The Real State®
The Real State of the Phoenix Commercial Real Estate Market

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

April 2020

Bridging the Gap in Lease Negotiations

While we seek to be optimistic about the post-COVID-19 landscape, we also need to be realistic about how quickly the Greater Phoenix economy will recover to the strong position it was in just a few months ago. In early April, Arizona Governor Doug Ducey signed Executive Order 2020-21, which ceased evictions and lockouts of small business tenants (500 or fewer employees) until May 31. Tenants are still obligated to pay the rent that was owed, however; failure to do so would put them in default and at risk of the customary eviction or lockout proceedings once the order expires. On April 29, Governor Ducey announced the extension of Arizona's stay-at-home order through May 15. The order included some modifications, such as the partial reopening of retail establishments starting May 4 for curbside pickup and delivery and a further loosening four days later. Dine-in at restaurants is expected to resume in May, with a best-case scenario of May 12.

With the deferral of rent payments and stalling of foreclosures, it will likely be next month or even later this summer before the full state of the market is clear. In the meantime, many landlords and tenants alike will be heading to the negotiating table. With lower rental rates occurring in the market, current owners may need to be more flexible on terms to avoid vacancies and retain viable long-term tenants. With COVID-19 impacting their revenue streams, tenants are seeking ways to decrease expenses, across most asset classes.

How do they bridge the gap? It can be tempting for tenants to overplay their leverage, but the more prudent course is to make good on their responsibilities if they have the ability. Likewise, it is in a landlord's best interest to have their tenants survive and thrive.

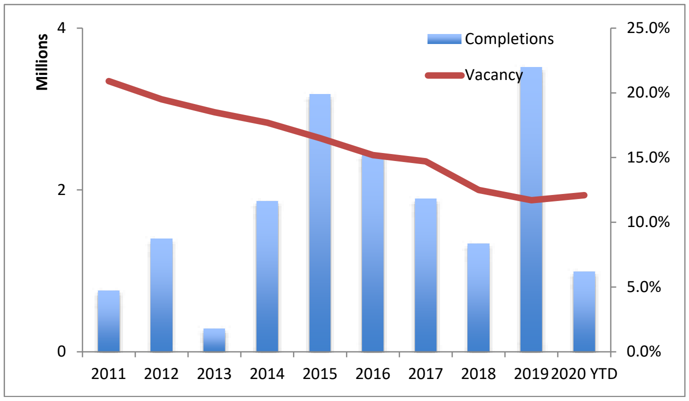
For both parties, the best plan is to consider the relationship aspect—first and foremost, negotiating in good faith. The main priority is to sit down and proactively problem-solve, with open books and minds. This includes recognizing that the person on the other side of the table may be going through difficult times as well. If the situation is contentious, enlisting a neutral third party can help pave the way for a mutually agreeble deal.

Common rent concession options include lease deferrals (tacking delinquent rent onto the back end of the lease); temporary lease waivers; rent reductions for a given period of time or the remainder of a lease; or even extending a lease at a lower rate upon expiration.

Beyond traditional leasing deals, we are observing an increase in subleases, as office-based businesses scale back on headcount and consolidate resources. Along the same lines, there are numerous cohabitation/office-sharing opportunities starting to hit the market, a trend we anticipate will continue for the foreseeable future.

Stay Current
In light of the fast pace of changes in the commercial real estate space due to COVID-19, we are updating our LinkedIn page on a frequent basis with news and analysis. You can follow us here: R.O.I. Properties – LinkedIn.

