

Savills Studley Report Phoenix office sector

Q3 2017



SUMMARY

Market Highlights

LEASING BELOW AVERAGE

Tenants have leased 7.9 msf in the last four quarters, well under the long-term average of 9.8 msf.

AVAILABILITY RATE FALLS *

The overall availability rate, 18.2%, fell by 40 basis points during the third quarter. The Class A availability rate fell by 90 basis points to 18.2%.

RENT UP SLIGHTLY

Phoenix's overall average asking rent was essentially unchanged, inching up by 0.3% to \$24.61. The Class A rate, \$28.31, dipped by 0.2% in the quarter, but has jumped by 4.2% year-on-year

SALES UP FROM A YEAR AGO

Year-to-date property sales (through July) total \$1.3 billion – a 53% increase from the first seven months of 2016.

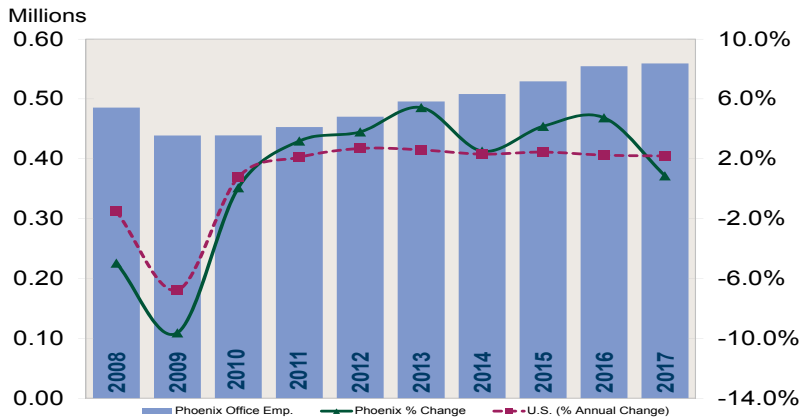
*Availability includes all vacant space as well as space marketed for lease with future occupancy in existing properties as well as those under construction.

.....
"Rental rates continues to inch up slightly in the most sought after sections of the market. Hiring and leasing activity has lost a step of late, though. There are few signs that a pullback is imminent, but demand drivers seem to be cooling."

Tiffany Winne,
Executive Vice President

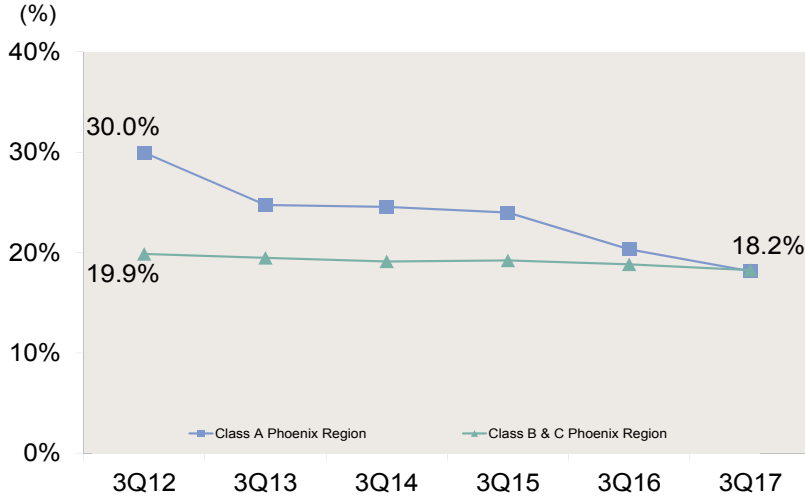
.....

