Northmarq

MARKET INSIGHTS

Vacancy elevated, but rents still push higher

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	3,799
UNITS DELIVERED	584

MARKET FUNDAMENTALS

VACANCY RATE	8.1%
YEAR-OVER-YEAR CHANGE	+230bps
ASKING RENTS	$1,182
YEAR-OVER-YEAR CHANGE	2.0%

TRANSACTION ACTIVITY (YTD)

MEDIAN SALES PRICE	$95,000

Tucson Multifamily
2Q 2023

HIGHLIGHTS

- The Tucson multifamily market posted a mixed performance during the second quarter, as rents advanced while the vacancy rate pushed to a new high. Development activity remains strong as projects totaling 584 units have been delivered to this point in 2023.
- The local vacancy rate rose 60 basis points during the second quarter, reaching 8.1 percent. Year over year, vacancy increased by 230 basis points.
- Rent growth accelerated in recent months after holding fairly steady in the previous three quarters. Rents rose 1.6 percent during the second quarter to $1,182 per month. Local rents increased 2 percent during the past 12 months.
- Multifamily sales activity has been light to this point in the year, as only a few transactions closed during the past six months. Most properties are selling with cap rates between 5.75 percent and 6.25 percent.

TUCSON MULTIFAMILY MARKET OVERVIEW

Following a slowdown of multifamily deliveries in 2022, developers ramped up the pace of completions in the first half of 2023. Projects totaling approximately 580 units have come online to this point in the year, nearly doubling the total for all of 2022. Elevated supply growth and the seasonal outflow of students drove further vacancy increases, pushing the rate to 8.1 percent. While second quarter vacancy increases are common in Tucson as students and seasonal renters leave the area for the summer months, this marked the highest vacancy rate in the market since 2015. Despite the rise in vacancy, rents advanced at a solid pace during the second quarter after growth was mostly flat in prior periods.

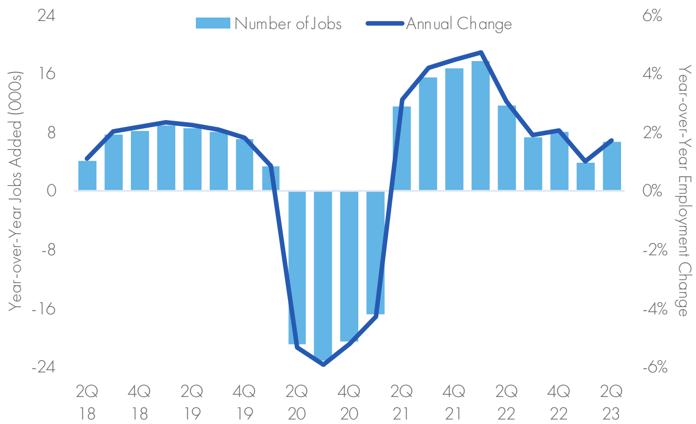
Multifamily investment activity in Tucson has been limited to just a few deals in the first half of 2023 as borrowing costs remain heightened and a degree of economic uncertainty persists. Class C properties ranging between 40 to 60 units have made up the entirety of the transaction mix to this point in 2023 after many larger Class B assets and a few Class A projects traded in recent years. The lack of upper-tier and middle-tier assets changing hands has dragged on pricing in the last six months. The median sales price during the first half of the year was $95,000 per unit, down 37 percent from last year's peak in pricing. Additionally, cap rates have ticked higher and are averaging between 5.75 percent and 6.25 percent.

EMPLOYMENT

- The Tucson employment market continues to expand, although the pace of growth has slowed in recent quarters. During the first half of this year, employers added approxiamtely 1,500 net new jobs, bringing the year-over-year gain to 6,700 new positions.
- The overall annual employment growth rate in Tucson was 1.7 percent as of the second quarter, with several industries recording modest gains or slight losses. Gains in the manufacturing and leisure and hospitality sectors have been the strongest, accounting for approximately half of the total new jobs added in the market during the past year.
- Sion Power Corporation will be growing its existing manufacturing operations in Tucson. The company is adding a 111,400-square-foot battery manufacturing site near Tucson's Airport. Upon completion in 2026, the site will create more than 150 jobs. During the past 12 months, manufacturing employment in Tucson has expanded by 4.3 percent.
- **FORECAST:** Total employment growth in Tucson should reach approximately 1 percent this year, with the addition of 4,000 jobs. Net growth in 2023 is on pace to about half the rate of expansion recorded in 2022.

Total employment growth should reach 1 percent this year.

