Northmarq

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	42,767
UNITS DELIVERED	15,043

MARKET FUNDAMENTALS

VACANCY RATE	7.4%
YEAR-OVER-YEAR CHANGE	+100bps
ASKING RENTS	$1,575
YEAR-OVER-YEAR CHANGE	-2.5%

TRANSACTION ACTIVITY (YTD)

MEDIAN SALES PRICE	$270,300

Phoenix Multifamily
4Q 2023

MARKET INSIGHTS

Deliveries picking up, likely to accelerate in 2024

HIGHLIGHTS

- An active pace of new apartment construction dragged on property performance in 2023, despite healthy renter demand for units. With the development pipeline totaling more than 42,700 units under construction, supply-side pressures will persist through 2024.
- Vacancy pushed higher throughout much of 2023; during the fourth quarter, the rate rose 40 basis points to 7.4 percent. For the full year, vacancy rose 100 basis points.
- After mostly holding steady in the first half, rents retreated in the final six months of 2023. Rents ended the year at $1,575 per month, down 2.5 percent from one year earlier.
- The investment market picked up slightly during the fourth quarter, but transaction volumes were down 68 percent from 2022 to 2023. Prices ticked lower to $270,300 per unit, while cap rates averaged 5.25 percent.

PHOENIX MULTIFAMILY MARKET OVERVIEW

Operating conditions in the Greater Phoenix multifamily market softened to close 2023. Vacancy rates continued on their upward trajectory, pushed higher by a spike in the delivery of new units. Absorption outpaced levels from 2022, but could not match the volume of new supply entering the market. Rents, which had held fairly flat throughout the first half, dropped 2 percent in the final three months of the year, compounding a more modest decline in the third quarter. The primary stress in the local market is the volume of new construction. In 2023, more than 15,000 units were delivered, and projects totaling nearly 55,000 rental units have been added to the area inventory since 2020. While nearly every submarket has some new development in the pipeline, fast-growing suburbs such as Goodyear and Avondale in the West Valley, and Gilbert and Chandler in the Southeast Valley are leading the way for new construction.

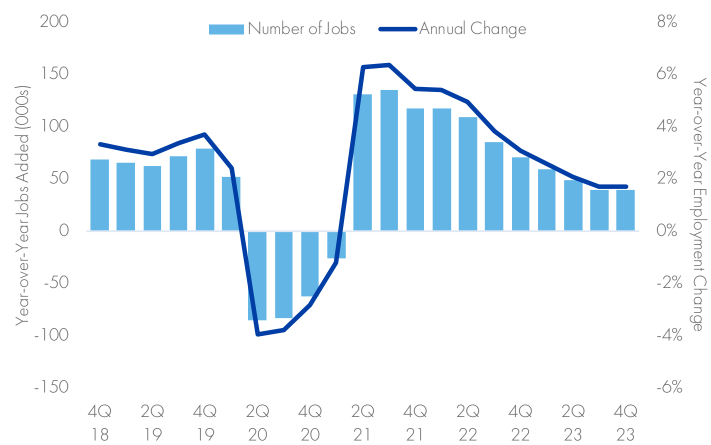
Investment activity in the Phoenix region slowed considerably in 2023, with the number of properties changing hands declining by 68 percent from the prior year. Transaction counts were modest in the fourth quarter as well, although they did inch higher from the prior period. As cap rates have risen to approximately 5.25 percent, the expectations gap between buyers and sellers has begun to narrow, and sales activity in the second half of the year nearly doubled levels from the first half. Part of the recent uptick in transactions has been a significant number of sales of newer, Class A developments. Properties built since 2020 accounted for more than half of the total transactions in the second half of 2023, which somewhat offset a sharp decline in sales involving Class B and Class C properties.

EMPLOYMENT

- Employers added workers at a steady pace in 2023. Employment growth reached 1.7 percent during the past year, with 40,000 net new jobs added.
- Growth in the professional and business services sector was cut nearly in half from 2022 to 2023. The sector added approximately 7,500 jobs during the past year, a 1.9 percent expansion.
- The Phoenix area continues to record gains in the semiconductor industry. During the fourth quarter, ASM International announced plans to expand its North American headquarters in Scottsdale. The company has approximately 800 employees in the area, with plans to add another 500 workers in the coming years.
- **FORECAST:** While employers are forecast to expand payrolls in 2024, the pace of growth will lag average levels from the past few years. Total area employment is forecast to expand by 0.8 percent in 2024, with employers likely to add 20,000 net new jobs.

Employment growth reached 1.7 percent during the past year.

