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Bifurcation in Two Forms

By John Salustri | Phoenix

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Coppola: "Long term, you can't have a robust marketplace if you are relying just on class A."

PHOENIX—The race is on for class A space. So says **R. Craig Coppola, CCIM, SIOR, CRE,** founding principal of **Lee & Associates**' **Phoenix** office. But in a recent interview, Coppola told GlobeSt.com that bifurcation comes in two packages, and there is another split—this one largely of culture—between the global providers of real estate services and the independents. First, the brick-and-mortar.

"There is a differential between Phoenix class A office product and every other class," he says. "When you're talking about a five- or six-basis-point difference between A and B or C office product, that's substantial." That differential is caused by the flood of capital chasing quality assets, increasing prices and compressed cap rates for class A properties.

"There are really two different buyers in the market," Coppola observes. "One is the value-add buyers, and they're getting priced out of class A properties." Specifically by large institutional buyers who, he says, are "driving the market," even in secondary cities, like Phoenix.

But are we getting to a tipping point? No, says Coppola, one of the top producers in Lee's 52 office network. At least not yet: "I'll tell you why. Irrational to me is where the price per foot is quite a bit higher than replacement cost. The building where we office sold 18 months ago—it was recently renovated and it's leased up. You would think the new buyer overpaid. But he actually paid $5 million less than the former buyer did two owners ago."

Not surprisingly, vacancies in the years since the Great Recession support the institutional taste for quality. Overall, reports Coppola, Phoenix metro vacancy has fallen from a painful 27% in 2010 (It had been 12% just four years prior) to a more manageable if still not-pretty 20% in Q4 of last year. But a more nuanced look at the stats reveals an interesting trend (*see chart below*).

Phoenix Vacancy by Asset Class

Vacancy	2006	2010	2014
CLASS A	10.7%	28.6%	21.1%
CLASS B	13.1%	26.4%	21.8%
CLASS C	7.9%	21.3%	17.1%

"This shows the propensity of the new class A buildings to lease at a faster velocity than B and C projects," Coppola explains. "Tenants are moving to a new location, creating nicer space, getting very competitive rates and redesigning their offices." In short, investors are following the fundamentals.

Coppola's worry is for the B and C spaces, which he sees strangled by a jobs market that doesn't support those sectors. He points out that if we examine the employment statistics, "only five or six markets have been driving the national recovery this cycle: Washington, DC; Silicon Valley; Austin; Dallas; and Houston. Most other markets are still below where they were prior to the recession. Certainly national policies haven't allowed growth to come back, and that has really hurt the B market and small multi-tenant office development. Long term, you can't have a robust marketplace if you are relying just on class A."

A robust market also dictates choices of providers, and Coppola observes a game-changing trend for the market in the recent spate of service provider M&As. "There seems to be a big push for the top four or five global players to continue to grow," he says. "They currently account for only approximately 19% of the market share. There's no other industry where such huge companies have such little market share." So, he says, the drive is on for them to capture more.

Certainly, such consolidation is changing the face of the market. "Twenty years ago you could be a lone wolf. Today, you need a team because the speed of the business has changed, and the amount and quality of services we provide have changed. So has the depth of knowledge required to be successful."

The bifurcation here comes in the culture. Lee & Associates, Coppola points out, is growing as well, and now counts 52 offices. But he points to the differences: “The major nationals have some great brokers and they can compete anywhere in the world. But their business is different from the independents. Their services are institutionalized in terms of procedure creation and national account business. But when the client is looking for more of an entrepreneurial broker, we get the business. Commercial real estate remains a cottage industry where local quality representation is paramount.”

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About Our Columnist

John Salustri has covered the commercial real estate industry for nearly 25 years. He was one of the founding editors of GlobeSt.com, and is a four-time recipient of the Excellence in Journalism award from the National Association of Real Estate Editors. Contact John Salustri.

Bio