

# Multifamily Research

## Market Report

Third Quarter 2016

Philadelphia Metro Area

### Strong Performance Drives Capital Into Apartment Assets

#### **Economy, demographics maintaining high standard of asset performance.**

Expanding payrolls and a respectable rate of household formation provide plenty of momentum to sustain a strong apartment sector in the Philadelphia metro in the near term. Supply growth is also accelerating and will contribute to a climb in the vacancy rate this year, but property owners continue to realize rent increases in excess of the rate of inflation and the market's long-term growth trend. Consistent monthly gains in employment marked the first half of the year in the metro, while some variations in submarket performance also emerged. New Jersey submarkets displayed new vigor as vacancy declined and the average rent grew more than 4 percent. Elsewhere, property owners in suburban Philadelphia saw steady

new-renter traffic and renewals that lowered vacancy and supported an advance in rents. In Center City, where hundreds of new rentals have come online in recent years, low vacancy persisted. An additional buildup in office-using employment and expansion of retail and other services for renters offer prospects for additional performance improvement.

#### **Portfolio deals, private capital driving market.**

The strong performance of multifamily assets is reinforcing property values and maintaining a heightened level of transactions in the market. Sales rose over the past 12 months, led by a rise in portfolio sales to large investors and funds. Cap rates in these institutional-caliber deals have compressed to approximately 5 percent to

establish the benchmark in the metro. Single-asset deals also increased modestly from one year ago, signaling a steady level of interest from private capital and demonstrating an ability to access debt markets. Properties with a value-add component remain highly sought, while the appeal of stabilized suburban assets continues to grow. Assets here generally change hands in the low- to mid-7 percent range, and tenancies in some of the higher-end neighborhoods can be resilient due to the high cost of single-family residences in these areas. As usual, a vast majority of sales occur in Pennsylvania, but a rise in deals in South Jersey may indicate changing motivations among owners.

### 2016 Multifamily Forecast

2.0% increase  
in total employment



#### **Employment:**

Expansions in office-using fields, healthcare, and leisure and hospitality will drive a gain of 58,000 jobs in the Philadelphia metro in 2016, surpassing last year's addition of 48,200 positions.

5,600 units  
will be completed



#### **Construction:**

Developers will complete 5,600 units this year; the total includes about 4,800 units in the Pennsylvania submarkets of the metro. In 2015, 3,300 rentals were delivered.

40 basis point  
increase in vacancy



#### **Vacancy:**

An expanding local economy will generate new demand for rental housing, but completions will exceed net absorption this year to raise the vacancy rate 40 basis points to 4.7 percent. Last year, net absorption of 4,200 units reduced the vacancy rate 30 basis points.

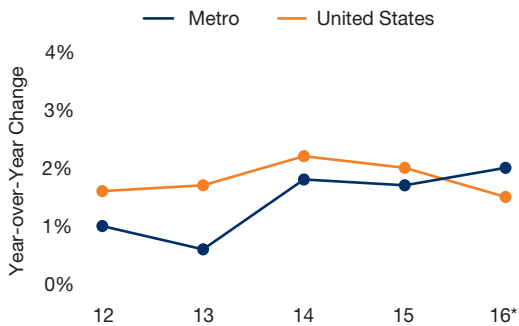
4.8% increase  
in effective rents



#### **Rents:**

The average rent will advance 4.8 percent in 2016 to \$1,241 per month, an acceleration from the past three years when an average annual gain of 2.6 percent was recorded.

### Employment Trends

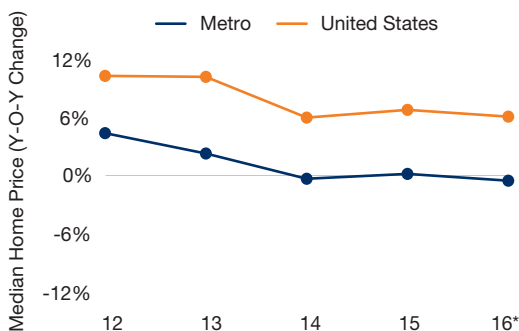


## Economy

- Employers continue to expand. Over the 12 months ending in the second quarter, nearly 62,000 positions were created in the metro, outpacing the gain of 45,600 jobs in the preceding 12-month span.
- More than one-half of the new hires since midyear 2015, or 32,600 positions, were created in the first six months of this year. Professional and business services, which encompasses degreed office-using fields, added more than 13,000 jobs year to date. Medical positions were also included in the roughly 4,500 education and health services posts created so far this year.
- Bars, restaurants and hotels added workers in the first half to staff up for hosting the Democratic National Convention in July. Approximately 13,000 leisure and hospitality positions were created in the first of this year, an increase from less than 2,000 new hires in the corresponding period in 2015.

