Market Insights

Greater Tucson Multifamily 2Q 2022

Northmarq

Construction Activity

2,456

Units under construction

312

Units delivered (YTD)

Market Fundamentals

5.7%

Vacancy

+130bps | Year over year change

$1,159

Asking Rent

+16.8% | Year over year change

Transaction Activity

$125,000

Median sales price per unit (YTD)

Rent Growth Accelerates, Even as Vacancy Pushes Higher

Highlights

- The Tucson multifamily market showed signs of returning closer to stable performance in the second quarter, following a volatile past few years. Vacancy followed its historical trend of pushing higher during the summer months. Rents showed continued strength, rising nearly 3 percent in the past three months.
- Apartment vacancies in Tucson trended higher for the third consecutive quarter, rising 90 basis points to 5.7 percent. In the past 12 months, vacancy has increased by 130 basis points.
- The pace of rent growth accelerated in the second quarter. Rents advanced 2.9 percent to $1,159 per month in the second quarter, building on a 2.3 percent gain at the start of 2022. Year over year, the average rent in Tucson climbed 16.8 percent.
- During the second quarter, the median sales price was $125,000 per unit, nearly identical to pricing in the first quarter. Transaction activity increased from the start of the year, and the average cap rate remained steady at about 4 percent.

Tucson Multifamily Market Overview

The Tucson multifamily market recorded a mixed performance in the second quarter of 2022 as both vacancies and rents increased. It is a seasonal trend for vacancies in Tucson to rise in the spring as students attending the University of Arizona leave town for the summer. As enrollment has increased in recent years, the number of students departing Tucson during the summer months has grown. While vacancies ticked higher, rents continued to post strong quarterly and annual gains. While no significant projects were delivered during the second quarter, the number of projects that are under construction continued to increase, which will result in an uptick in deliveries in the second half and into 2023.

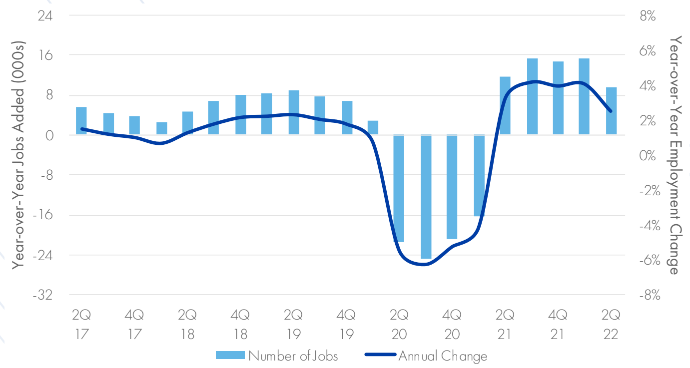
The local multifamily investment market has thrived in recent months. Transaction activity gained momentum in the second quarter with more properties changing hands than at the start of the year. While the median sales price remained unchanged from the first quarter, pricing is 10 percent higher than the 2021 figure. To this point in 2022, transactions have been comprised of Class B and Class C assets, but prices could receive an additional boost as new Class A units are leased-up, stabilized, and sold. Investors have more aggressively placed capital in Tucson in recent years, a trend that has continued in 2022. The average transaction size has recorded a steady, upward climb since 2019, approaching $30 million year to date.

Employment

- The local labor market posted healthy gains through the second quarter. During the past 12 months, employers in Tucson added 9,500 jobs, an expansion of 2.5 percent.
- Employment growth was propelled forward by gains in the education and health services sector. Year over year, education and health employment has expanded by 6 percent with the addition of 4,000 net new jobs.
- Walgreens and allied partner VillageMD announced plans to open eight new primary care facilities in the Tucson area in 2022. This expansion will create 285 full-time jobs and employ 140 medical professionals including physicians, nurse practitioners, and medical assistants.
- **Forecast:** Total employment in Tucson is expected to expand by 7,000 jobs this year, an annual growth of 1.8 percent.

> During the past 12 months, employers added 9,500 jobs.

