ASU Commercial Brokers Forum Survey
Forecast for April 2017 – September 2017

Introduction

“That's life. Something always happens. We don't live in stasis, frozen in amber.”
— Dean Koontz, Chase

The results of the recent commercial broker’s survey are not a big surprise. In October 2016 uncertainty had crept into the sentiment and it showed in responses to our survey questions. The rhetoric of the Presidential election, uncertainty about the outcome of the election and softening in some sectors, caused a decreasing number of respondents to believe we were in an expansion mode a trend started in spring 2016. Previous survey results showed that after 1½ years of 100% Respondents believing metro Phoenix market was moving in an upward direction. That changed in fall 2016 when only 88% believed we were moving in an upward direction and only 52% believed metro Phoenix was expanding. But, something always happens. The election is over and the surprise behind us, confidence seems to have returned. When asked, 59% of Respondents said we were in an expansion mode and 92% said the commercial market was moving upwards. One Respondent stated “One of the things to note is that the response options included: expansion, recovery, correction, maturity, and recession. The good news is that no one picked recession.” The survey results are similar to previous reports of survey results, which show a belief by Respondents that we continue a slow and steady recovery. It is pretty clear that uncertainty and a cautious attitude among Respondents remains, but the type of growth we have indicates solid economic fundamentals are the reason. Looking at survey results, discussing the market with the brokers, and looking at the markets statistics, seems like we are almost in equilibrium.

When the results of the survey were discussed at the Forum, the participants continued to express confidence in the market when considering the long term outlook, but there is a lack of absolute, unconditional confidence in the short term. Growth continues, projects are getting done but they are in line with demand. There is also an indication that the recovery is beginning to spread to sub-markets previously unaffected meaning benefits are becoming more widespread. When discussing the market and survey results with Forum members, it is impossible to make categorical observations unless it is prefaced with “It depends.” Forum members still referred not to just sub-markets but to micro-markets – areas within sub-markets. This is as good an indication of the state of the market as any – a very granular analysis is still needed to understand potential for any given product in any given sub-market. We are certainly not over building and possibly we are in equilibrium – developing only what is needed to keep the market stable.

The development, for the most part, has been and remains, user driven. There is very little speculative development. The speculative development that is underway or planned, is very tactical and providing supply the market wants because available space is obsolete. When you look at the trends, and read the comments of Forum members, the conclusion is clear that we are on pretty solid ground but outside factors are making it difficult for metro Phoenix to expand at a more robust rate and that is creating uncertainty about the next six months. Concerns still exist and the geography of the expansion is still not uniform – some products and submarkets are doing much better than others but we are beginning to see supply added to areas of the Valley that had
not benefited from recovery. Demand is beginning to push opportunity for expansion to submarkets other than the core areas. For example, employment growth in the west Valley is beginning to make multifamily feasible.

Background

The Forum has now been held for 3 1/2 consecutive years (nine separate surveys). It was first held in October 2013. This report includes results of a survey conducted in March 2017 and a discussion with Forum members held on March 22, 2017 about those survey results. The survey was sent to over 400 commercial real estate sales persons from all segments of the market and all product types. More than 180 responded. This report presents the results from those respondents and comments made by members of The Commercial Real Estate Brokers Forum. The Forum is composed of 15 of the Valley’s most successful commercial real estate brokers representing all major product types, brought together by the W. P. Carey School of Business and the Center for Real Estate Theory and Practice with the assistance of Pete Bolton, Managing Director of Newmark, Grubb, Knight, Frank. The purpose of the Forum is to provide meaningful, insightful and relevant input on the commercial real estate market in Phoenix. The Forum members come from a variety of sectors and specializations as well as a cross-section of the many brokerage houses in the Valley. The Center for Real Estate Theory and Practice conducts the survey and brings together the Forum every six (6) months to discuss and track the perceptions, insights and trends in the Phoenix commercial real estate market. The comments presented in this report are those made by Forum members during a meeting to discuss the survey results.

