

# ApartmentResearch

M A R K E T U P D A T E

Marcus & Millichap

Philadelphia Metro Area

Third Quarter 2010

## RECOVERY UNDER WAY; INVESTMENT TO HEAT UP

Driven by resurgent renter demand, the Philadelphia apartment market has reached a turning point and will improve modestly over the remainder of 2010. Job creation will slow in the second half as the private sector tentatively expands, but new demand will be sufficient to lower vacancy and raise rents for the first time in two years. In the early stages of the recovery, the metro area's high-end apartments will lead the resurgence in fundamentals. Class A vacancy continues to decline in most submarkets, including highly desirable areas along the Main Line and other suburban locations. Additional improvements in vacancy will encourage Class A property owners to withdraw concessions, resulting in a more vigorous pace of rent growth in the quarters ahead. The Class B/C segment continues to lag, especially in South Jersey and Delaware, but accelerated job creation next year will stimulate new demand for lower-rent units.

The solid performance of the apartment sector in the first half of 2010 will encourage investors who have been waiting for a recovery in fundamentals. Low interest rates and improved availability of financing have helped to narrow the gap between buyers' and sellers' expectations while providing greater leverage for buyers. Cap rates start in the mid-6 percent range for the best-quality product in high-density areas and push up to approximately 7.5 percent for stabilized, high-quality properties in the suburbs. Besides stabilized product, interest in distressed assets remains strong, and lenders are indicating that they are likely to begin disposing of low-quality properties rather than continuing to extend loans. Overall, the market's many positive characteristics will continue to reward investors who may remain averse to risk, as the deliberate pace of apartment construction and steady demand generators typically support the types of returns and appreciation potential desired as the economy emerges from the deep recession.

### 2010 ANNUAL APARTMENT FORECAST



**Employment:** The expected addition of 24,000 jobs in 2010 will expand total employment in the metro area by 0.9 percent. Last year, 100,000 positions were eliminated.



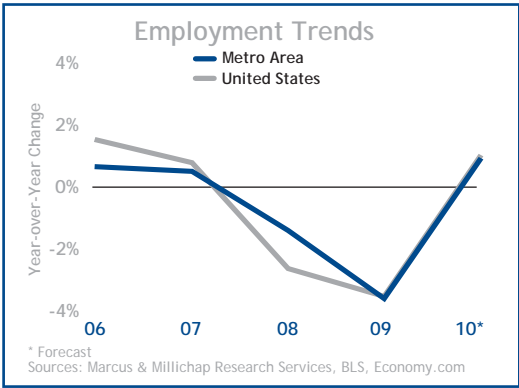
**Construction:** Developers will complete approximately 900 apartments this year, an increase from 442 units in 2009 but only a 0.4 percent addition to stock. Limited deliveries through the coming quarters will accelerate a recovery in rents and vacancy.



**Vacancy:** Although the economic recovery will likely be bumpy and job growth will slow over the remainder of 2010, vacancy will still decline 20 basis points this year to 6.3 percent. An 80 basis point increase was recorded in 2009.



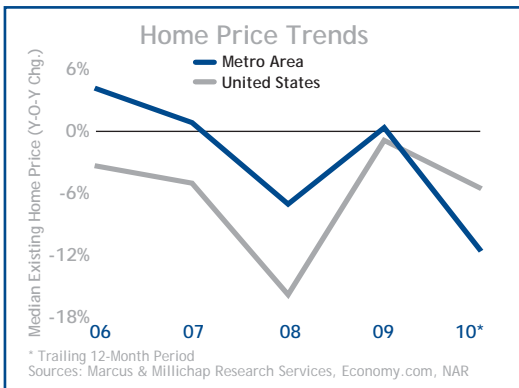
**Rents:** This year, asking rents will increase 1.2 percent to \$1,014 per month, after declining 2.1 percent in 2009. Following a 3.9 percent drop last year, effective rents will rise 1.8 percent in 2010 to \$963 per month as owners gradually withdraw concessions.