Employment Overview



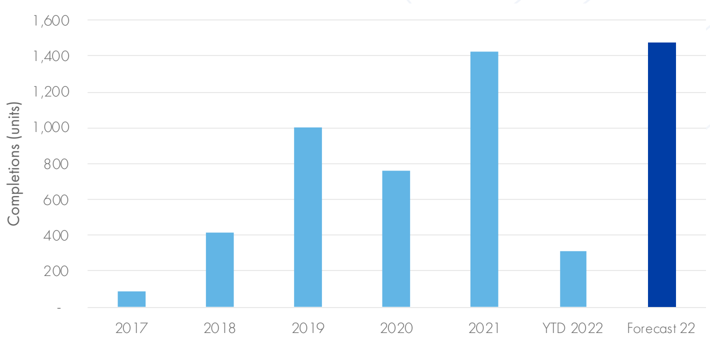
Sources: NorthMarq, Bureau of Labor Statistics

Development and Permitting

- After an increase in completions throughout 2021 and during the first quarter of this year, there were no significant projects that came online in the second quarter. Year to date, 312 units have been completed, down from the 736 units that delivered during the first half of 2021.
- The number of units that are under construction is on the rise. Projects totaling nearly 1,200 units broke ground in the second quarter. There are more than 2,450 units currently under construction in Tucson, an increase of 57 percent compared to one year ago.
- The pace of permitting has accelerated, as developers have pulled permits for nearly 800 multifamily units during the first half of 2022. During the same time last year, developers only pulled permits for around 330 units.
- **Forecast:** While deliveries tapered off during the second quarter, there are several large-scale projects forecast to come online by the end of the year. The total number of deliveries is expected to rise to nearly 1,500 units by the end of 2022, slightly higher than the number of units that came online last year, but nearly double the market's long-term annual average.

> There are more than 2,450 units currently under construction.

Development Trends



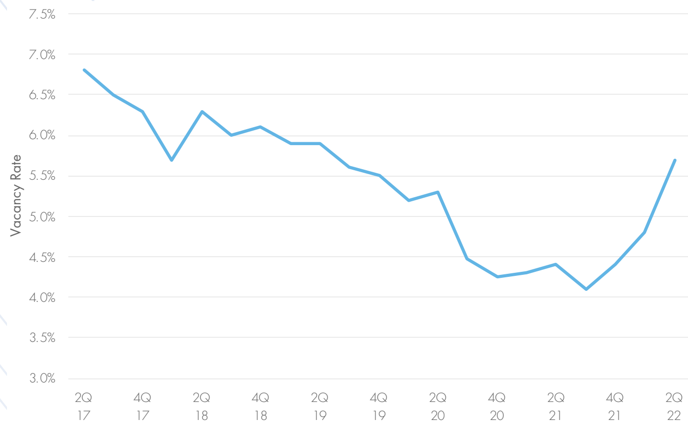
Sources: NorthMarq, Apartment Insights, CoStar

Vacancy

- After dropping to a record low in 2021, vacancy has trended higher in recent periods. During the second quarter, the vacancy rate rose 90 basis points, reaching 5.7 percent. Vacancy typically trends higher in Tucson in the second quarter; the rate is expected to improve in the second half of the year.
- Year over year, the vacancy rate in Tucson is up 130 basis points. The current rate is still below the market's long-term average of 6 percent recorded since 2015.
- Vacancy has generally trended higher in most submarkets in the Tucson region during the past year. Fairly close-in submarkets, including Flowing Wells and North Central Tucson, had a combined vacancy rate near 7 percent, up from less than 5 percent one year ago.
- **Forecast:** Vacancy is expected to improve slightly by the end of the year as demand regains momentum. The vacancy rate is forecast to end 2022 at 5.3 percent, down 40 basis points from the current level but 90 basis points higher than at the end of 2021.

> "The vacancy rate rose 90 basis points in the second quarter.

