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

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

AUGUST 2021

Retail Adapting on the Road to Recovery

Even before the arrival of the pandemic, competition from Amazon and other online retailers was causing headaches for traditional brick-and-mortar locations. When lockdowns and other social restrictions made in-person shopping an even greater challenge, the situation looked dire.

With the worst of the pandemic behind us, however, retail is looking stronger as we head into the fall. Foot traffic is up at regional malls and multitenant strip malls, and neighborhood retail has successfully shifted from products to services. According to CoStar, mall vacancy rates fell 150 basis points last year, and it is expected that they will decline an additional 170 basis points in 2021. AZ Big Media recently reported that investment sales are up in Greater Phoenix retail real estate, and the market posted positive net absorption in the first half of the year—more than twice what was absorbed in all of 2020. In particular, two trends have been key in fostering recovery:

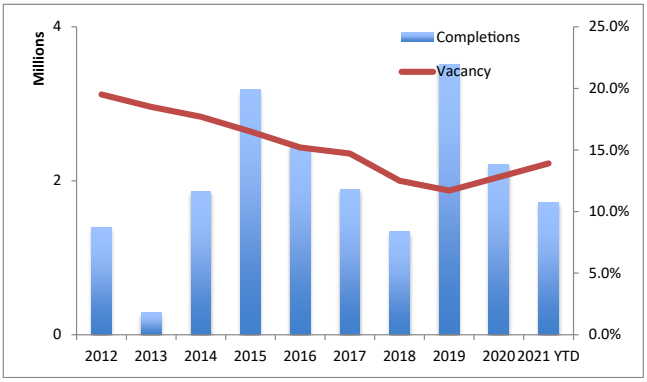
Trend #1: Service-Based Retail, and Drive-thru, Takeout and Cloud Kitchens
Advances in technology and changes in consumer habits (particularly the desire to eat at home) are the story here. A number of chains are placing their bets on for the long term by investing heavily into the drive-thru/pick-up window channels. During the pandemic, drive-thrus had a 25% to 35% increase in sales and continue to have momentum. Similarly, digital orders at fast-food restaurants have increased by 23% since first implemented, a number which is anticipated to triple in 2021. Cloud/ghost kitchens provide lower risk and higher return, particularly in high-rent areas.

Trend #2: Adaptive Re-Use and Mixed-Use
Next, adaptive re-use and mixed-use trends in Phoenix and across the nation, particularly within hospitality and retail, have continued to unfold. Mixing office and multifamily use creates a virtuous circle: helping mall owners create foot traffic through the addition of office workers and residents, who in turn benefit from easy access to mall amenities such as dining and shopping. Last-mile delivery and distribution centers are often another feasible option for malls with empty space.

Brick-and-mortar continues to be a tough arena, and real estate research firms are predicting that more than half of all major U.S. department stores in malls will have permanently shuttered by the end of 2021. Notwithstanding, consumers still want to touch and feel their goods, and many digital-native retailers (such as Warby Parker, Untuckit, Allbirds, Away and Third Love) are opening up/operating brick-and-mortar stores for this very reason. While department stores may be a thing of the past—or may need to right-size/boutique their operations—there is life in retail, and consumers have dollars to spend. In addition to the trends above, limited construction and Phoenix's growing population should help coax this market into balance as it continues to evolve.

For expert guidance in buying, selling or leasing commercial real estate, contact the team at R.O.I. Properties: info@roiproperties.com or 602-319-1326.

Office



The removal of COVID-19 restrictions on Arizona businesses and a rise in vaccinations have encouraged employers to welcome employees back to the office, contributing to a perception the market is returning to normal. The feeling is welcome, given that the pandemic disrupted Phoenix's consistently positive performance.

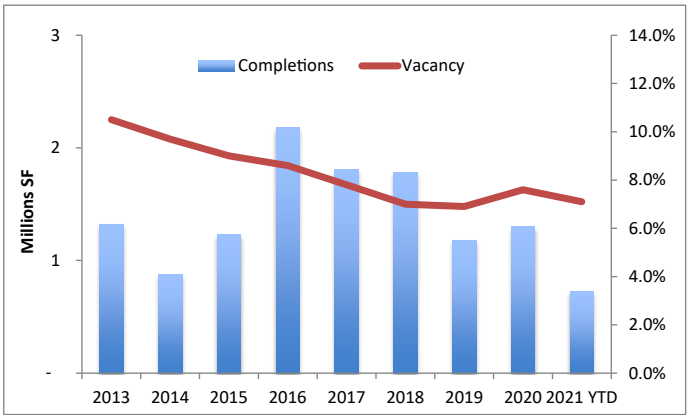
Decision-makers have become more comfortable making long-term leasing decisions again, and quarterly leasing volume returned to near pre-pandemic activity in Q2 2021. Simultaneously, some tenants who found their remote workers performed well during the pandemic will stay fully remote or shift to a hybrid work schedule. These tenants are relinquishing unused office space, and as a result, sublease availabilities have surged to a record high. The concurrent rise in leasing activity and sublease availabilities indicates there is no one-size-fits-all solution for businesses operating post-pandemic. There is still a great degree of uncertainty about the pandemic's long-term effect on office space use.

