

The Real State[®]

The Real State of the Phoenix Commercial Real Estate Market



APRIL 2021

Glimpses of Recovery and Change in Greater Phoenix

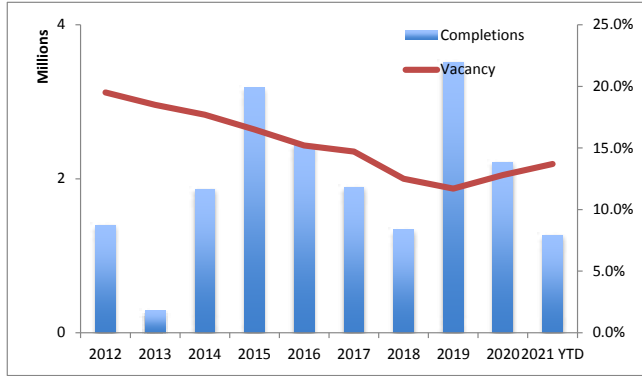
As post-pandemic social restrictions start to ease with the arrival of vaccines, plus the most recent round of stimulus funds, we are beginning to see glimpses of what recovery looks like in the Valley of the Sun. This month, the Arizona Office of Economic Opportunity announced that the state's labor force has officially risen higher than it was prior to the pandemic, and at 1.8%, Arizona's population growth was 4 times larger than the U.S. growth rate of 0.4%. Here's the current view of several key commercial property sectors:

- **Hotels in recovery mode.** The story here is pent-up demand and significant increases in occupancy rates. Even with limited crowds, according to new statistics from the Arizona Office of Tourism, Phoenix had the [highest hotel occupancy in the top 25 markets](#) at 77% for the week of March 14. In particular, resumption of business and leisure travel are expected to give a boost to higher-priced properties.
- **Retail regional malls trend to mixed-use.** In March, Christown Spectrum announced plans to add residences, a hotel, entertainment and high-rise business offices on the 98-acre site. The Paradise Valley Mall's redevelopment plan includes a mix of residential and commercial buildings, including apartments, office space, a grocery store, restaurants and retail stores. Scottsdale Fashion Square recently completed a [multi-year redevelopment](#) that includes new-to-the-market tenants, remodeled stores and services such as pickup for online purchases, expanded restaurant patio seating, and shopping by appointment. Plans for Metrocenter Mall have not been disclosed yet, but likely include adaptive reuse with a mix of uses as well.
- **Big box retail spaces shrink or vacate.** Convenient locations and large open spaces have proved these sites as a good solution for last-mile distribution warehouses and fulfillment centers for retailers. Amazon, of course, had adopted this strategy long before the coronavirus, but we are also seeing them repurposed for uses such as municipal facilities, charter schools, worship sites, recreational centers, etc.
- **Neighborhood retail centers focus on services not products.** With retailers struggling to beat their online competitors, neighborhood shopping centers (think grocer-anchored centers) are skewing towards services rather than shops with products. "Medtail," a hybrid of retail and healthcare, fitness/health centers, educational sites, restaurants, and even residential units are among the options.
- **Office still faces headwinds.** The outlook is not so rosy in this sector, with vacancy rates lurking just below 15% and significant downward pressure on rents. COVID-19 will leave its most meaningful, deep and long-term impact in the office market, with sublease space growing and leases coming up for renewal. Most law firms, financial service firms and technology companies—among many others—are planning to shrink their footprints or incorporate office hotel/guest office concepts. Even with widespread discounts, vacancy rates are anticipated to climb in the coming two years or more.

ARE DISTRESSED ASSETS ON YOUR INVESTING RADAR?

With an economic recovery underway in Greater Phoenix, it will be a tight window if you're looking for distressed properties or bargains. This will likely require a targeted approach to succeed, looking for one-off deals in smaller assets and businesses that have been impacted. 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

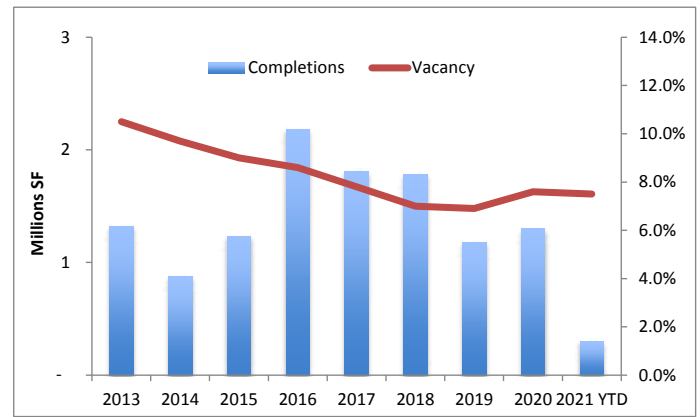


Following a long stretch of rent growth, rents edged down for the first time since 2012 in Q1 2021. Before the pandemic, healthy fundamentals had translated into steady rent gains that had consistently outpaced the National Index. But rent growth started to decelerate several years ago from the highs of 2015–16 when rents had climbed 6%–7% annually.

