

Rise of the Silicon Desert

Multifamily Summer Report 2016

Commerce Authority Woos Tech Firms

New Residents Drive Up Rents

Investors Feed Unassuaged Hunger

Market Analysis

Summer 2016

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Valley of the Sun Continues to Heat Up

Phoenix's multifamily market is on a roll as a consequence of its strong job market amid a population influx unlike any other in the Southwest. Rents rose an impressive 7.3% year-over-year through June, although the metro remains inexpensive compared to the national average. Property values have gone up as well, although investors continue to be bullish on a market where the cost of entry is still relatively affordable.

While heavily reliant on trade, transportation, education and health services, the metro has succeeded in diversifying its economy in recent years. Efforts made to attract tech companies from the neighboring state of California have pushed employment in the sector to all-time highs; in fact, the phrase "Silicon Desert" is slowly catching on in the Scottsdale and Tempe submarkets. As a result, rents in upper-tier assets have mostly managed to keep up with those of assets for working-class households.

Development is starting to pick up again. With occupancies at the 96.0% level, the pipeline has reached more than 40,000 units. Supply is concentrated in the metro's Central and Eastern submarkets, where most of the rent growth is occurring. We expect that continued population growth and job creation will keep occupancy rates up even as completions rise, though the supply pipeline will serve to moderate rent growth to 5.4% in 2016.

Recent Phoenix Transactions

IMT Deer Valley



City: Phoenix
Buyer: IMT Capital
Purchase Price: \$101 MM
Price per Unit: \$120,793

Pillar at Scottsdale



City: Scottsdale
Buyer: Security Properties
Purchase Price: \$96 MM
Price per Unit: \$177,644

Skywater at Town Lake



City: Tempe
Buyer: Heitman
Purchase Price: \$94 MM
Price per Unit: \$287,195

Citrine

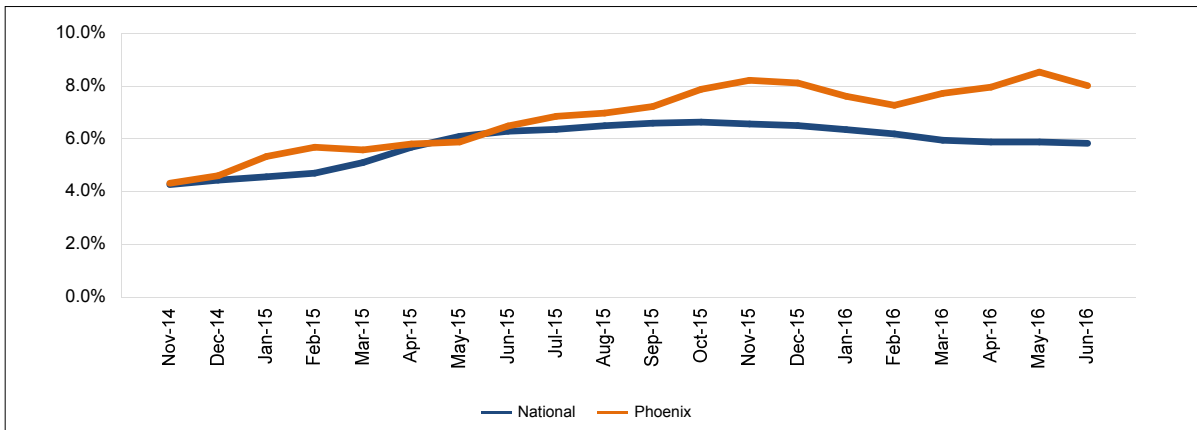


City: Phoenix
Buyer: Simpson Housing
Purchase Price: \$94 MM
Price per Unit: \$301,000

