



NAI Horizon

4th Quarter  
**2019**  
Office  
Market Report

# Q4 2019

## OFFICE MARKET METRO PHOENIX

# Phoenix Market Snapshot

## OVERVIEW

For the Phoenix office market, California is the gift that keeps on giving.

San Francisco-based (or formerly) McKesson Corp., the nation's largest pharmaceutical distributor and ranked sixth on the Fortune 500 list and only behind Walmart, ExxonMobil, Berkshire Hathaway, Apple and UnitedHealth Group, made national news in late 2018 when it announced it would relocate its corporate headquarters to the North Texas community of Irvine, near Dallas-Ft. Worth.

Yet quietly and efficiently in the last 12-to-18 months McKesson has taken down over 500,000 square feet of Class A office space in two Valley locations: Tempe, Scottsdale and Tolleson.

In September 2019 California Governor Gavin Newsome signed into law Assembly Bill (AB) 5, which requires employers to apply the "ABC test" to determine if workers in California are employees or independent contractors for the purposes of the state's Labor Code and Unemployment Insurance Code, and the Industrial Welfare Commission (IWC) wage orders.

Translation: California employers face higher labor and operating costs. Think Uber, Lyft, food delivery companies and others that are part of the innovation and Ecommerce economies that don't fall under traditional employment roles.

Which brings us to the biggest lease in the 4th quarter last year, to DoorDash, a San Francisco-based logistics and on-demand food delivery service company. DoorDash committed to 345,000 square feet at Lincoln Property Company's The Grand at Papago Park Center, a marquee project for the region with over 2 million square feet of offices that sport almost one-half mile of freeway frontage on the Red Mountain 202 freeway, off-ramps on the east and west sides of the road, the first light rail station stop from Sky Harbor Airport and close to executive housing and strong labor pool in Paradise Valley, Scottsdale, Tempe, Chandler and Metro Phoenix. DoorDash's new digs are a consolidation and expansion from two Phoenix locations.

The recent California legislation isn't, of course, the primary driver behind the California exodus of companies or business units of corporations – it's the broader problems associated with aging infrastructure (lack of investing in it), exorbitant housing costs and associated high costs of living, traffic, and now, a homeless problem so severe in San Francisco that even companies like Oracle have pulled the plug on hosting its annual OpenWorld conference in the City by the Bay. Starting in 2020, the software firm will host it in Las Vegas.

## LEASING, ABSORPTION & DEVELOPMENT

Meanwhile, other significant fourth quarter leases and expansions in the Phoenix area include:

- Opendoor, another San Francisco-based startup that specializes in buying single-family homes and reselling them through an online app, leased three floors (100,000 square feet) in the just-completed Watermark project in Tempe.
- Allstate leased 117,000 square feet at Chandler Corporate Center, adding to the 100,000 SF it already occupies at Allred Park Place Central, both being in Chandler.
- Silicon Bank, already in about 122,000 square feet at Hayden Ferry Lakeside near Tempe's Rio Salado Parkway, took another 38,000 square feet.
- Toyota Financial Services leased about 63,000 square feet in just-completed Allred Park Place on Spectrum Blvd. – that's in addition to the 133,000 square feet the company occupies about a mile away in Chandler.

Net absorption of regional office space was once again strong in the fourth quarter, as it has been since the recovery began in 2012. Since the first quarter that year, there have been only two quarters with negative net absorption, and

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### LEASING, ABSORPTION & DEVELOPMENT CONTINUED

only a few with low net absorption numbers, such as the fourth quarter of 2018 when net absorption was 61,597 square feet. By comparison net absorption was positive 911,215 square feet in the most recent quarter, and for calendar 2019 it was slightly more than 3.6 million square feet, or pretty consistent with 2018 when the Metro Phoenix office market positively (net) absorbed 3.44 million square feet of office space.

Developers delivered 598,176 square feet of new offices in the fourth quarter last year, and 3.1 million square feet in all four quarters of 2019. In 2018, developers delivered 1.37 million square feet of office and in 2017, 2.28 million square feet of office space was completed.

This is about as good as it gets, when a market consistently absorbs nearly everything that is built.

