

MARKETBEAT

Tucson

Office Q4 2017



TUCSON OFFICE

Economic Indicators

	Q4 16	Q4 17	12-Month Forecast
Tucson Employment	376k	373k	▲
Tucson Unemployment	4.6%	4.1%	▼
U.S. Unemployment	4.7%	4.1%	▼

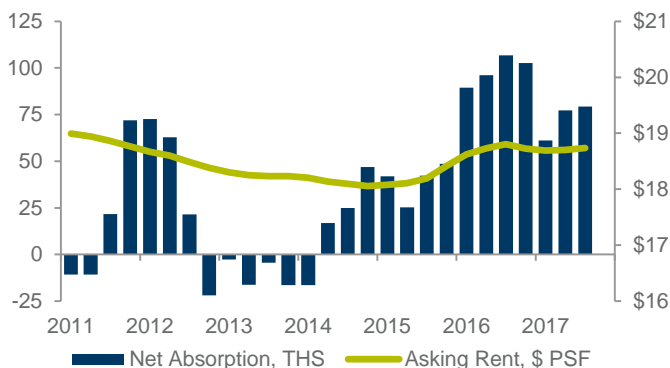
Market Indicators (Overall, All Classes)

	Q4 16	Q4 17	12-Month Forecast
Vacancy	10.5%	9.0%	▼
YTD Net Absorption (sf)	411k	304k	▲
Under Construction (sf)	16k	249k	■
Average Asking Rent*	\$18.61	\$18.93	▲

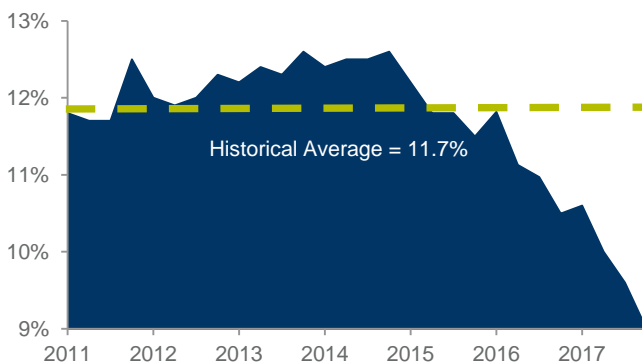
*Rental rates reflect gross asking \$psf/year

Overall Net Absorption/Overall Asking Rent

4-QTR TRAILING AVERAGE



Overall Vacancy



Economy

Tucson's economic health generally tracks that of Arizona and the nation as a whole, which bodes well for our region. Personal income for the U.S. in November was up 3.8% over a year ago. This is good news because inflation over that period was up only about 2.0%. According to Eller College economists, the Tucson MSA job data preliminarily reported by the Bureau of Labor Statistics is likely understated by thousands of jobs, and once adjusted in the spring for actuals, will reflect what is felt in the marketplace: that employment has steadily grown every quarter since Q3 2015. Housing permit activity was up 16.7% year-over-year through November, while median home prices are up 12.2%, all trending very favorably after several years of limited growth.

Market Overview

Absorption of professional office and medical space continued at a solid pace. The Q4 office vacancy rate of 9.0% is the lowest since the Great Recession, and was impacted by a net absorption of some +300,000 square feet (SF) during the past twelve months. However, current market lease rates do not yet support speculative office development due to the high cost of construction. Consequently new development is primarily build-to-suit, most notably Caterpillar's 150,000 SF corporate HQ now under construction. Office sales activity is typically investor oriented, with average deal size around \$1.6 million, with cap rates ranging between 7.5% to 8%.

Outlook

Overall, the Tucson office market is expected to demonstrate improving metrics in 2018. The Tucson office vacancy rate should continue to modestly and consistently decrease. A declining vacancy rate should eventually spur upward pressure on lease rates for well-positioned Class B and Class A offices. Overall average multi-tenant asking rent rates may increase by 5% to around \$20.00 per square foot. We also expect to see initial positive effects from the new federal tax law. The legislation includes a range of benefits for commercial property owners and investors. Besides the corporate tax rate being reduced from 35% to 21% in 2018, property owners can expect a 20% tax reduction on income from pass-through entities and a revised depreciation schedule allowing realization of tax benefits over 25 years instead of 39 years. In some cases commercial property owners will be able to immediately expense the full value of capital expenditures on their properties. While it's challenging to quantify where the next quarter will take us, the positive momentum locally underpinning an already strengthening national commercial real estate economy points to positive news for the Tucson office marketplace.

