Market Insights

Greater Tucson Multifamily 3Q 2021

Northmarq

Construction Activity

1,346

Units under construction

1,325

Units delivered (YTD)

Market Fundamentals

4.1%

Vacancy

-40bps | Year over year change

$1,053

Asking Rent

+21.5% | Year over year change

Transaction Activity

$97,300

Median sales price per unit (YTD)

5.0% | Cap rates (YTD)

With Vacancies Low and Demand Elevated, Rents Spike

Highlights

- The Tucson multifamily market posted continued improvement during the third quarter. The vacancy rate fell even as developers continued to bring new units to the market. Fueled by tightening vacancy rates and continued renter demand, rents remained on a steep upward trajectory.
- Vacancy dropped 30 basis points during the third quarter with the rate falling to 4.1 percent. Year over year, area vacancy is down 40 basis points, with a minor decline likely in the fourth quarter.
- Apartment rents in Tucson continued to surge during the third quarter, advancing 6.1 percent after an 8.5 percent spike in the second quarter. Rents have increased 21.5 percent year over year, ending the third quarter at $1,053 per month.
- The pace of multifamily property sales accelerated during the third quarter, spiking 20 percent from levels recorded in the second quarter. Prices are on the rise, with the median price reaching $97,300 per unit year to date, while cap rates have averaged approximately 5 percent.

Tucson Multifamily Market Overview

The Tucson multifamily market posted healthy levels of net absorption and a vacancy rate that approached an all-time low during the third quarter. These forces combined to fuel another sharp rise in rents, which advanced more than $50 per month during the third quarter and are up nearly $200 per month from one year ago. Renter demand for units is sparking the rent increases; the most recent period marked the fifth consecutive quarter of positive net absorption in the Tucson area. Developers are bringing new projects online to meet rising demand. Apartment construction is on pace to reach a 25-year high in 2021; even with this significant inventory growth, the vacancy rate is forecast to post a modest decline this year.

Improving property fundamentals have contributed to a healthy pace of transaction activity in the Tucson multifamily market for the past several years, and the investment market gained momentum during the third quarter. More properties traded at higher prices in the third quarter, as investors have become more aggressive, and competition for assets has intensified. While a few newer properties have changed hands in recent months, the bulk of the sales activity has been occurring in 1980s- and 1990s-vintage Class B properties. The median price in these types of properties has reached nearly $150,000 per unit, up from less than $90,000 per unit in 2019.

Employment

- Employment in Tucson is bouncing back; year over year through the third quarter, local employment has expanded by 5.6 percent with the addition of over 20,000 jobs. It will likely take another quarter or two of gains for total area employment to return to pre-COVID levels.
- Education and health services is one of the largest employment sectors in Tucson and has recorded steady gains. In the past year, the sector has expanded by 4 percent with the addition of more than 2,500 jobs.
- Imperial Brown, a manufacturer of walk-in coolers and freezers for commercial kitchens, is opening a plant in Tucson, creating about 100 new jobs. The new facility will be the company's fourth plant near the Tucson airport when it opens in 2023.
- **Forecast:** Employers are on pace to add approximately 21,000 jobs this year, a growth rate of more than 5.5 percent.

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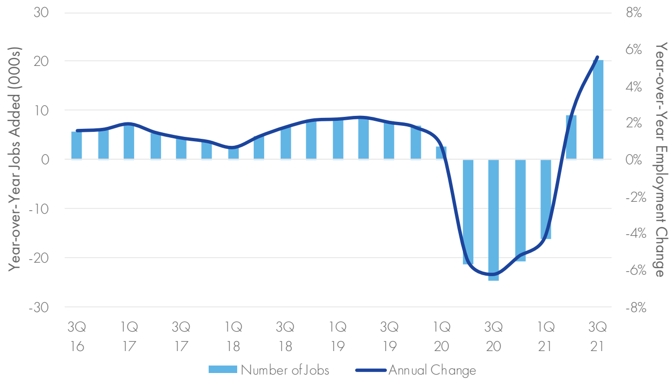
Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

