

3Q24

Phoenix Office Market Overview



Market Observations

Economy

- Phoenix’s labor market remains strong, with a 3.5% unemployment rate in August, 70 basis points lower than the national average.
- The education and health and business and professional services sectors led local job gains over the past 12 months, with information and manufacturing seeing the biggest losses.
- Overall office-occupying employment is up 5.2% compared to its pre-pandemic total. 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 the coming months.

Major Transactions

- The largest deal of the quarter was signed by Move.com, which took over 65,655 SF of McKesson’s lease at 5601 N Pima Road. The sublease expires in three years.
- Samuel & Co Inc, a real estate services company, acquired a 366,513-SF office property in Central Scottsdale, marking one of the largest sale transactions of the year. The property was 100% occupied by CVS Health Corporation at the time of sale, who had recently executed a 15-year lease extension.
- 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.

Market Fundamentals

- The market incurred an additional 477,367 SF of net occupancy losses this quarter. This is the eighth consecutive quarter of negative absorption.
- Under-construction levels are only 13.3% of what they were at the start of the pandemic. Hybrid work models and escalating vacancy are deterring developers from breaking ground.
- Total vacancy (26.1%) is up 280 basis points from the same time last year. A fully vacant and available project totaling 133,356 SF delivered this quarter with an additional 334,022 SF of new product currently underway.
- 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.

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.

1. Economy
2. Market Fundamentals
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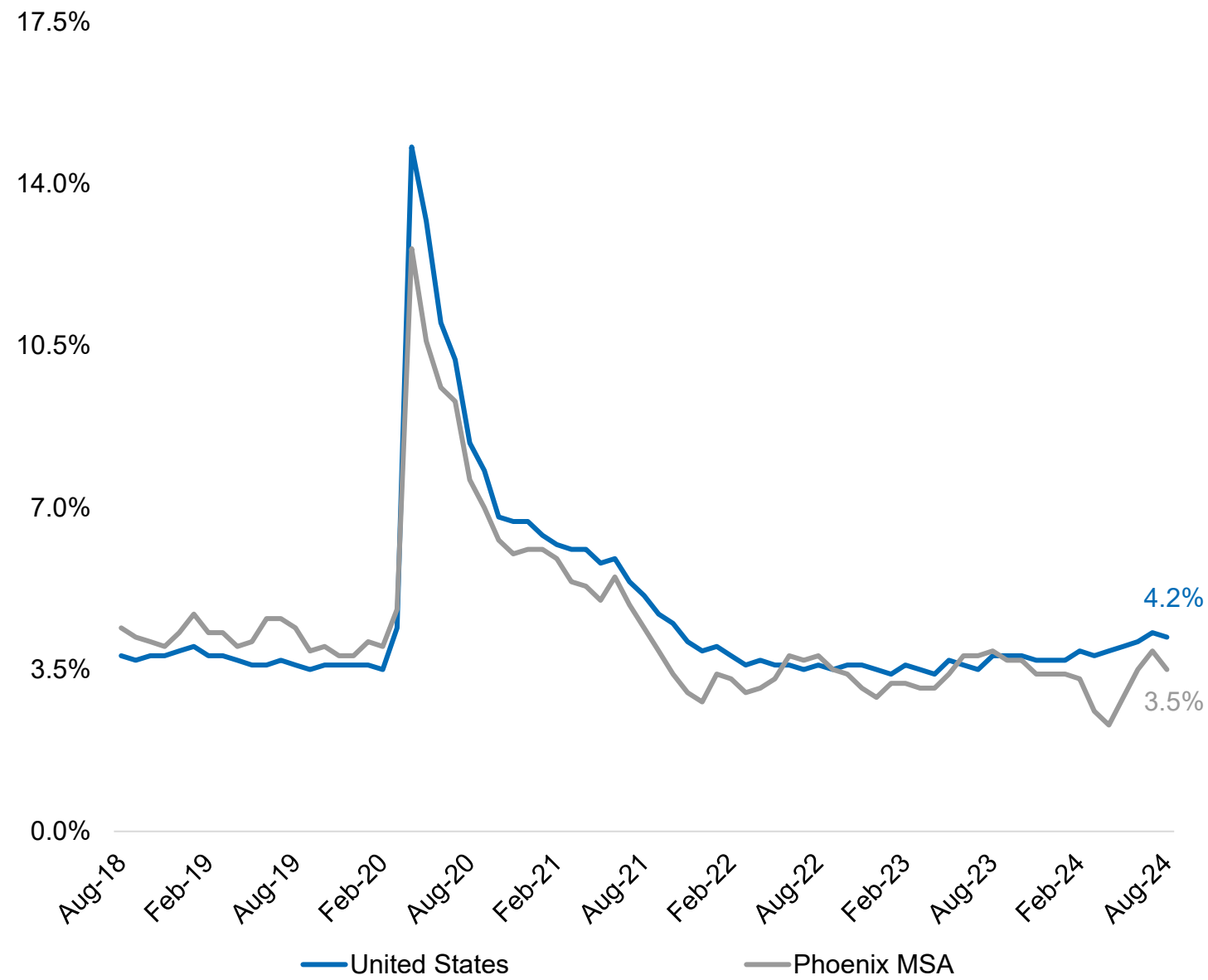
Economy



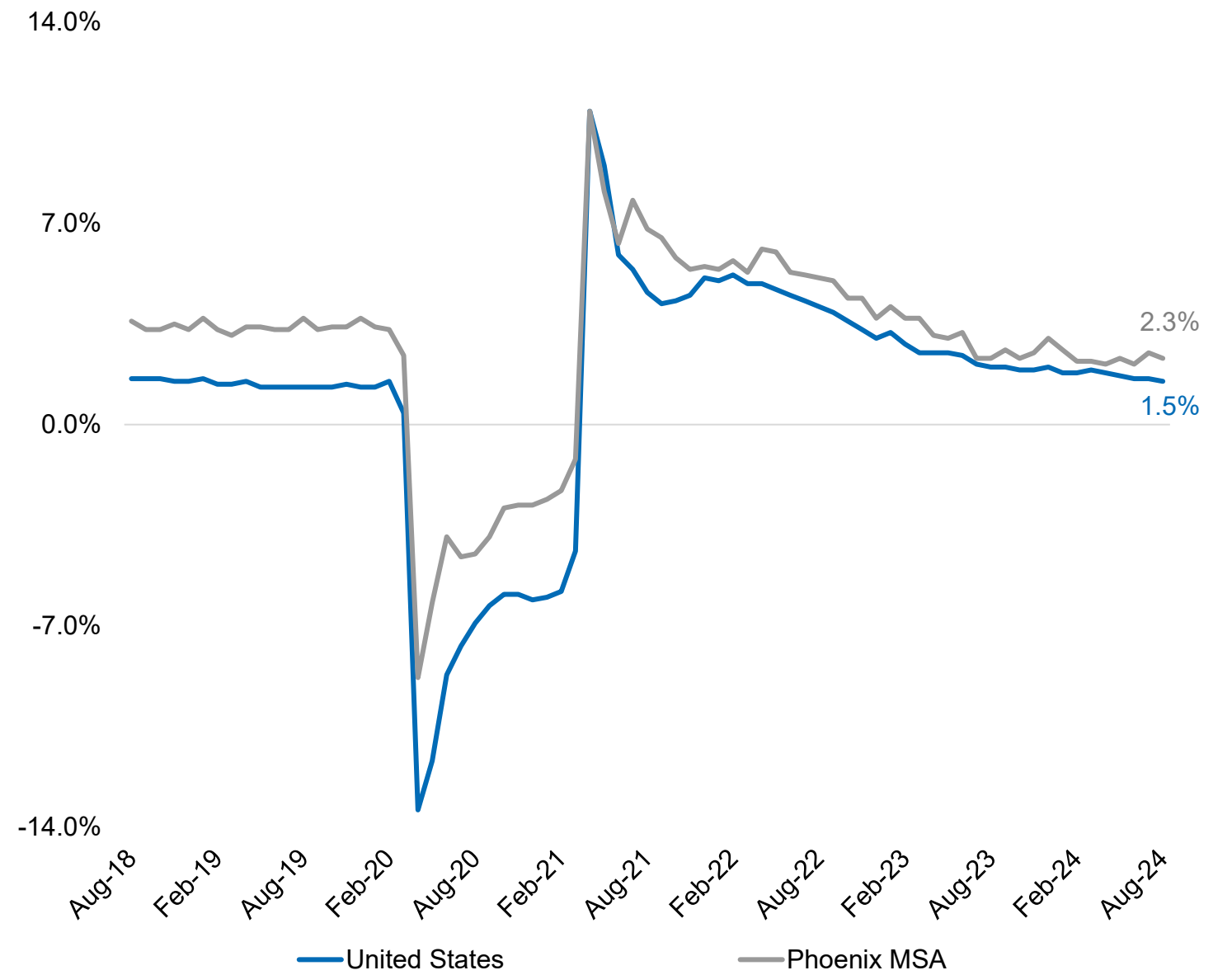
Phoenix's Labor Market is Outperforming the Nation's

