



NAI Horizon

1st Quarter
2018
Office
Market Report

What Does the Future Hold?

It's like déjà vu...all over again, once opined the always quick-witted Yankees Hall of Famer, Yogi Berra. His tongue-in-cheek comment does though accurately convey the positive sentiment in the Greater Phoenix commercial office sector for Quarter 1 of 2018.

For starters, rental rates continue to highlight a sustainable supply/demand condition; the average value across all submarkets ticking up to \$25.39/square foot, a \$1.64 increase year-over-year from first quarter 2017. Class A, B and C are defining their levels and creating definitive gaps: \$30.16, \$23.01 and \$18.55/square foot respectively.

Underpinning the steady rate increases, an economic growth cycle bringing in new market tenants from competing metros, as well as producing organic expansion. This migration and local vibrancy is accelerating an already powerful wave of construction, nearly 2.9 million square feet of space layered on top of 2017 build numbers exceeding 7 million square feet. Quarter 1 also extended an end of year story; the development of spec space, which has been largely dormant in the commercial office recovery. The majority of Class A construction in the first quarter (2 million square feet) was spec. Meanwhile, Class B's share of new construction (850,000 square feet) found its way into build-to-suit projects.

The construction narrative is compelling and points to the strength of the sector, even as it reveals some interesting dynamics. Namely, the smaller building market remains underserved due to the high costs of construction, while the majority of development unfolds in large floor plate footprints with high parking ratios. What this could reveal over time remains to be seen, particularly if the shortage of smaller properties becomes acute. And with the evolution of autonomous vehicle technology, as well as re-designed work environments catering to mobility and shared collaborative

OFFICE TRENDS



Noteworthy trends include the signing of larger leases and for longer duration, a mix of tenants wanting to lock-in pricing and owners wanting to amortize and manage the rising cost of tenant improvements. As usual the Tempe submarket is robust, boasting the highest per square foot rental rate \$32.43/square foot. Joining this top performer; Scottsdale, Chandler, Gilbert and Downtown Phoenix.

While the East Valley still reigns supreme in the office sector, the West Valley is beginning to see greater demand with its strengthening labor pool and income demographics, along with a burgeoning transportation infrastructure. However, with still limited supply coming online, the timeline for equalization in Valleywide development is still out in the distance.

Lastly, Class B spaces are still the hot commodity, as investors renovate and reposition these assets to lure tenants perhaps seeking greater affordability.

All told, Quarter 1 office continues to outperform with still an 18-24-month runway ahead. Or as Berra said: "It ain't over till it's over."

workspaces, these properties may need to be reassessed.

The only slight hiccup in the data, a net 150,000 square feet of absorption, falling short of 2017's figures. But with a strong pipeline of demand, absorption should return to a normal trajectory.

ECONOMIC TRENDS



The Office Market is a compilation that includes Class A, Class B, and Class C buildings with at least 10,000 SF of space. Medical office buildings are included. Some information contained herein has been obtained from third party sources, including CoStar and the Bureau of Labor Statistics, deemed reliable but has not been independently verified by NAI Horizon. NAI Horizon makes no warranties or representations as to the completeness or accuracy thereof. NAI Horizon makes no guarantee about projections, opinions, assumptions or estimates. Occasionally corrected or updated information becomes available for both current and historical data thereby invalidating specific comparison to previously issued reports.

Q1 2018

OFFICE MARKET METRO PHOENIX

Phoenix Market Snapshot

Market Overview

	Total RBA	Vacant SF	Vacant %	Net Absorption	RBA Delivered	RBA Under Construction	Average Rental Rate
CLASS A	50,339,718 SF	7,207,442 SF	14.3%	(68,255) SF	362,218 SF	2,030,135 SF	\$30.16/SF
CLASS B	89,340,342 SF	14,890,290 SF	16.7%	147,081 SF	26,174 SF	851,965 SF	\$23.01/SF
CLASS C	12,846,821 SF	1,434,895 SF	11.2%	74,177 SF	-	-	\$18.55/SF
TOTAL	152,526,881 SF	23,532,627 SF	15.3%	153,003 SF	388,392 SF	2,882,100 SF	\$25.39/SF
Q4 2017	152,138,489 SF	23,297,238 SF	15.3%	1,283,947 SF	394,519 SF	2,269,580 SF	\$25.03/SF
Q3 2017	151,820,895 SF	24,254,666 SF	16.0%	334,085 SF	409,108 SF	1,638,007 SF	\$24.37/SF

