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

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

January 2021

The Year Ahead in Commercial Real Estate

2020 was a challenging year for commercial real estate, although many of the effects from COVID-19 were accelerations of existing trends, as we noted in our Great Acceleration blog series. With the easing of restrictions—and the promise of achieving herd immunity through vaccinations and recovery from infections—R.O.I. Properties is optimistic that 2021 will see improvement in Greater Phoenix's economic prospects. Here's a brief overview of how we view the state of the various market sectors in the coming months:

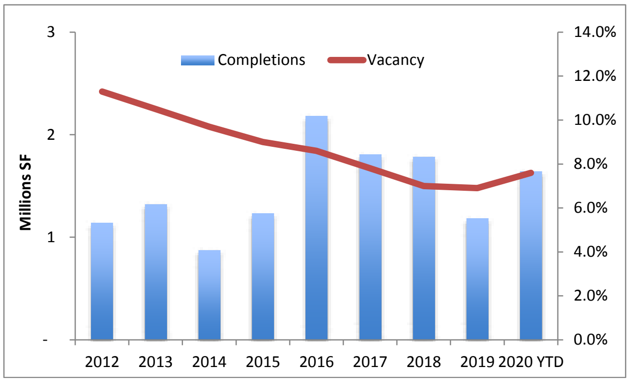
Hospitality and Entertainment. These asset classes (along with retail) were the most immediately impacted by the pandemic. From the outset, we saw a significant increase in non-performing loans and actual and potential loan defaults for loans collateralized by hotels, motels, restaurants, theaters, gyms, and just about any element of travel, hospitality and entertainment. We believe there is significant pent-up demand for travel and all forms of entertainment, and we anticipate a strong bounce back as the year evolves. In particular, the popularity of working from anywhere (WFA) will be a benefit for travelers. Long-term hotels are seeing a wave of investor interest for repurposing into other uses, such as apartments and low-income housing.

Retail. The bricks-and-mortar segment of this asset class has further struggles ahead. Online ordering offers convenience and much broader options to satisfy consumers' needs, at their fingertips. Locations that have embraced internet-based purchasing are in better shape than those with storefront-only. There are numerous success stories of internet-native retailers such as Warby Parker, Bonobos, and UNTUCKit, which are incorporating bricks-and-mortar locations into their strategies, as many consumers like to touch/feel before buying. This year is likely to see further repurposing of properties and mixed-use solutions, such as healthcare locations within neighborhood centers, special use facilities being incorporated into big-box locations, residential components incorporated into regional shopping centers, and co-working facilities incorporated into regional malls to drive retail and hospitality traffic.

Office. While the impact on office space was not immediate, as many decisions are on hold until lease renewal, we believe that this asset class will see long-term challenges. Businesses are utilizing and occupying offices differently. Less in-person presence is required, but employees and employers will still see a need for***...continued on page 3***

ARE YOU INTERESTED IN INVESTING IN COMMERCIAL PROPERTIES?
Expectations for bargain hunting should be moderated as the market recovers. Many of the asset classes have already been hit hard, and it will be a tight window if you're looking for distressed properties. 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.

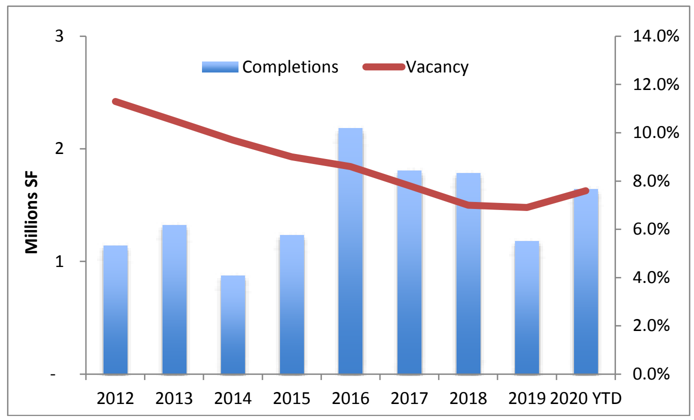
Office



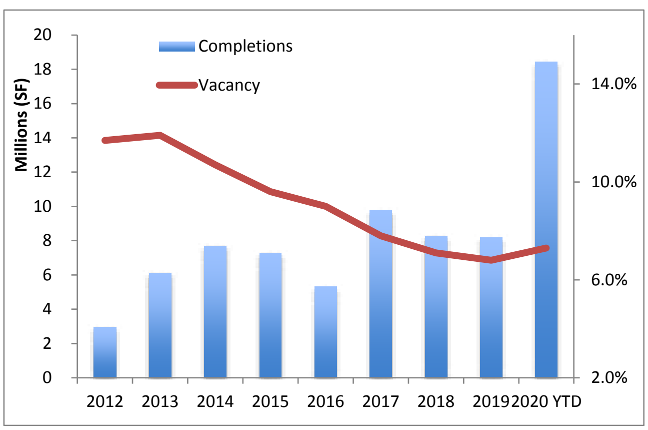
Investment activity has substantially slowed due to the pandemic. In previous quarters, investors were bullish on Phoenix, and the buyer pool expanded, with more out-of-state investors drawn to the market's comparably higher yields. Increased buyer competition had put upward pressure on pricing, and office properties have only recently approached near the previous peak pricing.—*CoStar*

