

Alliance Bank
OF ARIZONA®

Tucson

Regional Intelligence Report

NOVEMBER 2022

Prepared by Beacon Economics, LLC
Presented by Alliance Bank of Arizona

Economic Outlook: Arizona

Overview

Despite widely held misconceptions, the first half of 2022 was not technically a recession in the U.S. The decline in output was driven by rapidly shifting patterns of demand, which in turn were driven by frenetic changes in Federal Reserve policy.

While parts of the U.S. economy will remain cool because of rising interest rates, consumer spending will continue to push the overall economy forward for the rest of the year and into 2023. Inflation may be peaking, but it will not decelerate rapidly—price growth and interest rates are expected to remain elevated in the near term. The potential for a real recession in the nation will increase with measures to control inflation and push up real (vs. nominal) interest rates.

The growing federal deficit and debt levels pose economic wildcards. Future shifts will depend on how long bond markets tolerate the deficits and growing debt.

Traditionally, a recession is defined as two quarters of negative growth. Indeed, data suggests that overall output in the nation fell about 0.5% in the first half of 2022. However, over the same period, the U.S. unemployment rate dropped from 3.9% to 3.5%, the nation added 3 million jobs and industrial production climbed to a record-high level. Even so, real growth has slowed and there are signs of stress in parts of the economy, such as new housing.

Regional Employment

Arizona's labor market has continued to steadily recover from the COVID-19 pandemic, adding 433,000 jobs since bottoming out in April 2020. This is more than the total jobs lost between February and April of 2020. With the ongoing labor market recovery, total payroll employment is now 3.1% (or 94,200 jobs) above the pre-pandemic peak in February 2020.

Employment levels in Tucson remain slightly below the pre-pandemic peak in February 2020, with employment levels now 0.5% (or 1,900 jobs) below their peak. The low unemployment rate in Tucson (3.8%) suggests there are jobs for those seeking employment.

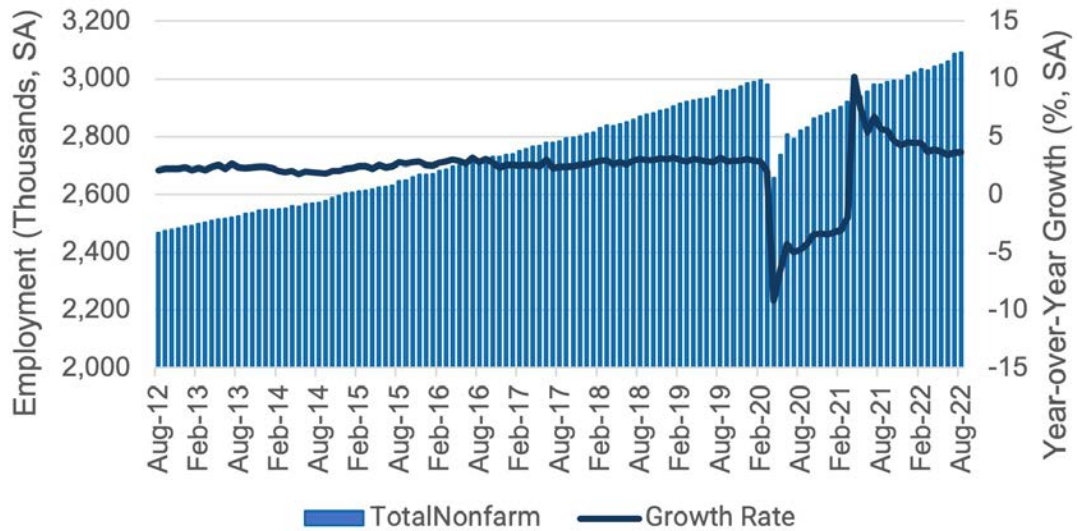
Unemployment rates have also improved from 2020's highs. In Arizona, the unemployment rate is now 3.5%, which is near an all-time low. Arizona's labor force has also expanded, increasing by 116,400 workers since February 2020, a 3.3% increase. Tucson has seen unemployment levels rise in recent months; however, at 3.8% the unemployment rate in Tucson is well below pre-pandemic levels. (By contrast, while Arizona's labor force has steadily expanded since the beginning of the pandemic, the labor force in the U.S. has grown by just 0.1% over that same period.)

