

Office Market Trends Phoenix

Grubb & Ellis|BRE Commercial, LLC Research

First Quarter 2009



Falling Demand Softens Rents

Executive Summary

The first quarter of 2009 saw a dramatic decline in net absorption which was particularly alarming after the huge losses in occupied space from the previous year. In 2008 the total net loss was just over one million square feet for the entire metro area. The first quarter of 2009 experienced a net loss in occupied space of nearly 495,000 square feet. Falling demand has caused asking rents to decline, in some cases considerably as landlords position their buildings to be more competitive.

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Overall average Class A and Class B asking rents are down \$1.91 and \$1.37 from the previous quarter in the Central Business District. For the entire metro area average Class A and B asking rents are down \$0.98 and \$0.61 from the previous quarter. These asking rent reductions do not account for other leasing concessions which have already saturated the market. Since asking rental rates are the last item to fall in a down market it is clear the total economic costs to landlords are more extensive.

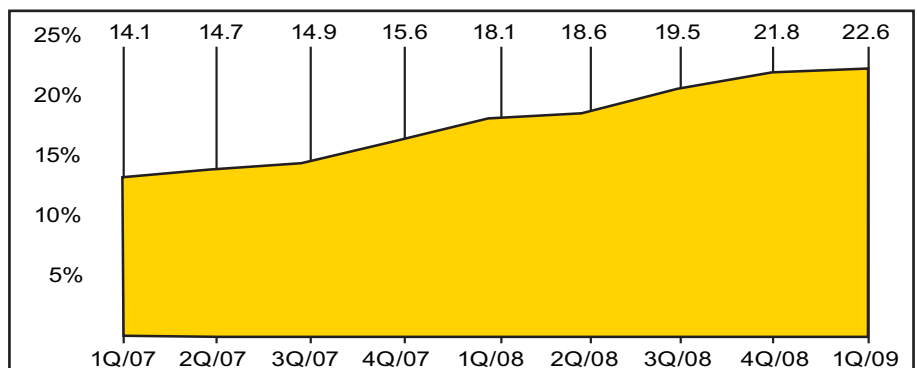
The potential for further rental rate reductions appears likely as landlords shift their strategy to offering low cost occupancy for the near term. Low cost leasing opportunities are intended for 24-36 month terms at most. Tenants looking for long-term opportunities will find difficulty in securing ultra low cost leases. In addition to the current demand deficit, landlords are also competing with a vast amount of sublease space. From the tenants' perspective the current low cost direct lease opportunities are starting to resemble the available sublease space. For example, subleases in many cases are short term and offered at reduced asking rents. Subleases however, may provide turn-key options which can offer more value than the direct space.

Phoenix Office Market Trends

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Office Direct Vacancy Rate*

* All Classes of Space

Office Market Trends First Quarter 2009

Tenants looking for long-term opportunities will find difficulty in securing ultra low cost leases.



Grubb and Ellis | BRE Commercial is pleased to exclusively offer the Papago Gateway Center a new, 265,000 SF 7- Story, Class A, LEED certified office and lab building, located at the NWC of Mill Avenue and Washington Street in Tempe. Developed by Chesnut Properties.

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Market Overview

Of the 22 submarkets, eight showed positive net absorption. The Chandler and Scottsdale North submarkets accounted for the highest gains for the first quarter with 81,607 and 44,765 square feet respectively. The Downtown North submarket reported the largest loss of space with 129,079 square feet of negative net absorption. Class C space accounted for the lowest negative net absorption figure, with a loss of 6,917 square feet, while Class A took the greatest hit with 248,538 square feet of negative net absorption. Class B had the lowest direct vacancy rate of 20.1 percent, as the result of a 100 basis point increase from last quarter which was the largest increase of the three classes. Class A space has the largest direct vacancy rate with 24.9 percent; up 80 basis points from the fourth quarter of 2008. The highest vacancy rate occurred in the Mesa East submarket with a direct vacancy rate of 68.4 percent; the highest sublease rate occurred in the Tempe/South Chandler submarket with a rate of 5.15 percent. The lowest direct vacancy rate of any submarket was found within Downtown South at 12.8 percent, followed by Midtown at 14.4 percent.

The overall asking rental rate in the Phoenix Metro market for the first quarter was \$25.09 per square foot, down from \$25.75 per square foot the previous quarter. Along with increasing vacancy, 14 of the 22 submarkets saw a decrease in Class A rates. The lowest rental rates are found in the Northwest Phoenix submarket followed by the Airport Area, with average Class A rates of \$22.84 per square foot and \$24.60 per square foot, respectively. The Camelback Corridor again recorded the highest average Class A lease rate of \$32.86 per square foot. While there have been reductions in asking rental rates, much of the value for tenants in recent transactions has been in the form of free rent and other concessions.

