2Q24

Phoenix Office Market Overview

NEWMARK

Market Observations

Economy

- Phoenix's labor market remains strong, with a 2.9% unemployment rate in May, 80 basis points lower than the national average.
- Education and health services led local job gains over the past 12 months, with information and leisure/hospitality seeing the biggest losses.
- Current office-occupying employment is 4.3% higher 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 second quarter of 2024 contracted by 134,4561 SF. Absorption losses are expected to slow but continue for the rest of the year.
- Construction activity has fallen sharply since 2020. Hybrid work models and elevated vacancy are deterring developers from breaking ground. A mere 393,578 SF of industrial product is currently under construction.
- Vacancy jumped to 25.0% in the second quarter as tenants continued to shed space.
- Asking rent growth has slowed amid an overabundance of lingering market listings.
- 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 Dutch Bros or Fennemore recommitted to current space or relocated to new space during the second quarter.
- Most tenants are reducing their footprints due to hybrid work models, with the average transaction size contracting by 5.5% year-over-year.
- Leasing volume on a square footage basis was down 5.1% quarter-over-quarter.
- Medical office sales activity is stronger than traditional office, given stronger fundamentals in the former.

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

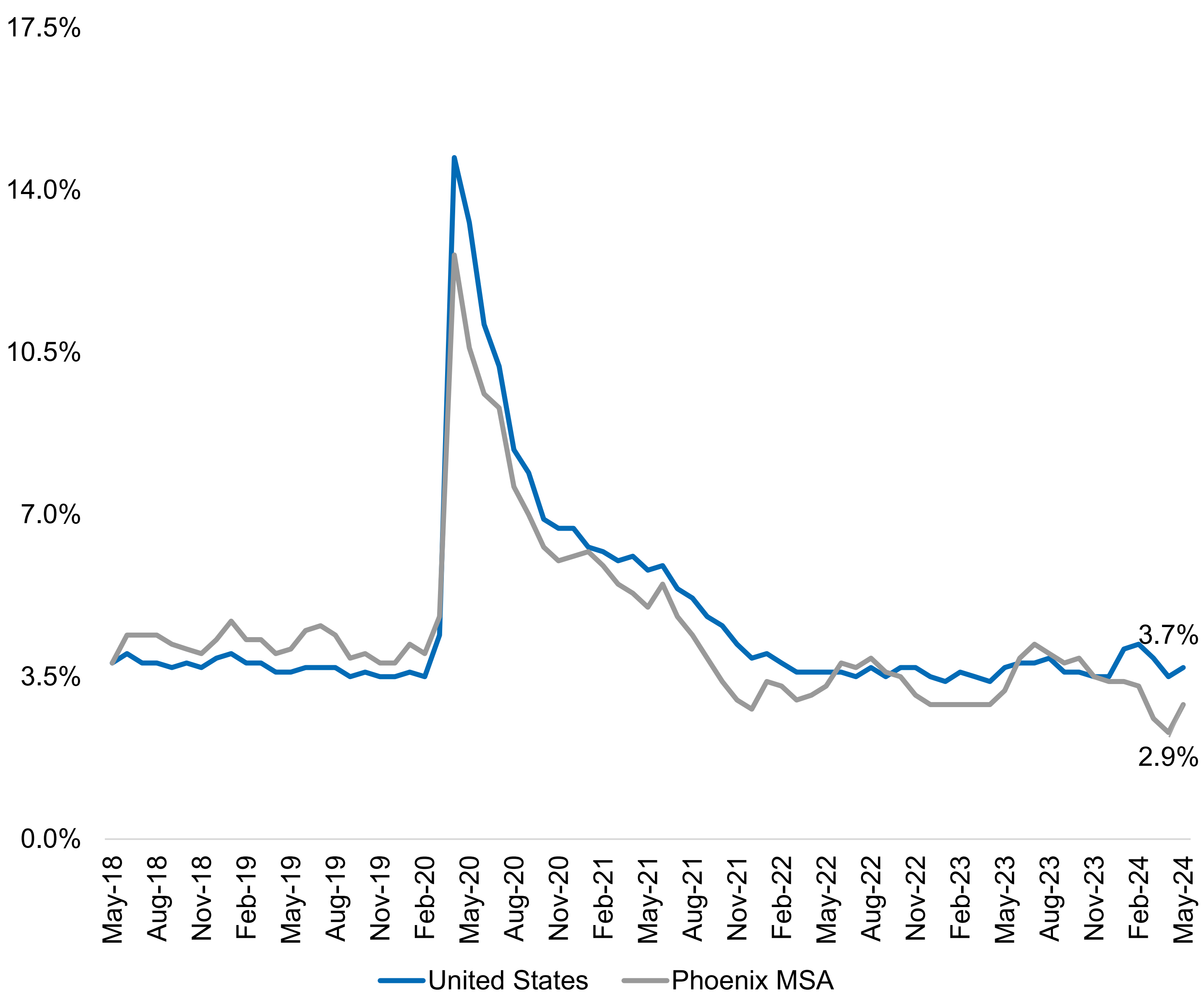
2Q24

Economy

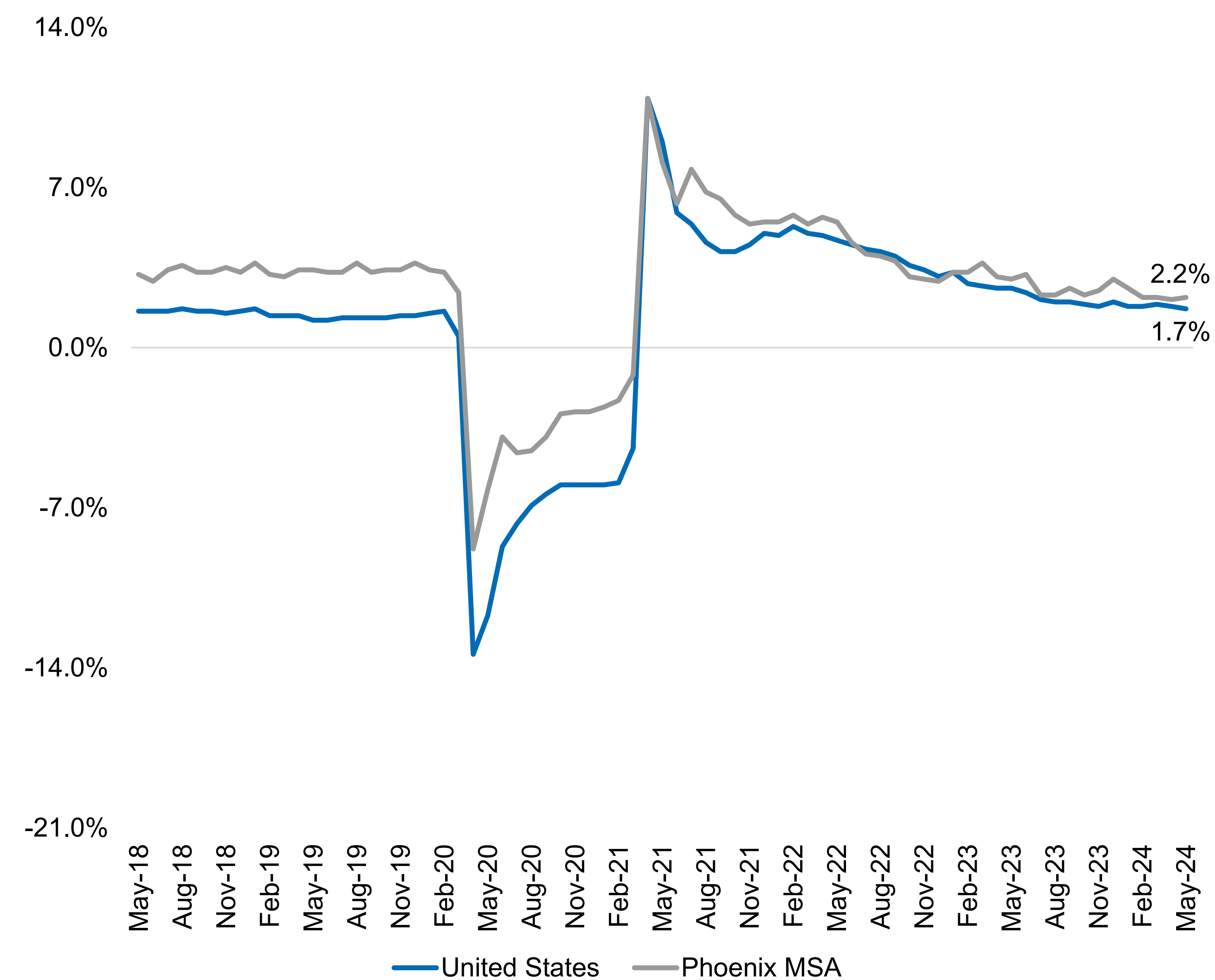
Phoenix's Labor Market Shows Favorable Trends Ahead of National Averages

