

FIGURES | PHOENIX MEDICAL OFFICE MARKET | Q3 2024

Phoenix Medical Office Market Remains Stable Despite Slipping Fundamentals

▲ 14.3%

Vacancy Rate

▼ (123,058)

SF Net Absorption

▲ 410,000

SF Construction

▼ \$25.29

Overall Base Rate

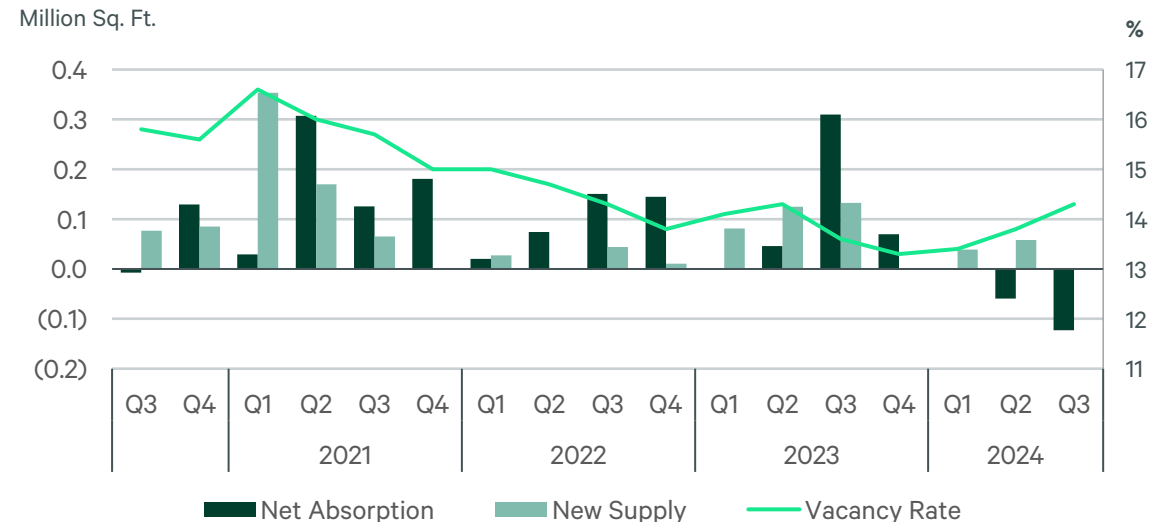
Note: Arrows indicate change from previous quarter.

KEY TAKEAWAYS

- There were 123,058 sq. ft. of negative net absorption to close out the third quarter of 2024.
- The quarter-over-quarter vacancy rate increased 50 basis points to 14.3%.
- The overall base rate decreased 0.5% quarter-over-quarter to \$25.29 per sq. ft.

While Phoenix has continued to see a steady demand of varying medical tenants, the third quarter of 2024 posted 123,058 sq. ft. of negative net absorption. Class A product ended the quarter with 1,482 sq. ft. of positive net absorption, while Class B and C product ended the quarter with a combined 124,540 sq. ft. of negative absorption. While there were no buildings delivered in the third quarter of 2024, Rancho Santa Fe Phase II broke ground for 30,000 sq. ft. in West Phoenix.

FIGURE 1: Supply and Demand



Source: CoStar, Q3 2024.

Availability and Vacancy

In the third quarter of 2024 the vacancy rate rose 50 bps to 14.3%. However, over the past three years, vacancy has decreased by 140 basis points. The rate has remained below 16% since Q2 of 2021.

The West Phoenix submarket posted the lowest vacancy rate at 5.9%. Tenants looking in West Phoenix are often attracted to the area due to its aging demographic as well as its strong growth metrics evidenced by many new housing developments. The Central Corridor also recorded a considerably low vacancy rate at 7.1%. Most of the available space was concentrated in East Phoenix, Scottsdale, and Northwest Phoenix where each submarket had over 800,000 sq. ft. available. The Northwest Phoenix submarket registered the highest availability rate at 19.5%.

