Market Insights

Greater Phoenix Multifamily 2Q 2022

Northmarq

Construction Activity

28,116

Units under construction

5,610

Units delivered (YTD)

Market Fundamentals

5.4%

Vacancy

+130bps | Year over year change

$1,661

Asking Rent

+18.6% | Year over year change

Transaction Activity

$300,000

Median sales price per unit (YTD)

Investment Activity Gains Momentum, Prices Push Higher

Highlights

- Construction of new units is accelerating in the Phoenix multifamily market, and the quickening pace of development is bringing supply and demand closer to equilibrium. Apartment construction levels should remain elevated for the next several quarters.
- Vacancy has trended higher in each of the first two quarters of 2022. The rate rose 60 basis points in the second quarter, reaching 5.4 percent. Year over year, vacancy has spiked 130 basis points, following a period of rapid declines since mid-2020.
- Even as absorption slowed, rents continued to push higher. Average rents are up 18.6 percent year over year, reaching $1,661 per month at the end of the second quarter.
- Following a record-setting year in 2021, the investment market is off to a stronger start to this year. The pace of transactions accelerated in the second quarter, and prices surged. The median price reached $300,000 per unit in the first half of the year, 35 percent higher than in 2021. Cap rates have averaged 3.5 percent.

Phoenix Multifamily Market Overview

Following several strong periods, operational performance in the Greater Phoenix multifamily market began to show signs of softening a bit in the second quarter. Vacancy rose for the third consecutive quarter, topping 5 percent for the first time in two years. The rate rose in response to a spike in new construction and a cooling pace of absorption. Some of the easing demand is largely seasonal; the second quarter is routinely the period of the lowest absorption in the Phoenix market. One aspect of the vacancy rise that is not seasonal is the spike in new construction. The number of units under construction has essentially doubled in the past two years, and developers have been delivering an average of about 10,000 units per year since 2017, up from 6,000 units per year in the preceding periods.

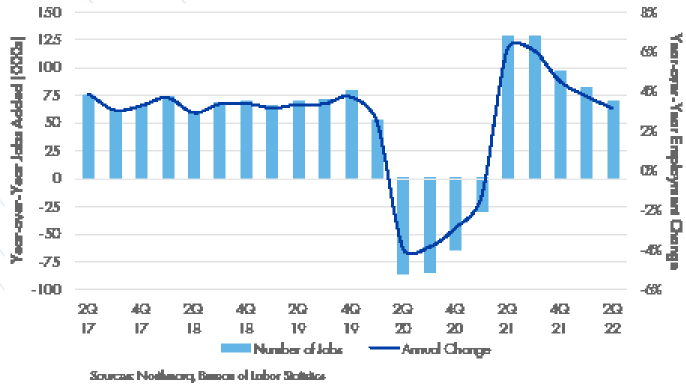
Investors remained active in Phoenix during the second quarter. More properties sold in the second quarter than during the first quarter, and transaction counts in the first half of 2022 are slightly ahead of the pace recorded in the first half of last year. Cap rates inched higher in the second quarter, reflecting the rising interest rate environment. The biggest change in the investment landscape in the second quarter was the sharp upturn in per-unit prices. The median price in transactions that closed in the second quarter was over $317,000 per unit, as several properties sold in some of the highest-demand and highest-cost submarkets. The median price in properties that have traded to this point in 2022 has reached $300,000 per unit, 35 percent higher than the median price last year.

Employment

- Employers continue to expand in the Phoenix area. During the past 12 months, employment in the market has grown by 3.1 percent with the addition of nearly 70,000 jobs.
- While most sectors in the local economy are expanding, some of the most rapid gains are in the manufacturing sector, which has grown by 5.2 percent year over year with the addition of more than 7,000 jobs. Local manufacturing employment should continue to outperform the market's rate of growth as hiring ramps up at both Intel and Taiwan Semiconductor in the coming years.
- One consistent source of growth in the Phoenix economy has been companies that establish a presence in the market and then expand. During the second quarter, satellite communications company Viasat announced plans to develop more than 300,000 square feet of new space in the company's ASU Research Park in Tempe. The project will be completed in three phases, and the company will add 1,500 workers beginning in mid-2024.
- **Forecast:** The Phoenix area is on pace to record widespread gains across most industries in 2022. Employers are forecast to expand payrolls by 2.9 percent this year with 65,000 net new jobs expected to be added.

