Northmarq

MARKET INSIGHTS

Investment activity accelerates, still lags earlier levels

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	40,566
UNITS DELIVERED	10,447

MARKET FUNDAMENTALS

VACANCY RATE	7.0%
YEAR-OVER-YEAR CHANGE	+120bps
ASKING RENTS	$1,607
YEAR-OVER-YEAR CHANGE	-2.7%

TRANSACTION ACTIVITY (YTD)

MEDIAN SALES PRICE	$264,700

Phoenix Multifamily

3Q 2023

HIGHLIGHTS

- Construction has been elevated throughout 2023 in the Phoenix multifamily market, a trend that continued in the third quarter. Renter demand has gained momentum year to date, offsetting some of the supply-side pressures in the region.
- Vacancy rose 30 basis points in the third quarter, duplicating the increase that occurred during the second quarter. The rate has increased 120 basis points in the past 12 months, ending the third quarter at 7 percent.
- Rents dipped in recent months, dropping to $1,607 per month. Average rents in the Greater Phoenix market are down 2.7 percent year over year.
- Investment activity to this point in 2023 has been limited, but transactions picked up in recent months, particularly among newer assets. Year to date, the median price reached $264,700 per unit.

PHOENIX MULTIFAMILY MARKET OVERVIEW

The Greater Phoenix multifamily market recorded softening operational conditions during the third quarter, with vacancies rising and rents inching lower. The challenges are almost entirely supply-driven, as net absorption has been consistently strong, topping 3,200 units during the third quarter and exceeding 10,000 units year to date. Still, completions have outpaced new demand, driving vacancies from all-time lows closer to longer-term averages recorded in prior cycles. Development has been widespread throughout much of Maricopa County, and vacancies have pushed higher in nearly every submarket in the region during the past year. Rent trends have been more inconsistent, generally remaining flat in submarkets where overall rents are lower, while contracting more significantly in parts of the Valley that have received the greatest competitive impact from new supply growth.

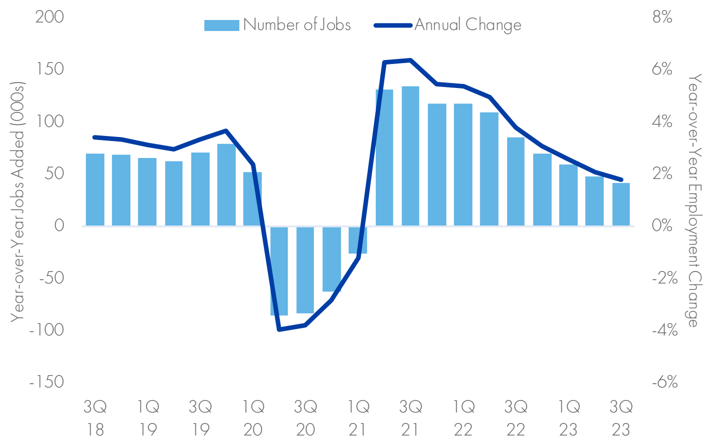
Phoenix has been a leading market for multifamily investment during the past several years, but transactions have slowed considerably to this point in 2023. There was some momentum generated during the third quarter, with the number of transactions that closed in the past three months nearly doubling levels from the previous quarter. Still, year-to-date transaction volume is about 75 percent behind the pace established in 2022. One factor that is beginning to thaw the investment market is a rise in cap rates. In recent months, cap rates have averaged approximately 5.25 percent, although there are many transactions that are closing with cap rates between 5.5 percent and 6 percent. Another recent trend is increasing activity among newer assets, which drove sales prices higher in recent months. More than half of the properties that sold during the third quarter involved properties that were delivered in 2020 or later.

EMPLOYMENT

- The pace of local employment growth has gradually cooled in recent periods, but the local economy continues to expand. Year over year, employers have added 42,300 net new jobs in the Phoenix area, a 1.8 percent rate of growth. Last year at this time, growth rates were averaging more than 3.7 percent.
- A growing population and an expanding residential housing pipeline have supported significant payroll additions across the construction sector. Total construction employment is up 5 percent in the past 12 months with the addition of more than 7,500 new jobs. Construction has been a steady source of growth over the long term; during the past decade, gains have averaged 5.6 percent per year, and more than 65,000 construction jobs have been added.
- The financial activities sector continues to expand in the Phoenix area, even as the pace of growth in other white-collar sectors cools. During the past 12 months, financial employment has grown by 2.1 percent with the addition of 4,500 net new jobs.
- **FORECAST:** Employers are on pace to add approximately 45,000 jobs in Phoenix this year, a 2.1 percent rate of growth.

Employers are on pace to add 45,000 jobs this year.

