The Real State®

The Real State of the Phoenix Commercial Real Estate Market

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

September 2023

Distressed Deals and Note Sales on the Rise

Banks are in the business of making money on financial instruments, not managing real estate assets. Lenders are reluctant to take back a property through the expensive and time-consuming foreclosure process, nor do they want to own and operate complex and management-intensive assets. You can imagine the headaches for a lender that has office buildings on its balance sheet that need to be repositioned, repurposed, or re-tenanted. Not only does it represent significant capital expense and risk, it's siphoning away time better spent on their core mission.

As a result, we are seeing a trend towards banks selling notes instead of taking properties through foreclosure. At the same time, that trend is being noticed by private equity firms seeking to capitalize on the long-term prospects of commercial real estate: According to Ernst & Young, about $1.2 trillion is available for investment in commercial real estate, up from $900 billion in 2021.

That isn't to say that smaller investors can't get in on the action of loan acquisitions—but this is not run-of-the-mill investing as you find in the acquisition of typical commercial assets. While institutional lenders may not want the expense, time, and trouble to foreclose on non-performing loans, an opportunistic note buyer typically will have to step into the lender's shoes to foreclose and acquire the property, or otherwise collect on the loan instrument. The R.O.I. Properties team is currently working with several buyers of notes, helping them to formulate strategies to value, manage, sell and/or turn the notes/properties around. Executed properly, such deals allow an investor to own a property at a discount and reap the benefits of potential increases in rental rates, other revenue/redevelopment opportunities, and valuations, as the economy improves.

GlobeSt.com recently estimated there will be 3,600 distressed deals during the next two years from which to choose. Although experienced real estate investors may try to discover potential distressed investment assets on their own, it is an extremely competitive market and the process is often best executed with expert help and an extra dose of caution:

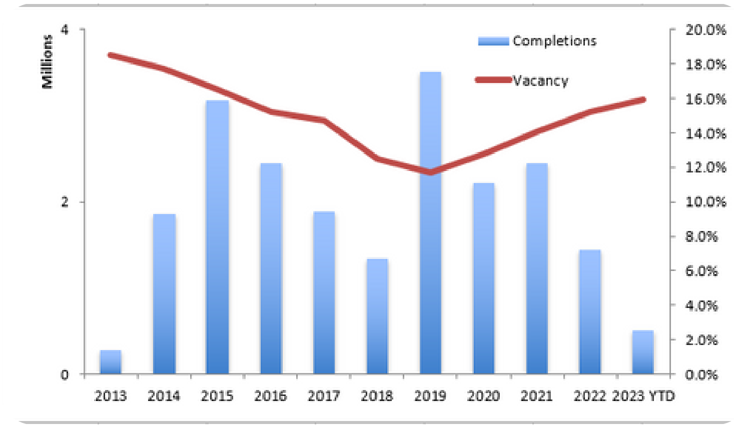
- We are in a period in which cap rates are higher, returns are tightening, and property values still remain fairly high.
- Investing in distressed property also incurs additional risk for the investor since they are the party executing the foreclosure rather than the original lender. Foreclosure and bankruptcy processes can take years sometimes, and as such, require appropriate discounting.
- Finally, the opportunities vary widely by market sector, property age/condition, and location.

Suffice it to say: In addition to plenty of dry powder, the phrase *caveat emptor* needs to be part of any investor's distressed property strategy.

Get the Inside Line on Distressed Properties

R.O.I.'s professional network—including commercial property owners, lenders, asset managers, fiduciaries, trustees, and others —can be a valuable asset when it comes to uncovering distressed properties that aren't yet publicly listed. Plus, our team can assist in every capacity, from crunching the numbers, to negotiating the best deal, to valuing, managing, and repositioning properties. If you are interested in learning more about available opportunities, please contact us at info@roiproperties.com or 602-319-1326., please contact us at info@roiproperties.com or 602-319-1326.

