MARKET REPORT | 4Q/2018

Greater Tucson Multifamily

NorthMarq

Sales Activity Accelerates in Larger Transactions

Highlights

- The Tucson multifamily market posted strong performance to close 2018. Rents rose during the fourth quarter, and more apartment properties sold at higher prices.
- Vacancy inched up 10 basis points during the fourth quarter. Despite the rise in the final few months of the year, the vacancy rate ended 2018 at 6.1 percent, down 20 basis points for the full year.
- Asking rents spiked 2.5 percent in the fourth quarter, reaching $786 per month. Rents posted an annual increase of 7.8 percent in 2018, building on a gain of 6 percent in 2017.
- The investment market heated up as the year came to a close, with sales activity accelerating and prices pushing higher. Cap rates dipped by about 30 basis points in 2018, averaging approximately 6 percent for the year, while the median price surged to $57,500 per unit. Cap rates averaged approximately 5.5 percent during the fourth quarter.

Tucson Multifamily Market Overview

The Tucson multifamily market strengthened in 2018, with rapid rent growth the clearest indicator of the improvement in operating conditions. The pace of rent growth has accelerated in each of the past five years, including an increase of nearly 8 percent in 2018. Two factors are generally contributing to rent gains: a strengthening pace of employment growth and a local vacancy rate that has improved in each of the past six years. With the vacancy rate having been trimmed nearly in half over the past several years and economic growth on an upswing, apartment operators have accelerated the pace of rent increases in response to more robust renter demand for units. While demand has been increasing, construction of new units has been modest in the past two years, a trend that is expected to reverse course in 2019.

Market Indicators

	4Q/2018
Vacancy	↑
Rents	↑
Transaction Activity	↑
Price Per Unit	↑
Cap Rates	↓

Summary Statistics — Tucson Market

Summary Statistics	Tucson Market
Vacancy Rate	**6.1%**
- Change from 4Q 2017 (bps)	**-20**
Asking Rents (per month)	**$786**
- Change from 4Q 2017	**7.8%**
Median Sales Price (per unit YTD)	**$57,500**
Average Cap Rate (YTD)	**6.0%**

Tucson Multifamily Market Overview (cont.)

Investors were active in Tucson in 2018, building on a spike in sales from the prior year. Strong property fundamentals supported a steady flow of transactions throughout the year, with a surge of building sales in excess of $20 million. The larger deals have pushed prices higher. The median price in sales above the $20-million threshold was $108,400 per unit, compared to a median price of about $50,000 per unit in all other transactions. This trend was most pronounced during the fourth quarter, where activity was dominated by larger sales; the average transaction during the fourth quarter was approximately $18 million. Cap rates averaged approximately 6 percent in 2018, compressing for the fifth consecutive year.

Submarket Statistics

Submarket Name	4Q 2018 Vacancy	4Q 2017 Vacancy	Annual Vacancy Change (BPS)	4Q 2018 Rents	4Q 2017 Rents
University	3.7%	5.4%	(170)	$890	$842
Catalina Foothills	4.8%	4.9%	(10)	$864	$809
Northwest Tucson	5.3%	5.9%	(60)	$989	$910
Oro Valley/Catalina	5.5%	8.1%	(260)	$1,124	$992
Northeast Tucson	5.5%	4.7%	80	$944	$891
East Tucson	5.6%	6.6%	(100)	$741	$693
Southwest Tucson	5.6%	6.7%	(110)	$711	$671
Tucson Mountain Foothills	6.0%	6.8%	(80)	$874	$825
Flowing Wells	6.4%	5.0%	140	$651	$614
North Central Tucson	6.6%	6.0%	60	$684	$649
Pantano/Lakeside	7.0%	7.7%	(70)	$718	$672
South Tucson/Airport	7.0%	6.9%	10	$595	$565
Southeast Tucson	7.7%	8.6%	(90)	$584	$545
South Central Tucson	8.3%	7.8%	50	$690	$623

