



Steven Skarphol, PLLC
Associate Broker, MBA
LEED Green Associate
Superior Court Real Estate
Special Commissioner
 Zillow Rated 5 ★★★★★

The Skarphol Rapport[©]

Q1-2022

A QUARTERLY MARKET UPDATE - FOR BUYERS, SELLERS, AND INVESTORS



8388 E Hartford Dr, Suite 100
 Scottsdale, AZ 85255-7806
 602-317-5164 / 602-595-7200
Steve@Skarphol.com



**Markets Climbing to New Heights...
 Is there a Summit Ahead?**



Pinnacle Peak Summit

“The summit is what drives us, but the climb itself is what matters.”
Conrad Anker

EXECUTIVE SUMMARY – RESIDENTIAL REAL ESTATE MARKET IN 60 SECONDS

The residential market is more turbulent than ever. Double-digit price appreciation continues in the face of mortgage rates spiking over 2% in the last 3 months. Further, disruptive policies like tariffs and unprovoked war in Ukraine have boosted the rate of inflation to new highs raising the anxiety in the stock market. Reflecting on over 50 years in business it is clear the impact will not be equal in all markets.

Arizona is benefiting from huge investments in the tech sector including semiconductors, software, EV, PV, and battery production. This is echoed by massive land purchases expanding residential and industrial capacity. Somewhat concerning however is the shift by major new home builders to the Build-for-Rent model, where entire subdivisions are built-to-rent and sold to a single institutional buyer which further constrains an already anemic home inventory. Also, of concern is the impact of water shortages in the west which is causing municipalities to “circle the wagons” like Scottsdale, which recently cancelled a hauled water agreement with Rio Verde creating a water crisis for the area.

Trends are positive, bringing high volumes of engineering, medical, and technology jobs, and investment to the region, which should translate into beneficial wage growth for the region supporting a healthy local economy into the foreseeable future.

LUXURY MARKET: The over \$1M market continues to surge with 2021 sales up 78% over 2020 and 174% higher than 2019. First quarter results are on a 500 home per month pace and accelerating. Record corporate earnings and new wealth following the tech trend into the Valley has routinely set new price records. An example is a YouTube influencer couple paying \$6.990M cash for a 2.25-acre new home LOT in Paradise Valley on the side of Mummy Mountain; a record. Pair this with a record \$21M sale for a 15,736 sq ft contemporary mansion on 4.27 acres. The very best and modern properties should be ‘cashing-out’. Homes needing updating also can bring a good price as high-end flippers pursue opportunities. Luxury buyers should expect to pay over list on the best properties as more than 50% of the transactions in the last 30 days closed \$50k-\$100k over list. Any successful purchase represents a good inflation hedge for the near-term.

BUYERS: Inventory for buyers in the \$500k - \$1M are seeing more opportunities as new supply favors this price range. At \$500k and under, all buyers are seeing limited options. The typical homes come with property or system condition issues, functional obsolescence, or location factors like traffic noise. I am having success for my buyers identifying best fit and best offer strategies to secure contracts and work through property issues. Patience and continuous review of search criteria is key. As always, I never advise my clients to purchase above their comfort level because life can change abruptly, and real estate is not a liquid asset.

SELLERS: For my sellers under \$1M my first recommendation is DON'T sell. Rather, whether looking to upsize or downsize, review strategies to hold for rent or cautiously leverage equity to add rental property income. Phoenix has posted a 32.9% price appreciation YOY for the 33rd consecutive month on the Case-Shiller Home Price Index so long-term appreciation as an inflation hedge is indicated. The Cromford Market Index, which is the leading indicator on future home pricing, is falling fast suggesting increasing supply and diminishing demand will be moving us to a more normal seller's market. Time to be cautious.

LAND OPPORTUNITIES: Land purchases have increased in response to the declining residential inventory. This is reflected in nearly 20% of all new home building permits are in locations in the unincorporated areas of Maricopa County. Land buys are a great inflation hedge for a future build. Further, land is a solid diversification to hold for the long term or create generational wealth potential. This trend is also appearing in more interest in 55-year ground leases to capitalize on current development land values while deferring income over an extended period.

