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# *Executive Summary*

## **Copper Square Office Market Competitive Analysis**

Prepared for:  
Downtown Phoenix Partnership

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The Copper Square Office Market Competitive Analysis was commissioned by the Downtown Phoenix Partnership (DPP) to assist in understanding the assets of and challenges to Copper Square, the 90-square block core of Downtown Phoenix, for office development and users and to develop strategies to strengthen its market position. This study projects demand for office space over the short term (1 to 3 years) and long term (5 to 10 years) while taking into account the potential impact of major improvements in the area such as the new ASU Downtown Campus, the Bioscience Campus, U of A medical school, light rail, the Civic Plaza expansion, and numerous residential projects

### **Findings and Conclusions**

There is significant optimism and momentum about the future prospects for the growth and development of Downtown Phoenix. There are also challenges to overcome. The following is an overview of the findings and conclusions of this report followed by economic development strategies that could be implemented to promote the office market and employment base in Downtown Phoenix.

**1. Advantages of Copper Square:** Copper Square has a number of advantages that will help promote the development of office space in the future including:

- Prestige and notoriety of companies that locate there.
- The presence of major amenities such as theaters, sporting venues, museums, government facilities, and other major infrastructure elements.
- A central location within the region drawing upon a large labor shed with reasonable driving times.
- Major construction projects that will enhance Copper Square in the future such as the expansion of Civic Plaza, the construction of the 20-mile light rail starter segment, the construction of T-Gen and the Bioscience Campus, and the construction of the Downtown ASU Campus.
- Significant infrastructure including mass transit, vehicular transportation corridors and telecommunications facilities.
- Zoning that permits high-rise office development by right compared to other urban cores.

For Copper Square to grow its successes, all these elements must come together to create the metro area's premier business and entertainment location.. True progress will only occur when the plans for Downtown progress beyond drawings and become reality. The key to success lies with the ASU Downtown Campus that will bring additional employees and students to Copper Square.

**2. User-Oriented Challenges Facing Copper Square:** There are several challenges affecting Copper Square that must be overcome to create a successful office market. Those challenges include:

- A lack of a significant inventory of decision maker housing close to Copper Square.
- Negative perceptions about Copper Square in the minds of long time residents.
- The lack of some basic amenities such as significant retail and shopping outlets.
- Perceived security and safety issues (this issue is more perception than reality).
- Perceived low achieving school districts that may preclude families with children from living in Downtown.
- An office market that is too dispersed between the Copper Square and Midtown submarkets and does not provide the critical mass to support a wide range of amenities and convenience services.

**3. Real Estate-Related Challenges Facing the Copper Square Office Market:** The primary challenges with respect to the office market are:

- The cost of providing structured or underground parking for new office buildings.
- Rent levels that may not support new office construction today.
- The lack of anchor tenants for new high-rise buildings.
- Few modern office towers with floor plates larger than 25,000 square feet (similar to the Phelps Dodge and Collier Center buildings). Older towers developed in the 1970s demonstrate design obsolescence for today's business corporations.
- Land costs that aggravate the steep cost of high-rise office development.
- The lack of an existing inventory of older or historic buildings that can be remodeled into office buildings, particularly for small or start-up firms.

**4. Future Office Demand:** The future of the Copper Square office market is bright. While there are short term challenges to overcome, the long term outlook is positive. For Copper Square to effectively compete with suburban office markets, it must offer a unique product. That product is a downtown that operates 24 hours a day, seven days a week with strong residential, retail, entertainment and employment components. Phoenix is on its way to creating the type of environment that will attract employers and decision-makers to Copper Square if all presently planned projects come to fruition, particularly the ASU Downtown Campus.

Copper Square will need to provide a wide variety of office types to accommodate different sizes and types of businesses. Data analysis shows that the mix of private-sector businesses and industries located in Downtown Phoenix are very similar in many respects to the employment mix in competing cities. The predominant uses found in downtowns across the country include accounting, finance, insurance and real estate, legal services, and engineering/architecture firms. In addition to Class A office space, buildings with moderate rents for small and start-up companies are also important. Downtown Phoenix has the opportunity to capture additional professional services and creative firms (advertising, architecture, etc.) as well as be a player in the regional economy and capture a share of the region's priority business or industry clusters that include biosciences, advanced business services, information technology and software.