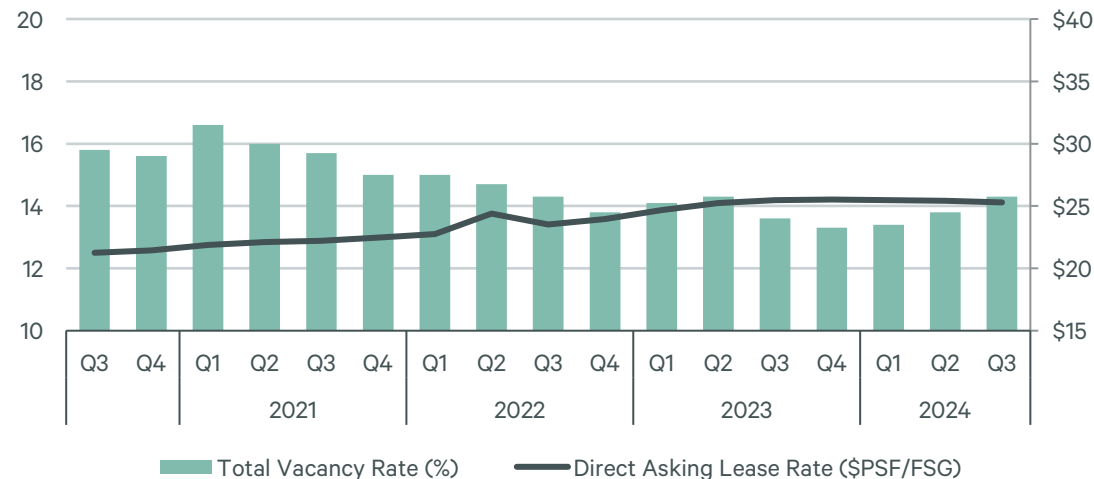
Class A product had the highest vacancy rate landing at 23.4%. Despite the large percentage of vacant space, the net rentable area subset is only 18.2% of the total inventory. This means that as new product was delivered in the past and going forward it had/will have a much more volatile effect on the Class A vacancy rate given the demand for high-quality space.

Lease Rates

In the third quarter, the overall base rate decreased to \$25.29 per sq. ft. from \$25.42 per sq. ft. in the second quarter of 2024. Year-over-year lease rates were down \$0.17 per sq. ft. across the Valley which was a decrease of 0.6%. The three-year average growth rate was 4.6% to end the third quarter with Classes A and B having posted growth rates above 4%.

The West Phoenix submarket had the highest overall base rate at \$28.55 followed by the Central Corridor submarket at \$28.11. With West Phoenix and Scottsdale both having overall asking rates above \$28, it's no surprise they are the two submarkets with the most amount of product under construction. The only two submarkets with overall asking rates below \$24 were Northwest Phoenix and East Phoenix, both of which have vacancy rates above 15%. Despite a small decrease in the last couple quarters, the overall asking rate in Phoenix remains stable with average rents well above \$25, which had not happened prior to 2023.

FIGURE 2: Overall Vacancy Rate and Lease Rate



Source: CoStar, Q3 2024.

FIGURE 3: Lease Rates by Class



Source: CoStar, Q3 2024.

Lease Transactions

In the third quarter of 2024, there were three leases recorded above 10,000 sq. ft. The largest of these was a new lease by Phoenix Autism Center taking 13,758 sq. ft. at Arcadia Medical - South. Phoenix Autism Center is family-owned early intervention ABA Therapy Center motivated by helping children and families learn and grow by creating engaging and fun individualized support plans. Arcadia Medical – South is owned by Healthpeak Properties and is part of a 28,147 sq. ft. complex located in the East Phoenix Submarket. Despite only having three leases above 10,000 sq. ft. in the third quarter, total leasing activity increased by 58,514 sq. ft. quarter over quarter within 111 total deals. Within the total number of deals 6.3% were subleases and 11.6% were inked within Class A buildings.

