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

Marcus & Millichap

Philadelphia Metro Area *Fourth Quarter 2009*

Rise in Vacancy Tempered by Lack of Addition to Inventory

The Philadelphia apartment market is expected to continue to face challanges operationally through year end, although a decline in construction activity and deceleration in job cuts may help slow vacancy increases in quarters ahead. Metrowide multi-family rental stock has expanded by just 0.6 percent since the beginning of the year, and there are only about 1,100 units under way. Additionally, just 2,800 units are in the planning pipeline, a 50 percent decline from six months ago. Along with a limited pace of deliveries through the next 12 months, the rate of job losses in the metro also continues to slow. Fewer than 1,600 positions were lost in August, representing the smallest number of cuts since layoffs started in September 2008. Increased expansion and hiring announcements lend support to an eventual economic recovery. A new Walmart, for example, will open in Warminster this fall, creating 350 jobs. In the meantime, however, owners can expect an increase to vacancy in the fourth quarter due to softer near-term employment-generated demand, which will likely translate to additional concessions as owners compete for tenants.

Investor interest will likely gain momentum into next year as signs of a recovery become clearer. While transaction velocity is down nearly 30 percent since the beginning of 2009 compared to the same period last year, sales activity has picked up slightly over the past few months. Cap rates, meanwhile, continue to trend higher, with Class A assets averaging in the high-6 percent to low-7 percent range and Class B properties trading in the high-7 percent to low-8 percent range. Initial yields for each class are up about 25 basis points to 50 basis points during the past year. Rising yields and expectations for sturdier operations may begin to draw experienced local investors back into the market over the next year. Buyers interest in that time will likely center on well-located, stabilized assets in high-demand areas such as University City and Center City, as well as along the Main Line.

2009 Annual Apartment Forecast

2.8% decrease in total employment

Employment: Total employment in the metro area is expected to decrease by 2.8 percent, or 80,000 jobs, this year, as cuts in the manufacturing and trade, transportation and utilities sectors persist. In 2008, 46,100 jobs were removed from the market.

500 units will be completed

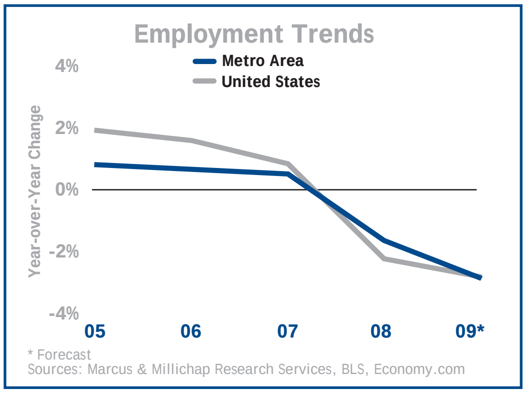
Construction: A year after builders delivered 1,300 apartment units, 500 units will be added to the Philadelphia market in 2009. Completions will expand rental inventory 0.3 percent, compared with supply growth of 0.7 percent last year.

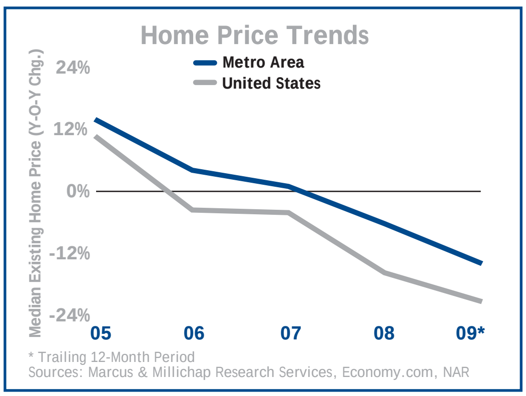
80 basis point increase in vacancy

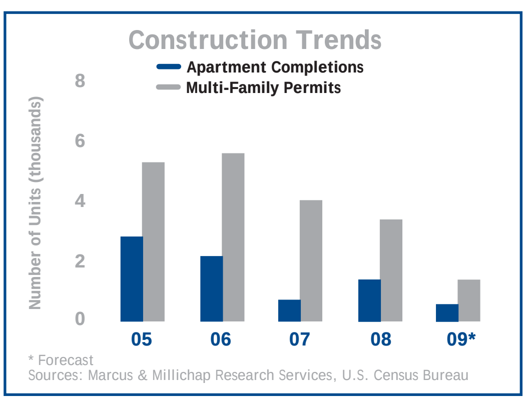
Vacancy: Despite a significant slowdown in construction activity this year, softer renter demand due to job losses will push vacancy higher. By year end, vacancy is forecast to reach 6.5 percent, up from 5.7 percent at the close of 2008.

1.1% decrease in asking rents

Rents: In 2009, asking rents are expected to decline 1.1 percent to $1,012 per month, while effective rents are projected to fall 2.4 percent to $960 per month. Asking and effective rents gained 2.2 percent and 2.1 percent, respectively, last year.







