PHOENIX, AZ

25 PERCENT

The **percentage of space still available** out of the retail construction underway at the end of the third quarter.

2016

- STABLE ECONOMY
- INDUSTRIAL PLAYER
- UNEMPLOYMENT DOWN

OVERALL MARKET

Phoenix market stabilizes under the new model of substantially decreased population growth and regained job market stability.

SUMMARY & FORECAST

While far from pre-recession activity levels, the Phoenix job market has regained stability, if not dynamism over the last 18 months. The challenge has been and will continue to be sustaining growth in the revised Phoenix, which has a substantially different appearance than the pre-recession Phoenix when residential migration and the associated housing boom had been the significant market driver.

While construction jobs number roughly 50 percent of their 2005 figures, the number of construction jobs did increase during the summer. Phoenix is now a 20,000-unit per year housing market, down considerably from the 63,000-unit high mark set in 2005, but right-sized to meet demand. Unemployment was down to 4.1 percent in November 2016. Economists predict that while sluggish, the regional economy will grow in 2017.

Commercial real estate growth is also seeing a slow-but-steady recovery pattern. The office market, fairly unique in that the region's sprawl has resulted in several distinct, non-adjoining submarkets, is, in fact, seeing a recovery which is outpacing that of the Phoenix economy, on the whole. Demand for large contiguous floor plates greatly exceeds existing supply. This has prompted construction of new Class A product along freeway interchanges in select sub-markets such as Tempe, Gilbert, Scottsdale and north Phoenix. The office market posted almost three million square feet of net absorption through the third quarter 2016, in line with 2015 levels. Overall vacancy was down to 15.4 percent on September 30, 2016.

The industrial market achieved just over three million square feet of net absorption through the third quarter, less than half of the almost eight million achieved in 2015. The average quoted lease rate was $.57 per square foot per month across all submarkets and classes of industrial space, up from $.52 per square foot per month at the close of 2015. The decrease in net absorption is further evidence of the pause in job growth this summer. Phoenix has also been plagued by a loss of traditionally high-paying manufacturing jobs. However, recent marketing by economic development officials may be able to turn this around as Phoenix vies for several aerospace and defense companies, which will add allure to the Phoenix area. As companies move to the area and further deplete Phoenix' available space, net absorption should increase in 2017. Look for several large deals in 2017 as business confidence grows in the Phoenix area as a re-emerging industrial player.

The retail market is also seeing a slow return to health in regards to now grocery-anchored projects, with Fry's Food Stores, Safeway and Sprouts leading the way. Just over 1.4 million square feet of positive net absorption has been logged through the third quarter of the year, which is on par with the 1.9 million square feet of total net absorption logged in 2015. The average asking rental rate was up to $14.60 per square foot per year at the end of the quarter, having increased every quarter of 2016. However, it should be noted that new construction rental rates are typically exceeding $30 per square foot per year with high demand intersections leasing in the upper $40's to low $50's per square foot per year. It is expected that the Q3 2016 vacancy rate of 9.0 percent will continue to decrease in 2017. In keeping with the decreased demand posed by smaller residential migration, construction of Phoenix retail properties has slowed since its pre-recession peak. At the close of the third quarter, there was a mere one million square feet of new retail development under construction, almost half of that in one submarket and 75 percent of it preleased, as the market continues to right-size in order to meet demand.

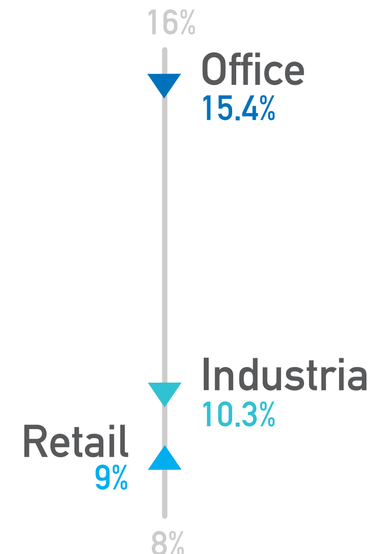
LARGEST LEASE SIGNINGS

As of Q3 2016

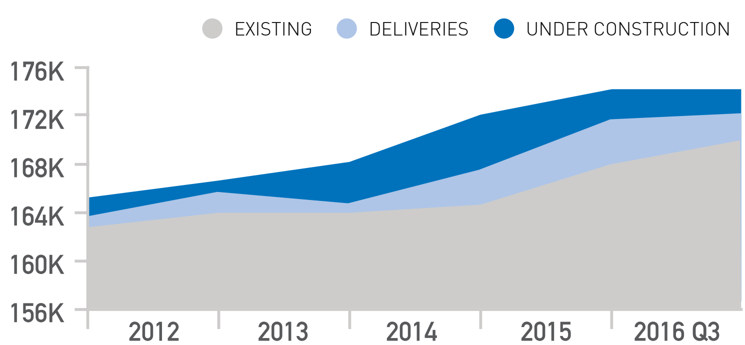
	LEASE TYPE	LEASE LOCATION	SIZE (SF)
States Logistics	Industrial	670 S 91st Ave	417,600
Nestle Water	Industrial	1635 S 43rd Ave	394,775
Farmers Insurance	Office	24000 N Farmers Way	150,000
CVS Health	Office	444 N 44th St	138,240
Thrifty Lots	Retail	8200 W Peoria Ave	58,000
El Super	Retail	2223 W Camelback Rd	46,000

