The Real State®
The Real State of the Phoenix Commercial Real Estate Market
R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS
October 2024

CRE Buyers on the Hunt for Value-Add Investments

Value-add investment opportunities continue to bubble up in the Phoenix commercial real estate market. As discussed in several recent issues of *The Real State*, the overall trend is price discovery, and closing in on investor and owner expectations. As those gaps close, we are seeing more deals come together. Multifamily activity, in particular, is becoming more balanced. We are still not out of the woods in either multifamily or office, because that will take time, but the increasing number of transactions are starting to provide guidance.

On the industrial side, the volume and type of activity is very submarket specific and impossible to paint with a broad brush. After a three-year surge in industrial development across Greater Phoenix—including more than 35 million SF in the past 12 months—each submarket is reacting a little differently to conditions, depending upon how much product and land is available. Three examples to illustrate the current dynamic:

- In the West Valley, the market reached the point of overdevelopment, and much of this is being delivered on a spec (without a tenant) basis. Although a lot of industrial product has been built, there is still open and vacant land along the I-10, the 101, and the 303.
- Activity at the Sky Harbor International Airport submarket—where there is very little land available for development and very few excess properties—continues to be hot.
- The other notably active market—the North Valley—is driven primarily by the area around the TSMC semiconductor plant, including vendors and other support infrastructure.

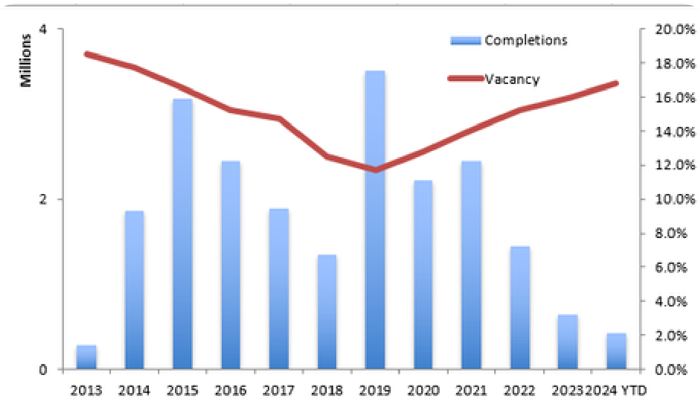
Buying and Selling in the Current Market: Thanks to property owners becoming more realistic in their pricing, buyers in the multifamily and office markets have access to more value-add opportunities than any time since the market peak. Retail is the asset class of choice right now, with a lot of people chasing those deals, but value can be found in circumstances where rent levels are below market. Industrial is performing well, but decision making needs to be strategic in order to tap into value: What are the vacancy rates within the specific submarket? How much product is coming on line? How much of it is on a spec basis without tenants?

With a market in flux—and buyers on the hunt for value—sellers need to be realistic and objective about those same factors. How do you maximize your value appeal in a market when some products are being heavily discounted, while others are gaining attention and traction?

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



The steady rise in office vacancy remains unabated in Phoenix as the third quarter nears a close. 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 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.

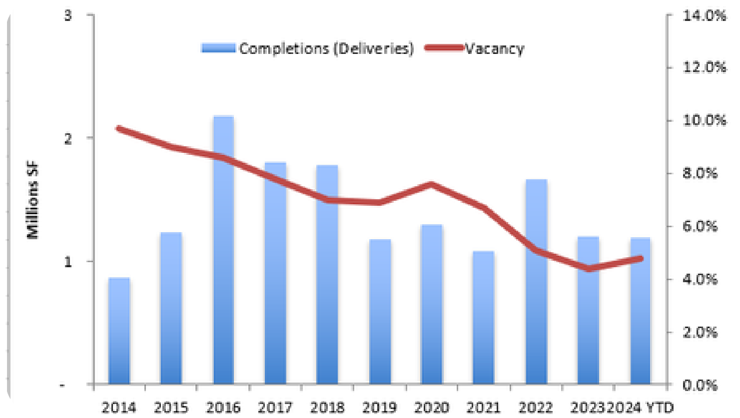
The net amount of space vacated since the onset of COVID has now reached over 5 million SF, surpassing the total occupancy loss seen during the worst of the Great Recession. More than half of the space givebacks occurred in the past 18 months, as tepid tenant demand persists even four years after the pandemic's start. Empty space is accumulating more quickly in larger suites and single-tenant buildings than in smaller ones.

