

Brokers Forum Report

March 22, 2016

Forecast for April 2016 – September 2016

The Center for Real Estate Theory and Practice



ASU Commercial Brokers Forum Survey Forecast for April 2016 – September 2016

Introduction

Ideally we would say that the entire metro commercial real estate market is fully recovered and growing at a brisk pace, but we can't say that - yet. Based on our survey results we repeat what was said six months ago – *“the market is better – and getting better, but it is still shaky in some products areas and submarkets”*. We must add to this a small uncertainty that has crept into the minds of those at our Forum. It is not clear when we will look to the future with absolute, unconditional confidence. The word that comes to mind is “Interesting”. One of the participants at the Forum said, “The market is more psychologically driven than statistically driven at the moment.” We see this in the responses. Growth is occurring, projects are getting done and we continue to make progress as a metro area. This is dampened by an uncertainty which is impacting decision making. Global economics and our political process makes a clear, certain projection of market conditions more difficult. When you look at the trends and read the comments the conclusion is clear that we are on pretty solid ground but outside factors are creating uncertainty. Although panelists feel expansion continues, concerns still exist and the geography of the expansion is still not uniform – some products and submarkets are doing much better than others, but sufficient demand isn't certain as yet to push opportunity for expansion to submarkets that have been slower to recover.

Background

On March 22nd, a group of some of the Valley's most successful commercial real estate brokers representing all major product types, were brought together by the W. P. Carey School of Business and the Center for Real Estate Theory and Practice to provide meaningful, insightful and relevant input on the commercial real estate market in Phoenix. These brokers came from a variety of sectors and specializations as well as a cross section of the many brokerage houses in the Valley. This discussion is part of a series of forums held every six (6) months by the Center for Real Estate Theory and Practice in order to track the perceptions, insights and trends in the Phoenix commercial real estate market.

The purpose of this forum is to seek informed opinion and hopefully achieve consensus on forward-looking key indicators of the commercial real estate market in the Phoenix metropolitan area. The forum was organized with the help of Pete Bolton, managing director of Newmark Grubb Knight Frank. The forum was conducted as an open discussion about what is happening “on the street” in commercial real estate. The intention of this gathering was to detect current trends, discover similarities and differences among various sectors and submarkets and document anecdotal evidence, opinions and insights from the group. This report is a summary of their opinions. Each session builds on the previous ones and the information gathered is synthesized chronologically to provide an indication of trends.

This is the seventh report of the Commercial Real Estate Broker Survey which addresses what the panelists believe will happen between April and September 2016. The following charts indicate the answers to the associated questions asked of the panel. Preceding the charts are statements

made by panelists about the specific market segment. The responses are anonymous. This is done so the panel members feel comfortable providing unbridled opinions. Reading the comments will give readers a sense of what these important players in the commercial markets are thinking. Readers should note that the comments are those of the brokers and are as close as possible to being verbatim. This is not a refined analysis of market conditions.

In our last report we felt comfortable saying that for the next six months there will be little change in performance in all segments of the metro Phoenix real estate market. It is clear from the results of this edition of the forum that those who know this market best are feeling slightly less certain about where we are but remain confident the metro area will continue to expand. We are confident saying 2015 was better than 2014 and, we should see little change before the end of Q3 2016. But that little bit of uncertainty mentioned previously is now into the back of our minds. The question to be answered, only in retrospect, is: "Will the uncertainty have a negative impact on the market?". If it does, we do not think it will be profound, rather it would be a slight pause. Most all economic fundamentals suggest continued recovery and growth – but still only in certain submarkets.

Many of the same systemic problems that have persisted for the past several years still exist to some degree in some submarkets - attracting more high-wage earning jobs, construction labor shortages are still a problem but construction hiring is increasing, tight lending is still making anything other than institutional grade borrowing tough and continues to keep a governor on new construction. When asked what direction the Phoenix market is moving, the percent saying "up" dropped to 67% from 100% where it had been for the past year. When asked the question "Where are we in the cycle?" 62% said "Expansion" - this is down from 90% six months ago. Our respondents are feeling good about where we are but a little less good. Significant is the sentiment. Since January 2014, when asked "what is the overall feeling about the metro Phoenix commercial real estate market" 100% of respondents were "Optimistic". For the first time since January 2014, 92% said Optimistic. They all wished for more activity in most segments, but they see the progress. How we are growing is different from before the recession and continues to reflect a maturing metro development pattern. These are the forward-looking opinions of the professionals who are in the market every day. These survey results are their opinions based upon their experience.

Mark Stapp
Executive Director, Master of Real Estate Development
Director, Center for Real Estate Theory and Practice
Fred E. Taylor Professor of Real Estate

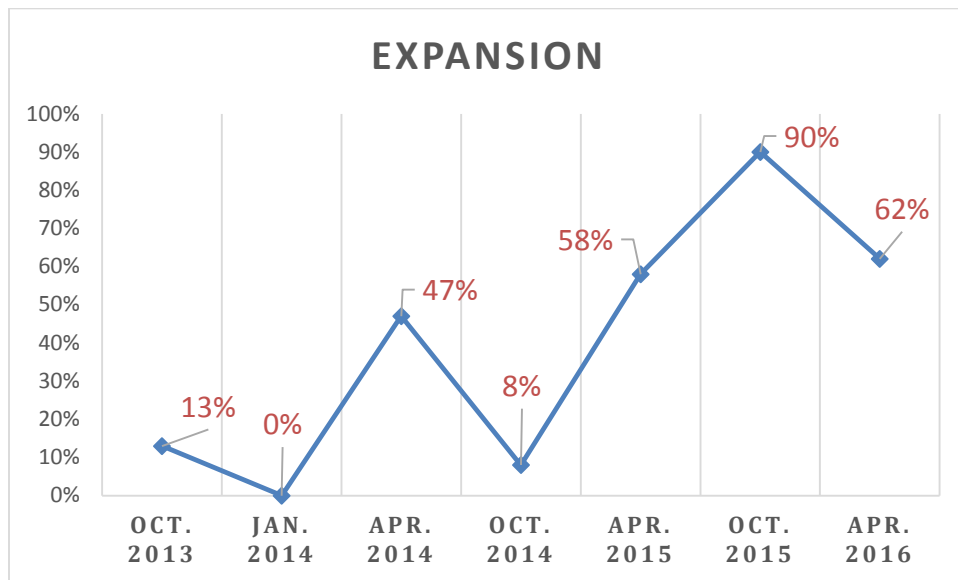
Below are consensus statements made by the panel and charts that show responses to questions asked of the panel. For most questions, panel members could choose “Up”, “Down” or “Stationary”. For simplicity sake, we chose to only show % of respondents selecting “Up” but believe this adequately show trends.

