MARKET REPORT | 2Q/2019

Greater Tucson Multifamily

NORTHMARQ

Vacancy Holds Steady, Rents Rise at Mid-Year

Highlights

- The Tucson multifamily market recorded its strongest second quarter in approximately 10 years. Vacancy is low and rents are rising, supporting new development and rising property sales prices. As construction accelerates in the second half, there could be some leveling off of market fundamentals.
- Vacancy in Tucson was 5.9 percent in the second quarter, holding steady during a period where the rate typically pushes higher. The current vacancy figure is 40 basis points lower than the rate one year ago.
- Asking rents reached $804 per month, a 7.1 percent year-over-year increase. The increase from the first quarter to the second quarter was 1.3 percent.
- Prices pushed higher and more apartment properties sold during the second quarter, but activity levels continued to trail year-earlier volume. The median price thus far in 2019 is up to approximately $74,800 per unit, while the average cap rate is a tick under 6 percent.

Q2 Snapshot	Tucson Market
Market Fundamentals	
Vacancy	**5.9%**
- Year Over Year Change	**-40 bps**
Asking Rent	**$804**
- Year Over Year Change	**+7.1%**
Transaction Activity	
Median Sales Price Per Unit (YTD)	**$74,800**
Cap Rates (Avg YTD)	**5.9%**
Construction Activity	
Units Under Construction	**2,094**
Units Delivered YTD	**280**

Tucson Multifamily Market Overview

The Tucson multifamily market had a particularly strong period of performance during the second quarter. Vacancy in the market typically creeps higher during the second quarter, but the rate held steady during the past three months. With renter demand steady and vacancy being held in check, rents are rising. Rent growth has been particularly strong since 2017, although the pace did slow a bit during the first half. Part of the fuel for the local multifamily market has been in the strengthening labor market. Employment growth in Tucson was fairly modest at the earlier stages of the recovery, but gains in recent years have been averaging approximately 5,000 net new jobs per year, while apartment developers have been bringing approximately 500 new units to the market annually.

The Tucson investment market gained some momentum during the second quarter. Activity picked up and prices rose, reflecting the overall health of the market. The mix of assets that has changed hands through the first half of 2019 has been fairly evenly divided between properties of more than 100 units and less than 100 units. While activity in these sizes is similar, pricing and cap rates have been dramatically different. In the larger properties, the median sales price has been more than $77,000 per unit, compared to approximately $57,000 per unit in the older properties with fewer than 100 units. Cap rates in larger properties have averaged approximately 5.2 percent, where cap rates in smaller assets are 100 basis points higher on average.

Employment

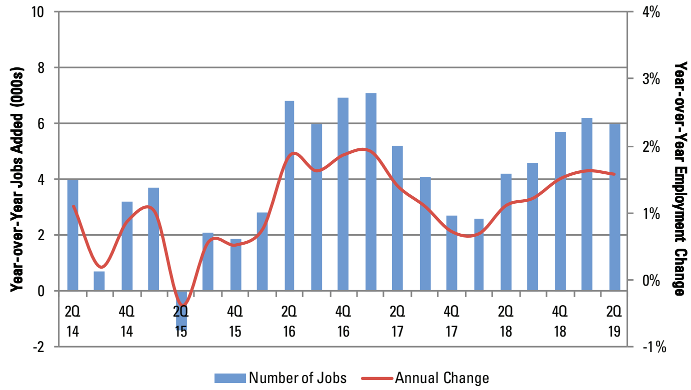
> Employment growth in Tucson continued at a steady pace during the second quarter. Year over year, 6,000 net new jobs have been added in Tucson, a 1.6 percent increase.

> The education and health services sector remains a source of growth in the area. The sector expanded by 3.6 percent during the past 12 months, adding 2,400 new workers. This represents 40 percent of the total jobs created in Tucson in the past year.

> While the Tucson area has attracted several call center companies in recent years, there was a notable local call center that announced significant job cuts during the second quarter. Concentrix Corp. eliminated 785 call center positions at its Tucson location.

> **Forecast:** With healthy expansions forecast across several industries, employment in Tucson is expected to grow by 1.7 percent with the addition of 6,500 workers in 2019. This follows growth of 5,700 new jobs in 2018.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

Year over year, 6,000 net new jobs have been added, a 1.6 percent increase

Vacancy

> Vacancy in Tucson held steady at 5.9 percent from the first quarter to the second quarter. Vacancy almost always ticks higher in Tucson during the second quarter as students from the University of Arizona break for the summer, so a flat vacancy rate is a particularly strong showing.

> The current vacancy rate is 40 basis points lower than the rate from one year ago. This marked the second consecutive quarter where vacancy has held below 6 percent; vacancy had averaged approximately 6.5 percent from 2016-2018.

> Areas in the southern portion of the Tucson metro area are posting some of the most significant vacancy declines as employers add workers. Vacancy rates in the South Central Tucson, Pantano/Lakeside, and Southeast Tucson submarkets have posted year-over-year vacancy declines of more than 100 basis points.

