



NAI Horizon

3rd Quarter
2019
Office
Market Report



Q3 2019

OFFICE MARKET METRO PHOENIX

Phoenix Market Snapshot

OVERVIEW

The Phoenix office market continues to hit on all cylinders. Demand for space remains strong. All key indicators point toward the market remaining healthy, especially for landlords. Absorption is solid. Vacancy declined – again, and rents continued to increase.

In fact, asking rents for Class A new product in Tempe are surpassing \$45 a foot – a new high-watermark. Moreover, average gross asking office rents exceeded \$26 a foot for the first time on record, ending the third quarter at \$26.04 per-square-foot.

There are rumblings that rising rents are spurring companies in Class A buildings to consider relocating to Class B space, but we have not heard of any such deal taking place – yet. If the trajectory of the office market continues as is, it will be a matter of time before it does actually happen. Just like there is “flight to quality” in markets emerging from recession, businesses do move when the economics of their operations compel them to do so.

There’s a dearth of space for smaller owner-user office buildings, especially near downtown Phoenix and in Midtown. Land and construction costs are too prohibitive for builders to build small buildings.

Tempe and Downtown Phoenix have the greatest concentration of new office space on the way, with 833,693 square feet under construction in the former and 507,399 square feet under construction in the latter, at the close of the third quarter.

LEASING, ABSORPTION & DEVELOPMENT

WageWorks, a compensation and managed benefits company, executed the largest lease in the third quarter, taking down 150,000 square feet in Class A space in Mesa. Deloitte, meanwhile, took 97,000 square feet in expansion space at 300 E. Rivulon Blvd. in Gilbert, in addition to the 102, 434 square feet it already occupied at 310 E Rivulon Blvd, the sister building next door. In addition to its primary space, Costar shows that Deloitte also leases 21,992 square feet at 2901 N Central Ave. in a lease set to expire in September 2020. We would not be surprised if some of those Phoenix jobs are shifted to Gilbert prior to that time.

The quarter was another strong one for absorption, with 980,602 square feet of positive net absorption of Phoenix-area office space. While good, that was not nearly as robust as the same quarter a year ago, when over 1.58 million square feet of offices were positively net absorbed. The Phoenix office market, since the country started to emerge from recession, is highly indicative of how well the regional economy has performed during the recovery. Since the first quarter of 2010, there have been only four quarters of negative net absorption for office space. That’s remarkable – 35 quarters out of 39 have seen positive net absorption! During that 9 years and three quarters of time, Phoenix has added 13.59 million square feet of office space. Total office inventory now stands at nearly 187 million square feet – about double what it was 20 years ago.

For the third quarter, 799,750 square feet of offices came online, and at the close of the quarter there were 31 office buildings under construction totaling 2,491,292 square feet.

VACANCY & RENTAL RATES

The vacancy rate closed the quarter at 12.1 percent – close to where it was a year ago, at 12.3 percent. The vacancy rate has now stayed below 13 percent for five consecutive quarters, which has been the pattern since the office market started recovering at an accelerated pace five years ago. For example, vacancy slowly declined from

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VACANCY & RENTAL RATES CONTINUED

15.3 percent at the end of 2Q2016 to 14.6 percent five quarters latter (3Q2017), then took another five quarters to drop below 13 percent for the first time in this cycle – in 3Q2018.

With sustained levels of occupancy and positive net absorption naturally comes continued rent increases, and the third quarter was no exception. While quarter-over-quarter average asking rents across all product types and submarkets inched upward only six cents per-square-foot, average asking rents increased by 88 cents from a year ago, finishing the recent quarter at \$26.04 per foot (psf) as noted earlier. Average rents are almost \$5 a foot greater than the third quarter of 2010; it's been a slow and steady rise. The usual suspects – Camelback Corridor (\$32.35 psf), Downtown Phoenix (\$31.51 psf), Tempe (\$31.32 psf) and South Scottsdale (\$30.41 psf) led the way with the highest-priced submarkets.