Questions regarding the overall metro Phoenix real estate market

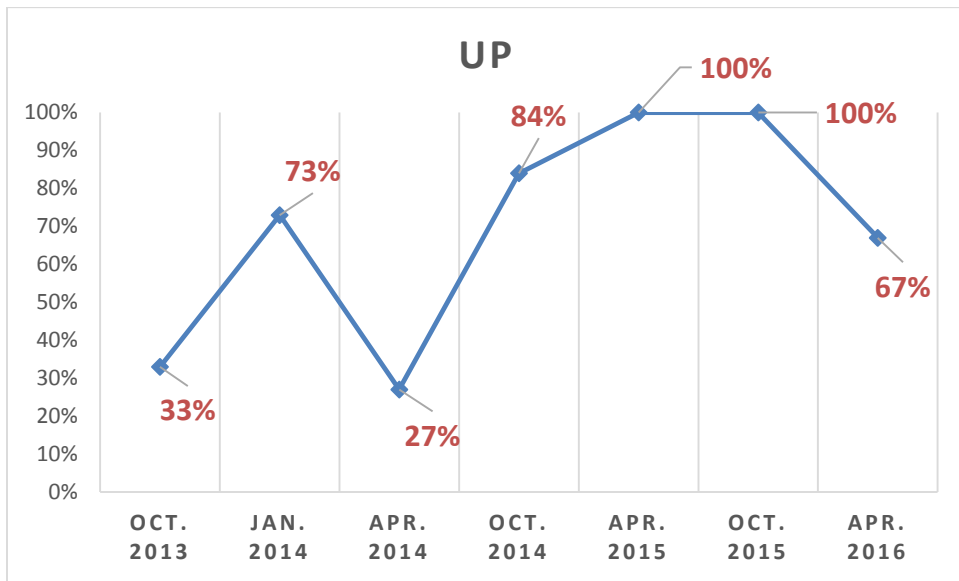
CONSENSUS STATEMENTS:

- The market is more psychologically driven than statistically driven.
- There is continued activity in the marketplace and enthusiasm is building.
- Even with some companies giving back space in the market (Zenefits) it is not a real estate issue, but an operational issue.
- The Valley is completely sub-market driven, some submarkets have not come close to recovery and others are clearly expanding.

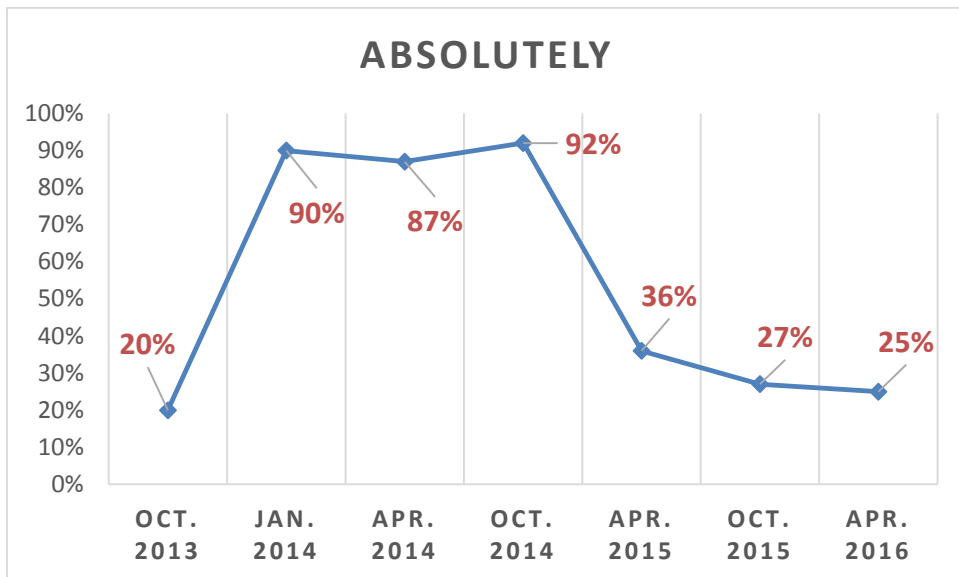
Where are we in the cycle?



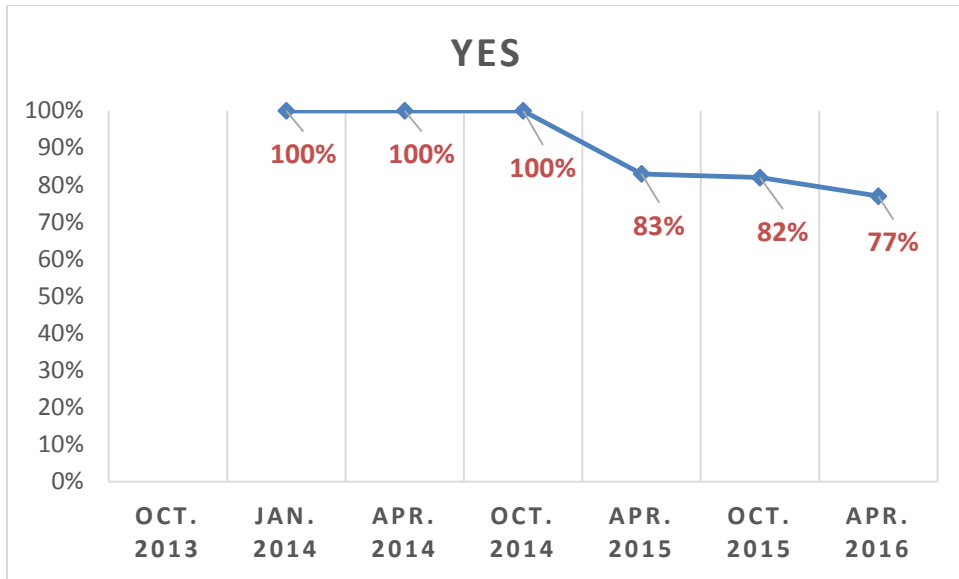
In what direction is the metro Phoenix market moving?



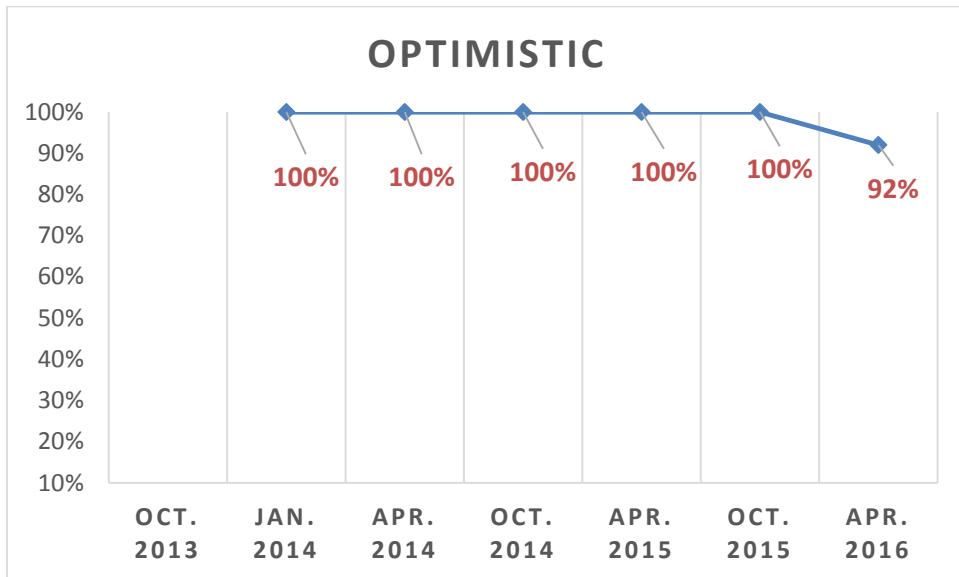
Will the number of people who have stopped working or stopped looking for work affect commercial real estate markets?



Is uncertainty in the federal government affecting the commercial real estate market and hindering our local growth potential?



What is the overall feeling about the metro Phoenix commercial real estate market?

