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## PHOENIX Business Journal

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# Commercial real estate market winds up decade of extremes

Phoenix Business Journal - by [Jan Buchholz](#)

In 1989, *Barron's*, a national financial magazine, predicted the end of a boom era in Phoenix, with the collapse of both the commercial and residential real estate markets.

The article cited office vacancies soaring beyond 20 percent and foreclosures accounting for 42 percent of all residential sales. It noted that the bubble of speculative land brokerage was about to burst, and that financial institutions were in distress. It also discussed a decline in population growth and a stagnating economic base far too dependent on construction and housing.

"For all its pretension to major city status, Phoenix remains a locale arrested in development between brash adolescence and adulthood. The city can be both charming and exasperating," the article read. "But the one constant that binds virtually everyone in the area is a unshakable faith in the future expansion of Phoenix. Yet that growth is, by no means, assured."

### Worse than *deja vu*

Years pass, but some things stay the same. Today, office vacancies in the Valley are again over 20 percent. Industrial vacancies are at 17 percent, and the retail market is struggling after an overabundance of shopping properties were delivered in 2007 and 2008.

Foreclosures on Phoenix homes still generate dismal headlines, and many touted commercial developments are either on hold or scrapped.

Real estate pundits continue to decry the area's ongoing reliance on population growth and real estate to fuel its economic engine, and they're calling for change.

Phoenix has muddled through the past 20 years fairly spectacularly. Still, local economists, real estate brokers and economic developers warn that radical change is warranted during this severe recession.

"Historically, the state and especially the greater Phoenix area have outperformed the nation in both expansion and recession periods," said John Lenio, economist for CB Richard Ellis' economic incentives group in Phoenix. "This time is different. Arizona ranks last among all states for job retention at the present time. Unfortunately, this may be the new norm without some serious efforts to diversify our economic base."

### At a crossroads

Chris Mackay, economic development director for the city of Chandler, agrees that this cycle is different.

"We can't live on construction. We can't live on population growth. We're at a crossroads and facing competition from other states," he said.

Despite the contention that Phoenix needs a new economic steering mechanism, Craig Henig, senior managing director of CBRE in Phoenix, has watched troubled real estate times transform into the best of times. He remembers the last major downturn during the savings and loan crisis around 1990, which hit Arizona particularly hard. And he remembers the *Barron's* article well.

"It poured a lot of gas onto the fire, but it also created a lot of opportunity. Buildings were bought well below replacement costs, and people migrated here like crazy," Henig said.

In fact, *Barron's* pessimistic prognostication did not come to pass. For sure, the economy was sluggish for several years, but Phoenix forged ahead.

During the 1990s, new communities were delivered in every direction. Phoenix Sky Harbor International Airport was expanded and remodeled. Two major sports facilities were completed: Chase Field and U.S. Airways Center.

New highways were built, including State Route 51 and Loop 101, which was completed in 2002. Loop 202, which encircles the east Valley, was built between 2005 and 2009. Both opened up new employment centers and resulted in numerous office and industrial projects being developed.

"The opening of the 101 opened up the Deer Valley corridor," said Keith Lambeth, senior vice president of Colliers International in Phoenix. "Deer Valley was not a submarket, and overnight it became a vibrant scene."



Jim Poulini/Phoenix Business Journal

Chris Toci of Cushman & Wakefield has been involved with some of the most monumental office transactions of the decade, including SunCor's sale of Hayden Ferry Tower II in Tempe for \$92.5 million.

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Thus, during the 1990s, telecom companies, insurance firms such as USAA and investment firms such as Charles Schwab opened and expanded operations here.

“Phoenix was embraced because we don’t have disasters here,” said Charles Miscio, another Colliers senior vice president.

Those kinds of companies don’t want to deal with hurricanes, earthquakes and other acts of God, he said. They prefer nice climates without surprises.

#### Downtown Phoenix transforms

With the suburbs opening up to more commercial development, business and political forces launched a concerted effort to create a vibrant downtown.

In 2000, the 23-story Collier Center was built by developer Opus West in partnership with Barron Collier Co. Bank of America became the anchor tenant.

In 2001, the 20-story Phelps Dodge tower, now called One Central Avenue, was built as headquarters for the mining giant that later merged with Freeport-McMoRan Copper & Gold Inc.

In 2003, the city of Phoenix began development of the Phoenix Bioscience Campus at Seventh and Van Buren streets. That campus now includes the Translational Genomics Research Institute, International Genomics Consortium, the University of Arizona College of Medicine–Phoenix in partnership with Arizona State University, the UA College of Pharmacy, Northern Arizona University’s allied health program and Phoenix Union Bioscience High School. The ASU College of Nursing opened in 2009.

ASU’s downtown campus also includes the Walter Cronkite School of Journalism and Mass Communication, which opened in 2008.

Add to that the \$600 million expansion of the Phoenix Convention Center and the 31-story Sheraton Phoenix Downtown Hotel, both completed in 2008, and a vibrant city is beginning to unfold.

The One Central Park East office building was completed in 2009 and will serve as the new headquarters for Freeport-

McMoRan. Several floors of that office tower, built by Mesirow Financial, are being converted into a boutique business hotel to be operated under the Westin brand.

