The Real State®
The Real State of the Phoenix Commercial Real Estate Market
R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS
June 2020

Greater Phoenix CRE Sings a New Tune: Ch-ch-changes

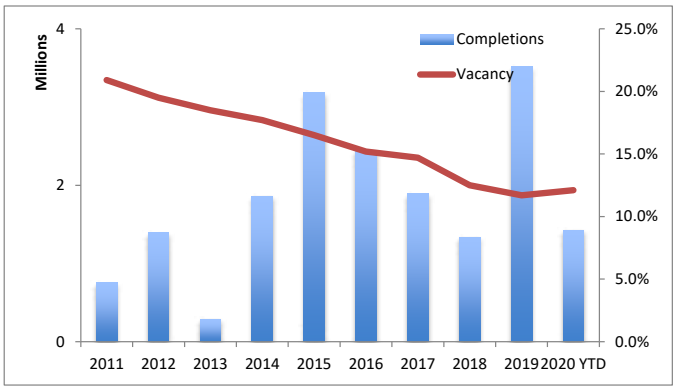
While the challenges are numerous, the Valley has significant advantages over other metro areas, which will lead to a stronger and quicker recovery—since the current recession was not economically driven and the Greater Phoenix Area has a much more diversified economic base than we did during the Great Recession. All things considered, the owner-occupant market is holding up reasonably well in most sectors of Phoenix commercial real estate. Meanwhile, investor properties are in a state of flux, with many unknowns. How COVID and will impact the real estate market in the coming months remains uncertain, but here are a few trends the R.O.I. Properties team is monitoring closely:

- **Investors are in wait-and-see mode when it comes to commercial properties.** There are plenty of investor funds with capital in formation, but investors are holding back on their acquisitions, as there is "pricing discovery" underway. Owners are reeling off of historically low cap rates/high prices just a few, short months ago. Investors are seeking discounting due to the current economic situation, so there is a disconnect between what they are willing to pay, and what current owners are willing to sell for. Read more.
- **Remote work leads to subleasing and cohabitating trends.** COVID-19 has forced many organizations into recognizing the utility of working from home—and many have been pleasantly surprised by the actual levels of productivity their workforces have achieved. There is plenty of desirable office space in the Valley, and the wave of cohabitation and subleasing may point to what the future looks like in absorbing it.
- **Nonprofits look at commercial properties as a lifeline.** During the Great Recession, nonprofits had a tough time with capital campaigns as well as normal donations. In the midst of the COVID-19 pandemic, the challenges have come in the form of cancellations and delays of traditional fundraising events amid a soft economic environment. This is an excellent time for nonprofits to take a hard look at underutilized real estate assets, with the potential for deploying them as an alternative fundraising strategy. Opportunities include: selling under-utilized assets; restructuring operations/holdings which may include leasing or sale of real estate; and sale-leasebacks, where the non-profit sells the property, but retains possession of the property for a period of time, which enables the non-profit to be able to maximize the value of the property, while retaining occupancy. Read more.
- **Net lease properties facing headwinds.** In good economic times, single-tenant...*cont. on pg. 4*

How to Keep Pace with the Great Acceleration

In the coming weeks, the R.O.I. Properties blog will be running a series on the Great Acceleration: How trends have been pushed forward in commercial real estate sectors from retail and entertainment to office and industrial. For the latest updates, please follow us on LinkedIn: R.O.I. Properties – LinkedIn.

