Northmarq

MARKET INSIGHTS

Transaction activity slows, but large sales continue

CONSTRUCTION ACTIVITY

UNDER CONSTRUCTION	2,841
UNITS DELIVERED	312

MARKET FUNDAMENTALS

VACANCY RATE	7.4%
YEAR-OVER-YEAR CHANGE	+300bps
ASKING RENTS	$1,157
YEAR-OVER-YEAR CHANGE	5.2%

TRANSACTION ACTIVITY (YTD)

MEDIAN PRICE PER UNIT	$149,700

Tucson Multifamily
4Q 2022

HIGHLIGHTS

- Operating conditions in the Tucson multifamily market softened during the fourth quarter, as asking rents decreased for the first time in roughly seven years, and local vacancy spiked. Renter demand in 2022 was slightly negative, after absorption totaled approximately 1,150 units in 2021.
- After tightening for the past few years, area vacancy was on an upward trajectory in 2022. The rate trended higher for the fifth consecutive quarter in the final three months of the year. Vacancy rose 110 basis points in the fourth quarter, reaching 7.4 percent. Year over year, the rate spiked 300 basis points.
- As vacancies continued to push higher, operators brought rents lower. During the fourth quarter, asking rents decreased by less than 1 percent to $1,157 per month. Despite the recent dip, rents still advanced 5.2 percent in 2022.
- Transaction volume in the last three months trailed levels recorded during the previous quarter. Prices continued to push higher as the median sales price for 2022 reached $149,700 per unit, up 32 percent from the median price last year.

TUCSON MULTIFAMILY MARKET OVERVIEW

The Tucson multifamily market cooled in recent months, as the vacancy rate spiked, and average rents declined for the first time since 2015. Despite softening property fundamentals, the number of projects in the development pipeline continued to swell, reaching a cyclical high during the fourth quarter, with approximately 2,840 units under construction. Although apartment developers have several projects underway, no significant deliveries have been completed since the first quarter. Instead, a handful of developments that were originally on pace to come online in 2022 were eventually pushed back and should be completed in the coming year. Local vacancies rose swiftly during the fourth quarter, as absorption levels continued the cooling trend that had been in place for much of 2022.

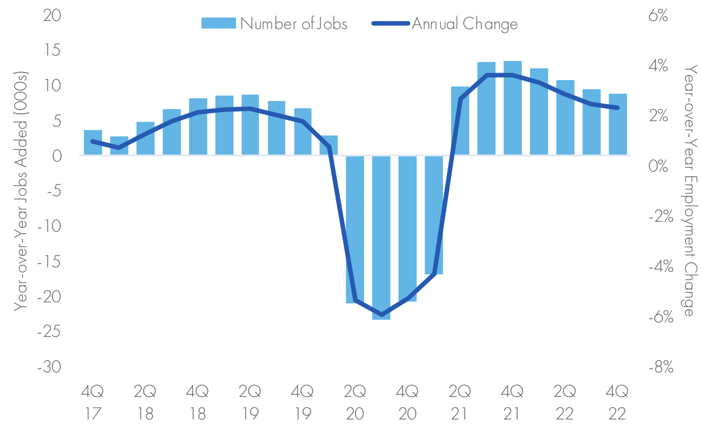
The Tucson investment market recorded a mixed performance during the fourth quarter, as elevated interest rates impacted activity and cap rates in transactions that closed throughout the region. Sales velocity continued to slow during the fourth quarter, falling 50 percent from levels recorded during the third quarter. Further, transaction activity for the full year was down 35 percent from the pace set in 2021. Despite the pace of transactions, prices continued to trend higher. The median price in 2022 reached $149,700 per unit, up 32 percent from the prior-year figure. While prices contracted throughout much of the country late in the year, pricing in Tucson held fairly steady, buoyed by continued activity in large transactions.

EMPLOYMENT

- The Tucson labor market continued to expand, adding approximately 8,800 jobs in 2022, a 2.3 percent growth rate. Gains were healthy in the fourth quarter with employers adding 3,300 net new jobs.
- The education and health services sector recorded rapid growth in 2022 and has been outperforming the overall labor market in recent years. This industry expanded by 6.6 percent in the past year and grew by 2,400 workers.
- Utah-based American Battery Factory, a battery cell manufacturer, recently selected Tucson as the company's official headquarters, which will also serve as its first gigafactory site. Upon completion in 2024, the 267-acre site at Aerospace Research Campus in the Southeast submarket will eventually accommodate more than 1,000 employees.
- **FORECAST:** After healthy job growth in each of the past two years, the labor market in Tucson is projected to slow during the next 12 months. Area employers are forecast to add about 2,000 jobs in 2023, an annual gain of 0.5 percent.

