1Q24

Phoenix Office Market Overview


NEWMARK

Market Observations

Economy

- Phoenix's labor market remains strong, with a 3.3% unemployment rate in February, 90 basis points lower than the national average.
- Education and health services led local job gains over the past 12 months, with information and manufacturing seeing the biggest losses.
- Overall office-occupying employment is up 5.1% compared to pre-pandemic levels. The big question for the Metro is to what degree global layoffs at large tech firms, such as Google, Meta and Amazon, impact local jobs in 2024.

Market Fundamentals

- Office occupancy in the first quarter of 2024 contracted by 291,071 SF. Absorption losses are expected to slow but continue into 2024.
- Under-construction activity has trended down sharply since 2020. Hybrid work models and rising sublet availability are deterring developers from breaking ground.
- Vacancy and asking rents both increased year-over-year. Total vacancy grew to 24.7%, with only 252,578 SF of new product currently underway to come online during 2024.
- Sublease space entering the market has slowed down, with the transition from sublease availability to direct escalating. More direct-transitions are expected since many of the larger sublet offerings come to term in 2024 and 2025.

Major Transactions

- Larger tenants such as Amazon and Pulte Homes recommitted to current space or relocated to new space during the first quarter.
- Quarterly leasing volume was down by 5.2% quarter-over-quarter. Office activity remains stable but with most users reducing footprints as they adapt hybrid work models that demand less space, overall occupancy is negatively affected. While leasing activity is down compared to pre-pandemic totals, it is more stable relative to other metros in the Southwest region.
- Sales activity remains stronger among medical office compared to traditional office as medical office in Phoenix shows strong market fundamentals. Some landlords are beginning to feel pressure as loans come due and more distressed or bank-owned assets are expected to enter the market.

Outlook

- Uncertainty reigns in the macroeconomic outlook. Occupiers and investors alike will approach deals with greater caution as a result, which will impact leasing and sales activity.
- Market vacancy will increase further as lease expirations occur and tenants continue the trend of renewing and/or leasing at smaller footprints.
- Phoenix remains an attractive locale for both local and out-of-state office users due to its strong economic fundamentals in population growth, diversified economic sectors and a highly educated workforce.