**Outlook:** Local employers will create 58,000 positions this year, the highest total in any calendar year during the current economic cycle.

### Home Price Trends

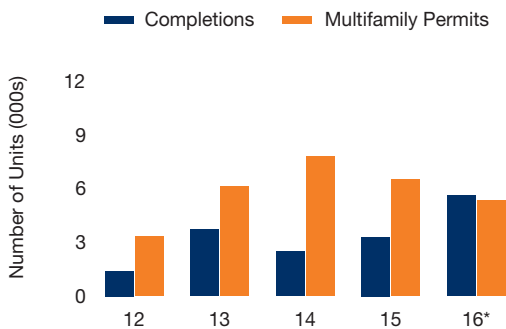


## Housing and Demographics

- Additional residents re-entered the labor force, contributing to a 50-basis-point rise in the unemployment rate to 5.2 percent so far this year. The slight increase in labor market slack minimally affected the median household income in the first two quarters, when it advanced 1.4 percent year to \$67,500 per year.
- The median price of an existing single-family residence was \$221,300 in the second quarter and was virtually unchanged from one year ago and the second quarter in 2014. Over the same two-year span, the average rent rose 7.5 percent and now exceeds the average monthly payment on the median-priced home, assuming traditional financing.
- Approximately 11,900 households were created since the second quarter last year, raising to 73,000 the number of new households formed since job growth resumed more than six years ago.

**Outlook:** The metro has repeatedly proved to be highly resistant to a large-scale migration of renters to owner-occupied housing. A considerable population of students, service-sector workers and lifestyle renters are unlikely to reverse this trend.

### Construction Trends



## Construction

- Developers placed in service more than 3,900 rentals over the 12 months ending in the second quarter this year, an acceleration from the approximately 2,700 units delivered in the preceding 12-month period.
- Projects containing 1,762 units were delivered in the first six months of this year, but only 475 units were completed in the second quarter, distributed among several small projects. The 192-unit Westfield 41 in North Montgomery County was the largest project delivered in the April-to-June span.
- Work continues on approximately 3,800 apartments that are slated for completion in the second half of this year. The total includes 1,369 units in multiple mid- and high-rises in Center City and nearly 1,400 units in the suburbs.

**Outlook:** Developers remain on track to complete 5,600 units in 2016, topping last year's total and marking the highest amount of new units in 16 years.

\* Forecast

\*\* Trailing 12 months through 2Q

## Vacancy

- Tenants occupied an additional 4,100 apartments since midyear 2015 to trim the vacancy rate 10 basis points to 4.3 percent in the second quarter this year. The vacancy rate is unchanged so far in 2016, however.
- The vacancy rate of 3.9 percent in Center City marks a minor increase from the end of last year. In properties built since 2010, the vacancy rate rose 90 basis points to 3.9 percent during the period even as deliveries slowed, perhaps reflecting a slower rate of lease renewals. Including other submarkets in the urban core, negative net absorption was recorded in the first half of 2016.
- Solid demand trends persist in the suburbs. In Pennsylvania, the vacancy rate decreased 20 basis points in the first two quarters to 4.0 percent. Net absorption totaled 1,400 units during the period and accounted for most of the increase in occupied stock in the entire market.

**Outlook:** Apartments scheduled for completion in the second half of the year will contribute to a 40-basis-point increase in vacancy to 4.7 percent.

## Rents

- The average rent grew 4.2 percent over the past year to \$1,233 per month in the second quarter. Most of the increase occurred in this year's first half, historically a period of high rent growth.
- Older vintage rentals generally outperformed their new counterparts since the second quarter last year. The average rent in properties in service since 2010 rose in the mid-2 percent range, but 1990s-era assets posted an increase of 4.3 percent. Rentals from the 1980s and 1970s also registered year-over-year gains in the average rent in the high-3 percent range during the past year.
- At midyear, about 3 percent of all units offered leasing incentives, including a somewhat smaller proportion of rentals built since 2000. The average leasing incentive is roughly three weeks of free rent.

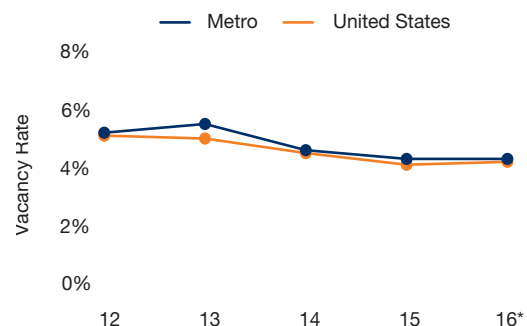
**Outlook:** Tight vacancy will support an advance in the average rent of 4.8 percent this year to \$1,241 per month.

