Northmarq

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	3,485
UNITS DELIVERED	2,000

MARKET FUNDAMENTALS

VACANCY RATE	8.2%
YEAR-OVER-YEAR CHANGE	+80bps
ASKING RENTS	$1,187
YEAR-OVER-YEAR CHANGE	2.6%

TRANSACTION ACTIVITY (YTD)

MEDIAN SALES PRICE	$125,400

Tucson Multifamily
4Q 2023

MARKET INSIGHTS

Investment activity limited to Class C properties

HIGHLIGHTS

- Multifamily property performance in the Tucson market softened during the fourth quarter, as vacancy rose and rents decreased. Developers delivered a cyclical high of completions in 2023, with 2,000 units coming online.
- The vacancy rate rose 30 basis points in the final three months of 2023 to 8.2 percent. Year over year, vacancy is up 80 basis points.
- Average rents posted gains in the first nine months of the year before inching lower in the fourth quarter. Despite the recent decline, rents in Tucson advanced 2.6 percent in 2023, finishing the year at $1,187 per month.
- Transaction activity remained limited in the fourth quarter, tracking trends that prevailed throughout much of the year. The total sales transactions were down 77 percent from the previous year. The median price was $125,400 per unit in 2023.

TUCSON MULTIFAMILY MARKET OVERVIEW

Operating conditions in the Tucson multifamily market softened in 2023, with some mixed performance occurring during the fourth quarter. For the full year, vacancy rose, reaching its highest point since 2014. Vacancy increases in 2023 were the result of an influx of new supply that outpaced net absorption by a significant margin. This was a slightly different trend than was posted in the prior year, when the spike in vacancy was fueled by a decline in the number of occupied units. The market posted its second consecutive quarter of positive absorption in the final few months of 2023, although renter demand could not keep pace with supply growth. Developers delivered more than 1,000 units during the fourth quarter, the highest total of completions in any quarter in more than a decade.

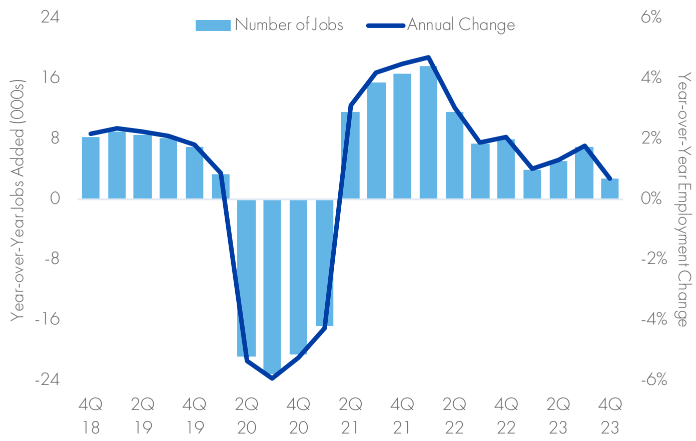
Investment activity in Tucson was limited during the fourth quarter, continuing a trend that was in place throughout most of 2023. A handful of properties changed hands in the final few months of the year, although rising interest rates and softening property fundamentals resulted in greater caution among area investors. For the most part, the properties that sold in 2023 were Class C assets, typically 1980s-vintage assets. Traditionally, the sales mix is more diverse, with Class A and Class B properties accounting for a healthy share of transactions, but these types of assets did not transact in any significant numbers in 2023. Cap rates averaged between 6 percent and 6.25 percent to close the year. The older mix of assets that traded and the rise in cap rates resulted in price declines; the median price in 2023 was $125,400 per unit, down from nearly $150,000 per unit in 2022.

EMPLOYMENT

- The local labor market expanded in 2023, however, growth was modest compared to levels recorded last year. Area employers added 2,800 workers in 2023, expanding payrolls by 0.7 percent.
- Employment trends in Tucson were mixed across sectors during the past year. The financial activities industry posted some of the market's fastest expansion. Employment in this sector rose 3.6 percent, with the addition of 700 new workers.
- American Battery Factory broke ground during the fourth quarter on a 2-million square foot facility at the Aerospace Research Campus. The company will manufacture lithium-ion phosphate battery cells and is expected to have an economic impact of $3.1 billion. Upon completion, the site is expected to employ 1,000 workers.
- **FORECAST:** The Tucson employment market is expected to record modest gains in 2024. Area employers are forecast to add 1,000 positions, a 0.3 percent increase.