Rent Trends

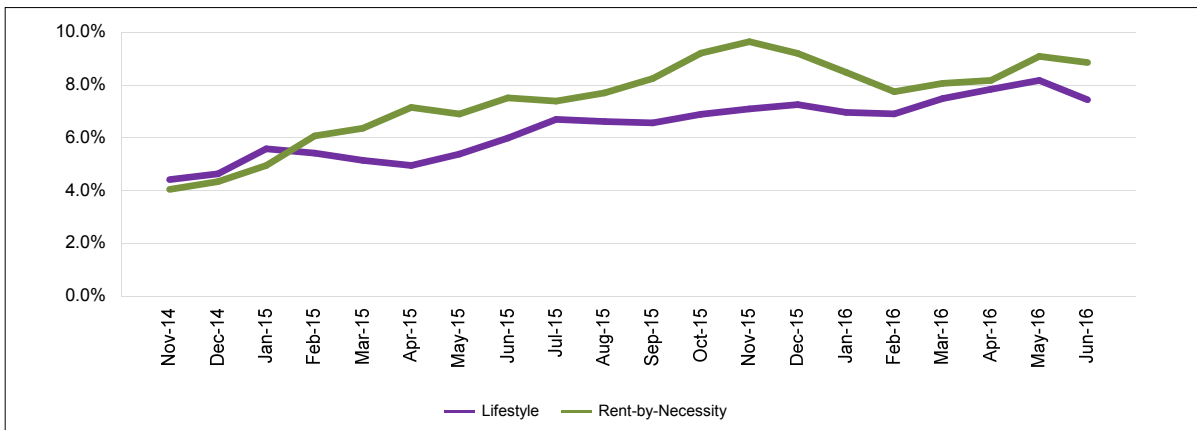
- Phoenix rents rose 7.3% year-over-year through June, outperforming the 5.6% national average. Rents in the metro average \$894, still far below the \$1,213 national average. Above-trend rent growth is driven by robust demand from the influx of residents to the metro, along with expansion of the job market. That has enabled occupancy to remain in the 96% range, even though supply has risen steadily throughout the past three years.
- Gains were led by the working-class Renter-by-Necessity segment, which rose 8.5% year-over-year to \$738, as the metro lags nationally in household income. Increased employment in the technology and financial sectors is driving rents in the Lifestyle segment, which was up 6.5% year-over-year, reaching \$1,075 at the end of June.
- The most substantial rent growth occurred in the metro's Central and Southeastern submarkets, including Christown(14.2%), East Mesa (11.5%), Central East Phoenix (9.4%) and South Mesa (7.3%). Properties in Scottsdale and Chandler charge average rents well above the \$1,000 mark, while rents in the North Paradise Valley and South Tempe submarkets have only recently crossed that threshold.
- Solid occupancy and relatively low inventory expansion have driven rents throughout the cycle. We expect new supply will moderate some of the frothy increases and rents will grow by 5.4% in 2016.

Phoenix vs. National Rent Growth (Sequential 3 Month, Year-Over-Year)



Source: YardiMatrix

Phoenix Rent Growth by Asset Class (Sequential 3 Month, Year-Over-Year)

