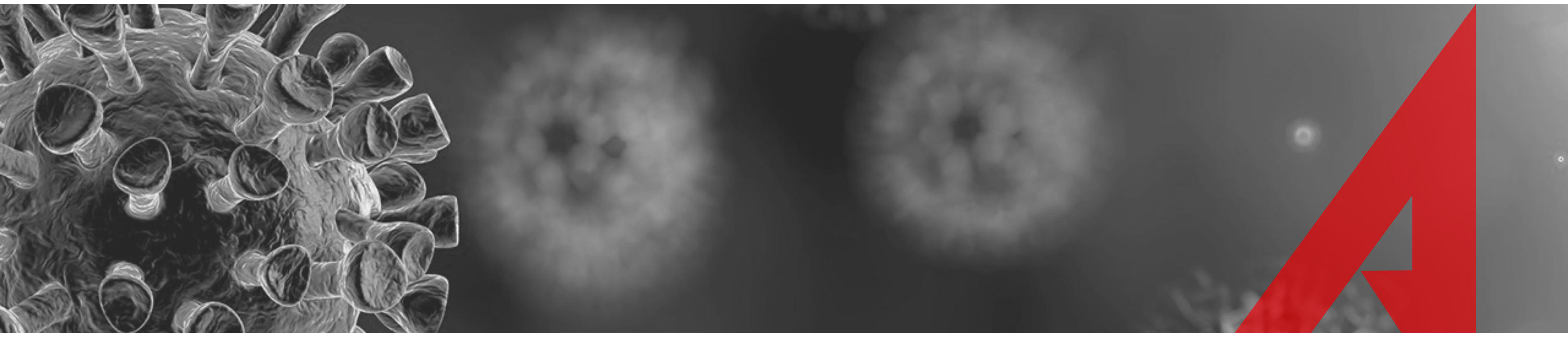
NAI Horizon

1st Quarter 2020 Industrial Market Report



INTRODUCTORY OVERVIEW

Picking up the pieces. That's what we are doing. Where we go from here will depend on how well we pick up the pieces.

British writer Damian Barr recently posted on Twitter: "We are not all in the same boat. We are in the same storm." It is a storm we eventually will emerge from and everyone has the same question: when?

Perhaps the second biggest question that is on people's mind is whether we are entering a recession or a depression, to which Charles Schwab & Co, Sr. VP and Chief Investment Strategist Liz Ann Sonders wrote: "We may need a new descriptor this time – perhaps a 'screeching halt.' Even though we likely aren't yet in the teeth of the hit to the economy, the data through the first week of April was epically horrific."

She was principally referencing the rapid acceleration in jobless claims, yet there was also the survey of 18 investment firms and banks, the likes of which included Credit Suisse, UBS, JPMorgan, Goldman Sachs, Deutsche Bank and others, which predicted the decline in U.S. GDP for the second quarter would be in a range from negative 9.0% to negative 50%. The blended average was 22.48% negative GDP. Put in perspective, U.S. GDP declined 4% peak to trough over a span of six quarters during the 2008-2010 Great Financial Crisis.

The UCLA Zimon Center Director Stuart Gabriel is of the V-shaped recovery camp (a steep plunge to the bottom followed by a rapid bounce back), predicting second quarter GDP in the negative range of 30% to 40% and a third quarter negative GDP rate of 5% yet followed by growth in the fourth quarter. It's anyone's guess, and what we really want to know – will there be a football season?

RECESSION OR DEPRESSION?

In late March NAI Horizon brokers Don Morrow and Dylan Whitwer conducted a survey on the impact of COVID-19 to real estate markets, seeking the opinions of professionals from private capital, family offices, institutions and others. They published the results on April 20. Among other questions was: "How long will the current recession last?"

The optimists thought less than 3 months (3.9%) and three-to-six months (23.5%), while the middle-of-the-roaders thought 6 months to one year (37.3%), and the pessimists are expecting 1-to-2 years (27.5%) and longer than two years (7.8%).

