METRO PHOENIX

Office

4th Quarter

2022 OFFICE Market Report

Q4 2022

OFFICE MARKET
METRO PHOENIX

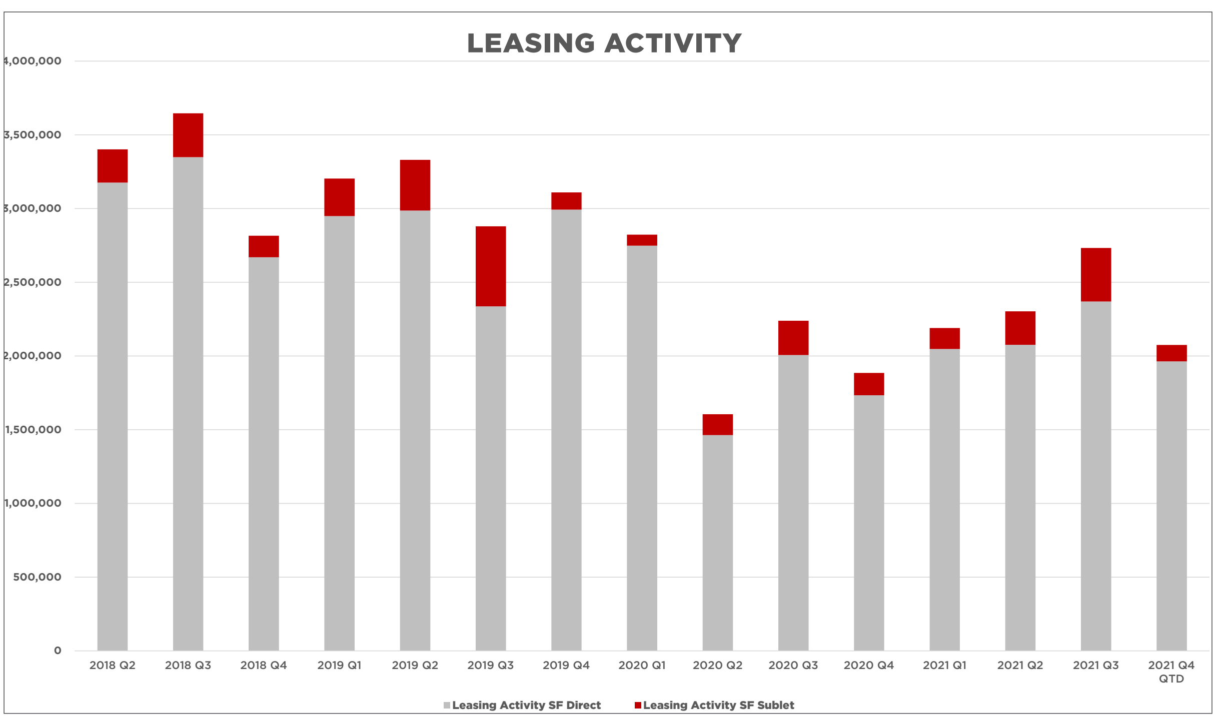
National Trends

By the beginning of the fourth quarter last year, the U.S. office vacancy rate had reached 12.3% — close to where it was at the peak of the global financial crisis in 2009, according to data firm CoStar Group, Inc. CoStar reports that the rates in some major metropolitan areas, including New York, San Francisco, and Washington, D.C., are at their highest levels in more than two decades. Further, corporate tenants are flooding the market with sublease space, the primary way to reduce space commitments before leases expire.

About 218 million square feet of sublease space is now available nationwide, which is nearly double the amount compared to the end of 2019. D.C. and San Francisco vacancy rates are north of 20%, and counting sublease space, more than one-quarter of their office markets are vacant. Companies are putting off searching for new office space as well. According to VTS, a firm that operates a data platform that tracks tenant demand, searches for new offices fell 44% in 2022, compared with 2018 and 2019.

As we get deeper into January, however, there is a glimmer of optimism that the office markets will improve, though no one expects any massive reversal from the trends of the last few years.

Employers are beginning to mandate a return to the office in more significant numbers. Disney recently announced that it expects staff to work in the office four days a week – Monday through Thursday, starting March 1st. Newly returned CEO Bob Igor cited creativity and collaboration as cornerstones of