While the state has increased payrolls overall since the beginning of the pandemic, growth has been mixed within industries. The surge in e-commerce spending has helped boost payrolls in Arizona's Transportation, Warehousing and Utilities sector by 27.2% (or 33,600 jobs) since February 2020. Other sectors with sizable payroll increases over this period were Manufacturing (7.6% or 13,800 jobs), Construction (7.1% or 12,500 jobs), Retail Trade (6.1% or 19,900 jobs), Financial Activities (5.0% or 11,600 jobs), Wholesale Trade (4.8% or 4,800 jobs), and Information (3.2% or 1,600 jobs).

The largest job losses in Arizona have been concentrated in the Administrative Support sector, with 21,300 fewer workers compared to February 2020, an 8.3% decline. Other significant job losses have occurred in Government (-2.2% or -9,200 jobs) and Leisure and Hospitality (-1.6% or -5,500 jobs).

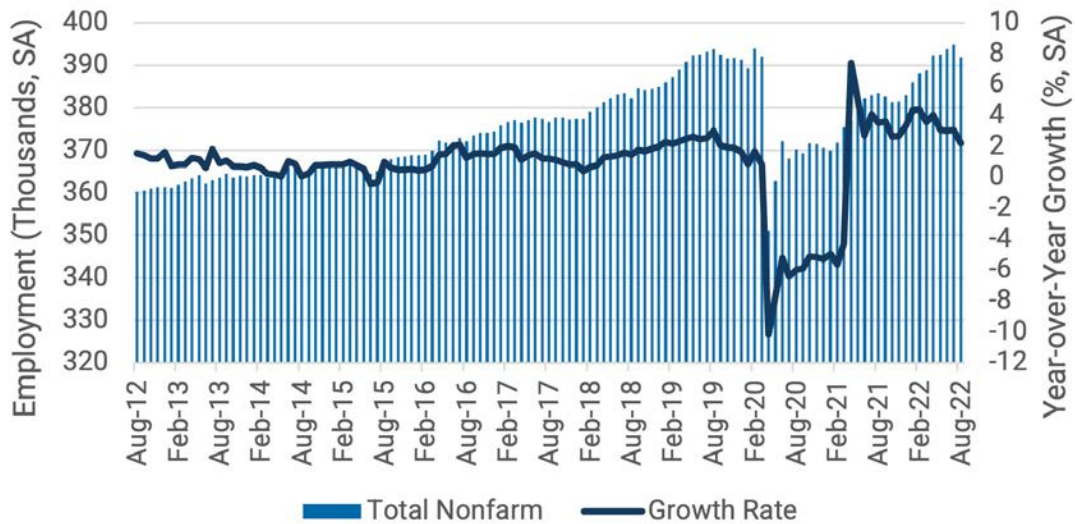
The surge in e-commerce spending has helped boost payrolls in Tucson's Transportation, Warehousing and Utilities sector by 44.4% (or 6,600 jobs) since February 2020. Other sectors with sizable increase in payrolls over this period were Wholesale Trade (5.0% or 400 jobs), Manufacturing (4.8% or 1,300 jobs), Other Services (2.5% or 400 jobs), Leisure and Hospitality (1.7% or 800 jobs) and Retail Trade (1.0% or 400 jobs).

