Marcus & Millichap

Multifamily Research
Market Report

Second Quarter 2018

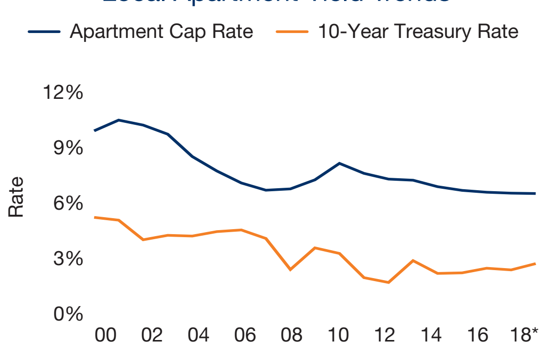
Philadelphia Metro Area

Development Abates Moderately; Competitive Yields Boost Buyer Interest

Healthy rental demand prompts substantial downtown construction, vacancy moves up. New job opportunities and rising incomes are supporting more household formations, which in turn furthers apartment demand. The higher absorption of apartments in recent years has motivated increased development, as total deliveries will surpass 4,000 units for the third consecutive year. Almost half of these new arrivals will open in Center City, the most for any submarket. The supply-side pressure will push the metro's vacancy rate up by a slight degree, although at sub-5 percent, the rental market remains tighter than the national rate.

Rents rise, especially among luxury spaces. While vacancy ticks up by a modest amount, rent growth continues due to healthy demand. Class A assets have seen the largest gains, with the most appreciation occurring in areas where completions have recently dropped. This is the case in Cherry Hill and Northwest Philadelphia, where the submarkets' average rental growth for Class A rents reached double digits. A similar situation is happening in Southwest Philadelphia. Now that the 1,000-unit Presidential City complex concluded its six-year development process, and other ongoing construction is minimal, market demand is propelling rents up here. Combined with rent growth in Class B/C buildings, the aggregative impact will support gains on par with the past three years.

Local Apartment Yield Trends



* Cap rate trailing 12-month average through 1Q; Treasury rate as of March 29th
Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2018 Outlook

4,400 units will be completed

Construction:
Development slows year over year, although deliveries since 2015 have averaged 2,000 more units a year compared to the entire post-recession period.

30 basis point increase in vacancy

Vacancy:
The net absorption of units will fall slightly short of new supply, pushing vacancy up to 4.7 percent, the same level it was at in 2016.

2.5% increase in effective rents

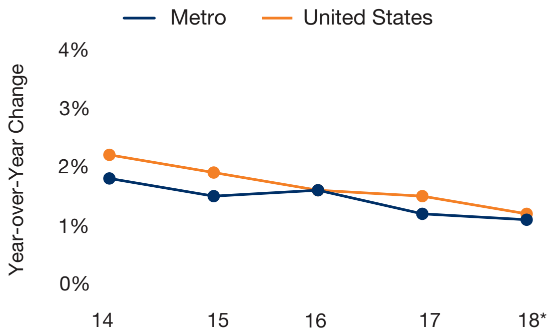
Rents:
Growth in effective rent matches the pace set in 2015 and 2016 as the average rate rises to $1,298 per month.

Investment Trends

- Institutional-grade investors closed multiple trades in the Wilmington area, where sales velocity improved 44 percent over the past 12 months. Recently sold properties generally held 200 or more units, at an average cost of $120,500 per door.
- The Center City submarket has led the metro in total annual transactions for three of the past five years. Deal activity through the first quarter of 2018 suggests this is likely to be the case again this year. Since March 2017, many buyers have been acquiring Class C properties for an average sale price of $180,000 per unit with initial returns in the low-6 percent zone.
- Over the past 12 months, trading activity increased for assets situated along the Main Line between Wynnewood and Wayne. The affluent area traditionally houses some of the students, staff and faculty of nearby colleges, including Villanova University. Highway and rail routes into downtown add convenience.

1Q18 – 12-MONTH PERIOD

Employment Trends

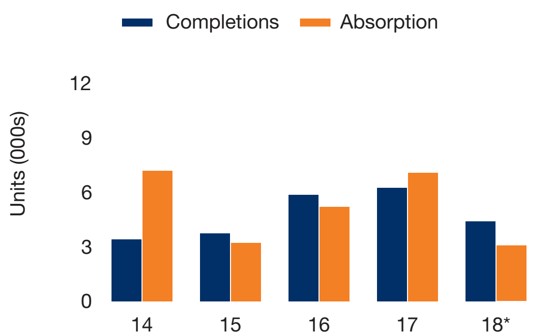


EMPLOYMENT:

1.2% increase in total employment Y-O-Y

- Employers added 35,200 positions over the past year, with the education and healthcare sectors accounting for 50 percent of the hiring. In the previous year, the workforce grew by 1.6 percent.
- Due to continued strong job growth, Philadelphia's unemployment rate dipped down to 4.7 percent, tying its lowest level for the decade.