Retail

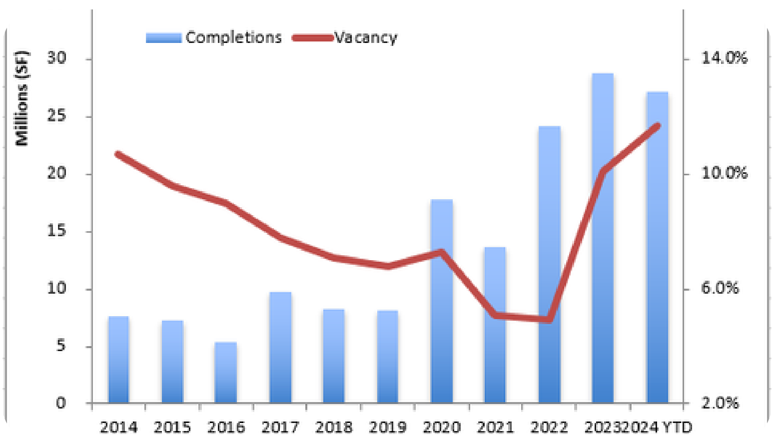
Conditions in the Phoenix retail market remain near the tightest level on record as the fourth quarter kicks off. Strong demographics, continued income growth, and healthy job gains fuel robust underlying tenant demand. These stout demand drivers, coupled with the modest construction pipeline and limited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

The Valley recorded 740,000 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.

One of the main factors supporting the improvement in property fundamentals during the current expansion cycle has been the lack of new construction. About 1.7 million SF delivered over the past 12 months, down from an average of 2.1 million SF from 2015 to 2019.



Industrial



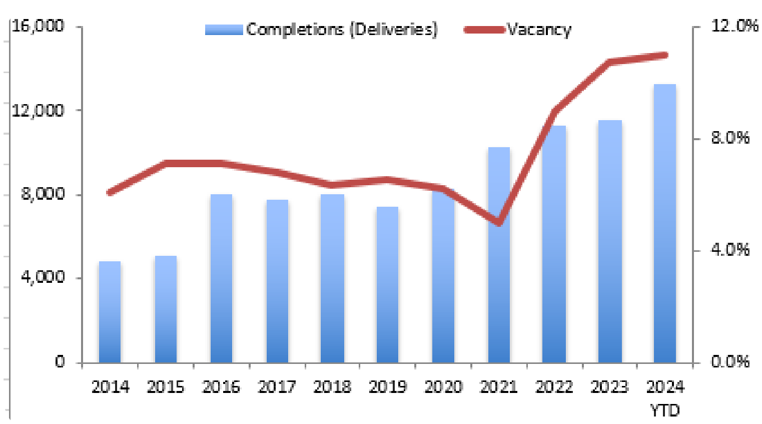
A deluge of new development completions continues to drive Phoenix's industrial vacancy rate higher, a condition that could persist into mid-2025. Builders delivered an unprecedented 35.4 million SF of net new industrial space over the past 12 months, driving a normalization of market conditions. For 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. For example, Logistics Plus and Amazon signed on for a total of 4.1 million SF at newly built industrial properties in the West Valley this year, reiterating the area's attractiveness as a logistics option. These factors, along with advanced manufacturing momentum, drove 10.3 million SF of net absorption over the past 12 months, the third most in the nation.

Multifamily

Multifamily 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, indicating a recovery in property performance could take place in the next year.

The Valley recorded 18,000 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 3 Star properties has been the most notable revelation. Midpriced communities saw 4,900 units of net absorption over the past 12 months, compared to thousands of units of negative net absorption the prior two years combined. These healthy first-half demand figures caused metrowide vacancy to rise modestly since the end of 2023, reaching 11.0% today.



