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

R·O·I PROPERTIES®
ENHANCING REAL ESTATE ASSETS

October 2023

In the Current Environment, It's All About Financing

Deal volume is down significantly in the Greater Phoenix commercial real estate market. Transactions are still happening, but usually not with third-party financing. Instead, the trend continues to be toward seller carry-back financing, which we've discussed in several issues of *The Real State* this year. The other scenario that we are seeing more of, particularly in the multifamily sector, is the use of assumable loans/financing. Depending upon when financed and the terms, a buyer may be able to assume a loan with a rate in the neighborhood of 3%-4.5% rather than current market rates of 8%+.

In the current environment, many owners are running up against some very strict time deadlines to either refinance—which is not promising, because it adds significant cost—or to sell a property before the loan terms out. If you are a seller who is willing to carry back some money, or is fortunate enough to have assumable financing on your current loan, you have a saleable asset. If you are in a position where you have neither, and can't find some form of alternative financing, then your options are more limited. You will need to price your property on a cash-sale basis, or be prepared to lower your price.

For buyers, the situation is reversed. Cash is king, as always, and offers the smoothest route to formulate a deal. It's all about getting creative in structuring a win-win deal, which may involve the seller carrying-back financing, or checking for existing assumable financing. Be sure to explore and understand the existing financing terms on the product that that is of interest to you.

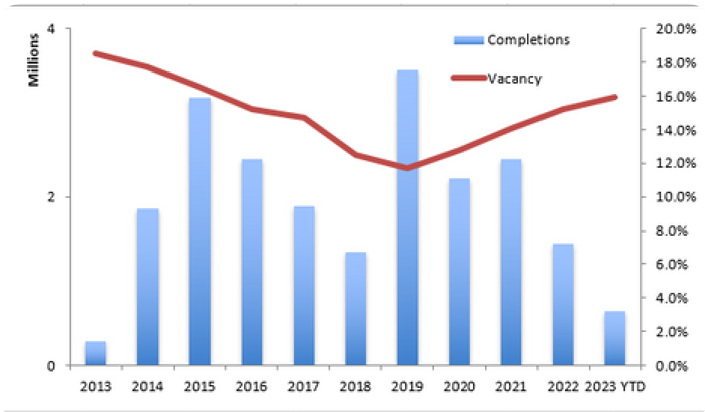
Phoenix is not alone in the challenges hitting commercial real estate, with banks pulling back on lending activity across the country. According to CoStar, loans on nonresidential properties declined 3.8% in September 2023 compared to August 2022, and an estimated $1.9 trillion in commercial real estate loans will mature in the next four years—47% of which are on bank balance sheets. While the office market remains the area of biggest concern, formerly hot markets such as industrial and multifamily are also seeing a more cautious approach from lenders. "Banks are starting to say 'We need to watch [the multifamily market], let's be more cautious about the loans and the refinancing we're doing,'" Chad Littell, national director of capital market analytics at CoStar, recently told the *Phoenix Business Journal*.

The Federal Reserve's October 2023 Financial Stability Report also struck a note of caution: "Aggregate CRE prices measured in inflation-adjusted terms continued declining through August. Capitalization rates at the time of property purchase, which measure the annual income of commercial properties relative to their prices, have increased modestly from recent historically low levels but have not increased as much as real Treasury yields, suggesting that prices remain high relative to rental income."

Let's Get Creative

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

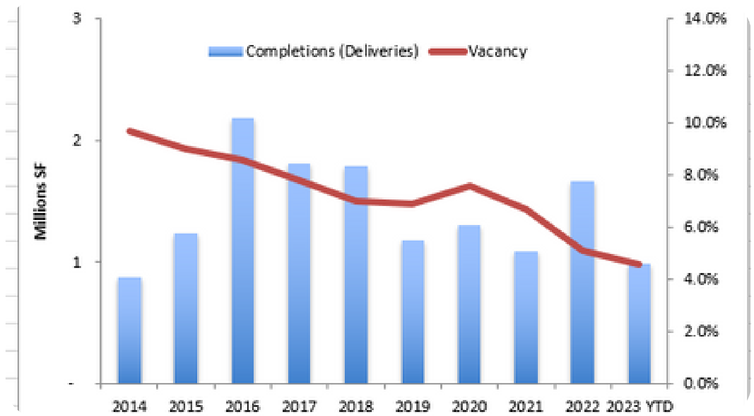


The surge in sublease availabilities further underscores the challenging environment the sector is facing. About 7.8 million SF is currently on the sublet market, up from an average of 2 million SF from 2006 to 2019. That amount represents 3.9% of the metro's total office inventory, ranking Phoenix as one of the most heavily impacted sublease markets in the country. Geographically, Chandler and Tempe have shouldered the brunt of the impact as technology and insurance firms downsize or shutter offices here.

