MARKETBEAT

TUCSON

Multifamily Q1 2023

	YOY Chg	12-Mo. Forecast
7.49% Vacancy Rate	▲	▲
563 New Deliveries, units	▼	▲
$1,164 Effective Rent, Per Unit	▼	▬

(Overall, All Property Classes)

ECONOMIC INDICATORS Q1 2023

	YOY Chg	12-Mo. Forecast
398.4K Tucson Employment	▲	▲
3.9% Tucson Unemployment Rate	▲	▲
$63.4K Tucson Median Household Income	▲	▲

Source: BLS, Census Bureau

Source: apartmentinsights.com

Tucson Economy:

In the first quarter of 2023, the US economy demonstrated higher than expected job growth. With robust hiring each month, somewhat tempered in March at 236,000 jobs, the labor market showed remarkable resilience. Job growth in a tight labor market is expected to drive the next interest rate hike from 25 to 50 basis points. Focusing on Arizona and the Tucson MSA, upward revisions in employment data for 2021 and 2022 reflected a healthy regional economy. Tucson's nonfarm employment rose from 392.5k in Q1 2022 to 398.4k in Q1 2023, while the unemployment rate increased from 3.4% to 3.9%. The consumer price index dropped for an eighth straight month to 5.7, and Tucson's outlook remained positive, with median household income up 3.6% year-over-year and population growth at a steady pace.

Market Overview:

Tucson's average vacancy rate increased 0.03% to 7.49% in Q1 2023, representing a 2.64% decrease YOY. The Tucson market's leasing activity slowed as the new year turned, but towards the end of the first quarter picked back up velocity. The average gross apartment rent without utilities increased $7 (.61%) from Q4 2022 to $1,164 per unit/$1.53 per square foot (sf). Of completed transaction in the quarter, only one was larger than 40 units, an alarming sign of the drastic slowdown in sales volume in the 40+ unit market for apartments. The subject property, 52 units built in 2000, sold for $8,800,000 ($169,231 per unit/$188.03 per sf.)

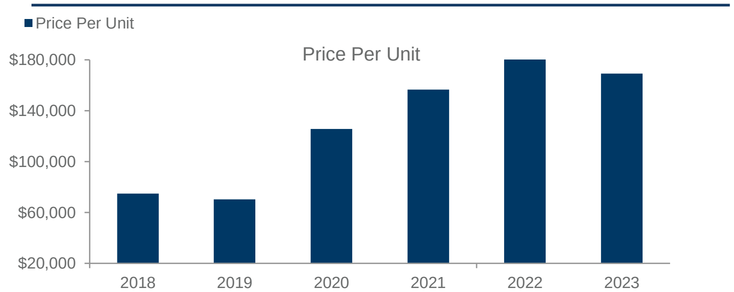
Rents and Lease-up Duration:

The beginning of 2023 saw slower leasing than expected. Managers are reporting lower demand for apartment across all submarkets. We attribute this to an adjustment to rapid rent inflation in Tucson, expected to pull back slightly throughout the remainder of the year. Apartment Insights reports on 15 submarkets, of which five recorded gross rents above $1,400/unit. From Q1 2022, Tucson's average gross rent rose $38/month, a 3.37% increase. During the first quarter, gross rents increased in eight submarkets, with a high of $164 in Southeast Tucson (primarily due to one major, new luxury property) and a $49 increase in the Southwest submarket. Average gross rents fell in six submarkets, with the highest drop of $24 (-2.40%) occurring in the Flowing Wells submarket.

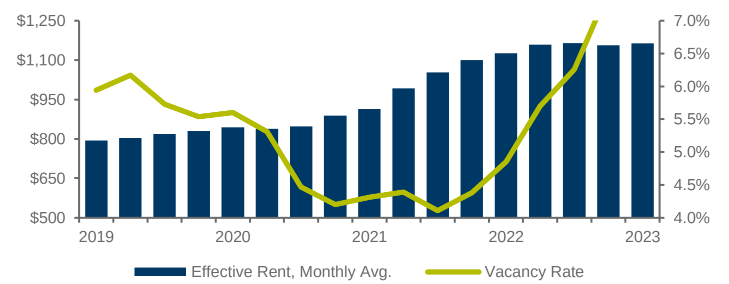
Supply vs Demand:

In the Tucson MSA the available market supply of apartment units has increased, while the demand for those assets has softened. Potential buyers show concern over increasing interest rates and other economic factors. When evaluating the trends for 2023, there is clear indication that overall vacancy holding strong, which puts Tucson's market in a competitive position for renters. Cited rent increase trends will continue as we enter Q2. Owners with pricing expectations based on activity in 2022 will need to adjust to current values and market conditions. While Q1 2023 saw considerably fewer sale transactions than recent trend, we forecast an increase in the months ahead provided that the gap closes between sellers' expectations and purchasers' willingness to pay.