Area employers are forecast to add about 2,000 jobs in 2023.

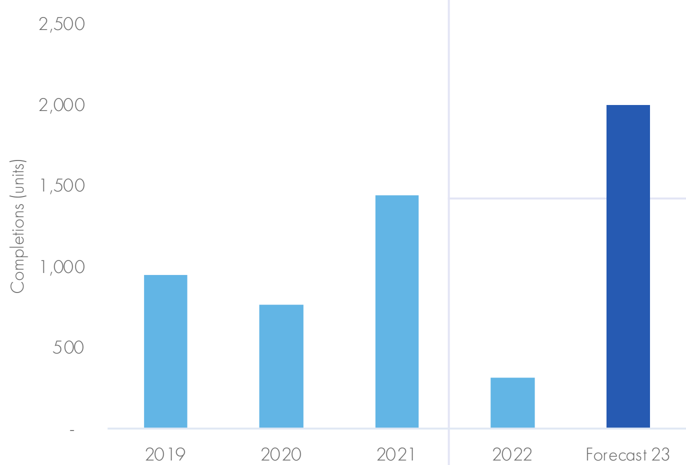
EMPLOYMENT OVERVIEW



Sources: Northmarq, Bureau of Labor Statistics

More than 310 units were delivered during the past year.

DEVELOPMENT TRENDS



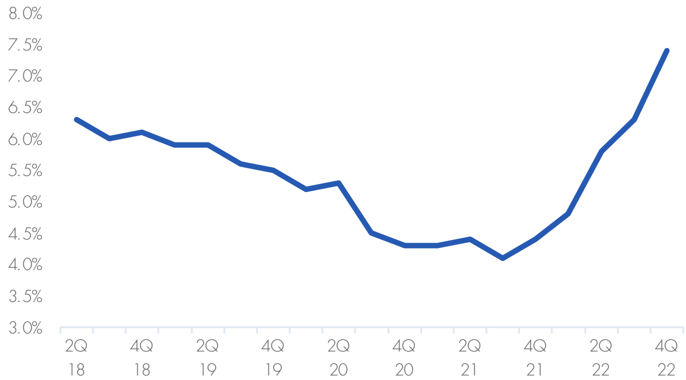
Sources: Northmarq, Apartment Insights

DEVELOPMENT & PERMITTING

- Multifamily development activity has been minimal in recent periods, as no significant projects have come online since the first quarter of 2022. More than 310 units were delivered during the past year, down from an average of nearly 740 units per year from 2017 to 2021.
- Developers have been active in moving new projects into the construction pipeline. Projects totaling approximately 2,840 units are currently under construction, more than double the levels recorded one year ago.
- Permitting trends were mixed in 2022. Developers pulled permits for approximately 1,700 multifamily units in 2022, up 78 percent from the prior year. Activity cooled in the final few months of the year, with permits for only 230 multifamily units issued during the fourth quarter.
- **FORECAST:** Developers are forecast to deliver projects totaling approximately 2,000 new apartment units in 2023, more than doubling the region's long-term annual average for new construction.

The average Class A vacancy ended 2022 at 5.8 percent.

VACANCY TRENDS



Sources: Northmarq, Apartment Insights

VACANCY

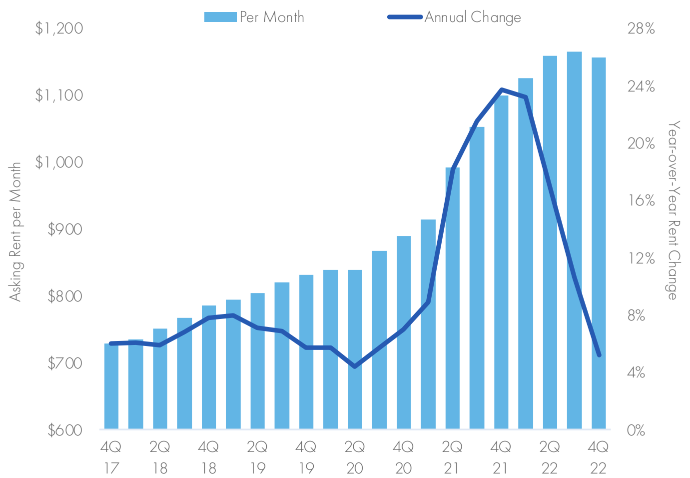
- Absorption levels fell sharply in recent quarters, causing the local vacancy rate to spike at the close of the year. Vacancy rose 110 basis points in the last three months of 2022, reaching 7.4 percent.
- After gradually trending lower for much of the past decade, the vacancy rate spiked 300 basis points in 2022. The rate reached a five-year low of 4.1 percent in 2021. Historically, vacancy in Tucson has generally ranged from 6 percent to 8.5 percent.
- Class A vacancy rates are often among the lowest in the region, in part due to a limited inventory of luxury units. The average Class A vacancy ended 2022 at 5.8 percent, up from 4.2 percent one year earlier. The Class A rate may trend higher in the year ahead as construction activity ramps up.
- **FORECAST:** Local vacancy is projected to continue trending higher in 2023, as new inventory is expected to outpace demand. Vacancy is forecast to rise 100 basis points in the next year, reaching 8.4 percent.