Local unemployment remained below the national average for the fifth consecutive month, with May's rate coming in at 80 basis points lower. 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

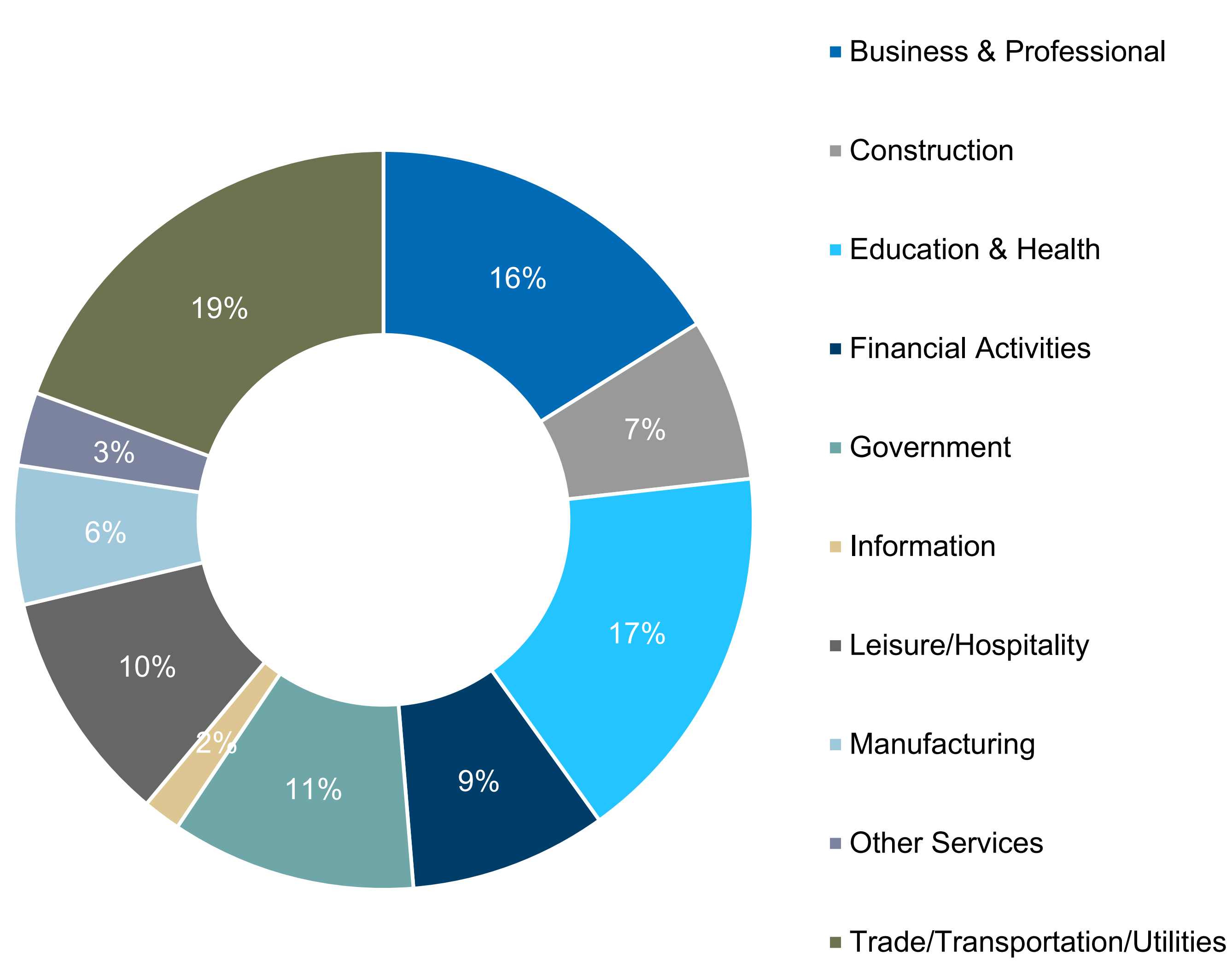


Source: U.S. Bureau of Labor Statistics, Phoenix MSA
Note: May 2024 data is preliminary.

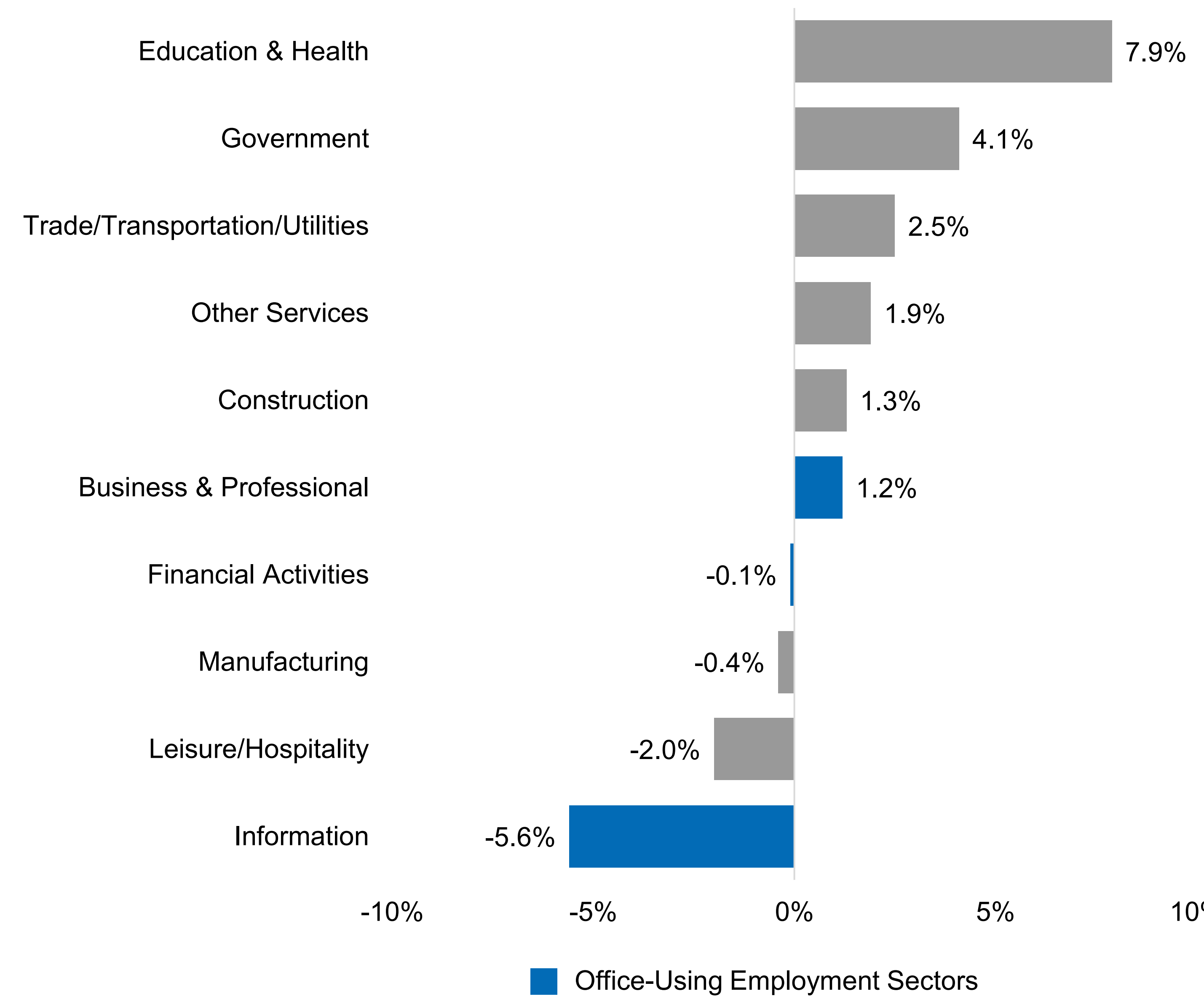
Job Growth Was Pronounced in Already Strong Employment Sectors

Education and health led all industries in annual job growth, followed closely by government and trade/transportation/utilities. For office-occupying sectors: information contracted by 5.6% and financial activities by 0.1%; business and professional saw minimal gains at 1.2%.

