

Commercial real estate outlook for 2008

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It's the multi-million-dollar question facing the Valley's commercial real estate industry:

How badly will the housing market's crash and subsequent sub-prime mortgage crisis hurt commercial development in 2008?

The answer, according to two Valley organizations that addressed the issue this past week, depends on which sector and geographic submarket you're talking about.

For example, multifamily housing, or apartments, have seen rent growth screech to a halt and occupancy falter, especially in suburban areas; the office sector is exhibiting symptoms of a slowdown across the Phoenix metro area, with vacancy rates rising and space absorption slowing in the third quarter. But industrial real estate has cooled slightly, and experts say current activity is taking place at a more manageable level.

Meanwhile, retail projects are sprouting up everywhere, with developers breaking ground on big box-anchored "power centers," - even as new malls open the Southeast and West valleys.

Experts say current Some economists are skeptical how such retail developments will fare in the next two years with higher adjustable-rate mortgage payments and rising gas prices expected to drag on consumer spending in 2008.

Apartment Outlook Grim

Panelists speaking at two separate real estate forums this week provided cautious forecasts for developing and investing in commercial real estate in 2008.

But none went so far as to say that the market would hit the skids like it has on the residential side.

Those in the apartment sector are expecting a tough year ahead, and brokers and developers attribute that to more single-family homes joining the rental pool as owners try to stave off selling or foreclosure.

The occupancy rate for apartments across the Valley fell to 91.2 percent in the third quarter, down from 95.4 percent a year ago, according to industry tracker RealFacts. Rent growth slowed from 7.2 percent last year to 2.6 percent in the most recent quarter.

Eric Brown, president of Engle Homes' Artisan Homes division, said in his opinion, it is a difficult time to be an apartment developer in the Valley.

"If you could be asleep for three years and wake up, it'd be a great thing to do," said Brown, one of eight panelists who participated in the Urban Land Institute's discussion Tuesday afternoon at Sanctuary.

"It is going to be ugly next year," he said.

Office Sector Slowing

The office sector has already experienced some softening, partly because financial services firms and other businesses tied to housing have either downsized or closed up shop.

As a result, the amount of available sublease space will likely increase in the coming months, said Tom Johnston, senior managing director of Cushman & Wakefield of Arizona Inc.

Johnston was one of three speakers at a Friday event hosted by the Phoenix chapter of Lambda Alpha International, a professional organization for real estate practitioners, at the Camelback Inn.

Data he presented show that absorption, or the amount of available space that was leased during a certain time frame, hit 1.01 million square feet at the end of the third quarter. The total for all of 2006 was 3.46 million square feet.

At the same time, the amount of new office space built during the first three quarters of 2007 - 2.85 million square feet - already surpasses last year's total of 2.46 million square feet.

That means the Phoenix market is close to being oversaturated, Johnston said.

Industrial Activity Steady

The industrial sector, which has experienced white-hot growth in the last three years, has also started to slow.

But unlike the apartment and office sectors, experts say current activity is approaching a more realistic level.

"We're growing, (but) it's a slow growth," said Tony Lydon, a senior vice president with the Phoenix office of Grubb & Ellis/BRE Commercial LLC, on Tuesday.

Through the third quarter, the consumption of industrial building space reached 2.9 million square feet, according to Grubb & Ellis data. The year-end total for 2006 was 6.3 million square feet.

Fred Stiles, asset manager of EJM Development Co., an industrial development firm in Scottsdale, said leasing activity has slowed.

But there is still high demand for properties, especially for hard-to-find buildings that provide on-site fleet storage, Lydon said.

Retail Insulated

Conventional wisdom would assume retail would be the commercial real estate sector hit hardest next year by the housing downturn.

Credit institutions are tightening their lending standards, consumers can no longer bank on their home equity to spend and gas prices are expected to hit \$4 a gallon in some areas by the summer.

But brokers and developers are bullish on the local retail sector's ability to withstand the slowdown.

They note that job and population growth in Phoenix remains strong, which will bode well for retailers.

"I've never been this busy," Judi Butterworth, a principal with Phoenix-based retail brokerage De Rito Partners Inc. who was a panelist at Tuesday's event.

Butterworth and David Glimcher, an owner of Scottsdale-based retail developer Glimcher Ventures Southwest, said developers are still trying to play catch-up to the housing boom that took place three years ago.

"Our projects are better leased today than they were three or four years ago," Glimcher said.