Northmarq

MARKET INSIGHTS

Vacancy elevated, but showing signs of stabilizing

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	3,467
UNITS DELIVERED	443

MARKET FUNDAMENTALS

VACANCY RATE	7.5%
YEAR-OVER-YEAR CHANGE	+270bps
ASKING RENTS	$1,164
YEAR-OVER-YEAR CHANGE	3.4%

TRANSACTION ACTIVITY (YTD)

MEDIAN SALES PRICE	$169,200

Tucson Multifamily
1Q 2023

HIGHLIGHTS

- Operating conditions in the Tucson multifamily market were stable in the first quarter. Rents rose and vacancies remained near current ranges. Development activity picked up with projects totaling roughly 450 units coming online in the first quarter.
- After recording steep increases throughout 2022, the vacancy rate inched higher by just 10 basis points during the first quarter to 7.5 percent. Year over year, the rate rose 270 basis points; this marked the highest vacancy rate in the region since 2015.
- With the vacancy rate holding fairly steady in the first quarter, apartment rents trended higher at a modest pace. Asking rents rose 0.6 percent during the first quarter, reaching $1,164 per month. Year over year, rents are up 3.4 percent.
- Multifamily sales activity was minimal during the first quarter, with transaction volume dropping by 75 percent from the previous period. Pricing rose, with the median sales price reaching $169,200 per unit.

TUCSON MULTIFAMILY MARKET OVERVIEW

The Tucson multifamily market recorded a solid performance during the first quarter, even as the pace of deliveries accelerated, and developers continued to expand the construction pipeline. Projects totaling nearly 3,500 units are currently under construction throughout the region, more than double the levels recorded one year ago. As supply growth picked up in the last three months, property fundamentals generally sustained prior levels. Following 12 months of steep vacancy increases, the vacancy rate ticked higher by just 10 basis points in the first quarter to 7.5 percent. Rents advanced slightly at the start of 2023 after dipping in the previous period.

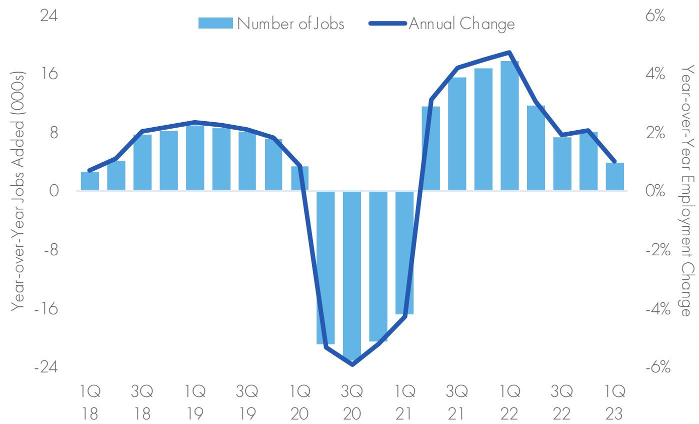
Transaction volume in the multifamily investment market was extremely limited in recent months as investors adjust to higher borrowing costs and more conservative underwriting. Sales velocity trended lower for the third straight quarter, and total transactions in the first three months of 2023 represented just a fraction of average activity levels. While the number of transactions in recent months was minimal, per-unit pricing has remained elevated. In the first quarter, the median price was $169,200 per unit, up 13 percent from the median price in 2022. Cap rates continued to trend higher with most properties trading with cap rates between 5 percent and 6.25 percent.

EMPLOYMENT

- Year over year, area employers added 3,900 workers, increasing total employment by 1 percent. Nearly all the additions occurred in 2022, however, as growth has been flat to this point in 2023.
- The leisure and hospitality sector has been expanding at an elevated rate in recent periods, as several hotels have opened in Tucson during the past 24 months. One such hotel is The Eddy, which opened in the Catalina Foothills submarket in the first quarter. Total leisure and hospitality employment is up 3.7 percent year over year, following net additions of 1,600 jobs.
- A former movie theater in Tucson, Century Park 16 Theatres, has recently been demolished to make way for Casino del Sol's new casino and hotel. Located on Grant Road, near Interstate 10, the first phase of construction is scheduled to begin next year. Upon completion in 2027, the new casino is expected to create roughly 800 jobs.
- **FORECAST:** The local labor market is expected to expand at a modest pace in the coming quarters. Area employers are forecast to add 2,000 workers in 2023, increasing payrolls by 0.5 percent.