The purpose of this forum is not only to seek informed opinion but to hopefully achieve consensus on forward-looking key indicators of the commercial real estate market in the Phoenix metropolitan area. The Forum is an open discussion about the survey results and what is happening “on the street” in commercial real estate. The combination of the survey results and the discussion with Forum members, is used to detect current trends, discover similarities and differences among various sectors and submarkets and document anecdotal evidence, opinions and insights. This report is a summary of their opinions. Each session builds on previous surveys and the information gathered is synthesized chronologically to provide an indication of trends.

This is the ninth report of the Commercial Real Estate Broker Survey and addresses what the panelists believe will happen between April 2017 and September 2017. The following charts indicate the survey results and the comments of Forum members made during discussion of the survey results. The responses are anonymous. This is done so that panel members feel comfortable providing unbridled opinions. Reading the comments will give readers a sense of what these important players in the commercial markets are thinking. Readers should note that the comments are those of the brokers and are as close as possible to being verbatim. This is not a refined analysis of market conditions.

We added a few new questions in order to better understand certain product segments. In the last survey we also asked the question: “Are local economic development programs and the real estate markets aligned?” We asked this to see what the market thinks about the ability to be competitive with other markets. Respondents believe our local economic development efforts are getting better
but are hampered by a lack of tools to compete against our peer markets. We recognize that this is a competition for employees and employers and we need to be attractive to both.

It is clear from the results of this edition of the Forum that those who know this market best are feeling slightly more certain about where we are heading and remain confident the metro area will continue to expand at least for the next six (6) months. There is certainly not exuberance about the market – but this is cautious optimism.

Systemic problems that have persisted for the past several years remain a factor. The global market and uncertain political environment means caution. The economic development various groups have been making significant progress and have seen success attracting more high-wage earning jobs. Construction labor shortages are still a problem as is tight lending both making anything other than institutional grade borrowing tough and this continues to keep a governor on new construction. The industrial segment is currently king and multifamily is taking a more cautious approach to new development. All Forum members wished for more activity in most segments, but see the progress. The market continues to reflect a maturing metro development pattern. We are still thought of as a “boom and bust” market but that perception shows a misunderstanding of reality. As I’ve stated previously, maybe what’s happening is we are growing up and this is a more sustainable pattern. I think as a place, we need to continue doing what is necessary to build community and that will help create a sustainable growth pattern and increase our resiliency to those potential systemic problems.

These are the forward-looking opinions of the professionals who are in the market every day and know it best. These survey results are their opinions based upon their experience.

Mark Stapp  
Executive Director, Master of Real Estate Development  
Director, Center for Real Estate Theory and Practice  
Fred E. Taylor Professor of Real Estate
Below are consensus statements made by the panel and charts that show responses to questions asked of the Forum members. For most questions, Forum members could choose “Up”, “Down” or “Stationary”. For simplicity sake, we chose to only show the percentage of respondents selecting “Up” but believe this adequately show trends.

THE MARKET OVERALL

CONSENSUS STATEMENTS on the overall market in Metro Phoenix:

