Northmarq

MARKET INSIGHTS

Renter demand cools despite continued job gains

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	34,239
UNITS DELIVERED	12,924

MARKET FUNDAMENTALS

VACANCY RATE	6.4%
YEAR-OVER-YEAR CHANGE	+210bps
ASKING RENTS	$1,616
YEAR-OVER-YEAR CHANGE	+2.0%

TRANSACTION ACTIVITY (YTD)

MEDIAN PRICE PER UNIT	$286,900

Phoenix Multifamily

4Q 2022

HIGHLIGHTS

- After recording some of the strongest operating conditions in the country in recent years, multifamily market fundamentals cooled across the Greater Phoenix region at the end of 2022. Vacancy rose as completions outpaced renter demand, and rents fell in response to the supply-demand imbalance.
- Vacancy rose 60 basis points during the fourth quarter, reaching 6.4 percent. The rate spiked 210 basis points in 2022, the first year that local vacancy pushed up since 2016.
- Following a minimal dip in the third quarter, rents contracted at a faster clip to close the year. Rents dropped 2.2 percent in the fourth quarter, reaching $1,616 per month. Despite the declines in the second half, rents inched up 2 percent in 2022.
- Fewer multifamily properties traded in the fourth quarter, and prices dipped after steep increases in recent years. The average cap rate in the fourth quarter exceeded 5 percent. The median price for the full year was $286,900 per unit, but fell to $242,400 per unit in transactions that closed in the final three months of 2022.

PHOENIX MULTIFAMILY MARKET OVERVIEW

The fourth quarter was a period of continued development and slowing renter demand in the Greater Phoenix multifamily market. Net absorption in the period was positive but minimal, while developers continued to bring new units to the market at an elevated pace. The result was a sharp rise in vacancy, particularly in the second half of the year. With more supply than demand in the market, operators reduced rents in the fourth quarter, following a modest dip in the preceding period. For the full year, rents inched up just 2 percent, after spiking by nearly 28 percent in 2021. The soft absorption results stand in stark contrast to the region's ongoing labor market strength. Employers continue to expand payrolls across most industries with manufacturing likely to be a source of growth in the coming years.

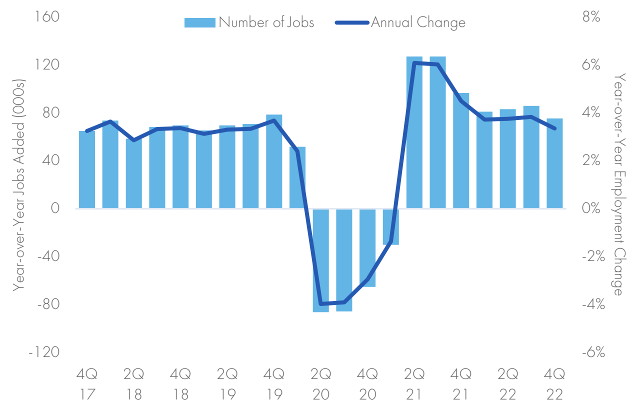
Area investment activity continued to cool during the fourth quarter, with the number of properties selling in the final three months retreating more than 60 percent from levels recorded during the same period in 2021. Many market participants are responding to the higher costs of capital as well as the slowing pace of absorption, although there is still an expectations gap between buyers and sellers. Some of that gap narrowed during the fourth quarter when average cap rates topped 5 percent, about 100 basis points higher than one year earlier. While cap rates have pushed higher in recent months, there may be some leveling off in the coming quarters, particularly if the pace of interest rate increases slows. Most Treasury yields began to trend lower in the final few weeks of 2022, which could carry over to borrowing costs and cap rates.

EMPLOYMENT

- Employers were active in adding new jobs in 2022. The local labor market expanded by 3.4 percent in the past year, with a gain of approximately 75,000 net new jobs to the Greater Phoenix region. This followed more than 95,000 positions added in 2021.
- Advanced manufacturing is going to be a source of significant employment growth in the Phoenix area over the next decade, with major capital expenditures being made by Intel and Taiwan Semiconductor. In 2022, manufacturing employment in the market spiked by 8 percent with the addition of more than 11,000 jobs in the sector.
- In 2023, Virgin Galactic will open three hangars for a spaceship assembly plant near the Phoenix-Mesa Gateway Airport in Southeast Mesa. The manufacturing facility is expected to produce six new spacecrafts per year and will bring about 400 aerospace engineering and manufacturing jobs to the area.
- **FORECAST:** The slowing national economy will likely result in more modest gains in the local labor market, particularly in some of the region's largest industries such as finance and real estate. Total employment in Phoenix is forecast to grow by 0.8 percent in 2023, with a gain of 20,000 jobs projected.