Retail

There are many uncertainties about the length and depth of the disruption caused by the coronavirus. The recovery depends on an improving health situation and when people will feel comfortable revisiting crowded retail locations. Fortunately, the Phoenix retail market is in a better position than in years past, thanks to a slowdown in development. New supply has been limited to build-to-suits, mitigating supply-side risks in the near term.—*CoStar*



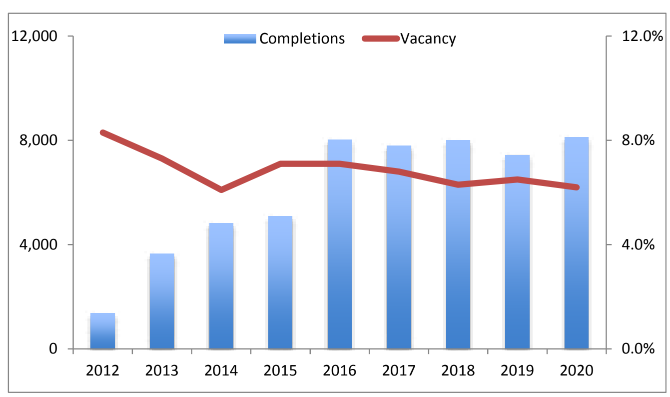
Industrial



Many companies established industrial operations in Phoenix because of the low cost of doing business and proximity to major regional markets, particularly in California. Phoenix's average industrial rent is near the National Index but is roughly 35%-40% below average rents in Los Angeles and Orange County. Investors remain bullish on the Phoenix market. Despite a respite in investment activity during the onset of the pandemic, sales volume accelerated later in 2020. Last year's sales volume approached the market high in 2019.—*CoStar*

Multifamily

Investors are bullish on Phoenix, and competition for multifamily assets has increased, especially among out-of-state buyers. The market had set new records for investment in 2018 and 2019. The pandemic set 2020 off course, but investment rebounded in the second half of the year. Pricing has surged, and cap rates have compressed below 5.5%. Despite the contraction, Phoenix still offers a 50–150-basis-point spread over California rates, which is driving yield-motivated investors to the market.—*CoStar*



Residential Snapshot

From December 2020 to January 2021, the supply-demand index rose from 402.4 to 472.7. The supply index dropped 6.2 points, while the demand index dropped 5.8 points. In the last 6 months of 2020, the increase in the overall index was primarily due to demand rising to 35% above normal. In the past 6 weeks, however, demand has begun to wane—but supply is dropping faster.

- 111,403 new listings added to the Arizona Regional MLS in 2020, which is among the lowest in 20 years.
- While new listing activity is typically strong in January through March, this January is seeing the lowest number of new listings recorded in at least 20 years, down 15.3% from the first month of 2020.
- New single-family permits were up 37% in November compared to the previous year, promising another 2,655 homes slated to be built and bringing the 2020 year-to-date total to 28,204.
- 2020 closed out the year with the second-highest number of closings through the Arizona Regional MLS for Greater Phoenix, bested only by 2005.
- The total dollar volume sold in 2005 was $30.9B; 2020 easily made the #1 historical mark at $39.8B, up 19.5% over 2019 at $33.3B, which was the previous record.

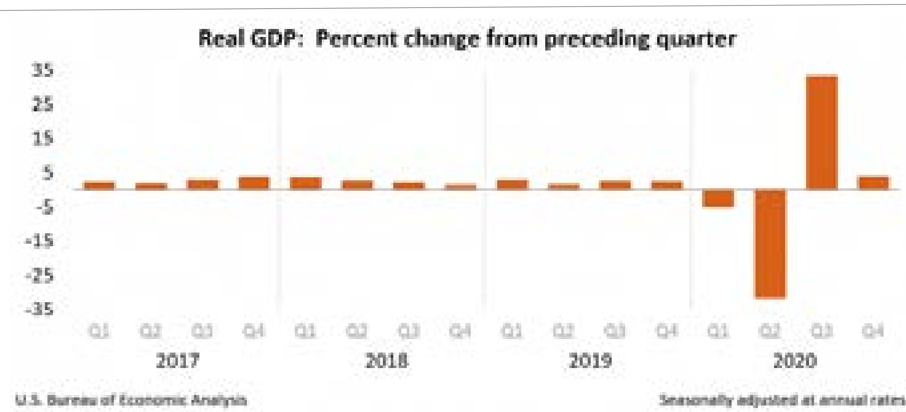
continued from page 1...collaboration, perhaps on a rotational basis, with social distancing and hygiene requirements addressed. Garden offices seem to be the highly desirable “new normal” with less “touch” common areas, etc. We believe that many employers, whether tenants or owners, will reduce the size of their footprint over time, but include more highly amenitized state-of-the-art spaces within their offices.

