ApartmentResearch
MARKET REPORT
Marcus & Millichap

Philadelphia Metro Area — *Fourth Quarter 2013*

Economy on Sound Footing, Driving Apartment Sales

Respectable job growth and the formation of new households reduced vacancy in the Philadelphia metro over the first nine months of 2013 and is supporting a strong multifamily sector. Nearly every private-employment sector added workers during the period, though many industries still have additional hiring to do to recapture all of the positions lost during the downturn. Job opportunities in degreed fields or those requiring specialized training, such as healthcare, are available, but lower-skilled workers continue to face challenges. Specifically, deficits to former peak staffing levels in retail and wholesale trade persist and may be suppressing the performance of apartment buildings on the lower rungs of the quality scale. Economic trends are pointing upward, however, which could hasten the pace of hiring in lagging employment sectors in the quarters ahead. A recent regional survey by the Federal Reserve showed a rise in the index of new orders for goods and services and also signaled improved prospects for hiring.

Although investor demand outweighs the number of properties listed for sale, deal volume continues to surge. Nonetheless, the recent rise in long-term interest rates is motivating additional owners to place properties on the market. Generally, for owners contemplating a sale in the next year or two, the current bidding climate and the relatively modest rise in interest rates improves the probability of executing a transaction. Lenders are competing to provide acquisition loans, with leverage reaching as high as 80 percent. In many instances, local and regional banks have emerged as more competitive sources than the agencies. Cap rates are virtually unchanged from six months ago, and healthy disparities persist between first-year returns on different classes of assets. Class A properties, for example, typically trade in the low- to mid-5 percent range, while Class B properties change hands in the mid-6 to low-7 percent band. Cap rates for Class C or lower-quality properties with working-class tenancies typically start in the mid-8 percent range, though many deals settle closer to 9 percent.

2013 Annual Apartment Forecast

1.2% increase in total employment

Employment: Payrolls will swell by 33,000 jobs in 2013 to expand employment in the metro 1.2 percent. Growth in education and health services employment underpinned the creation of 28,700 positions in 2012.

3,400 units will be completed

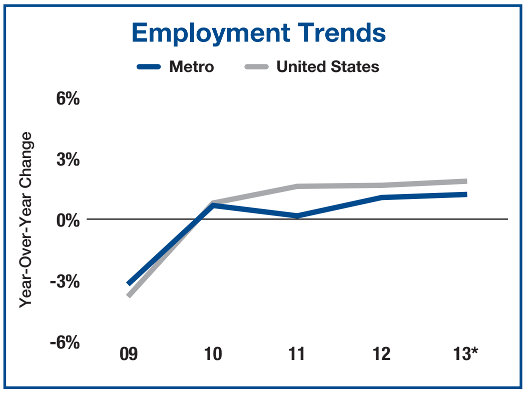
Construction: Projects containing 3,400 units will come online in 2013, up from 1,278 rentals last year. New stock will be placed in service in 10 of the metro's 16 submarkets. The greatest impact is in Center City, where 1,429 new rentals will expand stock 4.6 percent.

30 basis point decrease in vacancy

Vacancy: Vacancy will decline 30 basis points this year to 4.9 percent, the lowest year-end level in six years. The vacancy rate was unchanged in 2012.

2.6% increase in effective rents

Rents: Following a 1.1 percent bump in 2012, average rents in the metro will rise 2.6 percent this year to $1,128 per month. With the projected increase, rents will have climbed 10 percent since bottoming four years earlier.



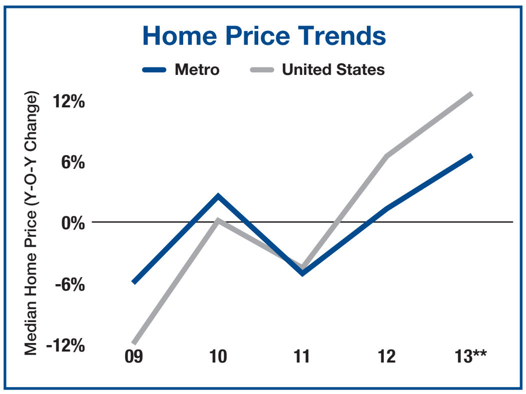
Economy

- Nine of 10 private-employment sectors expanded payrolls in the first nine months of 2013 to create a net 26,400 new jobs in the metro. In the corresponding period last year, employers hired 22,900 workers.

- The education and health services sector remains a vigorous engine of job growth. Expanding medical practices added more than 15,000 employees in the first three quarters of 2013, outpacing an increase of 8,400 jobs during the same stretch last year. Also, the opening of new hotels supported a gain of 7,500 jobs in the leisure and hospitality sector.

- A resurgence in residential building generated 2,000 new construction jobs so far this year. Hiring in professional and business services, meanwhile, persists, though at a slower pace than one year ago. Thus far in 2013, 4,200 jobs were added, down from 9,400 positions in the first three quarters of last year.

- **Outlook:** Employers in the metro are on track to add 33,000 jobs this year, entirely in private-employment sectors.