TABLE OF CONTENTS

1. Economy
2. Market Fundamentals
3. Appendix

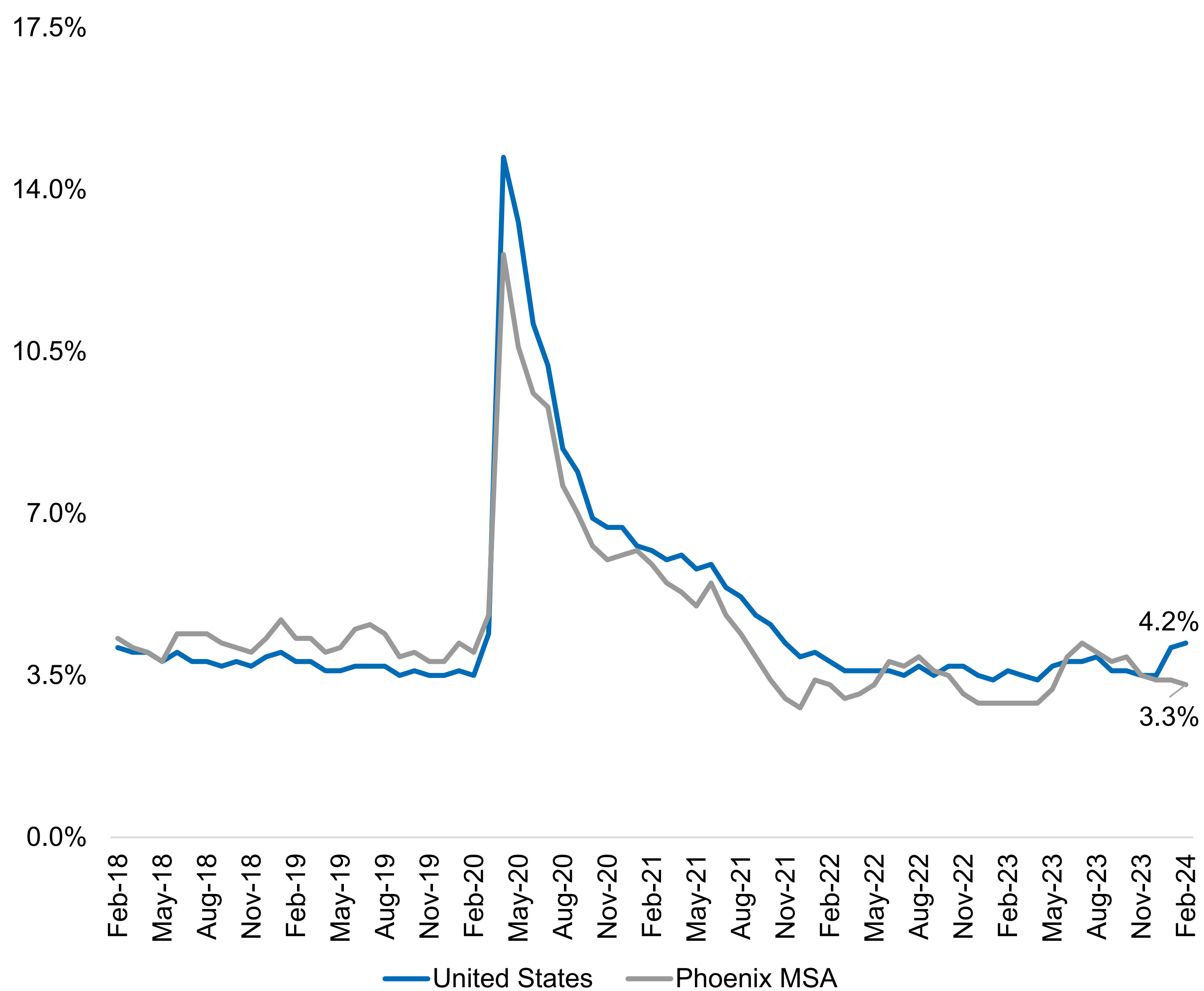
1Q24

Economy

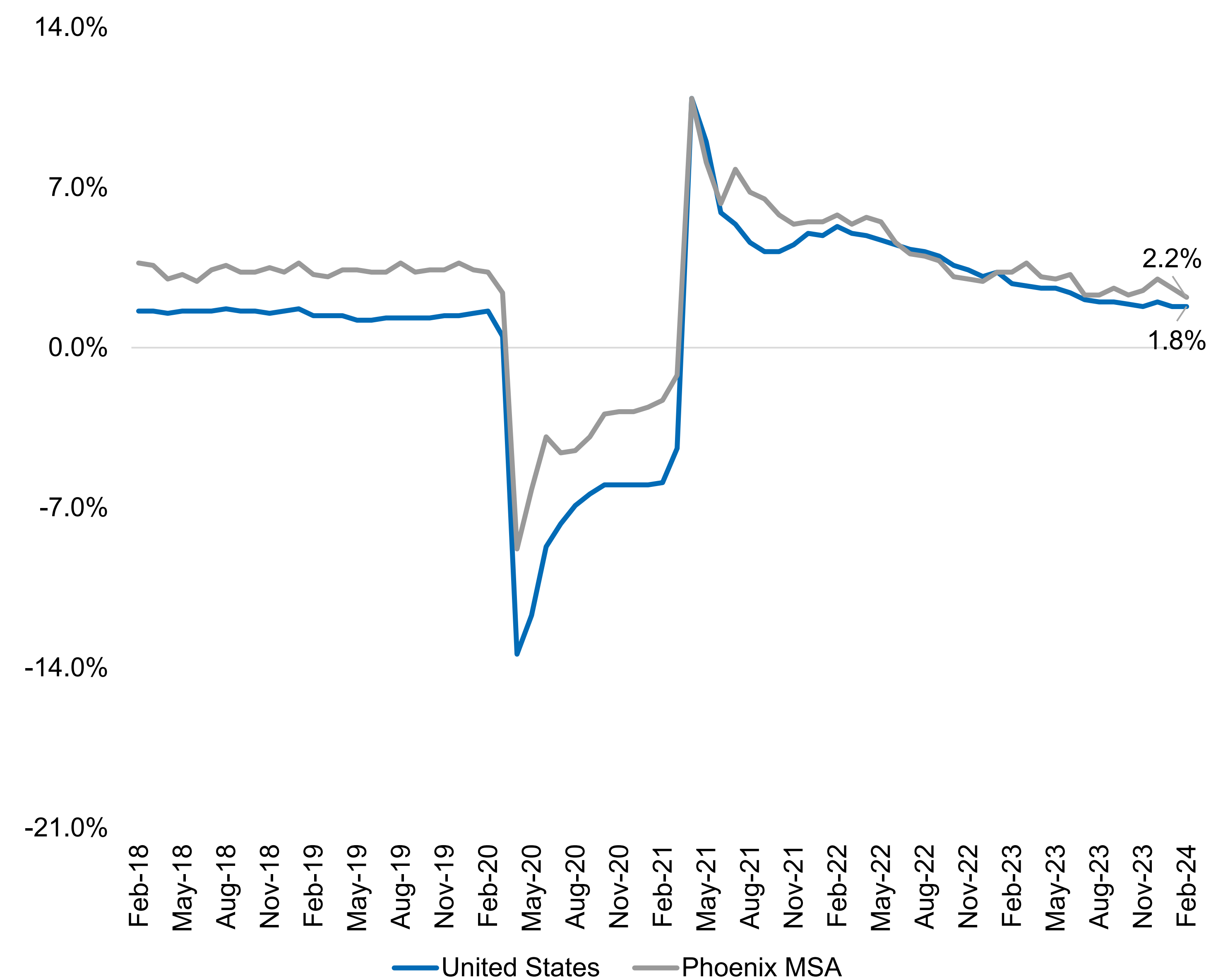
Phoenix’s Labor Market Sees Promising Growth and Employment Gains

Local unemployment continued to tighten and was 90 basis points under the national average in February. Overall local job growth has slowed but remains in the positive for now as companies adapt to softening economic conditions.

Unemployment Rate, Not Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change

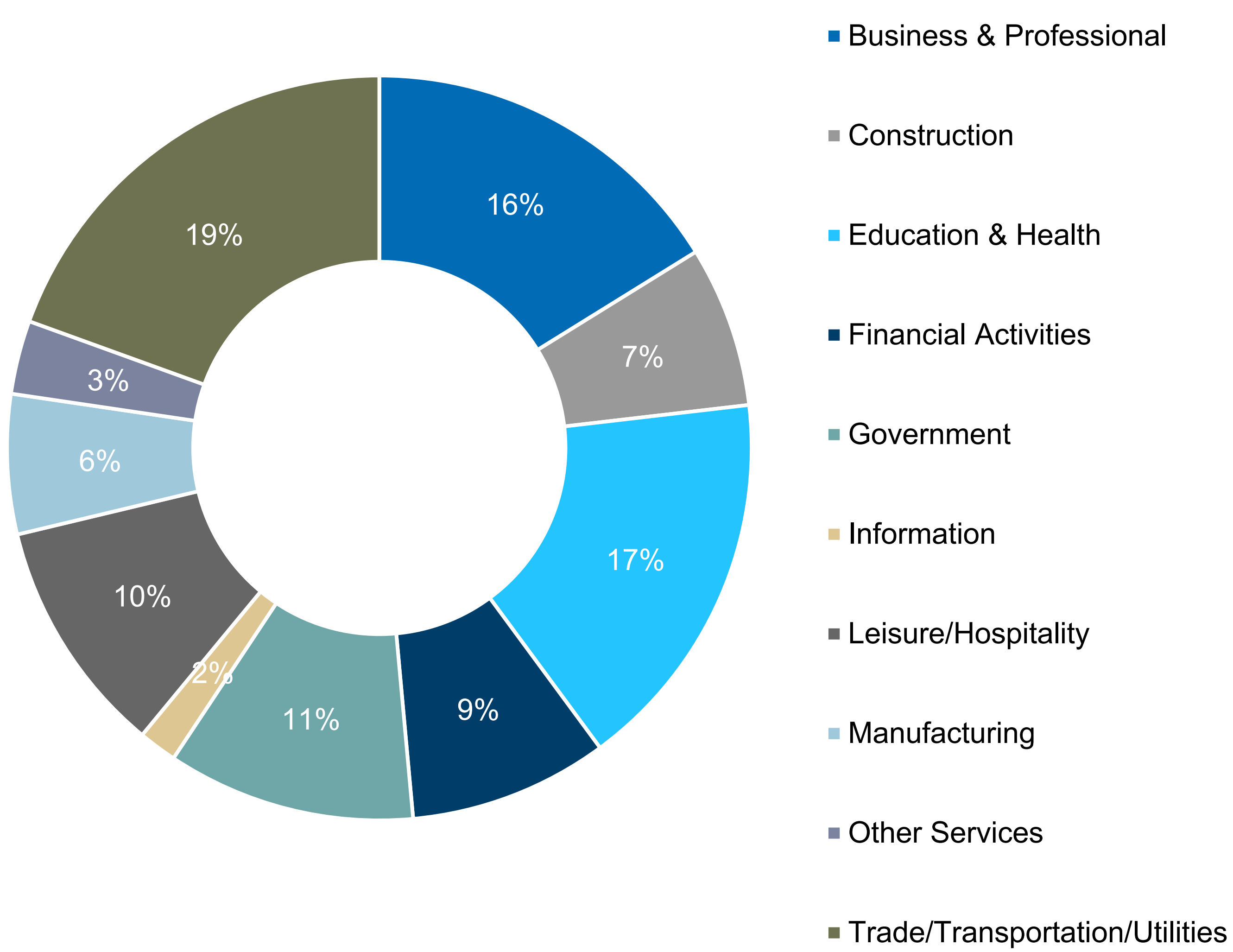


Source: U.S. Bureau of Labor Statistics, Phoenix MSA
Note: February 2024 data is preliminary.

