NAI Horizon

1st Quarter 2021 Office Market Report

Economic Overview

The Recovery is Well Underway

The economic recovery underway in the U.S. can be summarized in three words: pent up demand. With the exception of jumping on a Zoom call, there is pent up demand for everything. Going to restaurants, a ballgame, on a vacation (and one that requires air travel), going back to the office. You name it. Look at Phoenix traffic during commute hours. To use a non-technical phrase, it sucks. Again.

Here are just three headlines in one newspaper on one day in mid-April:
"Oil Demand Recovers Amid Vaccine Hiccups"
"Logjam of Cargo Ships Ease at California Ports"
"Oil Demand Recovers Amid Vaccine Hiccups"

West Texas Intermediate Futures, the U.S. gauge for oil demand (vs. Brent Crude, globally), jumped 4.6 percent in a day when this report was being written, to close at $63.15 a barrel. A year ago that barrel of oil was trading at its lowest point in 10 years, at $16.52. See the retail and industrial reports for details from those other two headlines.

With stock markets still breaking records and banks reporting very strong earnings, it's beginning to look like Alan Greenspan's "Goldilocks Economy," which the former Federal Reserve Chairman popularized in the late 1990s, though he was not the first banker to use the phrase to describe a sustainable economy that is not too hot or too cold, and features low inflation.

With nearly 200 million Americans inoculated, doctors doom and gloom appear wobbly and on the ropes, while Captain Confidence is taking control of the narrative.

The Recovery is Well Underway

At the close of 2020, jobs in Arizona were 3 percent below their February 2020 peak and represented a substantial 90,100 job gap, over half of which were in leisure and hospital sectors of the state's economy, as the travel and tourism industry remained hard hit by the pandemic. Further, in December, all major employment sectors, with the exception of transportation and warehousing, were below their peak. Income growth in the state surged in the second and third quarters of 2020, driven upward by a gigantic flow of federal relief funds into the state that helped to stabilize the economy in general and spurred gains in retail sales of tangible goods and trade, transportation, and warehousing jobs in particular.

Ongoing population growth and demand for housing remained high throughout the pandemic

Arizona total housing permits rose 23.0% in 2020 to 57,281. That was up from the revised 2019 annual total of 46,580. Most of the increase was driven by single-family activity, which rose to 41,465. That was an increase of 22.0%. Multi-family permits rose 25.5% to 15,816 in 2020.

Phoenix MSA housing permits increased 27.4% to 45,694 in 2020. Single-family permits increased to 31,475 (up 25.8%) and multi-family permits rose to 14,219 (up 31.1%).

Tucson MSA housing permits also increased last year, but at a slower pace. Total permits rose 14.9% to hit 4,956. Single-family permits accounted for all of the increase, rising 21.6%. Multi-family permits dropped 13.3% in 2020.

Q1 2021 OFFICE MARKET METRO PHOENIX

Economic Overview continued

The house prices indexes from the Federal Housing Finance Agency (FHFA) measure repeat sales on single-family homes, and thus are not impacted by composition effects that can distort trends in median house prices. Data for the third quarter of 2020 also indicate strong house price appreciation in Arizona, with prices up 7.9% over the year statewide, 8.3% in Phoenix, and 7.2% in Tucson. By comparison, nationally, house prices were up 4.7% over the year in the third quarter.

We'll report on travel and tourism data in a future market report this year, but suffice it to say late winter and early spring travelers returned to Arizona in droves in recent months, and with it came a nice bounce in that sector of the state's economy – both in terms of hiring and spending.

(Sources: Saudi Aramco, The Wall Street Journal, Economic and Business Research Center, The University of Arizona's Eller College of Management).

Phoenix Market Snapshot

PHOENIX OFFICE MARKET TURNS NEGATIVE, YET NOT FOR LONG

We titled our 4th quarter report ‘Phoenix Office Market Stumbles from the Pandemic,” because it had—and why wouldn’t it? By the numbers, the office market has worsened, and substantially so. First quarter net absorption was negative 853,261 square feet, a figure that we have not seen since the Great Financial Recession in 2009-2010. Net absorption in 2Q2009 was negative 1.17 million square feet. In the teeth of that recession, for the five quarters from 3Q2008 to 3Q2009, the Phoenix office market’s absorption was negative 2.98 million square feet.

