Northmarq

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	39,246
UNITS DELIVERED	7,095

MARKET FUNDAMENTALS

VACANCY RATE	6.7%
YEAR-OVER-YEAR CHANGE	+130bps
ASKING RENTS	$1,616
YEAR-OVER-YEAR CHANGE	-2.7%

TRANSACTION ACTIVITY (YTD)

MEDIAN SALES PRICE	$251,200

Phoenix Multifamily
2Q 2023

MARKET INSIGHTS

Rents stabilize at midyear, setting the stage for a rebound

HIGHLIGHTS

- Market conditions in Phoenix outperformed expectations during the second quarter. Net absorption has been particularly strong, with demand in the first half of 2023 already outpacing the total for all of 2022. Renter demand is offsetting much of the impact of a very active development pipeline.
- Vacancy rose 30 basis points in the second quarter, a period where the local rate nearly always trends higher. At 6.7 percent, area vacancy is up 130 basis points year over year.
- Rents inched higher in recent months, offsetting a modest dip from the start of the year. Rents are $1,616 per month at midyear. Current rents are down 2.7 percent from peak levels recorded one year ago.
- While property operations have steadied, investment activity has remained limited to date. Sales velocity slowed in the second quarter but did gain some momentum in June. Cap rates averaged about 5.3 percent.

PHOENIX MULTIFAMILY MARKET OVERVIEW

While operating conditions in the Phoenix multifamily market were mixed during the second quarter, recent property performance has outpaced expectations. The second quarter has historically been the weakest period for rents and vacancies in Phoenix, as renter demand for housing often softens as part-time residents depart for cooler climates. Despite the seasonal challenges, rents inched higher in the second quarter—reversing a contraction from earlier in the year—and vacancy inched up only 30 basis points, a slightly smaller seasonal increase than the market's long-term average. Property operations were fairly steady even during a period of rapid supply growth; approximately 4,500 new units were delivered in the past three months, the highest quarterly total in nearly two years. Recent market performance was supported by a resumed pace of significant absorption. More than 3,000 units were absorbed during the second quarter, and net absorption year to date has already exceeded the 2022 total for the full year.

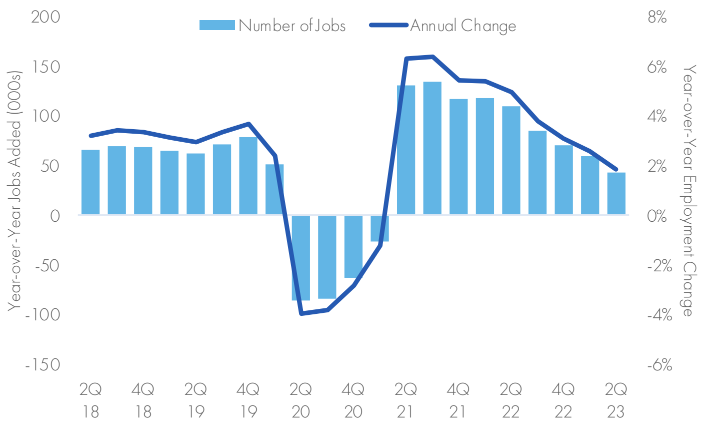
While the Phoenix region showed some operational stability in recent months, the investment market continues to lag behind. Fewer properties sold during the second quarter than during the first three months of the year, although there was a modest increase in transactions in the final month of the quarter. Still, current transaction counts are down approximately 80 percent from 2022 levels, and per-unit prices have declined from peak levels. Investors are responding to the steep increases in interest rates by slowing their pace of acquisitions and seeking higher cap rates in the properties that do change hands. The average cap rate during the first half of 2023 was 5.3 percent, about 175 basis points higher than one year ago. Cap rates have pushed up, with the trajectory closely tracking the yield increases on 2-year and 10-year Treasury bonds since the beginning of 2022. Per-unit prices are lower than levels from a year ago, but they did trend higher during the second quarter.

EMPLOYMENT

- Employers continue to add workers, although growth has slowed to a more measured pace in the past few periods. Year over year through the second quarter, total employment in the Phoenix market has expanded by 1.9 percent with the addition of 43,500 jobs.
- The local economy is recording rapid growth across construction, manufacturing, and warehousing and transportation industries. Combined, these sectors have added more than 15,000 jobs in the past year, a growth rate of 3 percent.
- During the second quarter, Moov Technologies opened its new headquarters in Tempe. The company relocated from San Francisco, and currently has a local workforce of 180 employees. The company was established in 2021 and has already doubled its number of employees since moving to Tempe.
- **FORECAST:** After more than 70,000 net new jobs were added in 2022, employers are forecast to increase area payrolls by 50,000 workers this year, a 2.1 percent rate of growth. During the past decade, gains have averaged more than 55,000 new jobs per year.