Vacancy Trends



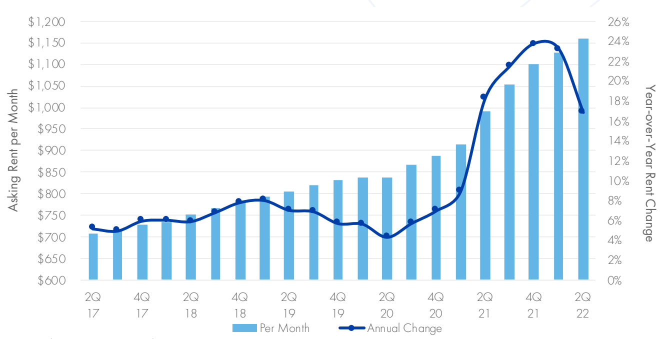
Sources: NorthMarq, Apartment Insights

Rents

- Despite a rise in vacancies, rents continued to increase. During the second quarter, Tucson rents advanced 2.9 percent, rising to $1,159 per month. This followed a 2.3 percent increase at the start of this year.
- Current asking rents are 16.8 percent higher than levels from the second quarter of last year. Annual rent growth topped 20 percent in each of the preceding three quarters.
- Class A asking rents are up 28.3 percent in the past 12 months, ending the second quarter at $2,190 per month. The average Class A asking rent rose by $70 per month during the past three months. Class A rents will likely advance as construction of new units remains elevated.
- **Forecast:** The pace of rent growth during the past 18 months will prove to be unsustainable. Rents are expected to rise 8 percent in 2022, ending the year at $1,188 per month.

> "During the second quarter, Tucson rents advanced 2.9 percent.

Rent Trends



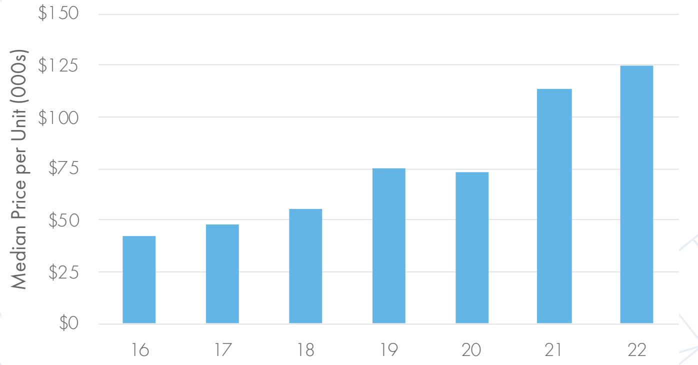
Sources: NorthMarq, Apartment Insights

Multifamily Sales

- The multifamily investment market gained momentum during the second quarter with the number of transactions rising 30 percent from levels at the start of the year. Sales velocity in the first six months of 2022 closely tracked activity recorded during the same period in 2021.
- During the second quarter, the median price was $125,000 per unit, nearly identical to pricing levels from the first few months of the year. The median price has increased by 10 percent from 2021.
- Cap rates have averaged approximately 4 percent in 2022, similar to levels from last year. To this point, rising costs of capital have not driven cap rates higher, although that could change in the second half of the year.

> The median price in the second quarter was $125,000 per unit.

Investment Trends



Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

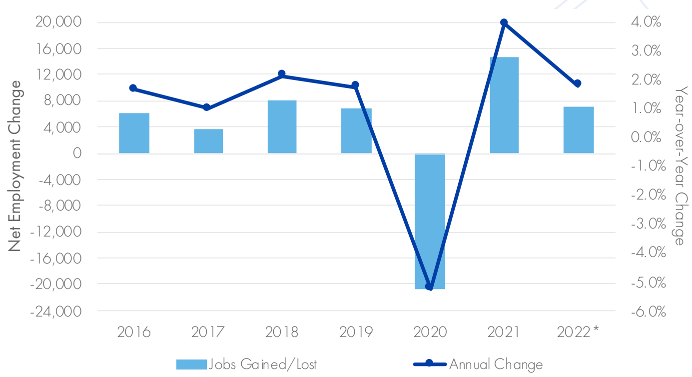
Property Name	Street Address	Units	Sales Price	Price/Unit
Villas las Mandarinas	2020 S Columbus Blvd., Tucson	324	$34,000,000	$104,938
Ascent on Pantano	550 N Pantano Rd., Tucson	196	$33,000,000	$168,367
Mission Creek	1451 W Ajo Way, Tucson	200	$28,500,000	$142,500
Palomino Crossing	750 E Irvington Rd., Tucson	240	$28,000,000	$116,667
San Marin	5650 S Park Ave., Tucson	176	$26,350,000	$149,716

