



Phoenix office market report

Q4 2023

**AVISON
YOUNG**

Phoenix office market trends

24.5%

Total Vacancy Rate (%)

The Phoenix office market continues to see persistently high vacancy, with total vacancy sitting at 24.5% for Q4 2023. Direct and sublet vacancy, at 18.6% and 5.9% respectively, equate to a total of 23.3 million square feet of vacant space.

In contrast to Q3 2023, where vacancy was 24.4%, the Valley saw a mere 0.1% increase in Q4 2023. Looking at the growth of vacancy from Q1 to Q3 2023, there were 1.0% increases between each quarter due to both direct and sublet space hitting the market. This trend may indicate that vacancy rates are reaching a plateau as the velocity of increased availability has slowed.

-94.5k

Total Net Absorption (sf)

In Q4 2023, net absorption reported -94,555 square feet compared to last quarter reporting -910,000 square feet and Q2 reporting -970,000 square feet. While the lack of office space demand has put the market in a tough position, Q4 has observed a noticeable deviation from previous quarters in 2023, as the market saw a decrease in negative absorption. This means the rate at which negative absorption grows appears to be decelerating. Although Q2 and Q3 of this year didn't fare well, the year-end brought in a positive turn with its 10.4% decrease in negative absorption from Q3 to Q4 2023.

\$131.7m

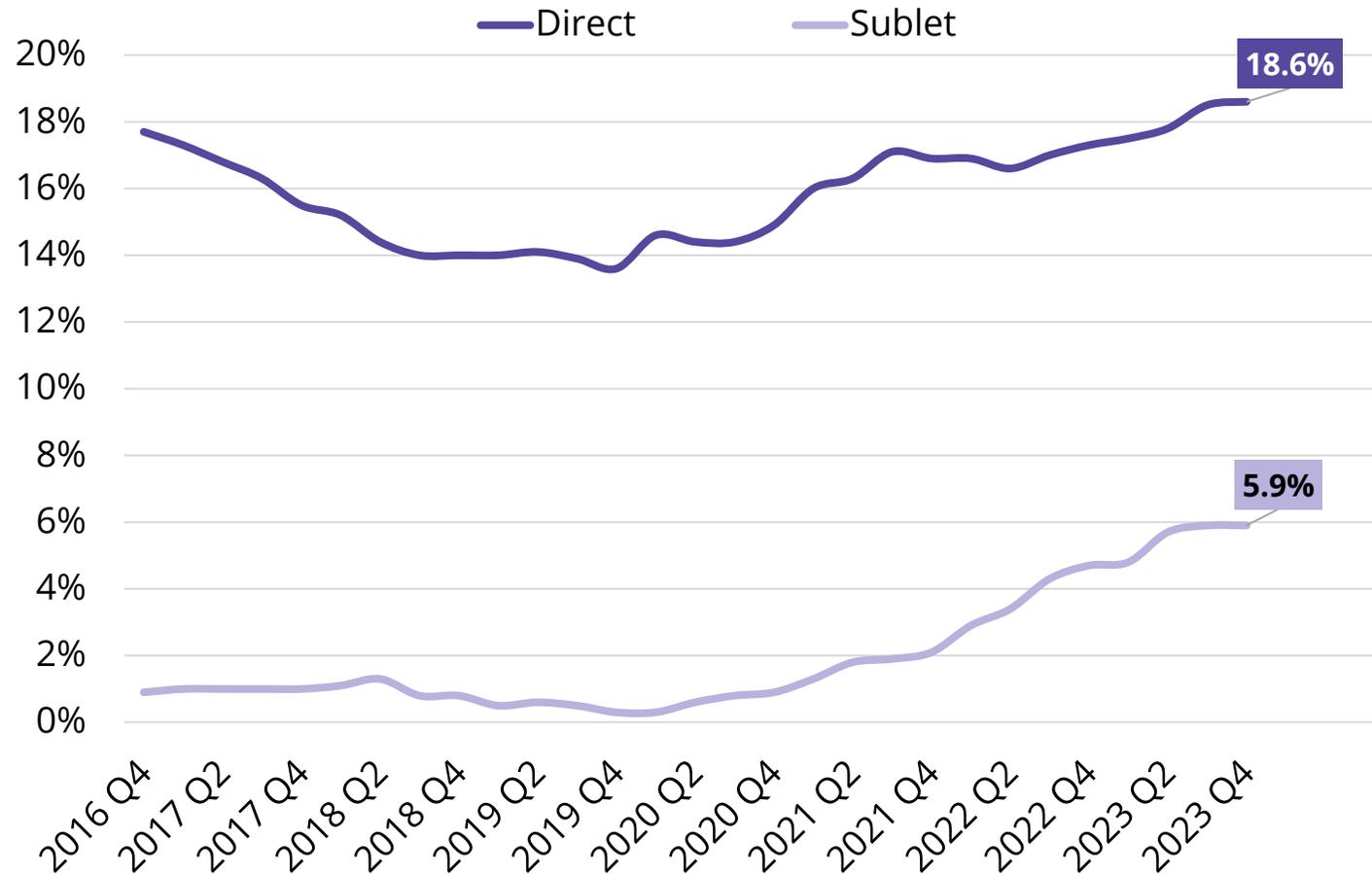
Transaction Volume* (by \$)