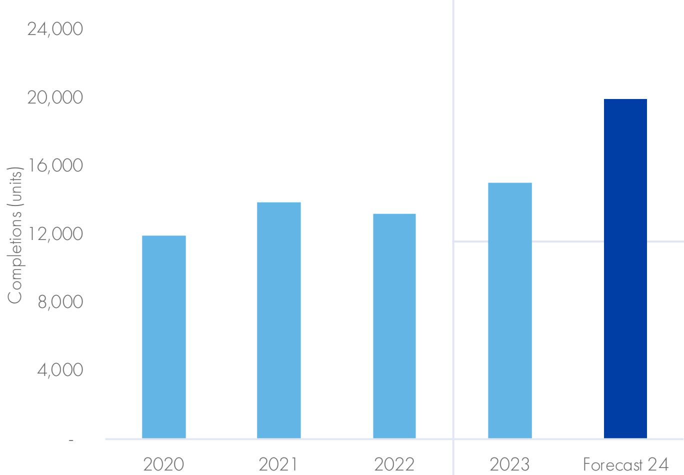
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

For the full year, more than 15,000 units came online.

DEVELOPMENT TRENDS



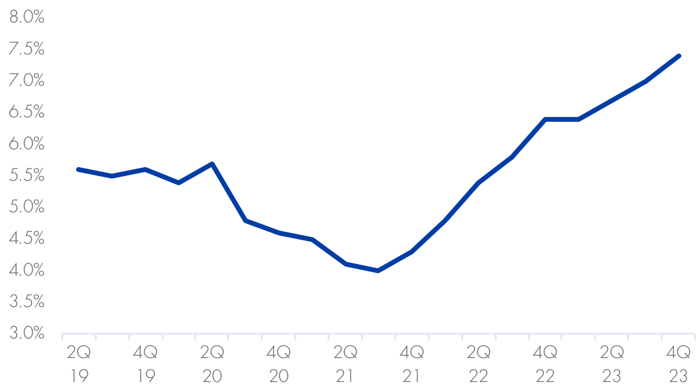
Sources: Northmarq, Apartment Insights

DEVELOPMENT & PERMITTING

- Projects totaling more than 4,500 units were delivered during the fourth quarter, the highest three-month total of deliveries since early 2020. For the full year, more than 15,000 units came online, up 13 percent from 2022 levels.
- Supply growth will remain elevated during the next two years. Nearly 42,800 units were under construction at the end of 2023, up from about 35,000 units one year earlier. Current levels of construction have likely peaked, with starts forecast to slow considerably in 2024.
- Multifamily permitting levels declined slightly from 2022 to 2023, with a more rapid drop-off anticipated in the year ahead. Developers pulled permits for approximately 17,600 multifamily units in 2023. The region's long-term average is closer to 11,500 multifamily permits issued per year.
- **FORECAST:** Apartment deliveries are forecast to peak in Phoenix in 2024, with approximately 20,000 units scheduled to be delivered. The pace of new construction should slow following this year.

In 2023, vacancy rose 100 basis points to 7.4 percent.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

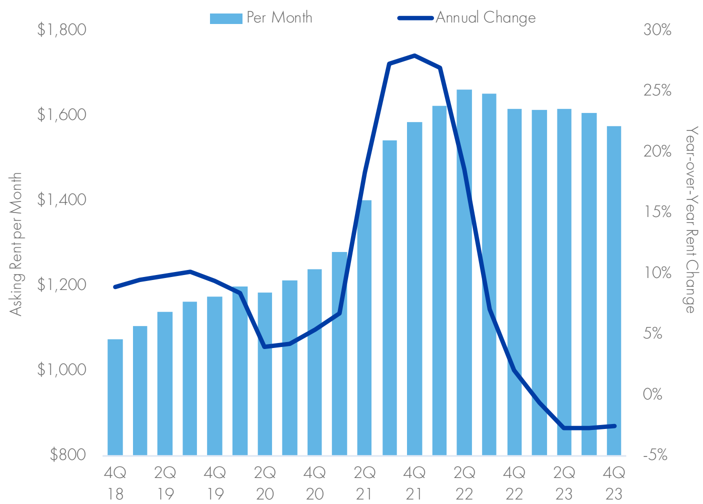
- Vacancy rose 40 basis points during the fourth quarter, and the rate has pushed higher in eight of the past nine quarters. Local vacancy has been rising by an average of approximately 35 basis points per quarter since the end of 2020.
- In 2023, vacancy rose 100 basis points to 7.4 percent. This followed a vacancy spike of 210 basis points during the prior year. Prior to 2022, vacancy in the Phoenix region had tightened for five consecutive years.
- Job centers in the Northeast Valley and Northwest Valley are generally recording better vacancy conditions than the market as a whole. The North Scottsdale/Fountain Hills submarket ended the year with the lowest vacancy rate in the region. Vacancy in the submarket fell 20 basis points in 2023 to 5.6 percent. In the Deer Valley/North Peoria, submarket, vacancy was 6.1 percent at year end.
- **FORECAST:** With construction elevated and the pace of job growth likely to slow, vacancy is expected to reach its highest level in nearly a decade. The rate is forecast to rise 180 basis points in 2024 to 9.2 percent.