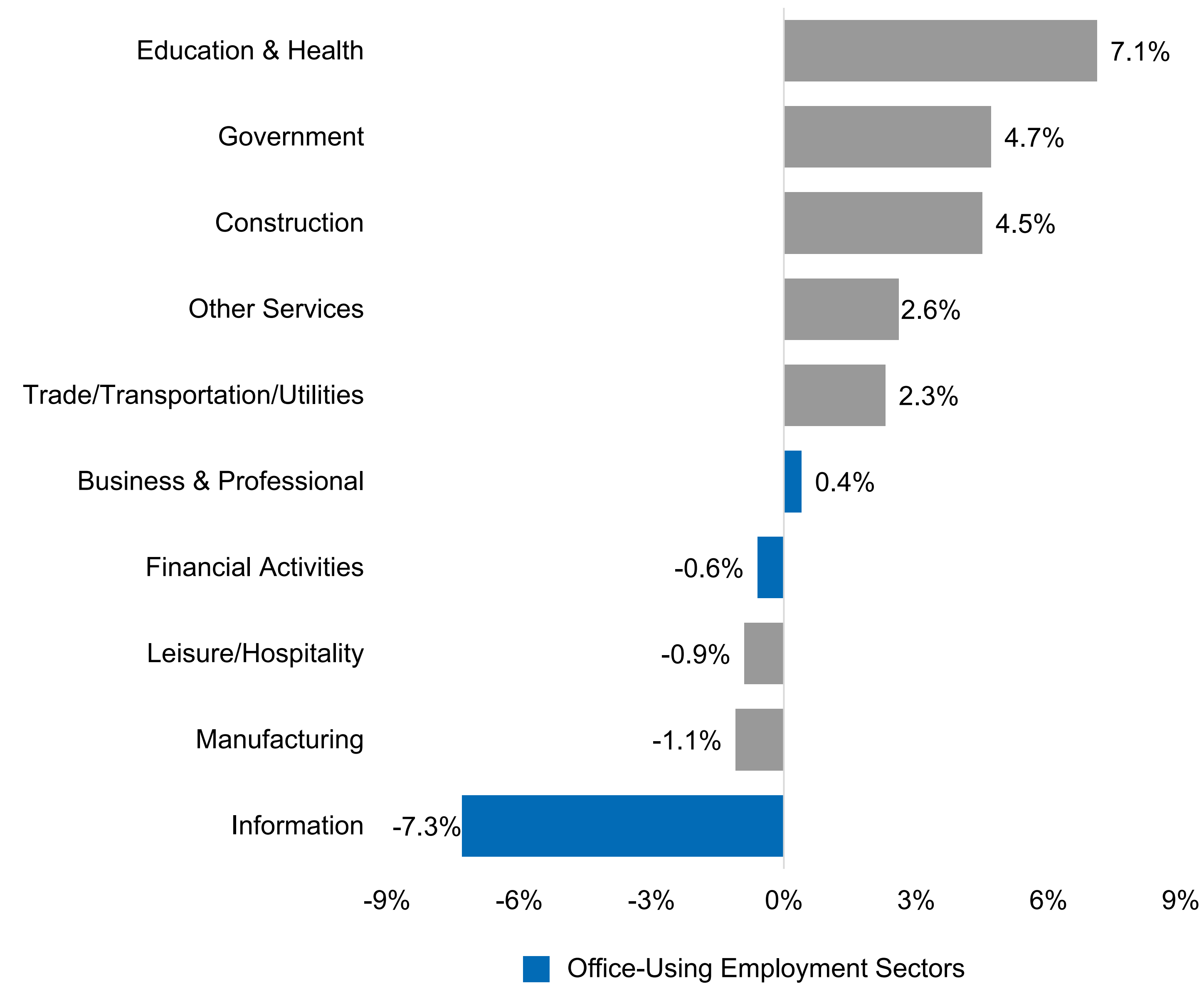
Job Growth Was Pronounced in Already Strong Employment Sectors

Education and health led all industries in annual job growth, followed closely by government and construction. Sizeable population growth in recent years supports the first two segments, while construction remains elevated on account of record high industrial development in the region. For office-occupying sectors: information contracted by 7.3% and financial activities by 0.6%; business and professional saw minimal gains at 0.4%.

Employment by Industry, February 2024



Employment Growth by Industry, 12-Month % Change, February 2024

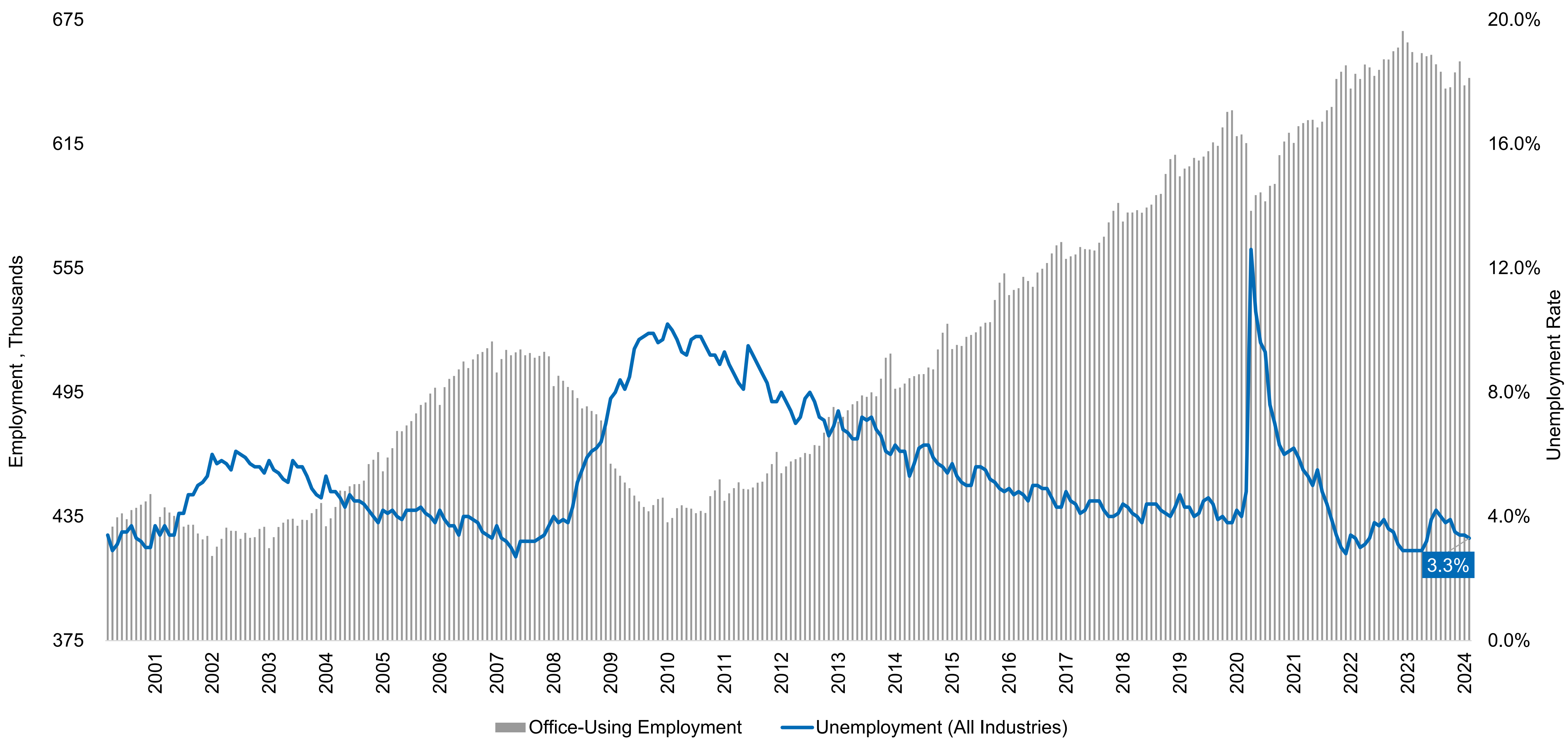


Source: U.S. Bureau of Labor Statistics, Phoenix MSA
Note: February 2024 data is preliminary.