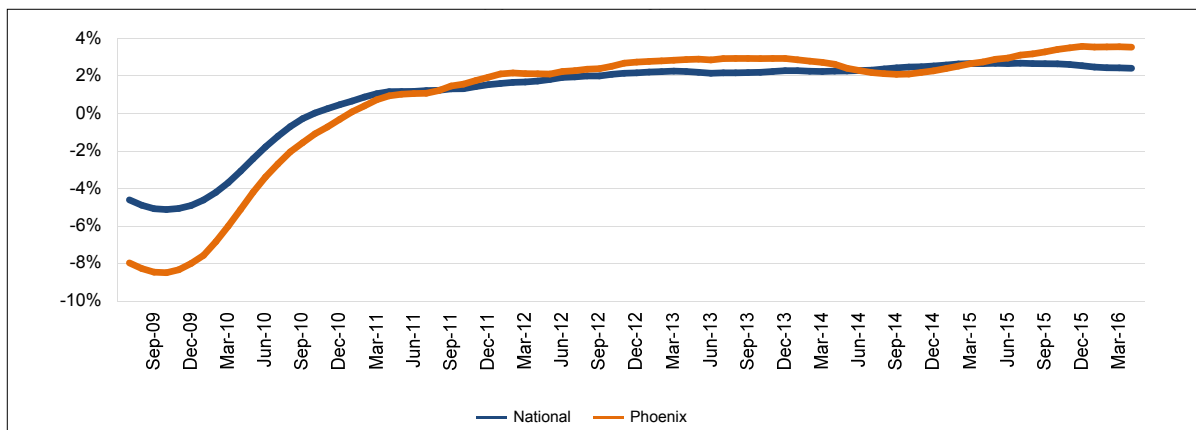


Source: YardiMatrix

Economic Snapshot

- The metro added nearly 70,000 jobs in the 12 months ending in April, a whopping 3.6% increase, well above the national rate of 2.3%. The strong performance comes on the heels of several years when job growth plateaued at about 2%. The state is among the leaders in job creation, establishing increased demand for housing in the process.
- Job growth was led by the professional and business services sector, which added 17,300 new jobs. Strong performance in the office-using sector helped produce roughly 1.5 million square feet in net absorption of office space. That has led to a robust office development pipeline, which combined with growing activity in the housing market has driven gains in the construction sector. Construction added 7,200 jobs, a 7.1% growth rate.
- Wage increases and the metro's position as a regional hub for distribution helped the trade, transportation and utilities sector add 12,600 jobs, solidifying its position as a cornerstone of the metro's economy.
- The information sector grew by 2,800 new jobs, a 7.7% year-over-year expansion. Phoenix is second only to San Francisco for rate of job creation in the sector, lending credibility to the Arizona State University-led concept of "Silicon Desert." The Arizona Commerce Authority has targeted California-based tech companies seeking to expand and has facilitated their relocation. Meanwhile, Zenefits and Uber are rolling out expansions in the metro.

Phoenix vs. National Employment Growth (Year-Over-Year)



Sources: YardiMatrix, Bureau of Labor Statistics (not seasonally adjusted)

Phoenix Employment Growth by Sector (Year-Over-Year)

Code	Employment Sector	Current Employment		Year Change	
		(000)	% Share	Employment	%
60	Professional and Business Services	336	17.0%	17,300	5.4%
40	Trade, Transportation and Utilities	383	19.4%	12,600	3.4%
65	Education and Health Services	292	14.8%	12,300	4.4%
55	Financial Activities	175	8.8%	10,400	6.3%
15	Mining, Logging and Construction	108	5.5%	7,200	7.1%
70	Leisure and Hospitality	217	11.0%	4,500	2.1%
50	Information	39	2.0%	2,800	7.7%
80	Other Services	67	3.4%	1,400	2.1%
90	Government	243	12.3%	700	0.3%
30	Manufacturing	118	6.0%	-400	-0.3%

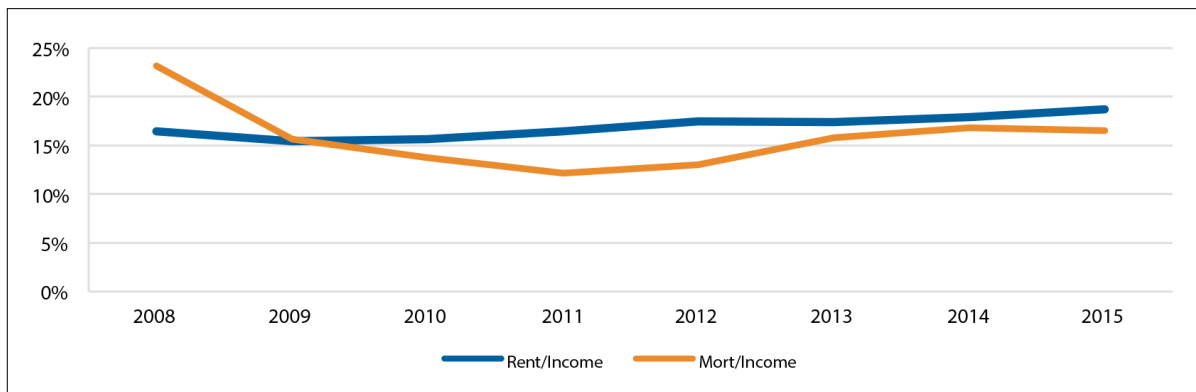
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