Industrial. This asset class shows no signs of stopping in 2021. A lot of product is under construction, particularly along the 303 and I-10. One trend to watch is so-called last-mile industrial, which caters to the need to get closer in town—today’s consumer expects everything quickly. Amazon is setting the bar high here, with distribution centers throughout the Valley.

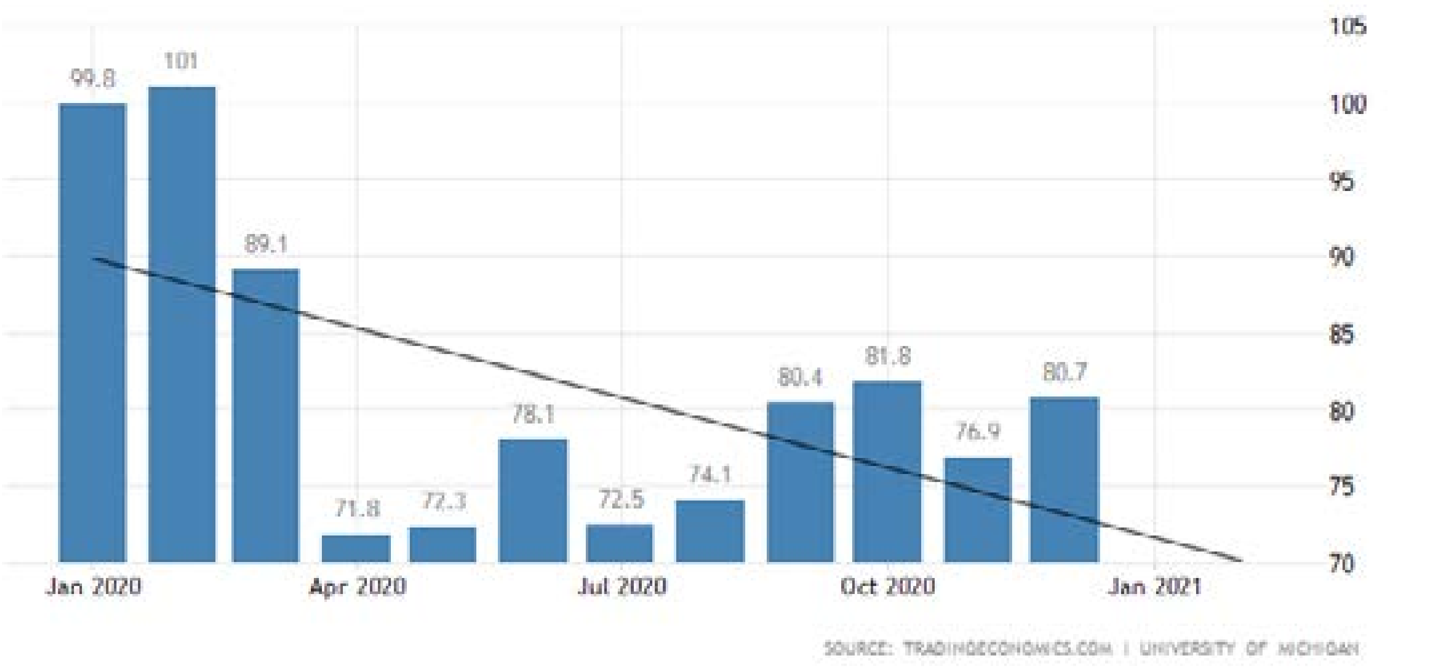
Multifamily. After going strong for several boom years, Phoenix leads the country in apartment construction. As we have cautioned previously in The Real State, the Greater Phoenix area has 20,000+/- units under construction and in the pipeline, and the market will eventually cool off. From R.O.I.’s perspective, Class A projects are the most overbuilt, but investors are still flowing in. Add it all up, and it’s difficult to predict what will happen.

Real GDP

Real gross domestic product (GDP) increased at an annual rate of 4.0% in the fourth quarter of 2020, according to the “advance” estimate released by the Bureau of Economic Analysis. In the third quarter, real GDP increased 33.4% For the year, real GDP decreased 3.5% in 2020 (from the 2019 annual level to the 2020 annual level), compared with an increase of 2.2% in 2019.



Consumer Confidence



"GDP will likely grow by 5% this year because of the additional fiscal stimulus coming from Congress... That growth rate will push the economy past its prepandemic level sometime in the middle of this year. As the pandemic recedes, consumers' savings could be used to splurge on services that people have been skipping, setting up a possible boom in that sector."

—Kiplinger Economic Forecasts, GDP: 5% Growth Likely This Year

Articles of Interest

Real Page – January 12
U.S. Apartment Demand Holds Strong in Typically Slow 4Q

GlobeSt.com – January 19
Changes Come for Retail's Distribution Model

Reuters – January 21
U.S. labor market recovery fading; housing, factories underpin economy

GlobeSt.com – January 21
$200B of Investment Capital Will Come Off of the Sidelines This Year

Trepp – January 20
COVID-19 Deals a Blow to Property Values; Hotels, Retail Properties See Biggest Drops