Strong Leasing Activity Promotes Vacancy Compression

▼ 5.3%	▲ 214.2K	▶ 120K	▲ $0.92
Vacancy Rate	SF Net Absorption	SF Construction	NNN / Lease Rate

Note: Arrows indicate change from previous quarter.

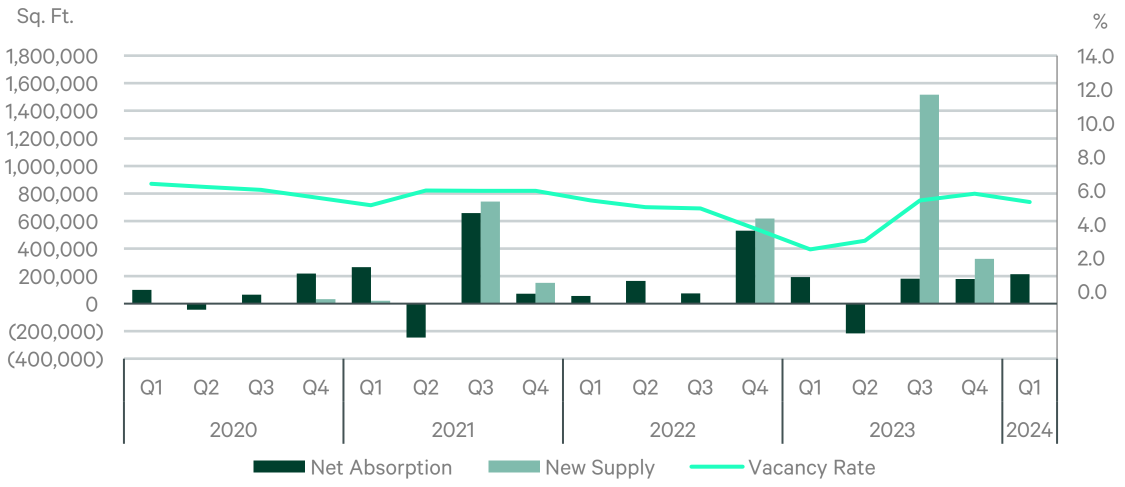
KEY TAKEAWAYS

- Vacancy decreased 50 basis points (bps) quarter-over-quarter to 5.3% in Q1 2024.
- Net absorption continued to trend in positive territory for the third consecutive quarter and outpaced the trailing 3-year quarterly average of 144,250 SF.
- Development activity remained stagnant across the metro, as no new industrial properties broke ground or delivered in Q1 2024.

Tucson continued to see a rise in gross leasing activity, with tenants committing to over 1.1 million sq. ft. of industrial space during Q1 2024. This marks a 127% increase in activity in comparison to the prior quarter, which highlights the strong tenant demand present in the Tucson industrial sector.

Net absorption rose to the highest quarterly level since Q4 2022, which allowed a sizable drop in vacancy during the first quarter. At 5.3%, vacancy is roughly 130 bps lower than the rate recorded at the end of 2019. The combination of strong tenant demand and minimal competition from new speculative supply has fostered robust rent growth, as the average asking rent increased 7% quarter-over-quarter to $0.92 per sq. ft.

FIGURE 1: Supply and Demand



Source: CBRE Research, Q1 2024.

Availability and Vacancy

Industrial space availability in Tucson decreased to 6.1%, equivalent to nearly 2.6 million sq. ft. of available space at the end of Q1 2024. Local availability fell the most in the Airport submarket, which recorded a decline of 540 bps quarter-over-quarter to 5%. Overall, five of the metro's eight submarkets saw vacancy descend quarter-over-quarter. Closing Q1 2024, availability was tightest in the North Central submarket, as the area boasted a rate of 1.1%. Meanwhile, the Northwest submarket maintained Tucson's highest availability rate at 13.5%.

Market-wide vacancy dropped 50 bps to 5.3% in Q1 2024, a rate that is just 10 bps above the metro's trailing 3-year average. This marks the largest quarterly vacancy decline recorded in Tucson since Q1 2023. Much of this decrease can be attributed to lack of speculative supply in the development pipeline coupled with an increase in leasing activity. Strong tenant demand in the Airport submarket helped lower the local vacancy rate by 540 bps to 4.8%. In contrast, the Southeast submarket posted the highest vacancy increase, as the local rate jumped 170 bps during the quarter to 2.7%. Vacancy was the tightest in the West Central, North Central and Southwest submarkets, with each of these areas recording a local vacancy rate below 2%.

