

## Industrial Market to Stabilize in the Second Half

### Key Takeaways

- Greater Phoenix industrial vacancy has remained in a fairly tight range in recent quarters, with net tenant move-ins and new development closely mirroring one another.
- Construction of new buildings was very active in 2014 and in the first half of 2015, but the pace of development has begun to slow. Easing new construction should allow for some modest vacancy improvement in the second half of this year.
- Net absorption slowed during the second quarter, although tenants remain in a fairly active expansion phase. Net absorption has been positive in all but one quarter since 2011.
- Asking rents are ticking higher, with annual gains averaging in the 2.0 to 3.0 percent range depending on property type and submarket.
- Investment activity has been volatile, with few properties selling in the first quarter and then a spike in transactions during the second quarter. Current sales velocity is somewhat lagging 2014 levels. Prices have pushed higher and cap rates have compressed somewhat.

### Greater Phoenix Industrial Market

The Greater Phoenix industrial market hit a bit of a lull in the second quarter, with net absorption and leasing activity slowing while vacancy ticked higher. Despite the recent slowdown in activity, conditions are expected to improve by the end of the year, particularly as the delivery of new space slows.

One segment of the economy that could provide a boost to the local industrial market is for-sale housing. To this point in the cycle, nearly all of the new demand for housing has been met by rentals, with new single-family home construction dramatically lower than long-term trends. There are signs that the housing market may be strengthening

#### Market Indicators Relative to prior period

	Market Q2 2015	Market Q2 2014
Vacancy	↑	↓
Net Absorption	↓	↑
Construction	↓	↓
Rental Rate	↑	↓

#### Second Quarter Economic Trends\*

Phoenix Metro Employment	↓	↑
U.S. Employment	↑	↑

\*Source: Bureau of Labor Statistics

#### Summary Statistics

	Phoenix Industrial Market
Vacancy Rate	12.1%
Change from 2Q 2014 (bps)	-20
Net Absorption (thousands SF)	524
New Construction (thousands SF)	1289
Under Construction (millions SF)	1.6
Asking Rents Per Square Foot Per Month	\$0.52
Change from 2Q 2014	2.6%

## Greater Phoenix Industrial Market (continued)

as permitting for single-family units thus far in 2015 is up more than 25 percent from year-earlier totals. In the coming years, demand for single-family homes should begin to rise, sparking new home construction that will facilitate additional industrial space demand from housing-related tenants.

One of the noteworthy changes in recent market conditions has been the reintroduction of new construction in areas that had received little

new supply in recent years. While developers had been active in both the Southeast Valley and Southwest Valley, little new construction had taken place in recent years in the Northwest Valley and the Airport Area. That trend began to reverse in the second half of last year and has continued into 2015. To this point in the cycle, only the Northeast Valley has been insulated from new construction.