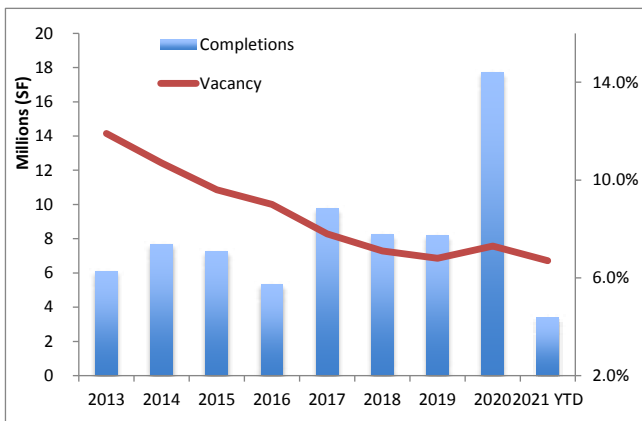
Rent pressures will continue to mount over the next several quarters due to a rise in direct availabilities and sublease space. Sublease spaces are offered at a 10%–30% discount to direct marketed space throughout the market. The discount varies by class, location, and lessor motivation. Downtown Phoenix offers some of the highest discounts due to its more than 20% availability rate.

Retail

Vacancies have lifted from 7% in Q4 2019 to 7.5%. The closure of Metrocenter Mall in Phoenix dealt a substantial blow to net absorption in Q3 2020. In July, the underperforming mall officially closed, though many anchors had shuttered years before: Macy's in 2015, Sears in 2018, and JCPenney in 2019. The mall's owner said that Metrocenter could no longer sustain operations due to the drop in occupancy levels because of COVID-19. Vacancies are expected to temporarily rise upon the closure of Paradise Valley Mall in Q2 2021. Similar to Metrocenter, that mall has struggled for years and will ultimately close due to low occupancies during the pandemic. The mall has been approved for redevelopment; construction and partial demolition are expected to start later this year.



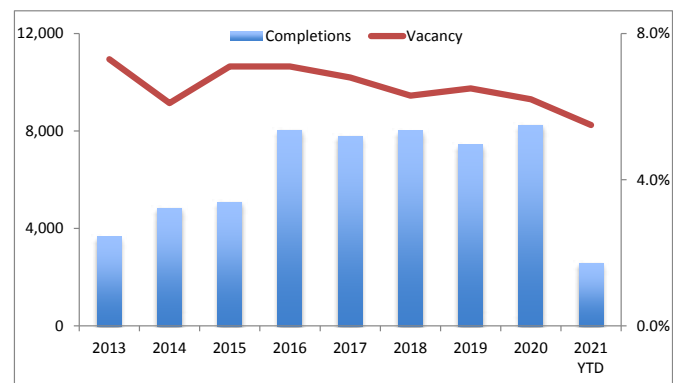
Industrial



Last year marked one of the best years on record in the Phoenix industrial market. Demand and new supply reached new highs, activity which has carried into the Q1 2021. 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 demand for warehouse and distribution facilities. Last year, Amazon signed 11 leases ranging from small last-mile fulfillment to extensive distribution centers. The e-commerce giant has also built new facilities, including a 2.3-million-SF fulfillment center. Not all industrial users have benefited from the changes over the past year. A curtailment in apparel and discretionary goods spending has negatively affected select retailers with warehouse and distribution space.

Multifamily

While the overall vacancy rate has steadily compressed since Q2 2020, it's about 150 basis points above the stabilized rate. Vacancies are higher in supply-heavy urban areas of Phoenix, including Downtown Phoenix, Scottsdale, and Tempe. During the onset of the pandemic, renters' preferences shifted from top-tier apartments in city centers to affordable units in the suburbs. Many people couldn't justify paying a \$200–\$500/month premium to live in luxury apartments near employment hubs when companies had extended work-from-home policies and apartments temporarily restricted access to amenities. As a result, areas in the West and East Valleys are outperforming submarkets such as Downtown Phoenix, Camelback, and Old Town Scottsdale, but conditions have improved over the past few quarters.



Residential Snapshot

Although the supply-demand index fell significantly over the past month, it will be barely noticeable on the street; the market simply cooled to where it was in late January/early February of this year. There will still be multiple offers and closings over asking price. Two notable changes occurred in the past month: Demand entered the normal range, and the supply index stopped dropping and has stabilized at 78% below normal. Extremely low supply continues to be the major driver of rapid appreciation. Demand is the less important of the two factors until supply rises to more normal levels and the majority of homes are no longer receiving multiple offers. Here are some of the other residential real estate trends that we're keeping an eye on:

