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

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ENHANCING REAL ESTATE ASSETS

DECEMBER 2021

A Year in Review: Commercial Showing Momentum

For the fifth year in a row, the Phoenix metro area ranked as the fastest-growing city in the United States, according to the US Census Bureau. Phoenix's appeal as a business-friendly destination has spurred local investment and attracted headquarters, acquisitions, and development from California's pricy coastal markets. Here's an overview of how the four commercial real estate sectors performed in 2021:

Industrial Sector. Industrial has been a standout in recent years due to online commerce and strong demand for "last mile" delivery. The pandemic further fueled demand for warehouse and distribution space in Phoenix after a record year in 2020. An estimated 18 to 20 million square feet of industrial space was leased, led by the West Valley. Amazon alone inked 13 leases from January 2020 through June 2021, and last week announced a 63,000-SF expansion at its existing 100 Mill facility in Tempe. As might be expected, Amazon-leased facilities command high prices, including a recent $71.5 million purchase in Glendale.

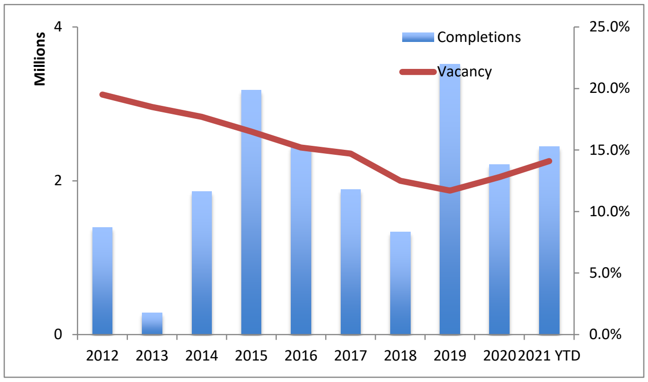
Retail Sector. Boosted by pent-up demand, retail leasing is approximately back to pre-pandemic activity levels. Vacancies ticked up slightly in the first half of the year, but robust absorption in Q3 2021 and the demolition of over 1 million SF brought vacancy rates to pre-pandemic levels as well. Looking ahead, the retail market will have divided potential, which means investors need to take a targeted approach. Discount, grocery, drive-thru, and service-based retailers will continue to expand, while other retailing segments will continue being challenged by e-commerce and evolving consumer expectations and preferences.

Multifamily Sector. Multifamily performed well through much of the pandemic, and vacancies have compressed below 5% in all three property types. Record apartment demand has been compounded by historically low single-family housing inventory, resulting in the country's highest rent-growth rates, in excess of 20%. After a robust sales year, December is finishing strong, with the 1,222-unit Vaseo apartment community selling for $325 million on the 15th and a 5-property, 1,448-unit portfolio selling for $414.5 million on the 21st.

Office Sector. Office space recorded its weakest performance since the Great Recession. Vacancy rates and available space are up; in addition, a significant percentage of leases are coming due in the next few months, which could increase direct and sublease space. On the optimistic side, leasing activity has increased; asking direct lease rates and average gross rates have risen in all three property classes this year; and Q3 investment sales notched the second-best quarterly volume in the past three years. In early December, Block 23 in downtown recorded the year's top sale at $150 million. Still, the prospects for this market remain uncertain while businesses formulate work-from-home/hybrid strategies and reduce their footprints to save on expenses.

If you own or are interested in purchasing commercial real estate as an investment property, we welcome the opportunity to discuss the best available options. 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



Following a long stretch of rent growth before the pandemic, rents have stagnated more recently. Annual rent growth currently registers at 1.1%, compared to the national average of -0.4%.

Despite 32 quarters of rent appreciation, Phoenix maintains its position as an affordable office market. The average office rent in Phoenix is roughly 30% less than the national index, and the discount relative to West Coast markets is even greater. Average rent in San Francisco is about two and a half times that in Phoenix, and Los Angeles is about 50% higher.

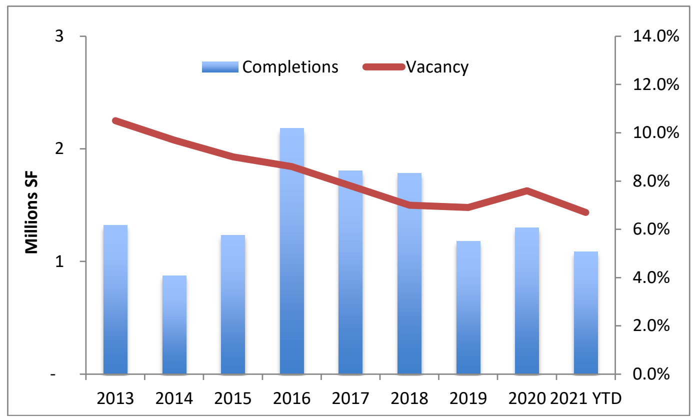
Phoenix's relative affordability will likely continue to attract tenants looking to relocate or expand operations in the western part of the United States without paying sky-high rents in coastal markets.