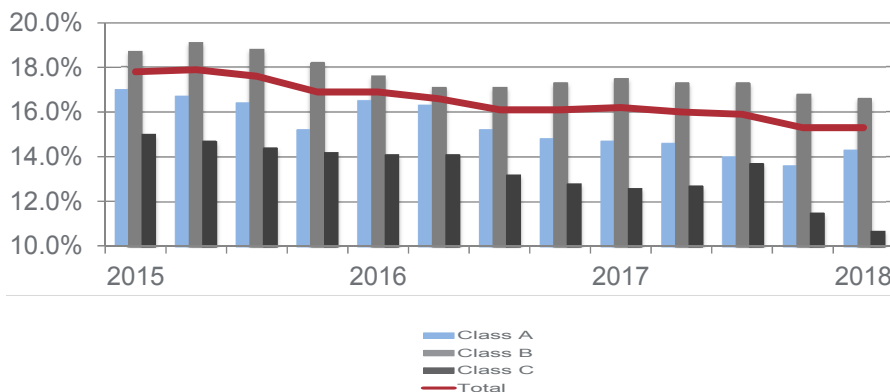
Significant Lease Transactions

Address	Tenant	Size	Class	Type
5801 N Pima Rd	McKesson	61,510 SF	A	Move In
400 E Van Buren St	ASU	60,203	A	Move In
1450 S Spectrum Blvd	Allstate	50,311 SF	A	Move In
111 E Rivulon Blvd	Morgan Stanley	31,655	A	Move In
4615 E Elwood St		27,136 SF	A	Move In

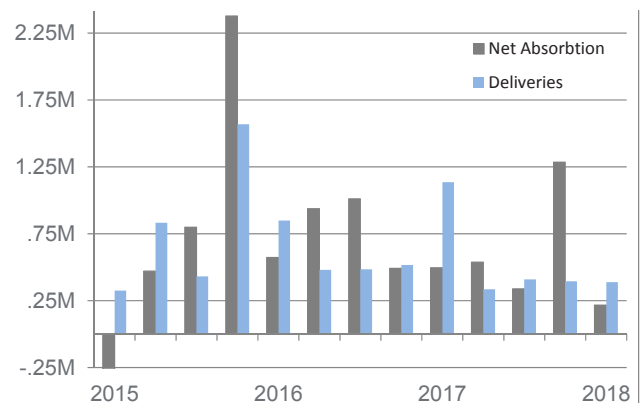
Significant Sale Transactions

Address	Date	Size	Class	Price
Central Arts Plaza	01/26/2018	485,687 SF	A	\$80.7M (\$166.16/SF)
El Dorado Tech Center	01/24/2018	180,480 SF	B	\$39M (\$243.63/SF)
Squaw Peak Corp Ctr	02/22/2018	165,748 SF	A	\$38.35M (\$231.37/SF)

