdale, Gilbert, Glendale and Buckeye as the areas seeing the most interest. Schwarz breaks it down by use. Addressing the office market, he names Tempe, Scottsdale, Camelback Corridor, and the Southeast Valley as the suburban markets in Metro Phoenix that seem to be of greatest interest to investors because of the anticipated shift of office use and demand post-pandemic. In industrial and multifamily, he says demand is everywhere. "In regard to industrial, it really comes down to where developers can find available land," he says, noting that this has resulted in the greatest amount of activity being along the Loop 303 near I-10. "But developers would prefer infill locations if they can find them," he says. "We have been very fortunate to uncover land opportunities in the 'heart-of-town' for six new projects totaling 1,700,000 square feet."

THE MARKET THEN AND NOW

"The reality is that some things are quite different from a few years ago, and others are similar. However, everything has accelerated," Schwarz says. He points out that movement out of core business markets such as New York, San Francisco and Chicago is real. "The primary prior issues in office space of employers seeking a way to control their P&L and the high costs of tenant improvements for landlords have only been exacerbated by the pandemic. Work-from-home will definitely be explored by many companies and should result in a softer office market around the country for a number of years." He believes, however, that Phoenix is among the markets that will bounce back more quickly.

As Kotter points out, "The influx of people from other states such as California is driving the difference. Phoenix has done a good job attracting new employers to the area, with more coming every year. We have 130,000 people moving here every year. An influx of people that big is going to have a huge impact on the commercial real estate market."

Explains Davis, "With the exodus from California and other poorly managed states, an influx of investors has poured into Arizona, reducing our cap rates by a point or more and reducing local inventory." She notes, for example, that absolute triple net lease coffee franchises and fast-food chain investment properties could be purchased around a 5 to 5.5% cap rate two years ago, but same investment today is trading for the low 4% cap rates. "Brokers and investors need to stay on top of the market to secure a quality commercial real estate investment in Arizona. A lot of cash is coming in from other states, influencing our inventory. Deals are closing quickly and at unheard-of prices."

Full work-from-home is not expected to last very long and flex working is expected to take over as the primary approach of employers, according to Schwarz, who also sees industrial and multifamily continuing to perform extraordinarily well. "There is a ton of capital available and information flows very quickly now, so there are no hidden secrets in our business," he says. "It's really a matter of who knows how to uncover the best opportunities."

Pointing out that new development generates jobs and also provides buildings to which new requirements can locate, Schwarz says, "This is a big issue for some larger users who need accessibility to land, buildings and labor" and notes that not every market can provide these attributes in a cost-efficient way. "Fortunately, for us, Phoenix and the other markets in which we are active (Nevada, Colorado and Utah) can.

"While some of these markets, especially Phoenix, were heavily reliant on the impact that real estate generated on economic growth, that has shifted now with significantly more diversified economies in which CRE growth is more of a reactor to the growth occurring rather than a driver of it. We are seeing massive construction costs increases currently due to substantial demand and lower manufacturing outputs, which will likely keep over-development in check on a going forward basis."

CRE remains an integral part of our economy. Says Kotter, "If you think about real estate: You bring housing to a location and that housing brings people into a community to live and spend. The production of a new manufacturing business helps the real estate market because it creates jobs which creates a need for housing."

"As long as people and companies continue to migrate in masses to Arizona, our economy will thrive," says Davis. "People support commercial real estate; commercial real estate supports people."

Photo courtesy George Oliver (The Alexander, library)

Phoenix CRE from a Developer's Perspective

SEGMENT STRENGTHS

"Along with the industrial sector, multifamily housing is the hot commodity in the Valley," says Michael D'Andrea, vice president of development at the Related Group. "With the population growing at an exponential rate, there is a shortage of single-family inventory and we are now seeing multi-family and industrial projects outpacing office and retail projects, which have been adversely affected due the pandemic."

There is general agreement that those two sectors are hottest right now, but they seem to be jockeying each other for that top position, as some developers vote for one and some the other.

