MARKET REPORT

Marcus & Millichap

MULTIFAMILY

Philadelphia Metro Area

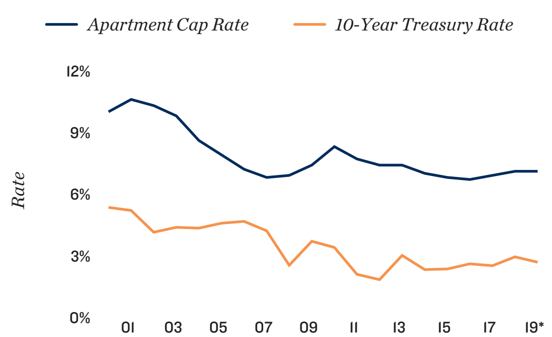
Q2/19

Investors Increasingly Turn to Philadelphia's Center City as Developers Look Farther Out

Declining availability boosting rents outside downtown. Numerous completions will be coming to Center City this year, although multifamily development in the urban core is trending down. Fewer arrivals will help recently opened buildings lease units, benefiting operations. Center City's current average vacancy rate of 5.4 percent is one of the highest of all of Philadelphia submarkets. Minimal construction in other areas is reducing availability. Lower Camden County and Bucks County will end 2019 with no new supply delivered over the last two years as each has a vacancy rate in the 3 percent band. A lack of arrivals is in turn fueling above-market rent growth.

Construction activity expands in certain suburbs. While development is slowing in Center City, it is accelerating in other locales. The greater Norristown and Merion area will welcome over 1,000 units this year, mostly concentrated in the community of Bala-Cynwyd with four prominent openings near the Cynwyd metro station. A substantial drop in the submarket's vacancy rate in 2018 signals that there is ample demand for the new arrivals, as renters look for residential options with downtown access that are comparatively more affordable. Deliveries are also expected in Northeast Philadelphia. Urban density in Center City is pushing some builders farther north to transitioning neighborhoods, with three new buildings coming online in Olde Kensington. Several of these areas also happen to be inside opportunity zones, encouraging future construction or redevelopment.

Local Apartment Yield Trends



** Cap rate trailing 12-month average through 1Q; Treasury rate as of March 29*

Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2019 Outlook

5,900 UNITS
will be completed

CONSTRUCTION:

Annual completions rise to their highest level observed so far this cycle, as the development pipeline shifts moderately away from the urban core toward prominent suburban neighborhoods.

20 BASIS POINT
decrease in vacancy

VACANCY:

The vacancy rate inches below the 4 percent threshold for the second time in 13 years to 3.9 percent. In 2018, vacancy fell 40 basis points.

3.0% INCREASE
in effective rents

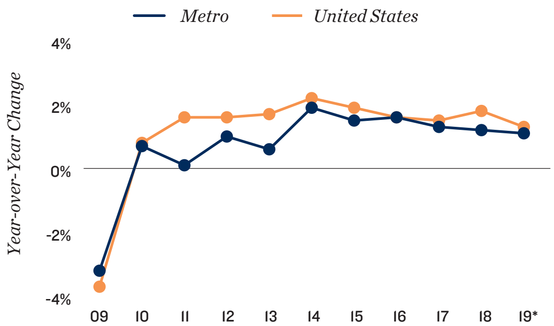
RENTS:

Monthly rates continue to climb as the average effective rent advances to $1,362 per month this year, building on a 5.2 percent rate of growth in 2018.

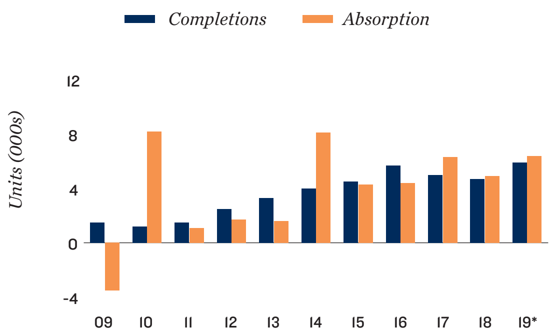
Investment Trends

- Over the past five years, a greater concentration of sales activity has taken place in Center City, with properties in Rittenhouse and Washington squares changing hands most frequently. The average age of a building in the submarket is 100 years, but assets nevertheless trade at some of the highest per unit sale prices in the metro thanks to the popularity of the downtown location with renters. Newer buildings or those recently renovated produce cap rates in the mid-5 percent zone.
- Transaction velocity also remains high in neighborhoods north of Center City. Several Class B properties built in the last five years with fewer than 20 units exchanged ownership with initial returns in the mid-6 to high-6 percent zone. These properties may appeal to private investors less interested in older, Class C inventory.
- A growing number of trades involve out-of-market investors, including buyers from New York, California and Illinois. Yields in Philadelphia can be 100 to 400 basis points above those in their local metros.

