MARKET REPORT

Marcus & Millichap

MULTIFAMILY
Phoenix Metro Area

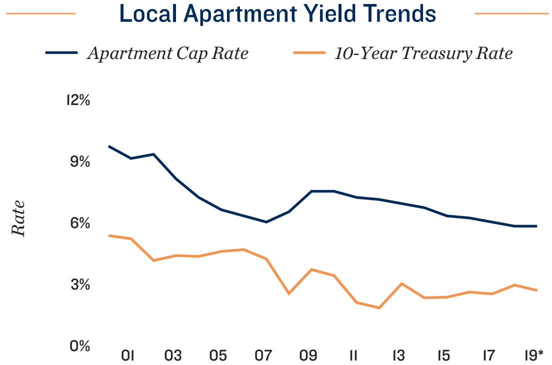
Q2/19

Market Demand Sustains Development; Few Barriers to Entry for West Coast Investors

Rental demand spurred by higher education; job growth bolsters construction in the core and neighboring suburbs. Arizona State University, with large campuses in Tempe, downtown Phoenix, Glendale and Mesa, has transformed the multifamily properties surrounding these areas. Grand Canyon University has also rejuvenated the multifamily rental assets in the West Valley submarket. With these institutions and several others located in the Greater Phoenix area, the growing skilled labor force is benefiting job growth by supporting several Fortune 500 companies, which are increasing their footprints throughout the metro. These expansions are allowing more graduates to remain in the Phoenix metro and are attracting many new professionals to the market, ultimately enhancing rental demand in Phoenix and in its neighboring suburbs. The rising number of residences has compressed vacancy rates in the metro as thousands of units are absorbed annually. As a result, market demand will allow rental prices to continue to rise and spur new apartment construction in the upcoming years.

Apartment growth continues in Phoenix and the East Valley. The Chandler and Gilbert submarkets had the largest growth rates in apartment inventory over the past five years with absorption outpacing completions in each year. During this time, these submarkets' apartment inventories have grown by at least 25 percent, while the local vacancy rates fell by more than 50 basis points each. Phoenix is also growing its rental supply, as nearly 2,000 units will be finished this year.

Local Apartment Yield Trends



** Cap rate trailing 12-month average through 1Q; Treasury rate as of March 29*

Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2019 Outlook

7,730 UNITS
will be completed

CONSTRUCTION:

Multifamily construction continues in Phoenix as 7,730 units are scheduled to be completed in 2019.

10 BASIS POINT
decrease in vacancy

VACANCY:

Vacancy will dip to 4.4 percent in 2019, following a 90-basis-point drop last year.

7.3% INCREASE
in effective rents

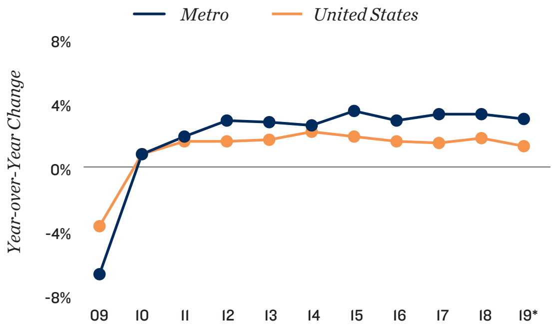
RENTS:

The average effective rent will reach $1,150 per month, rising from $1,072 per month in 2018.

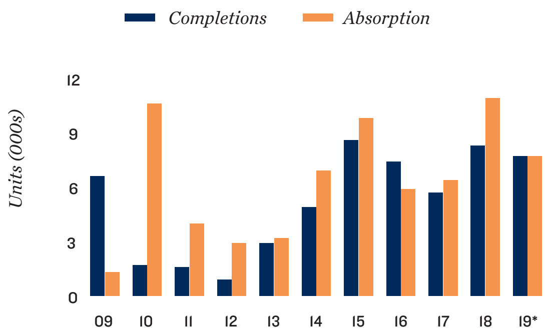
Investment Trends

- Phoenix multifamily properties are targeted by cash-flow-focused investors as the past four quarters' deal flow increased by 21 percent compared with the previous time period, due largely to heavy trading during the first quarter.
- The sales price per unit has appreciated by 145 percent since the trough of the recession, half of which occurred after 2013, allowing both long-term and short-term owners to capitalize on the equity gained.
- The market average cap rate has compressed 20 basis points to 5.7 percent compared with the first quarter of last year as bidding becomes more competitive among out-of-state buyers.
- First-year returns here are 150 basis points above what can be achieved on similar assets in coastal southern California metros, enticing many private investors in these areas to continue scouring the Phoenix market for opportunities.