NATIONAL OFFICE NEWS

WeWobble

When shared-office space unicorn WeWork's parent company, The We Company, pulled its IPO a couple weeks ago, it sent a shudder to landlords across the U.S. WeWork is the largest space user in New York City, and has a presence in virtually every primary U.S. market and plenty of secondary markets, including Phoenix. With its founder out the door and new management in place shedding secondary businesses associated with We, all eyes will be on the company's operations moving forward in its main asset class – offices.

Tech Drives Office Occupancy

Not surprisingly, technology companies are dominant occupiers of office space around the U.S. According to one globest.com report, since 2010, 58 of the 89 San Francisco Bay Area-headquartered tech and life science companies have taken over 30 million square feet of offices in other cities. They also grew at home, committing to 55 million square feet of Bay Area office space during the same period and now occupy some 103 million square feet of office and R&D space in and around Silicon Valley and San Francisco.

Shaken, Not Stirred

Meanwhile in New York City (and everyone loves to keep tabs on the Big Apple, right?), Manhattan office leasing has cooled this year with a slowdown in leasing activity and high negative-net absorption in the quarter – the highest since 2009, according to another globest.com report. Some 5.7 million square feet of office leases were signed in Manhattan in the quarter, bringing the year-to-date (gross) total to over 21 million square feet, but that's down 12 percent from the same period a year earlier. For the quarter, Manhattan absorption was negative net 1.7 million square feet while Midtown Manhattan's was negative net 2.1 million square feet of absorption for the period. Let's hope that New York is not a bellwether for the rest of the office market in the U.S.

OFFICE TRENDS



ECONOMIC TRENDS



Q3 2019

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Market Overview

	Total RBA	Vacant SF	Vacant %	Net Absorption	RBA Delivered	RBA Under Construction	Average Rental Rate
CLASS A	53,412,788 SF	7,502,786 SF	14.0%	701,710 SF	696,795 SF	1,737,006 SF	\$30.82/SF
CLASS B	107,035,003 SF	13,584,975 SF	12.7%	215,962 SF	102,955 SF	754,286 SF	\$24.06/SF
CLASS C	26,445,983 SF	1,552,482 SF	5.9%	62,930 SF	-	-	\$18.60/SF
TOTAL	186,893,774 SF	22,640,243 SF	12.1%	980,602 SF	799,750 SF	2,491,292 SF	\$26.04/SF
Q2 2019	186,126,647 SF	22,853,718 SF	12.3%	445,094 SF	592,016 SF	3,167,289 SF	\$25.98 /SF
Q1 2019	185,743,153 SF	22,915,318 SF	12.3%	1,168,792 SF	1,079,313 SF	3,077,393 SF	\$25.80/SF

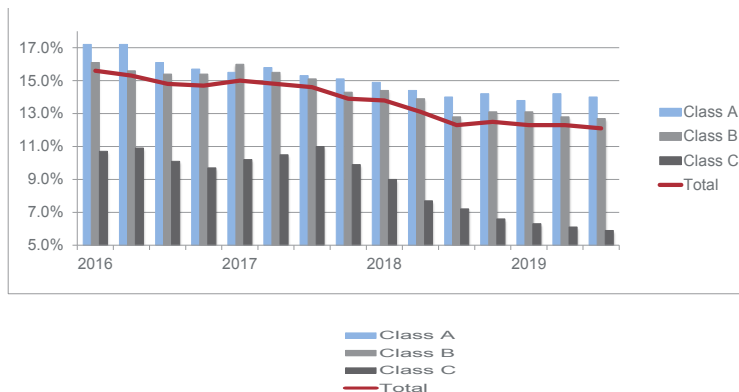
Significant Lease Transactions

Address	Tenant	Size	Class	Type
NEC Riverview Auto Dr.	WageWorks	150,000 SF	A	Move In
300 E Rivulon Blvd	Deloitte	97,248 SF	A	Move In
1333 S Spectrum Blvd	Not Disclosed	34,143 SF	A	Move In
950 W Behrend Dr	Cox Communications	31,016 SF	B	Move In
14601 S 50th St	Not Disclosed	30,212 SF	B	Move In

