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The Skarphol Rapport©

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

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ABR

The Real Estate Market is

Opportunities for Buyers & Sellers!

"Investing is laying out money now to get more money back in the future."

Warren Buffet

"Residential real estate industry update on the class-action litigations against NAR et al."

A few residential resale industry changes are set to commence August 1st, 2024.

1. **The most impactful change for Buyers is that they must have an executed Buyer Broker Employment Agreement with a real estate agent prior to being able to tour a property. Buyer agents will now initiate a representation agreement as a first step in assisting Buyers with purchasing a property.**

2. **Listing agents representing the Seller at their open houses will not be able to discuss price and contract terms with Buyers unless they have an existing Buyer Broker Employment Agreement with another agent or they are willing to hire the listing agent to also represent them on the spot; a limited dual agency situation. Alternatively, Buyers can decline representation <u>in writing</u>. This breaks a system that has worked well for over 100 years, so refinements will obviously evolve over time as the new rules are 'road' tested.**

3. **Buyers will negotiate Buyer's agent compensation during the discussion of the Buyer Broker Employment Agreement. Understanding that Buyers may be <u>responsible for paying a portion or all of the compensation</u> is a key provision of the agreement. Sellers may still offer to compensate the Buyer's agent, but Buyer's agents will submit a request to the Seller when the purchase offer is submitted. This is a new form and a new significant point of negotiation in the purchase process. Previously, agent compensation was never included in the purchase agreement. The change now makes agents parties to the contract. This will create some bumps in the road as Buyers attempt to purchase properties in a competitive market. The VA has already adapted the loan process permitting Veteran Buyers to pay for real estate agent compensation in the closing process.**

4. **Sellers will negotiate agent compensation in the Listing Employment Agreement process. This has always been the case, but there will be more focus in the discussion now with Sellers during the listing appointment. It is a change in emphasis and explaining more about the marketing process and the value of offering compensation to the Buyer's agent for a successful timely sale.**

5. **Multiple Listing Services are now prohibited from advertising agent compensation. The commercial real estate market has always been this way.**

Bottomline is the changes now being implemented increase the burdens on the agents, Sellers, and Buyers: new forms, new restrictive rules, increased timelines, increased costs. The great irony is the alleged beneficiaries of the changes will be negatively affected and inefficiencies introduced by the changes will drive compensation up not down! This is just like the Mortgage Industry and Wall Street fraud that caused the last Great Recession. The corrective response was changes in process that negatively impacted agent, Buyers, and Sellers: new forms, new restrictive rules, increased timelines, increased costs. CRAZY!

EXECUTIVE SUMMARY – RESIDENTIAL REAL ESTATE MARKET IN 60 SECONDS

LUXURY MARKET ($1M - $75M): Sellers and buyers in the luxury market are enjoying robust activity with ample reasons to celebrate. Sellers are experiencing average days on the market under 80 days which is substantially below historically average of 150 days or more. Strong economic factors, stock market, and local job growth fuel the demand. Luxury buyers are being provided an abundance of high-quality inventory to choose from which has increased 45% YOY.

BUYERS (under $1M): Active listings for buyers under $1M is up over 59% YOY. So, the limited inventory has made a rapid correction. Unfortunately, interest rates persisting above the 6.5% range has restricted the choices for first time homebuyers. Rates have also chilled the market for the move-up buyers with substantial home equity because most have existing loans interest rates below 4%.

SELLERS (under $1M): The substantial increase in active listings has extinguished some of the fireworks boosting the averages days on the market to more than 60 days. This is almost triple the days from the hot seller's market in 2020-2021. Most markets are approaching a balanced market, which means picky buyers seeking quality updated homes and seller's expectations set to expect to provide concessions to secure a buyer.

RESIDENTIAL RENTALS: Average rental rates surged over 35% from June of 2019 to June of 2021, largely due to housing shortages and the pandemic. However, substantial increase in rental inventory has held average rents flat for the last 3 years. New supplies to the market will continue to keep stabilizing pressure on rents.

RESIDENTIAL INVESTORS: Fix n Flip activity has slowed as investors face inventory shortages on the acquisition side and high interest rates chilling buyers on the purchase side. Opportunities can be identified but additional caution is indicated as prices level off as most markets move into a more balanced status equalizing buyers and sellers in transactions.

LAND OPPORTUNITIES: New homebuilders continue to acquire and develop large swaths of land, with the State land department fueling the expansion in Maricopa and Pinal counties. Buildable custom home lots remain in short supply, particularly in-fill lots in the Metro Phoenix market. Due diligence is key when pursuing raw land.