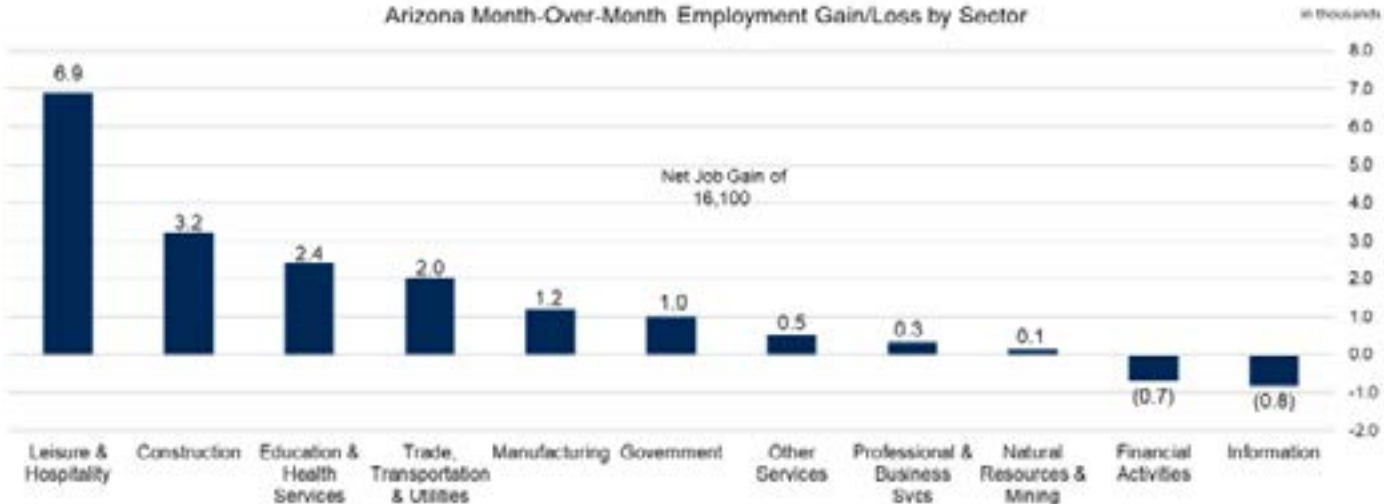
- The supply level listed in the Arizona Regional MLS has been stable for two months now.
- Overall, every price point is significantly lower in supply than this time last year, which was the peak inventory count due to the pandemic.
- New home permits for 2021 through February are up 20.4% compared to last year and are at the highest level since 2006.
- Sales over asking price represent 55% of all sales closed so far in April through the Arizona Regional MLS.
- The average sales price per square foot is \$242.11, up 31% over April 2020 and 3.7% higher than last month's final measure of \$233.54. This monthly appreciation rate results from a combination of a higher concentration of luxury listings closing escrow and sales price to list price ratios over 102% under \$500K.

YOUR EXPERT COMMERCIAL REAL ESTATE ADVISORS 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.

Unemployment

The Arizona seasonally adjusted unemployment rate decreased to 6.7% in March 2021 from 6.9% in February 2021. The U.S. seasonally adjusted unemployment rate decreased to 6.0% in March 2021 from 6.2% in February 2021. Over the month, Arizona's seasonally adjusted labor force increased by 6,749 individuals or 0.2%. Over the year, the labor force decreased by 321 individuals. Arizona nonfarm employment increased by 16,100 jobs or 0.6% in March. Historically (2011–2020), nonfarm employment has averaged a gain of 7,600 jobs in March. The government sector recorded a gain of 1,000 jobs in March. The private sector recorded a gain of 15,100 jobs in March. Historically (2011–2020), private sector employment has averaged a gain of 8,300 jobs in March.



Source: Produced by the Arizona Office of Economic Opportunity in cooperation with the U.S. Dept. of Labor, Bureau of Labor Statistics

Consumer Confidence



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

“The Federal Reserve at its most recent FOMC meeting recommitted itself to keeping short-term interest rates near zero for the foreseeable future, which likely means into 2023 or 2024. The Fed is also continuing to purchase \$80 billion of Treasury securities and \$40 billion of mortgage-backed securities every month, adding to its balance sheet. The Fed is ‘all in’ to do whatever it takes to support the economy. It has said that it will be willing to tolerate inflation above 2% for a time. That means that the Fed will not raise short-term rates even if inflation begins to pick up. But if inflation rises strongly later on, the Fed would likely respond.”

—Kiplinger Economic Forecasts, [Inflation Fears Outweigh the Fed’s Dovishness](#)

Articles of Interest

AZ Big Media – April 20

[Phoenix hotel occupancy expected to outperform national levels](#)

Phoenix Business Journal – April 20

[‘We’ve never been busier’: Valley industrial developer has millions of square feet under construction](#)

Phoenix Business Journal – April 14

[Phoenix near top in US ranking for industrial construction in 2021](#)

Trepp – March 24

[Co-tenancy Clauses in Retail Leases: Do They Really Matter?](#)

Wall St. Journal – April 6

[After Covid-19, Office Leases Largely Come With Bargain Rates](#)