Market Insights

Greater Tucson Multifamily 3Q 2022

Northmarq

Construction Activity

2,360
Units under construction

312
Units delivered (YTD)

Market Fundamentals

6.3%
Vacancy

+220bps | Year over year change

$1,165
Asking Rent

+10.6% | Year over year change

Transaction Activity

$142,500
Median sales price per unit (YTD)

Rents Post Modest Quarterly Increase, Even as Vacancy Ticks Higher

Highlights

- The Tucson multifamily market recorded mixed performance in the third quarter. Vacancy rose, but rents also trended higher. Absorption cooled despite continued growth in the local labor market. Fewer properties sold, but transactions closed at higher prices.
- Apartment vacancies increased for the fourth consecutive quarter. The rate rose 60 basis points during the third quarter, closing at 6.3 percent.
- Even as vacancies rose, rents still pushed higher. Rents reached $1,165 per month, 10.6 percent higher than one year ago. The pace of gains moderated in recent months.
- Transaction activity slowed somewhat in the third quarter, but sales volume to this point in 2022 has closely tracked levels from one year earlier. The bulk of the activity has occurred in larger transactions in recent months. The median sales price year to date has climbed to $142,500 per unit, up 26 percent from the 2021 median price.

Tucson Multifamily Market Overview

The Tucson multifamily market is coming back into balance after being undersupplied during several periods of heightened demand. Developers are ratcheting up activity levels; more than 1,700 units have been delivered to the market since the beginning of 2021, with projects totaling more than 2,300 additional units currently under construction. The result of the elevated levels of construction activity has been a series of increases in the quarterly vacancy rate, after very tight conditions prevailed in 2020 and 2021. The third quarter is typically a period where the vacancy rate improves, particularly in the University submarket, as students return to the University of Arizona for the new school year. While vacancy declined in the University submarket during the third quarter of this year, the overall market rate rose. This marked the first time in more than a decade where vacancy in Tucson rose from the second quarter to the third quarter.

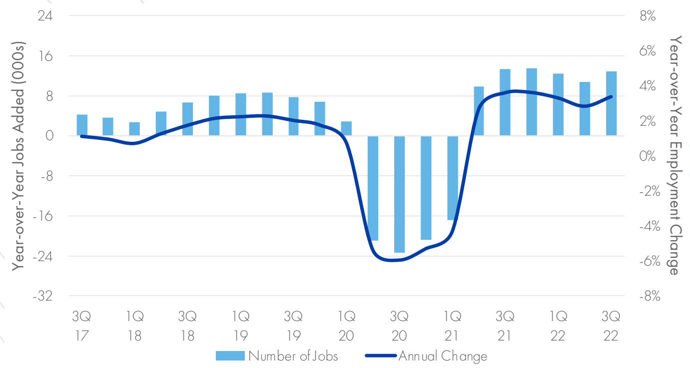
The local investment market is showing signs of resiliency despite a rising interest rate environment that has required buyers and sellers to adjust expectations. During the third quarter, sales velocity declined modestly, although year-to-date activity levels are down just 5 percent from the pace recorded through the first nine months of 2021. While the number of properties that are selling is closely tracking the prior year, pricing is setting a new course. The median price thus far in 2022 is up more than 25 percent from the 2021 median, and prices rose again during the third quarter. Some of the upward surge in pricing is likely the result of the mix of properties changing hands. Nearly all of the transactions in the third quarter involved assets that sold for more than $25 million. In most cases, the properties were nearly fully leased and often located near the primary employment corridors in Central Tucson.

Employment

- The local labor market continues to expand. Year over year through the third quarter, 12,900 jobs have been added, an increase of 3.4 percent. Employers in the area have added 4,200 workers in recent months.
- Employment levels in Tucson's leisure and hospitality sector continued to recover, nearly returning to pre-COVID levels. During the past 12 months, the leisure and hospitality sector added 4,400 new jobs with additional gains likely in the coming quarters.
- Northwest Healthcare recently expanded its Houghton campus with the addition of a new medical office building. The 45,000-square-foot add-on is fully operational as of the third quarter and is set to accommodate more than 450 new jobs.
- **Forecast:** Employment levels in Tucson are expected to increase by 11,500 jobs during 2022, an expansion of 3 percent.

> Year over year, 12,900 jobs have been added.

