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Three-Peat: Outlook for Valley Industrial Market Rooted in Past Two Decades

By John Werstler

If the last two-and-a-half decades are any indication, we can rest easy that the remaining years of the ‘00s will be good ones from a business and real estate standpoint.

Remember the early 1980s and the early ‘90s? Most of us would rather not. Even the first part of this decade had its speed bumps, as high vacancies and record-low absorption took the market on a series of detours. But, in both the ‘80s and the ‘90s, the story ended on a happy note. The market rebounded and the latter years of both decades ended with strong finishes.

So far, the pattern has repeated itself in the 2000s with a few years of rough patches, followed by a mid-decade turn-around. Based on history, then, the next several years appear promising for the Valley’s industrial market.

Heading into 2005, the engine that drives the market is still being fueled by our strong local economy. Approximately 50,000 new jobs were created last year and the explosive housing market shows no sign of slowing down. A turning point occurred in 2004 as business owners decided to trust these local indicators – rather than the still-faltering national economy – and move, expand or even purchase industrial space. As a consequence, the overall industrial market vacancy rate fell to 8.5 percent in the fourth quarter of 2004, from a high of 10 percent. The market experienced a net absorption of 6.3 million SF – the most since 2000, when 10.7 million SF were absorbed.

One of the strongest segments of the market has been the owner/user market. This is where the majority of new construction – approximately 4.5 million SF last year – occurred.

Speculative development, on the other hand, has been curbed in recent years by limited land supply, a shortage of improved sites and increasing construction costs. Developers, feeling the pinch from skyrocketing hard costs, have found it difficult to justify the rents needed to build new projects. Rents in existing buildings have remained flat for the past couple years due to a slowdown in demand from national and regional companies and an increase in demand from users wanting to purchase buildings.

But all that is about to change. As the market heats up again, and demand outpaces supply, rents are due for a 10 percent increase across the board. Look for increases this year as high as 15 to 20 percent in some sub-markets.

Rising interest rates also will have an effect on the market. As rates increase, and developable land becomes more expensive and more scarce, the "it's-cheaper-to-own-than-to-rent" argument will lose steam. Owners/users will find that it is suddenly more expensive to finance a building than it will be to lease space in an existing structure.

Industrial condos may be the exception to this rule, especially if interest rates remain low. Users in the 3,000 to 10,000 SF range, particularly in the Deer Valley and Southeast Valley submarkets, have latched on to this product type, which answers their desire to own without confronting the hassles and high cost of new construction.

Overall, key submarkets in 2005 include the northwest Valley and southeast Valley, particularly Deer Valley Airpark and Chandler Airpark. The completion and planned expansions of freeways, primarily the 101 and 202, are the driving forces behind industrial expansion in the northwest and southeast portions of the Valley.

Deer Valley, although it is running out of land, continues to be a popular alternative to Scottsdale, which also is short on available industrial land around the airpark. The tremendous growth in housing in northwest Phoenix, coupled with the completion of Loop 101, has made this a very active submarket in the past and will continue to fuel its strong performance. Companies that contribute to the fast-paced residential construction industry have found a home base here.

In the southeast Valley, developers will continue to buy up available land along the Loop 202, near Chandler Regional Airport, for future projects. Back office and manufacturing space is plentiful in this market due to a slow-down in the electronics industry and the relocation of many call center operations overseas.

Residential development also is driving the market in southwest Phoenix. Land values and rents have been stagnant for the past 20 years, but that's about to end. We are seeing an increase in land values and rental rates, and will also witness a broader spectrum of user types, including owner/user multi-tenant and even some flex-type user.

The Tempe/Sky Harbor area, traditionally the most active submarket, has less than 150 acres left to develop. New development will be limited in this market, which is the Valley's largest and most diverse industrial hub. Vacancies will continue to drop and lease rates will spike. As we head into the second half of this decade, it appears – as in times past – that the roller coaster years are behind us. Positive job growth numbers and continued population increases in our region should remain in our favor as we see how history repeats itself.

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