Western Alliance Bank®

ECONOMIC OUTLOOK: PHOENIX, ARIZONA

Regional Intelligence Report

OCTOBER 2024

Prepared by Beacon Economics, LLC
Presented by Western Alliance Bank

Overview

- The Phoenix labor market is the strongest in Arizona and one of the fastest-growing among similarly sized markets. From July 2023 to July 2024, total nonfarm employment in Phoenix increased by 2.6%, outpacing growth in the U.S. (1.6%).

- Phoenix has seen significant labor force expansion since the onset of the pandemic, trailing only Austin and Dallas (MD) among comparable markets. Since February 2020, Phoenix's labor force has expanded by 10.6%, significantly outpacing the 2.4% increase nationwide.

- Health Care jobs accounted for roughly 28% of all jobs added in Phoenix over the last year. Other sectors enjoying significant gains include Government; Administrative Support; Professional, Scientific, and Technical Services; Wholesale Trade; Construction; and Logistics.

- Home prices in Phoenix remain well above pre-pandemic levels, but appreciation is cooling. From July 2023 to July 2024, the median single-family home price grew 1.2%, trailing the U.S. (4.3%). Phoenix's home prices are now 48% above February 2020 levels.

- Although national housing inventory remains low, Phoenix's inventory increased over the last year and is now near pre-pandemic levels. As consumers come to accept that interest rates may stay higher for longer, and that the days of sub-3% rates are behind us, inventories should continue to grow.

- Given the high cost of home ownership, demand for apartments in Phoenix remains strong. Despite rising vacancy rates, last year saw 8,227 units of net absorptions, indicating vacancy rates have risen due to new supply being added, not increasing demand.

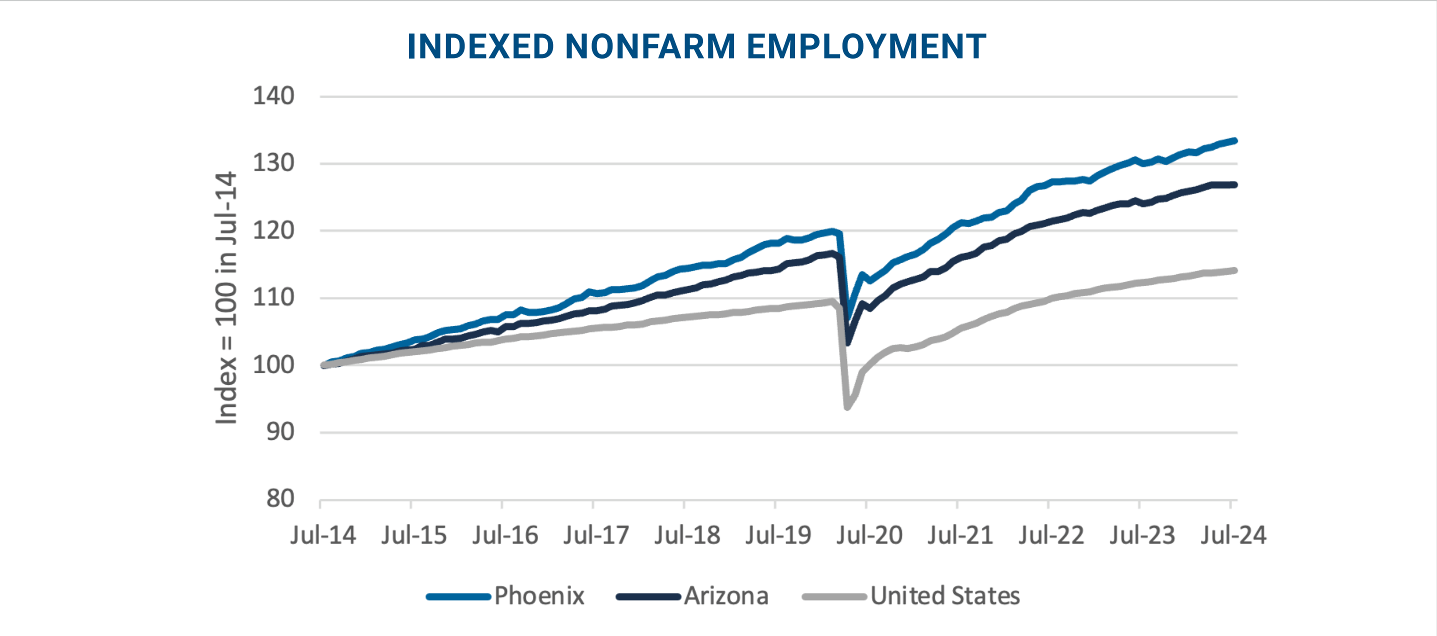
- Residential permit activity increased over the last year in Phoenix and is now above pre-pandemic levels. This was fueled by increases in single-family permitting, while multifamily permitting saw declines.