Completions and Absorption

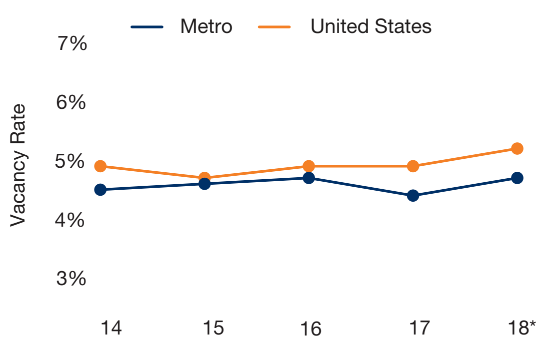


CONSTRUCTION:

6,000 units completed Y-O-Y

- Developers brought approximately 300 fewer units online over the past 12 months than in the previous yearlong period.
- The most deliveries for the first quarter were made in Center City, adding almost 600 units to the 1,300 apartments that have already arrived since March 2017. A further 1,430 rentals will open in the area before 2019.

Vacancy Rate Trends

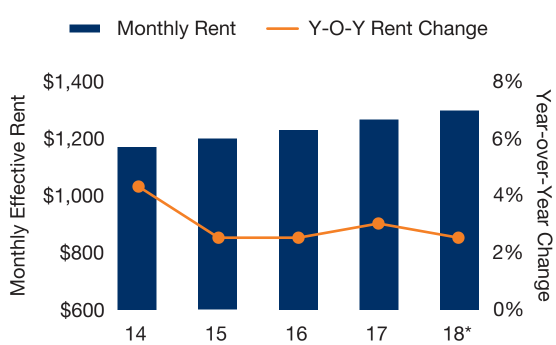


VACANCY:

10 basis point increase in vacancy Y-O-Y

- Six years of elevated construction has pushed the metro's vacancy rate up to 4.9 percent.
- Two quarters in a row without deliveries has kept vacancy below 4 percent in Bucks County, where operations are now some of the tightest in the market. One of the larger year-over-year vacancy declines of 80 basis points occurred in the Wilmington area south of Philadelphia.

Rent Trends



RENTS:

4.1% increase in effective rents Y-O-Y

- The average effective rent rose to $1,282 per month over the past year. In the 12 months ending March 2017, effective rents improved by 2.2 percent.
- Rent growth year over year was highest for Class A properties, moving up by 6.7 percent. This was followed by gains of 4.8 percent and 2.5 percent in Class B and C buildings, respectively.

* Forecast

DEMOGRAPHIC HIGHLIGHTS

1Q18 MEDIAN HOUSEHOLD INCOME

Metro **$71,372**

U.S. Median $60,686

1Q18 AFFORDABILITY GAP

Renting is **$235** Per Month Lower

Average Effective Rent vs. Mortgage Payment*

MULTIFAMILY (5+ Units) PERMITS❖

5,290 2H 2017

17% Compared with 2H 2014-2016

1Q18 MEDIAN HOME PRICE

Metro **$236,310**

U.S. Median $257,628

FIVE-YEAR HOUSEHOLD GROWTH**

83,000 or **0.7%** Annual Growth

U.S. 1.1% Annual Growth

SINGLE-FAMILY PERMITS❖

7,049 2H 2017

8% Compared with 2H 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 1Q18

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Northeast Philadelphia	3.2%	-10	$1,034	4.0%
Gloucester County	3.7%	50	$1,191	2.8%
Bucks County	3.8%	-80	$1,176	2.3%
Norristown/Upper Merion/ Lower Merion	4.3%	-60	$1,386	0.2%
Burlington County	4.6%	30	$1,242	4.0%
Northwest Philadelphia	4.7%	-50	$1,312	0.7%
Delaware County	4.8%	70	$1,055	0.3%
Lower Camden County	4.8%	20	$1,064	2.8%
Outer Wilmington	4.9%	-80	$1,139	4.6%
Southwest Philadelphia	5.0%	-90	$1,498	9.6%
Overall Metro	**4.9%**	**10**	**$1,282**	**4.1%**