Area employers added 2,800 workers in 2023.

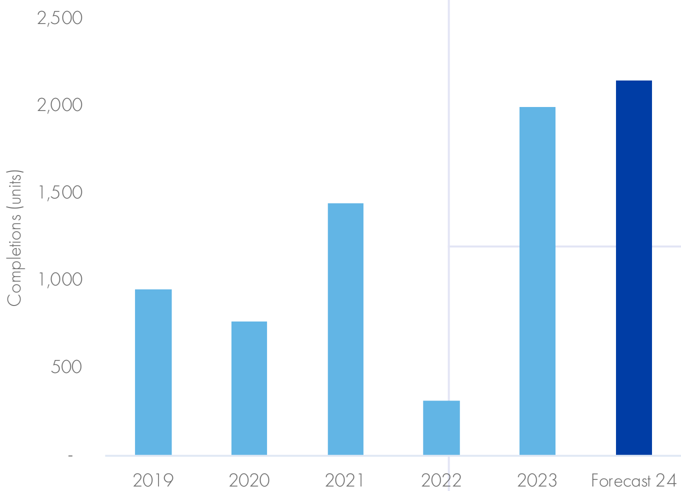
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

Projects totaling 2,000 units came online in 2023.

DEVELOPMENT TRENDS



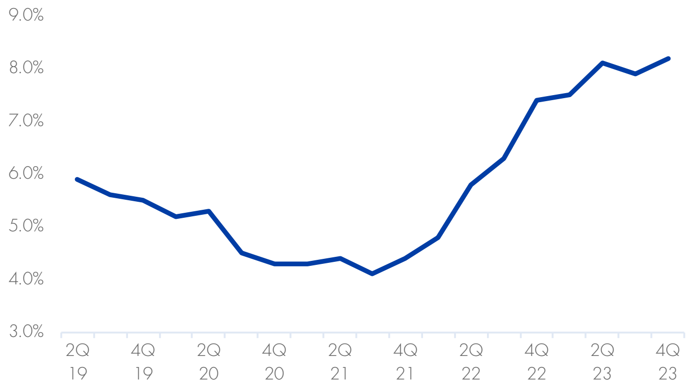
Sources: Northmarq, Apartment Insights

DEVELOPMENT & PERMITTING

- Multifamily deliveries in Tucson accelerated with more than 1,000 units coming online during the fourth quarter. This concluded an active year of new construction; projects totaling 2,000 units were delivered in 2023, up from roughly 300 units in the prior year.
- Nearly 3,500 units are currently under construction in the Tucson area, up 23 percent from one year ago. The Northwest Tucson submarket is leading the way with more than 1,000 units under construction at the end of 2023.
- Multifamily permitting was light in the second half of 2023; developers pulled permits for more than 500 units in the last six months, down 35 percent from the first half of the year.
- **FORECAST:** Construction will continue at a rapid rate in 2024. Projects totaling 2,150 units are forecast to come online in the year ahead.

Area vacancy rose 30 basis points in the last three months.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

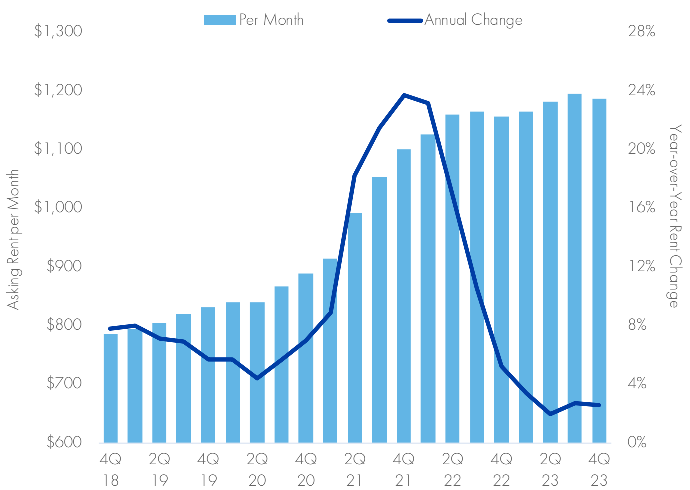
- The vacancy rate trended higher at the end of the year, after dipping slightly in the previous quarter. Area vacancy rose 30 basis points in the last three months to 8.2 percent. Year over year, vacancy is up 80 basis points.
- Northeast Tucson was one of the few submarkets that posted a vacancy improvement in 2023. The rate dipped 20 basis points during the year to 8.2 percent. Despite the recent tightening, vacancy in the submarket is still up 100 basis points from its five-year average.
- While vacancy rose across all asset classes in 2023, Class B properties posted a modest uptick, and the rate for middle tier properties is below the regional trend. The rate for Class B properties rose 20 basis points to 7.8 percent.
- **FORECAST:** Vacancy will likely remain elevated as supply growth is expected to be strong in the coming quarters. The rate is forecast to finish 2024 at 8.5 percent, up 30 basis points.