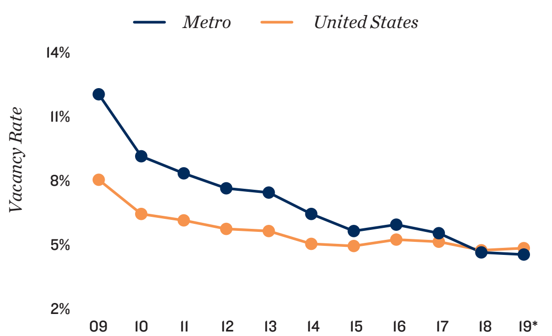
Employment Trends



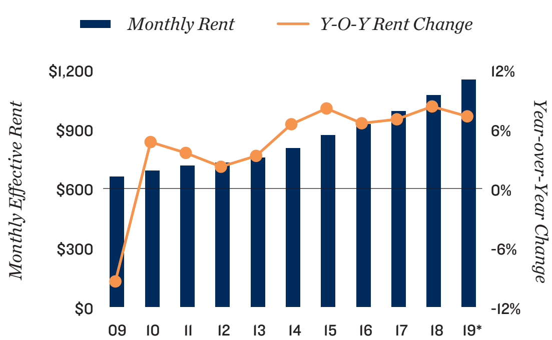
Completions and Absorption



Vacancy Rate Trends



Rent Trends



* Forecast

Source: CoStar Group, Inc.

1Q19 – 12-Month Period

EMPLOYMENT

2.7% increase in total employment Y-O-Y

- Over the past 12 months ending in March, Phoenix payrolls expanded by nearly 57,000 positions. The previous annual period posted a 3.6 percent increase in total employment.
- Over the past couple of years, job growth has been bolstered by an robust demand for employees in educational and health services as well as construction.

CONSTRUCTION

8,000 units completed Y-O-Y

- In the last four quarters, deliveries increased supply by 2.3 percent compared with the previous period, when supply rose by 1.9 percent.
- The largest delivery since last April was the 440-unit Camden North End 1 in the Deer Valley submarket.

VACANCY

70 basis point decrease in vacancy Y-O-Y

- The total deliveries over the past 12 months was outmatched by the positive net absorption of 9,700 units, compressing the metro vacancy rate to 4.3 percent.
- Over this time, the submarket with the largest drop in vacancy was South Phoenix, which dropped 180 basis points to 3.9 percent.

RENTS

10.2% increase in the average effective rent Y-O-Y

- Since last March of last year, the average effective rent has climbed to $1,104 per month. The year-over-year rent growth was one of the highest in the country.
- The Northeast Phoenix submarket had the sharpest average rent gain with a 12.1 percent growth to $1,019 per month in the past year. South Scottsdale posted the lowest advance in average rent at 5.4 percent, lifting the rate to $1,447 per month.

Demographic Highlights

Five-Year Population Growth*

563,400

1Q19 Population Age 20-34 (Percent of total population)

