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The Skarphol Rapport©

Q4 - 2023

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

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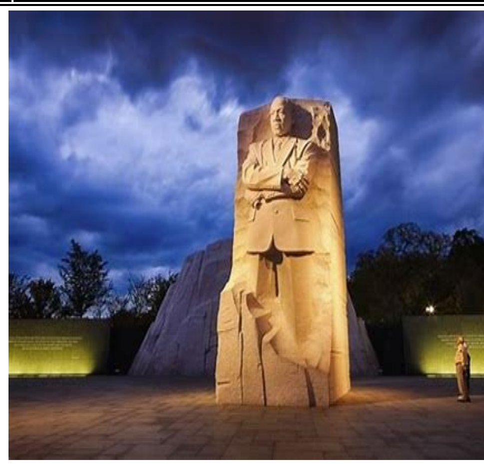


"Injustice anywhere is a threat to justice everywhere."

Dr. Martin Luther King Jr.

EXECUTIVE SUMMARY – RESIDENTIAL REAL ESTATE MARKET IN 60 SECONDS

LUXURY MARKET: ROCKET! The average price per square foot for closed sales in the luxury market is up over 42% in the last two years. Clearly this is not inflation as we know it. Wealth-flight from California and wealth transfer from PPP loans targeted investment diversification into high-end luxury homes. The supply side was well funded as flippers and speculative builders purchased older inventory to demolish and rebuild soft contemporary masterpieces with the best materials and finishes. The new inventory rocketed average price per square foot well above the $1k per square foot into the stratosphere with no limit in sight. Homes $10M - $25M closing for cash is typical. However, it does burden the older inventory of luxury homes that are dated or needing work and these homes continue to languish on the market. 2023 was another amazing year and 2024 is continuing to follow the rocket's tail! Bottom line is an enjoyable time to be a seller and equally enjoyable time to be an opportunistic buyer.

BUYERS (under $1M): CROMULENT! Rates have dropped from 8% to the mid-six% range in the last two months providing CROMULENT relief for buyers waiting to gain footing in a continuing seller's market. After reflecting on experiencing and surviving eight or more recessions, I spent time reviewing the time value of money and the home purchase conundrum. I am convinced that buying a home using a 30-year loan is not sound investment advice. My conclusion is that purchasing with a 15-year loan is the best option because it forces a higher re-investment, principal reduction and reduces the interest expense by 45%. I will be educating my first-time homebuyers on the pros and cons hopefully with a result of setting them on a path to financial independence from generational debt!

SELLERS (under $1M): NOT SO CROMULENT! Inventory continues to be constrained, benefiting sellers as we moved quickly from a month or so of balanced market conditions towards a sellers' market again. However, it is the quality of the inventory that is making the market NOT SO CROMULENT for buyers resulting in concession pressure on sellers for rate buy downs and property condition discounts. A sellers' market with over 60% of the sales closing with concessions in the last 30 days of the year does not seem positive for sellers, but the reality is most sellers have earned substantial appreciation over the last 5 years. So, new sellers to the market need to focus on putting the property in the best possible condition, anticipate concession for rate buy down and set the price to market to complete a sale within 60 days.

RENTALS: STABLE. From 2020 rents have increased an average of 8% per year. A closer look reveals the increase occurred during the pandemic resulting in stable rents since the end of 2021. The market is further impacted by a healthy addition of new units, albeit mostly targeted at the high-end renters. Also, increased regulation and enforcement related to short term rentals has caused those intended STR units to be placed into the longer-term rental market for 12-month minimum terms. Millennials opting for flexibility and amenity-rich communities are choosing to rent instead of buy, keeping the vacancy rates stable as well with the steady flow of new units under construction and coming online. Expecting these trends to continue for the near future with household formations being supported in the rental housing inventory.

Several new build-for-rent subdivisions are planned, under construction, or in the rent up phase with new home builders adding this product line to their portfolios.

ADU's: **Phoenix adopted the accessory dwelling unit (ADU) changes to the residential zoning districts allowing adding rentals units to a residential property. The rental units cannot be short term rentals, but this is a terrific way to add additional space to an existing property. The investment calculations are attractive in most areas of Phoenix because the cost to construct per sq. ft. is below or substantially below the average value added. A great multigenerational option and a good strategy when high mortgage rates make selling and moving-up impractical.**

LAND OPPORTUNITIES: **RARE. Land is like mass in that it cannot be created or destroyed metaphorically speaking. That said land has always been the seed to create long term value because of its relative location, hence the source of the location, location, location cliché! Opportunities exist, but as we continue to develop supply is depleting and forcing the development horizon to the perimeter of the metroplex following freeway corridor expansion. Like all commodities, prices are continuing to rise. Thinking about investing or purchasing land…call me to discuss current market conditions around your interest.**

