Office Recovery Remains Highly Localized as Tenants Favor Infill

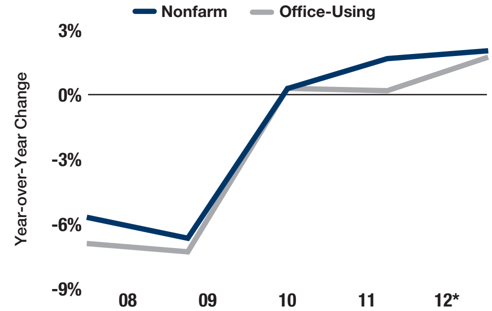
Local incentives encourage companies to expand in Phoenix, while minimal construction and solid job growth will support positive absorption this year. The Arizona Innovation Accelerator Fund Program will allocate federal funds to startups and businesses looking to grow. Landlords of Class A properties in downtown, the Camelback Corridor, Tempe and Scottsdale will offer lucrative concessions to attract these growing companies or tenants with expiring leases. The University of Phoenix, for example, recently vacated over 270,000 square feet at Hohokam Towers in Tempe and increased its footprint to 440,000 square feet at the Fountainhead Corporate Park. In Chandler, the development of the Intel Fab 42 plant is enhancing business in the region and will allow operators to backfill empty office space. Although operations in the suburbs will struggle, improving demand for infill space will help reduce marketwide vacancy to a three-year low.

Institutional buyers searching for a safe haven will target investment-grade properties in core areas, while high-net-worth individuals will acquire distressed assets. Some operators facing maturing debt will be forced to short sale or go into foreclosure, prompting banks to liquidate some assets immediately. Cash-paying local and California investors are seeking highly vacant Class B/C properties selling on a price-per-square-foot basis with plans to reposition the asset to improve occupancy. In the top-tier arena, coastal investors looking for solid returns and lower price points will target underperforming Class A buildings in Scottsdale, Chandler and Midtown, where buildings can trade at initial yields around 8 percent. REITs and life insurance companies, meanwhile, will search for trophy properties secured with a corporate tenant. These best-in-class assets will trade at cap rates near 7 percent.

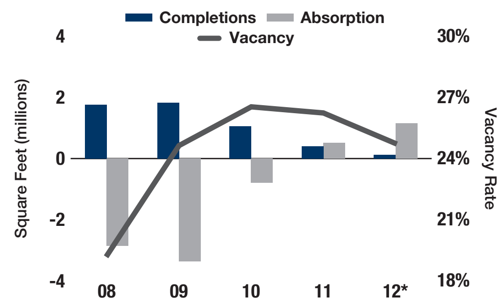
2012 Market Outlook

- **2012 NOPI Rank: 33, No Change.** Although payrolls are expanding, high vacancy prevented Phoenix from making headway in the NOPI.
- **Employment Forecast:** Employment will reach more than 90 percent of pre-recession levels as the metro gains 35,000 jobs, growth of 2.0 percent, including 7,500 office-using positions.
- **Construction Forecast:** Construction will fall to a 17-year low as developers complete 120,000 square feet in 2012, increasing stock by 0.2 percent.
- **Vacancy Forecast:** Limited new supply and solid job growth will help reduce vacancy 150 basis points this year to 24.7 percent.
- **Rent Forecast:** Asking rents will grow 0.4 percent in 2012 to $22.31 per square foot. Effective rents will rise 0.5 percent to $17.36 per square foot.
- **Investment Forecast:** Overleveraged operators will seek equity partners to recapitalize their properties. Many of these landlords will use the capital to retain tenants, while owners struggling to cover their monthly debt service will use the equity to help restructure their loans.

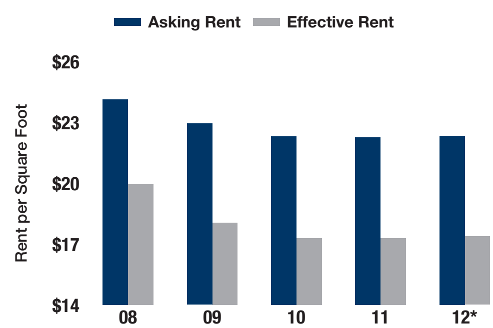
Employment Trends



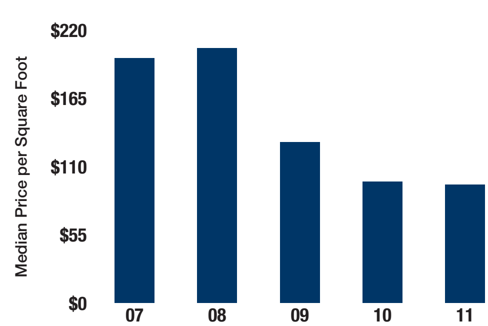
Office Supply and Demand



Rent Trends



Sales Trends



* Forecast

Sources: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

Market Forecast Employment: 2.0% ▲ Construction: 120K ▼ Vacancy: 150 bps ▼ Asking Rents: 0.4% ▲