55+ HOUSING: This market segment has amazing potential. Prices have increased substantially less than all other residential segments. Acquiring properties to fix n flip has potential as demand increases and a large portion of these sales close for cash, taking away some of the risk related to high interest rates. The renovate, rent, and hold strategy has the best opportunity to create a portfolio of properties with long term stable tenants and substantial upside as the aging population continues to migrate to the sunbelt. I also believe the opportunity to rent a renovated unit on longer term lease with fixed increases will be an attractive option for seniors; capital reserves can be preserved from downsizing and routine maintenance is handled by a landlord for easy low maintenance living.

KEY STATISTICS – Single-family homes:
Active Listings: 16,265 – up 28% YOY (Well below 25K average). Listings Under Contract: 7,162 – down 2.7% YOY.
Sales: 65,926 – lowest level in decades Sales Volume: $17.4B 2024 YTD versus $21.0B YTD 2023 (down 20.7% YOY)

EXECUTIVE SUMMARY – COMMERCIAL REAL ESTATE MARKET IN 60 SECONDS

MULTI-FAMILY: Record new inventory has increased the pressure on landlords to offer concessions and has put downward pressure on rents. The best properties have a 6.6% vacancy rate. The pandemic caused a nearly 30% rent growth, but rents are now stable or declining as tenants and roommates seek better accommodations with abundant options available.
Cap rates have increased substantially as high interest rates for investors negatively impact the deal structure requiring more equity.

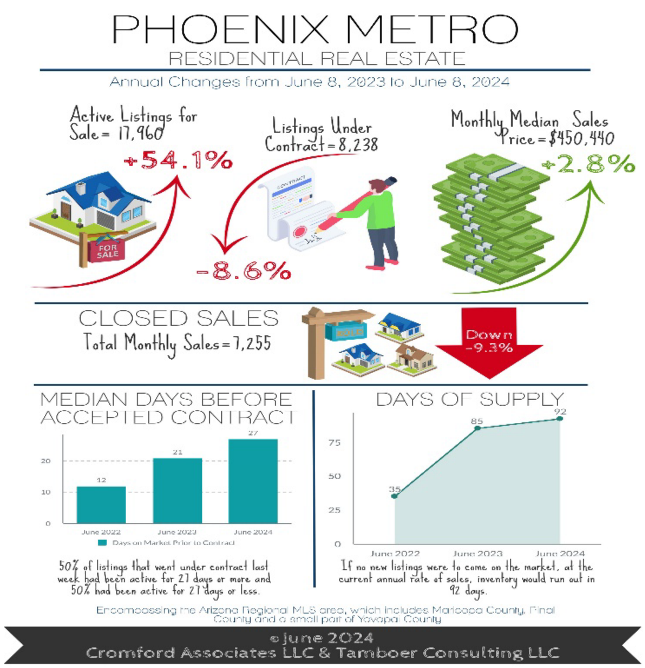
OFFICE: The office market recovery is fragmented with prime properties commanding $50 per sq ft rents while the rest of the market struggles with a 17.4% vacancy rate. Subleasing is dominating the rental inventory as new office development has stalled. Office conversions to residential are very active in this market, in fact, Arizona is the #1 market. However, construction costs, interest rates, and labor shortages are negatively impacting on-budget timely completions. Once the development community gains experience from completed projects, I expect this trend will continue as efforts to create additional housing units and buyer interest in amenity focused projects make their way into the conversion mainstream.

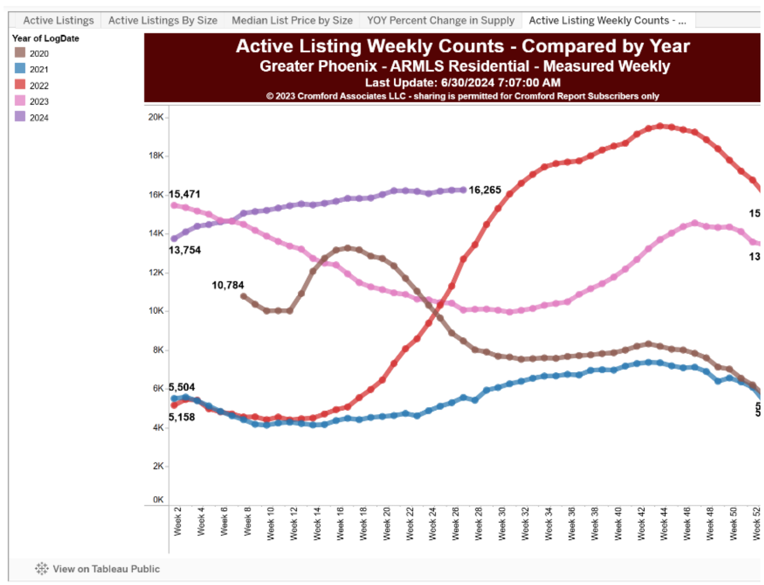
MEDICAL OFFICE: Consolidation and innovation are the primary disruptors in this segment. AI is targeted at improving processes, enhancing efficiency, and potentially boosting margins. New inventory remains limited. Construction costs have stalled some new development, but demand is steady keeping rental rates trending upward while cap rates also trend upward in response to persistent high interest rates.