In the dynamic 2023 sales landscape, year-to-date sales stand at \$725 million, a figure significantly lower than recent annual averages such as 2022 and 2021 both reporting over \$2B in sales each. In Q4 2023, sales volume totaled \$131.7 million, which added to the compounding concerns about the office market's health, as sales saw a substantial \$90 million drop from Q3 2023.

Faced with challenges, investors may explore niche segments like medical office, which is seeing healthy growth, as the sector contributed to roughly 40% in Q4 2023 total transaction volume. The evolving healthcare infrastructure offers stability amidst the unpredictable office market.

***Transaction volume stats include medical office properties, other statistics do not.**

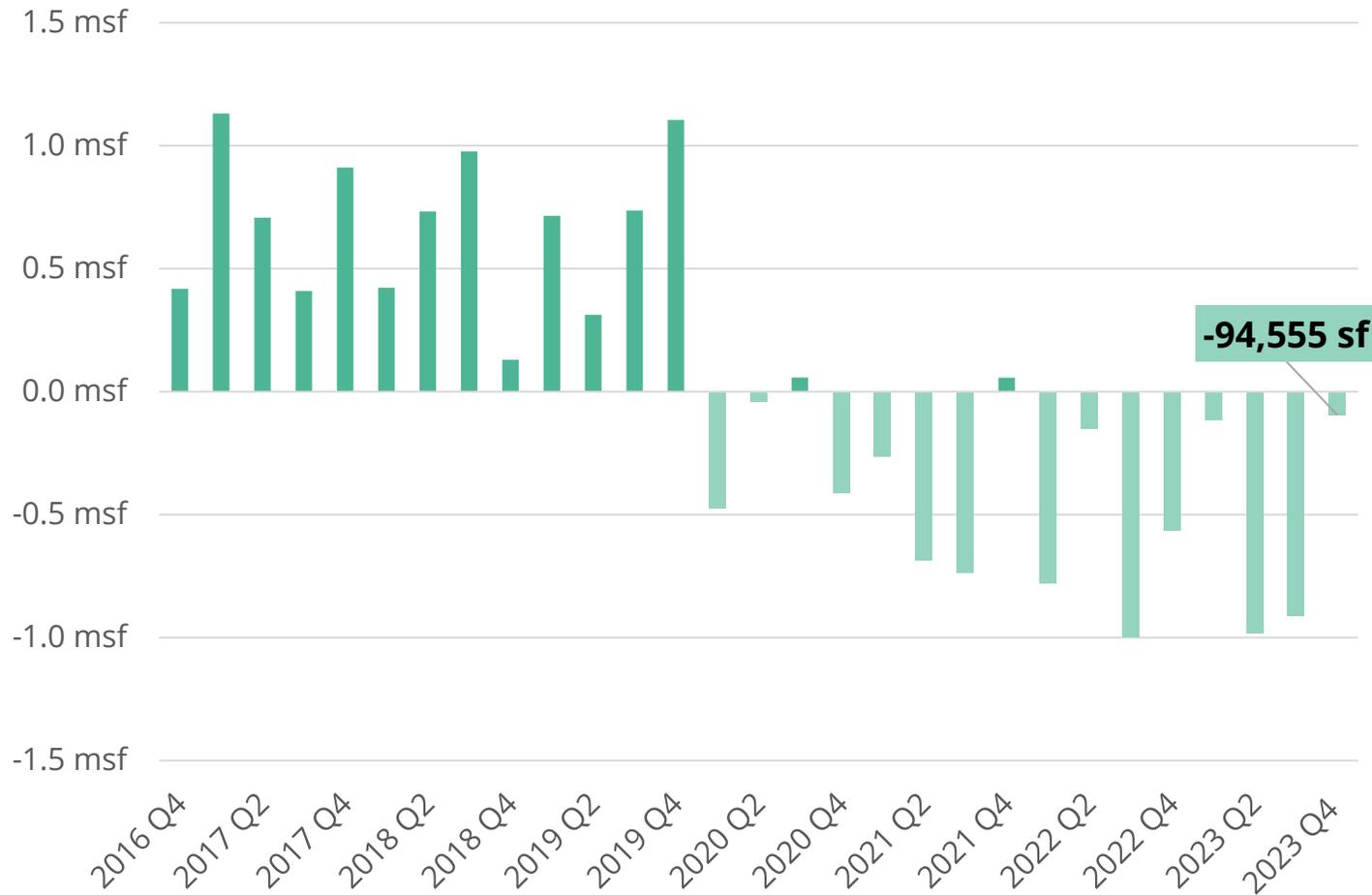
Phoenix office: Direct and sublet vacancy (%)



While the Phoenix office market experienced little growth this quarter, all prior quarters in the year recorded a consistent 1% uptick in vacancy (quarter-over-quarter). Q4 2023 saw a remarkable departure from this trend with a minimal increase in direct vacancy of 10bps taking the rate from 18.5% (Q3) to 18.6%.

