Multifamily Research
Market Report

Third Quarter 2018

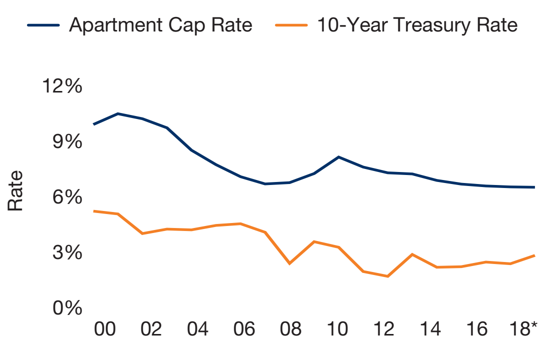
Philadelphia Metro Area

Developers Begin to Shift Out of Downtown to Where Rent Growth is Highest

High rents in the urban core are prompting more renters to look toward the suburbs, improving performance in those areas. The average effective rent in Center City is about $1,000 more per month relative to the rest of the market, aiding demand for affordable apartments outside the CBD. As such, property performance is improving the most in suburban locations, especially those with few recent completions. Less than 3 percent of deliveries made over the past four years have gone to Gloucester County, keeping vacancy under 3.5 percent and enabling rents to appreciate 24.4 percent during that time. Rents in Center City only rose 5.9 percent during that same span, while vacancy increased. Southwest Philadelphia recorded similar gains as Gloucester County, all while experiencing a supply wave.

Key suburban cities gaining new arrivals. The high demand in suburban submarkets is drawing more developers outside of downtown to areas that have not seen as many deliveries in recent years. Construction activity is picking up most notably in Central Wilmington and Northeast Philadelphia. As the most populated city in Delaware, Wilmington supports several demand drivers of its own, in addition to being a manageable drive to Philadelphia. Much closer to the core, Northeast Philadelphia has a large supply of older stock but is only recently seeing new development, giving it one of the tightest vacancy rates for Class A units in the market.

Local Apartment Yield Trends



* Cap rate trailing 12-month average through 2Q; Treasury rate as of June 28.
Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2018 Outlook

4,600 units will be completed

Construction: Deliveries for 2018 will fall below what was completed last year or the year before. Approximately 40 percent of the new units will be in Center City.

10 basis point decrease in vacancy

Vacancy: Moderating construction amid continued demand will support a small contraction in the vacancy rate to 4.3 percent. Last year vacancy fell 30 basis points.

3.4% increase in effective rents

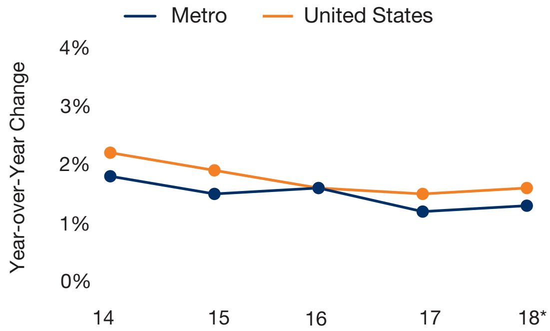
Rents: An increase in Class B rent growth is supporting an overall rise in the metro's average effective rent to $1,302 per month. In 2017 rates appreciated 2.9 percent.

Investment Trends

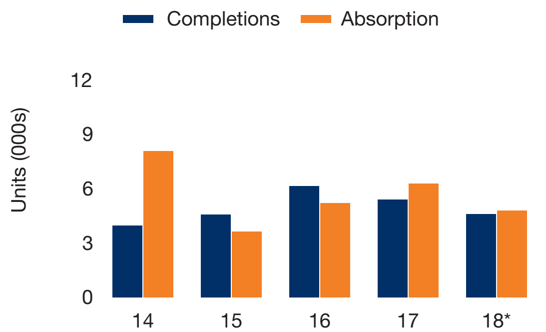
- The anticipated completion of the AmerisourceBergen headquarters with the rest of the SORA West multi-use complex in 2020 will bring new jobs and attractions to Conshohocken. Young professionals relocating to the area for work and play will find few apartments built after 2000. Investors interested in value-add opportunities may find older properties, which could be repositioned to meet the expected future demand.
- Sales velocity rose over the past 12 months thanks in part to a threefold increase in the number of New York-based buyers. Investors from the neighboring state acquired assets across the market, with an average sale price just above the metro average of $163,300 per unit and cap rates in the low-6 percent range.
- Improving property fundamentals have helped double investor interest in the north side of Philadelphia over the past two years, where initial returns can range 100 basis points or more above the metro average of mid-6 percent.

