Key Factors Creating Strong Industrial Market for Phoenix

BY BRET C. BORG

The momentum continues. The industrial market in metropolitan Phoenix is strong and the future appears very bright. Several economic issues are impacting the local industrial market:

Imports

The Ports of Los Angeles and Long Beach are exploding, accounting for approximately 40% of all imports and 80% of all Asian imports into the continental U.S. Phoenix is viewed as a consumption market; full trailers arrive and return back to Southern California empty.

Housing Boom

The housing boom has had, and is anticipated to continue to have, a tremendous impact on demand and growth in all commercial real estate markets. Direct benefactors to the increasing demand on industrial product include building contractors, furniture, floor covering and home improvement companies. Construction payrolls grew by 10.7% in 2004. This trend is expected to continue over the next several quarters.

Population Growth

Several factors, including a low cost of living, available natural resources and a strong employment base, continue to push metropolitan Phoenix's population net growth in excess of 100,000 per year with job growth expected to continue at a 3% per year rate.

There have been several significant non-economic issues affecting the metropolitan Phoenix industrial market:

— See *Industrial Market* on page 8

Increased Demand For Rail

Inflated oil prices are increasing demand on the railroad system. Due to constraints on profitability caused by increased operating costs and deferred maintenance on the railroad infrastructure, there is no guarantee that your building will be serviced even if the spur and switch already exist which will increase rents at properties that have rail service.

Higher Cost for New Construction

New developments are realizing significant cost increases. Vacant land prices have increased in all submarkets, the largest increase being realized in the Southwest submarket with land prices doubling within the last year. In addition, steel and concrete prices have skyrocketed. As vacancies on existing product continue to decline, rental rates are increasing enough to justify new construction, even with the increased costs. The end result is significantly higher rental rates for all industrial products with peak rate increases projected in the 2007/2008 timeframe.

		PROJECTIONS				
	Actual 2004	2005	2006	2007	2008	2009
New Construction (MSF)	2.7	2.1	4.2	5.2	5.4	4.8
Inventory (MSF)	218.7	220.8	225.0	230.2	235.5	240.3
Availability Rate	13.1%	11.6%	10.7%	10.4%	10.5%	10.4%
Net Absorption (MSF)	4.3	5.0	5.9	5.2	4.6	4.5

MSF = Millions of Square Feet
Source: RREEF Market Research Department

High Demand to Own

Development of industrial condos continues to be highly successful. Businesses can own their facility with debt service payments being equivalent to rent payments for comparable properties. Although there may be tax and appreciation benefits to ownership, the "silent cost" of industrial condos is a permanent commitment to size inflexibility.

Bigger "Big Boxes"

Buzz Oates introduced distribution boxes with bay depths in excess of 500' with cross dock capabilities, a new concept to Southwest Phoenix. Until recently, most big box distribution buildings had bay depths less than 300 feet, generally to produce a favorable overhead door to square footage ratio. These larger buildings can be split in half for front load or offered as larger cross-dock facilities and will become more common as demand increases.

The market statistics in metropolitan Phoenix, as compiled by RREEF's Market Research Department are to the left.

Rent concessions have reduced significantly and rental rates are increasing. Landlords, particularly in smaller business parks, may want to secure shorter term leases, wherein they can take advantage of the anticipated tighter market within the next two to three years.

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Source: RREEF Research. Note that certain information in this article constitutes forward-looking statements. Due to various risks, uncertainties and assumptions made in our analysis, actual events or results or the actual performance of the markets covered by this article may differ materially from those described. The information herein reflect our current views only, are subject to change, and are not intended to be promissory or relied upon by the reader. There can be no certainty that events will turn out as we have opined herein. CLU