Local unemployment (currently, 3.5%) has remained below the national average (4.2%) for 12-straight months. 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



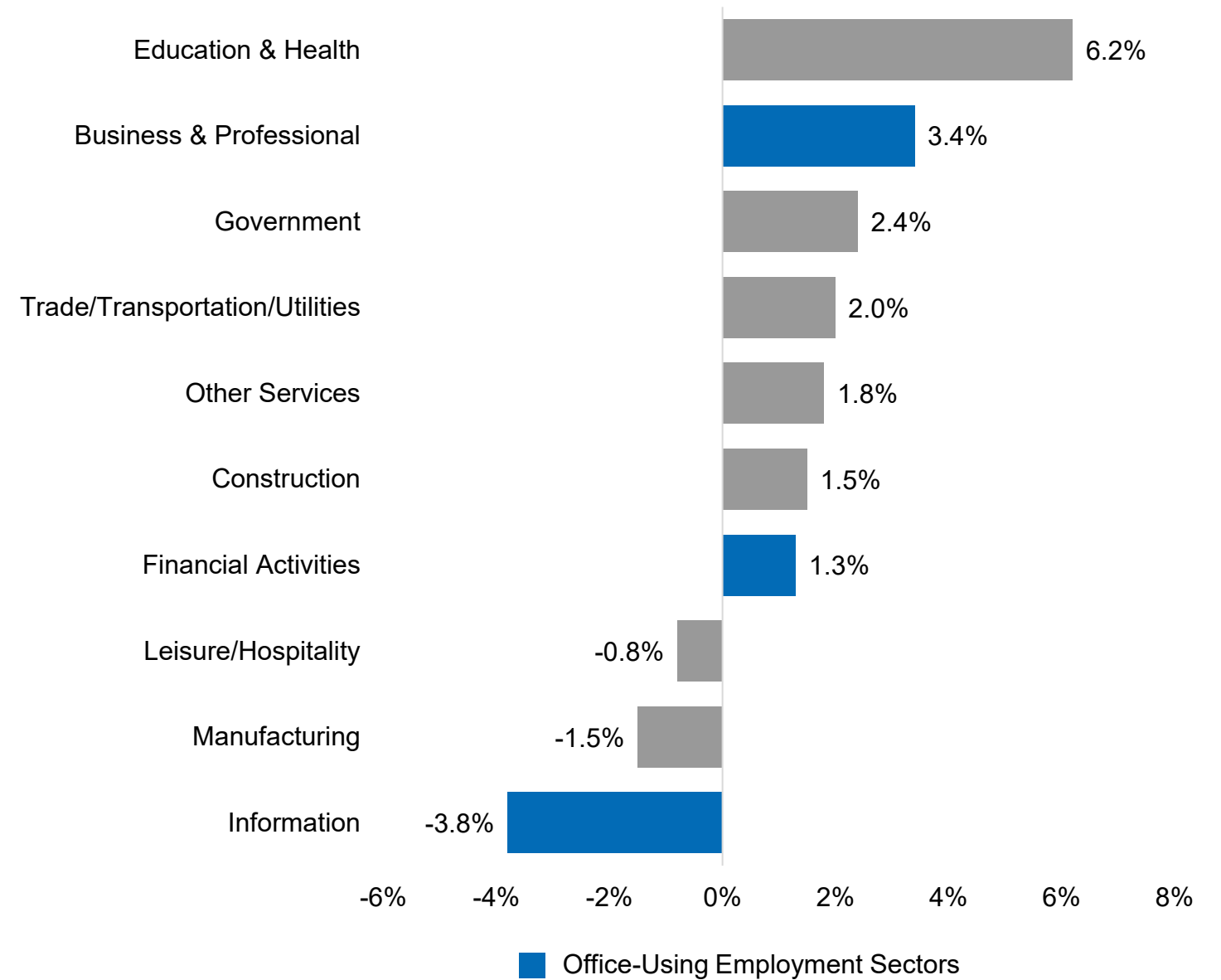
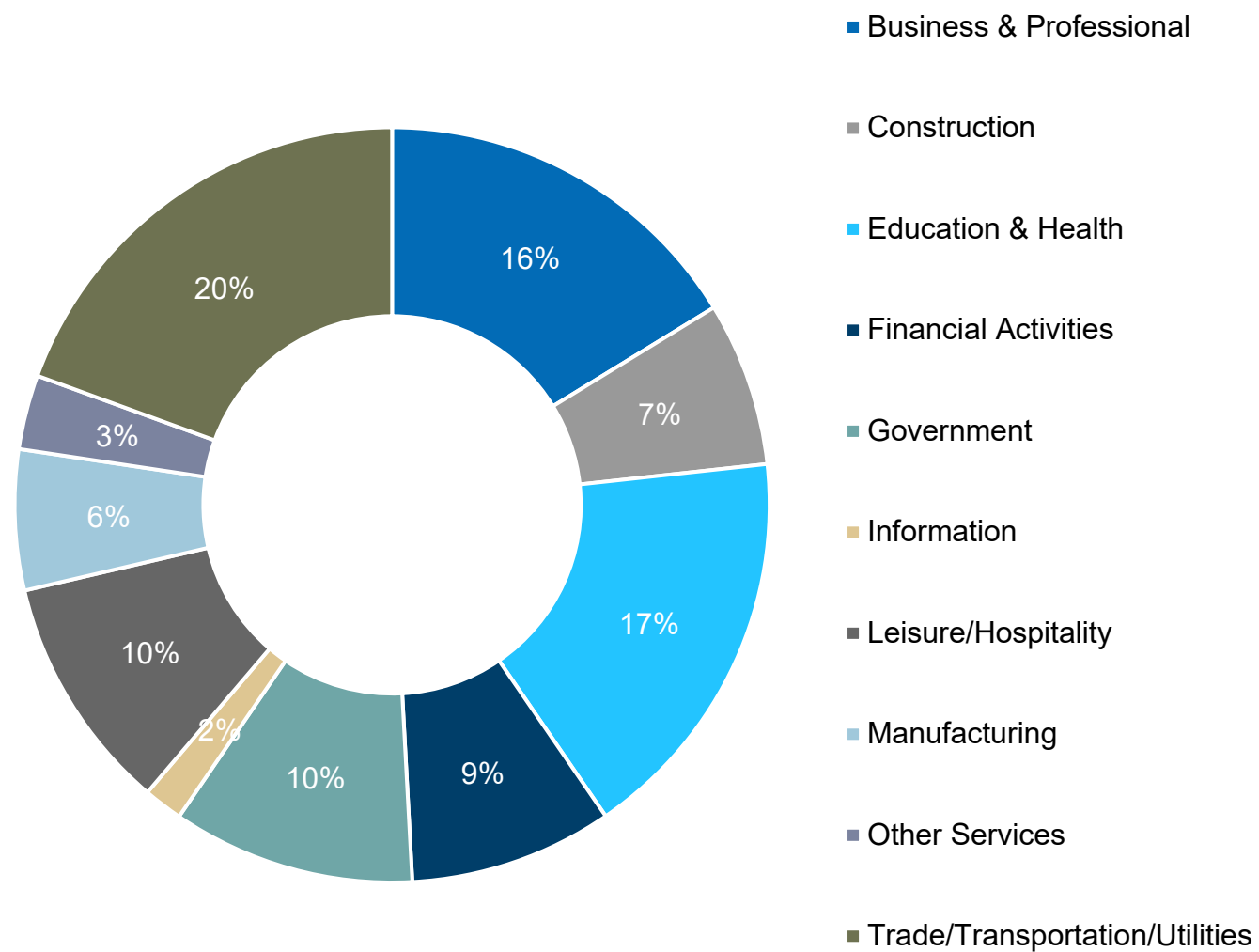
Source: U.S. Bureau of Labor Statistics, Phoenix MSA
 Note: August 2024 data is preliminary.