## Recent Transactions in the Market

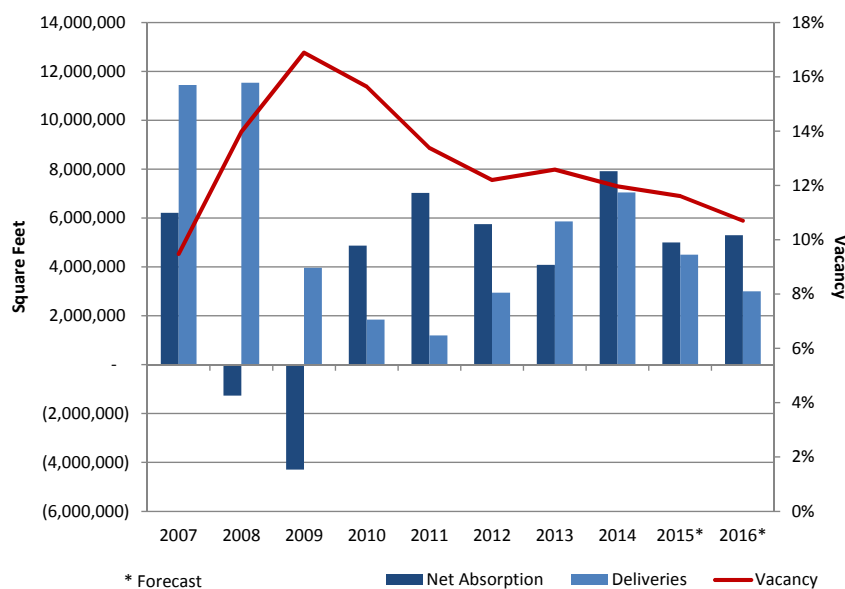
### SALE ACTIVITY

Property Address	Submarket	Sale Date	Sale Price	Size SF	Sale Price SF	Class
4625 & 4675 E Cotton Center Blvd., Phoenix	S Airport N of Roeser	4/28	\$17,850,000	147,627	\$121	B
2299 W Obispo Ave., Gilbert	Chandler/N Gilbert	6/5	\$17,850,000	182,363	\$98	B
5670 S 32nd St., Phoenix	S Airport S of Roeser	4/24	\$14,700,000	155,114	\$95	A
4242 E Palm St., Mesa	Falcoln Field/Apache Junction	6/18	\$8,600,000	56,919	\$151	B
8700 E Thomas Rd., Scottsdale	Scottsdale/Salt River	5/20	\$6,750,000	128,795	\$52	B

### LEASE ACTIVITY

Property Address	Submarket	Tenant	Size SF
1616 W 17th St., Tempe	Tempe Northwest	Home Depot	111,349
2021 E Jones Ave., Phoenix	S Airport N of Roeser	Michael Lewis Company	94,885
2120 W Guadalupe Rd., Gilbert	Chandler/N Gilbert	Paragon Vision Sciences	45,000
33 S 56th St., Chandler	Chandler	Armorworks	42,569
5240 W Buckeye Rd., Phoenix	SW North of Buckeye Rd	Express Furniture	32,241

## Historical Absorption, Deliveries and Vacancy Rates



## Vacancy:

- › Vacancy in the Greater Phoenix industrial market ticked higher in the second quarter, reaching 12.1 percent, 10 basis points higher than three months earlier. Despite the recent uptick, market vacancy has remained in a fairly tight range over the past several quarters, fluctuating between 11.8 percent and 13.2 percent since the beginning of 2013.
- › Despite the recent uptick, modest improvement is the prevailing vacancy trend in the Greater Phoenix industrial market. During the past 12 months, the rate has dipped 20 basis points, and vacancy is 50 basis points lower than 24 months ago.
- › The Northwest Valley is benefitting from the ongoing expansion of the Loop 303, which is leading to development and a few large tenant move-ins. Vacancy in the Northwest Valley ended the second quarter at 8.2 percent, the lowest rate of any submarket cluster in Greater Phoenix. The rate averaged nearly 12 percent in the Northwest Valley as recently as 2012.
- › **Forecast:** Vacancy in the Greater Phoenix industrial market is expected to tick lower in 2015, but improvement will be modest. Vacancy is forecast to end the year at 11.6 percent, with net absorption outpacing new development by approximately 500,000 square feet for the year.

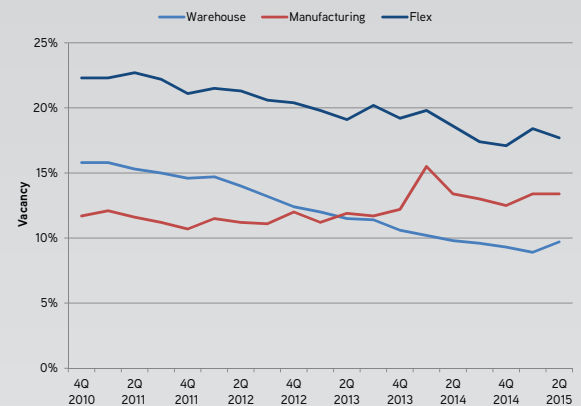
## Absorption and Leasing Activity:

- › Net absorption totaled approximately 523,000 square feet during the second quarter, bringing the year-to-date total to just over 2 million square feet. While absorption was positive in the second quarter, this marked the lightest period of net tenant demand growth in nearly two years.
- › Tenants have been expanding in the Greater Phoenix industrial market for the past several years, but the pace of demand growth appears to be slowing somewhat. Since 2010, net absorption has averaged more than 1.4 million square feet per quarter, but over the past year, that average has dipped closer to 1.1 million square feet per quarter.
- › The Southeast Valley submarket has been experiencing a flurry of activity in recent quarters. Year to date, net absorption in the Southeast Valley has topped 1.1 million square feet. Since the beginning of 2014, net absorption in the Southeast Valley has been nearly 4.2 million square feet, representing more than 40 percent of the Greater Phoenix total.
- › **Forecast:** After several large build-to-suit projects drove net absorption to nearly 8 million square feet in 2014, the figure should retreat closer to 5 million square feet this year. Net absorption has been positive since 2010, averaging nearly 6 million square feet per year.

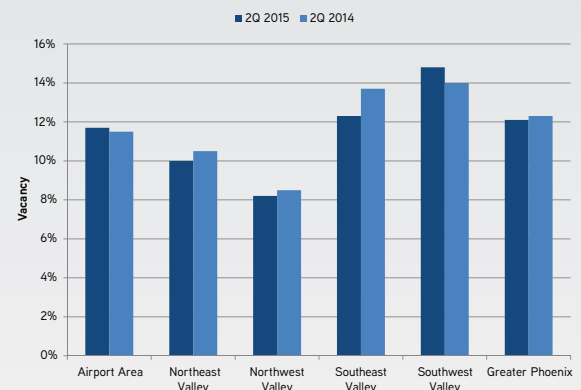
## Rental Rates:

- › Asking rents have bounced off the bottom, inching higher in recent quarters. The average asking rent in Greater Phoenix is \$0.52 per square foot, per month, 2.6 percent higher than one year ago.

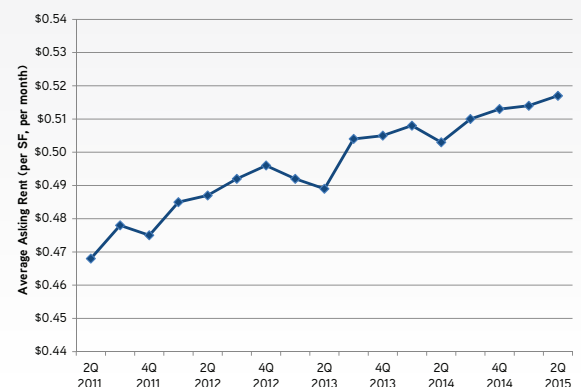
### Vacancy by Building Type



### Vacancy Among Major Submarkets



### Asking Rent Trends



## Rental Rates (continued):

- The rebound in the local office market is providing a boost to flex buildings. Average asking rents for flex buildings reached \$0.96 per square foot, per month, 4.1 percent higher than one year ago. Since reaching a cyclical low in mid-2012, asking rents for flex buildings have jumped 12.4 percent.
- Leasing activity in some of the Greater Phoenix area's newer product has gained momentum in recent quarters, supporting rental rates in these buildings. In properties built since 2013, average asking rents have increased by more than 8.5 percent in the past 12 months to \$0.43 per square foot, per month.
- **Forecast:** Asking rents are forecast to record modest increases in the mid-2 percent range. Last year, average asking rents rose by approximately 1.5 percent.