Metro 21%

U.S. 21%

1Q19 Median Household Income

Metro $64,843

U.S. Median $64,259

Five-Year Household Growth*

211,400

Population of Age 25+ Percent with Bachelor's Degree+**

Metro 29%

U.S. Average 30%

1Q19 Total Households

Rent 36%

Own 64%

** Forecast ** 2018-2023*

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19

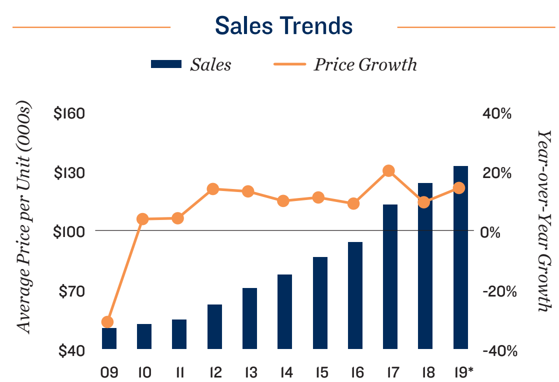
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
East Mesa	3.4%	-50	$1,065	9.3%
Northeast Phoenix	3.5%	-110	$1,019	12.1%
Peoria-Sun City-Surprise	3.8%	-50	$1,098	8.0%
South Scottsdale	3.8%	-60	$1,447	5.4%
South Phoenix	3.9%	-180	$1,156	11.9%
Southwest Mesa	3.9%	-60	$973	9.8%
Deer Valley	4.0%	-130	$1,208	10.0%
East Phoenix	4.0%	-120	$1,037	8.1%
Gilbert	4.0%	-140	$1,207	11.8%
Avondale-Goodyear-West Glendale	4.1%	-60	$1,093	9.2%
Overall Metro	**4.3%**	**-70**	**$1,138**	**10.2%**

SALES TRENDS

Multifamily Assets Draw Out-of-State Investor Interest; Trade Velocity Improves

- Trade velocity grew again in the Phoenix metro in 2018. The stability of the multifamily market in Phoenix attracts California capital sources to the area.
- The average sale price per unit increased 14.3 percent since March of last year, bringing the price per unit to $132,300, well below comparable assets in other major metros on the West Coast.

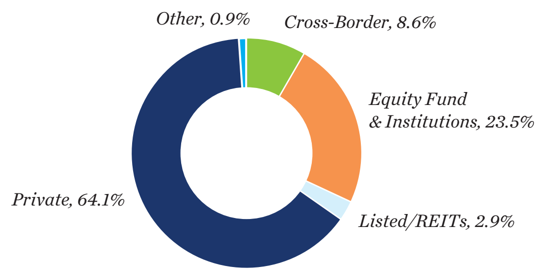
Outlook: Buyers are chasing returns by targeting Class C properties in the West Valley and Tempe submarkets. The West Valley submarket provides the Phoenix area's highest average first-year returns, roughly 30 basis points above the metro average.



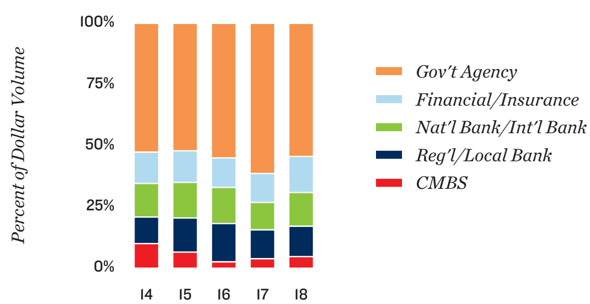
** Trailing 12 months through 1Q19*

Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

1Q19* Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



** Trailing 12 months through 1Q19*
Includes sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

- **International pressures weigh on domestic outlook; Fed remains patient.** Amid ongoing trade disputes between the U.S. and China and slowing growth throughout the European economy, the global economic outlook has become more cautious. Market volatility, combined with muted sentiment, has sponsored a flight to the safety of Treasurys, pushing the 10-year yield below 2.6 percent. While domestic growth has moderated recently, the waning impact of the tax cut stimulus will likely trim forward estimates further. As a result, the Fed has decided to cease reducing its balance sheet reduction through quantitative tightening by September and removed the potential for rate increases through the remainder of the year. The bond market has begun to price in a much more dovish Fed, with flattening interest rates reflecting more caution. Fed officials will likely focus on the intersection of a global growth slowdown and continued labor market strength to refine their plans moving forward, keeping interest rates stable for the foreseeable future.
- **Abundant liquidity sources balance conservative approach to underwriting.** The availability of debt for apartment assets remains elevated, spurred by the recent pivot by the Federal Reserve. Sourcing will be led by Fannie Mae and Freddie Mac, in addition to a wide array of local, regional and national banks, and insurance companies. Loan-to-value (LTV) ratios are trending between 65 and 75 percent on stabilized properties. The decline in interest rates has rewidened the spread between cap rates and Treasurys, reducing lender concerns about the risks related to repayment and valuation at maturity. Development and value-add projects have seen more conservative lending due to concerns surrounding overdevelopment and the length of the business cycle, leading to a greater use of alternative financing structures such as mezzanine loans and preferred equity to cover the additional capital requirements.

National Multi Housing Group

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; National Association of Realtors; Moody's Analytics; Real Capital Analytics; RealPage, Inc.; TWR/Dodge Pipeline; U.S. Census Bureau