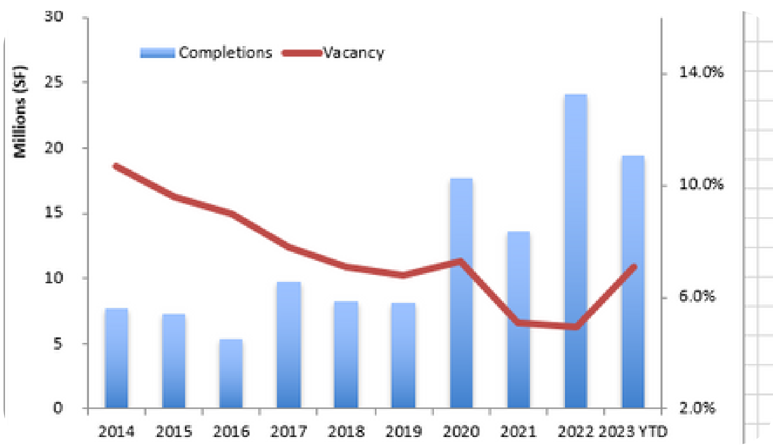
The lack of meaningful construction activity has helped avoid exacerbating the supply and demand imbalance. Developers completed just 1.1 million SF over the past 12 months and only 890,000 SF is currently underway. The bulk of the pipeline is comprised of medical properties, which have held up better than their traditional office counterparts.

Retail

The scarcity of available space has made it difficult for retailers to sign new leases as they find limited options for expansion. Though net absorption is more than 50% above the pre-COVID five-year average, actual leasing volume is about 5% lower and has been easing over the past six quarters. Instead, the primary driver for elevated absorption has been a lack of store closures. The amount of space being vacated every quarter has consistently trended downward over the past five years as strong balance sheets and healthy profit margins keep most national retailers in a fundamentally sound position. As a result, the Valley is approaching a structural bound on growth as limited existing space availabilities and a lack of speculative development restrain expansion opportunities.



Industrial

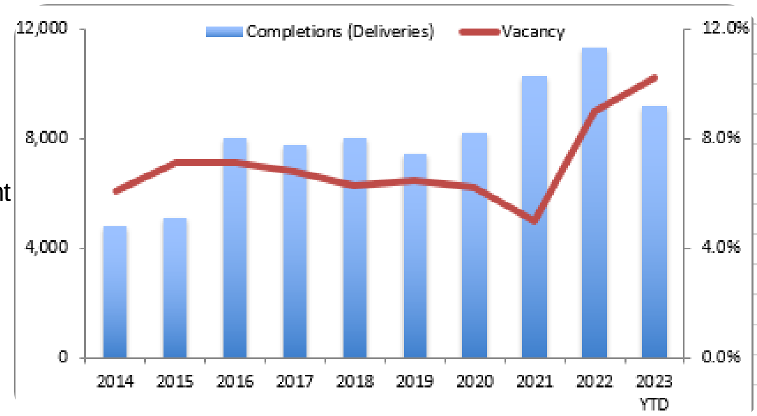


The Valley's rapidly growing consumer base, along with its critical role in national supply chains, has prompted a surge in construction activity for large, modern industrial parks that support users' distribution efforts. In addition, the high-quality labor force and business-friendly regulatory climate have made the area a top choice for advanced assembly. Several major manufacturing facilities are underway, including TSMC's $40-billion semiconductor campus in Deer Valley and Intel's $20-billion expansion of its Ocotillo chipmaking operation in Chandler.

About 48.2 million SF of industrial space is currently underway, representing 11.1% of existing inventory. That share ranks Phoenix as one of the most aggressively built industrial markets in the nation along with Savannah, GA, and Austin.

Multifamily

The effect of the construction pipeline will be felt through 2024. About 33,000 units are under construction, representing 8.7% 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 4 & 5 Star segment. The Valley's fast-growing west-side suburbs have also been a target of new development. Relative affordability and growing employment opportunities have spurred aggressive population growth in areas like Goodyear, Buckeye, Surprise, and Glendale. Builders have responded, adding more than 10,000 units to the North West Valley and South West Valley submarkets since 2020. Build-to-rent (BTR) developers have been particularly active, with more than a third of deliveries since 2020 being BTR projects, outpacing garden-style developments during that time.