RENTS

- After trending higher in the first three quarters of 2023, asking rents inched lower in recent months. Area rents decreased by 0.8 percent during the fourth quarter to $1,187 per month. Rents rose 2.6 percent in 2023.
- Most submarkets in Tucson recorded modest rent increases in 2023. Generally, submarkets in the southern portion of the market posted the strongest annual gains.
- Rents in the lower tiers pushed higher in 2023, even as vacancy rose. Class C rents spiked 6 percent in the past year, reaching $933 per month in the fourth quarter.
- **FORECAST:** The pace of rent growth is forecast to slow in the coming year. Rents in Tucson are expected to rise roughly 1 percent in 2024, reaching $1,200 per month.

Rents rose 2.6 percent annually.

RENT TRENDS



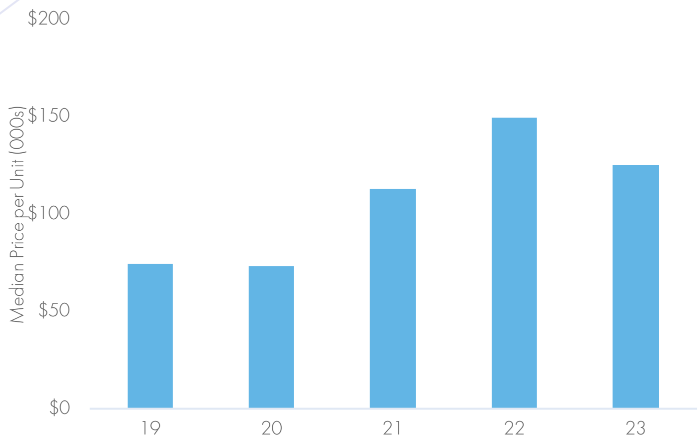
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- Transaction volume in the Tucson multifamily investment market remained limited in the closing months of the year, as elevated cap rates continued to hinder deals. Total sales activity in 2023 was down 77 percent from the previous year.
- The median sales price during the year was $125,400 per unit, a 17 percent decrease from 2022. The decline can be attributed to the high concentration of sales of Class C properties which made up 88 percent of transactions, compared to just over half of all sales in 2022.
- Cap rates held steady in recent months, averaging between 6 percent and 6.25 percent in the final three months of 2023.

The median sales price in 2023 was $125,400 per unit.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

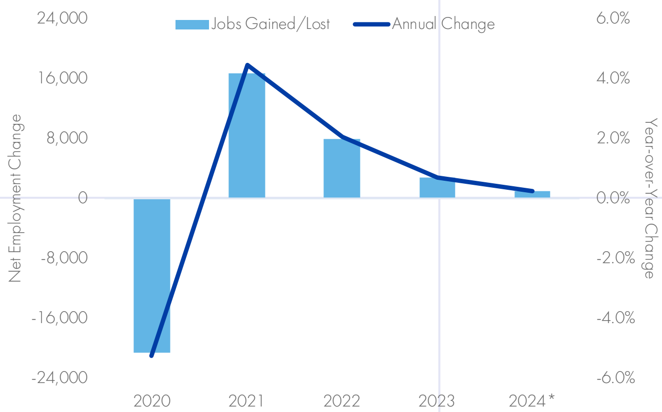
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
The Place at Spanish Trail	8601 E Old Spanish Trail, Tucson	256	$33,000,000	$128,906
Equinox on Pima	4399 E Pima St., Tucson	107	$14,500,000	$135,514

LOOKING AHEAD

Following a year of rapid inventory growth, developers are on pace to deliver another 2,150 apartment units in Tucson in 2024, causing supply-side pressures in the local market to intensify. This will mark the highest two-year total of apartment completions in the market in more than 30 years. The new supply growth comes at a time when the pace of renter demand is likely to moderate. Absorption accelerated in 2023, but is forecast to cool in the coming year, with the local economy expected to post only minimal job gains. Area vacancy is expected to rise for the fourth consecutive year in 2024, although the rate is on pace to remain below levels that were recorded in the local market from 2011-2014. To this point, operators have been able to implement modest rent increases, and minimal gains could be achieved in 2024.