Employment by Industry, May 2024



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

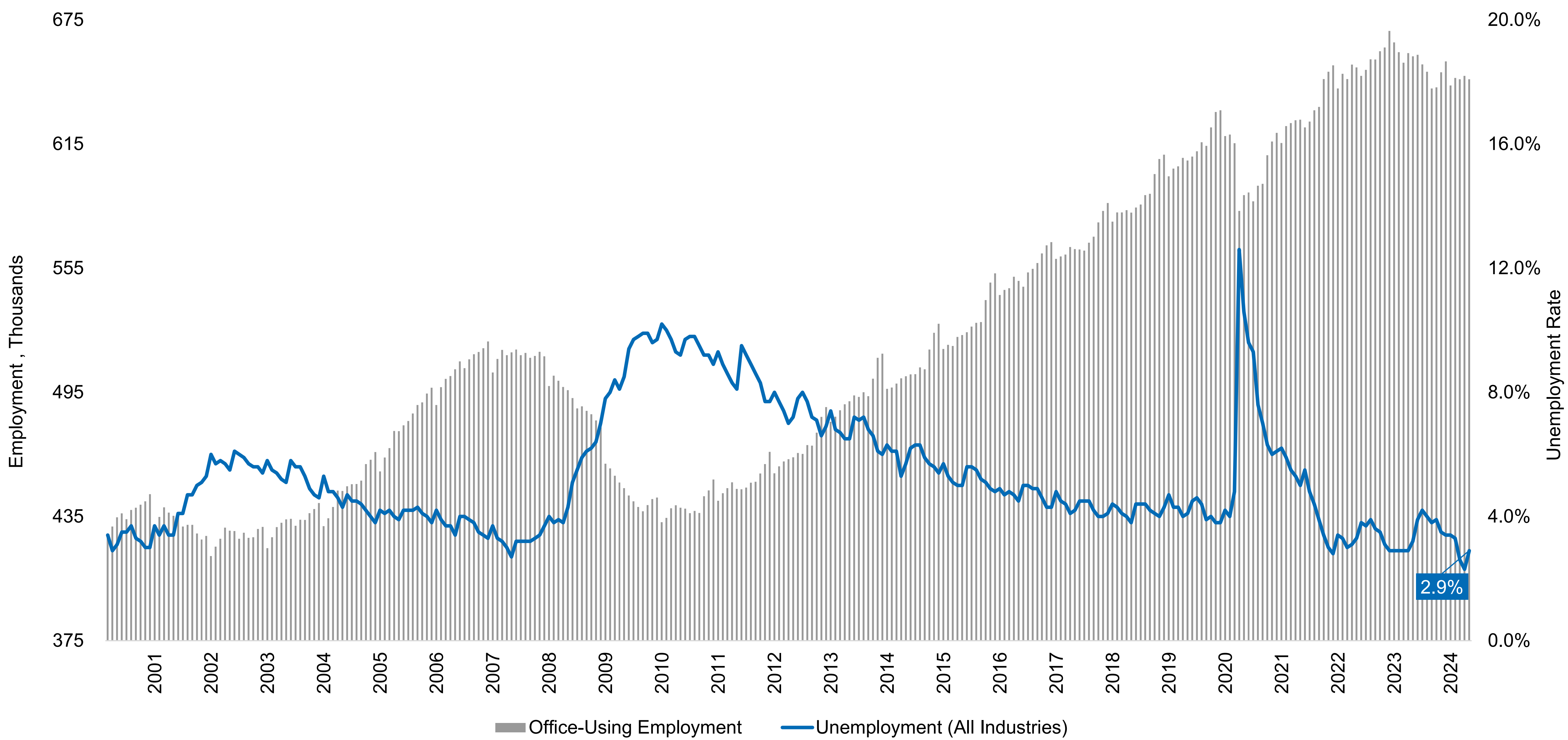


Source: U.S. Bureau of Labor Statistics, Phoenix MSA
Note: May 2024 data is preliminary.

Office-Using Employment Experiencing Losses But Still Stronger Than Prepandemic

Office-using employment remains 4.3% higher than the market's pre-pandemic total from February 2020. Employment losses in the financial activities and information sectors contributed to a modest decline in office-using employment in 2023.

Office-Using Employment* and Unemployment Across All Industries



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

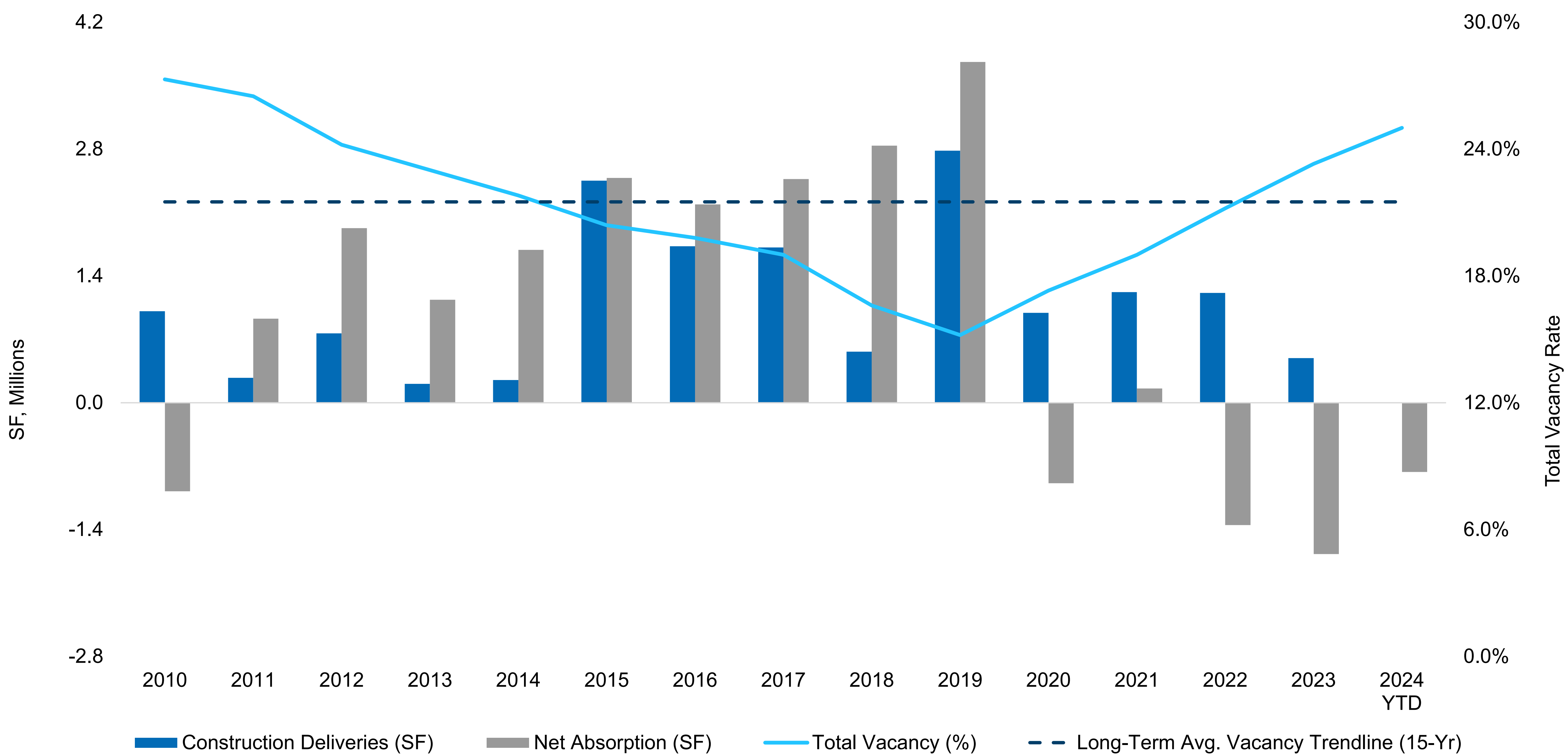
2Q24

Market Fundamentals

Vacancy Continued to Rise in the First Half of the 2024

Total vacancy was 25.0% at the end of the second quarter of 2024, 350 basis points higher than the 15-year average (21.5%). Space givebacks continued as office users contracted footprints via renewals and new leases. The absence of new construction delivers this year will help to moderate near-term rises in vacancy.