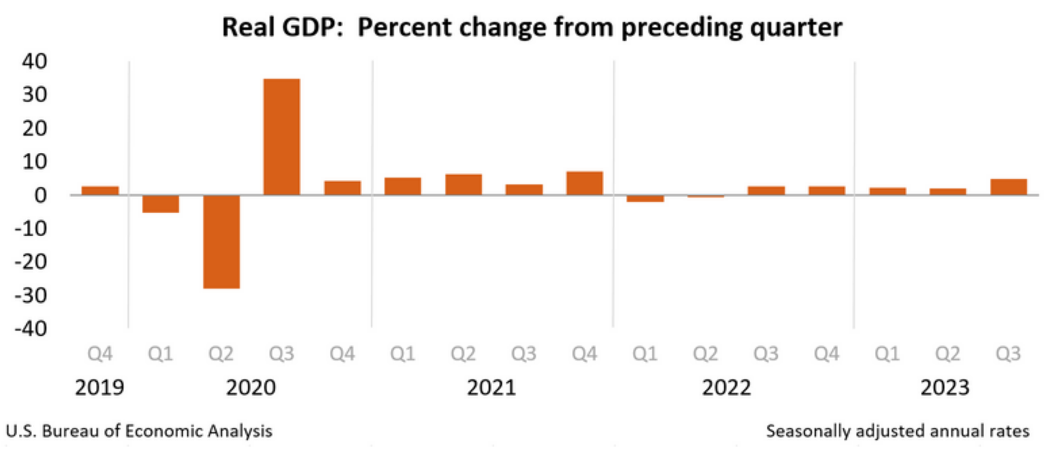
Residential Snapshot

Transaction volumes are down significantly in the Greater Phoenix residential market, with inventory growing specifically under $1 million. While we're still technically in a seller's market, it's becoming more competitive for would-be sellers. For buyers, additional inventory (and the approaching holiday season) means more choice and opportunities to negotiate, whether in some type of seller credit, rate buy-down, or requesting more meaningful reductions on the front end or once the property is in escrow. If they felt they missed their opportunity in last year's buyer's market, they may get a second chance before the end of 2023. From September to October 2023, the supply-demand index declined from 146.0 to 127.1, with the supply index rising from 51.5 to 56.9 and the demand index dropping from 75.2 to 72.3. At the current rate of decline in the overall index, Greater Phoenix could be in a balanced market by mid-November and buyer's market in December.

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

- Rising supply has taken a harder turn upwards over the past 8 weeks; some of the increase can be attributed to seasonal expectations in the luxury and 55+ housing segments.
- Demand is dropping, however, as rates jumped a full point over the past 3 months, resulting in increased days on market for sellers.
- New listings are still the lowest recorded in at least 23 years for year-to-date 2023 and month-to-date October 2023.
- As the seller's market weakens in Greater Phoenix, some may be surprised by the annual appreciation rate of 6.2%. This is primarily the result of the third-best year historically for the sale of larger, luxury and pre-luxury homes over $1M, the second-best October to date so far, and the #1 October to date for sales over $2M.
- Only homes over $1M are seeing sales prices increase more than 5% YOY, all others are either flat or up just 2-3%.

REAL GDP: Q3 2023 – ADVANCE ESTIMATE



Real gross domestic product (GDP) increased at an annual rate of 4.9 percent in the third quarter of 2023, according to the "advance" estimate released by the Bureau of Economic Analysis. In the second quarter, real GDP increased 2.1 percent.

The GDP estimate released is based on source data that are incomplete or subject to further revision by the source agency. The "second" estimate for the third quarter, based on more complete data, will be released on November 29, 2023.

Source: US Bureau of Economic Analysis

WESTERN BLUE CHIP ECONOMIC FORECAST - 2024

	CURRENT $ PERSONAL INCOME	RETAIL SALES	WAGE & SALARY EMPLOYMENT	POPULATION GROWTH	SINGLE FAMILY HOUSING PERMITS
ARIZONA	4.6%	3.3%	1.8%	1.3%	7.8%
CALIFORNIA	3.3%	2.9%	0.9%	0.2%	8.0%
COLORADO	4.8%	3.1%	1.2%	0.9%	13.8%
IDAHO	6.2%	4.6%	2.6%	1.5%	12.9%
MONTANA	4.5%	1.0%	1.0%	1.0%	15.0%
NEVADA	4.8%		2.8%	1.5%	4.0%
NEW MEXICO	4.3%		1.1%	0.3%	16.4%
OREGON	4.5%		1.5%	0.5%	15.0%
TEXAS	4.7%	4.1%	2.4%	1.4%	9.2%
UTAH	5.9%	3.7%	2.6%	1.5%	11.5%
WASHINGTON	4.5%	1.6%	1.4%	0.8%	22.3%
WYOMING	4.5%	2.5%	1.3%	0.3%	10.0%

Retail Sales forecasts are replaced by Gross Gaming Revenue for Nevada, and Manufacturing Employment for New Mexico and Oregon, in their respective state-specific forecasts.

The adjacent table displays the 2024 consensus forecast (expressed in terms of annual growth percentage changes) in 12 Western states, on October 16, 2023.

Source: Western Blue Chip Economic Forecast

Articles of Interest

Globe St. – Oct. 24
The Fed Says CRE Valuations Are Still Elevated

Globe St. – Oct. 25
Markets That Might Feel Multifamily Construction Glut the Most

Globe St. - Oct. 26
Multifamily's Sudden Jump in Maturity Defaults

CoStar - Oct. 26
A World Series Commercial Real Estate Showdown

AZ Big Media – Oct. 18
Will water and capital concerns cool white-hot industrial market?

Phoenix Business Journal – Oct. 18
Banks have pulled back from office real estate but no CRE sector 'will be spared'

Phoenix Business Journal – Oct. 30
Retail leasing gains strength in Phoenix, driving vacancy rate to record low