- Under the new administration, we are going to see maybe 2.5 percent of GDP growth versus 0.75 or 1.25 percent.
- One of the things to note is that the response options included: expansion, recovery, correction, maturity, and recession. The good news is that no one picked recession.
- There are a number of people who believe that the new administration is going to give us 24 more months of expansion, especially in Arizona.
- Maturity would imply that we are in a pretty steady state. People are recognizing the fact that there is a significant amount of potential in our market, but we are also still reeling from 2008.
- Unemployment is down to 4.7% in Metro Phoenix. All you have to do is try to hire somebody at what you think is a correct wage today. If someone is in the $55k range, they want $60k, they want $65k. Instead of getting 100 resumes, we are getting 25.
- The GPEC folks have done a fabulous job in the past couple of years. They have done a good job of articulating our competitive advantages.
- The problem is that the economic development people do not have the tools. When it comes time to actually sit down at the table and say, “What can you offer us versus what Texas can offer us?” They don’t have the tools. They have the heart. They have the effort. They have everything, but they don’t have the tools.
- GPEC will help introduce you to employers and things of that nature, which is all helpful, but there is just no hardcore incentives like there are in other markets.
- In defense of the government economic development industry in our market, incentives are not as important as they once were. What is more important today is labor and HR. Qualified workforce trumps—no pun intended—incentives. Incentives are still very important, but maybe not as important as they were to us 25 years ago. We didn’t have as much to sell.
- Industries like cyber security have $150,000 a year jobs, but no qualified applicants.
- Now it is new manufacturing like robotic manufacturing, and you need a higher skill set for those types of jobs.
- Everyone just assumes that interest rates are going to go up. Returns are going to go down. Returns have to go down. It is good for the cash buyer, but not so good for the leverage buyer.
• The interest rates have been so artificially low for so long that it is actually a healthy thing to see the rates go marginally up.
• For the ones who haven’t studied history, interest rates were as high as 22 percent in the 80’s and the market still did kind of okay. Certainly nothing like it is today.
• The cap rates have held steady, so they aren’t compressing.
• The anticipation is that the rates are going to go up, but none of us really know what will happen.

Where are we in the cycle?

In what direction is the metro Phoenix market moving?
Will the number of people who have stopped working or stopped looking for work affect commercial real estate markets?

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Are local economic development programs and the real estate markets aligned?

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Is uncertainty in the federal government affecting the commercial real estate market and hindering our local growth potential?

How will changes in Federal regulations related to commercial real estate lending affect the market over the next 6 months?
Where are interest rates for commercial loans headed in the next six months?

Where are investor returns headed in the next six months?
Has cap rate compression helped effect gains in core real estate values over the past six months (September 2016 – April 2017)?

Will cap rate compression continue in the next 6 months (April 2017 - September 2017)?
What is the overall feeling about the metro Phoenix commercial real estate market?

OFFICE MARKET

CONSENSUS STATEMENTS:

- It has always taken a long time for this market to absorb office space, we have a lot of product.
- The biggest problem is that we have a lot of obsolete product, it is not easy to tear it down and get it out of the market.
- What is the vacancy rate right now? It depends on who you ask, but most of us are around 20 to 21 percent. It was as high as 27 percent back in 2012-2013.
- The challenge is that there is a lot of functionally obsolete space that is too expensive to tear down and there is plenty of land available.
- The kind of office space that new companies want is different now. A big company will come to town and the office guys are talking to them about six or eight potential deals that are 150,000 to 300,000 square feet of office space along the 101 corridor, but each one of them wants to build new buildings. State Farm is a perfect example.
- The vacancy rate will go lower because the overall number of total square footage will get bigger. That amount of vacant space will never get leased. What happens to that space?
- Perhaps the most encouraging thing we have seen is the tearing down of 25 - 30 year old buildings, and that is being replaced by apartments, hotels, and four story office. That is progress, but you can only do it on Camelback Road, you can’t do it anywhere else.
• It is very spotty. Class A office vacancy rates are going down. Class B is going down and Class C is going up. You literally have to go submarket by submarket now. You can’t just make an overall statement, I think we track 17 submarkets. Everybody breaks everything down differently.
• For those in Class A office space, we show them what they can get in Class B. The rents in Class B and Class C are going to go up, because Class A rents are approaching $40/square foot in a lot of areas.
• No one goes to Class C office space on purpose.
• We are seeing some of the creative office space going in at renovated old industrial or Class C office, although the small to medium industrial space doesn’t have parking.
• The warehouse district part of town is not big enough to make a blip on the numbers. There are three or four buildings with 50, 60 employees, but there won’t be a 2,000 employee company going down there.
• These young employees want to be where there’s food options and action. It’s a different thinking for the employees for sure.
• There is a real tendency towards businesses that can’t find what they want to build what they want on reservation land.
• If companies can’t find what they want along the 101 or the 202, reservation land is a viable option because it is in the middle between Tempe and Scottsdale.
• It is interesting that Red Moutian Weight Loss, as an example, is moving into retail space when they have always been an office user.
• Simon Med Clinic is another example, they are combining back office with equipment storage with business operations into a 40,000 square feet industrial space. Plus, all of their employees are fighting to be there because they want to be in that big box space.
• Pure medical office is at a 12 to 14 percent vacancy rate, but so much of it is antiquated. That’s why they are starting to build new.

