MARKET REPORT

RETAIL

Phoenix Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

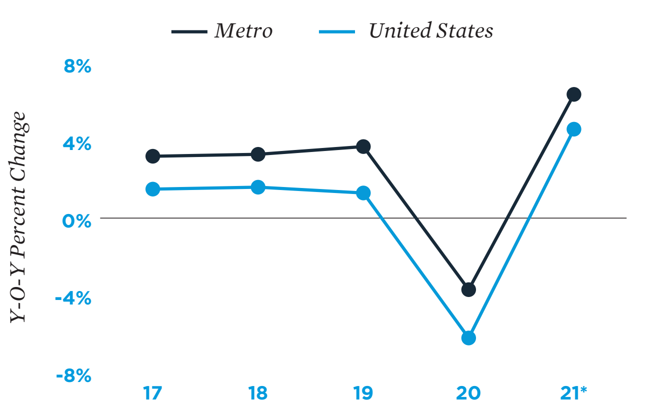
3Q/21

Moderate Supply Pipeline, Demographic Tailwinds Help Balance the Retail Landscape in Phoenix

Period of recovery sets stage for longer-term enhancement. Several factors indicate Phoenix is on the verge of turning the corner after a difficult stretch. Supply pressure is minimal this year, with annual completions expected to fall below 1 million square feet for the first time since 2018. At the same time, space demand is strengthening as retailers are eager to get a foot in the door of the rapidly growing market. Phoenix is projected to have one of the 10 fastest household expansions among major U.S. metros through 2025, with more than 250,000 new households forming over that five-year span. The additional residents will boost spending throughout the market, prompting retailers to lease space. Through the first half of 2021, leasing activity has been the strongest in the East Valley and Pinal County submarkets, as suburban sprawl is generating the need for shopping in outlying areas.

Some submarkets have a steeper climb ahead. North Scottsdale and North Phoenix were among the most impacted areas during the past year as pandemic-related restrictions depleted foot traffic at typically high-volume retail districts. As of June, vacancy was up more than 250 basis points year over year in North Phoenix and availability increased nearly 500 basis points in North Scottsdale. These two submarkets now have the most elevated vacancy rates in the metro, both in the double digits. Rental rates in these areas have yet to be pressured by rising availability, though, as each submarket noted annual asking rent growth greater than 3 percent. The return of high-quality spaces to the leasing market contributed to this, however, and sustaining organic rent growth will likely necessitate vacancy improvement.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Retail 2021 Outlook

137,000 JOBS
will be created

EMPLOYMENT:

Phoenix's employment count will exceed the pre-pandemic peak by more than 46,000 positions at the end of this year, with the job total growing by 6.4 percent. Entering August, the unemployment rate was 6.1 percent, leaving a margin for further gains.

700,000 SQ. FT.
will be completed

CONSTRUCTION:

Less space will be finalized in 2021 than in any year dating back to 2011, with market inventory scheduled to expand by just 0.4 percent. Compared with last year's addition, delivery volume is projected to moderate by more than 500,000 square feet.

0 BASIS POINT
change in vacancy

VACANCY:

Conditions are stabilizing in Phoenix after a 90-basis-point rise in availability last year. The vacancy rate remains unchanged at 8.6 percent in 2021, substantially lower than the trailing-decade average of 9.5 percent.

2.9% INCREASE
in asking rent

RENT:

Rent growth will resume as vacancy settles and demand improves, with the average asking rate climbing to $16.50 per square foot in 2021. The enhancement will undo the 0.2 percent decline registered in 2020.

