Marcus & Millichap

Multifamily Research
Market Report

Third Quarter 2017

Philadelphia Metro Area

Vacancy Tight in Suburbs as Deliveries Concentrated in Center City

Apartment completions rise, absorption strong on heels of steady annual employment gains. Last year, Philadelphia created the largest volume of jobs since the turn of the century. As applicants filled these positions, rental demand increased and 6,200 apartments were filled since July 2016, one of the strongest performing annual periods since 2010. As apartment deliveries are anticipated to peak in 2017, a healthy pace of absorption continues in the second half, keeping apartment vacancy historically low. Most of these completions are heavily concentrated in Center City Philadelphia, where approximately 2,000 apartments will open this year.

Vacancy contracts below historical norms in many suburban submarkets as developers focus on Center City. A number of companies are opening offices in Philadelphia's Center City, boosting apartment demand in this area. While developers have concentrated deliveries to meet the increased number of residents moving here, limited supply additions in other portions of the metro have produced extremely low vacancy. Nearly half of all submarkets recorded rates below 3 percent in the second quarter, and tight conditions have contributed to strong rent growth in some areas.

Multifamily 2017 Outlook

5,500 units will be completed

Construction: Apartment deliveries reach a new peak this year following the completion of nearly 4,700 units during 2016.

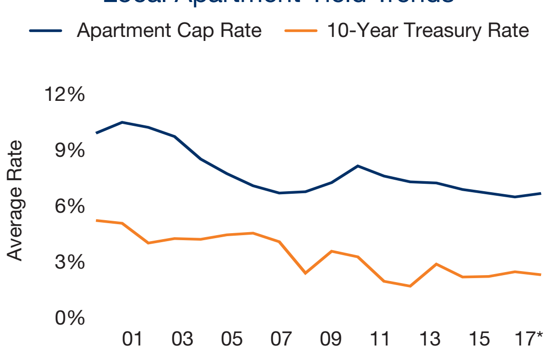
30 basis point increase in vacancy

Vacancy: Supply additions will outweigh demand this year, pushing the vacancy rate up to 4.2 percent. Last year, vacancy declined 40 basis points.

5.3% increase in effective rents

Rents: The pace of rent growth rises as vacancy remains tight. The average rent will advance to $1,300 per month, building on last year's increase of 4.3 percent.

Local Apartment Yield Trends



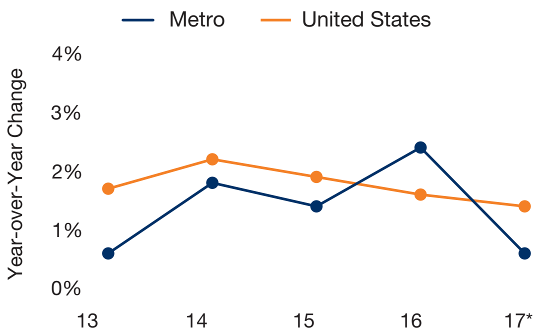
* Trailing 12 months through 2Q17

Sources: CoStar Group, Inc.; Real Capital Analytics

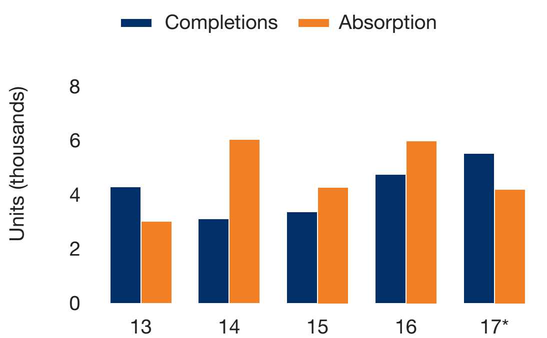
Investment Trends

- Investors from New York, New Jersey and Washington, D.C., are targeting the metro for properties, increasing buyer competition for Philadelphia apartment assets. These buyers are searching for a wide range of investment opportunities, from value-add deals to newly constructed assets, depending on investment strategies.
- Private metro buyers continue to dominate deal flow, targeting Class B and C properties in downtown Philadelphia and suburbs to the north and west. These assets typically trade for first-year yields in the mid-5 percent to 7 percent range.
- High barriers to entry have kept additions to supply at a minimum when a number of other metros across the country are ripe with development. As a result, the opportunity to repurpose older buildings into apartments has been popular. These propositions, as well as value-add deals, are in high demand.