ARIZONA TOTAL NONFARM EMPLOYMENT



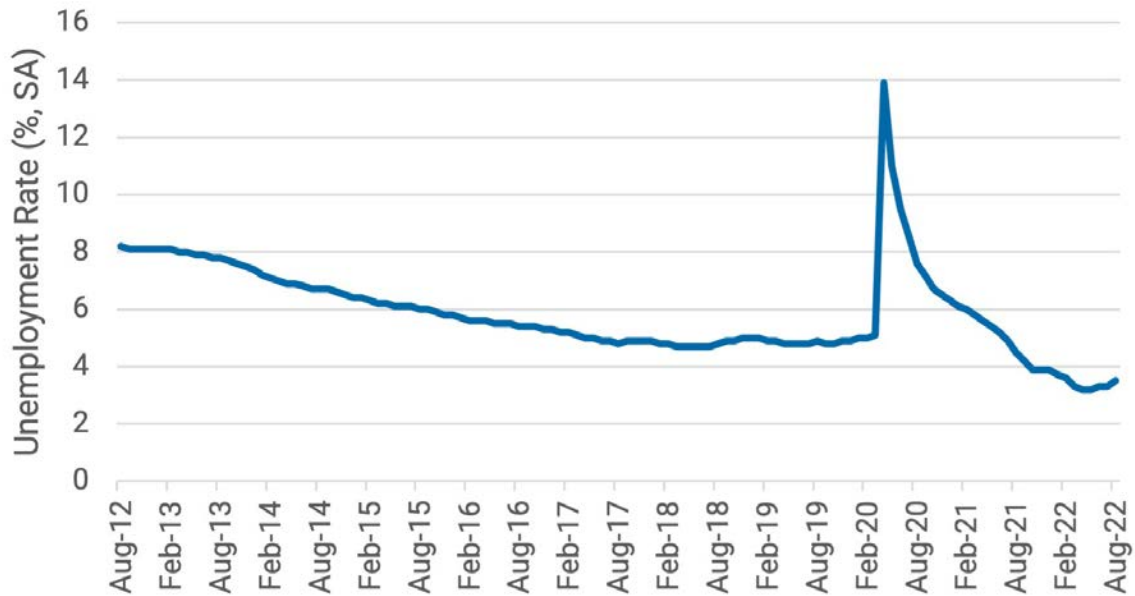
Source: U.S. Bureau of Labor Statistics

TUCSON TOTAL NONFARM EMPLOYMENT



Source: U.S. Bureau of Labor Statistics

ARIZONA UNEMPLOYMENT RATE



Source: U.S. Bureau of Labor Statistics



INDUSTRY EMPLOYMENT: ARIZONA

Sector	August-22 Emp. (000s)	Chg. Since Feb-20 (%)	Chg. Since Feb-20 (000s)
Transport,Warehouse,Util.	157.3	27.2	33.6
Manufacturing	194.2	7.6	13.8
Construction	188.3	7.1	12.5
Retail Trade	347.7	6.1	19.9
Financial Activities	245.4	5.0	11.6
Wholesale Trade	104.9	4.8	4.8
Information	51.3	3.2	1.6
Education/Health	485.1	1.6	7.6
Professional/Business	456.1	1.2	5.5
Other Services	95.0	0.1	0.1
Mining and Logging	12.8	0.0	0.0
Leisure and Hospitality	335.6	-1.6	-5.5
Government	417.5	-2.2	-9.2
Total Nonfarm	3,090.5	3.1	94.3