Job Growth Was Pronounced in Already Strong Employment Sectors

Education and health led all industries in annual job growth, followed by business and professional and government. For other office-occupying sectors: information (where tech companies are generally grouped) contracted by 3.8%, while financial activities was up by 1.3%.

Employment by Industry, August 2024

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

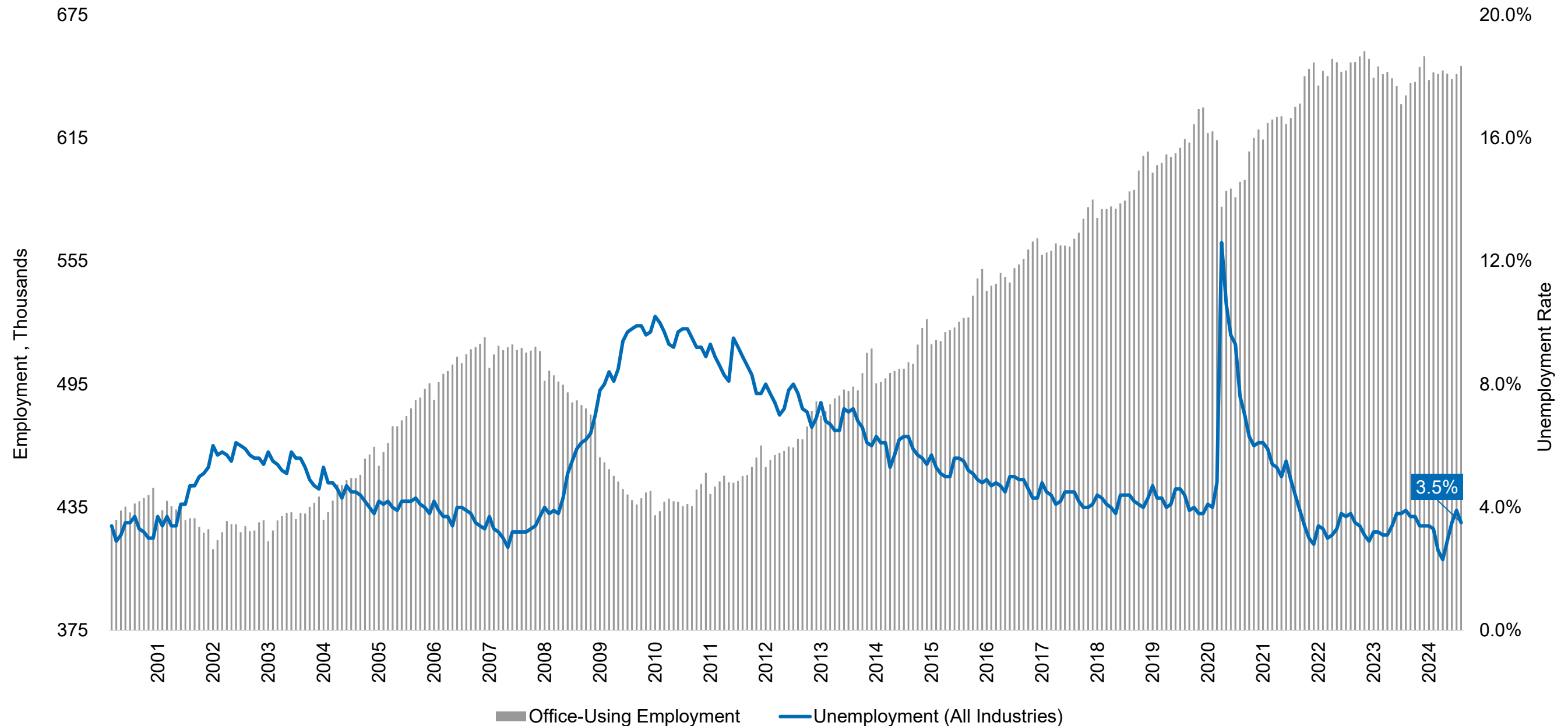


Source: U.S. Bureau of Labor Statistics, Phoenix MSA
 Note: August 2024 data is preliminary.

Office-Using Employment Higher than Before the Pandemic

Office-using employment remains 5.2% higher than the market's pre-pandemic total from February 2020. It is 2.8% higher from 12 months ago. Both are attributed to population growth in recent years—more residents leads to more demand for population-serving office occupiers, such as insurers, banks and law firms.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Phoenix MSA

Note: August 2024 data is preliminary.