Where are office vacancy rates headed in the next six months?
Where are Class A office vacancy rates headed in the next six months?

Where are Class B office vacancy rates headed in the next six months?
Where are Class C office vacancy rates headed in the next six months?

Where are office rents headed in the next six months?
Where are Class A office rents headed in the next six months?

- 80% in 10/14
- 83% in 04/16

Where are Class B office rents headed in the next six months?

- 68% in 10/14
- 77% in 04/16
Where are Class C office rents headed in the next six months?

Is this a tenant or landlord office market?
Will we see more Office Spec Development in the next 6 months?

![Yes](chart)

How will the amount of available shadow space change in the next 6 months?

![Increase](chart)
INDUSTRIAL MARKET

CONSENSUS STATEMENTS:

- Vacancy rates are going up because of the general profile of tenants; what they do in the space is higher up the food chain, it is e-commerce and high-end manufacturing.
- They pay their workers higher wages because they are doing more skilled labor activities in the box, and the rent follows that, so the rent goes up.
- The sectors that are very active are e-commerce, food and beverage, and new world manufacturing with robotics. These areas are paying much better wages. For example, there is a 300,000 square foot insulated glass manufacturing facility, sixty to seventy percent of the finished product will go into Southern California. They are paying $65,000 a year for positions in the plant because these are high-end manufacturing, advanced manufacturing using robotics.
- There are a lot of manufacturers that are coming to Arizona. Arizona is going to be a huge winner in the U.S. renaissance for manufacturing.
- There has been more built on the 303 in the last year and a half to two years than in the last ten to twenty years. It is such a good thing that manufacturing is coming into this valley.
- Robotics manufacturing is almost more of an emerging tech sector than traditional manufacturing which will require more technically focused jobs.
- Definitely improvements are going up. A lot more air-conditioned space than there used to be. That costs money to put in, and so as a result of purely increased tenant improvements, the rents are going to go up. There are 20 developers that have land positions that can put up a building in 8 months. There is always going to be some stability, but a lot of times they don’t have time to wait for that build-to-suit. The rates will probably go up a little bit. The rate are increasing based more on the tenant improvements than they are on a supply and demand ratio.
- There is still plenty of space right now. It depends on the size, of course, but when it comes to 200,000 to 300,000 square feet, you probably have a lot more choices than you do at 400,000 square feet and above.
- There are six or seven spec projects going up in the West Valley in Phoenix. This is a new market and they have preleasing on six out of those seven properties.
- It can take eight months to a year to find a new building.
- We are in good shape compared to the State of California where construction is taking upwards of three years to complete a project and it can get it done in 12 – 18 months in Arizona.
- I know of three to four deals that are delayed four months because of construction labor constraints.
- It is very important to get the right kind of general contractor teams on your projects. They have to have strong relationships with the subs. You can get it done and on time,
because a lot of these build to suits have a very aggressive speed mandate. You’ve got to meet all their milestones.