Looking Ahead

The outlook for the Tucson multifamily market is for fairly steady performance through the remainder of this year, following a period of rapid rental growth rates. After vacancies inched higher in the second quarter, the rate should stabilize in the second half and remain fairly close to current levels. Rents are on the rise, but gains in 2022 will be closer to the average annual increases from 2017 to 2020, rather than the sharp upward spikes posted last year. Apartment construction is expected to remain elevated in the second half and throughout 2023, alleviating some of the undersupply conditions that have been in place in Tucson for the past several years.

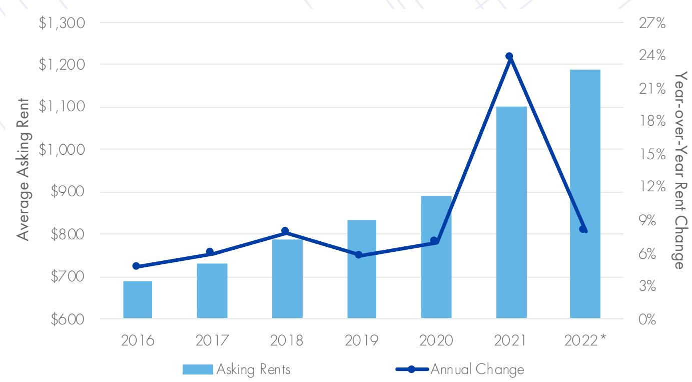
Investor demand is expected to remain healthy in the second half of this year. The bulk of the investment activity is occurring in transactions priced between $20 million and $35 million, which reflects a shift in the types of transactions and buyers that are active in the market. As recently as a few years ago, more than half of the investment transactions would have been below $10 million. The pool of transactions in the next 24 months will likely include some of the several new, Class A projects that are slated to be delivered. The sale of new, higher-end assets will likely drive up per-unit pricing and could influence cap rates.

Employment Forecast



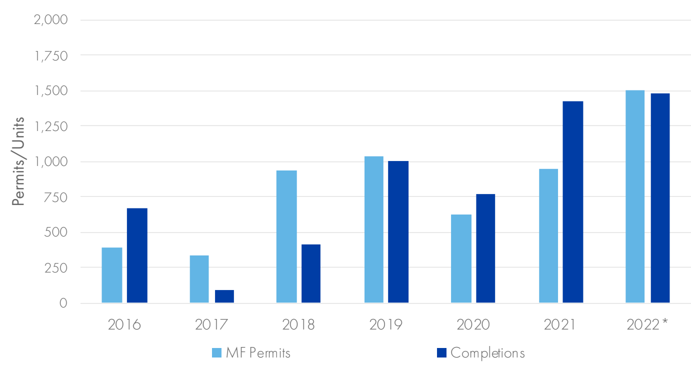
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



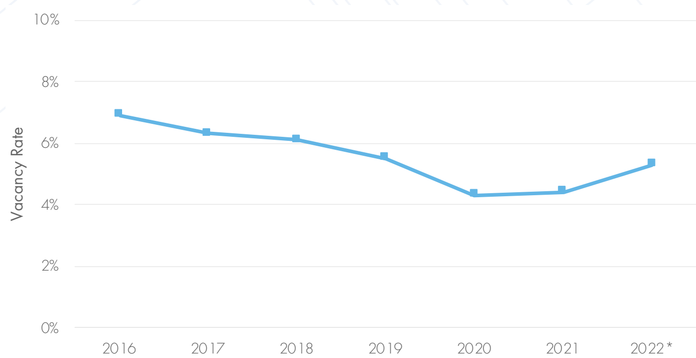
* Year End Forecast
Sources: NorthMarq, Apartment Insights

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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