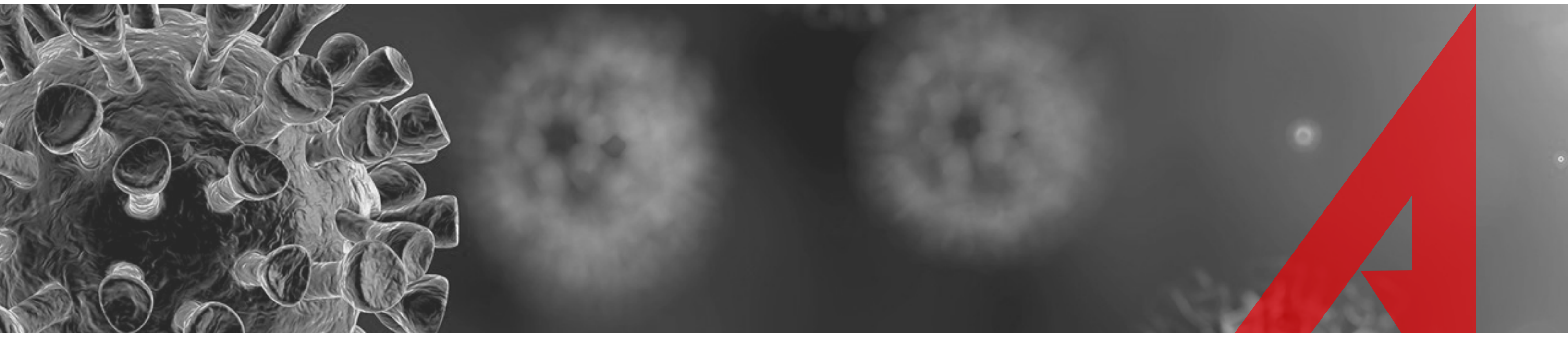
As a reminder, recessions are typically considered to be when two consecutive quarters of negative gross domestic product growth occurs, while an economic depression is widely considered to be when there is a decline in real GDP of 10% or a recession lasting two or more years. Another way to look at it is, as this report writer's father used to say: "A recession is when you are out of a job. A depression is when I am out of a job."

Back to Sonders from Schwab, among her long-term implications of the COVID Economy included "Deglobalization" as a force that is unlikely to recede and was already underway courtesy of the trade war and increased tariffs. We'll have more to say on this in the industrial report. Also, Corporate America was quick to respond to shelter-in-place orders particularly with regard to remote working, which may lead to a structural change in how they operate. The genie is out of the bottle on working from home, and we'll have more to say about this in the office report. Further, video conferencing is likely to replace some face-to-face meetings, especially the frequency of business travel, according to Sonders.

ARIZONA

Arizona jobless claims surpassed 418,000 during the third week of April, wiping out about two-thirds of employment gains over 10 years in the state in just five weeks, according to AZBIGMEDIA, many of which, as expected, were in hospitality and retail industries. From the depths of the recession in 2010, 631,000 jobs were added through the beginning of this year and in that recent five-week span, 418,016 Arizonans filed for unemployment.

However, R.L. Brown, the author of RL Brown Reports on Arizona's homebuilding and housing markets wrote on April 24: "It is certainly reasonable to assume that at the end of the day the Phoenix and Tucson housing markets



ARIZONA CONT.

could benefit from new populations and jobs leaving other areas in response to their trials and tribulations from the pandemic." In other words, the Great California Exodus will accelerate as people leave dense urban areas due to germ fear or sadly, because they simply cannot afford to live in the Golden State anymore – especially if they lost their jobs.

As for Phoenix-area commercial real estate, the data in these reports reflect the entire quarter ending March 31, yet the reality is that activity was pretty normal up until late February and then, the freeze. This is true for industrial, office and retail sectors -- deals that were close to closing, closed, while others were suspended. Currently, there is widespread sentiment of "let's wait and see" yet at the same time, like all changing markets, there is and will be opportunities in this downturn. We could not separate the leasing data by month but suffice it say most of the positive results happened in the first eight weeks of the year.

For investment real estate, lenders have largely put down their pencils down, and illiquidity could become an issue if the situation doesn't change soon.

In terms of recovery, while it is imminent, it is likely to be slow. Too many industries have been impacted by the COVID Economy, too many jobs lost, with many, many bankruptcies certain to follow. On a mid-April Bisnow Zoom call featuring Phoenix Mayor Kate Gallego, the former city councilwoman and earlier in her career, economic development director, shared that Sky Harbor Airport was on track to set a record in March for the most passengers in one month ever, and instead saw a drop in passenger traffic by 95%. The airport is the biggest income generator for the city's General Fund and already Phoenix has slashed its budget $26 million (in perspective, the city did $200 million in budget cuts in the last recession). Mayor Gallego said on the call that she doesn't expect to return to the Pre-COVID passenger traffic counts until 2023.