Mike Orr, senior vice president with SunCap Property Group who heads its Western projects, sees industrial development the most desirable market segment currently, with multifamily a close second. "The pandemic has accelerated the rise of e-commerce and will continue to fuel the need for high-quality industrial space. In the industrial space, the demand for speed to market has only increased," he says, noting SunCap's clients are looking for sites and partners that can deliver for them within a compressed timeline.

"Across the state, we have seen a higher demand for industrial sites," says Carrie Kelly, executive director of the Arizona Association for Economic Development, noting that Sun Corridor Inc. has reported seeing nearly 100 new opportunities for industrial companies relocating to the Tucson area. "Arizona is also seeing an influx of entrepreneurs and small-sized businesses," she says.

On the other hand, Curt Kremer, founder and managing partner of George Oliver Companies, says, "It seems like multifamily is still the leader of the clubhouse in Arizona, although industrial has made an aggressive push over the past 12 to 18 months to challenge for that lead.

"At George Oliver," he continues, "we are obviously bullish on office due to our recent successes with our projects. Office still has a bright future in Arizona, but right now the investor's appetite is noticeably stronger for multifamily and industrial. Record-high industrial demand was a key motivator for the launch of our new entity, G.O. Industrial."

Photo courtesy RED Development (CityScape)

Although noting that interest in office space has been minimal over the past year as many industries have successfully gone virtual, Kelly says, "Office buildings are anticipated to start filling up at the end of the year, and the Greater Phoenix area has a growing market of flex office space."

"Within the office industry, we are realizing interest in financial institutions, technology and healthcare companies based in Phoenix looking to expand their footprint," says Mike Ebert, managing partner of RED Development, sharing that Alliance Bank recently expanded its CityScape Phoenix headquarters from one floor to six floors, now totaling 155,000 square feet and creating 110 new seats for new part-time, remote and contract employees. "Overall," he says, "leasing occupancy across RED's Arizona portfolio continues to remain strong."

Additionally, Ebert says, "On the retail side, we are experiencing active interest within food and entertainment. New-to-market 810 Billiards & Bowling are leasing locations at both CityScape Phoenix and Chandler Village, which are both opening this summer."

Both Tucson and the Valley block of Phoenix, Mesa and Scottsdale were recently identified in the top 10 commercial real estate markets for 2021, according to Kelly. With that, she cites Mitchel Allen, Greater Phoenix Economic Council senior vice president for Business Development, and Thomas Maynard, vice president for Business Development, for noting that "freeways rule in Greater Phoenix," as she points out that industrial development interest is highest along the 303 Corridor in the West Valley in Goodyear and Glendale and the southeastern portion of the Loop 202 near Phoenix-Mesa Gateway Airport in the Mesa and Gilbert area, and the greatest interest for office space is near ASU's main campus and newer builds along key transportation corridors. "As we move past the pandemic," she says, "office activity should increase."

Noting that his company, George Oliver, focuses its development on two product types – industrial and experiential office, Kremer says, "For our Industrial product, we're concentrated on the ground-up development and repositioning of industrial and e-commerce real estate, which, in metro Phoenix, has us closely monitoring active submarkets like the Loop 303 corridor in the West Valley, the Loop 202 corridor in the East Valley toward Williams Gateway Airport, and infill sites where there is opportunity for redevelopment and last-mile fulfillment projects.

"On the office side, we currently own CASA in North Phoenix, Lofts in North Scottsdale and The Alexander and The Johnathan in downtown Chandler. We also just completed the acquisition of Hayden Station on Mill Avenue in downtown Tempe. We are still focused on finding additional assets in those markets or in Central

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—Curt Kremer

Photo courtesy George Oliver (CASA)

Scottsdale. The demand drivers in these markets continue to outpace other Valley locations and seem to fit our office product the best."

D'Andrea sees Scottsdale as "the city with the most cache in Arizona," although he notes growth continues to improve in the southeast Valley, northeast parts of Phoenix and in the West Valley in cities like Glendale, Peoria, Avondale and the I-303 corridor.