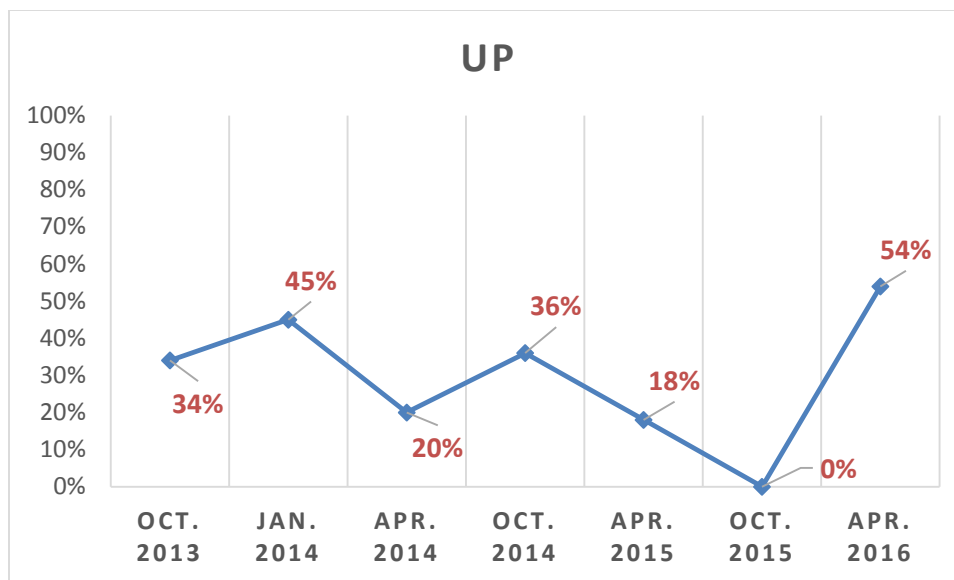


Questions regarding the metro Phoenix Multi-Family real estate market

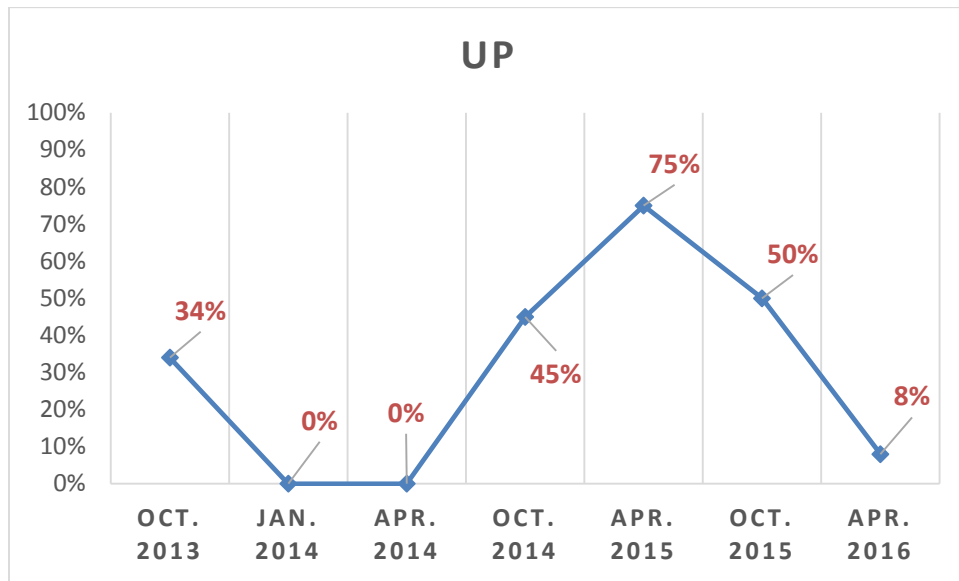
CONSENSUS STATEMENTS:

- The multifamily market is extremely submarket driven – millennials and baby boomers alike want to be near good restaurants, and good shopping without having to get in a car.
- It is very difficult to get rents to support new construction – B and C class product is being repurposed.
- Two-thirds of Americans cannot afford a 2 bedroom apartment.
- A lot of the institutional investment is leaning toward affordable housing options. “A” space is getting too expensive.
- Fannie & Freddie are falling over themselves to lend in the affordable and manufactured housing arenas.
- Everyone is chasing knowledge-based employees – tech workers rather than call center workers.
- There is a lot of pressure for Phoenix to increase the minimum wage.

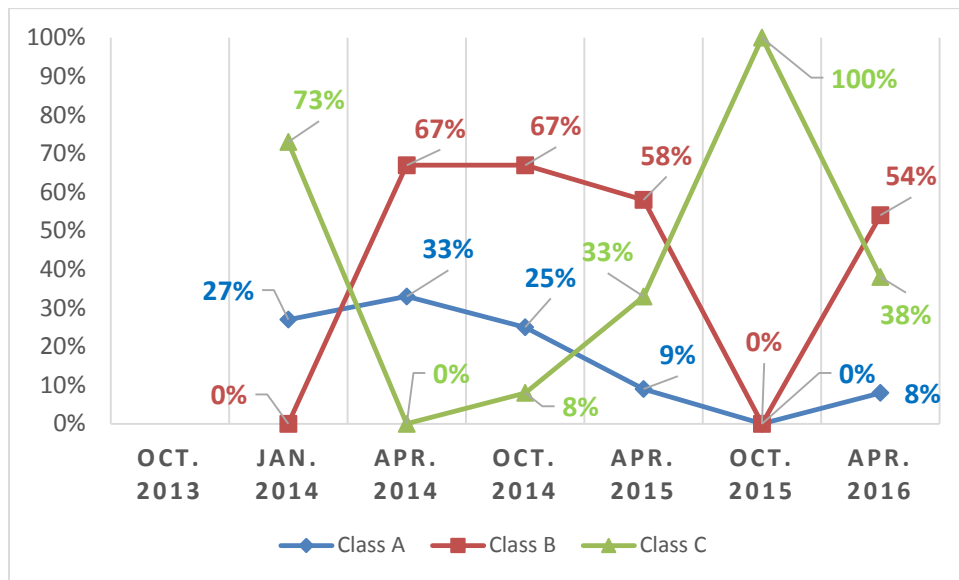
Where are **apartment vacancy rates** headed in the next six months (October 2015 – March 2016)?



Where are **apartment rents** headed in the next six months (October 2015 – March 2016)?



Which **multifamily property class** will realize the greatest rent growth over the next six months (October 2015 – March 2016)?