Yet, it's not all gloom and doom. As Arizona Gov. Doug Ducey recently stated, "Arizona was leading in economic momentum heading into the downturn, and Arizona will lead the way out." Businesses are starting to re-open, and tourism will return (try testing the resolve of traveling golfers, snowbirds and sun lovers!). It is not Pollyannaish to believe that Arizona will rebound faster than many states. In addition to proximity the California, the NAFTA Highway runs right through the state to Mexico, and Arizona has greatly diversified its economy in the last 10 years, even being dubbed "Wall Street West' for all of the financial institutions with a presence in Arizona. The state will be a net beneficiary when the U.S. reinvents its supply chain and "re-shores" many of those business functions back to North America from Asia.

As for managing the virus itself, we are all anxiously waiting for successful therapeutics and ultimately, a vaccine.

A note to readers: the overviews to all three of our first quarter reports on office, retail and industrial are the same for each report. The intention is to provide an overview of economic conditions before getting into the details of each property sector, because what happens next with the economy will determine what happens in commercial real estate. So if you read the introduction once and intend to read another report, skip down to find the new content in each report.

Q1 2020 INDUSTRIAL MARKET METRO PHOENIX

Phoenix Market Snapshot

INDUSTRIAL REAL ESTATE EXPECTED TO OUTPERFORM OTHER ASSET CLASSES

This is the sentiment in every major U.S. market, that industrial real estate is expected to outperform other asset classes in the property sector, though there is a credible argument that industrial will only be on par with multifamily, especially Class B and C apartment communities that may benefit from a recession.

Warehouses might not be full at the moment – because overseas shipments are being delayed, especially from Asia, and those container ships are not making ports of call in U.S. harbors. Consequently, product is not making its way to markets across the country. The trucking industry is partly idled. Rail yards are full of trains, going nowhere. All of the Class I rail operators – BNSF, Kansas City Southern, Conrail (which operates CSX and Norfolk Southern) and others, are waiting for shipping traffic to resume. And it will.

There's talk of reshoring many of the manufacturing businesses that decamped for cheaper labor over the past 20 years, mostly to China, some to Vietnam, and remember back in the day when most of the computer hardware industry went to Malaysia? Making motherboards over there may be one thing, but you have to believe in the post-COVID economy – regardless of who wins the Oval Office in November, this movement will become real. Deglobalization was the phrase used in the Overview section of these reports. People say, 'oh, we'll fix this virus thing and go back to the way we lived before.' No. It is really different this time. Personal Protection Equipment (PPE), a host of pharmaceuticals, steel and other core industrial products will become essential (just as we have used the word essential to describe the types of businesses that could stay open while Americans stayed home) and will be among the industrial products that we want made here, warehoused here, and readily available.

If you think about it, this is industrial real estate's shining moment, as never before have so many people now come to understand what two words mean, and how important they are to all of our lives. They are words that have been in our lexicon for years but now they are in headlines: *"supply chain"*

The goal is to be less reliant on "the world's factory," as China has been called.

A reliable and safe supply chain is absolutely essential to maintaining and running a healthy and strong U.S. economy. It will be regarded by people, even politicians, as equally important as a maintaining a strong military. Indeed, this is industrial real estate's moment.

Already there is word that the City of Phoenix is in the market looking for air conditioned, refrigerated or cold storage industrial buildings, to store PPE equipment.

Refrigerated and cold storage industrial building demand is also expected to grow in the future to help support the food supply chain. Grocery stores will require more local storage, for fresh produce and frozen goods. Industry executives say consumer habits formed during this period will likely stick and lead to growing demand as companies reset their distribution strategies.

Demand could be particularly strong for temperature-controlled warehouse space to store food if consumers keep ordering groceries online, a market that has been booming as more people stay at home under social-distancing guidelines and have food delivered.

Near term, recently published statements by Prologis provide some guidance as to what to expect for industrial properties regionally (Prologis made this comments in a national context). The company stated that 60 percent of their clients are expanding while 40 percent are shrinking. Food, beverage, ecommerce, essentials, are growing while clothing, sporting goods and home furniture is shrinking. Prologis also stated that they are temporarily stopping any and all speculative projects from going forward, yet would finish projects they have already started.

