MARKET REPORT

Marcus & Millichap

MULTIFAMILY

Philadelphia Metro Area

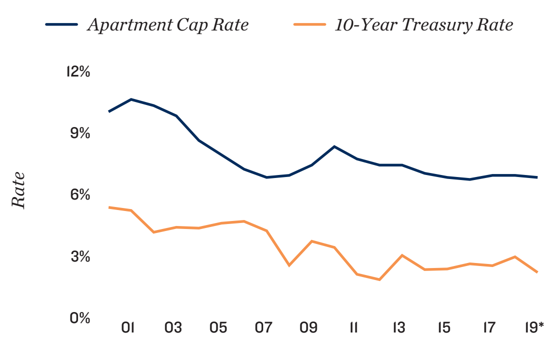
Q3/19

Robust Renter Demand in Pockets of Greatest Construction Drive Performance Gains

Philadelphia suburbs continuing to flourish. The combination of more affordable rents and proximity to suburban offices supports housing demand in Philadelphia's western townships. Interest in rental living has been especially strong in King of Prussia and the general Norristown/Merion area. Apartments near the town's walkable shopping district are in particularly high demand. Despite welcoming more deliveries since 2015 than anywhere outside Center City, the submarket's vacancy rate fell 190 basis points during that span to 3.6 percent in June. Although another 1,170 apartments will open here this year, strong absorption is expected to support continued vacancy declines and rent growth.

Cranes stay in Center City as development increases in New Jersey. Construction activity remains concentrated in Center City, even as the pace of building moderates year over year. About 1,130 units have been completed here so far in 2019, with another 420 or so rentals anticipated to open by year end. Leasing activity is exceeding the pace of deliveries, lowering vacancy and bolstering rent growth. Outside of Center City, the development pipeline is expanding considerably in Burlington County. Following the arrival of 174 units last year, more than 1,000 rentals will come online by December. Most of the openings are garden-style units, offering an alternative lifestyle to smaller facilities in more urban settings. The rise in inventory will weigh on vacancy in the short term, but at a current rate of 2.6 percent, there is ample room to grow supply without substantially impacting operations.

Local Apartment Yield Trends



** Cap rate trailing 12-month average through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2019 Outlook

6,100 UNITS

will be completed

CONSTRUCTION:

The development pipeline will achieve a more than 20-year high in 2019 as apartment supply in the metro expands by 1.6 percent. Last year about 4,700 apartments were completed.

20 BASIS POINT

decrease in vacancy

VACANCY:

Vacancy will fall to 3.9 percent this year after declining 30 basis points in 2018. The last time availability fell below 4 percent at year end was in 2006.

3.8% INCREASE

in effective rents

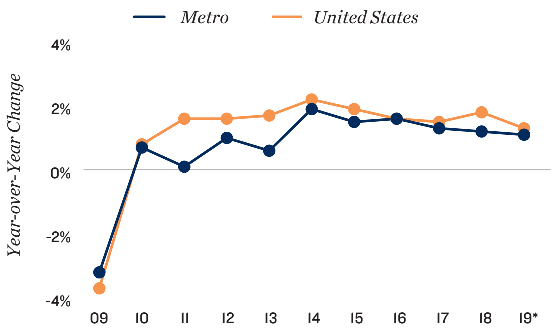
RENT:

Heightened construction activity will weigh on rent growth following the 5.3 percent gain last year as the average effective rate climbs to $1,368 per month.

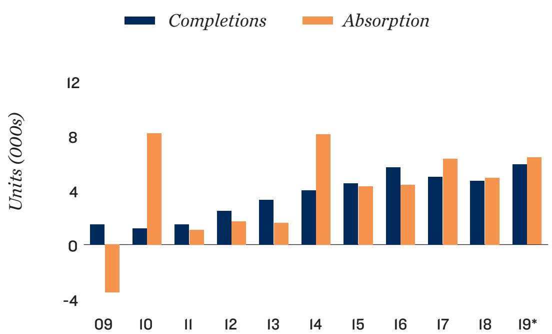
Investment Trends

- Center City continues to be the most actively traded submarket in the metro, as both older and newer properties were exchanged. Here transactions involved assets built pre-1930s, although a limited number were buildings completed within the last five years. Cap rates for assets, regardless of year built, fell into the mid-5 to low-6 percent zone, but entry costs were much higher for modern facilities.
- A series of transactions priced over $100 million contributed to record dollar volume over the past four quarters. Institutional investors targeted assets in popular rental areas including Center City, University City and King of Prussia. Most assets were built since 2000 and changed hands for initial returns in the mid-5 to mid-6 percent band.
- In southern New Jersey, buyers remain focused on assets situated near Cherry Hill, Burlington and Clementon. Entry costs generally fell under $100,000 per unit, supporting the acquisition of Class C properties with more than 100 doors by investors in the $10 million to $20 million price tranche.

