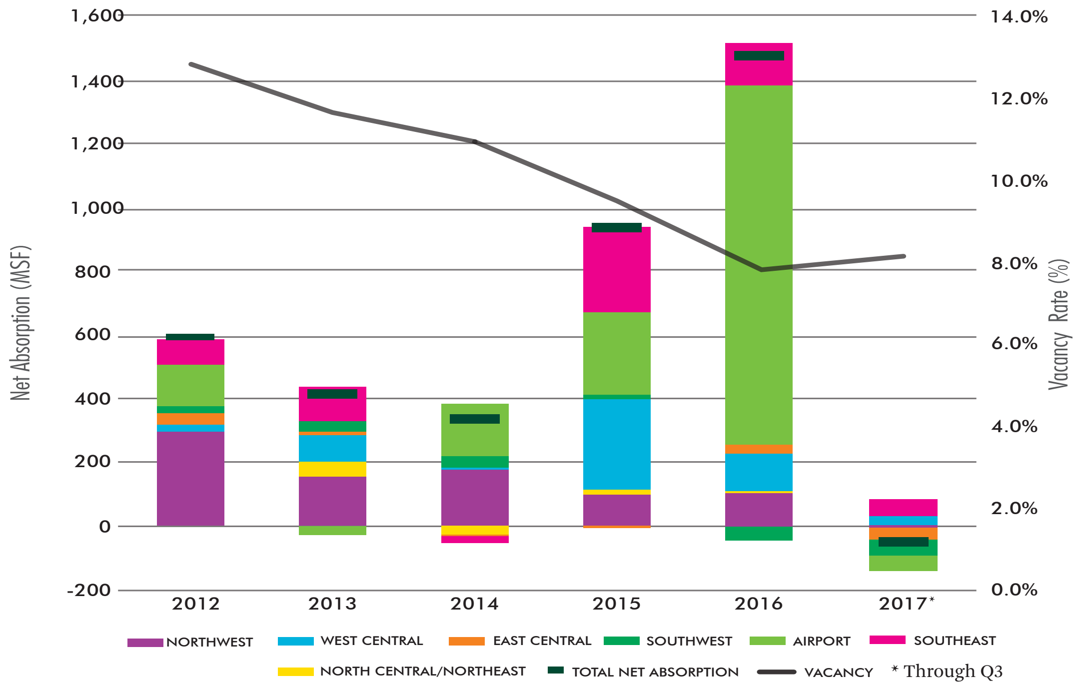
Tucson Industrial & Logistics, Q3 2017

Tucson industrial fundamentals mixed across submarkets

Vacancy	Rental Rate	Net Absorption	Under Construction
8.2%	$0.50 Per Sq. Ft.	16,362 Sq. Ft.	749,928 Sq. Ft.

*Trend arrows indicate year-over-year change. Data reflects market totals.

Figure 1: Net Absorption and Vacancy Rates



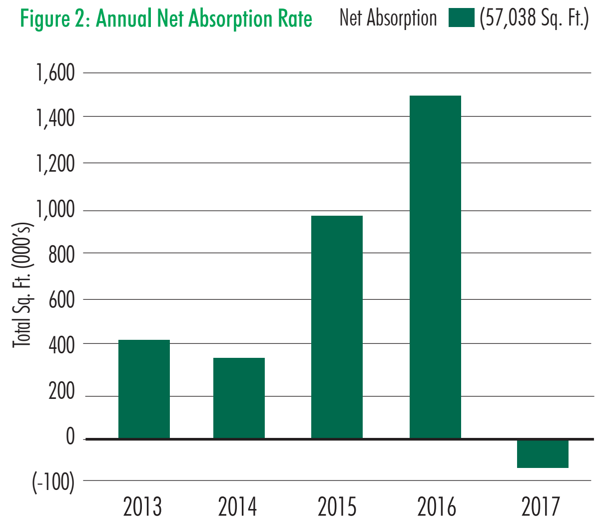
Tucson's industrial market finished the third quarter of 2017 with a mixed outlook. Year-to-date the market recorded negative net absorption of 57,038 sq. ft. However, the third quarter showed some improvement, with 16,362 sq. ft. of positive net absorption—marginally making up for the 66,142 sq. ft. of negative net absorption in the previous quarter. Marketwide vacancy was unchanged from the previous quarter as tenants shifted between submarkets.