Employment

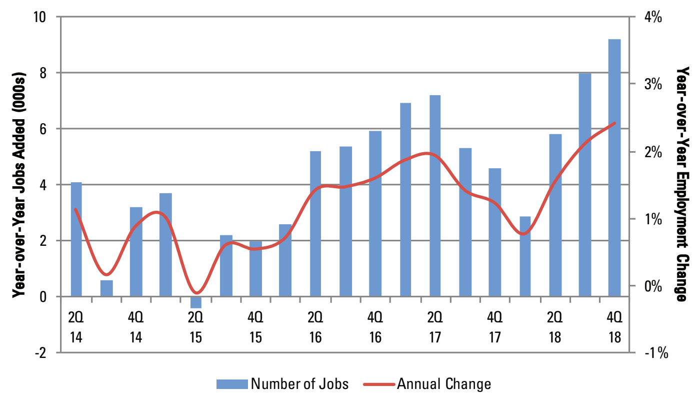
> Job growth in Tucson accelerated in 2018, with 9,200 new positions added, a 2.4 percent pace of growth. This doubled the job growth recorded in 2017.

> Employment in blue-collar segments of the economy gained momentum during 2018. The manufacturing, construction, and transportation/warehousing sectors combined to add more than 3,000 jobs for the year. Gains averaged 5.5 percent in these industries in 2018, far outpacing the overall pace of expansion in the local labor market.

> After a modest contraction in 2017, growth in the education and health services sector rebounded in 2018. A total of 2,600 new jobs were created in education and health fields in 2018, an annual gain of approximately 4 percent.

> **Forecast:** Employment in Tucson recorded the strongest growth in more than a decade in 2018, and the pace of gains will likely slow a bit in the year ahead. The current forecast calls for approximately 7,000 net new jobs, a 1.8 percent expansion.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

2.4 percent pace of growth doubled job growth recorded in 2017

Vacancy

> The vacancy rate in Tucson inched up 10 basis points from the third quarter to the fourth quarter, ending the year at 6.1 percent. After being on a fairly steady downward trend for a few years until the end of 2016, vacancy has not shown much of a clear direction in recent quarters.

> Vacancy in Tucson declined 20 basis points in 2018, following a 60-basis-point drop in the preceding year. This was the sixth consecutive year where the local vacancy rate improved.

> Vacancy in local high-end units tightened considerably at the end of the year. The vacancy rate in Class A apartments dipped approximately 100 basis points from the third quarter to the fourth quarter, ending the year at 4.6 percent.

> **Forecast:** The vacancy rate in Tucson has declined over the past several years but will likely increase slightly in 2019. The initial forecast calls for an uptick of 20 basis points to 6.3 percent by the end of the year.

Vacancy Trends

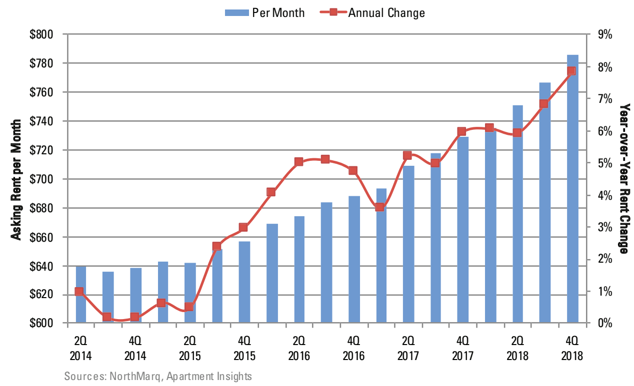
Sources: NorthMarq, Apartment Insights

Vacancy has not shown much of a clear direction in recent quarters

Rents

- Rents in the local multifamily market are posting strong gains. Asking rents ended 2018 at $786 per month, up 7.8 percent from the year-end 2017 figure. Rents ended the fourth quarter at $1.05 per square foot, per month.
- Asking rents spiked 2.5 percent from the third quarter to the fourth quarter, the strongest quarterly increase on record. Rents posted increases of at least 2 percent in each of the final three quarters of 2018.
- Strong renter demand for apartments is fueling rent growth and driving down vacancy even as new units come online in the Northwest Tucson submarket. Asking rents increased by 8.7 percent in 2018, reaching $989 per month.
- **Forecast:** Asking rents are forecast to increase by 6.5 percent in 2019, ending the year at $837 per month. Rent increases have averaged 6.2 percent annually during the past three years.