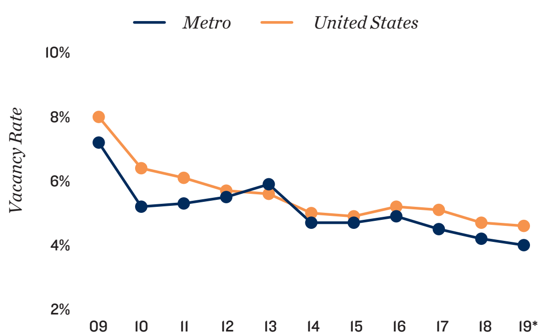
Employment Trends



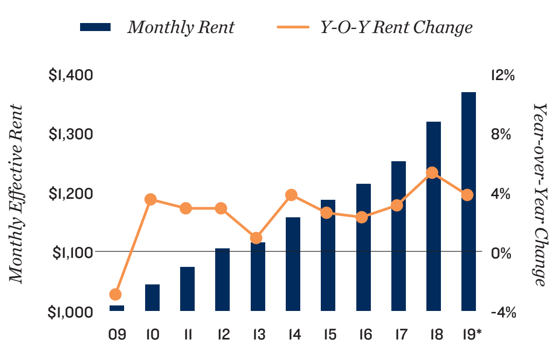
Completions and Absorption



Vacancy Rate Trends



Rent Trends



** Forecast*

Source: RealPage, Inc.

2Q19 – 12-Month Period

EMPLOYMENT

1.0% increase in total employment Y-O-Y

- Employers added 29,200 personnel to staffs over the 12-month period ended in June, down from the 35,300 roles created during the previous annual period.
- Employment growth is diversified across numerous professions, including those in hospitality, business services and healthcare. Increasing multifamily development is also supporting hiring in the construction sector, up 4.6 percent year over year in June.

CONSTRUCTION

5,500 units completed Y-O-Y

- Philadelphia's apartment inventory grew by 1.2 percent over the past four quarters as approximately 1,000 more units were delivered since June 2018 than in the preceding 12 months.
- Development activity continued to be concentrated in Center City with the arrival of over 2,000 apartments. Another 1,100 units opened in the Norristown/Merion area, well above the 440 rentals completed in the prior period.

VACANCY

80 basis point decrease in vacancy Y-O-Y

- Positive absorption across the market facilitated a drop in Philadelphia's vacancy rate to 3.5 percent in June, more than compensating for a 10-basis-point increase a year ago.
- A lack of substantial development contributed to a 160-basis-point vacancy decline in North Montgomery County to 3.2 percent. Availability dropped under 3 percent in both Bucks and Burlington counties for the same reason.

RENT

5.1% increase in the average effective rent Y-O-Y

- The average effective rent reached $1,356 per month at the end of the second quarter, aided by above-market appreciation in Delaware and Chester counties south of the city of Philadelphia.
- Rent growth occurred in similar magnitudes across different types of apartments, led slightly by Class A units, where monthly payments rose 8.3 percent year over year to $2,019. Rents improved by 6.0 to 6.6 percent for Class B and C units, respectively.

Marcus & Millichap

Demographic Highlights

2Q19 Median Household Income

Metro $72,909

U.S. Median $64,784

2Q19 Affordability Gap

Renting is $240 *Per Month Lower*

*Average Effective Rent vs. Mortgage Payment**

Multifamily (5+ Units) Permits*

8,372 *1H 2019*

39% *Compared with 1H 2016-2018*

2Q19 Median Home Price

Metro $247,267

U.S. Median $269,186

Five-Year Household Growth**

88,700 *or* 0.7% *Annual Growth*

U.S. 1.0% *Annual Growth*

Single-Family Permits*

6,781 *1H 2019*

6% *Compared with 1H 2016-2018*

**Mortgage payments based on quarterly median home price with a 30-year fixed-rate conventional mortgage, 90% LTV, taxes, insurance and PMI.* ***2019-2024* ** Annualized Rate*

SUBMARKET TRENDS

Lowest Vacancy Rates 2Q19**

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
Burlington County	2.6%	-190	$1,238	2.5%
Northeast Philadelphia	2.6%	-60	$1,087	4.2%
Bucks County	2.7%	-80	$1,250	4.3%
Delaware County	3.0%	-40	$1,131	6.6%
North Montgomery County	3.2%	-160	$1,409	6.3%
Norristown/ Upper Merion/Lower Merion	3.6%	-30	$1,508	3.1%
Chester County	3.7%	-80	$1,552	6.3%
Southwest Philadelphia	3.9%	-160	$1,588	1.7%
Center City Philadelphia	4.7%	-70	$2,141	4.4%
Camden/Cheery Hill	5.1%	-90	$1,400	2.6%
Overall Metro	**3.5%**	**-80**	**$1,356**	**5.1%**