Given current low vacancy rates for Class A office in central Phoenix, the market is now operating with a shortage of high quality space for those tenants desiring to locate in signature buildings. Companies looking to locate in central Phoenix have few options – either lease space in a Class B building or move to a different sub-market. The aging office inventory in Midtown generally does not appeal to Class A tenants. The large amount of vacant Class B space in Midtown may serve as a temporary alternative to the Copper Square office market until new Class A buildings are brought on line. While the Camelback Corridor has an available supply of Class A space, recent zoning cases suggest new high-rise office development may face stiff challenges from neighborhood groups. Another factor that will affect available office space is the growing trend toward office condominium conversion that is shrinking the available supply.

Interviews with office development companies indicate that demand for Class A space is present, but the challenges of constructing office space in Copper Square have stalled the market at the current time. Completion of the next Class A office building in Downtown will likely occur in the 2008 to 2009 timeframe. Given the lead time to negotiate leases, prepare plans and construct a building, the earliest an office structure could be ready for occupancy is 2008. This time lag will permit rents to adjust upward as the office market continues to improve.

### **Overview of Downtown Office Market**

The following conclusions have been developed concerning the Metro Phoenix office market and, specifically, the Downtown Phoenix market.

1. Over the past twenty years, the Downtown office market has lost market share to suburban locations. Today, the Downtown market accounts for 9.7% of total rental square footage in Metro Phoenix compared to 11.6% in 1995. The combined Midtown and Downtown areas account for 24.9% of total square footage versus 33.9% ten years ago. The submarkets that have been accounting for the largest proportion of office growth include Scottsdale, Deer Valley, Tempe and the Sky Harbor Airport area. However, while Downtown's percentage of the overall office market has declined, it has maintained a strong and growing share of the metro area's Class A product.
2. With vacancy rates in the Downtown area dipping below 10% and Class A vacancies standing at less than 7%, there is now limited inventory to accommodate new employment growth. In fact, the Downtown sub-market has the lowest vacancy rate in Metro Phoenix. The strong growth in the last two years is related to the anticipated revitalization of Downtown due to the construction of the Bioscience Campus, the ASU Downtown Campus, the light rail system, Civic Plaza and a new convention hotel. For continued growth of the office market, all of the above projects must become reality, especially the ASU Campus.
3. Vacancy rate data indicates a significant shortage of high quality Class A space in central Phoenix. The large vacant inventory of Class B space in Midtown offers an

alternative to tenants looking to locate in Central corridor. However, this space is likely a short-term fix for tenants and should not deter development of Class A space in Copper Square.

4. As of the second quarter of 2005, quoted asking rents for Class A space in Downtown Phoenix were nearly equal to the metro wide average and rising rapidly over the past two years. While this is a positive trend, current rents make it difficult to support the construction of new office buildings, particularly high rise towers. With the declining vacancy rate in Copper Square, rent increases are imminent.

### **Financial Feasibility Analysis**

A proforma financial analysis for three alternative office building configurations was constructed to evaluate the rents required to generate sufficient investment returns to an institutional investor. The analysis demonstrates that the construction of high-rise office space produces modest returns on investment with today's rent structure compared to traditional rates of return sought by institutional investors. This is primarily related to the difficulties in the Metro Phoenix office market which is currently producing vacancy rates in excess of 15%. While Class A buildings in Copper Square are essentially at full occupancy, the construction of such buildings is complicated by rising land costs and the construction cost of structured parking. The true rent required to induce development of an office building in Downtown Phoenix is over \$30 per square foot although some developers believe that \$28 rents will work in the short term.

The value of financial modeling is the ability to modify certain assumptions to test the impact on rents and other financial aspects of office development. Two of the most important variables identified by office developers are land cost and the construction cost of parking. This financial analysis suggests that land cost is not particularly a major cost factor because even at a price of \$100 per square foot, the land component only represents about 6% of the total cost of a project. Parking on the other hand represents 23% of the cost of a project. When the land cost is reduced from \$100 to \$75 per square foot, the required rent declines by only \$0.30 per square foot. By comparison, required rents decline by \$1.10 per square foot when the parking standard is changed from 2.5 to 2.0 spaces per 1,000 square feet, a much larger impact.

Therefore, developing a strategy to resolve parking issues in Copper Square will likely provide a greater stimulus for the office market than subsidizing land cost. While land cost is certainly a significant issue affecting certain parts of Copper Square, the cost of parking is even more serious and is worthy of further study by Copper Square stakeholders.