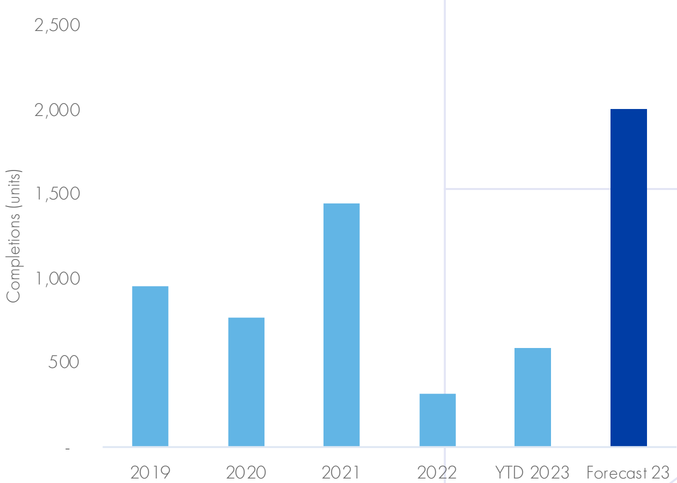
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

Projects totaling more than 580 units have come online.

DEVELOPMENT TRENDS

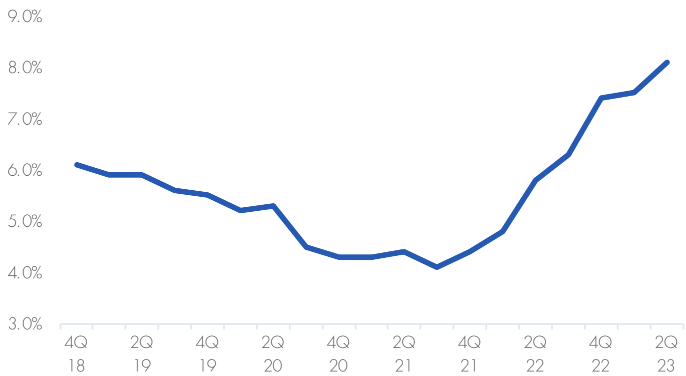


DEVELOPMENT & PERMITTING

- The pace of multifamily deliveries gained momentum in the first half of 2023 after completions were limited in 2022. Projects totaling more than 580 units have come online year to date; since 2015, developers have delivered an average of 675 units per year.
- The construction pipeline continues to expand, with nearly 3,800 units under construction at the end of the second quarter, up more than 50 percent from levels posted one year ago. Two projects totaling nearly 400 units broke ground in the University submarket in recent months.
- Permitting slowed in recent months after issuance accelerated earlier in the year. Developers pulled permits for roughly 250 multifamily units in the last three months, less than half of the levels recorded in the first quarter.
- **FORECAST:** Apartment construction will be active through the end of the year, with projects totaling approximately 2,000 units scheduled to come online in 2023. This year's scheduled delivery total is expected to be the most active year of new supply additions since 1995.

Vacancy in the northern submarkets is generally among the lowest in the market.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

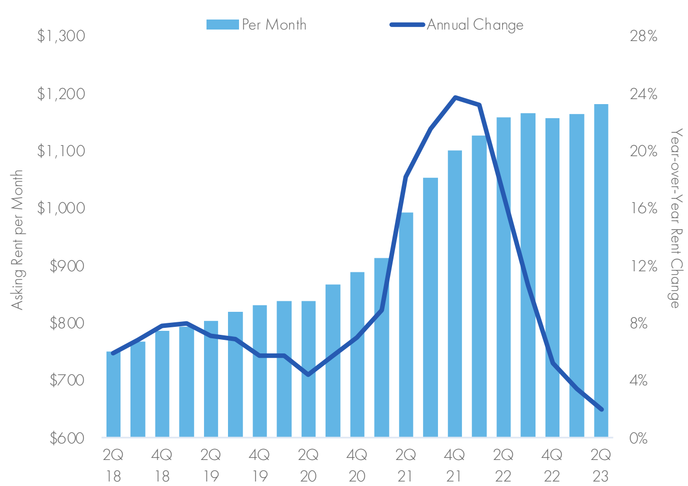
- The vacancy rate in Tucson continued to rise in recent months, as apartment deliveries outpaced renter demand. Local vacancy trended higher by 60 basis points during the second quarter to 8.1 percent. Vacancy has increased 230 basis points year over year, and the current figure is the highest rate in Tucson since 2015.
- Vacancy rates in the northern portion of the Tucson region are generally among the lowest in the market. Vacancies in the Oro Valley/Catalina, Northwest Tucson, and Catalina Foothills submarkets ranged between 6.9 percent and 7.9 percent during the second quarter.
- While vacancy has generally trended higher throughout much of the market, the rate in Class A properties has improved. Vacancy in upper-tier units declined by 70 basis points in the past year to 7.4 percent. Class A vacancy levels may rise as new units come online.
- **FORECAST:** The vacancy rate in Tucson is forecast to inch somewhat higher in the second half of 2023 and finish the year at 8.4 percent. While vacancy in recent years has generally ranged between 5 percent and 6 percent, the region's longer-term average is closer to 7.5 percent.

