

Phoenix, Arizona



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Multifamily Housing Update

June 2010

EXECUTIVE SUMMARY

In its economic performance rankings of the top 100 U.S. metro areas, the Brookings Institution placed Phoenix in the bottom quintile, a rare spot to find the quintessential growth market, largely due to the Valley's devastating payroll job losses during the Great Recession. Indeed, total Phoenix payrolls fell -11.9% from cycle peak to 1Q10, ranking 93rd in the group, straddled by two odd bedfellows: Youngstown (#92) and Toledo (#94), Ohio.

First quarter performance was little better. Metro payrolls tumbled at a 74,200-job, -4.2% year-on-year pace, up from 2009's worst ever 146,700-job, -7.9% loss, yet badly trailing the -2.3% U.S. average. The troubled housing industry remained the principal source of the Valley's difficulties, contributing directly by way of the rapid contraction of the construction industry (22,900-job, -20.9% y-o-y decline), and indirectly with cuts in the retail trade and financial and employment service sectors, which together hemorrhaged 17,300 jobs.

The April and May data were much improved, by contrast, raising hopes of a quick and decisive recovery. Measured on a year-on-year basis, payrolls fell only 27,300 jobs in April and 12,000 in May, getting help from the resurgent construction, manufacturing, retail and business service sectors. Expressed on a seasonally-adjusted basis, the metro added 21,400 jobs in the period, representing the largest two-month gain recorded since 3Q04. Although the creation of about 6,500 temporary Census jobs inflated the May results, the data clearly evidenced development of a meaningful spring uptrend.

The **RED Research** econometric payroll model is quite trend sensitive. Therefore, the spring awakening gives rise to a significant upward revision to

our previous forecast published in May. The 21,800-job loss previously projected for 2010 is trimmed to -9,000 jobs, while our anemic 33,000-job average annual gain in 2011-12 is upgraded to 54,100 and 62,800 jobs, respectively, in 2011 and 2012.

Brightening job prospects didn't produce a surge of apartment leasing during 1Q. Reis report that local owners filled 464 vacant units in the period, down from 505 during 4Q09. But there was a dearth of new supply, allowing average occupancy to rise 20 basis points sequentially to 87.9% nonetheless. Occupancy gains were strongest in a few upscale areas, including Scottsdale, Chandler and Goodyear, where newer properties were able to backfill vacant product, sending occupancy 90 to 250 bps higher. But at the end of the day, vacancy rates of 10% or more were still observed in 13 of 18 submarkets.

Rents were firmer, producing the first sequential quarter gains in 18 months. Asking rents tumbled further, falling \$3 (-0.4%) from December to March, but concession levels receded \$4, allowing effective rents to rise 0.1% to \$675. Scottsdale and Chandler submarkets led the way, chalking down gains of 1.3% or more. Conversely, mature submarkets in the southeast quadrant generally underperformed, particularly South Mesa, Tempe and South Central Phoenix, where rents fell -0.3% to -0.9% sequentially.

Property markets were active as 25 apartments valued at \$1.5mm or more exchanged hands in 1Q. Trade was dominated by liquidations of over-levered class-B projects and broken condo deals. Institutions were more active in the spring when several class-A projects exchanged hands. Going in yields were in the mid- to high-5% range, with the bellwether Scottsdale asset priced to a 5.8% cap.

SNAP SHOT

	Y-o-y change	Projected YE 2010
Vacancy (12.1% - 1Q10)	↑ 60 bps	↑ 30 bps
Effective Rents (\$675 - 1Q10)	↓ 4.3%	↑ 0.1%
Cap Rate (7.2% - 1Q10)	↑ 60 bps	↓
Employment (1,692.4m - 1Q10)	↓ 74.2m	↓ 9m

KEY POINTS

- Owners in some upscale precincts backfilled recent construction projects, raising average occupancy in Scottsdale, Chandler and Goodyear. Conditions elsewhere were relatively steady, although some southeast-quadrant class-B properties experienced further occupancy erosion.
- Effective rents rose sequentially in 1Q10 following 18 months of consistent declines. Lower concessions costs offset a \$3 (-0.4%) face rent decline to produce a \$1 (0.1%) real rent advance.
- First quarter payroll trends were weak, but the economy seemed to find traction in the spring. After posting a 5,400-job seasonally-adjusted gain in 1Q (-74,200 jobs, -4.2% y-o-y), hiring appeared to resume in earnest in April and May. The Valley of the Sun added 21,400 jobs during the period, the largest two-month advance recorded since 2004.
- **RCR** upwardly revised its payroll forecasts for 2011 and 2012 to 54,100 (3.2%) jobs and 64,800 (3.7%) jobs, respectively.
- Above average cap rates and an improving performance outlook combine to give metro assets an attractive total return profile.