Office-Using Employment Trends

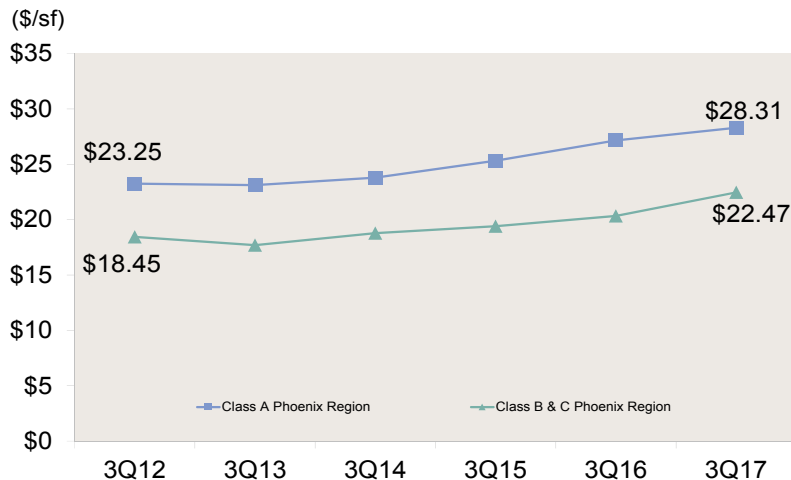


Source: Bureau of Labor Statistics

Availability Rate Trends



Asking Rent Trends



Market Moving in Different Directions

It is difficult to say for certain how much longer this recovery will carry on in the Phoenix region. Key indicators have been sending mixed signals all year—leasing and hiring have both slowed during 2017. Development of new office product appears to have peaked. On the other hand, investors continue to expand their holdings and rental rate growth has been persistent in several submarkets.

Labor Market Lull

Phoenix is still benefitting from a fair number of corporate relocations, but the blockbuster announcements involving the hiring of hundreds of employees have become more infrequent. The core industries that really drive demand for office space have registered weaker gains. Office-using employment slipped to less than 1.0% in the last 12 months (through July 2017) a big dropoff from the 4.8% in the prior 12 months and 4.0% in 12 months before that. The recovery may be losing strength or the region may be dealing with a deficiency in terms of the skilled labor that companies need the most. Top tech firms such as Amazon, Google and Facebook are still pursuing talent in multiple cities, but they have been most active in markets such as Seattle, Atlanta and Denver.

Tenant Activity Slowing

Leasing activity, like job growth, has moderated in recent quarters. Tenants leased 7.9 msf in the last four quarters, well under the long-term annual pace of 9.8 msf. Velocity has slowed. The highest-quality amenity-rich Class A buildings in prime locations have garnered the strongest interest. Conditions remain tight in a few areas – particularly newer buildings clustered along Highway 101/Loop. Even in these buildings, though, it is taking longer to get leases completed.

Investors More Bullish

Investors, on the other hand, seem quite sanguine about Phoenix's prospects for growth. They can find quite a bit of value in this market. Excluding the very highest-caliber properties in Old Scottsdale and Tempe, most properties are selling for less than \$300/sf. More investors, not just local players and West Coast buyers, are expanding their presence. Earlier this summer, for example, Goldman Sachs paid \$81.7 million (\$277/sf) for 3131 and

3133 Camelback. Additionally, New York City-based Gramercy Property Trust and Austin, Texas investor TPG Real Estate acquired Nexus @ ASU Research Park for \$27.6 million (\$222.83/sf).

Buyers are attracted to higher yields and a market that appears to have some upside in terms of rental rate growth. Asking rent has been rising, and increased by 6.6% to \$28.31 in Class A buildings over the last year. Cap rates are 150 to 300 basis points higher than in gateway markets such as Manhattan or Los Angeles.

Developers Still Hedging Bets

Developers on the other hand are operating more cautiously. This cycle has been much more measured in terms of development. Construction volume is well below the long-term trend, a key reason that the drawdown in excess space has been strong in many submarkets. For the most part, developers and lenders have adhered to a cautious approach, building only if they secure anchor tenants. A handful of speculative developments have popped up in recent quarters, but they are limited in scale or landlords are building mixed-use projects. Camelback Collective, for example, a joint venture between Holualoa Companies and LaPour Partners will feature 118,090-sf of office space and a 160-room hotel.

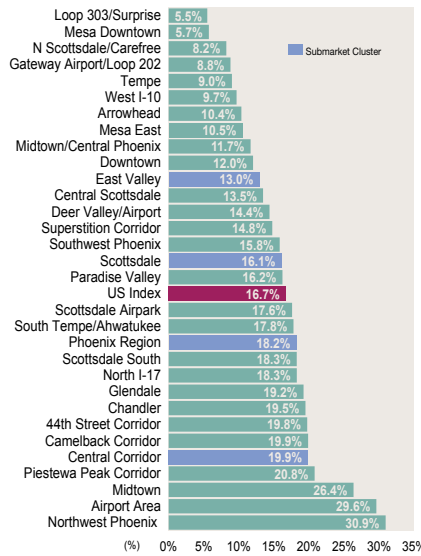
Construction has probably peaked for this cycle. During 2015, 3.2 msf delivered. The total fell to 2.5 msf in 2016. As of September, 1.6 msf had delivered, with another 1.5 msf underway - 55.4% of it pre-leased. Comparing the region to other high-growth Sunbelt markets, Phoenix ranks nearly last in terms of construction.

