

PHOENIX



EXECUTIVE SUMMARY

- Arizona's pioneering "sandbox legislation" to grant regulatory relief for tech innovators is bearing fruit.
- Large projects nearing completion will take some time to absorb but rental rates expected to hold for retail and industrial, and rise slightly for office.
- Phoenix emerges as a data center powerhouse with major player expansion and new projects announced.
- State responding to climate crisis with closure of major coal plant and construction of two solar storage battery projects.
- Amazon's physical store experiment launched in Scottsdale testing bridge between e-commerce and brick and mortar locations.

"Innovation" is a key word stakeholders might repeat about the Metro Phoenix economy outlook. Recovery from the depths of a brutal downturn, harsher here than most cities faced, forced a rethink in the way the region perceives itself, an investment in the qualities that make it attractive and unique, and a more thoughtful approach to capital deployment as trend lines surge upward.

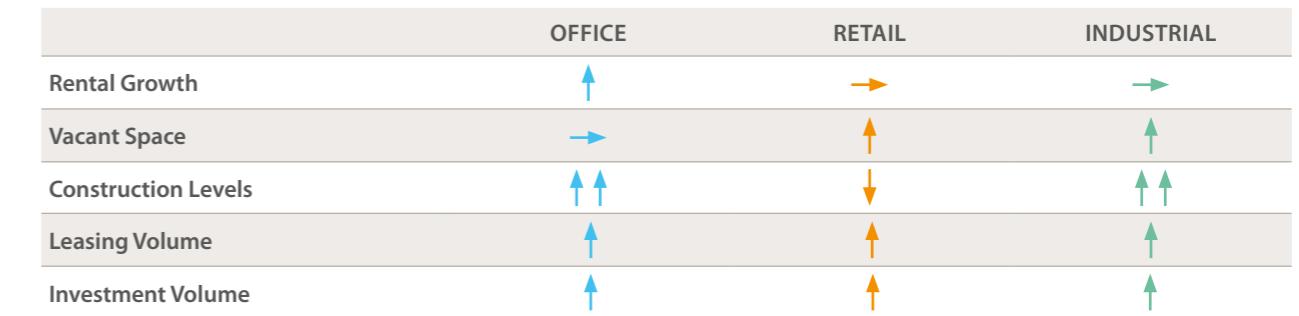
After a long climb out of a deep recession, Phoenix today feels more stable than ever and better able to ride out the next inevitable economic storm. The current Goldilocks economy, not too hot and not too cold, is the result of careful planning and lessons learned from past dramatic cycles. The previous cycle's explosive growth and collapse left a tattered real estate landscape, particularly in the retail sector. Strategic risk rather than maverick betting defines the current cycle and strategic partnerships promoting innovation light the way forward.

In early 2018, Governor Doug Ducey signed into law House Bill 2434 that granted regulatory relief for Financial Technology innovators. A year later, the Governor extended the program's reach to include Property Technology with House Bill 2673, firmly establishing the state's reputation as a business-friendly incubator in tandem with ASU's innovation initiatives that earned it first place in U.S. News & World Report's list of most innovative national universities. The influence of such far-sighted legislation and well-considered growth is being felt across all property sectors. So far, eight companies are enrolled in the Sandbox programs. It has helped boost the state as a legislative innovator that has taken action to attract the next generation of economic drivers.

Adapting to economic and demographic changes also means that traditional real estate property categories are evolving and becoming more flexible. Employers experiencing sharp growth are using flex space provided by third parties. Industrial space is becoming more

KEY MARKET METRICS – 2020 EXPECTATIONS

Annual growth rates, estimated for year-end 2020 vs year-end 2019.



flexible. Fulfillment centers blend office and industrial uses and require proximity to consumers. As online grocery demand rises, cold storage distribution and fast delivery warehouses become critical differentiators in business. These changes can spark innovation but also create unique challenges for brokers to fit client needs with consumer demand against local economic, geographic, and political pressures.