### **Analysis of Downtown Office Markets of Peer Cities**

As part of this study, a variety of information was collected and analyzed regarding downtown employment and the downtown office markets in cities that are considered competitors and/or peers to Metro Phoenix. The cities researched include Baltimore, Denver, Houston, San Diego and Seattle. Employment data was collected for a one-mile radius surrounding the central business district. In all cases, employment in the downtown areas in these peer cities was significantly higher than the Phoenix metro area, often twice as large as found in

Downtown Phoenix. The proportion of government employment in Downtown Phoenix is significantly higher than the other peer cities. Almost one third of employment in Downtown is classified as public administration, compared to no more than 10% in other cities. This data points to the need to diversify the employment mix in Downtown to focus more on business services and similar industries. While government is a stabilizing force in Downtown, more private investment will attract new businesses and spur further growth.

The type and mix of private sector employment in Downtown Phoenix, excluding government jobs, is not much different than other communities. The downtowns of most major cities are dominated by professional firms (lawyers, accountants, architects, and engineers) and finance and insurance companies. Accommodation and food services are typically a strong component as well. Each community has its individual strengths based on its historical economic characteristics. Seattle has a strong information industry component, likely due to the presence of companies such as Microsoft. San Diego has a large accommodation and food services component related to tourism and its convention center. But overall, Downtown Phoenix's mix of private sector employment is very similar to every other city – it's just that Downtown has a smaller overall number of employees than the peer communities.

It is interesting to note that recent efforts to broaden the employment base of Downtown appear to be consistent with other successful endeavors implemented in peer cities. The expansion of Civic Plaza will help increase food service and hotel employment in the Downtown. The construction of the ASU Downtown Campus will bring more residents Downtown and help spur more retail employment. Efforts to expand the office market will provide space for additional professional firms. All these redevelopment directives will help Downtown become a stronger employment center, but the mix of private-sector employment will likely remain similar to many peer communities.

### **Downtown Office Demand**

The growth of the Downtown office market is dependent upon the growth of the Metro Phoenix economy. The University of Arizona Forecasting Project predicts that job growth in Metro Phoenix will slow in the next few years before expanding through 2015 when job growth could reach close to 100,000 jobs annually. Employment growth is expected to average over 66,000 jobs each year over the next ten years.

Analysis of recent office vacancy data for the metro area indicates that Class A office space is currently at a premium in the Downtown and Midtown sub-markets of central Phoenix. The combined vacancy rate in the two sub-markets is 6.2%. In addition, according to Lee & Associates, between 2000 and 2005 Downtown captured 21% of the metro area's increase in occupied Class A office space. It also was responsible for over 23% of the Metro Phoenix increase in Class A office inventory. But while Class A buildings are well occupied, Class B and C space in Midtown has vacancies above 20%. Even in Downtown, Class B space has a 14.7% vacancy rate according to Lee & Associates.

For those tenants looking for high quality Class A space, there are few alternatives in the central Phoenix area. A tenant can either locate out of central Phoenix or find occupancy in a Class B building. Class B rents in Midtown are very attractive at an average of \$16.70 per

square foot. However, many corporate tenants would likely rather rent Class A space at higher rents if space were available. With the aging of the stock of office buildings, Midtown has become less attractive to those businesses seeking occupancy in a signature building or location.

This data points to a significant shortage of high quality Class A space in central Phoenix. The large vacant inventory of Class B space in Midtown offers a temporary alternative to tenants looking to locate in Central Avenue corridor. However, this space is likely a short-term fix and should not deter development of Class A space in Copper Square.

The Central Phoenix sub-markets offer prime locations for high-rise and mid-rise office buildings. Generally, there are few Class A buildings over six stories in height in suburban sub-markets. By comparison, sites in Copper Square have, by right, unlimited height restrictions, subject to limitations that may be imposed by proximity to Sky Harbor International Airport. Downtown Phoenix has the potential to continue to capture a major share of the Class A office market, particularly with the public investments being made in the area. In fact, it will likely continue to be, along with Midtown, one of the few areas in Maricopa County that has the land area and zoning available to attract high rise office development.

Demand for Downtown Phoenix Class A space from 2005 to 2015 is projected to total between 2.5 and 3.0 million square feet. Class B and C space, comprised of smaller buildings, is estimated at 800,000 to 1 million square feet (or 25% of total demand). Altogether, demand for office space in Downtown Phoenix is forecasted between 3.3 million and 4.1 million square feet over the next ten years.

Table A			
<b>Projected Office Space Demand 2005 - 2015</b>			
<b>Downtown Phoenix</b>			
Class A Market			
Capture Rate	Class A SF	Class B & C SF	Total SF
18.0%	2,501,000	834,000	3,335,000
22.0%	3,057,000	1,019,000	4,076,000
% of Total SF	75.0%	25.0%	100.0%
Source: Elliott D. Pollack & Co.			