RENTS

- Rents in Tucson trended higher in recent months after remaining fairly flat for much of the past year. Average rents rose 1.6 percent during the second quarter, reaching $1,182 per month. Year over year, rents are up 2 percent.
- The Flowing Wells submarket—which has historically had one of the market's lowest average rental rates—has recorded robust rent growth for two consecutive years. Since the beginning of 2021, asking rents in this submarket advanced by more than 30 percent. Rents in the Flowing Wells area reached $1,016 per month in the second quarter.
- After surging in recent years, asking rents tapered off in one of Tucson's most expensive submarkets. Rents in the Oro Valley/Catalina submarket dipped 3.7 percent in the last 12 months to $1,579 per month. Rents in the submarket began to inch higher in the second quarter, signaling a recovery could be under way.
- **FORECAST:** Asking rents will likely tick higher through the end of the year. Area rents are projected to finish 2023 at nearly $1,200 per month, an annual increase of approximately 3.5 percent.

Year over year, average rents are up 2 percent.

RENT TRENDS



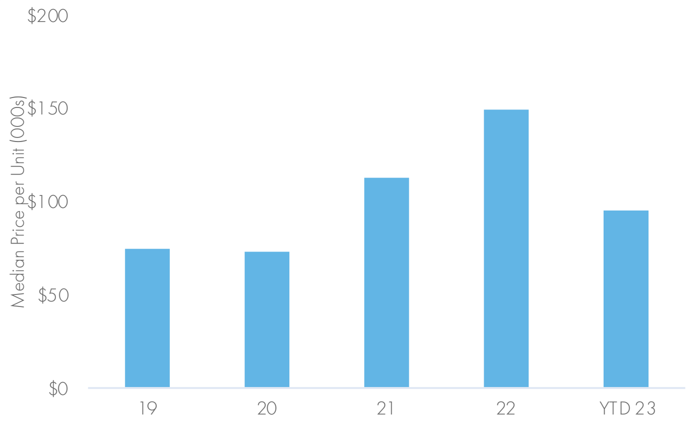
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- Multifamily transaction activity has been limited to this point in the year with only a handful of properties changing hands in the first half of 2023. Sales velocity year to date is down approximately 80 percent from the first half of 2022.
- In the small number of deals thus far in 2023, the median sales price fell to $95,000 per unit, down 36 percent from last year's spike. Nearly every property that traded in the last six months was an older, Class C asset with between 40 to 60 units.
- Over a more extended period, the mix of properties that has changed hands is more consistent with the market inventory as a whole, and more accurately reflects market pricing. The median price in sales that have closed during the past 12 months is $155,700 per unit.
- Recent pricing trends vary by property class. During the past 12 months, the median price in Class B sales has been $172,700 per unit, while the median price in Class C properties is closer to $100,000 per unit.
- Cap rates trended higher in recent months, reflecting the higher borrowing costs in the market. Most properties are selling with cap rates between 5.75 percent and 6.25 percent.

The median price in Class B sales has been $172,700 per unit.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

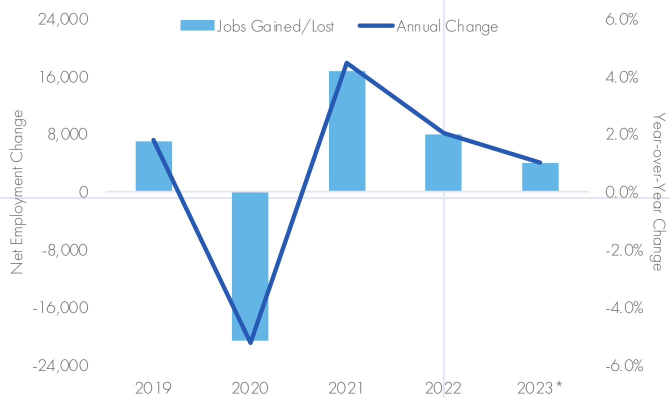
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
Palo Verde Terrace	3493 E Lind Rd., Tucson	52	$3,850,000	$74,038
Coronado Vista Courtyard Apartments	1511 N Craycroft Rd., Tucson	40	$3,800,000	$95,000