Despite the modest numerical shift, this change carries a seemingly positive turn for the market, where growing vacancy rates may reach a plateau.

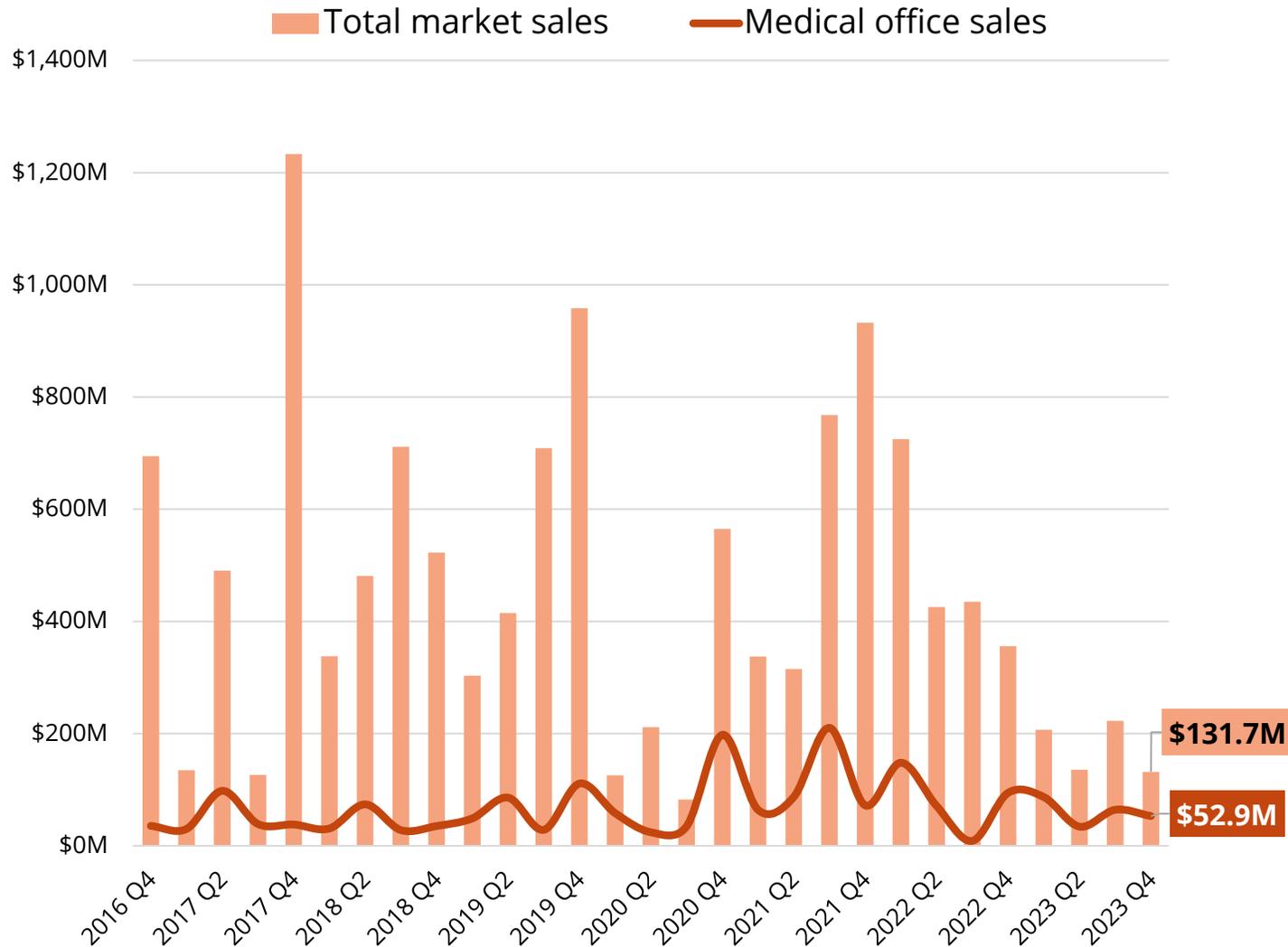
Phoenix office: Net absorption (sf)



Negative net absorption continues to pose challenges in the Phoenix office market quarter-over-quarter. However, this quarter reflects a decrease in this adverse trend compared to the last two quarters, where Q2 and Q3 showed signs of stabilization.