- Some of the jobs are working weekends or they’re running all the shifts, depending on who it is and what they want.
- If it’s e-commerce, that will be 500, 600 jobs that ramp up to maybe 1,200 or 1,000 seasonally or at least September through February to facilitate returns.
- Homebuilding is just starting to come back in the West valley. Traffic is a huge pain there and back. That’s the biggest problem we have—is I-10 in the West Valley.
- The other thing that will have a big effect on the West Valley is the southbound freeway. When that opens up, you can bypass downtown. We think that that actually might bring distribution to the Southeast Valley. It will make hiring more feasible. If you live in Ahwatukee, you’d never work on 51st Avenue in Buckeye right now, because that drive is insane going through town. If you live in Ahwatukee, you can just jump on the southbound freeway and be at 59th Avenue and I-10 in 15 minutes. That makes a big difference. That opens up your population, your employment pool. It opens up the product and the uses, it used to be Southwest Phoenix was all distribution. Southeast was all technical. I think you might start to see some more distribution in the Southeast Valley now if you can get there without having to go through downtown Phoenix.

**Where are big box industrial vacancy rates headed in the next six months?**

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Where are big box industrial rents headed in the next six months?

Is this a tenant or landlord industrial market?
Will we see considerable Spec Development in the industrial market over the next 6 months?

**RETAIL MARKET**

**CONSENSUS STATEMENTS:**

- Retail in the Valley runs hot and cold. There is space that companies are lining up for and other space that has been vacant for a decade.
- I think part of the challenge comes with ownership. If you have an owner who hasn’t adapted to the new mindset of what’s possible for the space, it just sits there, because they’re waiting for things to recover and in many cases it’s just not going to recover.
- If you don’t have someone who’s creative enough to, for example, bring in nontraditional office tenants and/or do some shadowing in your shop space, then a lot of the tenants that were out there for that space have gone out of business.
- They’re not coming back. Their businesses have evaporated into the Internet. I do think raising interest rates will help, because banks will want to lend to more local people to start businesses. I do think you’ll see a bit of renaissance in retail, where people will go for quality - experience of going to a quality restaurant. Even going to a quality tailor or something like that. People who can afford will find things that the Internet can never replace. Most of those people haven’t been able to get into business because the lending hasn’t been there.
The vacancy rate is below ten. It’s like 9.7, but it’s exactly the same thing. There’s this dichotomy in the market. All the new construction is basically almost preleased. However, I don’t know how they can afford it. How can you sell sandwiches and pay $42 a foot and still stay around. There will be some fall out. We’re now big foodies. You’re seeing a lot of the restaurants that come with a huge amount of TI dollars.

There is a vast amount of uncertainty in the retail market. For example, Albertson’s is talking about possibly merging with Sprouts. Well, what’s that gonna do? Then Amazon’s opening 20,000 square foot stores now in Seattle to test that concept. It’s just constant change and you have to ask, “who’s gonna survive? What do you do?”

We have 12 huge centers, Sprouts, a couple of new Safeways, and more of Fry’s, but if you go into the Fry’s now, they’re selling clothes.

Nobody’s selling stuff anymore, it’s all services. You got every single known to man dentist, kids’ dentists, chiropractors, nail salons, whatever. All service tenants. There are these Phoenix salon suites and they’re getting $50 to $60 a foot in TIs and 10-year lease in new space. That’s changing that whole thing, because now we’re seeing empty nail salons, empty beauty salons, which we never saw.

Malls are big targets, but maybe more important is if you look around your neighborhood, and you look at your Fry’s that was built 20 years ago, and it’s got 40,000 feet of shop space, what’s that gonna be? Those are all over the place.

There are approximately 223 empty big boxes over 10,000 square feet, because a lot of the Fresh and Easies have never converted. There is at least one space that is going to be divided up into shops.

Cities seem to want to leave retail zoning in place, although they know that they’re never going to see a retail tax dollar coming in from it. They know the realities now, the cities are now generally okay with it.

If you tear a center down, what are you going to put there?

It’s interesting. The hard corner is still going to be the hard corner. It’s valuable to someone. I think we’re going to see that happen next seven to ten years.

Papago Plaza has 12 acres and they’re in a deal to do apartments on about seven of it. Leaving five acres just on Scottsdale Road. They have to rezone everything, the whole thing, but they’re really being conscious of the offsets so that they won’t interfere with the one story surrounding neighborhood.