*** Includes submarkets with more than 20,000 units of inventory*

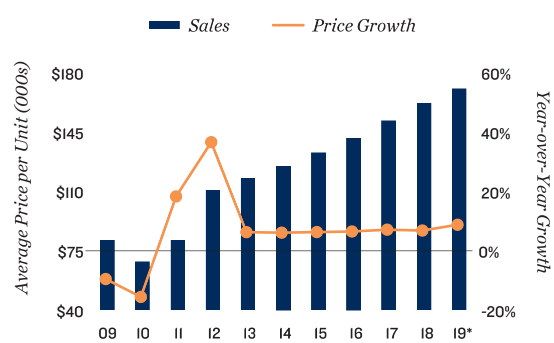
SALES TRENDS

Sales Prices Continue Climb as More Investors Turn To the Suburbs

- While transaction velocity moderated over the past 12 months, total dollar volume improved to a new cycle record. This trend was aided by a 8.8 percent rise in the average sale price to $170,600 per unit.
- Higher sale prices contributed to a modest 10-basis-point decline in the metro's average cap rate to 6.7 percent after remaining flat for the previous three years.

Outlook: Higher rents downtown, new offices outside the city center and other demographic factors may prompt some investors to anticipate a greater shift toward suburban renting. More buyers may look for opportunities in both larger and smaller suburban towns.

Sales Trends

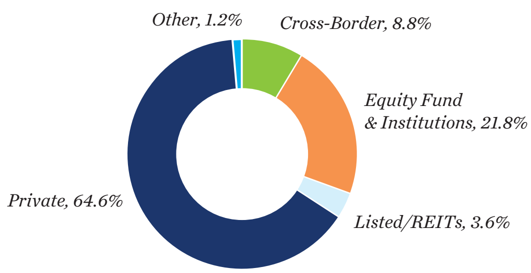


** Trailing 12 months through 2Q19*

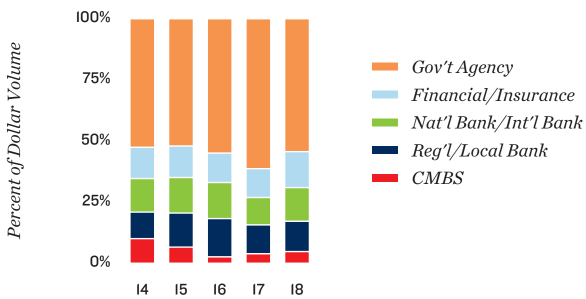
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

2Q19* Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



** Trailing 12 months through 2Q19*
Includes sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

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

- **Fed takes action to sustain economic momentum.** The combination of trade disputes between the U.S. and China together with slowing European growth converged to weigh on the global economic outlook, sparking action by the Federal Reserve. To combat the restraints on growth, largely driven by uncertainty surrounding international trade, the Federal Reserve cut its overnight rate by 25 basis points and halted its balance sheet reductions, known as quantitative tightening. Though this action runs the risk of lifting inflation pressure, the Fed has communicated its willingness to let the economy "run hot." Many believed the Fed action would offer a boost to domestic markets until the trade war was escalated immediately after the Fed announcement. This new bout of uncertainty pushed the 10-year Treasury yield below 2 percent for the first time since 2016. Though domestic growth has moderated, the nation's economic foundation remains solid, headlined by the tight labor market and muted inflationary pressure. Fed officials will continue to focus on economic risks spilling over from the trade war with China, potentially calling for additional rate reductions this year.
- **Abundant liquidity balances conservative underwriting.** Debt financing for apartment assets remains strong, supported by a variety of lenders. However, Fannie Mae and Freddie Mac, two mainstay apartment capital sources, will step to the sidelines in the second half of the year as they reach their lending caps on market rate assets. The Government Sponsored Enterprises will remain active lenders for "uncapped business," including environmentally sustainable and affordable housing properties. A wide range of local, regional and national banks; pension funds; insurance companies and CMBS sources will remain active. All have responded to the falling interest rate climate by reducing mortgage rates, but lender spreads have widened as the 10-year Treasury rate has fallen. Given the downward pressure on interest rates, lender caution has risen, particularly for construction loans. Though lending is still available for these types of projects, investors may need to blend mezzanine debt with other capital sources until they prove out their concepts and substantially fill units. For stabilized existing assets in most major markets, financing remains plentiful.

National Multi Housing Group

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 Analyst | Research Services

For information on national apartment trends, contact:
John Chang
Senior 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