### VACANCY & RENTAL RATES

That last sentence was a perfect segue for our first market observation: building owners are pushing rents to new and higher levels, and we may see a new high-water mark on rents during the first half of the year if the investors behind First + Farmer achieve their asking rents of \$47-\$48 per foot in pre-leasing. Located at 206 South Farmer in Tempe, in addition to one of the best locations in the entire market, First + Farmer's four floors offer sophisticated and innovative design with building sustainability features that are unique to the market, such as on-building, planted landscaping that will create an effective thermal barrier. Coupled with deeply recessed windows, the property will be among the most energy efficient in the Valley. Further, the 30,000-square-foot floorplates will appeal to single-floor occupiers, and they subdivide nicely into 7,000-square-foot to 8,500-square-foot offices.

In our fourth quarter report last year we noted that escalating rents were likely to cause some firms to relocate in search of maintaining their existing rents, or lowering them, and we can report that indeed is beginning to happen. One small office occupier in Class B space on the Camelback Corridor has been paying \$24 per-square-foot and with its lease term expiring, the new rate in the same space is \$32 per foot. The tenant is actively in the market seeking space between-\$20-\$24 a foot and after several market tours, bemoaned the fact that "you get what you pay for."

However and on the flip side of that coin, one tenant in the market was considering space that would have featured lower rent than the space they ultimately chose on the Camelback Corridor, which featured higher quality space but more importantly to that occupier, better proximity to a key client. Real estate remains a location, location, location business.

Overall gross asking rates closed 2019 at \$26.25 per-square-foot, just a bit more than the end of 2018 when average rents were \$25.36 a foot. 4th quarter 2019 Class A average asking rent was \$31.09 with some of the premier buildings in the market achieving rents in the low-\$40s.

The overall average vacancy rate ended the quarter at 11.8 percent. A year ago the overall vacancy rate was 12.4 percent. The vacancy rate has steadily declined from a high at the beginning of the recovery when it was 20.3 percent and the end of the first quarter in 2010.

The second market observation to be made is that certain submarkets are languishing and there isn't a clear cut reason for this trend. 24th and Camelback Rd in the Camelback Corridor, traditionally ground zero for one of our strongest submarkets, had been improving, but with a negative net absorption from 2018 through 2019, and the addition of new inventory, the Corridor ended the fourth quarter with a 16 percent vacancy rate. The Midtown Market vacancy ballooned to 23% in 2014 but has made some headway closing 2019 at 17.6%. Northwest Phoenix, continues to languish with vacancy rates of between 22% and 25% over the past 10 years closing 2019 at 22.6%.

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#### Market Overview

	Total RBA	Vacant SF	Vacant %	Net Absorption	RBA Delivered	RBA Under Construction	Average Rental Rate
CLASS A	54,367,017 SF	7,406,121 SF	13.6%	774,570 SF	532,401 SF	1,921,428 SF	\$31.10/SF
CLASS B	109,861,701 SF	13,491,785 SF	12.3%	178,029 SF	65,775 SF	976,565 SF	\$24.11/SF
CLASS C	26,020,198 SF	1,459,256 SF	5.6%	(41,384) SF	-	-	\$19.03/SF
<b>TOTAL</b>	<b>190,248,916 SF</b>	<b>22,357,162 SF</b>	<b>11.8%</b>	<b>911,215 SF</b>	<b>598,176 SF</b>	<b>2,897,993 SF</b>	<b>\$24.75/SF</b>
Q3 2019	189,682,742 SF	22,702,203 SF	12.0%	1,014,190 SF	807,750 SF	2,643,869 SF	\$25.99 /SF
Q2 2019	188,907,615 SF	22,941,266 SF	12.1%	461,228 SF	622,204 SF	3,327,867 SF	\$25.94/SF