Development and Permitting

- The pace of multifamily development activity is accelerating in response to consistently strong renter demand. Developers completed projects totaling 560 units during the third quarter, bringing completions through the first three quarters of this year to 1,325 units.
- Projects totaling nearly 1,350 units were under construction in Tucson during the third quarter, similar to levels from one year ago. While many of the projects that have been delivered in recent years have been located in close-in submarkets, many of the largest projects currently under construction are in outlying submarkets in Southeast Tucson or Northwest Tucson.
- With renter demand high and vacancy low, permitting is gaining momentum. During the first nine months of 2021, developers pulled permits for approximately 640 multifamily units, a 24 percent increase compared to the same period one year ago.
- **Forecast:** Projects totaling more than 1,700 units are forecast to be delivered in 2021, more than doubling the number of units that came online in 2020.

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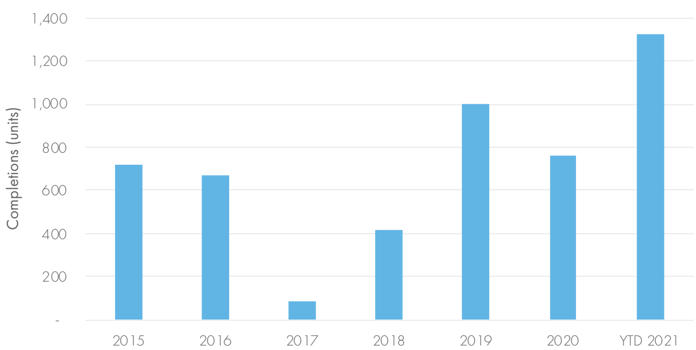
Development Trends



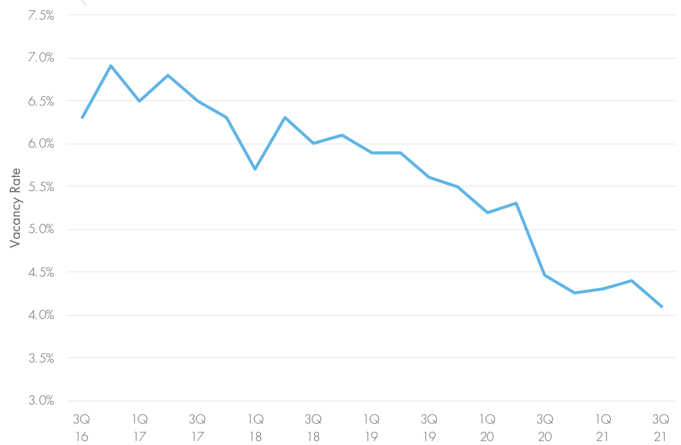
Sources: NorthMarq, Apartment Insights

Vacancy

- After inching higher during the first half of 2021, vacancy in Tucson fell in the third quarter even as the pace of new deliveries accelerated. The rate dipped 30 basis points in the third quarter, retreating to 4.1 percent. Vacancy has tightened 40 basis points year over year, and the current rate is the lowest figure in the Tucson market in more than a dozen years.
- Vacancy in the University submarket has stabilized, following a period of inconsistent demand due to mostly online learning at the University of Arizona during the previous school year. Vacancy in the University submarket tightened to 4.4 percent in the third quarter, after averaging 8 percent since the beginning of 2020.
- Year to date, net absorption has totaled nearly 1,200 units, up 12 percent from the same period in 2020. Renter demand for apartment units has been fairly consistent since 2014, averaging 950 units per year.
- **Forecast:** Vacancy is forecast to end 2021 at 4 percent, down 30 basis points from one year earlier.

> Vacancy has tightened 40 basis points year over year.