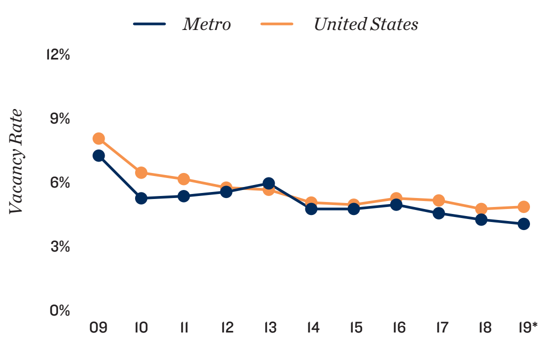
Employment Trends



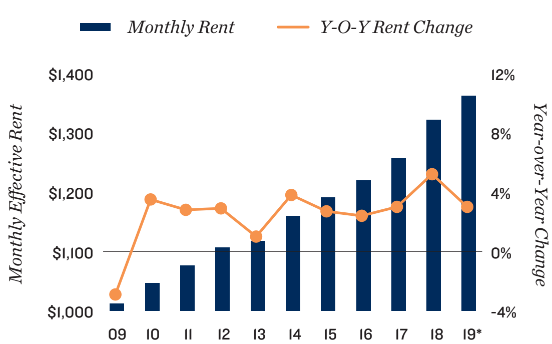
Completions and Absorption



Vacancy Rate Trends



Rent Trends



** Forecast*

Source: CoStar Group, Inc.

1Q19 – 12-Month Period

EMPLOYMENT

1.3% **increase in total employment Y-O-Y**

- Employers created 38,100 jobs over the past 12 months, approximately 5,000 more positions than were added during the preceding annual period.
- Education and health services, the market's primary industries, led employment growth again with over 17,700 new hires. Active development across a range of real estate sectors also supported about 9,000 new roles in construction.

CONSTRUCTION

4,900 **units completed Y-O-Y**

- About 200 more apartments opened in the metro over the past four quarters compared with the year prior. Center City remained the most actively developed area with 2,000 deliveries.
- The construction pipeline expanded most notably in Central Wilmington with the completion of 430 rentals. A majority of those units came online in 2018 when two properties opened, one west of the city along Route 7 and another downtown.

VACANCY

50 **basis point decrease in vacancy Y-O-Y**

- Robust summer leasing activity contributed to a decline in the marketwide vacancy rate to 4.3 percent year over year in March.
- Availability is lowest in Northeast Philadelphia at 3.2 percent despite an increase in the number of apartment openings. Vacancy also fell 130 basis points to 4.9 percent in Central Wilmington despite elevated construction activity.

RENTS

4.9% **increase in the average effective rent Y-O-Y**

- The average effective rent climbed to $1,331 per month over the past four quarters after posting a 3.8 percent annual increase a year ago in March.
- Rent growth at or above 5 percent occurred in North Montgomery County and Delaware County. Fewer concessions boosted Class B monthly rates in Montgomery County, while less recent construction in Delaware County bolstered effective rates at existing buildings.

Demographic Highlights

Five-Year Population Growth*
21,200

1Q19 Population Age 20-34 (Percent of total population)
Metro 21%
U.S. 21%

1Q19 Median Household Income
Metro $72,314
U.S. Median $64,259

Five-Year Household Growth*
68,700

Population of Age 25+ Percent with Bachelor's Degree+**
Metro 35%
U.S. Average 30%

1Q19 Total Households
Rent 36%
Own 64%

** Forecast ** 2018-2023*

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
Northeast Philadelphia	3.2%	-10	$1,050	1.5%
Bucks County	3.5%	-40	$1,233	5.3%
Gloucester County	3.5%	0	$1,204	0.5%
Burlington County	3.8%	-60	$1,219	2.7%
Lower Camden County	3.9%	-40	$1,081	3.1%
Delaware County	4.0%	-60	$1,108	6.7%
Norristown/Upper Merion/ Lower Merion	4.3%	-20	$1,477	4.9%
North Montgomery County	4.3%	-150	$1,385	8.2%
Chester County	4.7%	-60	$1,520	5.5%
Northwest Philadelphia	4.7%	20	$1,338	4.5%
Central Wilmington	4.9%	-130	$1,156	0.1%
Overall Metro	**4.3%**	**-50**	**$1,331**	**4.9%**