KEY STATISTICS – Single-family homes:

Active Listings: 6,027 – up 32% YOY, but still 75% below normal.

Listings Under Contract: 10,697 – down 13% YOY and represents only .6 of a month's supply.

Sales: 104,509 units – the rate declining with fewer homes available and mortgage rate surge dampening demand.

Sales Volume: \$13.7B for the quarter– strong push into Q2 expected.

EXECUTIVE SUMMARY – COMMERCIAL REAL ESTATE MARKET IN 60 SECONDS

Commercial real estate market is also chaotic at best. Unprecedented demand in multi-family and industrial sectors has inventories shrinking, prices soaring and vacancies compressing along with cap rates. Retail and office are responding dynamically to the full impact of the COVID-19 pandemic with retail surges in adaptive re-use and office use adjusting as work is redefined, remote working expands, and employees slowly and reluctantly return to the office environment.

Medical office demand remains high as supply lags, impacted by supply chain issues in basic building materials further exacerbated by persistent labor shortage. Limited commercial, residential and industrial land has prices soaring, but ironically massive industrial acquisitions and planned developments in the Southwest, Northwest and Southeast Valleys will bring thousands of acres of capacity into the mainstream to meet surging logistics and technology sector expansions. Consolidation is a personal concern as large institutions on a buying-binge expand portfolio size and extend geographic holdings. Too-big-to-fail raises to the top of my mind. Time to be cautious.

Multi-family: Q1 delivered 2,772 units in 12 projects. Almost 40,000 units are under construction in 157 projects. Construction delays will be reflected in delayed completion of units while almost 27,000 units are in various stages of planning, undoubtedly vulnerable to cancellation due to costs breaking the financial viability of some of the 106 projects on the drawing board. Resale units are in short supply with as-is cap rates hovering in the 3%-4% range. Still a good time to invest in multifamily but expect to pay market. Experience in renovating and rolling up the rents are key to making current acquisitions work for the near-term hold.

Medical Office: Vacancy rate is holding steady at 8.7% with good growth in rental rates to an average of \$23.05 per sq ft. New supply remains impacted by land cost and construction supply chain issues for materials and labor. Demand is expected to grow as universities align with cutting-edge research growing the sector's ecosystem and expanding the need for space.

Office: Vacancy rate hovering around 22% is seeing a positive trend with a 'flight-to-quality' as companies adjust to the ravages of COVID-19 with positive absorption in class A over shadowing larger negative absorption in class B office. Downward pressure is holding average rents around \$27 per sq ft expressed in the form of increasing cap rates. Currently 1.1M sq ft are under construction primarily in the Phoenix and Tempe submarkets with Tempe dominating with almost 500k sq ft in process.

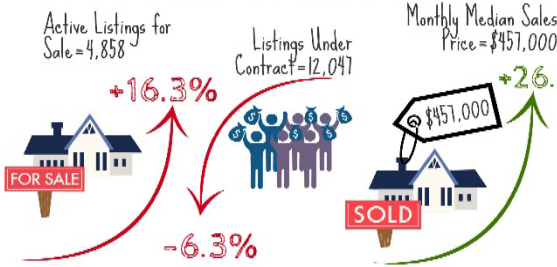
Industrial: Vacancy rate declining to 4.5% and demand surges from eCommerce and supply chain sectors expand. A record 33.3 msf is under construction valley wide. Rents on a NNN basis have increased from \$.60 psf per month to over \$.73 psf per month YOY. Recent announcements include a 1,300-acre industrial corridor being developed in the West Valley to accommodate continued demand for warehousing, manufacturing, and distribution space. Large industrial projects have been announced for the Southeast Valley as well.