Prologis has current projects in Goodyear (mentioned in Significant Transactions), a single building of 303,842 square feet on N. 61st Avenue in Phoenix (called Prologis Loop 202 at I-10) and Prologis Riverside Center, which is two buildings totaling 347,000 square feet on S. 48th Avenue in Phoenix that are scheduled for a May delivery.

Another reason to expect demand for industrial space to return to robust levels is that U.S. manufacturers are claiming to shift away from 'just-in-time manufacturing' that relied on highly efficient supply chain operations and that they are more likely to warehouse core parts and components to avoid disruption in the future.

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Phoenix Market Snapshot

ECOMMERCE AND ONLINE SALES ARE THE NEW NORMAL

Online grocery sales are expected to surge in the future as America adjusts to a new normal, and buys more food online. More than half of 1,000 U.S. consumers surveyed last month said they bought groceries online because of COVID-19, according to a poll by U.S.-Israeli warehouse automation provider Get Fabric Ltd., which does business as Fabric. One in five respondents said they did so for the first time. Walmart Inc. generated nearly $900 million in online grocery sales in March, up 21% compared with February and nearly double the level of March 2019, according to data provider 1010data, which tracks credit- and debit-card sales. For local examples of how these trends impact the industrial property market, see Significant Industrial Transactions further down in this report.

1ST QUARTER DATA - DEVELOPMENT & ABSORPTION

Developers completed 2,427,134 square feet of industrial product in the first quarter this year, compared with 1,870,338 square feet in the fourth quarter last year and 559,695 square feet in the first quarter 2019. There have been only two quarters since 2014 that had more deliveries than the first quarter this year; developers brought online 3,403,091 square feet in the fourth quarter 2018 and added 2,901,715 square feet to the inventory in the first quarter 2014.

There were 67 industrial buildings under construction totaling more than 14 million square feet at the end of the first quarter.

Absorption was net positive 723,216 square feet for the recent quarter, compared to 1,893,601 square feet in the fourth quarter last year and 800,148 square feet in the first quarter 2019. NAI Horizon industrial brokers reported that some of the deals they were working on in February managed to get closed in March despite the coronavirus, while others were stalled and some are still in the works. “Demand is there but there’s a bottleneck due to the lack of travel, stay-at-home order, plus developers are slow to take action, but I think it is going to turn around in a significant way,” said one.

VACANCY & RENTAL RATES

The vacancy rate for Phoenix-area industrial real estate concluded the first quarter at 7.7 percent, which is up from 7.2 percent in the fourth quarter last year and up 60 basis points from a year ago when vacancy was 7.1 percent at the close of the first quarter 2019. The vacancy rate has remained below 8 percent since the third quarter 2017, or 10 straight quarters. For perspective, it was 17.1 percent a decade ago at the end of the first quarter 2010. The vacancy rate has fallen almost 10 full percentage points, despite the fact that developers delivered over 50 million square feet of industrial product (gross).

Rental rates continued their slow march upward since they started climbing in the first quarter 2012 when the overall, triple net rent was $0.49 per square foot. The first quarter this year ended up right where it was at the end of last year, at $0.59 per square foot, which is up slightly from a year earlier when overall rent averaged $0.57 per foot at the close of the first quarter 2019.

SIGNIFICANT INDUSTRIAL TRANSACTIONS

Amazon continues to expand as in February they signed a lease for 1,100,000 SF in Ten-Warehouse 1 on West Roosevelt they will occupy in April. They also signed two deals in early March totaling 569,792 square feet – both on W. Buckeye Road (both buildings owned by Colony Capital), with occupancy slated for June. Those deals are in addition to an 855,000 square foot lease Amazon signed with Prologis in October last year at the Prologis Commerce Park at Goodyear, which is scheduled for completion in November this year, and a 554,000 square foot lease at in the 202 W Logistics Center on S. 59th Avenue where their occupancy will commence in August. This will bring their total industrial presence in the Phoenix area to over 9 million square feet in 17 buildings.