## ECONOMY

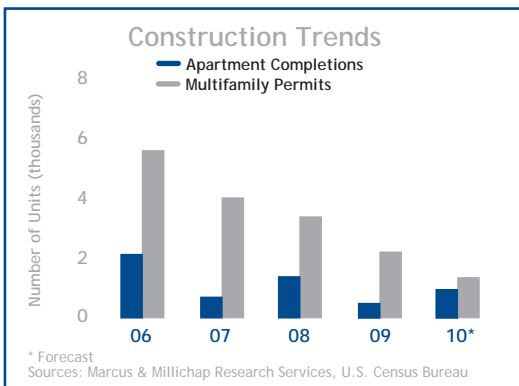
- ◆ Despite the elimination of census jobs in June, local employers added 19,500 workers in the second quarter, the strongest pace of hiring since 2006. Year over year, total employment contracted 0.6 percent, or by 16,100 jobs.
- ◆ The government sector added approximately 4,700 workers thus far in 2010, representing nearly 30 percent of all jobs created in the period. Some of these are temporary census jobs and will expire in the next few months as census work concludes.
- ◆ In the Wilmington section of the metro area, 3,900 jobs were created in the second quarter, following a gain of 800 positions in the prior period. Private employment sectors accounted for approximately 90 percent of the jobs added in Wilmington during the second quarter, and year to date.
- ◆ **Outlook:** The addition of 24,000 jobs in 2010 will expand total employment in the metro by 0.9 percent. Last year, 100,000 positions were eliminated.

## HOUSING AND DEMOGRAPHICS



- ◆ Permits for 8,500 units of single- and multifamily housing were issued in the 12 months ending in the second quarter, a 15 percent increase from the exceedingly low level in the preceding year. On average, 16,700 permits were issued annually over the past 10 years.
- ◆ In the Pennsylvania section of the MSA, 1,200 units of multifamily housing were permitted in the last 12 months, a 21 percent increase. Approximately 700 units were permitted in South Jersey, the same number as in the previous year.
- ◆ The rate of household creation has improved, contributing to a strong first half of 2010 for the apartment sector. In that time, 5,300 households were formed, up from 3,900 households in the corresponding period last year.
- ◆ **Outlook:** Despite an accelerated pace of multifamily permit issuance in Pennsylvania, the current level of activity remains well below historical norms. As a result, limited construction will persist in the near term.

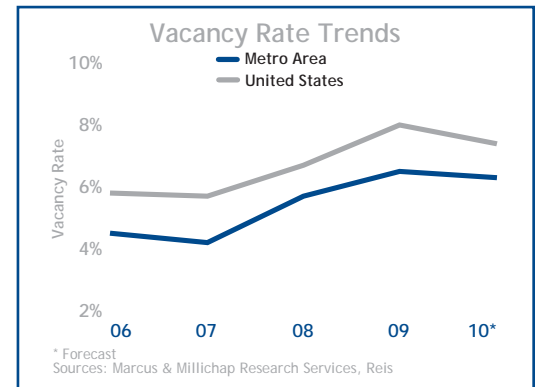
## CONSTRUCTION



- ◆ Two projects amounting to 285 units were completed this year, bringing the year-over-year total to 573 apartments. In the second quarter, 146 units came online at 777 South Broad in Center City, while the 139-unit second phase of the Riverwalk at the Millenium in Conshohocken also was delivered.
- ◆ Two developments are under way and scheduled for completion in the second half. The largest of these is the 317-unit Abitare in the Camden West submarket; half of the units were to come online in the third quarter, with the remainder due for completion by year end.
- ◆ In addition to a subdued level of permitting, the pipeline of planned projects remains thin. Approximately 4,300 units are planned but not scheduled for construction, representing 2 percent of existing inventory.
- ◆ **Outlook:** Developers will complete approximately 900 apartments this year, up from 442 units in 2009 but only a 0.4 percent addition to stock.