At the close of Q2 and Q3, net absorption was recorded at -970,000 sf and -910,000 sf respectively. Q4 shows a significant improvement, concluding the year with a net absorption of -94,555 sf.

Phoenix office: Transaction volume (\$)



While Q3 for the Phoenix office market saw a great recovery for year-to-date sales, Q4 did not fare well, as sales dropped in comparison to the previous quarter and closed out the year, bringing in \$131.7M.

On a better note, the medical office sector continues to fare well due to heavy government subsidization and increased healthcare demands from the COVID-19 pandemic. The sector has contributed to more than 40% of the total transaction volume for Q4 2023 – roughly \$52.9M out of \$131.7M, providing an opportunity to shift the focus to stabilize traditional office space.

Appendix



Phoenix office market activity

Q4 - Top leasing activity

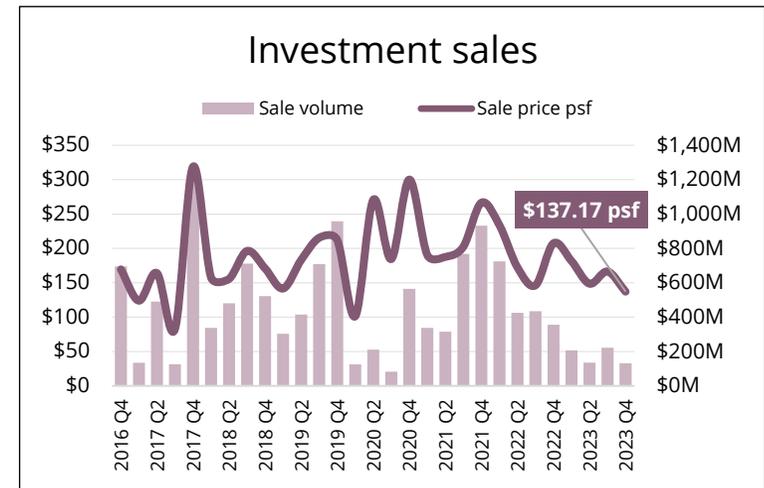
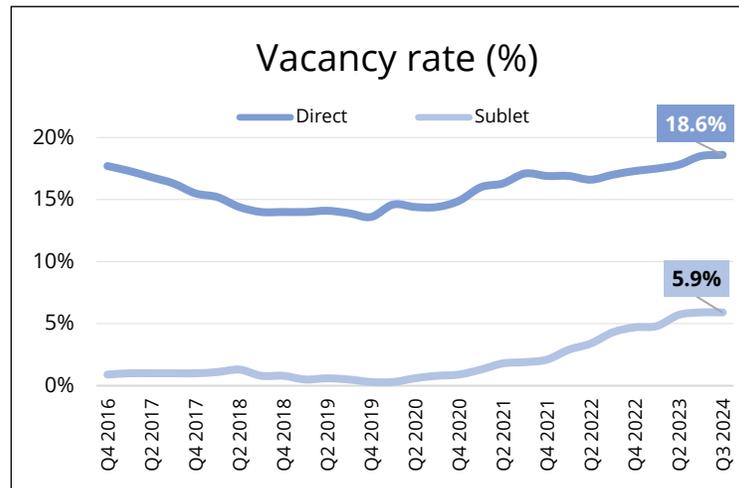
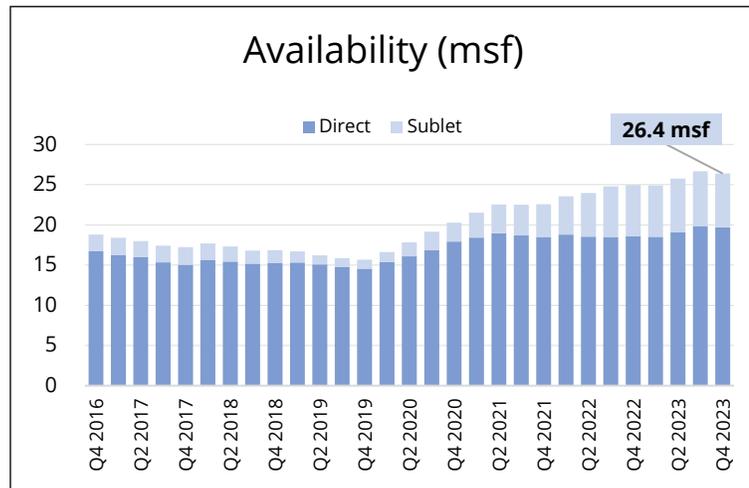
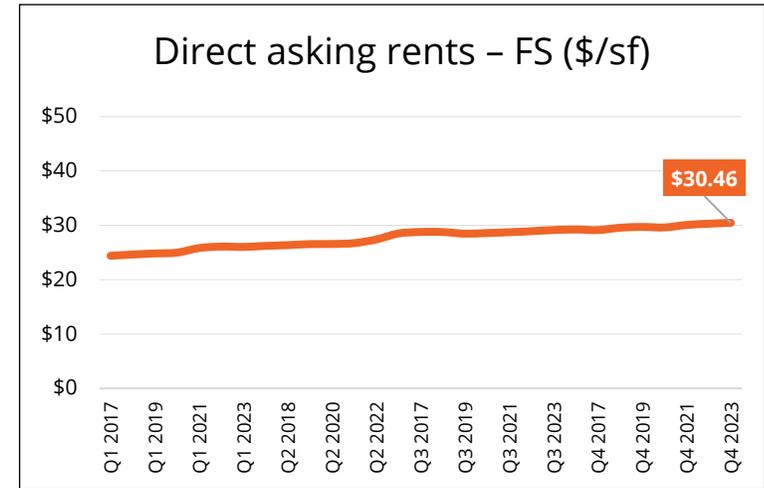
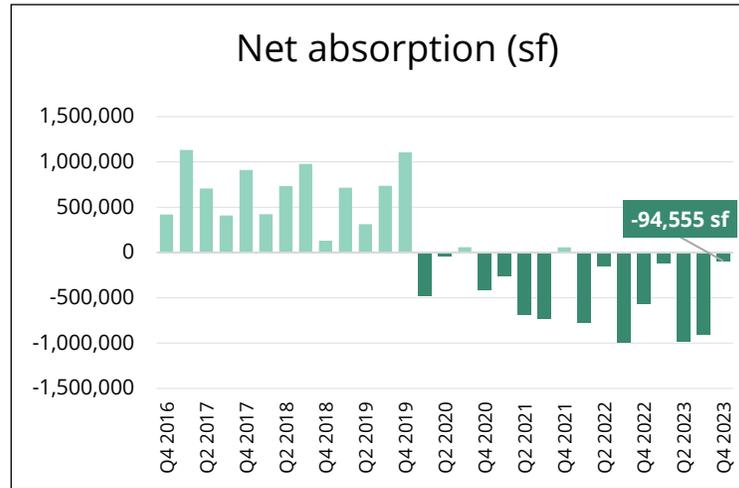
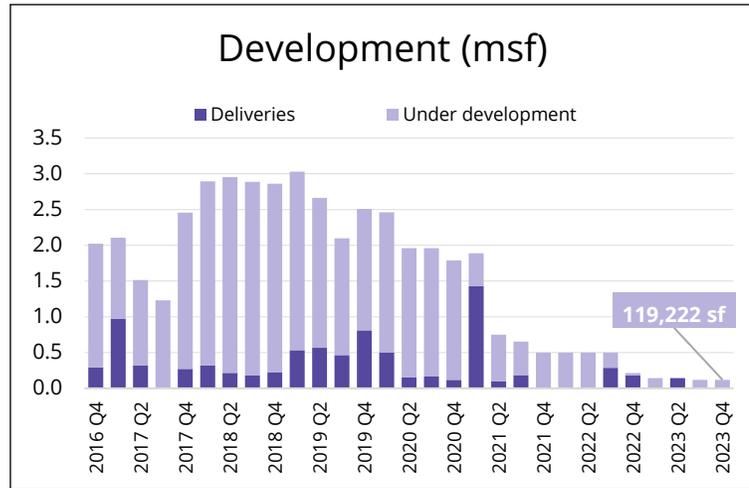
Tenant	Address	Submarket	Sign date	Size (sf)	Transaction type	Lease type