But, as Ebert notes, it truly depends on the product type the developer is interested in. "When it comes to office properties, significant interest and leasing activity continues in Downtown Phoenix at CityScape Phoenix and Block 23, along with our new mixed-use development at 44th and Camelback Road and two North Tempe developments."

Justin LeMaster, vice president of U.S. Industrial for Hopewell, sees greatest interest in the

West Valley, along the I-10 and Loop 303 corridors; and in the East Valley cities of Chandler, Gilbert and Mesa.

And, pointing out that the Loop 303 corridor has a lot of industrial development right now, Orr shares that SunCap's Gilbert Spectrum development in the Town of Gilbert has received significant interest from industrial and office users alike. "With a limited supply of industrial land and available industrial product in the Southeast Valley, we have three buildings totaling 300,000 square feet going through site plan approval in the Town of Gilbert with groundbreaking anticipated in July."

ATTRACTION TO DEVELOPERS OLD AND NEW

"Most developers who have been here remain active. Many have become more active," says LeMaster. He notes that 20 years ago, the Phoenix economy was heavily driven by single-family home building and hospitality, but "our economy has become much more diverse and we have seen tremendous growth from tech, manufacturing and e-commerce-related companies, which has attracted developers and investors who were not interested in Phoenix in the past.

"This also," he continues, "has to do with our growth and that we have now become an emerging Tier 1 market, where before Phoenix was considered a Tier 2 (Secondary) market. Now, Phoenix is on the radar of many large institutional investors and capital groups, where before many were not focused on Phoenix."

In this regard, observes Ebert, "We're seeing more institutional investors that used to mainly focus on coastal primary markets begin to move into the Phoenix market to find stability and value that can't be matched elsewhere."

In fact, shares Orr, "There are numerous new capital sources and development companies considering investing and developing in the Phoenix MSA. In virtually every conversation SunCap has with prospective capital partners in other markets, they inquire about our Phoenix pipeline. When we share we are active in the Southeast Valley in the Town of Gilbert, we consistently receive additional inquiries into our plans."

George Oliver's Kremer reports similar experience. "We have absolutely seen new developers in all product types show up to Phoenix over the past six months," he says, explaining, "Phoenix's fundamentals are extremely attractive to outside investors and there's plenty of recent data calling out Phoenix as a top growth market for just about every commercial real estate product type over the next five years."

He adds, "Everyone has been affected differently by the events of the past 12 months, and everyone has responded in their own unique way. Depending on the product type, we've seen our competition either hold back on the sidelines until there's more certainty in what's to come, or make a heavy push to fill their pipelines and position themselves with plenty of product for the expected recovery."

Discussing industrial, in which his company specializes, SunCap's Orr says that "2020 saw many Phoenix developers of office and mixed-use projects turn their attention to industrial development." Calling 2020 "a record year for industrial real estate" and observing it appears to be continuing into 2021, with several new projects announced, he notes, "Colliers reported that in 2020 there was 13.9 million square feet of net absorption and 16.0 million square feet of industrial space delivered — the most industrial inventory ever for a single year."

Emphatically stating, "Most certainly there is much interest in the Metro Phoenix Market," D'Andrea explains, "The sub-market economic indicators are creating demand for developers of all product types to come stake a flag in the sand throughout Phoenix. The pandemic has fueled migration patterns of people coming from high-density coastal cities to cities more inland areas that offer more sprawling living opportunities, such as Arizona, Texas and Colorado. Even large operations such as Nationwide Insurance, USAA, Amazon, Intel, Pay Pal, Wells Fargo and Taiwan Semiconductor are offering high-paying opportunities with job growth, which has become very attractive to multifamily housing developers."