Philadelphia

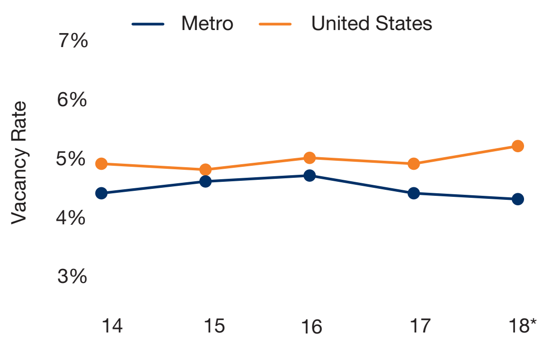
Employment Trends



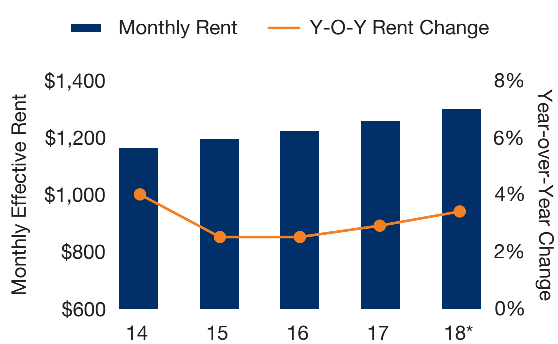
Completions and Absorption



Vacancy Rate Trends



Rent Trends



* Forecast

2Q18 – 12-MONTH PERIOD

EMPLOYMENT:

1.1% increase in total employment Y-O-Y

- The addition of 32,900 workers over the past 12 months helped push down the jobless rate 40 basis points to 4.3 percent in June.
- Hiring over the past year was focused largely in the education and health services sector and in the professional and business services sector. Employers added a combined 26,800 jobs in those fields.

CONSTRUCTION:

5,100 units completed Y-O-Y

- Deliveries made over the past four quarters fall below what was completed in the previous annual period. Most arrivals were in Center City, where 1,820 units opened.
- About 7,100 apartments are underway and 5,100 of them expected to arrive within the next 12 months. More than 2,700 of those rentals are heading for the suburbs.

VACANCY:

0 basis point change in vacancy Y-O-Y

- Vacancy stayed at 4.2 percent year over year in June as apartment absorptions slowed during the winter. In the previous annual period, vacancy rose 10 basis points.
- Vacancy fell by triple digit margins in Northwest and Southwest Philadelphia. Demand surged above 1,000 units in the latter submarket, while in the former the construction pipeline condensed by about half.

RENTS:

2.8% increase in effective rents Y-O-Y

- Annual rent growth about doubled the rate of appreciation from last year as the average effective rent amount increased to $1,293 per month.
- Rents advanced more slowly in the first half of 2018 as less appreciation occurred among Class C apartments. Much of that has been due to mild decreases for such units in Montgomery, Chester and Camden counties.

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*
37,200

2Q18 POPULATION AGE 20-34
(Percent of total population)
Metro **21%**
U.S. 21%

2Q18 MEDIAN HOUSEHOLD INCOME
Metro **$71,910**
U.S. Median $61,179

FIVE-YEAR HOUSEHOLD GROWTH*
81,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR'S DEGREE+**
Metro **34%**
U.S. Average 29%