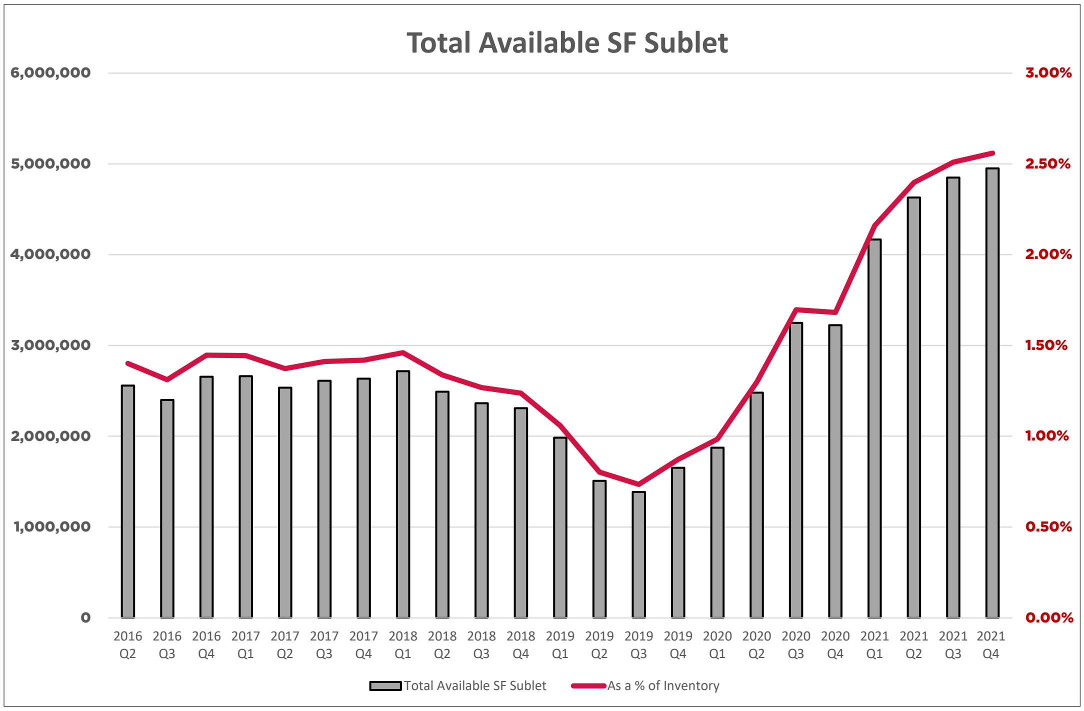
Q4 AT A GLANCE:

VACANCY: 14.9% ▲
SF CONSTRUCTION: 1.38M SF ▼
AVG FSG RATE: $28.62 ▲

the Disney franchise, saying, “In a creative business like ours, nothing can replace the ability to connect, observe, and create with peers that comes from being physically together.” This sentiment is the sentiment of many company leaders, though it often goes unsaid publicly.

Tech companies in Salt Lake City are bringing their workers back as well, with local news reports stating that several companies have mandated staff back into the office 3-5 days a week, the biggest of which is Adobe. Others include home-grown tech companies: Podium, Pluralsight, Entrata, Xactware, Weave, DigiCert, Carrus, and a call center operated by Visa.

According to a March Gallup report, nearly 60% of remote-capable jobs — estimated at 60 million in the U.S. — will have a hybrid schedule moving forward, with 32% fully remote and only 9% in the office full-time.



