The Real State®

The Real State of the Phoenix Commercial Real Estate Market

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

November 2023

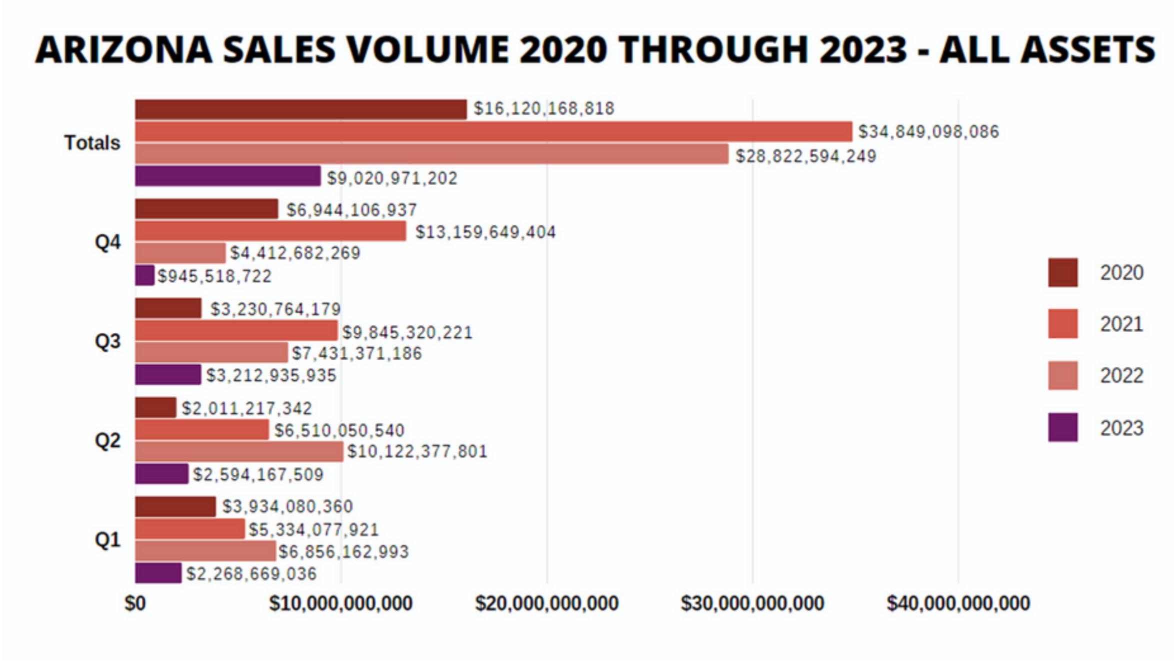
CRE Activity Down Overall, but Some Pockets Are Alive/Well

The Greater Phoenix commercial real estate market has not seen much change since the previous issue of *The Real State*. Institutional buyers and investment-driven deals remain on hold. That said, there will always be buyers looking for the right opportunities at the right price.

The current buyer pool tends to skew towards buyers in economically resilient owner-occupants, and private equity funds—especially those that are more entrepreneurial or value driven. They recognize the opportunity in the marketplace, thanks to the recent price adjustments that have been happening in multifamily and those that were already baked into the office cake over the past year plus. Industrial appears to be holding steady for now. Seller financing and assumable loans have helped owners bridge the gap in interest rates and return expectations, while helping sellers achieve higher pricing.

While the residential market traditionally gets quieter over the holidays as many homeowners temporarily de-activate their properties, the commercial market can be quite busy. For business or other financial reasons, buyers may be motivated to close before the end of the year, although we are seeing a notable lack of 1031 exchange activity.

Regardless of whether Q4 2023 finishes with a flurry of activity, the final sales numbers will ring in the New Year dramatically below the past two years—and even the pandemic-hindered 2020. The big takeaway for 2023 has been significantly lower transaction volume overall—and in every commercial asset class, as set forth in the adjacent chart.