Source: U.S. Bureau of Labor Statistics

INDUSTRY EMPLOYMENT: TUCSON

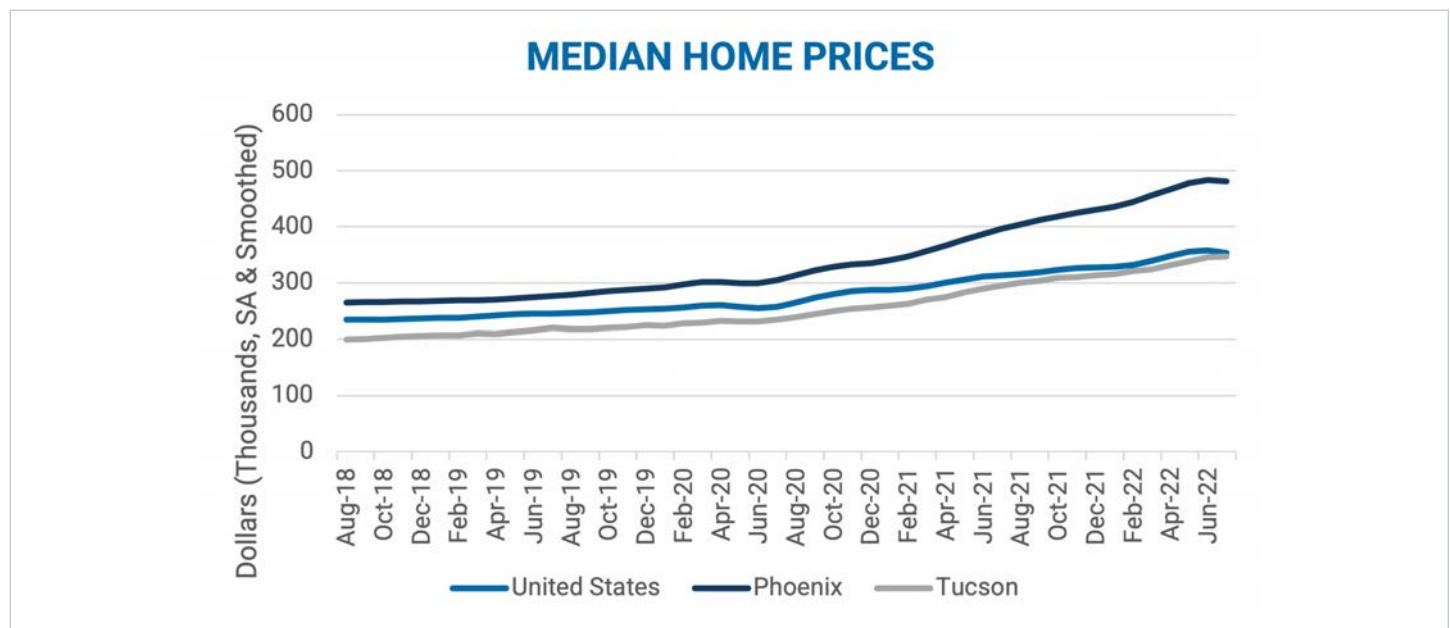
Sector	August-22 Emp. (000s)	Chg. Since Feb-20 (%)	Chg. Since Feb-20 (000s)
Transport,Warehouse,Util.	21.4	44.4	6.6
Wholesale Trade	7.6	5.0	0.4
Manufacturing	29.1	4.8	1.3
Mining and Logging	1.9	2.9	0.1
Other Services	14.5	2.5	0.4
Leisure and Hospitality	45.6	1.7	0.8
Retail Trade	41.6	1.0	0.4
Financial Activities	17.8	0.1	0.0
Construction	18.3	-0.3	-0.1
Education/Health	69.0	-1.5	-1.1
Government	76.6	-3.5	-2.7
Information	5.2	-11.9	-0.7
Professional/Business	43.7	-13.5	-6.8
Total Nonfarm	392.0	-0.5	-1.9

Source: U.S. Bureau of Labor Statistics

Residential Real Estate

The housing market has been another strength of Arizona's economy over the last two years. However, rising interest rates and stretched prices have led to a notable slowdown in 2022.

Within this context, home prices in Arizona continue to increase rapidly. From July 2021 to July 2022, the median home price rose 21.2% in Phoenix, reaching \$480,567. In Tucson, median home prices rose to \$347,157 in July 2022, a 17.6% increase from a year earlier. Home prices in Phoenix and Tucson grew at a faster pace than the U.S., where median prices rose by 13.0% over the same period.



Source: Zillow

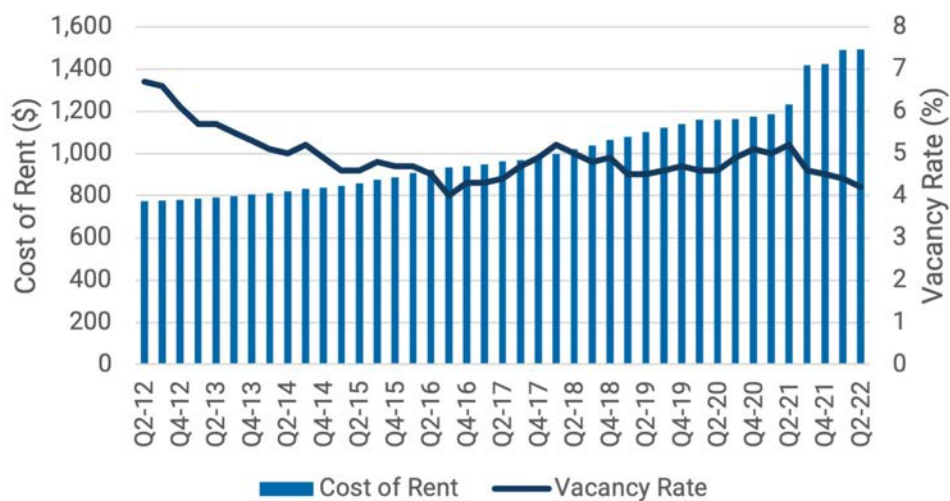
In Phoenix, there were 54,010 homes sold in the first eight months of 2022, representing a 21.7% decline compared to the first eight months of 2021. In Tucson, there were 22,899 homes sold in the first eight months of 2022, representing a 21.6% decline.