Retail

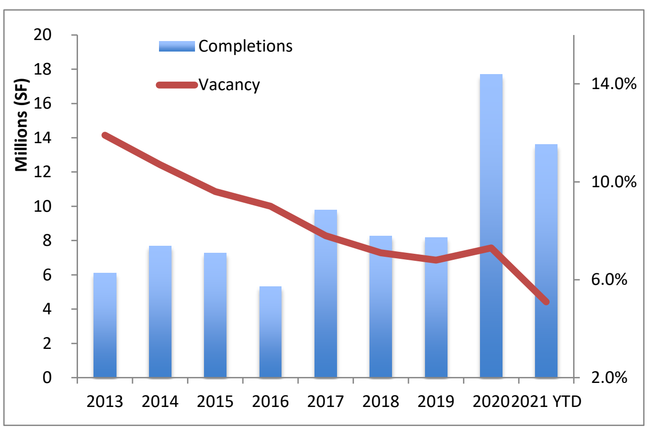
Rent growth has steadily trended upwards since falling to a low at the end of 2020. The pace of rent growth in Phoenix is outperforming the national index by a considerable margin.

Over the past 12 months, same-store asking rents changed by 4.5%, compared to the national average of 2.7%. Rents vary substantially by location, product type, and quality. Areas with more expensive rents, including Scottsdale, Chandler, and Gilbert, have recorded some of the weakest rent growth recently, while more affordable areas of Phoenix have recorded higher gains.

Average rents in the metro are about 15% below the 2007 high and they are unlikely to return to that rate in the near term. Looking ahead, rent growth will continue at a healthy pace over the next few years according to the base case scenario.



Industrial



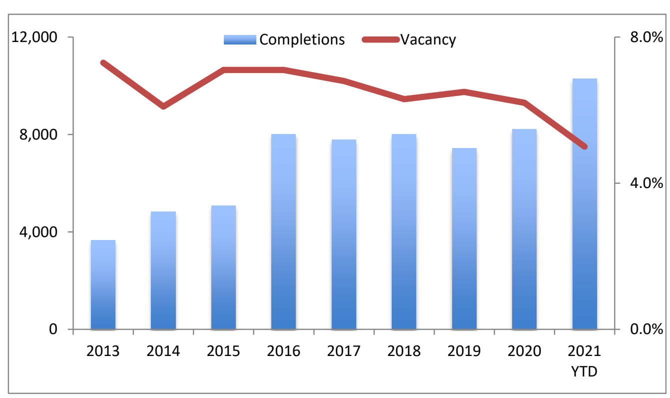
Despite substantial new supply, industrial vacancies have held tight, which has supported 36 straight quarters of positive rent growth in the market. Historically, rent growth in Phoenix had lagged the national index, but after gaining some momentum in 2019, rent growth has consistently outpaced the U.S. average. Still, Phoenix maintains its position as an affordable market for its size. Rents average $9.70/SF, which is near the national average and 30%-40% below asking rents in California markets.

The pace of rent growth is expected to hold firm in the near term and decelerate by mid-2022, according to the base case scenario. The wave of speculative deliveries in Phoenix may limit landlords' leverage to raise rents in some areas of the Southwest Valley in the near term.

Multifamily

Substantial new supply has not yet slowed multifamily rent growth in Phoenix. Rents continue to climb, and Phoenix remains one of the top markets in the country for rent growth. Rent gains have consistently outperformed the U.S. average over the past five years, but Phoenix maintains its place as an affordable market in the Western region. Phoenix rents are below the national average and account for about 20% of the metro's median household income. That rent-to-income ratio is much more favorable than Los Angeles, San Francisco, San Jose, and Seattle—all of which are markets that recorded negative rent growth in 2020.

While rents in all of Phoenix's submarkets are growing, some areas have outperformed. Rents in the suburbs returned to January 2020 levels six months before urban neighborhoods reached the same milestone. Deer Valley and East Valley submarkets have topped all other areas for rent growth. Rent gains have also been impressive In the affordable West Valley, where residential development has not kept pace with household growth.