*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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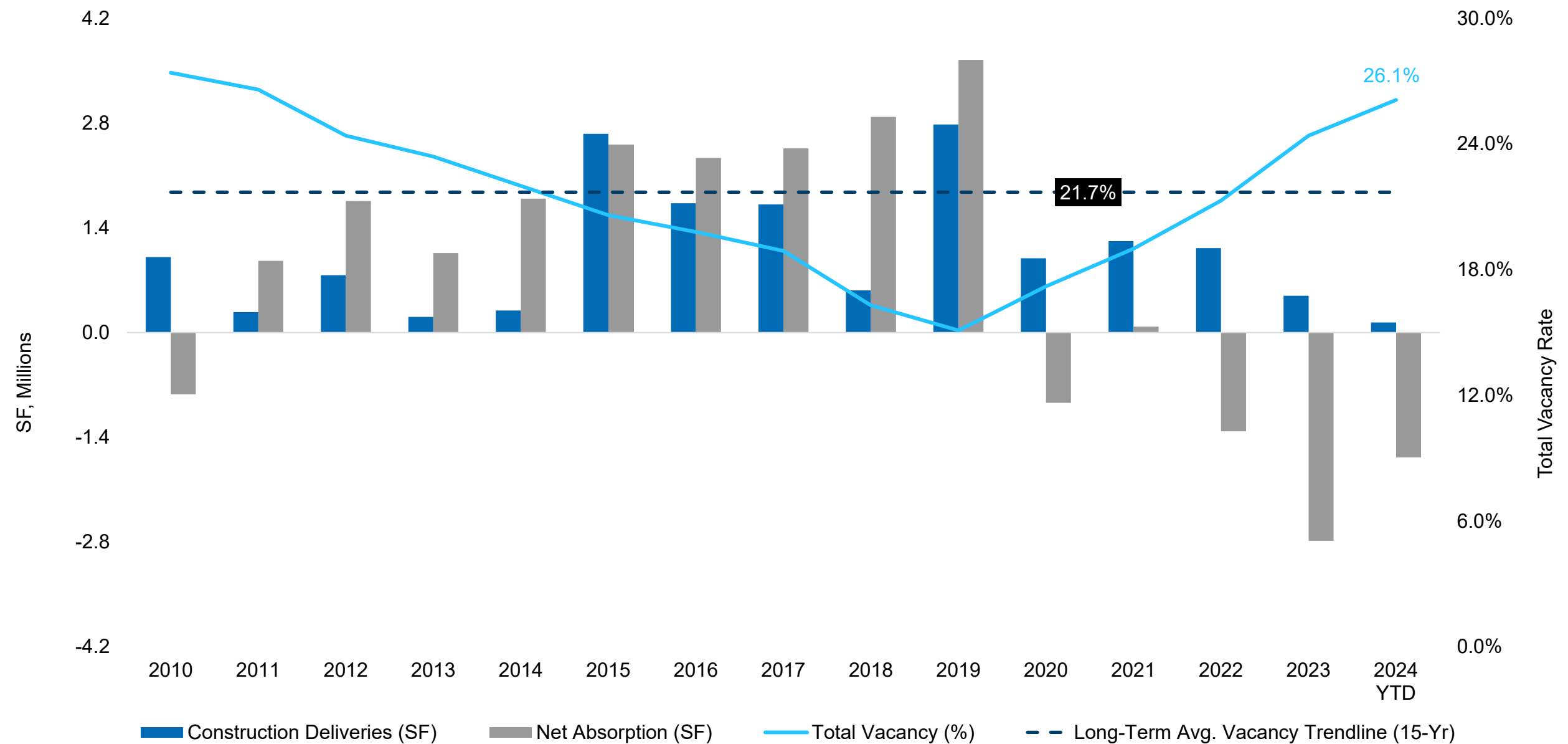
Market Fundamentals



Vacancy Continues Its Upward Trajectory in the Second Half of 2024

Total vacancy was 26.1% at the end of the third quarter of 2024, 440 basis points higher the 15-year average (21.7%). Space givebacks continued as office users reduced their footprints. Few construction deliveries (and a limited under construction pipeline) will help to moderate vacancy's rise amid ongoing tenant downsizes.

Historical Construction Deliveries, Net Absorption, and Vacancy | Greater Phoenix

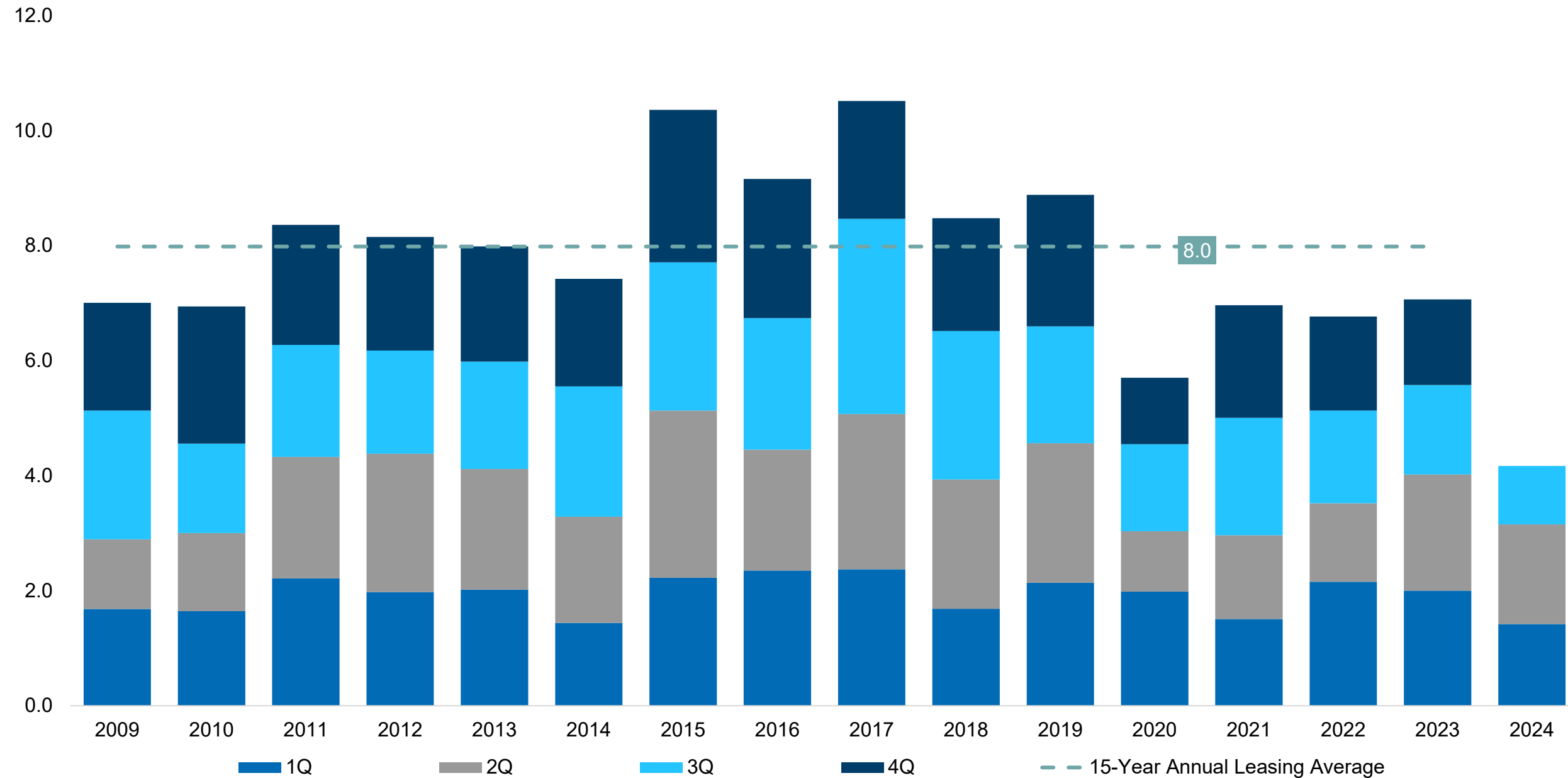


Source: Newmark Research

Muted Leasing Activity Brings Down Year-To-Date Totals

This quarter's leasing activity was noticeably minimal, with fewer, smaller deals taking place. Office tenants are generally renewing or signing new leases at smaller footprints due to hybrid work models.