The decline in home sales can be attributed to the jump in prices over a short period of time. Throughout the state, the prospect of higher monthly mortgage payments has pushed many potential buyers to the sidelines. When adjusted for inflation, the cost of owning a home is comparable to the highs in 2005. However, today's lending standards mean borrowers have greater financial security, and a market crash of the magnitude of 2008 is unlikely. Still, a number of metrics point to a slowdown in price growth in the state.

Despite demand cooling, inventory remains low in Arizona. During the first eight months of 2022, there was an average of 16,920 units for sale per month in Phoenix, 35.1% below 2019 levels. In Tucson, there was an average of 2,643 units for sale per month during the first eight months of 2022, which was 47.5% below 2019 levels.

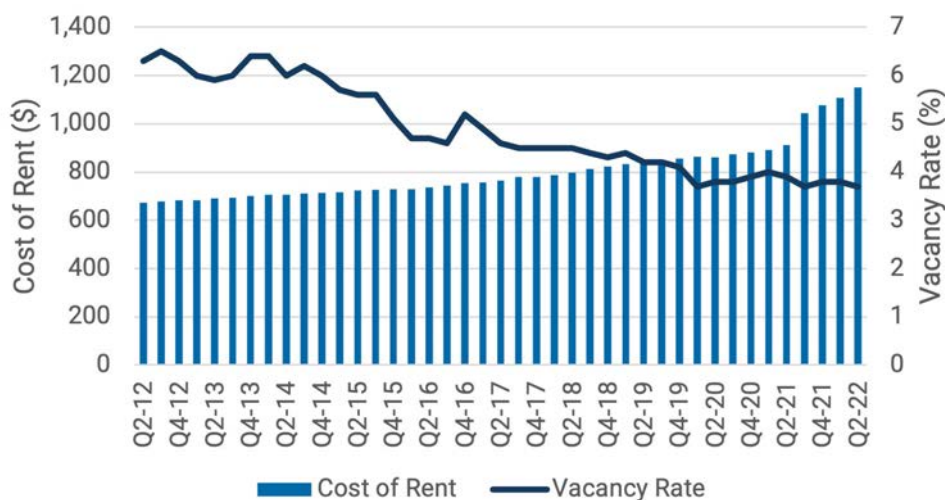
Meanwhile, demand for apartment units has surged over the last year in Arizona. In Phoenix, the apartment vacancy rate fell to 4.2%, a 1.0 percentage point decline from a year ago. Vacancy rates for apartment units also declined in Tucson over this period; at 3.7%, rates are down 0.2 percentage points from a year earlier. In addition, the average asking rent grew by 21.0% in Phoenix and by 26.2% in Tucson. This pace of growth puts the Phoenix and Tucson metropolitan areas well ahead of the 16.7% growth seen across the U.S. over that same period. Despite significant price appreciation over the last year, average asking rents in Phoenix (\$1,494) and Tucson (\$1,152) are still lower compared to the U.S. average (\$1,724).

