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

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ENHANCING REAL ESTATE ASSETS

OCTOBER 2021

Turning Up the Volume on Investment Deals in Phoenix

Led by the apartment and industrial sectors, sales of commercial real estate assets in the U.S. hit record-breaking highs in Q3 2021. A new report by PwC and the Urban Land Institute, "Emerging Trends in Real Estate," reinforces what we've seen anecdotally in the Phoenix market: We've been the beneficiary of people and businesses fleeing big cities, and the opportunity for distressed sales hasn't materialized compared to previous recessions. Even without bargains being available, the volume of investment deals in Phoenix has been strong and steady this year, not that different from before the pandemic. According to Vizzda, which tracks commercial real estate transactions, at least 14 deals exceeded $100 million in metro Phoenix between June 21 and September 21. Here's a brief overview of overall trends in various sectors.

Industrial: Phoenix ranked #5 in the U.S. for industrial construction in Q3 2021—about 25 million SF under construction. E-commerce growth, warehouse space, and supply chain needs have continued to underscore the Valley's increasing value as a regional hub. Leasing activity is tight enough that rents are on the rise and bidding wars have become more frequent. Notable sales have included the $186 million Park 303 Phase I in Glendale—which was the largest single property sale in Valley history—and $103 million Lincoln Logistics Center 40 in Goodyear.

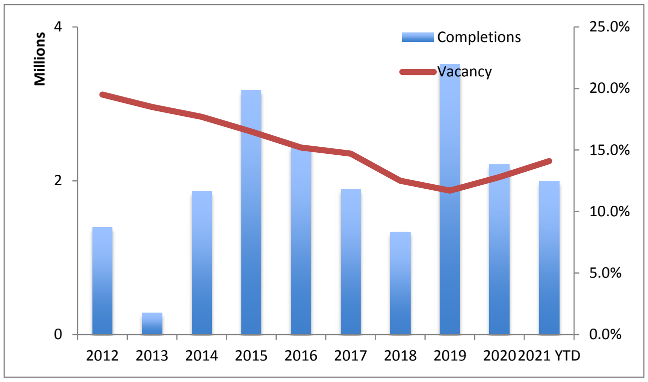
Office: Perhaps one of the biggest surprises in Q3 2021 was the volume of office properties in Phoenix that traded: $858 million. For perspective, that's 94% of the volume of investment deals posted through the first two quarters, and the YTD median price/SF is $185. Major deals included two buildings at the Rio 2100 campus near Tempe Town Lake (purchased for $132M) and the Fountainhead Office Plaza near I-10 and Fountainhead Parkway (purchased for $117.5 million).

Multifamily: The multifamily market has been active on the deal-making front in recent years, and the past few weeks have been no different. Recent high-dollar transactions have included Elliots Crossing Apartments ($136.1 million sales price, $274,949/unit); The Stewart ($124.5 million, $399,126/unit); Broadstone Grand ($106.5 million, $355,000/unit); Cyprus Apartments ($155 million, $282,846); and Oxford Apartments ($127.9 million, $296,006).

Retail: As noted in the R.O.I. Properties blog earlier this month, the retail real estate recovery keeps chugging along. An influx of new residents and businesses has driven surprising strength in retail, particularly demand for restaurants and grocery-anchored centers. A perfect example of the latter is the $18.25 million sale of Sunrise Promenade, a Peoria shopping center anchored by supermarket chain Aldi.

No matter what commercial real estate sector you are interested in investing in, the team at R.O.I. Properties can help you formulate a strategy for success. Contact us at: info@roiproperties.com or 602-319-1326.

Office



Following a long stretch of rent growth before the pandemic, office rents have stagnated more recently. Annual rent growth currently registers at 0.8%, compared to the national average of -0.4%.