SALE PRICE PER UNIT



OVERALL VACANCY & EFFECTIVE RENT



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Multifamily Q4 2022

MARKET STATISTICS

SUBMARKET*	INVENTORY (UNITS)	VACANCY RATE	YOY VACANCY RATE CHANGE	AVG EFFECTIVE RENT/UNIT	AVG EFFECTIVE RENT PSF	YOY % EFFECTIVE RENT GROWTH
Oro Valley/Catalina	2,615	6.27%	-39.07%	$1,568	$1.63	-4.33%
Northwest	8,695	7.05%	-34.75%	$1,447	$1.55	1.5%
Catalina Foothills	5,726	5.78%	-44.11%	$1,205	$1.57	-1.71%
Northeast	1,987	7.95%	-59.49%	$1,455	$1.50	1.04%
East	8,221	7.79%	-41.33%	$1,074	$1.44	6.05%
North Central	8,197	8.32%	-38.82%	$981	$1.42	4.83%
Flowing Wells	8,644	8.72%	-33.14%	$976	$1.58	5.25%
Foothills	3,780	6.02%	-30.39%	$1,321	$1.63	12.63%
University	4,509	4.75%	-12.3%	$1,221	$1.93	3.4%
South Central	6,595	6.93%	-18.75%	$965	$1.47	1.51%
Pantano/Lakeside	5,412	9.10%	-44.39%	$1,070	$1.51	16.7%
South/Airport	6,165	7.32%	-43.44%	$1,076	$1.68	3.77%
Southwest	2,415	7.85%	-29.80%	$1,072	$1.47	3.63%
Southeast	956	9.31%	-62.76%	$1,581	$1.52	43.83%
Market	**5,279**	**7.49%**	**54.43%**	**$1,215**	**$1.54**	**7.01%**

*Submarket Marana excluded from report due to low inventory

Source: apartmentinsights.com

Financing:

"Reflecting on Q1 2023; loan production was down 76% compared to 2022, as anticipated. This was driven by elevated cost of funds to the borrowers, widening the gap between buyer and seller expectations. With the increase in interest rates, leverage has been a continuing challenge. Demand for multifamily has kept values stable, however rent grow has been stagnant, further driving down supportable loan amounts. It is worth mentioning; while production was limited, 50% of the transactions in Q1 were purchase transactions. Q2 2023 reflects a shift in market sentiment. Loan production is expected to be at or above 2022 production levels comparatively YOY. We anticipate a marginal increase or plateauing of the Federal Funds rate in Q2 and expect some lender cost of funds relief by Q1 of 2024. The battle against inflation is tracking well, as we've seen for the 10th consecutive month a decrease in inflation percentage. While no investor/lender has a crystal ball into the future with interest rate prediction, having strong indicators to interest rate stability encourages better property analytics of investment real estate. Quality inventory and motivated sellers, Q2 2023 is pacing to be outstanding in terms of loan production. Multifamily has shown resilience in our Tucson market, low vacancies, modest rent compared to surround markets, lower price per door, and key growth factors bringing quality employment the area, keep investment activity strong."

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Outlook:

Tucson's multifamily investment market has shifted gears as we conclude Q1 2023, experiencing higher transaction volume in the 10-40 unit space. While many markets have been impacted by economic headwinds, people are still eager to purchase apartments despite a more conservative outlook with pricing. Financing has also become a large obstacle in the transaction process during the first quarter of this year. There are new developments in pipeline being constructed in Marana, Vail, and other prime fill-in locations. There is limited inventory for C class properties across the Tucson market which will keep its demand high as we enter Q2. Overall, rents will likely flatline this year due to the various vacancies and slower lease up. As cap rates continue to increase, cash buyers are likely to become competitive again, as they have been priced out of the market in recent years due to low cost of debt.

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