A few owners are repositioning obsolete buildings. These developers are responding to a gap in the market – tenants can still find plenty of traditional corporate office space available, but the availability of tech/creative office space is relatively low. Retrofitting an industrial or loft property into a cool creative office space is not a cheap undertaking – it is costly to black or white out a ceiling. Sound abatements can be costly. Finally, tech firms, particularly those with ample funds to spend, have a taste for interesting and often expensive furniture.

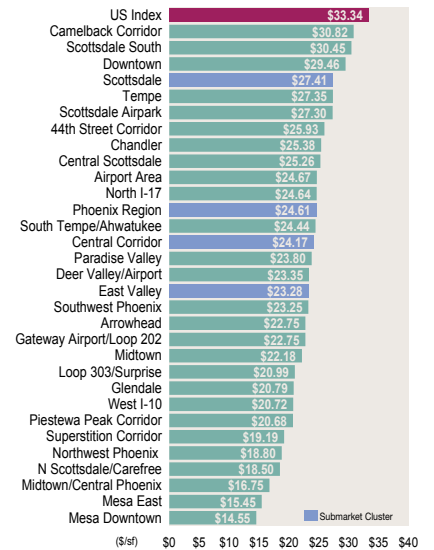
Availability Levels Vary Widely

Construction activity has not gotten out of hand, in part because landlords realize that while conditions are tight in a handful of areas, the region as a whole still has a

Availability Rate Comparison



Overall Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
MUFG Union Bank	173,055	1101 W Washington St	Tempe
Consumer Cellular	165,107	17500 N Black Canyon Hwy	Deer Valley/Airport
Wells Fargo	81,896	2501 S Price Rd	Chandler
Centene	75,211	1665 W Alameda Dr	Tempe
Stantec	55,000	3111 W Frye Rd	Chandler
Varsity Tutors	49,505	2120 E Rio Salado Pky	Tempe
Uber	42,866	201 E Washington St	Downtown
US Army Corps of Engineers	28,500	3636 N Central Ave	Midtown
North Central University	27,990	8667-8701 E Hartford Dr	Scottsdale/Airpark
Benchmark Electronics	27,323	4141 N Scottsdale Rd	Scottsdale South
Sum of Top Leases	726,453		

lot of opportunity for tenants particularly companies looking for value-plays. Old Scottsdale and Downtown Tempe have sub-10% vacancy rates for the highest-quality product and options have tightened in much of the East Valley. That still leaves a lot of territory in North and West with availability exceeding 25%. Additionally, while it has captured some significant leases of late, Central Corridor is far from tight.

As rent in the most high-end buildings exceeds \$40/sf, the market is seeing more differentiation emerge from one submarket to the next. Landlords are still competing with each other for the most creditworthy tenants in most of the market. Landlords will roll out extensive concessions on the Corridor. Midtown still has a lot of big blocks of A- second generation space. Southeast Phoenix has multiple areas – Mesa, Gilbert and Chandler – that offer both existing product and new speculative development

Looking Forward

The region may be at a tipping point for rents. Sticker shock is curbing growing footprints. Moderate rental growth could continue for a few more quarters, particularly in the highest-caliber properties, but price resistance is increasing. Additionally, the market is very dependent on continued movement of out-of-market firms. As we head into the second half of 2018, rental rate growth is likely to lose momentum.

Local labor markets could rebound in the second half of the year. Several employers have recently announced plans for major hiring initiatives, but most forecasts are projecting sub-3.0% growth. The Arizona Office of Economic Opportunity for example, is forecasting 2.8% overall employment growth for Phoenix.