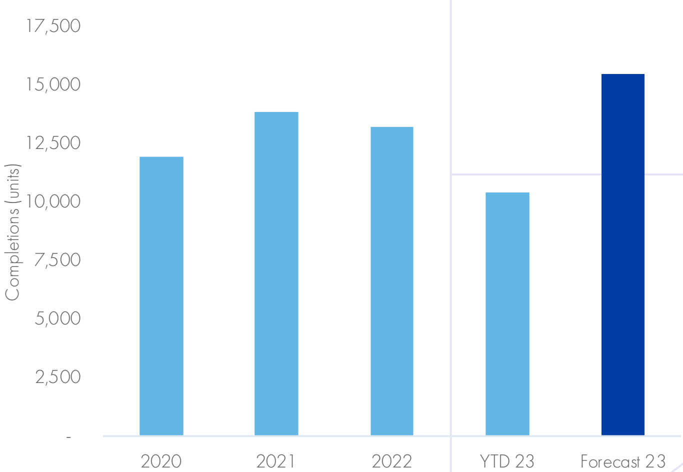
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

Multifamily permitting has declined from peak levels but remains active.

DEVELOPMENT TRENDS



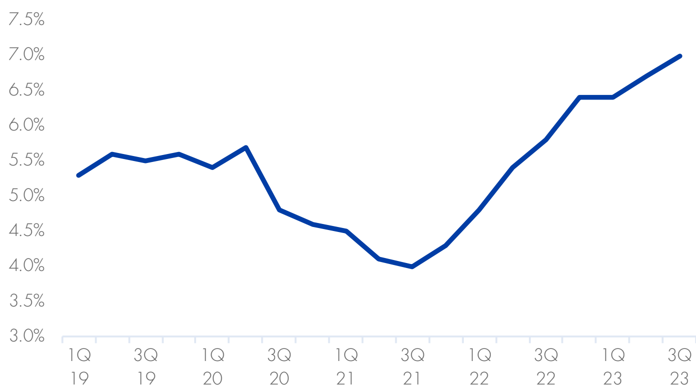
Sources: Northmarq, Apartment Insights

DEVELOPMENT & PERMITTING

- After more than 4,500 units were delivered during the second quarter, the pace of completions slowed modestly in recent months. Developers brought approximately 3,350 units online in the third quarter. Year to date, nearly 10,500 multifamily rental units have been completed, up 8 percent from the same period in 2022.
- Projects totaling more than 40,500 units were under construction at the end of the third quarter, 31 percent higher than the total one year ago. Developers are active throughout the Phoenix region, with the Goodyear/Avondale submarket leading the way with more than 8,000 units currently under construction.
- Multifamily permitting has declined from peak levels but remains elevated. Year to date through the third quarter, developers have pulled permits for approximately 12,500 multifamily units, down 8 percent from the same period in 2022. In recent years, the fourth quarter has accounted for the highest volume of permitting, but the pace is forecast to cool in the final few months of 2023.
- **FORECAST:** Developers are on pace to deliver approximately 15,000 new rental units to the market in 2023. This will mark an escalation in the pace of deliveries, following three consecutive years of elevated levels of new construction. Since 2020, completions in Greater Phoenix have averaged approximately 13,000 units per year.

Vacancy ended the third quarter at 7 percent.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

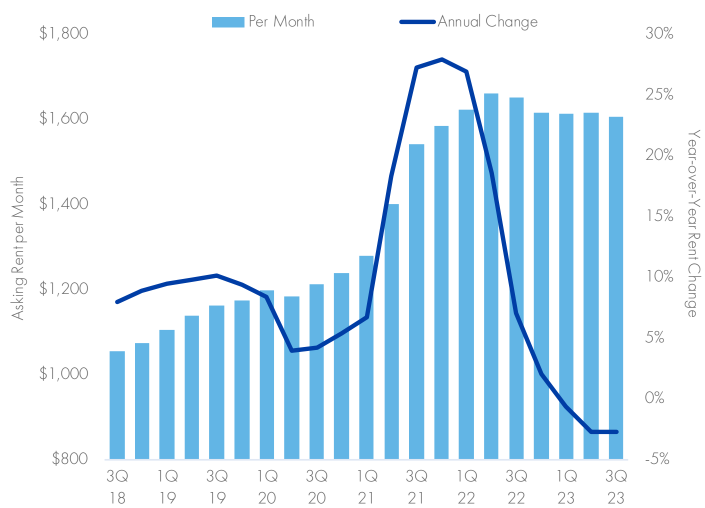
- Vacancy rose 30 basis points to 7 percent during the third quarter, and the rate has pushed higher in seven of the past eight quarters. The 30-basis point decline in the third quarter mirrored the increase that was recorded in the second quarter.
- During the past 12 months, area vacancy has increased by 120 basis points. The current rate is the highest quarterly figure in the region since the end of 2013.
- While vacancy has trended higher across most parts of the Greater Phoenix region, submarkets located in some of the market's largest employment corridors are posting tighter conditions. The South Scottsdale, North Tempe, North Scottsdale and Deer Valley/North Peoria submarkets all have vacancy rates of 6.5 percent or lower, and annual vacancy increases in these areas have averaged just 30 basis points.
- **FORECAST:** Vacancy will likely inch higher in the final few months of 2023. The rate is forecast to end the year at 7.2 percent, 80 basis points higher than one year earlier. Prior to the all-time lows reached in recent years, vacancy in Phoenix averaged about 6.3 percent from 2012 to 2019.