Office-Using Employment Experiencing Losses But Still Stronger Than Prepandemic

Office-using employment remains 5.1% higher than the market's pre-pandemic total from February 2020. Although white-collar employment is healthy, there have been modest inclines and declines since December 2022 due to fluctuations in the financial activities and information sectors since the start of 2023.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Phoenix MSA
Note: February 2024 data is preliminary.
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

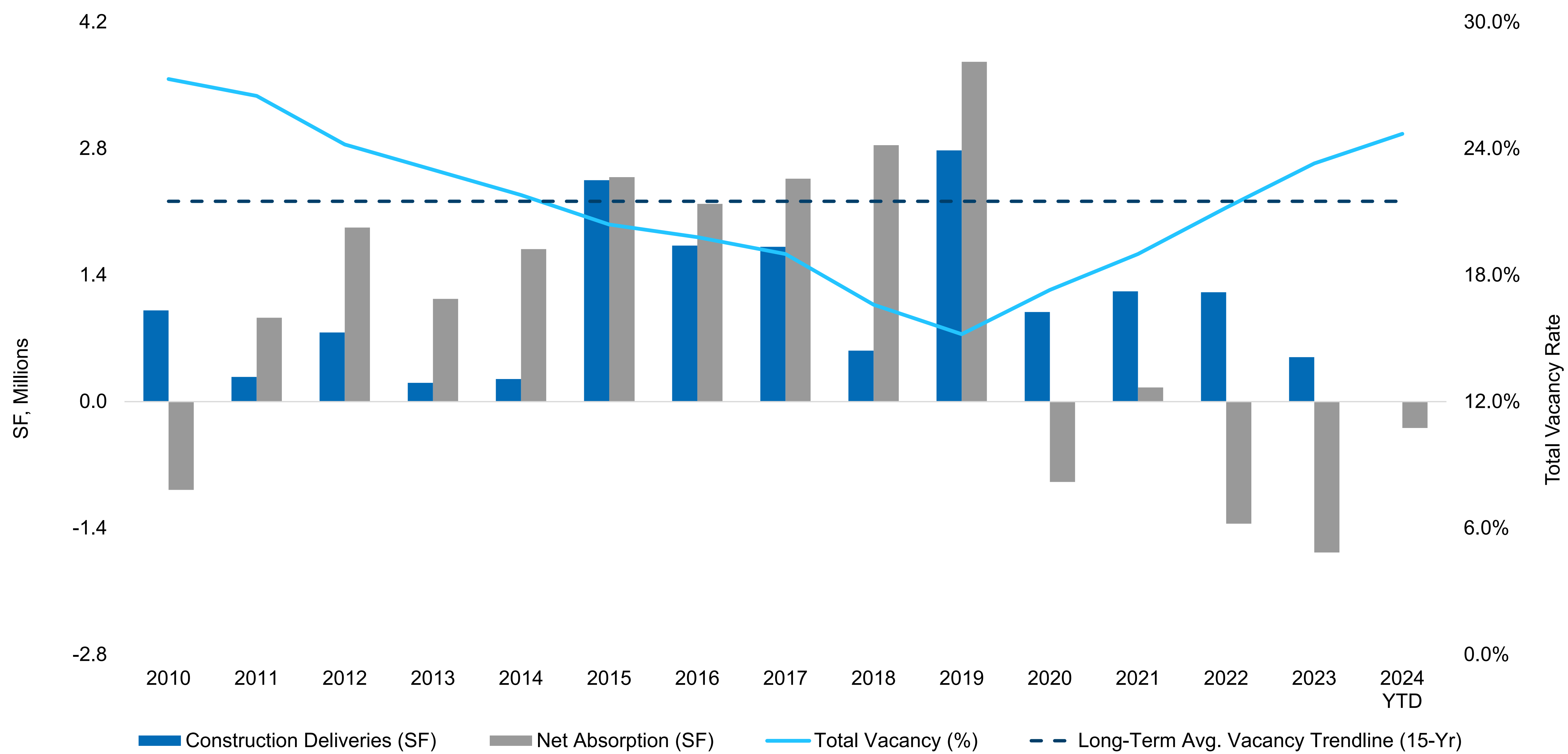
1Q24

Market Fundamentals

Vacancy Continued to Rise in the First Quarter of the 2024

Total vacancy was 24.7% at the end of the first quarter of 2024, 320 basis points higher than the 15-year average (21.5%). Space givebacks continued as office users contracted footprints via renewals and new leases. No new construction starts or deliveries occurred in the first quarter; overall vacancy will progressively level out as office construction slows.