Year over year, employment has expanded by 1.9 percent.

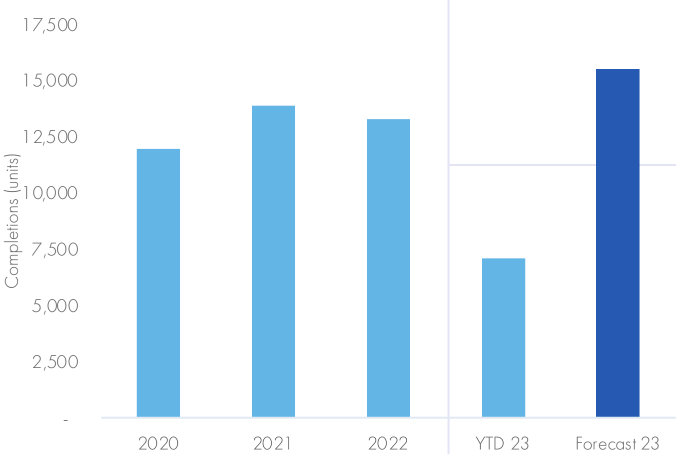
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

More than 39,200 units are currently under construction.

DEVELOPMENT TRENDS



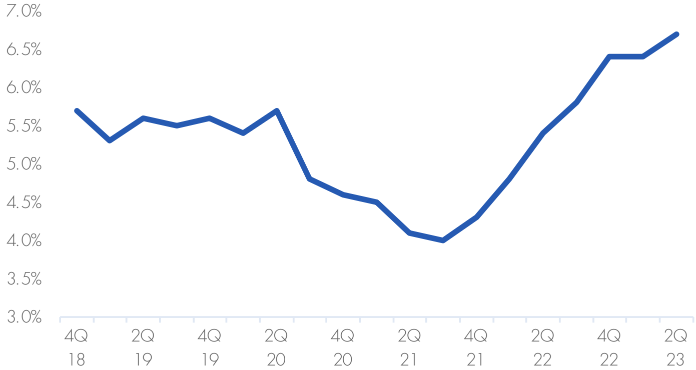
Sources: Northmarq, Apartment Insights

DEVELOPMENT & PERMITTING

- Approximately 4,500 new rental units were delivered across the Phoenix market during the second quarter, and nearly 7,100 units have come online through the first six months of the year. The pace of development is on the rise; deliveries year to date are 26 percent ahead of the 2022 pace.
- Rental communities totaling more than 39,200 units are currently under construction, compared to 28,100 units that were under way one year ago. The Sky Harbor and North Tempe submarkets are particularly active; these adjacent submarkets combined to total nearly 8,000 units under construction.
- Multifamily permitting has slowed after peaking in late-2022. Developers pulled permits for approximately 3,200 units during the second quarter, 38 percent lower than the average volume during the previous four quarters. With construction financing increasingly difficult to secure, the pace of permitting is likely to slow in the second half.
- **FORECAST:** Developers will continue to bring new rental projects to the market throughout the remainder of this year and into 2024. Deliveries are forecast to reach approximately 15,500 units in 2023, after more than 13,000 units have come online in each of the past two years.

The vacancy rate in the second quarter rate reached 6.7 percent.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

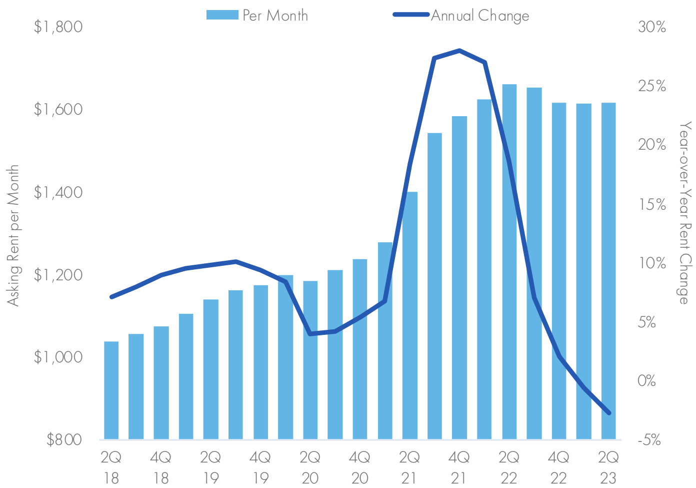
- After steadying at the start of the year, vacancy rose 30 basis points in the second quarter with the rate reaching 6.7 percent. Vacancy conditions in Phoenix routinely soften during the second quarter; the rate has pushed higher in nine of the past 10 second quarters, posting an average quarterly increase of 35 basis points.
- Year over year, area vacancy has increased by 130 basis points. The rate has averaged 5.8 percent during the past decade and 5.3 percent since 2018.
- While vacancy has trended higher throughout the Phoenix region, the northeast portion of the market is generally faring best. Vacancy rates in the North Scottsdale/Fountain Hills submarket inched up only 10 basis points in the past year, ending the second quarter at 6.5 percent. In the Union Hills/Cave Creek submarket, vacancy is 5.8 percent, after rising just 30 basis points in the past 12 months.
- **FORECAST:** Vacancy is expected to end the year at 7.1 percent, 70 basis points higher than at the end of 2022. An active pace of new development will present supply-side pressures in the market, resulting in a rise in vacancy.

