

# Multifamily Research

## Market Report

Second Quarter 2016

Philadelphia Metro Area

### Steady Job Gains Bolster Philly Apartment Demand, Construction

**The Philadelphia apartment market continues to improve as steady employment growth over the past several quarters has created a large pool of current and potential renters.** A large service sector, including healthcare, retail trade, and professional and tech services, continues to post strong job additions, with thousands of positions generated in these segments over the last 12 months. This growth facilitated a rise in household formation during the last four quarters, tripling from March of last year as more than 23,700 households were created. Rising demand for area housing has encouraged developers to ramp up construction efforts and permitting activity for multifamily projects. This year, deliveries will reach the highest level in more than 15 years,

causing some fluctuation in the metro's vacancy rate in the months to come. However, a hiring boom in the first quarter will sustain healthy demand for the significant number of units scheduled for completion this year, keeping vacancy below 5 percent. This will foster steady rent gains through the remainder of the year, pushing the metro average to a cyclical high.

**A stable pace of economic growth and healthy property operations are attracting investors to the Philadelphia apartment market this year.** Sales of assets priced over \$20 million continue to rise as institutions and REITs become more active in the market, and first-year returns for these properties have compressed to nearly 5

percent in recent quarters. Private capital investors, however, are scouring the metro for upside potential, seeking properties with some sort of inefficiency to correct and create additional value. Well-located, stabilized complexes in suburban submarkets are also appealing and typically change hands in the low- to mid-7 percent range. The low cost of debt is creating a vibrant investment climate and supporting buyer activity this year. In addition, strong demand for area assets continues to lift prices, and investors with near-term debt obligations may be inclined to sell as market conditions facilitate their ability to realize return objects.

### 2016 Multifamily Forecast

2.1% increase  
in total employment



#### Employment:

Strong job growth in the first quarter of this year will support the creation of 60,000 jobs in Philadelphia during 2016, an annual rise of 2.1 percent. Last year, the private and public sectors added 48,200 workers to payrolls, increasing the employment base 1.7 percent during the 12-month period.

5,600 units  
will be completed



#### Construction:

Following the completion of nearly 3,300 units in 2015, area developers will expand apartment stock by 5,600 rentals this year. Nearly 2,000 of these apartments will come online in the Center City Philadelphia submarket.

50 basis point  
increase in vacancy



#### Vacancy:

Demand will not keep pace with supply additions this year, and the metro's vacancy rate will rise 50 basis points from 2015 to 4.8 percent by the end of 2016. Last year, the rate declined 30 basis points year over year.

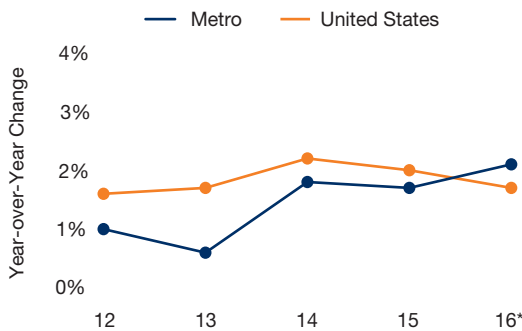
3.1% increase  
in effective rents



#### Rents:

As vacancy remains tight this year, the average rent will rise at a steady pace, reaching \$1,221 per month by year end, an annual increase of 3.1 percent. This follows a 2.6 percent annual bump in the average during 2015.

### Employment Trends

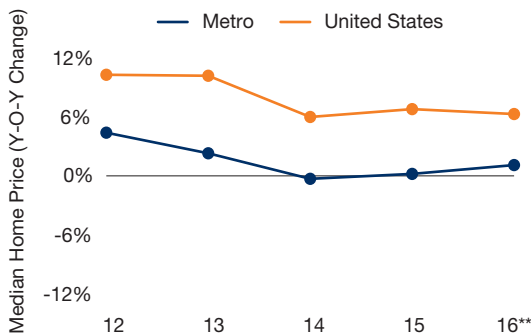


## Economy

- Philadelphia employers created nearly 25,000 positions in the first three months of 2016, for an annual headcount expansion of 76,500 workers, or a 2.7 percent rise, and the strongest pace of expansion in nearly 20 years. In the previous 12-month period, jobs grew 1.5 percent.
- Gains during the last year were led by the professional and business services sector, where more than 20,000 positions were generated in the last 12 months. The majority of these jobs were professional and technical services positions, as well as administrative and waste services jobs. In addition, the education and healthcare sector added approximately 16,700 workers.
- Building on a 100-basis-point annual decline last year, the metro's unemployment rate fell an additional 90 basis points year over year to 4.6 percent in March. Steady job growth over the past few years has pushed the rate down nearly 450 basis points since peaking at the end of 2009.

**Outlook:** Strong job growth in the first quarter of this year will support the creation of 60,000 jobs in Philadelphia during 2016, an annual rise of 2.1 percent.

