Market Insights

Greater Phoenix Multifamily 3Q 2022

Northmarq

Construction Activity

31,063
Units under construction

9,695
Units delivered (YTD)

Market Fundamentals

5.8%
Vacancy

+180bps | Year over year change

$1,652
Asking Rent

+7.1% | Year over year change

Transaction Activity

$295,900
Median sales price per unit (YTD)

Softer Multifamily Conditions Despite Continued Job Gains

Highlights

- While the local economy is still growing at a steady pace, operating conditions in the Phoenix multifamily market cooled in recent months. Future growth drivers remain healthy, and current property fundamentals are stronger than the market's long-term averages.
- Vacancy rose 40 basis points in the third quarter, reaching 5.8 percent. The rate is up 180 basis points after reaching an all-time low one year ago.
- For the first time in more than a decade, rents inched lower in the third quarter, dipping 0.5 percent to $1,652 per month. Despite the minimal quarterly decline, current rents are up 7.1 percent year over year.
- The investment market softened during the third quarter as interest rates pushed higher. Cap rates rose, averaging 4.25 percent, while the number of property sales slowed.

Phoenix Multifamily Market Overview

After an extended upswing that resulted in local vacancy rates hitting all-time lows, and rents surging higher at one of the fastest rates in the country, property performance in the Phoenix multifamily market has begun to cool in recent quarters. While recent metrics indicate a change of direction in the market, current conditions remain fairly consistent with the Phoenix region's long-term supply and demand balance. Vacancies have risen in each of the past four quarters, and the rate advanced 40 basis points in the past three months. Average rents dipped for the first time in more than a decade, following several periods of rapid gains. For at least the past year, operators have leveraged very tight occupancy conditions and strong absorption levels to push rents higher; during the third quarter, the market began to show signs that a plateau for market rents may have been reached, at least in some of the region's more expensive submarkets.

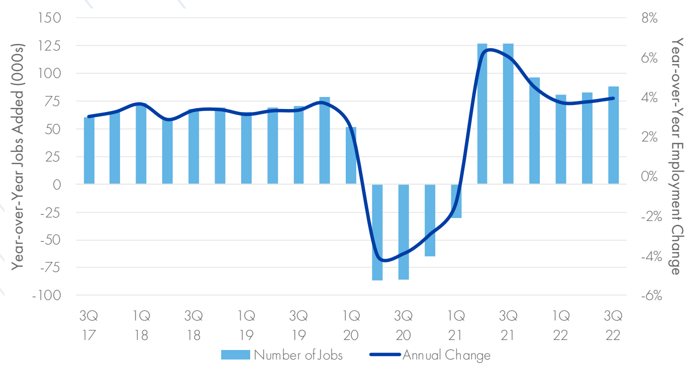
The investment market responded to continued increases in interest rates by slowing a bit during the third quarter. Sales velocity was elevated during the first half of the year but retreated by approximately 40 percent from the second quarter to the third quarter. Transactions still closed—and generally, at elevated prices—but a widening expectations gap between buyers and sellers hindered some transactions. The greatest disruption in the investment market is being recorded in Class C properties, which accounted for nearly half of the total transactions in the first half but represented about 35 percent of sales in the third quarter. Investors are demonstrating a preference for higher-quality properties, following several periods of acquiring older assets with low rents and implementing value-add strategies. Cap rates are trending higher. During the third quarter, the average cap rate was approximately 4.25 percent, up from 3.5 percent in the first half of the year.

Employment

- The employment market in Phoenix has remained strong and continues to expand at a rapid pace. During the past 12 months, area employers have added nearly 88,000 workers to payrolls, a growth rate of 3.9 percent. Growth in the third quarter was particularly robust with a gain of approximately 25,000 jobs.
- Gains in the education and health services sector are being fueled by the Phoenix area's rapid population growth. Year over year through the third quarter, the sector has posted a growth rate of 5.9 percent with a net increase of more than 17,000 new jobs.
- In the past few years, Taiwan Semiconductor and Intel have announced plans for thousands of new jobs and billions of dollars in capital expenditures for semiconductor manufacturing facilities. In addition to these projects, more than a dozen related companies have announced expansion plans, moves that will bring nearly 6,000 net jobs to the Greater Phoenix region.
- **Forecast:** Employers in Phoenix are forecast to add approximately 80,000 jobs in 2022, after nearly 100,000 positions were added as the economy recovered last year. Growth will total more than 3.5 percent, slightly higher than the market's average pace of expansion in the years leading up to the COVID-19 period.