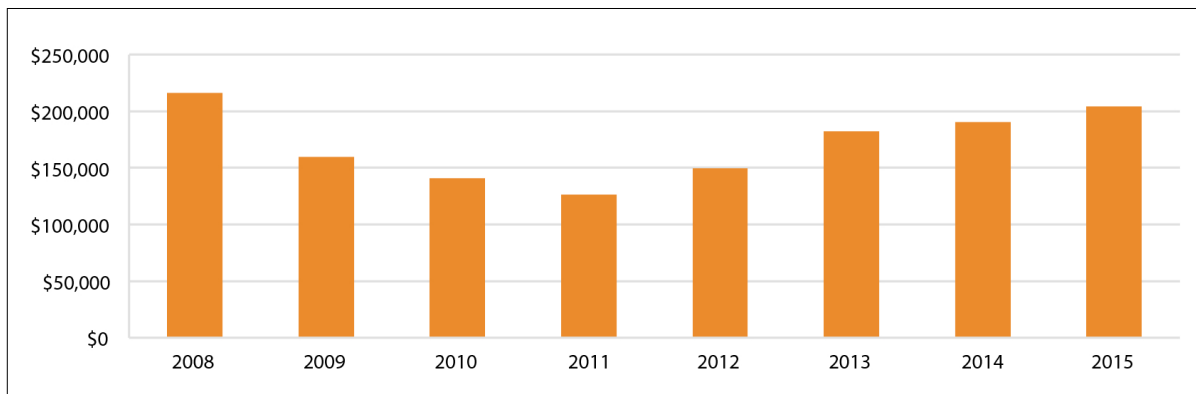
- Arizona is among the leading states for job growth. However, the state continues to lag behind 41 other states in per-capita personal income, which has affected affordability for both homeowners and renters.
- The median home price ended 2015 at \$204,093, the first time since 2008 that the price crossed the \$200,000 mark. Meanwhile, rents ended June at an average of \$894, the highest recorded level during the current cycle. An influx of jobs in high-paying sectors and an increase in household creation have kept vacancy low and demand high for the past few quarters. As rents continue to trend upwards and development focuses on the higher end of the spectrum, affordability is likely to become more of an issue.

Phoenix Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

Phoenix Median Home Price



Source: Moody's Analytics

Population

- The appealing climate and healthy job market are steering new residents to the metro.
- Phoenix grew by 2% in 2015, among the national leaders and above the 0.8% U.S. average.

Phoenix vs. National Population

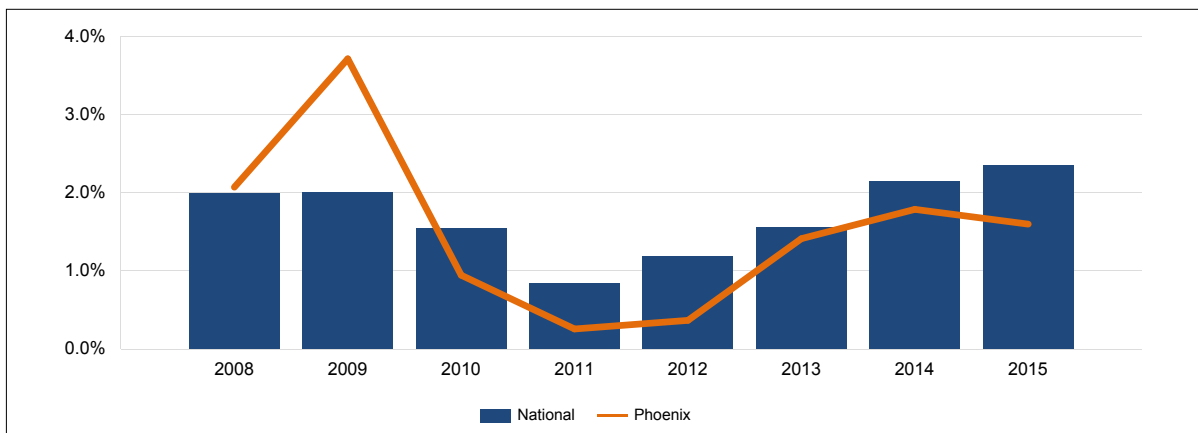
	2010	2011	2012	2013	2014	2015
National	309,346,863	311,718,857	314,102,623	316,427,395	318,907,401	321,418,820
Phoenix-Mesa-Scottsdale, AZ Metro	4,204,981	4,250,001	4,327,809	4,400,688	4,486,543	4,574,531