Submarket	Total		Available SF			Availability Rate			Asking Rents Per SF		
	Inventory SF (1000's)	Leasing (Last 12 months)	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. (1)	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
Airport Area	9,190	248	2,721	-0.2%	2,813	29.6%	-0.1%	30.6%	\$24.67	0.0%	\$22.23
Airport Area - Class A	1,642	12	467	-1.6%	448	28.5%	-0.5%	27.3%	\$26.52	-0.4%	\$25.80
South Tempe/Ahwatukee	5,663	302	1,008	-2.6%	1,304	17.8%	-0.5%	23.0%	\$24.44	2.3%	\$21.11
South Tempe/Ahwatukee - Class A	776	11	20	-28.7%	109	2.5%	-1.0%	14.1%	\$28.44	10.0%	\$24.99
Downtown	8,528	420	1,026	-15.9%	1,092	12.0%	-2.3%	12.8%	\$29.46	0.7%	\$25.56
Downtown - Class A	4,641	304	653	-14.0%	703	14.1%	-2.3%	15.1%	\$30.23	0.3%	\$27.26
Midtown	10,345	615	2,726	-0.4%	2,747	26.4%	-0.1%	26.6%	\$22.18	0.4%	\$21.21
Midtown - Class A	4,576	177	1,266	3.1%	1,200	27.7%	0.8%	26.2%	\$24.61	-0.1%	\$23.54
44th Street Corridor	3,040	197	600	-4.3%	614	19.8%	-0.9%	20.2%	\$25.93	1.9%	\$23.28
44th Street Corridor - Class A	1,715	110	340	-7.2%	405	19.8%	N/A	N/A	\$26.80	2.6%	\$25.87
Camelback Corridor	8,317	707	1,653	6.8%	1,943	19.9%	1.3%	23.4%	\$30.82	1.4%	\$28.09
Camelback Corridor - A	4,652	451	1,041	4.8%	1,236	22.4%	1.0%	26.6%	\$34.12	2.4%	\$32.09
Midtown/Central Phoenix	2,754	175	322	10.5%	423	11.7%	1.1%	15.4%	\$16.75	2.2%	\$17.33
Midtown/Central Phoenix - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Chandler	6,439	0	1,256	-9.1%	1,627	19.5%	-2.0%	25.3%	\$25.38	-0.9%	\$23.93
Chandler - Class A	2,109	73	244	-33.9%	341	11.6%	-5.9%	16.2%	\$27.85	0.8%	\$28.13
Gateway Airport/Loop 202	733	148	65	-3.7%	105	8.8%	-0.3%	14.4%	\$22.75	-3.8%	\$24.38
Gateway Airport/Loop 202 - Class A	0	519	0	0.0%	0	N/A	N/A	N/A	N/A	N/A	\$27.36
Mesa Downtown	898	0	51	11.6%	109	5.7%	0.6%	12.1%	\$14.55	0.8%	\$15.10
Mesa Downtown - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Mesa East	971	42	102	-4.8%	131	10.5%	-0.5%	13.5%	\$15.45	3.2%	\$17.19
Mesa East - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Superstition Corridor	3,772	27	557	-4.0%	728	14.8%	-0.6%	19.3%	\$19.19	0.8%	\$19.34
Superstition Corridor - Class A	574	0	167	4.1%	147	29.1%	1.1%	25.6%	\$23.28	0.5%	\$23.25
Tempe	9,422	54	850	-23.7%	1,423	9.0%	-2.8%	15.1%	\$27.35	-6.2%	\$24.96
Tempe - Class A	5,413	0	306	-44.9%	888	5.7%	-4.6%	16.4%	\$34.03	0.2%	\$29.94
N Phoenix/Cave Creek	22	0	0	0.0%	0	0.0%	0.0%	0.0%	N/A	N/A	\$20.95
N Phoenix/Cave Creek - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Paradise Valley	2,844	34	461	-0.3%	486	16.2%	0.0%	17.1%	\$23.80	2.3%	\$22.21
Paradise Valley - Class A	1,304	201	251	0.7%	249	19.2%	0.1%	19.1%	\$27.89	2.4%	\$25.95
Piestewa Peak Corridor	2,258	597	470	-4.3%	536	20.8%	-0.9%	23.7%	\$20.68	5.2%	\$18.84
Piestewa Peak Corridor - Class A	287	262	17	0.0%	15	5.8%	0.0%	5.1%	\$26.50	0.0%	\$24.51
Northwest Phoenix	7,231	0	2,236	6.9%	2,099	30.9%	2.0%	29.0%	\$18.80	3.0%	\$17.17
Northwest Phoenix - Class A	1,160	0	663	38.1%	478	57.2%	15.8%	41.2%	\$22.58	3.2%	\$21.91
Arrowhead	1,611	110	167	-10.3%	220	10.4%	-1.2%	13.6%	\$22.75	1.6%	\$22.09