RENTS

- After holding steady in recent periods, rents softened in recent months. Average rents dipped 0.6 percent during the third quarter, dropping to $1,607 per month. Current rents are 2.7 percent lower than one year ago.
- Class A rents recorded the steepest declines, falling 1.6 percent during the third quarter to an average of $2,644 per month. Class A rents have dropped 8.5 percent from their 2022 peak, but are down just 2 percent year over year.
- Rents have contracted throughout Greater Phoenix, although the submarkets with the lowest average rents are generally recording more modest declines. In some segments of the market such as Tempe, Chandler, and Gilbert, where rents are high and there has been a significant amount of competition from new product, rents have declined between 3.5 percent and 5.5 percent over the past year.
- **FORECAST:** Rents are expected to finish this year nearly identical to levels posted at the end of 2022. Average rents should total approximately $1,620 per month at the end of the fourth quarter.

Average rents dipped to $1,607 per month.

RENT TRENDS



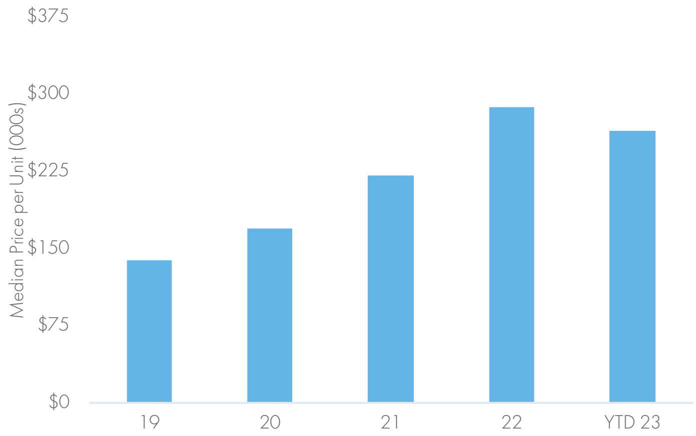
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- Sales velocity accelerated during the third quarter, nearly doubling the total number of transactions that closed in the second quarter. Despite the recent rise, year-to-date investment volume is down about 75 percent from the same period in 2022. Sales in the third quarter were down 57 percent from the third quarter of last year.
- Sales activity in newer properties accelerated in the third quarter. Multifamily complexes built since 2020 accounted for more than 60 percent of transactions in the last three months, up from 20 percent of sales during the first half.
- Year to date, the median price has reached $264,700 per unit, down 8 percent from the median price in 2022. Much of the price decline can be attributed to cap rates, which began trending higher in the second half of last year.
- As activity picked up in the sales of newer assets, prices pushed higher in the third quarter. Several properties changed hands at prices in excess of $300,000 per unit in recent months, with a few sales topping $450,000 per unit. The median price in all sales the closed in the third quarter was $289,900 per unit.
- Cap rates showed signs of leveling off during the third quarter. Recent cap rates have averaged approximately 5.25 percent, although many assets are trading with cap rates between 5.5 percent and 6 percent. A few Class A properties have changed hands with cap rates below 5 percent in recent months.

Recent cap rates have averaged approximately 5.25 percent.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

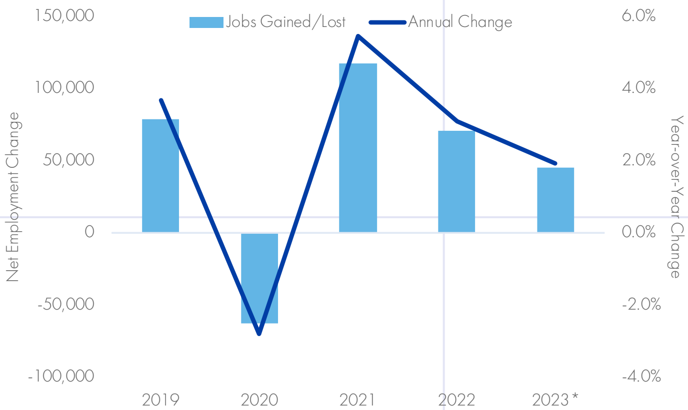
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
District at Scottsdale	15446 N Greenway Hayden Loop, Scottsdale	332	$161,500,000	$484,446
Arcadia Cove	2252 N 44th St., Phoenix	432	$130,500,000	$302,083
Aiya	2350 S Wade Rd., Gilbert	360	$112,000,000	$311,111
Sunset View	2323 N 150th Dr., Goodyear	286	$61,000,000	$213,287
Obsidian on 85th	10860 N 85th Ave., Peoria	100	$18,500,000	$185,000