> During the past 12 months, employers added nearly 88,000 workers.

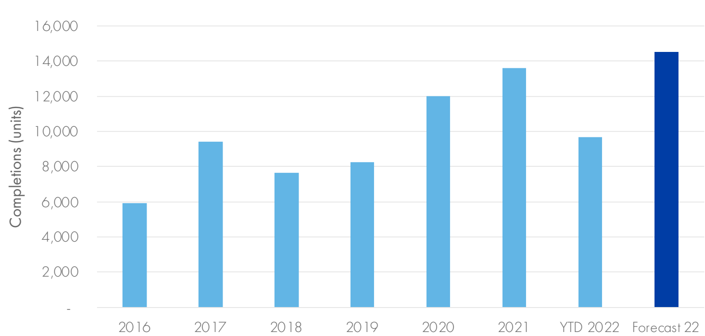
Employment Overview



Sources: Northmarq, Bureau of Labor Statistics

> Multifamily developers delivered more than 4,000 units in the third quarter.

Development Trends



Sources: Northmarq, Apartment Insights

Development and Permitting

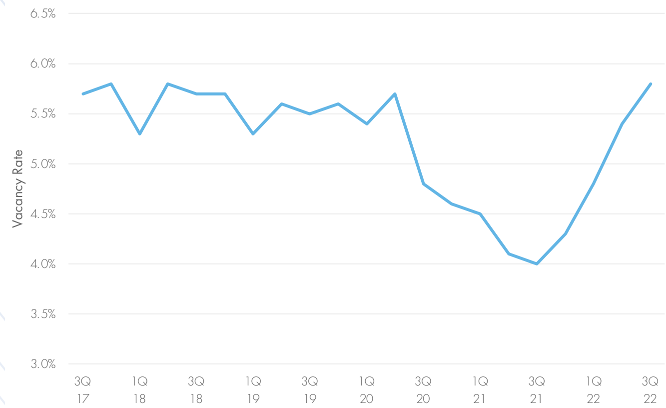
- Multifamily developers have remained active, delivering more than 4,000 units in the third quarter. Year to date, nearly 9,700 units have been completed; deliveries through the first three quarters of this year are about 20 percent ahead of the 2021 pace.
- Projects continue to move into the construction pipeline. As of the third quarter, apartment developments totaling more than 31,000 units were under construction, compared to approximately 25,000 units that were under way one year ago. The North Tempe submarket accounts for more than 10 percent of all units that are currently under construction.
- After closely tracking 2021 levels during the first half of the year, the pace of multifamily permitting issuance accelerated during the third quarter. Developers have pulled permits for approximately 12,000 multifamily units year to date, up 18 percent from the same period in 2021.
- **Forecast:** Developers are on pace to deliver approximately 14,500 rental units this year, about 7 percent higher than the 2021 total. Construction is forecast to remain elevated for the next few years.

Vacancy

- Vacancy in Phoenix rose 40 basis points during the third quarter, reaching 5.8 percent. The rate has ticked higher in each of the past four quarters, reversing a trend that began in mid-2020 when the rate fell for five consecutive periods.
- Year over year, the local vacancy rate has increased by 180 basis points. Current vacancy levels are similar to rates recorded from 2017 through the middle of 2020. Only two submarkets in the metro area recorded annual vacancy declines through the third quarter.
- Vacancy in Class A units ended the third quarter at 6.3 percent, 190 basis points higher than one year earlier. The rate in the top tier has averaged 5.8 percent since 2020 but has peaked as high as 8.6 percent.
- **Forecast:** Vacancy is forecast to hold steady in the fourth quarter, and the rate should end the year at 5.8 percent. This would mark the first vacancy increase in a calendar year since 2016.

> "Vacancy in Class A units ended the third quarter at 6.3 percent.

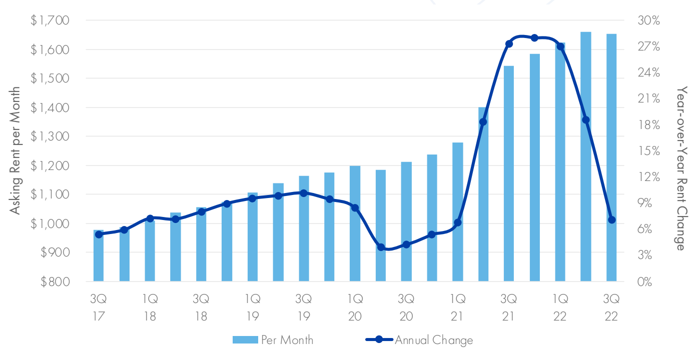
Vacancy Trends



Sources: NorthMarq, Apartment Insights

> "In the 12-month period ending in the third quarter, rents rose 7.1 percent.

