

Tucson Industrial & Logistics, Q4 2017

Limited quality space leaves market constricted

Vacancy
8.1%

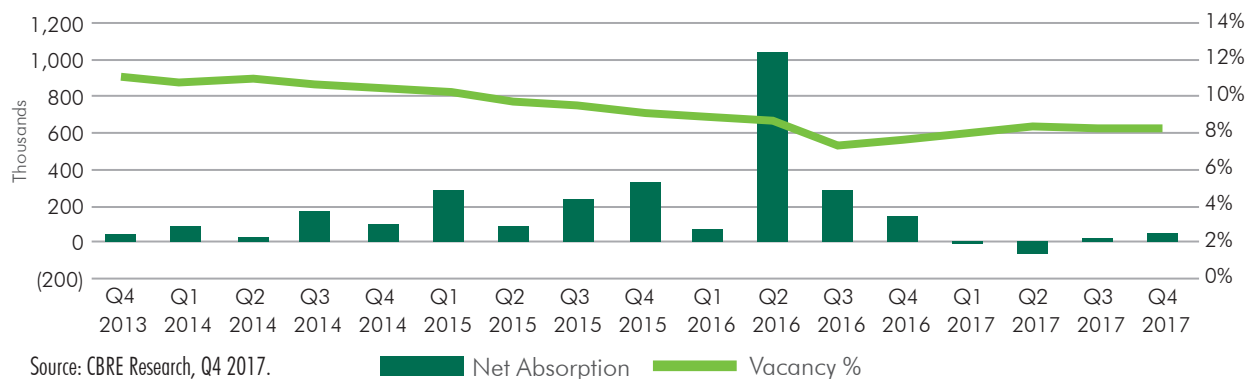
Rental Rate
\$0.50 Per Sq. Ft.

Net Absorption
42,866 Sq. Ft.

Under Construction
749,928 Sq. Ft.

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

Figure 1: Net Absorption and Vacancy



Tucson's industrial market performed well in the fourth quarter, registering 42,866 sq. ft. of net absorption. Despite a positive Q4, the market recorded 11,772 sq. ft. of negative net absorption for the full year. Quarter-over-quarter, vacancy ticked down 10 basis points (bps) and the average asking lease rate rose slightly to \$0.50 per sq. ft. triple net (NNN), marking a 6% increase year-over-year.

Performance was split throughout the market, by product type and geography. Warehouse space achieved the most significant decline in vacancy in the fourth quarter. Additionally, manufacturing space remains in high demand and is becoming increasingly difficult to find. Meanwhile, the Airport submarket has 1,316,146 sq. ft. in vacant space in the fourth quarter, which accounts for 44% of the market's industrial

vacancy. Half of this vacant space is manufacturing product, which is outdated and in need of major improvements. As the market tightens, this outdated remaining space may require a repurposed use to meet tenant demand in the submarket. Still, fundamentals improved in the most popular submarkets such as the Northwest and Southwest, where vacancy fell quarter-over-quarter by 30 bps and 80 bps, respectively.

The most active users this quarter included professional and financial service firms who leased out space for call centers. In addition, goods-manufacturing users in the healthcare and engineering industries were heavily active in the Southwest and Airport submarkets. Lastly, aerospace and defense firms continue to grow marketwide, generating additional demand for space.

NET ABSORPTION

Net absorption totaled 42,866 sq. ft. in Q4, adding to the 16,362 sq. ft. net absorption in the previous quarter. Despite positive activity in the second-half of 2017, the full year ended with 11,772 sq. ft. of negative net absorption. The Airport and Northwest submarkets recorded the highest levels of absorption during Q4 2017 with 23,390 sq. ft. and 26,699 sq. ft., respectively. This increase was due to tenants that expanded their space needs including Sunstreet Mortgage (14,635 sq. ft.) and new leases for Port Plastics (12,066 sq. ft.) in the Airport submarket. Several smaller transactions drove positive absorption in the Northwest submarket. These included Central Alarm Desert Telecom (9,000 sq. ft.) and Hamilton Distillers (8,000 sq. ft.) in Northwest Tucson. TuSimple took 50,400 sq. ft. in the Southeast submarket. Still, the Southeast submarket recorded 36,248 sq. ft. of negative net absorption.

VACANCY

In Q4 2017, Tucson's industrial vacancy rate slipped 10 bps quarter-over-quarter to 8.1%; however, on a year-over-year basis, vacancy ticked up 20 bps. All but two submarkets recorded a decrease in vacancy during the quarter. The East Central and Southeast submarkets posted the only increase in vacancy, bumping up 80 bps and 60 bps, respectively. Vacancy decreased the most in the Northwest submarket and West Central submarkets, declining 40 bps and 80 bps, respectively. This decrease is largely attributed to tenants seeking space in high-demand submarkets where there is an abundant supply of research and development (R&D) and distribution space.

