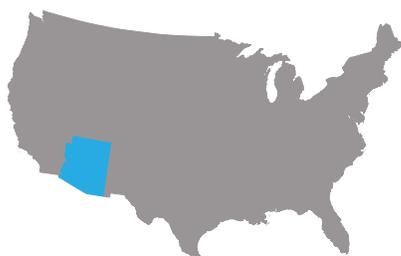


PHOENIX | ARIZONA RESEARCH & FORECAST REPORT



Continued Healthcare Uncertainty Obscures Modest Market Improvement

THE BROADER VIEW

The Greater Phoenix medical office market strengthened somewhat in the second quarter, with vacancy dipping, rents increasing and sales prices pushing higher. Despite the recent improvement, vacancy remains elevated, particularly in the off-campus buildings that comprise the bulk of the medical office inventory in the metro. Absorption of this space will ultimately be supported by population growth and continued hiring in the healthcare sector, but it will take some time for these trends bring the medical office market closer to equilibrium. In the interim, modest improvement in the sector is likely between now and the end of the year.

CURRENT CONDITIONS

Employment in Greater Phoenix remained stuck in neutral in the second quarter, following minimal gains in the first three months of the year. Local employment is 1.8 percent higher than one year ago—representing 32,300 additional jobs—but more than 80 percent of those gains were recorded in the second half of 2013. To date, local employment growth has been sluggish, but the recent trend of more pronounced growth in the second halves of years offers some optimism that employment expansion could gain momentum in the coming months.

Over the past several years, the local healthcare sector has expanded more rapidly than the overall economy, a trend that continued in the second quarter. Approximately 1,700 healthcare jobs were added in the second quarter, bringing the total for growth over the past 12 months to 8,800 new positions. This represents a 4.1 percent annual increase in the healthcare sector, more than doubling the pace of expansion in the overall labor market. During the past five years, healthcare employment in Greater Phoenix has expanded by an average of nearly 6,500 positions per year, and similar gains are forecast for 2014.

Vacancy in the Greater Phoenix medical office market dipped during the second quarter, ending the period at 20.2 percent, compared to 20.4 percent three months ago. While the rate is down slightly year over year, medical office vacancy has remained fairly flat for the past several years. Since 2010, vacancy in medical office buildings has ranged between 19-21 percent.

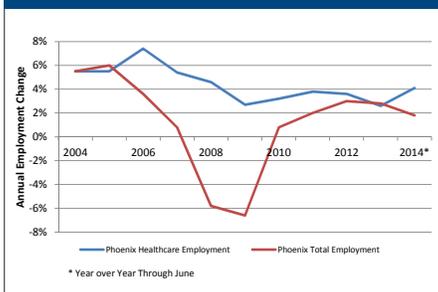
Vacancy in on-campus buildings continued to tick higher, reaching 13.3 percent in the second quarter. This marked the sixth vacancy increase in the past seven quarters for on-campus facilities, but upward movement has been modest during these periods, totaling 270 basis points. Over the past 12 months, vacancy in on-campus buildings has increased 100 basis points on negative net absorption of approximately 25,000 square feet.

Vacancy in off-campus buildings ended the second quarter at 21.4 percent, down from 22.1 percent one year ago. Trends in off-campus buildings have been mixed over the past few years, with vacancy

MARKET INDICATORS

	Q2 2014	Q2 2013
TOTAL VACANCY	↓	↑
ON-CAMPUS VACANCY	↑	↑
COMPLETIONS	—	↑
NET ABSORPTION	↑	↓
ON-CAMPUS NET ABSORPTION	↓	↓
ASKING RENTS	↑	↑

GREATER PHOENIX EMPLOYMENT



showing no clear direction from one quarter to the next. This is due in part to the ongoing changes brought about by the implementation of the Affordable Care Act. Uncertainty surrounding the Affordable Care Act continues to linger, with contradictory rulings on the legality of insurance subsidies issued by two separate federal appeals courts early in the third quarter.

With the exception of a flurry of activity at the end of 2013, sales velocity for non-condo medical office buildings has been very steady. Year to date, investment activity is down approximately 10 percent from the first half of 2013. While fewer buildings have changed hands, pricing is pushing higher. The median price in transactions thus far in 2014 is \$107 per square foot, a more than 30 percent increase from last year's median price. Cap rates are in the mid-7 percent range, similar to 2013 levels.

Sales of medical office condos spiked nearly 60 percent from the first quarter to the second quarter, repeating a trend that occurred last year. On the whole, sales volume of condos is on the rise; year to date, velocity is up nearly 50 percent from first-half 2013 levels. Thus far in 2014, approximately half of the medical office condo sales have occurred in the Southeast Valley; the median price in these deals has been \$124 per square foot. The Northwest Phoenix submarkets of Arrowhead and Deer Valley have accounted for approximately 20 percent of the transactions in 2014 and the median price in these deals has been \$152 per square foot, trailing only Scottsdale, where the median price year to date has reached \$165 per square foot.

485 offices in 63 countries on 6 continents

United States: 146
 Canada: 44
 Latin America: 25
 Asia Pacific: 186
 EMEA: 84

- \$2.1 billion USD in annual revenue
- 1.46 billion square feet under management
- 15,800 professionals worldwide

(Based on 2013 results)

COLLIERS INTERNATIONAL

PHOENIX
 2390 E. Camelback Road, Ste 100
 Phoenix, Arizona 85016

TEL +1 602 222 5000
 FAX +1 602 222 5001

SCOTTSDALE
 14080 N. Northsight Blvd.
 Scottsdale, Arizona 85260

TEL +1 480 596 9000
 FAX +1 480 948 0502

Bob Mulhern
 Managing Director | Greater Phoenix
 bob.mulhern@colliers.com

Jim Keeley, SIOR, CCIM
 Founding Partner | Scottsdale Office
 jim.keeley@colliers.com

Pete O'Neil
 Research Manager | Greater Phoenix
 pete.oneil@colliers.com

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