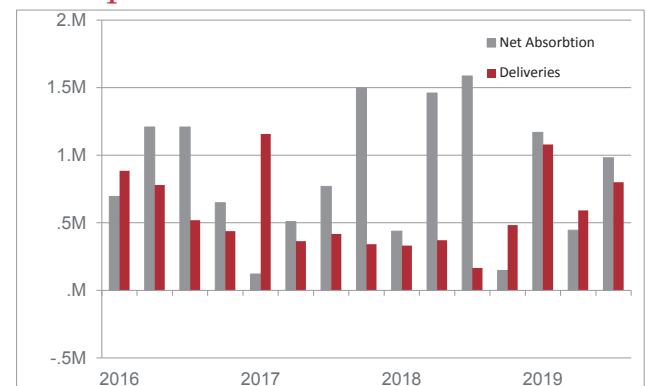
Significant Sale Transactions

Address	Date	Size	Class	Price
FBI Regional HQ	7/26/2019	210,202 SF	B	\$92,250,000 (438.86/SF)
U.S. Bank Center	8/23/2019	373,013 SF	A	\$66,466,954 (\$178.19/SF)
Esplanade III	7/2/2019	163,607 SF	A	\$60,250,000 (\$368.26/SF)
Northsight Corporate Center	8/20/2019	136,862 SF	B	\$51,476,000 (\$376.12/SF)
Waypoint 4	8/14/2019	153,134 SF	A	\$44,565,228 (\$291.02/SF)

