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

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ENHANCING REAL ESTATE ASSETS

AUGUST 2024

How Retail Became the New Investor Darling

In the days of the Covid pandemic, the industrial and multifamily sectors were popping, while retail appeared to be in a doom spiral along with office space. Were we ever going to shop in public again? Had online commerce made bricks and mortar stores obsolete? As time passed, like the old Mark Twain saying, it became obvious that the tales of retail's death had been greatly exaggerated. Today, with people clamoring for in-person goods, services, and restaurants like never before—investors are hot on the case. A look at the metrics tells the story:

- Vacancy has proven to be very healthy, hovering around the 5.2% range.
- One of the key statistics to consider in commercial real estate is the percentage of current inventory that is under development. Retail has just 1.18% of the current inventory under development—far less than multifamily or industrial. This is good for retail absorption and indicates that the Phoenix market will not suffer from high vacancy rates anytime soon.
- Year-over-year rent growth of 7.1% proves significant retail demand. Just as multifamily and industrial experienced record rent growth a few years ago, retail is having its moment. Phoenix is also outperforming the national average of retail rent growth, which is just over 2%.

Although there is not much retail development overall, the locations where it's occurring are highly strategic. Two of the major players in the Greater Phoenix development landspace, DMB and Vestar, are in the process of developing Verrado Marketplace, a 500,000-square-foot, upscale location with major tenants such as Target, Harkins, Ross, and a variety of restaurants.

Medtail: The Retail Sector Standout

Ten years ago, the idea of getting a physical exam or MRI and picking up groceries without having to leave the parking lot would have sounded crazy. But the reality of the so-called medtail movement—medical in a retail location/center—has made it common. Traditionally, a hospital was an anchor location, and then all the doctors affiliated with it would have their medical offices within the same overall complex, along with offices focused on testing and medical imaging. At first, physicians may have felt like it was déclassé to set up a practice in a non-medical retail location, but ultimately, it was a business decision to get closer to the consumer base. The rise of medtail received a further boost during the pandemic, just at a time when retail vacancy rates were a major concern. In many cases, medtail also makes sense from an infrastructure perspective, an easy option for backfilling a former CVS, Walgreens, or even Bed Bath and Beyond with medical tenants who do not need to be in a hospital setting or cannot afford the time and expense of a ground-up, build-to-suit development.

Retail's current success extends far beyond the traditional rotation of restaurants, services, and merchandise. Medtail concepts are often high performing with outstanding financials—whether a veterinary clinic or an urgent care in a strip center. Investors should be open to investigating their options and including them in potential acquisitions.

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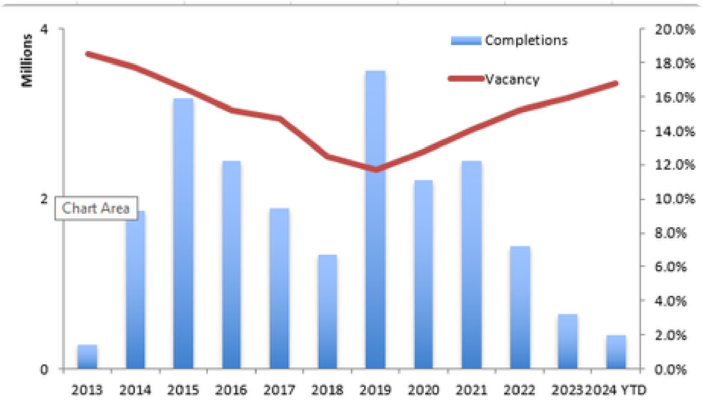
Office



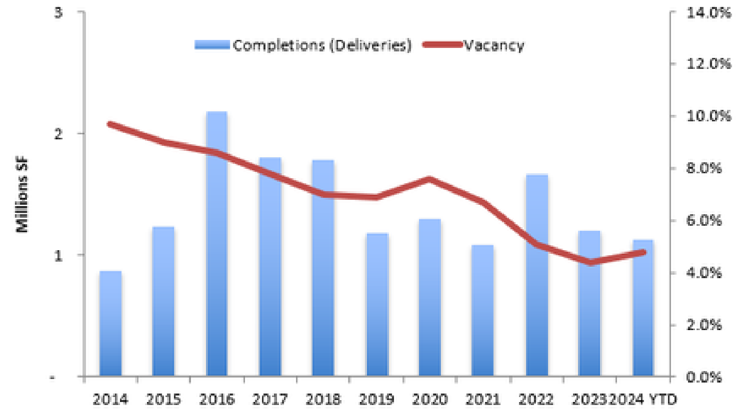
The steady rise in office vacancy remains unabated in Phoenix as the third quarter kicks off. Many users are scrutinizing the effective use of their footprints, often resulting in space reductions or closures. Additionally, job growth has been sluggish in traditionally office-using employment sectors for over two years. This structural lowering of underlying space demand caused vacancy to climb more than 550 basis points since Q4 2019, and expectations are for further increases over the midterm as pre-pandemic leases expire.

