MARKET REPORT

Marcus & Millichap

MULTIFAMILY
Philadelphia Metro Area

Q4/19

Job Growth Supports Greater Leasing Activity; Construction Increases in the Suburbs

Elevated apartment absorption drops vacancy and improves rents. Steady job growth will contribute to the formation of more than 22,000 households in Philadelphia this year, raising demand for homes and rentals. Leasing activity surged over the summer and autumn seasons, with more apartments absorbed over that six-month span than in all of 2018, leading to a sharp drop in vacancy. Tighter availability is supporting rent growth of more than 5 percent for the second year in a row, the highest sustained period of appreciation reported so far this cycle. Monthly payments are increasing even more for apartments on the higher end of the rental scale. Class A rents are advancing at an above-market rate despite elevated new construction, due in part to a growing pool of skilled labor.

Development activity contracts in Center City but expands elsewhere. The market's overall multifamily construction pipeline is increasing, with development activity spreading out from the core. While Center City will still receive the highest concentration of deliveries this year, the pace of openings is slowing. Completions are instead going to destinations such as North Montgomery County and the Greater Norristown area, including King of Prussia. More projects are also underway in Burlington County, headlined by the 271-rental Barclay Chase at Marlton, which will come online before year end. Looking beyond 2019, there are more than 1,100 units underway in the New Jersey county. Another submarket where the local pipeline is expanding rapidly is Chester County, where 1,200 apartments will be built within the next few years.

Multifamily 2019 Outlook

5,200 UNITS
will be completed

CONSTRUCTION:

Approximately 900 more apartments will be delivered in 2019 than were completed last year, with most of the development activity taking place in Center City and suburban Philadelphia.

70 BASIS POINT
decrease in vacancy

VACANCY:

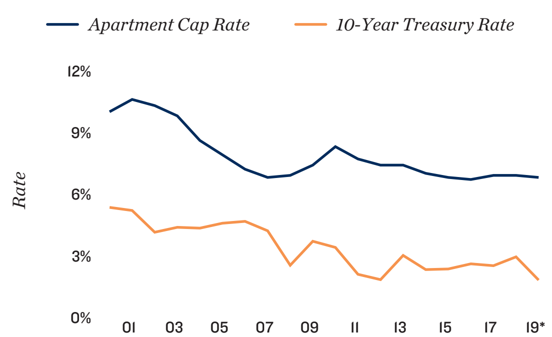
Net absorption will surpass supply additions by about 2,500 units, dropping vacancy to 3.4 percent this year. The rate last dropped below 3.5 percent in 2001.

5.2% INCREASE
in effective rents

RENT:

The average effective rent will climb to $1,385 per month in 2019, matching the pace of growth from last year.

Local Apartment Yield Trends

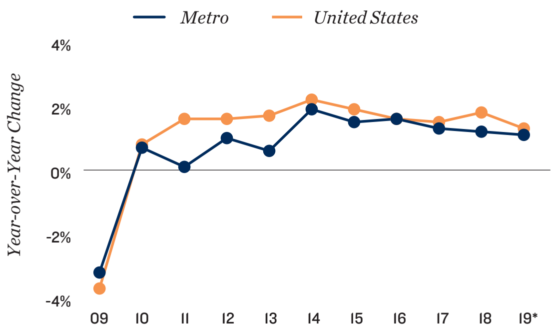


** Cap rate trailing 12-month average through 3Q*
Sources: CoStar Group, Inc.; Real Capital Analytics

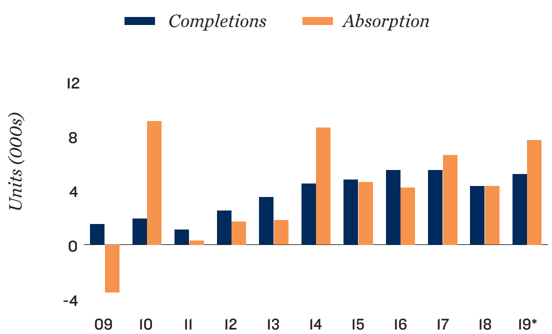
Investment Trends

- Center City continues to capture the largest share of sales activity among Philadelphia submarkets, comprising 13 percent of all trades reported in the 12 months preceding October. Heavy construction in the area has prompted buyers in the $1 million to $10 million tranche to pursue Class C buildings with fewer than 20 units that serve a different renter pool, while institutions have a larger sample size of recently completed assets to consider.
- Transaction velocity has increased notably in northeast Philadelphia. Buyers with less than $10 million in available capital are acquiring Class C buildings at below-market-average sale prices and cap rates in the high-5 to low-7 percent zone.
- In the southern New Jersey segment of the market, investors are finding opportunities most often around Cherry Hill and in both Burlington and Camden counties. Class C properties with more than 100 units changed hands for entry costs under $100,000 per unit.