> **Forecast:** While renter demand for apartments is expected to remain strong, construction of new units is scheduled to accelerate before the end of the year, resulting in higher vacancies. The vacancy rate is forecast to tick up to 6.2 percent by the end of 2019.

Vacancy Trends

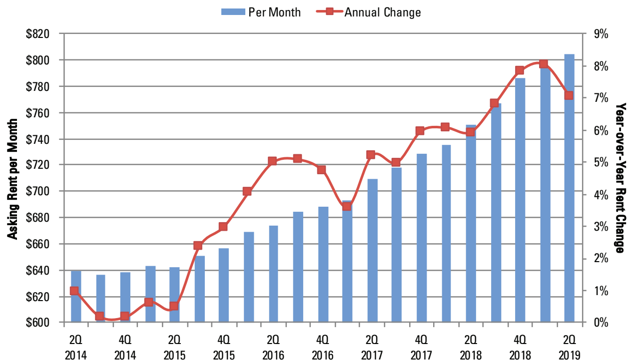
Sources: NorthMarq, Apartment Insights

The current vacancy rate is 40 basis points lower than the rate from one year ago

Rents

- Following a 1 percent increase in the first quarter, asking rents in Tucson advanced 1.3 percent during the second quarter. Current average asking rents topped $800 per month for the first time, ending the second quarter at $804 per month.
- Asking rents have increased 7.1 percent year over year. Annual rent growth has averaged nearly 6 percent since 2017.
- While the most dynamic vacancy improvements have been recorded in the submarkets at the southern portion of the Tucson area, the strongest rent gains have been in the northern segment of the market. Submarkets such as Oro Valley/Catalina and Northwest Tucson have posted above-average annual rent increases.
- **Forecast:** After spiking in recent years, rents in Tucson will likely advance at a more modest pace in 2019. Asking rents are forecast to rise 5 percent this year, reaching $825 per month.

Rent Trends



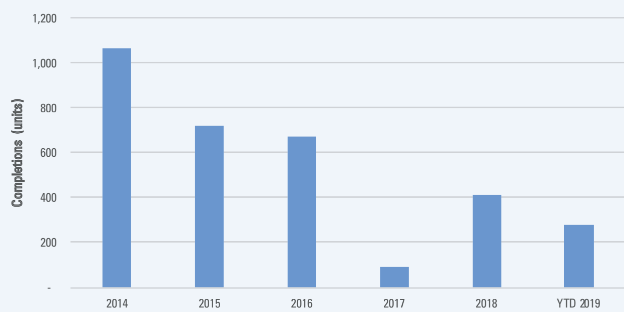
Sources: NorthMarq, Apartment Insights

Annual rent growth has averaged nearly 6 percent since 2017

Development and Permitting

- Developers delivered approximately 280 units during the first half of 2019, nearly identical to the construction levels from the same period in 2018.
- Deliveries of apartments have been modest since the beginning of 2017, but the development pipeline is filling up. There are approximately 2,100 units currently under construction, with several projects under way near the University of Arizona.
- More than 550 multifamily permits were issued during the first half, up nearly 80 percent from the same period, one year ago.
- **Forecast:** The consistent renter demand for apartments is supporting new apartment construction. Approximately 1,200 units are forecast to be delivered this year, up from fewer than 500 units in 2018.

Development Trends



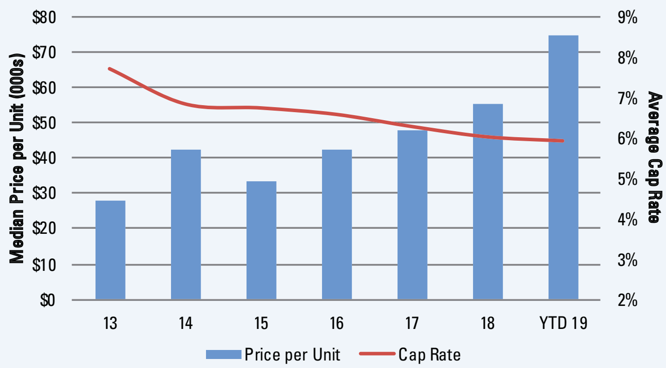
Sources: NorthMarq, Apartment Insights

There are approximately 2,100 units currently under construction

Multifamily Sales

- Investment activity got off to a slower start to 2019 but accelerated in the second quarter. Sales velocity rose 20 percent in the second quarter. Year-to-date transaction volume is trailing 2018 levels by more than 40 percent.
- Prices continue to push higher. The median price during the second quarter was $75,000 per unit, and the median price thus far in 2019 is approximately $74,800 per unit.
- After compressing during the first quarter, cap rates trended back close to longer-term averages in the past three months. Cap rates have averaged just below 6 percent thus far in 2019, down slightly from the average recorded last year.