This summer, the massive CityScape project will be delivered by Scottsdale-based RED Development. It includes an office tower and retail components that downtown has needed for years, including a drugstore and a specialty grocer. A Kimpton Hotel also will be built there.

#### West Valley rises

Also during the past decade, large-scale projects were delivered in Glendale. Jobing.com Arena, home of the Phoenix Coyotes hockey team, opened in December 2003. The University of Phoenix Stadium, home of the Arizona Cardinals, opened in August 2006. Neighboring those venues is Westgate City Center, which includes stores, restaurants and the Renaissance Phoenix-Glendale Hotel, which was finished just in time for the Super Bowl in January 2008.

Other significant hotel properties brought online throughout the Valley include the Westin Kierland Resort & Spa in northeast Phoenix, the JW Marriott Desert Ridge Resort & Spa in north Phoenix, the W Hotel in Scottsdale, the Wild Horse Pass Hotel & Casino in the Gila River Indian Community, and the InterContinental Montelucia Resort & Spa in Paradise Valley.

Retail options also grew significantly during the past 10 years.

Westcor, a subsidiary of Macerich Corp., continued its local retail dominance with the opening of Chandler Fashion Center in 2001 and SanTan Village in Gilbert in 2007. Another retail player also continued to make waves: Vestar Development Corp. perfected the power center concept, rolling out Tempe Marketplace in 2007 to bustling crowds.

A third local retail developer, De Rito Partners Development Inc., built Mesa Riverview in 2007 and paid \$88 million for the aging Scottsdale Pavilions center on the Salt River Pima-Maricopa Indian Community, east of Scottsdale.

Although De Rito bought at the height of the real estate market, the risk and the multimillion-dollar renovations may pay off. The Arizona Diamondbacks and Colorado Rockies, in partnership with the Salt River tribe, announced last summer that a new spring training facility would be built just north of the Pavilions.

A short distance east of there, the tribe’s Talking Stick Resort & Spa will open this year.

#### Lake makes waves

In Tempe, the landscape has changed dramatically in 10 years. In late 1999, Tempe Town Lake was formed by creating a dam in the Salt River wash and purchasing water from the Central Arizona Project. The picturesque setting impelled development — particularly on the south shore, near downtown Tempe.

SunCor led the way with the nautical-themed Hayden Ferry Lakeside, which includes two office towers and luxury condominiums. Tower II is one of the many Class A office structures in the Valley that captured a high price when it was sold at the height of the real estate market in 2008. Sumitomo Corp. paid \$92.5 million.

Other office sales of prominence include the two towers at Renaissance Square in downtown Phoenix.

What might best showcase the run-up in value might be the 2006 and 2007 sales of Chase Tower. In 2006, it sold for \$103 million. The following year, it traded for \$167 million.

But true to the Valley's long-standing reputation for luxury lodging, the biggest sales of the decade were reserved for hotel properties. In 2006, the Westin Kierland Resort & Spa sold for \$392 million. That same year, the Fairmont Scottsdale Princess sold for \$345 million.

The fever pitch of prices and transactions was cooling dramatically by late 2008. Large-scale developments such as the partially completed CityNorth mixed-use project in north Phoenix and the Centerpoint residential high-rises in Tempe may not be completed for some time.

#### Industrial boom to bust

The industrial market, once sizzling, now is a shadow of its former self. The sales pitch that the West Valley could challenge Southern California as a distribution hub has been discarded, said Don MacWilliam, a senior vice president of Colliers International.

"There was the hype in 2006, 2007 and 2008 that Phoenix was becoming a first-tier distribution hub," MacWilliam said. "Now we're off everybody's radar screen. We've gone back to regional status."

In the months ahead, the concern is that large commercial real estate loans will go into default, sending the local economy into yet another dizzying roller-coaster ride.

"The highs and lows of the past four to five years certainly have been the most severe in my professional experience, and probably since the Depression era," said Don Miner, a director of law firm Fennemore Craig PC and principal of the Arizona School of Real Estate & Business.

#### From limbo to life

Miner sees some stability returning to the market, and said responsible lending practices must be enforced. He's also confident that developments sitting in limbo will spring back to life.

"Over time, the market and sustainable business opportunity will take care of the projects that were not completed in the last downturn," he said.

Mackay said she's more optimistic, too.

"The industry has exhaled. We're seeing a significant uptick in activity," she said. "Buyers are starting to pull the trigger instead of just kicking tires."

Beth Jo Zeitzer, president of ROI Properties and an expert in distressed properties, said the recession is a window of opportunity for a few.

"This market is not for the faint of heart or risk-averse investor," Zeitzer said. "Those with laser-sharp focus, a long-term vision and patient capital will flourish in the next phase of the market."

Even so, Lenio offers words of advice that hark back to *Barron's* 1989 assessment.

"Arizona no longer can rely on sunshine and golf course to attract new business," he said.

"If we don't get it this time, we're never going to get it," Mackay said.

This story was part of the Phoenix Business Journal's annual Commercial Real Estate magazine distributed with the March 26 print edition. Other features include deals that made the record books, movers and shares, a timeline of events and the Best of NAIOP awards. Print edition subscribers, [click here to see the magazine](#).

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