LOOKING AHEAD

Following an extended period of minimal apartment construction since 2015, development in Tucson will continue to ramp up through the end of this year and into 2024. Developers are forecast to deliver projects totaling approximately 2,000 units in 2023, the highest annual total in nearly 30 years. The forecast supply growth is expected to drive the vacancy rate higher, but increases in the second half will likely be mild, as students return to Tucson and lease-up new units. Apartment operators in Tucson have shown they can implement rent increases despite softer vacancy conditions. Asking rents should continue to advance at a steady pace in the coming quarters.

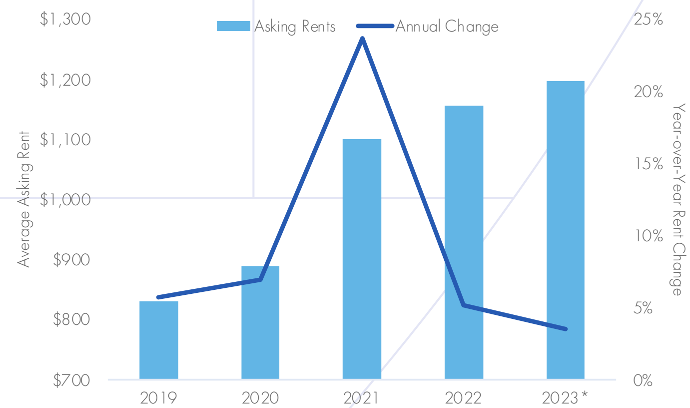
The local investment market has been in a lull for much of 2023 after transaction volume accelerated in recent years. Multifamily investment in Tucson has historically been fueled by local investors, but the buyer pool expanded at the height of the market as there were more buyers seeking to allocate capital than available properties. Looking ahead, the market will likely revert closer to the historical trend. Some of this change has been reflected in the types of properties that have changed hands thus far in 2023. Activity has been concentrated below $10 million year to date, after dozens of assets traded at $20 million or above during the past few years.

EMPLOYMENT FORECAST



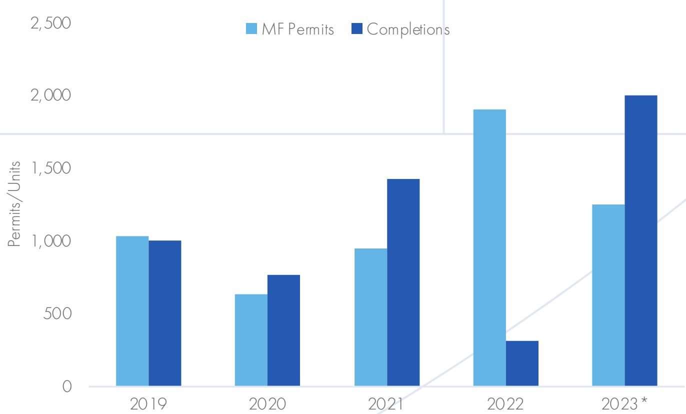
** Year End Forecast*
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



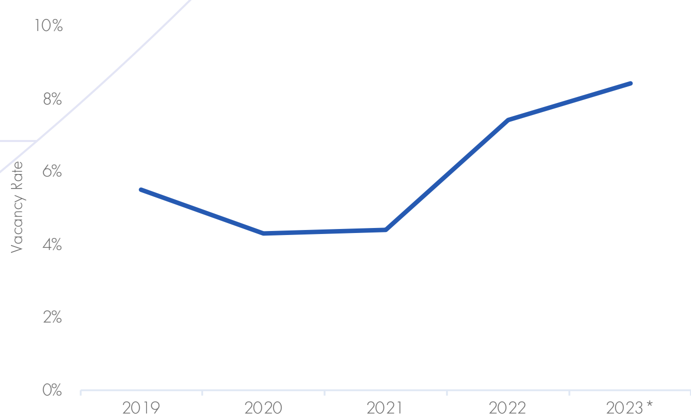
** Year End Forecast*
Sources: Northmarq, Apartment Insights

CONSTRUCTION & PERMITTING FORECAST



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

VACANCY FORECAST



** Year End Forecast*
Sources: Northmarq, Apartment Insights

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