Opportunity and Challenges

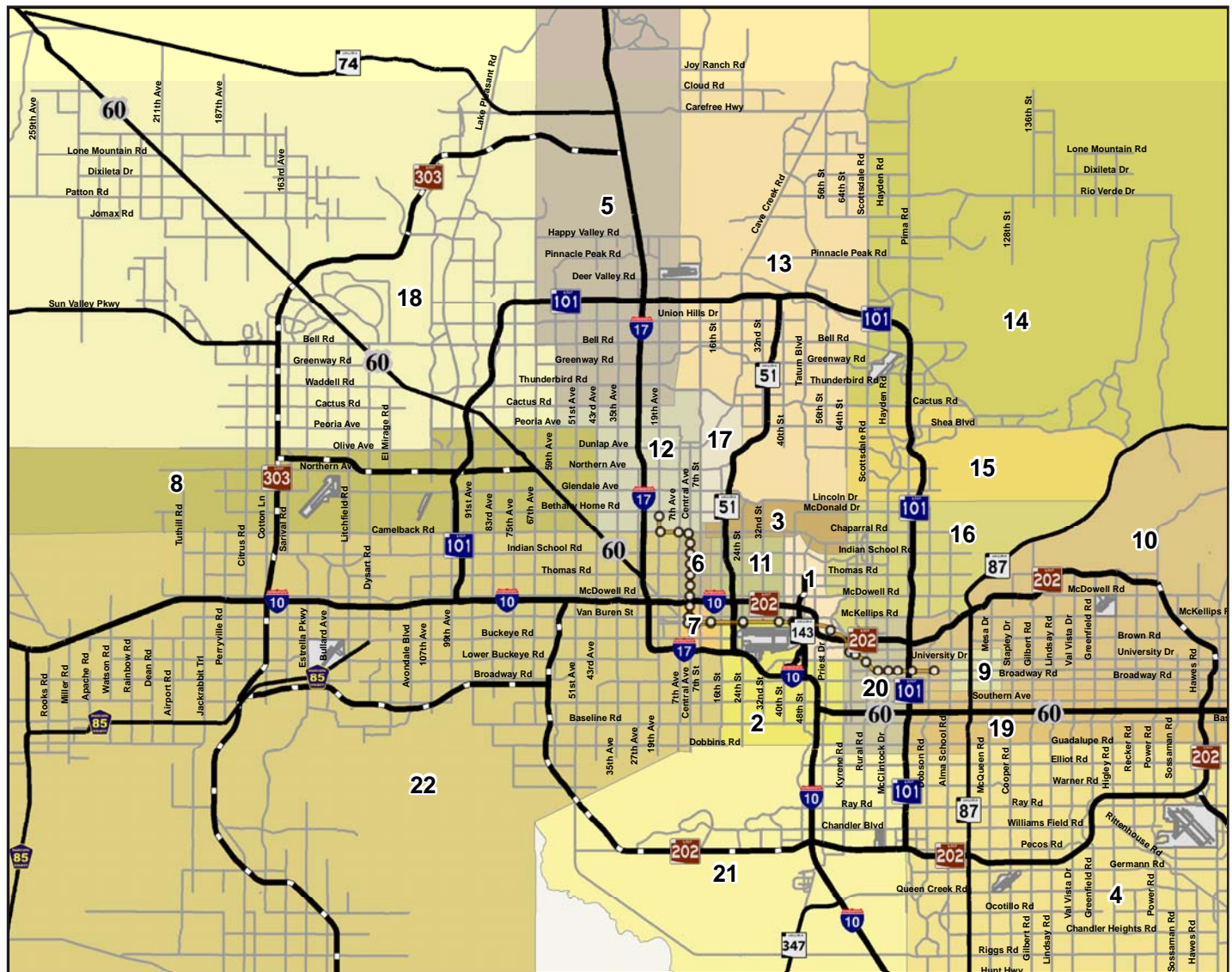
The biggest challenge facing the office market continues to be the demand deficit. Due to the failing market landlords have been compelled to reduce asking rents in addition to the previously offered leasing concessions. Owners are aggressively seeking tenants for the short term as they believe the market will rebound within 24-36 months. They will not cripple their buildings with below market rents which extend beyond the recovery. The challenge for tenants who are in a position to commit to a long term deal is they are unable to do so at heavily reduced rates. However, with the uncertainty in the economy the short term lease option seems to work well for both tenants and landlords. Further rental reductions may continue throughout the year should demand for space continue to slide.