PHOENIX APARTMENT MARKET



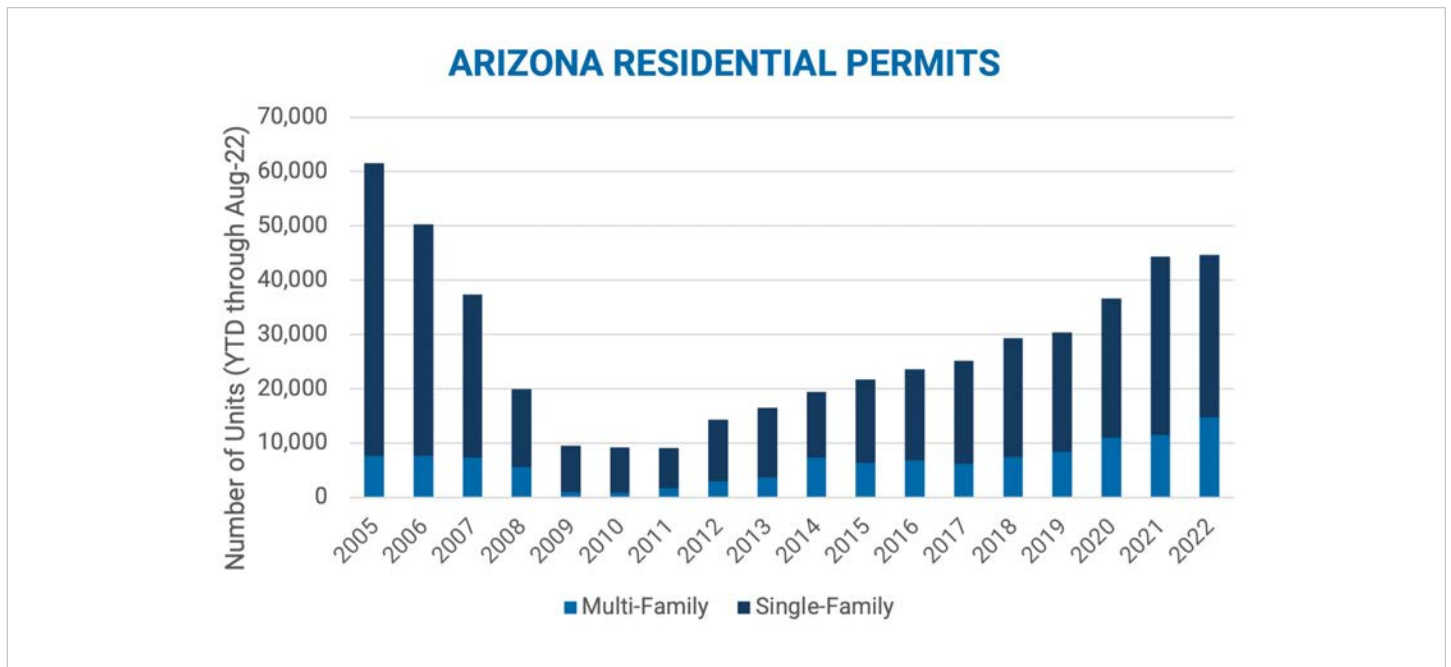
Source: REIS (Moody's Analytics)

TUCSON APARTMENT MARKET



Source: REIS (Moody's Analytics)

Construction permit activity has also slightly increased over the last year in Arizona. During the first eight months of 2022, residential permitting activity in Arizona is up 0.7% over the same period in 2021. This growth is being fueled by a 28.6% increase in multi-family permitting and slightly offset by a 9.1% decrease in single-family permitting.



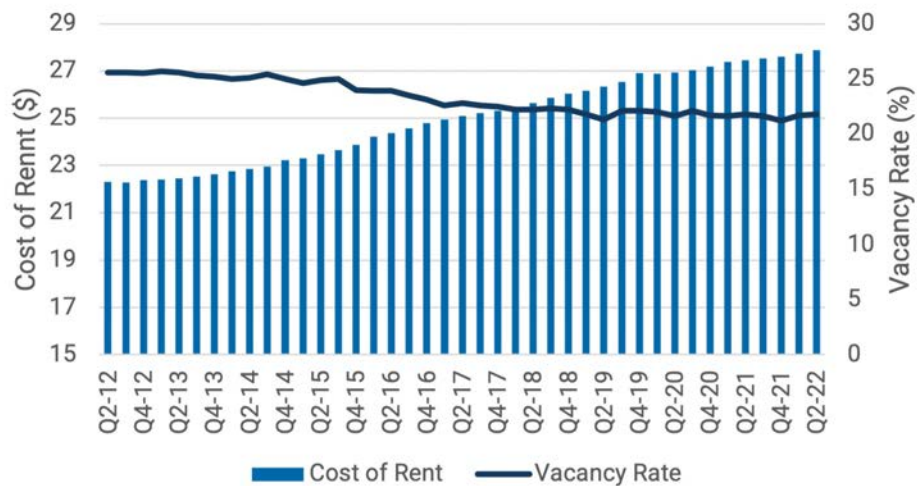
Source: Construction Industry Research Board (CIRB)