Vacancy throughout the market remains bifurcated, and some submarkets weigh heavily on the market's fundamentals, though this is steadily improving. Submarkets in north and west Tucson have relatively-low vacancy rates below 5.0%; while vacancy in a few areas remains in the double-digits. In the Airport submarket (where a bulk of leasing activity occurred this quarter) vacancy stood above 14.0%. Nevertheless, the Airport submarket's vacancy has dramatically reduced since reaching a recessionary peak of 20.4%. The abundant supply of large and available space in the submarket will continue to attract manufacturing users. Furthermore, as advanced manufacturing and aerospace and defense industries continue to expand in Tucson, demand for large spaces in the Airport and Southeast submarket will build, relieving vacancy in those areas and marketwide.

NET ABSORPTION

The Tucson industrial market ended Q3 2017 with positive net absorption of 16,362 sq. ft., up from the 66,142 sq. ft. of negative net absorption recorded in the previous quarter. The Airport and Southeast submarkets posted the highest levels of net absorption in the third quarter, totaling 29,514 sq. ft. and 54,128 sq. ft., respectively. This was largely attributed to users such as Keystone Automotive Industries (120,000 sq. ft.), which expanded in the Airport submarket, and Arizona Laminate (15,489 sq. ft.), which moved from the Southwest submarket to the Southeast submarket. Meanwhile, the Southwest submarket recorded the highest negative net absorption during the period, totaling 36,189 sq. ft.

Figure 2: Annual Net Absorption Rate

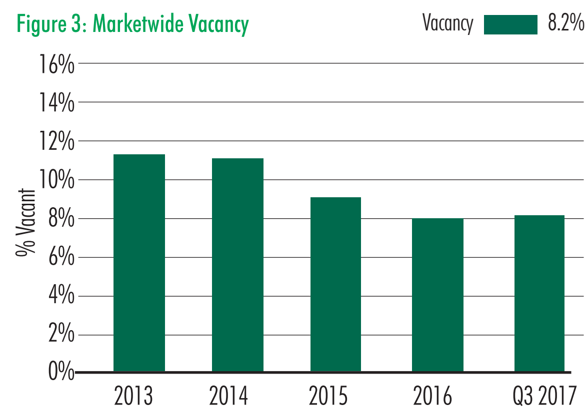


Source: CBRE Research, Q3 2017.

VACANCY

Tucson's marketwide vacancy rate remained flat quarter-over-quarter ending Q3 2017 at 8.2%. On a year-over-year basis, vacancy increased 40 basis points (bps). Half of the submarkets in the market posted annual improvements in vacancy. Additionally, three submarkets (North Central, Northwest and West Central) had vacancy rates below 5.0% and available space remains scarce. Over the past 12 months, healthy demand in the West Central and Southeast submarkets pulled down vacancy 170 bps and 40 bps to 4.4% and 7.3%, respectively. During the same period, the East Central and Northwest submarkets posted a 240-bps and 50-bps increase in vacancy to 9.2% and 3.6%, respectively.

Figure 3: Marketwide Vacancy

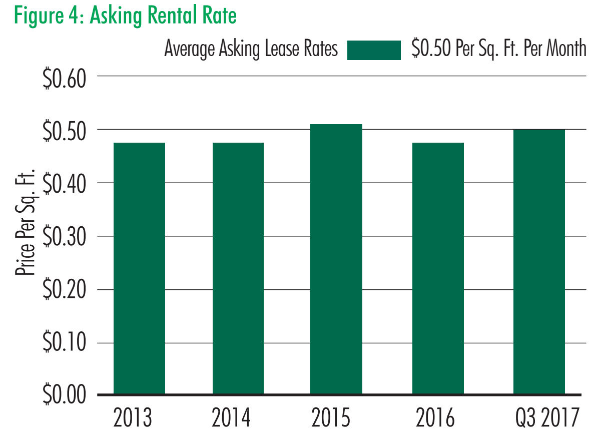


Source: CBRE Research, Q3 2017.