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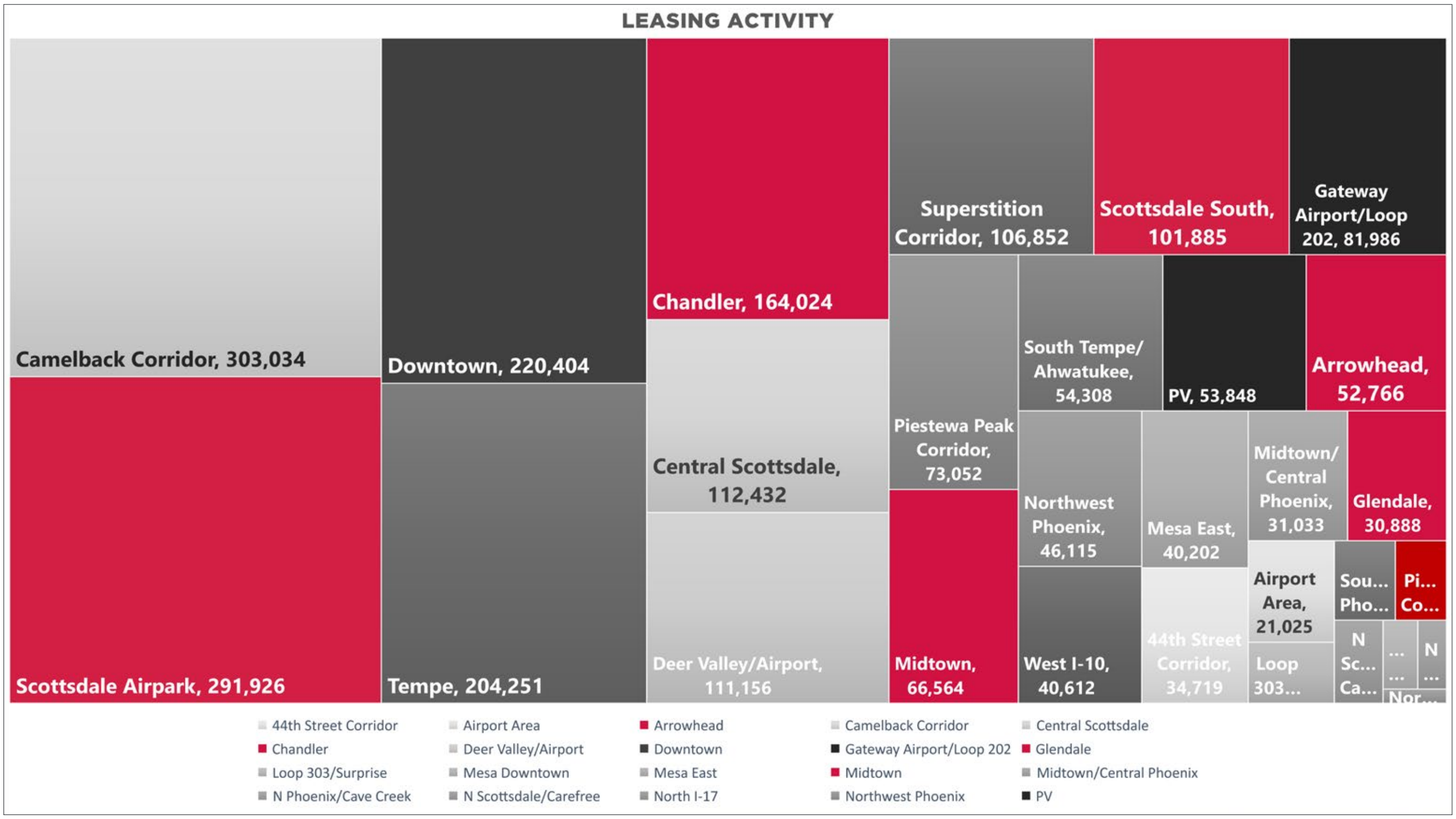
Recently, newly empowered House Republicans have introduced a bill that would force many government office workers back into five-day workweeks — called The SHOW-Up Act, or shorthand for Stopping Home Office Work's Unproductive Problems. That may be presumptive and hyperbolic; however, the move would have sweeping implications for the office market, especially in D.C. According to one report, the federal government leases millions of square feet and spends about $5.7 billion annually on rent. In addition, the government also owns millions of square feet. The 24 agencies surveyed by the Government Accountability Office said they intend to shed some of their office space over the next three years.

This brings us to the latest update on remote and hybrid work strategies and trends – which we have written about in these reports on numerous occasions in the past couple of years.

According to a March Gallup report, nearly 60% of remote-capable jobs — estimated at 60 million in the U.S. — will have a hybrid schedule moving forward, with 32% fully remote and only 9% in the office full-time.

More than 70% of companies plan to go forward with hybrid work strategies, per an occupier sentiment survey earlier last year by one of the national real estate services firms. In a separate study by consulting firm EY, hybrid work schedules are now the norm for 70% of workers. However, 58% of companies surveyed by EY said they were planning to improve or expand their existing occupancy to both accommodate in-office flexible work schedules and enhance the workplace environment to draw people back into the office. Further, and this is a step along this trendline, 40% of companies surveyed said they had already implemented a four-day, in-office