### Home Price Trends

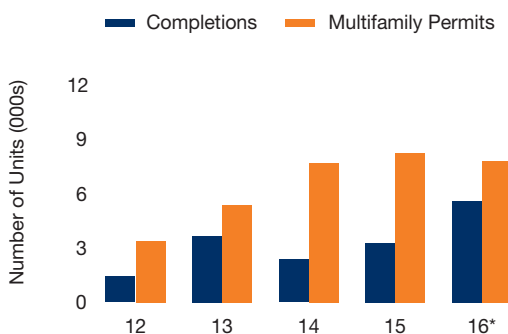


## Housing and Demographics

- Single-family permitting issuance is up nearly 8 percent from one year ago as builders pulled an annualized 8,200 permits in March. Meanwhile, multifamily permitting issuance nearly doubled during the same span as developers pulled permits for nearly 7,300 units.
- The median single-family home price ticked up 1.1 percent in Philadelphia over the last 12 months, reaching \$223,400 in March. Income growth, however, continued to outpace appreciating home values, and the median household income rose 3.5 percent to \$67,500 annually. This is more than \$15,000 above the minimum needed to qualify for a traditional mortgage on a median-priced residence in the metro.
- Assuming 20 percent down and payments for taxes and insurance, the monthly mortgage payment for a median-priced single-family home is approximately \$1,175 per month, on par with the average monthly rent for area apartments.

**Outlook:** Though homeownership is attainable for many metro residents, the apartment market will remain strong as many young professionals choose the convenience of renting over owning a home.

### Construction Trends



## Construction

- More than 3,600 apartments were added to inventory during the last four quarters ending in March, including 1,050 units in the first three months of 2016. In the previous 12-month time frame, developers completed nearly 2,700 rentals.
- The Parc at Plymouth Meeting was the largest project completed so far this year, adding 398 units to stock in the Norristown/Upper Merion/Lower Merion submarket in January. The Courts at Spring Mill Station, also in this submarket, was delivered late in the fourth quarter of 2015 and added 385 rentals to inventory.
- Developers have approximately 8,000 apartments under construction in the metro, with completion dates scheduled through the end of 2017. The Center City Philadelphia submarket is set to receive the bulk of deliveries as 3,260 units are underway in the area. Chester County and Norristown/Upper Merion/Lower Merion submarkets will also realize a significant share of new units.

**Outlook:** Area developers will expand apartment stock by 5,600 apartments this year. Nearly 2,000 of these rentals will come online in Center City Philadelphia.

\* Forecast

\*\* Trailing 12 months through 1Q

## Vacancy

- Supply additions outweighed apartment demand during the last 12 months, and vacancy ticked up 10 basis points year over year, reaching 4.7 percent in March. The average rate declined 30 basis points in the previous yearlong timeframe.
- Heightened demand for apartments in Center City Philadelphia, Gloucester County and Lower Camden County during the last four quarters pushed vacancy down below 4 percent in each submarket. Gloucester County boasts the lowest rate in the metro, reaching 2.8 percent in March, a 40-basis-point tumble from one year ago.
- Vacancy is tightest for properties built prior to 1980, with the rate reaching 4.3 percent at complexes built in the 1970s, and 4.5 percent for those apartments completed before 1970. These assets are in high demand by investors seeking upside potential, and rehabilitated properties are garnering strong rent growth.

**Outlook:** Demand will not keep pace with supply additions this year, and vacancy will rise 50 basis points from the end of 2015 to 4.8 percent by the end of this year.

## Rents

- Tight conditions across the metro encouraged strong rent growth during the last year, with the average advancing 3.5 percent year over year to \$1,202 per month at the end of the first quarter. A 2.6 percent uptick was posted in the prior period.
- Rent growth for apartments built since 2000 rose at the slowest pace, reaching \$1,663 per month in March, a 1.8 percent year-over-year increase. The price gap between these complexes and those built before the new millennium remains wide, with rent at 1990s properties averaging \$375 less per month.
- Rent is highest in Center City Philadelphia, where a 6.5 percent annual gain increased the average to \$2,110 per month. Rent in the remaining Philadelphia submarkets ranged from a low of \$965 in Northeast Philadelphia to a high of \$1,382 in Southwest Philadelphia.

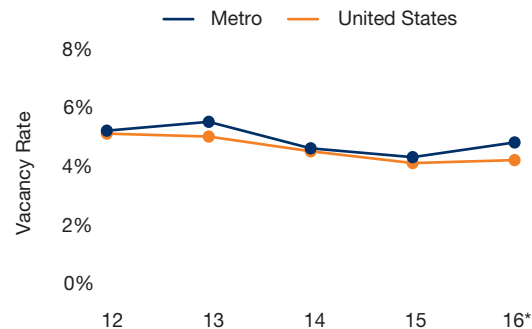
**Outlook:** As vacancy remains tight this year, rent will grow at a steady pace, reaching \$1,221 per month by year end, an annual increase of 3.1 percent.