Historical Construction Deliveries, Net Absorption, and Vacancy

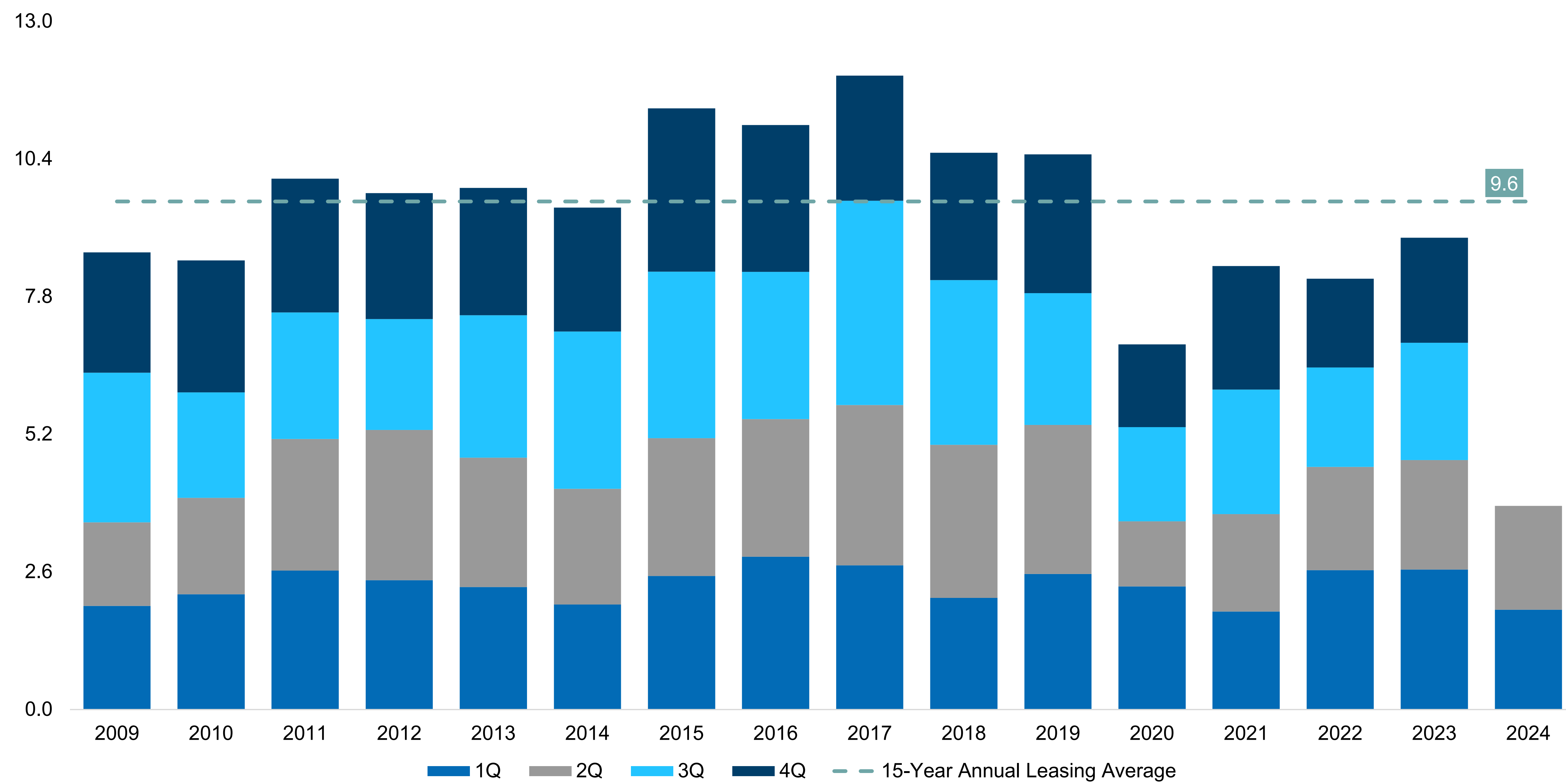


Source: Newmark Research

Leasing Activity Remains Dampened Amid Tenant Contraction Trends

Tenant footprint reductions have fueled the decline in leasing activity relative to the pre-pandemic era: the average deal size from 2020 through 2Q24 fell by 12.6% compared to 2016-2019 as the rapid adoption of hybrid work models reduced square-footage-per-employee space requirements. The number of deals closing and tenants active in the market remains historically strong.

Total Leasing Activity (MSF)

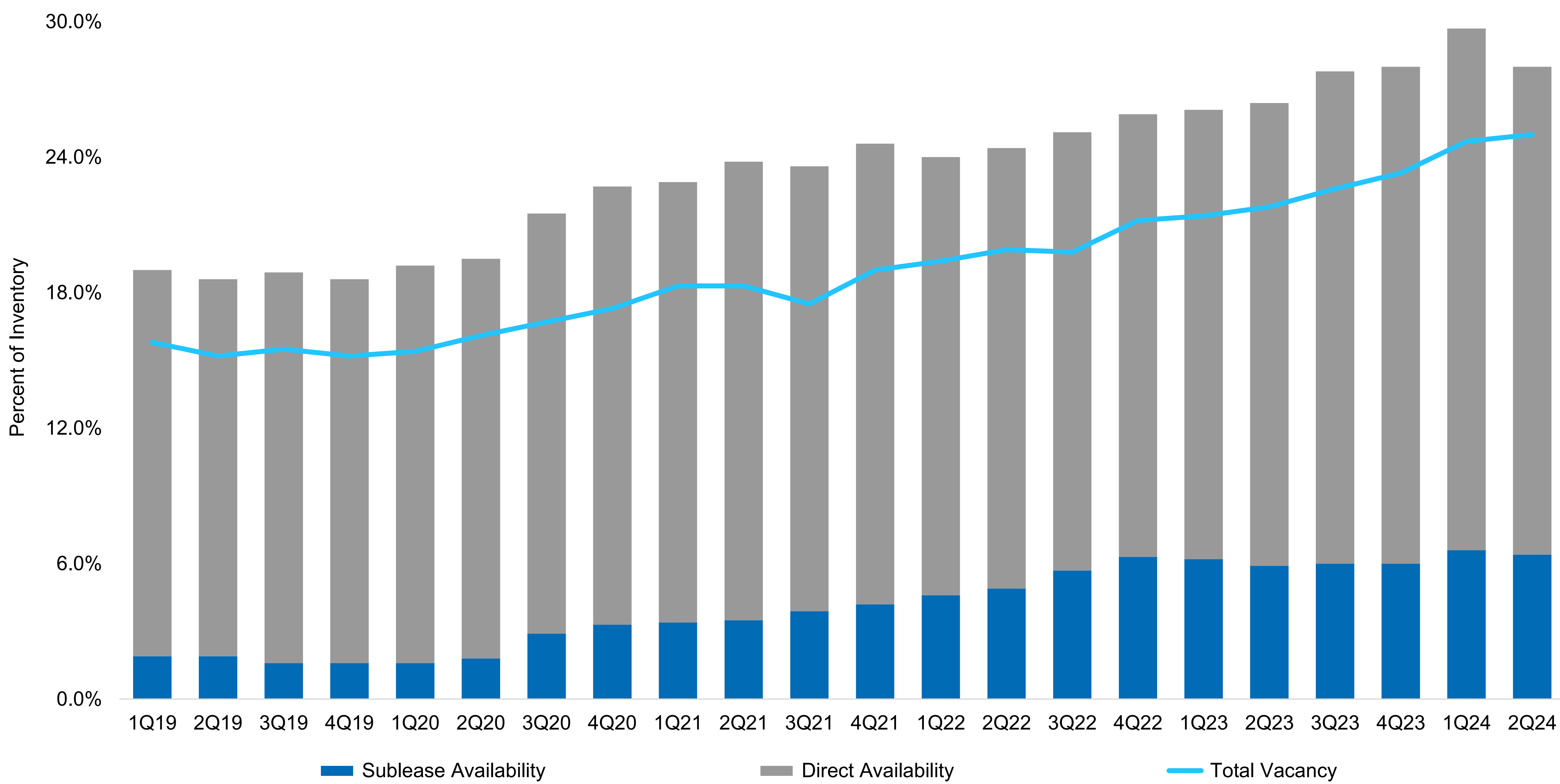


Source: Newmark Research

Total Availability Declines From First-Quarter Peak

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. In the second quarter of 2024, sublet availability saw a small decrease of 20 basis points quarter-over quarter, while direct availability saw a larger decrease of 150 basis points as some larger deals passed from one tenant to another without vacancy hitting the market. By and large, available space is staying on market longer and this nudges vacancy upwards as tenants progressively move out.