RENTS

- Rents ticked up in recent months, offsetting the minimal decline recorded at the beginning of the year. Rents ended the second quarter at $1,616 per month. Current monthly rents are identical to levels recorded at the end of 2022.
- Rents have dropped by 2.7 percent year over year. The Phoenix area posted some of the most rapid rent growth in the country from 2018 to 2021, but rents have been essentially flat since the beginning of 2022.
- Rents have contracted at the high-end of the quality spectrum since peaking one year ago. Class A asking rents are down nearly 7 percent from peak levels, while average Class B rents have declined 4.8 percent year over year.
- **FORECAST:** With rents stabilizing during the second quarter, there should be room for modest gains in the second half. Average rents are forecast to tick up 2.1 percent to $1,650 per month.

Rents ended the second quarter at $1,616 per month.

RENT TRENDS



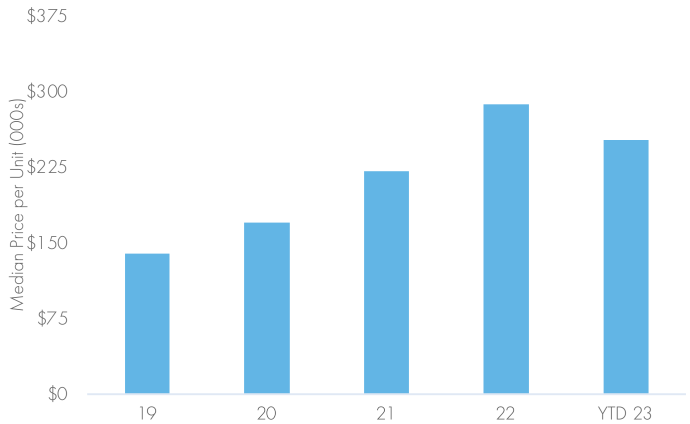
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- Sales velocity slowed by approximately 25 percent from the first quarter to the second quarter. Transaction activity was limited during the early part of the second quarter before accelerating in June. More than 70 percent of the properties that sold during the second quarter closed in the final month of the period.
- Despite the uptick in sales during the final few weeks of the first half, year-to-date transaction activity is down nearly 80 percent from levels during the same period in 2022. Sales velocity peaked in the second half of 2021.
- The median price through the first half of this year is $251,200 per unit, 12 percent lower than the median price in 2022. Market-wide prices first topped $200,000 per unit in 2021.
- The median price in the second quarter was $261,400 per unit, up from $233,700 per unit at the start of the year. Class A units have accounted for approximately one-third of transactions in recent months; the median price in Class A property sales reached nearly $430,000 per unit.
- Cap rates averaged approximately 5.3 percent during the second quarter, similar to levels recorded at the beginning of the year.

Cap rates averaged approximately 5.3 percent during the second quarter.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

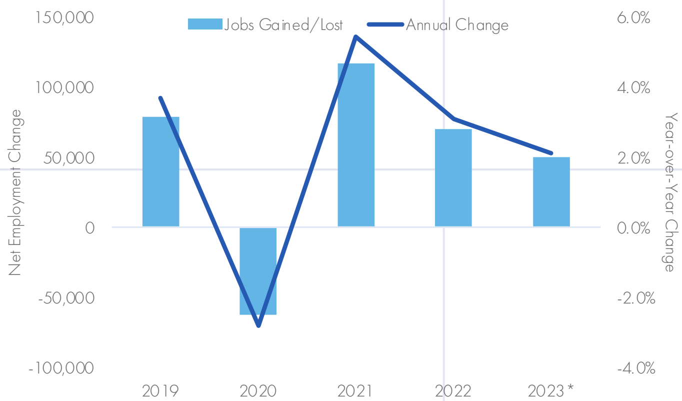
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
Alta Raintree	8688 E Raintree Dr., Scottsdale	330	$141,500,000	$428,788
Soltra at SanTan Village	1690 S San Tan Village Pky., Gilbert	380	$140,000,000	$368,421
The Griffin	3234 N Scottsdale Rd., Scottsdale	277	$127,780,000	$461,300
Bayside	20245 N 32nd Dr., Phoenix	176	$46,000,000	$261,364
Solaire on Scottsdale	801 E McKellips Rd., Tempe	124	$28,300,000	$228,226