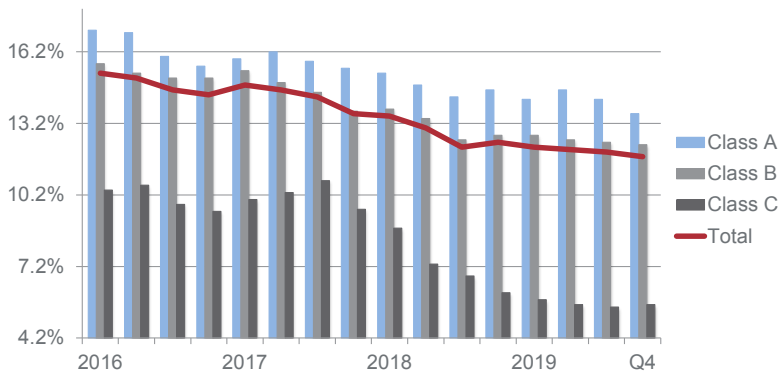
#### Significant Lease Transactions

Address	Tenant	Size	Class	Type
1033 W Roosevelt Way	Door Dash	345,795 SF	A	Move In
NWC Loop 101 (Cavasson)	Choice Hotels	150,000 SF	A	Move In
410 N Scottsdale Rd	Opendoor	100,807 SF	A	Move In
1650 S Price Rd	Toyota Financial Svcs	63,000 SF	B	Move In
80 E Rio Salado Pkwy	Silicon Valley Bank	38,222 SF	A	Move In

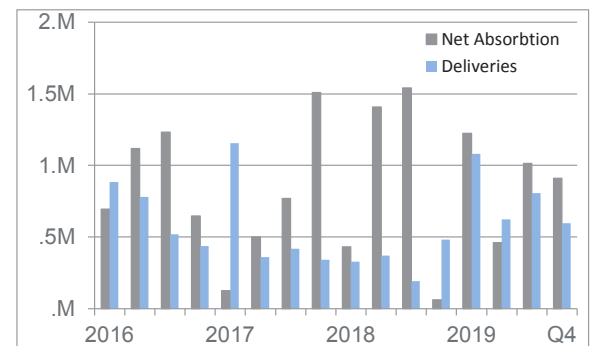
#### Significant Sale Transactions

Address	Date	Size	Class	Price
Biltmore Center II	12/24/2019	288,435	A	\$94,700,000 (\$328.32/SF)
Grand @ Papago Park Ctr	12/24/2019	213,026	A	\$90,000,000 (\$422.48/SF)
Biltmore Center I	12/24/2019	211,624	A	\$69,500,000 (\$328.41/SF)
Henkel Corporate Center	12/10/2019	372,000	A	\$65,000,000 (\$174.73/SF)