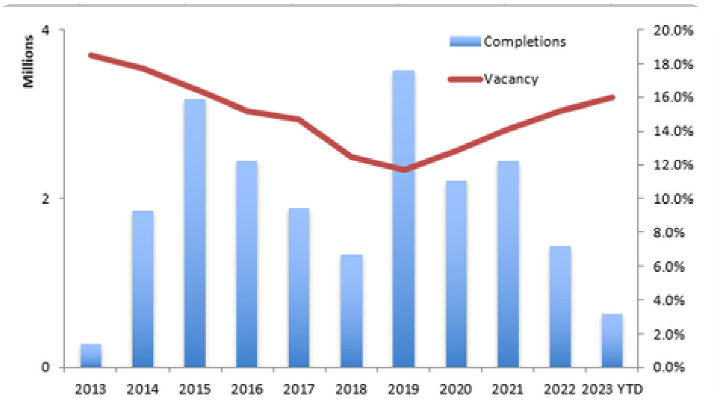


Source: CoStar

Get a Head Start on Your 2024 Real Estate Plans

Whether you own a commercial property that you would 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.

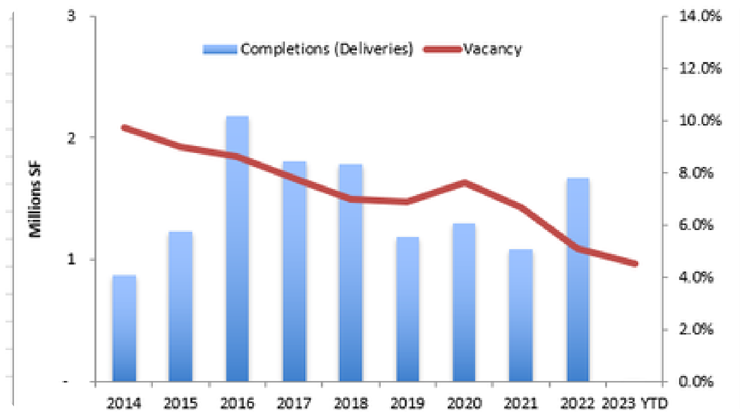
Office



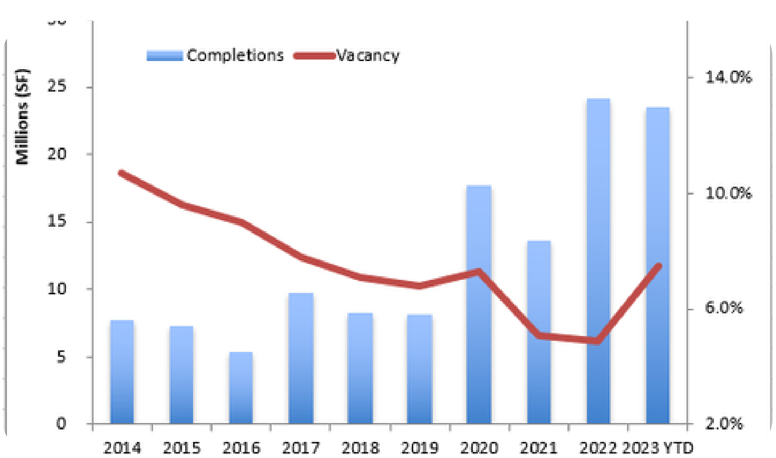
Phoenix saw the addition of another -630,000 SF of net vacant office space to the market in Q3 2023, as tepid demand and broad-based economic uncertainty continued to pressure the sector. Total empty space has climbed nearly 50% since the end of 2019, driving the metro-wide vacancy rate from 11.0% in Q4 2019 to 16.0% today, matching a level last seen in 2015. The increased adoption of hybrid work arrangements has led to a structural shift in the relationship between job growth and occupied office space, with occupiers placing renewed emphasis on space utilization. Prior to the pandemic, the two metrics would generally move in the same direction, but the rise of flexible configurations has reduced their correlation. For example, although total employment in the traditional office-using sectors is now 40,900 positions higher than before the pandemic, total occupied office space has declined by more than 3 million SF.