Atlanta-based MDH Partners acquired an industrial portfolio of properties scattered throughout the greater Phoenix area. CoStar reported that MDH paid $40 million, or $132 per square foot, for the six-property portfolio. Two of the buildings are on N. Dysart Road, two are on E. Indigo Street, one is on N. Higley Road and one building is on S. 48th Street. Phoenix’s industrial market appeal is proximity to nearly 30 million Southern California people within a one day drive and only four hours to Las Vegas.

Q1 2020

INDUSTRIAL MARKET
METRO PHOENIX

Phoenix Market Snapshot

Market Overview

Market Overview	Total RBA	Vacant SF	Vacant %	Net Absorption	RBA Delivered	RBA Under Construction	Average Rental Rate
Distribution	78,548,887 SF	9,156,182 SF	11.7%	956,873 SF	1,651,658 SF	5,587,149 SF	$0.49/SF
Manufacturing	60,544,500 SF	2,340,136 SF	3.9%	(133,651) SF	32,700 SF	2,139,360 SF	$0.57/SF
Warehouse	149,280,029 SF	10,125,909 SF	6.8%	166,998 SF	706,776 SF	6,301,219 SF	$0.59/SF
Flex	33,255,916 SF	3,023,625 SF	9.1%	(267,004) SF	36,000 SF	37,812 SF	$1.05/SF
TOTAL	321,629,332 SF	24,645,852 SF	7.7%	723,216 SF	2,427,134 SF	14,065,540 SF	$0.59/SF

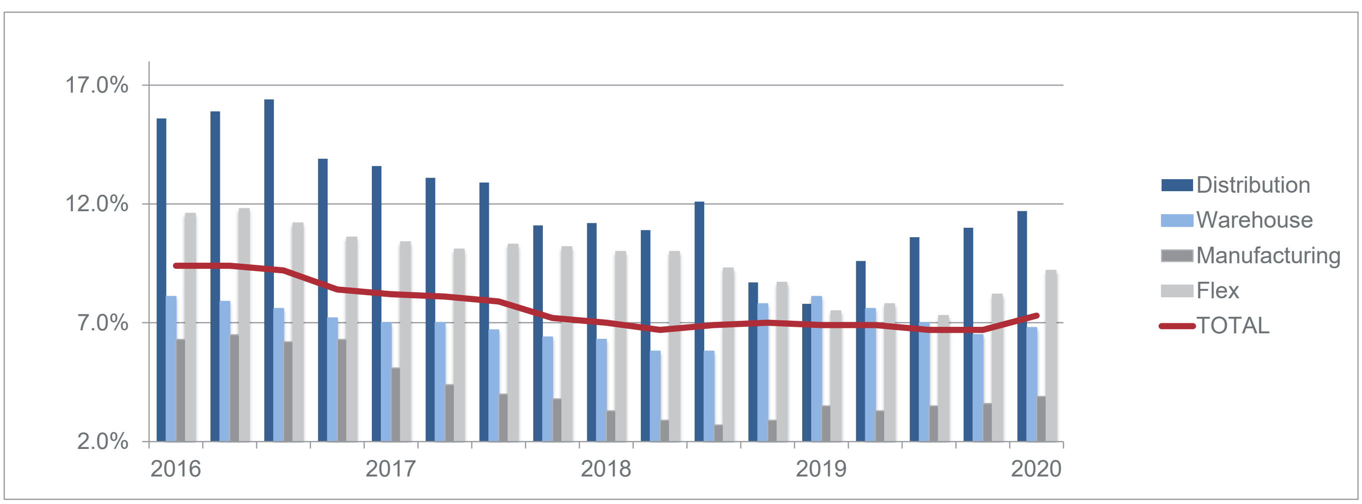
Significant Lease Transactions

Significant Lease Transactions	Address	Tenant	Size	Building Type	Type
7811 N Glen Harbor Blvd	Glendale	ThyssenKrupp	370,000 SF	Distribution	Move In
402 N 44th Ave	Phoenix	Hydro	221,116 SF	Warehouse	Move In
1250 S 71st Ave	Phoenix	Arizona Shower Door Co.	151,288 SF	Warehouse	Move In
3011 E Broadway Ave	Phoenix	Ryder Last Mile, Inc.	101,856 SF	Warehouse	Move In
					Move In

Significant Sale Transactions

Significant Sale Transactions	Address	Date	Size	Building Type	Price
3333 S 59th Ave	Phoenix	2/28/2020	554,000 SF	Distribution	$61,000,000
16920 W Commerce Ln	Goodyear	2/18/2020	513,407 SF	Distribution	$43,536,356
16920 W Commerce Ln	Goodyear	2/18/2020	306,977 SF	Distribution	$26,000,000

Industrial Vacancy Rates



The Industrial Market is a compilation that includes distribution, warehouse, manufacturing and flex buildings. Some information contained herein has been obtained from third party sources 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.

