MARKET REPORT | 3Q/2020

Greater Tucson Multifamily

NORTHMARQ

Vacancy Tightens, Rents Spike in the Third Quarter

Highlights

- The Tucson multifamily market posted one of the most statistically sound quarters on record as rents spiked and vacancy fell significantly in the third quarter. These trends were likely more a result of pent-up demand than a market shift.
- Vacancy fell 80 basis points in the third quarter, reaching 4.5 percent; the rate is down 110 basis points year over year.
- After holding steady in the second quarter, rents surged in the third quarter, rising 3.3 percent to $867 per month. Year over year, asking rents are up 5.7 percent.
- The Tucson multifamily market has recorded very steady investment performance through the first three quarters of 2020. Transaction activity has occurred at a consistent pace, the median price year to date is $65,500 per unit, and cap rates have averaged approximately 5.8 percent.

Q3 Snapshot	Tucson Market
Market Fundamentals	
Vacancy	**4.5%**
- Year Over Year Change	**-110 bps**
Asking Rent	**$867**
- Year Over Year Change	**+5.7%**
Transaction Activity	
Median Sales Price Per Unit (YTD)	**$65,500**
Cap Rates (Avg YTD)	**5.8%**
Construction Activity	
Units Under Construction	**1,304**
Units Delivered YTD	**715**

Tucson Multifamily Market Overview

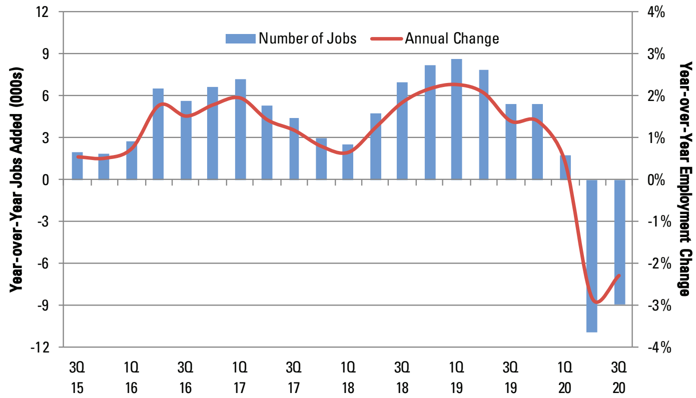
The Tucson multifamily market recorded a remarkably positive third quarter. Employment kept recovering, although at a slower pace than in May and June. Vacancy recorded a sizable dip but was supported by a couple of factors: one is a wave of pent-up demand from the COVID-19 lockdowns, and the other is an eviction moratorium preventing landlords from evicting out-of-work tenants behind on payments. Rent prices got back on track after a flat second quarter and advanced 3.3 percent in the third quarter.

Investment activity in the Tucson area has been very steady throughout 2020, countering trends at the national level. Since March, the bulk of the activity has occurred in the $5 million range, with transactions dominated by local and regional participants. A few larger deals closed at the end of the third quarter, which could be a signal of things to come at the end of this year and into 2021. With smaller transactions accounting for a larger share of total deals, cap rates have crept up approximately 30 basis points in 2020, averaging 5.8 percent year to date.

Employment

- The Tucson labor market has largely stabilized in recent months, following volatility in the first half of the year. During the third quarter, approximately 1,600 jobs were added back to the local economy. Total employment is down just 2.3 percent year over year.
- Tucson's large public sector has been a source of stability in the local labor market. The government sector accounts for approximately 20 percent of Tucson's total employment base; year over year, local government employment is down just 0.4 percent.
- In August, Dallas-based COMSovereign announced an agreement to open a 140,000-square-foot factory in Tucson, near Interstate 10 and East Irvington Road. The facility will produce most of its wireless radio products and serve as the primary manufacturing site for its power supply and drone business units. The company expects to hire more than 300 workers in Tucson beginning in the fourth quarter.
- **Forecast:** Total employment in Tucson is forecast to decline approximately 1.8 percent in 2020, bringing employment levels close to year-end 2018 levels. In 2021, the market is forecast to add workers.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

Tucson's large public sector has been a source of stability in the local labor market

Vacancy

- Vacancy reached cyclical lows during the third quarter, falling 80 basis points to 4.5 percent. Year over year, vacancy has declined 110 basis points. The rate has been improving for the past several years, but this is the fastest annual decline in four years.
- After some modest negative net absorption during the second quarter, renter demand spiked during the past three months. Net absorption totaled approximately 750 units in the third quarter, the most in a single quarter since the beginning of 2016.
- During the third quarter, 14 out of 15 submarkets in Tucson reported improvements in vacancy, with the University submarket being the exception. Renter demand in areas surrounding universities has lagged in several markets. Vacancy in the University submarket ended the third quarter at 10 percent.
- **Forecast:** If job losses linger for a few more quarters, there could be some upward pressure on vacancy. The rate is forecast to end 2020 at approximately 5 percent.

