



NAI Horizon

4th Quarter
2020
Office
Market Report

Q4 2020

OFFICE MARKET METRO PHOENIX

Phoenix Market Snapshot PHOENIX OFFICE MARKET STUMBLES FROM THE PANDEMIC

Net absorption for the year was negative 301,107 square feet and negative in three of the four quarters for 2020. Somewhat ironically, the largest quarterly negative net absorption number was the first quarter, with -218,302 square feet – or the majority of the negative number for the year. That was pre-pandemic, so one could say the pandemic wasn't the only reason for the slow-down in office occupancy and that the office market was poised for a bit of a correction without the virus outbreak.

The negative net absorption numbers are directly linked to the spike in sublease space in 2020. Available sublease went from 1.7 million square feet at the beginning of last year to about 3.1 million at the end of it, and it is expected to grow. In the second quarter last year, for example, there were over 600,000 square feet of direct leases signed yet net absorption was only 160,132 positive because of the surge in sublease space.

Looking at leasing volume, 548 transactions were consummated in the fourth quarter – one less than the third quarter last year. In 2020, 2,168 office lease transactions were signed, compared with 3,046 in 2019 and 3,074 in 2018.

Flipping back to absorption data, however, with over 3.84 million square feet of positive net absorption in all of 2019 and 3.78 million square feet of positive net absorption in 2018, it appears the pandemic accelerated what was already a slowing office market in Phoenix.

143,201 square feet of new office space was delivered in the fourth quarter. In 2020, office developers and builders brought 2.2 million square feet of new office inventory to market, compared with 3.25 million square feet in 2019 and only 1.27 million square feet in 2018. At the start of 2021, developers have over 2.8 million square feet of office property under construction.

Notwithstanding slower demand, the fourth quarter vacancy rate climbed a modest 10 basis points from the third quarter last year and closed out 2020 at 12.6 percent, compared with a year earlier, when it was 11.5 percent.

The vacancy rates for bellwether submarkets Camelback Corridor, Tempe, Downtown Phoenix, Chandler and Central Scottsdale ended 2020 at 17.2 percent, 10.2 percent, 13.1 percent, 11.1 percent and 11.2 percent, respectively. Tempe – which is two distinct submarkets with Rio Salado and its proximity to ASU as a downtown, Class A location versus suburban South Tempe, suffered the highest negative net absorption number for a submarket in the fourth quarter, with -92,550 square feet, followed by Scottsdale Airpark, at -86,380 square feet and Midtown with -78,719 square feet.

Average asking office rental rates ended the fourth quarter at \$27.48 per-square-foot and were up for the year. At the end of 2019 average asking rents were \$26.40 a foot. How long rents can stay near recent highs with rising vacancy and added supply from sublease offerings remains to be seen, and is subject to regional economic stability during the first half of the year.

WORK-FROM-HOME UPDATE

The most compelling real estate story from 2020 is carrying over into 2021 and we will continue to monitor it – the work-from-home (WFH) phenomenon. Forecasting the future of office occupancy has become a cottage industry unto itself, with books now being written about and stories published weekly.

Without hard data on actual and current office occupancy of Phoenix offices, we can only offer anecdotal information from NAI Horizon's sales professionals. One person, who works for a national homebuilder, works almost exclusively from home while another, who works for one of nation's largest insurance companies, has been told to work-from-home indefinitely.

Upwork, the American-based freelancing platform published its Future Workforce Pulse Report in December projecting that the number of remote workers would double in the next five years. By 2025, according to Upwork, 36.2 million Americans will be working remotely, an increase from about 16.8 million people from pre-pandemic rates.

A Joblist survey recently found that 60 percent of workers worked remotely last year, while a New York Times poll of remote workers from August last year found that 86 percent were satisfied with the arrangement. Meanwhile, Urban Land Institute and EY published a report in October that found 59 percent of 550 real estate professionals surveyed from around the globe expect to work remotely two days a week or more from here on. That compares to 69 percent who worked remotely for one day a week or not at all before the pandemic.

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LEASING HIGHLIGHTS

PennyMac Loan Services plans to open its first office in Phoenix and signed a lease in the fourth quarter for almost 75,000 square feet (the entire two-story building) at 3201 E. Elwood Street in Phoenix's Sky Harbor International Airport submarket. The Westlake Village CA-based company is one of the largest lenders in the United States with over 6,000 employees and \$117 billion in loans funded in 2019, according to PennyMac's website.

However, the largest lease in the fourth quarter -- which is also the biggest office deal since the pandemic started, was a 125,000-square-foot sublease deal executed by Scottsdale-based JFQ Lending at 7720 N. Dobson Road. The sublessor was International Cruises and Excursions. JFQ Lending is currently located at 15990 N. Greenway Hayden Loop in Scottsdale.