LEASE RATES

Tucson's average asking lease rate increased 4.2% from the previous quarter to $0.50 NNN per sq. ft. on a monthly basis. The Southeast submarket recorded the highest rent increase quarter-over-quarter, reflecting healthy demand in the area. Here, rent climbed 19.1% to $0.51 NNN per sq. ft. Over the same time span, average rent in the Northwest submarket—which has one of the lowest vacancy rates marketwide—increased 12.2% to $0.59 NNN per sq. ft. Meanwhile, the East Central submarket recorded a 8.2% decrease in average rent, falling to $0.40 NNN per sq. ft.

Figure 4: Asking Rental Rate



Source: CBRE Research, Q3 2017.

CONSTRUCTION

No new industrial product came online in the third quarter of 2017 or over the past 12 months. However, 749,928 sq. ft. is currently under construction. Activity is heavily concentrated in the Airport submarket, which accounts for two-thirds of all construction. This includes the largest project to break ground in the third quarter—the 300,181-sq. ft. build-to-suit (BTS) distribution facility for Chamberlain. In the Southeast submarket, construction continued on the rail-served warehouse at the Port of Tucson, which totals 238,743 sq. ft. and is expected to deliver in December 2017. Additionally, the 19,033-sq.ft. Switchgear Solutions warehouse remained under construction in the Northwest submarket and is scheduled for completion in Q4 2017.

An additional 260,232 sq. ft. of industrial space is in the planning pipeline. The planned projects include two speculative distribution centers with target delivery dates in 2018. Additionally, the University of Arizona has proposed a 120,000-sq. ft. expansion at The Bridges, which will consist of R&D space, that is currently in the design phase.

OUTLOOK

Tucson's employment growth was sluggish in the third quarter, rising 0.4% year-over-year in August.[1] While job gains typically slow in the summer months, metro employment growth was less than half of what it was compared with last year. However, employment is expected to gain some momentum and rise to 0.9% by year-end 2017.[2] Steady growth will support demand for industrial space amid sustainable levels of new supply. While limited, the majority of new supply consists of build-to-suit (BTS) projects that will support market fundamentals. As available space becomes more limited in high-demand areas such as the Airport and Southeast submarkets, rents are expected to rise.

Furthermore, heightened demand among e-commerce users for quality warehouse and flex space does not align with the available inventory in Tucson, making their search increasingly difficult. This should place short-term pressure on developers to deliver speculative developments that meet the needs of these tenants.

[1] Bureau of Labor Statistics, August 2017.
[2] University of Arizona, Economic and Business Research Center, 2017

Figure 5: Industrial Market Statistics

Submarket	Gross Rentable Area Sq. Ft. (±)	Vacancy Rate %	Availability Rate %	Q3 2017 Net Absorption Sq. Ft. (±)	Under Construction Sq. Ft. (±)	*Average Asking Lease Rate Monthly (NNN) $
Airport	9,436,670	14.2	18	29,514	492,161	0.59
East Central	1,161,300	9.2	12.3	(23,565)	0	0.72
North Central	1,124,817	1.4	1.4	8,674	0	0.56
Northeast	67,200	5.4	5.4	(1,200)	0	0.49
Northwest	6,720,801	3.6	4.3	(14,541)	19,033	0.40
Southeast	10,970,620	7.3	8.1	54,128	238,734	0.40
Southwest	2,188,922	12	12.8	(36,189)	0	0.51
West Central	4,886,450	4.4	6.2	(459)	0	0.51
Totals	**36,556,780**	**8.2**	**9.9**	**16,362**	**749,928**	**0.50**

*Lease rates are quoted as a triple net weighted average of all lease types based on asking price per square foot per month
Source: CBRE Research, Q3 2017.

Figure 6: Key Transactions

Size Sq. Ft. (±)	Tenant	Address
120,000	Keystone Automotive Industries	6000 S Country Club Rd.
68,721	SION Power	2900 Elvira Rd.
33,650	A&M Business Interior Services	505 E 17th St.
18,779	Machine Solutions Inc	3440 Britannia Dr.
15,489	Arizona Laminate	4617 S Contractors Way

Source: CBRE Research, Q3 2017.

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