MARKET REPORT | 3Q/2018

Greater Tucson Multifamily

Apartment Market Strengthens as Job Growth Gains Steam

Highlights

- The Tucson apartment market improved during the third quarter with vacancy dipping and rents posting strong gains. The market is being supported by an accelerating pace of employment growth.
- Vacancy dipped by 30 basis points in the third quarter, ending the period at 6 percent. The current vacancy rate is 50 basis points lower than one year ago.
- Asking rents posted another quarterly increase in excess of 2 percent. During the past 12 months, asking rents have spiked by 6.8 percent, reaching $767 per month.
- Investment conditions cooled a bit during the third quarter with sales velocity slowing and the median price inching lower. Year to date, the median price is $50,000 per unit, while the average cap rate is just under 6 percent.

Tucson Multifamily Market Overview

Following some mixed conditions during the summer months, the Tucson multifamily market bounced back during the third quarter. The vacancy rate has averaged just slightly more than 6 percent over the past year, the lowest four-quarter average in more than 20 years. With vacancy consistently low, rents are pushing higher and apartment development is picking up. In recent years, new construction has been concentrated in the Northwest Tucson and University submarkets, with deliveries exceeding 1,000 units in each submarket since 2012. In the coming quarters, this trend will continue with projects totaling nearly 300 units under way in the University submarket and 150 units under construction in the Northwest Tucson area.

Market Indicators

	3Q/2018
Vacancy	↓
Rents	↑
Transaction Activity	↓
Price Per Unit	↓
Cap Rates	↓

Summary Statistics	Tucson Market
Vacancy Rate	6.0%
- Change from 3Q 2017 (bps)	-50
Asking Rents (per month)	$767
- Change from 3Q 2017	6.8%
Median Sales Price (per unit YTD)	$50,000
Average Cap Rate (YTD)	6.0%

Tucson Multifamily Market Overview (cont.)

While property fundamentals are quite strong, the investment market has cooled off a bit thus far in 2018, including a dip during the third quarter. Sales volume recorded the steepest drop in sales of complexes with 50-100 units. These transactions, which are generally priced between $2 million and $5 million, are typically fueled by local investors and buyers from neighboring California. These investors were likely ahead of the curve, prompting the surge in sales volume that began in 2016. Despite the modest decline in activity in recent months, cap rates have compressed thus far in 2018. Average cap rates year to date are down approximately 30 basis points from 2017 levels at just under 6 percent.

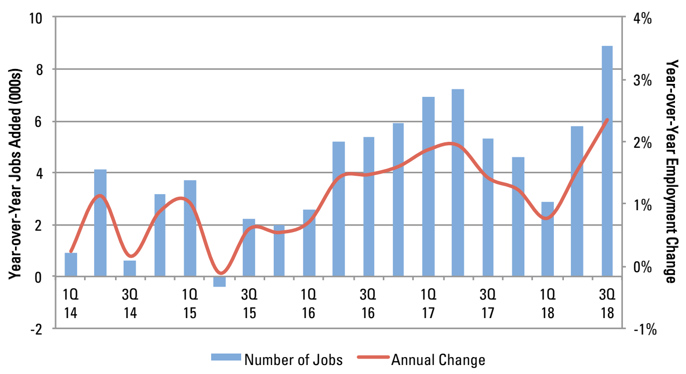
Submarket Statistics

Submarket Name	3Q 2018 Vacancy	3Q 2017 Vacancy	Annual Vacancy Change (BPS)	3Q 2018 Rents	3Q 2017 Rents
Northeast Tucson	4.2%	5.2%	(100)	$930	$906
University	4.3%	5.5%	(120)	$886	$845
Flowing Wells	4.9%	5.8%	(90)	$636	$611
Oro Valley/Catalina	5.0%	7.1%	(210)	$1,069	$932
Southwest Tucson	5.2%	6.7%	(150)	$709	$665
Catalina Foothills	5.3%	4.8%	50	$835	$789
East Tucson	5.5%	6.0%	(50)	$734	$691
North Central Tucson	6.2%	6.7%	(50)	$666	$647
South Tucson/Airport	6.2%	8.0%	(180)	$596	$562
Southeast Tucson	6.3%	10.1%	(380)	$584	$533
Northwest Tucson	6.5%	5.5%	100	$957	$880
South Central Tucson	6.6%	8.6%	(200)	$671	$626
Pantano/Lakeside	7.4%	8.2%	(80)	$697	$662
Tucson Mountain Foothills	8.0%	6.5%	150	$862	$819