They better hurry up, because they’re building 1,000 units on that street or some crazy thing. Four dealerships have been leveled on McDowell. They’re building some very nice product. No place to go in Scottsdale, except south.

There is a great future along McDowell and the people that have been snoozing on it are missing the boat. I’ve been workin’ on that condo project for two and a half years, and people were laughing at me two and a half years ago. We’re not laughing anymore.
Where are retail vacancy rates headed in the next six months?

Where are retail — anchored center rents headed in the next six months?
Where are retail - unanchored center rents headed in the next six months?

Where are retail — big box (over 25K square feet) rents headed in the next 6 months?
Is this a tenant or landlord retail market?

Will we see an increase/decrease in Big Box Absorption over the next 6 months?
MULTIFAMILY MARKET

CONSENSUS STATEMENTS:

- The apartment guys are going nuts. Multifamily is coming back to the West Valley.
- There are a few groups working on an alternative apartment, which is the ten to twelve units per acre, typically it’s a little cottage. It is just a detached standalone casita basically. It looks like a cottage. It looks and feels like an apartment, but you don’t have people living next to you. They’re paying six bucks a foot to go to these sites that nobody wanted to go to, so they can pay as much as the garden guys, but it lives like a single family house, so you don’t have to go up the two flights of stairs to get to your front door.
- There is one in Goodyear, north of the freeway, in the Palm Valley area. They leased it up and raised rents before they were even built. Then they sold it off on the market.
- There’s a bunch in Chandler. There’s a couple in Gilbert. There’s one in Cave Creek under construction. There’s two south of the ten in Estrella.
- You can’t afford a home. You don’t wanna drive. You have to get an apartment or rent a house, but house rentals are at a three percent vacancy, there are two hundred and fifty thousand homes available for rent. Three percent vacancy on rental single family.
- The apartment market is strong. Obviously it’s very strong. We do have some class A products, all built in the same area. You could draw a circle around probably three prominent areas and that would be downtown Phoenix, Tempe, South Scottsdale.
- There was a lot happening in downtown Scottsdale, but that’s stopped now. I haven’t seen much in construction down there other than small products. Those are competing hard on the class A. That’s new product, urban style with the underground parking. That’s where I think your rents are fighting it out a little bit for leasing. The rest of the market seems extremely healthy.
- Vacancies are running anywhere from three to five percent depending on what submarket you’re in and how much you’re pushing your rents. Rents seem to continue to increase, except for this little pockets that are fighting it out, downtown Tempe for example.
- The Class A plus product in the urban core is going for around two dollars a square foot, anywhere from $1.80 to $2.10. That’s where it’s really competitive.
- When there’s high concentrations like South Scottsdale, it’s a little bit softer.
- Tempe is going to get softer. Class A rents flattened out two quarters in a row. Actually it has dropped down a little bit. What is strange is Class B product prices jumped up 25 percent last year, but rents only went up 5 percent in the same space.
- The Class B price jump was because of the value add component. Everybody has been real focused on value add. That was one space where they could do the value add.
- Well, at one point, value add was heavy lifting, where you came in and you did clubhouses. You did balconies. You did parking, resurface roofs. That was heavy lifting. Most of those parts have been done in the market now. Once in a while, you’ll find a deal that has heavy lifting. Most of it now is interior improvements. They will come in and put
in new appliances, new wood flooring, new lighting fixtures, new plumbing fixtures. It could be anywhere from $3,000 a unit to $12,000 a unit. Most of the products have been touched from a value add standpoint.

