

Greater Tucson Multifamily

With Rents on the Rise, Cap Rates Compress

Highlights

- > Operating conditions in the Tucson multifamily market strengthened during the first quarter. Vacancies tightened and rents rose. Apartment completions have been limited to this point but are forecast to accelerate.
- > The vacancy rate dipped 20 basis points in the first quarter to 5.9 percent. This is just the second time in the past 10 years that the rate has fallen below 6 percent.
- > Asking rents continued on their upward trajectory, ending the first quarter at \$794 per month. Rents have increased by 8 percent in the past 12 months.
- > The investment market was mixed to start the year. The number of sales retreated, but prices rose and cap rates compressed. The median price reached \$62,300 per unit, while cap rates dipped into the mid-5-percent range in transactions that closed during the first quarter.

Tucson Multifamily Market Overview

The first quarter is typically a strong period for the Tucson multifamily market, and that trend held during the first few months of 2019. Vacancy inched lower, dipping below 6 percent for just the second time in the past 10 years. Rents rose, with the current asking rents up 8 percent from one year ago and nearly 15 percent higher than the average figure from two years ago. Deliveries of new units have been modest in recent quarters, but more projects are working through the development pipeline in response to the strong conditions that have been posted in recent periods.

Market Indicators

| Quarterly Changes | 1Q/2019 |
|---------------------------|---------|
| Vacancy | ↓ |
| Rents | ↑ |
| Transaction Activity..... | ↓ |
| Price Per Unit..... | ↑ |
| Cap Rates | ↓ |

Summary Statistics

Tucson Market

| | |
|--|-----------------|
| Vacancy Rate..... | 5.9% |
| - Change from 1Q 2018 (bps)..... | +20 |
| Asking Rents (per month)..... | \$794 |
| - Change from 1Q 2018..... | +8.0% |
| Median Sales Price (per unit YTD)..... | \$62,300 |
| Average Cap Rate (YTD)..... | 5.5% |

Tucson Multifamily Market Overview (cont.)

The investment market got off to a bit of a slower start in 2019 despite the strong property fundamentals. Fewer apartment properties sold in the first quarter than sold in either the most recent quarter or the same quarter one year ago. The drop-off in activity did not mean a decline in

demand, however, as prices pushed higher and cap rates compressed by approximately 50 basis points in the first quarter. With operating conditions remaining healthy, transaction activity will likely gain momentum as more properties come to market.

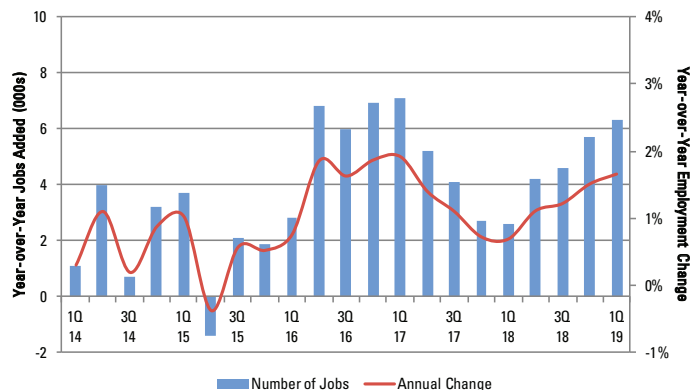
Submarket Statistics

| Submarket Name | 1Q 2019 Vacancy | 1Q 2018 Vacancy | Annual Vacancy Change (BPS) | 1Q 2019 Rents | 1Q 2018 Rents |
|---------------------------|--------------------|--------------------|--------------------------------|------------------|------------------|
| University | 3.4% | 4.2% | (80) | \$894 | \$855 |
| Southwest Tucson | 4.0% | 5.4% | (140) | \$724 | \$682 |
| Oro Valley/Catalina | 4.7% | 6.5% | (180) | \$1,119 | \$987 |
| Northwest Tucson | 4.9% | 5.2% | (30) | \$1,007 | \$907 |
| Catalina Foothills | 5.0% | 4.7% | 30 | \$859 | \$804 |
| East Tucson | 5.0% | 5.3% | (30) | \$752 | \$711 |
| Tucson Mountain Foothills | 6.0% | 5.1% | 90 | \$891 | \$841 |
| Flowing Wells | 6.4% | 5.6% | 80 | \$655 | \$623 |
| Northeast Tucson | 6.6% | 4.9% | 170 | \$994 | \$903 |
| North Central Tucson | 6.7% | 6.4% | 30 | \$691 | \$646 |
| South Tucson/Airport | 6.8% | 6.2% | 60 | \$597 | \$583 |
| Southeast Tucson | 7.1% | 9.5% | (240) | \$585 | \$556 |
| South Central Tucson | 7.5% | 6.4% | 110 | \$679 | \$637 |
| Pantano/Lakeside | 7.5% | 7.0% | 50 | \$725 | \$675 |