Rent Trends



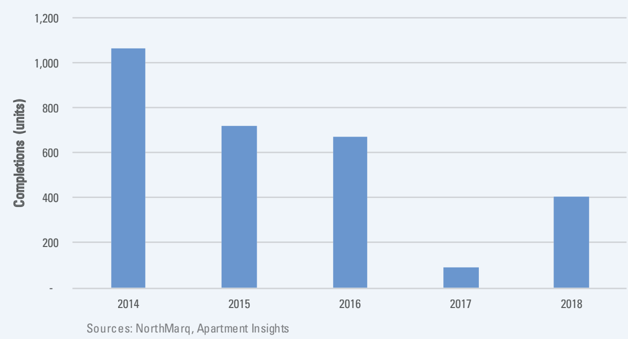
Sources: NorthMarq, Apartment Insights

Asking rents had the strongest quarterly increase on record

Development and Permitting

- Deliveries totaled approximately 400 units in 2018, up from fewer than 100 apartments in 2017. The pace of completions slowed in the second half of 2018, following a rise in the second quarter. Construction has averaged nearly 700 units per year since 2010.
- After two years of modest deliveries, construction activity is gaining momentum. Projects totaling approximately 1,650 units are currently under construction, with the bulk of the units set to deliver in 2019.
- After a very slow start to the year, multifamily permitting was mostly consistent in the final three quarters of the year. Developers pulled permits for approximately 850 multifamily units in 2018, including about 300 permits during the fourth quarter.
- **Forecast:** Deliveries are forecast to total approximately 1,000 units in 2019, which would mark the most deliveries in Tucson since 2014.

Development Trends



Sources: NorthMarq, Apartment Insights

Projects totalling approximately 1,650 units are currently under construction

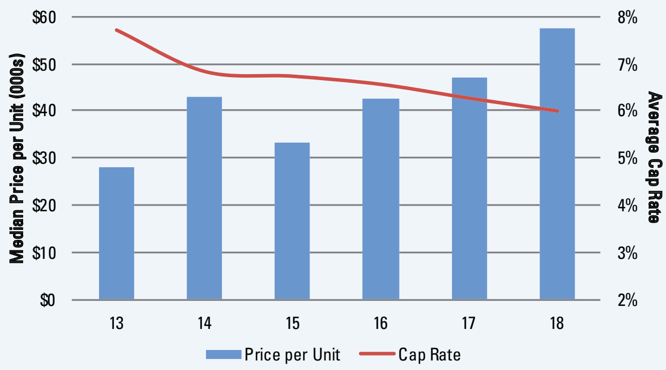
Multifamily Sales

> Sales velocity was up 8 percent from the third quarter to the fourth quarter, and transaction activity for 2018 was nearly identical to 2017 levels. Transaction volume was up in 2018, fueled by a surge in larger deals. Sales of buildings priced at more than $20 million spiked by 55 percent from 2017 to 2018.

> Prices trended much higher during the fourth quarter, with the median price reaching $76,000 per unit in transactions that closed in the final three months of the year. This was the highest median price for a single quarter in nearly a decade. The median price for the full year was $57,500 per unit, up 20 percent from the preceding year.

> Cap rates dipped in the middle of the year and then retreated again in the fourth quarter, averaging approximately 5.5 percent in the final three months of the year. Cap rates fell by about 30 basis points in 2018, marking the fifth straight year of cap rate compression.

Investment Trends



Prices trended much higher during the fourth quarter

Recent Transactions in the Market

MULTIFAMILY SALES ACTIVITY

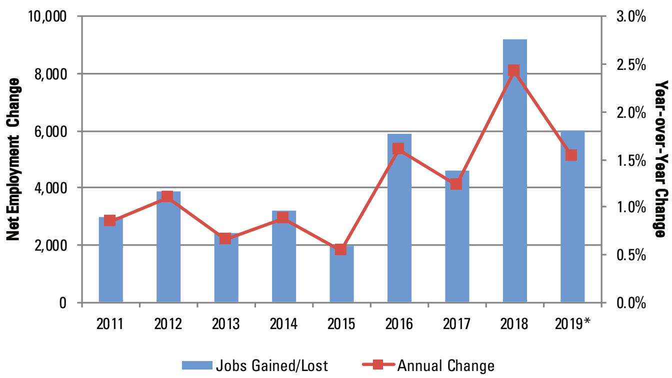
Property Name	Street Address	Units	Sales Price	Price/Unit
The Place at Rock Ridge	10333 N Oracle Rd., Tucson	319	$39,500,000	$123,824
Palomino Crossing	750 E Irvington Rd., Tucson	240	$13,750,000	$57,292
Paseo Del Sol	6280 S Campbell Ave., Tucson	152	$12,500,000	$82,237
Copperhill	7950 E Stella Rd., Tucson	160	$11,800,000	$73,750