Employment

- After modest expansion in recent years, employment in Tucson is gaining momentum. Nearly 9,000 net new jobs have been added year over year, a 2.4 percent increase. One year ago, the growth rate was just 1.4 percent.
- The Tucson area is recording robust growth in white-collar industries. The professional and business services sector has expanded by 2,200 jobs in the past year, a 4.3 percent increase.
- With the local economy improving, development is picking up. Construction employment has spiked by 7.5 percent in the past year with the addition of 1,200 positions.
- **Forecast:** The pace of employment growth will nearly double from 2017 to 2018. After 4,600 jobs were added in 2017, employers are forecast to add approximately 8,500 positions this year.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

Employment in Tucson is gaining momentum

Vacancy

- Vacancy in Tucson fell 30 basis points during the third quarter, dipping to 6 percent. This marked the fourth quarterly decline in the past five periods. After recording fairly significant declines from 2012 to 2015, vacancy in Tucson has been trending lower at a gradual pace since the beginning of 2016.
- The current vacancy rate in the Tucson metro area is 50 basis points lower than one year ago. Vacancy has posted year-over-year declines in each of the past four quarters.
- Vacancy has tightened throughout the Tucson market. Currently, half of the 14 submarkets in the metro have vacancy rates of 5.5 percent or lower and the highest vacancy rate is just 8 percent. One year ago, four submarkets had vacancy rates at 8 percent or higher and one submarket had a vacancy rate in the double digits.
- **Forecast:** Vacancy in Tucson is forecast to remain fairly flat in the fourth quarter, and the rate should end the year at approximately 6 percent. This would represent a 30-basis-point decline from the year-end 2017 figure and would mark the sixth consecutive year of vacancy improvement.

Vacancy Trends

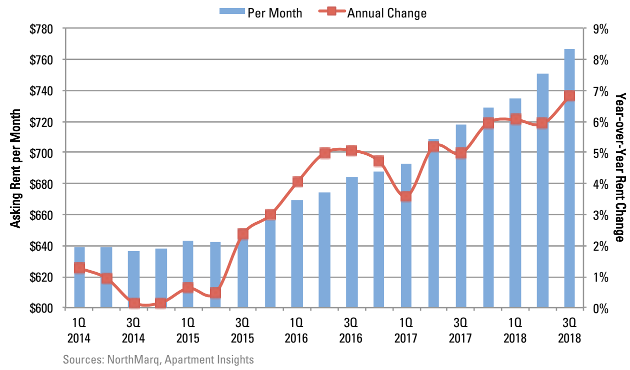
Sources: NorthMarq, Apartment Insights

Vacancy has tightened throughout the Tucson market

Rents

- Asking rents reached $767 per month in the third quarter, 6.8 percent higher than one year ago. Rents ended the third quarter at $1.03 per square foot, per month.
- Following a 2.2 percent increase in the second quarter, asking rents rose another 2.1 percent during the third quarter. Rents have advanced in each of the past 13 quarters; gains have averaged 1.4 percent per quarter in that time.
- Submarkets in the northern portion of the market have been recording some of the strongest rent growth. Asking rents in the Oro Valley/Catalina submarket have posted double-digit annual gains, while rents in Northwest Tucson have advanced by 8.8 percent in the past year. These submarkets also have some of the highest rental rates being offered in all of Tucson.
- **Forecast:** Asking rents are forecast to increase by 6.9 percent in 2018, ending the year at $779 per month. The pace of rent gains has accelerated in each of the past three years.

Rent Trends



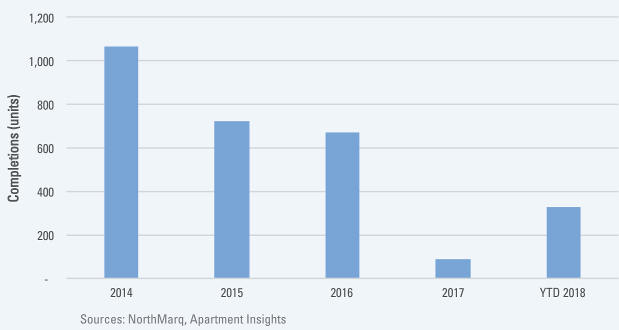
Sources: NorthMarq, Apartment Insights

Rents have advanced in each of the past 13 quarters

Development and Permitting

- Construction has been modest thus far in 2018, with approximately 330 units having come online year to date. Completions are up from the 2017 pace; during the first three quarters of last year, fewer than 100 units had been delivered.
- Development will pick up in the coming quarters. Projects totaling nearly 1,100 units are currently under construction. More than half of these units are scheduled to deliver in 2019.
- Multifamily permitting slowed during the third quarter after spiking in the preceding period. More than 550 multifamily permits have been issued thus far in 2018, up from the pace recorded in the first nine months of last year.
- **Forecast:** Approximately 550 apartment units are forecast to be delivered in Tucson in 2018. Since 2015, completions have averaged nearly 500 units per year.