- There is also light value adds where companies are coming back and enhancing what’s already been done. If they spent $7,000 a unit, they might come in and spend $3,000 a unit. They can still get another $75 or $100/month bump.
- Baby boomers and millennials basically are occupying the more premium locations.
- All of the class A builders are very hush hush about their occupancies right now. Even the property management people, you have to really twist their arm to find out what’s going on.
- What’s your estimate for delivery this year, 2017? How many units roughly do you think
- Right now 8,800, 4,400 comin’ out of the ground right now.
- We’re up 30 percent?
- Phoenix is the big one right now, 3,800 units coming out of the ground right now in Phoenix. Last year was 2,250. Scottsdale is only at 852.
- Last year it was 1,400 and Phoenix was 2,250.
- This is the first time we’ve started building west of I-17.
- What’s happening to the older communities, are they just vacant?
- No, there’s such a scarcity of affordable housing in this market. It’s crazy. You’re seeing the C market go crazy in rental increases, because they were getting $600 and $700/month a unit. Their moving up $80, $90, $100 a month in rental rates, because the B’s are now getting a $1,000, and the A’s are $1,100 to $1,900 or more.
- Plus there’s a lot of C’s that are in great locations that push the B’s and even squeezed more of the C marketplace.
- What about next year? I hear vertical financing’s shutting down for a lot of those apartment guys.
- Construction in Houston has come to a halt almost, but here I think they’re just more conservative. I don’t think it’s shutting down.
- It depends on what location.
- Lenders are calling each other and talking to each other about what they’re lending on. Lenders are saying, “Okay. We’ll do a 300 unit project, but it’ll be 150 units of phase one. We’ll see how you do. Then we’ll fund phase two depending upon your stabilization on phase one.”
Where are apartment vacancy rates headed in the next six months?

Where are Class A apartment vacancy rates headed in the next six months?
Where are Class B apartment vacancy rates headed in the next six months?

Where are Class C apartment vacancy rates headed in the next six months?
Where are apartment rents headed in the next six months?

Where are Class A apartment rents headed in the next six months?
Where are Class B apartment rents headed in the next six months?

Where are Class C apartment rents headed in the next six months?
Which multifamily property class will realize the greatest rent growth over the next six months (October 2015 – March 2016)?

![Graph showing rent growth for Class A, B, and C properties over time.]

Have apartment rents for newly constructed projects reached their peak given the current market conditions?

![Graph showing rent growth over time with a conclusion of "YES" at a certain point.]

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Will the availability of labor be an issue in the development of Apartment projects over the next 6 months?

How much has the cost of materials impacted rental rates?
Will apartment affordability be a concern over the next 6 months?

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**YES**

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**LAND/HOUSING MARKET**

**CONSENSUS STATEMENTS:**

- Homeowners are buying. They’ve been buying. Last year we were up 15 percent on permits. I think we’re up five over that this year right now. There’s a push to the periphery. We’ve had stuff that people said last year, you’ll never sell it. The homebuilders aren’t looking. Now it’s all in escrow. We had builders looking in Coolidge again just because it’s below replacement costs. It’s cheap.

- Whereas they would tell me, “No, no, no. will not go there” Now it’s like, “Okay. I’ll look. I’ll go drive down there.” It’s half of what it costs to replace the lot, and the dirt’s free. Buckeye, all the finished lots are basically gone. We haven’t turned a dirt there yet, but DR Horton, Meritage, those guys are now doing eight, ten a month. In the high one hundreds.

- The periphery market, people are driving out again, whereas before—six months ago, they said it wouldn’t happen. Then people were just clippin’ along. We are seeing a big rush to affordability in every market, even in the higher price point markets, just a little bit lower end, the absorptions are higher.

- The homeowners are taking less margins. They tell you the low 20s gross, but it’s probably more like 15 or 16. They’re not making much money. They’re trying to play a little IRR game with New York. They’re combining IRR and gross margin to try to get somewhere near a 40. Pricing is coming down a little bit. They’re trying to turn it faster. They’re all buying like they need to increase 30, 40 percent over the next couple years. Inventory is pretty good. There’s some guys are doing spec. Some aren’t.
Someone made the comment about labor. We still have a big labor issue. It takes six, seven months to build a house, which it shouldn’t, it used to be three to four months, so you’re double the time. It was 90 working days That’s what we built houses in, 90 working days. Now it’s 120 or more.