Retail

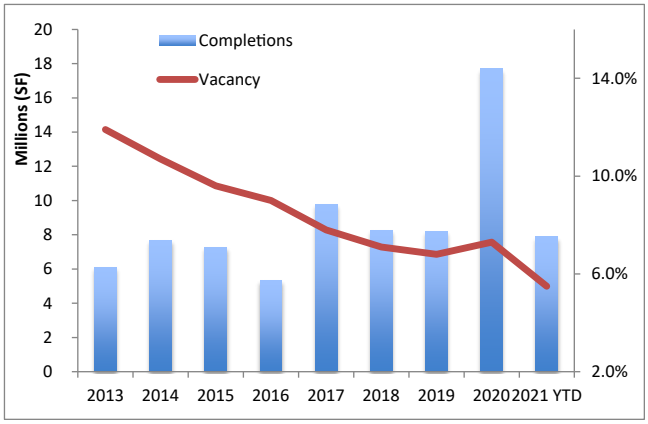
The improving economic and health situation has increased optimism in the local retail market. Leasing activity has accelerated, and new investors are entering the market, wanting to capitalize on the robust population growth in the Valley of the Sun.

Despite the improvement, the market still has a road to recovery following the disruption of the pandemic. Phoenix has one of the highest vacancies rates among large retail markets. Many retailers closed in the years before the pandemic due to the evolving retail landscape, and the pandemic exacerbated the issues. Retailers scattered across the market have left behind vacant space from 2,000-SF coffee shops to 20,000-SF gyms and 150,000-SF big box stores.

Fortunately, the Phoenix retail market is in a better position than in years past. An influx of residents is driving demand for home and necessity goods. Additionally, the supply pipeline has moderated over the past 10 years and there is little supply-side risk in the market



Industrial



Last year marked one of the best years on record in the Phoenix industrial market, and if 2021 trends keep pace, the market will likely meet or exceed last year's extraordinary performance. The Valley's rapidly growing consumer base and trends accelerated by the pandemic have bolstered the need for industrial space. The shift away from brick-and-mortar retail to online has generated significant demand for warehouse and distribution facilities.

Phoenix's strong demand drivers and competitive advantage remain in place. Approximately 35 million consumers can be reached within a single day's truck ride from metro Phoenix, fueling industrial space demand among companies in the e-commerce, logistics, and construction industries. Phoenix has also become one of the most active data center markets in the country due to Arizona's tax incentive for data center development, a robust and growing power grid, and limited occurrence of natural disasters.

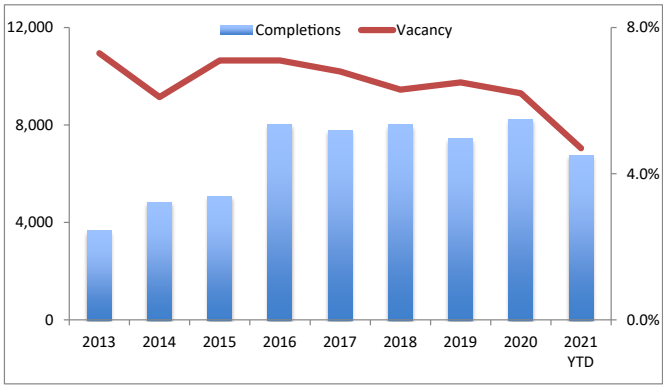
A low cost of doing business and proximity to major regional markets, particularly in California, continues to draw industrial tenants to the market. Phoenix's average industrial rent is near the National Index but is roughly 35%-40% below average rents in Los Angeles and Orange County.

Multifamily

Phoenix multifamily fundamentals have improved since the onset of the pandemic, and vacancies have compressed to a historic low. Before the coronavirus, fundamentals were solid and supported by some of the country's strongest employment and household growth, along with low levels of single-family inventory. The market's positive performance since the pandemic has been bolstered by federal and state aid that has helped people pay the rent and eviction moratoriums that have kept renters in their apartments.