Available Space and Total Vacancy as Percent of Overall Market



Source: Newmark Research

Phoenix Sublease Availability Highest in Southwest

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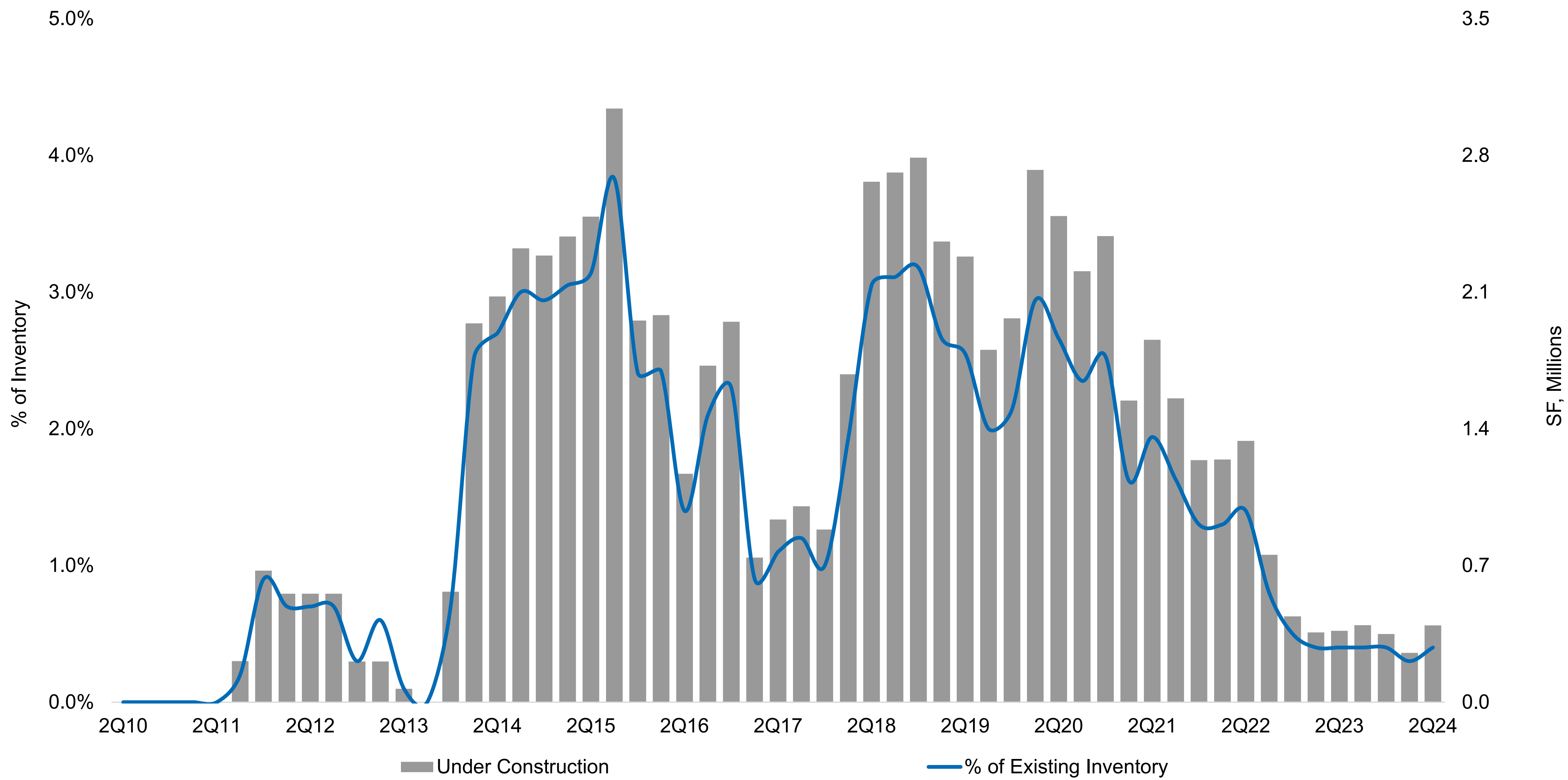
Under-Construction Activity Remains Limited

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. With only 393,578 SF of traditional office space currently underway, 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