The JFQ expansion and PennyMac move into Arizona demonstrates that some industries are doing well in the pandemic while others are not.

With home owners making improvements to their homes in droves last year and residential sales of both new and resale houses reaching records, 2020 was a banner year for mortgage lenders while 2020 marked the biggest decline for the traveling industry in history.

Regardless, they are big leases and indicate that all companies are not going to work-from-home forever.

The world's largest dedicated semiconductor foundry, Taiwan Semiconductor Manufacturing Company (NYSE: TSM), signed a two years office lease for 46,735 square feet at the two-building Canyon Corporate Plaza office campus on W. Dunlap Avenue in Phoenix. The deal indicates a potential trend that could drive short-term demand for Phoenix-area offices from the manufacturing sector, or at least help absorb some of the excess sublease space in the market.

In early December Taiwan Semiconductor purchased 1,129 acres of land in North Phoenix near the northwest corner of the Loop 303 and 43rd Avenue and plans to build an advanced semiconductor fabrication plant, breaking ground this year with the expectation that production would begin at the facility by 2024.

While it is not known how many jobs the company will originate at its North Phoenix plant, site selection experts typically use a jobs multiplier of three for every core job a new company brings to a region – in ancillary services such as food servers, dry cleaners, carpenters, CPAs, etc., so if Taiwan Semi's new facility brings 600 jobs to Phoenix it would roughly equate to 2,400 new jobs for the Valley.

SALES HIGHLIGHTS

There were numerous large office asset sales in the fourth quarter.

Lincoln Property Co. sold its newly developed Grand2 property. The deal was the largest office transaction in Phoenix last year, and the fifth largest office deal in the U.S. Grand2 is a 9-story, 358,000-square-foot office building fully leased to San Francisco-based DoorDash. Apex Capital Investments Corp. purchased the property for \$187.5 million.

TA Realty of Newport Beach sold the Park at SanTan in Chandler for \$65 million to DPC Development Companies based in Colorado or \$266 per-square-foot. The 220,000 square feet of Class A offices were built in 2007 and includes 260 parking spaces.

A Southern California investment group paid \$21.7 million for a two-building office property in Chandler. Yonezawa-Miller Company, a real estate development firm based in Diamond Bar, California, bought Portico Place at 2121 and 2195 W. Chandler Blvd. from Milwaukee, Wisconsin-based real estate company Irgens Partners. Yonezawa-Miller paid \$238.31 per square foot for the 89,182-square-foot property, an amount that is near the average of \$237 a square foot for the Chandler area, according to CoStar.

December was a strong month for investment sales in the Phoenix metro market with \$451 million transacted during the month. In addition to the aforementioned large sales, there were a number of office condominiums sold, 56 percent of which went to medical occupiers. However, some of the sales featured sale/leasebacks, which is an alternative way of capitalizing on the real estate asset – by taking the money up front in a sale, versus rental income later.

Demand from owner/occupiers to buy smaller buildings – those between 2,500 square feet and 20,000 square feet remains high, and what comes to market is usually sold quickly.

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Market Overview

| | Total RBA | Vacant SF | Vacant % | Net Absorption | RBA Delivered | RBA Under Construction | Average Rental Rate |
|--------------|-----------------------|----------------------|--------------|---------------------|-------------------|------------------------|-----------------------|
| CLASS A | 56,861,619 SF | 8,348,362 SF | 14.7% | (197,134) SF | 117,394 SF | 2,441,347 SF | \$31.71/SF, FS |
| CLASS B | 111,999,170 SF | 14,688,457 SF | 13.1% | 21,872 SF | 25,807 SF | 392,570 SF | \$24.90/SF, FS |
| CLASS C | 25,740,564 SF | 1,481,524 SF | 5.8% | 6,931 SF | - | - | \$20.41/SF, FS |
| TOTAL | 194,601,353 SF | 24,518,343 SF | 12.6% | (168,331) SF | 143,201 SF | 2,833,917 SF | \$27.48/SF, FS |
| Q3 2020 | 194,476,994 SF | 24,225,653 SF | 12.5% | (74,836) SF | 493,173 SF | 2,977,118 SF | \$27.64/SF, FS |
| Q2 2020 | 193,983,821 SF | 23,657,644 SF | 12.2% | 160,362 SF | 558,725 SF | 3,078,361 SF | \$27.40/Sf, FS |