Retail: Pad sales are increasing as drive-thru food options continue to expand. Major mall redevelopments like Metro Center with light rail extending to the site expanding access and transit options creating mixed use properties with residential, office and retail in the mix. Paradise Valley Mall, now you see it and now you don't, has been demolished except for JC Penny's and Costco to make way for 21st century urban mixed use bringing a variety of housing options, office, medical and retail components. This trend is also continuing in the Southeast Valley. Vacancy rate is 7.5% valley wide. Average rents are up \$.70 psf to \$15.87 psf NNN. Re-opening continues to improve the financial picture for landlords and new NNN single tenant deals with national credit tenants bodes well for the foreseeable future.

Land: All types of land zoning are in high demand. It is the fundamental asset providing 'location' to any development project and they are not making it any more...so to speak. Desirable A-2 and C-3 sites are in limited supply when outdoor storage and RV storage uses are being requested. Other residential, multifamily, commercial, and industrial uses are also seeking a reduced number of available sites. Considering that only 17% of the State of Arizona is in private ownership the land shortage is not surprising. Comparing that to 32% controlled by the State of Arizona, the State Land Department's role is the future growth of the Valley cannot be understated.

PHOENIX METRO RESIDENTIAL REAL ESTATE

Annual Changes from April 8th, 2021 to April 8th, 2022



CLOSED SALES

Total Monthly Sales = 9,808

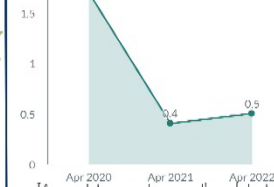


MEDIAN DAYS BEFORE ACCEPTED CONTRACT

S	M	T	W	Th	F	S
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30					

50% of listings that went under contract last week had been active for 7 days or less

MONTHS OF SUPPLY



If no new listings were to come on the market, at current monthly rate of sales, inventory would run out 0.5 months.

Encompassing the Arizona Regional MLS area, which includes Maricopa County, Pinal County and a small portion of Yavapai County

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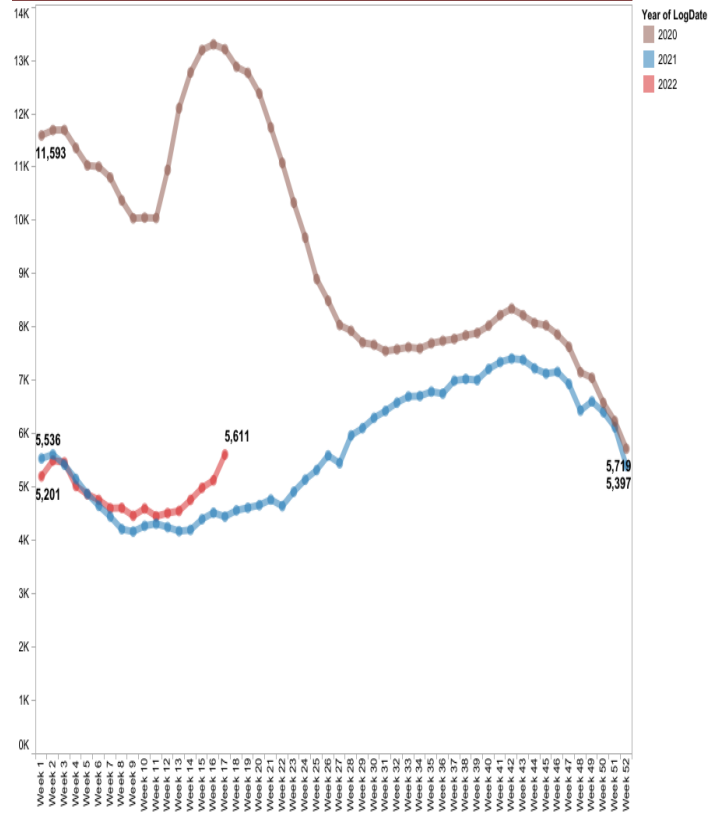
Cromford Associates LLC & Tamboer Consulting LLC

