The Real State®

The Real State of the Phoenix Commercial Real Estate Market

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

SEPTEMBER 2024

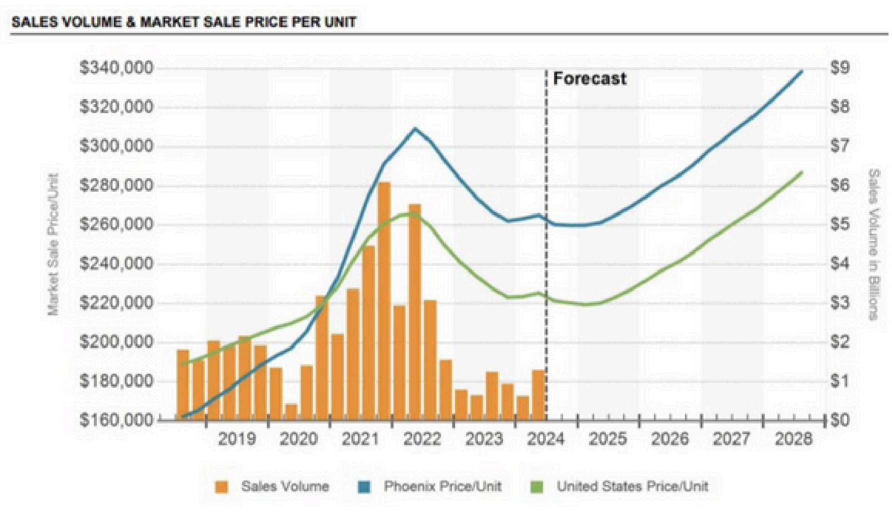
Increased Activity and Price Discovery in Multifamily

The Federal Reserve rate decrease of 50 basis points has garnered plenty of attention and the drop in interest rates has also impacted commercial properties—specifically multifamily buyers, including both institutional and private investors. In the past few weeks, we have seen a high volume of buyers interested in acquiring properties, deals going into escrow, and completed investment transactions. Is this a result of interest rates, buyers getting excited about having investment opportunities in one of the nation's hottest multifamily markets, or a combination of factors?

All investment asset classes are particularly sensitive to interest rates. Multi-family assets are particularly attractive to investments as an investor has the ability to spread its risk through multiple tenants/revenue pockets.

As noted briefly in the July issue of The Real State, the multi-family market is undergoing a period of price discovery. In general, deals are coming together at 20%-25% discount compared to last trade at the market peak, which occurred in late 2021/early 2022, before interest rates started going up dramatically. Yes, the situation is not as challenging as it is on the office side, but some investors may be stuck with deals they are unable to trade without taking a price hit, due to declining rental rates, higher vacancy rates, lack of financing, and other factors.

For multifamily buyers, this may spell opportunity: good products and owners who need to sell or are concerned about their position. On the sellers' side, it is a welcome sight to see buyers who are out there buying.



Source: CoStar

Notable Recent Deals

What has price discovery looked like in the Phoenix multifamily market? Recent sales have included:

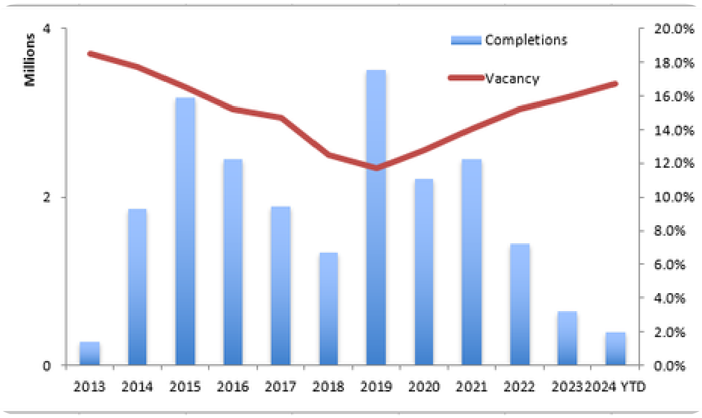
- Villas De Azul in Phoenix, a 301-unit property that sold for $33 million in September 2020 and sold for $30.1 million earlier this month—an 8.8% decrease in almost exactly four years.
- Escondido Apartments on N. 36th St. in the Arcadia area of Phoenix. The 75-unit property sold for just over $20 million in March 2022 and changed hands for $16 million at the end of August—a 20.2% drop.

Continued on page 4...

Maximize the Value of Your Real Estate Assets

Whether you own a commercial property that you'd like to sell, or are interested in learning more about investment opportunities in the current market, the R.O.I. Properties team can negotiate the most favorable deal for you. Please contact us at: info@roiproperties.com or 602-319-1326.

