JONES LANG LASALLE

Real value in a changing world

Office Insight

Phoenix . Q4 2013

Positive gains this year despite mixed signals from Washington

Economy

2013 was marred by skepticism as political upheaval from Washington and economic risks from abroad threatened to derail an already slow recovery. The year ended on a very positive note with just under 1.0 million square feet of total positive net absorption. Unfortunately, this total still falls almost 500,000 square feet short of last year's year-end results.

Despite the government shutdown in October, Phoenix reported a steady 2.3 percent job growth since last year, adding 36,000 jobs. Education and Health Services as well as Trade, Transportation, and Utilities contributed the most, together adding 18,000 jobs. Professional and Business Services and Financial Activities, the two sectors most closely tied to office-using employment, also recorded strong gains adding 7,000 and 6,000 jobs respectively. The unemployment rate has fallen back under 7 percent to settle at 6.8 percent after hovering around 7.2 percent throughout most of the year.

Market conditions

2013 is the first year to record four consecutive quarters of positive net absorption since before the recession in 2006. Although absorption gains fell short of 2012 totals, this consistent demand despite political brinkmanship in Washington is fueling a steady recovery. The fourth quarter saw similar absorption gains as compared to last quarter filling 379,550 square feet of previously vacant office space across the Valley. Total vacancy fell another 50 basis points to 23.8 percent.

New development remains at historically low levels with only 281,799 square feet being delivered this year. Current projects are limited to two BTS projects for General Motors and GoDaddy in the Southeast Valley, SkySong in South Scottsdale, and building four of Allred Park Place in Chandler. Developers are beginning to commit to Phoenix's recovery as several new proposed office buildings are expected to break ground in early 2014.

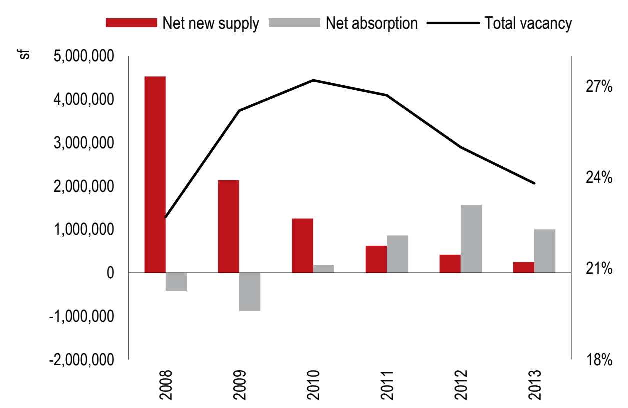
As expected the three hottest trending submarkets, the Camelback Corridor, Tempe, and Deer Valley, ended the year far ahead of any of their neighbors. These three submarkets were the only three to record over 100,000 square feet of positive net absorption each, with Camelback Corridor absorbing 401,696 square feet this year.

Outlook

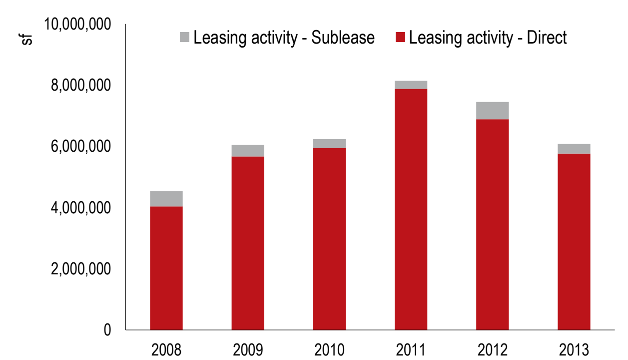
With much of the government uncertainty behind us, 2014 is setting itself up for stronger growth and employment gains, especially among the office-using sectors. Washington has agreed in December on next year's budget eliminating any risk of another government shutdown and the Federal Reserve has detailed its path for rolling back quantitative easing, effectively removing the speculation for when the financial support was to end. Although Phoenix is still several quarters away from regaining all of the jobs lost in the recession, the Valley is expected to start gaining traction through 2014.