While there is cause for concern, when looking at the bigger picture, the first quarter numbers appear to be a temporary setback. First, a presentation of the balance of core metrics from the first quarter.

Central Scottsdale bore the brunt of the negative net absorption, while Northwest Phoenix and Camelback Corridor posted negative net absorption numbers of 197,308 square feet and 156,477 square feet respectively. However, it is worth noting not all submarkets are created equally, and two of the three most impacted submarkets thus far in this cyclical correction are among the most expensive in the metro region.

The total number of leasing transactions including subleases was 594 in this quarter, which was comparable to the 608 completed transactions in the fourth quarter last year.

The vacancy rate spiked 100 basis points quarter-to-quarter and was 13.6 at the end of the first quarter, or an increase of 160 basis points from a year earlier, when it was 12 percent at the start of 2020.

Vacant sublease space climbed to nearly 1.77 million square feet at the end of the first quarter—or over 500,000 square feet from the end of last year—and increased by nearly 1 million square feet since the first quarter of 2020.

A little more than 1.4 million square feet of office supply was delivered in the first quarter. This includes build-to-suit projects for Nationwide Mutual Insurance Company and Choice Hotels. The latter of which is 150,000 square feet on five floors, located at the NWC Loop 101 in Scottsdale. The Choice Hotels building called Cavasson, which is within the Nationwide campus, is part of the 134-acre, master-planned Nationwide campus that will encompass 1.8 million square feet of Class A office, apartments, retail, restaurants and hotels.

More office product is on the way, with 1.9 million square feet of office under construction at the close of the first quarter, compared with 3.1 million square feet under construction a year earlier.

Some of the notable projects under construction now include 100 S. Mill Avenue in Tempe, an 18-story, 287,000-square-foot glass tower with an asking rent of $50.50 per foot. Scottsdale Entrada, a nearly three-story office building located at 6400 E. McDowell Rd. in Scottsdale, is comprised of 244,998 square feet. Additionally, in the Camelback Corridor submarket, an 181,494-square-foot office building is rising that will span four floors when complete.

Rental rates, so far, do not seem impacted by the surge in supply and lack of strong demand, as the average asking rate at the end of March was $24.99 per-square-foot (psf), a couple of pennies more than the 4th quarter last year and up from $24.72 psf a year earlier.

As the pandemic’s consequences relate to the office market and change in supply-demand dynamics, it will take more time to understand the extent to which companies adopt hybrid onsite and remote work models as well as the subsequent impacts on occupancy demand and vacancy rates.

Phoenix Market Snapshot

In terms of work models in a post-pandemic landscape, the implantation of a flexible work week proves most favored with companies such as Google and JP Morgan embracing a hybrid model. Chase’s CEO Jamie Dimon recently said that for every 100 seats the company used to occupy, they will fill 60 of them. While some employees will have flexible days and hours, others will be at their respective jobs daily with 10 percent of the company permanently working remotely, Dimon said. Furthermore, Google’s CEO Sundar Pichai announced in early May that there will be more choices regarding where employees work. Upon implementation, the work week for Google will result in approximately 60 percent of employees working in office a few days a week, 20 percent working in a new office location and 20 percent working fully from home, said Pichai.

However, with the mystery of Covid-19 fading and the distribution of the vaccine expanding nationally, confidence appears to be returning. In KMPG’s 2021 CEO Outlook Pulse Survey, it was reported that only 17 percent of respondents will downsize their office footprint, compared to the KPMG survey in August 2020 that said 69 percent of respondents would reduce their office footprint.

Although only time will tell the how demand for office space plays out, most media reports, particularly from a basket of CRE trade journals, are calling for 15 percent or even greater reduction in office occupancy. Perhaps this is a temporary adjustment, or perhaps the U.S. office ecosystem is evolving into a changed environment with more permanence. As stated earlier, we won’t fully understand until later this year or next year how companies change business operations based on their respective pandemic experiences.

In Phoenix, meanwhile, the bigger, near-term picture is that activity on office space is up significantly from the fourth quarter, based on NAI Horizon agent testimonials thus far in 2021 and the types of transactions they have closed.

Here’s why we remain upbeat about the Phoenix office market, despite the negative absorption data and spike in sublease space.