- Demand for office space in Phoenix declined over the last year, with -2,150,000 square feet of net absorptions. Vacancy rates have risen due to a 3.3% decline in occupied space.

- Increased e-commerce consumer spending has caused demand for Warehouse and Distribution space in Phoenix to surge. Last year saw 11,677,000 square feet of net absorptions, indicating that a significant amount of new supply caused vacancy rates to rise.

Labor Markets

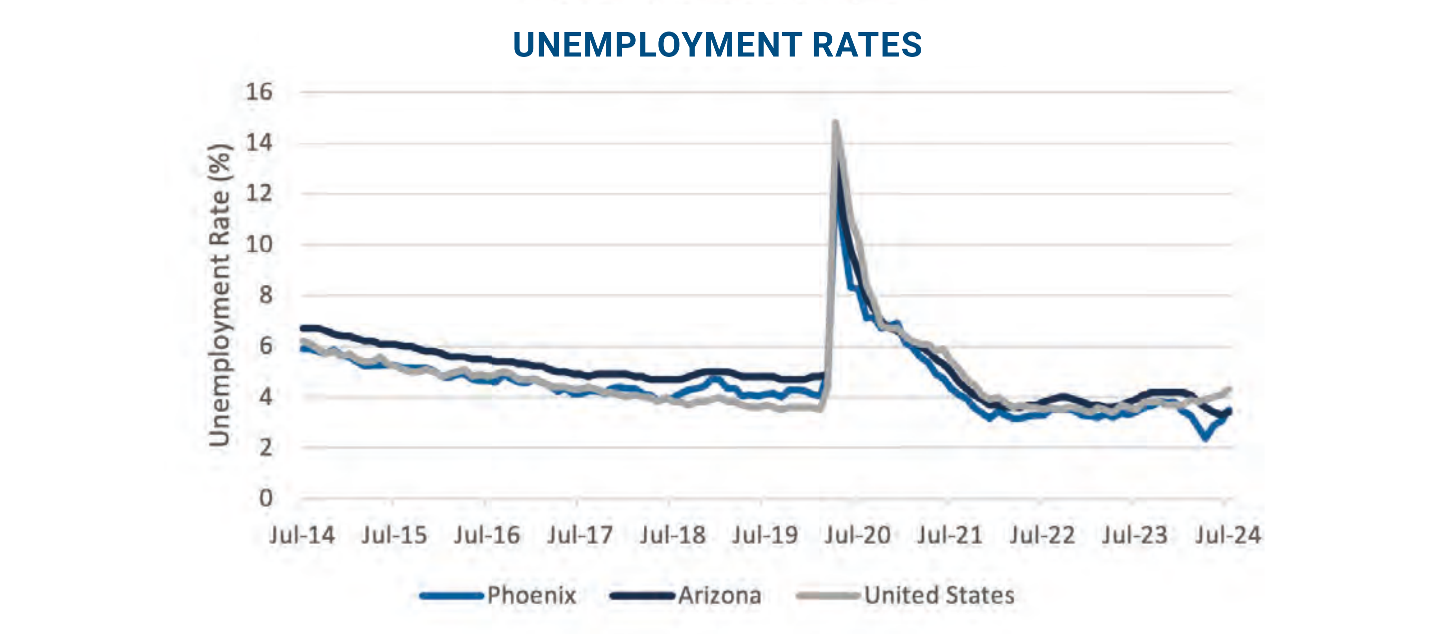
The Phoenix labor market is the strongest in the state. From July 2023 to July 2024, total nonfarm employment in Phoenix increased by 2.6%, outpacing the U.S. (1.6%). Among similarly sized markets, only Las Vegas, Miami, and Philadelphia (MD) outpaced Phoenix. In addition, 249,300 more people are employed in payroll positions in Phoenix than in February 2020, an 11.2% increase. This is a large increase compared to the U.S. (4.2%). Among similarly sized markets, only Austin and Dallas (MD) saw more significant increases.