Forecast

Net absorption for 2009 is now expected to be negative; the question is how far will occupancy slide. After very poor leasing in the first quarter the market appears to still be heading in a downward direction. Positive effects from the government stimulus efforts remain to be seen and employment levels are still falling from last year's level. However, construction activity is down considerably from the 2007-2008 levels which will help the supply imbalance. Excellent leasing opportunities exist valley wide; if the uncertainty in the economy starts to unravel, tenants will be highly motivated to take advantage of the current leasing deals available.

Office Market Trends First Quarter 2009

Office Submarket Map Phoenix First Quarter 2009



- | | | |
|------------------------|-------------------------------|--------------------------|
| 1 44th Street Corridor | 9 Mesa Downtown | 17 Squaw Peak Corridor |
| 2 Airport Area | 10 Mesa East | 18 Sun City |
| 3 Camelback Corridor | 11 Midtown | 19 Superstition Corridor |
| 4 Chandler/Gilbert | 12 Northwest Phoenix | 20 Tempe |
| 5 Deer Valley/Airport | 13 North Phoenix/Desert Ridge | 21 Tempe South/Chandler |
| 6 Downtown North | 14 Scottsdale Airpark | 22 West Phoenix |
| 7 Downtown South | 15 Scottsdale North | |
| 8 Glendale | 16 Scottsdale South | |

Office Market Trends First Quarter 2009

Office Market Submarket Breakout Phoenix First Quarter 2009

By Submarket* (All Classes)	Total SF	Direct Vacant %	Sublease %	Direct Vacant + Sublease %	Net Absorption		Under Construction	Asking Rent
					Current Qtr.	Year To Date		
44th Street Corridor								
Class A	2,686,037	31.8%	3.46%	35.2%	(11,278)	(11,278)	-	\$26.14
Class B	1,226,733	17.5%	1.72%	19.3%	(29,357)	(29,357)	-	\$22.65
Class C	81,748	16.3%	-	16.3%	257	257	-	\$14.62
Airport Area								
Class A	840,550	12.8%	2.17%	15.0%	(30,872)	(30,872)	-	\$24.60
Class B	1,507,809	19.5%	1.90%	21.4%	(3,457)	(3,457)	-	\$18.81
Class C	299,688	25.0%	-	25.0%	10,765	10,765	-	\$15.28
Camelback Corridor								
Class A	3,938,427	19.8%	2.44%	22.2%	(13,600)	(13,600)	484,520	\$32.86
Class B	2,189,822	15.4%	2.39%	17.8%	(41,290)	(41,290)	-	\$25.45
Class C	488,406	16.9%	0.97%	17.9%	16,755	16,755	-	\$20.36
Chandler/Gilbert								
Class A	776,141	35.3%	-	35.3%	77,657	77,657	188,485	\$27.45
Class B	566,275	35.9%	1.09%	37.0%	3,950	3,950	-	\$22.96
Deer Valley/Airport								
Class A	1,149,709	19.9%	4.22%	24.1%	(27,895)	(27,895)	-	\$25.22
Class B	1,018,168	23.7%	1.97%	25.7%	(11,180)	(11,180)	-	\$23.41