1Q18 TOTAL HOUSEHOLDS
34% Rent
66% Own

* 2017-2022
**2016

SUBMARKET TRENDS

Lowest Vacancy Rates 2Q18

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Northeast Philadelphia	3.1%	0	$1,041	2.2%
Gloucester County	3.2%	50	$1,183	-0.3%
Delaware County	3.3%	30	$1,065	1.0%
Bucks County	3.5%	-10	$1,196	2.0%
Norristown/Upper Merion/ Lower Merion	4.0%	-20	$1,440	2.6%
Northwest Philadelphia	4.0%	-130	$1,321	2.2%
Southwest Philadelphia	4.2%	-150	$1,497	9.6%
Outer Wilmington	4.3%	-90	$1,153	5.3%
Lower Camden County	4.4%	80	$1,085	2.1%
Burlington County	4.6%	120	$1,243	1.1%
Overall Metro	**4.2%**	**0**	**$1,293**	**2.8%**

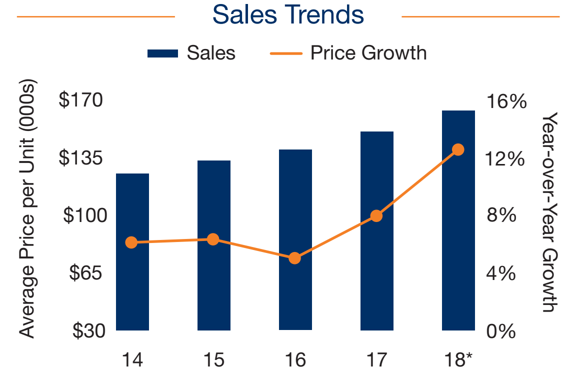
SALES TRENDS

Price Gains Benefit Owners While Advantage Over Other Markets Brings in New Investment

- Transaction velocity climbed for the fourth consecutive annual period, with heightened competition driving the average sale price up 13 percent year over year to $163,300 per unit.
- Rising prices have also contributed to cap rate compression this year, with the average first-year yield falling 20 basis points to 6.4 percent.

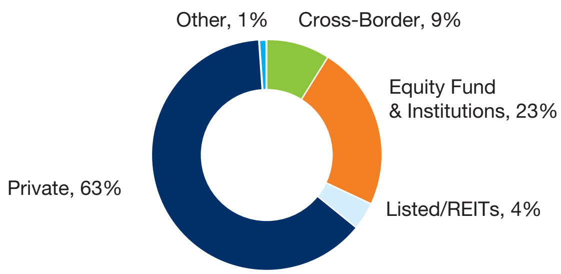
Outlook: Higher initial returns and lower entry costs compared with most other large East Coast markets will drive more out-of-state and foreign investment in the Philadelphia metro.

Sales Trends

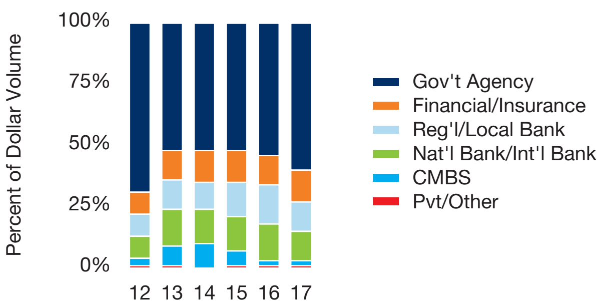


* Trailing 12 months through 2Q18
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

2Q18 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

- **Healthy economy and inflationary pressure drive rate increases.** The Federal Reserve appears committed to normalizing the fed funds rate, but further action could be restrained this year as headwinds could weigh on the economy. Economic growth and inflation have had a dramatic effect on the 10-year Treasury rate, which has more than doubled over the past two years to 2.85 percent. However, capital inflows as investors seek alternative investment options are holding the rate below 3 percent.
- **Borrowing costs rise, cap rates remain compressed.** Debt providers are facing a rising cost of capital, leading to higher lending rates for investors. To compete for loan demand, some lenders may choose to absorb a portion of the cost increases while others will require higher equity stakes up front. More complex and creative approaches to financing properties may begin to emerge as investors seek to reach return objectives.
- **Lending market remains competitive as interest rates rise.** 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. Multifamily interest rates currently reside in the mid-4 percent to mid-5 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 low-4 percent to low-5 percent span.

National Multi Housing Group

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Price: $250

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