Historical Construction Deliveries, Net Absorption, and Vacancy

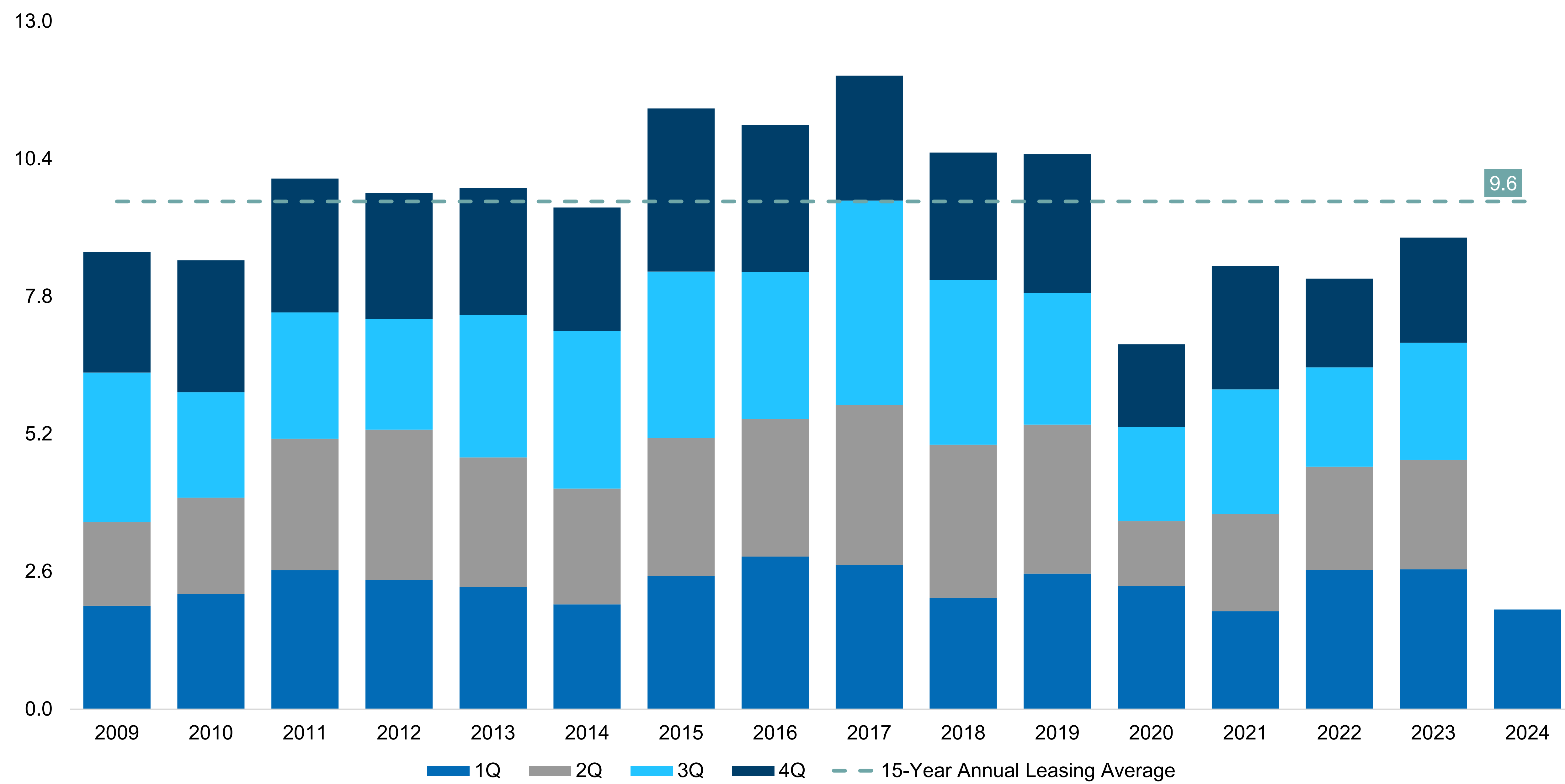


Source: Newmark Research

First Quarter Leasing Activity Sees a Slight Dip

While lowered activity may raise concerns, the number of deals closing and tenants active in the market remains strong. The biggest difference is the amount of space being leased in each deal – the average deal size from 2020 through 1Q24 was 12.8% smaller compared to 2016-2019. The number of deals closing for the same time frame only decreased by 4.8%.

Total Leasing Activity (MSF)

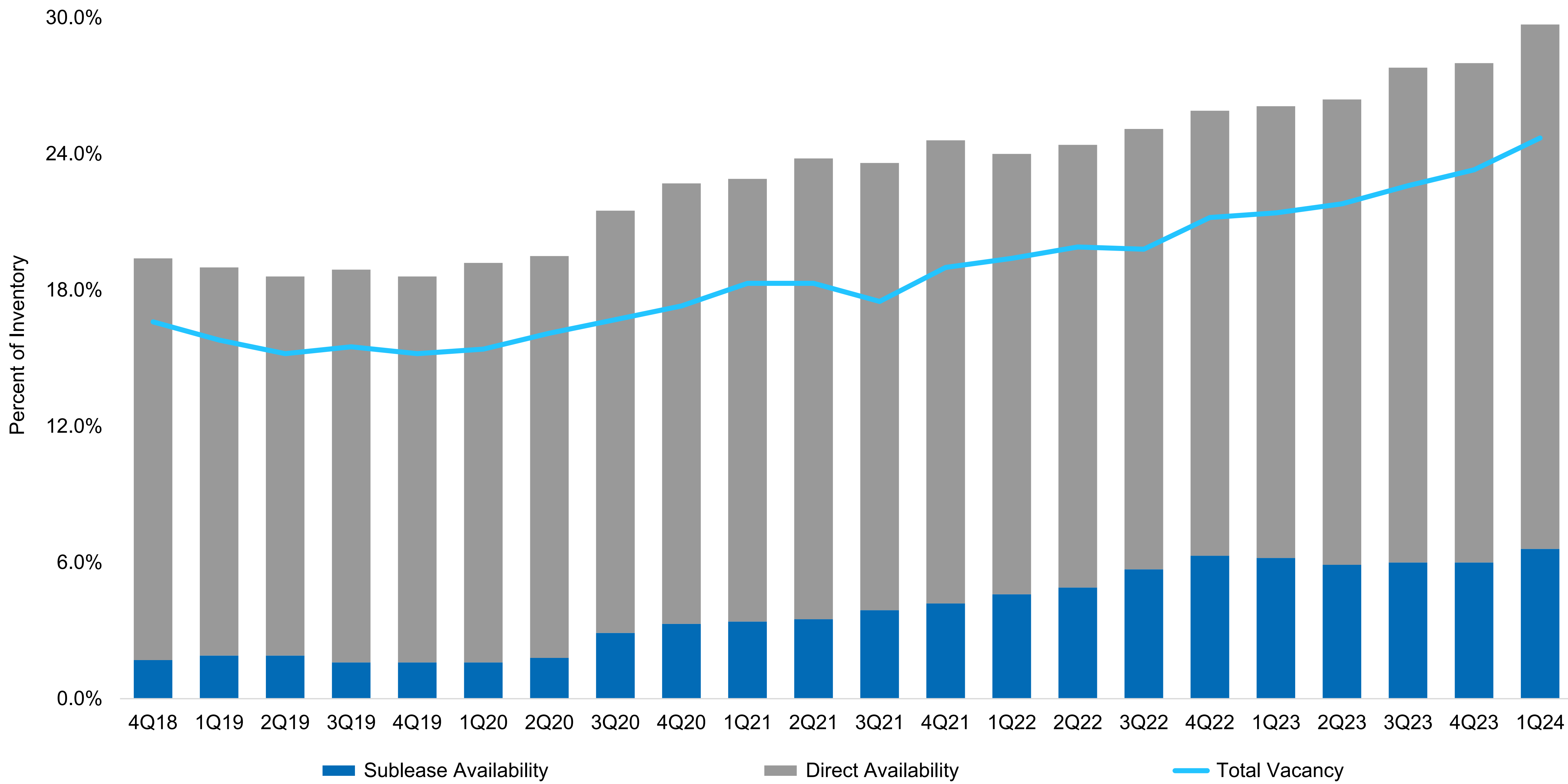


Source: Newmark Research

Sublease Availability Continues to Trend Upwards

From the onset of the pandemic until the end of 2022, sublease availability saw steady increases as tenants reduced footprints for a multitude of reasons, including hybrid work models and general cost-saving measures. Sublet availability was 6.6% at the beginning of 2024, while direct availability increased an additional 110 basis points quarter-over-quarter. By and large, available space is staying on market longer and this nudge vacancy upwards as tenants progressively vacate.

