OFFICE MARKET REPORT ▸ 2010

The Phoenix office market continues the most severe correction since the late 1980s. Last year proved unquestionably to be a challenging one plagued with economic uncertainty, unprecedented job losses and a severe drop in asset values. Phoenix is experiencing a painful cleansing of unrealistic market and debt conditions once thought as normal as little as two years ago.

As of this printing, Phoenix's 2009 net absorption has reached -1.5 million SF, representing nearly double 2008's negative absorption, and a cumulative loss of -2.25 million SF in the past 24 months. This statistic reflects the true severity of the recession relative to previous cycles. Even in the RTC days Phoenix could always rely on 1 million SF of positive net absorption due to consistent job growth. The current "all inclusive" recession, however, has dragged Arizona's job growth from second in the nation in 2006, to battling for dead last in 2009. Direct office vacancy stands at 24.6 percent, more than double the 11.95 percent achieved at the market peak in Q4 2006. Add on subleases and a true vacancy reaches nearly 30 percent, a figure responsible to the market wide, class wide, substantial drop in rental rates (25 to 35 percent).

The capital markets and dramatic increase in vacancy derailed investment sales activity in 2009. Higher capitalization rates, coupled with substantial rent decreases, sent values plummeting. The average cap rate among the significant office sales (5) averaged 9.17 percent, with the best two assets trading at 10 percent and 10.7 percent caps, respectively. Prices will continue to decline throughout 2010. The reality is that the sales market is the foreclosure market. Save for a handful of users with specialized business, all buyers are looking for bank-owned pricing, whether it's bank-owned or not. The year 2009 brought more than 2,600 commercial sector foreclosures on the market. This year will bring more debt maturities and likely a substantial amount of large amount new defaults.

The new year will also bring us a step (or an "inning") closer to the bottom of the commercial real estate market. We will know our market has begun a bona fide recovery when we see the return of local, medium-size companies expanding. It is important to remember that over the long term, Arizona is fundamentally an outstanding place to live, do business and play. In the short term, however, the Phoenix office market will experience a painful systematic re-pricing of rental rates, buildings, land and debt. A crisis for many, we must remember it is still a cycle (albeit a prolonged cycle). While the next three to five years will continue to be extremely trying for owners competing in the marketplace, the 10-12 year outlook is filled with the hope of a more diverse, productive and innovative Arizona economy.

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Based in the Phoenix office of Lee & Associates, The Coppola Group, (R. Craig Coppola, Founding Principal, and Andrew Cheney, Principal), specialize in Class A leasing and sales throughout the Phoenix office market, as well as national tenant representation services. Lee & Associates is one of the largest national commercial real estate brokerage providers with regional expertise. As a group of independently owned and operated companies, Lee & Associates currently has more than 33 offices located in California, Arizona, Nevada, Missouri, Illinois, Michigan, New Jersey, Texas and Wisconsin. Additional information is available at www.lee-associates.com.

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