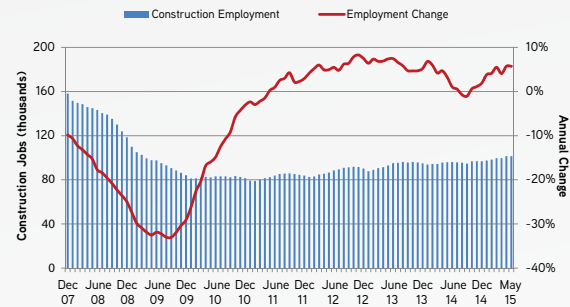
## Construction:

- Construction slowed in the second quarter following a very active period of deliveries during the preceding 12 months. Nearly 1.3 million square feet of industrial space came online in the second quarter, following the delivery of more than 1.7 million square feet in the first three months of the year.
- Deliveries should slow in the second half of this year, with only 1.6 million square feet of space currently under construction. Last year at this time, projects totaling 3 million square feet were under construction, and two years ago more 7 million square feet of space was under way.
- Construction is accelerating in the Airport Area submarket cluster. Approximately 880,000 square feet of new space has delivered in the area over the past 12 months, and an additional 511,000 square feet is under way. In comparison, less than 400,000 square feet of industrial space came online in the Airport Area from 2009-2013.
- **Forecast:** After more than 7 million square feet came online in 2014, developers are slated to deliver approximately 4.5 million square feet of space this year. More than half of the projects slated for delivery are spec buildings.

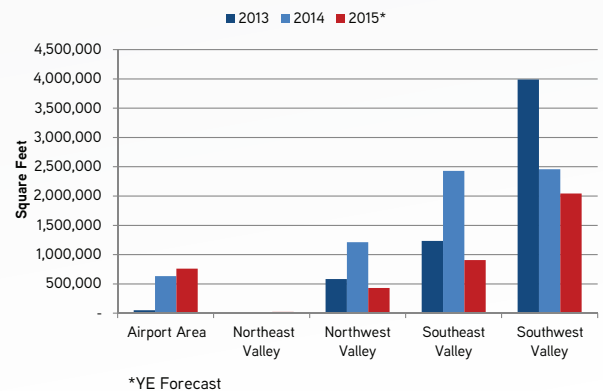
## Investment Trends:

- Sales of industrial buildings have been volatile thus far in 2015. After slowing considerably during the first quarter, investment activity spiked in the second quarter, as the number of buildings changing hands increased by more than 60 percent. Year to date, total activity is down 9 percent from the first half of 2014.
- Sales prices have been trending higher, with the median reaching \$72 per square foot thus far in 2015. This is 9 percent higher than the 2014 median price. In transactions that closed during the second quarter, the median price was \$70 per square foot, although 20 percent of the buildings sold in the second quarter traded for more than \$100 per square foot.
- Cap rates have averaged 7.5 percent thus far in 2015, including some modest compression during the second quarter. On the whole, average cap rates have remained between the mid-7 percent to low-8 percent range since 2012.