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SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT QTR OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	YTD LEASING ACTIVITY (SF)	UNDER CNSTR (SF)	OVERALL AVERAGE ASKING RENT (ALL CLASSES)*	OVERALL AVERAGE ASKING RENT (CLASS A)*
Central	9,757,451	32,111	1,211,466	12.7%	-28,968	62,749	501,357	0	\$18.76	\$23.54
Downtown	5,288,888	0	210,056	4.0%	105,171	110,379	115,889	249,000	\$20.05	\$27.26
East	1,254,860	0	187,213	14.9%	6,325	11,969	13,569	0	\$17.66	N/A
Foothills	1,352,659	3,450	95,511	7.3%	-6,428	2,976	55,795	0	\$21.26	N/A
Green Valley/South	359,077	0	45,055	12.5%	1,897	2,667	8,555	0	\$21.69	N/A
North/Oro Valley	3,599,213	0	369,005	10.3%	-6,121	8,909	127,193	0	\$19.34	N/A
Northwest	485,938	2,334	75,858	16.1%	1,644	10,317	13,218	0	\$20.81	N/A
Southeast	517,782	0	28,967	5.6%	17,102	38,210	26,624	0	\$16.86	N/A
Southwest	1,768,251	0	76,310	4.3%	19,198	32,978	2,750	0	\$16.71	N/A
West	1,650,971	0	8,287	0.5%	7,814	22,988	30,236	0	\$13.70	N/A
TUCSON TOTALS	26,035,090	37,895	2,307,728	9.0%	117,634	304,142	895,186	249,000	\$18.93	\$24.77

*Rental rates reflect gross asking \$psf/year

	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT QTR OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	YTD LEASING ACTIVITY (SF)	UNDER CNSTR (SF)	DIRECT AVERAGE ASKING RENT*	OVERALL AVERAGE ASKING RENT*
Class A	2,812,808	4,816	183,922	6.7%	36,766	58,629	297,506	61,000	\$24.90	\$24.77
Class B	18,002,904	33,079	1,864,732	10.5%	40,322	218,903	503,665	188,000	\$18.52	\$18.48
Class C	5,219,378	0	259,074	5.0%	40,546	26,610	94,015	0	\$14.97	\$15.03

Key Lease Transactions Q4 2017

PROPERTY	SF	TENANT	TRANSACTION TYPE	SUBMARKET
8950 N. Oracle Rd	41,134	Simpleview	New	North/Oro Valley
1450 S. Eastside Loop*	21,826	Department of Child Safety	New	Southeast
1455 W. River Rd*	20,000	MaaxCloud	New	North/Oro Valley
44 E. Broadway Blvd	16,400	CPI	New	Downtown

*C&W | PICOR transaction

Key Sales Transactions Q4 2017

PROPERTY	SF	SELLER/BUYER	PRICE / \$PSF	SUBMARKET
4690 N. Oracle Rd*	211,152	Tanager/ Comcast	\$23,500,000/\$111	West
2255 W. Ina Rd	46,094	Sierra Bravo Properties, LLC/ West Coast Capital Partners	\$2,729,689/\$59	North/Oro Valley
8950 N. Oracle Rd	41,134	Ozark Asset Management/ Simpleview	\$4,500,000/\$109	North/Oro Valley
4575 E. Broadway Blvd	18,969	Peach Properties/ Tucson Assets, LLC	\$3,150,000/\$166	Central

*C&W | PICOR transaction

Cushman & Wakefield | PICOR
5151 E. Broadway, Suite 115
Tucson, Arizona 85711
picor.com

For more information, contact:
Barbi Reuter, President
Tel: +1 520 546 2744
breuter@picor.com

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