Office



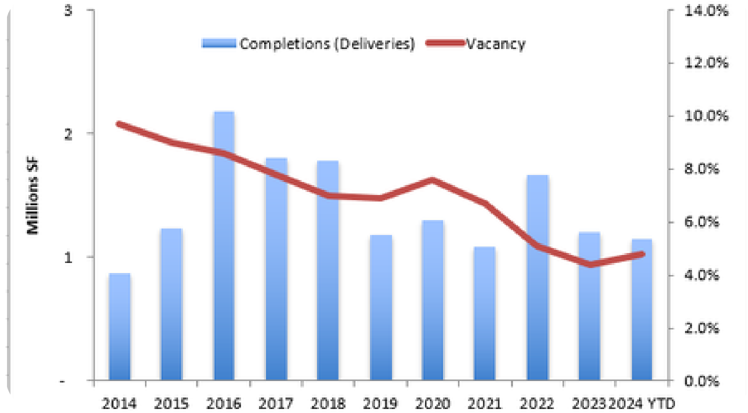
Like other metros, supply additions have reached a near standstill in Phoenix. Weaker underlying tenant demand, higher development costs, and limited availability of construction financing have made it difficult for builders to break ground. While the reprieve of new construction has helped avoid exacerbating the supply and demand imbalance, it could result in a shortage of first generation office space in the midterm, providing occupiers with fewer premium expansion options.

Just 270,000 SF of gross new office space was completed over the past 12 months, a meaningful slowdown from the 2.8 million SF added per year on average from 2015 to 2021. The only two leasable non-medical offices to deliver this year were originally built-to-suits that the user later chose not to occupy: a 133,400 SF office for Carvana and a 135,000 SF office for Viasat. Both are located in Tempe and remain vacant.

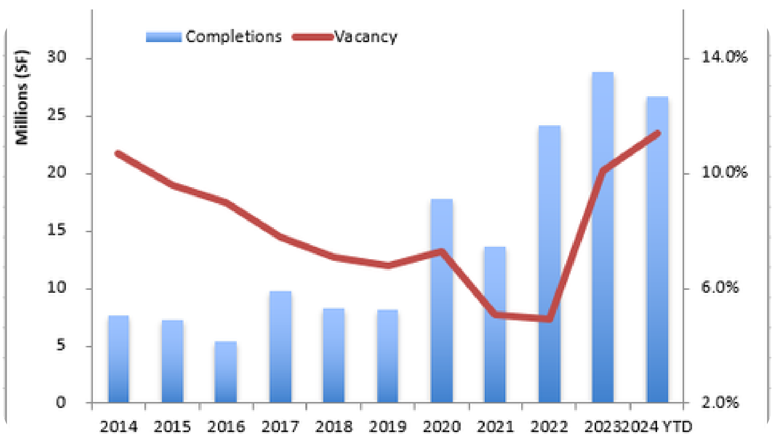
Retail

The lack of meaningful construction activity over the past decade has been one of the primary contributors to the Valley's historically tight market conditions. Developers shifted their focus to other property types during the most recent expansion cycle, particularly in Phoenix, which was hit especially hard during the global financial crisis.

Over the past 12 months, builders completed just 1.7 million SF of net new retail space, a considerable downshift compared to 2006-08, when more than 10 million SF per year was delivered. Though the amount of space under construction has risen above the prepandemic average to 2.9 million SF in 24Q3, less than 20% is available for lease, keeping supply-side pressure largely at bay. Spec big box is rare, and most builders will often have their anchors and junior anchors in tow before beginning construction, as well as having a decent amount of the shop space preleased.



Industrial



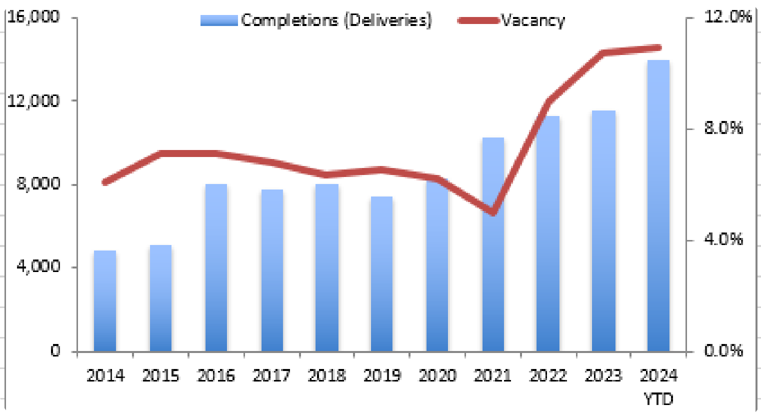
The Phoenix industrial market is contending with one of the most aggressive development pipelines in the country. The second quarter was the fourth consecutive quarter with 10+ million SF of net deliveries as a wave of construction poured 38.0 million SF into the market over the past 12 months. For comparison, developers completed 39 million SF from 2014 to 2019, indicating Phoenix received six years of pre-pandemic supply additions in just 12 months.