LEASE RATES

Tucson's average asking lease rate rose to \$0.50 per sq. ft. NNN during Q4 2017, a 4.2% increase quarter-over-quarter. Over the past 12 months, average rents increased 6.4% marketwide. The East Central and Southeast submarkets recorded the greatest increase in asking rents, bumping up 5.0% and 5.9% quarter-over-quarter. The tight vacancy rates in these submarkets at or below the marketwide average has given landlords leverage to place upward pressure on asking rents.

Figure 2: Annual Net Absorption Rate

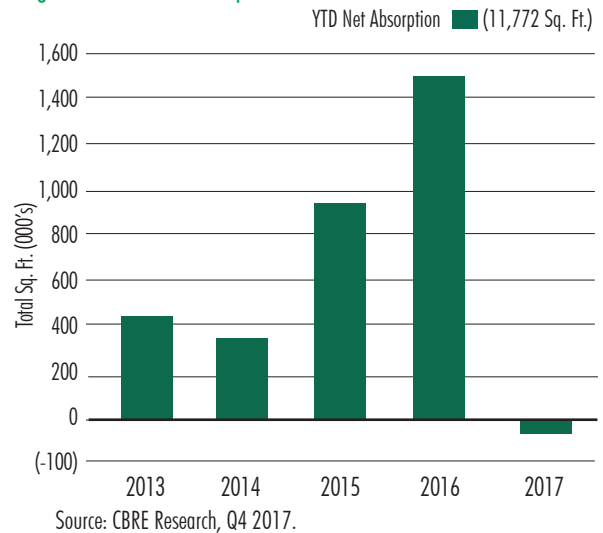


Figure 3: Marketwide Vacancy

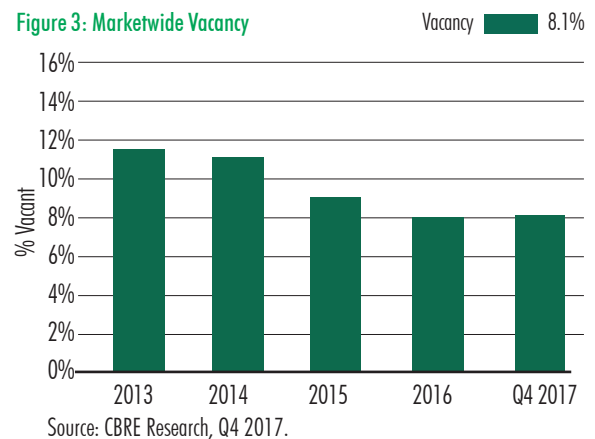
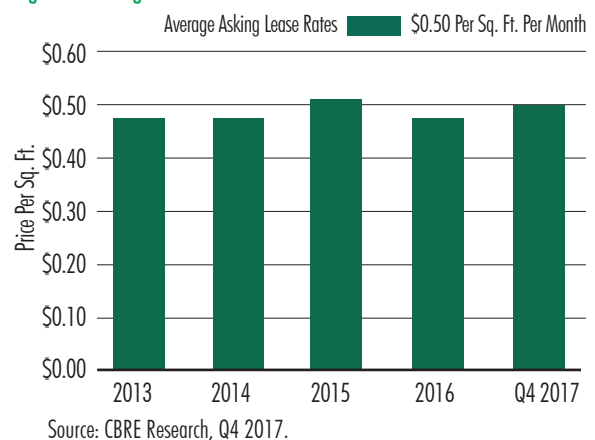


Figure 4: Asking Rental Rate



CONSTRUCTION

New construction remained muted during the fourth quarter as no new industrial space came online. Marketwide, 749,928 sq. ft. was under construction. A majority of the construction activity is concentrated in the Airport submarket with 492,161 sq. ft. underway. Meanwhile, in the Southeast submarket, the Port of Tucson—a 238,734 sq. ft. rail-served warehouse facility—remains under construction with a completion date slated for the first half of 2018. Construction also continues on the 19,033-sq.ft. build-to-suit (BTS) for Switchgear Solution in the Northwest submarket.

The combination of speculative construction and BTS projects will continue to bolster fundamentals into 2018. The Airport submarket is expected to see continued traction with the completion of the Chamberlain BTS (300,181 sq. ft.) in early 2018. An additional 104,232 sq. ft. is currently in the planning pipeline for the Airport submarket. Meanwhile, in the Southwest submarket 120,000-sq.-ft of speculative R&D space remains in the planning stages at The Bridges master-planned development.

OUTLOOK

Despite slower than expected employment growth, Tucson's industrial fundamentals improved in the second half of 2017. Employment growth declined 0.7% over the past 12 months of 2017; however, employment growth is projected to increase 1.2% in 2018.¹ Manufacturing employment in Tucson is expected to accelerate 3.7% in 2018, which should spur additional demand for manufacturing space throughout Tucson.