> During the past 12 months, employment has grown by 3.1 percent.

Employment Overview

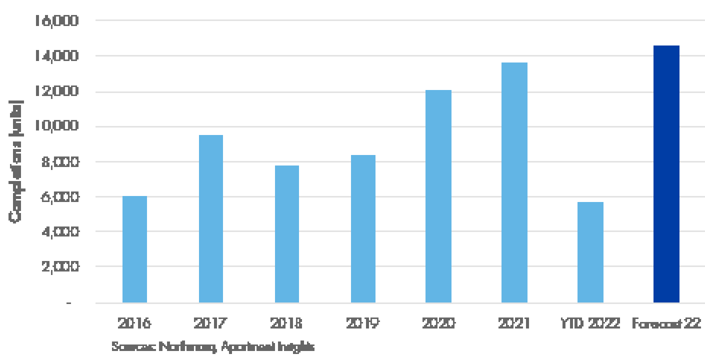


Development and Permitting

- Several projects totaling nearly 3,500 units were delivered in the second quarter. Year to date, more than 5,600 units have been completed, up from fewer than 4,800 units in the first half of 2021.
- The Phoenix area is on pace for elevated deliveries for the next few years. At the end of the second quarter, more than 28,100 units were under construction in the metro area. While nearly every submarket has some construction activity under way, the Goodyear/Avondale area leads the way with approximately 5,150 units under construction.
- Developers are showing a bit more caution after a sharp increase in permitting activity in 2020 and 2021. During the first half, permits for approximately 6,300 multifamily units were pulled, down 8 percent from the same period in 2021. Permitting activity peaked in the fourth quarter of last year, when permits for more than 5,000 multifamily units were issued.
- **Forecast:** Apartment deliveries have increased in each of the past three years, a trend that is expected to continue in 2022. Developers are on pace to deliver approximately 14,500 units this year, up 7 percent from 2021 levels.

> During the first half, permits for 6,300 multifamily units were pulled.

Development Trends

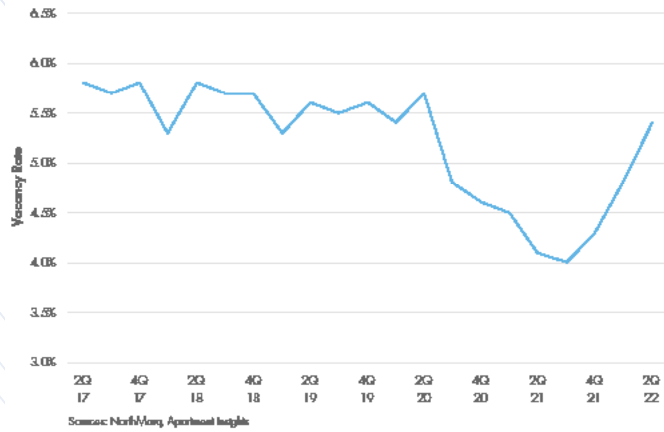


Vacancy

- After an extended period of improvement, vacancy rates in Phoenix are returning closer to earlier averages. The rate rose 60 basis points in the second quarter, reaching 5.4 percent. The local vacancy rate typically inches higher in Phoenix during the second quarter due to part-time residents who do not stay in the Valley during the summer months.
- Vacancy has trended higher in each of the past three quarters, following a period where the rate fell for five consecutive quarters. Year over year, vacancy has increased 130 basis points. Since 2018, the rate has averaged 5.1 percent.
- Vacancy in Class A units rose 160 basis points from the first quarter to the second quarter, reaching 7.5 percent. The Class A rate has risen 190 basis points in the past year and is at its highest point since 2020.
- **Forecast:** The vacancy rate in Phoenix generally tightens after peaking in the second quarter. With thousands of units expected to come online in the second half, vacancy is only expected to tick lower from current levels. The rate is forecast to end 2022 at 5.2 percent, up 90 basis points from the end of last year.