Retail

New supply additions have been modest during the most recent expansion cycle, supporting over a decade of steady improvement in the Phoenix retail market. Harsh lessons learned during the global financial crisis have left developers and lenders much more disciplined this time around, keeping supply-side pressure largely at bay. In the sector's heyday, from 2006 to 2008, builders delivered over 10 million SF per year, a far cry from the 1.4 million SF per year completed on average over the past 10 years. Another key factor helping return balance to supply and demand has been the removal of older, obsolete stock. About 6.1 million SF of retail space was demolished over the past decade, largely driven by pre-1980s suburban product and department store closings.



Industrial



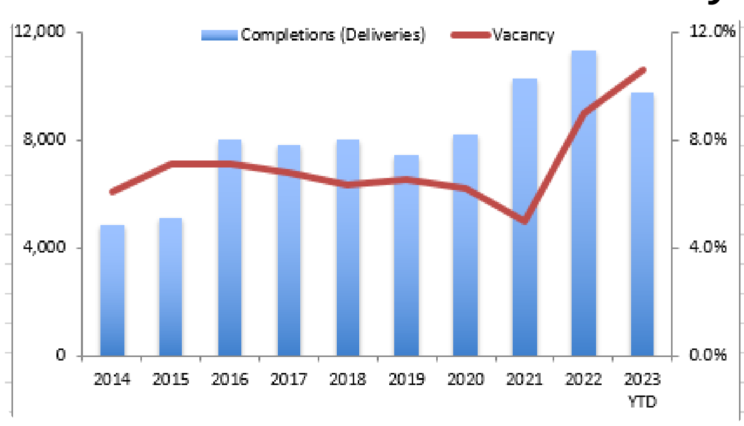
Conditions are shifting in the Phoenix industrial market as a wave of new construction overwhelms sturdy leasing activity. Developers completed a record 13.7 million SF in Q3 2023, outpacing the second-strongest quarter for gross deliveries on record by several million SF. The surge caused vacancy to spike to 7.5% today, erasing most of the occupancy gains made during the pandemic era. While leasing volume has shown some signs of moderating, particularly for spaces larger than 350,000 SF, the substantial supply pipeline remains the primary driver of higher vacancies.

A total of 47.0 million SF is currently under construction, which equates to 10.6% of the market's current existing total square footage. Meanwhile about two-thirds of space now under construction remains unleased.

Multifamily

Supply-side challenges plague the Phoenix multifamily market as a wave of deliveries overshadows rebounding rental demand. Over the past 12 months, apartment builders delivered a staggering 17,000 units, outpacing the pre-COVID five-year average of about 7,100 units per year. The surge in construction activity has kept vacancies on an upward trajectory since mid-2021 and turned rent growth negative.

The effect of the construction pipeline will be felt through 2024. About 34,000 units are under construction, representing 9.1% of existing inventory. That figure ranks Phoenix as one of the most aggressively built markets in the country. With much of the development activity focused on luxury properties, supply pressure has been most acute in the Class A segment.