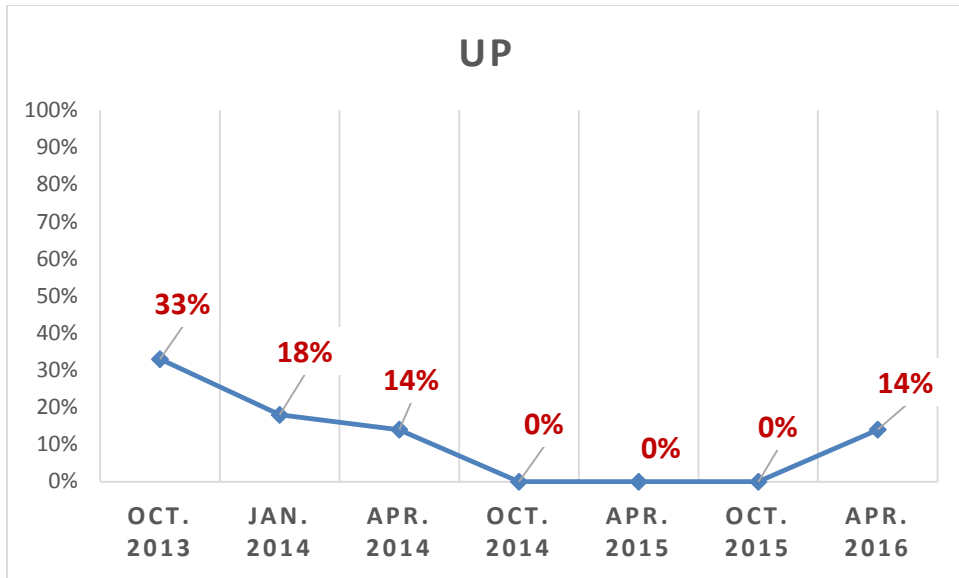


Questions regarding the metro Phoenix Industrial real estate market

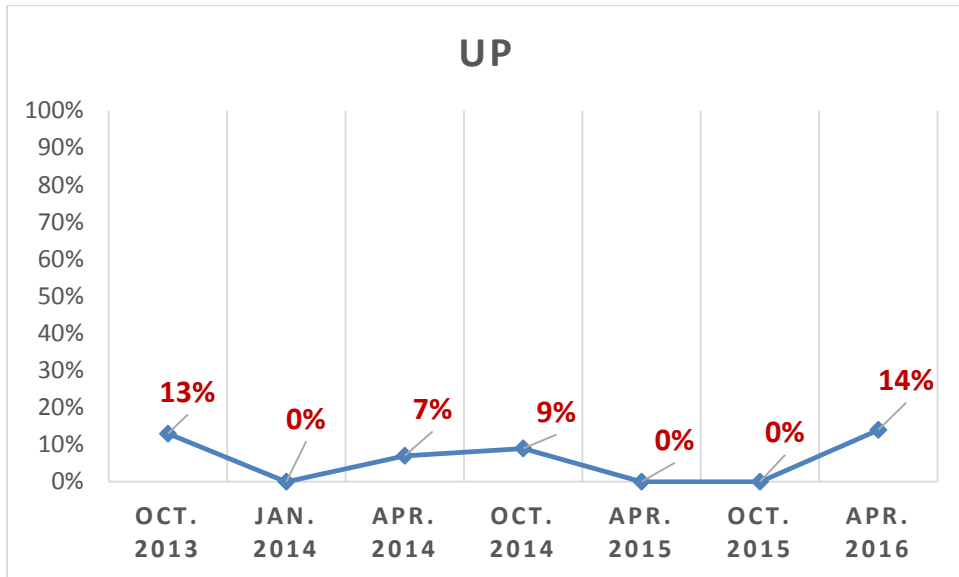
CONSENSUS STATEMENTS:

- The metro Phoenix area is under 10% vacancy, which is 30-40% higher than the Inland Empire.
- Phoenix had 8 or 9 significant deals over 200,000 square feet last year whereas Southern California had approximately 30.
- The Core Phoenix market size is 20,000 to 80,000 square feet.
- Look at Tempe – business parks there are old (low ceiling height, lack of technological infrastructure, etc.), clients will look outside of the area to find newer buildings.
- Vacancy rates are not decreasing because there is always land to build new in other areas.
- The big-box industrial spaces in the Southeast valley are more build to suit, e-commerce has created more specification in the use of the space.
- Chandler airpark and the Sky Harbor have the most activity.
- There is plenty of land available, rent growth is not expected to rise any time soon.
- There is demand, but supply is keeping up and keeping rents stable.
- Very few barriers to entry to get into the market.
- Capital markets are looking for industrial properties – there has been a shift toward industrial and there are not that many out there to buy. Off market deals are the only way to make sure they get in.
- Most investors are looking for single-tenant properties around 30,000+ square feet.
- Last mile fulfillment is also a big consideration.

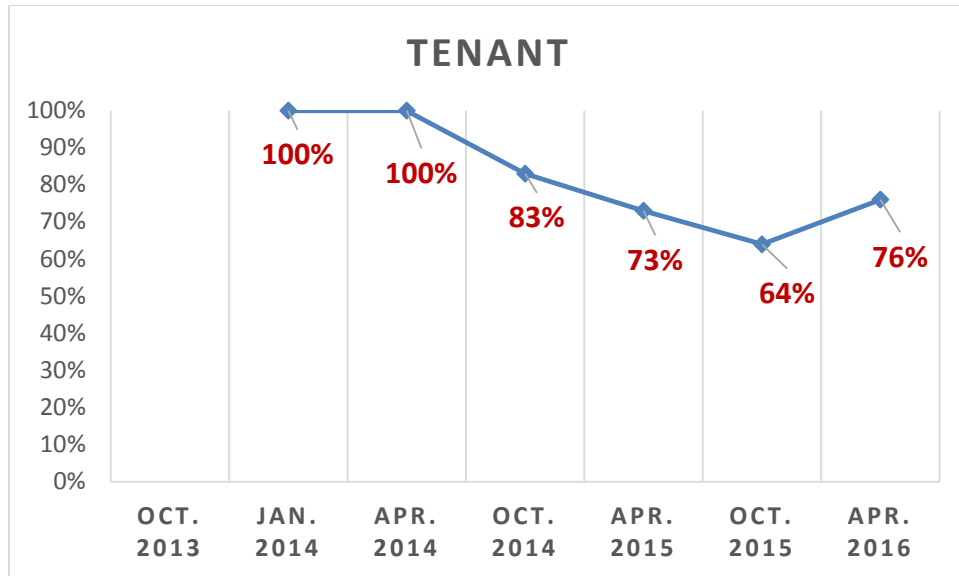
Where are **big box industrial vacancy rates** headed in the next six months (October 2015 – March 2016)?



Where are **big box industrial rents** headed in the next six months (October 2015 – March 2016)?



Is this a tenant or landlord **industrial** market?