Year over year, area employers added 3,900 workers.

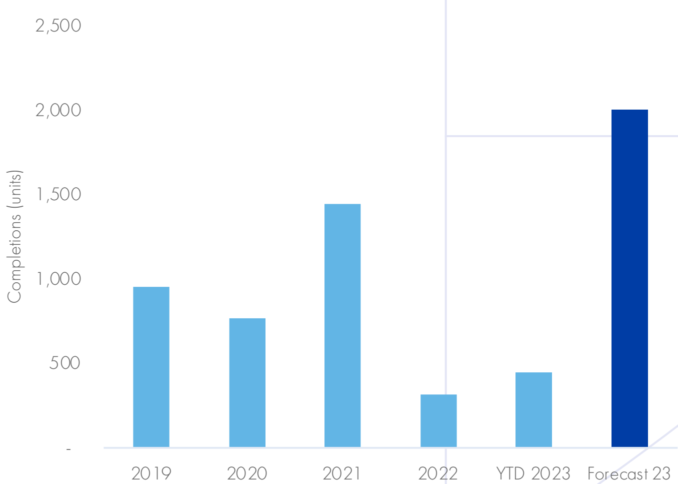
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

Projects totaling nearly 450 units came online during the first quarter.

DEVELOPMENT TRENDS

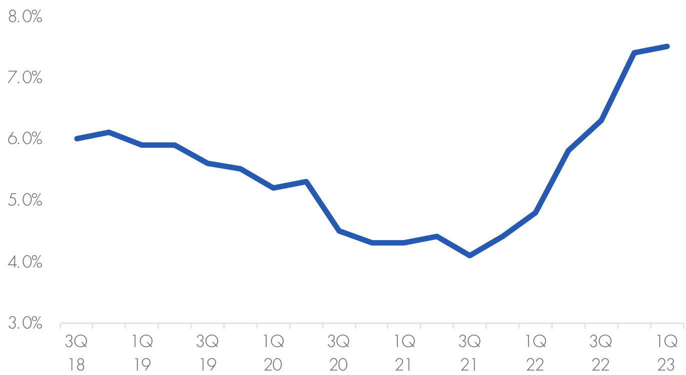


DEVELOPMENT & PERMITTING

- Following more than six months of limited development activity, the pace of multifamily deliveries strengthened in recent months. Projects totaling nearly 450 units came online during the first quarter, up slightly from last year's annual total.
- The number of units in the construction pipeline has more than doubled during the past 12 months. Projects totaling nearly 3,500 units were under construction at the end of the first quarter. The heaviest concentration of new development is in the South Tucson/Airport submarket, which accounts for roughly 30 percent of the units under construction.
- Multifamily permitting slowed slightly in recent months after peaking in 2022. Developers pulled permits for roughly 300 units in the first quarter, down 30 percent from the previous period. From 2017 to 2022, an average of 250 permits were issued per quarter.
- **FORECAST:** The pace of multifamily deliveries will accelerate in the coming months. Projects totaling approximately 2,000 units are set to come online in 2023, after deliveries averaged 675 units per year since 2015.

Area vacancy rose just 10 basis points in the first quarter.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

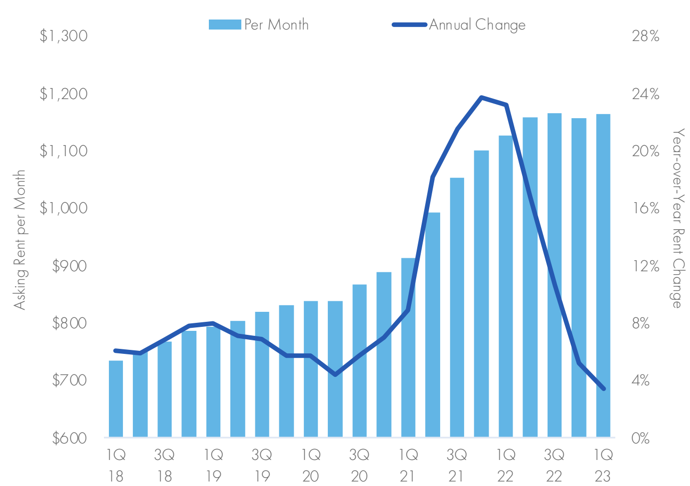
- After the local vacancy rate trended higher at a rapid pace in 2022, conditions stabilized at the start of this year. Area vacancy rose 10 basis points in the first quarter, reaching 7.5 percent. This is the highest quarterly vacancy rate in Tucson since 2015.
- Despite a minimal uptick in the first quarter, the rate rose 270 basis points during the past 12 months. There are some areas where conditions are improving; in the University submarket, vacancy dropped 60 basis points year over year to 4.8 percent.
- Historically, the handful of top-tier buildings in Tucson have maintained the tightest vacancy conditions, but elevated construction levels in recent months applied upward pressure to the Class A vacancy rate. Class A vacancy rose 450 basis points during the past 12 months to 8.3 percent.
- **FORECAST:** New inventory should continue to outpace renter demand in the coming periods, pushing the vacancy rate higher. Local vacancy is projected to finish 2023 at 8 percent, up 60 basis points for the year.