Office



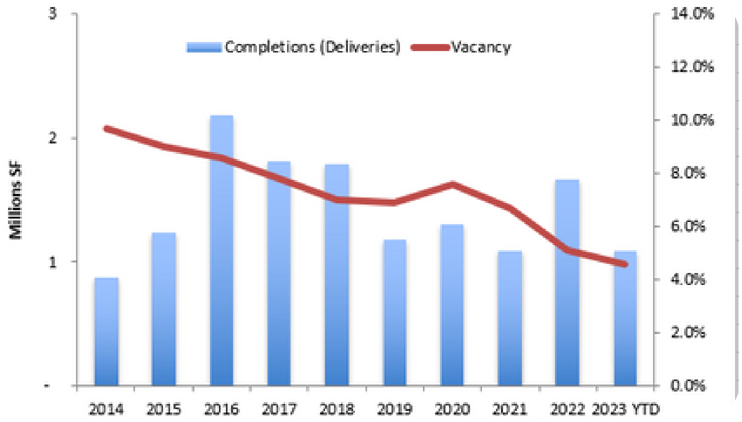
Office construction has decelerated over the past few years with just 990,000 SF of new office space delivered over the past 12 months, one of the lowest levels in nearly a decade. Construction starts have similarly eased as macro headwinds facing the sector and tighter lending standards for new construction financing reduce developer bullishness.

Marketwide, 1.1 million SF is under construction, about a quarter of which is available for lease. Construction is heaviest in Tempe, particularly in the northern part of the submarket near the Tempe Town Lake waterfront, which is home to some of the Valley's highest-end office space.

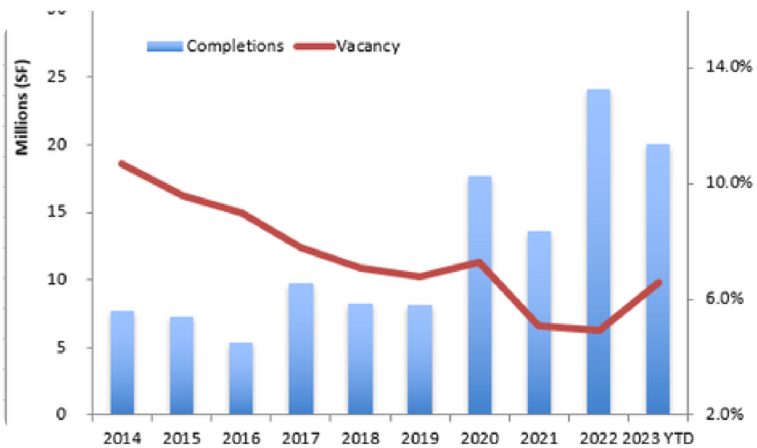
Retail

The Phoenix retail market continues to outperform as the metro's attractive demographic profile and diversified local economy fuel leasing activity. Roughly 4.2 million SF of space was absorbed in the past 12 months, ranking Phoenix as one of the strongest markets in the nation for new demand. Robust absorption levels together with the continued demolition of outdated retail inventory drove the metrowide vacancy rate down to 4.6%, the lowest mark on record.

Vacancy at historically low levels combined with a limited pipeline of speculative construction has made it difficult for retailers to find available space. As a result, new lease signings began to wane over the past nine months as tenants found few available options. Moving forward, retailers may need to consider building their own locations if they plan to expand.



Industrial



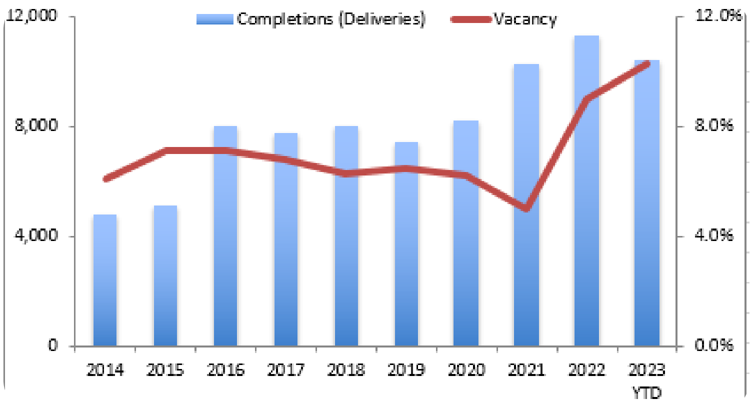
The Valley's rapidly growing consumer base, along with its critical role in national supply chains, has prompted a surge in construction activity for large, modern industrial parks that support users' distribution efforts. In addition, the high-quality labor force and business-friendly regulatory climate have made the area a top choice for advanced assembly. Several major manufacturing facilities are underway, including TSMC's $40-billion semiconductor campus in Deer Valley and Intel's $20-billion expansion of its Ocotillo chipmaking operation in Chandler.