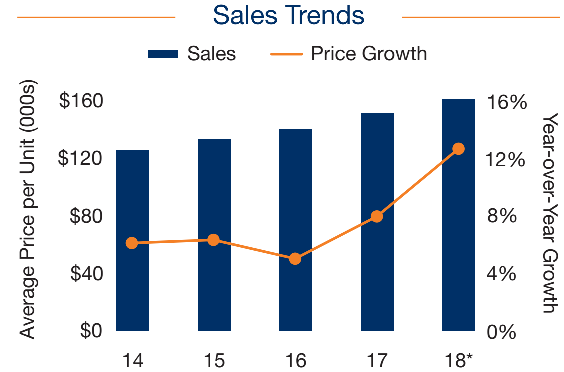
SALES TRENDS

Transaction Prices Climb Higher as Competitive Yields Draw Investors

- Transaction volume and sale price have both improved year over year. The average price increased 13 percent between the first quarter of 2017 and the first quarter of 2018 to $160,000 per unit.
- Cap rates have continued to compress. The average yield for the market is now at mid-6 percent, down from high-6 percent in 2015.

Outlook: Out-of-market investor demand remains strong as prices appreciate more quickly and yields average 100 to 170 basis points above nearby Washington, D.C., or New York City.

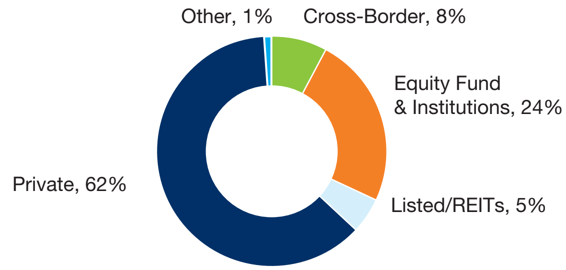
Sales Trends



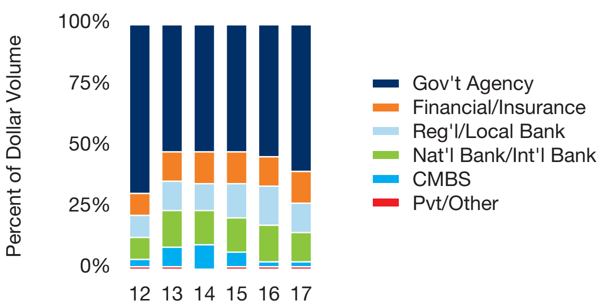
* Trailing 12 months through 1Q18

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

1Q18 Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



Include sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

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

- **Fed raises benchmark interest rate, plots path for additional increases.** The Federal Reserve increased the federal funds rate by 25 basis points, lifting the overnight lending rate to 1.5 percent. While the Fed noted that the inflation outlook had moderated in recent months, an upgraded economic forecast factoring in recent tax cuts and a rollback in regulation strengthened growth projections for the next two years. As a result, the Fed has guided toward two additional rate hikes this year, while setting the stage for as many as four increases in 2019.
- **Lending costs rise alongside Fed rate increase.** As the Federal Reserve lifts interest rates, lenders will face a rising cost of capital, which may lead to higher lending rates for investors. However, in an effort to compete for loan demand, lenders may also choose to absorb a portion of the cost increases. While higher borrowing costs may prompt buyers to seek higher cap rates, the positive economic outlook should provide rent growth that outpaces inflation over the coming year. As a result, sellers remain committed to higher asking prices, which has begun to widen an expectation gap as property performance and demand trends remain positive.
- **The capital markets environment continues to be highly competitive.** Government agencies continue to consume the largest share, just slightly over 50 percent, of the apartment lending market. National and regional banks control approximately a quarter of the market. Global markets and foreign central banks are keeping pressure down on long-term interest rates. Pricing resides in the 4 percent realm with maximum leverage of 75 percent. Portfolio lenders will typically require loan-to-value ratios closer to 70 percent with interest rates in the high-3 to mid-4 percent range. The passage of tax reform and rising fiscal stimulus will keep the U.S. economy growing strongly and rental demand will remain high with the national apartment vacancy rate at 5 percent at the end of 2017.

National Multi Housing Group

Visit www.MarcusMillichap.com/Multifamily

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

Prepared and edited by
Cody Young
Research Associate | Research Services

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

Price: $250

Philadelphia Office:

Sean Beuche Regional Manager
2005 Market Street, Suite 1510
Philadelphia, PA 19103
(215) 531-7000 | sean.beuche@marcusmillichap.com

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