Overall unemployment currently stands at a low 3.8% and as the Metro Phoenix area continues to add new residents with increasingly higher skill sets, the labor market is competitive and the pool deep with talent. The quality of jobs is also increasing. The region expects to continue its stellar job and population growth scenario, as personal incomes climb in tandem with economic expansion. The inflow of workers primarily from other domestic markets has helped boost spending in the retail sector as well.

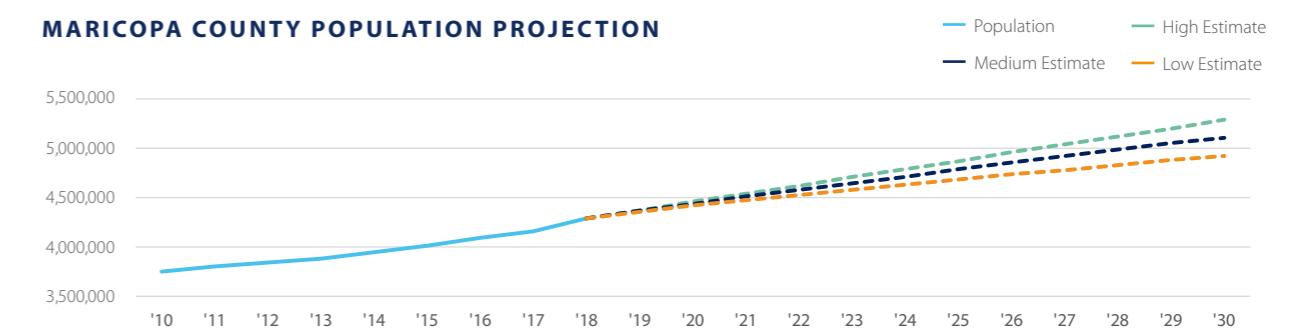
Office rental rate growth outlook is favorable despite a large amount of product, including significant speculative space, coming online in the near term. Vacancy rates

have been steadily declining overall, and key submarkets are particularly competitive. Absorption levels are expected to remain strong as the pace of new supply has been well-calculated to meet increasing demand.

A partial list of major companies planning entry or expansion into the Phoenix market includes some of the nation's biggest firms: Google and its Waymo autonomous vehicle subsidiary; various Microsoft data centers; Deloitte doubling its footprint in Gilbert; American Express transferring 3,000 workers to new facilities at its north Phoenix campus; Intel proposing a \$7 billion, 2.2 million square feet (msf) Fab42 semiconductor manufacturing facility in Chandler; WageWorks at The Union at RiverView in Mesa; Voya adding 1,000 workers to its new 151,000 sf call center in Chandler; Allstate Insurance Company also in Chandler; Farmers Insurance expanding its North Phoenix operations by 150,000 sf and adding over 900 jobs; and Nationwide Insurance breaking ground for a 136-acre campus with 1 msf of office space in Scottsdale.

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MARICOPA COUNTY POPULATION PROJECTION