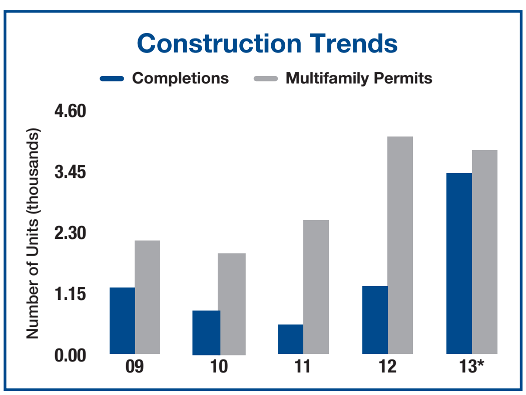
Housing and Demographics

- Builders broke ground on 9,000 units of housing over the year ending in the third quarter, a 3 percent gain from the preceding 12 months. Single-family starts accounted for all of the increase, as multifamily starts dipped 5 percent year over year to 3,200 units.

- Several multifamilyproperties started construction in the third quarter. These include 252 units at the first phase of the Uptown at Worthington complex in Chester County; and 159 units at Rivergate in Burlington County.

- Respectable job growth supported a 29 percent increase in the number of existing single-family homes sold over the past year. The median price advanced 7 percent to $224,300.

- **Outlook:** The recent drop in multifamily starts may herald a temporary pause in the delivery of new rentals following the completion of several projects currently under construction.



*Forecast
**Trailing 12-month period through 3Q

Construction

- In the 12 months ending in the third quarter, developers completed more than 1,800 apartments, expanding rental stock a mere 0.5 percent. Approximately 1,200 units were brought online in the preceding year.

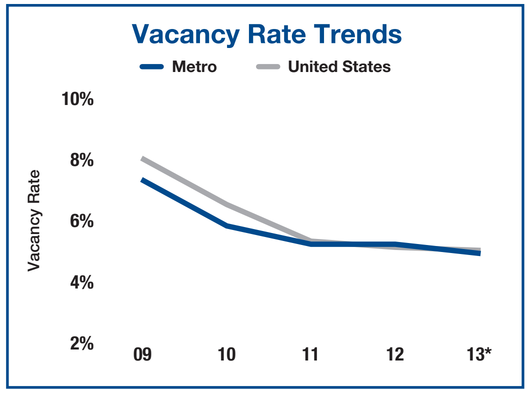
- Year to date, 1,801 rentals were placed in service. Projects completed in the third quarter include 2116 Chestnut, a 34-story high-rise in Center City with 321 units. In South Jersey, the 233-unit Dwell at Cherry Hill came online, and 354 units of student housing were also delivered in the University City submarket.

- Nearly 1,600 apartments are underway and scheduled for completion in the fourth quarter. Work continues on an additional 2,500 units that are slated to come online in 2014.

- **Outlook:** After averaging less than 1,000 units completed annually in the past five years, developers will bring online 3,400 rentals this year to expand rental stock 1 percent.

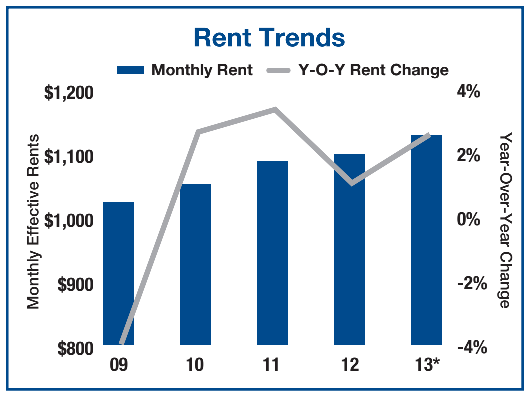
Vacancy

- Vacancy plunged 50 basis points in the third quarter to 4.7 percent behind net absorption of more than 2,800 units. The vacancy rate is unchanged year to date, although in excess of 3,400 additional apartments were occupied during the period.
- Vacancy fell across all vintages. Properties built since 2000 were 4.4 percent vacant in the third quarter, falling 20 basis points from the preceding three-month stretch and 10 basis points from year-end 2012. Vacancy in 1980s-vintage complexes plummeted 80 basis points to 4.4 percent from July to September, although the rate is up 10 basis points year to date. Properties built prior to 1980, however, recorded a drop in vacancy so far this year.
- More than 900 units were delivered in Center City thus far in 2013, contributing to a 150-basis point jump in vacancy there to 4.9 percent. Apartments constructed since 2000 were 5.6 percent vacant at the end of the third quarter, an increase from 1.4 percent at the end of last year.
- **Outlook:** Nearly half of the rentals scheduled for completion this year will come online in the final quarter, pressuring vacancy. For the entire year, however, vacancy will decrease 30 basis points to 4.9 percent.