Rent Trends



Sources: Northmarq, Apartment Insights

Rents

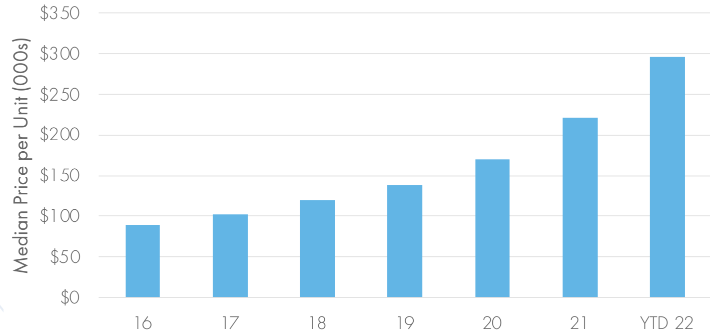
- After several periods of rapid growth, rents recorded their first quarterly decline in more than a decade during the third quarter. Average rents ticked down 0.5 percent during the past three months to $1,652 per month. This followed an increase of nearly 5 percent recorded in the first half of this year.
- Annual rent growth averaged more than 20 percent for more than a year, but the rate of gains has slowed to a more sustainable pace. In the 12-month period ending in the third quarter, rents in the region rose 7.1 percent, with average rents advancing by approximately $110 per month.
- While the pace of rent growth has cooled in recent months, there are several submarkets where rents have continued to post double-digit percentage gains. Close-in submarkets north of Downtown Phoenix posted average rent increases of nearly 15 percent in the past year. In several suburban submarkets, annual growth rates have averaged about 5.5 percent.
- **Forecast:** Continued additions in the local labor market should allow vacancy rates to level off and drive some additional rent increases in the final three months of 2022. For the full year, rents are forecast to rise 5.7 percent, ending 2022 at approximately $1,675 per month.

Multifamily Sales

- After increasing during the first half of the year, sales activity cooled in recent months, as buyers and sellers adjusted to the new lending environment. Transaction counts fell 40 percent from the second quarter to the third quarter. Total sales velocity year to date is down 14 percent from the same period in 2022.
- Prices ticked lower in the third quarter, but levels remain considerably higher than in recent years. The median price in the third quarter was approximately $274,000 per unit. Year to date, the median price is $295,900 per unit, 34 percent higher than the 2021 median price.
- Cap rates averaged about 3.5 percent in the first half of 2022 but have crept higher in recent months. The average cap rate in deals that closed in the third quarter was approximately 4.25 percent, with some properties trading at cap rates above 5 percent toward the end of the quarter.

> Year to date, the median price is $295,900 per unit.

Investment Trends



Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

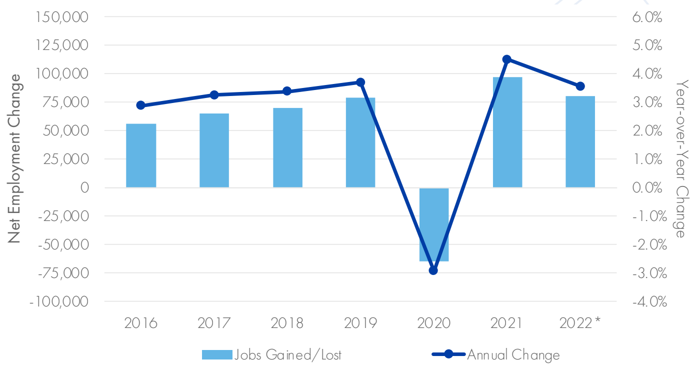
Property Name	Street Address	Units	Sales Price	Price/Unit
Skywater at Town Lake	601 W Rio Salado Pky., Tempe	328	$160,000,000	$487,805
Tempe Metro	1811 E Apache Blvd., Tempe	408	$134,000,000	$328,431
Colter Park	909 W Colter St., Phoenix	386	$81,000,000	$209,845
The Residences of Central Phoenix	2020 W Glendale Ave., Phoenix	265	$63,070,000	$238,000
Sonoma Valley	975 S Royal Palm Rd., Apache Junction	176	$44,500,000	$252,841