Sales Transactions

In the third quarter, there were 31 sales transactions surpassing \$1 million. The largest sale transaction at 3815 E Bell Rd occurred as part of a portfolio sale consisting of 32 properties across the country. The overall sales price of the portfolio was \$674.3 million, totaling 2,024,373 sq. ft. and averaging \$333.09 per sq. ft. The seller of the investment sale was Healthpeak Properties (Public REIT) while the buyers were Varde Partners (Investment Manager) and Unity Investment Management (Private REIT). 3815 E Bell Rd was 70.2% leased at the time of the sale. Of the 31 total transactions throughout the third quarter over \$1 million, 25.8% were part of a portfolio sale while 35.4% were condo sales. The average size of these transactions was 19,856 sq. ft. while the average price per sq. ft. was \$328.24.

Top Lease Transactions

Tenant	Sq. Ft.	Property
Phoenix Autism Center	13,758	Arcadia Medical - South
Willow Birth Center	11,259	Medical Collaborative at Pima Center
Cigna	10,447	Edwards Medical Plaza

Source: CoStar, Q3 2024.

Top Sale Transactions

Address	Size (SF)	Sale Price	Price/SF	% Leased
*3815 E Bell Rd	127,252	\$36,000,000	\$282.90	70.2
*7330 N 99th Ave	65,476	\$21,800,000	\$332.95	87.2
*9520 W Palm Ln	52,082	\$18,320,607	\$351.76	94.8
*16836 E Palisades Blvd	46,121	\$13,000,000	\$281.87	100
*9220 E Mountain View Rd	40,495	\$12,382,370	\$305.78	97.9

*Part of a Portfolio Sale

Source: CoStar, Q3 2024.

Development Activity

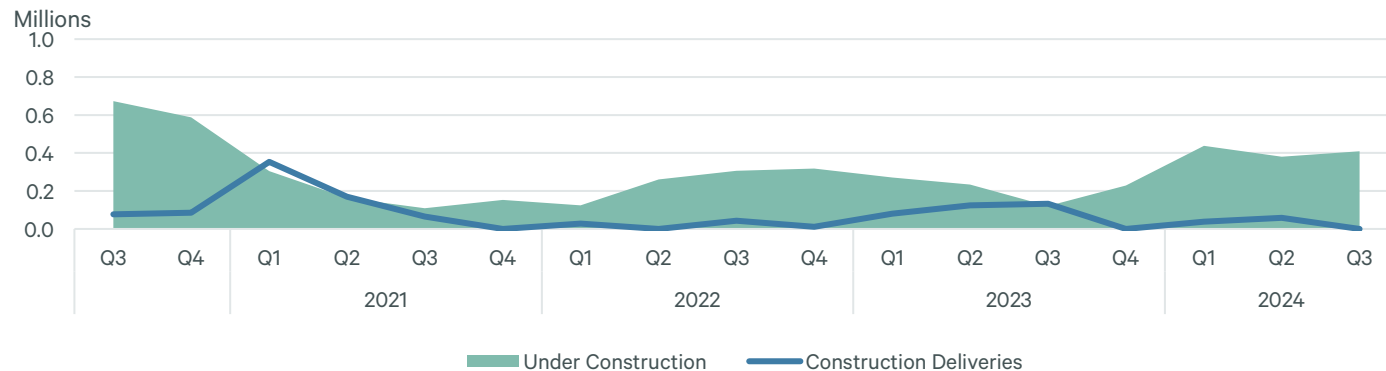
The third quarter of 2024 experienced no deliveries. The notable groundbreaking within the quarter occurred in West Phoenix where Rancho Santa Fe Phase II broke ground for 30,000 sq. ft. Submarkets with under construction product currently include Scottsdale, West Phoenix, and Northwest Phoenix. There were 410,000 sq. ft. under construction in the third quarter which is 1.5% of the total stock. Historically speaking this is 110,952 sq. ft. greater than the trailing three-year average, representative of developer's confidence in Metro Phoenix's demographics and growth tailwinds.

