Recession Rising Like Phoenix With Area Delinquencies Surging

By Brian Louis

Oct. 1 (Bloomberg) -- Drive up to the Peaks Corporate Park in north Scottsdale, Arizona, and the only person you’ll encounter at the luxury office complex is a security guard.

The development was planned to offer executive suites with views of the McDowell mountains, neighbors such as General Electric Co. and a location just minutes away from Jack Nicklaus’s Desert Mountain golf courses. Plans to lure tenants haven’t materialized and today the complex in this city next to Phoenix is empty, the entrance blocked by a traffic barricade.

Delinquencies in the Phoenix area on loans backed by office, industrial, retail and apartment properties have risen more than five-fold since March, according to data compiled by Bloomberg. The Phoenix region has the second-worst U.S. delinquency rate, behind Detroit’s 10 percent. In Phoenix, the economic recovery looks a lot like a recession.

“A commercial recovery in markets that are heavily dependent on construction will be slow, which means the overall recovery will lag the nation as a whole,” said Susan Wachter, a real estate professor at the University of Pennsylvania’s Wharton School in Philadelphia. “These are more volatile markets and getting back to normal could take years.”

Phoenix and other southern and western cities such as Atlanta, Houston and Dallas grew because they offered an affordable lifestyle to middle-class Americans, said Edward Glaeser, an economics professor at Harvard University in Cambridge, Massachusetts. That growth has slowed.

Slowing Growth

The Phoenix area’s population is forecast to increase 1.6 percent in 2009 from 2008 and 1.8 percent in 2010, according to a forecast by Scottsdale, Arizona-based real estate and economic consulting firm Elliott D. Pollack & Co. That’s the slowest growth since at least 1990. Employment may fall 6 percent in 2009 and another 1 percent in 2010, according to the firm.

The real estate crisis has brought economic growth to an end. Arizona had the highest unemployment rate since 1983 in July at 9.2 percent, according to the U.S. Bureau of Labor Statistics. The rate fell to 9.1 percent in August. Single-family building permits in metropolitan Phoenix may fall to 5,973 this year, down 81 percent from 2007, according to a consensus forecast of real estate and consulting firms and universities compiled by Arizona State University’s W.P. Carey School of Business.

“The economy in Phoenix is in tatters right now,” said Matthew Anderson, a partner at Foresight Analytics LLC in Oakland, California. “It’s now really hit the skids.”
The decline demonstrates that it may take even longer for states with slower growth to emerge from the recession.

Rising Unemployment

In August, 19 states had higher unemployment rates than Arizona’s, U.S. Bureau of Labor Statistics show.

Worse, more real estate is at risk of defaulting throughout the U.S. Investors in commercial mortgage-backed securities are holding assets with a delinquent unpaid balance of $28.9 billion, up more than five fold since June 2008, according to a report issued by the Congressional Oversight Panel. Under a worst-case scenario, the panel estimates that commercial real estate and construction loan losses through 2010 may total $81.1 billion at 701 banks with assets of $600 million to $80 billion.

"The problems in commercial real estate are just getting started and they will dampen what is already going to be a weak economic recovery," said Jim Rounds, senior vice president and senior economist at Elliott D. Pollack. "In Arizona, the recession is probably going to last to the middle of the next calendar year."

Growth Fallout

Wachter, who has been studying housing markets for more than two decades, predicts that Phoenix won’t see a recovery until at least 2012.

The city of Phoenix is suffering the fallout from growth that boosted its population from 983,403 in 1990 to 1.6 million in 2008, according to the Census Bureau. Single-family building permits in Maricopa County, which includes Phoenix, rose more than five-fold from 1975 to the peak earlier this decade.

Delinquencies for loans backed by office, industrial, retail and apartment properties that were bundled into securities in Phoenix increased five-fold since March, according to data compiled by Bloomberg.

The Phoenix office vacancy rate probably exceeds 30 percent, including space that’s leased yet vacant because the tenants have pulled out, Rounds said.