Source: U.S. Bureau of Labor Statistics

Despite the recent rise in unemployment nationwide, rates remain low in Phoenix. Even as unemployment has risen in the city in recent months, it remains below pre-pandemic levels. In July 2024, the Phoenix unemployment rate was 3.5%, a 0.1 percentage-point increase from July 2023. Nationwide figures were higher at 4.3%, and the U.S. saw a more significant increase in unemployment over the last year.

The Phoenix labor force has expanded significantly since the beginning of the pandemic, with 260,700 more people in the region's labor force compared to February 2020. At 10.6%, this was a larger increase than the U.S. (2.4%), and among similarly sized markets, only Austin and Dallas (MD) saw more significant increases. From July 2023 to July 2024, Phoenix's labor force expanded by 2.9%, outpacing the U.S. (0.8%) and second only to Boston and Houston.



Source: U.S. Bureau of Labor Statistics

Employment growth in Phoenix has been broad-based, with most sectors adding positions over the last year. The biggest gains were in Health Care, which increased payrolls by 17,500 jobs from July 2023 to July 2024, a 5.3% increase. The additional Health Care jobs accounted for roughly 28% of all jobs added over the period. Every sector in Phoenix has expanded since the start of the pandemic except for Administration Support. However, payrolls in this sector are up by 3.8% over the last year, a contrast to nationwide declines.

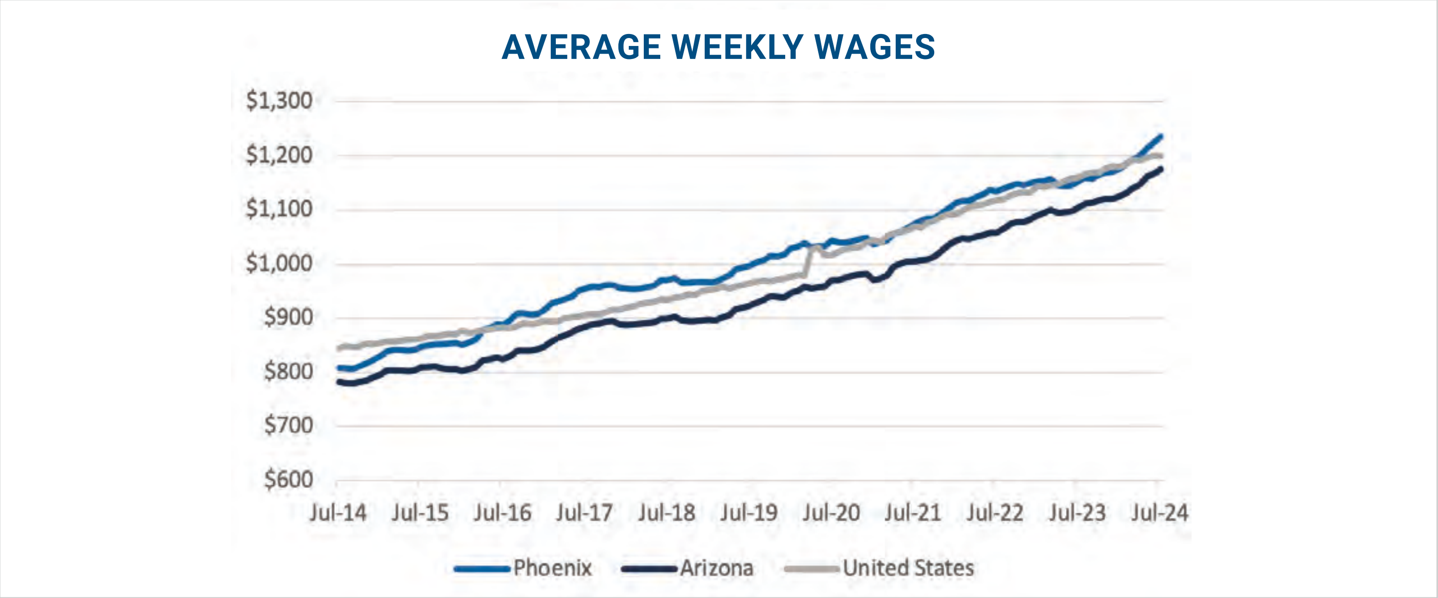
Job losses were most pronounced in Leisure and Hospitality, with payrolls down by 2,100 positions (-0.8%). Declines in Leisure and Hospitality were driven by declines in Food Services, which reduced payrolls by 2,900 (1.6%) over the last year. Other significant job losses occurred in Information and Manufacturing.