Peckham Industries	3150 S 48 th St	Airport Area	October 2023	136,194	Sublease	New Lease
Northrup Grumman	1715 N McQueen Rd (Bldg 3) – SWC Elliot Rd & McQueen Rd	Chandler	October 2023	119,222	Direct	New Lease
OfferPad	433 S Farmer Ave	Tempe	November 2023	41,164	Direct	New Lease
Ports America	222 S Mill Ave	Tempe	November 2023	27,240	Direct	New Lease
Trinity Air Medical	4100 W Galveston St	South Tempe/ Ahwatukee	November 2023	25,981	Direct	New Lease

Q4 - Top sales activity

Buyer	Address	Sale date	Building size (sf)	Sale price	Sale price psf	Seller
Providence Real Estate Group	14350 N 87th St, Scottsdale	November 2023	138,693	\$26,500,000	\$191.07	New York Life Investments
Envita Medical Centers of America	16552 N 90th St, Scottsdale (Bldg B)*	October 2023	128,998	\$15,930,000	\$123.49	Strategic Office Partners
Stenson Tamaddon	200 E Van Buren St, Phoenix	November 2023	245,513	\$14,500,000	\$59.06	ViaWest Group
UDLR Healthcare	5757 W Thunderbird Rd*	December 2023	86,492	\$13,500,000	\$156.08	Banner Health
Margaret Rice	22363 E Domingo Rd – NWC E Ocotillo Rd & Signal Butte Rd*	December 2023	22,000	\$12,180,000	\$553.73	Cypress West Realty Management, Inc.