Supply-side pressure will likely continue over the next several quarters. Phoenix is the nation's top construction market, with 29.5 million SF currently underway. That amount represents 6.2% of existing inventory, tripling the 1.8% share for the overall US. With nearly 60% of development progressing without a tenant in place, the delivery of empty spec space is expected to put further upward pressure on vacancy over the near term.

Multifamily

Supply-side challenges plague the Phoenix multifamily market as a wave of deliveries overshadows rebounding rental demand. Over the past 12 months, apartment builders delivered a staggering 22,000 net new units, outpacing the pre-COVID five-year average of about 7,100 units per year. The surge in construction activity has caused vacancies to rise quickly since mid-2021 and turned rent growth negative.

The impact of the construction pipeline will be felt through at least 2025. About 28,000 units are under construction, representing 7.1% of existing inventory. That figure ranks Phoenix as one of the most aggressively built markets in the country. With much of the development activity focused on luxury properties, supply pressure has been most acute in the class A segment, though weakness has also extended to B and C properties.



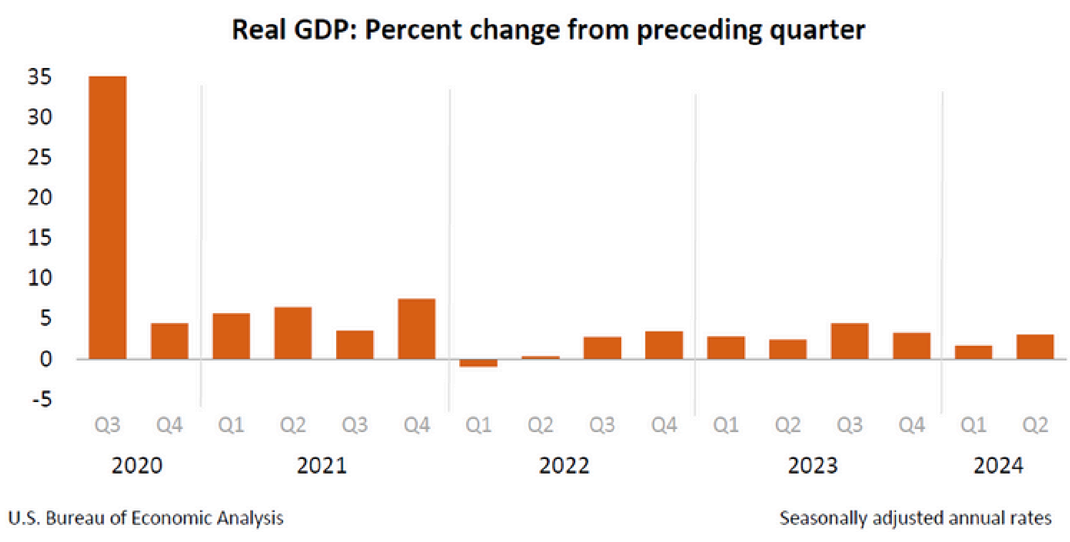
Residential Snapshot

August to September 2024, the supply-demand index dropped from 100.7 to 99.7, with supply up 2.7 points and demand essentially flat. With 30-year mortgage rates coming down to just over 6%, it provides some optimism that people can afford to finance a new property and move after being home-locked for years. As of the most recent figures, inventory levels have exceeded 17,000 units on the market. While that represents an uptick from the past few years, a typical Phoenix residential market in equilibrium is around 22,000–23,000. Given that the ink has barely dried on the Fed announcement, it is unclear exactly how it will affect the market in pricing and inventory dynamics—and how buyers will react. While most families are probably settled in for the school year, some may dip into the marketplace with more appealing rates. This also presents an opportunity for agile sellers who might have been on the fence to get their properties on the market before more product hits the market and the holiday lull.

