MARKET REPORT | 4Q/2019

Greater Tucson Multifamily

Strengthening Jobs Outlook Supporting Apartment Fundamentals

Highlights

- The Tucson multifamily market closed 2019 on an upswing, with local employers adding workers, rents rising, and the vacancy rate tightening.
- Vacancy dipped 10 basis points in the fourth quarter, ending the year at 5.5 percent. The rate fell 60 basis points from the end of 2018 to the close of 2019.
- Asking rents trended higher throughout 2019, ending the fourth quarter at $831 per month. Average rents rose 5.7 percent during the year.
- Investment activity slowed in the fourth quarter, and sales velocity in 2019 was down approximately 35 percent from 2018 levels. While fewer properties sold, prices pushed higher; the median price reached $74,800 per unit, while cap rates compressed to an average of 5.5 percent for the year.

Q4 Snapshot	Tucson Market
Market Fundamentals	
Vacancy	**5.5%**
- Year Over Year Change	**-60 bps**
Asking Rent	**$831**
- Year Over Year Change	**+5.7%**
Transaction Activity	
Median Sales Price Per Unit (YTD)	**$74,800**
Cap Rates (Avg YTD)	**5.5%**
Construction Activity	
Units Under Construction	**2,060**
Units Delivered YTD	**950**

Tucson Multifamily Market Overview

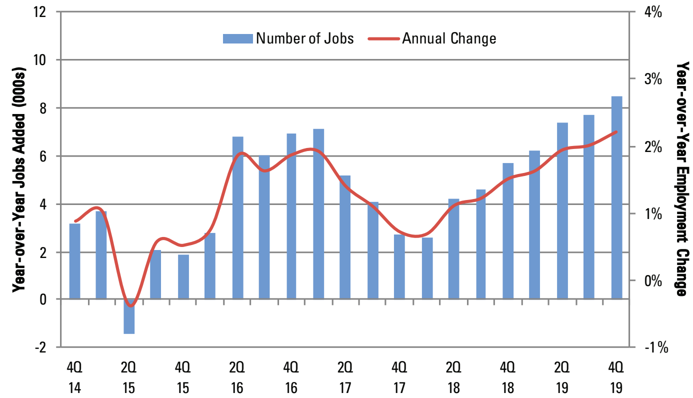
The Tucson multifamily market recorded one of its strongest years on record in 2019, with the vacancy rate tightening throughout the year and rents posting healthy gains. This occurred during a year when developers delivered projects totaling 950 new units, the highest year of new development in the market since 2014. Annual absorption has been consistent, fueled by an accelerating pace of hiring in recent years. Employment growth in Tucson has been driven by attracting businesses from other, more expensive markets as well as from expansions of existing companies.

Sales of apartment properties in Tucson in 2019 were fairly active in the second and third quarters, but the market recorded minimal activity at both the beginning of the year and in the final few months of the year. As a result of the inconsistent transaction pattern, 2019 marked a four-year low for total transaction activity in the market, even as the market's operating fundamentals hit cyclical highs for occupancy and rents. While the strong property performance did not fuel a rise in transaction activity in 2019, prices spiked and cap rates compressed, particularly in the second half.

Employment

- Employment growth in Tucson has gradually ticked higher over the past few quarters. In 2019, employers added 8,500 workers to payrolls, a 2.2 percent rate of growth. This follows a gain of 5,700 jobs in 2018.
- The education and health services sector led the way for employment growth in 2019, expanding by 5.6 percent with the addition of 3,800 net new jobs. This nearly tripled gains in the sector from 2018.
- Tucson has benefitted from attracting new companies to the market as well as organic growth from existing companies. In 2019, GEICO moved 1,500 existing employees into a new office in southwest Tucson. The company plans to add an additional 700 workers at the new facility.
- **Forecast:** After adding 8,500 new jobs in 2019, the Tucson market is forecast to add approximately 6,000 new jobs in 2020, a 1.5 percent pace of growth. Local employers have expanded payrolls an average of 5,100 jobs per year since 2015.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

In 2019, employers added 8,500 workers to payrolls, a 2.2 percent rate of growth

Vacancy

- Vacancy inched 10 basis points lower in the fourth quarter, dipping to 5.5 percent. The rate improved in three of the four quarters in 2019 and is at its lowest rate in more than a decade.
- Vacancy fell 60 basis points in 2019, after tightening 20 basis points in 2018. The local vacancy rate has improved in each of the past seven years.
- One factor driving new construction is the low vacancy rate in Class A apartments. The Class A vacancy rate fell to 3.9 percent at the end of 2019, 70 basis points lower than one year ago.
- **Forecast:** Vacancy is forecast to remain flat in 2020, with additions to inventory and renter demand for apartments likely to be near equilibrium. The vacancy rate is expected to end the year at 5.5 percent.