Employment

- > Employers in Tucson continue to expand payrolls at a healthy pace. Year over year, total employment in the metro area has grown 1.7 percent with the addition of 6,300 jobs.
- > Growth in the construction and manufacturing trades continues to provide fuel to the local employment market. Construction employment has surged 6.8 percent in the past year, while the manufacturing sector has expanded 4.9 percent. The two sectors have combined to grow by 2,300 new positions during the past 12 months.
- > White-collar industries have added workers in the past year but at paces that more closely track the expansion of the local labor market. The financial activities sector has grown 2.2 percent in the past year, while professional and business services employment has expanded 1.4 percent. Combined, these two sectors have totaled approximately 1,100 net new jobs in the past year.
- > **Forecast:** Employers in Tucson are forecast to continue to expand at a fairly steady pace in 2019. Approximately 6,000 jobs are expected to be added this year, a 1.5 percent pace of growth. From 2016-2018, growth averaged 1.4 percent annually.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

Construction employment has surged 6.8 percent in the past year

Vacancy

- > Vacancy in Tucson dropped 20 basis points in the first quarter, dipping to 5.9 percent. There is some seasonality to this number; vacancy in Tucson routinely improves in the first quarter before rising during the second quarter.
- > Vacancy is up 20 basis points compared to one year ago. Vacancy has averaged 6.4 percent since the beginning of 2016, and the 5.7 percent from 12 months ago was the lowest point recorded in more than 10 years.
- > The University submarket posted the lowest vacancy rate in the market as of the first quarter, at just 3.4 percent. Vacancy in the University submarket typically rises during the second quarter and then retreats in the third quarter.
- > **Forecast:** With deliveries expected to accelerate in 2019, the local vacancy rate is forecast to creep higher. Vacancy is forecast to end the year at 6.3 percent, 20 basis points higher than at the end of 2018.

Vacancy Trends



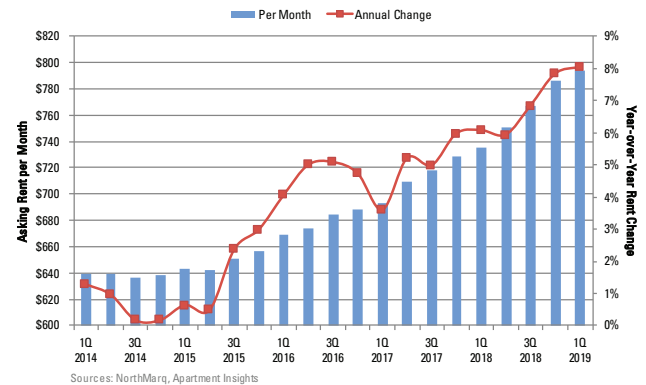
Sources: NorthMarq, Apartment Insights

Vacancy is up 20 basis points compared to one year ago

Rents

- > Rents continue to push higher. The average asking rent was \$794 per month at the end of the first quarter, up 8 percent from one year earlier.
- > The pace of rent growth is accelerating. One year ago, rents had posted an annual increase of 6.1 percent. Since 2015, rent growth has averaged 5.4 percent per year.
- > Rent growth remains strongest in the northwest portion of the Tucson market. Both the Oro Valley/Catalina and the Northwest Tucson submarkets posted double-digit rent increases during the past 12 months.
- > **Forecast:** The Tucson multifamily market is forecast to record another year of healthy rent growth. Asking rents are forecast to increase 6.9 percent in 2019, ending the year at \$840 per month.

