

Construction Picking Up as Vacancy Dips

Key Takeaways

- › Conditions in the Greater Phoenix industrial market continued to improve during the first quarter, although the pace of net absorption lagged the robust levels from 2017. The outlook for the remainder of 2018 calls for an accelerating pace of tenant move-ins.
- › Net absorption reached nearly 1.2 million square feet in the first quarter, the seventh straight quarter where net absorption exceeded 1 million square feet. Vacancy has retreated to 7.6 percent, the lowest figure in more than a decade.
- › Asking rents rose to start the year, ticking up to \$0.58 per square foot, per month. Current asking rents are up 2.5 percent from one year ago.
- › Deliveries slowed to less than 710,000 square feet in the first quarter, but the amount of space under construction has risen to more than 6.2 million square feet. More than 3.5 million square feet of spec development is under way.
- › The median price during the first quarter was \$97 per square foot, a 17 percent from the 2017 median price. Cap rates have averaged 6.8 percent to start 2018, reflecting the heightened investor demand for local industrial assets.

Greater Phoenix Industrial Market

The Greater Phoenix industrial market did not maintain the breakneck pace from 2017 in the first few months of this year, but the first quarter proved to be a solid start to what is forecast to be a healthy 2018. Net absorption once again topped 1 million square feet—the seventh consecutive quarter where that has occurred. This pace should be sustainable in the coming quarters; the market recorded a stretch of 17 consecutive quarters of net absorption over 1 million square feet from 2003-2007.

Market Indicators Relative to prior period

	Market 1Q 2018	Market 1Q 2017
Vacancy	↓	↓
Net Absorption	↓	↑
Construction	↓	↑
Rental Rate	↑	↑

First Quarter Economic Trends*

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

*Source: Bureau of Labor Statistics

Summary Statistics

	Phoenix Industrial Market
Vacancy Rate	7.6%
Change from 1Q 2017 (bps)	-110
Net Absorption (thousands SF)	1,158
New Construction (thousands SF)	709
Under Construction (millions SF)	6.224
Asking Rents Per Square Foot Per Month	\$0.58
Change from 1Q 2017	2.5%

Greater Phoenix Industrial Market (continued)

Net absorption is forecast to accelerate between now and the end of the year. Several large leases with move-ins scheduled for the remainder of the year have already been signed and the increase in spec inventory will likely generate additional leasing volume in the coming quarters. The national economy continues to expand and the local economy should gain strength. One driver in the local economy will be the housing market, which has been posting rising prices and accelerating permitting activity.

Conditions in the investment market were generally very healthy during the first quarter. Prices surged, with the median price topping \$90 per square foot, a figure that has not been reached since 2007-2008. The number of properties that sold slowed a bit from the fourth quarter, but this is a common occurrence where sales velocity tends to spike toward the end of the year, siphoning off some activity from the first few months of the following year. Cap rates inched higher from lows recorded in the fourth quarter, but at 6.8 percent, the average cap rate is 90 basis points lower than one year ago.