Net absorption climbed in the first half of 2021 and outpaced new supply by a wide margin. But landlords will need to brace for a wave of deliveries over the next few quarters. The construction pipeline is robust and limited to top-tier rentals, whereas demand for affordable units has surged. The mismatch in supply and demand will likely push up Class A vacancies in the near term.

Phoenix's demand drivers are even stronger than before. Historically, the Valley of the Sun has attracted people in search of affordable living and job opportunities. This trend will accelerate due to work-from-home arrangements that will lure renters from pricey West Coast markets.



Residential Snapshot

The Home Opportunity Index was released this month by the National Association of Home Builders, and it measured 56 for Q2 2021. That officially places Greater Phoenix below the normal range of 60-75 for affordability. Logically, one would expect demand to drop under these circumstances, as it did in Q4 2018 when the index dropped to 57. This time, however, demand grew stronger, which leads us to believe the housing market is being driven a little less by normal owner-occupants and a bit more by investors at this stage of the game. Here are a few of the key housing trends that R.O.I. Properties is observing:

- Over the past 13 weeks, supply has risen another 45%, but it's still not even a third of what would be considered normal for the month of August.
- The fastest-growing price point for supply continues to be $400K–$500K, which has doubled since the end of May from 693 active listings to 1,388, followed by the $500K–$600K range, up 87% from 450 to 840.
- Listings under contract took an unforeseen jump over the past two weeks. This is exclusively attributed to a sharp, unseasonal increase in contracts accepted between $400K–$800K.
- With affordability at its lowest point since 2018, it's clear that demand is not being driven by exclusively by traditional owner-occupant buyers. July acquisitions by corporate iBuyers increased 573% over last year, accounting for 962 sales.
- About 11–23% of iBuyer re-sales were to corporate investors, large and small. iBuyer demand is not true demand, because they neither live in the home nor rent the home to a tenant. iBuyer activity does not affect inventory, because as they purchase a home, they immediately list it again.

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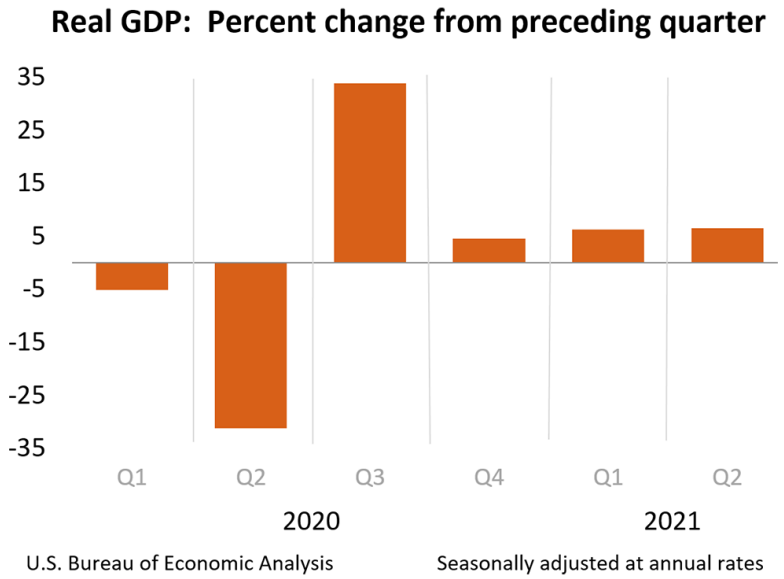
At R.O.I. Properties, we work hard to ensure that our clients thrive in every real estate market—particularly as market conditions shift. Contact us at 602.319.1326 or info@roiproperties.com.

Real gross domestic product (GDP) increased at an annual rate of 6.6% in Q2 2021 according to the US Bureau of Economic Analysis "second" estimate, reflecting the continued economic recovery, reopening of establishments, and continued government response related to the COVID-19 pandemic. In the second quarter, government assistance payments in the form of loans to businesses and grants to state and local governments increased, while social benefits to households, such as the direct economic impact payments, declined. In the first quarter of 2021, real GDP increased 6.3% (revised).