VACANCY RATES

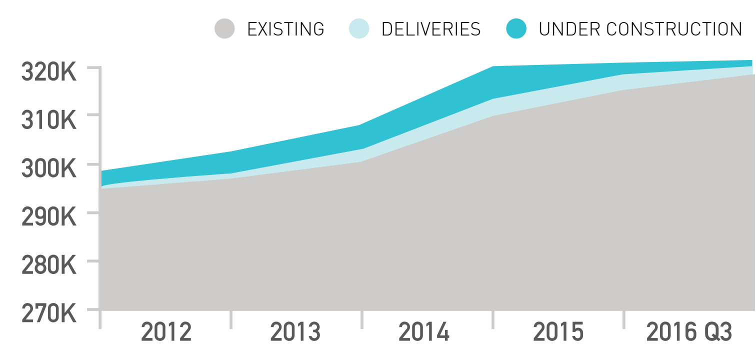
As of Q3 2016



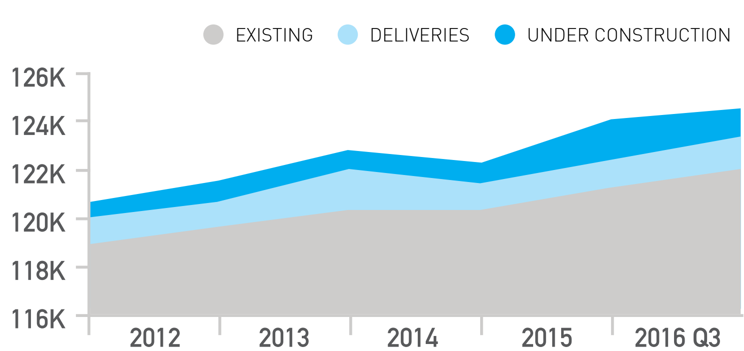
OFFICE INVENTORY GROWTH



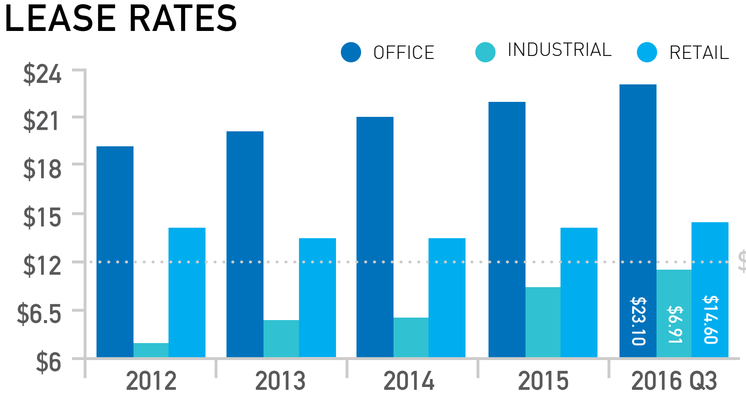
INDUSTRIAL INVENTORY GROWTH



RETAIL INVENTORY GROWTH

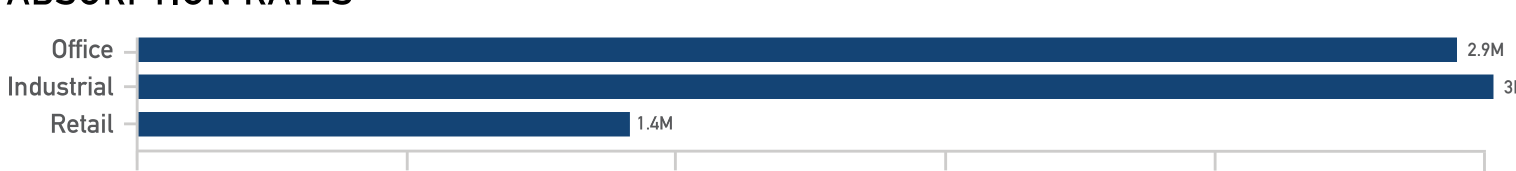


LEASE RATES



*Rates are per square foot per year. Industrial is adjusted from monthly.

ABSORPTION RATES



SOURCES: REIS, CoStar, "Arizona's Economy" - Economic and Business Research Center (EBRC) @ University of Arizona's Eller College of Management. Coamerica Bank, Phoenix Business Journal, Phoenix Chamber of Commerce, Wells Fargo Securities Economics Group