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

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

MARCH 2023

Mitigating Risk in an Uncertain Market

The Greater Phoenix commercial real estate continues to experience some nervous tension—with particular concerns about the office market and how problematic it will be down the road.

Last month, we described the state of the market as somewhat frozen, and the arrival of warm spring weather has not changed that dynamic. The exception is for well-capitalized buyers who can come into a deal with all cash, or those who can negotiate a creative financing solution. The mid-March sale of Aventura Apartments, a 408-unit complex in Avondale, serves as an example of how some deals are structured. The buyer assumed financing from KeyBank, $45.8 million that terms out in 2031—at a 3.97% interest rate that is remarkably low by today's standards—plus an additional $17.8 million in Fannie Mae financing from the same lender to bridge the gap, plus a healthy down payment of almost $40 million.

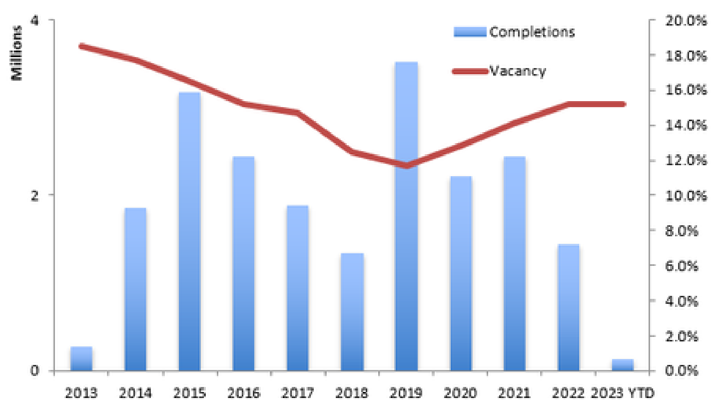
Buyers seeking value deals with the potential of stabilized earnings are returning to the market; it's an interesting trend, although not yet widespread. These buyers need to do some heavy lifting in renovation and re-tenanting before they get to stabilized income. The most notable action is in smaller (under 25 unit) multi-family, multi-tenant retail and, to a lesser extent, smaller multi-tenant industrial properties. In a market where companies are facing uncertain headwinds, buyers are trying to spread the risk across multiple tenants. After a long stint as the most favored asset classes, larger unit (100+ unit) multifamily, and industrial activity, has slowed.

In addition, we are not seeing as much activity on the single-tenant front. Triple net lease properties are still popular, but they're becoming more difficult to find—and during due diligence, tenants are being vetted far more closely to assess their potential as a good long-term play. Investors are having to digest a lot of information, and it doesn't always feel like they can know for sure what qualifies as a safe asset.

Of course, the overall uncertainty is also happening against the backdrop of the Silicon Valley Bank collapse just a few weeks ago. In the early going, it's difficult to know where the situation is headed, other than companies scrambling to spread their risk at different institutions. Banks' lending ability will be impacted, likely with a more highly regulated environment—which could be externally imposed or with banks choosing to adopt guidelines for less leverage and increased scrutiny on loans.

Whether you are located in Arizona, out of state, or in another country, we welcome the opportunity to discuss the best available options for buying and selling commercial real estate investment properties. The team at R.O.I. Properties is ready to help you formulate a strategy for success that aligns perfectly with your business goals. Please contact us at: info@roiproperties.com or 602-319-1326.