Class C	22,541	16.3%	-	16.3%	-	-	-	\$19.50
Downtown North								
Class A	3,486,256	17.9%	1.29%	19.2%	(138,879)	(138,879)	-	\$25.20
Class B	4,740,341	17.7%	0.58%	18.3%	2,664	2,664	-	\$20.87
Class C	804,717	15.5%	-	15.5%	7,136	7,136	-	\$16.79
Downtown South								
Class A	2,976,334	12.4%	0.75%	13.2%	(9,912)	(9,912)	1,030,000	\$30.04
Class B	2,081,652	7.6%	1.79%	9.4%	(3,616)	(3,616)	-	\$25.16
Class C	719,352	29.1%	1.17%	30.3%	(19,035)	(19,035)	-	\$23.54
Midtown								
Class B	452,296	13.3%	-	13.3%	12,081	12,081	-	\$21.33
Class C	664,379	15.1%	0.59%	15.7%	(800)	(800)	-	\$17.59
North Phoenix/Desert Ridge								
Class A	1,228,469	35.7%	1.70%	37.4%	15,173	15,173	-	\$28.77
Class B	674,861	16.7%	0.53%	17.2%	(4,192)	(4,192)	-	\$21.65
Class C	24,500	22.6%	-	22.6%	1,225	1,225	-	\$17.25
Northwest Phoenix								
Class A	1,392,858	21.0%	0.33%	21.3%	(11,656)	(11,656)	-	\$22.84
Class B	2,600,158	27.0%	1.34%	28.3%	(78,391)	(78,391)	-	\$19.11
Class C	285,493	9.9%	0.72%	10.6%	4,616	4,616	-	\$14.59
Scottsdale Airpark								
Class A	4,398,357	27.1%	4.96%	32.0%	(70,363)	(70,363)	438,425	\$28.56
Class B	1,656,888	21.0%	0.49%	21.5%	(2,858)	(2,858)	-	\$23.70
Scottsdale North								
Class A	2,862,281	30.2%	3.31%	33.5%	86,992	86,992	-	\$28.55
Class B	1,794,399	24.7%	1.61%	26.3%	(37,565)	(37,565)	-	\$24.01
Class C	211,141	20.8%	-	20.8%	(4,662)	(4,662)	-	\$20.46
Scottsdale South								
Class A	2,057,147	19.7%	5.02%	24.8%	(47,782)	(47,782)	-	\$27.47
Class B	930,070	16.9%	1.59%	18.5%	(14,652)	(14,652)	-	\$25.08
Class C	251,215	35.8%	0.36%	36.2%	97	97	-	\$20.22
Squaw Peak Corridor								
Class A	474,284	10.5%	-	10.5%	11,233	11,233	-	\$24.60
Class B	1,318,995	18.7%	1.60%	20.3%	(8,062)	(8,062)	-	\$20.51
Class C	272,658	25.2%	1.83%	27.0%	(4,437)	(4,437)	-	\$20.68
Superstition Corridor								
Class A	985,902	34.9%	1.03%	35.9%	(28,991)	(28,991)	-	\$25.23
Class B	966,831	27.3%	1.13%	28.4%	4,565	4,565	-	\$19.36
Class C	236,193	9.0%	0.40%	9.4%	(2,850)	(2,850)	-	\$16.25
Tempe								
Class A	1,452,859	28.1%	0.97%	29.0%	(57,627)	(57,627)	260,000	\$31.76
Class B	806,129	22.1%	0.22%	22.3%	(22,989)	(22,989)	-	\$18.43
Class C	258,562	20.0%	-	20.0%	(1,727)	(1,727)	-	\$21.12
Tempe South/Chandler								
Class A	1,450,612	26.3%	3.32%	29.6%	(15,452)	(15,452)	48,000	\$26.64
Class B	558,784	16.1%	10.53%	26.6%	(981)	(981)	-	\$21.19
Class C	69,213	-	-	-	-	-	-	-
West Phoenix								
Class A	295,373	41.7%	1.66%	43.3%	7,251	7,251	-	\$28.87
Class B	486,229	53.6%	-	53.6%	(4,530)	(4,530)	-	\$23.11
Class C	182,531	30.9%	-	30.9%	(91)	(91)	-	\$15.85

