MARKET REPORT

OFFICE

Phoenix Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

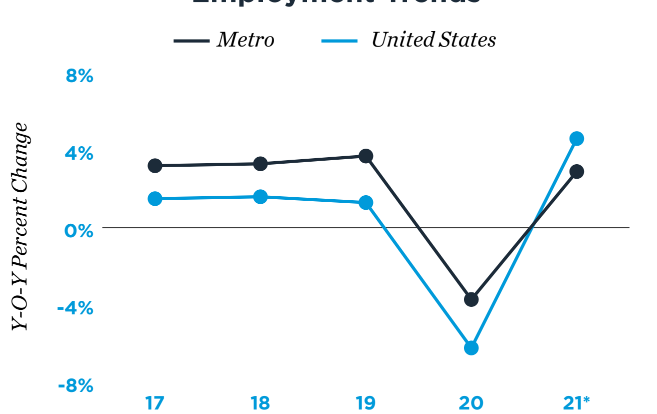
2Q/21

Return of Positive Absorption, Unwavering Net Migration Bolster Office Prospects

Class A leasing and company relocations fuel improvement. Influenced by economic volatility and remote work arrangements, a number of Phoenix office tenants reduced their footprints over the past year. These decisions heightened the volume of lease expirations and sublet space on the market, placing vacancy at its highest point in more than five years. Nonetheless, signs of recovery have emerged. During the first quarter of 2021, the metro registered positive absorption and the number of lease executions rose by 10 percent when compared with the same period last year. Class A leasing activity in Phoenix's largest submarkets and commitments by corporate tenants as well as relocating West Coast startups helped to boost recent performance. Alliance Bank of Arizona inked two leases totaling 165,000 square feet in downtown Phoenix early this year while California-based firms Align Technology, Robinhood and RadNet Inc. each agreed to occupy more than 20,000 square feet in Tempe or the Airport Area.

Population gains bolster office outlook. Phoenix was the top U.S. metro for net migration in 2020. A growing labor pool and the market's business-friendly environment are positioned to support company relocations moving forward. An increase in available talent may also motivate growing companies with an existing footprint to bolster local staffs after returning to in-person work. These circumstances may represent a boon for properties undergoing a rebrand or renovation following major vacancies, while net migration should also bolster demand for medical office space.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.; U.S. Census Bureau

Office 2021 Outlook

62,000 JOBS
will be created

EMPLOYMENT:

Phoenix will recover more than three-fourths of the 80,900 positions lost during 2020, equating to employment growth of 2.9 percent this year. Traditional office-using firms are expected to expand staff counts by 12,600 professionals in 2021.

2,070,000 SQ. FT.
will be completed

CONSTRUCTION:

Completions slightly trail the 2.1 million square feet finalized in 2020. Still, office stock will grow by more than 1.0 percent for a third straight year. A 460,000-square-foot property largely occupied by Nationwide Insurance represents the largest 2021 delivery.

50 BASIS POINT
increase in vacancy

VACANCY:

Deliveries outpace positive absorption, elevating vacancy to 18.3 percent, a rate last recorded in 2015. While office availability rises, Phoenix records the smallest vacancy increase among Mountain metros after registering a 300-basis-point spike last year.

0.1% INCREASE
in asking rent

RENT:

Positive absorption and a high volume of Class A space on the leasing market will push average rent upward for a ninth consecutive year. While nominal, the year's gain will nudge the metro's mean marketed rate up to $24.74 per square foot.

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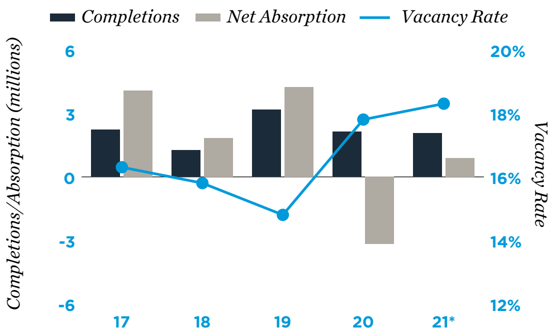
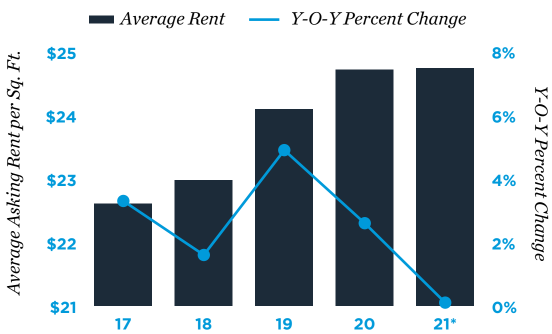
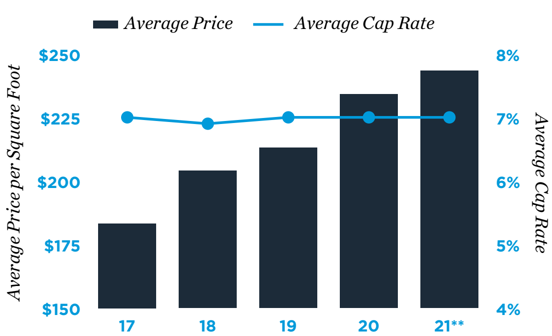
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

IPA Office

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1Q21—12-Month Period

CONSTRUCTION

2,506,000 square feet completed

- Driven by supply additions in Scottsdale and East Valley, office inventory grew by 1.5 percent over the past four quarters ending in March. During the prior year, developers completed 3.4 million square feet.
- As of May, construction was underway on 2.1 million square feet of space with completion dates extending into 2022.

VACANCY

310 basis point increase in vacancy Y-O-Y

- Phoenix's vacant stock grew by 5.6 million square feet over the past year, pushing availability up to 18.4 percent. All submarkets with inventories of 20 million square feet or more posted 200-basis-point-plus increases.
- Class A vacancy elevated 520 basis points to 22.3 percent, while Class B/C availability climbed 200 basis points to 16.3 percent.

RENT

0.2% increase in the average asking rent Y-O-Y

- Average rent in both the Class A and B/C segments adjusted by less than 1.0 percent during the past 12 months, lifting the overall marketed rate slightly to $24.69 per square foot.
- Aided by a vacancy rate 400 basis points below the metro average, the East Valley noted a 3.0 percent increase in average asking rent.

Investment Highlights

- During the past six months ending in March, sales activity reached its strongest point since 2007 as pent-up demand for listings was released after investors gained greater clarity on pricing and office fundamentals. Still, transaction velocity over the past year dropped 5 percent, hindered by a lull in deal flow from April through September of 2020.
- Phoenix recorded a nearly 12 percent increase in pricing over the past 12 months, one of the largest gains among major U.S. office markets. The high volume of post-2000-built Class B trades pushed the metro's average up to $243 per square foot. Despite this pricing elevation the average cap rate was unchanged at 7 percent.
- Since last April, out-of-state buyers have accounted for 40 percent of total deal flow. Attracted by Phoenix's growth prospects, these investors are acquiring Class A and B assets in the metro's largest submarkets of Scottsdale and the East Valley, accepting returns in the 6 percent range.
- Population gains fueled strong investor demand for medical office assets over the past year, translating to a 4 percent rise in annual sales activity and a 16 percent boost in average pricing. Buyers are targeting the East Valley, Northwest Phoenix and other areas of residential expansion.