More offices are becoming available. Los Angeles-based commercial broker CB Richard Ellis Group Inc. said in a second quarter report 2.2 million square feet will be ready for occupancy this year and in early 2010.

Late Payments Rise

As tenants abandon space, landlords are struggling to meet their obligations. Commercial properties with mortgage payments 60 days late or more rose to 8.5 percent as of August in the Phoenix, up from 1.6 percent in March, data compiled by Bloomberg show.

"The commercial markets are the second shoe to drop," said Marshall Vest, the director of the Economic and Business Research Center at the University of Arizona’s Eller College of Management in Tucson. Vest has lived in Tucson since 1970 and worked at the business school studying and forecasting the Arizona economy for 30 years.

For the last three decades, Arizona’s population growth has exceeded most of the nation’s. From 1970 to 2007, the state’s population more than tripled to 6.3 million. Its population growth ranked second or third in the U.S. from 1970 through 2008, according to Pollack data.

Onetime Growth Engine

The state was also an engine for job growth. Arizona was fourth in the U.S. in employment growth from 2000 to 2008 and second from 1990 to 2000. Arizona’s gross state product, a measure of overall economic activity, jumped to $249 billion last year from $30.3 billion in 1980.

Residential construction soared from 1980 to 2005, the peak of the new-home market boom in the state. Single-family building permits rose from 22,919 in 1980 to 87,415 in 2005, according to data on Texas A&M University’s Real Estate Center Web site.
The fallout can be seen throughout the Phoenix. Completed and empty office buildings and retail developments dot the desert landscape of the region, the 12th-largest metro region in the U.S. Vacant retail shops are hard to ignore.

'Going Under'

"It's kind of going under locally," said Chris Dellrie, who was working at Axis Sports, a sporting goods and clothing store, one of at least two businesses open in a Gilbert shopping center that's mostly empty.

The slump forced Opus West Corp., one of the region's biggest real estate developers, to file for Chapter 11 bankruptcy this year, listing debts of $1.46 billion and $1.28 billion in assets, according to bankruptcy records. Opus West is part of the Opus Group, a real estate developer based in Minneapolis.

"It's really nothing out of the ordinary," said Craig Henig, senior managing director at CB Richard Ellis in Phoenix. "They believed like everyone that the market would expand."

At 24th at Camelback II, an 11-story, 300,000-square-foot office building going up in Phoenix near the Arizona Biltmore Country Club, developer Hines hasn't preleased any of the space. The building will be finished in the first quarter of 2010, said Kim Jagger, a spokeswoman for the Houston-based real estate company. Jagger said there are at least half a dozen potential tenants.

'Horrible Economy'

People who've moved to Phoenix and adjacent suburbs have found life difficult as the economy has slumped.

Ambre Mauro moved to Gilbert, a suburb of Phoenix, in March after struggling in Oregon.

"The economy was horrible there," said Mauro, 25, who graduated from Brigham Young University-Hawaii with a degree in exercise sports science. "Eventually I decided to come here."

Things aren't much better in Arizona. Mauro now holds two jobs. She's a personal trainer and front desk clerk at a local gym and a waitress at a Japanese restaurant, where she makes about $10 an hour, including tips.

"I have a four-year degree and I never expected to be a waitress," Mauro said.

About 25 miles northeast of downtown Phoenix, the Peaks Corporate Park stands as a reminder of just how optimistic developers were about the region's growth prospects.

Prestigious Neighbors

The office complex was built in one of the most prestigious and wealthy parts of the state, where the median price for a new home was $920,000 in the second quarter.

A Web site for the development boasts that it's near several resort hotels including the Boulders, a Waldorf Astoria property, and "neighbors such as General Electric, Pacesetter, DHL, Taser, USF Bestways, Toll Brothers, Pulte Homes." Dale Dowers, a principal with the developer, didn't return calls or e-mails for comment.

With no tenants, the development's courtyard is barren but for a sculpture featuring wildlife.

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