Sources: U.S. Census, Moody's Analytics

Supply

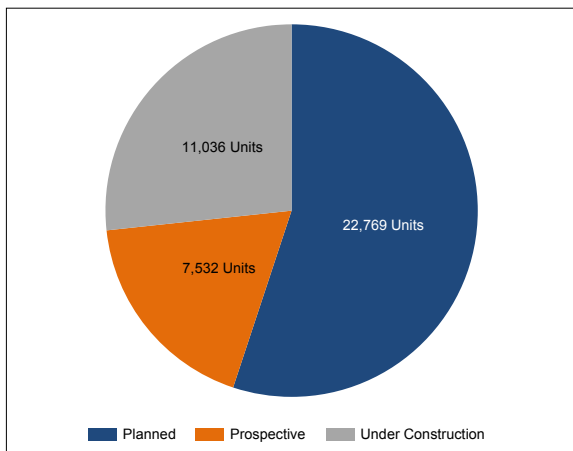
- Just over 4,000 units were added to the multifamily supply in 2015, boosting inventory by 1.6%, which is 80 basis points lower than the national rate. The metro has had to burn off the high vacancies caused by heavy development before the last financial crisis, and occupancies for stable properties are at 96.0%.
- The pipeline has expanded substantially over the past year, with roughly 41,000 units currently in various stages of development, a 141% increase compared to the summer of 2015. The bulk of the pipeline is in planned projects that total about 22,800 units.
- Of the 11,000 units currently under construction in the metro, most are concentrated in the Central and Eastern areas. Submarkets located east of Phoenix's Sky Harbor International Airport—including South Scottsdale, North Tempe and Gilbert—have roughly 4,000 units under construction.
- The largest project currently underway is Gray Development Group's extensive redevelopment of the Biltmore Club in East Camelback, which will add a new hotel, a condo component, as well as 480 rental units. Completion is projected for the end of 2017. The largest project set for completion by the end of the year is Mark Taylor's 388-unit San Milan apartment community in Union Hills.

Phoenix vs. National Completions as a Percentage of Total Stock (as of June 2016)



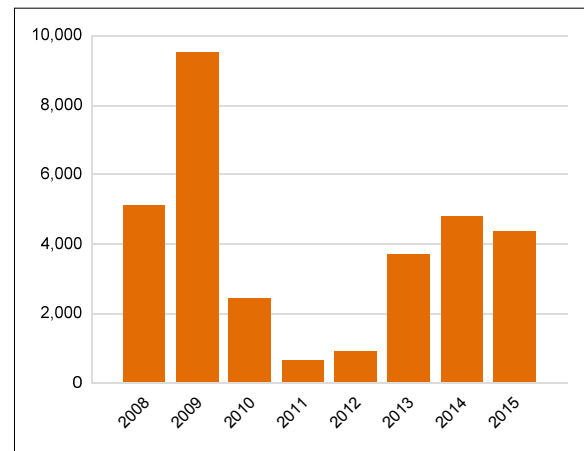
Source: YardiMatrix

Development Pipeline (as of June 2016)



Source: YardiMatrix

Phoenix Completions (as of June 2016)