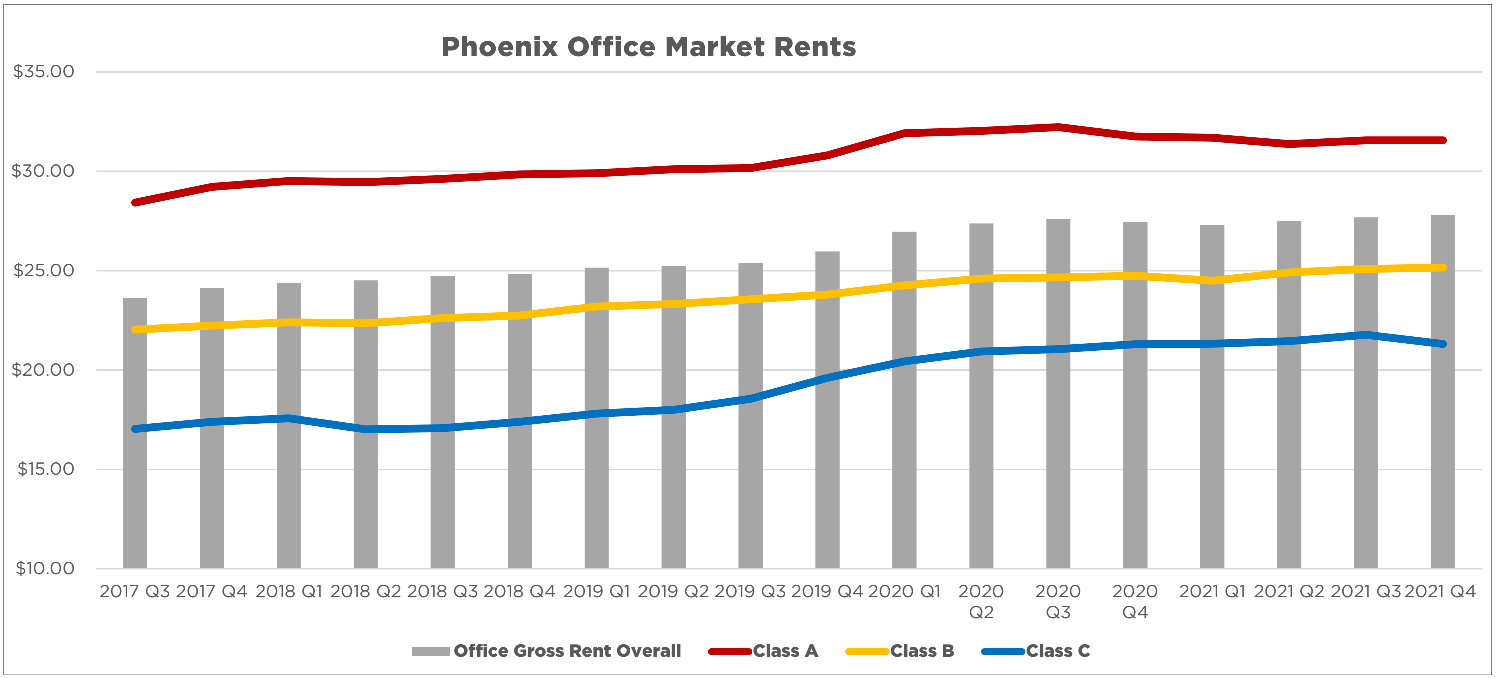
workday, or were in the process of creating one. This four-day workweek is not a hybrid workplace model. Instead, it is a new template for some companies – a four-day (only) work week

4th Quarter Phoenix Office Market

In late November, plans for the massive mixed-use project in Peoria, Stadium Point at P83, moved forward as Peoria's City Council approved a tax incentive agreement for the estimated $510 million project. If Stadium Point becomes a reality with its current plan, at some juncture in the next decade, the Phoenix suburb would have a new pair of Class A office towers totaling more than 645,000 square feet to go along with 65,000 square feet of retail space, 357 multifamily residences, a separate 28,000-square-foot food court, and a 200-key hotel.

Looking at the numbers, the total vacancy across all office asset classes and all Valley submarkets reached 15% in the fourth quarter – up from 13.9% a year earlier. Pre-pandemic, at the close of the

… if one combines direct leasing data and subleasing data, two of the last eight quarters showed positive net absorption, leaving the office market's overall net absorption for all of 2021 and 2022 at negative 1,541,880 square feet.



2019 fourth quarter, the overall vacancy rate was 11.4%. The amount of available sublease space at that time was 0.03%, with just about 561,000 square feet of sublease space in the market. Now, sublease space accounts for 2.7% of the overall availabilities, or a tad over 5.2 million square feet.

From a data perspective, the market has had eight consecutive quarters of negative net–sublease absorption totaling 4,009,948 square feet. However, if one combines direct leasing data and subleasing data, two of the last eight quarters showed positive net absorption, leaving the office market's overall net absorption for all of 2021 and 2022 at negative 1,541,880 square feet.

While that still isn't fantastic news for the regional office market, the upside is that direct leasing has been pretty good the past couple of years—it just couldn't keep up with the chunks of space a couple dozen and mostly large employers returned to the market.

For example, last quarter, there were 518 direct leases closed and 40 sublease deals transacted. The previous quarter it was 572/42, and before that: 675/38, 648/43, 627/30, 704/41, 666/34, and 583/37 direct and sublease transactions per quarter.

Rental rate trends also express the relative stability of the Phoenix office market. Despite an over-arching negative trend for the U.S. office market and the inflation-badgered economy, overall, asking office market rates continue to climb in Phoenix.

Last quarter, asking rents for all classes of space, A, B, and C, reached $27.07 per-square-foot (PSF). That's up from $26.13 PSF a year earlier, and up from $25.13 PSF at the end of 2020. That is nearly an 8% rental rate increase over two years, regardless of all the headwinds.

Despite an over-arching negative trend for the U.S. office market and the inflation-badgered economy, overall, asking office market rates continue to climb in Phoenix.

In the fourth quarter of last year, builders delivered 193,900 square feet of office inventory to the market. At the close of the year, developers had 1.3 million square feet of new product under construction, about half of which is pre-leased.

One of the most significant projects finalized in 2022 was Mortenson's The Beam on Farmer, a speculative 184,000-square-foot office building near the Tempe Town Lake/Salt River waterfront. Meanwhile, over 3 million square feet of office space is currently proposed in the area one-mile north and south of the river between the Loop 202 and Loop 101.