Investment Trends



Sources: NorthMarq, CoStar

The median price thus far in 2019 is $74,800 per unit

Recent Transactions in the Market

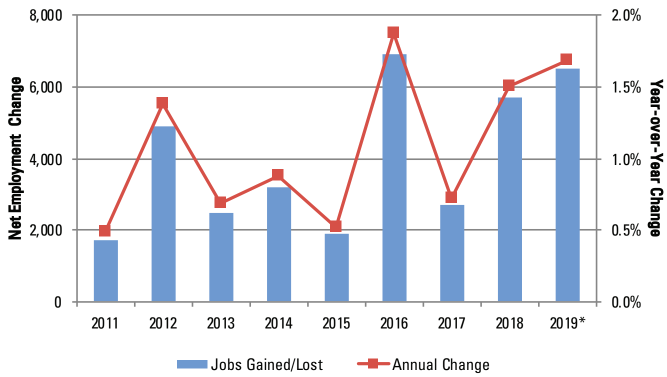
MULTIFAMILY SALES ACTIVITY				
Property Name	**Street Address**	**Units**	**Sales Price**	**Price/Unit**
Fox Point	3700 N Campbell Ave., Tucson	296	$22,125,000	$74,747
Crown Villas	550 S Camino Seco Rd., Tucson	144	$10,800,000	$75,000
Wildcat Canyon Village	1050 E 8th St., Tucson	76	$9,194,500	$120,980
INDI Tucson	1920 N 1st Ave., Tucson	89	$8,000,000	$89,888

Looking Ahead

The Tucson multifamily market is expected to be active in both supply and demand during the second half of 2019. Renter demand for units is forecast to be healthy, with employment expanding across a number of industries and the new school year bringing students into the University submarket and surrounding areas. While demand is likely to pick up, supply is also going to increase, with projects totaling nearly 1,000 new units forecast to be delivered in the final two quarters of the year. As these new complexes come online, the vacancy rate is expected to inch higher, but the increase should be modest.

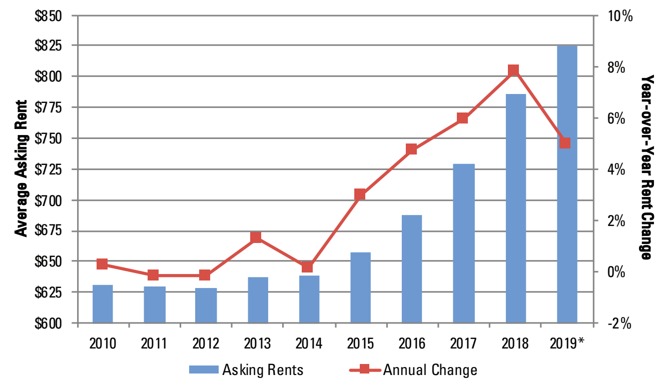
Investment conditions are forecast to remain favorable in the coming quarters. Multifamily properties are posting healthy performance, and interest rates are low enough to sustain cap rates that have dipped below 6 percent in recent quarters. The mix of assets changing hands highlights the strength of the market, with investors finding opportunities at both the high and low ends of the pricing spectrum. The one factor that could constrain transaction activity is a limited supply of properties listed for sale. Sales of apartment properties have been quite active during the past few years, likely reducing the number of assets available for acquisitions in the near term.

Employment Forecast



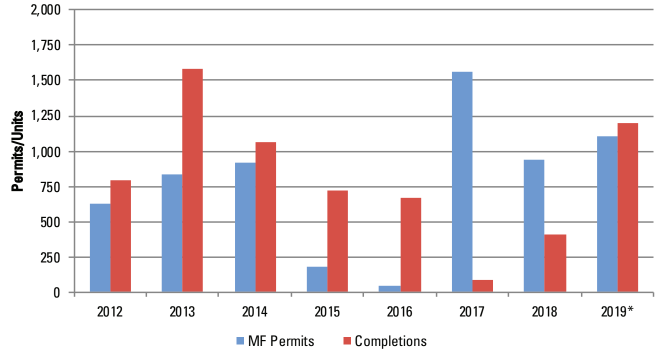
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



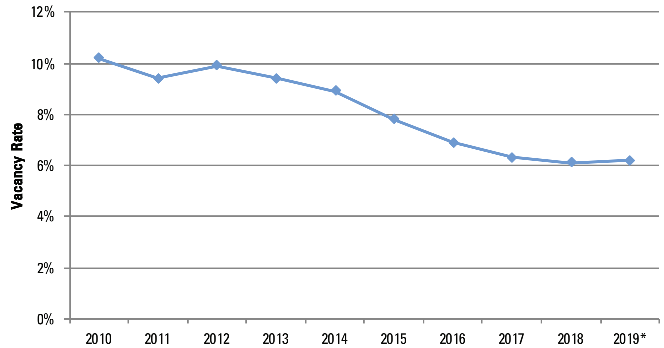
* Year End Forecast
Sources: NorthMarq, Apartment Insights

Construction & Permitting Forecast



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

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Apartment Insights

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.

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