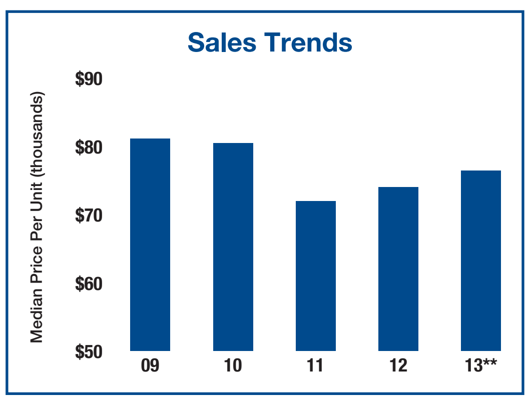
Rents

- Although average rents increased 1.8 percent over the first three quarters of 2013 to $1,119 per month, a 0.3 percent decline was recorded in the third quarter. Eight submarkets posted lower rents in the July-to-September span.
- Rents at properties built since 2000 decreased 3.0 percent in the third quarter, primarily as a result of new properties coming online. At rentals built during the 1970s across the metro, the average rent dropped 1.2 percent during the quarter to $1,022 per month.
- Of the eight submarkets where average rents decreased, only three also posted a drop over the past year, suggesting that many owners cut rents to attract tenants in the third quarter, a period of high seasonal demand. Average rents in Northeast Philadelphia slipped from July to September, for example, but rose 0.8 percent since the third quarter last year.
- **Outlook:** This year, the average rent in the metro will advance 2.6 percent to $1,128 per month.



Sales Trends**

- Additional property owners tested the market recently, contributing to a 34 percent increase in transaction velocity during the past year.
- The surge in velocity and additional deals at higher price points supported a 48 percent increase in dollar volume over the past year. Prices were also slightly higher. The median price of properties sold over the past year was $76,400 per door, up from $74,000 per unit one year earlier.
- Cap rates are virtually unchanged from six months ago. Class B properties, for example, trade at cap rates starting in the mid- 6 to low-7 percent range.
- **Outlook:** Liquid and accessible debt markets, and motivated investors will sustain a high volume of transactions in the months ahead.



Source: Costar Group, Inc.

*Forecast

**Trailing 12-month period

Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- Prior to the federal government shutdown and impasse over the debt ceiling, favorable economic trends were accumulating. Most notably, employers were adding jobs at a respectable rate, and the housing market reported consistently positive signs. The recent events in Washington, though, will likely shave a few points from economic growth in the fourth quarter. In addition, the negative effect on economic growth will weigh on the Federal Reserve's deliberations over the tapering of economic stimulus.
- Fannie Mae and Freddie Mac continue to assume a prominent role in apartment financing. Currently, the GSEs are underwriting terms of five, seven and 10 years and LTVs of up to 75 percent, higher in select instances. Ten-year loans for more than $3 million offer interest rates from approximately 4.6 percent to 5.1 percent, but rates trend lower for shorter loan maturities.
- Portfolio lenders, including commercial banks and life companies, continue to compete for business. Loans of more than $3 million for terms of 10 years are underwritten at leverage of up to 75 percent, and interest rates vary from 4.5 percent to 5.3 percent. For five-year loans, interest rates range from approximately 3.4 percent to 4.0 percent. Interest rates on loans of less than $3 million generally range from 20 basis points to 40 basis points higher.
- After initially adjusting terms during the surge in 10-year interest rates in the second and third quarter, the CMBS market has settled. Conduit loans are generally written at rates varying from 4.7 percent to 5.1 percent and leverage up to 75 percent and, in limited instances, 80 percent. Proceeds are limited by debt yields from 8.0 to 8.5 percent.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Chester County	3.2%	30	$1,281	1.8%
2	Delaware County	3.4%	-10	$1,024	1.4%
3	Norristown/Upper Merion/Lower Merion	3.7%	-130	$1,254	1.5%
4	Northwest Philadelphia	3.7%	60	$1,205	0.8%
5	Newark, DE	4.1%	-30	$990	-2.5%
6	Bucks County	4.5%	40	$1,030	1.5%
7	North Montgomery County	4.5%	-150	$1,191	4.1%
8	Burlington County	4.6%	20	$1,043	-1.1%
9	Gloucester County	4.8%	-10	$907	-1.8%
10	Center City	4.9%	170	$1,954	-2.2%
11	Camden/Cherry Hill	5.3%	-80	$1,181	-0.2%
12	Central Wilmington	5.3%	90	$1,054	5.6%
13	University City	5.4%	-20	$1,231	1.2%
14	Northeast Philadelphia	5.5%	130	$891	0.8%
15	Outer Wilmington	5.8%	80	$950	1.8%
16	Lower Camden County	6.5%	30	$955	3.6%

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Visit www.NationalMultiHousingGroup.com or call:
John Sebree
Director, National Multi Housing Group
Tel: (317) 218-5300
john.sebree@marcusmillichap.com

Marcus & Millichap
Real Estate Investment Services

Prepared and edited by
Art Gering
Senior Analyst
Research Services

For information on national apartment trends, contact
John Chang
First Vice President, Research Services
Tel: (602) 687-6700
john.chang@marcusmillichap.com

Philadelphia Office:
Spencer Yablon
Vice President, Regional Manager
spencer.yablon@marcusmillichap.com
110 W. Elm Street
Suite 600
Philadelphia, Pennsylvania 19428

Tel: (215) 531-7000
Fax: (215) 531-7010

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