Arrowhead - Class A	81	97	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Deer Valley/Airport	7,935	17	1,141	3.0%	1,588	14.4%	0.4%	20.0%	\$23.35	-0.5%	\$22.70
Deer Valley/Airport - Class A	2,025	185	251	2.5%	397	12.4%	0.3%	19.6%	\$25.78	0.0%	\$25.97
North I-17	401	18	73	0.9%	113	18.3%	0.2%	28.2%	\$24.64	-0.6%	\$22.67
North I-17 - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Central Scottsdale	6,302	132	848	1.1%	1,031	13.5%	0.1%	16.4%	\$25.26	-0.5%	\$22.69
Central Scottsdale - Class A	2,327	411	298	5.0%	379	12.8%	0.6%	16.3%	\$27.75	-3.5%	\$25.09
N Scottsdale/Carefree	1,245	100	102	9.4%	316	8.2%	0.7%	25.4%	\$18.50	2.8%	\$20.92
N Scottsdale/Carefree - A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Scottsdale Airpark	10,174	10	1,790	-1.3%	1,731	17.6%	-0.2%	17.0%	\$27.30	0.5%	\$25.73
Scottsdale Airpark - Class A	5,803	0	1,209	-3.9%	1,116	20.8%	-0.9%	19.2%	\$28.82	1.0%	\$27.61
Scottsdale South	5,143	410	939	-10.5%	764	18.3%	-2.1%	14.9%	\$30.45	1.4%	\$25.09
Scottsdale South - Class A	2,265	117	365	-20.8%	360	16.1%	-4.2%	15.9%	\$32.19	1.9%	\$29.47
Glendale	1,832	959	352	-5.0%	441	19.2%	-1.0%	24.1%	\$20.79	-4.2%	\$22.55
Glendale - Class A	293	557	27	-32.1%	7	9.2%	-4.3%	2.2%	\$24.31	-0.4%	\$28.00
Loop 303/Surprise	555	345	31	-11.8%	51	5.5%	-0.7%	9.2%	\$20.99	1.3%	\$23.33
Loop 303/Surprise - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Southwest Phoenix	1,718	180	272	0.0%	292	15.8%	0.0%	17.0%	\$23.25	3.6%	\$20.29
Southwest Phoenix - Class A	917	165	142	0.0%	174	15.5%	0.0%	19.0%	\$26.00	4.0%	\$23.00
West I-10	869	0	84	13.9%	106	9.7%	0.0%	12.2%	\$20.72	-3.8%	\$22.97
West I-10 - Class A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Central Corridor	18,873	1,294	3,753	-5.2%	3,839	19.9%	-1.1%	20.3%	\$24.17	-0.5%	\$22.45
Central Corridor - Class A	9,217	2,786	1,919	-3.5%	1,902	20.8%	-0.7%	20.6%	\$26.52	-0.8%	\$24.92
East Valley	22,234	1,489	2,882	-12.6%	4,123	13.0%	-1.9%	18.5%	\$23.28	-6.1%	\$22.69
East Valley - Class A	8,096	1,578	718	-33.9%	1,375	8.9%	-4.5%	17.0%	\$30.23	-4.2%	\$28.41
Scottsdale	22,864	683	3,680	-3.1%	3,843	16.1%	-0.5%	16.8%	\$27.41	0.8%	\$24.35
Scottsdale - Class A	10,395	727	1,871	-6.5%	1,854	18.0%	-1.3%	17.8%	\$29.27	0.0%	\$27.70
Phoenix Region	120,211	7,961	21,906	-2.4%	23,278	18.2%	-0.4%	19.4%	\$24.61	0.3%	\$22.55
Phoenix Region - Class A	42,560	3,226	7,727	-4.7%	8,652	18.2%	-0.9%	20.3%	\$28.31	-0.2%	\$27.16

Please contact us for further information

Savills Studley
 Anchor Centre East
 2231 E. Camelback Road
 Suite 209
 Phoenix, AZ 85016
 (602) 783-1610

Office Contact
 Tiffany Winne
 EVP, Designated Broker
 twinne@savills-studley.com
 (602) 402-6068

Corporate Research Contact
 Keith DeCoster - Director
 kdecoster@savills-studley.com
 (212) 326-1023

(1) Percentage point change for availability rates.

Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf. Statistics are calculated using both direct and sublease information.

The information in this report is obtained from sources deemed reliable, but no representation is made as to the accuracy thereof. Statistics compiled with the support of The CoStar Group. Copyright © 2017 Savills Studley