Marcus & Millichap

Multifamily Research Market Report

Second Quarter 2017

Philadelphia Metro Area

Robust Household Formation Fosters Demand for Apartments

Job growth aids household formation, underpinning apartment demand. Driven by hiring in education and health services, the Philadelphia economy is poised to register another year of steady growth. The expanding workforce, coupled with rising incomes, will support additional household formation this year and benefit multifamily demand. The need for apartments has prompted a flurry of construction, which will reach a new high in 2017. The bulk of development will feature mostly upper-tier rentals and be located in Center City and King of Prussia. Several high-rise luxury towers are under construction that combine retail and dining options, appealing to young professionals seeking a live-play-work lifestyle

Low vacancy pushes rents. The surge in apartment construction will place some upward pressure on vacancy this year, but the rate will remain tight. A low vacancy rate will support another year of steady rent growth, raising the level to a record high. Effective rents in several popular neighborhoods have the potential to extend above $1,500 per month. As a result, more affordable areas including Northeast Philadelphia and Gloucester County may continue to register sub-3 percent vacancy.

Multifamily 2017 Outlook

6,500 units will be completed

Construction: Following the completion of 4,900 units in 2016, construction will accelerate this year as developers are on track to deliver 6,500 apartments.

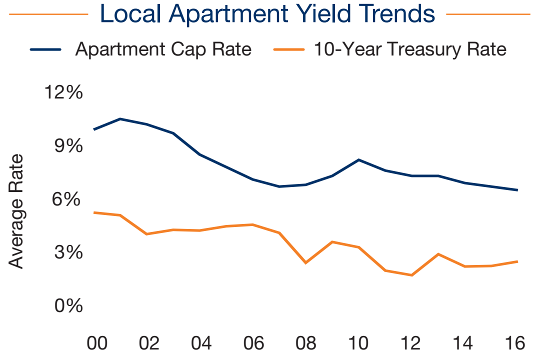
40 basis point change in vacancy

Vacancy: The average vacancy rate will rise 40 basis points to 4.9 percent as the number of completions outpaces net absorption this year.

5.3% increase in effective rents

Rents: Average effective rent will climb to $1,300 per month, after registering a 4.3 percent increase in the previous year.

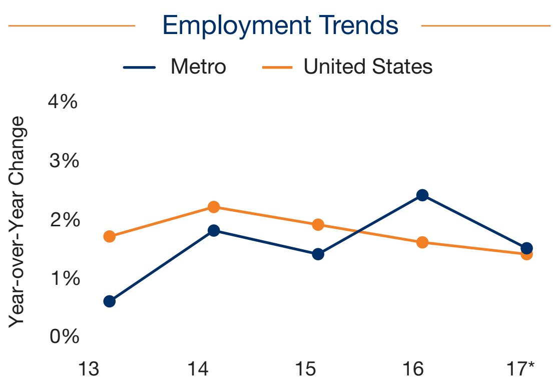
Local Apartment Yield Trends



Sources: CoStar Group, Inc.; Real Capital Analytics

Investment Trends

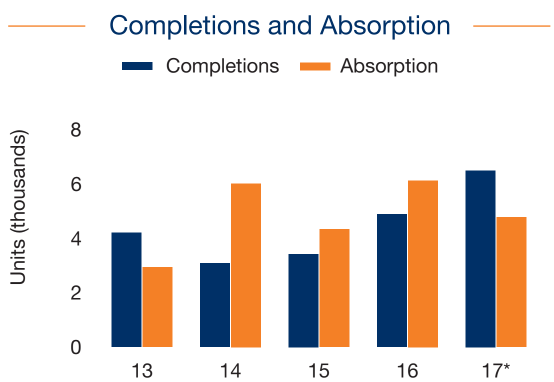
- Philadelphia's healthy job market, coupled with rising effective rent, will motivate investors to acquire area apartment assets. Buyers in the $1 million to $10 million price tranche dominate the bidding environment, targeting Class B and C properties with value-add potential.
- Properties in Center City and University City will pique investors' attention. However, limited listings in these areas will push buyers into outlying neighborhoods, particularly northern Philadelphia. Here, properties can trade with initial returns up to 100 basis points greater than the metro average.
- Investor demand tightened average first-year returns 20 basis points in the past 12 months to the mid-6 percent span. Properties in well-located areas, including Center City, can change hands nearly 100 basis points less than average.