Investors continue to place capital in the Phoenix office market. Approximately $2.9 billion in office assets has traded here in the past 12 months, on pace with the five-year annual average of $2.9 billion. At $230 PSF, pricing remains well below the national average of $340 PSF. Despite the rise in vacancies, sublet space, and interest rates, cap rates have remained relatively stable at 7.1%, though early projections indicate they will likely rise in the coming year.

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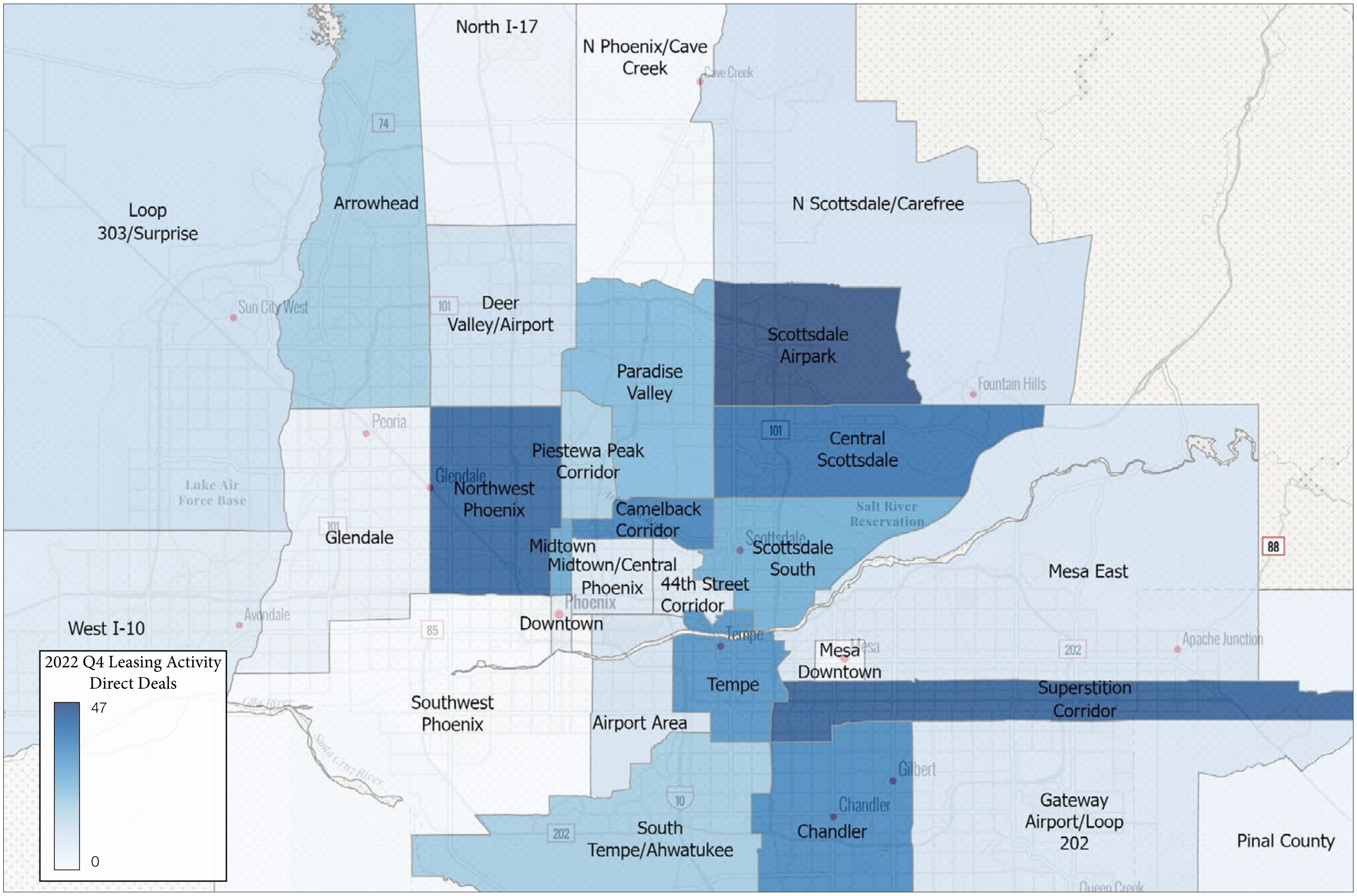
Phoenix Market Snapshot