RENTS

- Following years of steady increases, average rents dipped less than 1 percent during the fourth quarter, closing the year at $1,157 per month. This marks the first quarterly rent decline in the region in more than seven years.
- Despite the recent dip, rents rose 5.2 percent in 2022. Annual rent growth averaged 5.7 percent from 2015 to 2020 before spiking in 2021.
- Asking rents for Class B properties inched higher in the fourth quarter after dipping in the previous period. The average rent in Class B properties ended 2022 at $1,279 per month, up 3.4 percent year over year.
- **FORECAST:** Asking rents are expected to inch higher in the coming quarters. Average rents are forecast to rise 2 percent in the year ahead, finishing 2023 at $1,180 per month.

Rents rose 5.2 percent in 2022.

RENT TRENDS



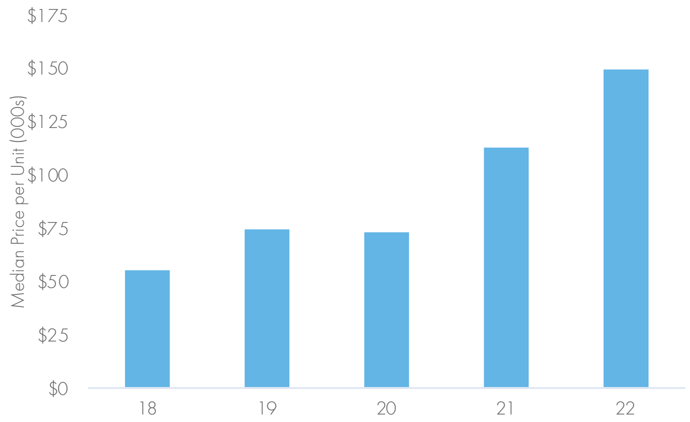
Sources: Northmarq, Apartment Insights

MULTIFAMILY SALES

- Multifamily sales velocity continued to slow during the fourth quarter, as transaction volume in the last three months fell 50 percent from the previous period. The total number of sales in 2022 finished the year down approximately 35 percent from 2021 levels.
- Despite fewer properties trading in recent months, prices continued to push higher. The median price reached $149,700 per unit through the end of 2022, up 32 percent from the median price last year. During the fourth quarter, the median price was approximately $151,400 per unit.
- Cap rates rose in the second half of the year. Most properties have been selling with cap rates between 4.5 percent and 5 percent since interest rates began to trend higher, after averaging closer to 4 percent in the first half.

The median price reached $149,700 per unit.

INVESTMENT TRENDS



Sources: Northmarq, CoStar

RECENT TRANSACTIONS MULTIFAMILY SALES ACTIVITY

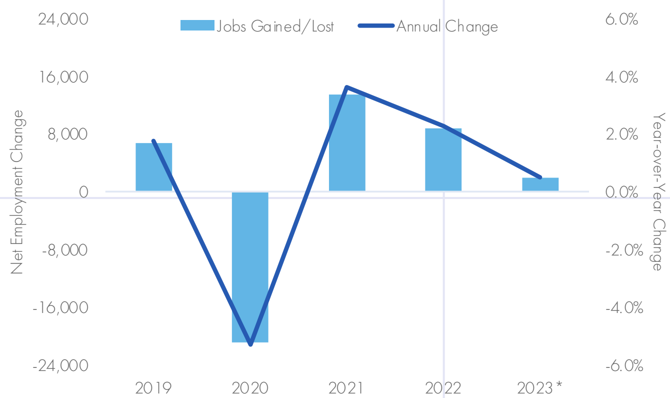
PROPERTY NAME	STREET ADDRESS	UNITS	SALES PRICE	PRICE/UNIT
Sol y Luna	1020 N Tyndall Ave., Tucson	341	$203,000,000	$595,308
Villas Las Toronjas II	6821 E Broadway Blvd., Tucson	279	$42,500,000	$152,330
Elevate Apartments	550 S Camino Seco Rd., Tucson	144	$21,800,000	$151,389
Dakota Canyon	6201 E Pima St., Tucson	80	$9,500,000	$118,750
Tierra Alegre	3355 E Fort Lowell Rd., Tucson	72	$8,500,000	$118,056