Employment Overview



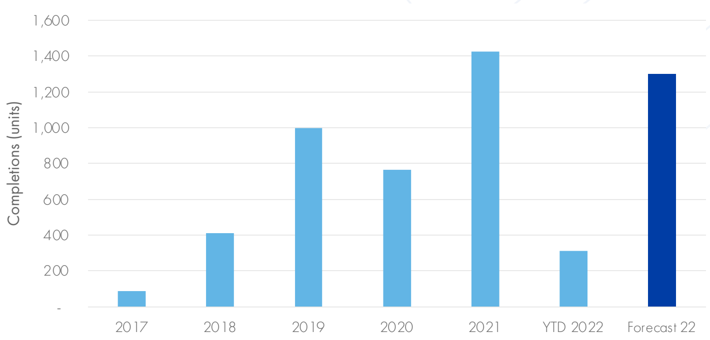
Sources: NorthMarq, Bureau of Labor Statistics

Development and Permitting

> Year to date, 312 units have been completed.

- Apartment deliveries have leveled off in Tucson, following an active 2021 that continued into this year. No significant multifamily projects have come online since the first quarter. Year to date, 312 units have been completed. The market's long-term average is approximately 750 completed units per year.
- While deliveries have been limited to date, several projects totaling 2,360 units are included in the current development pipeline. The number of units under construction is up 78 percent from levels recorded in the third quarter of last year.
- Multifamily permitting levels continued to climb in recent months, following elevated levels in the first half. Thus far in 2022, permits for 1,400 units have been pulled, up approximately 30 percent from last year's figure for the full year.
- **Forecast:** Despite only a few significant projects coming online to this point in the year, the pace of completions is likely to accelerate in the fourth quarter. Total deliveries for the full year are forecast to reach approximately 1,300 units, similar to levels recorded in 2021.

Development Trends



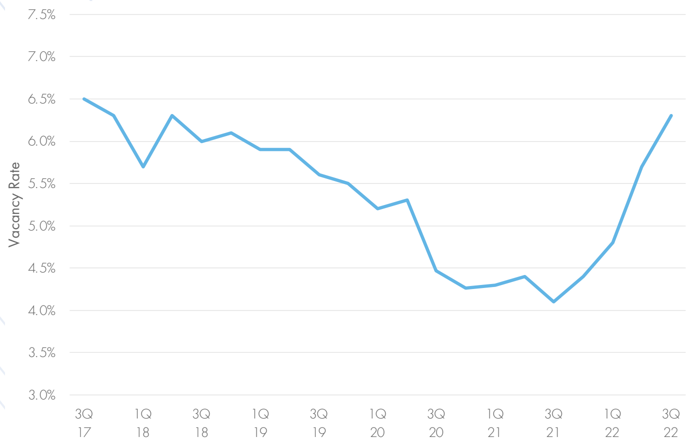
Sources: NorthMarq, Apartment Insights, CoStar

Vacancy

- The vacancy rate ticked up to start the second half of 2022. During the third quarter, local vacancy rose 60 basis points, reaching 6.3 percent. Year to date, net absorption has totaled only about 250 units, down 75 percent from levels in the same period in 2021.
- During the past 12 months, the vacancy rate in Tucson is up 220 basis points. The current rate has surpassed the market's long-term average of 6 percent. Vacancy had dipped into the low- to mid-4 percent range during the second half of 2020 and remained low throughout much of last year.
- The University submarket recorded expected improvements in the third quarter, as students returned to the area for classes. Year over year, the vacancy rate in the University submarket has dropped 70 basis points to 3.7 percent.
- **Forecast:** After pushing higher for much of the year, the local vacancy rate is expected to stabilize during the fourth quarter. Vacancy is forecast to end the year at 6.4 percent, closer to levels recorded in 2017 and 2018.

> During the third quarter, local vacancy reached 6.3 percent.

Vacancy Trends



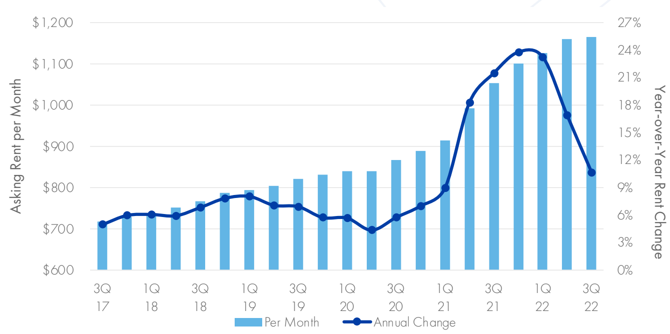
Sources: NorthMarq, Apartment Insights

Rents

- Increases in the vacancy rate have slowed rent growth in Tucson. During the third quarter, asking rents inched up less than 1 percent, closing at $1,165 per month. Prior to recent spikes, quarterly rent growth averaged 1.7 percent from 2018 to 2020.
- Year over year, asking rents advanced 10.6 percent. Including the third quarter of 2022, the market's annual pace of rent change has topped 10 percent for six consecutive quarters.
- Local rents are trending higher across property classes with some of the most rapid gains occurring at the high-end of the market. Class A asking rents spiked 12.8 percent in the past year, reaching $2,136 per month at the end of the third quarter.
- **Forecast:** Rent growth should continue to slow, following the rapid pace set during the second half of last year and early parts of 2022. Rents are forecast to reach $1,188 per month at year end, an annual increase of 8 percent.