In 2022, manufacturing employment spiked by 8 percent.

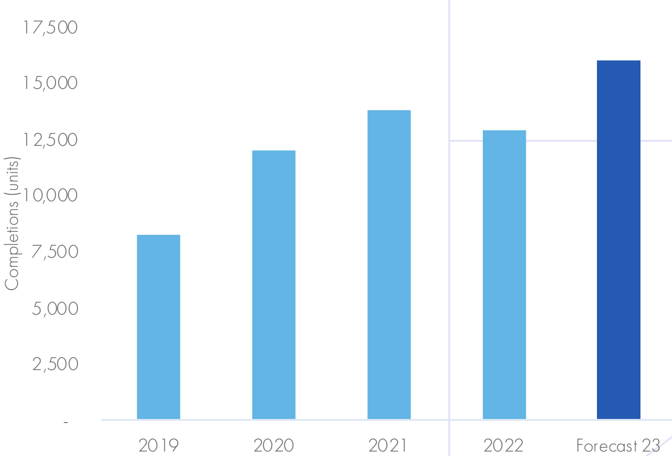
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

For the full year, more than 12,900 units came online.

DEVELOPMENT TRENDS



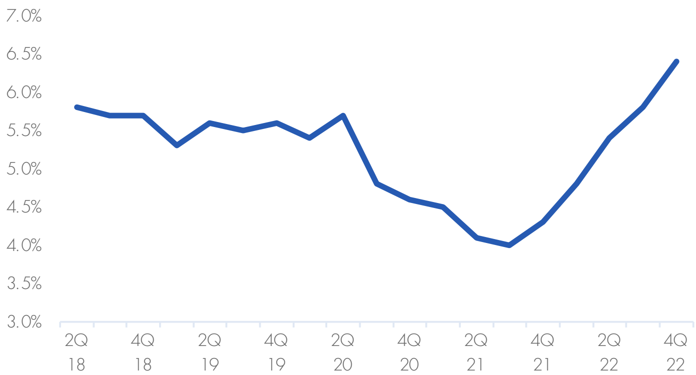
Sources: Northmarq, Apartment Insights

DEVELOPMENT & PERMITTING

- Developers delivered approximately 3,200 units during the fourth quarter, and for the full year, more than 12,900 units came online. Completions in 2022 were down 5 percent from 2021 levels. This marked the third consecutive year where more than 12,000 units were completed.
- Construction of new rental properties remains on the rise throughout the Greater Phoenix region. Projects totaling more than 34,200 units were under construction at the end of 2022, up 31 percent from one year earlier. The Goodyear/Avondale submarket is leading the region with projects in development; nearly 9,200 units are under construction in the submarket.
- Multifamily permitting issuance has been elevated in each of the past three years. In 2022, developers pulled permits for nearly 16,800 units, up 8 percent from 2021 levels. The fourth quarter was the period where the fewest permits were pulled; permits for approximately 3,500 multifamily units were issued in the final three months of the year.
- **FORECAST:** Developers are slated to deliver approximately 16,000 new units in 2023. The completions projected to come online this year represent a 23 percent increase from the average number of units completed per year since 2020.

Only one submarket ended 2022 with a vacancy rate below 5 percent.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

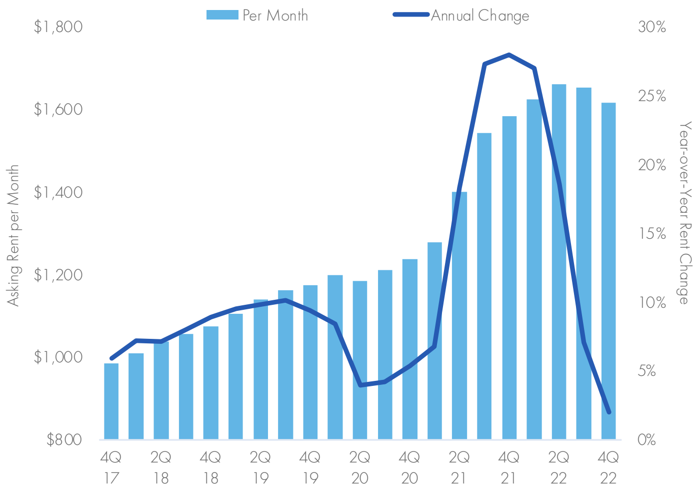
- Vacancy in Phoenix rose 60 basis points in the fourth quarter, reaching 6.4 percent. The rate has trended higher in each of the past five quarters, reversing a trend of tightening vacancy conditions that prevailed throughout the second half of 2020 and nearly all of 2021.
- For the full year, vacancy pushed up 210 basis points in 2022. This marked the first calendar year that vacancy increased in the Greater Phoenix region since 2016.
- Vacancy increases have been widespread throughout the region and not just concentrated in submarkets where new construction has been focused. Only one submarket ended 2022 with a vacancy rate below 5 percent; at the end of 2021, more than 80 percent of the Valley's submarkets were posting vacancy rates below 5 percent.
- **FORECAST:** With construction activity expected to accelerate and the pace of economic growth forecast to cool, vacancies should push higher in 2023. The rate is expected to rise 100 basis points, ending the year at 7.4 percent.