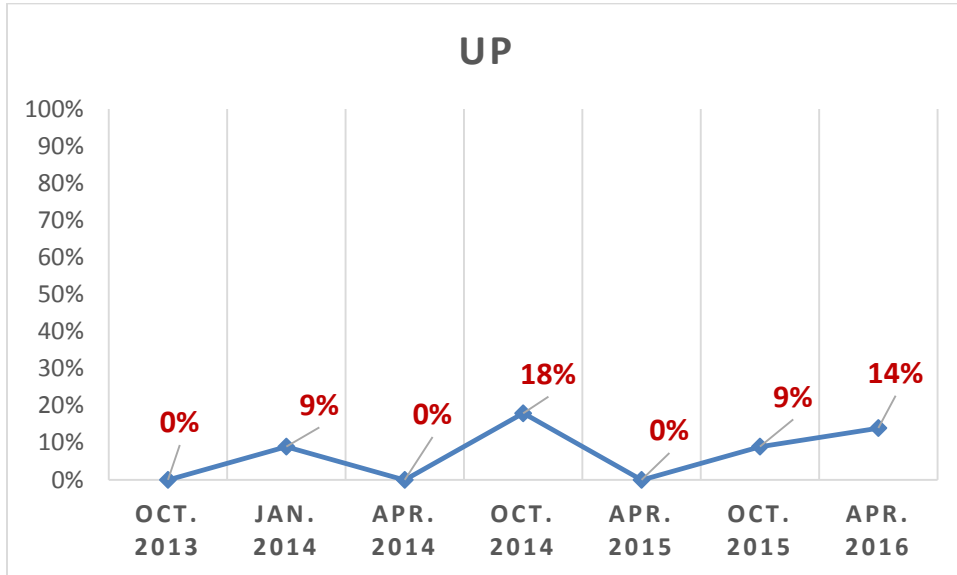


Questions regarding the metro Phoenix Office real estate market

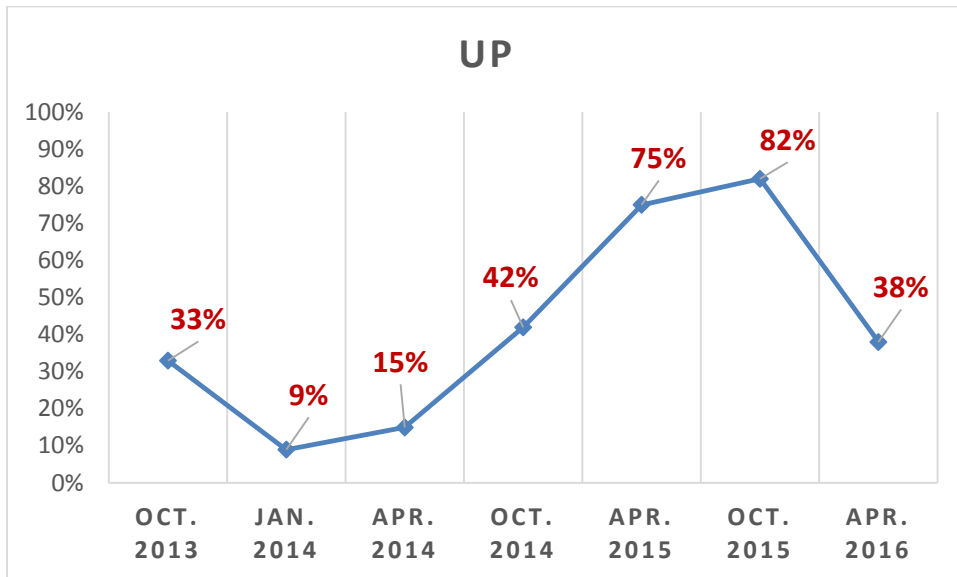
CONSENSUS STATEMENTS:

- Mixed use product are doing really well.
- Medical office is attractive because of all the growth in hospital construction. Rents are higher the closer to a hospital campus you are.
- Hospitals are controlling the world – doctors must go where their patients are which is close to the hospitals.
- Medical reimbursements take so long that sometimes tenants cannot afford the rents for the space they need.
- Medical condos are booming and the time to buy is now as prices are still within reach, however, individual doctors cannot afford them, so specialty groups are the new owners.
- Medical office has played a huge role in absorption numbers.
- Major products coming out of the ground within the next 90-120 days will affect vacancy rates.
- Companies are gravitating to urban core areas to satisfy labor demands – big tenants are kicking the tires.
- Consumer confidence is back. Tenants jockeying for position in the urban core for small blocks of space is a good indicator of the market rebound.
- Office rents are submarket driven – some product is below market rents.
- The market is extremely segmented – almost have to talk asset by asset for comparison.

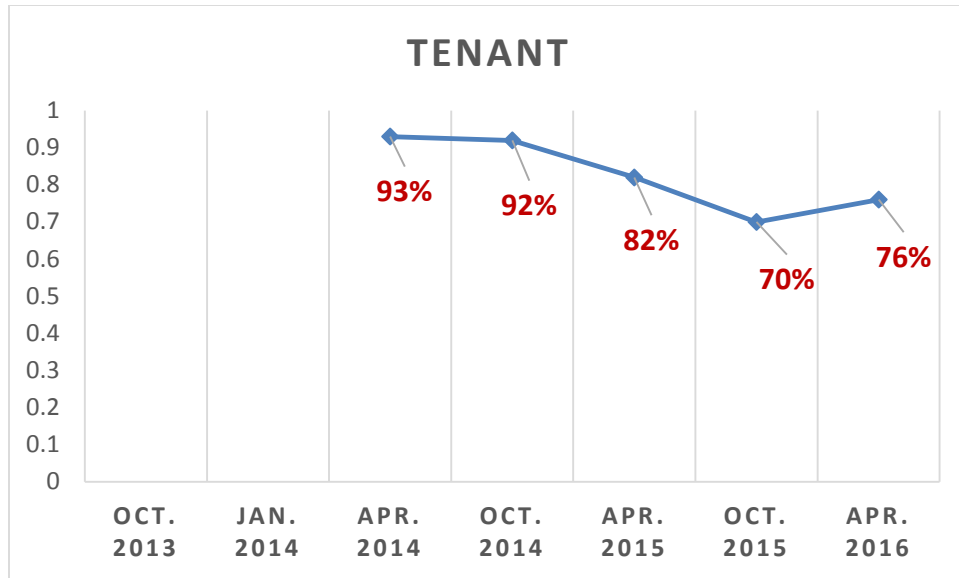
Where are **office vacancy rates** headed in the next six months (October 2015 – March 2016)?



Where are **office rents** headed in the next six months (October 2015 – March 2016)?



Is this a tenant or landlord **office** market?

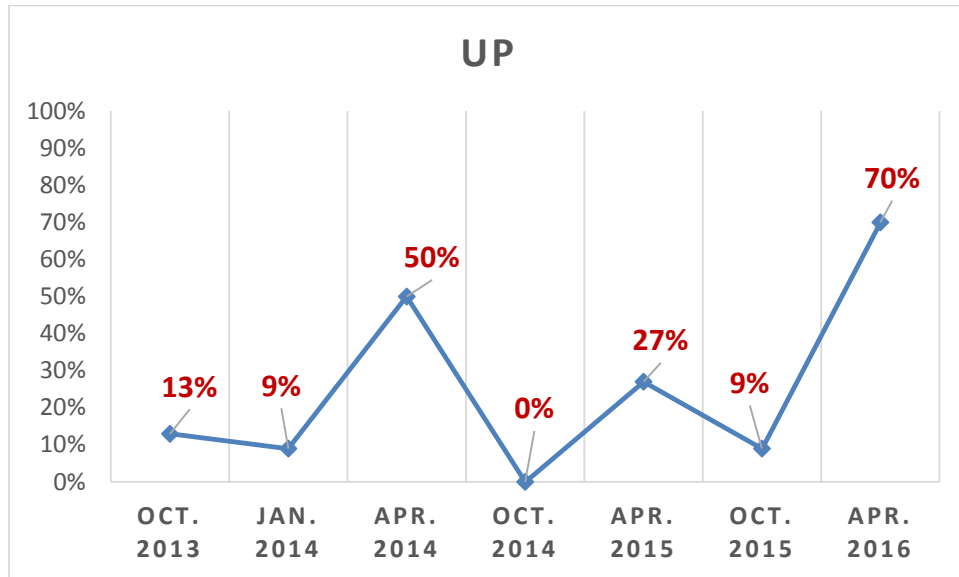


Questions regarding the [metro Phoenix Retail real estate market](#)