Office Vacancy Rates



Absorption & Deliveries



Q1 2018

OFFICE MARKET METRO PHOENIX

Submarket Snapshot

	RBA		Vacant SF		Vacant %		Net Absorption		Deliveries		Under Construction		Avg FSG Rate
44th Street Corridor	3,659,588	—	480,459	▼	13.1%	▼	84,138	▲	—	—	—	—	\$26.16
Airport Area	11,954,951	▲	2,769,441	▲	23.2%	▼	219,056	▲	235,000	▲	160,910	▼	\$23.45
Arrowhead	2,906,129	—	419,757	▼	14.4%	▼	13,296	▲	—	—	12,350	▲	\$24.98
Camelback Corridor	8,528,658	—	1,477,633	▲	17.3%	▲	(167,052)	▼	—	—	118,500	—	\$31.84
Central Scottsdale	7,492,715	—	851,977	▼	11.4%	▼	14,171	▲	—	—	—	—	\$25.74
Chandler	8,935,893	▲	1,329,624	▼	14.9%	▼	164,774	▲	127,218	▲	1,111,348	▲	\$26.18
Deer Valley/Airport	11,201,862	—	1,427,110	▼	12.7%	▼	281,031	▲	—	—	—	—	\$23.36
Downtown	10,135,910	▲	1,268,524	▼	12.5%	▼	143,825	▲	26,174	▲	240,000	▼	\$31.13
Gateway Airport/Loop 202	1,428,209	—	157,545	▼	11.0%	▼	13,302	▼	—	—	49,600	▲	\$24.94
Glendale	2,582,960	—	447,832	▼	17.3%	▼	5,047	▼	—	—	125,000	—	\$24.81
Loop 303/ Surprise	1,903,568	—	214,707	▼	11.3%	▼	6,818	▲	—	—	—	—	\$24.27
Mesa Downtown	935,139	—	55,557	▲	5.9%	▲	(12,973)	▼	—	—	—	—	\$14.81
Mesa East	2,017,536	—	137,768	▼	6.8%	▼	11,420	▼	—	—	—	—	\$17.42
Midtown	12,004,355	—	2,415,660	▼	20.1%	▼	128,474	▲	—	—	—	—	\$22.37
Midtown/Central Phoenix	3,908,369	—	463,221	▼	11.9%	▼	26,469	▲	—	—	—	—	\$20.13
N Phoenix/Cave Creek	81,281	—	7,106	▼	8.7%	▼	1,200	▼	—	—	—	—	\$19.89
N Scottsdale/Carefree	1,108,888	—	223,056	▲	20.1%	▲	(33,510)	▼	—	—	—	—	\$22.75
North I-17	488,286	—	93,864	▼	19.2%	▼	1,275	▼	—	—	—	—	\$24.40
Northwest Phoenix	8,457,461	—	2,160,843	▲	25.5%	▲	(210,281)	▼	—	—	—	—	\$18.63
Paradise Valley	3,696,339	—	495,354	▼	13.4%	▼	46,928	▲	—	—	—	—	\$24.62
Piestewa Peak Corridor	2,915,154	—	792,290	▲	27.2%	▲	(270,095)	▼	—	—	—	—	\$22.36
Pinal County	799,794	—	69,181	▲	8.6%	▲	(1,638)	▼	—	—	—	—	\$20.46
Scottsdale Airpark	12,227,054	—	1,803,465	▲	14.7%	▲	(384,330)	▼	—	—	36,735	—	\$27.78
Scottsdale South	5,686,956	—	864,631	▲	15.2%	▲	(64,982)	▼	—	—	—	—	\$30.54
South Tempe/Ahwatukee	6,682,669	—	1,094,576	▲	16.4%	▲	(27,430)	▼	—	—	317,176	▲	\$23.37
Southwest Phoenix	2,810,318	—	294,252	▼	10.5%	▼	6,800	▲	—	—	—	—	\$25.16
Superstition Corridor	4,938,141	—	683,154	▲	13.8%	▲	(157,661)	▼	—	—	—	—	\$20.18
Tempe	11,388,232	—	833,808	▼	7.3%	▼	317,488	▲	—	—	786,481	—	\$32.43
West I-10	1,881,172	—	208,135	▼	11.1%	▼	13,940	▲	—	—	—	—	\$23.30

Class A

A classification used to describe buildings that generally qualify as extremely desirable, investment-grade properties and command the highest rents or sale prices compared to other buildings in the same market.

Class B

A classification used to describe buildings that generally qualify as a more speculative investment, and as such, command lower rents or sale prices compared to Class A properties.

Class C

A classification used to describe buildings that generally qualify as no-frills, older buildings that offer basic space and command lower rents or sale prices compared to other buildings in the same market.

Deliveries

Buildings that complete construction during a specified period of time. In order for space to be considered delivered, a certificate of occupancy must have been issued for the property.

Full Service Gross (FSG) Rental Rate

Rental rates that include all operating expenses such as utilities, electricity, janitorial services, taxes and insurance.