It’s getting better. They’re not complaining about it as much, so it’s gone down a little bit. That’s really the limitation. Everybody says, “Hey, we can sell homes. We just can’t build ‘em.”

What’s the end of the year number? Nobody’s goin’ too crazy. Everybody thinks it’s gonna be around 20,000 permits. We were at 17.8 last year. It’ll be—some people are sayin’ 22,000 maybe 23,000. I don’t think they can get them on the ground. That’s the issue, but everybody’s buying like they have to increase—if everybody’s increasing by 25 percent or something. There’s not enough to go around. We are seeing homebuilders go to bigger tracks. Most of those are in the periphery. No one’s programming ten sales a month, it is more like three, four, five.

A couple different product lines as opposed to before it was, “Hey, we’re doin’ two a month. We’ll do one product line. Give me one parcel at 70 lots.” Now they’re buying bigger parcels. Meritage has bought almost 500 lots. Next to the community, they’re doing ten a month. They still have to improve it, of course, but they’ve got to go to parcel.

Some of the big publics, like Lennar, they’re buying bigger parcels with the plan to sell parcels off to other homebuilders. If you actually put the improvements in the ground, you can sell it off and make a profit.

We’ve had some new guys try to come into the market and go compete in the very low end. Saying they’ll buy bigger tracks, but they haven’t done anything yet. It’s good. They’re complaining about margins, but they all grin and bear it.

They are building smaller product. It’s affordable, so instead of doing 1,500 square feet, they’ll start at 1,200. Try to get the price down.

A 1,200 square foot house? It’s probably $100K somewhere.

No one is building three-story. They can’t get construction crews out there to work on it. They just say, “I don’t want to build a three-story house. I can go do something easier on one or two story down the road.” It’s more expensive. A lot more expensive to build those. Most who are trying to do an alternative product are stopping at two story.

Three story is expensive to build and the consumer typically doesn’t like three story, although I’m hearing that’s changing a little bit. Three story walk up is kinda tough, unless it’s a great location. There is a project in downtown Gilbert that’s flyin’ off the shelves, but you can walk to all those restaurants, and it’s relatively cheap.

I’ve been contracted by some homebuilders, and they’re looking for properties, possibly big box where you can take down half of the shopping center. Something like that. They want to do two story condos, and I thought that was so interesting. They can pay, because it’s a high demand, I guess. Its’ really hard to find something that’s middle to higher income vacant. It’s really been interesting.
Have land prices reached their peak?

Have homebuilders stopped buying land?
Are homebuilders backing out of land deals?

Is the tight inventory for homes on the market affecting the commercial side at all?
Will the difficulty for buyers to qualify and get financing have a great impact on homebuilding over the next 6 months?

What will have the greatest impact on homebuilding over the next 6 months?

ALL OF THE ABOVE: LAND PRICES, LABOR COSTS & MATERIAL COSTS
INVESTMENT MARKET

CONSENSUS STATEMENTS:

- The market is still robust, especially for the class A product. Lots of institutional money out there that needs to get placed. Returns in the primary markets - New York, Chicago, Los Angeles, San Francisco, have gotten really low. They are looking more at the secondary cities. There’s money that wants to get placed. It’s hard to find product. They’re aren’t that many opportunities. If there is value there’s still money lookin’ for it. The B and C stuff in between, you get something that’s 90 percent leased that’s B, less money.

- Overall, the market’s still good. I haven’t seen cap rates going up. They’ve been holding fairly steady. Maybe a little slippage on some secondary retail properties, cap rates quarter basis point rise, but other than that, it’s still good.

- I was on a national call yesterday to the capital markets guys. They always talk. These guys in San Francisco were talking. LA, $650.00 a square foot. CB in downtown—in Beverly Hills, downtown LA. They’re selling a $5,000 square foot building that sits on a primo corner. Used to be a dental office. $1500 a square foot.

Will the flow of investment capital into the Phoenix market over the next 6 months?
Where is the capital investment emphasis heading to over the next 6 months?