Total Leasing Activity (MSF)

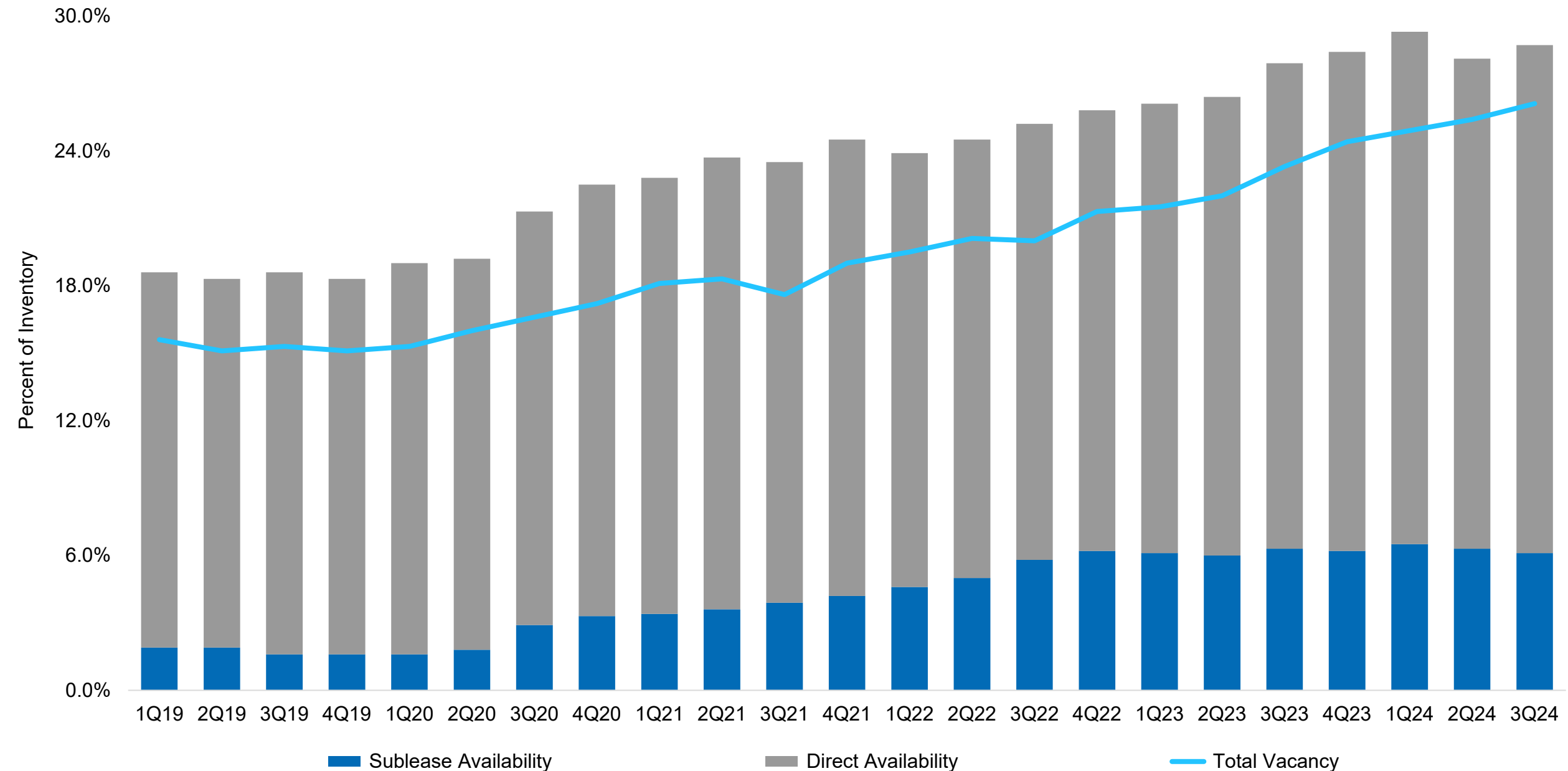


Source: Newmark Research

Total Availability Still On The Rise; Sublet Availability Has Plateaued

From the onset of the pandemic until the end of 2022, sublease availability saw steady increases as tenants reduced footprints due to hybrid work models and/or general cost-saving measures. Sublet availability saw a slight decrease of 20 basis points from last quarter, while direct availability was up 80 basis points over the same period; a function of sublease space coming to term and transitioning to direct space. By and large, available space is sitting on the market longer and this is nudging vacancy up as tenants progressively vacate.