LOOKING AHEAD

The year ahead is expected to be one where new supply growth exceeds the pace of new renter household formation in Tucson. The pace of deliveries should pick up in the coming quarters. Roughly 2,000 units are forecast to be completed in 2023, most of which will be delivered during the first half of the year. The primary result of the increasing development levels will be a rise in the local vacancy rate, which had tightened for nearly a decade before trending higher beginning in 2022. Although vacancy rates will likely push higher, rents should post a modest advance. Part of the increase will be a result of newer, more expensive units entering the region's fairly small Class A inventory. Vacancy rates for Class A properties are the lowest in the Tucson metro area, allowing for some upward pressure on average rents as the new projects are delivered.

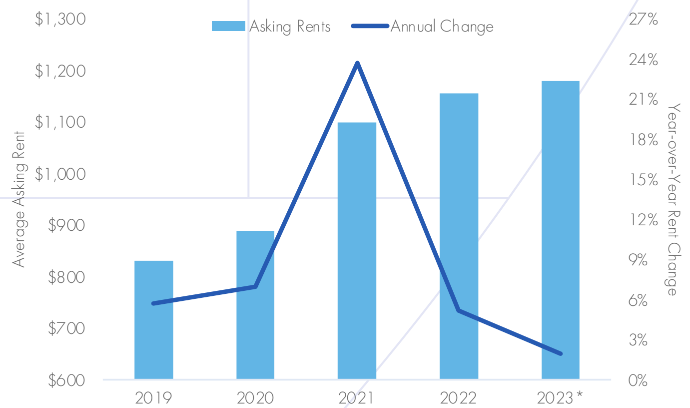
The investment market in Tucson is showing signs of adjusting to the higher interest rate environment, with cap rates increasing by nearly 100 basis points in the second half of 2022. In the new year, there could be some additional upward pressure on cap rates, but the bulk of the increase has likely already occurred. With construction activity on the rise, investors will pay particular attention to the competitive impact of new supply in the market, the rate of renewals in existing properties, and lease-up in new projects. The delivery of new construction could also generate additional transaction volume, but that will likely not occur until 2024. Buyers in the Tucson multifamily market have shown a preference toward larger transactions during the past 12 months, a trend that should continue.

EMPLOYMENT FORECAST



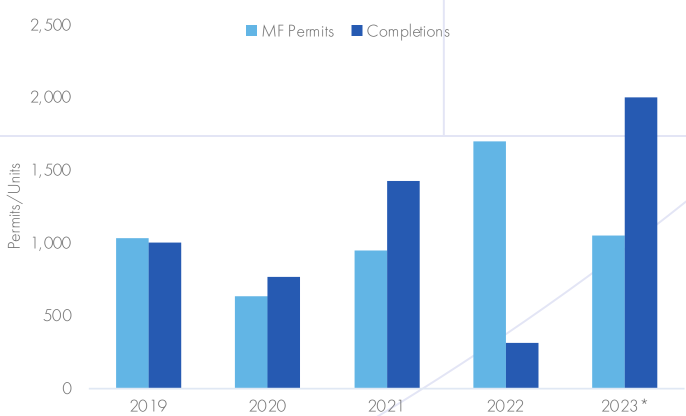
* Year End Forecast
Sources: Northmarq, Bureau of Labor Statistics

RENT FORECAST



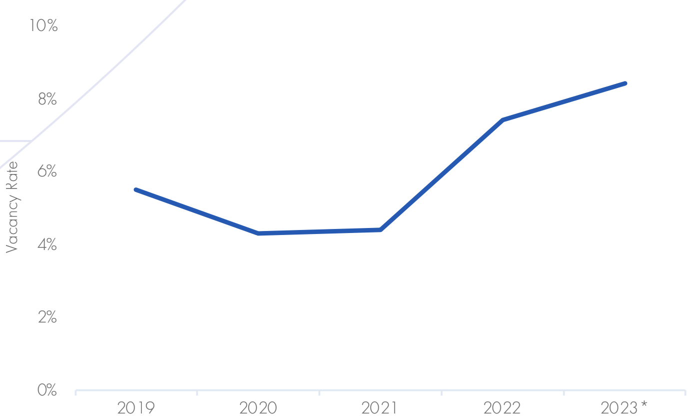
* Year End Forecast
Sources: Northmarq, Apartment Insights

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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