Recent Transactions in the Market

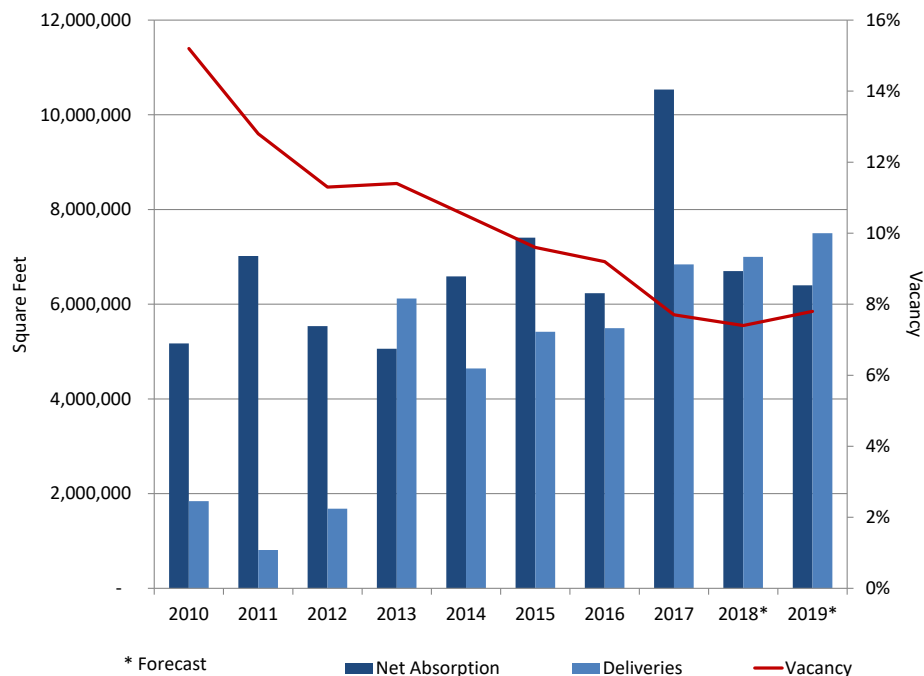
SALE ACTIVITY

Property Address	Submarket	Sale Date	Sale Price	Size SF	Sale Price SF	Class
450-590 N 54th St., Chandler/10 Chandler	Southeast	1/5	\$60,000,000	552,370	\$109	A/B
6600 W Latham St., Phoenix/Living Spaces	Southwest	2/26	\$36,327,000	437,234	\$83	A
5 S 84th Ave., Tolleson	Southwest	1/23	\$13,400,000	217,422	\$62	A

LEASE ACTIVITY

Property Address	Submarket	Tenant	Size SF
4550 W Watkins St., Phoenix	SW S of Buckeye Rd	Intuitive Surgical	131,840
10397 W Van Buren St., Tolleson	Tolleson	QEP Company	122,622
7775 W Buckeye Rd., Phoenix	Tolleson	ThredUp	122,125

Historical Absorption, Deliveries and Vacancy Rates



Vacancy:

- Industrial vacancy continued to decline at the start of 2018. Vacancy ended the first quarter at just 7.6 percent, 110 basis points lower than one year earlier. This marked the sixth consecutive quarter where the local vacancy rate has improved.
- Vacancy in the Southwest Valley continues to trend lower. The rate dipped to 7.5 percent as of the first quarter, down 100 basis points year over year. This is the lowest vacancy rate in the Southwest Valley since the third quarter of 2006.
- Leasing in newer properties has gained momentum in recent quarters, driving the vacancy rate lower. The vacancy rate in properties built since the beginning of 2017 is 36.5 percent, with net absorption topping 4 million square feet in these buildings during the past 12 months.
- Forecast:** Tenant demand for industrial space is forecast to remain strong in 2018, but spec development is on the rise. Supply and demand growth will likely be closely aligned in 2018, and the local vacancy rate is forecast to end the year in the low- to mid-7 percent range.

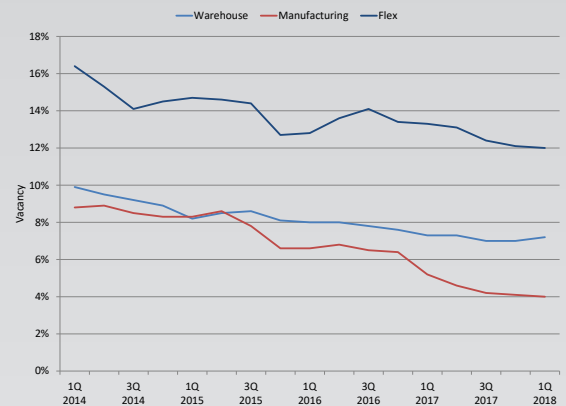
Absorption and Leasing Activity:

- Net absorption during the first quarter was more modest than in recent periods, but still topped 1.1 million square feet. In 2017, net absorption totaled more than 10 million square feet, the strongest single year in Greater Phoenix in more than a decade.
- Net absorption was positive in each of the five submarket clusters during the first quarter, with the Southwest Valley leading the way with more than 593,000 square feet. The Southwest Valley posted a record year for net absorption in 2017, totaling more than 5.3 million square feet.
- Absorption in the Greater Phoenix industrial market will receive a boost in the second half of 2018 with the completion of a build-to-suit distribution facility totaling 800,000 square feet for online pet retailer Chewy.com. The project is forecast to result in approximately 700 new jobs.
- Forecast:** The trend of strong levels of net absorption will continue in the coming quarters, and for all of 2018, tenants are forecast to move into a net of approximately 6.7 million square feet.