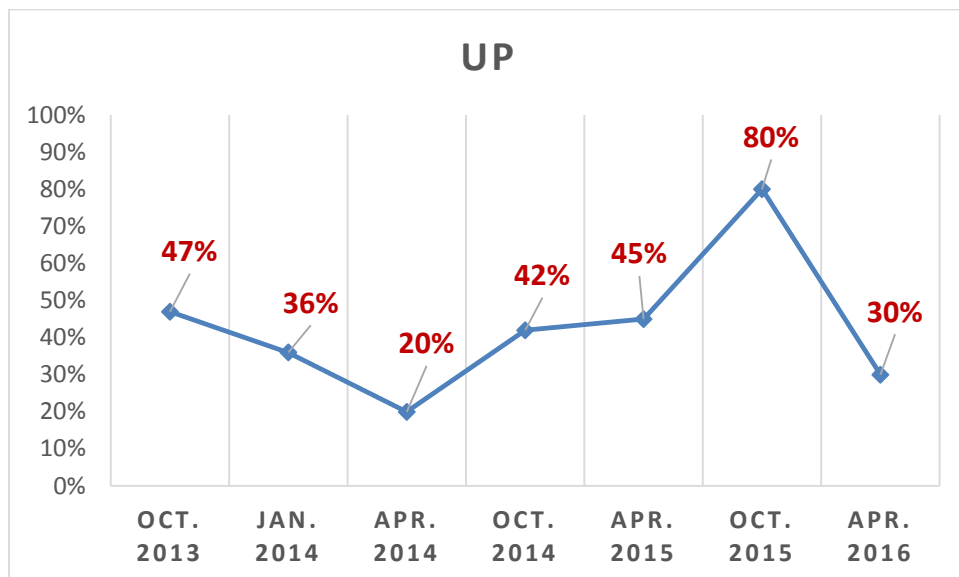
CONSENSUS STATEMENTS:

- Rents are high in new construction.
- Market is constantly changing due to e-commerce, have to consider selling anything in stores any longer.
- There are 223 big boxes over 200,000 square feet that are empty.
- Big- box anchored centers are struggling – only so many churches, schools and government office to go around.
- Service retail and restaurants are doing fine.
- Most new building is in the 20,000 square foot range.
- Having a hard time fighting e-commerce
- Rents are in high teens and \$40 square feet, not much in between.
- For the power centers, unless it is a trophy asset it is very difficult to get anyone to the table.

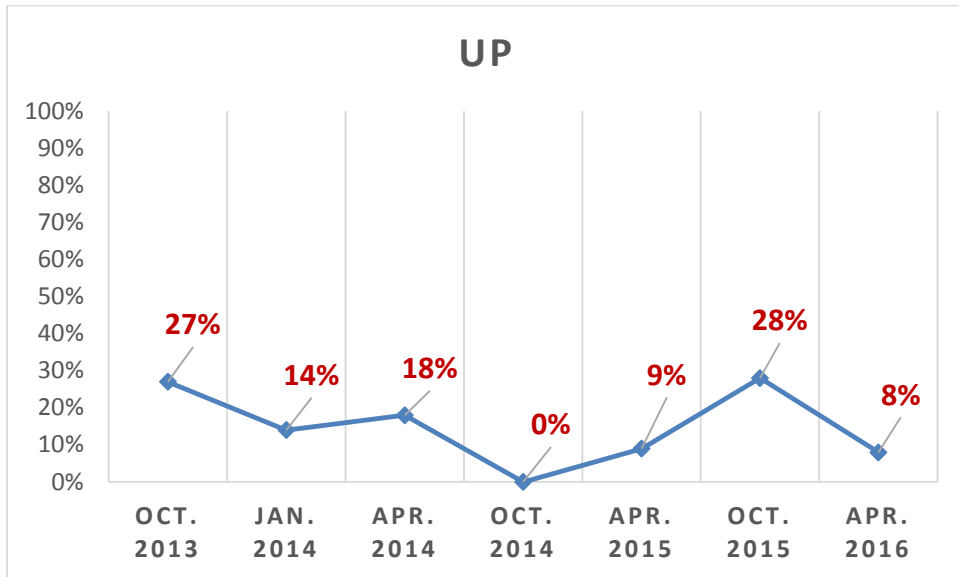
Where are **retail vacancy rates** headed in the next six months (October 2015 – March 2016)?



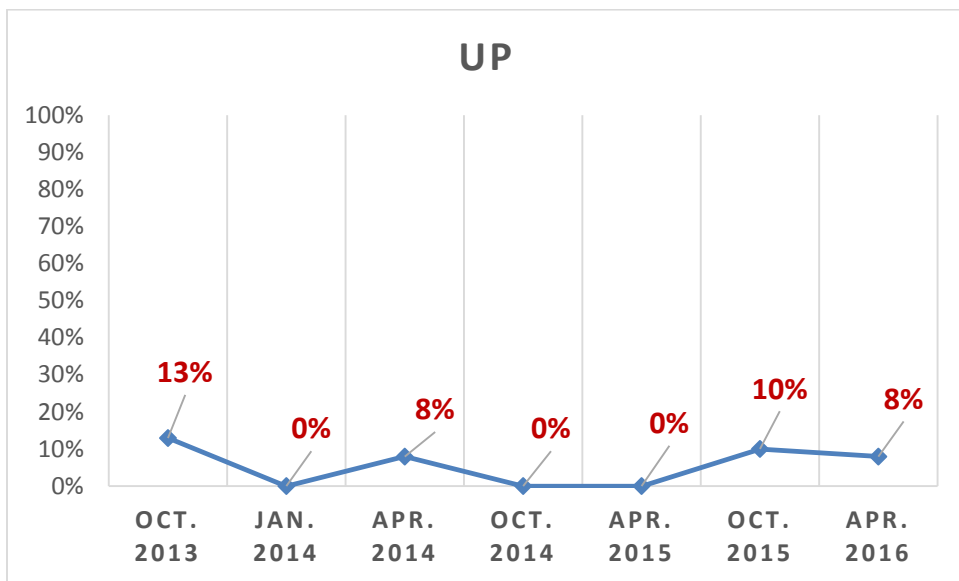
Where are **retail — anchored center rents** headed in the next six months (October 2015 – March 2016)?



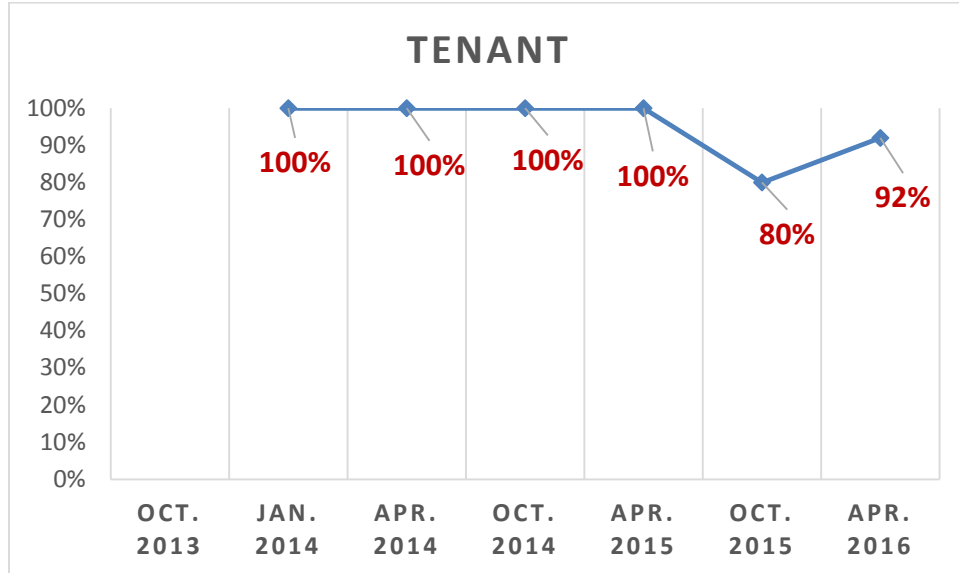
Where are **retail - unanchored center rents** headed in the next six months (October 2015 – March 2016)?