- Rents, as previously noted, have not declined.
- Tenants are paying rent on time, according to landlords we work with.
- Some of the new buildings coming to market – both mentioned earlier in this report and not referenced, are asking for aggressive rents in the high $40s and low $50s-per-foot.
- In some cases, landlords are not offering months of rent abatement. According to one NAI Horizon office specialist, a lease on which she is working involving a five-year term includes the landlord offering only one free month.
- In previous reports (from 2020) we’ve noted that some companies were indicating they would shed space when leases came due for renewal, or not renew at all and relocate. In a recent analysis by Moody’s Analytics REIS, Phoenix, Norfolk and Atlanta led office renewals at 79 percent, 75 percent and 74 percent, respectively, while Chicago’s office renewal rate was 50 percent and New York’s 45 percent.
- There is good preleasing activity at new office buildings under construction. Amazon leased 93,000 square feet at the 100 Mill building while Deloitte made a commitment for 32,000 square feet in the new high rise. WageWorks recently leased 150,000 square feet and Northrup Grumman is taking on new space. Intel just announced two new semi-conductor facilities and a $20 billion investment in Phoenix.
- Phoenix will presumably continue to grow for the same underlying reasons it has for years now—good employment opportunities, improving business culture, relative affordability, good quality of life and its weather. This bodes well for business growth, innovation and demand for office space.

Phoenix Market Snapshot

Could we, or will we see negative absorption numbers and more sublease space come to market in the next few months? Maybe so, but we predict it won’t stretch into four, five or six quarters as it did in the last recession because vaccines are being widely distributed, job markets are improving in almost every state and the economy in general is recovering from the pandemic. All are factors in minimizing a fall back into low absorption rates.

Largest Leases

Alliance Bank of Arizona renewed its lease for 97,064 square feet in multiple floors at 1 E. Washington in Downtown Phoenix in the CityScape building, which has 28-stories and totals 608,134 square feet. Union Bank renewed its lease of 72,715 square feet (asking rent was $30 per foot) on the fourth floor of a 4-story building comprised of 269,016 rentable square feet at 1500 N. Priest Drive in Tempe, while Arriva took 42,521 square feet in a sublease at 15147 N. Scottsdale Road in Scottsdale, or the entire second floor of a three-story, 120,000-square-foot building.

Here’s why we remain upbeat about the Phoenix office market, despite the negative absorption data and spike in sublease space.

Biggest Sales

Camco Investment Group out of Dallas acquired a 311,132-square foot, Class A office building at 1201 S. Alma School Road from Washington, DC-based Iron Point Partners LLC, for $39.5 million, or $127-per-square-foot. The asset, located in the Superstition Corridor and built in 1986, went into contract in early April. Los Angeles-based Held Properties paid $34 million for a 149,424-square-foot Class A office building at 15333 Pima Road in Scottsdale. The seller was locally based ViaWest Group and the price-per-foot worked out to $228. Built in 2001, the building is in the Scottsdale Airport submarket. Flagler Holdings LLC, based in Miami, FL, paid $23.65 million for a 49,318-square-foot medical office building at 1675 E. Melrose Street in Gilbert, or $479 per foot. The seller of the Class B building was Phoenix-based OrthoArizona.

Q1 2021 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	58,359,135 SF	9,817,742 SF	16.8%	(146,813) SF	1,366,224 SF	1,366,224 SF	$30.82/SF, FS
CLASS B	111,386,301 SF	15,108,203 SF	13.6%	(604,012) SF	383,074 SF	383,074 SF	$21.74/SF, FS
CLASS C	25,855,957 SF	1,597,282 SF	6.2%	(102,436) SF	-	-	$16.61/SF, FS
TOTAL	194,332,781 SF	26,523,227 SF	13.6%	(853,261) SF	1,400,829 SF	1,721,963 SF	$24.99/SF, FS
Q4 2020	194,197,971 SF	24,401,354 SF	12.6%	(257,471) SF	153,652 SF	2,839,026 SF	$24.97/SF, FS
Q3 2020	193,187,025 SF	24,009,073 SF	12.4%	(76,948) SF	470,173 SF	2,992,678 SF	$25.14/SF, FS