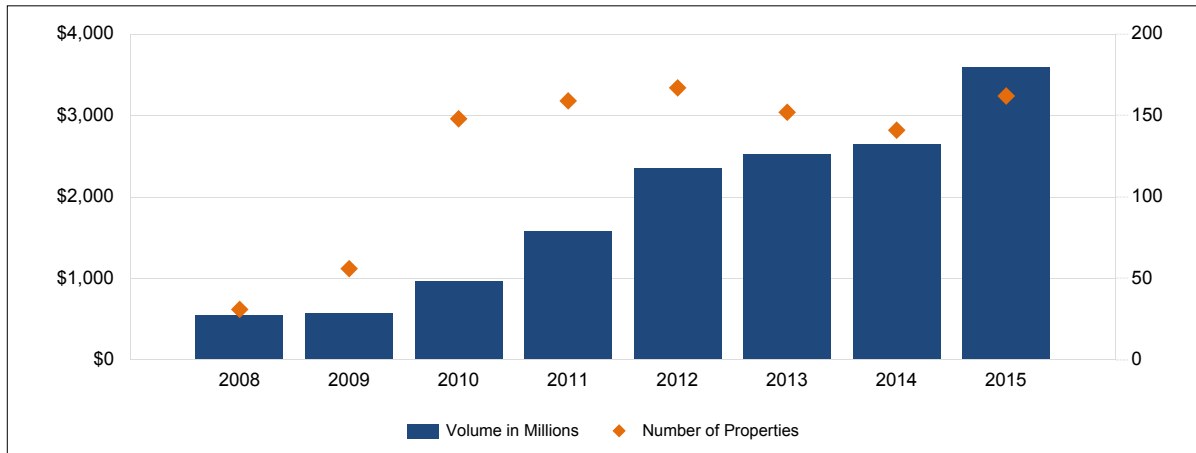


Source: YardiMatrix

Transactions

- Transaction activity totaled \$3.6 billion in 2015, up 36% over 2014. Volume has grown for seven straight years, with investor appetite showing no signs of waning. That reflects not only national trends but the bullish outlook for growth that many institutional investors have regarding the metro.
- With Phoenix one of the most sought-after secondary markets, property values are rising quickly. The average price per unit grew by roughly \$11,000 in 2015, reaching a post-recession high of \$90,414, although that's still roughly 25% below the national average.
- Cap rates continue to tighten, and Class A assets trade in the low 5 percent range. Investors are attracted to Phoenix for potential rent growth and its role as one of the top urban centers in the Southwest for population growth and new business activity.

Phoenix Sales Volume and Number of Properties Sold (as of June 2016)



Source: YardiMatrix

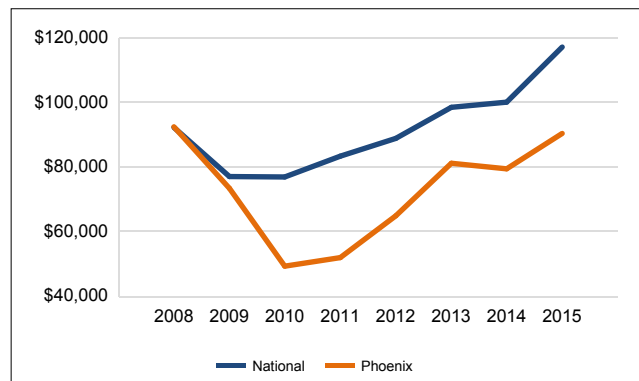
Top Submarkets for Transaction Volume¹

Submarket	Volume (\$MM)
Union Hills	562
Deer Valley	409
Chandler	386
North Scottsdale	302
North Tempe	295
Western Suburbs	259
South Scottsdale	233
Mountain Park	188

Source: YardiMatrix

¹ From July 2015 to June 2016

Phoenix vs. National Sales Price per Unit



Source: YardiMatrix

Read All About It!