As to mixed-use developments, Orr refers to one of his company's projects in discussing the "great opportunities in the Greater Phoenix market" that exist for developers: "There's been such an influx of new residents from out of state, and Downtown Phoenix is becoming a setting that seamlessly combines the live, work, play environment with centers like CityScape Phoenix. Due to that, there's an incredible

Photo courtesy Lee & Associates (SkySong)

"Arizona has proven it can weather the storm of an economic downturn because we took steps to diversify our economy after the last recession." –Carrie Kelly

demand for mixed-use developments in dense submarkets and that's making them an essential product right now."

Says Kelly, "Greater Phoenix is known for its accessibility to the availability of a skilled workforce." She notes that cities like Chandler and Gilbert have successfully recruited many companies to the area, including Mercy Care Hospital, Deloitte, Silent Aure, Progressive Insurance, and Northrop Grumman. "Arizona has become one of the most desirable states to work, which is exciting news for investors and developers interested in relocating to Greater Phoenix," she adds. "We also expect to see our downtown areas continue to be solid investments as well. With advances in technology throughout the pandemic, site selectors can 'visit' more destinations without the added travel expense, making the process much more efficient and affordable."

DRIVERS OF MARKET CHANGE

"Population growth, e-commerce, on-shoring of manufacturing and the 'COVID Factor' are all driving forces to what is happening right now in our market," LeMaster says, noting he has have never seen the amount of demand for multifamily and industrial that the market is showing now. The vice president of Hopewell Development's U.S. industrial segment says, "COVID has fueled Phoenix's growth, as people and companies are moving to Phoenix from all over the country at a rapid pace. COVID has also accelerated e-commerce growth and increased demand for more manufacturing here in the U.S. to produce products faster and control the supply chain."

Compared to when the COVID-19 pandemic hit in the second quarter and Phoenix multifamily activity "came to a screeching halt as everyone wanted to wait and assess the market to see how things were going to develop," D'Andrea says, "When it became clear Phoenix was remaining at the top as a destination city and rent payments were holding steady, activity began to pick up in the third quarter. He reports that, as of the fourth quarter of 2020 and into early 2021, the growth and supply continue to race to keep up with the high demand for more living and working possibilities.

"The demand for lower living costs will support demand for rentals in the West Valley," D'Andrea continues. "Workforce housing, which is already in short supply, will see greater demand due to economic uncertainty, which in turn will continue to push occupancies and rents higher on all apartment assets. Based on what we are seeing, multifamily housing is expected to remain the top product type of choice for investors, with increasing momentum heading into the second third and fourth quarters of 2021."

He notes, however, "Although the Phoenix market continues to grow and thrive for select residential and commercial product types, the cost of construction continues to outpace inflation and rental growth, which is a viable concern."

Looking at industrial development, Orr says its acceleration has been driven largely by an increase in e-commerce. "That, coupled with the pro-business environment in the Phoenix MSA, continues to drive demand."

Ebert reports that RED Development is seeing an increase in demand for new and expanded spaces with financial institutions and the healthcare and technology business sectors, compared to a few years ago. "There are more conversations about corporate headquarters relocating to Greater Phoenix than in the past," he says. "Also, there's been an acceleration of movement within the food and entertainment industries and a shift from specialty retail."

"Having been in the industry for almost 20 years, I think the biggest difference I see is diversification," says Hopewell's LeMaster. "Looking at Phoenix today, we are attracting jobs and industries that we wouldn't have had a chance to attract in previous cycles." Citing such drivers as ASU, business-friendly government policies and optionality for end users as big reasons for this change, he says, "I think the CRE industry across all product types is doing a great job of delivering better products than we were previously, which is proving the optionality thesis and attracting excellent users."

That diversification is the result of intentional effort, which Kelly believes is paying off. "Arizona has proven it can weather the storm of an economic downturn because we took steps to diversify our economy after the last recession," she notes. "The commercial real estate market looks bright because of statewide collaboration and a concentration on a skilled workforce and education. The Arizona Commerce Authority is taking a proactive approach to assisting communities with broadband infrastructure to drive future rural Arizona development. The pandemic also has brought rural regional communities together, and we see initiatives like in Yavapai County to create coordination among a wider area to drive economic development efforts."