RENTS

- Rents dropped 2.2 percent during the fourth quarter, following a minimal contraction in the preceding period. Average rents ended the year at $1,616 per month. Rent trends changed course at midyear; during the first half of 2022, rents rose 4.9 percent before declining 2.7 percent in the second half.
- Rent growth for 2022 totaled just 2 percent, the slowest pace of increase since 2013. Prior to 2022, the Phoenix market had produced a five-year run where rent growth never dipped below 5 percent, and the average annual increase topped 11 percent.
- Rent trends across submarkets were mixed in 2022. A handful of submarkets recorded minimal rent declines in the past year, while some lower-cost submarkets including Maryvale and Glendale posted annual rent increases of approximately 8 percent.
- **FORECAST:** Rents are forecast to inch higher in 2023, although supply-side pressures may result in declines in a handful of submarkets where completions are elevated. Rents are expected to end the year at $1,640 per month, a 1.5 percent uptick.

Average rents ended the year at $1,616 per month.

RENT TRENDS



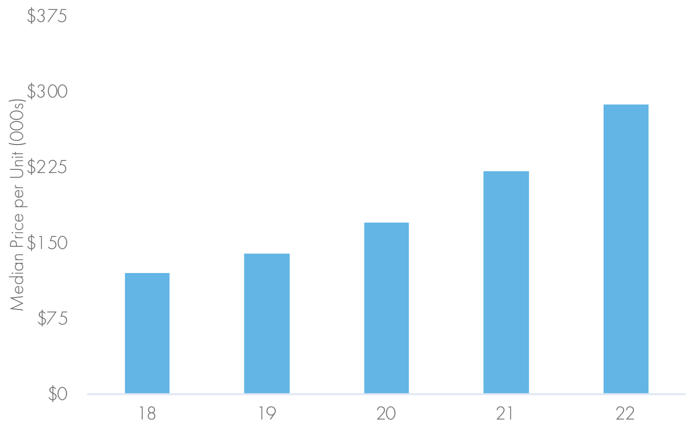
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- After a sharp decline in the third quarter, transaction counts slowed again to close out 2022. Sales velocity dropped 32 percent from the third quarter to the fourth quarter.
- For the full year, transaction activity in Greater Phoenix dropped 26 percent. The most significant year-over-year decline occurred in the fourth quarter, when transaction counts were down 62 percent from one year earlier.
- The median price in 2022 was $286,900 per unit, 29 percent higher than the median price in 2021. Prices retreated during the fourth quarter; however, the median price in transactions during the final three months of the year was $242,400 per unit.
- Cap rates continued to push higher during the fourth quarter. After averaging 4.25 percent in the third quarter, cap rates topped 5 percent in the final three months of the year. Higher financing costs and prospects for slower growth have fueled the increases.

Cap rates topped 5 percent in the final three months of the year.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

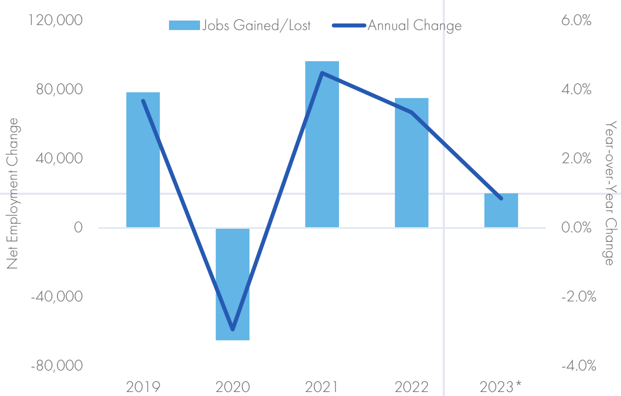
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
SeventyOne 15 McDowell	7115 E McDowell Rd., Scottsdale	274	$150,000,000	$547,445
Liv Crossroads	445 E Germann Rd., Gilbert	356	$116,000,000	$325,843
Crestone at Shadow Mountain	3033 E Thunderbird Rd., Phoenix	248	$79,250,000	$319,556
Christopher Todd Communities on Ellsworth	250 N Ellsworth Rd., Mesa	144	$53,000,000	$368,056
Cyrene at South Mountain	1540 E Burgess Ln., Phoenix	72	$35,440,000	$492,222
Arches Apartments	6240 N 63rd Ave., Glendale	200	$33,500,000	$167,500