The amount of net space vacated since the onset of COVID has now reached over -4.5 million SF, surpassing the total occupancy loss seen during the worst of the Great Recession. More than half of the space givebacks occurred in the past 18 months as tepid tenant demand persists even four years after the pandemic's start. Empty space is accumulating more quickly in larger suites and single-tenant buildings than in smaller ones.

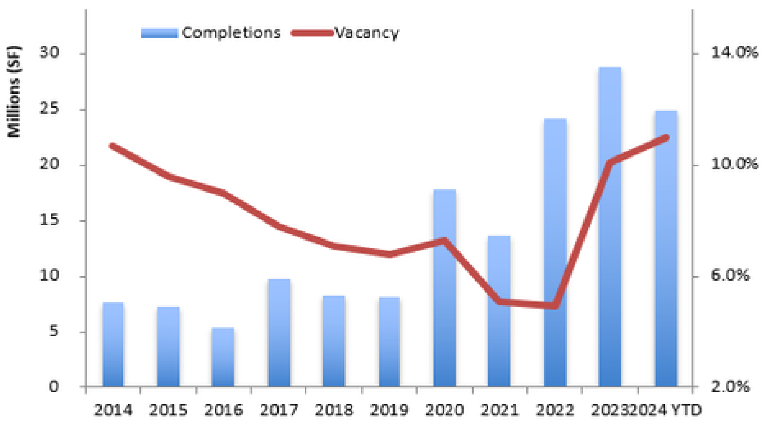
Retail

Conditions in the Phoenix retail market remain near the tightest level on record as the third quarter kicks off. Strong demographics, continued income growth, and healthy job gains are fueling robust underlying tenant demand. These stout demand drivers, coupled with the modest construction pipeline and limited store closures, have kept space availability and rent growth near all-time bests.

The Valley recorded 1.1 million SF of net absorption over the past 12 months, ranking Phoenix as one of the nation's top 15 strongest demand markets. Quickservice restaurants, beverage shops, discount retailers, and experiential tenants have been the primary sources of new retail leases this year.



Industrial



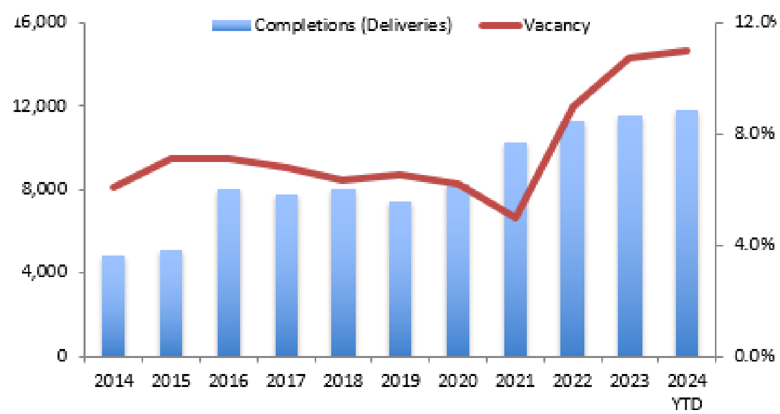
A deluge of new development completions continues to drive Phoenix's industrial vacancy rate higher, a condition that could persist into mid-2025. The second quarter marked the fourth consecutive quarter with 10+ million SF of net deliveries, bringing the total over the past 12 months to an unprecedented 41.2 million SF. For comparison, Phoenix averaged 8 million SF of annual net deliveries in the three years leading up to the onset of the pandemic.

The wave of construction overshadows a resilient demand picture. While demand has eased from the frenetic pace seen in 2021 and 2022, leasing volume is 20% above 2019 levels as occupiers related to logistics, construction, and manufacturing continue to expand. These factors, along with advanced manufacturing momentum, drove 14.3 million SF of net absorption over the past 12 months, the third most in the nation.

Multifamily

The Phoenix multifamily market took another step toward recovery in the first half of 2024. Easing inflation and rising consumer confidence have unlocked renter household formation, driving a rebound in underlying tenant demand. Though new supply additions continue to outpace leasing activity, the rate of decline in occupancy and rents has begun to flatten out, indicating that the market may be at or near the bottom regarding property performance.

The Valley recorded 16,000 units of net absorption over the past 12 months, outpacing the pre-COVID five-year average of 7,200 units. Though the lease-up of newly delivered luxury complexes drove the bulk of activity, a turnaround among Class B properties has been the most notable revelation. Midpriced communities saw 4,400 units of net absorption over the past 12 months, compared to thousands of units of negative net absorption the prior two years combined.



Residential Snapshot

July to August 2024, the supply-demand index dropped from 100.7 to 99.7, indicating an overall market in a balanced state. Interest rates are starting to come down a bit in anticipation of the Federal Reserve reducing rates in September. Although inventory has not changed significantly, further decreases should provide some momentum for additional product on the market, from people who are willing to list their homes and buy up, buy down, or make a lateral move. It's difficult, however, to know at what benchmark rate activity will really start jumping. After several years in an inventory-driven market, it will be an interesting test to see how we digest a sizable increase in supply.