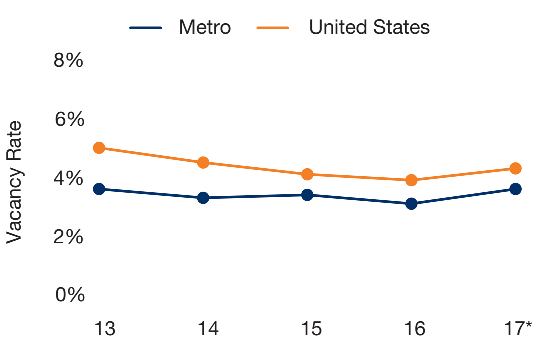
Employment Trends



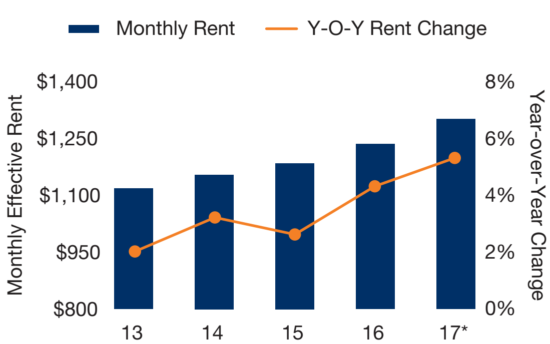
Completions and Absorption



Vacancy Rate Trends



Rent Trends



* Forecast

2Q17 – 12-Month Period

EMPLOYMENT:

1.5% increase in total employment Y-O-Y

- Philadelphia employers created 42,200 positions over the last 12 months, with the strongest additions occurring in the final months of 2016.
- The metro's unemployment rate fell 50 basis points during the last four quarters, reaching 4.7 percent in June and now resting slightly above the national rate of 4.4 percent.

CONSTRUCTION:

4,600 units completed Y-O-Y

- Builders completed 1,550 apartments during the second quarter, one of the strongest quarters for deliveries since 2012.
- Center City Philadelphia has been heavily targeted by developers, with approximately 4,500 apartments coming online since mid-2012. Another 3,850 units are slated for delivery through 2018.

VACANCY:

60 basis point decrease in vacancy Y-O-Y

- The absorption of 6,200 apartments over the last 12 months aided in tightening vacancy to 3.7 percent in the second quarter. One year ago, the rate squeezed 10 basis points.
- Class B and C properties boasted the lowest vacancy in the metro, with rates of 3.2 percent and 2.5 percent, respectively, in the second quarter.

RENTS:

4.2% increase in effective rents Y-O-Y

- Rent growth was strong across all classes, resulting in the overall average effective rent rising to $1,285 per month.
- Southwest Philadelphia recorded the strongest pace of rent growth during the last year, with the average rising 14.0 percent to $1,642 per month, the second highest in the metro. Center City Philadelphia also posted rent gains; the average increased 9.6 percent.

DEMOGRAPHIC HIGHLIGHTS

2Q17 MEDIAN HOUSEHOLD INCOME

Metro **$73,016**

U.S. Median $58,672

2Q17 AFFORDABILITY GAP

Renting is **$106** Per Month Lower

Average Effective Rent vs. Mortgage Payment*

MULTIFAMILY (5+ Units) PERMITS❖

6,231 1H 2017

14% Compared with 1H 2014-2016

2Q17 MEDIAN HOME PRICE

Metro **$220,600**

U.S. Median $246,000

FIVE-YEAR HOUSEHOLD GROWTH**

75,000 or **0.6%** Annual Growth

U.S. 1.1% Annual Growth

SINGLE-FAMILY PERMITS❖

7,585 1H 2017

6% Compared with 1H 2014-2016

*Mortgage payments based on quarterly median home price with a 30-year fixed-rate conventional mortgage, 90% LTV, taxes, insurance and PMI. **2017-2022 ❖ Annualized Rate

SUBMARKET TRENDS

Lowest Vacancy Rates 2Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Bucks County	2.4%	-40	$1,192	4.9%
Burlington County	2.4%	-110	$1,200	2.7%
Lower Camden County	2.4%	-80	$1,036	-1.0%
Gloucester County	2.5%	80	$1,078	7.5%
Delaware County	2.6%	-220	$1,207	4.0%
Camden/Cherry Hill	2.9%	-110	$1,266	1.4%
Northeast Philadelphia	3.1%	70	$1,039	5.6%
Chester County	3.1%	-100	$1,445	4.0%
Newark	3.5%	-150	$1,116	3.2%
Outer Wilmington	3.6%	-70	$1,067	3.3%
Overall Metro	**3.7%**	**-60**	**$1,285**	**4.2%**