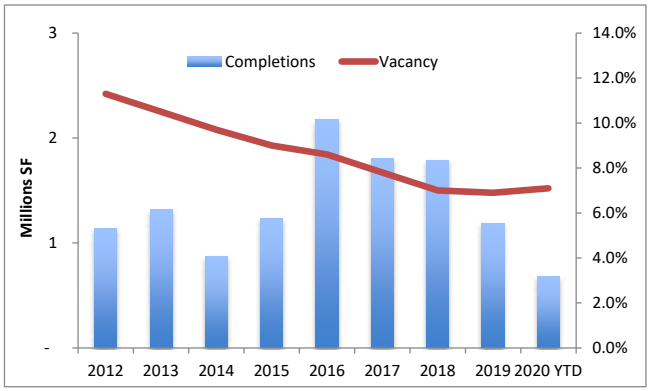
Office



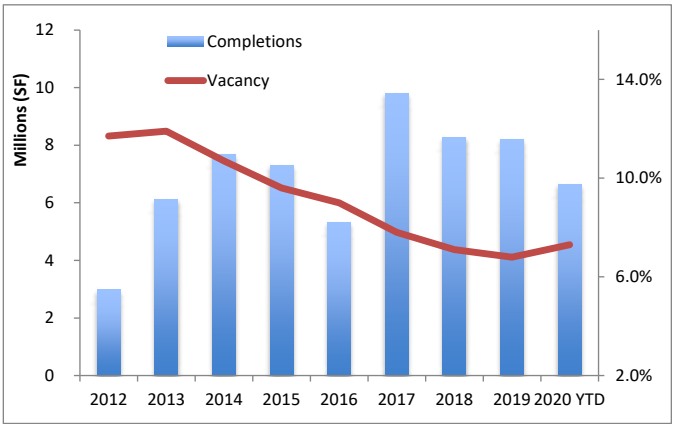
Year to date, 1,425,262 SF of office product has been added to the market. So far in the second quarter, 245,000 SF of office space has been started, which is down from the roughly 940,000 SF started in quarter one of this year. Vacancy rates are holding steady at around 12% for the year. Office construction hasn't absorbed the shock of the pandemic yet; change is likely on the way.

Retail

Construction starts are the lowest the Phoenix market has seen in 10 years, according to CoStar. Quarter one saw 118,000 SF in starts and quarter two has seen 100,000 SF. More than 686,000 SF of retail product has been completed so far this year. Vacancy rates have ticked up to 7.2%.



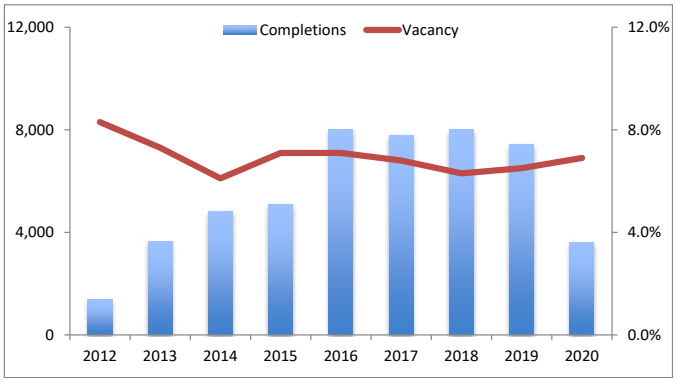
Industrial



More than 7.7 million SF of industrial space started in quarter one of the year, with another 1 million SF started so far in quarter two. According to CoStar, 6.6 million SF has been completed year to date. Vacancy rates remain around 7.2%, just slightly up from the 6.9% reported last year.

Multifamily

So far in 2020, more than 5,000 multifamily units have been started in the Phoenix metro and another 3,600 have been completed. CoStar reports that multifamily construction will remain elevated until 2021. At 6.8%, vacancy rates have risen from the 6.1% reported in 2019.