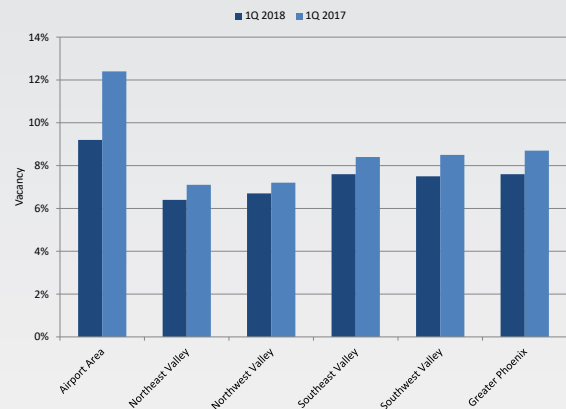
Rental Rates:

- Asking rents trended higher during the first quarter, reaching \$0.58 per square foot, per month. This represents a 2.5 percent year-over-year increase. The pace of rent growth cooled in 2017, but annual rent gains have averaged more than 3 percent over the last five years.
- Rents in big-box distribution buildings inched higher to start 2018, topping \$0.41 per square foot, per month. Asking rents in big-box distribution space have advanced by 1.6 percent year over year through the first quarter.

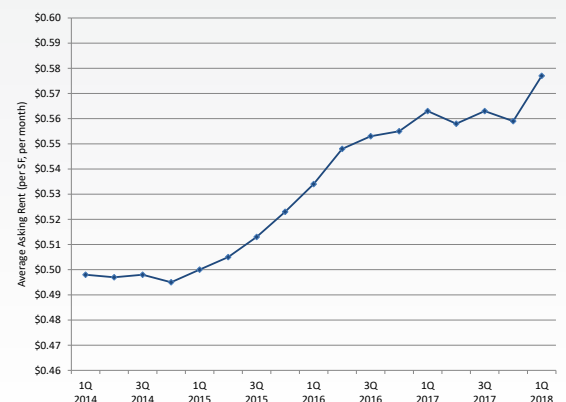
Vacancy by Building Type



Vacancy Among Major Submarkets



Asking Rent Trends



Rental Rates (continued):

- › New construction projects often help establish market rents. In the projects that are under construction in the Southwest Valley, asking rents are averaging approximately \$0.39 per square foot, per month. In the Southeast Valley, projects that are under way are averaging nearly \$0.75 per square foot, per month.
- › **Forecast:** Asking rents are forecast to advance by more than 3 percent in 2018. The pace of rent gains will be largely influenced by the leasing activity in the large spec buildings that come online before the end of the year.

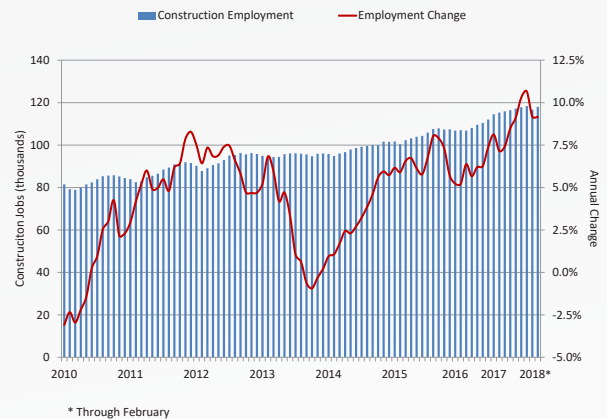
Construction:

- › The robust tenant demand in the local industrial market has made Phoenix a hot spot for development, although deliveries slowed during the first quarter. After more than 1.8 million square feet came online during the fourth quarter of last year, projects totaling less than 710,000 square feet were delivered during the first few months of 2018.
- › Industrial buildings totaling more than 6.2 million square feet are currently under construction, up from approximately 5.2 million square feet at the end of last year. Construction is expected to remain quite active in the year ahead, particularly in the West Valley along the Interstate 10 and the Loop 303.
- › One of the largest spec developments in recent years broke ground during the first quarter. The 1.1-million square foot TEN Distribution Center is the first building in a project that could ultimately total more than 3.6 million square feet in the Tolleson area, immediately south of the Interstate 10. The first phase of the project is scheduled to deliver by the end of this year.
- › **Forecast:** New construction is forecast to total approximately 7 million square feet in 2018, up from about 6.8 million square feet last year. New construction has averaged 5.7 million square feet annually over the past five years.

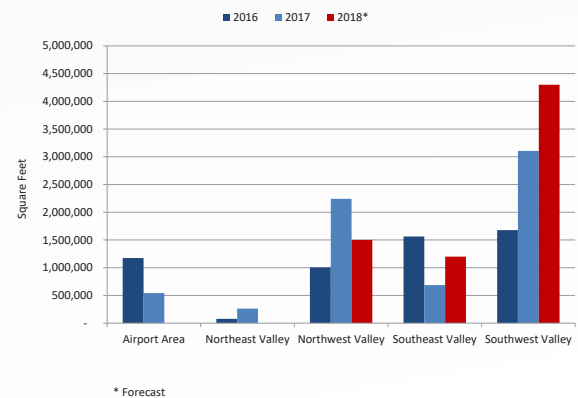
Investment Trends:

- › Sales of industrial buildings cooled during the first quarter, slowing by 17 percent from the fourth quarter of last year. Sales in the first few months of 2018 were nearly identical to levels from one year earlier, dipping just 2 percent compared to the first quarter of 2017.
- › Industrial buildings are commanding higher prices. The median price in buildings sold during the first quarter was \$97 per square foot, up 17 percent from the median price in 2017. While some of the highest prices are being recorded in owner-user sales, prices are also pushing higher in larger, investment transactions. The median price in buildings over 50,000 square feet was \$91 per square foot during the first quarter.
- › Cap rates dropped into the mid-6 percent range at the end of 2017 before inching higher in the first quarter of this year. Year to date, cap rates have averaged approximately 6.8 percent.