Available Space and Total Vacancy as Percent of Overall Market | Greater Phoenix



Source: Newmark Research

Phoenix Sublease Availability Highest in Southwest

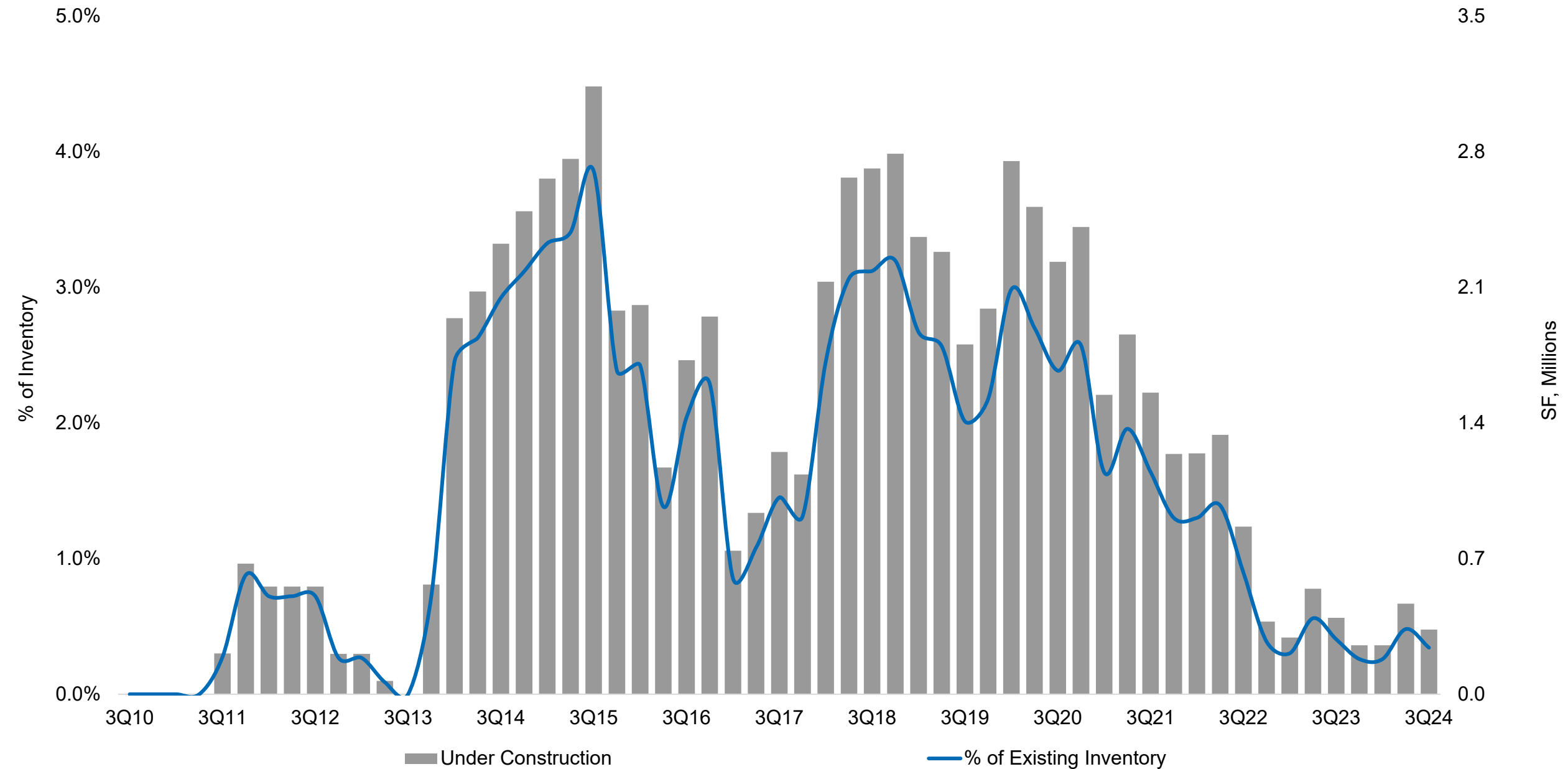


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Under-Construction Activity Remains Constrained

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 334,022 SF of traditional office space currently underway and a single delivery year-to-date, the office development pipeline will remain constrained as developers focus on other property types for the time being.