Vacancy Trends

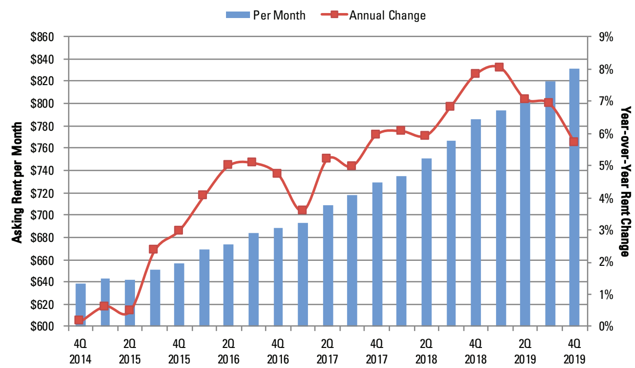
Sources: NorthMarq, Apartment Insights

The local vacancy rate has improved in each of the past seven years

Rents

- After rising 2 percent in the third quarter, asking rents grew another 1.3 percent during the fourth quarter. Rent growth has topped 1 percent in each of the past seven quarters.
- In 2019, asking rents rose 5.7 percent to $831 per month, following a spike of 7.8 percent in 2018. Rent growth has averaged 5.4 percent annually over the past five years.
- The University submarket has some of the tightest vacancy conditions, but rent growth slowed in 2019. After asking rents in the submarket rose just 2.4 percent in 2019, following average annual increases of 6.1 percent during the past five years.
- **Forecast:** Rent growth in 2020 is forecast to rise another 5.3 percent in 2020, with the average asking rent reaching $875 per month. With vacancy tight and absorption likely to remain healthy, landlords should be able to push rents higher in the year ahead.

Rent Trends



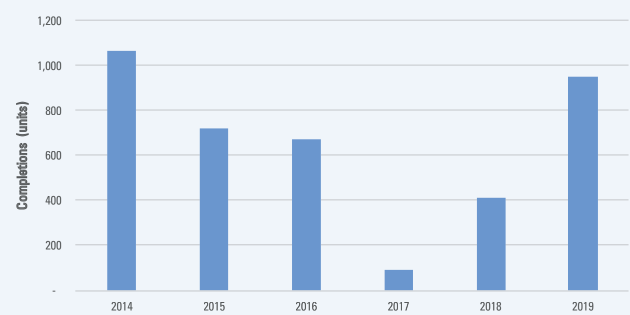
Sources: NorthMarq, Apartment Insights

Rent growth has averaged 5.4 percent annually over the past five years

Development and Permitting

- Apartment deliveries were concentrated in the second half of 2019. Developers completed projects totaling approximately 300 units in the fourth quarter, after more than 350 units came online in the third quarter. Completions for the full year totaled 950 units.
- Developers are responding to growing demand by moving more projects into the construction pipeline. Projects totaling more than 2,000 apartment units are currently under construction, up nearly 25 percent from the end of 2018.
- Multifamily permitting was fairly consistent throughout 2019. During the past year, developers pulled permits for approximately 1,000 multifamily units, up from 900 permits in 2018. During the fourth quarter, the multifamily permit total was approximately 250.
- **Forecast:** The year ahead will be an active one for new development, with the local inventory forecast to grow by approximately 1,500 new units. Deliveries in 2020 will approach the combined total of the past three years, putting some supply-side pressure on a few submarkets.

Development Trends



Sources: NorthMarq, Apartment Insights

Apartment deliveries were concentrated in the second half of 2019

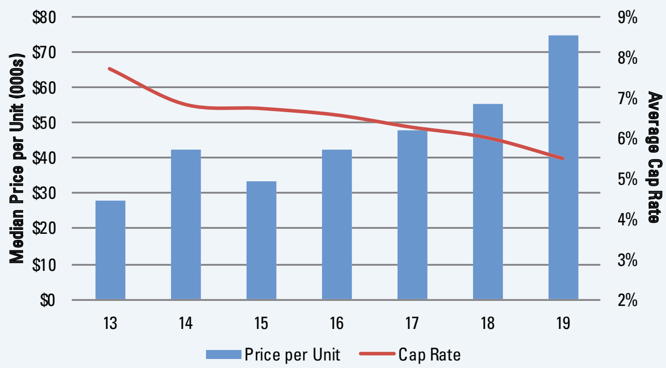
Multifamily Sales

> Sales of apartment properties slowed during the fourth quarter, extending the trend of a slower year of sales activity in 2019. Sales velocity in 2019 was down approximately 35 percent from 2018 levels.

> While fewer properties sold in 2019, prices posted strong gains throughout the year. The median price in sales occurring in the fourth quarter was $84,400 per unit, bringing the median price for the entire year up to $74,800 per unit. The median per-unit price rose 35 percent from 2018 to 2019.

> With prices pushing higher, cap rates compressed in 2019, averaging 5.5 percent. During the fourth quarter, average cap rates dipped below 5 percent, which may set the starting point for transactions in 2020.