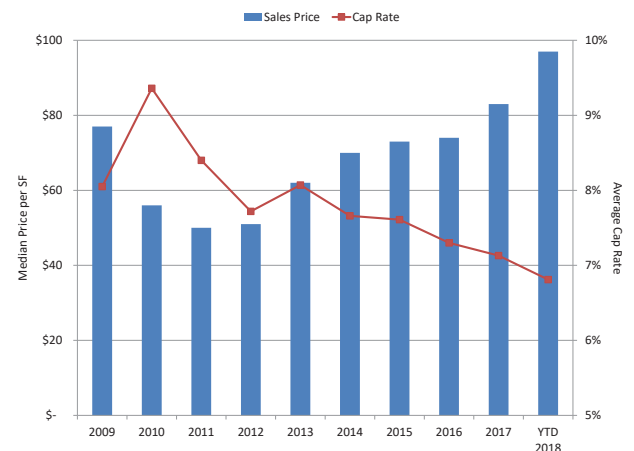
Construction Employment Overview



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	RATE 1Q-18	RATE 1Q-17	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	6,394,582	1,245,076	19.5%	-	0.0%	1,245,076	19.5%	24.0%	(4,011)	(4,011)	-	-	-		\$0.62
Warehouse	25,325,604	1,825,139	7.2%	27,480	0.1%	1,852,619	7.3%	9.8%	172,605	172,605	-	-	-		\$0.65
Manufacturing	8,441,688	212,227	2.5%	83,401	1.0%	295,628	3.5%	6.9%	57,958	57,958	-	-	-		\$0.50
Service Center/Showroom	1,556,611	51,727	3.3%	-	0.0%	51,727	3.3%	5.2%	14,372	14,372	-	-	-		\$0.75
Flex	4,246,927	754,112	17.8%	4,620	0.1%	758,732	17.9%	23.4%	(53,356)	(53,356)	-	-	-		\$1.09
Total	45,965,412	4,088,281	8.9%	115,501	0.3%	4,203,782	9.2%	12.4%	187,568	187,568	-	-	-		\$0.70
Northeast Market Cluster: Central Phoenix, Scottsdale Airpark, Scottsdale/Salt River															
General Industrial	637,618	33,433	5.2%	-	0.0%	33,433	5.2%	13.7%	25,606	25,606	-	-	-		\$0.94
Warehouse	5,556,250	417,749	7.5%	44,777	0.8%	462,526	8.3%	7.5%	29,468	29,468	-	-	-		\$0.86
Manufacturing	2,925,783	57,796	2.0%	-	0.0%	57,796	2.0%	3.1%	24,957	24,957	-	-	-		\$0.85
Service Center/Showroom	1,001,450	25,305	2.5%	-	0.0%	25,305	2.5%	5.1%	9,223	9,223	-	-	-		\$1.14
Flex	4,343,488	351,146	8.1%	0	0.0%	351,146	8.1%	8.6%	36,274	36,274	-	-	-		\$1.10
Total	14,464,589	885,429	6.1%	44,777	0.3%	930,206	6.4%	7.1%	125,528	125,528	-	-	-		\$0.97
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	8,855,231	535,281	6.0%	-	0.0%	535,281	6.0%	15.5%	(29,675)	(29,675)	-	-	-		\$0.43
Warehouse	29,184,253	2,174,147	7.5%	61,048	0.2%	2,235,195	7.7%	6.1%	24,358	24,358	498,920	498,920	795,271		\$0.55
Manufacturing	11,234,418	567,637	5.1%	-	0.0%	567,637	5.1%	4.2%	(12,580)	(12,580)	-	-	160,000		\$0.54
Service Center/Showroom	2,005,789	49,872	2.5%	1,874	0.1%	51,746	2.6%	2.0%	9,588	9,588	-	-	-		\$0.55
Flex	4,648,530	351,392	7.6%	-	0.0%	351,392	7.6%	9.6%	15,784	15,784	-	-	-		\$0.84
Total	55,928,221	3,678,329	6.6%	62,922	0.1%	3,741,251	6.7%	7.2%	7,475	7,475	498,920	498,920	955,271		\$0.54
Southeast Market Cluster: Chandler Airport, Chandler, Chandler N/Gilbert, Falcon Field/Apache Junction, Mesa, Tempe East, Tempe Northwest, Tempe Southwest															
General Industrial	10,607,034	885,088	8.3%	7,375	0.1%	892,463	8.4%	10.0%	178,378	178,378	-	-	147,672		\$0.57
Warehouse	36,971,983	2,764,006	7.5%	101,694	0.3%	2,865,700	7.8%	8.1%	201,113	201,113	210,280	210,280	377,086		\$0.62
Manufacturing	20,850,945	763,438	3.6%	100,500	0.5%	863,938	4.1%	5.7%	(174,019)	(174,019)	-	-	450,000		\$0.70
Service Center/Showroom	2,496,725	82,198	3.3%	-	0.0%	82,198	3.3%	5.0%	19,794	19,794	-	-	-		\$0.81
Flex	11,812,693	1,488,683	12.6%	79,751	0.7%	1,568,434	13.3%	13.1%	18,940	18,940	-	-	-		\$1.13
Total	82,739,380	5,983,413	7.2%	289,320	0.4%	6,272,733	7.6%	8.4%	244,206	244,206	210,280	210,280	974,758		\$0.73
Southwest Market Cluster: Goodyear, SW N of Buckeye Road, SW S Buckeye Road, Tolleson, Southwest Outlying															
General Industrial	48,917,624	4,642,725	9.5%	102,577	0.2%	4,745,302	9.7%	11.2%	271,521	271,521	-	-	1,496,340		\$0.37
Warehouse	32,548,041	1,843,896	5.7%	63,037	0.2%	1,906,933	5.9%	6.0%	148,866	148,866	-	-	2,797,716		\$0.39