CRE'S ECONOMIC IMPACT

"The impact of the CRE market on the economy is huge," says RED's Ebert. "The market is instrumental in attracting and retaining new businesses to the Valley and, in turn, creating new jobs for Arizonans."

Observing that speculative development creates supply for companies looking for space to occupy, Hopewell's LeMaster explains that many companies want to see, touch and feel the real estate prior to making a decision to locate to a new market. "CRE creates many jobs from not only the construction industry, but also the new jobs the companies are bringing to the Valley," he says.

"CRE has always had a huge impact on the Phoenix Market," says The Related Group's D'Andrea. He anticipates some moderation this year from the aggressive development and investment in apartments and multifamily living that we have seen, and notes that a new supply of units expected to hit the market in the next one to two years may raise concerns about oversupply in certain submarkets in Phoenix. But, he says, "We should expect our multifamily sector to remain strong, provided construction costs and key commodity volatility can stabilize.

Harking back to the earlier discussion of industrial and multifamily CRE segments, AAED's Kelly names them as the top two economic drivers in commercial real estate. "With so many people moving to the state, the demand for housing is high, and developers have been working nonstop to develop multifamily housing options," she says. She points out that the West Valley has seen a number of industrial parks developing along the 303 freeway, Goodyear's industrial corridor is nearly filled, and Glendale has recently started construction on a 335-acre lot for industrial use. And, while acknowledging that retail and office space took a backseat amid the pandemic, with people working and shopping from the comfort of their homes, she says, "This lull is only expected to last through the end of the year as more vaccines are distributed and people go back to work."

Also not to be overlooked is the revenue contributed by the CRE market at both the state and local level, which Ebert and LeMaster characterize as "significant."

"Phoenix is a real estate-driven market, where we've had the benefit of expansive development and minimal barriers to growth for many decades," says George Oliver's Kremer. Observing that can be both a blessing and a curse, he credits the metro area's cities and governing authorities for "a great job of allowing growth where it's needed and limiting growth where it's not." He believes the CRE industry has and will continue to create jobs and stimulate our local economies. "Based on the recent tenant activity we've seen in our product types," he says, "the Phoenix job market is going to continue to shine and attract new residents who are making the decision that many of us have already made — which is that life in Arizona is just better."

Phoenix CRE from a Lessee's Perspective

"Location is always a common need and concern," says Craig Coppola, an industry veteran and founding principal of Lee & Associates Arizona. "Additionally, all users of space want great access in and out of their location, including freeways."

Cathy Teeter, CBRE managing director, cites employee safety, engagement, productivity, and retention as some of the common concerns among occupiers across categories. "These were concerns prior to the pandemic and certainly remain high priorities," she says. "Other common concerns are rising construction costs, supply chain issues, and available labor." She notes that flexibility regarding tenants' footprint — the ability to shed surplus space while retaining the ability to accommodate future growth — will continue to be important to all occupiers going forward.

Addressing the office sector as distinct from the industrial, retail and multifamily sectors, Rick Padelford, an Arizona REALTOR® with Realty Executive Commercial, says, "As offices begins to open back up and vaccines continue to be more widely distributed, the office sector will need to consider how to clean and disinfect common area spaces and the evolution of air circulation throughout office spaces." He adds, "This is also something that we could see transferring to the retail sector," noting that COVID-19 created some common concerns among the sectors.

Office remains on shifting sands. "Leases are still on hold as tenants remain unsure of their next move," says Bob Mulhern, senior managing director of Colliers in Arizona. "Touring has pick up dramatically, which is a positive indicator that companies are still looking to return to the office." Observing that sublease space continues to be added to the market, he adds, "However, not all sublease space available is vacant. Some tenants are putting their space up on the market as an additional option."

Observes Teeter, "The full impact and evolution of remote working is creating a new dynamic in the office sector. It has brought about some uncertainty that has resulted, in some cases, in more office occupiers seeking shortened lease commitment lengths as they are figuring out their longer-term strategy." And there has been little in the way of new construction, she says.