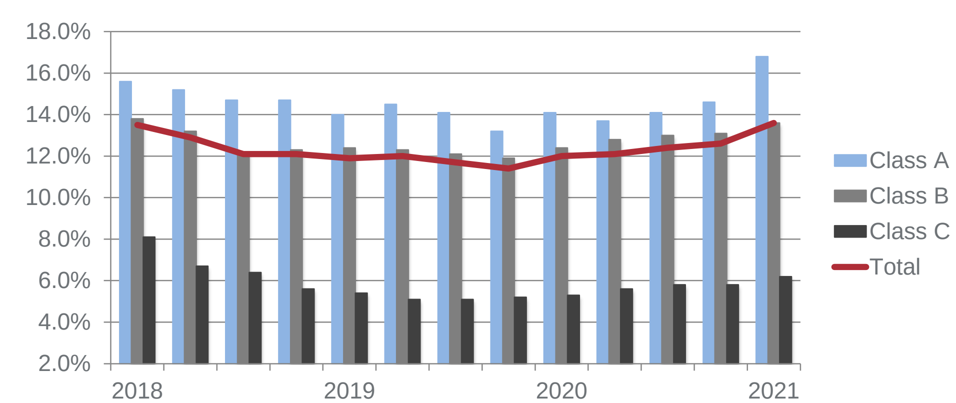
Significant Lease Transactions

	Address	Tenant	Size	Class	Type
1 E Washington St	Phoenix	Alliance Bank of AZ	97,064 SF	A	Renewal
1500 N Priest Dr	Tempe	Union Bank	72,715 SF	A	New
3075 W Ray Rd	Chandler	Pearson	44,439 SF	A	Renewal
15147 N Scottsdale Rd	Scottsdale	Arrivia	42,521 SF	A	New
1675 E Melrose St	Gilbert	Ortho Arizonai	41,441 SF	B	Renewal

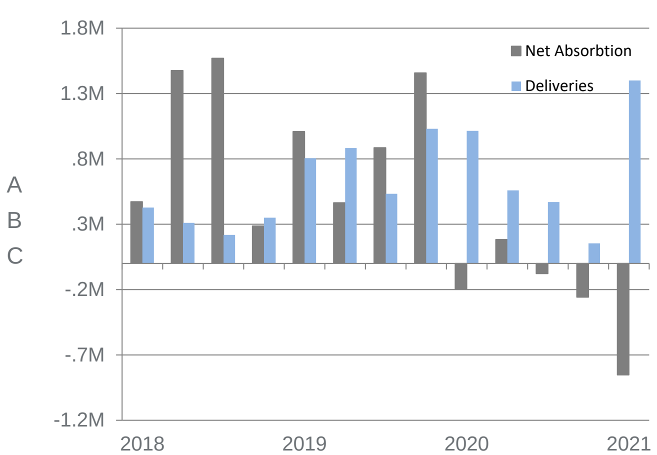
Significant Sale Transactions

	Address	Date	Size	Class	Price
Raintree Corp Center I	15333 N Pima Rd, Scottsdale	2/5/2021	149,424 SF	A	$34,000,000 ($227.54/SF)
Ortho AZ Building	1675 E Melrose St, Gilbert	2/16/2021	49,318 SF	B	$23,646,000 ($479.46/SF)
Arizona Business Park	15401 N 29th Ave, Phoenix	2/10/2021	36,678 SF	B	$18,800,000 ($512.57/SF)
Pecos Professional Plaza	16611 S 40th St, Phoenix	3/31/2021	38,856 SF	B	$12,175,000 ($313.34/SF)