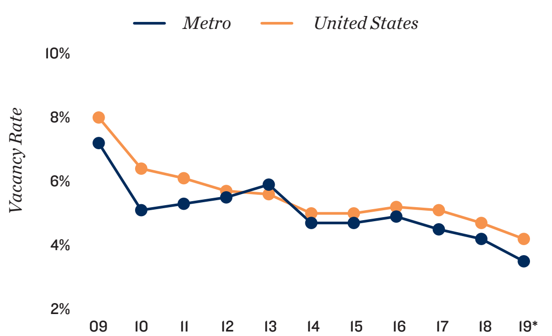
Employment Trends



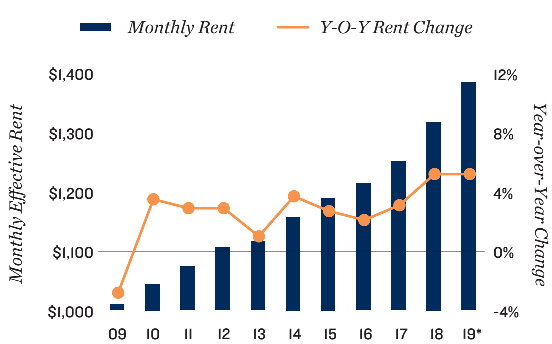
Completions and Absorption



Vacancy Rate Trends



Rent Trends



** Forecast*

Source: CoStar Group, Inc.

3Q19 – 12-Month Period

EMPLOYMENT

1.1% increase in total employment Y-O-Y

- Approximately 32,900 jobs were created over the 12-month period ended in September, about 500 more positions than were added during the previous annual period.
- Hiring was led by the professional and business services sector as well as the leisure and hospitality sector, with staffs growing by a combined 17,700 personnel. Ongoing commercial development also contributed to a 4.9 percent gain in construction workers.

CONSTRUCTION

5,500 units completed Y-O-Y

- The pace of development increased over the past four quarters as about 800 more apartments were delivered than in the prior yearlong span. Much of the year-over-year gain came from additional completions in the New Jersey portion of the market.
- The largest arrivals over the past 12 months include the Hamilton I in Center City with 539 units, followed by the 330-apartment Woodmont Townsquare in Sewell, New Jersey.

VACANCY

50 basis point decrease in vacancy Y-O-Y

- Greater apartment demand contributed to a decline in the metrowide vacancy rate to 3.2 percent in September despite heightened construction activity. Availability has not been this tight since 2001.
- Tight operations at the market level are aided by sub-3 percent vacancy in multiple submarkets, including Bucks, Delaware and Gloucester counties, as well as in Northeast Philadelphia.

RENT

5.3% increase in the average effective rent Y-O-Y

- The average effective rent rose to $1,379 per month at the end of the third quarter, building upon the 4.3 percent rate of growth recorded a year earlier. No other major Northeast metro besides Boston reported higher rent appreciation.
- Demand for apartments with more amenities contributed to a 8.6 percent increase year over year in the average effective Class A rent to $2,050 per month, surpassing gains for Class B and C buildings.

Demographic Highlights

3Q19 Median Household Income

Metro $73,581

U.S. Median $65,205

3Q19 Affordability Gap

Renting is $168 *Per Month Lower*

*Average Effective Rent vs. Mortgage Payment**

Multifamily (5+ Units) Permits❖

8,121 *1H 2019*

30% *Compared with 1H 2016-2018*

3Q19 Median Home Price

Metro $246,290

U.S. Median $272,227

Five-Year Household Growth**

93,800 *or* 0.8% *Annual Growth*

U.S. 1.0% *Annual Growth*

Single-Family Permits❖

7,384 *1H 2019*

3% *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 3Q19**

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Effective Rent	Y-O-Y % Change
Bucks County	2.2%	-90	$1,284	5.2%
Northeast Philadelphia	2.5%	0	$1,098	4.3%
North Montgomery County	2.6%	-140	$1,429	5.1%
Delaware County	2.7%	-60	$1,136	5.2%
Burlington County	3.0%	-30	$1,246	2.8%
Chester County	3.4%	-40	$1,588	6.4%
Camden/Cherry Hill	3.8%	-170	$1,394	2.7%
Norristown/Upper Merion/ Lower Merion	4.1%	-10	$1,556	3.5%
Center City Philadelphia	4.2%	-90	$2,198	6.6%
Southwest Philadelphia	5.4%	90	$1,626	2.5%
Overall Metro	**3.2%**	**-40**	**$1,379**	**5.3%**