INDUSTRY EMPLOYMENT: PHOENIX

Sector	Jul-24 Emp. (000s)	1-Year Chg. (000s)	1-Year Chg. (%)	LQ
Health Care	350.5	17.5	5.3	1.0
Government	260.6	8.1	3.2	0.7
Admin Support	206.2	7.6	3.8	1.4
Prof Sci Tech	148.2	5.3	3.7	0.9
Wholesale Trade	104.1	4.9	4.9	1.1
Construction	172.3	4.5	2.7	1.3
Logistics	125.5	3.6	3.0	1.1
Financial Activities	214.2	3.2	1.5	1.5
Other Services	79.4	3.0	3.9	0.9
Management	44.6	1.8	4.2	1.1
Retail Trade	251.0	0.7	0.3	1.0
Natural Resources	3.9	0.3	8.2	0.4
Manufacturing	147.8	-1.1	-0.7	0.7
Information	40.8	-1.7	-4.1	0.9
Leisure and Hospitality	249.2	-2.1	-0.8	0.9
Total Nonfarm	2,466.4	62.0	2.6	1.0

Source: U.S. Bureau of Labor Statistics

Average weekly wages in Phoenix have also continued to grow, reaching $1,235 in July 2024, a 7.1% increase from a year earlier. Over the same period, average weekly wages grew more modestly in the U.S. (3.3%) and Tucson (6.8%) but fell in Flagstaff (-5.8%). Since the pandemic began, Phoenix's wages have generally been at or below the national level. Recently, however, they have surpassed it.