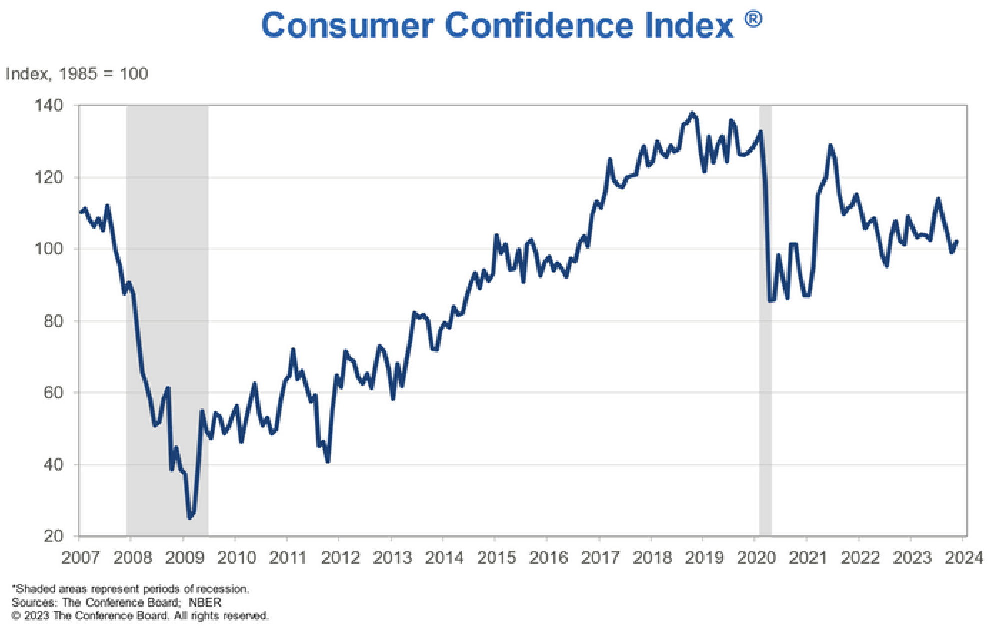
Residential Snapshot

Heading into the final month of 2023, inventory levels have increased slightly, demand is holding relatively flat, and interest rates ticked slightly downwards. Traditionally, people tend to take homes off the market during the holiday season, so it may be a game of wait-and-see till the New Year arrives. We are still seeing a tremendous amount of concession requests from buyers, particularly in entry-level and move-up properties that require financing. As has been the case all year, the luxury property market continues to see all-cash deals come together. October to November 2023, the supply-demand index declined from 127.1 to 109.4, with the supply index rising from 56.9 to 63.5 and the demand index dropping from 72.3 to 69.4. As predicted last month, Greater Phoenix is officially in a balanced market again and declining at a rate that would put it in a buyer's market by December. It remains unclear how long this opportunity for buyers will last, as conventional mortgage rates have dropped from a high of 8.0% last month to 7.36% today (6.71% for FHA).

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

- Active MLS supply continues to rise but appears to be slowing. This is typical for the last few weeks of the year as new listings drop significantly during the weeks of Thanksgiving and Christmas, with an anemic bounce in between.
- This season is the ideal time to be a buyer: Supply is elevated, sellers have been on the market longer, and price negotiations at contract replace price reductions in the MLS.
- The average list price per square foot is 11% higher than this time last year. Weekly price reductions are up 97% since July (with a median reduction of $10,000), but haven't yet brought down the overall average list price per square foot.
- The percentage of sales closing with some type of concession has remained consistent between 42-45% since May. However, as the seller's market began to weaken noticeably after August, the median seller contribution to the buyer increased from $8,000 to just over $9,200.

