

High office rents, land prices taking toll on small business

BY JAMES KINDLE

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High demand for the Valley's limited office space will continue in 2007, leaving large businesses unaffected but potentially forcing out some smaller, new companies, according to industry insiders.

"Absorption will outpace new supply this year," said Phil Breidenbach, senior vice president of office property solutions at Colliers International of Arizona, characterizing 2007 as having a "shortage of quality office space and (being) another year where rents

are going to rise again and surpass what are already record levels in most locations."

Breidenbach cites a number of reasons for office building demand continuing to outstrip supply.

A primary cause is a far higher cost of building new space compared to leasing existing office space. In the Central Corridor, for example, annual rental rates run \$25 to \$31 per square foot, but the cost of building new space is \$40 to \$43 per square foot, Breidenbach said.

Rent growth has jumped about 20 percent



Mike Coover

in the past 18 months, he said.

"Tenants are beginning to adjust to these new record rents. There aren't many who are willing to jump out of their seats and say, 'All right, I'll pay you that \$43 to build me that new building.'"

Compounding the problem is the demolition or conversion of office space into residential

areas, and a shortage of land for commercial building, especially in areas such as the Camelback Corridor, Breidenbach said.

Jamie Limber, president and chief executive of the 10-employee Christmas Light Co., said that during negotiations to build office space for his business, he saw land prices go up from \$9 per square foot to \$13 per square foot in one year in the area of 48th Street and Broadway Road.

Mike Coover, research and marketing

See **OFFICE**, Page 16

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OFFICE: Firms showing more interest in building facilities rather than leasing

Continued from Page 14

manager for commercial real estate brokerage Grubb & Ellis/BRE Commercial LLC, said the residential market slump won't cause a downturn in the office market, even for businesses involved in the residential real estate market.

"When you're talking about large banks and large mortgage companies, they're not going to be giving back the space," Coover said. "The only ones that are going to be (affected) are small upstart businesses."

Limber's company operates out of a 30,000-square-foot space in Cotton Corporate Center Flex, south of Interstate 10, near the south end of the Hohokam Expressway in Phoenix. He's seen first hand how the tighter office market affects small firms.

"I am one of the last little guys left in this complex," he said. "(Health care company) Schaller Anderson just took over a big building, TDK (a maker of CDs and tapes) is knocking on my door. The big guys are gobbling up more of the space, the lease space. ... If you're a little guy, you kind of get pushed to the side."

Limber thinks more small businesses are interested in building their own facilities instead of leasing, but are waiting for prices to cool.

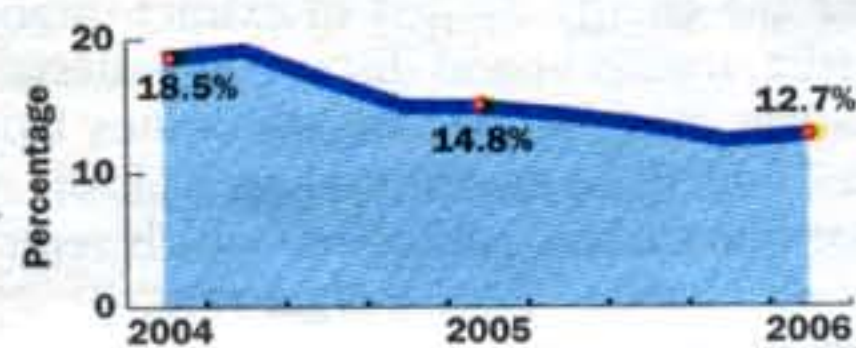
"For me, the longer I'm in business, the more it makes sense for me to buy and not lease," he said, "but I'm just backing off because the market's so hot right now that I know I'm going to pay an inflated price."

Remodeling existing buildings is much cheaper than building new ones right now, Limber said.

Fairytale Brownies' owners originally were looking to remodel, but did the oppo-

DECLINING AVAILABILITY

Fourth-quarter Valleywide office vacancy rate, all classes of space:



Source: Grubb & Ellis/BRE Commercial LLC

site, when they built a new headquarters in Cotton Center and opened last October.

David Kravetz, Fairytale's strategic planning team leader, said the company wanted to build equity instead of building its landlord's equity. Creating its own office also allowed the company to "design something more like we really wanted to run our business," he said.

Kravetz expects prices will remain high, and businesses that own rather than lease will experience significant appreciation.

Fairytale Brownies, which employs 30 workers off-season and about 100 workers before Christmas, occupies 26,000 square feet in the 37,000-square-foot building. Plans call for leasing the remaining space, but Kravetz hasn't found a renter.

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