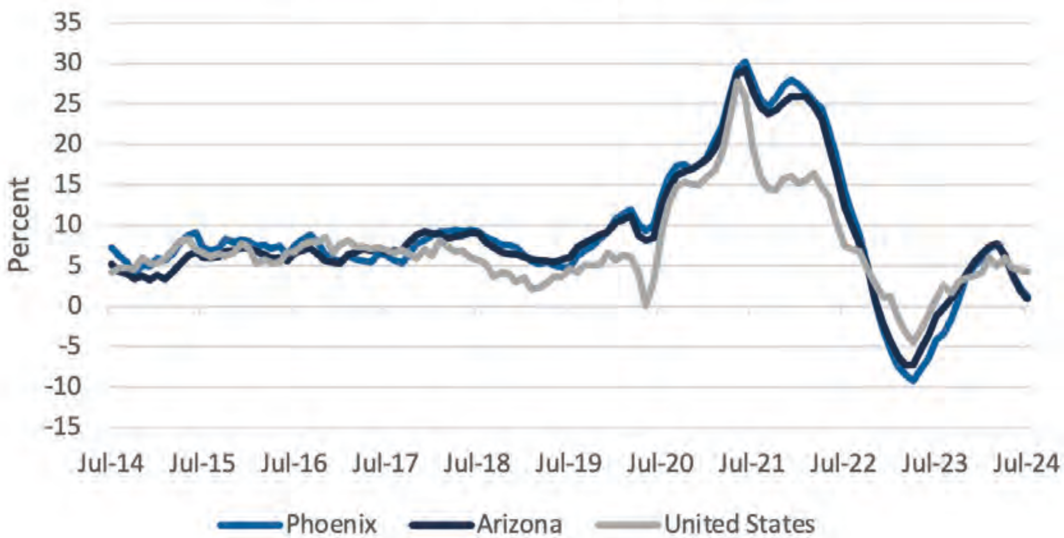


Source: U.S. Bureau of Labor Statistics

Residential Real Estate

The Phoenix housing market remains stable, even in the face of low affordability. Similarly, higher borrowing costs have not stopped home prices in Phoenix from rising to significantly higher levels than their pre-pandemic peak. Moreover, since many households took advantage of low rates to refinance, consumer debt burden is very low, even with higher interest rates. This suggests that a housing market collapse is highly unlikely, despite limited market turnover.