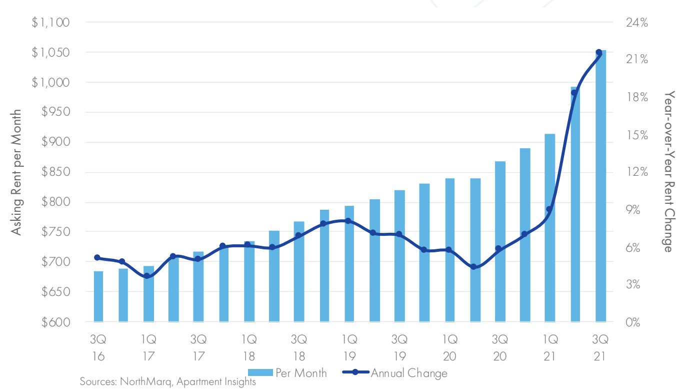
Vacancy Trends



Sources: NorthMarq, Apartment Insights

> Local rents have advanced 21.5 percent year over year to $1,053 per month.

Rent Trends



Sources: NorthMarq, Apartment Insights

Rents

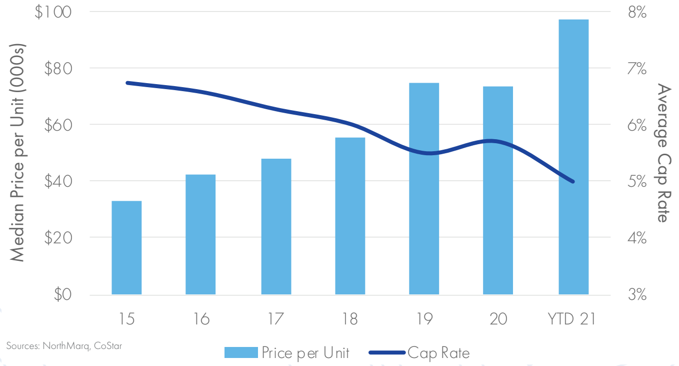
- Rents surged during the third quarter, building on rapid gains recorded during the preceding three months. Rents rose 6.1 percent in the third quarter, following an 8.5 percent spike during the second quarter.
- Local rents have advanced 21.5 percent year over year to $1,053 per month as of the third quarter. This marks one of the strongest annual rent increases in the country and the highest annual rent spike on record in Tucson.
- Class A properties have posted the most impressive rent growth of any class type in the area. Rents in Class A units are averaging nearly $1,900 per unit, a year-over-year increase of 24 percent.
- **Forecast:** Rents are forecast to end the year at approximately $1,066 per month, a 20 percent expansion from the end of 2020.

Multifamily Sales

- Investors are stepping up acquisition activity levels in Tucson as property fundamentals improve. Sales velocity increased by 20 percent from the second quarter to the third quarter. Year to date, total sales activity has closely tracked levels recorded during the first nine months of 2020.
- Pricing in 2021 has pushed higher to reflect the increase in demand. The median sales price year to date has been $97,300 per unit, almost 30 percent higher than the median price in 2020.
- Cap rates in Tucson have compressed as investor demand has intensified. Thus far in 2021, cap rates have averaged approximately 5 percent, down 70 basis points from one year earlier.

“ Cap rates have averaged approximately 5 percent.

Investment Trends



Sources: NorthMarq, CoStar

Recent Transactions

Multifamily Sales Activity

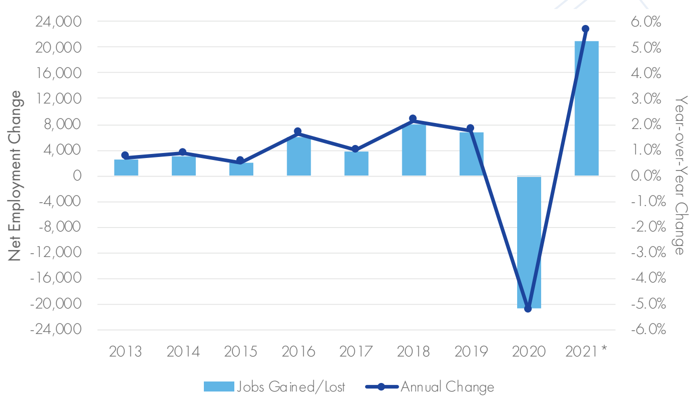
Property Name	Street Address	Units	Sales Price	Price/Unit
Encantada Riverside Crossing	1925 W River Rd., Tuscon	304	$92,750,000	$305,099
Villas de la Montaña	4880 E 29th St., Tuscon	332	$32,800,000	$98,795
Tierra Hills Apartments	3350 W Valencia Rd., Tuscon	232	$25,000,000	$107,759
Sierra Pointe Apartments	2350 E Water St., Tuscon	84	$7,700,000	$91,667