Commercial Real Estate

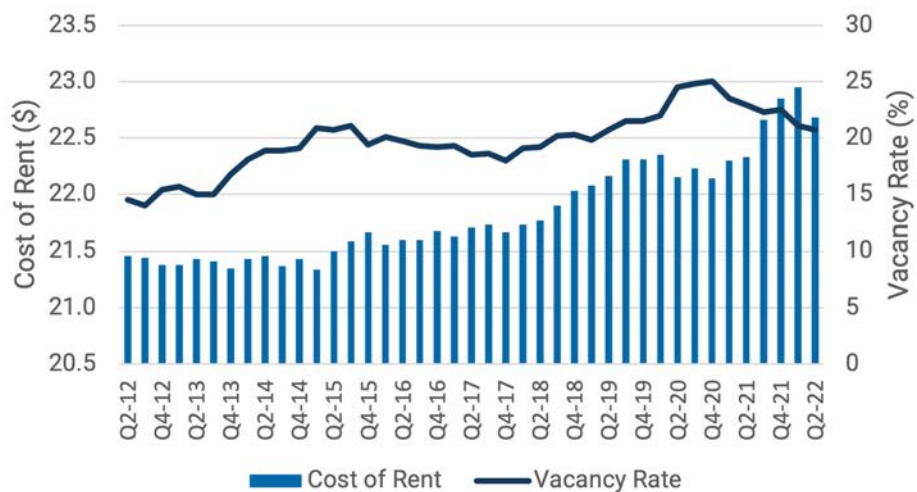
With more companies returning to normal operations, demand for office properties has grown over the last year in Arizona. In Phoenix, the office vacancy rate hit 21.8% in the second quarter of 2022, unchanged from a year earlier. Vacancy rates for office properties declined in Tucson over this period, at 20.7%, down 2.2 percentage points from a year earlier. The average asking rent increased by 1.6% in Phoenix and by 1.6% in Tucson, outpacing the 0.8% decline in asking rents in the U.S.