* Does not include submarkets with less than 700,000 square feet of office inventory.

Office Market Snapshot Phoenix First Quarter 2009

By Submarket (All Classes)	Total SF (1)	Direct Vacant % (2)	Sublease %	Direct Vacant + Sublease %	Net Absorption			Asking Rent(4)	
					Current Qtr.	Year-to-date	Under Construction(3)	Class A	Class B
Downtown North	9,031,314	17.6%	0.80%	18.4%	(129,079)	(129,079)	-	\$25.20	\$20.87
Downtown South	5,777,338	12.8%	1.18%	13.9%	(32,563)	(32,563)	1,030,000	\$30.04	\$25.16
CBD Total	14,808,652	15.7%	0.95%	16.6%	(161,642)	(161,642)	1,030,000	\$27.22	\$21.53
44th Street Corridor	3,994,518	27.1%	2.85%	29.9%	(40,378)	(40,378)	-	\$26.14	\$22.65
Airport Area	2,648,047	18.0%	1.77%	19.8%	(23,564)	(23,564)	-	\$24.60	\$18.81
Camelback Corridor	6,616,655	18.1%	2.31%	20.4%	(38,135)	(38,135)	484,520	\$32.86	\$25.45
Chandler/Gilbert	1,342,416	35.6%	0.46%	36.0%	81,607	81,607	188,485	\$27.45	\$22.96
Deer Valley/Airport	2,190,418	21.6%	3.13%	24.8%	(39,075)	(39,075)	-	\$25.22	\$23.41
Glendale	514,927	52.5%	-	52.5%	4,411	4,411	-	\$27.57	\$17.29
Mesa Downtown	273,666	14.7%	-	14.7%	(10,609)	(10,609)	-	-	\$18.09
Mesa East	294,241	68.4%	-	68.4%	4,324	4,324	-	\$28.00	\$24.50
Midtown	1,116,675	14.4%	0.35%	14.7%	11,281	11,281	-	-	\$21.33
N Phoenix/Desert Ridge	1,927,830	28.9%	1.27%	30.2%	12,206	12,206	-	\$28.77	\$21.65
Northwest Phoenix	4,278,509	23.9%	0.97%	24.9%	(85,431)	(85,431)	-	\$22.84	\$19.11
Scottsdale Airpark	6,055,245	25.4%	3.74%	29.2%	(73,221)	(73,221)	438,425	\$28.56	\$23.70
Scottsdale North	4,867,821	27.8%	2.54%	30.3%	44,765	44,765	-	\$28.55	\$24.01
Scottsdale South	3,238,432	20.2%	3.68%	23.9%	(62,337)	(62,337)	-	\$27.47	\$25.08
Squaw Peak Corridor	2,065,937	17.7%	1.26%	19.0%	(1,266)	(1,266)	-	\$24.60	\$20.51
Sun City	843,978	30.0%	1.09%	31.0%	5,970	5,970	-	\$28.26	\$26.96
Superstition Corridor	2,188,926	28.7%	1.01%	29.7%	(27,276)	(27,276)	-	\$25.23	\$19.36
Tempe	2,517,550	25.3%	0.63%	25.9%	(82,343)	(82,343)	260,000	\$31.76	\$18.43
Tempe South/Chandler	2,078,609	22.7%	5.15%	27.8%	(16,433)	(16,433)	48,000	\$26.64	\$21.19
West Phoenix	964,133	45.7%	0.51%	46.2%	2,630	2,630	-	\$28.87	\$23.11
Suburban Total	50,018,533	24.6%	2.22%	26.8%	(332,874)	(332,874)	1,419,430	\$28.14	\$21.95
Totals	64,827,185	22.6%	1.93%	24.5%	(494,516)	(494,516)	2,449,430	\$28.03	\$21.88
By Class (All Submarkets)								Available for Sublease CBD Suburban	
Class A	33,312,224	24.9%	2.56%	27.4%	(248,538)	(248,538)	2,449,430	101,424	1,207,673
Class B	26,343,126	20.1%	1.43%	21.5%	(239,061)	(239,061)	-	65,214	392,808
Class C	5,171,835	20.2%	0.50%	20.7%	(6,917)	(6,917)	-	8,435	26,195
Totals	64,827,185	22.6%	1.93%	24.5%	(494,516)	(494,516)	2,449,430	175,073	1,626,676

(1) Inventory includes speculative multi-tenant buildings greater than 20,000 SF (excludes medical, owner-occupied and other specialized buildings).

(2) Vacant space includes vacant direct space.

(3) Space under construction includes speculative for lease projects.

(4) Asking rates are per square foot per year full service.

* Grubb & Ellis statistics are audited annually and may result in revisions to previously reported quarterly and final year-end figures.

Office Market Terms and Definitions

Inventory: Office inventory includes all multi-tenant and single tenant buildings at least 20,000 square feet. Owner-occupied, government and medical buildings are not included.

Construction Type: Speculative ("spec") construction is designed to attract tenants likely to be in the market when the project is leasing. Build-to-suit construction is designed for a specific tenant.

Office Building Classifications: Grubb & Ellis adheres to the BOMA guidelines. Class A properties are the most prestigious buildings competing for premier office users with rents above average for the area. Class B properties compete for a wide range of users with rents in the average range for the area. Class C buildings compete for tenants requiring functional space at rents below the area average.

Vacancy and Availability: The vacancy rate is the amount of physically vacant space divided by the inventory. The availability rate is the amount of space available for lease divided by the inventory.

Net Absorption: The net change in physically occupied space over a period of time.

Asking Rent: The dollar amount asked by landlords for available space expressed in dollars per square foot per year. Office rents are reported as full service where all costs of operation are paid by the landlord up to a base year or expense stop.

Asking rates are per square foot per year full service: As part of our annual data benchmarking procedures, G&E has adjusted the methodology we use to weight average office asking rental rates. When calculating the average asking rate for a market or submarket, we previously weighted the asking rate in each building by the size of the building. Beginning Q1 2009, we are weighting the rate in each building by the amount of available space in the building. All historic rental rate data has been re-weighted to create a consistent trend line for the rent graphs appearing in this report. However, the rental rate data in this report will not be comparable to the rental rate data in our previously published reports due to this change in our methodology.

Average Weighted Asking Rent: An average market rent where the asking rent for each building in the market is weighted by square footage available.