Vacancy Trends

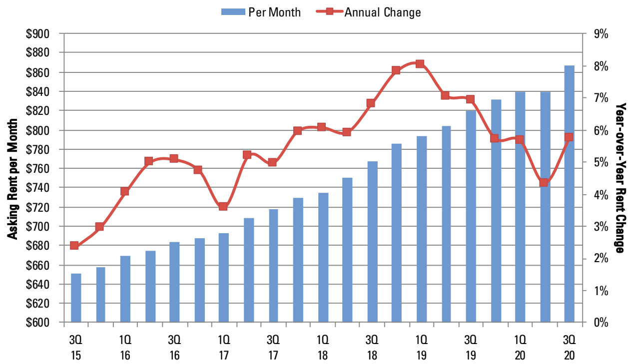
Sources: NorthMarq, Apartment Insights

Local vacancy rates dipped 80 basis points, ending the quarter at 4.5 percent

Rents

- Rents were flat from the first quarter to the second quarter, but there was a sharp rise during the past three months. Asking rents spiked 3.3 percent in the third quarter, reaching $867 per month.
- The rent gains recorded during the third quarter accounted for the bulk of the year-over-year increase. Current asking rents are 5.7 percent higher than one year ago. Since 2018, yearly rent gains have averaged approximately 6.4 percent.
- Rents in Tucson's large Class B segment have been posting steady gains. During the past 12 months, Class B asking rents have advanced 3.7 percent, ending the third quarter at $911 per month.
- **Forecast:** Rents are expected to level off in the fourth quarter as conditions return closer to normal after a period of strong demand in the third quarter. Asking rents are forecast to rise approximately 3 percent for the year.

Rent Trends



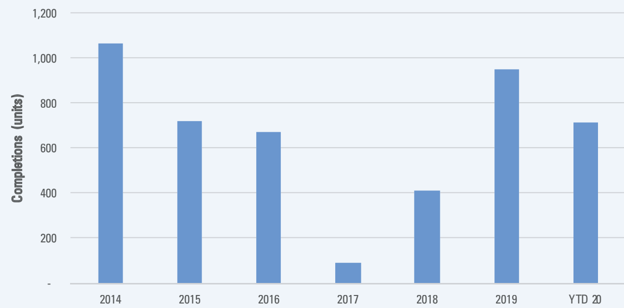
Sources: NorthMarq, Apartment Insights

Asking rents spiked 3.3 percent in the third quarter, reaching $867 per month

Development and Permitting

- Multifamily developers delivered approximately 555 units in the third quarter, bringing the year-to-date total to 715 units. Apartment completions through the first three quarters are up roughly 10 percent from the same period in 2019.
- As new apartments have come online, the number of projects in the construction pipeline has declined from earlier levels. Approximately 1,300 units are currently under construction, down nearly 40 percent from one year ago.
- Multifamily permitting is down from the elevated pace recorded last year. Developers have pulled permits for approximately 425 multifamily units to this point in 2020, a nearly 40 percent decline from the same period in the previous year.
- **Forecast:** New apartment deliveries are forecast to reach approximately 950 units in 2020, nearly matching the total new construction in 2019.

Development Trends



Sources: NorthMarq, Apartment Insights

Approximately 1,300 units are currently under construction, down nearly 40 percent from one year ago

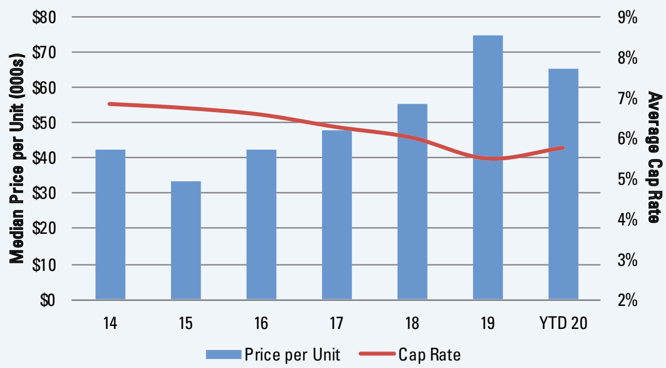
Multifamily Sales

> While nearly all major markets recorded a decline in transaction activity during the second quarter, sales in Tucson remained fairly steady. This level of sales velocity was maintained during the third quarter, and the number of deals that have closed this year has nearly matched the total from all of last year.

> Pricing has been quite consistent from quarter to quarter in Tucson this year, although the median price has lagged the 2019 level. Year to date, the median price is $65,500 per unit, down 12 percent from the full-year median price in 2019.

> The average cap rate for deals closed this year is 5.8 percent, up 30 basis points from the cap rate in 2019.