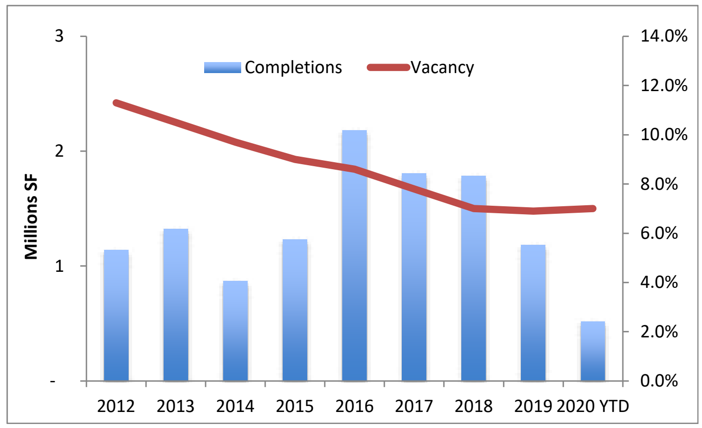
Office



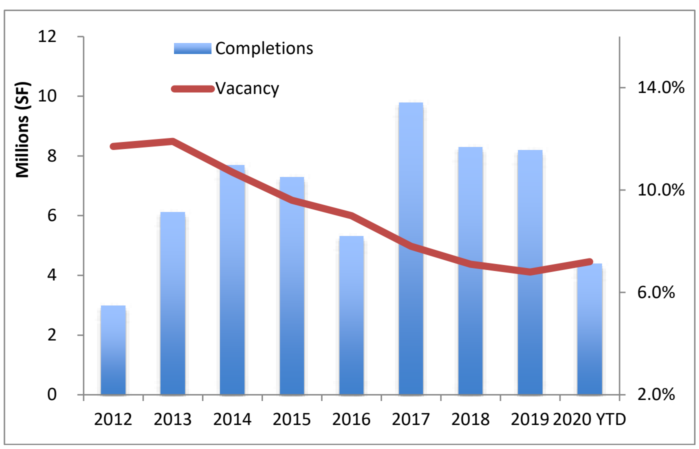
Prior to the arrival of COVID-19, 2020 office construction was off to a great start, with more than 986,000 SF completed in Q1. 4,500 SF of office product has been completed so far in Q2. Sales are still overall healthy, with over $340.8M of office product sold year to date, and $50M so far in Q2 alone. R.O.I. Properties is keeping a close eye on the potential impacts to this market from remote work and other factors.

Retail

Construction in the Phoenix retail market has been gradually slowing during the past two years, with only 519,000 SF brought to market so far in 2020. Reporting indicated that year to date, $446M has been traded, and $33M so far in Q2. Vacancy rates are still being reported at 7%; clearly that will be subject to change as the coronavirus situation evolves and we gain clarity on Arizona's ability to remove restrictions.



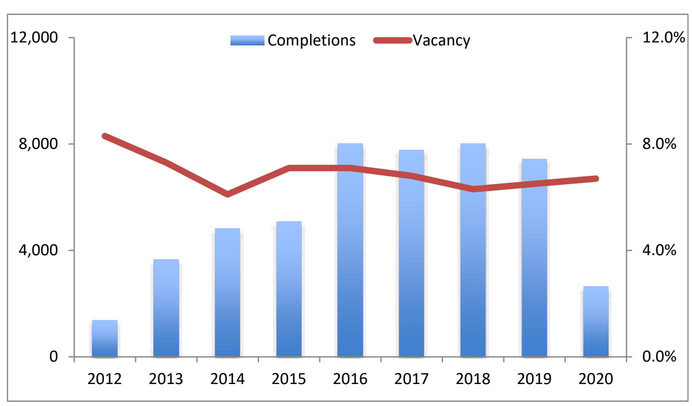
Industrial



Developers have brought more than 4.3 million SF of industrial product to the market year to date, with another 14 million SF still under construction. According to CoStar, over $1B of industrial space has traded year to date. The average price per SF has risen to $129/SF in 2020, a record high in Phoenix. Cap rates have held steady around 6.4% the past three years, with vacancy rates at 7.3%.

Multifamily

Reports indicate that 2,204 units were brought to market in Q1 2020; so far in Q2, only 447 units have been completed. Reported vacancy rates remain very low, at 6.7% year-to-date. So far in 2020, $1.5B of multifamily product has traded hands, $195M at this point in the second quarter. At $169,955/unit, average price per unit showed an 11% increase year over year. At the last reported number of 5.0%, cap rates remain at a cyclical low, pending further post-COVID data.