Where are **retail — big box (over 25K square feet) rents** headed in the next 6 months (October 2015 – March 2016)?



Is this a tenant or landlord **retail** market?

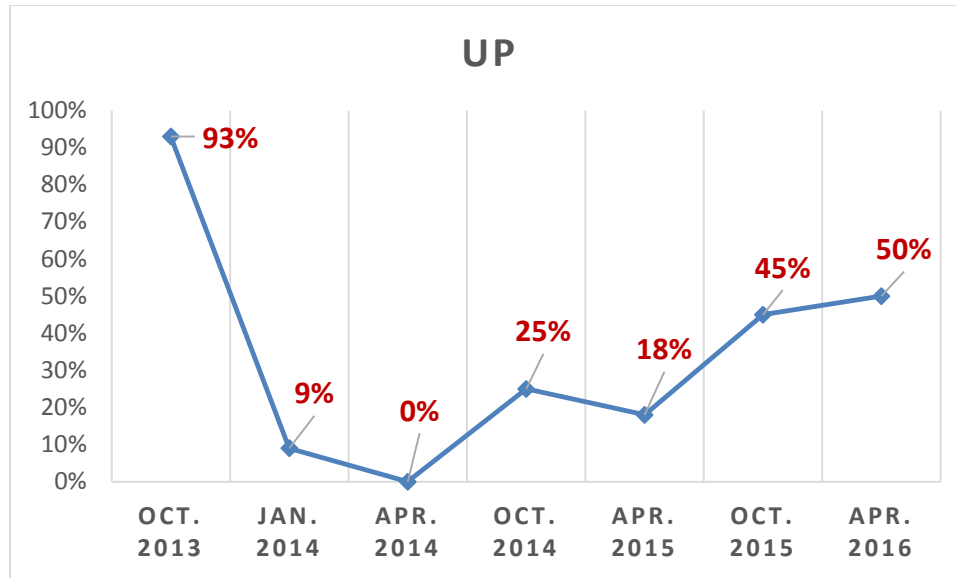


Questions regarding the metro Phoenix Capital markets

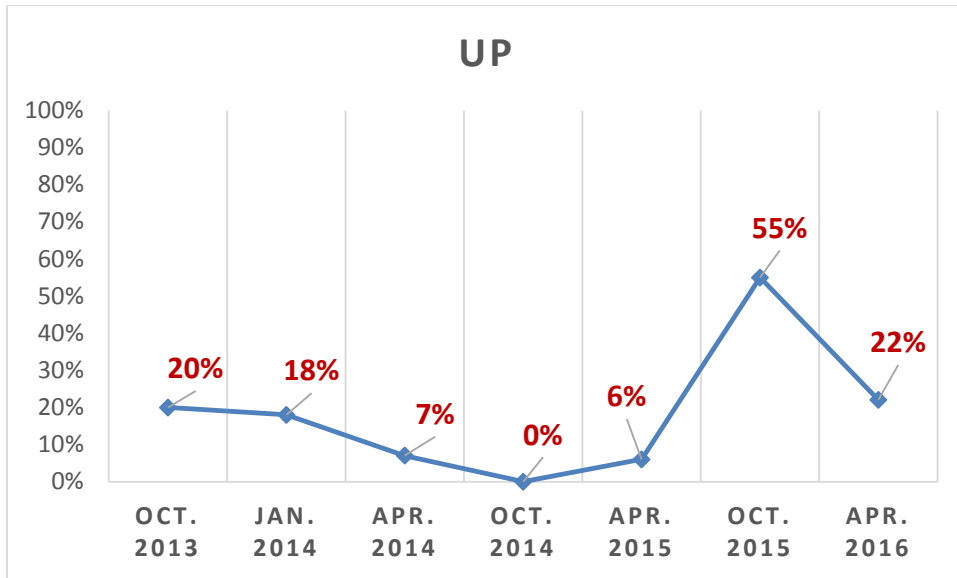
CONSENSUS STATEMENTS:

- Interest rates will eventually go up, but that is getting pushed back.
- Dodd Frank in December will have some affect on the capital markets.
- New rules will impact lending.
- None bank lending increasing in importance.

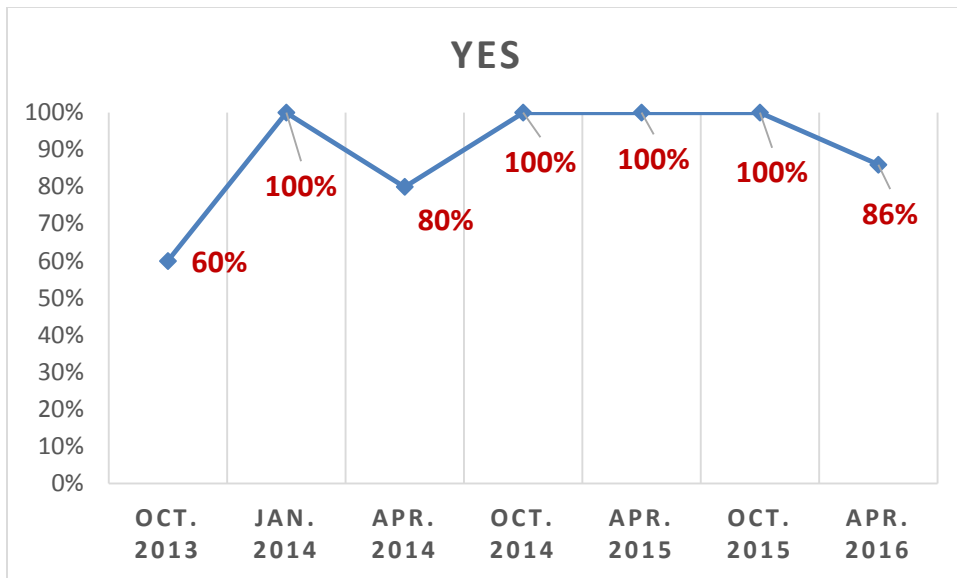
Where are interest rates for commercial loans headed in the next six months (October 2015 – March 2016)?