Key market indicators		12-month forecast	
Supply	Supply	↑	73,632,664 sf
	Direct vacancy rate	↓	23.1%
	Total vacancy rate	↓	23.8%
	Under construction (% preleased)	→	565,623 sf (73%)
Demand	Leasing activity 12 mo. % change	↑	-18.5%
	Net absorption	↑	379,550 sf
Pricing	12-month overall rent % change	↑	0.93%
	Class A overall asking rent	↑	$23.80 psf
	Class B overall asking rent	↑	$18.48 psf

Net new supply, net absorption and total vacancy



Leasing activity: direct vs. sublease space



Tenant perspective

The Phoenix economy is expanding at a moderate rate, adding new jobs on a regular basis which is beginning to translate into increased demand for office space.

However, the moderate growth rate is well below pre-recessionary levels and has resulted in only incremental drops in vacancy, giving landlords pause.

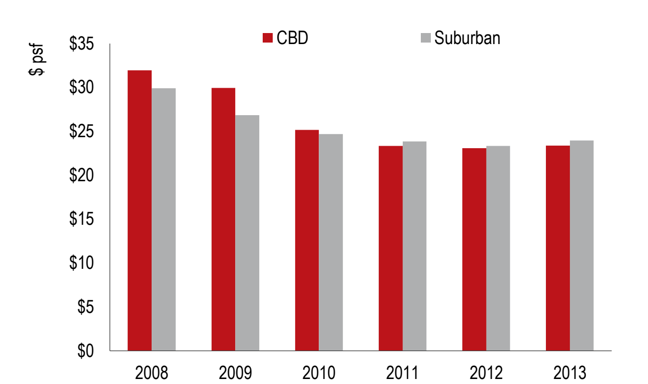
Occupiers are expected to retain their leverage at least through 2014 as Phoenix finds a way through its high levels of space inventory. They will continue to receive concessions as landlords compete to fill their vacant spaces. As occupiers are slowly priced out of the limited space available in submarkets such as the Camelback Corridor and Tempe, they will slowly gravitate to neighboring submarkets and continue to emphasize efficient space build-outs to save on costs.

Landlord perspective

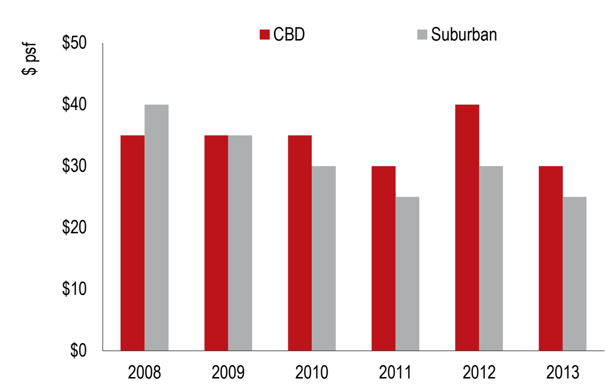
Commercial real estate fundamentals are expected to improve in line with the overall macroeconomic situation. As vacancy and absorption levels continue to record positive changes, landlords will be able to start driving prices to match. Rents have increased for the fourth consecutive quarter, growing by 2.1 percent over rents seen in the first quarter of this year. This year has been the first year rents have increased across the overall Phoenix market since 2007. Submarkets seeing strong demand such as the Camelback Corridor are seeing rents grow by 3-4 percent over the last year.

Development remains in check as demand has yet to increase enough to make a solid case for breaking new ground. A few select developers are beginning to explore the idea of adding to Phoenix's inventory, but overall limited construction will force occupiers to choose from existing available spaces.