Lease Rates

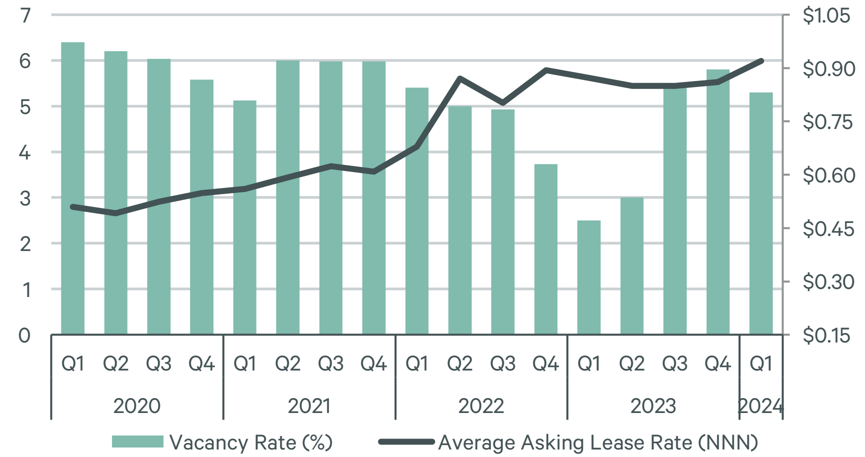
Although rent growth has slowed in recent quarters, the pace of gains has started to accelerate in the Tucson industrial sector. The direct average asking NNN lease rate increased by 7% quarter-over-quarter to $0.92 per sq. ft. in Q1 2024 and is up 5.5% compared to one year prior. North Central Tucson, the submarket with the lowest vacancy, recorded double digit rent growth quarter-over-quarter to $1.25 per sq. ft. Overall, six of the metro's eight submarkets posted rent growth during Q1 2024. The average asking rent remained the highest in Northeast Tucson at $1.46 per sq. ft.

Net Absorption and Leasing Activity

The industrial market captured over 1.1 million sq. ft. of gross leasing activity and 214,230 sq. ft. of positive net absorption in Q1 2024. Tenant demand was strongest in Airport submarket, as the area posted 454,538 sq. ft. of positive net absorption. The 3 largest leases signed in Q1 2024 all occurred in this submarket, as the ILS Company, Microstar Logistics and a vendor for Tesla each committed to spaces over 110,000 sq. ft.

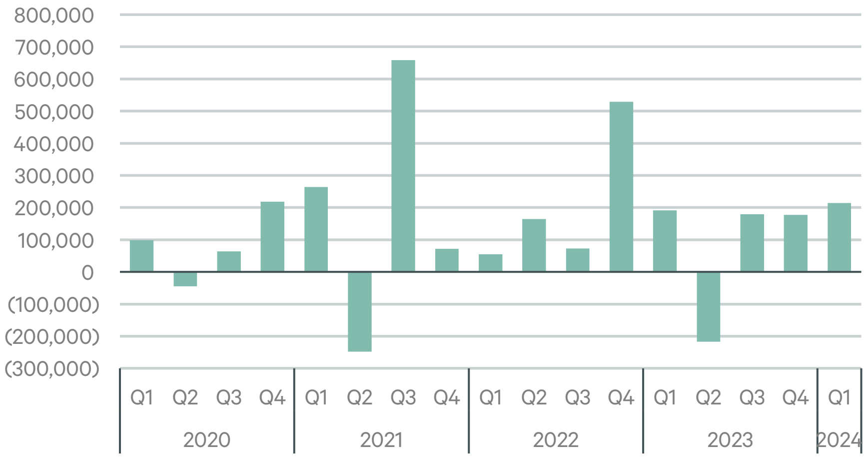
Meanwhile, the Southeast and Northwest submarkets experienced a pull back in tenant demand during Q1 2024. More than 260,000 sq. ft. of vacant space was returned to the market in these areas, which ultimately lifted local vacancy in each of these submarkets by at least 60 bps during the first quarter.

FIGURE 2: Overall Vacancy and Lease Rate



Source: CBRE Research, Q4 2023.

FIGURE 3: Net Absorption (Sq. Ft.)



Source: CBRE Research, Q1 2024.