Development Trends



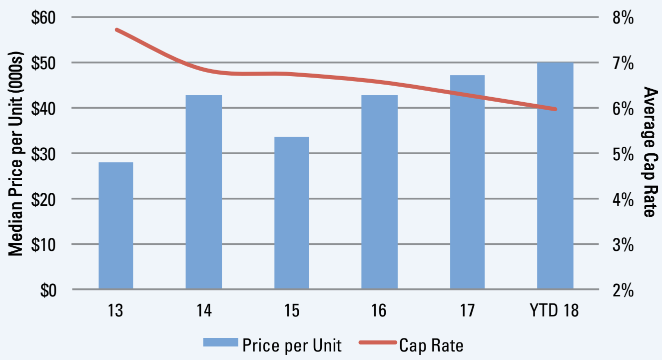
Sources: NorthMarq, Apartment Insights

Development will pick up in the coming quarters

Multifamily Sales

- Sales velocity dipped approximately 15 percent from the second quarter to the third quarter, and transaction velocity year to date is down 12 percent from the same period in 2017. The greatest decline in activity has been among smaller deals. During the first quarter of this year, sales of properties under $5 million accounted for nearly 60 percent of transactions. In the second and third quarters, transactions of these sizes were less than 40 percent of the market total.
- Prices ticked lower in the third quarter with the median price dropping to $49,200 per unit, down 25 percent from the second-quarter median price. In sales that have closed thus far in 2018, the median price is $50,000 per unit, up about 6 percent from the median price recorded in 2017.
- Cap rates averaged in the mid-5 percent range in both the second and third quarters, and the average year to date has been slightly less than 6 percent. Cap rates are down about 30 basis points from 2017 levels.

Investment Trends



The greatest decline in activity has been among smaller deals

Recent Transactions in the Market

MULTIFAMILY SALES ACTIVITY

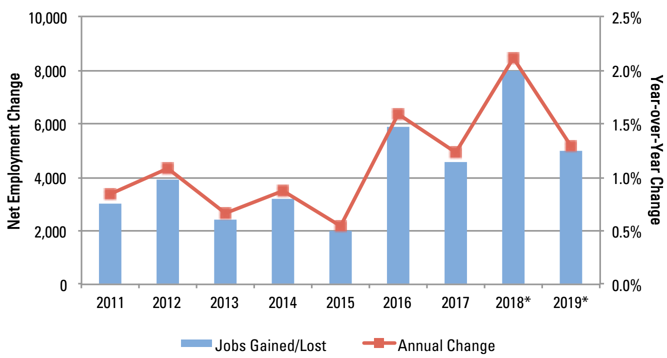
Property Name	Street Address	Units	Sales Price	Price/Unit
Pinnacle Heights	7990 E Snyder Rd., Tucson	310	$47,150,000	$151,121
Hacienda & Colonia Del Rio	4545 & 4601 N Via Entrada, Tucson	420	$43,000,000	$102,381
Mission Creek	1451 W Ajo Way, Tucson	200	$12,000,000	$60,000
Wilmot Vista	3225 S Wilmot Rd., Tucson	197	$8,800,000	$44,670

Looking Ahead

The Tucson multifamily market is positioned for continued health in the coming quarters. The market performed quite well in recent years despite employment growth that lagged the statewide and national averages. In recent quarters, however, the pace of job growth has been accelerating and spread across a greater number of industries, providing the fuel for renter demand for local apartments. The jobs that are being added should continue, and while apartment construction is picking up, annual completions of 500 units per year should be easily absorbed in the market without pushing the vacancy rate higher.