Available Space and Total Vacancy as Percent of Overall Market



Source: Newmark Research

Phoenix Sublease Availability Highest in Southwest

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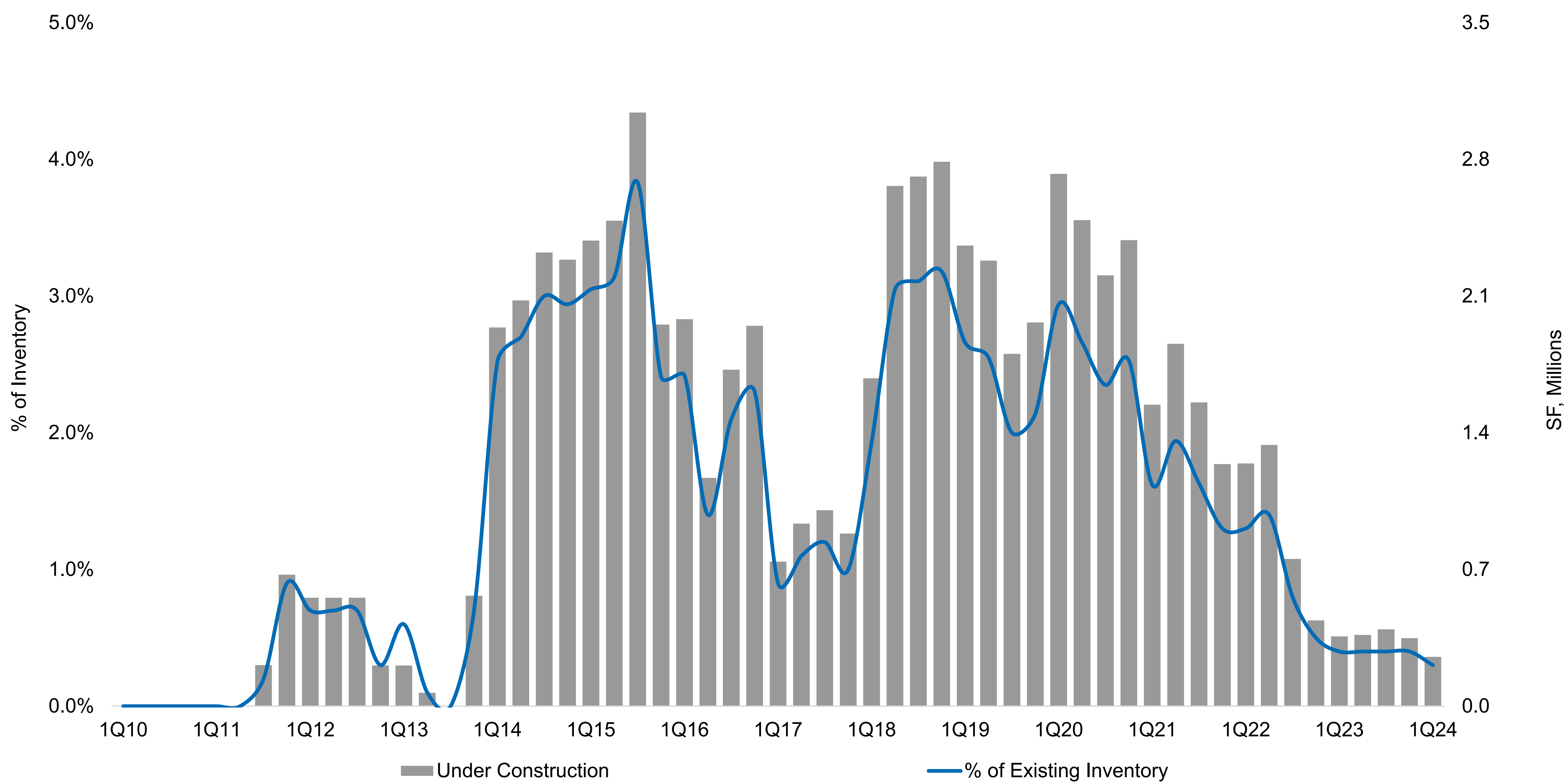
Under-Construction Activity Remains Constrained

Hybrid work models, sublet availability and measured tenant demand relative to pre-pandemic averages caused a sharp reduction in office under-construction activity since 2020. The halt in new construction starts gives room for new and current tenants to find existing availability. With only 252,578 SF of traditional office space currently underway and no deliveries in the first quarter of 2024, the office development pipeline is at a 10-year low.