KEY STATISTICS – Single-family homes:
Active Listings: 13,568 – down 13.6% YOY (Well below 25K average). Listings Under Contract: 4,663 – down 8.4% YOY.
Sales: 68,278 – lowest level in a decades Sales Volume: $38.2B Q4 2023 versus $46.0B Q4 2022 (INVENTORY IMPACTING)

EXECUTIVE SUMMARY – COMMERCIAL REAL ESTATE MARKET IN 60 SECONDS

Multi-family:  **This market segment continues to hold investor interest. Rental rate growth has stabilized, and inventory remains constrained. However, interest rates remain unattractive, which is pushing cap rates upward and depressing market values for all properties except the A+ grade units. The pipeline is delivering 8k-10k units per quarter, but this is still severely undersupplying the market. The primary issue is that the emphasis remains on the luxury market while affordability is approaching a crisis level. Expecting trouble as loan rates reset and debt service at current rates causes marginal projects to return to the lenders. Overall, 2024 should bring continued investment in the best properties as job and population growth continues to fuel a healthy regional economy.**

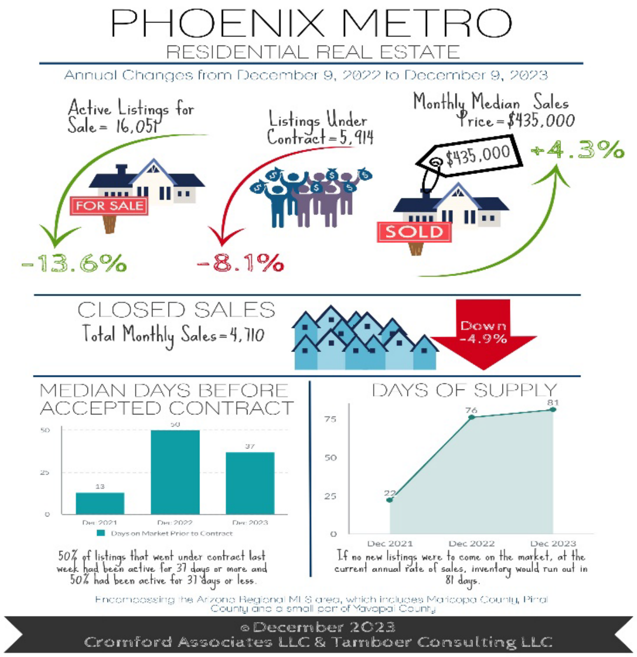
Office:  **Oh…the pain continues in this segment! Net absorption ends extremely negative for the year as businesses struggle with the power of the remote worker economy that developed out of the global pandemic. Vacancies are over 28% and climbing as indicated by the surge in sub-lease inventory. Rates have stabilized, but efforts to reposition properties have felt the headwinds of high interest rates and construction supply chain issues. Resulting delays have developers stopping or defaulting on projects. The consolidation and reset will continue in 2024 with NO new office projects under construction in Q4 2023.**

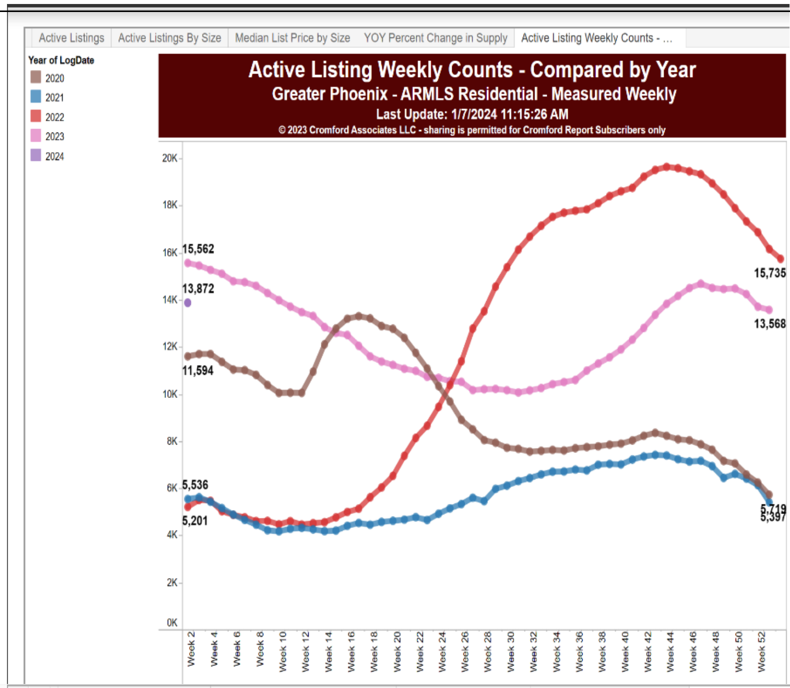
Medical Office:  **Medical office ended the year upbeat with a surge developing in the West Valley with hospital and medical office projects coming out of the ground. Rents increased 12.2% on average illustrating the demand and supply forces working in this segment. Employment and population growth is fueling demand as the manufacturing employment segment experiences expansion.**