Chandler Luxury Development
Secures Financing



TruAmerica Makes Significant
AZ Investment for \$80.9 Million



Invesco Sells 5-Building
Industrial Asset to BKM

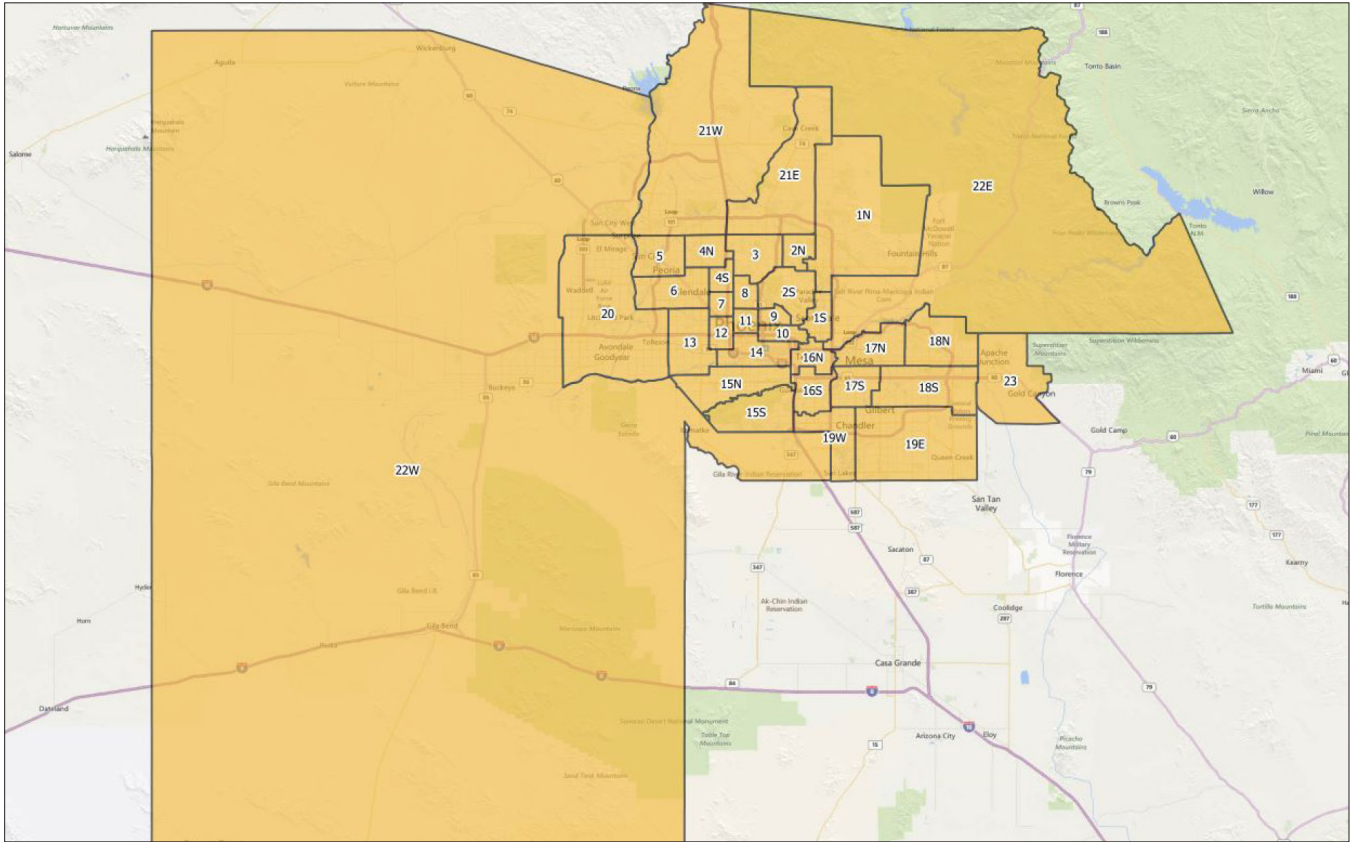


P.B. Bell Lakeside Community
Opens in Suburban Phoenix

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Phoenix Submarket Map



Area #	Submarket
1N	North Scottsdale
1S	South Scottsdale
2N	North Paradise Valley
2S	South Paradise Valley
3	Sunnyslope
4N	North Black Canyon
4S	Metrocenter
5	Sun City - Youngtown Peoria
6	Glendale
7	Northwest Phoenix
8	Christown
9	East Camelback
10	Central East Phoenix
11	Uptown
12	Central West Phoenix
13	Maryvale

Area #	Submarket
14	Sky Harbor
15N	South Phoenix
15S	Mountain Park
16N	North Tempe
16S	South Tempe
17N	North Mesa
17S	South Mesa
18N	East Mesa
18S	Superstition Springs
19E	Gilbert
19W	Chandler
20	Western Suburbs
21E	Union Hills
21W	Deer Valley
22W	Southwest Maricopa County
23	Apache Junction

Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter by Necessity households span a range. In descending order, household types can be:

- *A young-professional, double-income-no-kids household* with substantial income but without wealth needed to acquire a home or condominium;
- *Students*, who also may span a range of income capability, extending from affluent to barely getting by;
- *Lower-middle-income (“gray collar”) households*, composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- *Blue-collar households*, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- *Subsidized households*, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- *Military households*, subject to frequency of relocation.

These differences can weigh heavily in determining a property’s ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property’s status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

To learn more about Yardi® Matrix and subscribing, please visit www.yardimatrix.com or call Ron Brock, Jr., at 480-663-1149 x2404.

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