Office Under Construction and % of Existing Inventory

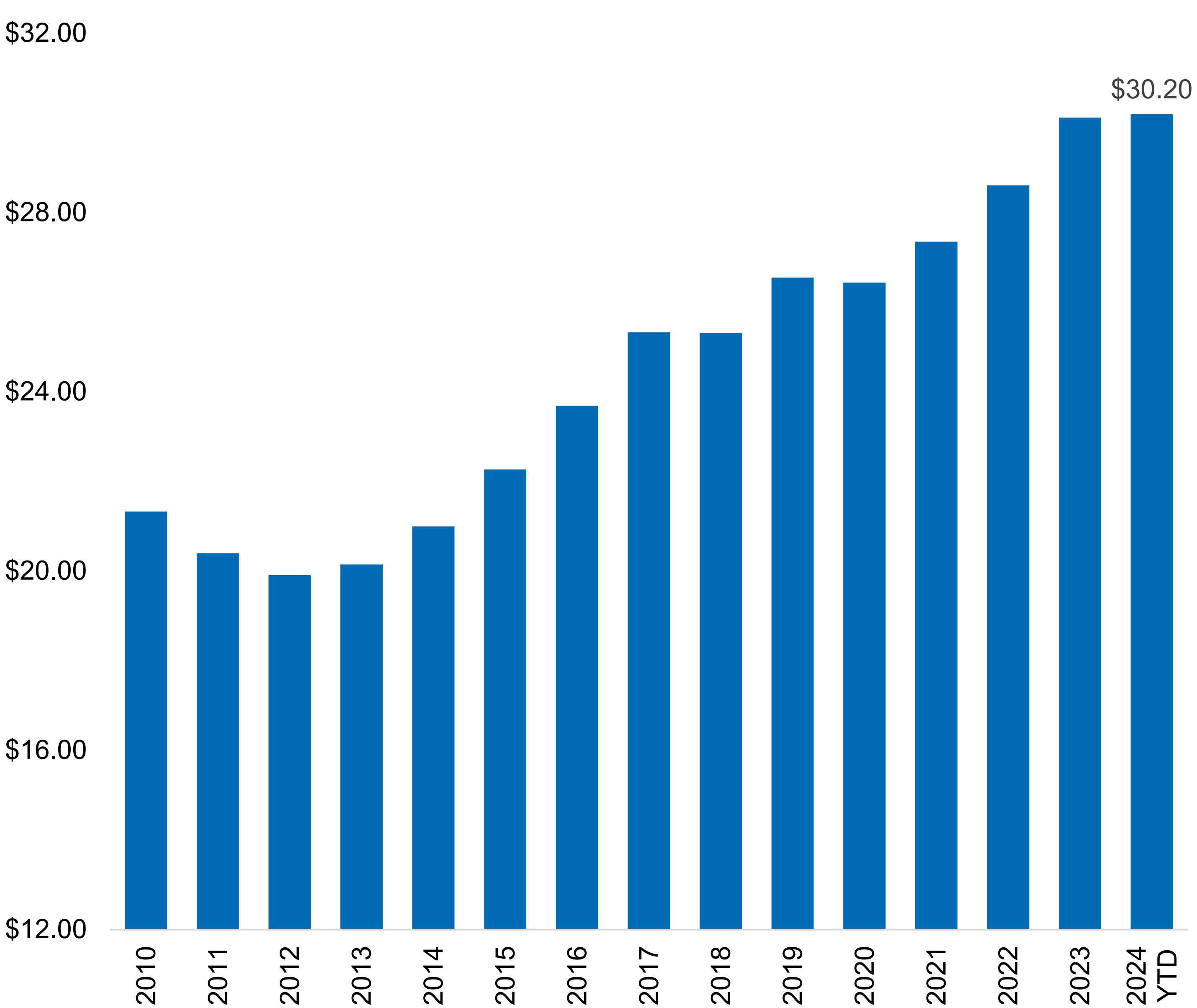


Source: Newmark Research

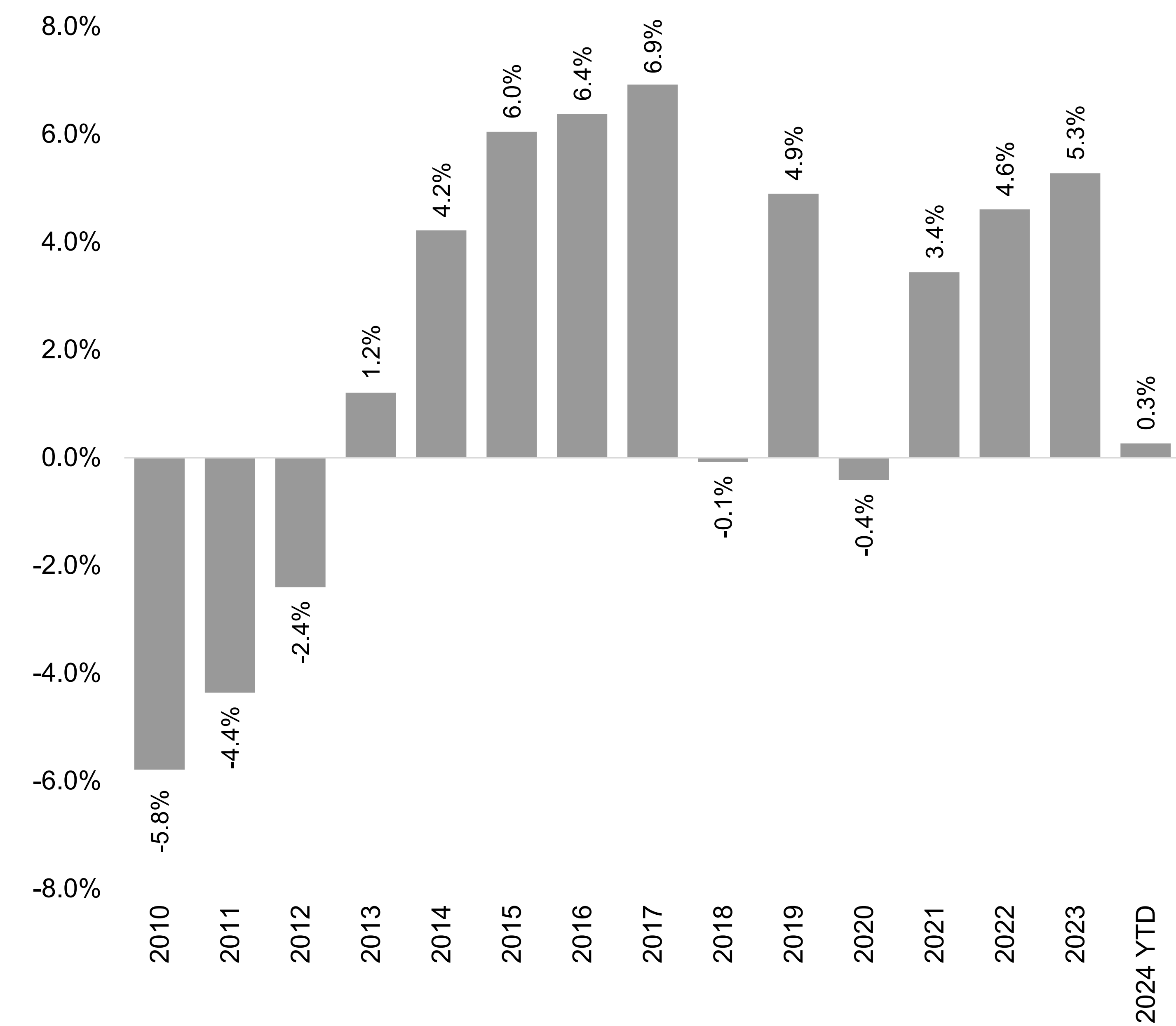
Asking Rents Start to Level Out

With vacancy continuing to rise, asking rates leveled out quarter-over-quarter, increasing by only 0.3%. Landlords are holding rates for direct space, preferring to offer more in way of concessions and tenant improvement allowances to attract and retain tenants. With marginal new deliveries expected throughout 2024 to potentially push new rate watermarks, asking rental growth is expected to stagnate until availability starts to see a decline.