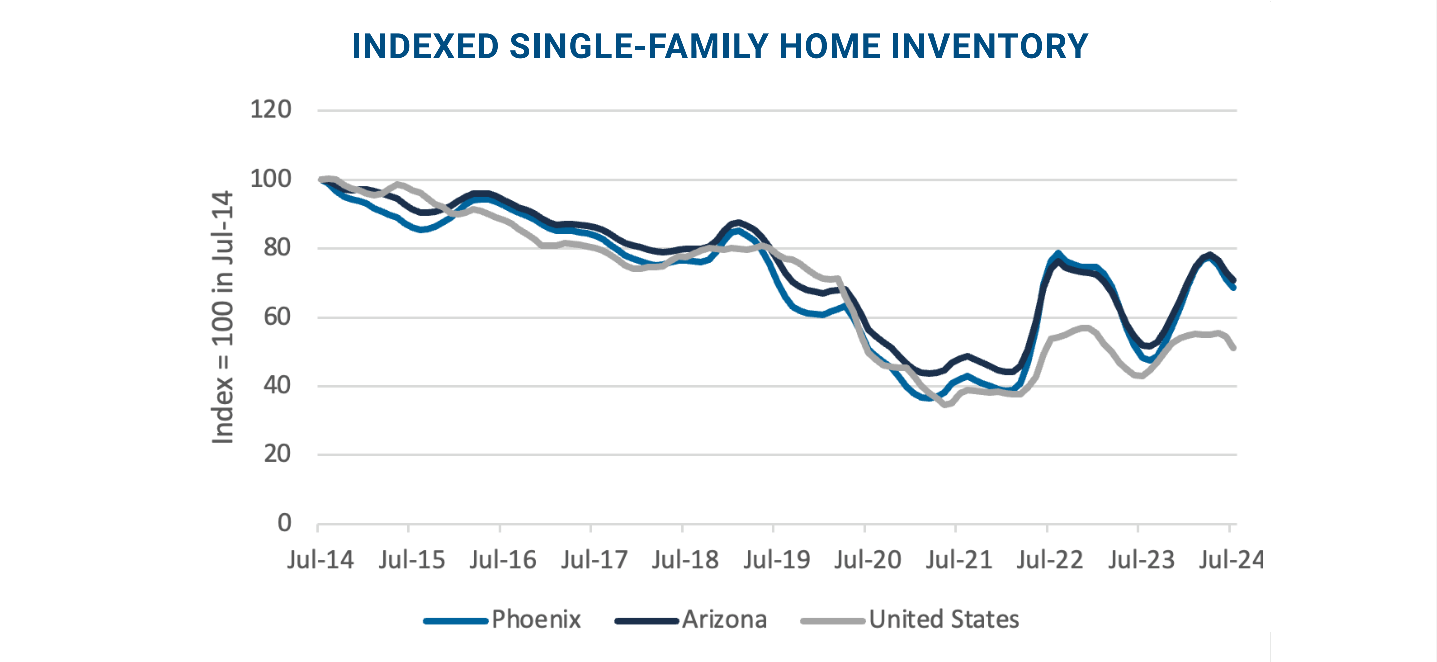
MEDIAN HOME PRICE GRAPH



Source: U.S. Bureau of Labor Statistics

But even as home prices outstrip pre-pandemic figures, appreciation in Phoenix is cooling. From July 2023 to July 2024, the median single-family home price grew 1.2%, trailing growth in Tucson (1.6%) and the U.S. (4.3%), but surpassing Arizona (1.0%) and Flagstaff (-0.9%). Phoenix's home prices are now 48% above February 2020 levels.

The national housing inventory remains low, despite increases over the past year. Inventory in Phoenix is now higher than the U.S. overall, with 3.3 months of supply as of July 2024, a one-month increase from July 2023. A balanced market typically equates to six to seven months of supply. A buyer's market typically has seven months of supply or more, while a seller's market has six months or fewer. Moreover, there were nearly 15,000 homes for sale in Phoenix in July 2024, a 42% increase from July 2023 but a 2.2% decline from July 2019. With consumers coming to accept persistently high interest rates, and realizing that sub-3% rates are a thing of the past, inventories should continue to grow.



Source: Redfin

With limited inventory and above-average mortgage rates, the number of homes sold in Phoenix remains below pre-pandemic levels. Existing single-family home sales fell by 2.7% from July 2023 to July 2024, a more modest decline compared to Arizona (-3.5%) and Tucson (-8.5%) but a more significant decline compared to the U.S. (-1.8%) and trailing growth in Flagstaff (6.4%).

However, there is relief on the horizon in the shape of the Fed's recently announced rate cuts. Although the pass-through from the federal rate to longer-term rates is not as strong, since the federal funds rate largely affects short-term rates, there have been some declines in mortgage rates. In May, mortgage rates were above 7%. They are now 6.1%, a source of much-needed relief for prospective buyers.

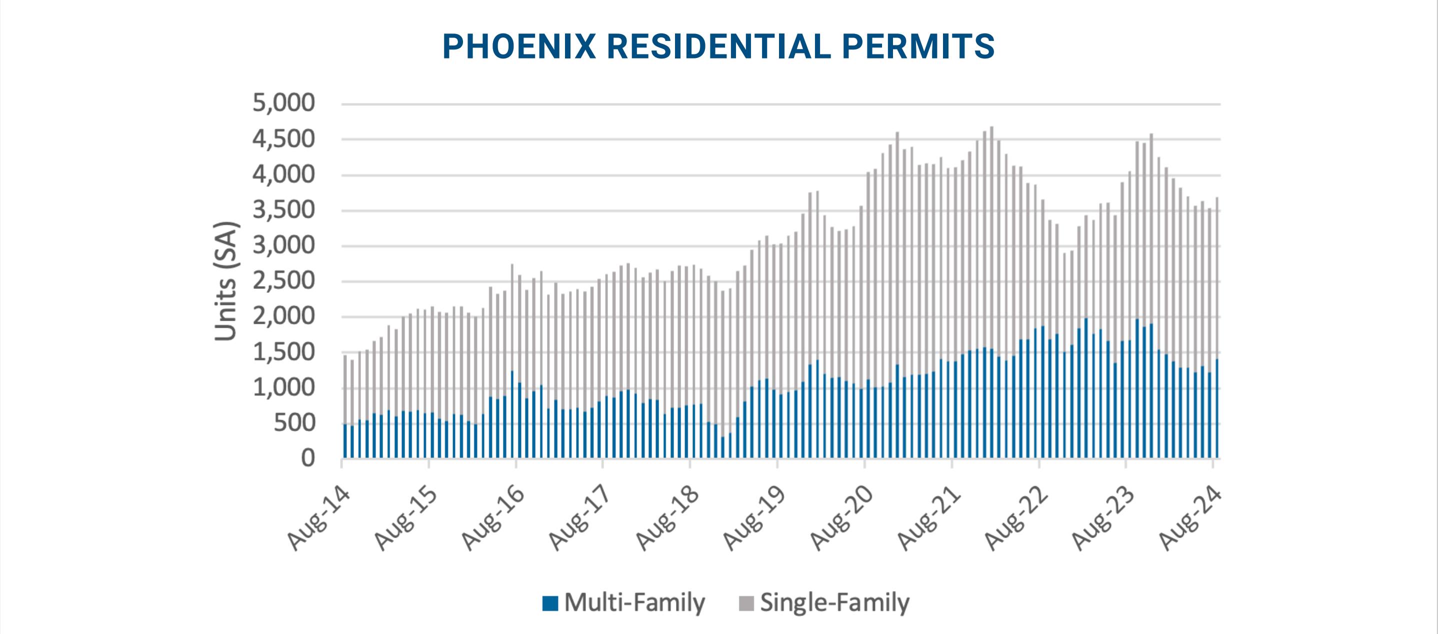
Given the high cost of home ownership, demand for apartments in Phoenix is strong, with vacancy rates rising to 7.8% in the second quarter of 2024, up 0.9 percentage points from a year earlier. However, last year saw 8,227 units of net absorptions, indicating vacancy rates have risen due to a significant amount of new supply. Vacancy rates are higher in Phoenix compared to Flagstaff (6.1%), Tucson (5.6%), and the U.S. (5.7%). Asking rents grew by 0.7% to $1,566 per unit per month and are up 37.4% since the fourth quarter of 2019, outpacing a 20.2% increase in the U.S. over the same period.