Office Under Construction and % of Existing Inventory

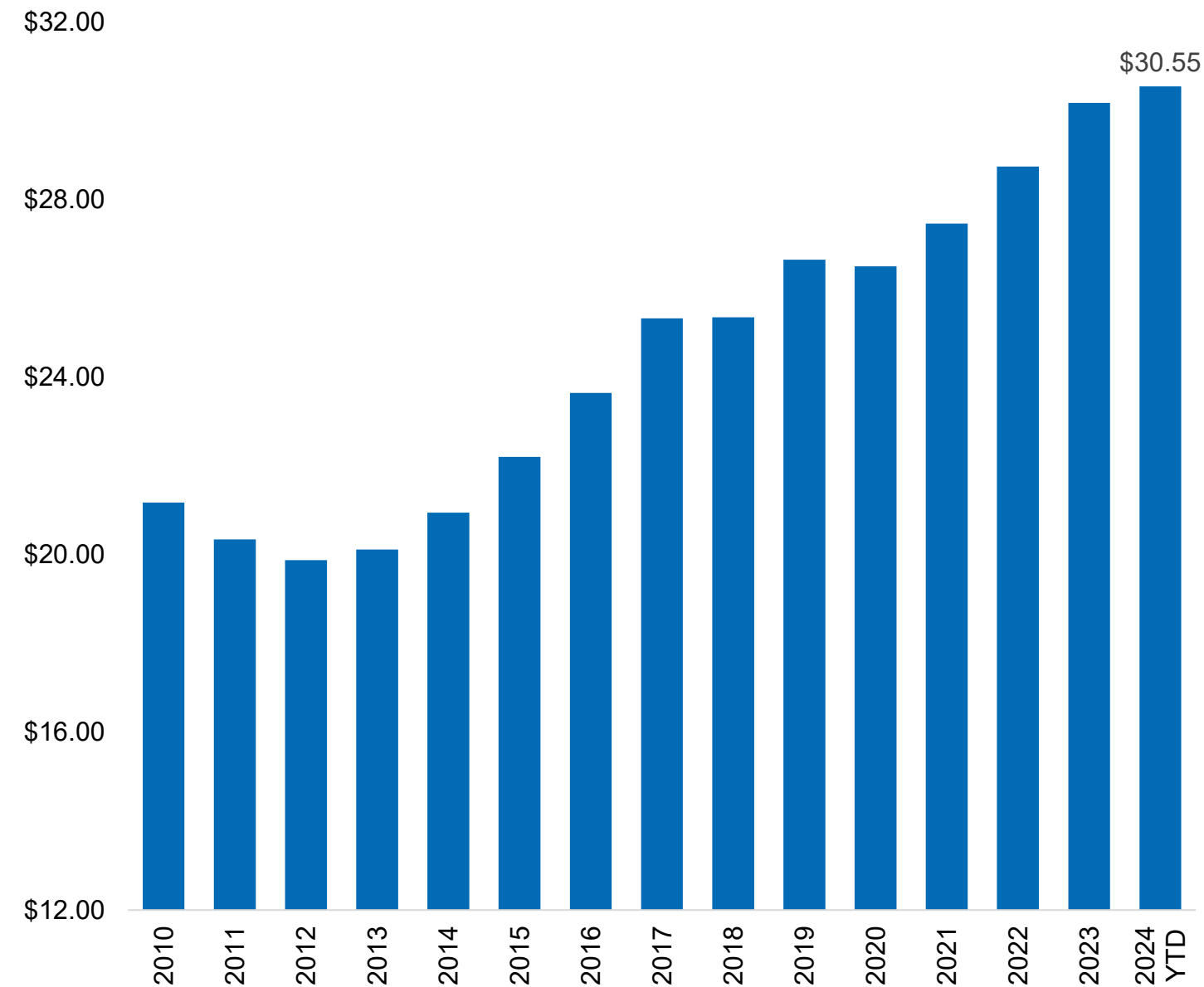


Source: Newmark Research

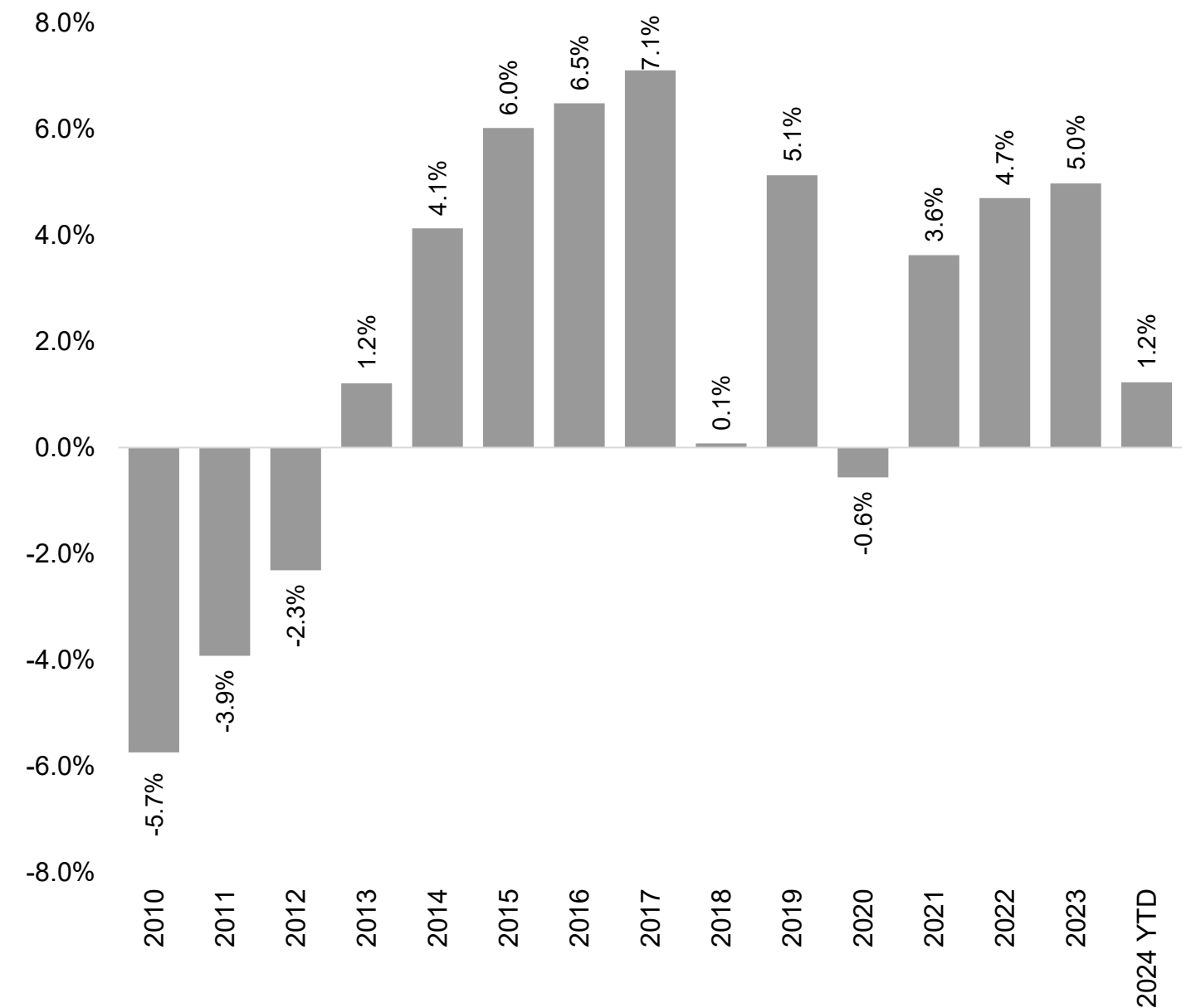
Asking Rent Growth Slows as Space Stagnates on Market

With vacant space sitting on market longer than the historical average, asking rental rate growth has stalled in 2024. 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 the remainder of the year that could potentially push new rate watermarks, rates are expected to hold at current levels until availability starts to see a decline.