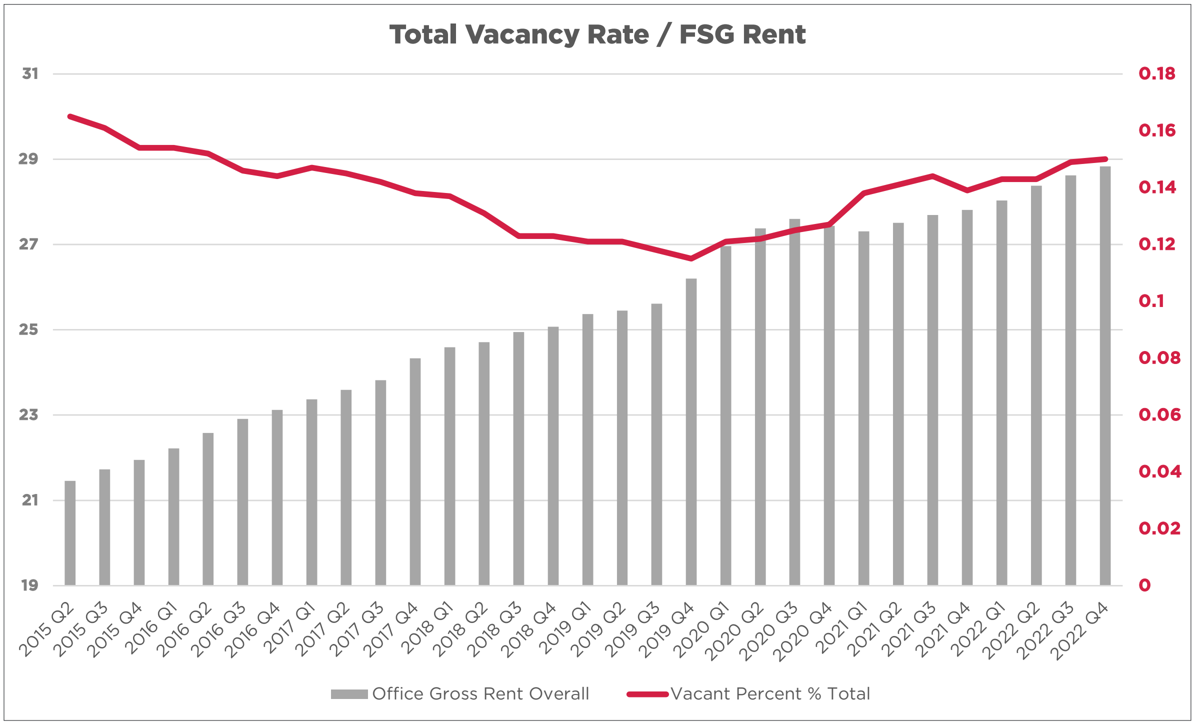
Market Overview

	Total RBA	Vacant SF	Vacant %	Net Absorption	Deliveries	Under Construction	Average Rental
Class A	60,448,480 ▲	14,382,162 ▲	23.8% ▼	(232,701) ▲	181,494 ▲	729,800 ▼	$31.59 ▲
Class B	106,262,144 ▼	13,668,846 ▲	12.9% ▲	61,317 ▲	12,406 ▼	556,975 ▲	$26.24 ▲
Class C	26,522,897 -	1,025,313 ▼	3.9% ▼	61,190 ▼	- -	- -	$23.13 ▲
All Submarkets	193,233,521 ▲	29,076,321 ▼	15.0% ▲	(239,465) ▲	193,900 ▼	1,286,775 ▼	$28.83 ▲
2022 Q3	193,069,083 ▲	28,672,418 ▲	14.9% ▲	(853,344) ▲	457,154 ▼	1,191,780 ▲	$28.61 ▲
2022 Q2	192,659,126 ▲	27,409,117 ▲	14.2% ▲	352,251 ▼	425,222 ▲	1,408,934 ▼	$28.41 ▼
2022 Q1	192,252,740 ▲	27,354,982 ▲	14.2% ▲	(803,114) ▼	27,504 ▼	1,454,156 ▼	$28.07 ▲