Investment Trends



Sources: NorthMarq, CoStar

Year to date, the median price is $65,500 per unit

Recent Transactions in the Market

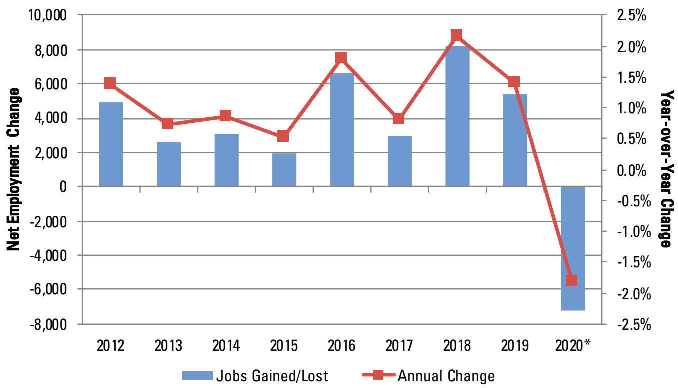
MULTIFAMILY SALES ACTIVITY				
Property Name	**Street Address**	**Units**	**Sales Price**	**Price/Unit**
255 North	255 N Granada Ave., Tucson	186	$40,000,000	$215,053
Legacy Apartments at Dove Mountain	12100 N Mountain Centre Rd., Marana	168	$34,000,000	$202,381
Woodridge Apartments	8225 E Speedway Blvd., Tucson	204	$15,400,000	$75,490
7 Four on Stone	3450 N Stone Ave., Tucson	73	$4,300,000	$58,904

Looking Ahead

Tucson multifamily properties are outperforming expectations, even in a period where economic volatility has created greater uncertainty in the market. Looking ahead to 2021, an expanding labor market should provide a boost to demand. An additional source of renter demand could be a resumption of more normalized classes at the University of Arizona. The University submarket is one of the few areas in the Tucson market where there is any significant vacancy, which would likely tighten if on-campus classes resumed.

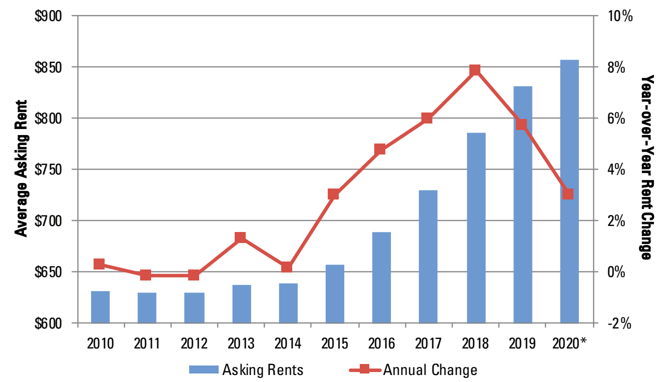
The Tucson multifamily market is on pace to end 2020 in a strong position. Recent quarters have been volatile, but the market is generally on an improving trajectory, evidenced by healthy renter and investor demand. In the coming quarters, the market should stabilize. To this point, the market's vacancy rate has continued to tighten, even as new units have been delivered. With an additional 1,300 units currently under construction and expected to be completed by the end of next year, continued absorption will be necessary to maintain vacancy at low levels.

Employment Forecast



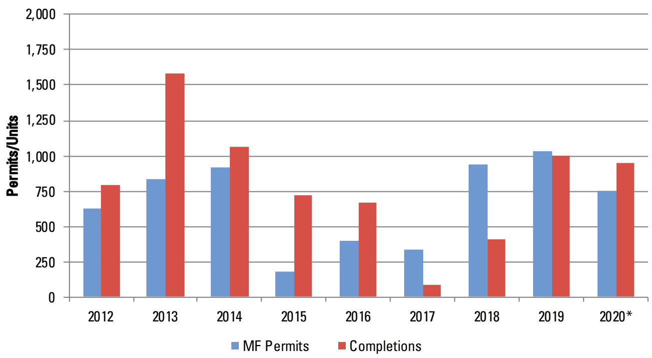
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



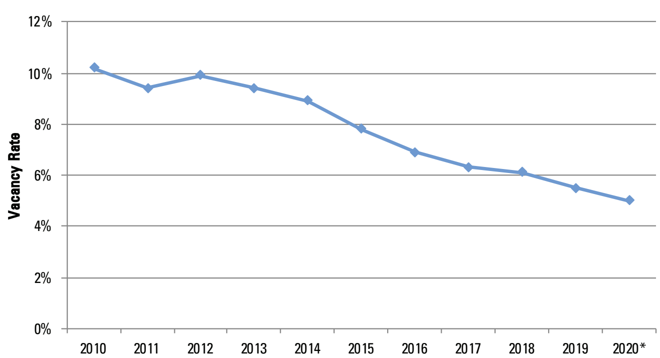
* Year End Forecast
Sources: NorthMarq, Apartment Insights

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 more than $14 billion, loan servicing portfolio of more than $61 billion and the multi-year tenure of our nearly 600 people.

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