Residential Snapshot

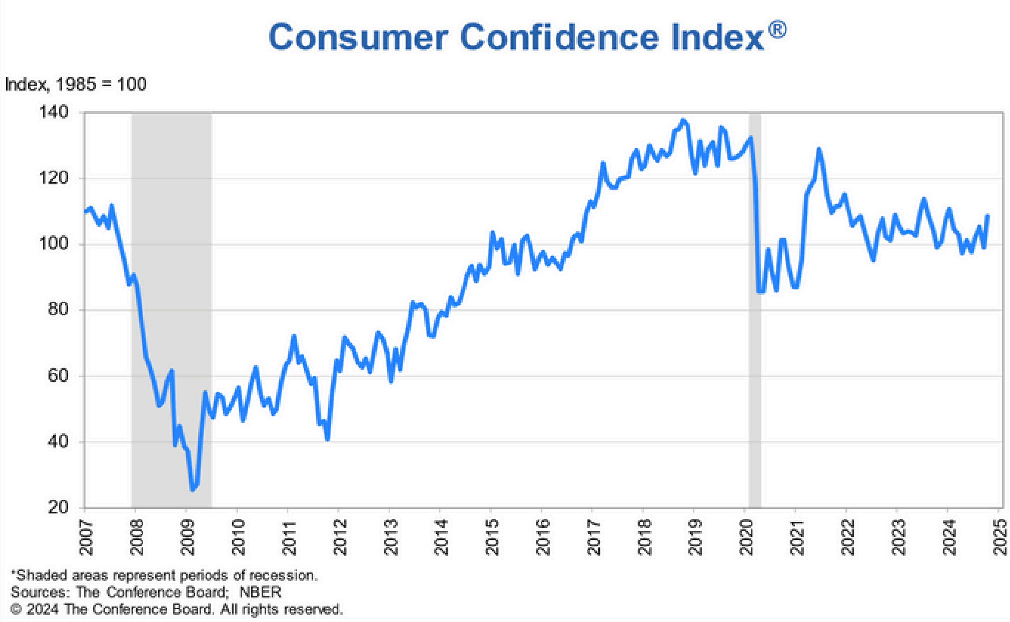
The Greater Phoenix residential market received a nice bump with the decrease in interest rates a few weeks ago, but that has since petered out. This week, consumer confidence notched its strongest monthly gain since March 2021, but stayed in the narrow range of the past two years. There is still concern in the marketplace, interest rates are impacting pricing dramatically, and many people returned to their holding pattern. Meanwhile, we remain in limbo—and all bets are off until the elections are over. The bond market's behavior ran counter to the Fed's 50 basis point decrease. While people were pleasantly surprised by the rate cut, it has been digested at this point. Could we see another rate cut in November or December? Like the old stock market adage "don't fight the Fed," the current situation with mortgage rates can be boiled down to "don't try to outguess the Fed."

September to October 2024, the supply-demand index dropped from 96.0 to 92.0, with a larger increase in supply than demand. Greater Phoenix is gliding towards a buyer's market once again. This is only the third time in a decade that we've drifted below 100; most recently was Q4 2022, and before that it was Q1 2014. Both times proved quite beneficial for buyers who took advantage.

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

- Asking prices per square foot are only 1-2% higher than last year for properties under $800K, and just about even with last year for the rest.
- The largest percentage of supply growth is under $300K, which is 44% mobile homes, 39% condos/townhomes, and only 17% single family homes.
- Overall, condo and townhome active supply is up 63% from last year. This could be a result of increasing insurance costs that lead to higher HOA fees.

CONSUMER CONFIDENCE INDEX



Source: US Consumer Confidence

Consumer confidence recorded the strongest monthly gain since March 2021, but still did not break free of the narrow range that has prevailed over the past two years. In October's reading, all five components of the Index improved. Consumers' assessments of current business conditions turned positive. Views on the current availability of jobs rebounded after several months of weakness, potentially reflecting better labor market data. Compared to last month, consumers were substantially more optimistic about future business conditions and remained positive about future income. Also, for the first time since July 2023, they showed some cautious optimism about future job availability.
—The Conference Board

GREATER PHOENIX BLUE CHIP ECONOMIC FORECAST

2025 ANNUAL PERCENTAGE CHANGE	Population	Personal Income	Retail Sales	Wage & Salary Employment	Manufacturing Employment	Construction Employment
ASU Economic Outlook Center	1.5%	5.0%	1.5%	2.2%	1.0%	4.0%
EconLit LLC	1.7%	4.5%	3.5%	2.1%	2.0%	2.8%
Elliott D. Pollack & Co.	1.6%	5.9%	5.5%	1.8%	1.7%	2.1%
Joint Legislative Budget Committee	1.5%	4.8%	4.0%	2.0%	1.2%	3.1%
Rounds Consulting	1.6%	4.0%	4.0%	1.5%	1.0%	3.5%
The Maguire Company	1.7%	5.1%	5.2%	2.1%	2.3%	2.3%
Southwest Growth Partners	1.5%	5.2%	3.5%	2.0%	2.0%	2.2%
University of Arizona Eller College	1.5%	6.3%	3.8%	2.3%	4.2%	-0.1%
CONSENSUS	**1.6%**	**5.1%**	**3.9%**	**2.0%**	**1.9%**	**2.5%**

Source: Greater Phoenix Blue Chip

Articles of Interest

CoStar Insight – Oct. 21
Investors and operators remain 'cautiously' optimistic at this year's Lodging Conference

AZ Big Media – Oct. 30
Industrial Vacancies and Rents Look to Stabilize Eventually

Business Journals/National Observer – Oct. 21
CRE investors prepare for a busier year of buying, selling in 2025

Phoenix Business Journal – Oct. 28
Commercial foreclosures rise as lenders approach 'inflection point'

Globe St. – Oct. 30
Apartment Development Shows Signs of Slowing

AZ Big Media – Oct. 8
20 of the coolest offices in Arizona for 2024