*Medical office properties

Phoenix office market indicators



Note: This report is exclusive to office properties that are 20 thousand sf and up.

Phoenix office: Submarket stats

Submarket clusters	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct availability	Sublet availability	Total availability*	Net absorption sf (Q/Q)	Net absorption % of inventory (Q/Q)	Annual direct asking rent psf (FS)
Airport Area	8,542,556	-	-	13.9%	15.1%	29.1%	53,403	0.63%	\$26.48
Central Corridor	17,023,612	-	-	26.5%	1.1%	27.7%	(37,615)	(0.22%)	\$27.83
East Phoenix	11,026,675	-	-	21.0%	3.6%	24.6%	85,899	0.78%	\$33.73
East Valley	24,313,760	110,442	119,222	21.2%	10.7%	31.8%	(179,105)	(0.74%)	\$34.26
North Phoenix	3,107,575	-	-	21.7%	3.3%	24.9%	(25,995)	(0.84%)	\$32.17
Northwest Phoenix	10,990,726	-	-	23.3%	8.7%	32.0%	96,189	0.88%	\$25.24
Scottsdale	17,349,287	32,054	-	16.4%	5.2%	21.3%	(40,058)	(0.23%)	\$34.37
West Phoenix	2,562,634	-	-	16.0%	0.5%	16.5%	(47,273)	1.85%	\$29.61
Market total	94,916,825	142,496	119,222	20.0%	6.03%	26.03%	(94,555)	(0.10%)	\$30.46

*Availability rates differ from vacancy rates due to space being listed as available prior to current leases' expiration and the pre-leasing of unreleased space.

Phoenix medical office market

Let's examine medical office trends in the valley.