Greater Phoenix Blue Chip

GREATER PHOENIX REAL ESTATE CONSENSUS FORECAST
RESIDENTIAL

	2021				2022			
	Single-family Permits	Multi-family Permits	Apt Vacancy (Q4 %)	Apt. Absorp.	Single-family Permits	Multi-family Permits	Apt Vacancy (Q4 %)	Apt. Absorp.
CBRE	26,700	10,000	6.4%	7,000	27,000	9,500	6.0%	5,000
Colliers International	39,000	15,000	4.5%	15,500	45,000	17,000	4.0%	16,500
CRA LLC	31,500	8,000	5.5%	7,500	33,000	7,000	5.5%	7,500
Elliott D. Pollack & Co.	31,000	12,000	5.5%	10,000	32,000	10,000	5.7%	7,000
Griffin Consulting	27,500	8,750	6.2%	7,400	28,250	8,000	5.7%	7,550
Southwest Growth Partners	33,000	6,000	6.5%	6,000	33,000	6,000	6.5%	6,000
U of A, Eller College	29,952	11,767	N/A	N/A	28,699	10,931	N/A	N/A
CONSENSUS	**31,236**	**10,217**	**5.8%**	**8,900**	**32,421**	**9,776**	**5.6%**	**8,258**
Actuals From Phoenix Housing Market Letter and Various Sources:								
2020 Actuals	28,965	14,894	5.2%	9,893				
2019 Actuals	23,876	10,225	5.6%	7,139				

GREATER PHOENIX REAL ESTATE CONSENSUS FORECAST
INDUSTRIAL (Millions of Square Feet)

	2021			2022		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE*	8.00	6.2%	9.50	7.00	6.0%	9.00
Colliers International**	12.09	6.9%	10.50	13.05	6.5%	12.00
Lee & Associates*	16.50	7.0%	15.00	13.00	6.8%	13.00
CONSENSUS-TOTAL SPACE	**12.20**	**6.7%**	**11.67**	**11.02**	**6.4%**	**11.33**
Actuals From CBRE:						
2020 Actuals	10.35	6.0%	13.30			
2019 Actuals	5.88	6.3%	10.68			

* ALL SPACE OVER 5,000 SQ. FT.
** ALL SPACE OVER 10,000 SQ. FT.

GREATER PHOENIX REAL ESTATE CONSENSUS FORECAST
RETAIL (Millions of Square Feet)

	2021			2022		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE*	0.25	8.5%	(0.10)	0.18	8.5%	0.20
Colliers International	0.51	7.9%	0.54	0.35	7.7%	0.38
CONSENSUS	**0.38**	**8.2%**	**0.22**	**0.27**	**8.1%**	**0.29**
Actuals From CBRE:						
2020 Actuals	0.00	8.0%	(0.01)			
2019 Actuals	0.02	8.0%	1.21			

* ALL SPACE OVER 30,000 SQ. FT.

GREATER PHOENIX REAL ESTATE CONSENSUS FORECAST
OFFICE (Millions of Square Feet)

	2021			2022		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE*	0.90	17.0%	0.39	0.89	17.5%	0.56
Colliers International*	1.46	14.1%	(0.16)	0.98	13.9%	1.00
Lee & Associates*	4.00	16.8%	(2.00)	5.00	17.0%	1.00
CONSENSUS	**2.12**	**16.0%**	**(0.59)**	**2.29**	**16.1%**	**0.85**
Actuals From CBRE:						
2020 Actuals	1.34	17.4%	(1.05)			
2019 Actuals	1.43	14.1%	3.21			

* ALL SPACE OVER 10,000 SQ. FT.

Source: https://morningconsult.com/form/consumer-confidence-dashboard/

"GDP will likely grow by 6.0% or more this year. Growth in the first two quarters was 6.3% and 6.6%, respectively, because of fiscal stimulus passed by Congress. The stimulus checks boosted personal disposable income by 10% at a yearly rate in the first half of the year, which led to an 11.6% gain in consumer spending. The quarterly savings rate dropped to 11% in the second quarter, from 21% in the first, but is still far above the normal level of 7.5%, indicating that more spending could be on tap later in the year... Expect 5.5% GDP growth next year. Despite all the logistical challenges, underlying consumer demand is strong and should support the economy well into next year, once the shortages have been addressed."
—Kiplinger Economic Forecasts, July 30: GDP: 6.0% GDP Growth Likely This Year

Articles of Interest

AZ Big Media – August 29
Metro Phoenix apartment construction ranks No. 3 in U.S.

Phoenix Business Journal – August 27
Why an Arizona hotel owner is transforming the property into apartments

AZ Big Media – August 28
How Arizona pro-business environment creates CRE opportunities

TreppTalk – August 26
Executive Summary: CRE Sentiment Survey Results; Hopeful Signs & Structural Concerns

Phoenix Business Journal – August 27
California HQ exodus accelerates as companies flee to Arizona and other low-tax states, report finds