Outlook

The third quarter of 2024 continued a similar trend to that of the entirety of 2023. Uncertainty around the interest rate environment and banking industry brought many challenges within the capital markets and development industries. With no new deliveries in the third quarter of 2024, construction costs have continued to present challenges for new developments. Many hospitals also saw a decline in profit margins in part due to the aftermath of COVID-19, restricting their ability to expand their physical footprint. However, medical institutions such as Banner and Honor Health currently hold land planned for future development. While certain product types continued to present unknowns, the Phoenix medical office market has experienced solid metrics across the board.

“Demand for health care services is stronger than ever, but institutional and private physician groups are struggling to work through the challenges they face with increasing labor costs and other overhead expenses combined with stagnate reimbursements. There is significant optimism going into 2025 that with inflation and the cost of capital coming down that the practices can once expand to meet the demands of their growing patient base. “ - **Philip Wurth, CCIM**

FIGURE 6: Under Construction and Construction Deliveries



Source: CoStar, Q3 2024.

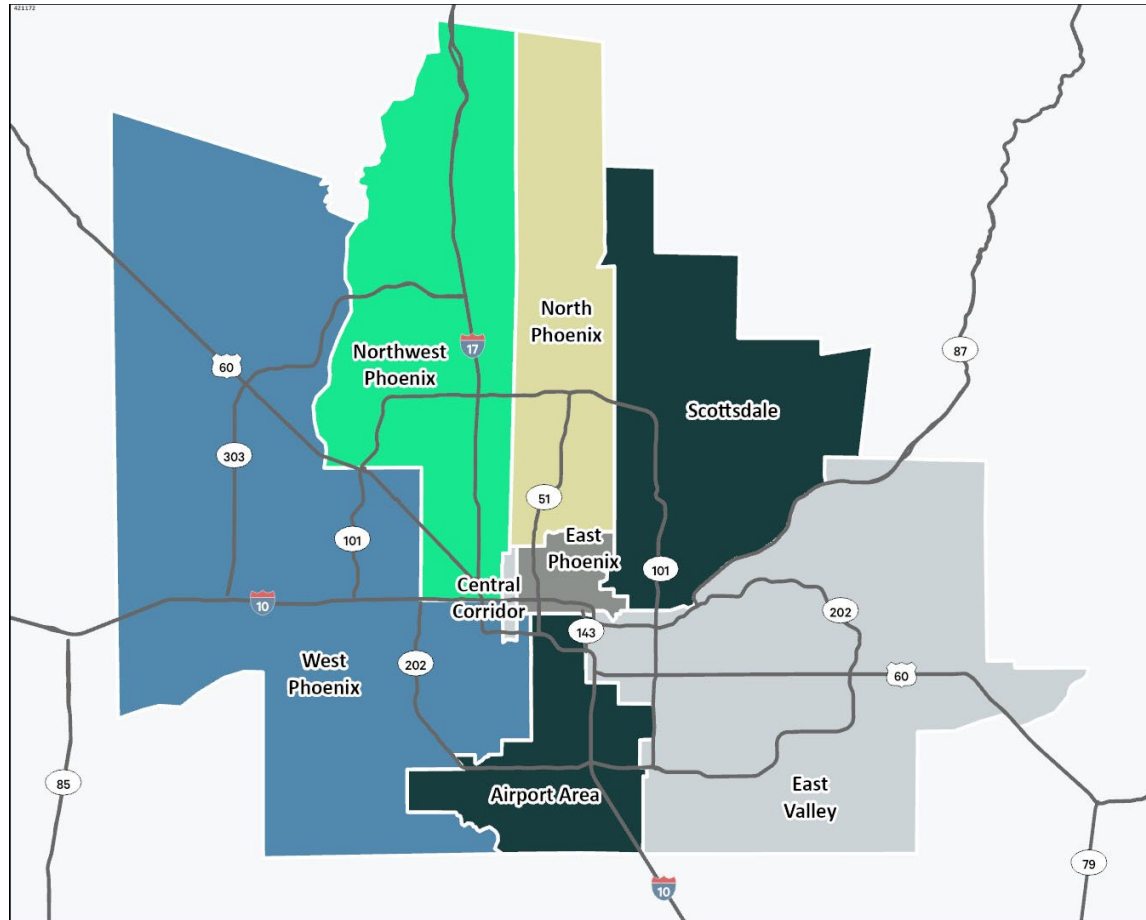
FIGURE 7: Market Statistics by Submarket