Rent Trends

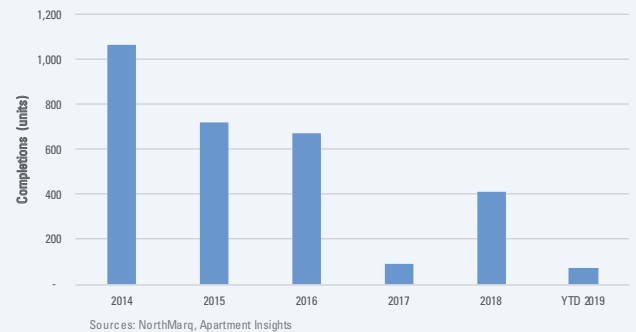


Rent growth remains strongest in the northwestern portion of the Tucson market

Development and Permitting

- > Developers have delivered nearly 500 units during the past 12 months, increasing the local inventory by 0.7 percent.
- > While deliveries have been fairly modest in the past two years, the development pipeline is filling. There are approximately 2,000 units currently under construction with deliveries scheduled to occur in 2019 and 2020.
- > Following a surge in 2018, multifamily permitting got off to a quick start this year. During the first quarter, permits for more than 200 multifamily units were pulled, the most active first quarter since 2016.
- > **Forecast:** Developers will respond to the strengthening market conditions by bringing approximately 1,200 apartment units to the market in 2019, nearly matching the combined total of new construction for the past three years.

Development Trends

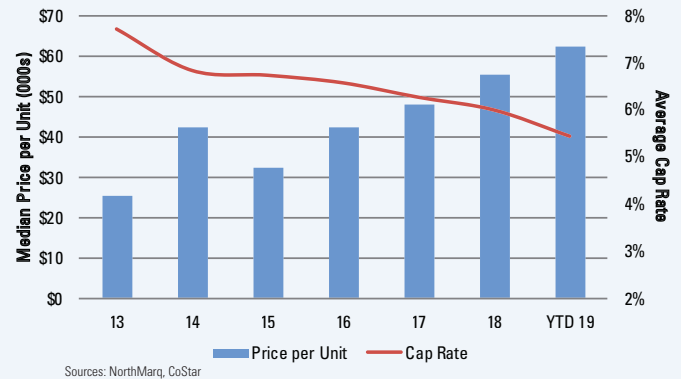


There are approximately 2,000 units currently under construction

Multifamily Sales

- > Sales velocity in the first quarter of 2019 lagged levels from the final three months of last year by more than 30 percent. Activity levels also lagged sales from the first quarter of 2018.
- > The median price in sales that closed during the first few months of 2019 was \$62,300 per unit, up nearly 15 percent from the median price recorded in 2018. A few properties have sold for more than \$100,000 per unit, but the bulk of the transaction volume is occurring in assets priced between \$50,000 and \$65,000 per unit.
- > After averaging approximately 6 percent in 2018, cap rates compressed in the first quarter of this year. The average cap rates in closed transactions in the first quarter was approximately 5.5 percent.

Investment Trends



The median price in sales that closed during the first part of 2019 was up nearly 15 percent from the median price recorded in 2018

Recent Transactions in the Market

MULTIFAMILY SALES ACTIVITY

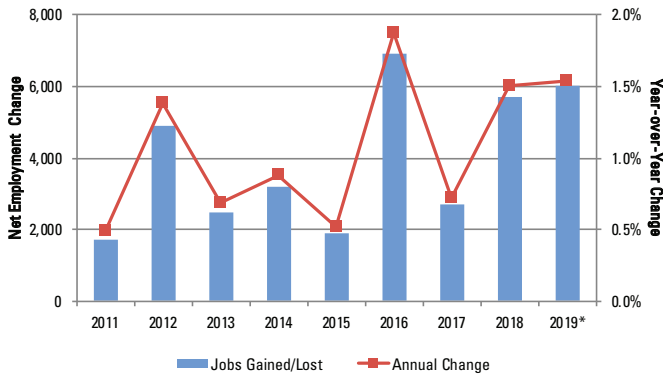
| Property Name | Street Address | Units | Sales Price | Price/Unit |
|------------------------------|-------------------------------|-------|--------------|------------|
| Canyons at Linda Vista Trail | 9750 N Oracle Rd., Tucson | 228 | \$41,250,000 | \$180,921 |
| Bear Canyon | 9055 E Catalina Hwy., Tucson | 238 | \$35,600,000 | \$149,580 |
| Mission Antigua | 5525 S Mission Rd., Tucson | 248 | \$21,800,000 | \$87,903 |
| Kimberly Woods | 6821 E Broadway Blvd., Tucson | 279 | \$17,475,000 | \$62,634 |