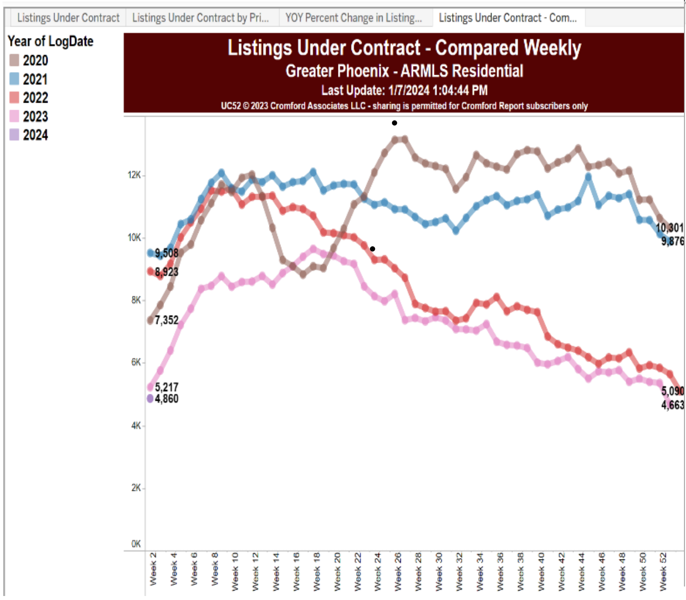
Industrial:  **The industrial segment rocketed to a record level delivering almost 30M sq ft of space in 2023. Rental rates also reached a new high of $1.06 PSF NNN. Investors also pushed sales volume to 3.8M square feet YOY. Investors continue to look for vacant new construction projects that will have lease-up opportunities in the face of continuing demand. Mega projects have been announced to service the data center and manufacturing segments. Expecting another record year in this segment as rates mediate and investors refine investment strategies to address this dynamic market.**

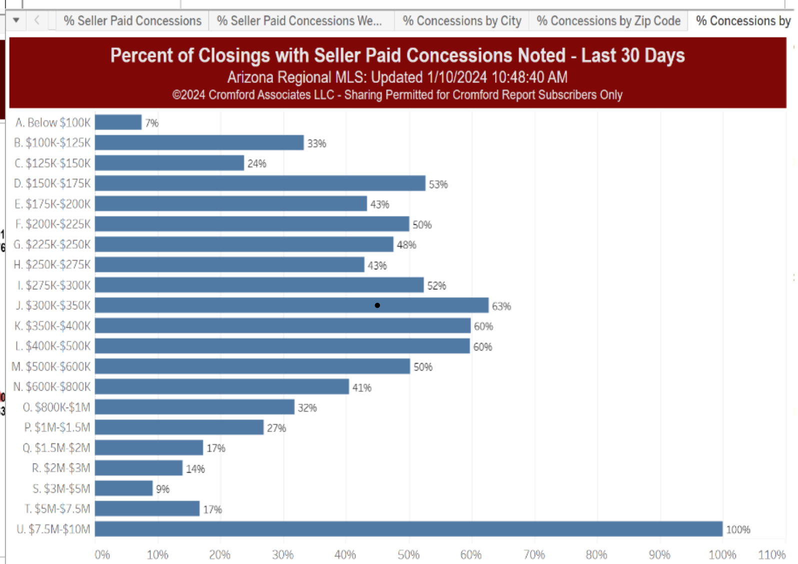
Retail:  **This segment has been very adaptive and resilient. 2023 ends with positive net absorption and an average vacancy approaching 4%. Cap rates moved coordinated with interest rates keeping market values on track with investor expectations. New construction deliveries have moderated to the market conditions with regional mall redevelopment highlighting the future of retail as a prominent element of large mixed-use developments adding residential, employment and transit components. Strong investor interest remains for the full spectrum from free standing to power centers.**

Land:  **Homebuilders paid record prices to purchase State Land parcels and continue to consume massive acreage as they stake out market share in the face of strong buyer demand for housing. Industrial developers secured large acreage valley wide in pursuit of robust manufacturing, data center, logistic supply chain, and EV markets. Another big year in land expected for land in all market segments.**









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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