The suggested mix of forecasted office space in Downtown, including the surrounding Downtown Redevelopment Area, is designed to accommodate all sizes of users. Between nine and eleven buildings larger than 100,000 square feet will be demanded over the next ten years. These buildings would be considered Class A product. The remaining structures would be comprised of smaller buildings generally located outside of Copper Square targeting professional services and creative firms.

Table B  
**Suggested Mix of Office Space  
Downtown Phoenix  
2005 - 2015**

SF Category	% of SF	Avg. SF/Building	18% Class A Demand		22% Class A Demand	
			SF (1000s)	Buildings	SF (1000s)	Buildings
Under 50,000	15%	15,000	500,250	33	611,400	41
50,000 to 100,000	10%	65,000	333,500	5	407,600	6
100,000 to 200,000	15%	120,000	500,250	4	611,400	5
Over 200,000	60%	400,000	2,001,000	5	2,445,600	6
<b>Totals</b>	<b>100%</b>		<b>3,335,000</b>	<b>48</b>	<b>4,076,000</b>	<b>58</b>

Source: Elliott D. Pollack & Co.

The Copper Square area represents about one-third of the Downtown Redevelopment Area, but encompasses the majority of government, entertainment, sports, civic, and office facilities in the area. It is also the only portion of the Redevelopment Area in which adopted city plans call for new high-rise development. Given the available land areas remaining for development in Copper Square, it will be important to concentrate high-rise office development directly in Copper Square close to the area’s amenities. The five high-rise towers that are suggested as possible additions to Downtown over the next ten years should be located in areas that generate synergy with major activity facilities in the area. Prime office sites should be reserved for office uses so that intense, concentrated development can occur in Copper Square.

Mid-rise and low-rise office development should occur on the edge of Copper Square and those parts of Downtown outside the Copper Square boundary. Areas where mid-rise and low-rise office development may be appropriate include the northwest quadrant of Copper Square and the area south of Copper Square south of Jackson Street. Land in Copper Square must also be reserved for future hotel development and high-rise condominium development that will create a 24/7 Downtown. The availability of land to accommodate these uses is extremely limited, particularly with the proposed ASU campus.

Additional low-rise and mid-rise office development should occur outside the boundaries of Copper Square. Some of this office development could occur in the warehouse area where existing buildings could be preserved and converted to office use. Additional areas that could accommodate lower intensity office include the northern central corridor, north of Fillmore Street and along Roosevelt Street. Lower intensity office development could compliment some of the office rehab activity that is occurring south of Roosevelt, west of Central Avenue.

At least two high-rise office proposals are in the preliminary planning stage in Copper Square. The difficulties of developing high-rise towers in the current environment may delay significant construction activity for the short term. The most difficult challenge appears to be securing a major anchor tenant. In spite of this issue, most developers believe that the next high-rise office building in Copper Square will be completed in the 2008 to 2009 timeframe. If the planned 2006 City bond election is approved by the voters (and ASU is a large

beneficiary of the bond package), some office development could occur in public/private partnership arrangements. Over the long term, the outlook for Downtown Phoenix is extremely positive. Additional high-rise buildings will be constructed over the next ten years as rents rise to a point where new construction is justified.

**Economic Development Strategies**

Following are the major economic development strategies that are targeted at promoting office development in Copper Square.

**1. Develop plans and programs for addressing vehicular parking issues in Copper Square.**

This study has identified that the construction cost for structured parking in the Downtown is a major impediment to the development of office buildings. Stakeholders need to develop a plan and strategy for the provision of parking within Copper Square that addresses ways in which the cost of structured parking can be reduced and/or where public parking structures can be situated closer to existing office buildings and future office sites. These strategies should also consider methods for subsidizing the construction of private parking facilities or assist companies in subsidizing employee parking costs. The light rail system may alleviate parking demand to some extent, but it is likely to continue to be a long term issue. A study of the use of parking facilities in the Downtown area will be helpful in determining the extent of the problem.

**2. Assist in the Write-Down of Land Costs Where Appropriate.**

Rising land costs are a barrier to development of office space in Copper Square. Stakeholders should develop plans and policies for providing subsidies or write-down of land cost to stimulate office construction. This assistance could be provided directly within public/private partnerships related to the development of the ASU Campus and translate into lower rents for mixed-use buildings.