Office



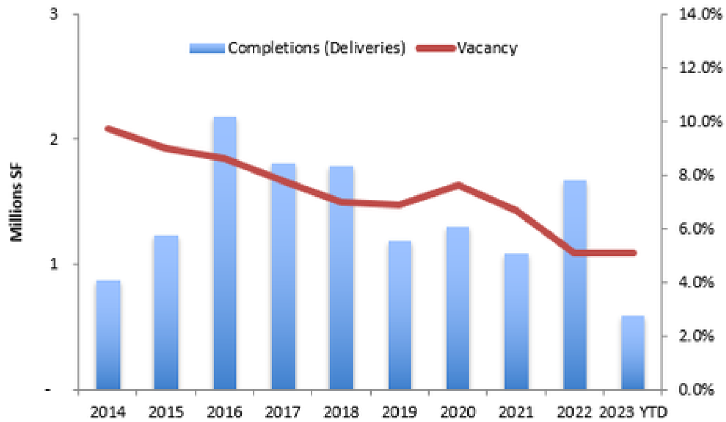
Office construction has decelerated over the past few years with just 890,000 SF of new office space delivered in 2022, the lowest level in nearly a decade. Construction starts have also eased as macro headwinds facing the sector and tighter lending standards reduce developer bullishness.

Marketwide, 1.3 million SF is under construction, and typically about a quarter of that space is available for lease. Construction is the heaviest in Tempe, a high-demand submarket with a large and high-quality talent pool.

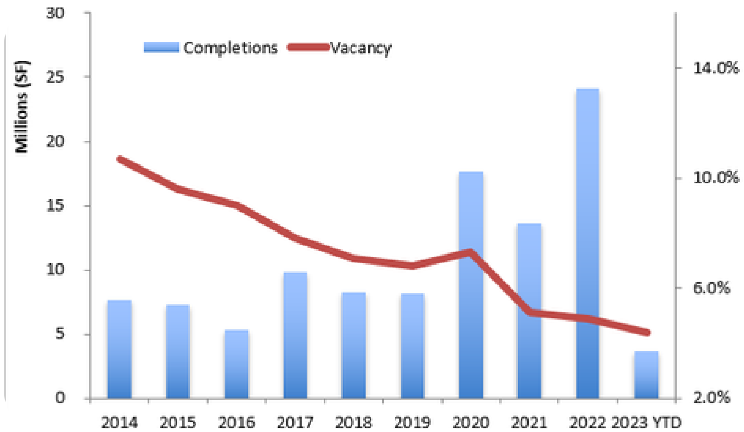
Retail

A healthy local economy coupled with robust job and population growth has left the Phoenix retail market well-positioned to weather a potential recession. Property performance has steadily strengthened over the past 18 months and the 4.3 million SF of net absorption in 2022, was the strongest level in 15 years. Accelerating demand from expanding retailers coupled with limited new construction drove the Phoenix vacancy rate to 5.3% to end the year, the lowest level on record.

According to CoStar's baseline forecast, which includes a mild recession in 2023, vacancy is expected to compress further in 2023, ending the year at a new all-time low.



Industrial

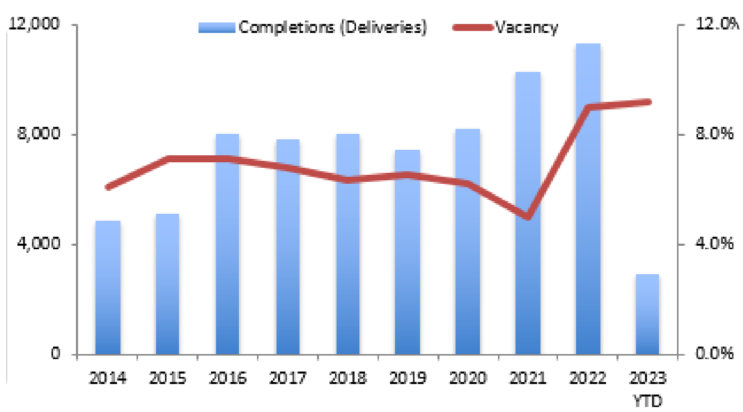


Industrial deliveries hit an all-time high in 2022, and are projected to hit a record again in 2023. This will challenge recently strong vacancies and rent growth. Construction activity has surged in recent quarters, and much of the space is being built without a tenant in place. This rise in speculative construction demonstrates the high level of confidence among developers and lenders that "if you build it, they will come."