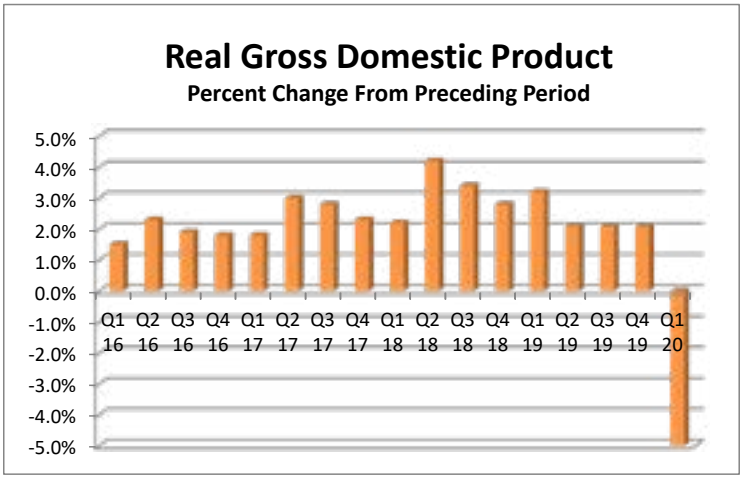
Residential Snapshot

This year's wild ride is not over yet in residential real estate From May to June 2020, the supply-demand index reversed course and rose nearly as fast as it fell in April, escalating from 149.3 to 211.1, due to both dropping supply and increasing demand. Stay-home orders starting in March resulted in pent-up supply and demand during what are typically peak months for contract activity. Although R.O.I. Properties believes Phoenix will fare better than most metro areas, several underlying factors may cause significant changes in the market going forward. The most significant unknowns include the expiration of extended unemployment benefits on July 25, the depletion of PPP funds, the extension of mortgage forbearance rules (currently scheduled through the end of 2020), and housing affordability. Here are a few of the key metrics we are following:

- April and May were weak for new listings due to the stay-home orders and pandemic safety measures. June has offered little relief, running 12% lower than last year.
- As of June 20, there were only 8,901 listings for sale through the Arizona Regional MLS and only 3,644 of those listings were single family homes under $500K. There have been 10,916 single family permits filed so far between January and May this year, up 9.8% from this time last year.
- May 2020 ended with an average sale price of $180.32/SF through the MLS, up 5.0% from last May and 2.5% lower than April 2020.
- Contract activity is 18% higher than it was this time last year, and sellers who intend to sell their home this year should consider taking advantage of the surge while it lasts.
- Contracts over $500K have soared 98% higher than this week last year and recovered 178% since April 5. The luxury market has come roaring back and average price measures will rise as a result.

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 or info@roiproperties.com.

Real GDP



Real gross domestic product (GDP) decreased at an annual rate of 5.0% in the first quarter of 2020, according to the "second" estimate released by the Bureau of Economic Analysis. In the fourth quarter, real GDP increased 2.1%.

The GDP estimate released today is based on more complete source data than were available for the "advance" estimate issued last month. In the advance estimate, the decrease in real GDP was 4.8%. With the second estimate, a downward revision to private inventory investment was partly offset by upward revisions to personal consumption expenditures (PCE) and nonresidential fixed investment.—*Bureau of Economic Analysis*

Unemployment

Arizona, U.S. Economic Indicators Unemployment Rate (Seasonally Adj.)

	May '20	Apr '20	May '19
United States	13.3%	14.7%	3.6%
Arizona	8.9%	13.4%	4.8%
Arizona unadjusted rate	8.7%	13.1%	4.6%

The Arizona seasonally adjusted unemployment rate was 8.9% in May 2020, down from 13.4% in April 2020. The U.S. seasonally adjusted unemployment rate decreased from 14.7% in April to 13.3% in May. Over the month, Arizona's seasonally adjusted labor force increased by 2,795 individuals. Over the year, labor force levels increased by 19,900 individuals or 0.6%. —*Office of Economic Opportunity*

"Recovery has started in the labor market. Employment rose by 2.5 million, or 11% of the jobs lost earlier this spring. The biggest gains were in construction, retail, health care and food service. Worker hours rose by 4.3% and the unemployment rate declined to 13.3% from 14.7% in April."—*Kiplinger*

Continued from pg. 1... net lease properties can be quite lucrative for investors. In less certain times, you are either running 100% occupancy or 0% occupancy, and you are either collecting rent or you are not. While net leases have had the hot hand in commercial real estate in the past few years, the COVID-19 pandemic has drastically curtailed the appeal of these deals. The hardest-hit businesses included theaters, health and fitness, and restaurants. COVID-19 has also influenced the underwriting for net lease transactions, adding to the pandemic-driven challenges of pricing discovery. A final risk proposition to consider is what happens to net lease properties and commercial real estate in general when the PPP loans dry up in phases over the summer. Read more.

Articles of Interest

Phoenix Business Journal – June 5
Tenants' troubles put stress on commercial real estate

AZ Big Media – June 19
Valley Partnership event outlines business opportunities that will arise from pandemic

Phoenix Business Journal – June 15
Blaming Covid-19, more Phoenix landlords fall behind on the mortgage payments

AZ Big Media – June 24
Why there's no better time to make a commercial real estate investment in Phoenix

Phoenix Business Journal – June 15
Flurry of office evictions unlikely after Arizona moratorium lifts