MARKET REPORT

Office

Phoenix Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

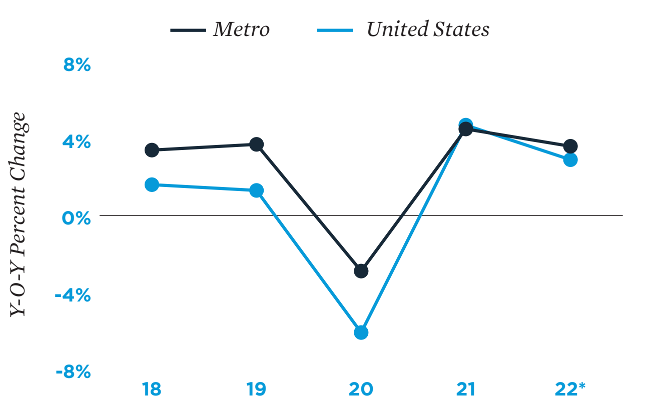
2Q/22

Phoenix Emerges with Fortified Labor Force; Vacancy Tightening in Key Suburban Locales

Preference shift aids high-rent submarkets. Performance among the metro's higher-end spaces and most desirable office hubs is improving. Firms committed to physical workplaces have shifted preferences to favor increased amenities and well-located complexes near retailers, as a means of enticing workers back to in-person operations. The metro's highest cost submarkets, East Phoenix and Scottsdale, recorded vacancy retreats of at least 190 basis points year-over-year in March. Both submarkets also registered positive net absorption in the Class A segment during that same period. In East Phoenix, the section of Camelback Road in the Biltmore area has seen strong leasing to start the year, while in Scottsdale the majority of deals have been inked near the Scottsdale Airpark. These movements highlight a flight-to-quality among firms, indicating the beginning stages of a more broad-based recovery to come.

Established firms expand and new entrants ink deals. Some of the state's most prominent firms are expanding operations in the metro. Despite recent staff reductions, Carvana has taken on an additional 130,000 square feet in Tempe, joining Opendoor in expanding its East Valley presence during the health crisis. Grubhub, DoorDash and Moov Technologies also announced leases in the East Valley, where vacancy was 120 basis points below the metro average in March. High profile leasing, competitive rental rates and expanded trade activity at Phoenix-Mesa Gateway Airport suggest the area will also remain an inviting option for both national and local firms.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

80,000 JOBS *will be created*

EMPLOYMENT:

This year's employment gain is slightly lower than 2021's advancement. However, with job counts ahead of pre-pandemic levels already and unemployment below 3 percent, this level of labor growth is a positive sign for office-use moving forward.

1,460,000 SQ. FT. *will be completed*

CONSTRUCTION:

Developers are projected to expand inventory by 0.9 percent this year. This slowdown in construction is welcome news for owners of existing assets, as more than 2 million square feet finalized in Phoenix in each of the last three years.

0 BASIS POINT *change in vacancy*

VACANCY:

Vacancy is set to remain flat on an annual basis, following a 30-basis-point climb in the first quarter of 2022. Net absorption was positive in three of the four quarters of 2021, suggesting demand will outpace supply before the end of 2022.

1.5% INCREASE *in asking rent*

RENT:

After posting a decrease for the first time since 2012 last year, the average asking rent will regain its positive trajectory in 2022, rising to $25.30 per square foot. The mean marketed rate has grown 4.1 percent since the onset of COVID-19.

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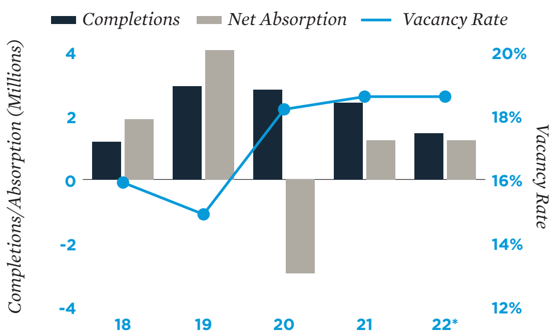
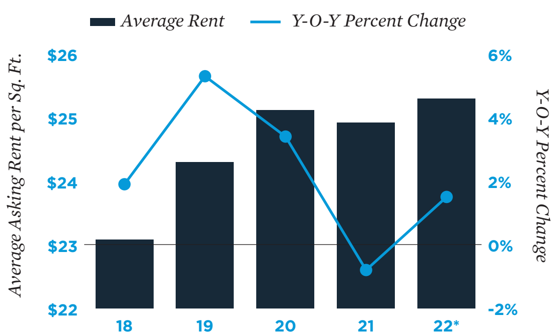
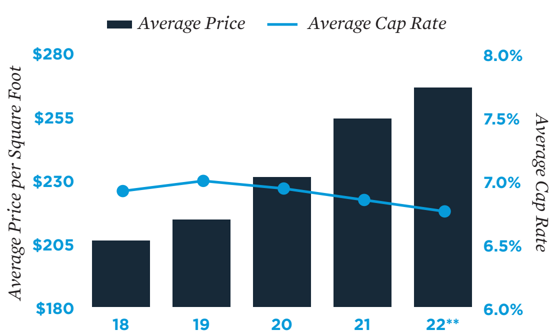
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

1Q 2022 - 12-Month Period

CONSTRUCTION

895,000 sq. ft. completed

- Builders have roughly 1.6 million square feet in the pipeline as of April, suggesting annual completion totals will rise in the near term.
- Much of the construction underway is speculative, highlighted by the Scottsdale Entrada and The Beam on Farmer in Tempe. Both properties are scheduled for completion this year and have available space.

VACANCY

20 basis point increase in vacancy Y-O-Y

- Retreating availability in Scottsdale and East Phoenix failed to overcome the metrowide impact of the omicron variant, resulting in a 30-basis-point vacancy rise in the first quarter, bringing the rate to 18.9 percent in March.
- West Valley has one of the lowest vacancy rates in the metro at 7.0 percent. Lower rents have attracted smaller firms into Class B/C space here.

RENT

0.4% increase in the average asking rent Y-O-Y

- Tighter conditions in the metro's highest-cost submarkets contribute to the average marketed rent climbing to $25.11 per square foot in March.
- A 10 percent rise in the average asking rent in the Scottsdale submarket is largely responsible for the positive movement to the overall rate. Asking rents in the core decreased in the past 12 months, albeit slightly.

Investment Highlights

- Sales velocity has never been higher for Phoenix office assets. Institutional activity is more robust than it was prior to the pandemic, with this type of investor making up a sizable portion of the transactions involving assets larger than 100,000 square feet. This boost, along with an increase in activity here across property subsectors, resulted in more office sales occurring in Phoenix than in all but two primary markets. This has lifted mean per-square-foot pricing to $266, and eased the average cap rate to 6.8 percent.
- The recent announcements in North Phoenix by Taiwan Semiconductor Manufacturing Company adds excitement to the area, as it joins Mayo Clinic in the locale. High level manufacturing and medical research in the area will create supplemental demand for office space in the coming years.
- The industrial boom along Interstate 10 in West Phoenix has likely aided local vacancy, which sits at 7.0 percent in the submarket, 110 basis points below the pre-pandemic rate. These office assets have been popular with in-state buyers and investors looking to pay near the metro average in entry costs, with cap rates in the mid-6 percent range most often. Northwest Phoenix and parts of East Valley, like Mesa and the Superstition Corridor, also provide investors with lower-cost options.

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