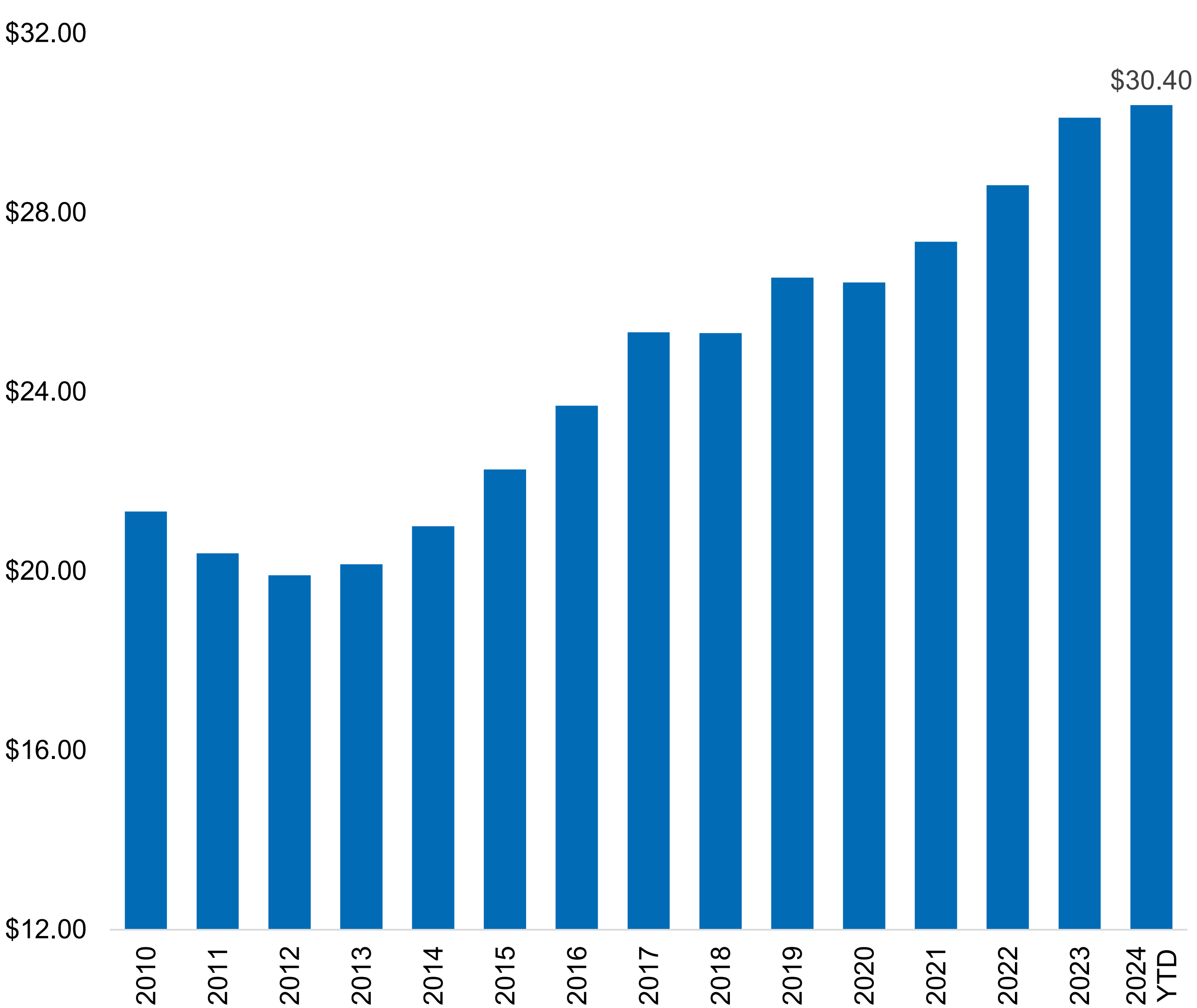


Source: Newmark Research

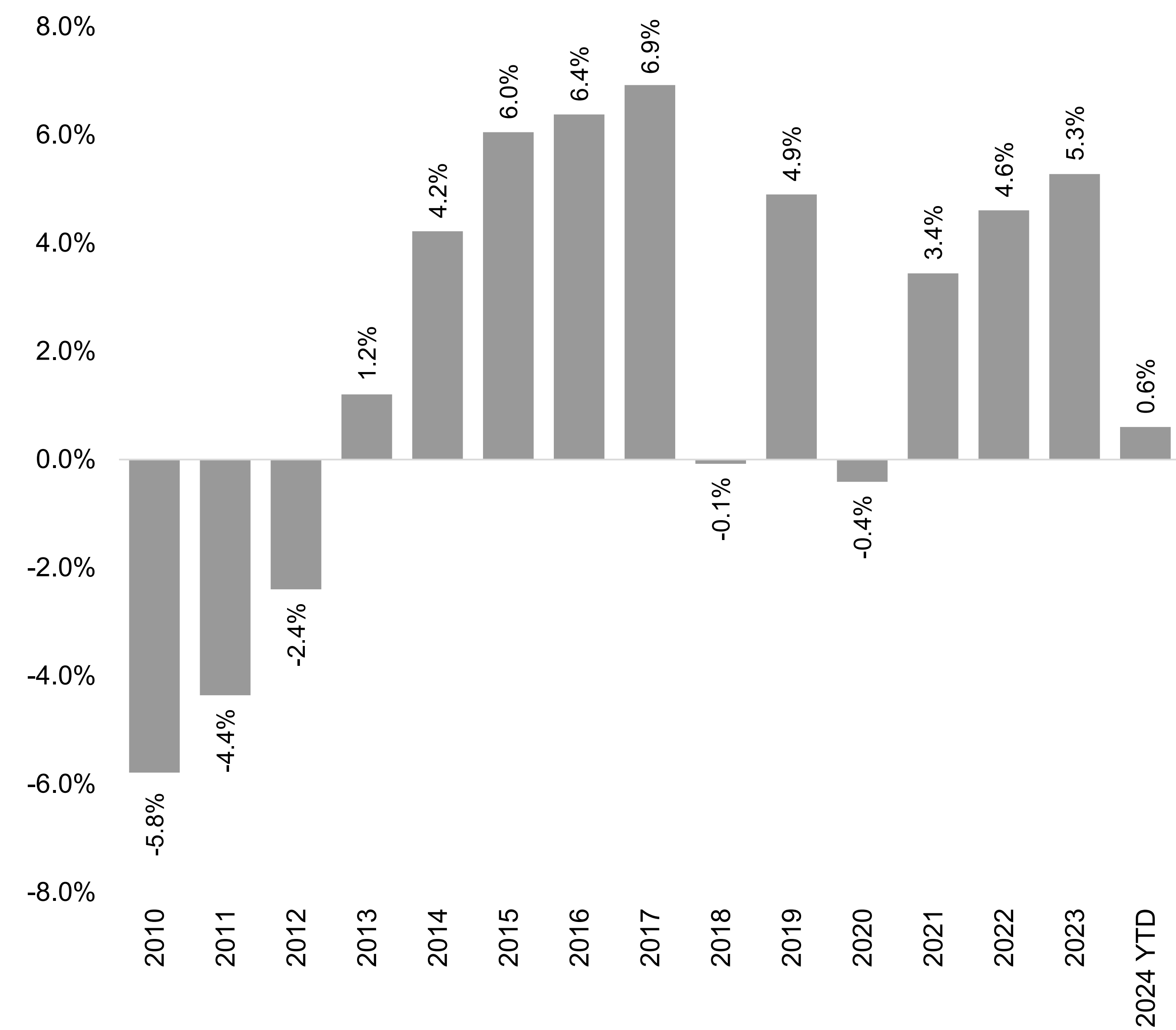
Asking Rent Growth Slows as Space Stagnates on Market

Office asking rent growth has stalled in 2024 as a growing inventory of vacant listings remains on the market for longer than the historical average. Landlords are holding rates for direct space, preferring to offer more in way of concessions and tenant improvement allowances to attract and retain tenants. Rates are not expected to appreciably increase until availability sufficiently declines.