Residential Snapshot

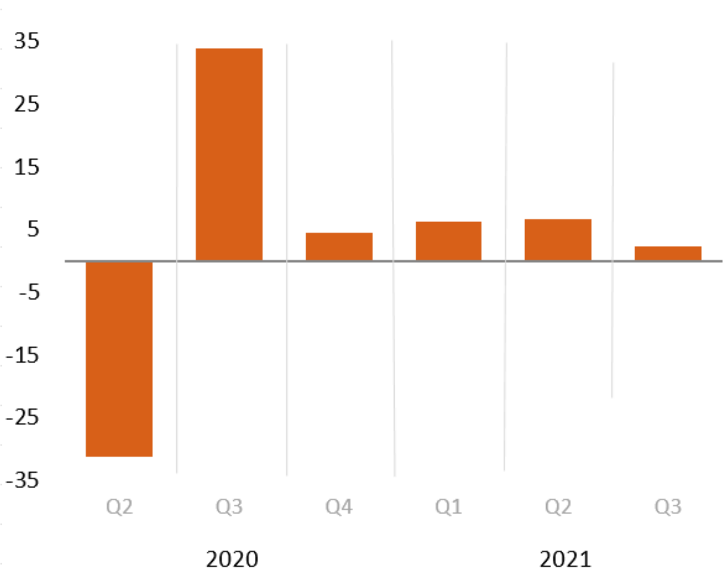
From November to December 2021, the supply-demand index rose 37.6 points. Although both indicators decreased, supply made the bigger move, which pushed the market higher into a seller's market. Last month, both indicators increased, but demand made the more significant move, also pushing the market higher into a seller's market. The result has been a 47-point increase in favor of sellers over the past 2 months. As national housing predictions for 2022 flood the headlines, it's easy to get caught up in the unknown and unpredictable: the expectation of rising interest rates, for example. While that's valid, it's also important to lean into the math and what we know. A flattening in sale prices is inevitable, but current measures show they will continue to rise for at least 3-6 months in Greater Phoenix.

Other key residential trends we're watching:

- Supply has fallen to 5,397, 2.5% below the year's starting point. While it's been an exciting ride the past 12 months, supply is still at a record low.
- As of December 23, the total number of new listings added to the MLS in 2021 is 113,205—the highest number of new listings added since 2011. While this may seem impressive, this number of annual new listings is not remotely close to the peak year of 2006, when over 171,000 were listed.
- Listings in escrow are at 9,876 as of December 26, up 3.9% from the beginning of 2021. Despite the decline since October, contract activity is still very high for this time of year.
- As of December 22, there have been 102,795 sales closed through the Arizona Regional MLS, up 4.7% from 2020 and 1.2% higher than the peak year of 2005 to date. This puts 2021 on track to be the #1 year for MLS sales.
- With just a few days left in 2021, annual appreciation is running at 26.2%.

REAL GDP

Real GDP: Percent change from preceding quarter



Real gross domestic product (GDP) increased at an annual rate of 2.3% in Q3 2021, following an increase of 6.7% in the second quarter. The increase was revised up 0.2 percentage point from the "second" estimate released in November. The deceleration in real GDP in Q3 was led by a slowdown in consumer spending. A resurgence of COVID-19 cases resulted in new restrictions and delays in the reopening of establishments in some parts of the country. In Q3, government assistance payments in the form of forgivable loans to businesses, grants to state and local governments, and social benefits to households all decreased.—*Bureau of Economic Analysis*