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

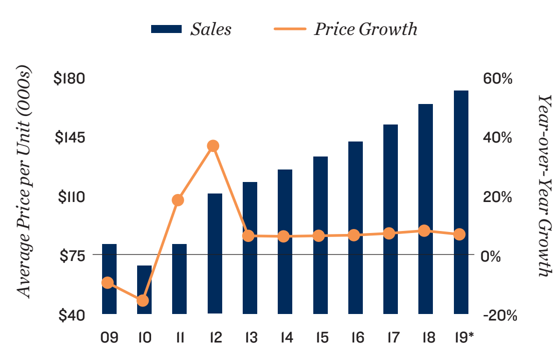
SALES TRENDS

Heightened Investor Demand Lifts Sales Prices as New York Rent Reform May Draw New Capital

- Annual transaction velocity increased by about 2 percent year over year in September, with the added investor interest supporting a 6.8 percent rise in the average sale price to $171,700 per unit.
- The appreciation in sales prices contributed to a 10-basis-point dip in the average cap rate to 6.7 percent. The metric has remained in the high-6 percent zone since 2017.

Outlook: Comparatively lower entry costs and higher cap rates continue to attract buyers from New York, where new restrictions have been imposed on multifamily property owners. This may prompt greater capital migration into Philadelphia, where rents are currently unregulated.

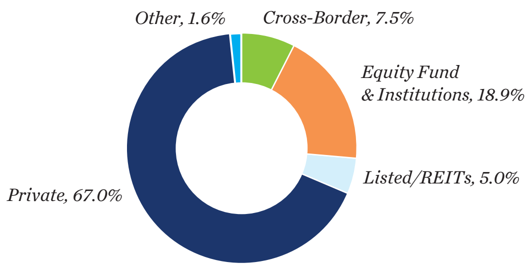
Sales Trends



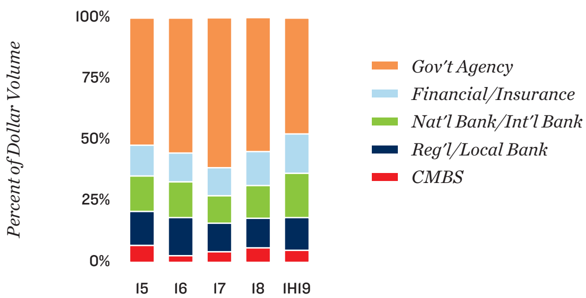
** Trailing 12 months through 3Q19*

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

1H19 Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



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

- **Fed cuts rate again, while balancing assortment of factors.** The Federal Reserve cut the overnight rate by 25 basis points at the end of October, the third reduction in less than 100 days in an attempt to lengthen the economic runway. Muted inflationary pressure and continued trade negotiations have boosted the probability for an additional rate cut in December as it is anticipated by some domestic and foreign markets. However, at the end of October, the U.S. and China were in talks for finalizing the first phase of a trade deal, potentially erasing the need for another rate reduction if the preliminary agreement quickly comes to fruition. This, along with positive economic indicators like strong wage growth, sustained job creation and a rising 10-year Treasury, will continue to make future decisions difficult for Fed members as they balance the array of forces tugging at both ends of possible outcomes. Global developments including slowing European economies as well as the progression of Brexit and its potential aftermath will also help determine future Fed decisions. Though recession risks remain, the economy's solid foundation has softened it in recent months, signaling continued domestic growth in the near future.
- **Abundant liquidity balances conservative underwriting.** Debt financing for apartment assets remains strong, supported by a variety of lenders. Fannie Mae and Freddie Mac, two mainstay apartment capital sources, were recently given increased lending caps, allowing the two Government Sponsored Enterprises to purchase $100 billion in loans during a yearlong period that started at the beginning of the fourth quarter 2019. A wide range of local, regional and national banks; pension funds; insurance companies and CMBS sources will also 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 remains near cycle lows. 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

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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