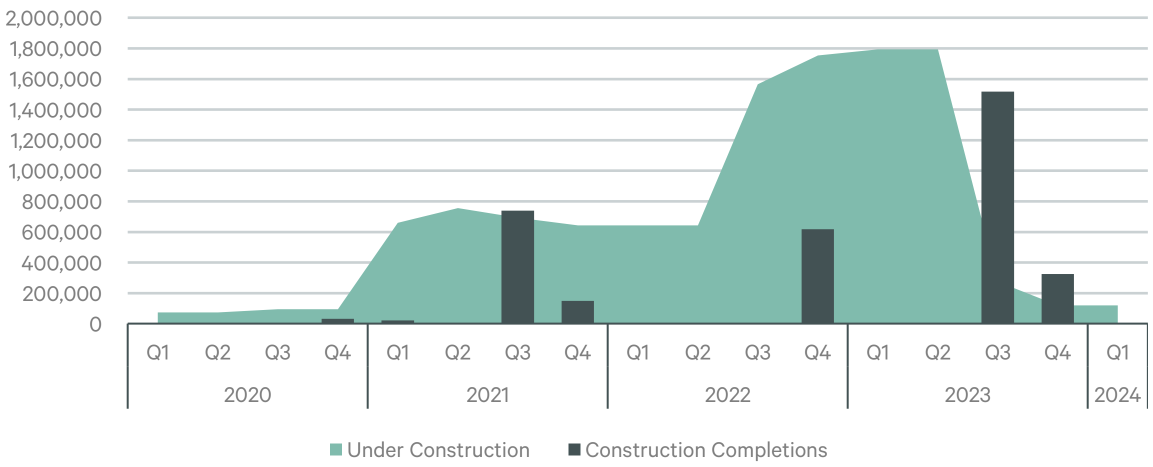
Development Activity

Following the completion of 1.8 million sq. ft. of industrial space over the last two quarters, deliveries in Tucson have slowed in Q1 2024. No new product came online or broke ground during the quarter, keeping the construction pipeline steady at 120,000 sq. ft. The only project under construction as of Q1 2024 is Bectin Dickinson's build to suit property in the Southeast submarket on the Northeast corner of Kolb and Valencia. Higher construction costs, tighter lending standards and economic uncertainty present barriers to development and will likely limit the amount of new speculative starts in the short-run.

Outlook

Although robust supply additions last year lifted metro vacancy near 6 percent, local market fundamentals have showed signs of tightening. The vacancy rate fell 50 bps quarter-over-quarter to 5.3%, which is well below levels observed before the pandemic. The market has also demonstrated remarkable stability, posting more than 175,000 sq. ft. of positive net absorption in each of the past three quarters. This tenant demand has translated into strong rent growth. The average asking rent rose to $0.92 per sq. ft. in Q1 2024, which represents over 21% growth over the past 3 years. Looking ahead, the market is well positioned to continue growing over the long-term. The diversity of tenants is increasing as the metro continues to attract firms in advanced manufacturing, logistics, e-commerce and warehousing. Supply pressure also remains minimal, as all 120,000 sq. ft. of space under construction has already been accounted for. Healthy tenant demand and low competition from new supply should drive additional rent growth and help limit upward pressure on vacancy in the coming quarters.

FIGURE 4: Under Construction and New Supply (Sq. Ft.)