Greater Phoenix Blue Chip

GREATER PHOENIX REAL ESTATE CONSENSUS FORECAST
RESIDENTIAL

	2021				2022				2023			
	Single-family Permits	Multi-family Permits	Apt Vacancy (Q4 %)	Apt. Absorp.	Single-family Permits	Multi-family Permits	Apt Vacancy (Q4 %)	Apt. Absorp.	Single-family Permits	Multi-family Permits	Apt Vacancy (Q4 %)	Apt. Absorp.
CBRE	34,000	12,000	4.5%	11,700	32,000	11,000	4.0%	14,800	33,000	11,000	4.0%	10,000
Colliers International	39,000	15,000	4.0%	16,500	45,000	16,000	4.5%	15,500	46,000	16,000	5.0%	15,000
CRA LLC	31,500	8,000	5.5%	7,500	33,000	7,000	5.5%	7,500	35,000	7,000	5.0%	7,500
Elliott D. Pollack & Co.	33,000	12,000	4.0%	14,000	30,000	14,000	4.0%	14,000	34,000	15,000	3.5%	15,000
Griffin Consulting	33,000	9,750	5.7%	9,150	34,500	9,600	5.5%	8,700	36,000	9,350	5.4%	8,250
Southwest Growth Partners	32,000	8,500	5.8%	8,000	33,000	8,000	6.0%	7,500	33,000	8,000	6.0%	7,500
U of A, Eller College	38,736	12,421	N/A	N/A	38,864	12,166	N/A	N/A	36,802	9,660	N/A	N/A
CONSENSUS	**34,462**	**11,096**	**4.9%**	**11,142**	**35,195**	**11,109**	**4.9%**	**11,333**	**36,257**	**10,859**	**4.8%**	**10,542**
Actuals From Phoenix Housing Market Letter and CBRE:												
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
OFFICE (Millions of Square Feet)

	2021			2022			2023		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE	0.90	19.5%	(1.50)	1.20	20.0%	(0.50)	1.00	19.0%	0.50
Colliers International*	1.80	14.4%	(0.75)	1.80	14.2%	0.45	2.00	14.0%	0.50
Lee & Associates*	3.00	17.8%	(0.63)	1.50	18.0%	0.25	2.00	17.6%	1.00
CONSENSUS	**1.90**	**17.2%**	**(0.96)**	**1.50**	**17.4%**	**0.07**	**1.67**	**16.9%**	**0.67**
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.

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

	2021			2022			2023		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE	0.40	9.0%	0.50	0.40	8.5%	0.60	0.50	8.0%	0.65
Colliers International	0.50	7.1%	0.65	0.68	6.9%	0.50	0.73	6.8%	0.75
CONSENSUS	**0.45**	**8.1%**	**0.58**	**0.54**	**7.7%**	**0.55**	**0.61**	**7.4%**	**0.70**
Actuals From CBRE:									
2020 Actuals	0.00	8.0%	(0.01)						
2019 Actuals	0.02	8.0%	1.21						

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

	2021			2022			2023		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE*	12.00	4.3%	20.00	13.00	4.2%	18.00	15.00	4.0%	16.00
Colliers International**	15.00	5.2%	22.00	16.50	5.0%	18.00	14.00	4.9%	18.00
Lee & Associates*	20.00	5.4%	24.00	26.00	5.3%	22.00	20.00	5.2%	18.00
CONSENSUS-TOTAL SPACE	**15.67**	**5.0%**	**22.00**	**18.50**	**4.8%**	**19.33**	**16.33**	**4.7%**	**17.33**
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.

The outlook for most sectors of the Greater Phoenix real estate market remains very positive. Single family housing is projected to remain strong through 2023 as is the market for apartments. The commercial market outlook is more mixed with industrial expected to show strong growth in 2022 before slowing modestly in 2023, while the office outlook is expected to experience a continued period of very slow growth in construction and absorption in both 2022 and 2023. The retail sector is also likely to continue a period of very modest growth over the next two years.

The apartment market is also facing very strong demand and a historically low level of supply at the present time. The Panel expects permits and absorption to be at a high level over the next two years, with vacancy rates remaining at historically low levels.

The office market outlook remains mixed with continued high vacancy rates expected through 2023. Spec construction is also projected to be relatively limited over the next two years, while absorption is expected to remain historically weak. The picture continues to be cloudy as the COVID-induced "work from home" phenomenon has changed how people look at returning to a pre-COVID work environment. It remains to be seen how this works out, but clearly a much higher percent of pre-COVID office workers will be working from home.

The industrial market remains extremely strong, with both new supply and absorption expected to be robust through 2023. This will cause vacancy rates to continue to fall in 2021, 2022 and 2023.

The retail market, while improving due to a stronger economy and the need for more neighborhood retail centers caused by strong single family growth, will still be tepid by historic norms. Vacancy rates are expected to decline modestly over the next two years.

Source: https://seidmaninstitute.com/greater-phoenix-blue-chip/construction/

Articles of Interest

Trepp.com – Dec. 28
Investor Interest in Commercial Properties Tops 2019 Levels

Phoenix Business Journal – Dec. 23
Kierland office building sells for $37M; 6 other Valley real estate deals to know

AZ Big Media – Dec. 20
Metrocenter Mall is getting a $750 million makeover

Phoenix Business Journal – Dec. 15
Another big year expected for industrial real estate in 2022

Globe St. – Dec. 28
On-Time Collection Rates Dropping for Mom and Pop Multifamily Landlords