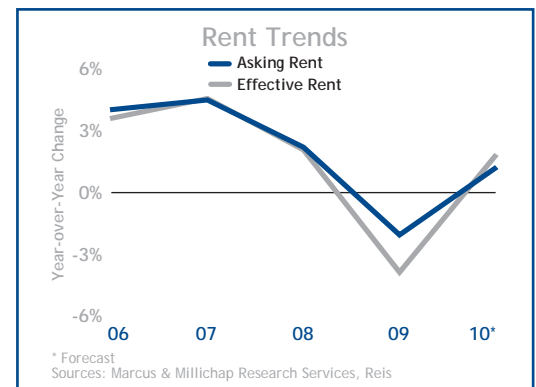
## VACANCY

- ◆ High-end units continue to perform well, while demand for Class B/C rentals remains somewhat unsteady. As a result, the marketwide vacancy rate for all properties was unchanged at 6.3 percent in the second quarter, after decreasing 20 basis points in the preceding quarter.
- ◆ Following three successive quarters of declines, Class A vacancy rose 20 basis points in the second quarter to 6.5 percent. Year over year, Class A vacancy slid 40 basis points, with 20 of 27 submarkets registering positive net absorption.
- ◆ In the Class B/C segment, vacancy inched down 10 basis points in the second quarter to 6.0 percent and is now up 600 basis points higher than a year ago. The rise in vacancy was widespread, with only eight submarkets recording an increase in occupied units.
- ◆ **Outlook:** Although the economic recovery will likely be bumpy and job growth will slow over the rest of 2010, vacancy will still decline 20 basis points this year to 6.3 percent. Vacancy increased 80 basis points in 2009.



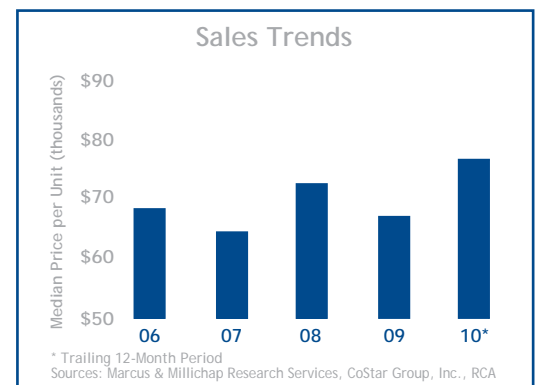
## RENTS

- ◆ Tenant demand started to improve in the first half, yielding a subdued pace of rent growth. Asking rents of \$1,007 per month in the second quarter were up 0.7 percent from the preceding period but remain 0.6 percent lower than one year earlier. Effective rents receded 0.8 percent year over year, despite a 1.4 percent gain in the second quarter to \$957 per month.
- ◆ Class A asking rents inched up 0.6 percent in the second quarter to \$1,197 per month as owners took the first tentative step to regain pricing power after raising occupancy over the past year. In the Class B/C segment, asking rents of \$828 per month were up 0.7 percent from the first quarter.
- ◆ Leasing incentives are declining. Concessions equaled 5.0 percent of asking rents in the second quarter, down 60 basis points from the first three months of 2010, yet still above the 3.7 percent level registered at the start of the recession.
- ◆ **Outlook:** This year, asking rents will increase 1.2 percent to \$1,014 per month, after declining 2.1 percent in 2009. Following a 3.9 percent drop last year, effective rents will rise 1.8 percent in 2010 to \$963 per month as owners gradually withdraw concessions.



## SALES TRENDS\*\*

- ◆ A lack of product for sale contributed to a 30 percent drop in transaction velocity over the past 12 months.
- ◆ The median price of properties sold in the last year rose 12 percent to \$76,700 per unit. The increase reflects a greater number of sales of quality assets in core locations, such as Center City.
- ◆ Cap rates typically start at 6.5 percent to 7.0 percent for top-quality properties in high-density areas to the mid-7 percent range for best-in-class suburban assets.
- ◆ **Outlook:** Low interest rates and greater availability of acquisition financing will continue to bridge the gap between buyers and sellers, leading to heavier deal flow through the remainder of this year and into 2011.



