ARIZONA'S 2021 MULTIFAMILY SECTOR MARKET OUTLOOK

» by Matt Thrasher

When I addressed the issue of Arizona's hospitality sector in the August TREND Report, I ended the article with a quote from OpWest Development's Tyler Kent who stated that: "There is no doubt Arizona's economy will recover. Even despite the pandemic, our state has seen some of the strongest population growth in the country. We see that driving the overall market growth for years to come." Fortunately for us, Mr. Kent has largely been proven right.

While there is no doubt that Arizona has suffered many of the same pandemic-induced economic troubles as the rest of the Nation, we can nevertheless look forward with optimism to 2021 as the beginning of a complete recovery. At the time I am writing this article, there are two approved vaccines and a fresh federal COVID-19 economic relief package has just been passed by the House and Senate. These two factors should bolster Arizona's already-occurring recovery and drive us forward into a near-term complete recovery.

To analyze Arizona's current commercial real estate (CRE) recovery, I chose to shift away from the hospitality sector and to the multifamily housing sector. I will first focus on the national CRE multi-family housing market, and then narrow the focus to Arizona's two major markets: Phoenix and Tucson.

National Trends

The significant trend to highlight at the national level is US GDP contraction. According to Moody's Analytics, US GDP should contract much less than was initially expected by many large institutions such as the IMF. Moody's predicts a US GDP contraction of less than 3% for 2020 and positive GDP growth in 2021. While any contraction in GDP is a bad thing, this is nowhere near as bad as predictions made this past summer of an 8% contraction. In fact, this contraction is smaller than the 3.8% contraction of the January 2008 to June 2009 period of the Great Recession. However, Moody's is quick to point out that despite this "rosy" GDP outlook, the US has still not recovered 9.4 million of the jobs that it has lost since the beginning of the pandemic. This disparity between job loss and GDP strength is likely largely due to government fiscal and monetary support.

Moving the CRE specifically, CRE transactions have begun to show signs of the same economic recovery evidenced by the GDP contraction figures. While overall year-to-date transactions are down significantly (50–60% depending on sector), third quarter transactions are up 10% over second quarter transactions which indicates some recovery stirring. While this gives rise to some optimism, given that larger economics trends often take some time to show up in the CRE markets, the CRE market in 2021 may struggle to recover their pre-COVID-19 transaction numbers.

The national multifamily sector is now also reflecting the overall economic troubles of the Nation. While it did take time for negative trends to materialize, in the third quarter, national apartment vacancies increased to about 5% and effective rents fell by 1.9%. While the 1.9% decline in effective rents may not sound significant, it is the worst quarter-to-quarter decline since the metric began being tracked in 1999. Thus, for 2020 as a whole, Moody's expects a 2.8% decrease in effective rates for the year, and for rents overall to decrease for 2021. Despite these negative trends, the vacancy rates will still be less than the vacancy rates seen following the Great Recession (8.1% in 2010). Moody's points to a 30% decrease in new apartment completion in 2020 for this lower vacancy rate. The multifamily productivity seemly shifted to industrial projects where warehouse and distribution construction has increased by about 30% during 2020.

Arizona Trends

Justifying the optimism of Mr. Kent's opening statement, Arizona's multifamily sector has shown resilience throughout 2020. Overall, Arizona has replaced 46% of the jobs lost during 2020. As I discussed in the August TREND Report, this total job loss was less than that experienced by many other states. Arizona's resilience is likely due to its industry diversity and high-skilled job market which contains companies such as the popular stock trading app Robin Hood (which added jobs in Phoenix in 2020). However, one trend highlighted by the Arizona Multihousing Association, is the uneven effect this pandemic has had on Arizonans. In Tucson for instance, lower-income earners have taken the brunt of the economic hardships, while higher-paying employers such as ADP, Raytheon, and Caterpillar have actually added jobs throughout 2020. This disparity is reflected in the shift in renters away from downtown Phoenix with its higher rents to the southeast Valley suburbs with cheaper options and space for home offices.

Reflecting these strong job numbers, Phoenix rents have remained strong and have in some instances actually gone up in 2020. In fact, one highlight in Arizona's multifamily housing sector is detached single family rental communities. These rental communities have shown strong demand as more units have entered the market. Additionally, in the Valley, 2020 will bring near-record levels of new apartments entering the market (9700 units), with more under development. This strong development likely reflects Arizona's growth in high-income jobs.

While Arizona has shown resilience and a characteristic toughness, we have not been totally immune from larger national trends. Accordingly, we should not expect a full recovery to 2019 year-end figures until 2022. Further, complete recovery will largely depend on the ability of the country to roll out an effective, safe vaccine and for governments to feel comfortable lifting restrictions. Regardless, Arizona's multifamily sector has remained strong throughout this crisis and in many cases has actually seen in increase in production, rents, and demand.

In sum, these factors lead us to only one conclusion: optimism in the face of a difficult period in our state's history.

Sources:
The Winds of Change: US Multifamily and Commercial Real Estate in 2021, Moody's Analytics
Apartment News, November/December 2020, Arizona Multihousing Association.

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