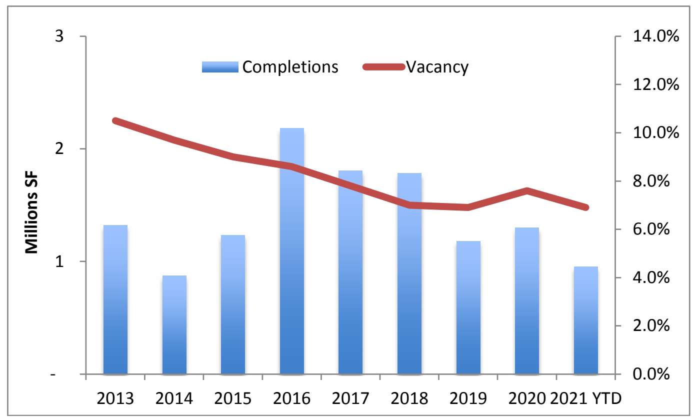
Unfavorable rent pressures will persist over the next several quarters according to CoStar's Base Case scenario, due to a rise in direct availabilities and sublease space. Sublease spaces are offered at a 10%–30% discount to direct space throughout the market. The discount varies by star rating, location, and lessor motivation. Downtown Phoenix offers some of the highest discounts due to its more than 20% availability rate.

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. San Francisco's average rent is about two and a half times that in Phoenix, and Los Angeles's is about 50% higher.

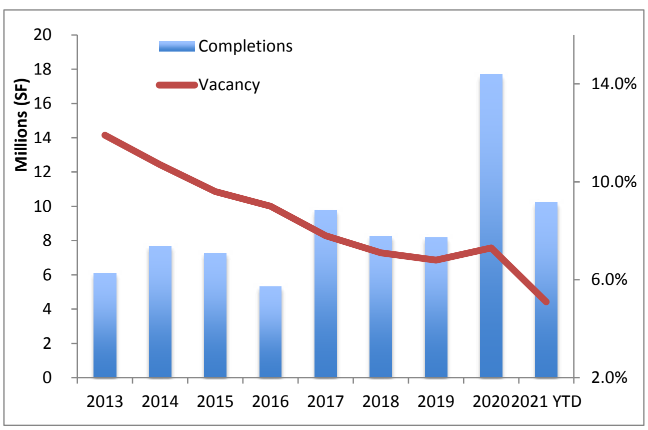
Retail

Retail sector rent growth slowed since the onset of the pandemic, following a long stretch of gains. But the pace of gains has improved over the past few months. Annual rents grew by an average of 2.9% from 2017–19, outpacing the National Index. Over the past 12 months, same-store asking rents changed by 3.4%.

Strip and neighborhood centers have realized the strongest rent growth, though still modest over the past few quarters. Malls have struggled the most; the segment has recorded measurable rent reductions over the past few quarters. Malls that have diversified their tenant bases to include more "internet-resistant" tenants such as theaters, restaurants, and even office space have fared better than malls whose main composition is apparel retailers. However, the pandemic hit many of those internet-resistant retailers the hardest due to social distancing.



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 late last year, rent growth has outpaced the U.S. average. Yet, Phoenix maintains its position as an affordable market. Rents average $9.60/SF, which is below the national average and 30%–40% below asking rents in California markets.

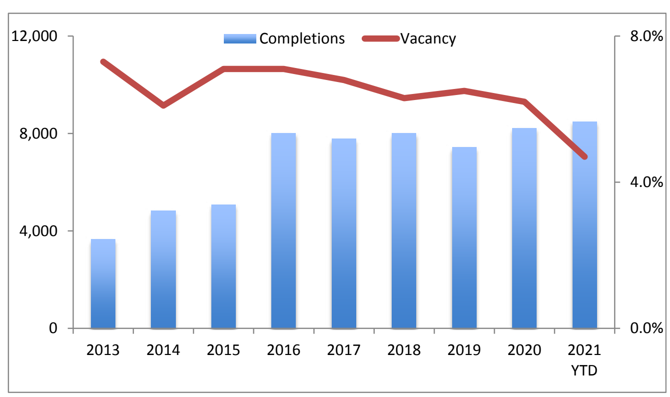
Annual rent growth has accelerated over the past few quarters to about 10.5%. Some submarkets have achieved robust rent growth, while others have lagged. High-demand and affordable submarkets are leading the market in rent growth.

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 outstripped 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.

Rents in Phoenix recovered from the COVID-19 dip faster than most large markets. A key reason for the impressive local performance was that stimulus payments went a longer way in Phoenix than they did in pricier metros.