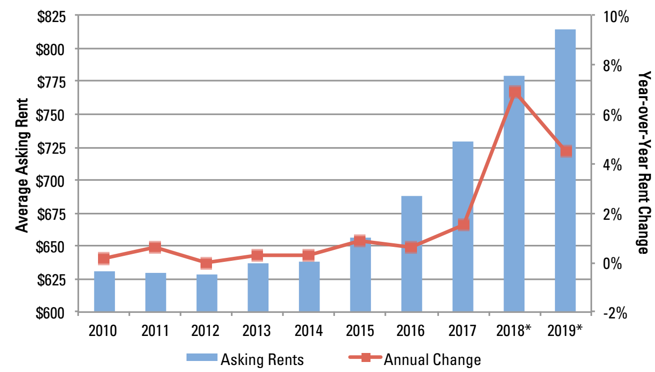
The outlook for the local investment market will be dictated largely by the supply of properties available for acquisition. Investor demand will likely remain elevated with tight vacancies and rising rents fueling activity. There could be a bit of an expectations gap with sellers expecting higher prices due to property performance and buyers finding higher financing costs than a few quarters earlier. Still, cap rates in Tucson should continue to offer a yield premium when compared to neighboring markets in Phoenix and Southern California, which should support ongoing investment activity even if interest rates inch higher.

Employee Forecast



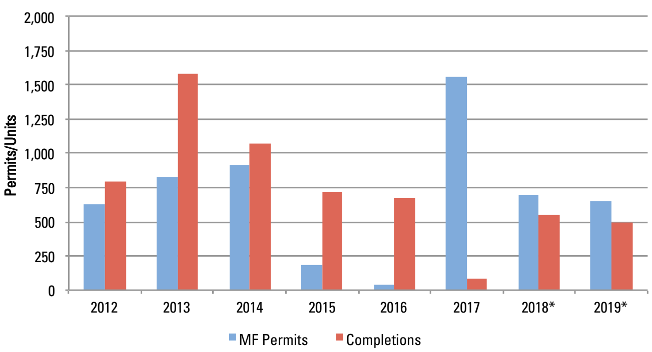
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



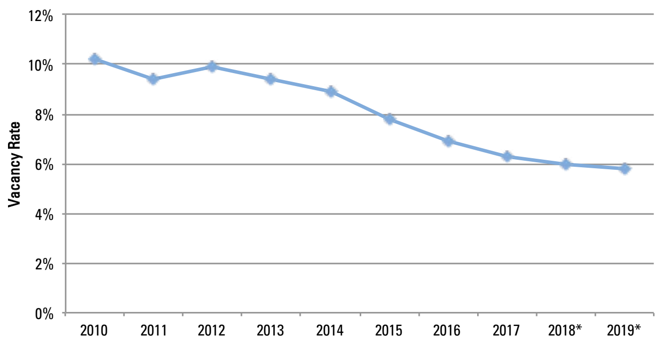
* Year End Forecast
Sources: NorthMarq, Apartment Insights

Construction & Permitting Forecast



* Year End Forecast
Sources: NorthMarq, Apartment Insights, Census Bureau

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Apartment Insights

About NorthMarq Multifamily

NorthMarq Multifamily has a market-leading position in multifamily property sales in markets across the U.S., offering commercial real estate investors a personalized approach to buying and selling multifamily and manufactured housing properties. These teams collaborate with NorthMarq Capital's debt and equity experts nationwide to provide a full range of capital markets services, developing innovative solutions for real estate investments.

NorthMarq Capital, the largest privately held commercial real estate financial intermediary in the U.S., provides debt, equity and commercial loan servicing through over 300 mortgage banking professionals in regional offices coast-to-coast and services a loan portfolio of more than $53 billion. For more information, please visit www.northmarq.com.

For more information, contact:

Bill Hahn
EXECUTIVE VICE PRESIDENT – NORTHMARQ MULTIFAMILY
602.952.4041
bhahn@northmarq.com

James DuMars
SENIOR VICE PRESIDENT, MANAGING DIRECTOR – NORTHMARQ CAPITAL
602.508.2206
jdumars@northmarq.com

Trevor Koskovich
PRESIDENT – NORTHMARQ MULTIFAMILY
T 602.952.4040
tkoskovich@northmarq.com

Pete O'Neil
DIRECTOR OF RESEARCH – NORTHMARQ CAPITAL
602.508.2212
poneil@northmarq.com

Copyright © 2018 NorthMarq Multifamily, LLC.

The information contained herein has been obtained from sources deemed reliable. While every reasonable effort has been made to ensure its accuracy, we cannot guarantee it. No responsibility is assumed for any inaccuracies. Readers are encouraged to consult their professional advisors prior to acting on any of the material contained in this report.

NORTHMARQ