About 58.1 million SF is underway with approximately 30% of that space already leased, a stark contrast to the nearly 75% of construction that was preleased about 10 years ago. Once that space is completed, the market's inventory will expand by 13.8%.

Multifamily

The Phoenix apartment market has seen a change of tides. During the pandemic, demand, rents, and supply climbed to unprecedented levels, transforming the area into one of the strongest apartment markets in the country. Starting in late 2021, however, market dynamics began to shift as high inflation and economic uncertainty reduced renter demand. The metro has seen negative net absorption in two of the past five quarters. The pace of absorption moderated at the same time construction activity ramped up, causing metro-wide vacancy to rapidly increase. As a result, annual rent growth has turned negative and concession usage is increasing.



Residential Snapshot

In the past month, the Greater Phoenix residential market had a nice upsurge in activity—further evidence, it appears, that people are getting accustomed to the new normal of low inventory levels. As noted in the past few months, there is definitely some caution in the market, but sufficient numbers of buyers are still stepping up and paying the premium. We are seeing more cash deals and alternative financing such as seller carrybacks, which helps with that trend from a pricing perspective. Many sellers remain reluctant to put their homes on the market because of the difficulty of finding a replacement property in the new interest rate environment.

From February to March 2023, the supply-demand index increased from 126.7 to 134.7, with a 3.2-point drop in supply and 0.8-point rise in demand.

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

- Active supply continues to decline in Greater Phoenix, down 32% since October.
- New homes with build dates between 2022-2024 make up 22% of overall active inventory in the Arizona Regional MLS.
- iBuyers such as OpenDoor and OfferPad listings compose less than 3% of supply, a significant change from last July and August when they were 12% of active listings.
- The median time listed prior to an accepted contract is currently 31 days, which holds true across nearly all price points. This is down 25 days from the January 1 measure of 56 days.
- The monthly median sales price looks like it will stick to $420,000 this month, up $5,000 (+1.2%) from the $415,000 recorded in December, January, and February.
- Sales price per square foot, however, has continued to improve for 3 months straight now, with a cumulative improvement of +4.7% since December.

consumer-confidence
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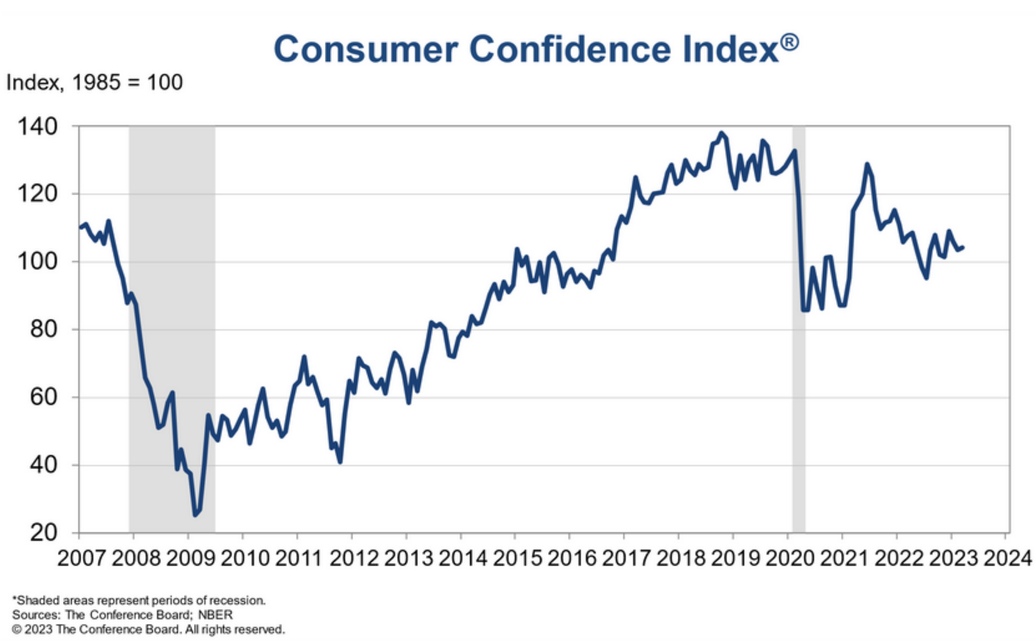
Under All Market Conditions

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.