#### Office Vacancy Rates



#### Absorption & Deliveries



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### Submarket Snapshot

	RBA		Vacant SF		Vacant %		Net Absorption		Deliveries		Under Construction		Avg FSG Rate
44th Street Corridor	4,108,726	—	427,424	▼	10.4%	▼	23,024	▲	-	—	-	—	\$26.36
Airport Area	9,961,135	▼	1,533,552	▼	15.4%	▼	56,163	▼	-	—	-	▼	\$22.47
Arrowhead	4,413,017	▲	502,156	▲	11.4%	▲	(7,474)	▼	25,401	▲	26,393	▼	\$25.81
Camelback Corridor	9,573,916	▼	1,557,788	▲	16.3%	▲	(41,389)	▼	-	—	65,000	—	\$32.31
Central Scottsdale	8,840,545	▲	841,291	▼	9.5%	▲	137,699	▲	-	—	90,000	▲	\$27.38
Chandler	12,195,108	▼	1,699,179	▼	13.9%	▼	591,844	▲	13,416	▼	169,826	▼	\$26.48
Deer Valley/Airport	14,173,720	▲	1,411,334	▲	10.0%	▲	115,560	▲	150,000	▲	8,000	▲	\$24.27
Downtown	11,163,846	▲	1,500,539	▲	13.4%	▲	256,795	▲	297,000	▲	227,000	▼	\$30.82
Gateway Airport/Loop 202	2,803,031	▲	246,682	▲	8.8%	▲	34,664	▼	60,000	▼	102,460	▲	\$28.15
Glendale	3,566,919	▲	338,443	▼	9.5%	▼	60,720	▲	-	—	195,000	—	\$26.39
Loop 303/Surprise	2,515,327	▲	235,755	▲	9.4%	▲	(10,409)	▼	-	▼	117,982	▲	\$25.62
Mesa Downtown	1,458,452	▼	124,949	▼	8.6%	▼	(15,329)	▲	-	—	-	—	\$20.69
Mesa East	3,550,791	▲	257,341	▼	7.2%	▼	13,252	▲	8,000	▲	-	▼	\$18.24
Midtown	13,098,946	▲	2,349,157	▲	17.9%	▲	(118,652)	▼	-	—	-	—	\$24.31
Midtown/Central Phoenix	6,147,113	▼	445,522	▼	7.2%	▼	(7,511)	▼	-	—	-	—	\$20.88
N Phoenix/Cave Creek	136,413	—	3,000	—	2.2%	—	-	—	-	—	-	—	\$18.36
N Scottsdale/Carefree	1,937,621	▲	217,574	▼	11.2%	▼	7,910	▼	-	—	24,000	—	\$23.52
North I-17	768,572	—	139,411	▲	18.1%	▲	(19,485)	▼	-	—	-	▼	\$24.92
Northwest Phoenix	10,846,523	▼	1,961,710	▼	18.1%	▼	189,154	▲	-	—	4,532	—	\$19.07
Paradise Valley	4,726,644	▲	442,592	▼	9.4%	▼	40,720	▼	-	—	-	—	\$25.31
Piestewa Peak Corridor	3,478,765	▼	433,711	▼	12.5%	▼	39,217	▲	-	—	-	—	\$23.94
Pinal County	1,651,957	▲	123,975	▲	7.5%	▲	(12,368)	▼	-	—	-	—	\$17.32
Scottsdale Airpark	13,166,768	▼	1,530,032	▼	11.6%	▼	27,227	▼	-	—	731,017	▲	\$30.00
Scottsdale South	7,660,819	▲	760,342	▼	9.9%	▼	34,453	▼	-	—	65,000	—	\$31.04
South Tempe/Ahwatukee	7,954,256	▼	1,020,586	▲	12.8%	▲	(37,989)	▲	-	▼	117,394	—	\$24.28
Southwest Phoenix	4,824,878	▲	244,039	▼	5.1%	▼	3,196	▲	-	—	48,000	▲	\$26.75
Superstition Corridor	6,201,651	▼	566,014	▲	9.1%	▲	(91,604)	▼	-	—	-	—	\$21.84
Tempe	16,682,679	▲	1,232,741	▼	7.4%	▼	18,857	▼	44,359	▼	859,333	▼	\$31.75
West I-10	2,640,778	▲	210,323	▲	8.0%	▲	(22,452)	▼	-	—	47,056	▲	\$25.62

## OFFICE TRENDS



## ECONOMIC TRENDS



### 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

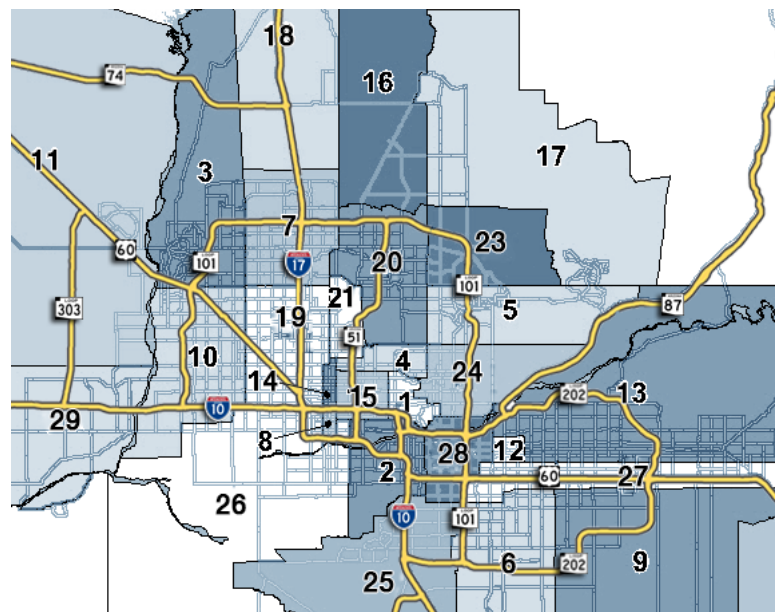
The status of a building that is in the process of being developed, assembled, built or constructed. A building is considered to be under construction after it has begun construction and until it receives a certificate of occupancy.

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

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