In the industrial sector, Teeter reports occupier activity at an all-time high, with record absorption in 2020 — and showing no signs of slowing at three months into 2021. "Additionally," she says, "we saw an increase in industrial rental rates due to unprecedented demand for space."

Noting that high level of activity, Mulhern says the biggest concern is the availability of smaller space. "Currently, every new developer in the market is building to attract larger users (more than 100,000 square feet), but the vacancy rate for industrial buildings under 50,000 square feet is less than 4%."

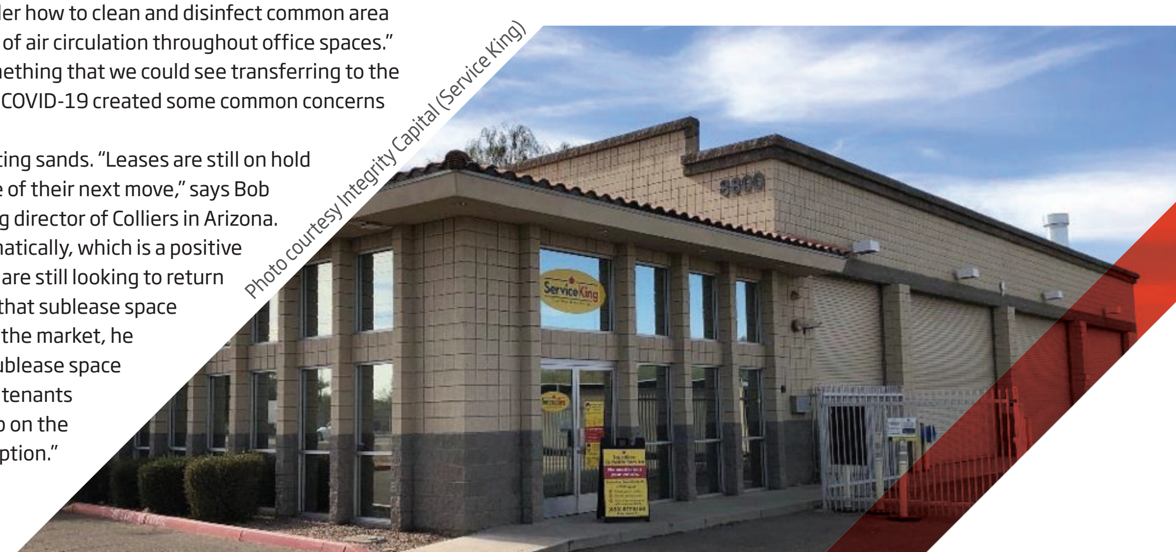

Photo courtesy Integrity Capital (Service King)

Confidence is a big difference between sectors, Coppola observes. "Industrial tenants have more confidence in their business plans for now, and will commit to longer-term leases. Office tenants are still trying to figure out what their new hybrid models will look like. They are searching for as much flexibility right now, particularly in lease term. Of these three sectors, retail continues to see the biggest disruption in its business, accelerated by the pandemic."

What little new construction there is in the retail sector, the concentration is on properties with drive-thru features, says Teeter.

"Retailers' main concern is e-commerce as it continues to grow and impacts brick and mortar locations," Padelford says. "Physical retail stores aren't going away, but they certainly don't need as much space as before." In fact, he points out, "As we see vacancy in larger retail spaces, we will continue to see the industrial sector repurpose a lot of this space both here in the Valley and nationally." A current example he offers of this adaptive reuse is Paradise Valley Mall being converted to a mixed-use project.

WHERE'S THE ACTION?