APARTMENT MARKET

Metro	Cost of Rent			Vacancy Rate		
	Q2-24 ($)	1-Yr Growth (%)	Change since Q4-19 (%)	Q2-24 ($)	1-Yr Change (pp)	Change since Q4-19 (pp)
United States	1,840	-0.1	20.2	5.7	0.5	1.0
Denver	1,788	-0.2	20.6	6.8	0.4	1.1
Flagstaff	1,728	-1.2	30.0	6.1	0.6	1.9
Inland Empire	1,821	-2.7	27.3	3.3	0.1	-0.1
Las Vegas	1,481	-2.0	26.7	3.2	0.2	-0.5
Phoenix	1,566	0.7	37.4	7.8	0.9	3.2
Salt Lake City	1,374	-0.1	26.8	5.9	0.9	0.6
Tucson	1,229	0.5	43.6	5.6	0.4	1.5

Source: REIS (Moody's Analytics)

Over the first eight months of 2024, residential permit activity in Phoenix increased by 4.6% compared to the same period in 2023. This increase was fueled by a 30.1% rise in single-family permitting, offset by a 23% drop in multifamily permitting. Residential permitting in Phoenix now outpaces pre-pandemic levels, with residential permits up 30.3% compared to the same period in 2019. On September 18, the Fed made the first cut to the federal funds rate in four years. At 0.5%, this reduction could sustain momentum by making construction project financing more affordable.



Source: U.S. Census Bureau

Commercial Real Estate

Despite increases in office-facing employment, the office segment of the commercial market remains one of the weaker performers. Office vacancy rates in Phoenix hit 24% in the second quarter of 2024, up 2.7 percentage points from a year earlier. Last year saw 2,150,000 square feet of net absorptions, with vacancy rates rising due to a 3.3% decline in occupied space. Vacancy rates are now lower in Tucson (19.6%) and the U.S. (20.1%). Asking rents grew 1.8% to an annual rate of $29.29 per square foot, keeping Phoenix office space more affordable than in the U.S. overall ($35.71) and more expensive than Tucson ($23.48).