> Since 2018, the vacancy rate has averaged 5.1 percent.

Vacancy Trends

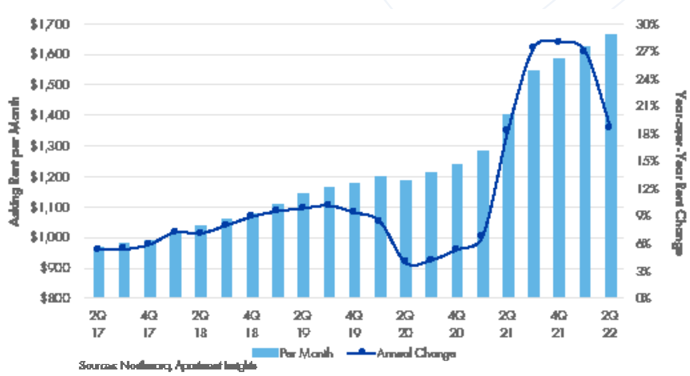


Rents

- Even as vacancy crept higher, operators were able to increase rents again in the second quarter. Average rents rose 2.3 percent in the second quarter, only slightly lower than quarterly gains at the end of last year and in the beginning of 2022.
- During the past 12 months, average area rents have spiked 18.6 percent to $1,661 per month. Annual rent growth topped 27 percent beginning in the second half of last year, but the pace of gains will ease in the coming periods.
- Every submarket in the Phoenix area has posted an annual rent increase of at least 13 percent, but the strongest spikes have generally been posted in areas surrounding Midtown and Maryvale. Rents in these submarkets averaged between $1,100 per month and $1,200 per month one year ago but are now closer to $1,450 per month to $1,550 per month.
- **Forecast:** Rent growth in Phoenix should approach nearly 9 percent this year. Rents are expected to end 2022 at approximately $1,725 per month. By the end of this year, average rents will be up nearly $500 per month from levels recorded at the end of 2020.

> During the past 12 months, rents have spiked 18.6 percent.

Rent Trends

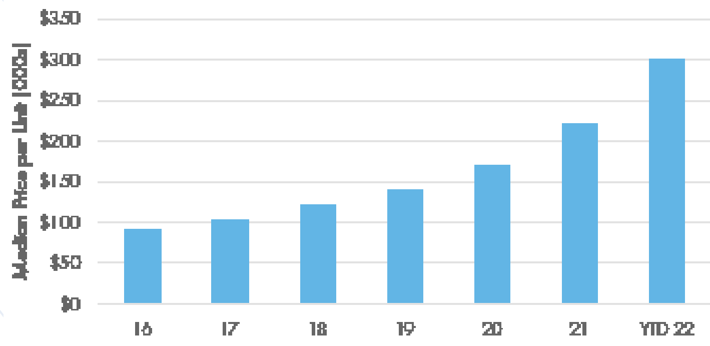


Multifamily Sales

- Investment activity accelerated in the second quarter with sales velocity rising 20 percent from levels at the beginning of the year. The number of properties that changed hands during the first half of 2022 was up slightly from the figure from the same period last year.
- Per-unit prices continued to trend higher in the second quarter, particularly with the sale of a few newer projects in high-demand areas such as Old Town Scottsdale and Downtown Tempe. The median price in properties that sold during the second quarter topped $317,000 per unit. During the first half, the median price reached $300,000 per unit, up 35 percent from the median price in 2021.
- Cap rates inched higher during the second quarter, rising to about 3.5 percent on average, 25 basis points higher than in the first quarter. While the average cap rate has not changed significantly, fewer properties are trading with cap rates below 3 percent, while a few more are selling with cap rates at or above 4 percent.

During the first half, the median price reached $300,000 per unit.