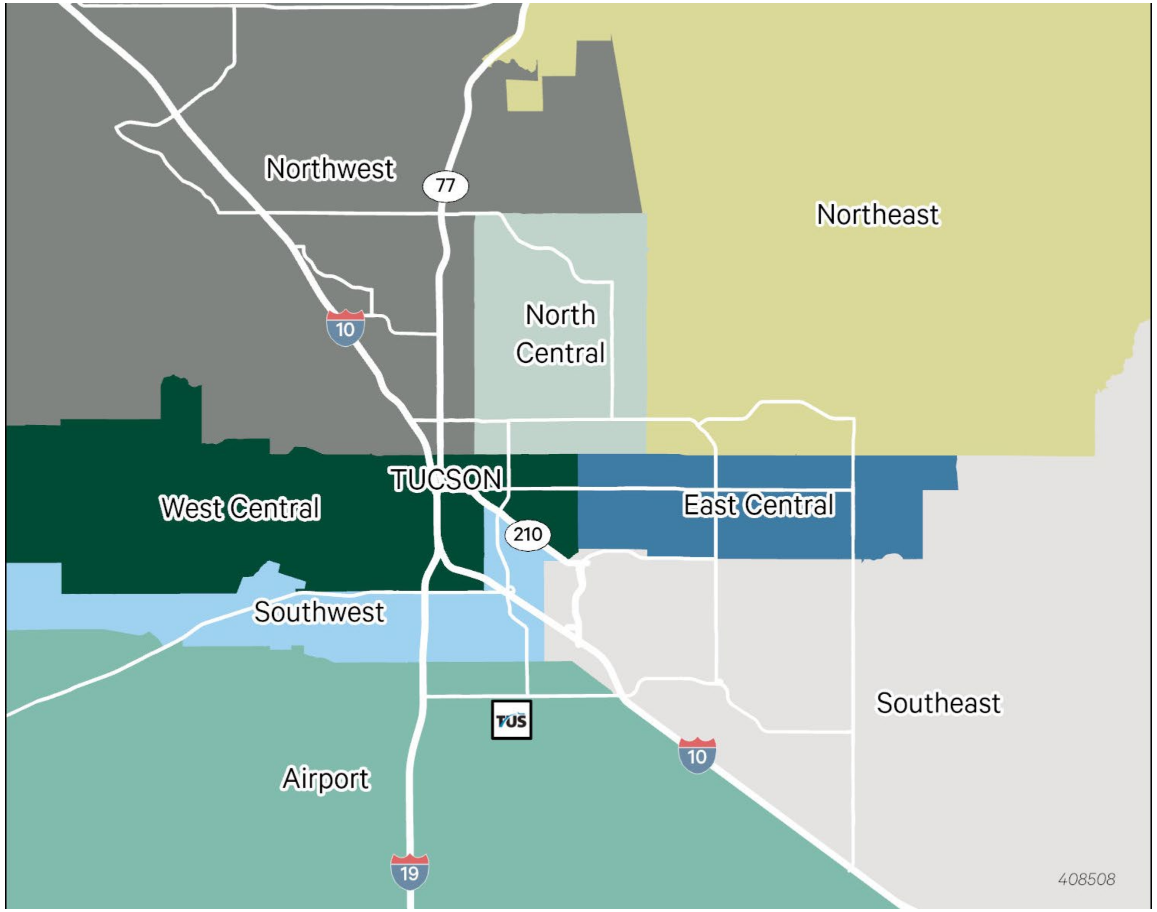


Source: CBRE Research, Q1 2024.

FIGURE 5: Submarket Stats

	Building Count	Net Rentable Area (Sq. Ft.)	Availability (%)	Vacancy (%)	Net Absorption (Sq. Ft.)		Under Construction (Sq. Ft.)	Construction Deliveries (Sq. Ft.)	Avg. Direct Asking Lease Rate ($PSF/NNN)
					Q1 2024	2024 YTD			
Airport	169	11,854,206	5.0%	4.8%	454,538	454,538	0	0	$0.89
East Central	44	1,189,709	4.8%	4.8%	2,801	2,801	0	0	$0.86
North Central	11	191,587	1.1%	0.0%	1,100	1,100	0	0	$1.25
Northeast	15	1,045,095	10.8%	10.6%	0	0	0	0	$1.46
Northwest	270	7,989,919	13.5%	13.3%	(52,531)	(52,531)	0	0	$0.78
Southeast	252	12,637,598	4.7%	2.7%	(210,110)	(210,110)	120,000	0	$0.75
Southwest	105	2,877,358	1.7%	1.6%	(1,440)	(1,440)	0	0	$0.76
West Central	179	4,458,840	2.6%	0.9%	19,872	19,872	0	0	$0.81
Tucson Total	1,045	42,244,312	6.1%	5.3%	214,230	214,230	120,000	0	$0.92

Source: CBRE Research, Q1 2024.



Definitions

Available Sq. Ft.: Space in a building, ready for occupancy within six months; can be occupied or vacant. Availability Rate: Total Available Sq. Ft. divided by the total building Area. Average Asking Lease Rate: A calculated average that includes net and gross lease rate, weighted by their corresponding available square footage. Building Area: The total floor area sq. ft. of the building, typically taken at the "drip line" of the building. Gross Activity: All sale and lease transactions completed within a specified time period. Excludes investment sale transactions. Gross Lease Rate: Rent typically includes real property taxes, building insurance, and major maintenance. Net Absorption: The change in Occupied Sq. Ft. from one period to the next. Net Lease Rate: Rent excludes one or more of the "net" costs (real property taxes, building insurance, and major maintenance) typically included in a Gross Lease Rate. Occupied Sq. Ft.: Building Area not considered vacant. Vacancy Rate: Total Vacant Sq. Ft. divided by the total Building Area. Vacant Sq. Ft.: Space that can be occupied within 30 days.

Survey Criteria

Includes all industrial buildings 10,000 sq. ft. in Tucson Metro. Buildings which have begun construction as evidenced by site excavation or foundation work.

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