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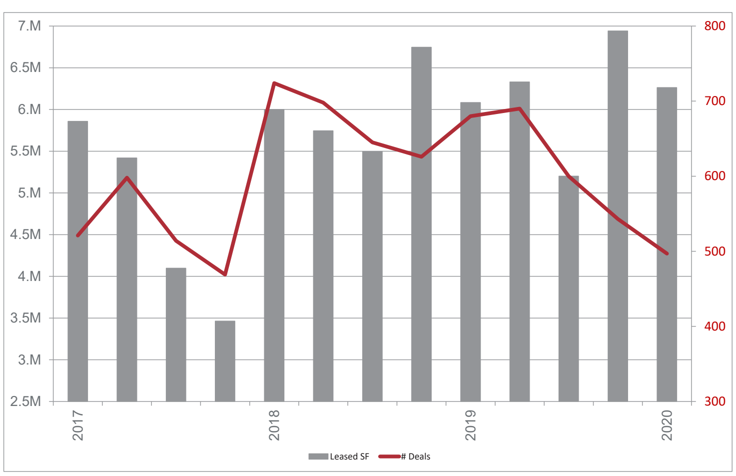
INDUSTRIAL MARKET METRO PHOENIX

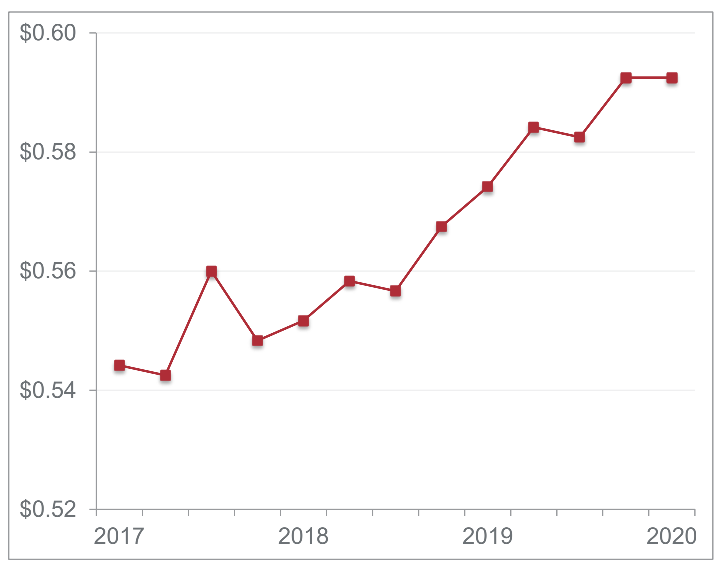
Submarket Snapshot

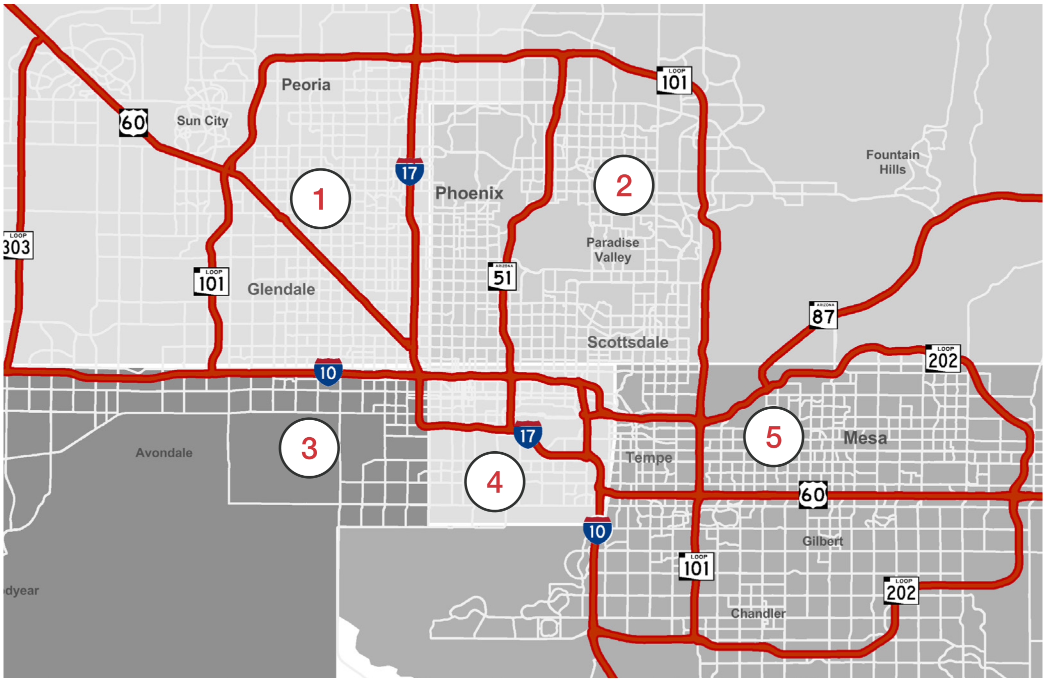
	RBA		Vacant SF		Vacant %		Net Absorption		Deliveries		Under Construction		Avg NNN Rate		Yearly NNN Rate	
Sky Harbor	49,426,439	▲	3,012,839	▲	6.1%	▲	(243,965)	▼	-	—	565,546	▲	$0.71	▲	$8.55	▲
Northeast Valley	14,982,056	▼	609,038	▲	4.1%	▲	(47,006)	▼	-	—	37,812	▲	$0.99	▲	$11.89	▲
Northwest Valley	62,569,696	▲	3,467,822	▲	5.5%	▲	663,955	▲	849,947	▲	5,261,527	▼	$0.58	▼	$6.95	▼
Southeast Valley	93,186,634	▲	7,229,959	▲	7.8%	▲	(294,295)	▼	533,094	▲	1,779,502	▲	$0.71	▼	$8.50	▼
Southwest Valley	101,464,507	▲	10,326,194	▲	10.2%	▲	644,527	▲	1,044,093	▲	6,421,153	▲	$0.46	▲	$5.49	▲
All Submarkets	321,629,332	▲	24,645,852	▲	7.7%	▲	723,216	▼	2,427,134	▲	14,065,540	▲	$0.59	—	$7.11	—
Overall Total 4Q19	319,267,372	▲	23,007,108	▼	7.2%	▼	1,922,170	▼	1,870,338	▼	9,812,667	▲	$0.59	▲	$7.11	▲
Overall Total 3Q19	317,405,459	▲	23,038,796	▲	7.3%	▲	2,237,173	▲	2,306,635	▲	7,406,259	▼	$0.58	▼	$6.99	▼
Overall Total 2Q19	315,116,969	▲	22,954,779	▲	7.3%	▲	855,825	▲	1,777,259	▲	7,559,893	▲	$0.58	▲	$7.01	▲