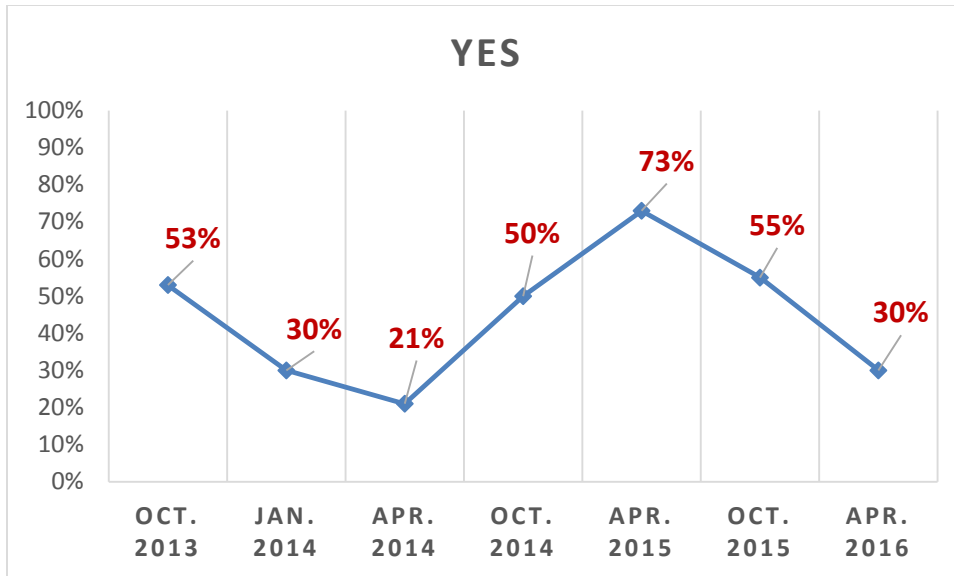
Where are **investor returns** headed in the next six months (October 2015 – March 2016)?



Has **cap rate compression** helped effect gains in core real estate values over the past six months (October 2014 – March 2015)?



Will **cap rate compression** continue in the next 6 months (October 2015 – March 2016)?

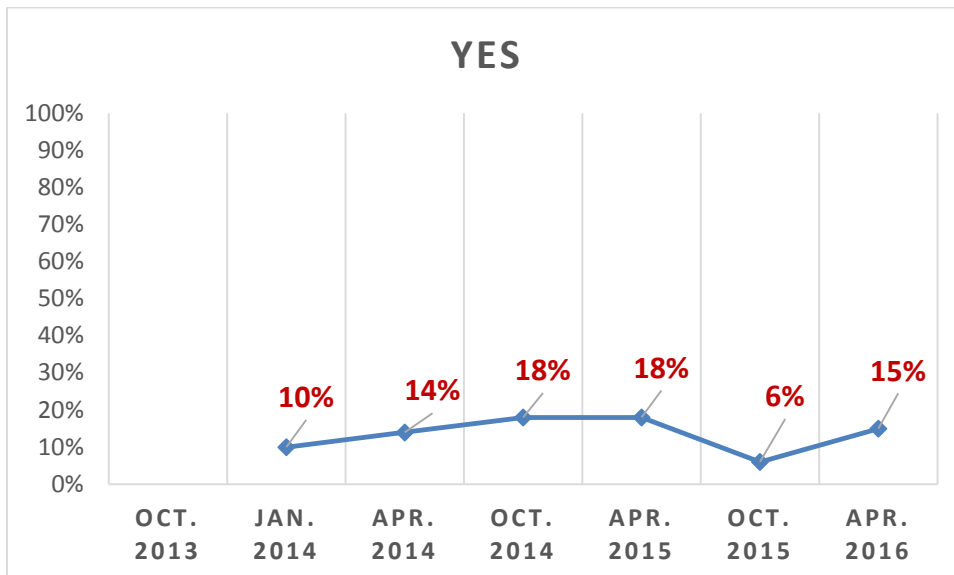


Questions regarding the metro Phoenix Land and Home real estate market

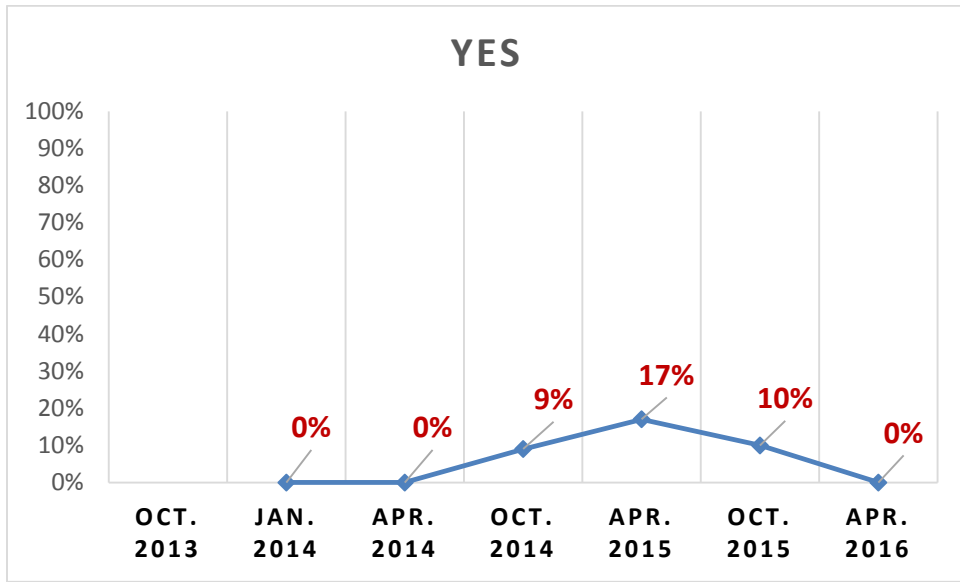
CONSENSUS STATEMENTS:

- Homebuilders are eager and are tying up land in the southeast and northwest valleys.
- Improving but not at a rapid rate.

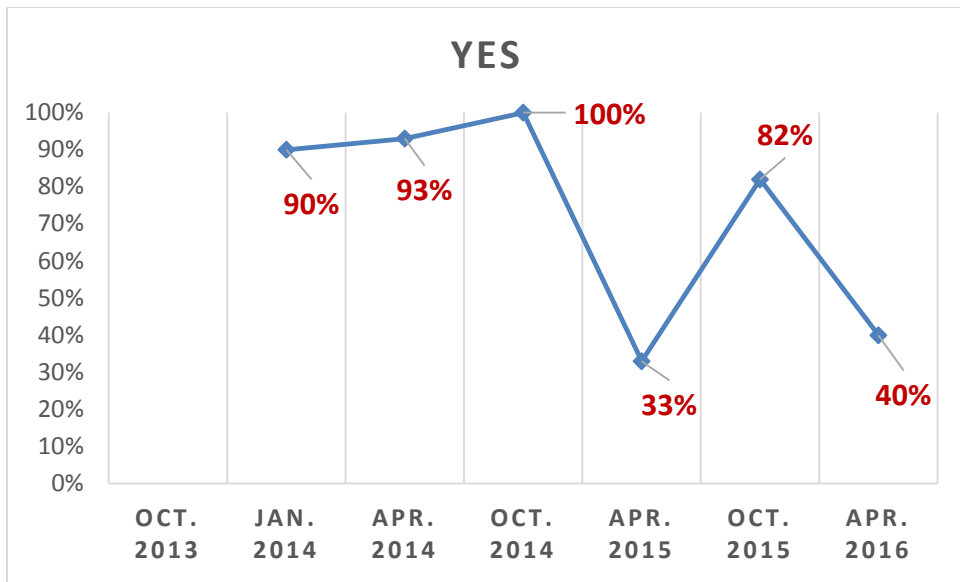
Have **land** prices reached their peak?



Have homebuilders stopped buying **land**?



Are homebuilders backing out of [land](#) deals?



Is the tight inventory for homes on the market affecting the commercial side at all?