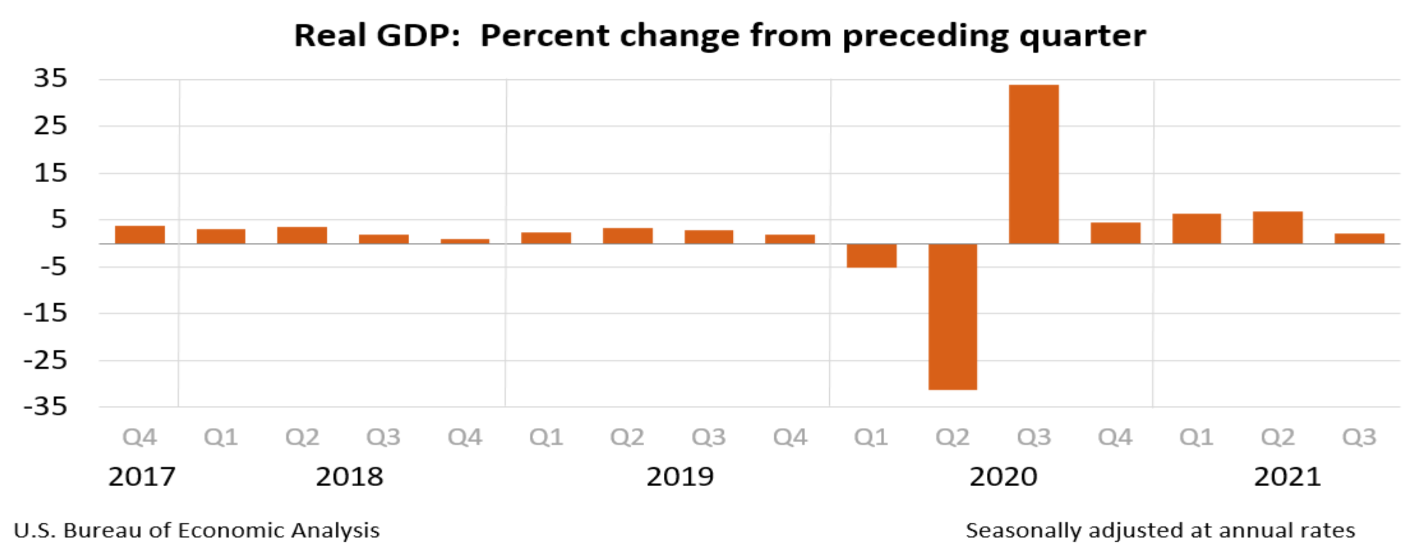
Residential Snapshot

From September to October 2021, the supply-demand index dropped 3.4 points, from 349.1 to 345.7—remaining strongly in seller's market range. Household formation measures whether independent households are consolidating or splitting off, which can cause supply to rise and fall. When this measure declines, two households consolidate into one and supply increases as one extra housing unit is left vacant. It doesn't typically see wild fluctuations, but the effects of the work-from-home movement caused it to spike nationally in 2020; since April 2021, it has declined along with affordability.

Other key residential trends we're watching:

- Q3 2021 ended with 31,049 new listings added to supply, 1.0% higher than the Q3 2020 count of 30,742. Since May 29, MLS supply has risen 59%, but total supply is still 10.2% lower than this time last year.
- The last balanced market in Greater Phoenix was in 2014 and supply in October that year was just over 23,000 listings. This week, the count is 7,387.
- Sales through the Arizona Regional MLS in Q3 2021 were 26,104, down 5.8% from the Q3 2020 count of 27,721. Listings under contract remain high seasonally, but sit 13% lower than last year.
- Metrics continue to show that the Greater Phoenix seller market has cooled, but it's far from weak. Prices are expected to continue rising (but more slowly), provided inventory levels continue at the current, extremely low levels. If inventory levels start increasing, prices will be impacted.
- There has been a subtle change in iBuyer activity lately, as they've scaled back their acquisitions to focus on selling the homes they've already accumulated. Case in point, Zillow announced they will not acquire any more homes this year, while OpenDoor and Offerpad have slowed in their acquisition rates.
- Combined, these top 3 iBuyers purchased 1,062 homes at a median of $435K and sold 605 for a median of $412K last month. They held 3,258 properties at the end of September.