Economy

- Local employers cut nearly 7,000 jobs in the third quarter. Since the start of the year, total employment has decreased by 60,000 positions, compared with the removal of 8,000 workers from payrolls during the corresponding period in 2008.
- The trade, transportation and utilities sector has reduced payrolls by the greatest absolute amount year to date, declining 2.3 percent with the loss of 12,000 jobs. A significant number of the jobs lost are related to the retail segment, which has been effected by declining consumer sales.
- The unemployment rate in Philadelphia was 8.5 percent as of July, up from 6.7 percent in December. Unemployment should stabilize during the fourth quarter as the job market steadies.
- **Outlook:** Total employment in the metro area is expected to decrease by 2.8 percent, or 80,000 jobs, this year. In 2008, 46,100 jobs were eliminated.

Housing and Demographics

- Permits for an estimated 1,100 units of multi-family housing were issued during the 12 months ending in the third quarter, a decline of 53 percent from the preceding year. Developers have pulled permits for approximately 4,700 single-family units over the last year, down 23 percent. Builders continue to scale back projects in response to the sluggish housing market.
- The median price of an existing single-family home in the Philadelphia metro was estimated at $190,000 in the third quarter, a 16 percent decrease from one year earlier. Demand for single-family housing has slowed in response to tighter financing requirements and falling prices.
- Despite the drop in the median price, the debt service on a median-priced home exceeds the average Class B/C asking rent by about $193 per month. One year ago, the cost of a mortgage on a median price Philadelphia metro home exceeded Class B/C asking rent payments by more than $500 per month, illustrating the increasing affordability of single-family homes.
- **Outlook:** Renters in lower-tier units will find for-sale space more affordable as the year progresses, but homeownership will likely remain out of reach due to more conservative financing requirements.

Construction

- Apartment completions have declined over the last year to 1,200 units, expanding rental stock by 0.2 percent. In the preceding 12-month period, 1,600 units were added.
- There are approximately 1,200 units under construction in the market, all of which have scheduled delivery dates in 2010.
- The pipeline of planned projects totals approximately 3,000 units, down from 5,000 units one year ago. Job losses, rising vacancy and difficulty obtaining construction financing are limiting development activity.
- **Outlook:** A year after builders delivered 1,300 apartment units, 500 units will be added to the Philadelphia market in 2009. Completions will expand rental inventory 0.3 percent, compared with supply growth of 0.7 percent last year.

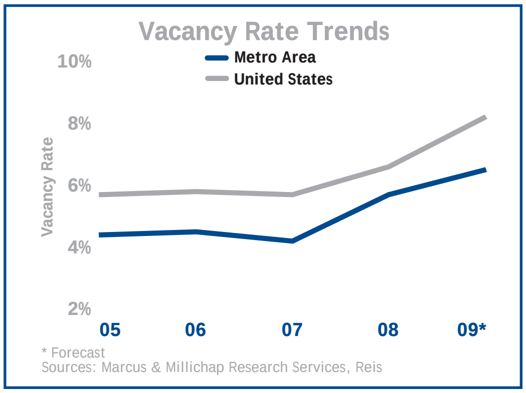
Vacancy

- Softer employment-generated demand has driven up vacancy over the last 12 months, despite limited construction activity. During that time, the average apartment vacancy rate has climbed 110 basis points to 6.2 percent.

- In the market's Class A complexes, vacancy has held steady at 7.1 percent since the beginning of the year. The rate has increased 110 basis points year over year, however, due to staff reductions among companies in the professional and business services sector.

- Estimated third quarter vacancy of 5.5 percent at Class B/C properties marks a 40 basis point rise from the end of 2008. Vacancy in lower-tier units has been steadier than in Class A apartments due to greater demand for more affordable housing options.

- **Outlook:** Despite a significant slowdown in construction activity this year, weakened renter demand stemming from job losses will push vacancy higher. By year end, vacancy is forecast to reach 6.5 percent, up from 5.7 percent at the close of 2008.



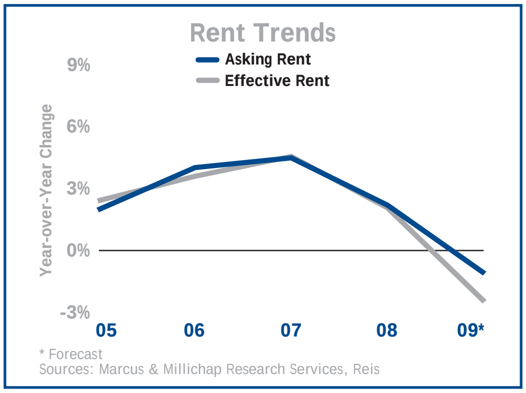
Rents

- During the 12 months ending in the third quarter, asking rents fell 0.8 percent to $1,018 per month, and effective rents dropped 1.8 percent to $971 per month. In the previous year, asking and effective rents rose 3.7 percent and 3.5 percent, respectively.