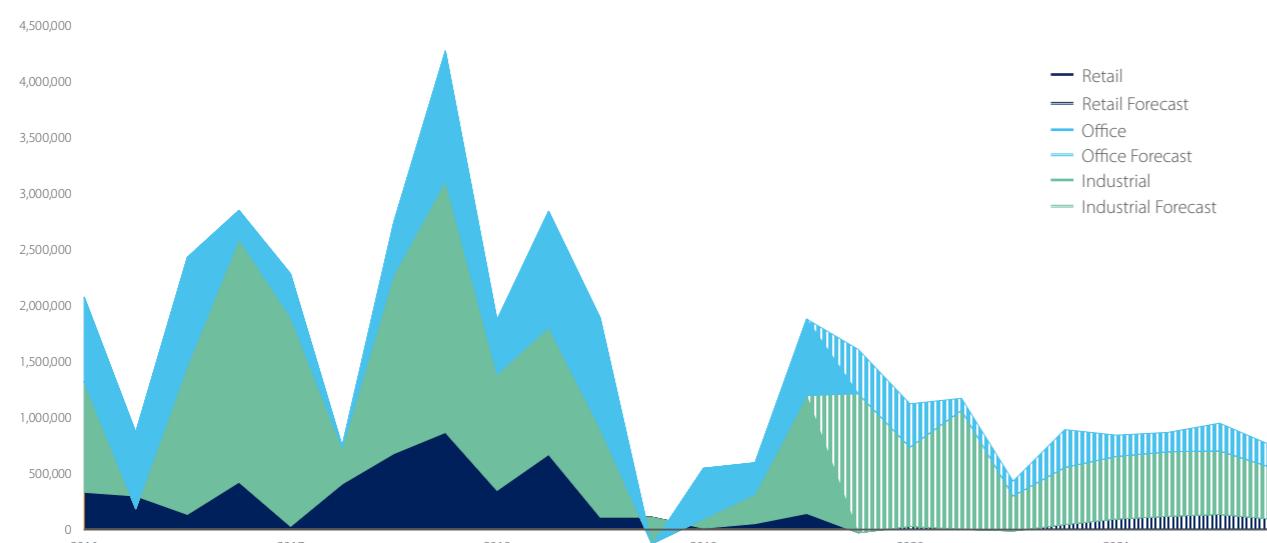
Source: Arizona Office of Economic Opportunity, 2018-2055 State & County Population Projects

ASU has helped bring new life to the sluggish Downtown Submarket, as its 10-year old satellite campus now enrolls 12,000 students in a district that is also attracting increased multifamily development. A campaign to upgrade older office product in the core submarkets is underway as well as improving access to amenities like the recent opening of the new Fry's grocery store at Cityscape at Block 23, filling a much-needed demand for Downtown's newer residents. The University has also recently acquired the Thunderbird School of Global Management. ASU will lease half of the 225,000 sf PBC Innovation Center at the Wexford Building, the first part of a planned 30-acre downtown biomedical campus. New residential towers in the area include 44 Monroe, The Stewart, The LINK Phx Phase I, Kenect, Central Station project, Residence at Collier Center, and Aspire Fillmore.

An enormous amount of new office, hotel, and multifamily development around Tempe Town Lake has made it the hottest real estate submarket in the Valley in recent years. An additional 2.7 msf of office is nearing completion. The Grand at Papago Park, a nine-story office building and 300-unit apartment complex, has reached completion as part of Papago Park Center, a 15-year 350-acre mixed-use development. Skysong Center, ASU's 1.2 msf innovation incubator and mixed-use community in South Scottsdale, has attracted new tenants, continues to expand and commands top-tier rents. The proposed Building 6 will add an additional 340,000 sf of office. Nearby, The Watermark Tempe's first phase is expected to open in early 2020. The 16-story office complex has already leased space to WeWork and Opendoor. On the lake's southern shore, a major biomedical and technology complex dubbed IDEA Tempe (Innovation, Discovery, Education, Art) will eventually add 1 msf of office space to the university-adjacent area known as the Novus Innovation Corridor.

Real estate players in Phoenix seem to have learned from past mistakes and put hard-won wisdom to use. While it is impossible to predict the timing and effects of the next economic downturn, metro Phoenix has wisely positioned itself to avoid past pitfalls when the next recession hits. Growth has been controlled, fundamentals are strong and leadership is innovative and forward thinking.