EMPLOYMENT:

2.0% increase in total employment Y-O-Y

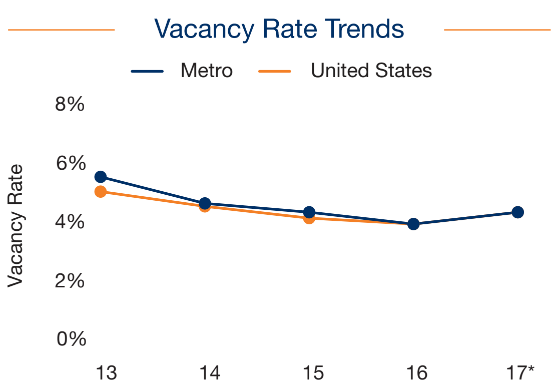
- Philadelphia employers created 57,000 positions during the last four quarters, following 51,800 new hires one year earlier. Education and health services fields led hiring last year as 26,900 workers were added.
- After posting a 100-basis-point decline in 2015, the unemployment rate ticked up 10 basis points last year to 4.7 percent as more individuals entered the workforce.



CONSTRUCTION:

4,300 units completed Y-O-Y

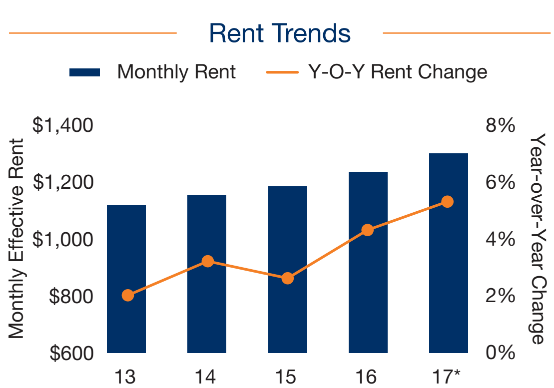
- During the 12 months ending in March, developers completed 4,300 apartments. In the prior annual period, more than 1,300 units were delivered.
- Construction will remain elevated as developers have roughly 7,700 rentals underway with completion dates scheduled through 2018. Of these deliveries, more than 770 will be age-restricted units and affordable housing.



VACANCY:

20 basis point decrease in vacancy Y-O-Y

- Healthy demand pushed vacancy down 20 basis points during the last four quarters to 4.5 percent. In the prior year, the rate inched up 10 basis points.
- The largest vacancy decrease during this time was registered in Delaware County. The rate plummeted 300 basis points to 2.9 percent as more than 1,140 apartments were absorbed.



RENTS:

4.5% increase in effective rents Y-O-Y

- Low vacancy generated a 4.5 percent increase in the average effective rent to $1,256 per month. In the prior 12 months, the average rent rose 3.5 percent.
- As vacancy plummeted 130 basis points in Burlington County, the average effective rent increased 5.6 percent during the last four quarters to $1,177 per month in March.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*

44,300

FIVE-YEAR HOUSEHOLD GROWTH*

75,000

1Q17 POPULATION AGE 20-34
(Percent of total population)

Metro **21%**

U.S. 21%

POPULATION OF AGE 25+
PERCENT WITH BACHELOR DEGREE+**

Metro **34%**

U.S. Average 29%

1Q17 MEDIAN HOUSEHOLD INCOME

Metro **$71,576**

U.S. Median $58,218

1Q17 TOTAL HOUSEHOLDS

33% Rent

67% Own

* 2017-2022

**2Q16

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Gloucester County	2.0%	-80	$1,083	11.2%
Northeast Philadelphia	2.7%	-200	$1,043	8.1%
Burlington County	2.8%	-130	$1,177	5.6%
Delaware County	2.9%	-300	$1,203	8.9%
Bucks County	3.1%	-110	$1,171	4.5%
Lower Camden County	3.3%	-60	$1,005	-2.0%
Norristown/Upper Merion/ Lower Merion	3.4%	-200	$1,342	0.9%
Camden/Cherry Hill	3.8%	-30	$1,257	2.9%
Outer Wilmington	3.9%	-60	$1,123	4.9%
Newark	5.0%	-40	$1,123	3.9%
Overall Metro	**4.5%**	**-20**	**$1,256**	**4.5%**