- In the market's Class A segment, asking rents declined 0.9 percent through the first three quarters of 2009 to $1,216 per month, 1.2 percent less than one year earlier. Class B/C asking rents were $836 per month in the third quarter, a decrease of 0.4 percent year to date and 0.8 percent year over year.

- Concessions have expanded in response to rising vacancy. Concessions were 4.7 percent of asking rents in the third quarter, up from 3.8 percent of asking rents in the same quarter last year.

- **Outlook:** Asking rents are expected to slip 1.1 percent to $1,012 per month this year, while effective rents are projected to fall 2.4 percent to $960 per month. In 2008, asking and effective rents gained 2.2 percent and 2.1 percent, respectively.



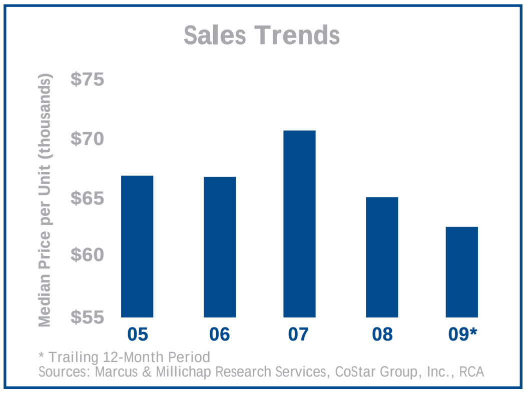
Sales Trends**

- Over the past 12 months, transaction velocity has declined 15 percent, compared with a 16 percent drop in the previous year.

- The median price of properties sold during the last year was $62,500 per unit, a decrease of 7 percent from the preceding 12-month period, when the median price fell 5 percent.

- In the past year, cap rates have averaged in the high-6 to low-7 percent range for Class A properties and Class B properties have averaged in the high-7 to low-8 percent range and above. Cap rates have risen about 50 basis points year over year.

- **Outlook:** Sales activity is expected to remain subdued in the near term due to investors' expectations for rising vacancy and increasing concessions. Cap rates will likely continue to trend higher over the next 12 months, potentially drawing more buyers back into the market.



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

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Capital Markets

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

- Compared to other core property sectors, apartments have fared best due to the availability of financing through government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Recent modifications to GSE guidelines will impact lender decisions, however, as borrower requirements include more substantial apartment ownership experience.

- Loan-to-value requirements range from 55 percent to 75 percent. Portfolio lenders are issuing loans at all-in rates of 6.00 percent to 6.75 percent for a five-year term and 6.9 percent to 8.0 percent for a 10-year term. Rates among agency lenders are roughly 150 basis points to 175 basis points lower. The government recently assumed full control of Fannie Mae and Freddie Mac, which may boost confidence in the GSEs, putting downward pressure on rates, but it also creates several near-term uncertainties.

- Delinquencies will rise further as a wave of maturities approaches; however, at-risk borrowers may find lenders amenable to loan extensions/modifications. Furthermore, Freddie Mac is under way on its second securitization of multi-family debt this year, and the government's TALF program is expected to at least provide a much-needed spark to the traditional CMBS market.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	West Delaware County	3.2%	100	$828	-1.2%
2	Foxchase/Lawndale	4.4%	(100)	$716	1.8%
3	East Delaware County	4.6%	150	$758	0.0%
4	Somerton/Bustleton	4.6%	(30)	$794	1.9%
5	Upper Bucks County	4.6%	(200)	$1,043	-0.8%
6	Torresdale/Bensalem	4.8%	230	$852	-0.5%
7	Upper/Lower Merion	4.8%	90	$1,106	2.6%
8	Lower Bucks County	4.9%	170	$869	1.4%
9	Moorestown/Maple Shade/Mt. Laurel	5.1%	10	$936	-1.7%
10	N.E. Chester/Upper Montgomery County	5.1%	(540)	$936	-1.1%
11	North Delaware County	5.1%	90	$1,121	4.3%
12	Central Chester County	5.2%	200	$1,113	-2.4%
13	Bala-Cynwyd	5.3%	20	$983	-0.4%
14	Burlington County	5.3%	20	$843	1.0%
15	Gloucester County	5.5%	220	$872	1.7%
16	Germantown	5.7%	40	$848	2.9%
17	Lansdale/Gwynedd	5.7%	200	$1,036	-0.8%
18	Olney/Oak Lane	5.8%	40	$727	0.1%
19	Center City	5.9%	220	$1,553	-1.1%
20	Roxboro/Chestnut Hill	6.2%	40	$1,030	1.2%
21	Camden	6.4%	(160)	$833	-0.6%
22	Camden West	7.6%	340	$831	2.8%
23	Moreland/Abington/Upper Dublin	7.8%	460	$1,144	-2.9%
24	West Philadelphia	7.8%	(70)	$912	0.8%
25	West Chester	9.6%	680	$940	-2.9%
26	Norristown/Plymouth/Norriton	9.9%	660	$1,104	2.6%
27	Cherry Hill/Eversham/Medford	10.1%	250	$1,049	-0.1%
28	North/Frankford/Holmesburg	10.5%	400	$745	0.5%

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