Office Average Asking Rent, $/SF/Year, FS



Year-over-Year Asking Rent Growth Rate

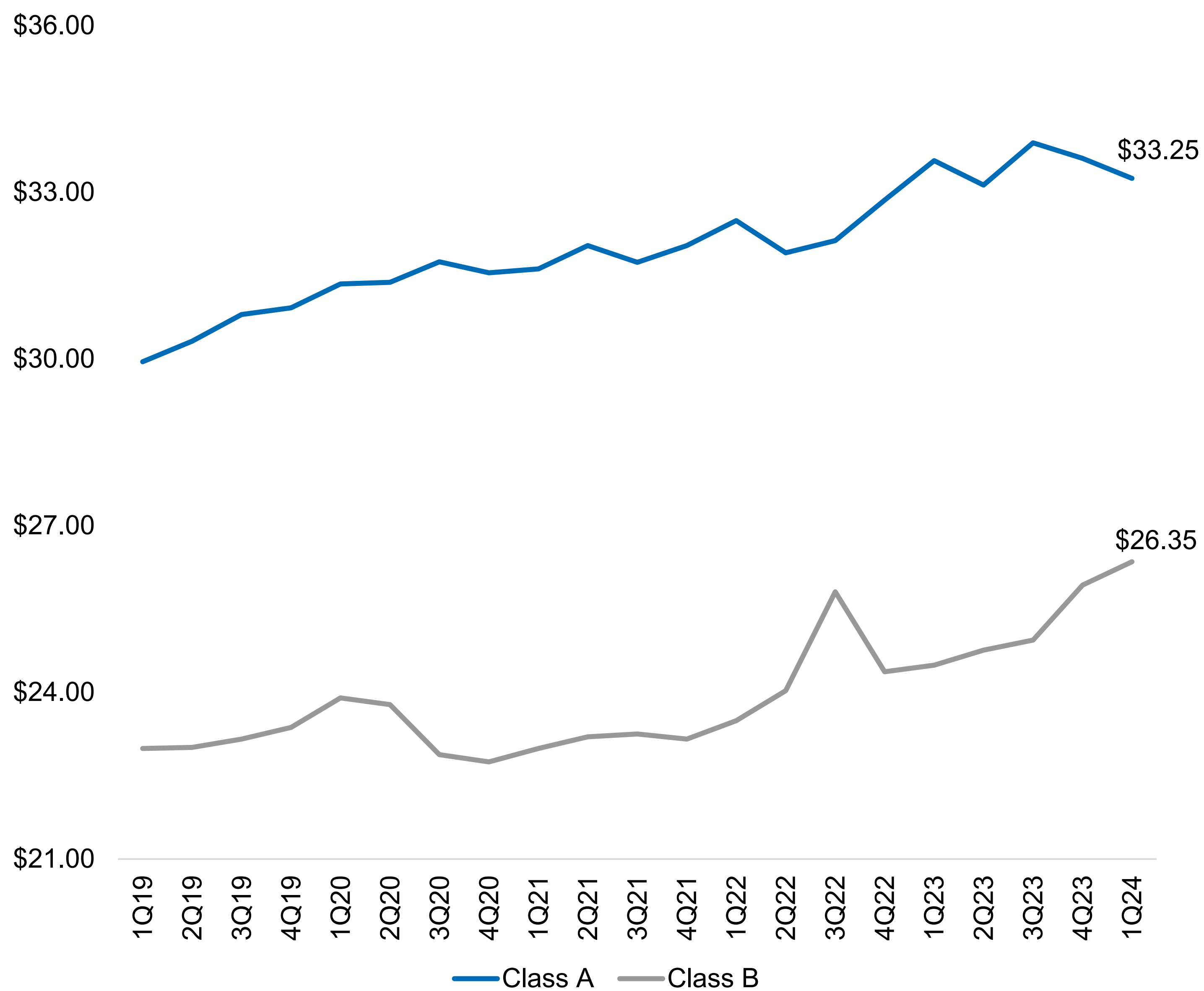


Source: Newmark Research

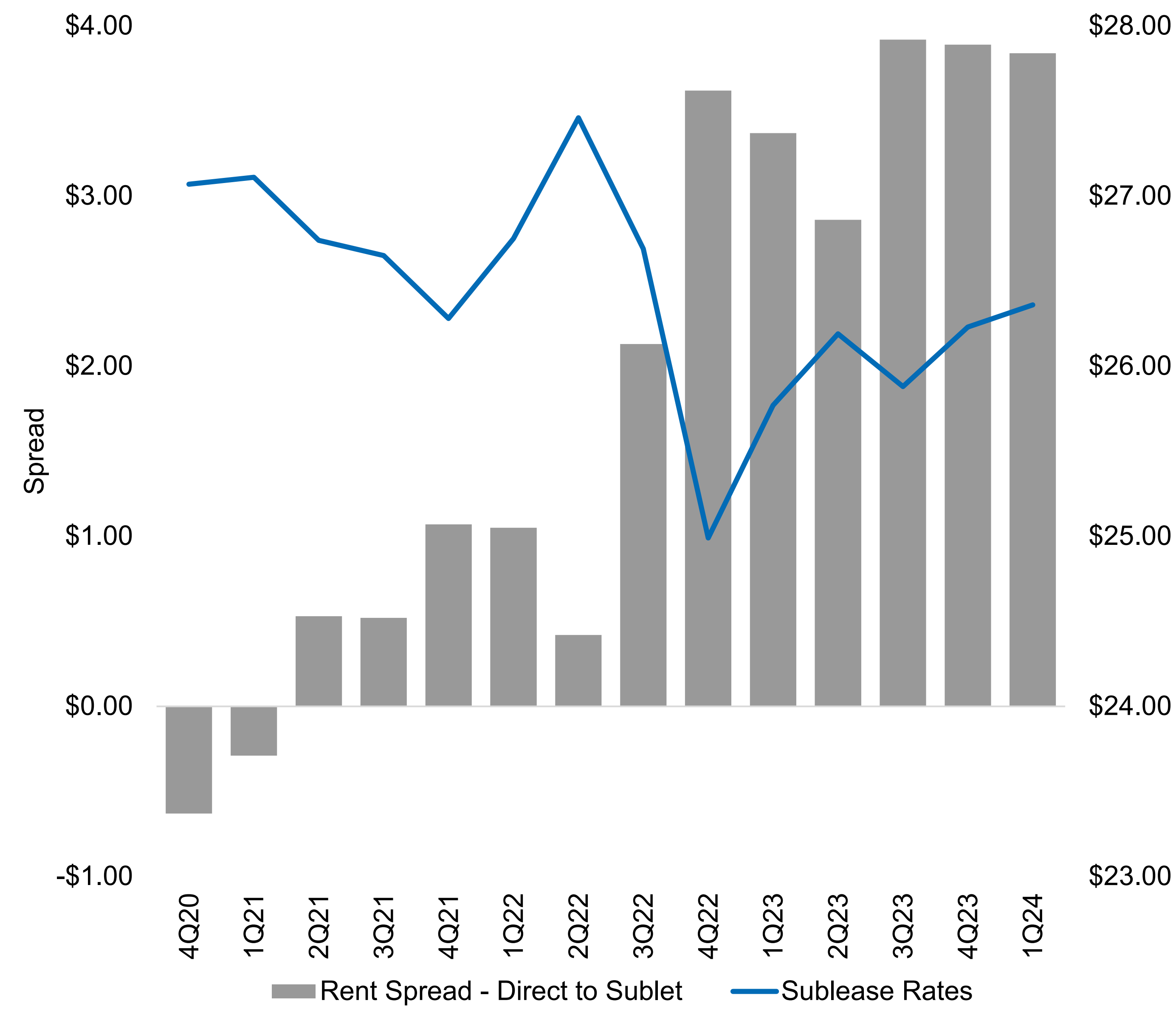
Class B Asking Rates Break Record as Tenants Look to Cost-Conscious Options

Class A direct asking rents continue to tick downwards, while Class B climbed to a new high. Smaller spaces in more cost-sensitive product is in higher demand among office users, allowing landlords to push rates but remain more affordable relative to A-caliber product. The rent spread between direct and sublease space is holding steady at $3.84/SF.

Class A and Class B Asking Rents, $/SF/Year, FS



Sublease Asking Rates



Source: Newmark Research

Renewals and Relocations Kick Off the Year for Lease Transactions

Major tech giants, such as Amazon, continue to have large footprints in the market. With high population growth, strong economic diversity and a highly educated workforce, Phoenix remains a strong location for many office users to conduct business.

Notable 1Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Amazon	Nexus at ASU Research Park	Tempe South/Chandler	Renewal	123,864
Amazon renewed their lease at Nexus in the ASU Research Park for 123,864 square feet.				
Fennemore Craig	Biltmore Center III	Camelback Corridor	Renewal & Downsize	52,886
Fennemore Craig gave back the 4th floor at Biltmore Center III in a downsize and renewal.				
Pulte Homes	Axis Raintree	Scottsdale North/Airpark	Direct Lease	65,266
Relocating from Terra Verde in North Scottsdale, Pulte Homes moved to Axis Raintree for 65,266 SF.				
GoDaddy	100 Mill	Tempe	Direct Lease	31,677
GoDaddy moved forward in a relocation and significant downsize from ASU Research Park to 100 Mill.				
Lucid Private Offices	Max at Kierland	Scottsdale North/Airpark	Direct Lease	25,169
Lucid Private Offices out of Dallas opened a second location in Metro Phoenix at Max at Kierland.				

Source: Newmark Research

Total Sales Volume Down Dramatically at Beginning of 2024

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Private, Opportunistic Buyers Are Active; Medical Office Attracts REIT Investors

Sales Activity Off to Steady Start in 2024

The Airport Area had the largest sale of the quarter with the Koll Cotton office building being sold to G.W. Williams Co. for $38 million. The Fed's anticipated interest rate cuts later this year will likely increase property sales volume. That, as well as more distressed or bank-owned assets entering the market.

Notable 1Q24 Sale Transactions

Building Address	Submarket	Sales Price	Price/SF	Square Feet
Koll Cotton – 4050 E. Cotton Center Blvd.	Airport Area	$38,000,000	$166	228,605
G.W. Williams Co. purchased seven, freestanding, single story, office/flex buildings from TerraCap Management; the buildings were 98% leased at close of escrow.				
Banner Sports Medicine – 7400 N. Dobson Rd.	Central Scottsdale	$28,600,000	$362	78,921
LaSalle Investment Management purchased this newly constructed, Banner Sports Medicine long term leased property from the developer, The Alter Group.				
McDowell Mountain Medicine – 9377 E. Bell Rd.	Scottsdale Airpark	$21,250,000	$251	84,725
TPG/Angelo Gordon purchased the 1999 constructed, three story, 93% leased medical office property from Healthpeak Properties.				
2525 W. Townley Ave.	Northwest Phoenix	$15,225,000	$152	99,918
The Valley School of Osteopathic Medicine purchased the vacant property as an owner-user from West Coast Capital; the building was originally built and owned by Blue Cross Blue Shield of Arizona.				
Talavi Corporate Center – 5651 W. Talavi Blvd.	Sun City	$9,325,000	$61	153,332
Woodside Capital Partners purchased this value-add four story property from Regent Properties in a lender facilitated sale; buyer intends to infuse capital into the property and build out several spec-suites.				

Source: Newmark Research

1Q24

Appendix

Phoenix Metro Office Submarket Map and High-Level Statistics | 1Q24

Phoenix Metro Office Submarket Statistics | 1Q24 (page 1 of 2)

Phoenix Metro Office Submarket Statistics | 1Q24 (page 2 of 2)

Population Has Increased Four Times Over the Past Five Decades

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