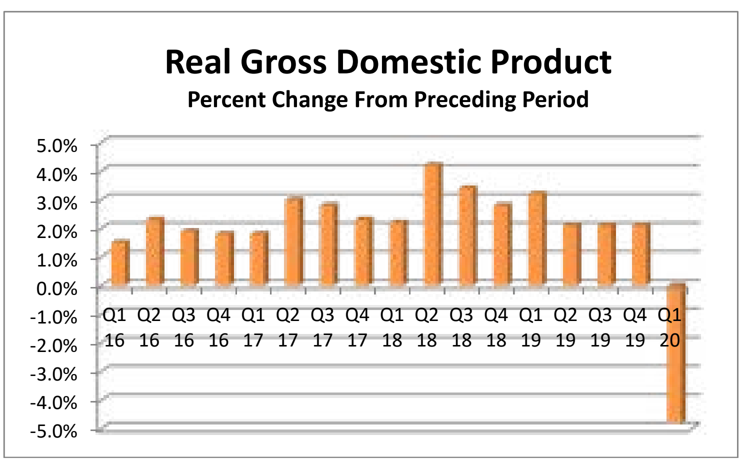
Residential Snapshot

The Greater Phoenix residential real estate market is searching for balance, and while the indices would indicate that we are technically in a seller's market, this is rapidly changing. From March to April 2020, the supply-demand index plummeted 72.9 points, from 236.9 to 164.0. A drop in demand was expected in light of the COVID-19 pandemic, but seeing the dramatic shift in the indices over the course of 4 weeks puts the impact in perspective. This presents a unique opportunity for a property owner looking to make a change or recapitalize, where there is still opportunity to sell at pre-COVID pricing, while supply is still low (and foreclosures are on hold). Other key statistics in the residential real estate market include:

- Q1 2020 ended with new listings down 5.2%, and as of April 23, Q2 is down 28.5%.
- Despite supply rising 32.4% in the past 5 weeks, week 16 is still 22.7% below 2019 levels. In fact, all price points are still below 2019 despite recent gains.
- The biggest jump in inventory is under $400K, up 56% in 5 weeks, providing more choice for buyers in the most affordable price points with fewer competing cash investors, at least for now.
- Inventory over $400K has not risen as sharply, and over $1M it has declined.
- March 2020 ended with an average sale price of $186.70/SF through the MLS, which is 8.5% higher than March 2019 and 1.0% higher than this February.
- After peaking the week of February 23 at 2,696, the weekly number of accepted contracts dropped 64% over the course of 6 weeks. In week 7, they did not decline—potentially indicating stabilizing demand.
- Beyond a dip in March sales, it is reasonable to anticipate low closings through June, given the unseasonal decline in contract activity over the past 7 weeks.

Your Expert Commercial Real Estate Advisors Under All Market Conditions
At R.O.I. Properties, we know/understand the market, and are working hard to ensure that our clients thrive in every real estate market—particularly as market conditions shift. If you would like objective, expert guidance on your individual circumstances, please know that we are here when you need us! Contact us at 602.319.1326.

Real GDP



Real gross domestic product (GDP) decreased at an annual rate of 4.8% in the first quarter of 2020, according to the "advance" estimate released by the Bureau of Economic Analysis. In the fourth quarter of 2019, real GDP increased 2.1%.

The decline in first quarter GDP was, in part, due to the response to the spread of COVID-19, as governments issued "stay-at-home" orders in March. This led to rapid changes in demand, as businesses and schools switched to remote work or canceled operations, and consumers canceled, restricted, or redirected their spending. The full economic effects of the COVID-19 pandemic cannot be quantified in the GDP estimate for the first quarter of 2020, because the impacts are generally embedded in source data and cannot be separately identified.
—*Bureau of Economic Analysis*

Consumer Confidence

The Conference Board Consumer Confidence Index® deteriorated further in April, following a sharp decline in March. The index now stands at 86.9 (1985=100), down from 118.8 in March. The Present Situation Index—based on consumers' assessment of current business and labor market conditions—also declined considerably, from 166.7 to 76.4. However, the Expectations Index—based on consumers' short-term outlook for income, business and labor market conditions—improved from 86.8 in March to 93.8 this month.—*The Conference Board*

Articles of Interest

AZ Big Media – April 16
How AZ commercial landlords are navigating COVID/rent relief

Phoenix Business Journal – April 23
Warnings multiply as Phoenix-area retail landlords brace for coronavirus fallout

National Real Estate Investor – April 7
Past Due: Tenants, Landlords Begin to Negotiate Rent Relief

The Broker List – April 8
Coronavirus Pandemic Has Shifted Leverage from Landlords to Tenants

AZ Big Media – April 26
NAIOP: Coworking will come back stronger after pandemic

AZ Big Media – April 22
Here's how coronavirus could boost demand for Phoenix warehouse space

GlobeSt. – April 29
Renters Are Enthusiastic About Searching for a New Apartment

Phoenix Business Journal – April 29
Site selectors: Phoenix positioned well for distribution sector growth post-pandemic

Phoenix Business Journal – April 26
Big-box industrial properties expected to best weather pandemic in Phoenix