About 48.2 million SF of industrial space is currently underway, representing 11.1% of existing inventory. That share ranks Phoenix as one of the most aggressively built industrial markets in the nation along with Savannah, GA, and Austin.

Multifamily

The Phoenix multifamily market faces one of the most substantial construction pipelines in the country. Unprecedented property performance following the onset of the pandemic spurred a wave of development activity that set multi-decade records in 2021 and 2022. The supply pressure will continue in the coming year, with an estimated 33,000 units currently underway, which will expand the market's inventory by about 8.7% once completed. That amount of units under construction ranks Phoenix among the top five fastest-growing multifamily markets in the United States.

Downtown Phoenix has been a major area of focus for development, composing 15% of the current pipeline. The region is in the midst of a dramatic revitalization that has reshaped the submarket into a premier destination for young professionals and students. Roosevelt Row, in particular, has emerged as a walkable, urban residential district with numerous bars, restaurants, entertainment options, and boutique retailers.



Residential Snapshot

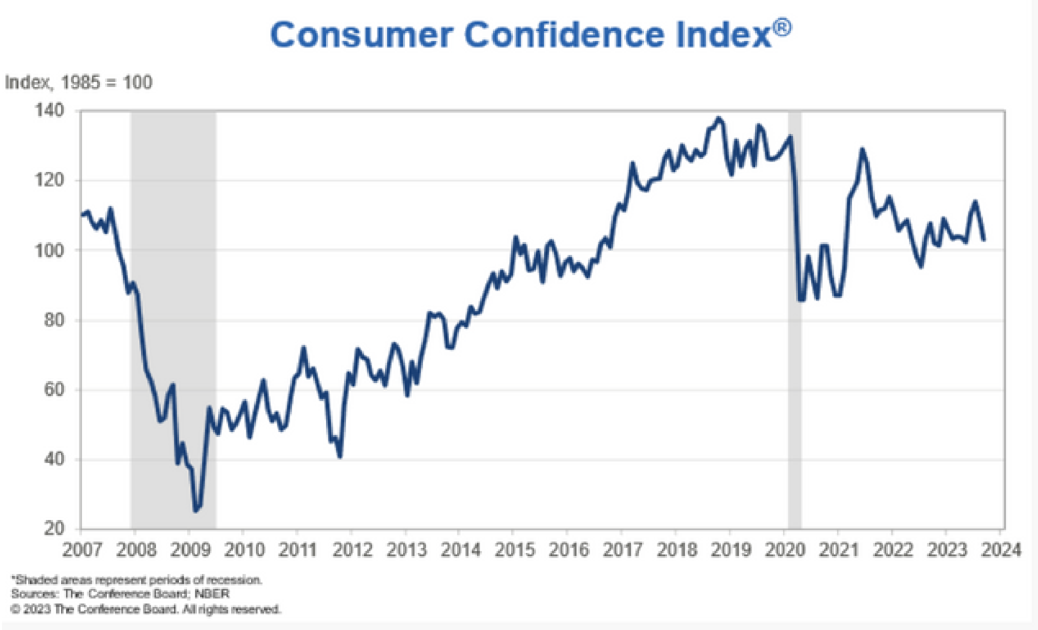
The story in the residential market continues to be a slow-moving slog of low inventory and increased interest rates, which recently rose to the highest they've been since 2000. Low rates in recent years worked to increase pricing, and those higher prices are now backfiring on the ability of owners to sell. A decrease in interest rates does not appear to be likely in the near future, and even then, it's unknown what it will take for buyers to start jumping back in.