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



Year-over-Year Asking Rent Growth Rate

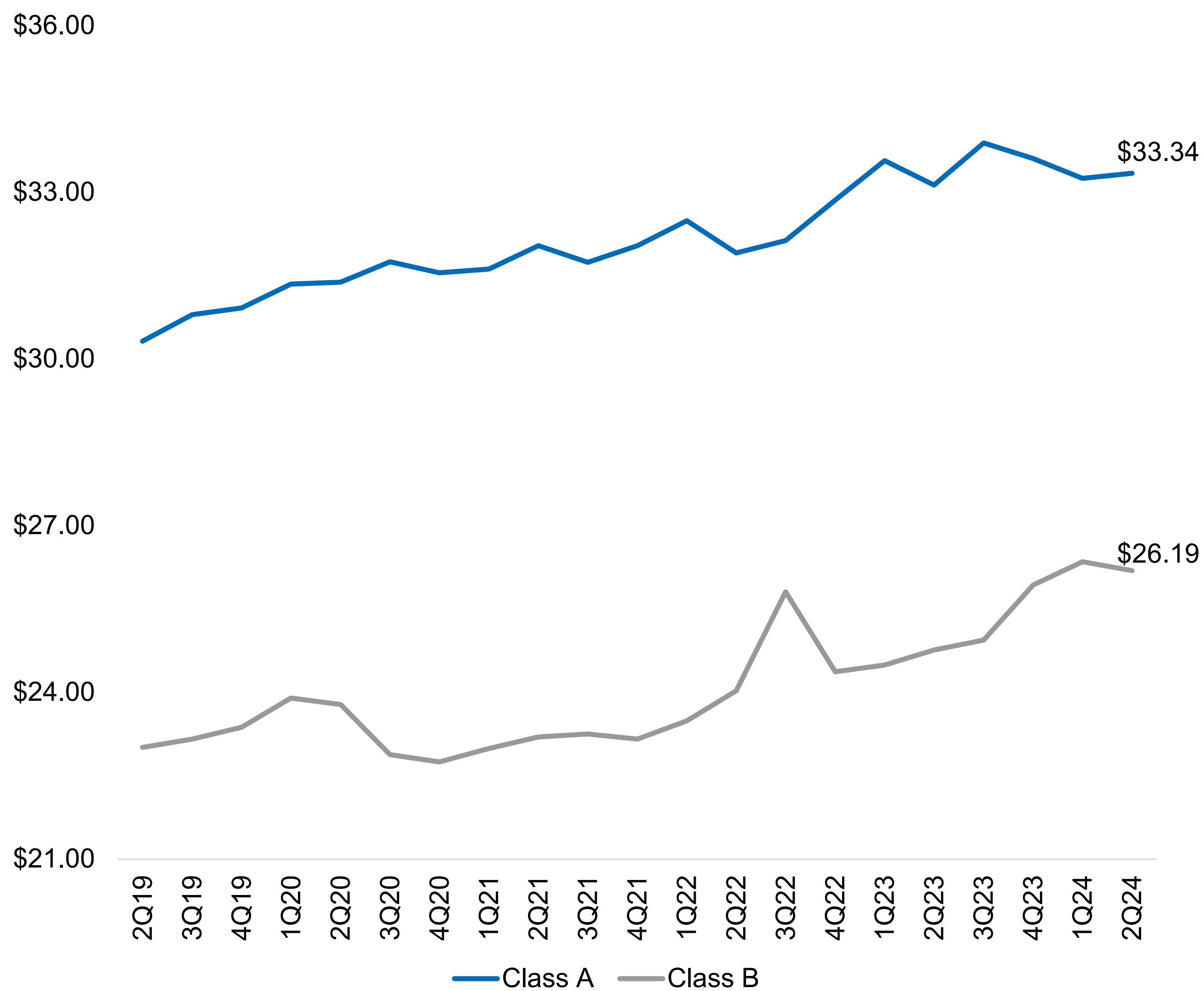


Source: Newmark Research

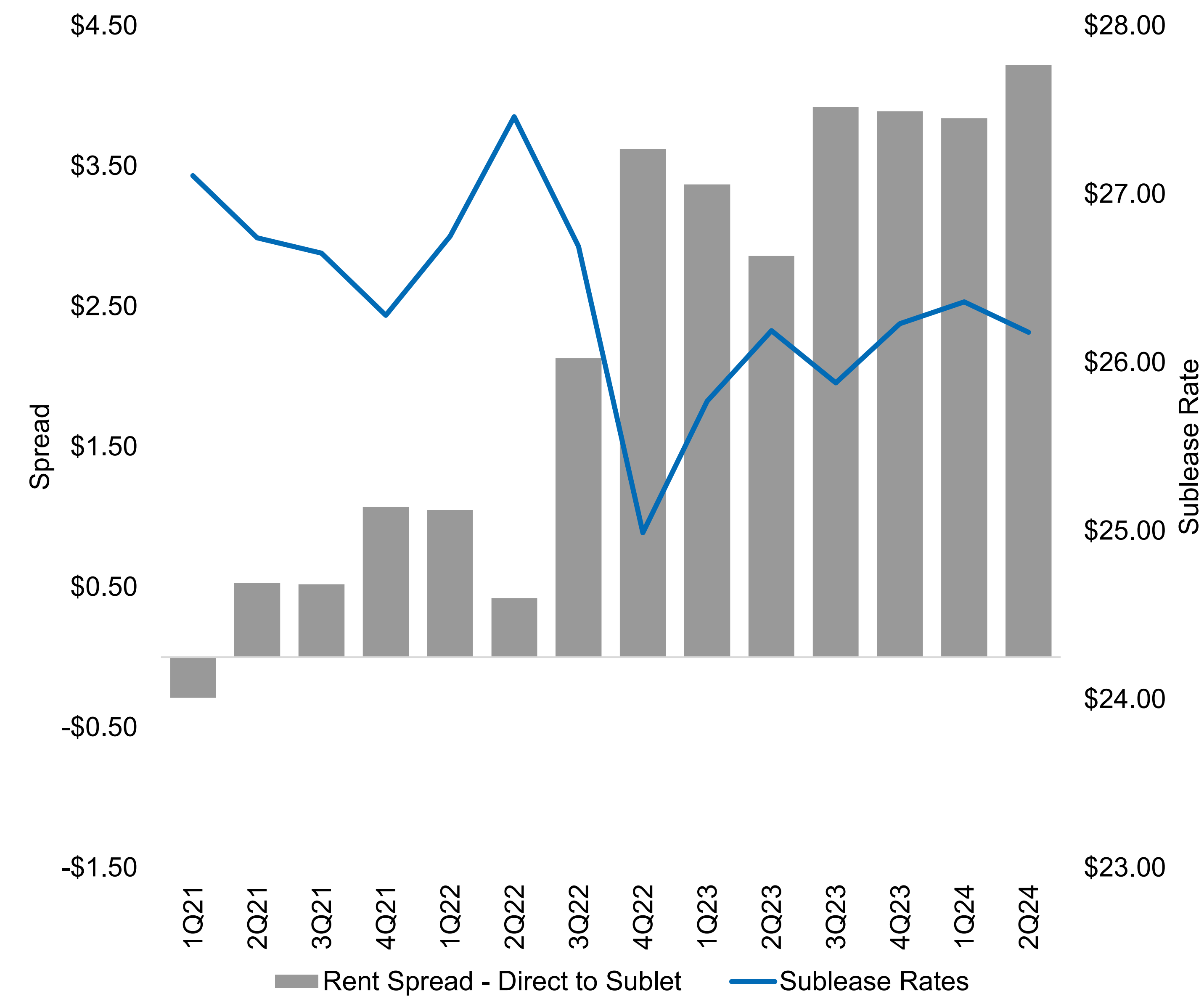
Rent Delta Between Direct and Sublet Widen

As sublease space enters and leaves the market, sublessors are bullish in competing with landlords by lowering rates to compete with direct space. The rent spread between direct and sublease space is now at $4.22/SF.

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



Sublease Asking Rates



Source: Newmark Research

2Q24 Notable Lease Transactions

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 2Q24 Lease Transactions

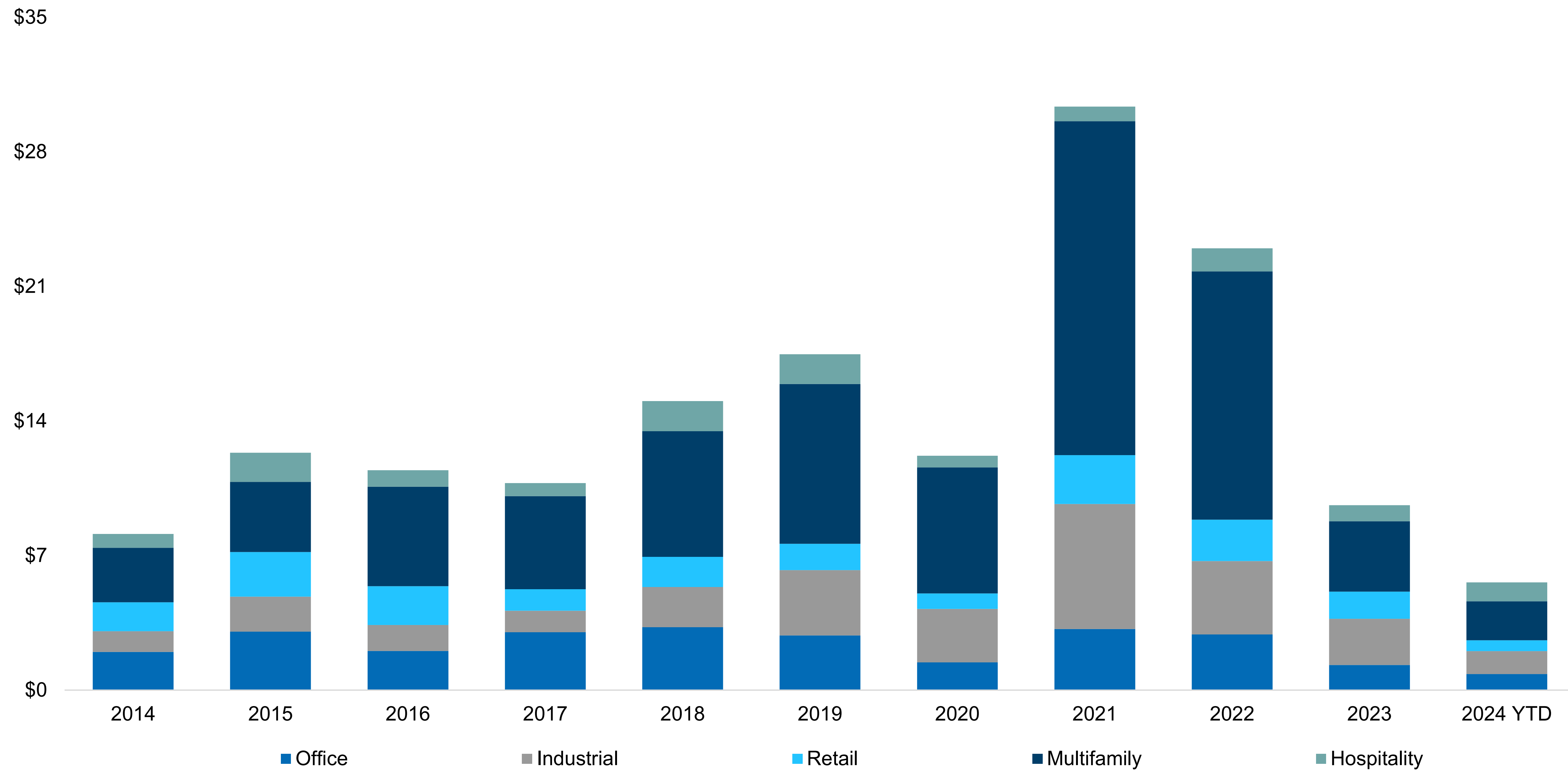
Tenant	Building(s)	Submarket	Type	Square Feet
Dutch Bros.	Liberty Center at Rio Salado	Tempe	Direct Lease	136,426
Dutch Bros. takes over as the sole tenant at Liberty Center, previously occupied by Carvana.				
Mobile Mini	Scottsdale Entrada	Scottsdale South	Direct Lease	89,716
Mobile Mini signed a direct lease at Scottsdale Entrada occupying 89,716 SF.				
Fennemore	Biltmore Center	Camelback Corridor	Lease Renewal	47,474
Fennemore elects to renew their lease at the Biltmore Center for another 3-years.				
LPL Financial	Marina Heights	Tempe	Direct Lease	42,467
LPL Financial sets their corporate office in the Tempe submarket, signing a new lease for 42,467 square feet.				
Colliers Engineering & Design Inc.	Elevate 24	Camelback Corridor	Sublease Relocation	35,741
Sublet by Edelman Financial Engines, Colliers Engineering & Design Inc. signed on for an 8-year term at Elevate 24.				