Manufacturing	10,527,642	365,970	3.5%	-	0.0%	365,970	3.5%	4.6%	170,953	170,953	-	-	-		\$0.38
Service Center/Showroom	2,484,091	34,874	1.4%	-	0.0%	34,874	1.4%	3.4%	0	0	-	-	-		\$0.52
Flex	1,246,081	122,495	9.8%	-	0.0%	122,495	9.8%	12.0%	1,920	1,920	-	-	-		\$0.98
Total	95,723,479	7,009,960	7.3%	165,614	0.2%	7,175,574	7.5%	8.5%	593,260	593,260	-	-	4,294,056		\$0.38
GRAND TOTAL															
General Industrial	75,412,089	7,341,603	9.8%	109,952	0.1%	7,451,555	9.9%	12.6%	441,819	441,819	-	-	1,644,012		\$0.44
Warehouse	129,586,131	9,024,937	7.0%	298,036	0.2%	9,322,973	7.2%	7.3%	576,410	576,410	709,200	709,200	3,970,073		\$0.55
Manufacturing	53,980,476	1,967,068	3.6%	183,901	0.3%	2,150,969	4.0%	5.2%	67,269	67,269	-	-	610,000		\$0.67
Service Center/Showroom	9,544,666	243,976	2.6%	1,874	0.0%	245,850	2.6%	4.0%	52,977	52,977	-	-	-		\$0.89
Flex	26,297,719	3,067,828	11.7%	84,371	0.3%	3,152,199	12.0%	13.3%	19,562	19,562	-	-	-		\$1.06
Total	294,821,081	21,645,412	7.4%	678,134	0.2%	22,323,546	7.6%	8.7%	1,158,037	1,158,037	709,200	709,200	6,224,085		\$0.58
QUARTERLY COMPARISON AND TOTALS															
Q1-18															
Total	294,821,081	21,645,412	7.4%	678,134	0.2%	22,323,546	7.6%	8.7%	1,158,037	1,158,037	709,200	709,200	6,224,085		\$0.58
Q4-17															
Total	294,111,881	21,943,065	7.5%	711,433	0.3%	22,654,498	7.7%		3,203,204		1,881,677		5,236,191		\$0.56
Q4-17															
Total	291,980,680	23,509,238	8.1%	464,207	0.3%	23,973,445	8.2%		2,946,294		2,321,749		4,025,755		\$0.56
Q3-17															
Total	289,658,931	24,106,634	8.3%	491,356	0.2%	24,597,990	8.5%		1,454,934		833,742		4,640,285		\$0.56
Q2-17															
Total	288,825,189	24,152,720	8.4%	1,067,147	0.4%	25,219,867	8.7%		2,930,676		1,802,551		4,772,669		\$0.56

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:

Despite getting off to a slower start to the year, the outlook for the Greater Phoenix Industrial market in 2018 is quite strong. The market recorded the strongest net absorption in more than a decade in 2017, totaling approximately 10 million square feet. Only five industrial markets in the country had stronger net absorption in 2017.

With vacancy at a cyclical low, there are two trends that are anticipated in the year ahead. The first is an increase in spec development. There is more than 3.5 million square feet of spec space currently under construction, representing a 25 percent increase from one year ago. The second trend that should emerge

in 2018 is that of strengthening rent growth. Net tenant demand has outpaced new development in seven of the past eight years, including the last four years. With vacancies tight, there should be some upward pressure on rents.

The investment market is proving to be particularly strong. Prices have spiked in recent quarters, with the most significant increases occurring in smaller spaces targeted by owner-users. In larger investment transactions, cap rates have been below 7 percent in each of the past two quarters, even as interest rates have begun to tick higher.

FOR MORE INFORMATION

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