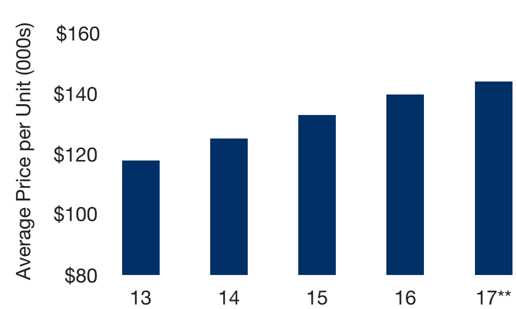
SALES TRENDS

Buyer Competition Rises as Regional Investors Target Philadelphia Apartments

- Sales of Philadelphia apartment assets remained steady over the last 12 months when compared with the prior year. The average price increased 10 percent annually to $144,000 per unit with cap rates holding firm in the mid- to high-6 percent band.
- Buyers targeted Center City apartments over the last year, with transaction velocity nearly doubling from one year ago.

Outlook: As listings become more limited in Center City, buyer demand for properties located in northern and western submarkets will rise this year.

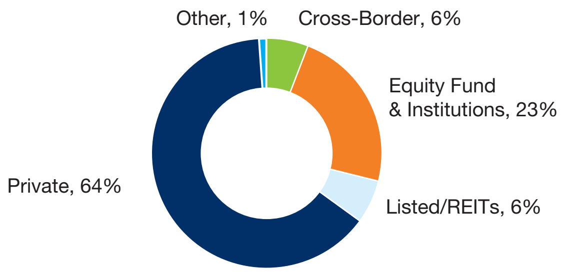
Pricing Trends



** Trailing 12 months through 2Q17

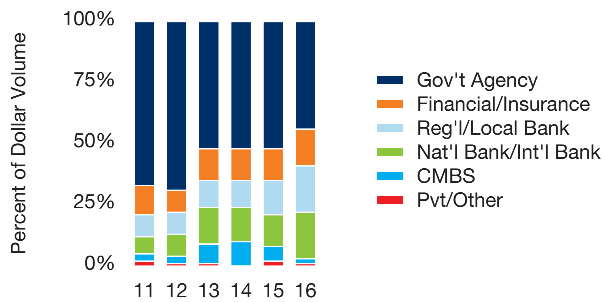
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

Apartment Acquisitions By Buyer Type*



* Trailing 12 months through 2Q17

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 in transition.** Despite the Fed raising its benchmark short-term rate three times in seven months and signaling another rise before the end of the year, long-term rates have remained stable. The yield on the 10-year U.S. Treasury bond remained in the low- to mid-2 percent range throughout the second quarter of 2017. The Federal Reserve wants to normalize monetary policy and, in addition to rate hikes, will likely start paring its balance sheet.
- **Sound economy a balancing act for Fed.** With unemployment hovering in the low-4 percent range, the lowest level since 2007, the Federal Reserve will remain vigilant regarding the possible rapid increase in inflation if wage growth takes off. Additionally, business confidence and job openings are near all-time highs. Businesses finally have the assurance to expand their footprints after years of tepid growth following the Great Recession. These conditions are allowing pent-up households to form, creating new apartment demand. The Fed, however, must now balance economic growth and job creation against wage growth and inflationary pressures.
- **Underwriting discipline persists; ample debt capital remains.** Overall, leverage on acquisition loans has continued to reflect disciplined underwriting, with LTVs typically ranging from 65 percent to 75 percent for most apartment properties. At the end of 2016, the combination of higher rates, conservative lender underwriting and fiscal policy uncertainty encouraged some investor caution that slowed deal flow, a trend that has extended into 2017. A potential easing of regulations on financial institutions, though, could liberate additional lending capacity and higher interest rates may also encourage additional lenders to participate.

National Multi Housing Group

Visit www.NationalMultiHousingGroup.com

John Sebree
First Vice President, National Director
National Multi Housing Group
Tel: (312) 327-5417
john.sebree@marcusmillichap.com

Prepared and edited by
Jessica Hill
Market Analyst | Research Services

For information on national apartment trends, contact:
John Chang
First Vice President | Research Services
Tel: (602) 707-9700
john.chang@marcusmillichap.com

Price: $250

© Marcus & Millichap 2017 | www.MarcusMillichap.com

Philadelphia Office:

J.D. Parker
Senior Vice President | Division Manager
Tel: (215) 531-7000
j.d.parker@marcusmillichap.com

2005 Market Street
Suite 1510
Philadelphia, PA 19103

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Note: Metro-level employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions valued at $1,000,000 and greater unless otherwise noted. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice.

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.