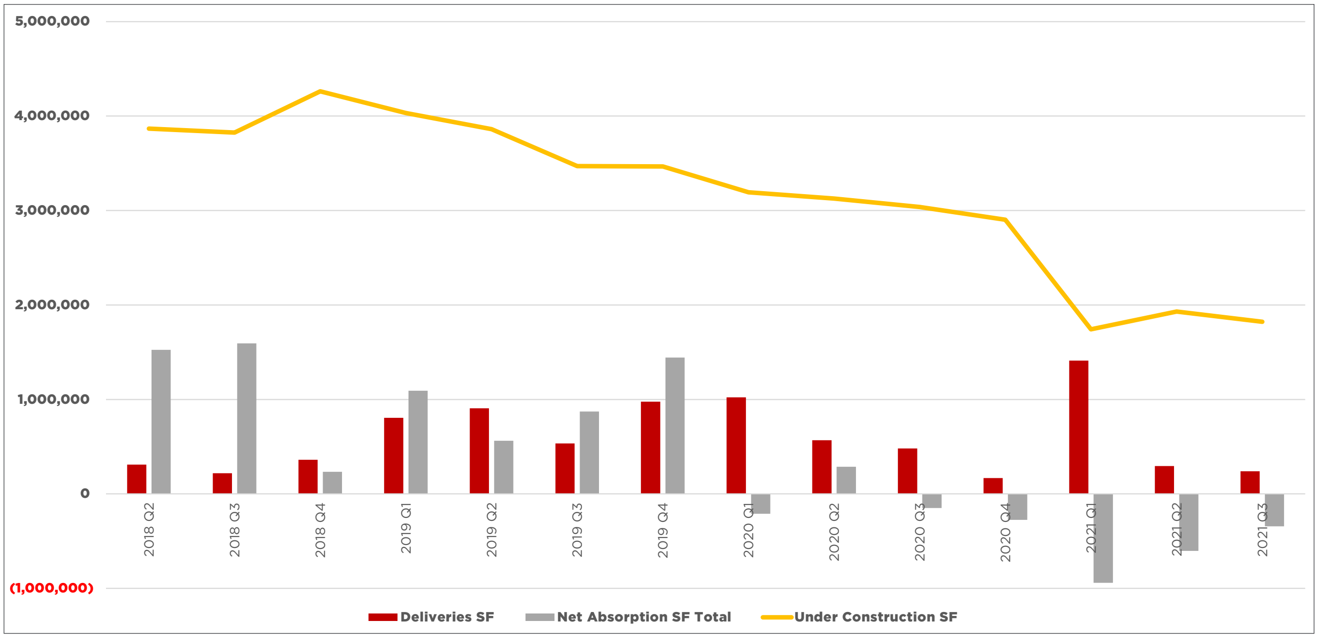
Office Leasing Activity in Phoenix Submarkets



Office Vacancy Rates



Supply, Demand & Under Construction



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Submarket Snapshot

	RBA		Vacant SF		Vacant %		Net Absorption		Deliveries		Under Construction		Avg FSG Rate	
44th Street Corridor	3,973,570	-	-	▼	-	▼	-	▲	-	-	-	-	$27.19	▲
Airport Area	6,577,371	-	1,132,671	▼	20.4%	▼	1,678	▲	-	-	-	▼	$21.50	▼
Arrowhead	4,697,901	-	420,552	▼	8.8%	▼	(3,167)	▼	-	▼	-	-	$29.36	▲
Camelback Corridor	8,930,007	-	1,547,431	▲	17.0%	▲	62,076	▼	181,494	▲	70,000	-	$35.22	▲
Central Scottsdale	9,088,115	-	1,246,997	▼	13.7%	▼	11,360	▲	-	-	-	-	$28.43	▲
Chandler	12,853,412	▲	1,969,297	▲	15.3%	▲	20,840	▲	-	▲	-	▼	$28.40	▲
Deer Valley/Airport	12,294,773	▲	2,513,091	▲	21.1%	▲	215,134	▲	-	▲	175,000	▼	$25.88	▲
Downtown	11,508,174	-	2,162,536	▲	19.0%	▲	(103,396)	▼	-	▲	120,000	▼	$32.56	▼
Gateway Airport/Loop 202	2,888,323	▲	150,996	▼	5.2%	▼	41,085	▼	1,615	▲	45,000	▼	$31.85	▼
Glendale	3,636,644	-	393,029	▲	10.7%	▲	12,936	▼	-	▼	-	-	$25.05	▲
Loop 303/Surprise	2,654,552	-	219,891	▼	8.3%	▼	(20,796)	▲	-	-	9,000	-	$30.94	▲
Mesa Downtown	1,518,561	-	169,249	▼	11.2%	▼	(40,946)	▼	-	-	-	-	$21.69	▼
Mesa East	4,864,356	-	525,870	▲	10.8%	▲	(1,553)	▼	-	-	46,095	▼	$32.08	▼
Midtown	13,099,958	-	-	▲	-	▲	-	▼	-	-	9,000	-	$24.94	▼
Midtown/Central Phoenix	5,993,720	-	429,746	▲	7.2%	▼	(20,369)	▼	-	-	90,000	-	$23.78	▼
N Phoenix/Cave Creek	148,013	-	1,330	-	0.9%	-	-	▲	-	-	-	-	$24.25	▲
N Scottsdale/Carefree	1,880,996	-	205,633	▼	10.8%	▼	33,414	▲	-	-	-	-	$24.66	▼
North I-17	909,503	-	138,302	▼	15.2%	▼	(16,512)	▲	-	-	-	-	$24.66	▲
Northwest Phoenix	11,014,807	-	1,965,421	▲	17.8%	▲	195,797	▼	-	-	-	-	$22.10	▲
Paradise Valley	5,396,045	-	633,633	▼	11.7%	▼	(11,557)	▲	-	-	-	-	$30.80	▼
Piestewa Peak Corridor	3,447,342	-	348,920	▼	10.1%	▼	(31,161)	▼	-	-	-	-	$25.54	-
Pinal County	1,689,670	▲	33,794	▼	2.0%	▼	7,737	▲	-	-	5,826	-	$21.43	▲
Scottsdale Airpark	14,015,561	-	1,975,607	▼	14.1%	▼	(69,303)	▲	-	▲	181,854	-	$32.79	▼
Scottsdale South	7,945,203	-	1,320,045	▼	16.6%	▼	86,439	▲	-	-	-	-	$34.79	▲
South Tempe/Ahwatukee	7,860,294	-	1,538,997	▼	20.0%	▼	(7,453)	▲	-	-	-	-	$27.47	▼
Southwest Phoenix	4,978,534	-	154,221	▼	3.1%	▼	57,209	▼	-	-	-	-	$27.54	▼
Superstition Corridor	6,904,511	-	653,164	▼	9.3%	▼	32,695	▲	10,791	▼	10,000	-	$25.69	▲
Tempe	20,443,960	-	3,739,791	▲	18.3%	▲	(635,917)	▼	-	-	465,000	-	$32.19	▲
West I-10	2,745,982	-	215,719	▼	7.9%	▼	(2,112)	▲	-	▼	69,000	▲	$31.87	▲
Total Valley	193,233,521	▲	29,076,321	▲	15.0%	▲	(239,465)	▲	193,900	▼	1,286,775	▼	$28.83	▲
2022 Q3	193,069,083	▲	28,672,418	▲	14.9%	▲	(853,344)	▼	457,154	▼	1,191,780	▲	$28.61	▲
2022 Q1	192,659,126	▲	27,623,267	▲	14.3%	▲	(820,650)	▼	10,832	▲	1,545,366	▼	$28.03	▼
2021 Q4	192,252,740	▲	26,934,015	▼	13.9%	▼	897,313	▲	277,300	▲	1,490,605	▲	$27.81	▲