Looking Ahead

The Phoenix multifamily market is forecast to remain active through the remainder of this year and into 2023. Renter demand for apartment units is expected to be fueled by a local employment market that is showing no signs of letting up and has been accelerating in recent months. Longer term, growth will be propelled by massive semiconductor plants opening in Chandler and Northwest Phoenix for Intel and Taiwan Semiconductor, respectively. These facilities are both scheduled to be operational beginning in 2024 and will result in thousands of direct and indirect jobs. On the supply side, multifamily developers are expected to remain active at least for the next few years. The number of units under construction has been trending higher, and multifamily permitting levels are on the rise. The rapid growth in both supply and demand could result in some quarterly volatility in vacancy levels.

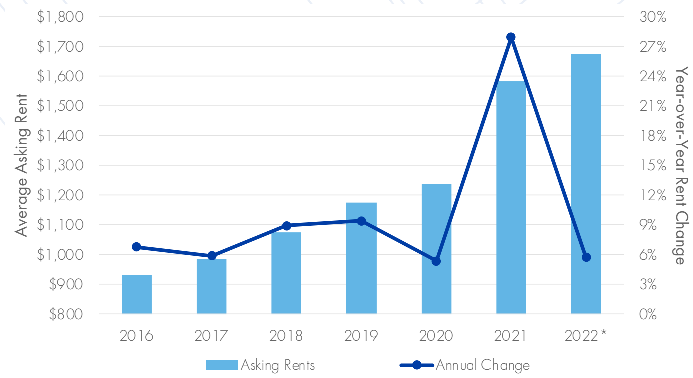
The local investment market got off to a very strong start to 2022, with transaction activity in the first half ahead of the record-setting pace established in the prior year. That momentum was paused in the third quarter, as buyers and sellers adjusted expectations to the new financing climate. There is a consensus that cap rates will push higher, but it may take a few more months to determine the new market equilibrium. During the third quarter, cap rates rose about 75 basis points on average, and there will likely be further increases in the final few months of the year. Two additional factors will likely influence the ultimate pace of cap rate rises: the strength of absorption of units and the rate of rent increases. Prior to the third quarter, renter demand was strong enough to support rapid rent increases, offsetting some of the impact of rising interest rates. If absorption accelerates, rent growth could follow.

Employment Forecast



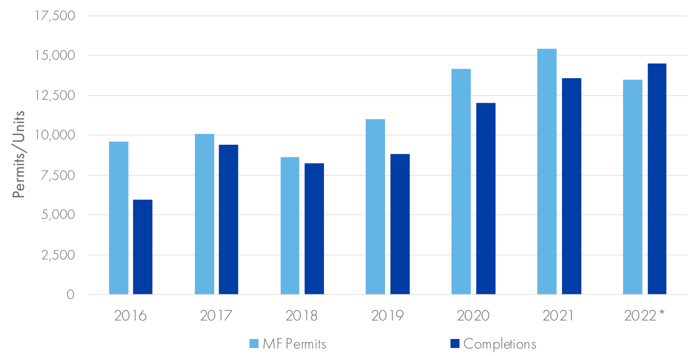
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

Rent Forecast



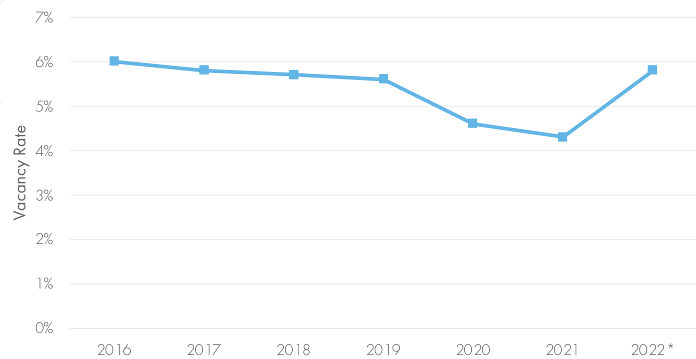
* Year End Forecast
Sources: Northmarq, Apartment Insights

Construction & Permitting Forecast



* Year End Forecast
Sources: Northmarq, Census Bureau, Apartment Insights

Vacancy Forecast



* Year End Forecast
Sources: Northmarq, Apartment Insights

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