Active Listing Weekly Counts - Compared by Year

Greater Phoenix - ARMLS Residential - Measured Weekly

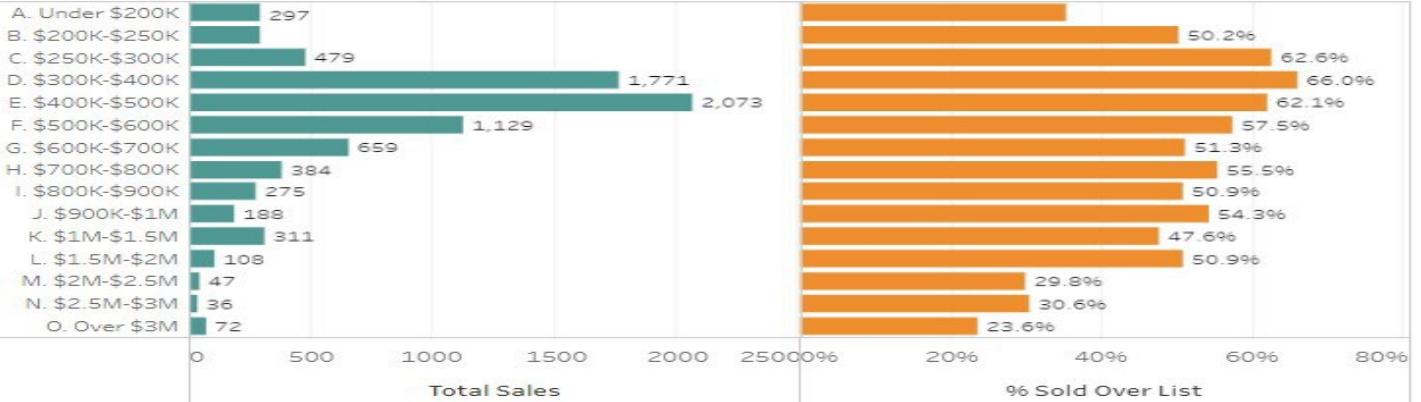
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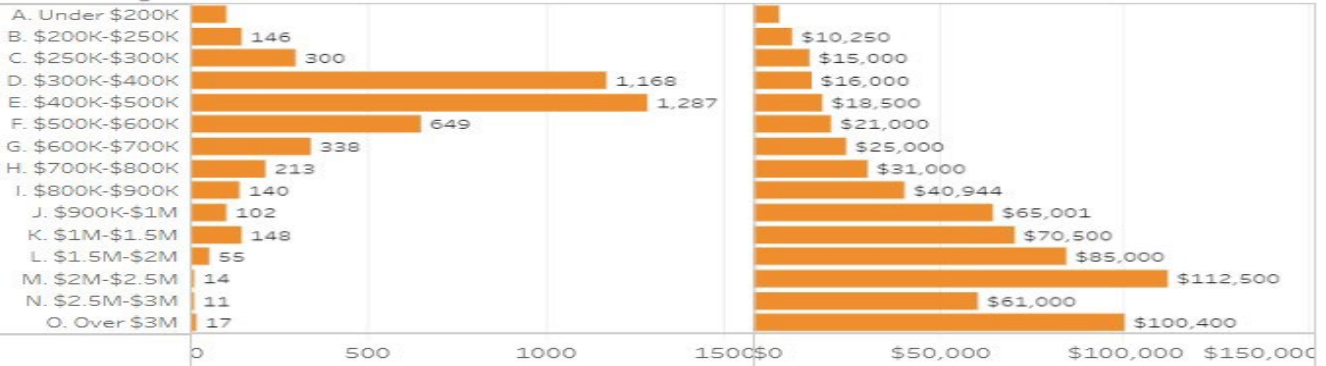


Closings over List Price - by Price Range Last 30 Days

List Price Rang..



List Price Ranges



SOURCES: Michael Orr, The Cromford Report, The Information Market, Phoenix Business Journal, The Rose Law Group /Belfiore – Dealmaker
ARMLS - the most accurate and comprehensive Arizona Real Estate Statistics and Data available

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