"That's easy," Coppola says. "Right now, warehouse industrial is on fire — along the 303 is the hottest — along with multifamily and single-family residential. All three are as strong as they have ever been." Citing Amazon's presence with almost 20,000 employees, 11 warehouses and fulfillment sites — to which it is actively looking to add more — plus its tech hub in Tempe, Coppola points out Amazon is not the only tenant moving to Arizona taking office, warehouse and manufacturing space. "Sub Zero, REI, White Claw, Silicon Valley Bank and thredUp have all moved in or expanded in the past few years. Pure office tech tenants, such as Robinhood and Align Technology, have also signed leases in Tempe, even during the pandemic." South Scottsdale, he says, remains another strong tech hub. "We lease SkySong, which is 95% in its existing buildings, which include Oracle and Limelight."

Teeter calls out Scottsdale, Tempe and Chandler as likely to continue to see good activity in office, along with the MetroCenter area north of Deer Valley, which she expects to benefit from Taiwan Semiconductor Manufacturing Co.'s announced $12 billion semiconductor fabrication plant construction.

Noting that available land in the Southeast Valley has become extremely scarce — as has land on the West Loop 303 corridor — Mulhern relates, "Recently, a back-office property was sold in South Tempe, which will be demolished and redeveloped as Class A warehouse space. The industrial market has had such positive rent growth and low vacancy that the new facility will be quickly absorbed."

"Right now, warehouse industrial is on fire – along the 303 is the hottest – along with multifamily and single-family residential. All three are as strong as they have ever been." –Craig Coppola

Land availability is the condition Teeter cites for the "incredible activity" industrial is seeing in the far East and far West Valley areas — Mesa Gateway in the former and Goodyear and Glendale in the latter. "The biggest concentration of vacant product is being built in those markets as they have the largest supply of developable industrial land. As a result, both of those submarkets are landing large requirements," she says. Retail's hot spots, she says, are Surprise, Chandler, Gilbert and Queen Creek.

The West Valley is where Padelford sees the greatest activity overall – and potentially continuing, as he notes the tremendous current growth in residential and industrial, and observes, "As that continues, the retail sector will follow.

"We're very fortunate in Maricopa County, as the net migration for this past year still exceeded 83,000. The greater Phoenix-area is still incredibly affordable compared to California and the 'gateway cities,'" Padelford continues. Crediting the Arizona Commerce Authority as well as the other economic development agencies for the great job they have been doing in continuing to bring in thousands of jobs, he says, "In commercial real estate, jobs drive just about everything. As long as jobs are being created, we will continue to have people move to Arizona, and then those individuals will need places to live, work and shop.

Noting that in the past quarter alone, Intel announced an additional $20 billion dollar expansion, and Taiwan Semiconductor (TSMC) its multi-billion-dollar plant in north Phoenix, Padelford says Maricopa County is becoming the largest chip manufacturer in the country — "and that is just one element of the massive growth we'll see in the years to come."

DIFFERENT TIMES, DIFFERENT MARKET

"The driving difference in the market between now and a few years ago," Padelford says, "is safety and health concerns. Certainly, the pandemic wasn't on anyone's radar and wasn't anything that anyone could predict, but there are a lot of similarities in the market." The similarities have to do with the setting in which people will work, he explains, as some people still want to work in an office even though work-from-home has become more common. "Some people believe they aren't as productive at home and long for the opportunity to easily collaborate with colleagues."

The retail sector has felt the impact of online shopping and e-commerce, as Padelford observes, "COVID-19 effectively accelerated tech and e-commerce by several years."

The industrial sector is also benefiting from e-commerce, as well as from the manufacturing industries, Mulhern says, but notes that multiple job industries are preforming well. Two in particular are healthcare and technology. "Unlike the previous cycle, where the economy was driven by home building construction, healthcare is now the leading industry in Phoenix," he says. And, citing Colliers' national report "O' Tech Talent, Where Art Thou," which analyzed tech talent in various categories, Mulhern notes Phoenix ranked No. 5 in 'volume rankings' because of the market's strong creation of graduate students, "which has been drawing the attention of tech tenants for the past couple years."

"Over the past decade," says Coppola, "we are now adding some very compelling additional difference-makers, including Arizona State University. For example, Zoom just signed a 30,000-square-foot lease in Tempe to build a new R&D center. Why? Proximity to ASU and its engineering school.