RENTS

- Average rents ticked higher during the first quarter after dipping slightly in the previous period. Area rents rose 0.6 percent in the first three months of 2023, reaching $1,164 per month.
- During the past 12 months, rents advanced by 3.4 percent. The pace is trailing gains from recent years but is closer to levels recorded from 2013 to 2018, when rent growth averaged 3.8 percent per year.
- While apartment rents rose across all asset classes in recent quarters, Class A units posted the largest gains. Year over year, rents for upper-tier units rose 4.6 percent to $2,071 per month.
- **FORECAST:** Rents are expected to continue rising at a modest rate in the coming quarters. Area rents are forecast to finish 2023 at $1,180 per month, an annual increase of 2 percent.

During the past 12 months, rents advanced by 3.4 percent.

RENT TRENDS



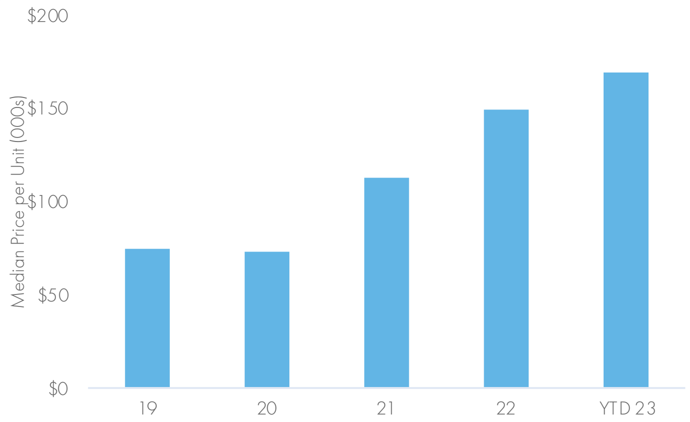
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- Multifamily sales activity slowed significantly at the end of 2022 and continued to taper off at the start of 2023. Sales velocity in Tucson during the first quarter was limited to only a handful of transactions, declining 75 percent from the previous period.
- While transactions were extremely limited in recent months, pricing pushed higher. The median sales price year to date is $169,200 per unit, up 13 percent from the median price in 2022.
- Cap rates continued to trend higher in recent quarters. The bulk of the properties that have sold in recent periods have had cap rates ranging between 5 percent and 6.25 percent.

The median sales price year to date is $169,200 per unit.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

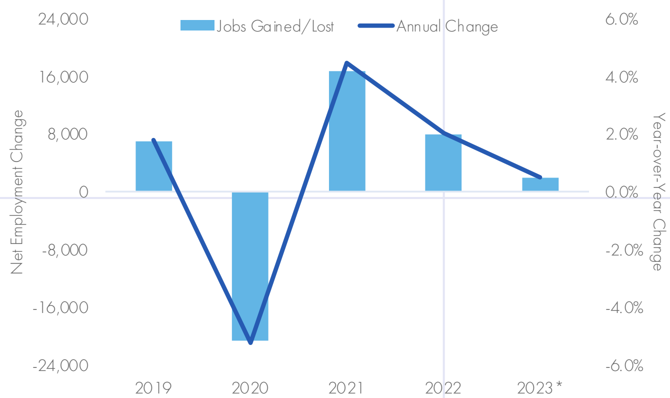
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
Mission Tierra Apartments	5505 S Mission Rd., Tucson	220	$38,000,000	$172,727
The Commons on Stella	6534 E Stella Rd., Tucson	199	$37,000,000	$185,930
Sahuarita Mission	1091 W Beta St., Green Valley	52	$8,800,000	$169,231