LOOKING AHEAD

The year ahead is likely to be one where new additions to supply exceed demand growth, resulting in a fairly steep rise in vacancy across much of the market. Developers have responded to surges in renter demand, and some of the most rapid rent growth in the country, by moving more than 100 new projects into the construction pipeline since 2021. The pace of deliveries has trended higher in recent years but will likely peak in 2023 and 2024, causing supply-side pressures. While new projects will come online, the region's long-term demand drivers are healthy, and new developments are located along the path of growth. Some of the highest concentrations of current construction projects are located in the Goodyear/Avondale and North Tempe submarkets—two regions where large commercial development is underway, and employment growth should be particularly strong.

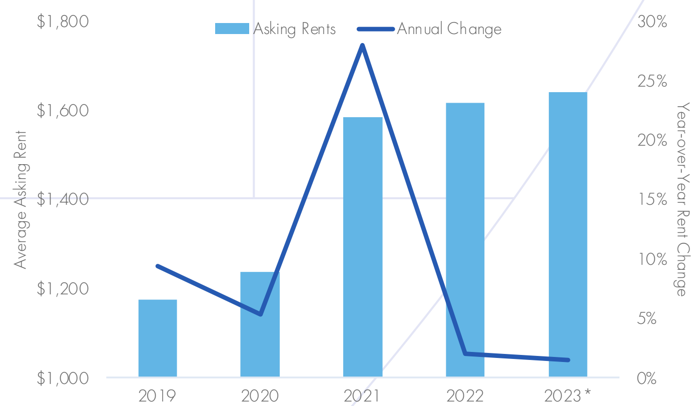
The local investment market will likely take the first quarter or the first half of 2023 to adjust to the changing operational conditions and capital costs. Some of the transition began to take shape during the fourth quarter, when cap rates rose nearly 100 basis points from the preceding period. Transaction activity has been limited in recent months, and uncertainty about the prospects for a recession is expected to linger for at least the first few months of 2023, which could further restrict sales velocity. Following a year of rapid interest rate increases, there is not yet a consensus of where or when rates will level off in 2023. As the outlook for the debt markets becomes clearer, cap rate expectations for buyers and sellers will more closely align, and transaction activity will ultimately regain momentum.

EMPLOYMENT FORECAST



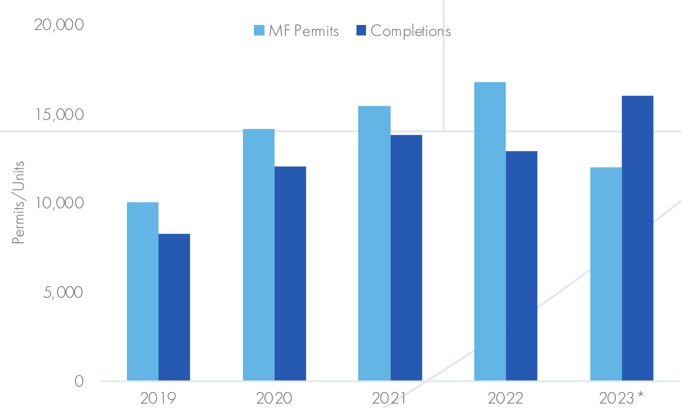
** Year End Forecast*
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



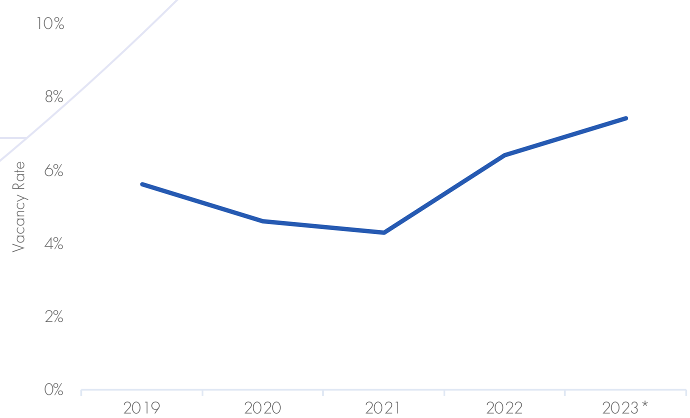
** Year End Forecast*
Sources: Northmarq, Apartment Insights

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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