

Office Condos are Here to Stay

Many real estate professionals have asked the question: "Is the Phoenix metropolitan area oversaturated with office condo product?" In short, the answer is no.



BY WILLIAM C. SAUL

Historically, the Valley's population and job growth have led the nation. Since 2000, Phoenix has attracted over 700,000 new residents, a 4.2 percent annual gain. Boasting over 100,000 new jobs in 2006, not only are national industries attracted to doing business in the Valley, but also smaller businesses, many of which are owned by lawyers, doctors and other professionals. The office condo option has had a proven track record over the past five years.

Phoenix's vibrant job market and steady influx of companies create an ongoing demand for space. Commercial construction will continue to post strong gains throughout 2007. The office market will remain firm in 2007 with vacancy ticking up only slightly from 2006. Developers delivered over 2 million SF of office space in 2006 and absorbed over 3 million SF. Although not the record year of 1999 with 4.8 million SF of office space delivered, office development is scheduled to remain strong with an anticipated 4.5 million SF of office space set to deliver in 2007.

Office condo developers hear the demand of business owners in Phoenix and have been responding by building the next generation to the original garden-style office condo. The numbers say it all. Based on a 10 million square foot overall inventory of existing office condo space, this year's supply of almost 3 million SF is

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a significant addition to the supply. Developers also are being given more options, which is crucial to a market such as Phoenix with such a rapid appreciation.

Office condos have proven to be a prudent investment based on an appreciation in price PSF. In 2006, the median price PSF rose by almost 12 percent to \$205 PSF. Present market conditions report a 10 percent increase for new office condo product. More important,

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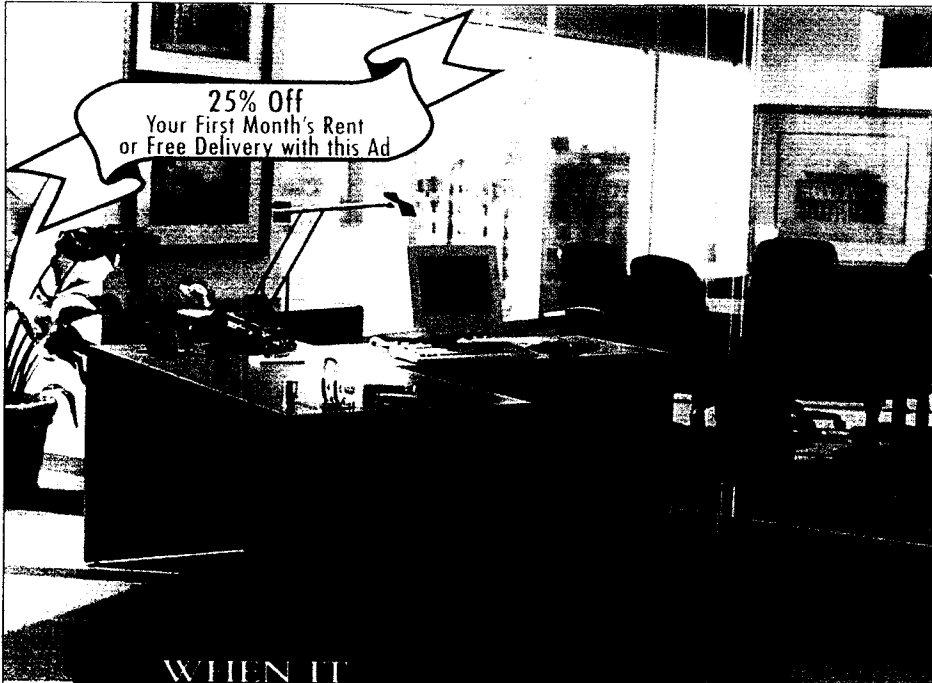
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the overall size of transactions has tripled. Previously, 25 percent of all transactions were less than \$1.5 million. Now, 25 percent of all transactions range from \$1.5 to \$5 million. At the close of 2006, there were 217 transactions reported. In a year-to-date evaluation, we have tracked 161 transactions, which appears to be on pace for a record year.

Low interest rates draw buyer interest, luring the small to mid-sized business owner towards the perks of owning versus leasing. Low interest rates for office condos were at 6.5 percent for a Small Business Administration loan or 6 percent for a commercial loan 18 months ago. Today's rates are 7.2 and 7 percent respectively, which prove to be a good rate for a sound investment. While interest rates are low and lease rates are high, the office condo market is not very likely to suffer in the long term.

There is a fine line between the financial merits of leasing versus owning, but the overwhelming advantage of the ownership position is the appreciation of the unit price and asset preservation through paying off your space versus loss savings of a rent payment. Office condos definitely make sense; not only do business owners benefit from potential long-term appreciation, but they also can take advantage of tax benefits and equity accumulation.

In a market that is chiefly fueled by population growth, economic expansion and low unemployment, the same fundamentals that once attracted office condo investors hold true for the new condo user. As opposed to our California neighbor, Phoenix is relatively affordable and has demonstrated a balance of supply and demand that fosters continued office condo development. Ownership, freeway access, parking ratios, attractive signage and T.I. flexibility are among the top reasons an owner may choose to purchase over lease.

So, what changes do office condo investors and owner/users have to look forward to in the future?

As seen in the developments at Chauncey Ranch Commerce Center in Scottsdale and Westgate City Lofts in Glendale, the next generation of opportunities is located within mixed-use developments.

Westgate exemplifies the new evolution of office condos. This vibrant mixed-

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use development offers 3 million SF of office space, 2 million SF of retail space and 2,000 residential units adjacent to two professional sports arenas: Jobing.com Arena and the University of Phoenix Stadium, home to the Arizona Cardinals.

"Westgate City Lofts is not an office condo development sitting on a corner. It offers upscale office condos within a total entertainment environment," according to Sheila Bale, associate vice president of Prudential CRES Commercial Real Estate.

The office condos range in size from 1,500 to 45,000 SF and run \$245 to \$200 per SF. The higher square footage price applies to condos with private patios that afford views of sporting events, such as the Super Bowl. All owners, including those who own the smallest size office condos, can create a huge impression by reserving space on a large patio with stadium views for their corporate events.

Chauncey Ranch Commerce Center, located near Scottsdale Road and the Loop 101 in North Scottsdale, is another development that breaks away from the office condo stereotype. It is a two-story, two-building Class A development with a shared lobby, restrooms, elevators and a parking structure in a prime location with easy freeway access. Restaurants, shopping, the Mayo Clinic and Thompson Peak Healthcare are in the immediate area.

Typically, condo projects are 30,000 to 40,000 SF with businesses occupying space ranging from 1,500 to 5,000 SF. In contrast, Chauncey Ranch boasts 100,000 SF, with many business owners purchasing 5,000 to 12,000 SF of office space. Scheduled for August 2007 completion, the project is already 90 percent sold out.

"The long-term investment in office space along the 101 corridor will pay off for several years to come," says Barbara Lloyd, senior advisor at Prudential CRES Commercial Real Estate.

With all indicators pointed to positive growth and continued absorption of new and existing office condo product, it is our belief that the office condo market is here to stay.

William C. Saul is president of Prudential CRES Commercial Real Estate, based in Scottsdale, Ariz. For more information, visit www.pruces.com or call 480-451-9077. CLU