LOOKING AHEAD

The Phoenix multifamily market will continue to be fueled by the pace of new construction and the volume of net absorption in the coming quarters. To this point in the year, deliveries of new units have been elevated but have not reached extreme levels, running about 8 percent ahead of the pace recorded in 2022. Renter demand has been considerably stronger than the year-earlier pace, although it will be difficult to sustain a steep upward trend in absorption if the pace of hiring retreats from earlier peaks. The final few months of this year and the early part of 2024 should result in the market finding a new equilibrium. Vacancies will likely remain in the low- to mid-7 percent range, similar to longer-term Phoenix averages prior to recent volatility. Rents, which spiked a few years ago, are forecast to hold steady near current figures, as operators strive to retain renters in an increasingly competitive leasing environment.

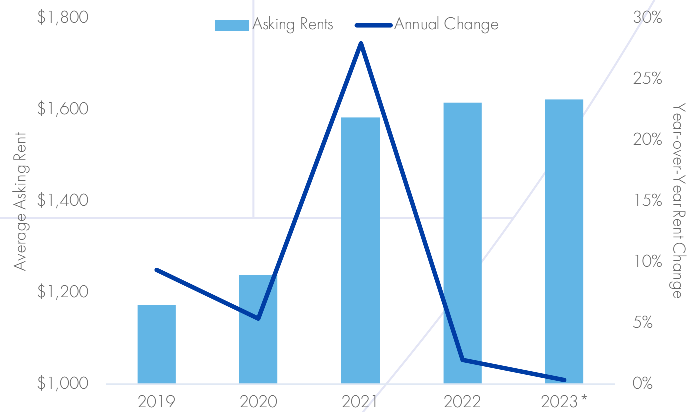
Local investment activity levels have bounced off of recent lows, but the investment market is not expected to fully rebound in the next few quarters. A pricing disconnect between owners and would-be buyers still exists, with each side of a potential transaction expecting some market movement in their direction. To this point, there has been some softening in operations, but the warnings calling for extreme weakening have missed the mark. As such, the investors that were anticipating opportunities brought on by steep price declines have not been able to deploy capital. Investors will likely remain in wait-and-see mode for a few more quarters, particularly as the current interest rate environment is offering little clarity in the near term but is expected to find a more stable plateau beginning in 2024. Once the uncertainty surrounding interest rates lifts, cap rates should settle in at a range that buyers and sellers can agree on.

EMPLOYMENT FORECAST



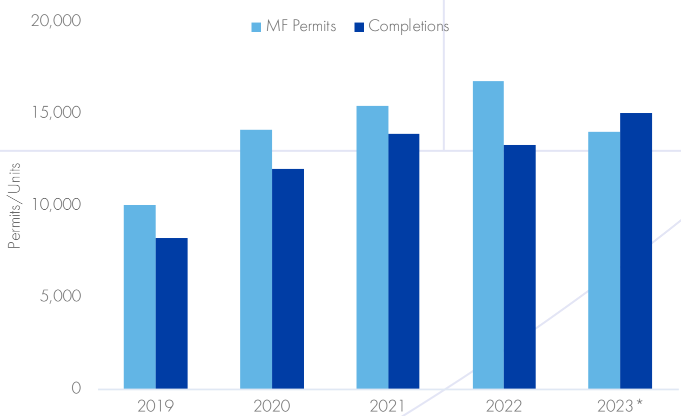
** Year End Forecast*
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



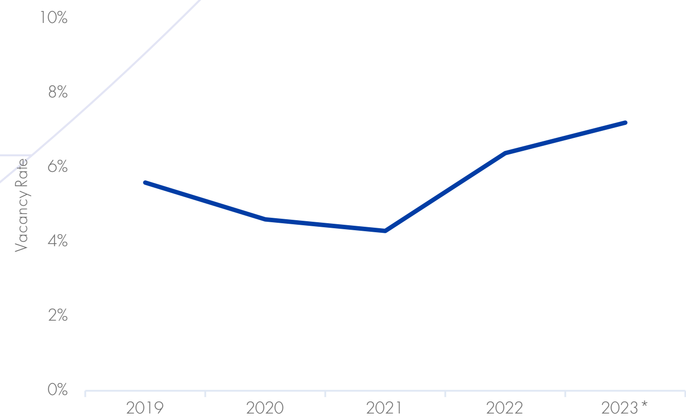
** Year End Forecast*
Sources: Northmarq, Apartment Insights

CONSTRUCTION & PERMITTING FORECAST



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

VACANCY FORECAST



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

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