Other market factors that R.O.I. Properties is tracking include:

- Supply is 57% higher than this time last year, but it has barely changed over the past 4 months.
- Typically, when a buyer backs out of a transaction, the property reverts to active status in the MLS with a "Back on Market" tag. The long-term norm for fallouts is 16-17% of listings under contract. July was slightly elevated at 17.5%, with 1,326 going back on market; the record was set in March 2020 when 3,042 (24%) immediately fell out due to COVID-19 fears.
- While fallouts are not an issue in our current market, fewer new listings are entering the market. Last year was the lowest count of new listings added to supply going back to 2001. This year is the second lowest, but with zero improvement in demand, the slight increase in new listings was enough to lift the supply line from January through May.
- Despite rates dropping significantly this month, contract activity under $1M failed to improve. That's to be expected as it takes a while for buyers to get going again after a long break—plus many will wait to see if rates continue to decline before they act.

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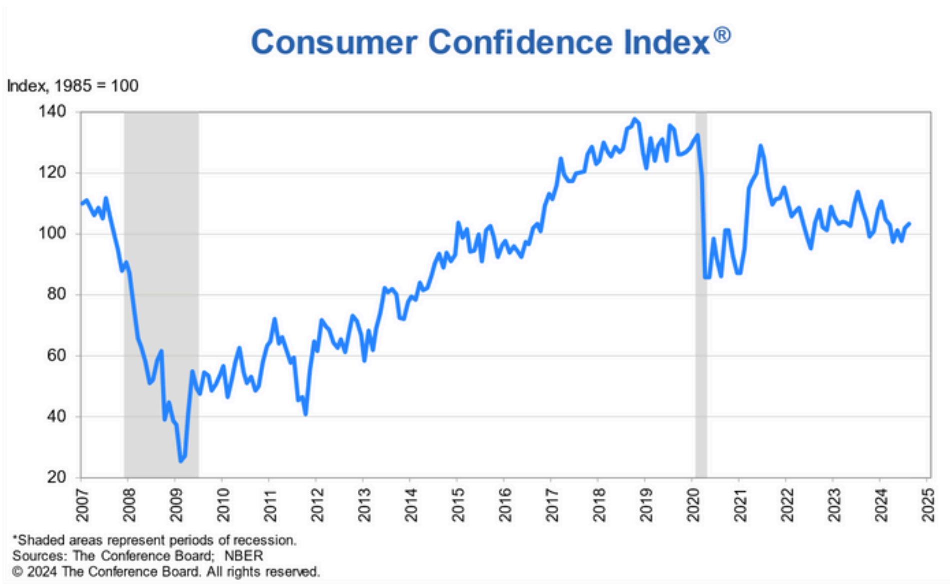
CONSUMER CONFIDENCE



Source: https://www.conference-board.org/topics/consumer-confidence

"Overall consumer confidence rose in August but remained within the narrow range that has prevailed over the past two years," said Dana M. Peterson, Chief Economist at The Conference Board. "Consumers continued to express mixed feelings in August. Compared to July, they were more positive about business conditions, both current and future, but also more concerned about the labor market. Consumers' assessments of the current labor situation, while still positive, continued to weaken, and assessments of the labor market going forward were more pessimistic. This likely reflects the recent increase in unemployment. Consumers were also a bit less positive about future income."

GREATER PHOENIX BLUE CHIP ECONOMIC FORECAST - Q2

2024 ANNUAL PERCENTAGE CHANGE	Population	Personal Income	Retail Sales	Wage & Salary Employment	Manufacturing Employment	Construction Employment
ASU Economic Outlook Center	1.3%	5.6%	2.0%	2.1%	-1.0%	4.0%
EconLit LLC	1.7%	5.0%	4.2%	2.4%	2.4%	2.7%
Elliott D. Pollack & Co.	1.7%	6.0%	2.2%	2.2%	-0.1%	2.7%
Joint Legislative Budget Committee	1.6%	4.3%	3.7%	2.2%	0.8%	3.3%
Rounds Consulting	1.7%	4.5%	4.5%	1.7%	1.0%	5.0%
The Maguire Company	1.6%	5.0%	3.5%	2.2%	2.5%	2.0%
University of Arizona Eller College	1.5%	6.2%	2.9%	2.6%	2.6%	-0.1%
CONSENSUS	**1.6%**	**5.2%**	**3.3%**	**2.2%**	**1.2%**	**2.8%**

Source: *https://seidmaninstitute.com*

Articles of Interest

ABC 15 – July 29
Phoenix officials travel to Taiwan as they plan $7 billion science park in Arizona

GlobeSt. – Aug. 22
Office Demand is Growing But H2 Employment Concerns Loom

Phoenix Business Journal – Aug. 19
Phoenix has top industrial leases in US in 2024

Phoenix Business Journal – Aug. 16
Phoenix among best in nation for real estate growth since 1980

Commercial Property Executive – Aug. 5
H1 Office Deal Volume High in Phoenix

AZ Big Media – July 15
Retail remains red-hot in the post-pandemic recovery