PHOENIX OFFICE MARKET



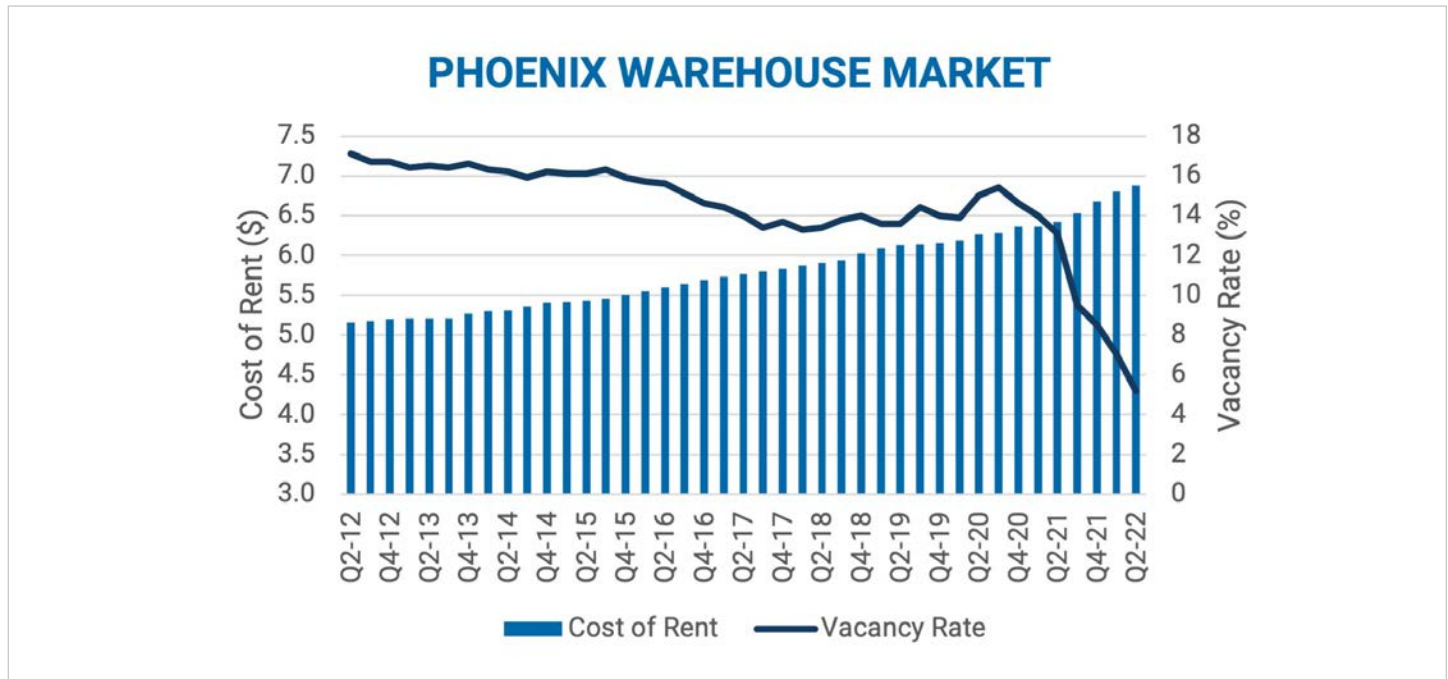
Source: REIS (Moody's Analytics)

TUCSON OFFICE MARKET



Source: REIS (Moody's Analytics)

Demand for retail space in Arizona has stabilized over the last year. In Phoenix, the retail vacancy rate hit 9.5% in the second quarter of 2022, down 0.3 percentage points from a year earlier. Vacancy rates for retail properties also declined in Tucson over this period, at 9.3%, down 0.5 percentage points from a year earlier. The average asking rent grew by 0.5% in Phoenix and by 0.7% in Tucson, putting Arizona just ahead of the 0.3% increase in asking rents in the U.S.



Source: REIS (Moody's Analytics)

The increase in demand for e-commerce has increased demand for warehouse space in Arizona. In Phoenix, the warehouse vacancy rate dropped to 5.2% in the second quarter of 2022, down 7.9 percentage points from a year earlier. Vacancy rates for warehouse properties also declined in Tucson over this period, at 8.2%, down 4.7 percentage points from a year earlier. In conjunction, the average asking rent grew 7.2% in Phoenix and 6.3% in Tucson, similar to growth in the U.S. (6.9%) over this period.

Demand for flex/research and development (R&D) properties has been more resilient relative to office and retail space in Arizona. In Phoenix, the vacancy rate for flex/R&D properties fell to 8.9% in the second quarter of 2022, a 3.7 percentage-point decline from a year earlier. The average asking rent for flex/R&D space grew 3.5% in Phoenix, while asking rent for flex/R&D space grew at a slightly faster pace (4.9%) in the U.S.



Prepared By Beacon Economics

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About Alliance Bank of Arizona

Alliance Bank of Arizona, a division of Western Alliance Bank, Member FDIC, delivers relationship banking that puts clients at the center of everything. Founded in 2003, Alliance Bank of Arizona offers a full spectrum of tailored business banking solutions and outstanding service, with offices in Greater Phoenix, Tucson and Flagstaff. Alliance Bank of Arizona was named 2021 Lender Firm of the Year by NAIOP Arizona, among many other awards and recognitions. As part of \$65 billion Western Alliance Bancorporation — ranked #1 top-performing large bank with assets greater than \$50 billion in 2021 by both American Banker and Bank Director — Alliance Bank of Arizona has the reach, resources and local market expertise that make a difference for customers.

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