Office Vacancy Rates



Absorption & Deliveries



Q1 2021

OFFICE MARKET METRO PHOENIX

Submarket Snapshot

	RBA		Vacant SF		Vacant %		Net Absorption		Deliveries		Under Construction		Avg FSG Rate	
44th Street Corridor	4,165,558	—	570,288	▼	13.7%	▼	621	▲	-	—	-	—	$26.31	▼
Airport Area	10,126,824	—	1,387,362	▼	13.7%	▼	19,583	▼	-	—	-	▼	$17.09	▼
Arrowhead	4,405,554	—	451,929	▼	10.3%	▼	(16,970)	▼	-	▼	128,000	—	$23.56	▼
Camelback Corridor	9,515,123	▼	1,817,431	▲	19.1%	▲	(156,477)	▲	4,175	▲	263,766	▲	$33.51	▼
Central Scottsdale	8,988,898	—	1,288,600	▲	14.3%	▲	(293,886)	▼	-	—	100,000	—	$26.60	▼
Chandler	13,083,392	▲	1,429,171	▲	10.9%	▲	49,847	▲	120,000	▲	365,000	▼	$27.70	▲
Deer Valley/Airport	14,330,114	▲	2,185,413	▲	15.3%	▲	75,022	▲	144,000	▲	-	▼	$20.32	▲
Downtown	11,508,992	▲	1,716,085	▲	14.9%	▲	(61,037)	▼	227,113	▲	-	▼	$31.01	▼
Gateway Airport/Loop 202	2,946,543	▲	248,601	▼	8.4%	▼	46,597	▼	26,000	▲	34,100	▼	$23.46	▼
Glendale	3,555,555	—	349,164	▲	9.8%	▲	(21,529)	▼	-	▼	-	—	$22.74	▲
Loop 303/Surprise	2,609,015	—	219,621	▼	8.4%	▼	31,298	▲	-	—	-	—	$22.92	▲
Mesa Downtown	1,522,901	—	129,305	▼	8.5%	▼	11,314	▲	-	—	-	—	$18.49	▲
Mesa East	4,784,988	—	378,057	▲	7.9%	▲	127,827	▲	240,000	▲	-	▼	$25.44	▲
Midtown	13,225,458	—	2,556,834	▲	19.3%	▲	(55,979)	▲	-	—	-	—	$23.75	▼
Midtown/Central Phoenix	6,092,647	—	459,269	▲	7.5%	▲	(41,756)	▼	-	—	-	—	$19.74	▲
N Phoenix/Cave Creek	148,013	—	5,660	—	3.8%	—	-	▲	-	—	-	—	$22.00	—
N Scottsdale/Carefree	1,890,422	—	238,656	▼	12.6%	▼	2,896	▲	-	—	-	—	$21.69	▲
North I-17	765,883	—	121,372	▼	15.8%	▼	20,851	▲	-	—	-	—	$18.76	▼
Northwest Phoenix	11,079,997	—	2,064,556	▲	18.6%	▲	(197,308)	▼	-	—	-	—	$19.23	▼
Paradise Valley	5,003,446	—	579,593	▼	11.6%	▼	(21,504)	▼	-	—	13,934	—	$24.67	▼
Piestewa Peak Corridor	3,479,865	—	459,366	▼	13.2%	▼	36,558	▲	-	—	-	—	$23.22	▼
Pinal County	1,678,481	▲	89,061	▼	5.3%	▼	40,486	▲	4,430	▲	-	▼	$16.81	▲
Scottsdale Airpark	13,995,029	▲	2,432,420	▲	17.4%	▲	92,578	▲	635,111	▲	150,000	▼	$28.56	▼
Scottsdale South	7,775,253	▲	1,034,288	▲	13.3%	▲	(134,413)	▼	-	—	244,988	—	$28.86	▼
South Tempe/Ahwatukee	8,234,772	—	1,242,468	▲	15.1%	▲	(147,904)	▼	-	▼	-	—	$19.50	▼
Southwest Phoenix	4,953,654	—	201,517	▲	4.1%	▲	(10,448)	▼	-	—	-	—	$24.14	▲
Superstition Corridor	6,693,992	—	870,142	▲	13.0%	▲	(119,309)	▼	-	—	22,040	—	$20.91	▲
Tempe	16,119,191	—	1,773,990	▲	11.0%	▲	(124,952)	▼	-	—	380,125	—	$29.52	▲
West I-10	2,509,000	—	223,008	▲	8.9%	▲	(5,267)	▼	-	▼	20,000	▲	$24.10	▲