LOOKING AHEAD

Much of the conversation surrounding the outlook for the Phoenix multifamily market in 2023 has been focused on an expanding construction pipeline and the competitive impact of new supply on existing property performance. While developers in 2023 are on pace to deliver the highest number of units to the local market in more than 30 years, the overlooked demand side of the equation is showing signs of positive momentum. During the first half, net absorption totaled nearly 7,000 units, the strongest six-month period of demand growth since the flurry of move-in activity that occurred in mid-2021. Absorption has not matched those heights or kept pace with deliveries of new units, but the continued leasing activity has provided some support for area vacancy levels and allowed rents to stabilize. In the coming quarters, job growth and continued in-migration should support new renter household formation and sustain absorption, and vacancy increases are expected to be fairly modest.

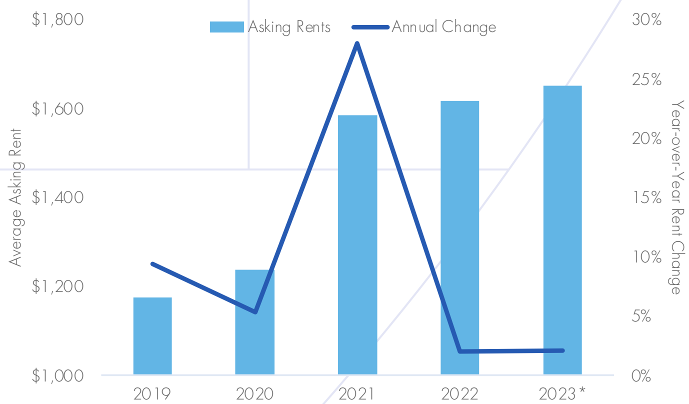
Multifamily investors remain cautious in Phoenix, with transaction counts down significantly from year-earlier levels. Buyers and sellers appear to be taking a wait-and-see approach, with both sides anticipating a more favorable lending environment when interest rates ultimately trend lower. To this point in the cycle, most of the properties that are changing hands have included traditional acquisitions of stabilized assets. A few signs emerged in the second quarter that could signal increased activity in the second half. The first was a surge in transactions at the end of the quarter, including some newer projects that have been delivered and leased-up. Additionally, with cap rates showing signs of leveling off and interest rates stabilizing, the expectations gap has likely begun to narrow. Investors will continue to monitor absorption rates, particularly as new projects come online, to assess renter demand, the potential for rent growth and the overall health in the market.

EMPLOYMENT FORECAST



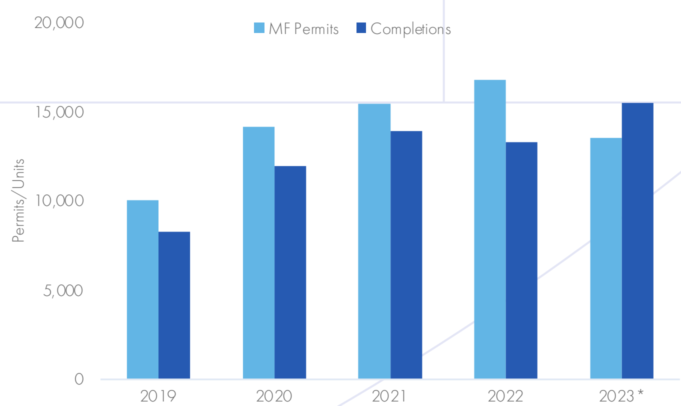
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



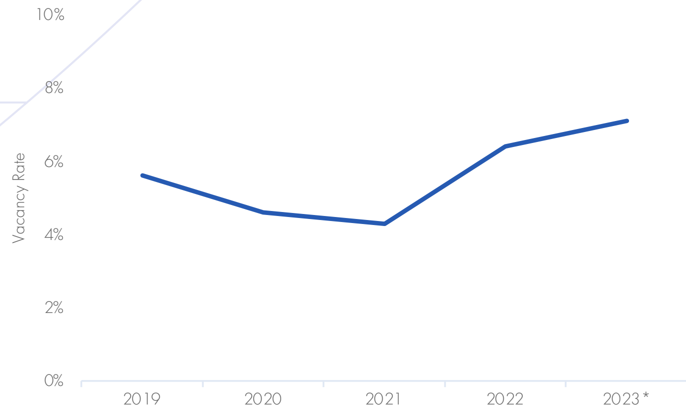
* Year End Forecast
Sources: Northmarq, Apartment Insights

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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