Looking Ahead

The local economy in Tucson took a bit longer than most other markets to gain traction during the recovery, but the market is now firmly in expansion mode, a condition that bodes well for the multifamily market going forward. While most forecasts call for a slowdown in the pace of national job growth in 2019, Tucson is expected to record a modest acceleration this year. The primary reason for this is that growth is forecast to be recorded across a more diverse set of industries in 2019 than in recent years, and the economy is attracting employers from outside of Tucson. Southern New Hampshire University has announced plans to open an operations center in the city, a move that will result in 350 new jobs.

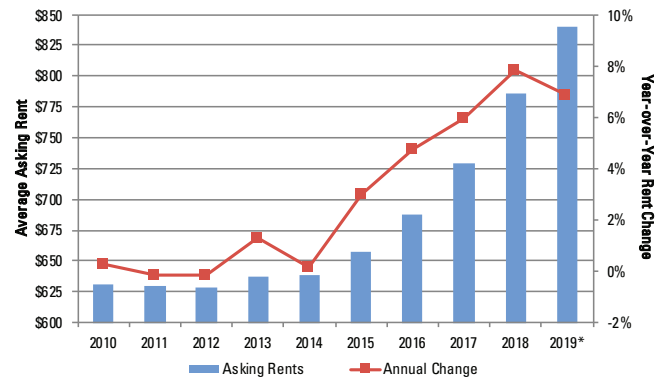
While sales velocity cooled a bit at the start of the year, there are indications that 2019 will be another active year in the local investment market. Local sales volume in 2018 was the strongest in more than 10 years, building on a very active 2017. The dip in apartment sales in the first quarter of this year was more a reflection of a lack of inventory available for acquisition in the market. With rents rising and interest rates low, prices are pushing higher and cap rates are compressing. As the market adjusts to the current pricing trends, there could be an uptick in activity in the coming quarters.

Employee Forecast



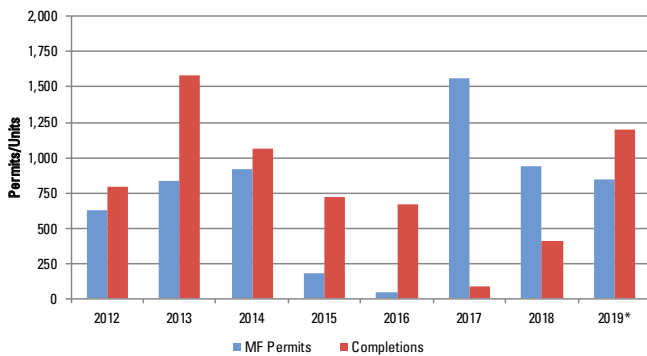
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



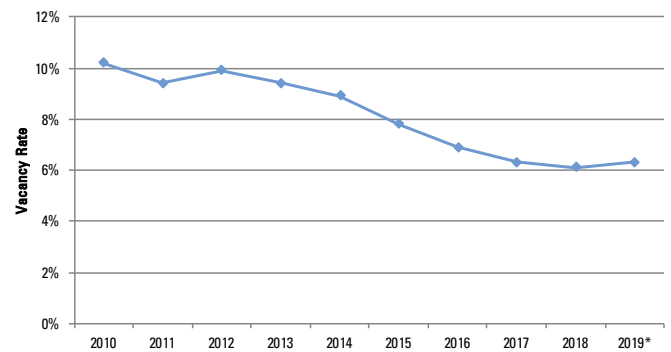
* Year End Forecast
Sources: NorthMarq, Apartment Insights

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 to more than \$57 billion and the multi-year tenure of our more than 550 people.

For more information, contact:

Bill Hahn

EXECUTIVE VICE PRESIDENT – INVESTMENT SALES

602.952.4041

bhahn@northmarq.com

James DuMarsSENIOR VICE PRESIDENT, MANAGING DIRECTOR –
DEBT & EQUITY

602.508.2206

jdumars@northmarq.com

Trevor Koskovich

PRESIDENT – INVESTMENT SALES

T 602.952.4040

tkoskovich@northmarq.com

Pete O'Neil

DIRECTOR OF RESEARCH

602.508.2212

poneil@northmarq.com

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