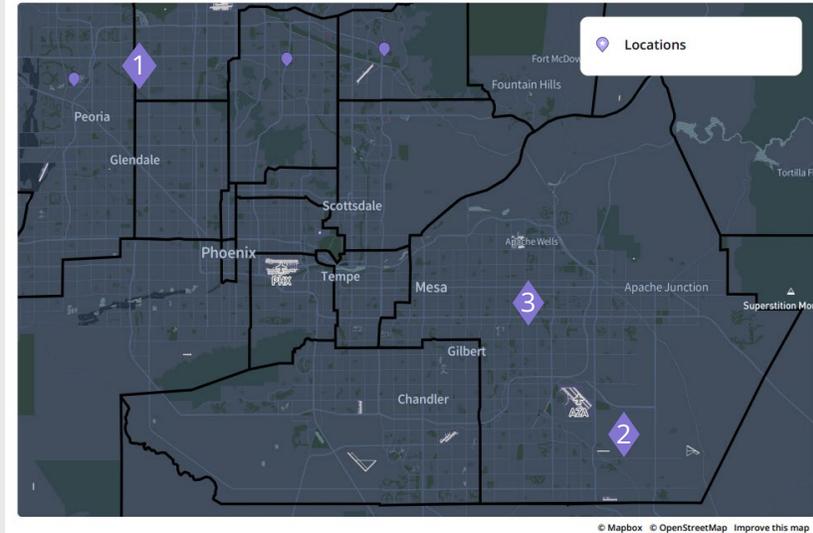


Top medical office sales nationwide - Q4 2023



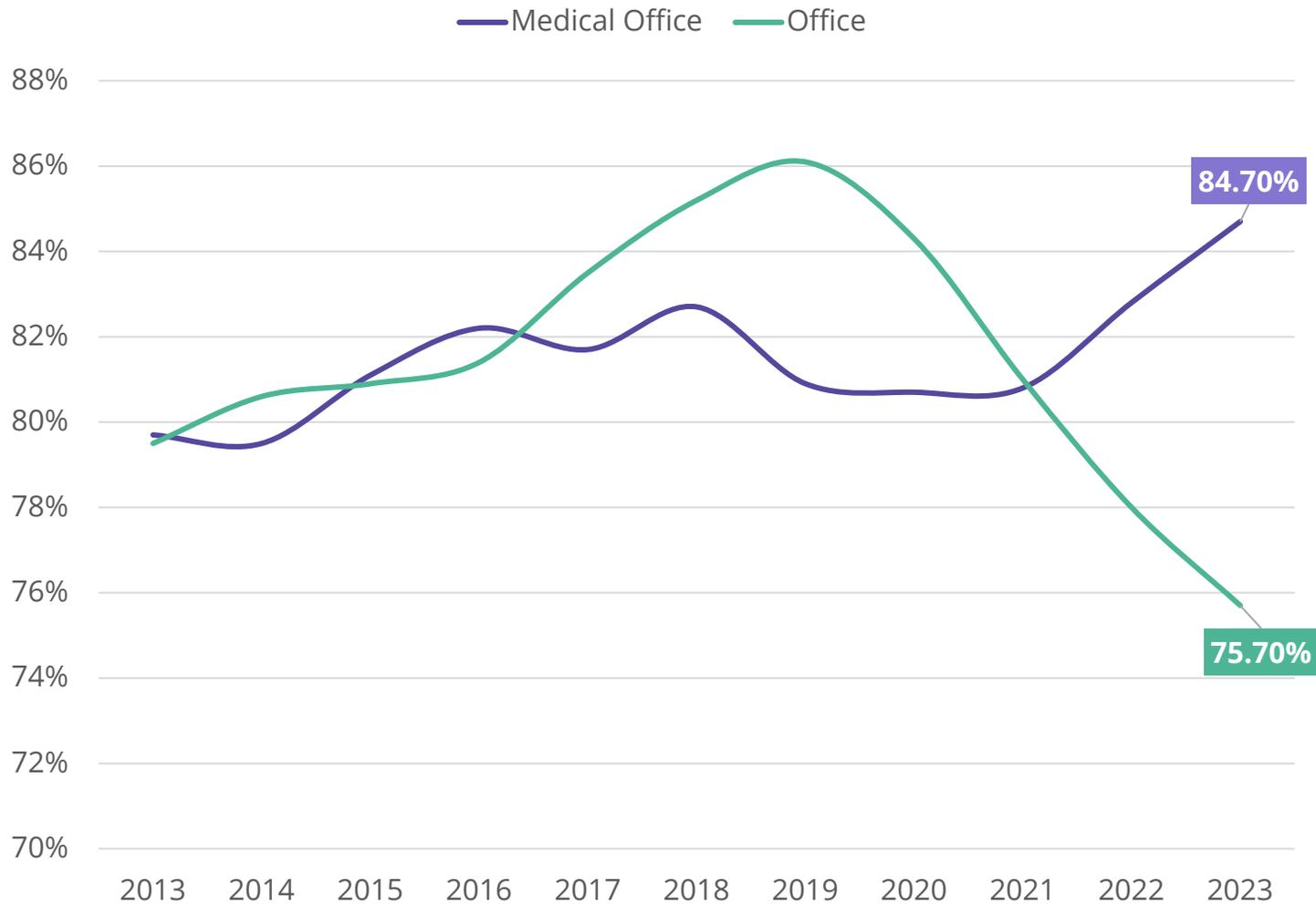
In Q4 2023, Phoenix is a leader in medical office sales across the nation. Positioned next to other markets known for their strong healthcare industry, Phoenix shows opportunity for investors and tenants alike. The valley's medical office sales made up 40% of its total office transaction volume this quarter, showing an upward perspective for the office market.