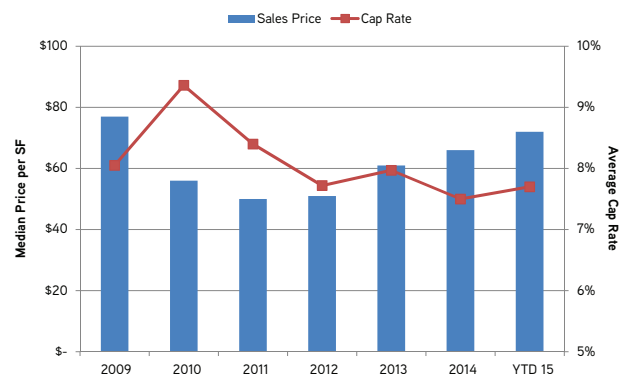
### Construction Employment Overview



### Construction Trends by Submarket



### Investment Trends



## Industrial Market

EXISTING PROPERTIES		DIRECT VACANCY		SUBLEASE VACANCY		TOTAL VACANCY		NET ABSORPTION - SF		NEW SUPPLY - SF		UNDER CONSTR		AVG. RENT
BUILDING TYPE	TOTAL INVENTORY SF	SF	RATE	SF	RATE	SF	VACANCY RATE Q2-15	VACANCY RATE Q2-14	CURRENT PERIOD	YTD	CURRENT PERIOD	YTD	SF	RATE (NNN)
INDUSTRIAL MARKET														
Airport Market Cluster: North Airport, S Airport N of Roeser, S Airport S of Roeser, SC N of Salt River, SC S of Salt River														
General Industrial	5,860,688	907,235	15.5%	-	0.0%	907,235	15.5%	9.7%	332,133	366,286	217,994	217,994	496,840	\$0.62
Warehouse	24,673,766	2,165,181	8.8%	141,647	0.6%	2,306,828	9.3%	9.4%	(264,655)	(111,547)	31,488	31,488	14,250	\$0.48
Manufacturing	8,647,679	1,119,399	12.9%	20,432	0.2%	1,139,831	13.2%	14.6%	(37,512)	(47,200)	-	-	-	\$0.48
Service Ctr/Showroom	1,770,293	53,808	3.0%	77,155	4.4%	130,963	7.4%	10.6%	14,353	53,713	-	-	-	\$0.40
Flex	3,996,859	727,247	18.2%	50,267	1.3%	777,514	19.5%	19.8%	(40,950)	(57,093)	-	-	-	\$1.03
<b>Total</b>	<b>44,949,285</b>	<b>4,972,870</b>	<b>11.1%</b>	<b>289,501</b>	<b>0.6%</b>	<b>5,262,371</b>	<b>11.7%</b>	<b>11.5%</b>	<b>3,369</b>	<b>204,159</b>	<b>249,482</b>	<b>249,482</b>	<b>511,090</b>	<b>\$0.63</b>
Northeast Market Cluster: Central Phoenix, Scottsdale Airpark, Scottsdale/Salt River														
General Industrial	816,327	175,600	21.5%	41,789	5.1%	217,389	26.6%	18.5%	(47,981)	(39,712)	-	-	-	\$0.92
Warehouse	5,436,899	515,052	9.5%	4,242	0.1%	519,294	9.4%	9.8%	26,770	2,082	-	-	-	\$0.84
Manufacturing	2,862,069	36,006	1.3%	2,350	0.1%	38,356	1.3%	0.9%	0	(7,198)	-	-	-	\$0.90
Service Ctr/Showroom	987,353	64,638	6.5%	-	0.0%	64,638	6.5%	6.4%	(9,482)	(7,817)	-	-	-	\$0.89
Flex	4,385,857	594,879	13.6%	9,951	0.2%	604,830	13.8%	17.0%	12,641	(12,119)	-	-	23,200	\$0.94
<b>Total</b>	<b>14,488,505</b>	<b>1,386,175</b>	<b>9.6%</b>	<b>58,332</b>	<b>0.4%</b>	<b>1,444,507</b>	<b>10.0%</b>	<b>10.5%</b>	<b>(18,052)</b>	<b>(64,764)</b>	<b>-</b>	<b>-</b>	<b>23,200</b>	<b>\$0.91</b>
Northwest Market Cluster: Deer Valley/Pinnacle Peak, Glendale, Grand Avenue, N Glendale/Sun City, North Black Canyon, North Outlying, W Phx N of Thomas, W Phx S of Thomas														
General Industrial	6,417,619	699,100	10.9%	-	0.0%	699,100	10.9%	10.3%	10,068	(22,622)	-	-	12,000	\$0.43
Warehouse	28,260,668	2,214,051	7.8%	25,006	0.1%	2,239,057	7.9%	8.7%	69,486	129,910	137,069	148,140	83,762	\$0.60