## Sales Trends

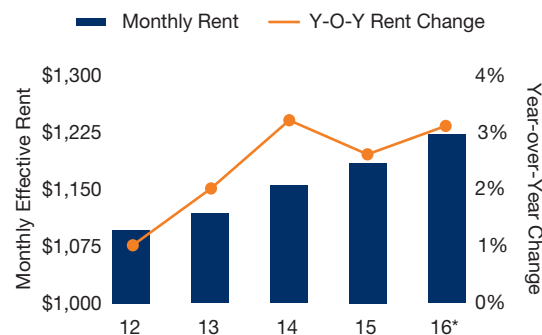
- Transaction velocity accelerated 13 percent during the last four quarters, slowing from an 18 percent advance in the prior trailing 12-month period. Sales activity remains concentrated in the Center City submarket, though North Philadelphia, University City and Upper Chester County all registered strong gains in investor interest during the last year.
- The average price per unit in the metro has been on a steady incline for the past four years, rising 7 percent year over year to \$134,600 per door in March. Assets located in the Center City submarket change hands at some of the highest prices, averaging nearly \$340,000 per unit over the past year.
- The average cap rate compressed 10 basis points in the 12 months, remaining in the mid- to high-6 percent range in March. Initial yields vary widely based on asset quality and location, with core properties trading near 4.5 percent and some suburban complexes garnering first-year returns closer to the mid-7 percent area.

**Outlook:** The development pipeline is becoming more active in select submarkets, though newly developed properties will have little effect on the operations of nearby Class B/C assets. As a result, demand for these complexes will rise, as the opportunity to rehabilitate and raise rents provides attractive upside to investors.

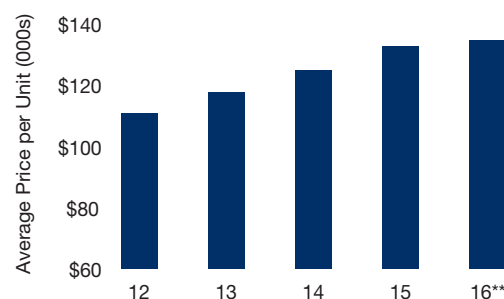
### Vacancy Rate Trends



### Rent Trends



### Sales Trends



\* Forecast  
 \*\* Trailing 12 months through 1Q  
 Sources: CoStar Group, Inc.; Real Capital Analytics

## Capital Markets

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

- The U.S. economy is resuming its steady pace of growth following an extended period of financial market volatility to start the year. Recent reports have highlighted a stable consumer environment, particularly as the labor market continues to improve. Advancement in commodity prices has reduced strain in the sector, helping oil-related economies bounce back. Meanwhile, commercial credit availability remains robust, prompting a positive outlook over the coming months.
- Developer activity remains robust, with deliveries for 2016 expected to top 285,000 units, the most new apartments delivered in a year since the 1980s. Lenders have begun to more closely monitor development activity and are now tightening funding for new projects in markets they believe face overdevelopment risk. With builder activity concentrated in just 10 major metros nationally, those markets are receiving the greatest scrutiny. Lenders will likely continue evaluating each project carefully, which will benefit the sector by reducing risks of overdevelopment.
- The capital markets environment continues to be highly competitive, with Fannie Mae and Freddie Mac underwriting loans up to 10 years with maximum leverage of 80 percent. Pricing will typically reside between the high-3 percent range to the low-4 percent range, depending on deal size. Portfolio lenders will also price in this range but will typically require loan-to-value ratios closer to 65 percent. Floating bridge loans and financing for repositionings are typically underwritten with loan-to-value ratios above 80 percent, while pricing at 250 basis points above Libor for recourse and extending to 450 basis points above Libor for non-recourse deals.

## Local Highlights

- Philadelphia will host the Democratic National Convention this summer, and tourism-related businesses will begin beefing up staffs this quarter to serve the 50,000 visitors the convention is expected to bring to the city. In addition to bolstering hotel revenues over the course of the event, restaurants and other retailers will benefit as these visitors are expected to pump \$300 million into the local economy. Jobs created by this convention will stir additional apartment demand as these workers typically live in rentals.
- The Camden/Cherry Hill submarket has benefited from few inventory additions over the past few years. In March, vacancy reached 4.1 percent on a 220-basis-point annual decline and is down 400 basis points since peaking in the first quarter of 2012. Rent growth, however, has been subdued, ticking up just 0.2 percent year over year to \$1,221 per month.
- Apartment vacancy in Southwest Philadelphia rose 340 basis points over the last 12 months, reaching 8.2 percent in March, the highest rate in the metro. Rent growth, however, advanced at the strongest pace, as the average surged 7.0 percent to \$1,382 per month. The Center City Philadelphia submarket is the only area to register a higher average rent.

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