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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.

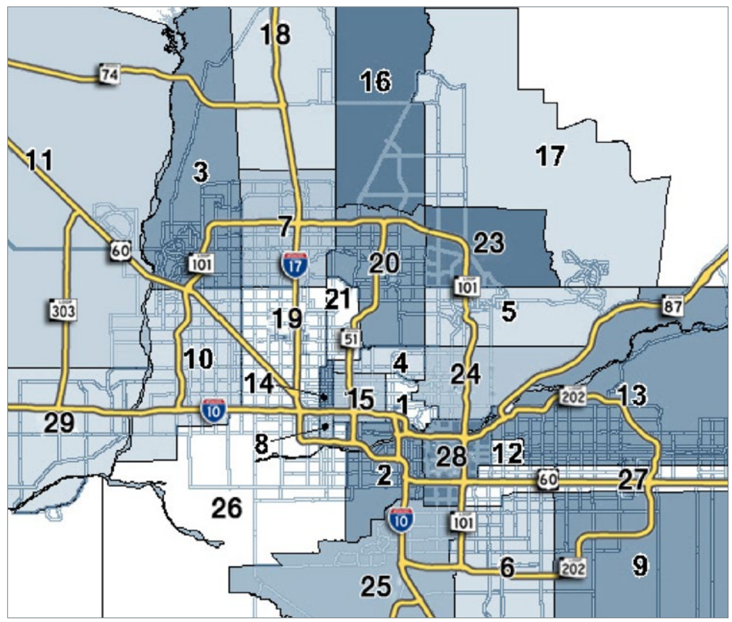
Rentable Building Area (RBA)
The total square footage of a building that can be occupied by, or assigned to a tenant for the purpose of determining a tenant's rental obligation. Generally RBA includes a percentage of common areas including all hallways, main lobbies, bathrooms, and telephone closets.

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

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NAI Horizon knows commercial real estate. With over 30 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 42 other countries, with more than 300 offices and more than 5,100 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 interests.

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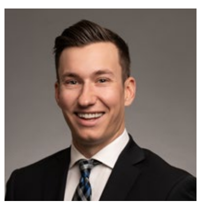

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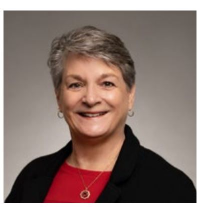

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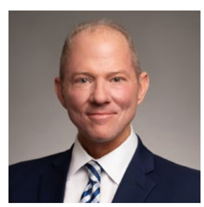

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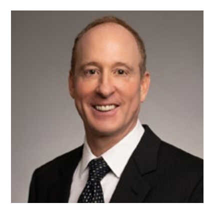

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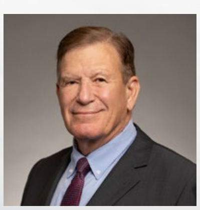

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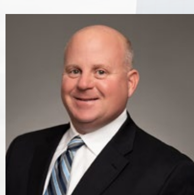

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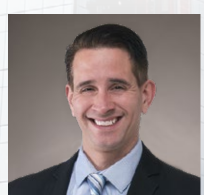

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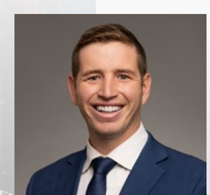

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