Leasing Activity

The volume of square footage that is committed to and signed under a lease obligation for a specific building or market in a given period of time. It includes direct leases, subleases and renewals of existing leases. It also includes any pre-leasing activity in planned, under construction, or under renovation buildings.

Net Absorption

The net change in occupied space over a given period of time. Unless otherwise noted, Net Absorption includes direct and sublease space.

Rentable Building Area (RBA)

The total square footage of a building that can be occupied by, or assigned to a tenant for the purpose of determining a tenant's rental obligation. Generally RBA includes a percentage of common areas including all hallways, main lobbies, bathrooms, and telephone closets.

Submarkets

Specific geographic boundaries that serve to delineate a core group of buildings that are competitive with each other and constitute a generally accepted primary competitive set, or peer group. Submarkets are building type specific (office, industrial, retail, etc.), with distinct boundaries dependent on different factors relevant to each building type.

Under Construction

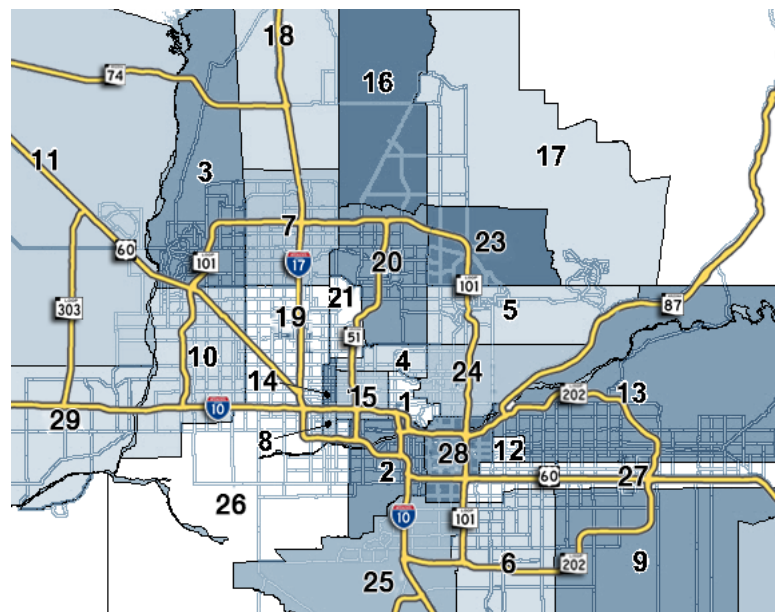
The status of a building that is in the process of being developed, assembled, built or constructed. A building is considered to be under construction after it has begun construction and until it receives a certificate of occupancy.

Vacancy Rate

A measurement expressed as a percentage of the total amount of physically vacant space divided by the total amount of existing inventory space. Under construction space generally is not included in vacancy calculations.

Vacant Space

Space that is not currently occupied by a tenant, regardless of any lease obligation that may be on the space. Vacant space could be space that is either available or not available.



PHOENIX OFFICE SUBMARKETS

1. 44th St Corridor
2. Airport Area
3. Arrowhead
4. Camelback Corridor
5. Central Scottsdale
6. Chandler
7. Deer Valley/Airport
8. Downtown
9. Gateway Airport/Loop 202
10. Glendale
11. Loop 303/ Surprise
12. Mesa Downtown
13. Mesa East
14. Midtown
15. Midtown/Central Phoenix
16. N Phoenix/Cave Creek
17. N Scottsdale/Carefree
18. North I-17
19. Northwest Phoenix
20. Paradise Valley
21. Piestewa Peak Corridor
22. Pinal County
23. Scottsdale Airpark
24. Scottsdale South
25. South Tempe
26. Southwest Phoenix
27. Superstition Corridor
28. Tempe
29. West I-10

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NAI Horizon knows commercial real estate. With over 25 years in the Valley, NAI Horizon's extensive market insight allows us to match client needs with the right solutions. NAI Global member firms span the U.S. and 55 other countries, with more than 400 offices and more than 7,000 local market experts on the ground. Supported by the central resources of the NAI Global organization, member firms deliver market-leading services locally, and combine their in-market strengths to form a powerful bond of insights and execution for clients with multi-market challenges.

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