Investment Trends



Sources: NorthMarq, CoStar

The median per-unit price rose 35 percent from 2018 to 2019

Recent Transactions in the Market

MULTIFAMILY SALES ACTIVITY

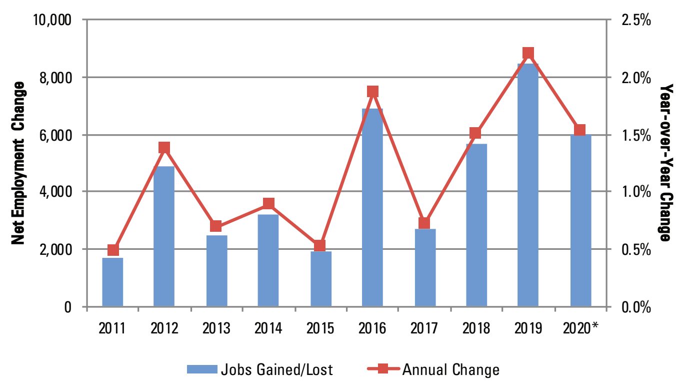
Property Name	Street Address	Units	Sales Price	Price/Unit
Los Portales	801 S Prudence Rd., Tucson	416	$40,000,000	$96,154
Copper Creek	6666 E Golf Links Rd., Tucson	99	$8,360,000	$84,444
Tuscany	4399 E Pima St., Tucson	107	$6,500,000	$60,748
St. Phillips Corner	3993 N Campbell Ave., Tucson	62	$5,500,000	$88,710

Looking Ahead

The outlook for the Tucson multifamily market is favorable in 2020. The year is expected to be an active one for both new supply growth and renter demand. Developers are forecast to bring projects totaling approximately 1,500 new units online in 2020, the highest total for new construction since 2013. While construction is picking up, demand will be fueled by the local employment market, which has gained momentum during the past two years. A more modest pace of job growth is forecast for 2020, but gains should be sufficient to largely offset the new development and maintain recent vacancy levels.

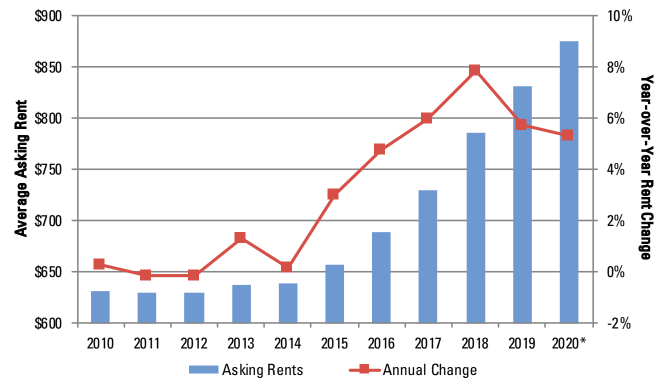
Investment activity is poised to gain momentum in 2020, following a period of slower sales velocity during the past 12 months. The Tucson market entered the economic recovery later than most of the rest of the country, but momentum in the economy has been building, with the market recording its strongest gains of the cycle during the past two years. In recent years, cap rates in Tucson have averaged 80 basis points higher than those in Phoenix. During the fourth quarter, however, cap rates in Tucson compressed. It may take a few months for investors to adjust to the latest activity.

Employment Forecast



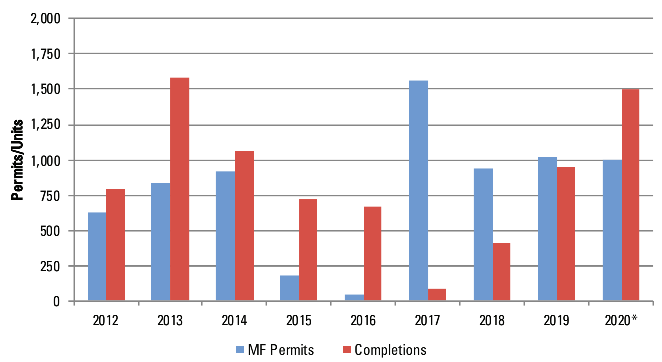
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



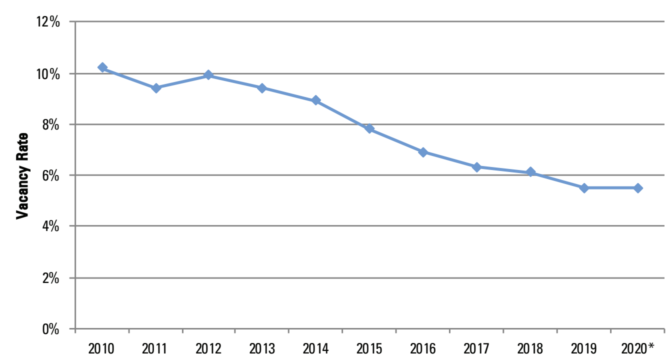
* Year End Forecast
Sources: NorthMarq, Apartment Insights

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 $14 billion, loan servicing portfolio of more than $60 billion and the multi-year tenure of our nearly 600 people.

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