> Year over year, asking rents advanced 10.6 percent.

Rent Trends



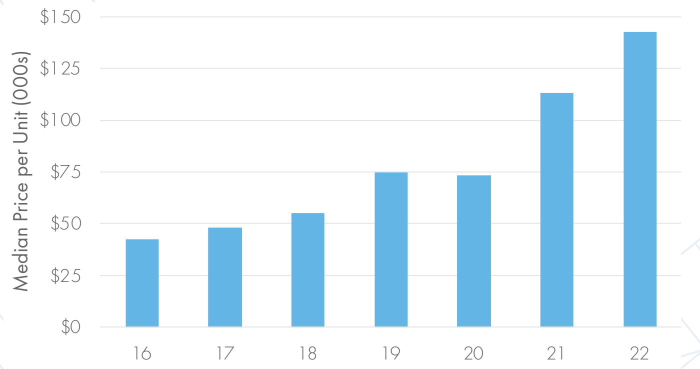
Sources: NorthMarq, Apartment Insights

Multifamily Sales

- Multifamily property sales slowed during the third quarter with activity dropping approximately 20 percent from the preceding three-month period. Transaction levels above $25 million remained fairly consistent, but there has been a decline in the number of sales of properties with fewer than 100 units. For the full year, sales velocity is down only about 5 percent when compared to the same period in 2021.
- Prices continue to push higher; the median price thus far in 2022 reached $142,500 per unit, up 26 percent from the 2021 median price. In transactions that closed during the third quarter, the median price approached $170,000 per unit.
- Cap rates are trending higher in response to rising interest rates. During the third quarter, most properties changed hands with cap rates between 4.5 percent and 5 percent. Cap rates will likely top 5 percent by the end of this year and remain elevated into 2023.

> The median price thus far in 2022 reached $142,500 per unit.

Investment Trends



Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

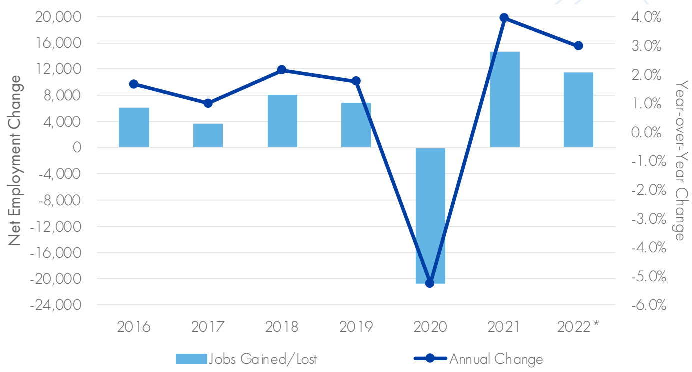
Property Name	Street Address	Units	Sales Price	Price/Unit
Hilands	5755 E River Rd., Tucson	826	$178,000,000	$215,496
Peaks at Redington	7700 E Speedway Blvd., Tucson	301	$53,900,000	$179,070
Metro Tucson	3985 N Stone Ave., Tucson	232	$38,500,000	$165,948

Looking Ahead

The Tucson multifamily market should stabilize in the next few months, setting the stage for healthy performance in 2023. The market recorded rapid absorption and steep rent increases beginning in 2021, which prompted developers to become more active to meet renter demand. To this point in 2022, deliveries have been modest, but several projects are slated to be completed in the fourth quarter, with additional inventory growth scheduled for next year. The vacancy rate has trended back closer to its long-term average in recent quarters and will likely remain near its current range well into 2023. Rents continue to push higher, but the pace of gains has slowed, and future gains will likely level off and come in closer to 3.5 percent to 5 percent. Renter demand should be supported by a healthy pace of growth in the local labor market.