RENTS

- Rents softened at the end of 2023, retreating 2 percent in the fourth quarter to $1,575 per month. For the full year, rents declined 2.5 percent, offsetting a 2 percent increase in 2022.
- Class A rents recorded the most significant rent declines for the second consecutive period. During the fourth quarter, Class A rents dropped 2.4 percent to $2,580 per month. In the second half, the average Class A rent declined by more than $100 per month. Concessions continue to increase in submarkets with the greatest supply-side pressures.
- While nearly every submarket is recording year-over-year rent declines, some submarkets along Interstate 17 are posting above-average drops. Rents in the Metrocenter and Northwest Black Canyon submarkets both declined by about 4 percent in 2023; rents in both submarkets had surged in 2021 and the first half of 2022 when overall vacancy conditions were tighter.
- **FORECAST:** Elevated vacancy rates are forecast to weigh on rents in 2024. Average rents are expected to drop 2.5 percent in the year ahead, similar to the declines posted in 2023.

Rents retreated 2 percent in the fourth quarter to $1,575 per month.

RENT TRENDS



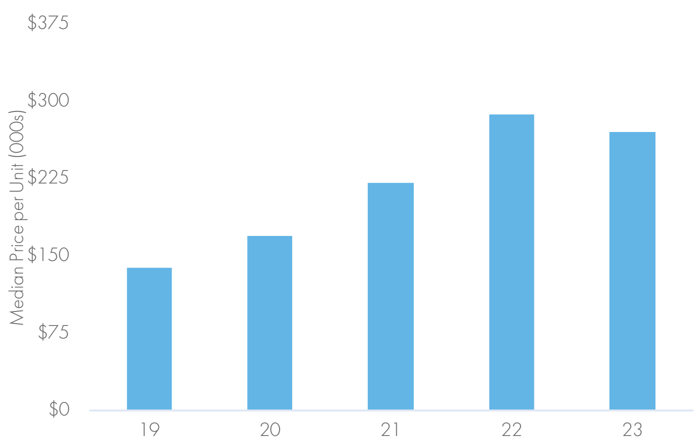
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- Sales activity was slow throughout 2023, but a few more properties changed hands in the fourth quarter than in the preceding three months. Transaction velocity rose 11 percent in the fourth quarter. The number of transactions that sold in 2023 was down 68 percent from 2022 levels.
- Transactions were concentrated in newer properties to close 2023. During the fourth quarter, sales of properties built since 2022 accounted for more than half of the total transactions. The median price in these sales was approximately $310,000 per unit.
- The median price in 2023 was $270,300 per unit, 5 percent lower than the median price in the prior year. Some of the price trends were a function of the mix of properties that changed hands during the past year; Class C assets accounted for only 23 percent of all sales in 2023, down from 40 percent in 2022.
- Prices were lower across property classes in 2023. The median price in Class A assets dropped 23 percent to $305,000 per unit, prices inched 8 percent lower in Class B units, and the median price in Class C sales declined 17 percent to $208,300 per unit.
- In properties that changed hands during the fourth quarter, cap rates averaged approximately 5.25 percent. Interest rates were particularly volatile at the end of the year, resulting in a wider range of cap rates throughout the quarter.

During the fourth quarter, cap rates averaged approximately 5.25 percent.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

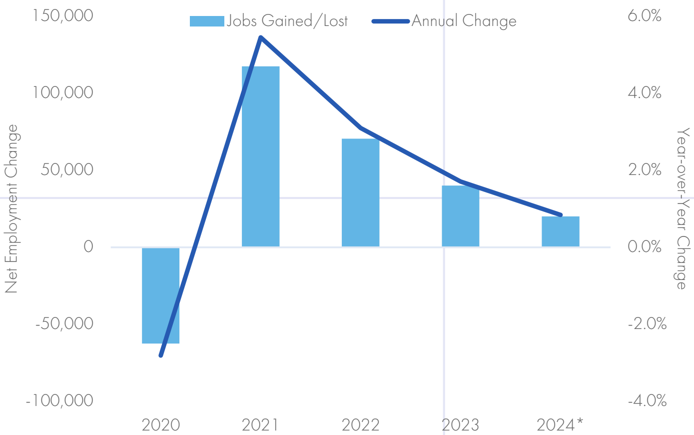
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
NOVO Broadway	711 W Broadway Rd., Tempe	324	$100,250,000	$309,414
Broadstone Dobson Ranch	1666 S Dobson Rd., Mesa	288	$85,225,000	$295,920
Alta Warehouse District	402 W Lincoln St., Phoenix	300	$82,000,000	$273,333
Villas on Ash	1381 N Gilbert Rd., Gilbert	165	$63,275,000	$383,485
Quail Run	13868 N 79th Ave., Peoria	156	$24,000,000	$153,846