Photo courtesy CBRE (freeway exchange perspectives)

Same with Infosys taking space on campus at Novus to open an innovation hub. ASU now has over 300 joint ventures with companies working side by side with ASU professors, students and researchers." That is in addition to what Coppola calls "the usual" factors impacting the market: great weather, growth opportunities, and proximity to California — "our biggest contributor to people moving into Arizona."

"A few years ago," Teeter says, "we saw healthy activity across all property segments in the Phoenix Metro area." In 2020, industrial posted its best year on record for net absorption and new supply. Asking rates are reaching their highest levels on record as vacancy continues to drop. As trends in ecommerce and onshoring accelerated during the pandemic, activity in the Valley picked up and continues to remain strong. "Today, more so than in years past, we are seeing an increasing number of occupiers coming into our market for the first time.

"Some of these companies already have plans to continue their growth in the Valley and expand their footprint," Teeter continues. "While industrial was strong in years past, the market size was just under 10 million square feet of annual net absorption between 2016 and 2018. Now, we expect 12 million square feet of net absorption, setting a new base level for this region going forward as more companies enter the market and the size requirements increase."

In the office market, Teeter reports a larger disparity emerging in activity between high-quality and less-desirable locations. Whereas in years past, demand across all building classes was fairly steady, she notes that throughout 2020, occupiers have shifted their focus to well-located, newer Class A properties, with employees' health and wellness top of mind as well as the creation of spaces that attract employees to the office.

"Efforts by our economic development partners from GPEC and ACA have helped draw interest from companies outside of Arizona and helped create a more diverse economic base. Some of the latest announcements from well-known high-tech manufacturers have had a ripple effect. Net migration to the Valley has only accelerated during the pandemic as work-from-home options have expanded throughout the nation.

"For occupiers, the Valley is seen as a place where their employees want to live due to high quality of life, climate and relative low cost of living," she says, although cautioning, "One area to watch is housing affordability. Housing is quickly becoming less affordable and that could have a dramatic effect on quality of life in the future."

CRE'S ECONOMIC IMPACT

"Per the NAIOP Research Foundation, commercial real estate contributes to 18% of all U.S. GDP, which — including the multiplier effect — is over $3.7 trillion in economic contribution," Coppola says, noting CRE is everywhere, from office space for all business to every retail shop/restaurant and apartments. "With Arizona's growth, commercial real estate is a key driver for the economy and our fortunes even more than the U.S., because we are growing so fast." And growth, he says, means commercial real estate. "The huge win for Arizona is the announcement of TSMC Semiconductor, which bought 1,000 acres of land and will build a $12-billion factory to manufacture semiconductors. This is almost 2,000 high-paying jobs directly, but they will need dozens of suppliers as well."

Specific to Arizona, Mulhern cites NAIOP's Economic Impact of Commercial Real Estate Report 2021: Commercial real estate development contributed $11 billion to Arizona's GDP, and the industry as a whole created and supported 83,805 jobs, which generated $4.0 billion in wages and salaries.

"Arizona offers high-quality real estate options for companies moving their operations to the Valley," Teeter notes, pointing out these opportunities attract new-to-market firms such as Align, LifeStance and Robinhood, and that TSMC, Intel and Electra Meccanica needed available real estate to bring their manufacturing to Arizona. "In short," she says, "real estate is one of the major components that companies consider when determining whether they will bring jobs to our state. Fortunately, we have had a great story to tell on the commercial real estate front, which has helped attract companies to Arizona and, in turn, fueled our area's population and economic growth."

The commercial real estate market's impact on our economy is tied to job opportunities, Padelford explains. "For every job that is created, the impact to the economy is more than just the job. That employee may have children, goes to restaurants, goes shopping and needs a place to live. When you talk about CRE, that single job has a significant impact on the economy as a whole."

Andrea Davis CRE andreadavis.co
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