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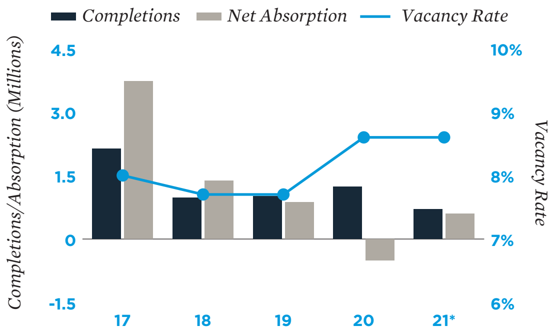
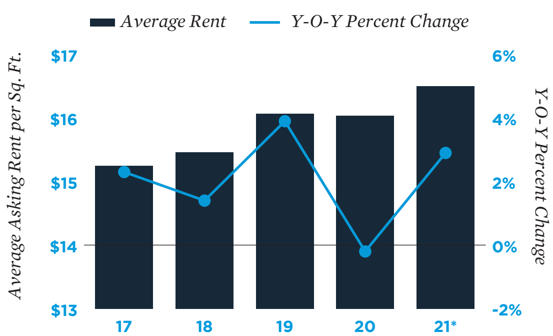
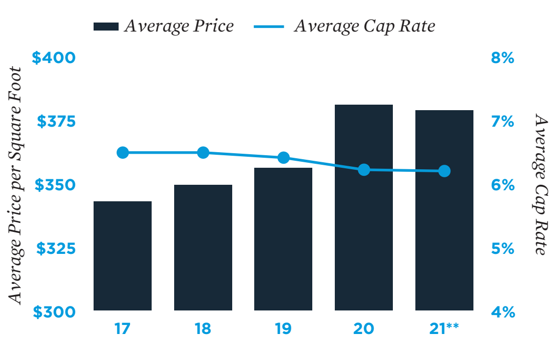
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q21 — 12-Month Period

CONSTRUCTION

1,009,000 square feet completed

- Additions over the past year ended in June came in slightly below the previous period's 1.1 million-square-foot volume. Entering the third quarter of 2021, an additional 570,000 square feet had broken ground.
- During the past 12 months, West Phoenix was the only submarket to have a supply enlargement exceeding 1 percent.

VACANCY

60 basis point increase in vacancy Y-O-Y

- Vacant stock grew by roughly 1.1 million square feet during the past four quarters ended in June as availability moved up to 8.7 percent.
- Multi-tenant vacancy soared 160 basis points year over year to 11.4 percent in the second quarter, which overshadowed the 10 basis points decline that occurred in the single-tenant segment to 7.0 percent.

RENT

3.8% increase in the average asking rent Y-O-Y

- Boosted by a 5.5 percent year-over-year hike in the average single-tenant asking rent, the overall mean rose to $16.46 per square foot in the second quarter, up 2.4 percent from year-end 2019.
- Rates in Downtown Phoenix have been notably suppressed, with the average rent down more than 10 percent since the first quarter of last year.

Investment Highlights

- Single-tenant deal flow grew by more than 30 percent annually during the 12-month period ended in June. More out-of-state investors set their sights on rapidly expanding Sunbelt markets like Phoenix, as employment recovered faster than many other metros and the demographic outlook is promising. The average single-tenant sale price and cap rate held relatively firm at $440 per square foot and 5.9 percent.
- The East Valley submarket remained the most popular for single-tenant transactions as household formation underscores prospects. North Phoenix also registered a significant uptick in activity with buyers from West Coast markets concentrating on restaurants and drugstores here.
- The trading of multi-tenant assets declined by about 10 percent on an annual basis during the four-quarter frame ended in June. General economic uncertainty and the segments' fundamental regression curtailed activity. The properties that traded during the past year had an average sale price of $260 per square foot and a mean first-year return of 6.7 percent.
- Multi-tenant deal flow nearly doubled in Scottsdale with several portfolios changing hands. The average entry cost here is roughly $280 per square foot and cap rates are in the 5 percent to 6 percent band.

IPA Retail

Daniel Taub

Senior Vice President, National Director

Tel: (212) 430-5100 | dtaub@ipausa.com

For information on national retail trends, contact:

John Chang

Senior Vice President, National Director | Research Services

Tel: (602) 707-9700 | jchang@ipausa.com

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