ABSORPTION FORECAST



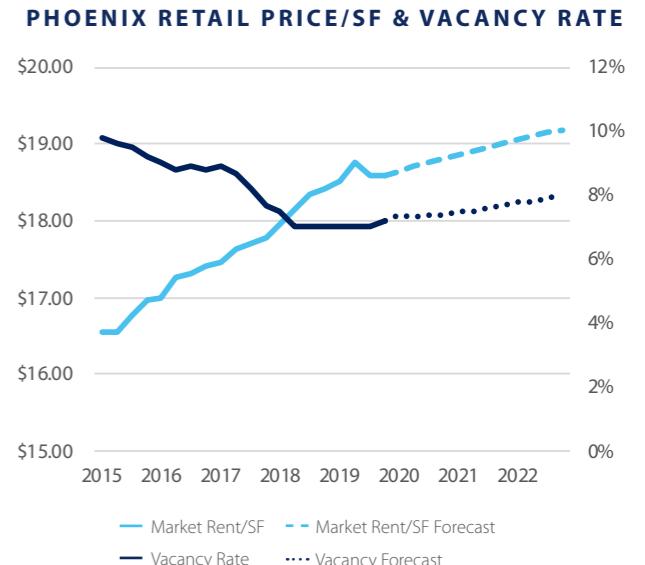
Source: CoStar Realty Information, Inc. and Reis, Inc.

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In the Camelback Corridor, a centrally-located submarket with a high concentration of financial services and real estate brokers as well as upscale retail and adjacent affluent neighborhoods, a major office and hotel project at 44th Street has been approved. 44|Camelback is a collaboration between local restaurant magnate Sam Fox and Red Development. The ambitious \$300 million, 17-acre project will include a hotel, three office buildings, a parking structure, a self-storage facility and also the Phoenix Suns and Phoenix Mercury practice facility.

Phoenix currently ranks in the top tier of data center markets in the U.S. and is the 12th largest globally. Operators place high value on the region's many assets including cheap power, plentiful land, a skilled workforce, attractive tax structure and real estate pricing, and low geographic and weather-related risks. Newer data centers are designed to use less water, a critical consideration in this desert metropolis, and attention is being paid to climate crisis issues and the need to move to renewable energy. Power provider SRP has just announced plans for two new large-scale solar batteries for Arizona's grid and the decommissioning of Navajo Generating Station, a 2.25-gigawatt coal-fired power plant. Major Phoenix data center players include Microsoft, currently in the process of building three data centers in the West Valley, Apple debuted a data and global command center in a 1.3 msf re-purposed building in Mesa this past August, and data and records management giant, Iron Mountain, is expanding its area presence with the construction of a 3-story, \$430 million data center campus in the North Airport Industrial Submarket.

Access to I-10 and California Markets has made the Valley's Southwestern quarter a magnet for new warehouse distribution facilities. Nike crossed political wires with the state's Governor over the Summer but managed to ultimately



Source: CoStar Realty Information, Inc. and Reis, Inc.

secure incentives related to the opening of a manufacturing site in Goodyear in which it plans to invest \$184 million in a 901,700 sf class A facility it purchased for \$70 million in August.

The Valley's Southeastern quarter has also seen increased industrial warehouse and distribution activity centered around the Phoenix-Mesa Gateway Airport where 4 msf of industrial space is anticipated over the next two decades. The project called SkyBridge, a multi-building, 450-acre inland air cargo hub in cooperation with Mexico, will establish a pre-clearance customs facility to expedite trade.

As the Internet economy continues to reshape the retail sector, a different view of its challenges is emerging. The perceived battle between virtual stores and brick and mortar is more of a chess game between players refitting retail to accommodate omni-channel strategies. While e-commerce currently accounts for about 10% of all retail sales, it is forecast to capture around 13.7% by 2021. This acceleration is less a threat to physical stores than it is a symbiotic relationship. A "halo effect" of web traffic on actual store traffic has recently been measured by ICSC showing that there is mutual benefit between web and brick and mortar stores. Omni-channel retailers require both in-store and online fulfillment capabilities. That has a spill-over effect into the industrial sector, whether that is for close-proximity cold storage for grocery orders, or warehouse and flex space for purchased goods fulfillment. Retailers like Amazon still require massive fulfillment centers in key locations to satisfy fast transactions. It recently opened a brick and mortar location at Scottsdale Quarter in November, 2019.