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

- Over the past 2 months, the number of new listings added weekly has improved 29% and overall supply has increased 11%. Some of the increase can be attributed to seasonality, since luxury listings increase when temperatures drop below 100 degrees. This time around, however, the increase is notable across most price ranges.
- While rising supply in response to declining rates wasn't on the radar for most industry outlets, it makes sense after the past 2 years of rate volatility. Many sellers become buyers after the sale, and they need certainty that rates will not increase significantly before they're able to secure a contract and close escrow. Recent events are giving them that optimism.
- Listings under contract have started an uncharacteristic slow rise over the past two weeks—uncharacteristic because this measure typically declines in the fourth quarter. Only 3 out of the past 20 years experienced a bounce in the last half of the year.

REAL GDP: Q2 THIRD ESTIMATE



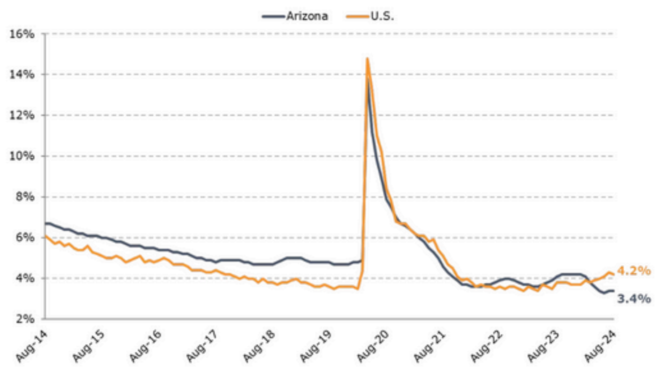
Source: BEA.gov

Real gross domestic product (GDP) increased at an annual rate of 3.0% in Q2 2024 according to the "third" estimate released by the U.S. Bureau of Economic Analysis. In Q1, real GDP increased 1.6%. The GDP estimate released today is based on more complete source data than were available for the "second" estimate issued last month. In the second estimate, the increase in real GDP was also 3.0%. The update primarily reflected upward revisions to private inventory investment and federal government spending that were offset by downward revisions to nonresidential fixed investment and exports. Imports, which are a subtraction in the calculation of GDP, were revised up.

UNEMPLOYMENT REPORT

ARIZONA & U.S. UNEMPLOYMENT RATES

Seasonally Adjusted, Rounded to Nearest Hundred



PERIOD	LABOR FORCE	EMPLOYMENT	UNEMPLOYMENT	UNEMPLOYMENT RATE
Aug-24	**3,761,600**	**3,633,000**	**128,600**	**3.4%**
OTM CHANGE	3,300	1,400	1,800	0.0
OTY CHANGE	53,300	74,900	-21,600	-0.7

ARIZONA OFFICE OF ECONOMIC OPPORTUNITY

Source: Produced by the Arizona Office of Economic Opportunity in Cooperation with the U.S. Dept. of Labor, BLS.

Source: Arizona Office of Economic Opportunity

The Arizona seasonally adjusted (SA) unemployment rate remained at 3.4% in August 2024 from July 2024. The U.S. SA unemployment rate decreased to 4.2% in August 2024 from 4.3% in July 2024. Month over month, Arizona's SA labor force increased by 3,283 individuals, or 0.1%. Year over year, the SA labor force increased by 53,276 individuals, or 1.4%. Month over month, Arizona not-seasonally adjusted (NSA) total nonfarm employment increased by 43,600 jobs.

Notable Recent Deals in Multifamily—*continued from page 1...*

- The Hera on 3213 E Flower St, Phoenix, 20 units, which sold in May 2024 for $10.45 million after selling for $15 million in June 2023—a 30.33% decrease.
- IMT North Scottsdale, 15509 N Scottsdale Rd, Scottsdale, 240 units: Sold in May 2022 for $145 million and March 2024 for $96 million—a 33.79% decrease.
- Fiesta Sun Apartments, a 45-unit property on 8639 N 7th St, Phoenix, which sold in October 2021 for $5.85 million and December 2023 for $4.73 million—a 19.15% drop.
- SkyWater at Tempe Town Lake, 601 W Rio Salado, Tempe. This 328-unit property fell from $160 million in July 2022 to $112 million in January 2024—30.00% decrease.

Articles of Interest

CoStar Insight – Sept. 25
Phoenix commercial real estate sales volume hits six-quarter high

GlobeSt. – Sept. 24
Industrial Vacancies and Rents Look to Stabilize Eventually

Phoenix Business Journal – Sept. 18
New development partner joins $850 million Metrocenter project

Phoenix Business Journal – Sept. 13
Rate cuts? Recession? Experts weigh in on Arizona's economic outlook

TreppTalk – Sept. 13
Retail Distress: Bankruptcies & Store Closures So Far in 2024

AZ Big Media – Aug. 30
Phoenix No. 1 in U.S. for largest industrial stock under development