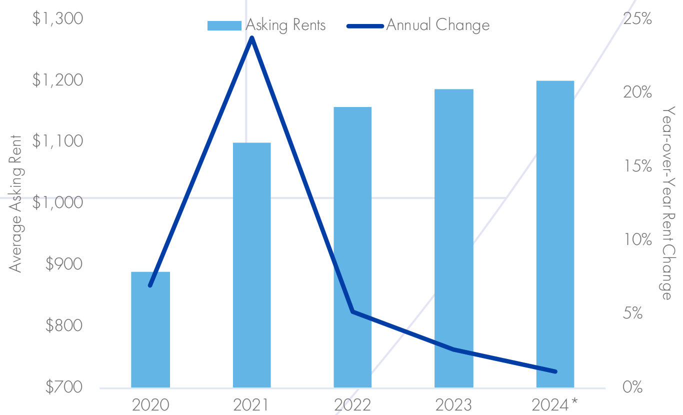
Investment activity in Tucson is likely to remain somewhat limited in the year ahead, although transaction volumes should bounce off of the lows that were recorded in 2023. During the past year, sales activity was limited almost entirely to older assets, but the transaction mix in 2024 should more closely reflect the market's overall product inventory. One traditional source of investment activity has not materialized in Tucson to date. Only a handful of the properties that have been delivered during the past decade have sold, although about 25 percent of those developments have been delivered since the beginning of 2022. While some developers are positioned to own and operate recent developments, others may be waiting for a more favorable sales environment to list assets after stabilization.

EMPLOYMENT FORECAST



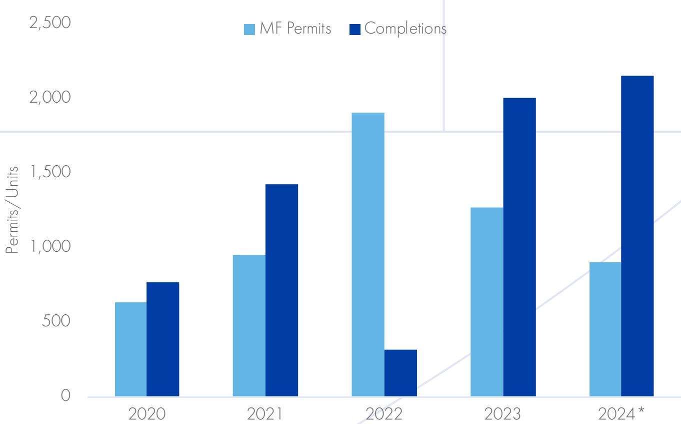
** Year End Forecast*
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



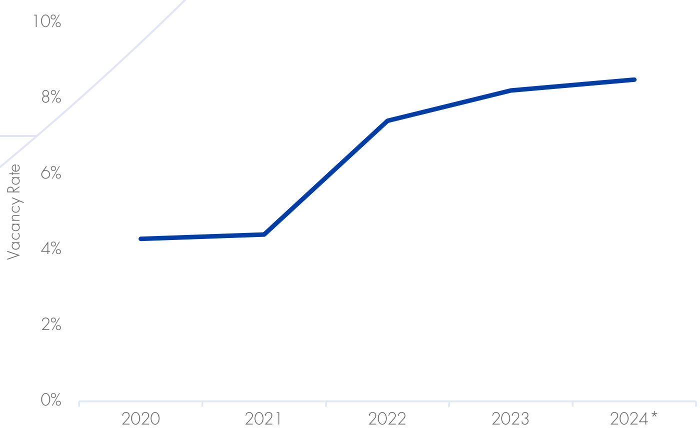
** Year End Forecast*
Sources: Northmarq, Apartment Insights

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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