Source: Newmark Research

Total Sales Volume Picked Up in Second Quarter

Sales volume peaked at $23.0 billion in 2021 and has dropped substantially across all property types since. Office sales have comprised around 17% of total volume over the past 10 years. First-quarter 2024 sales were low but picked up in the second quarter with promising headwinds to surpass 2023, one of the slowest years the Metro has seen in over a decade.

Phoenix: Sales Volume Across Commercial Property Segments ($ in Billions)

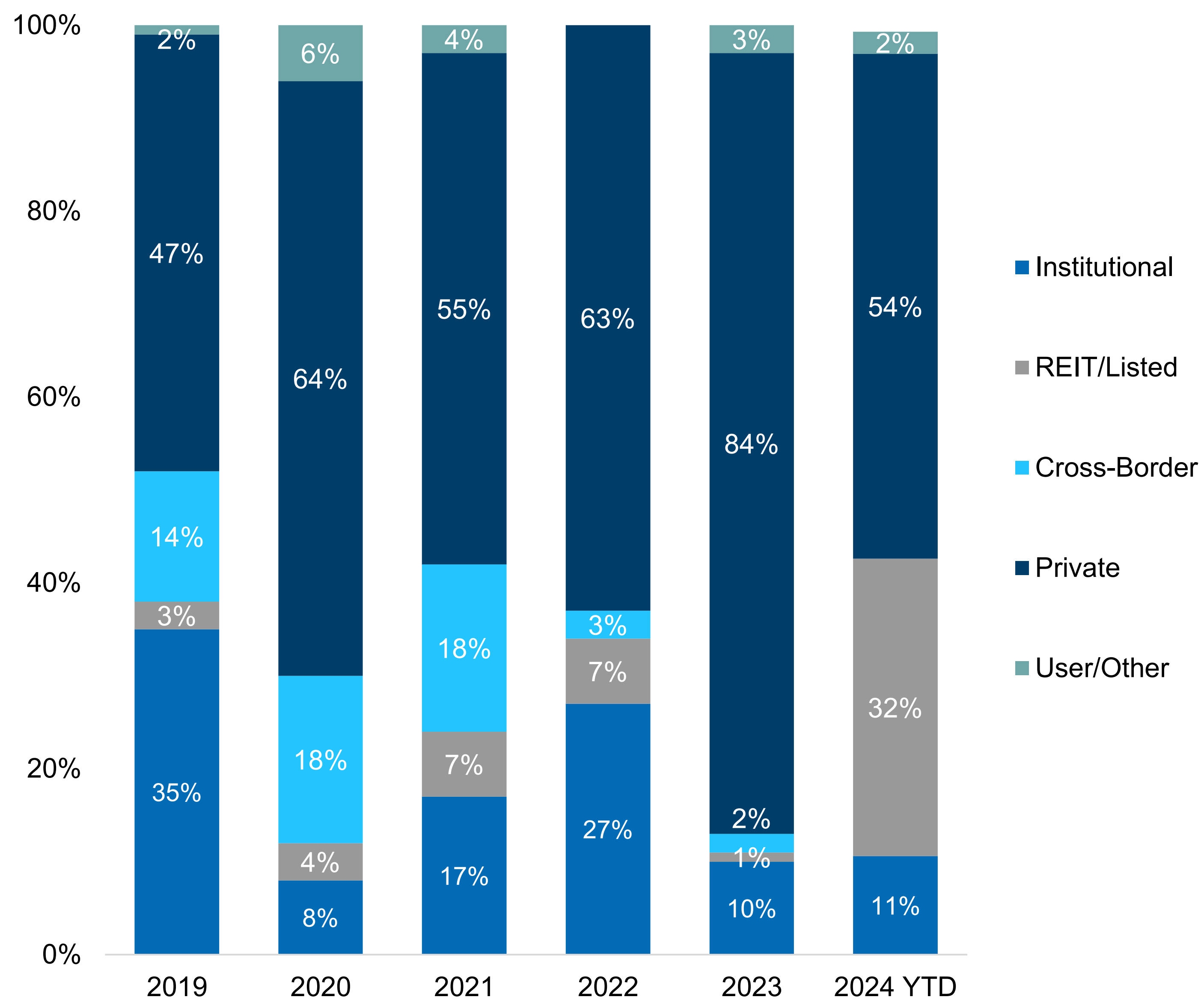


Source: Newmark Research, MSCI Real Capital Analytics
Note: Preliminary data is cited for the second quarter of 2024

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

Cash is king in higher-cost debt environments, and high-net worth individuals are generally active in such periods. Institutional and REIT/Listed entities, meanwhile, are generally less risk adverse and more beholden to the debt markets; however, the strength of Phoenix's healthcare market has kept medical office as an attractive location to place capital and buoy up overall office sales.

Phoenix: Office Buyer Composition, by Year | Based on Sales Volume



Phoenix: Most Active Office Buyers | Last 12 Months

Company	Investor Type	Volume	# of Properties
Healthpeak Properties	REIT/Listed	$250,400,000	17
Aligned Energy Data Centers	Private	$223,000,000	4
Easterly Gov Properties	REIT/Listed	$137,700,000	1
Presson Corp	Private	$125,600,000	3
John Hancock Real Estate Group	Private	$98,700,000	1
Columbus Properties Inc	Private	$86,100,000	1
Heitman	Institutional	$78,700,000	5
Humphreys Capital	Private	$66,400,000	1
Montecito Medical	Private	$62,300,000	2
Bridge Investment Group	Institutional	$61,800,000	1
Cardone Capital	Institutional	$59,300,000	1
Mill Creek Residential	Private	$58,000,000	2

Source: Newmark Research
Note: Preliminary data is cited for the second quarter of 2024.

Sales Activity Off to Steady Start in 2024

Office sales activity picked up in the second quarter of 2024, setting the stage for this year's volume to surpass 2023's total. 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 will likely enter the market.

Notable 2Q24 Sale Transactions

Building Address	Submarket	Sales Price	Price/SF	Square Feet
24th at Camelback – 2375 E. Camelback Rd.	Camelback Corridor	$86,100,000	$285	302,209
Part of an investment sale, 24th at Camelback was sold to Columbus Properties for $86.1 million.				
The Beam on Farmer – 433 S. Farmer Ave.	Tempe	$56,200,000	$300	187,088
Part of an investment sale, the Beam on Farmer was sold by Breakwater Property Partners for $56.2 million.				
Sky Harbor Center – 1825 E. Buckeye Rd. (Portfolio)	Airport Area	$44,300,000	$82	539,849
An individual investor acquired the interest in Sky Harbor Center, a 5-building office complex totaling 539,849 SF for $44.3 million.				
4141 Scottsdale – 4141 N. Scottsdale Rd.	Scottsdale South	$26,050,000	$161	162,227
George Oliver Companies purchased this 3-story office building from Palisades Capital Realty Advisors that was traded with a high vacancy rate.				
3200 N. Central – 3200 N. Central Ave.	Midtown	$24,470,000	$70	349,627
Sold to Younan Company Inc. by the DPC Development for $24.5 million, this newly renovated, 25-story office building was 72% occupied at the time of sale.				

Source: Newmark Research

2Q24

Appendix

Phoenix Metro Office Submarket Map and High-Level Statistics | 2Q24

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

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

Population Has Increased Four Times Over the Past Five Decades

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Newmark has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Research Reports are available at nmrk.com/insights.

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