**3. Leverage the City of Phoenix's Investment in the Bioscience Campus**

The City of Phoenix has made a significant investment in land acquisition for the Bioscience Campus. In an effort to promote the development of the bioscience industry in Copper Square, the City should use its land asset as an incentive to attract bioscience firms and private developers who may be willing to construct additional buildings. Due to the high cost of research labs and other related medical buildings, the write-down of land costs within the Campus, in combination with other incentives, could stimulate private investment.

**4. Reserve Sites for High-Rise Office Uses in Copper Square.**

There are only a handful of vacant sites in Copper Square that are suitable for intense office development. These sites should be identified and reserved in the long term for such uses. While residential condominiums are an important component of the development of Downtown Phoenix, there must be a balance between appropriate levels of office development and placement of residential uses in the area.

**5. Concentrate High-Rise Development in Copper Square**

An important component of a center city, urban environment is concentrated, intense development. Office development should form the core of this intensity through the construction of high-rise towers. High-rise office development should not be permitted to stray outside of Copper Square unless it is well positioned in an area that will ultimately assist in expanding the employment core.

**6. Consider Limiting Zoning For High-Rise Office Uses In Areas Outside Central Phoenix.**

Copper Square and other central Phoenix sub-markets offer prime locations for high-rise and mid-rise office development. Downtown sites have, by right, unlimited height restrictions (subject to limitations that may be imposed by proximity to Sky Harbor International Airport) and typically do not encounter neighborhood opposition related to high-rise development. This is a significant competitive advantage that Copper Square enjoys over other sub-markets and provides the opportunity for the area to continue to capture a major share of the Class A office market. For Copper Square to continue to exploit this advantage, the City of Phoenix should consider maintaining current height restrictions on office development in other parts of the City.

**7. Consider Spurring New Office Development Through Utilization of the Government Property Lease Excise Tax (GPLET) Program.**

Through the GPLET program, it may be possible to offset some of the operating costs for office development through abatement of property taxes. According to the Building Owners and Managers Association (BOMA), property taxes average \$3.50 per square foot per year for large office buildings in central Phoenix. The reduction of property taxes for an office building would result in a lower rent structure and improve the financial feasibility of new construction in Copper Square. The use of the GPLET program should be selective and only open to those projects that meet certain established criteria.

**8. Promote the Adoption of a Tax Increment Financing Program**

Tax increment financing has been shown to be an effective method for promoting the development of downtown areas in other parts of the country. It is an important tool that could assist in the development of office buildings in Copper Square. Efforts to adopt a tax increment financing program at the State Legislature should continue.

**9. Develop and Implement Targeted Marketing Programs for Expansion and Diversification of Downtown Employment**

Analysis of the employment composition in Downtown Phoenix shows a high proportion of government jobs compared to similar-sized cities. Expanding the number of jobs in Downtown as well as diversifying the employment mix are keys to a healthy central city. Marketing programs should address the breadth of tenants from small professional firms to large corporations. A particular focus of a marketing program should be single tenant users who may be able to anchor a mid-rise or high-rise building. Efforts should also be directed at small companies that may be interested in participating in the development of Copper Square.

A targeted marketing program should focus upon professional services firms (lawyers, accountants, architects, and engineers) and finance, insurance and real estate companies. These occupations have formed the core of private-sector employment in Copper Square as well as most other downtowns of similar-sized cities. The growth of employment in these fields will spawn job growth in other areas such as the food service business. The bioscience infrastructure that is being developed in Copper Square is also an asset that could lead to job growth. Bioscience/medical firms should be part of an overall plan for marketing efforts.

**10. Promote Public/Private Partnerships to Generate the Construction of Office Space**

The anticipated construction of major public facilities in Copper Square has created a unique opportunity to leverage development of office space by private interests. For instance, the ASU Downtown Campus will likely be developed in part by private developers who could combine University building space with traditional for-lease office space in a single building or complex. The participation of the City of Phoenix in land acquisition or the provision of parking structures could provide the means to overcome some of the financial challenges facing the office market. Similar negotiations could be conducted with developers of residential condos in Copper Square. The inclusion of office space in residential condo buildings or on the same site would accomplish several goals:

- It would create a mixed use building for living and working.
- It could lead to the creation of smaller office spaces that would be attractive to small creative firms.
- If the office space is sold as condominiums, it would bring reasonable returns to the investor and permit small firms to own their building space.

As a note of caution, a program of this type must be voluntary on the part of the developer and must be used only in cases where an office component makes sense. If the concept is heavily employed, it has the possibility of stifling residential condo development in the Downtown, something that will be extremely harmful to Downtown's future. Residential development must be a primary goal of development efforts in Downtown.