LOOKING AHEAD

Operating conditions are expected to be mixed in the remainder of the year as both asking rents and vacancies trend higher. Multifamily development will be elevated in the coming periods, with projects totaling approximately 2,000 units slated to be delivered in 2023, a cyclical high for the region. Tucson is not a market that routinely records significant waves of population growth or business relocation, and inventory growth should outpace absorption levels this year. The vacancy rate is forecast to finish the year at approximately 8 percent, the highest figure since 2014. While vacancies are expected to continue to trend higher, operators have demonstrated an ability to implement continued rent gains. Minimal rent upticks are forecast for the coming year.

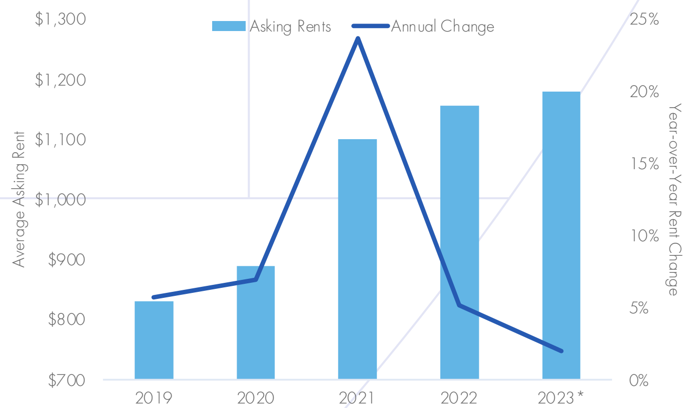
Multifamily sales activity in Tucson has been limited and may remain so in the next few periods. Momentum will eventually return to the market, especially as cap rates become more aligned with current interest rates. The market has already begun to demonstrate some upward movement, with properties beginning to transact with cap rates approaching or topping 6 percent. There could be a change in the mix of properties that sell through the remainder of 2023. In recent years, there has been a greater number of out-of-state buyers moving into the Tucson market and acquiring larger properties. This year, there could be a return to the market's traditional investment patterns, where activity was dominated by local operators, with transactions closing around $10 million.

EMPLOYMENT FORECAST



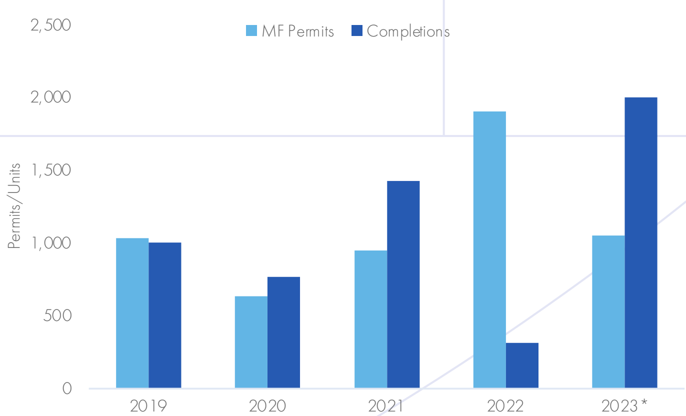
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



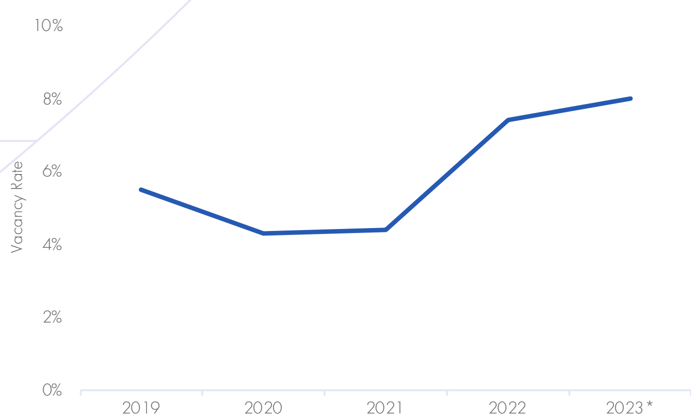
* Year End Forecast
Sources: Northmarq, Apartment Insights

CONSTRUCTION & PERMITTING FORECAST



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

VACANCY FORECAST



* Year End Forecast
Sources: Northmarq, Apartment Insights

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