MARKET REPORT

Multifamily

Tucson Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

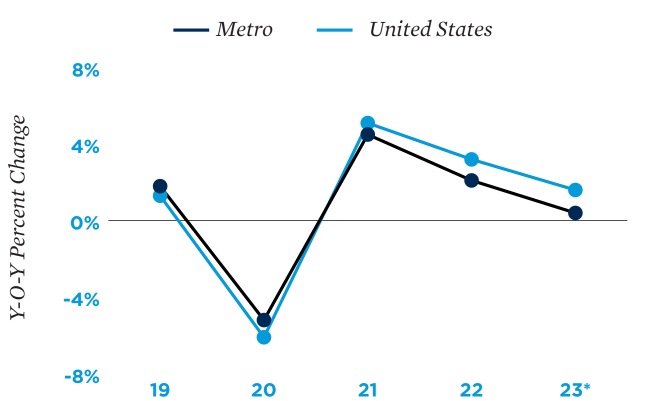
3Q/23

Elevated Homeownership Costs and Significant Hiring Plans Buoy Apartment Demand Prospects

Tight single-family market aiding Class A rental metrics. Over the 18 months trailing June, the difference between a typical monthly mortgage payment on a median priced home and the mean monthly rent for top-tier apartments in Tucson nearly doubled, rising to $1,060. Responding to elevated homeownership costs, a growing portion of locals are remaining in the renter pool for longer. This is most apparent in the Class A sector, with top-tier apartments recording the lowest rise in vacancy among class cuts during the past year. As a result, Tucson's top-tier metric was at least 50 basis points below other segments in June, after having the highest average rate among classes during the past three years. With the metro's single-family permitting activity also slowing to a half-decade low in early 2023, a notable lack of new housing inventory should continue to direct residents to Class A options long-term, benefiting performance in the segment.

Manufacturer hiring coincides with new West Tucson supply. In 2023, the submarket will feature the most apartment deliveries in the metro, with The Place at Silverbell Gateway and Cabana Bridges opening their first units in the final quarter. These complexes are expected to add a total 600 apartments to the area after being finalized in early 2024, growing local inventory by a record 7.5 percent. While this may push vacancy up near-term, American Battery Factory and Sion Power Corp. are expected to hire hundreds of skilled workers in the area through the end of 2026, supporting apartment demand.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.; RealPage, Inc.

Multifamily 2023 Outlook

1,500 JOBS
will be created

EMPLOYMENT:

The 0.4 percent employment growth rate for 2023 will be a decade-low, outside of a headcount reduction in 2020. Net gains over the first seven months were driven by the government sector, which added 4,420 roles.

800 UNITS
will be completed

CONSTRUCTION:

A 1.0 percent inventory expansion this year will double the long-term pace. West, Northwest and Central Tucson will comprise the bulk of new supply, as each is slated to host the delivery of more than 200 units in 2023.

180 BASIS POINT
increase in vacancy

VACANCY:

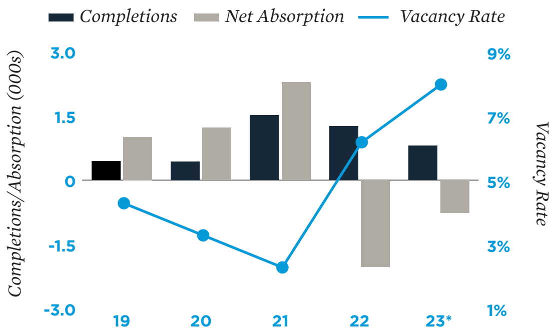
Vacancy will rise across the market to 8.0 percent overall in 2023. However, upward vacancy pressure should be less prevalent in submarkets along Tucson's east side. Deliveries will be nominal here during this year.

0.3% INCREASE
in effective rent

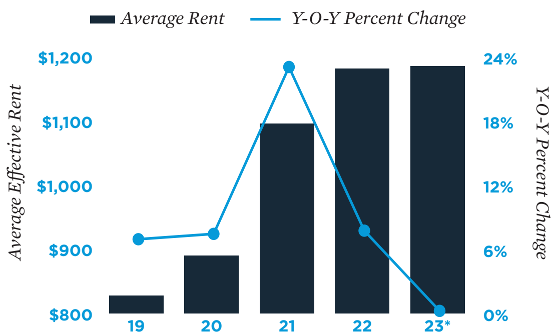
RENT:

By the end of 2023, the average effective rent in Tucson will reach $1,185 per month. This rate will represent a tick down from June's $1,202 figure, as new completions dampen recent rent momentum.

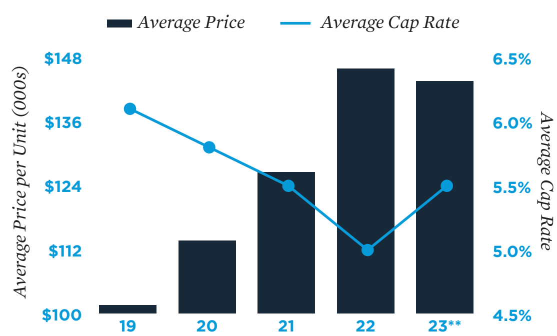
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

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Price: $250

2Q 2023 - 12-Month Period

CONSTRUCTION

455 units completed

- While the inventory growth rate of 0.5 percent during the year ended in June represented the lowest clip since 2020, the pace was roughly equivalent to Tucson's long-term average.
- Development over the past year was concentrated in Southeast Tucson, where about 160 units were completed.

VACANCY

310 basis point increase in vacancy Y-O-Y

- The three largest submarkets by inventory, East Tucson, Southeast Tucson and Central Tucson, each recorded vacancy increases over 240 basis points during the past year, lifting the marketwide rate up to 7.0 percent in June.
- Class A apartments noted the lowest vacancy climb among segments, as the sector's metric rose by 210 basis points to 6.6 percent.

RENT

3.2% increase in the average effective rent Y-O-Y

- An ease in construction activity has buoyed rent momentum over the past 12 months, pushing the average effective rate up to $1,202 per month.
- On average, apartments in Central Tucson reported 12.5 percent rent growth during the last year. This was the fastest pace recorded by any major western submarket outside of Los Angeles or San Diego during the span.

Investment Highlights

- The average cap rate over the year ended in June nudged up to 5.5 percent, ending a 13-year long span of declines. Historically elevated borrowing costs this year have widened lender spreads, putting downward pressure on property values and lifting cap rates. This trend has been most apparent in Central Tucson. Last year, assets here frequently traded at yields under 5.0 percent; whereas in 2023, apartment transactions in the area are mostly penciling in between 6.0 and 6.5 percent.
- Central Tucson has continued to be the focal point for trades over the first six months of 2023. Amid recent, abrupt rises in vacancy, some investors are placing greater emphasis on the University of Arizona as an apartment demand driver to anchor investments against further volatility. For this reason, many assets that have traded here this year have been in Rincon Heights, a neighborhood directly south of the university.
- Amid financing difficulties, trading activity for assets priced over $20 million has flattened in 2023. In fact, hardly any assets have traded over the $10 million benchmark, with active investors in Tucson mostly targeting sub-50-unit, pre-1970s-built apartments.