CONSUMER CONFIDENCE



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

The Conference Board Consumer Confidence Index® increased slightly in March to 104.2 (1985=100), up from 103.4 in February. The Present Situation Index—based on consumers' assessment of current business and labor market conditions—decreased to 151.1 (1985=100) from 153.0 last month. The Expectations Index—based on consumers' short-term outlook for income, business, and labor market conditions—ticked up to 73.0 (1985=100) from 70.4 in February (a slight upward revision). However, for 12 of the last 13 months—since February 2022—the Expectations Index has been below 80, the level which often signals a recession within the next year. The cutoff date for the survey was March 20, about ten days after the bank failures in the United States.

Western Blue Chip Economic Forecast

ARIZONA
Annual Percent Change 2023 from 2022

	Current $ Personal Income	Retail Sales	Wage & Salary Employment	Population Growth	Single Family Housing Permits
ASU Economic Outlook Center	4.5%	5.0%	1.8%	1.4%	-10.0%
EconLit LLC	4.5%	4.6%	2.9%	1.5%	0.0%
Elliott D. Pollack & Co.	3.0%	3.2%	1.7%	1.5%	-20.0%
Hoyle Cohen					
Joint Legislative Budget Committee	5.4%	3.2%	1.9%	1.5%	-2.0%
Neal Helm	4.5%	5.0%	3.9%	1.5%	3.0%
Rounds Consulting Group	2.5%	5.5%	2.8%	1.3%	5.0%
Southwest Growth Partners	4.8%	4.0%	3.8%	1.8%	0.0%
The Maguire Company	7.0%	7.2%	5.2%	1.8%	4.0%
The Retail Economist, LLC	2.3%	-0.9%	-3.2%	1.4%	-27.8%
UA - Eller College	4.5%	1.2%	1.1%	1.5%	-11.6%
VisionEcon/Governing Star Group	5.4%	6.2%	2.5%	1.6%	-3.8%
Consensus Forecast	***4.4%***	***4.0%***	***2.2%***	***1.5%***	***-5.7%***

Source: https://seidmaninstitute.com/wp-content/uploads/2023/01/AZWBCJan2023.pdf

Western Blue Chip Current Update:

POPULATION GROWTH WAS STRONGEST IN WESTERN AND SOUTHEASTERN STATES IN 2022

Western states accounted for five of the top ten states with the fastest population growth between July 2021 and July 2022. However, Florida (ranking number one for the first time since 1957) grew most rapidly (1.9%) over the period. Idaho, the number one fastest growing state in 2021, grew fastest among Western states and second fastest of all states (1.8%) in 2022. Texas was in fourth position (1.6%) for 2022, up from ranking seventh last year. Arizona slipped out of the top five in 2022, ranking in eighth place (1.3%). The largest drop in percentage growth ranking was for Utah, down from second place in 2021 to tenth fastest (1.2%) in 2022. At the national level, population grew by just 0.4 percent. Nationally, population growth has been slowing since peaking in 2015.

Source: https://seidmaninstitute.com/wbc-update

Articles of Interest

Globe St. – March 27
Sunbelt to Feel Multifamily Headwinds the Most

Phoenix Business Journal – March 23
Already booming, Pinal County cities are primed for more industrial, retail and housing development

AZ Central – Feb. 25
Most short-term rentals in metro Phoenix are still unlicensed

Phoenix Business Journal – March 24
Covid-19 sparked a downtown exodus in major cities. Here's how Phoenix weathered the storm.

AZ Big Media – March 28
West Valley developers capitalize on tourism boom