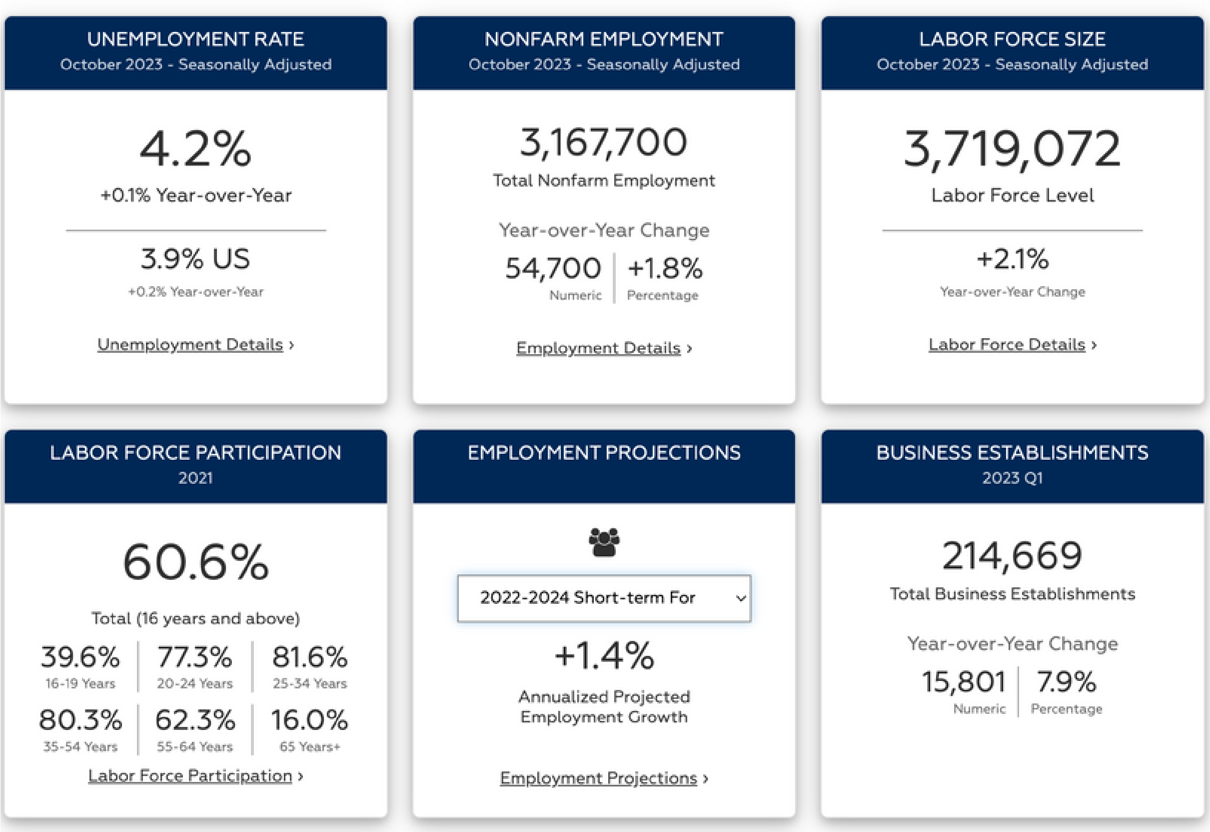
CONSUMER CONFIDENCE



Source: The Conference Board

"Consumer confidence increased in November, following three consecutive months of decline," said Dana Peterson, Chief Economist at The Conference Board. "This improvement reflected a recovery in the Expectations Index, while the Present Situation Index was largely unchanged. November's increase in consumer confidence was concentrated primarily among householders aged 55 and up; by contrast, confidence among householders aged 35-54 declined slightly. General improvements were seen across the spectrum of income groups surveyed in November. Nonetheless, write-in responses revealed consumers remain preoccupied with rising prices in general, followed by war/conflicts and higher interest rates."

ARIZONA ECONOMY AT A GLANCE



Source: Arizona Office of Economic Opportunity

Articles of Interest

Kiplinger – Nov. 29
Kiplinger's GDP Outlook: Slowdown in 2024 Will Be Short-lived

AZ Central – Nov. 22
Project to convert Phoenix offices on Camelback Road into apartments bought out of foreclosure

Bisnow - Nov. 17
Class-A Multifamily Rents Might Not Stabilize Until 2025, Analysis Finds

AZ Big Media – Nov. 27
Metro Phoenix posts historic level of industrial completions

TreppTalk – Nov. 15
A Risk Assessment of the Multifamily Market: Through the Lens of Bank CRE Loans

Phoenix Business Journal – Nov. 29
Multifamily loans will face a critical test in 2024 and beyond

The Real Deal – Nov. 16
Why real estate is so difficult to price right now