Manufacturing	10,742,475	769,616	7.2%	-	0.0%	769,616	7.2%	5.4%	(188,122)	18,175	-	173,000	146,000	\$0.48
Service Ctr/Showroom	1,868,085	18,040	1.0%	-	0.0%	18,040	1.0%	4.6%	16,965	12,119	14,940	14,940	-	\$0.67
Flex	4,928,105	579,718	11.8%	-	0.0%	579,718	11.8%	12.6%	60,144	72,401	-	-	-	\$0.80
<b>Total</b>	<b>52,216,952</b>	<b>4,280,525</b>	<b>8.2%</b>	<b>25,006</b>	<b>0.1%</b>	<b>4,305,531</b>	<b>8.2%</b>	<b>8.5%</b>	<b>(31,459)</b>	<b>209,983</b>	<b>152,009</b>	<b>336,080</b>	<b>241,762</b>	<b>\$0.57</b>
Southeast Market Cluster: Chandler Airport, Chandler, Chandler N/Gilbert, Falcon Field/Apache Junction, Mesa, Tempe East, Tempe Northwest, Tempe Southwest														
General Industrial	9,992,193	829,485	8.3%	11,757	0.1%	841,242	8.4%	11.9%	200,622	498,287	162,500	162,500	122,823	\$0.54
Warehouse	35,126,103	3,280,262	9.3%	36,968	0.1%	3,317,230	9.4%	11.1%	3,298	457,002	219,538	383,509	-	\$0.56
Manufacturing	24,056,889	3,305,101	13.7%	217,000	0.9%	3,522,101	14.6%	15.9%	213,923	240,150	-	-	-	\$0.55
Service Ctr/Showroom	3,172,879	162,818	5.1%	-	0.0%	162,818	5.1%	6.4%	(18,696)	(70,876)	-	-	-	\$0.58
Flex	13,023,294	2,463,515	18.9%	219,299	1.7%	2,682,814	20.6%	20.0%	198,446	44,660	237,000	237,000	-	\$1.00
<b>Total</b>	<b>85,371,358</b>	<b>10,041,181</b>	<b>11.8%</b>	<b>485,024</b>	<b>0.6%</b>	<b>10,526,205</b>	<b>12.3%</b>	<b>13.7%</b>	<b>597,593</b>	<b>1,169,223</b>	<b>619,038</b>	<b>783,009</b>	<b>122,823</b>	<b>\$0.67</b>
Southwest Market Cluster: Goodyear, SW N of Buckeye Road, SW S Buckeye Road, Tolleson, Southwest Outlying														
General Industrial	42,874,983	6,827,231	15.9%	32,000	0.1%	6,859,231	16.0%	16.4%	241,029	643,912	81,581	647,489	-	\$0.36
Warehouse	31,660,827	3,692,586	11.7%	128,597	0.4%	3,821,183	12.1%	9.8%	(294,338)	(334,565)	187,000	187,000	659,618	\$0.39
Manufacturing	11,051,852	1,779,158	16.1%	458,839	4.2%	2,237,997	20.2%	18.4%	13,193	170,595	-	844,420	54,200	\$0.31
Service Ctr/Showroom	2,624,833	77,006	2.9%	0	0.0%	77,006	2.9%	3.8%	13,077	21,679	-	-	-	\$0.45
Flex	1,354,650	267,091	19.7%	-	0.0%	267,091	19.7%	21.7%	(766)	1,035	-	-	-	\$0.57
<b>Total</b>	<b>89,567,145</b>	<b>12,643,072</b>	<b>14.1%</b>	<b>619,436</b>	<b>0.7%</b>	<b>13,262,508</b>	<b>14.8%</b>	<b>14.0%</b>	<b>(27,805)</b>	<b>502,656</b>	<b>268,581</b>	<b>1,678,909</b>	<b>713,818</b>	<b>\$0.36</b>
GRAND TOTAL														
General Industrial	65,961,810	9,438,651	14.3%	85,546	0.1%	9,524,197	14.4%	14.6%	735,871	1,446,151	462,075	1,027,983	631,663	\$0.42
Warehouse	125,158,263	11,867,132	9.5%	336,460	0.3%	12,203,592	9.8%	9.8%	(459,439)	142,882	575,095	750,137	757,630	\$0.49