Phoenix's Top Medical Office Sales - Q4 2023



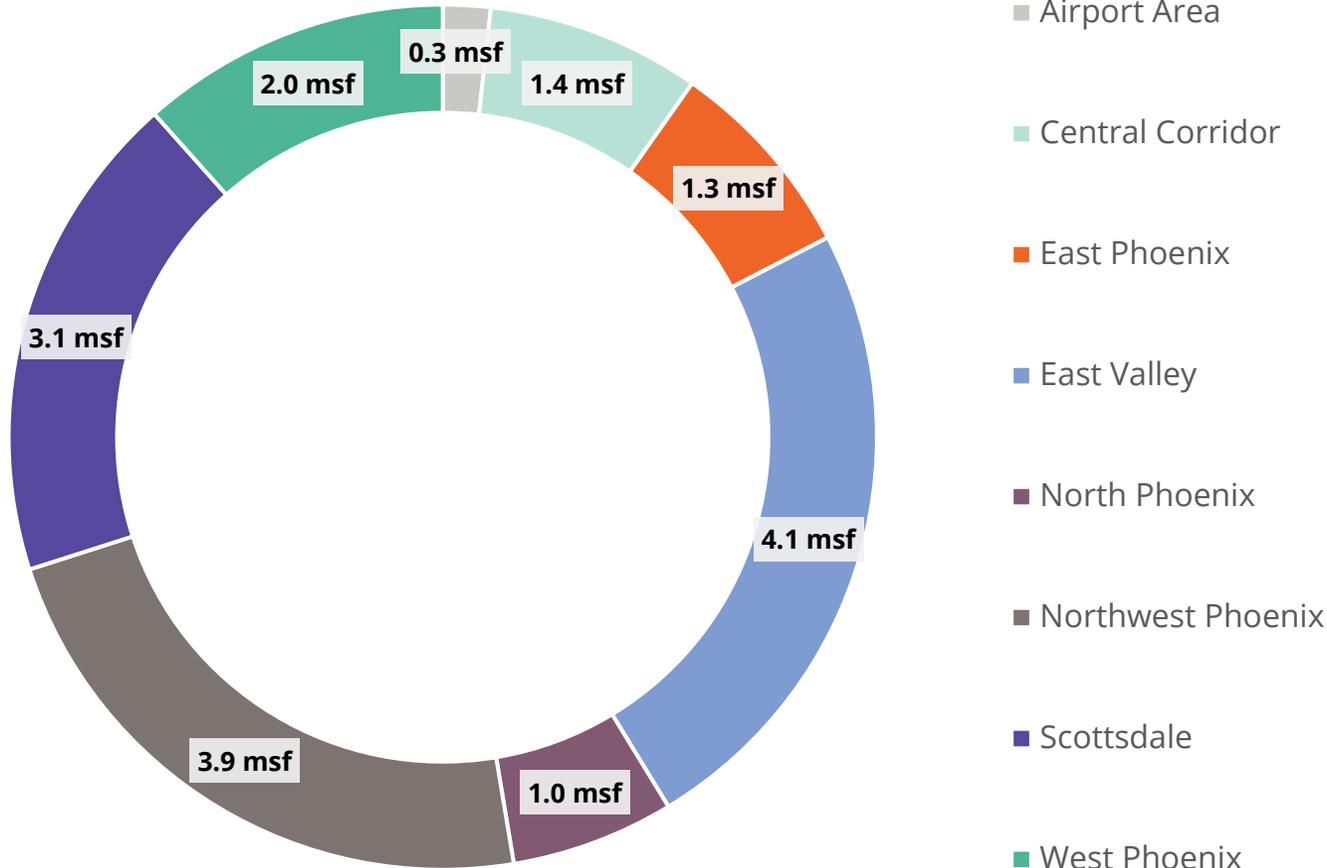
- 1** **5757 W Thunderbird Rd**
 \$13.5M - 86,492 SF
- 2** **22363 E Domingo Rd**
 \$12.2M - 22,000 SF
- 3** **5222 E Baseline Rd**
 \$12.0M - 62,480 SF

Phoenix office occupancy rates (%)



In the years following the COVID-19 pandemic, the Phoenix office market has faced profitability challenges, but the medical office sector has thrived, bolstered by government support and a growing 55+ population. This demand surge is evident in rising occupancy rates, hitting 84.7% by the end of 2023, in sharp contrast to the decline of traditional office occupancy since 2020. As the medical office sector establishes itself as an essential component of the current office landscape, many investors are shifting toward this dynamic portion of the office market.

Phoenix medical office inventory (msf): Submarket clusters



At the end of 2023, the Phoenix medical office market holds around 17.1 million square feet*, which makes up 18% of the Phoenix office market's total inventory. Submarkets in the Phoenix medical office sector with the highest levels of inventory include Scottsdale, Northwest Phoenix, and the East Valley. Of these three, the East Valley is the most attractive in the medical office sector as it observes lower vacancy, at 13.9%, and a substantial inventory of 4.1 million square feet.

*Does not include owner occupied space.

Office insights glossary of terms

Demand

- **Leasing activity:** total square footage of relocations, renewals, expansions and subleases expressed when the leases are signed, not when tenants take physical occupancy of the space
- **Absorption:** period-over-period change in occupied square footage

Supply

- **Direct vacancy rate:** space operated by landlords that is ready for immediate occupancy
- **Sublease vacancy rate:** space operated by sublandlords that is ready for immediate occupancy
- **Total vacancy rate:** sum of direct vacancy rate and sublease vacancy rate
- **Availability rate:** space that is vacant plus space that will become vacant over an indefinite time horizon, including spaces that are occupied by vacating tenants and under-construction properties

Office rents and concessions

- **Asking rents:** pricing guidance provided by landlords to tenants for available space expressed as full service (FS)
- **Base rents:** fair market value of market-level lease pricing based on representative executed leases, expressed as full service (FS)
- **Free rent period:** months of free rent that are typically provided upfront by landlords to tenants as a concession to offset the total cost of a lease and/or the construction timeline of an office suite
- **Tenant improvement allowance:** an allowance expressed in dollars per square foot provided from landlords to tenants to offset build-out, engineering, space planning and related permit costs
- **Net effective rent:** base rents discounted by the dollar values of tenant improvement allowance and free rent concessions expressed as full service (FS)

Capital markets

- **Investment volume:** office sales dollars expressed when the transactions close and based on inventory thresholds; partial-interest sale dollar amounts are not grossed-up to reflect the 100% value of the sale
- **Asset pricing:** unweighted average per-square-foot asset pricing of market-level closed sales
- **Cap rate:** net operating income divided by sale price; this measurement of market-level investment returns is calculated as an unweighted average based on closed investment sales

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