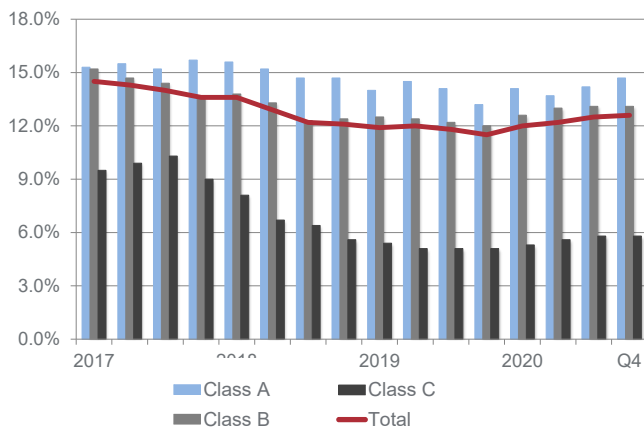
Significant Lease Transactions

| Address | Tenant | Size | Class | Type |
|------------------------------|-----------------------|-----------|-------|---------|
| N Dobson Rd | Banner Health | 80,000 SF | B | Move In |
| 1330 W Southern Ave | Amazon | 50,000 SF | B | Move In |
| 2510 W Dunlap Ave | TSMC | 46,618 SF | A | Move In |
| 1275 W Washington St | OnePoint Patient Care | 28,183 SF | B | Move In |
| 3600 E University Dr, Bldg D | HotChalk | 24,154 SF | B | Move In |

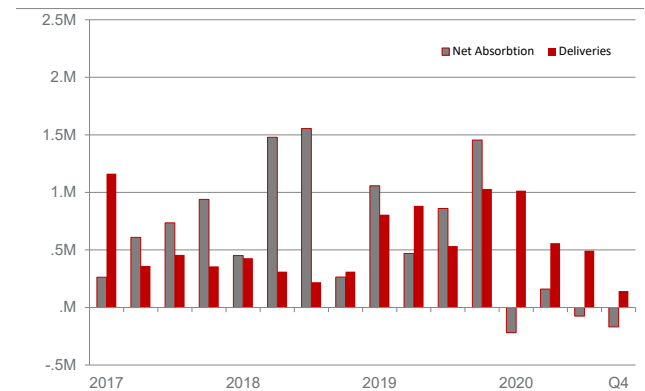
Significant Sale Transactions

| Address | Date | Size | Class | Price |
|----------------------------|------------|------------|-------|-----------------------------|
| Grand II @ Papago Park Ctr | 12/1/2020 | 358,800 SF | A | \$187,500,000 (\$522.58/SF) |
| The Park at SanTan | 12/6/2020 | 220,000 SF | A | \$58,499,726 (\$265.91/SF) |
| Plexus Worldwide HQ | 12/23/2020 | 73,060 SF | A | \$22,000,000 (\$301.12/SF) |
| CIT Bank - Cotton Corp Ctr | 12/30/2020 | 73,377 SF | B | \$21,000,000 (\$286.19/SF) |

Office Vacancy Rates



Absorption & Deliveries



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

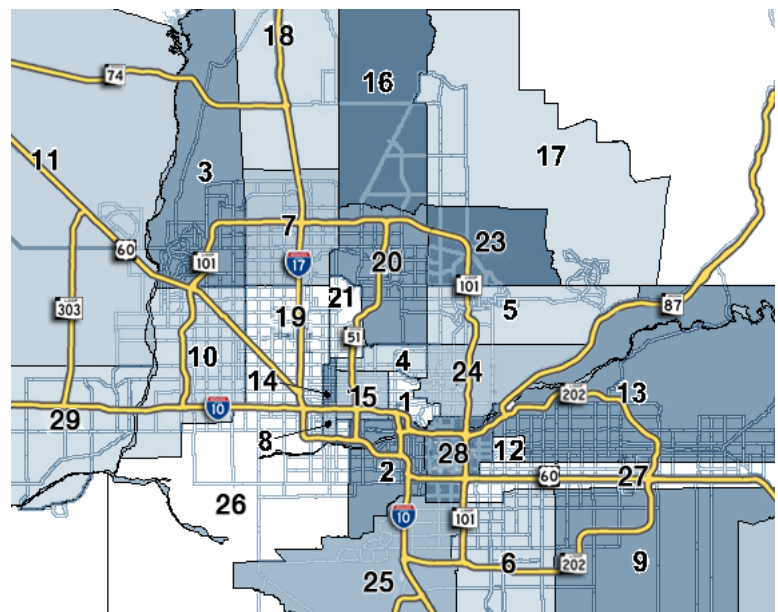
The status of a building that is in the process of being developed, assembled, built or constructed. A building is considered to be under construction after it has begun construction and until it receives a certificate of occupancy.

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

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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4th Quarter
2020

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