Overall Total 1Q19	313,432,893	▲	22,211,908	▼	7.1%	▼	797,548	▼	559,695	▼	6,982,193	▲	$0.57	▲	$6.89	▲
Overall Total 4Q18	313,006,272	▲	22,547,362	▲	7.2%	▲	2,708,176	▲	3,403,091	▼	4,940,547	▼	$0.57	▲	$6.81	▲

Industrial Lease Deals



Industrial Lease Rates





Industrial Submarkets

1. **Northwest Valley**
   Deer Vly/Pinnacle Pk, Glendale, Grand Avenue, N Glendale/Sun City, North Black Canyon, W Phx N of Thomas Rd, W Phx S of Thomas Rd
2. **Northeast Valley**
   Central Phoenix, Scottsdale Airpark, Scottsdale/Salt River
3. **Southwest Valley**
   Goodyear, SW N of Buckeye Rd, SW S of Buckeye Rd, Tolleson
4. **Sky Harbor**
   North Airport, S Airport N of Roeser, S Airport S of Roeser, SC N of Salt River, SC S of Salt River
5. **Southeast Valley**
   Chandler Airport, Chandler, Chandler N/Gilbert, Falcon Field/Apache Junction, Mesa, Tempe E, Tempe NW, Tempe SW

We are here.
Phoenix

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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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1st Quarter

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