Office Vacancy Rates



Absorption & Deliveries



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OFFICE MARKET METRO PHOENIX

Submarket Snapshot

	RBA		Vacant SF		Vacant %		Net Absorption		Deliveries		Under Construction		Avg FSG Rate
44th Street Corridor	4,110,013	—	464,996	▼	11.3%	▼	6,444	▲	-	—	-	—	\$26.47
Airport Area	9,984,429	—	1,589,715	▼	15.9%	▼	117,651	▲	-	—	346,743	—	\$22.42
Arrowhead	4,388,221	—	473,502	▲	10.8%	▲	(810)	▼	-	▲	35,794	▲	\$25.69
Camelback Corridor	9,594,369	—	1,514,404	▼	15.8%	▼	13,121	▼	-	—	65,000	—	\$32.35
Central Scottsdale	8,820,115	—	996,332	▼	11.3%	▲	(19,195)	▼	-	—	-	—	\$27.10
Chandler	12,211,452	▲	1,994,137	▲	16.3%	▲	67,409	▼	212,282	▼	175,912	▼	\$26.24
Deer Valley/Airport	11,963,217	—	1,258,536	▼	10.5%	▼	32,186	▲	-	—	-	—	\$24.74
Downtown	10,629,984	—	1,436,533	▲	13.5%	▲	(8,850)	▲	-	—	507,399	—	\$31.51
Gateway Airport/Loop 202	2,742,339	▲	218,191	▼	8.0%	▼	96,636	▲	80,000	▲	95,000	▼	\$28.03
Glendale	3,566,481	—	387,184	▼	10.9%	▼	9,520	▼	-	—	195,000	—	\$25.24
Loop 303/Surprise	2,489,423	—	226,146	▲	9.1%	▲	(10,474)	▼	5,000	▲	86,000	▲	\$25.35
Mesa Downtown	1,470,046	—	129,803	▲	8.8%	▲	(18,295)	▼	-	—	-	—	\$17.35
Mesa East	3,518,023	▲	262,593	▲	7.5%	▲	(11,561)	▲	5,355	—	8,000	▼	\$18.33
Midtown	13,075,344	—	2,242,207	▼	17.1%	▼	255,248	▲	-	—	-	—	\$24.16
Midtown/Central Phoenix	6,204,418	—	457,118	▼	7.4%	▼	48,106	▲	-	—	-	—	\$20.53
N Phoenix/Cave Creek	136,413	—	3,000	—	2.2%	—	-	▼	-	—	-	—	\$17.07
N Scottsdale/Carefree	1,873,476	—	225,484	▼	12.0%	▼	10,526	▲	-	—	24,000	—	\$23.15
North I-17	768,572	—	119,926	▼	15.6%	▼	965	▲	-	—	23,000	▲	\$24.34
Northwest Phoenix	10,860,721	—	2,135,049	▲	19.7%	▲	(289)	▼	-	—	4,532	—	\$19.15
Paradise Valley	4,725,922	—	483,312	▼	10.2%	▼	66,986	▲	-	—	-	—	\$24.71
Piestewa Peak Corridor	3,483,396	—	472,928	▼	13.6%	▼	9,381	▼	-	—	-	—	\$24.02
Pinal County	1,649,015	—	111,357	▼	6.8%	▼	9,898	▲	-	—	-	—	\$17.98
Scottsdale Airport	13,366,012	—	1,577,946	▼	11.8%	▼	98,428	▲	-	—	96,017	—	\$29.63
Scottsdale South	7,396,486	▲	813,971	▲	11.0%	▲	90,558	▼	151,318	▲	65,000	▼	\$30.41
South Tempe/Ahwatukee	7,962,270	—	982,597	▲	12.3%	▲	(66,904)	▲	117,176	▲	117,394	—	\$24.18
Southwest Phoenix	4,812,004	—	249,075	▲	5.2%	▲	(2,128)	▼	-	—	-	—	\$26.29
Superstition Corridor	6,203,579	—	477,045	▲	7.7%	▲	(5,668)	▼	-	—	-	—	\$21.94
Tempe	16,264,907	—	1,229,678	▲	7.6%	▲	38,283	▼	345,795	▲	833,693	▼	\$31.32
West I-10	2,628,077	—	186,871	▼	7.1%	▼	(1,787)	▼	-	▲	40,000	▼	\$25.46

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

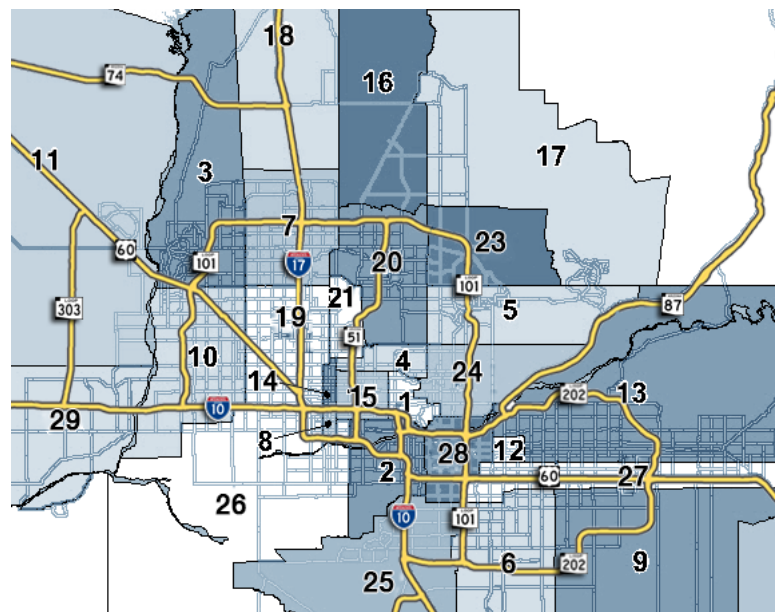
The status of a building that is in the process of being developed, assembled, built or constructed. A building is considered to be under construction after it has begun construction and until it receives a certificate of occupancy.

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 27 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 36 other countries, with more than 375 offices and more than 6,000 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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