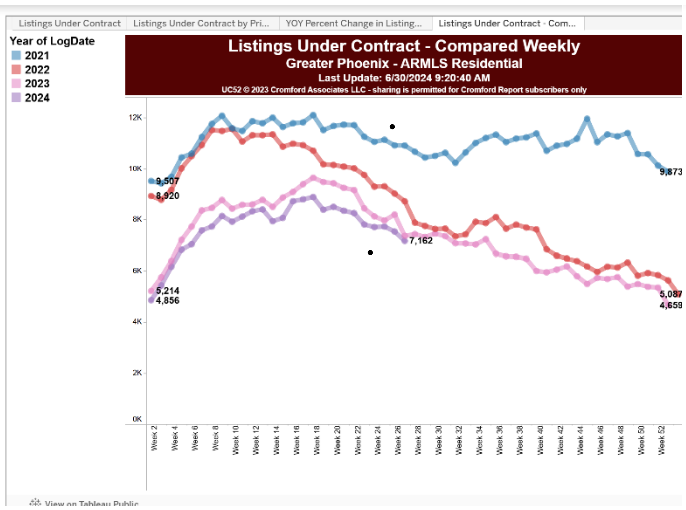
INDUSTRIAL: Demand for industrial space continues at a blistering pace. Glendale alone has three 1 million-square-foot-plus warehouses being absorbed. Fueled by strong population and job growth as well as connections to Southern California ports creates the momentum to build to meet continuing demand. Semiconductor sector construction has exceeded $60B. This sector is also bringing in high paying engineering jobs and creating a need for educational resources to shift to address the specialized skilled labor and attracting business expansion in the supply chain. Single family and multifamily developments are also underway to meet the increased housing demand.

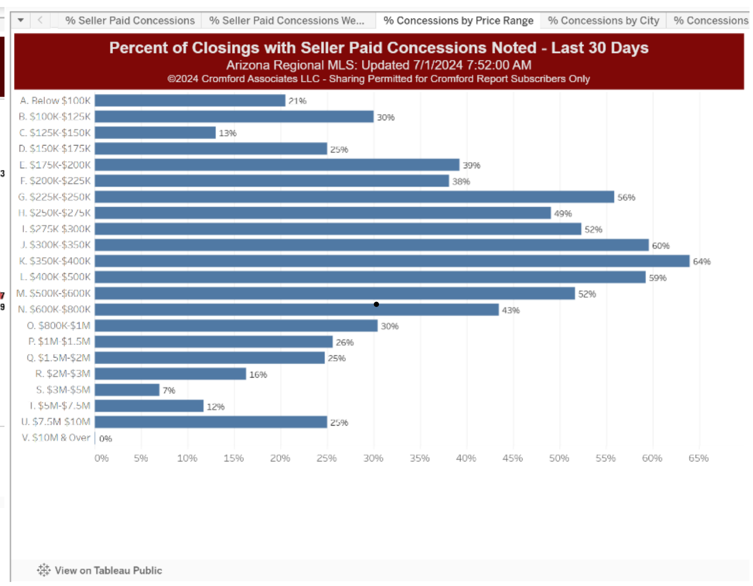
RETAIL: Retail vacancies are trending lower and currently is 5%. A 15-year high in new construction appears to be in line with demand as the shortage of existing viable spaces persists. Net absorption at 1.9 million square feet for 2024 is above the long-term average which is supported by increased housing with consumer demand expanding for necessity-based retailers. Experiential retail space is also in high demand with the expansive growth of the area's multi-family base.

LAND: Just behind the Nashville market, Phoenix ranks #2 for real estate investment and development. All sectors, housing, commercial, multifamily, and industrial are actively acquiring available sites. The State land department has held several large auctions bringing thousands of acres of State Trust land on-line for master planned communities, industrial parks, manufacturing facilities, and mixed-use developments*. Arizona is absolutely communicating to the world that this is the land of opportunity!*









SOURCES: ***Michael Orr, The Cromford Report, The Information Market**, Phoenix **Business Journal, The Rose Law Group /Belfiore – Dealmaker***
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