## Sales Trends

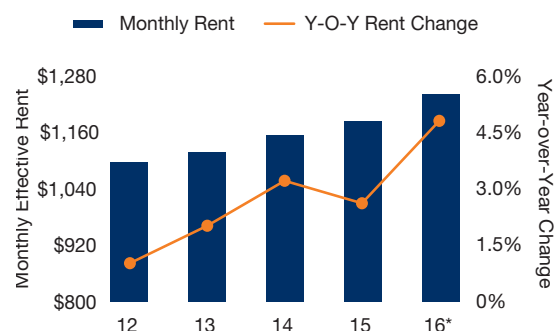
- Owners and investors remain highly motivated, driving a substantial increase in deal volume over the past 12 months. Higher prices and additional sales of properties pricing for more than \$20 million also triggered a notable hike in dollar volume.
- Sales of properties pricing for more than \$20 million jumped in excess of 50 percent during the past 12 months to surpass the overall increase in transaction velocity. Portfolio deals swept up a considerable number of assets in Pennsylvania and accounted for most of the gain. One-off transactions involving large complexes generally commanded more than \$200,000 per door.
- Properties sold over the past 12 months carried an average price of \$132,200 per unit, an increase of 5 percent from the prior year. The average cap rate has remained relatively stable in the mid- to high-6 percent range.

**Outlook:** The pace of transactions moderated in the first half of this year, though readily accessible acquisition debt and plentiful equity will maintain conditions for a liquid and transparent investment market.

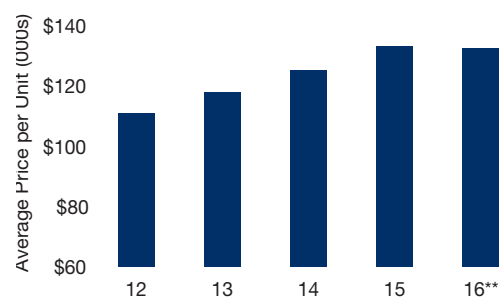
### Vacancy Rate Trends



### Rent Trends



### Sales Trends



\* Forecast

\*\* Trailing 12 months through 2Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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## Capital Markets

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

- Global capital markets have remained stable over the past few weeks, even as Brexit and the continued devaluation of the Chinese yuan have induced bouts of volatility into stock and bond markets. Meanwhile, U.S. economic data has proved resilient, with increases in retail sales and steady hiring supporting a measured pace of growth. Additionally, higher bond prices have lowered prospective yields, boosting the appeal of commercial real estate.
- As the homeownership rate continues to plumb new lows, investor interest in the multifamily sector remains upbeat. The U.S. vacancy rate reached 4.2 percent by the end of the first quarter, the lowest rate of the current cycle. As a result, builders have ramped up the planning pipeline, with completions forecast to rise to 285,000 units, the highest level in more than 20 years. However, new supply is heavily concentrated in a few large metros, reducing the national impact.
- Capital markets remain highly competitive, with a broad assortment of fixed-rate products available through commercial banks, life-insurance companies, CMBS and agency lenders. Fannie Mae and Freddie Mac are underwriting loans of 10 years at maximum leverage of 80 percent. Rates will typically reside in the high-3 to low-4 percent range, depending on underwriting criteria. Portfolio lenders will also price in this vicinity but will typically require loan-to-value ratios closer to 65 to 75 percent. Floating bridge loans and financing for repositionings are typically underwritten with LTVs above 80 percent, while pricing at 300 basis points above Libor for recourse deals and extending to 450 basis points above Libor for non-recourse transactions.

## Local Highlights

- The vacancy rate in New Jersey submarkets was a tight 3.3 percent in the second quarter after dropping 140 basis points from one year ago. Only 544 new units were placed in service during that span, and more than 1,300 rentals were absorbed. An increase in transaction velocity also occurred in South Jersey. Most of the deals occurred in the less-than-\$10 million segment and pricing varied depending on location and property age.
- Few transactions occurred in Delaware submarkets over the past 12 months, though property performance was rather respectable. Rising demand sliced the vacancy rate 50 basis points to 4.5 percent in the second quarter, though rent growth was subdued. Development is muted, however, with only 338 rentals slated for completion this year and approximately the same number of apartments on tap in 2017.
- The vacancy rate at high-rises in Center City declined slightly from one year ago, to 4.1 percent. Rent trends, however, appeared to soften. The average same-store rent, or the amount charged tenants in buildings that were in service one year ago, declined slightly since the second quarter last year and the proportion of rentals offering concessions rose to 8.4 percent. An additional high-rise building, the 321-unit 1919 Market, is scheduled for completion in the third quarter of this year.