Looking Ahead

The Tucson multifamily market had one of its strongest years on record in 2018, something that will prove difficult to repeat in the year ahead. While employment gains should continue to support renter demand for apartments, the pace of job growth will likely slow in 2019, with additions more in line with annual gains from 2016 or 2017. On the supply side, the delivery of new units is forecast to gain momentum in the coming quarters, which will likely result in a modest vacancy uptick in the year ahead, and more modest rent growth following a steep rise in 2018.

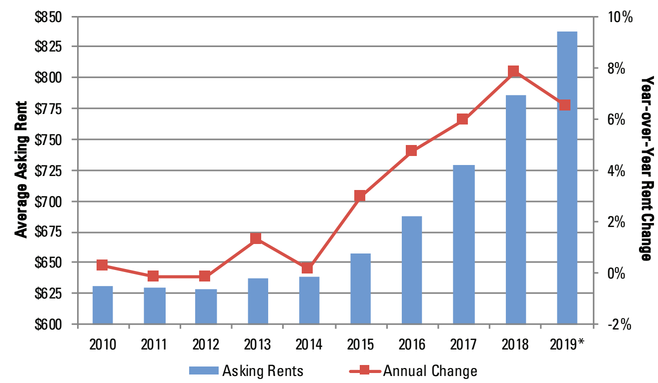
The outlook for investment activity in 2019 remains favorable. The Tucson multifamily market is attracting buyers who are seeking a yield premium from nearby markets where cap rates have compressed to 5 percent or less. This influx of more buyers coming into the market is part of the reason for the surge in sales of properties priced above $10 million and especially above the $20-million threshold. Another reason for the increase in larger transactions has been the price appreciation in the market; the median price per unit has doubled during the past five years.

Employee Forecast



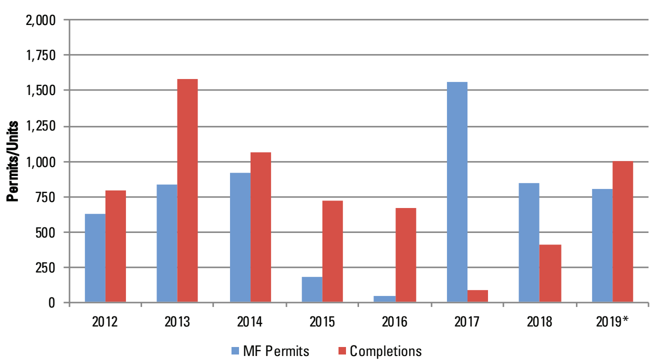
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



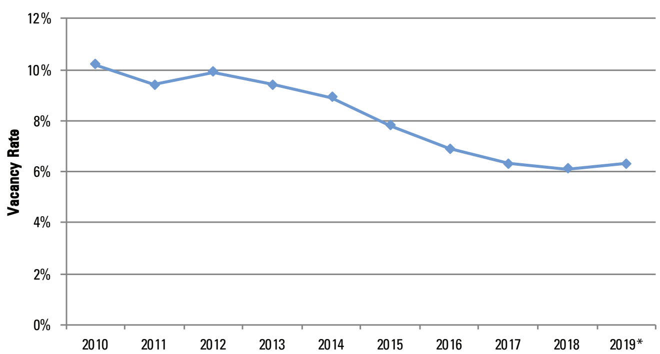
* Year End Forecast
Sources: NorthMarq, Apartment Insights

Construction & Permitting Forecast



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

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Apartment Insights

About NorthMarq

As a capital markets leader, NorthMarq offers commercial real estate investors access to experts in debt, equity, investment sales, and loan servicing to protect and add value to their assets. For capital sources, we offer partnership and financial acumen that support long- and short-term investment goals. Our culture of integrity and innovation is evident in our 60-year history, annual transaction volume of $13 billion, loan servicing portfolio of more than $55 billion and the multi-year tenure of our more than 500 people.

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