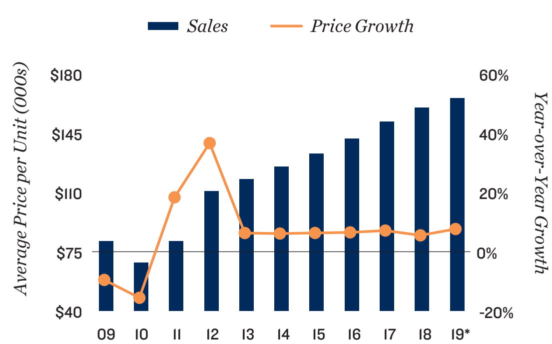
SALES TRENDS

Healthy Trading Activity Supports Continued Price Appreciation as Investors Plan for Next Cycle

- Trading velocity returned to 2016 levels as greater market volatility and higher interest rates in late 2018 likely contributed to a slowdown in deals signed in the first quarter of this year.
- Healthy investment demand nevertheless supported a 7.7 percent increase in the average sale price to $165,500 per unit, while the average cap rate inched up into the 7 percent band.

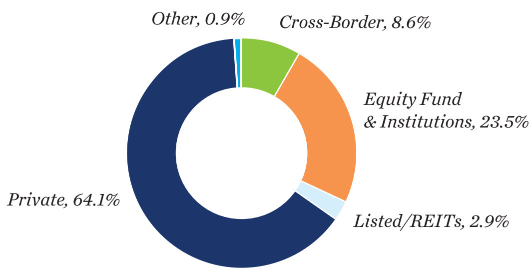
Outlook: Some investors are pursuing Class B properties in suburban settings for multidecade holds, expecting residential demand to improve outside the core in line with anticipated long-term demographic trends.

Sales Trends

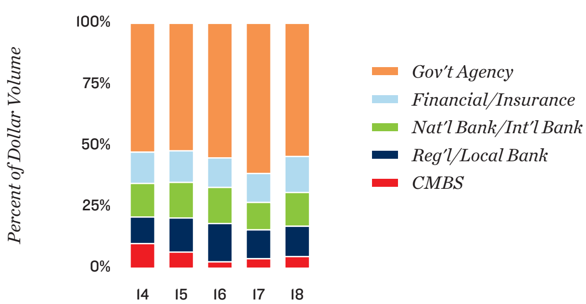


** Trailing 12 months through 1Q19*
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

1Q19* Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



** Trailing 12 months through 1Q19*
Includes sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

- **International pressures weigh on domestic outlook; Fed remains patient.** Amid ongoing trade disputes between the U.S. and China and slowing growth throughout the European economy, the global economic outlook has become more cautious. Market volatility, combined with muted sentiment, has sponsored a flight to the safety of Treasurys, pushing the 10-year yield below 2.6 percent. While domestic growth has moderated recently, the waning impact of the tax cut stimulus will likely trim forward estimates further. As a result, the Fed has decided to cease reducing its balance sheet reduction through quantitative tightening by September and removed the potential for rate increases through the remainder of the year. The bond market has begun to price in a much more dovish Fed, with flattening interest rates reflecting more caution. Fed officials will likely focus on the intersection of a global growth slowdown and continued labor market strength to refine their plans moving forward, keeping interest rates stable for the foreseeable future.
- **Abundant liquidity sources balance conservative approach to underwriting.** The availability of debt for apartment assets remains elevated, spurred by the recent pivot by the Federal Reserve. Sourcing will be led by Fannie Mae and Freddie Mac, in addition to a wide array of local, regional and national banks, and insurance companies. Loan-to-value (LTV) ratios are trending between 65 and 75 percent on stabilized properties. The decline in interest rates has rewidened the spread between cap rates and Treasurys, reducing lender concerns about the risks related to repayment and valuation at maturity. Development and value-add projects have seen more conservative lending due to concerns surrounding overdevelopment and the length of the business cycle, leading to a greater use of alternative financing structures such as mezzanine loans and preferred equity to cover the additional capital requirements.

National Multi Housing Group

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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; RealPage, Inc.; TWR/Dodge Pipeline; U.S. Census Bureau