Investment Trends



Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

Property Name	Street Address	Units	Sales Price	Price/Unit
The Moderne	4848 N Goldwater Blvd., Scottsdale	369	$260,000,000	$704,607
Liv North Scottsdale	15509 N Scottsdale Rd., Scottsdale	240	$145,000,000	$604,167
Rise Lakeside	11459 N 28th Dr., Phoenix	288	$75,300,000	$261,458
Tides at Parkview	1235 W Baseline Rd., Tempe	196	$66,500,000	$339,286

Looking Ahead

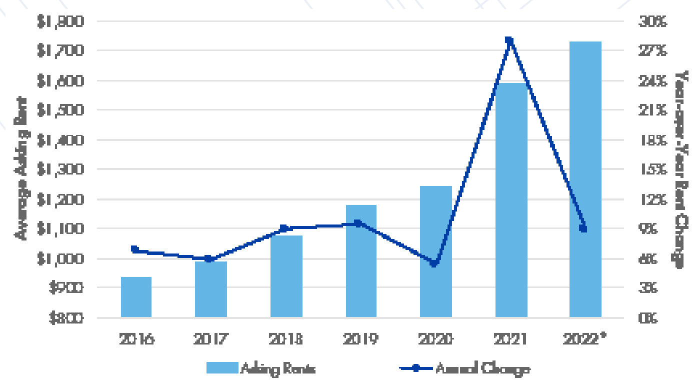
Following an extended period where the local multifamily market was overheated and undersupplied, conditions in the Phoenix area are forecast to return to more stabilized operations through the remainder of this year. Vacancies are expected to tighten a bit from current levels, but the rate will likely settle in very close to the market's five-year average. Rents are on pace to rise nearly 9 percent in 2022, similar to annual gains recorded in 2018 and 2019, but falling well short of the explosive growth recorded during the past 18 months. Construction of new units will remain on an upward trajectory; completions in 2022 are forecast to rise about 7 percent from last year's levels, although the pace of permitting is expected to cool in the second half.

The investment market recorded particularly strong performance during the first half of 2022, but an adjustment period is likely in the next few months. Prices have been on a rapid upward escalation for the past several quarters, but with the pace of rent growth expected to moderate, and borrowing costs rising, there could be some pushback on prices and modest upward pressure on cap rates. While transaction levels to this point are ahead of the 2021 pace, sales velocity could slow a bit in the next few months as buyers and sellers adjust expectations to the changing market conditions. Some of this activity occurred in the second quarter, but the accelerating pace of interest rate hikes could drag more heavily on transactions going forward.

Employment Forecast

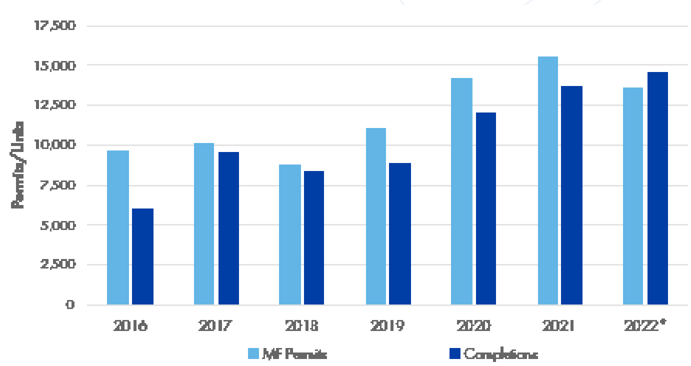
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

Rent Forecast



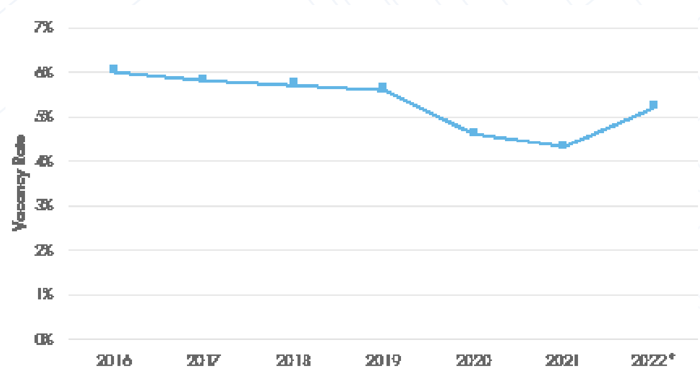
* Year End Forecast
Sources: Northmarq, Apartment Insights

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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