Looking at the numbers: From August to September 2023, the supply-demand index declined from 158.5 to 146.0. The supply index rose from 48.6 to 51.5 and the demand index dropped from 77.0 to 75.2.

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

- Supply continued to rise at a more accelerated rate over the past month. New listings every week are still at historic lows, but August had the highest number added to ARMLS since March.
- New listings for August, at 7,304, were 14% higher than July, but 25% lower than last year and 31% lower than August 2021.
- Listings under contract are down 11% from last month, which is the main contributing factor to our rise in supply.
- In a bit of good news for buyers, price reductions are on the rise and 43% of sellers paid for their buyers' closing costs last week.
- Housing demand continues to be starved by high mortgage rates. The annual sales rate of 69,549 over the past 12 months is a level the Greater Phoenix area hasn't seen since 2009. It's 36% lower than the peak number of sales achieved from June 2021 to June 2022 but still 41% higher than the rock-bottom level of sales measured between 2007-2008 after 3 years of decline.

CONSUMER CONFIDENCE



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

Present Situation

Consumers' assessment of current business conditions was slightly less pessimistic in September.

- While 20.9% of consumers said business conditions were "good," down from 21.5 percent in August,
- 16.4% said business conditions were "bad," down from 17.3%.

Consumers' appraisal of the labor market was slightly more positive in September.

- 40.9% of consumers said jobs were "plentiful," up from 39.9% in August.
- But 13.6% of consumers said jobs were "hard to get," up from 13.2% last month.

ARIZONA INDUSTRY EMPLOYMENT AND WAGES

NONFARM EMPLOYMENT
August 2023 - Seasonally Adjusted

3,163,300
Total Nonfarm Employment

Year-over-Year Change

57,000 Numeric | +1.8% Percentage

EMPLOYMENT BY SECTOR
August 2023 - Seasonally Adjusted

Total Nonfarm Payroll Em

3,163,300
Employment Level

Year-over-Year Change

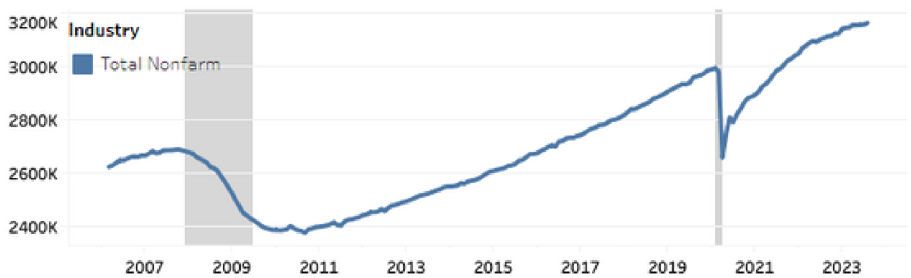
57,000 Numeric | +1.8% Percentage

ANNUAL AVERAGE WEEKLY WAGES IN ARIZONA (2022)

$1,245 Total, All Industries

Industry Category	Weekly Wage
Goods-producing	$1,513
Natural resources and mining	$1,256
Construction	$1,368
Manufacturing	$1,709
Service-providing	$1,202
Trade, transportation, and utilities	$1,115

Arizona Total Nonfarm Employment



Source: https://www.azcommerce.com/oeo/labor-market/unemployment/

Articles of Interest

Globe St. – July 20
Opportunities Open Up for Investors Looking for CRE Distress

JPMorgan Private Bank – Sept. 18
Uncovering opportunities in stressed commercial real estate

ABC15 – Sept. 6
Phoenix’s top malls play key role in record low for retail vacancies

AZ Big Media – Sept. 28
Will water and capital concerns cool white-hot industrial market?

Phoenix Business Journal – Sept. 27
Some office markets may be close to bottoming out while others are showing more cracks

Phoenix Business Journal – Sept. 8
How Phoenix's Class B office market, upcoming loan maturities stack up