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



Year-over-Year Asking Rent Growth Rate

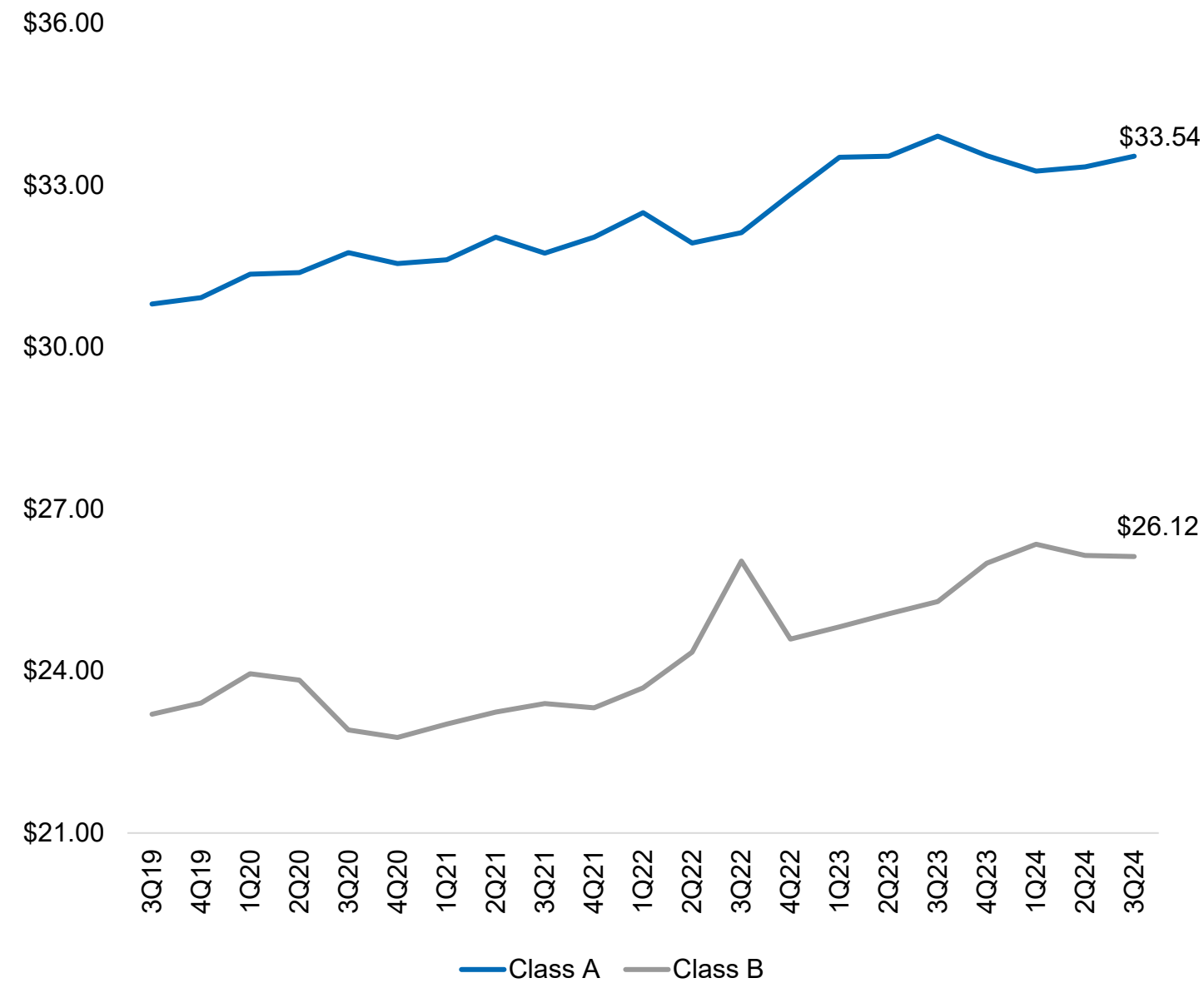


Source: Newmark Research

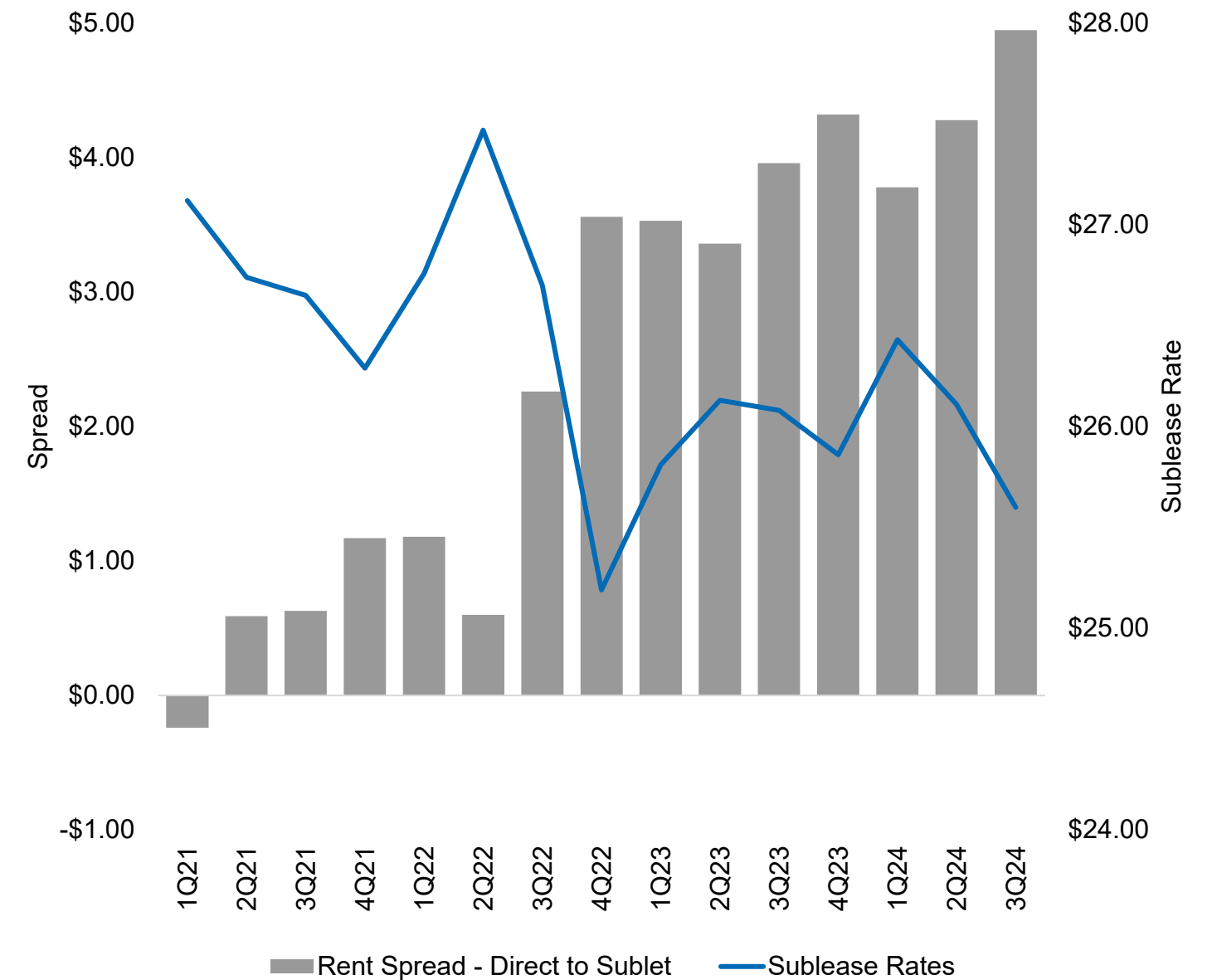
Rent Delta Between Direct and Sublet Widens

As sublease space enters and leaves the market, sublessors are bullish in competing with landlords by lowering rents to compete with direct space. The rent spread between direct and sublease space is now at \$4.95/SF.

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



Sublease Asking Rates



Source: Newmark Research

3Q24 Notable Lease Transactions

This quarter's top deals are a mix of direct leases, a sublease and a renewal, all of which were on the smaller side compared to previous quarters. Tenants continue to enact cost-cutting measures in the way of downsizing to mitigate high costs of business.

Notable 3Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Move.com	5601 N Pima Rd	Scottsdale South	Sublease	65,655
<i>The real estate company took over part of McKesson's lease, which expires in three years.</i>				
Clifton Larson Allen	80 E Rio Salado Pkwy	Tempe	Direct Lease	52,775
<i>Clifton Larson Allen took 52,775 SF at Hayden Ferry Lakeside 1, relocating from Midtown's Phoenix Plaza building.</i>				
The Mahoney Group	2625 W Geronimo Pl	Chandler/Gilbert	Direct Lease	35,198
<i>The Mahoney Group signed a 35,198 SF lease at Chandler Freeway Crossing in a headquarter relocation move from Mesa to Chandler.</i>				
Kimley-Horn	2046 Riverview Auto Dr	Mesa East	Direct Lease	34,771
<i>This is the civil engineering company's second location in the market.</i>				
Stealth Partner Group	18700 N Hayden Rd	Scottsdale Airpark	Direct Lease	32,069
<i>The tenant will occupy the space early next year and the lease will expire in 2032.</i>				

2024 Will Top 2023 in Sales Volume

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Private, Opportunistic Buyers Are Active



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Sales Activity Slower Than Last Quarter's But Still Elevated

Last quarter's surge in sales activity, combined with this quarter's, brought year-to-date totals closer to surpassing 2023 sales volume. The Fed's long-awaited interest rate cuts will drive up property sales volume in the quarters ahead and more distressed or bank-owned assets will likely enter the market.

Notable 3Q24 Sale Transactions

Building Address	Submarket	Sales Price	Price/SF	Square Feet
9501 E Shea Blvd	Central Scottsdale	\$71,500,000	\$195	366,513
<i>Samuel & Co Inc acquired the property that is 100% occupied by CVS Health who recommitted to the property with a 15-year lease extension.</i>				
Canyon Corporate Plaza II – 2510-2512 W Dunlap Ave (Portfolio)	Northwest Phoenix	\$20,586,516	\$64	323,003
<i>Caliber Companies purchased the two office buildings with plans for a multifamily conversion.</i>				
The Center – 2727 S 48 th St	Tempe	\$13,036,451	\$84	155,000
<i>Formerly owned and occupied by Bank of America, positioned on 12.7 acres, the property was sold for its land value and will be redeveloped into two mid-bay industrial buildings.</i>				
Rose Garden Commerce Center – 2411 W Rose Garden Ln	Deer Valley/Airport	\$12,000,000	\$178	67,280
<i>Schnitzer Properties Management sold the property to a private investor for \$12 million.</i>				
90 Mountain View I – 9977 N 90 th St	Central Scottsdale	\$11,000,000	\$121	91,082
<i>Los Angeles-based Regent Properties sold the property to West Coast Capital Partners who intends to position the property as a medical building given the proximity to the HonorHealth Shea Medical Center.</i>				

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Appendix



Phoenix Metro Office Submarket Map and High-Level Statistics | 3Q24



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Population Growth in Recent Decades and Future Projections



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