	Net Rentable Area (Sq. Ft.)	Availability	Vacancy	Net Absorption (Sq. Ft.)		Under Construction (Sq. Ft.)	Construction Deliveries (Sq. Ft.)	Overall Base Rate
				Q3 2024	2024 YTD			
Airport Area	716,672	37.9%	26.9%	24,020	18,337	0	0	\$17.53
Central Corridor	1,882,359	12.2%	7.1%	11,200	(11,187)	0	0	\$28.11
East Phoenix	2,053,933	18.5%	19.6%	(63,073)	(128,735)	0	0	\$23.93
East Valley	6,785,509	12.9%	12.1%	(48,678)	(17,746)	0	0	\$24.01
North Phoenix	1,492,379	15.4%	15.2%	13,677	(31,679)	0	0	\$24.43
Northwest Phoenix	5,799,792	19.5%	16.2%	(13,746)	(119,633)	88,000	0	\$23.79
Scottsdale	5,078,085	18.8%	19.9%	(46,070)	39,127	198,000	0	\$28.07
West Phoenix	3,203,081	9.0%	5.9%	(388)	70,134	124,000	0	\$28.55
Phoenix Total	27,011,810	12.5%	14.3%	(123,058)	(181,382)	410,000	0	\$25.29

FIGURE 8: Market Statistics by Class

	Net Rentable Area (Sq. Ft.)	Availability	Vacancy	Net Absorption (Sq. Ft.)		Under Construction (Sq. Ft.)	Construction Deliveries (Sq. Ft.)	Overall Base rate
				Q3 2024	2024 YTD			
Class A	4,922,578	23.4%	16.1%	1,482	75,191	366,000	0	\$28.67
Class B	19,249,076	15.7%	14.0%	(131,742)	(264,794)	44,000	0	\$24.92
Class C	2,840,156	7.9%	6.7%	7,202	8,221	0	0	\$19.70
Phoenix Total	27,011,810	12.5%	14.3%	(123,058)	(181,382)	410,000	0	\$25.29

Source: CoStar, Q3 2024.



Definitions

Available Sq. Ft.: Space in a building, ready for occupancy within six months; can be occupied or vacant. Availability Rate: Total Available Sq. Ft. divided by the net rentable area. Average Asking Lease Rate: A calculated average that includes net and gross lease rate, weighted by their corresponding available square footage. Net Rentable Area: The total floor area sq. ft. of the building, typically taken at the “drip line” of the building. Gross Activity: All sale and lease transactions completed within a specified time period. Excludes investment sale transactions. Gross Lease Rate: Rent typically includes real property taxes, building insurance, and major maintenance. Net Absorption: The change in Occupied Sq. Ft. from one period to the next. Occupied Sq. Ft.: Building Area not considered vacant. Vacancy Rate: Total Vacant Sq. Ft. divided by the total Building Area. Vacant Sq. Ft.: Space that can be occupied within 30 days.

Survey Criteria

Includes all office buildings with a medical secondary type 10,000 sq. ft. and greater in size in Phoenix metro. Buildings which have begun construction as evidenced by site excavation or foundation work.

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