LOOKING AHEAD

The year ahead will likely be a challenging one for the Phoenix multifamily market. Construction will remain elevated for a second consecutive year, while absorption is forecast to slow as the pace of economic growth cools. In prior cycles where the market's demand total has slowed, properties near job centers such as Scottsdale, Tempe, and Chandler have posted the lowest vacancy rates, even if these submarkets have had higher average rents. In 2024, these areas should outperform, although this cycle will be fueled as much by supply increases as it will by demand. While development is occurring throughout the region, submarkets with the most projects that are under construction include Gilbert, North Tempe, Goodyear/Avondale, and Glendale. These areas will likely record softer operating conditions and a greater use of concessions in attempts to attract and retain tenants.

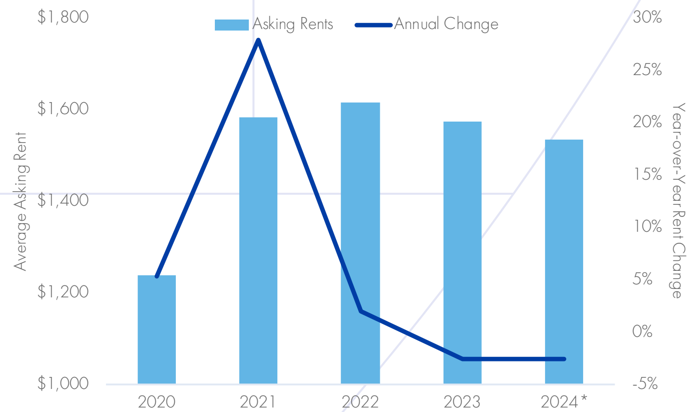
After a steep decline in transaction volume in 2023, investors are expected to be more active in the coming year. Interest rates stalled much of the activity in 2023, first by rising rapidly at the beginning of the year, and then extreme volatility in the final few months restricted buyers and sellers. The year ahead is expected to produce a more favorable interest rate environment, with most forecasts calling for declining rates in the second half. While cap rates rose in 2023, much of the increase occurred in the first half, and there have been signs of rates reaching a plateau. This should help close the expectations gap and facilitate more transactions. There will likely be some distressed properties changing hands, although many owners and lenders will attempt workouts.

EMPLOYMENT FORECAST



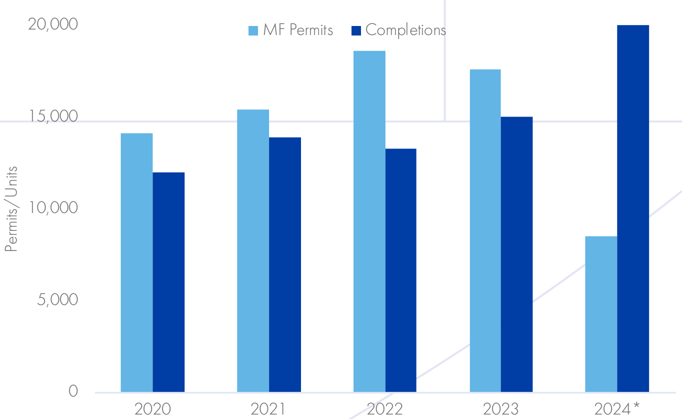
** Year End Forecast*
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



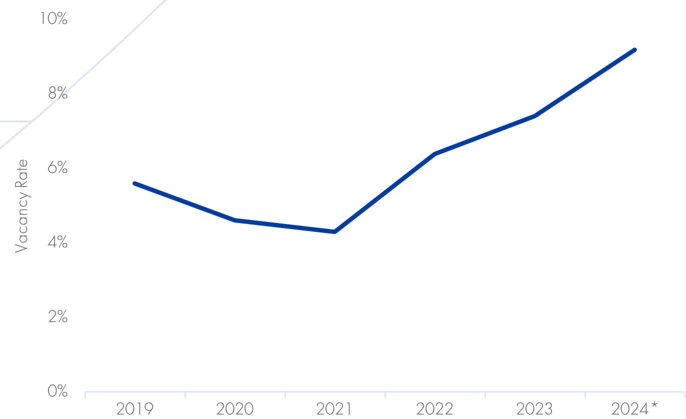
** Year End Forecast*
Sources: Northmarq, Apartment Insights

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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