OFFICE TRENDS

VACANCY RATE ▲

AVERAGE ASKING RATE ▲

NET ABSORPTION ▼

ECONOMIC TRENDS

CONSUMER PRICE INDEX ▲

30-YR FIXED MORTGAGE ▲

PHOENIX METRO UNEMPLOYMENT ▼

Q1 2021

OFFICE MARKET METRO PHOENIX

Methodology | Definitions | Submarket Map

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

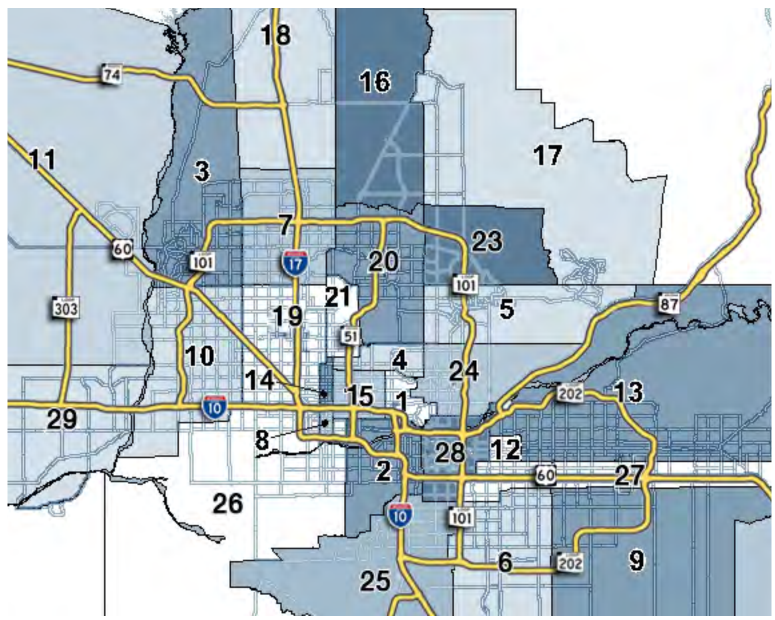
The status of a building that is in the process of being developed, assembled, built or constructed. A building is considered to be under construction after it has begun construction and until it receives a certificate of occupancy.

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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About NAI Horizon
Exceptional global commercial real estate solutions begin with local market leadership and expertise. Established in 1992, NAI Horizon is a full-service commercial real estate company serving Arizona with offices located in Phoenix and Tucson. NAI Horizon is passionate about the commercial real estate business, providing Brokerage and Property Management Services for local, national and international clients. NAI Horizon is a member of the NAI Global commercial real estate network providing real estate solutions to more than 300 offices worldwide. For more information visit www.naihorizon.com.

About NAI Global
Advisory Services, Leasing, Property Management, Property & Note Sales and Tenant Representation
NAI Global is a leading global commercial real estate brokerage firm. NAI Global offices are leaders in their local markets and work in unison to provide clients with exceptional solutions to their commercial real estate needs. NAI Global has more than 300 offices in 43 countries strategically located throughout North America, Latin America and the Caribbean, Europe, Africa and Asia Pacific, with 5,100 local market professionals, managing in excess of 1.1 billion square feet of property and facilities. Annually, NAI Global completes in excess of $20 billion in commercial real estate transactions and a gross revenue of $1.5 billion.thro
NAI Global professionals achieve extraordinary results for clients locally and globally through creativity, collaboration and the consistent delivery of exceptional knowledge and service that only market-leading firms can provide. NAI
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www.naihorizon.com

Office Specialists

Thomas Bean, CCIM
First Vice President
thomas.bean@naihorizon.com

Logan Crum
Senior Associate
logan.crum@naihorizon.com

Troy Giammarco
First Vice President
troy.giammarco@naihorizon.com

Kevin Higgins
Vice President
kevin.higgins@naihorizon.com

Lori Kahn, MBA
Associate
lori.kahn@naihorizon.com

Joan Krueger
Associate
joan.krueger@naihorizon.com

Laurel Lewis
Senior Vice President
laurel.lewis@naihorizon.com

Jennifer Loehnert
Associate
jennifer.loehnert@naihorizon.com

Lane Neville
Executive Vice President
lane.neville@naihorizon.com

Jay Mininberg, J.D.
Associate
jay.mininberg@naihorizon.com

Don Morrow
Senior Vice President
don.morrow@naihorizon.com

Mike Myrick, CCIM
Senior Vice President
mike.myrick@naihorizon.com

Joe Pequeno
Vice President
joe.pequeno@naihorizon.com

Dylan Whitwer
Associate
dylan.whitwer@naihorizon.com

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NAI Horizon

2944 N 44th Street, Suite 200
Phoenix, Arizona 85018
tel +1 602 955 4000
www.naihorizon.com