\*\* Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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## NATIONAL MULTI HOUSING GROUP

Visit [www.NationalMultiHousingGroup.com](http://www.NationalMultiHousingGroup.com) or call:

**Linwood C. Thompson**

Senior Vice President, Managing Director

National Multi Housing Group

Tel: (678) 808-2700

[lthompson@marcusmillichap.com](mailto:lthompson@marcusmillichap.com)

# Marcus & Millichap

## Real Estate Investment Services

Prepared and edited by

**Art Gering**

Senior Market Analyst

Research Services

For information on national  
apartment trends, contact

**John Chang**

Vice President, Research Services

Tel: (602) 687-6700 ext. 6803

[john.chang@marcusmillichap.com](mailto:john.chang@marcusmillichap.com)

Philadelphia Office:

**Spencer Yablon**

Regional Manager

[syablon@marcusmillichap.com](mailto:syablon@marcusmillichap.com)

1628 JFK Boulevard

Suite 1200

Philadelphia, Pennsylvania 19103

Tel: (215) 531-7000

Fax: (215) 531-7010

**Price: \$150**

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## CAPITAL MARKETS

By WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ Mixed economic indicators, stock market volatility and concerns surrounding the European debt crisis continue to drive investors to safety. As a result, the yield on the 10-year U.S. Treasury has declined since peaking at 4 percent in April; as of late July, the yield had fallen to 3 percent.
- ◆ Capital markets loosened over the past year, with life insurance companies ramping up lending and CMBS showing renewed signs of life. Nonetheless, the agencies remain the dominant sources of multifamily lending. This trend will continue through 2010 as the GSEs' multifamily portfolios outperform their residential mortgage operations, reducing the likelihood of drastic government-mandated changes to their apartment lending arms.
- ◆ Multifamily loan originations increased 37 percent in the second quarter but remained below levels reported during the same period last year. Fannie Mae and Freddie Mac's origination volume followed a similar pattern, rising in the second quarter but falling short of year-earlier levels.
- ◆ Loan-to-values range from 60 percent to 75 percent for portfolio lenders and push up to around 80 percent for best-of-class, agency-financed deals. All-in rates for five-year agency loans fall into the low-4 percent range, while 10-year loans price between 4.75 percent and 5.15 percent. While life companies will compete at these levels for best-of-class deals, most portfolio lenders are 100 basis points to 225 basis points higher.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Somerton/Bustleton	2.5%	-80	\$785	0.0%
2	Foxchase/Lawndale	3.3%	-90	\$717	1.1%
3	Upper Bucks County	3.6%	-140	\$1,046	1.4%
4	Torresdale/Bensalem	4.7%	10	\$848	0.6%
5	Central Chester	4.9%	0	\$1,107	0.5%
6	Roxboro/Chestnut Hill	5.3%	-80	\$1,013	-0.6%
7	NE Chester/Upper Montgomery	5.4%	160	\$914	-1.4%
8	Upper/Lower Merion	5.4%	80	\$1,075	-1.7%
9	Gloucester County	5.5%	-10	\$853	-1.2%
10	East Delaware County	5.6%	110	\$747	-0.4%
11	Lansdale/Gwynedd	5.6%	-10	\$1,039	1.4%
12	Lower Bucks County	5.9%	80	\$836	-2.8%
13	Moreland/Abington	5.9%	-180	\$1,144	1.1%
14	West Delaware County	6.0%	60	\$842	2.8%
15	Center City	6.1%	10	\$1,496	-2.7%
16	Germantown	6.1%	40	\$849	1.1%
17	North Delaware County	6.5%	130	\$1,098	-1.0%
18	West Philadelphia	6.6%	-120	\$861	-4.7%
19	Camden	7.1%	80	\$820	-0.6%
20	Camden West	7.1%	-20	\$818	-0.5%
21	Burlington County	7.4%	240	\$814	-2.5%
22	West Chester	7.4%	-230	\$928	-0.2%
23	Olney/Oak Lane	7.9%	230	\$688	-4.3%
24	Moorestown/Maple	8.2%	-30	\$920	-0.8%
25	Bala Cynwyd	10.1%	190	\$954	-2.0%
26	Cherry Hill/Eversham	10.2%	-40	\$1,032	-0.6%
27	North/Frankford/Holmesberg	10.2%	-180	\$725	-1.6%
28	Norristown/Plymouth	11.6%	210	\$1,051	-3.8%