OFFICE MARKET

Metro	Cost of Rent			Vacancy Rate		
	Q2-24 ($)	1-Yr Growth (%)	Change since Q4-19 (%)	Q2-24 ($)	1-Yr Change (pp)	Change since Q4-19 (pp)
United States	35.71	0.6	4.0	20.1	1.2	3.3
Denver	28.09	1.6	4.5	22.9	1.3	6.0
Inland Empire	25.27	2.3	8.8	14.9	-1.3	-1.7
Las Vegas	27.12	0.9	6.2	25.4	1.8	2.3
Phoenix	29.29	1.8	8.8	24.0	2.7	1.9
Salt Lake City	22.15	1.1	6.8	19.5	1.0	2.9
Tucson	23.48	0.0	5.2	19.6	-1.8	-1.9

Source: REIS (Moody's Analytics)

While the office sector has been weak, demand for retail space in Phoenix remains strong. The vacancy rates held steady at 9.1% in second quarter of 2024 (unchanged from a year earlier), and asking rents grew 1.4% to an annual rate of $21.23 per square foot. In addition, last year saw 232,000 square feet of net absorptions, indicating that vacancy rates have remained stable in spite of new supply. Phoenix has a relatively low vacancy rate compared to other markets in the Southwest and the country overall.

Net Absorption: *Net change in occupied space during the applicable time period.*

Metropolitan division (MD) *is a county or counties within a large MSA.*

Location quotients (LQ) *compare the concentration of an industry within a specific area to the concentration of that industry nationwide. An LQ greater than one indicates an industry with a greater share of the local area employment than is the case nationwide.*

RETAIL MARKET

Metro	Cost of Rent			Vacancy Rate		
	Q2-24 ($)	1-Yr Growth (%)	Change since Q4-19 (%)	Q2-24 ($)	1-Yr Change (pp)	Change since Q4-19 (pp)
United States	21.75	0.8	1.1	10.4	0.1	0.2
Denver	19.56	0.7	0.8	9.2	0.2	0.3
Inland Empire	22.91	0.8	-1.5	10.1	-0.3	0.2
Las Vegas	23.56	1.6	3.3	12.9	-0.2	-0.1
Phoenix	21.23	1.4	1.2	9.1	0.0	-0.5
Salt Lake City	18.82	1.2	2.8	12.1	0.6	0.4
Tucson	18.66	0.2	1.6	9.6	0.5	-0.4

Source: REIS (Moody's Analytics)

Increased e-commerce consumer spending has caused demand for Warehouse and Distribution space in Phoenix to surge — but new supply is still outpacing it. Vacancy rates in Phoenix climbed to 13% in the second quarter of 2024, a 3.8 percentage-point jump from a year earlier. While 11,677,000 square feet of net absorptions occurred last year, the rise in vacancy rates reflects a significant amount of new supply. In comparison, vacancy rates are lower in Tucson (2.7%) and the U.S. (6.5%). Meanwhile, asking rents in Phoenix grew 4.0% to an average annual rate of $9.14 per square foot, higher than rents in Tucson ($7.37) and the U.S. ($7.87).

WAREHOUSE MARKET

Metro	Cost of Rent			Vacancy Rate		
	Q2-24 ($)	1-Yr Growth (%)	Change since Q4-19 (%)	Q2-24 ($)	1-Yr Change (pp)	Change since Q4-19 (pp)
United States	7.87	2.5	39.0	6.5	1.2	-3.8
Denver	7.18	2.6	26.9	8.8	0.5	-1.0
Inland Empire	12.89	1.2	123.8	8.9	5.1	-0.9
Las Vegas	9.41	3.6	36.0	12.6	7.0	5.8
Phoenix	8.57	4.0	39.1	13.0	3.8	-1.0
Salt Lake City	8.34	2.6	40.9	12.1	1.2	5.2
Tucson	7.37	2.6	32.6	2.7	-1.3	-13.0

Source: REIS (Moody's Analytics)

Overall, Phoenix's economy continues to show strong positive trends. Its labor market is the strongest in Arizona and one of the fastest-growing among similarly sized markets. There are certainly modest signs of slowing — due to the housing sector — but that's to be expected, given the inflation-fighting steps taken by the Federal Reserve. Most importantly, the surge of inflation that had such an outsized impact on confidence over the past two years has faded away as the Fed's ongoing efforts to cool demand and shrink the money supply have finally paid off.

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