REAL GDP



Greater Phoenix Blue Chip

**GREATER PHOENIX REAL ESTATE CONSENSUS FORECAST
RESIDENTIAL**

	2021				2022			
	Single-family Permits	Multi-family Permits	Apt Vacancy (Q4 %)	Apt. Absorp.	Single-family Permits	Multi-family Permits	Apt Vacancy (Q4 %)	Apt. Absorp.
CBRE	26,700	10,000	6.4%	7,000	27,000	9,500	6.0%	5,000
Colliers International	39,000	15,000	4.5%	15,500	45,000	17,000	4.0%	16,500
CRA LLC	31,500	8,000	5.5%	7,500	33,000	7,000	5.5%	7,500
Elliott D. Pollack & Co.	31,000	12,000	5.5%	10,000	32,000	10,000	5.7%	7,000
Griffin Consulting	27,500	8,750	6.2%	7,400	28,250	8,000	5.7%	7,550
Southwest Growth Partners	33,000	6,000	6.5%	6,000	33,000	6,000	6.5%	6,000
U of A, Eller College	29,952	11,767	N/A	N/A	28,699	10,931	N/A	N/A
CONSENSUS	**31,236**	**10,217**	**5.8%**	**8,900**	**32,421**	**9,776**	**5.6%**	**8,258**
Actuals From Phoenix Housing Market Letter and Various Sources:								
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
INDUSTRIAL (Millions of Square Feet)**

	2021			2022		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE*	8.00	6.2%	9.50	7.00	6.0%	9.00
Colliers International**	12.09	6.9%	10.50	13.05	6.5%	12.00
Lee & Associates*	16.50	7.0%	15.00	13.00	6.8%	13.00
CONSENSUS-TOTAL SPACE	**12.20**	**6.7%**	**11.67**	**11.02**	**6.4%**	**11.33**
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.

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

	2021			2022		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE*	0.25	8.5%	(0.10)	0.18	8.5%	0.20
Colliers International	0.51	7.9%	0.54	0.35	7.7%	0.38
CONSENSUS	**0.38**	**8.2%**	**0.22**	**0.27**	**8.1%**	**0.29**
Actuals From CBRE:						
2020 Actuals	0.00	8.0%	(0.01)			
2019 Actuals	0.02	8.0%	1.21			

* ALL SPACE OVER 30,000 SQ. FT.

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

	2021			2022		
	Spec Construction	Vacancy (Year End %)	Absorption	Spec Construction	Vacancy (Year End %)	Absorption
CBRE*	0.90	17.0%	0.39	0.89	17.5%	0.56
Colliers International*	1.46	14.1%	(0.16)	0.98	13.9%	1.00
Lee & Associates*	4.00	16.8%	(2.00)	5.00	17.0%	1.00
CONSENSUS	**2.12**	**16.0%**	**(0.59)**	**2.29**	**16.1%**	**0.85**
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.

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

“A hot housing market, component shortages and supply chain disruptions are some of the reasons inflation is likely to stay elevated. Rents rose a robust 0.5%, which may be related to the end of eviction moratoriums. It is expected that the strong rise in housing prices will eventually cause rents to rise more than usual. The current 12-month inflation rate is 5.4%. Expect it to rise to 6.1% by the end of the year. This will be the highest rate of inflation since 1990. Expect inflation in 2022 to ease to 3% as shortages fade, but that will be still be higher than the 2% yearly average from 2016 to 2019, prior to the pandemic. Stronger inflation is likely to stay with us for a while. Higher inflation could get the Federal Reserve to start raising short-term interest rates in late 2022, instead of waiting to 2023, as originally planned.”—Kiplinger Economic Forecasts, Oct. 14, “Inflation Pressures Still Lurk”

Articles of Interest

Phoenix Business Journal – Oct. 19
Phoenix metro sees bidding wars for industrial space, record-breaking construction

The Business Journals – Oct. 21
An estimated $25B in US hotel deals have transacted this year as industry sees uneven recovery

AZ Big Media – Oct. 26
Investment sales of Phoenix office properties rally despite negative net absorption

Phoenix Business Journal – Oct. 14
ULI, PwC identify top markets to watch in 2022 as real estate investment powers up

The Real Deal – Oct. 14
How commercial real estate survived the pandemic