Manufacturing	57,360,964	7,009,280	12.2%	698,621	1.2%	7,707,901	13.4%	13.4%	1,482	374,522	-	1,017,420	200,200	\$0.43
Service Ctr/Showroom	10,423,443	376,310	3.6%	77,155	0.7%	453,465	4.4%	6.1%	16,217	8,818	14,940	14,940	-	\$0.57
Flex	27,688,765	4,632,450	16.7%	279,517	1.0%	4,911,967	17.7%	18.6%	229,515	48,884	237,000	237,000	23,200	\$0.96
<b>Total</b>	<b>286,593,245</b>	<b>33,323,823</b>	<b>11.6%</b>	<b>1,477,299</b>	<b>0.5%</b>	<b>34,801,122</b>	<b>12.1%</b>	<b>12.3%</b>	<b>523,646</b>	<b>2,021,257</b>	<b>1,289,110</b>	<b>3,047,480</b>	<b>1,612,693</b>	<b>\$0.52</b>
QUARTERLY COMPARISON AND TOTALS														
Q2-15														
<b>Total</b>	<b>286,593,245</b>	<b>33,323,823</b>	<b>11.6%</b>	<b>1,477,299</b>	<b>0.5%</b>	<b>34,801,122</b>	<b>12.1%</b>	<b>12.3%</b>	<b>523,646</b>	<b>2,021,257</b>	<b>1,289,110</b>	<b>3,047,480</b>	<b>1,612,693</b>	<b>\$0.52</b>
Q1-15														
<b>Total</b>	<b>284,986,075</b>	<b>32,663,572</b>	<b>11.5%</b>	<b>1,453,667</b>	<b>0.5%</b>	<b>34,117,239</b>	<b>12.0%</b>		<b>1,497,611</b>		<b>1,758,370</b>		<b>2,206,079</b>	<b>\$0.51</b>
Q4-14														
<b>Total</b>	<b>283,227,705</b>	<b>32,173,369</b>	<b>11.4%</b>	<b>1,683,111</b>	<b>0.6%</b>	<b>33,856,480</b>	<b>12.0%</b>		<b>745,045</b>		<b>1,119,221</b>		<b>3,786,679</b>	<b>\$0.51</b>
Q3-14														
<b>Total</b>	<b>282,108,484</b>	<b>31,525,078</b>	<b>11.2%</b>	<b>1,957,226</b>	<b>0.7%</b>	<b>33,482,304</b>	<b>11.9%</b>		<b>1,865,452</b>		<b>670,185</b>		<b>3,129,110</b>	<b>\$0.51</b>
Q2-14														
<b>Total</b>	<b>281,438,299</b>	<b>32,777,867</b>	<b>11.6%</b>	<b>1,899,704</b>	<b>0.7%</b>	<b>34,677,571</b>	<b>12.3%</b>		<b>4,295,824</b>		<b>2,372,750</b>		<b>2,995,164</b>	<b>\$0.50</b>

As new, corrected or updated information is obtained, it is incorporated in both current and historical data, which may invalidate comparison to previously issued reports.

## Outlook:

The Greater Phoenix industrial market is forecast to be fairly stable in the second half of this year, with new development slowing and net absorption expected to maintain a fairly steady pace. This will serve as a bit of a contrast from the past two years, where both new construction and leasing activity was quite

robust. Looking ahead, it will be interesting to note how the large blocks of recently delivered spec space are leased. Vacancy in projects built since 2013 is around 50 percent, and while there are several large blocks of available spaces, there are not as many options in the 20,000-80,000 square foot range.

### FOR MORE INFORMATION

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