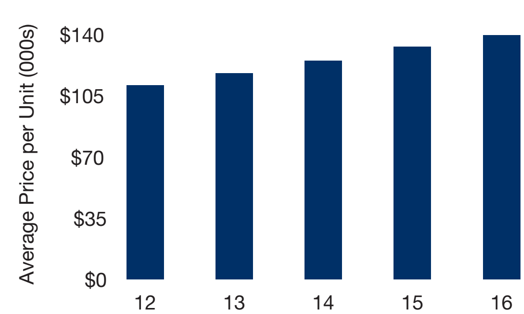
SALES TRENDS

Prices Advance as Fewer Listings Intensify Bidding for Apartment Assets

- Limited listings dropped transaction velocity 11 percent during 2016 after rising 24 percent in the prior annual period.
- The average price advanced 5 percent during the past year to $139,550 per unit as more buyers targeted properties built within the last six years.

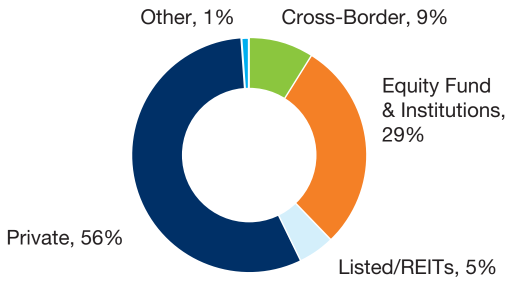
Outlook: Elevated levels of construction may provide investors additional opportunities at the top end of the market, where cap rates typically average in the low- to mid- 5 percent area.

Pricing Trends

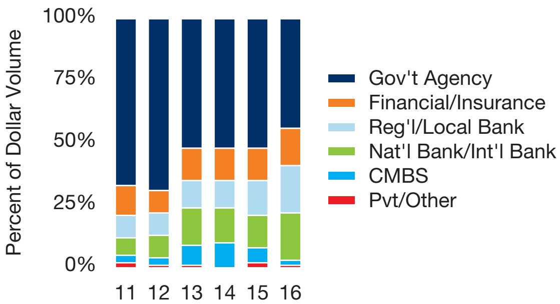


Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

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

- **Monetary policy actions set to accelerate.** The 10-year U.S. Treasury rate held below 2 percent until a surge following the election raised the rate above that threshold and potentially established a new and higher range for the benchmark. Moderate economic growth and muted inflation throughout the growth cycle allowed the Federal Reserve to hold off on rate hikes, which has supported additional cap rate compression. However, the Trump administration's fiscal plans built on higher spending and reduced taxes could accelerate economic growth. Intensifying inflationary pressure under that scenario could encourage the Federal Reserve to quicken the pace of its efforts to raise its short-term benchmark.
- **Inflation on the upswing, but for the right reasons.** Though inflationary pressures are beginning to grow, increases are occurring from a historically low base. Further, inflationary pressure has arisen from wage growth and stabilization of oil prices, both positives for the overall economy. Higher wages will encourage spending while inflationary pressure on prices will raise overall consumption, the primary driver of economic growth.
- **Underwriting discipline persists; ample debt capital remains.** Multifamily originations increased in 2016, with agency lending dominating the overall marketplace. The government agencies underwrote about $105 billion in loans last year and remain a primary source of multifamily originations in 2017 due to their efficient execution. Acquisition debt remained plentiful throughout 2016, but borrowers' rates rose late in the year in conjunction with higher Treasury yields and loan-to-value ratios compressed. The combination of higher rates and tighter lender underwriting created some investor caution that could carry over into 2017. A potential easing of Dodd-Frank regulations on financial institutions could create additional lending capacity for other capital sources.

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; National Association of Realtors; Moody's Analytics; Real Capital Analytics; MPF Research; TWR/Dodge Pipeline; U.S. Census Bureau.