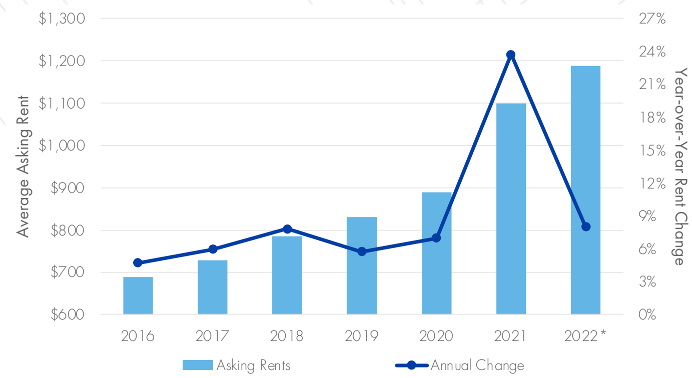
The local multifamily investment market is expected to continue to evolve in the coming quarters. In recent quarters, larger transactions have accounted for a greater share of total volume, and activity has cooled among smaller, private-capital acquisitions. With buyers showing a preference for larger deals and developers moving more projects through the construction pipeline, there will likely be an increase in sales of newer projects in 2023. Only a handful of Class A properties have changed hands in the past few years, during which time there has also been a shortfall of new inventory entering the market. The projects that come online will likely present new investment opportunities, particularly those that lease-up quickly. The projects that deliver through the remainder of this year and into 2023 will likely benefit from the steep rent increases that were recorded across the market since 2021.

Employment Forecast



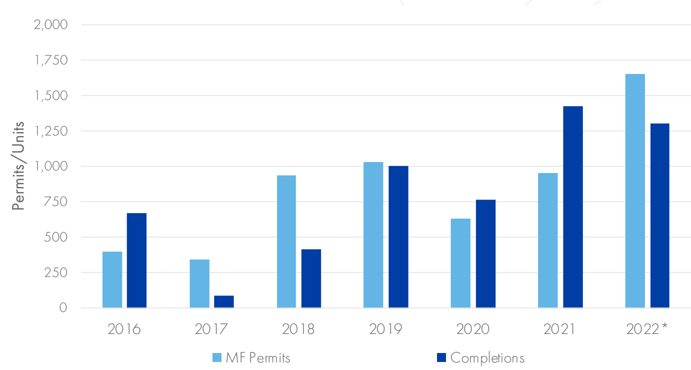
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



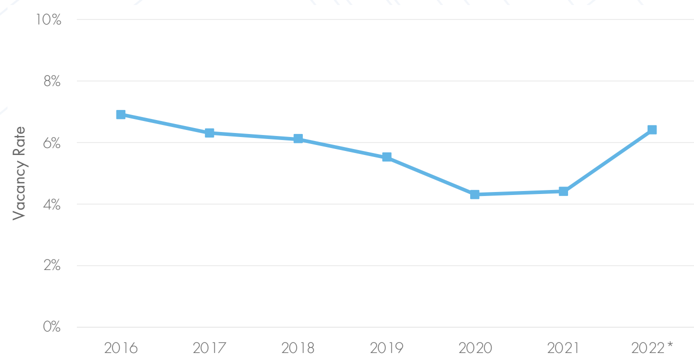
* Year End Forecast
Sources: NorthMarq, Apartment Insights

Construction & Permitting Forecast



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

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Apartment Insights

Northmarq

For more information, please contact:

Trevor Koskovich
President—Investment Sales
602.952.4040
tkoskovich@northmarq.com

Jesse Hudson
Managing Director—Investment Sales
602.952.4042
jhudson@northmarq.com

Bill Hahn
Executive Vice President—Investment Sales
602.952.4041
bhahn@northmarq.com

Brandon Harrington
Managing Director—Multifamily Debt & Equity
602.508.2204
bwharrington@northmarq.com

Pete O'Neil
Director of Research
602.508.2212
poneil@northmarq.com

About Northmarq

Northmarq offers real estate investors access to experts in debt, equity, investment sales and loan servicing. We combine industry-leading capabilities with an open, flexible structure, allowing our team of seasoned professionals to do the best work on behalf of clients and lenders. Our solid foundation and innovative approach have led to substantial growth, with more than 700 employees, loan servicing volume approaching $70 billion, and $30+ billion in transaction volume.

Copyright © 2022 NorthMarq Multifamily, LLC.

The information contained herein has been obtained from sources deemed reliable. While every reasonable effort has been made to ensure its accuracy, we cannot guarantee it. No responsibility is assumed for any inaccuracies. Readers are encouraged to consult their professional advisors prior to acting on any of the material contained in this report.

BUILT TO THRIVE®

northmarq.com