Users will find it increasingly challenging to find existing quality space in well-located areas due to the significant amount of outdated warehouse and manufacturing space marketwide. This is especially difficult in the Airport and Southeast submarkets. Yet, an abundant supply of industrial zoned land near interstate I-10 and I-19 will attract users to consider build-to-suit projects to meet their requirements.

¹ Bureau of Labor Statistics, November 2017.

Figure 5: Industrial Market Statistics

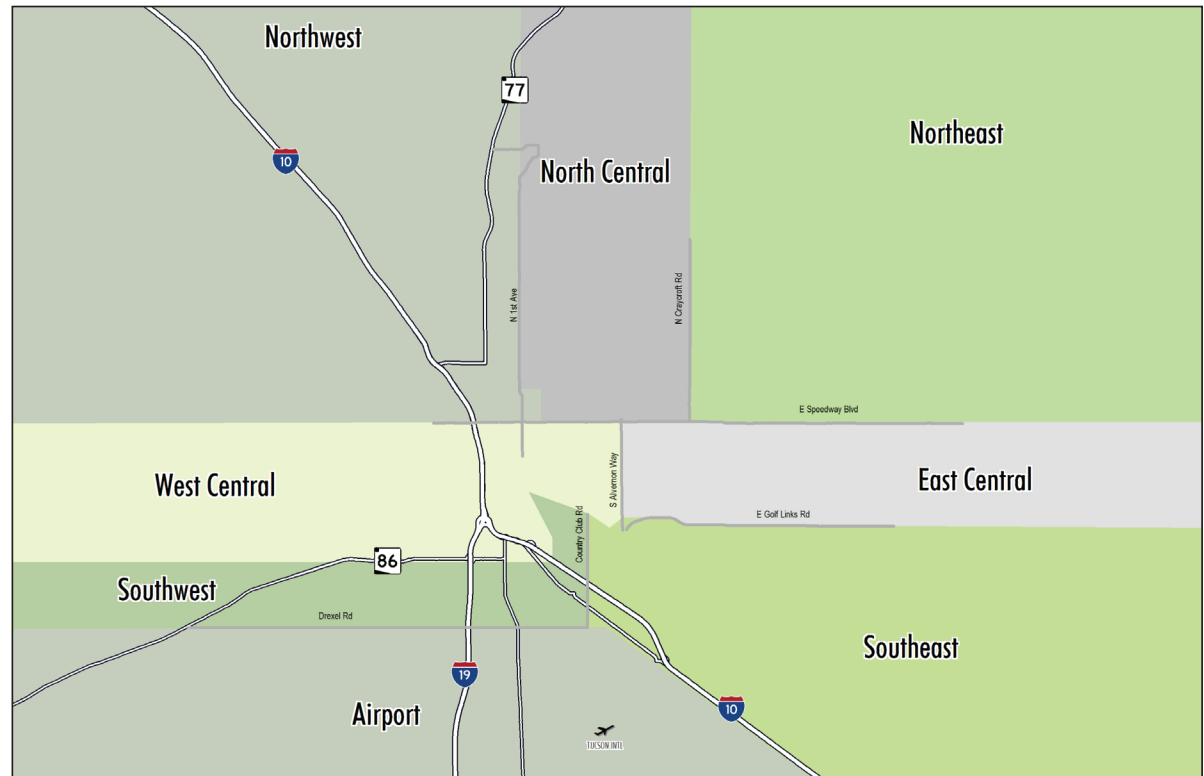
Submarket	Gross Rentable Area Sq. Ft. (±)	Vacancy Rate %	Availability Rate %	Q4 2017 Net Absorption Sq. Ft. (±)	Under Construction Sq. Ft. (±)	*Average Asking Lease Rate Monthly (NNN) \$
Airport	9,101,987	14.5	16.6	23,390	492,161	0.51
East Central	1,030,542	11.0	14.5	(8,200)	0	0.40
North Central	1,124,817	1.4	1.4	1,050	0	0.72
Northeast	67,200	0.0	0.0	3,600	0	0.56
Northwest	6,312,109	3.4	3.7	26,699	19,033	0.59
Southeast	10,508,417	8.0	8.7	(36,248)	238,734	0.51
Southwest	2,188,922	11.3	11.3	15,944	0	0.40
West Central	4,476,078	3.8	5.5	16,631	0	0.49
Totals	36,580,540	8.1	9.3	42,866	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, Q4 2017.

Figure 6: Key Transactions

Size Sq. Ft. (±)	Tenant	Address
91,200	Convergys Customer Management*	2350 W River Park Dr.
50,400	TuSimple	9538 E Old Vail Rd.
14,635	Sunstreet Mortgage	2705 E Medina Rd.
12,066	Port Plastics	2850 E Valencia Rd.
11,300	Crop Production Services	1101 E 18th St.

Source: CBRE Research, Q4 2017.


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