Looking Ahead

The Tucson multifamily market is expected to continue to record strong performance during the next several quarters. One significant step to stabilizing renter demand for apartments was the resumption of in-person classes at the University of Arizona. After heightened vacancy in the rental properties in the University submarket over the past year, the rate returned to historical levels during the third quarter and is expected to remain tight. Outside of that one submarket, the rest of the Tucson market has been thriving for the past several years, and additional gains are anticipated through the remainder of this year and into 2022.

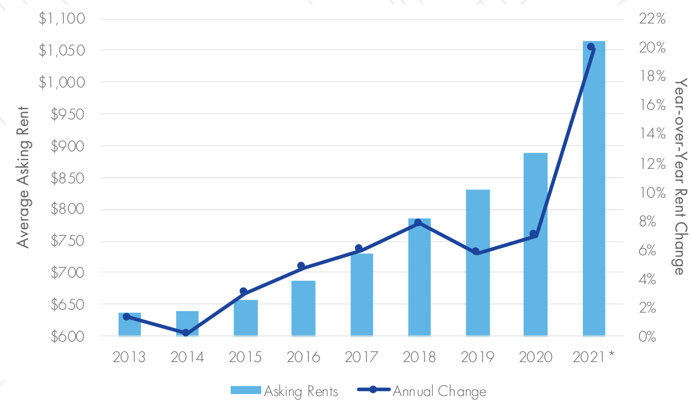
Investment activity in Tucson is forecast to remain on a mostly steady pace in the coming periods. While transaction activity in most markets recorded a slowdown in 2020 and a surge in sales in 2021, the Tucson market has maintained a consistent volume of sales since 2017. That trend is expected to continue at least through the remainder of this year. Local private capital investors are still playing a large role in the market, but there has been a surge in larger institutional-grade transactions in recent years, reflecting the increased renter demand for local properties. Sales topping $25 million have accounted for nearly half of all transactions this year.

Employment Forecast



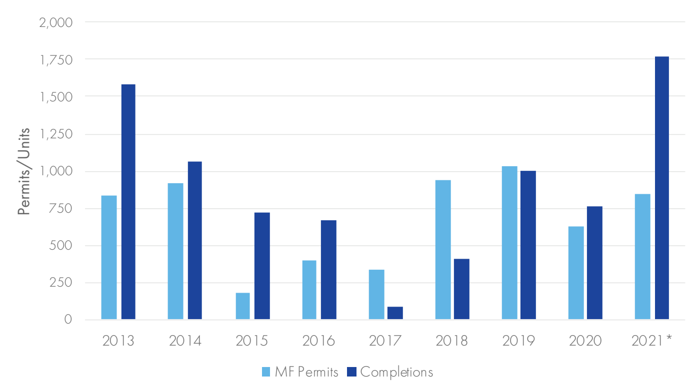
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



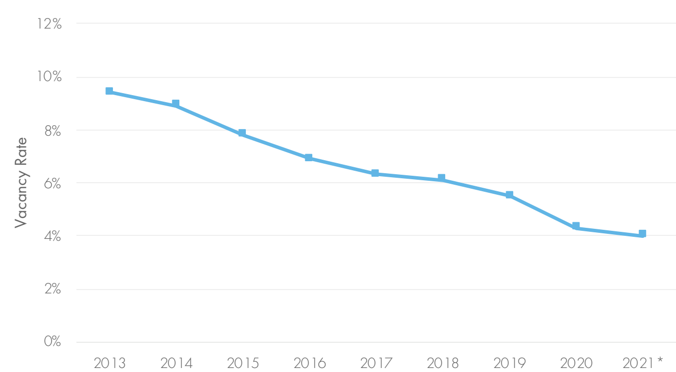
* Year End Forecast
Sources: NorthMarq, Apartment Insights

Construction & Permitting Forecast



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

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Apartment Insights

Northmarq

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