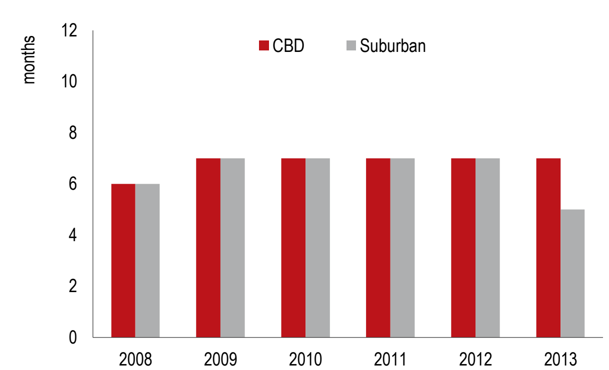
Class A overall asking rents



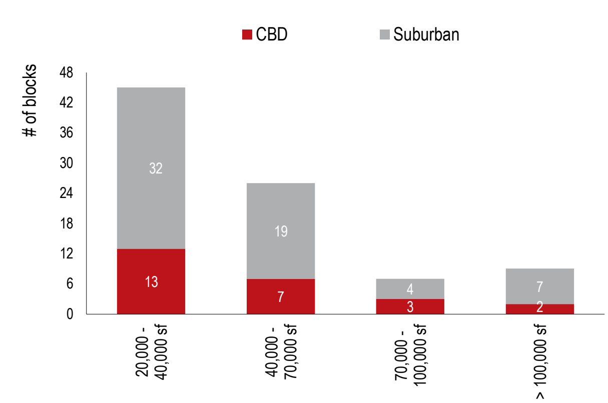
Class A tenant improvement allowance



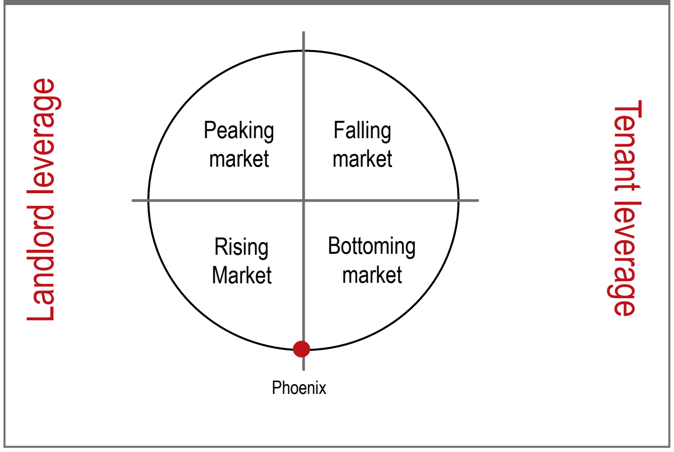
Class A free rent



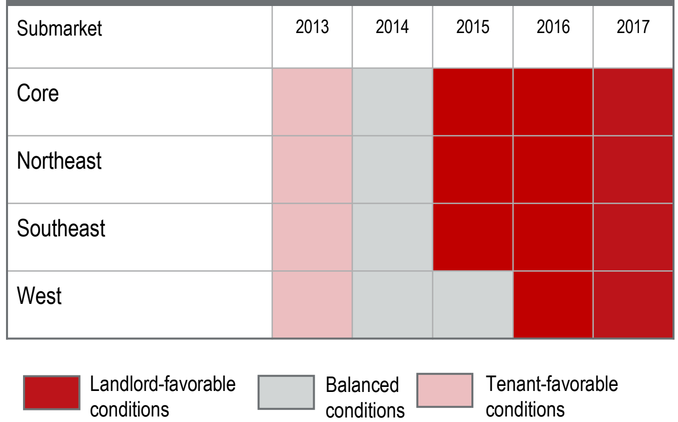
Class A blocks of vacant contiguous space



Property clock – current market conditions



Submarket leverage – market forecast



Completed lease transactions

Tenant	Address	Submarket	sf	Type
Matrix Absence Management	2421 West Peoria Avenue	Northwest Phoenix	68,554	New
AZ DOT	3838 North Central Avenue	Midtown	51,222	New
Tiffany & Bosco	2525 East Camelback Road	Camelback Corridor	42,787	New
Carlson Wagonlit Travel	2401 West Peoria Avenue	Northwest Phoenix	25,815	New
Accolade	8777 East Hartford Drive	Scottsdale Airpark	25,552	New
USA Digital Solutions	10835 North 25th Avenue	Northwest Phoenix	12,965	Renewal
ProVision	1501 West Fountainhead Parkway	Airport Area	11,883	New

Completed sale transactions

Property	Submarket	Buyer / Seller	sf	$ psf
Missouri Falls	Midtown	ICIC Commercial Investments / Private	187,446	$75
Arcadia Gateway Center	44th Street Corridor	MIG Real Estate / Private	89,835	$118
1511 North Project Drive	44th Street Corridor	SRP / Altier Credit Union	61,807	$126

Phoenix methodology: Inventory includes all Class A, B, & C office properties >20,000 square feet, excluding all condo, medical and government owned buildings and owner occupied buildings

Jones Lang LaSalle

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