

Facts & Figures

MARKETS ON THE MOVE ■ BY MARCUS & MILLICHAP



Slow and Steady

Despite an uptick in vacancies, the City of Brotherly Love still has a lot to offer.

Famed for being the first capital of the United States and the town where the nation was born, Philadelphia has a long and storied past. Today, it is the largest city in Pennsylvania and the sixth most populous city in the country. And that population has lured a diversified economy with strong representations in a variety of industries, including educational and health services;

trade, transportation, and utilities; and professional and business services.

Unfortunately, Philadelphia's local economy has not been immune to the spill-over from the weak national marketplace. Overall, the metro area is forecast to record net job losses this year. Philadelphia employers are expected to trim payrolls by about 7,000 positions this year, a decline of 0.2 percent. In contrast, employment last year grew by 16,800 jobs, or 0.6 percent.

Wilmington Finance, based in Plymouth Meeting, Pa., announced in mid-June that it will cease wholesale mortgage banking origination by the end of the year, eliminating 335 positions. Furthermore, Philadelphia-area manufacturing activity continues to decline, with 72 percent of local businesses indicating increasing costs of operations in June, compared with 61 percent just one month earlier, according to the Federal Reserve of Philadelphia.

Still, there are bright spots. The educational and health services sector is forecast to post impressive gains, adding nearly 7,500 positions, while the leisure and hospitality sector is expected to add 3,200 positions. Lockheed Martin was also recently awarded part of a \$1.4 billion contract to develop a next-generation global positioning system. The contract will bring 400 positions to the company's Newtown facility in Bucks County, Pa., just outside the Philadelphia metro.

Such tumult has left market watchers wary of the city, but despite the softer economic conditions and an anticipated rise in vacancy rates, the Philadelphia apartment market is likely to stay healthy through the end of 2008



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and into 2009, thanks to steady investor activity and resident demand.

A NUMBERS GAME

A quick look at current metrics speak volumes about Philadelphia. Occupancy remains at healthy levels and rent gains are holding steady. The marketwide vacancy rate of 4.4 percent in the second quarter was up 30 basis points from year-end 2007 and 40 basis points higher than during the second quarter of last year.

Second-quarter vacancy rates rose most steeply in the Class B and Class C sectors, while Class A and low-tier product saw a slight decline in vacancy rates. What's more, a slight increase in supply, coupled with softer demand due to an uptick in unemployment, will lead to a 50 basis point increase in the vacancy rate to 4.6 percent for the full year.

Meanwhile, Philadelphia asking rents ended the second quarter at \$1,015 per month, 3.4 percent higher than a year ago. Owners have been able to increase effective rents 3.2 percent year over year to the current rate of \$977 per month. Asking rents for Class A properties have risen 3.5 percent in the past year to \$1,217 per month. Rent growth in the lower tiers has been somewhat slower, with owners raising asking rents 3.3 percent to \$834 per month.

As a result, during the past 12 months, gross revenues rose 3 percent, slowed slightly by an uptick in vacancies. This revenue growth will likely decelerate through the second half of the year as additional stock is delivered and effective rent growth slows. In 2008, asking rents are expected to increase 2.8 percent to \$1,029 per month, while effective rents advance 2.5 percent to \$988 per month. This is a slow down from last year, when asking and effective rents gained 4 percent and 3.9 percent, respectively.

RISING SUPPLY

This year, a significant number of units are expected to come online in Philadelphia, which may affect the city's vacancy and occupancy rates going forward. Most of these units are Class A rental and are concentrated in the Northern suburbs of the city.

Overall, about 1,700 apartment units are under construction and scheduled for delivery in 2008 and later. And 2,100



additional units are in the planning phases. Nearly all of the new rentals will be located in Pennsylvania submarkets. Since the second quarter of 2007, 600 rental units have been added to the existing stock, raising rental inventory by 0.3 percent. In the preceding 12-month period, about 1,400 units were added to the metrowide inventory. Despite the increase from last year, additions to supply will boost inventory just 0.6 percent.

Interestingly, multifamily permits are on the rise in Philadelphia. Permits for 4,600 units of multifamily housing were issued through the second quarter of this year, up 11 percent from the same period last year. Still, it's difficult to say how many of these apartments will actually be delivered. The increase suggests an upward trend of activity, although many projects may not progress past the permitting stage.

Within Philadelphia's main city limits, many apartment investors have their sights set on urban infill projects due to lack of available land for development. As such, most of the activity is outside the downtown area, also known as Center City, where only 100 units are scheduled for completion this year.

Looking at specific submarkets, about 20 miles north of Philadelphia, in Bucks County, developer J.G. Petrucci & Co. is considering a transit-oriented development district near the Warminster train station. The plans submitted by Petrucci call for rezoning a 16-acre industrial site adjacent to the Jacksonville Plaza shopping center in order to deliver a 200-home, mixed-use development that will take advantage of the tract's proximity to the train station.

In nearby Berks County, northwest of the Philadelphia metro, Exeter JV Associates, a partnership of Ironwood Property Group and the Goldenberg Group, is working on the \$100 million Exeter Commons retail project. When the property is completed next summer, it will add hundreds of jobs to the area.

Meanwhile, Carl Dranoff, CEO of Philadelphia-based Dranoff Properties recently won a five-year, \$150 million contract from the Lower Marion Township to redevelop downtown Ardmore, which is 7 miles northwest of Center City. Unlike the developer's recent condo projects, the plans for Ardmore call for 335 new apartments, as well as 60,000 square feet of retail and restaurant space,

12,000 square feet of office space, 1,150 parking spaces, and a 95-foot-tall clock tower.

A STEADY TRICKLE

Activity in Philadelphia's apartment investment market will hold steady through the rest of the year, as both institutional and private buyers maintain a conservative bias regarding the local and national economy. Still, the pace of investment sales has slowed in the past 12 months as transaction velocity fell 26 percent. Fewer deals were recorded in each area of the market. Private buyers continue to dominate activity, accounting for 67 percent of trades over the past year. The median price for all transactions citywide fell 7 percent in the past 12 months, to \$65,500 per unit.

Some of the decline is the result of conservative underwriting, which then increased cap rates and widened the expectations gap between buyers and sellers. Class A properties, for instance, are trading in the low- to mid-6 percent range, while Class B properties average 6 percent to 7 percent.

Interestingly, the relatively steady flow of multifamily investment activity may have been driven by a lack of buyer activity in the single-family market, despite the relative affordability of homes in Philadelphia. The gap between the average monthly rent for a Class A apartment and the monthly mortgage payment on a median-priced home was \$42 in the second quarter of 2008, compared with a gap of \$196 a year earlier. However, lending standards continue to remain conservative, keeping many out of the for-sale market and driving individuals to remain in the renter pool until market conditions stabilize.

Overall, the Philadelphia investment market is expected to remain moderate through the end of 2008. Institutional and fund equity will continue to target Center City, with competition keeping prices near current premiums. Buyers will continue to target stabilized submarkets with attractive demographics, such as Main Line, Chester County, and Montgomery County.

With such a prominent history, Philadelphia can also bank on the future, providing solid multifamily opportunities to investors today and into tomorrow. **[M]**

Considering Philadelphia? Here's what you need to know:

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| 1 Population: 1,434,628 | 4 Median Household Income: \$35,540 |
| 2 Occupancy: 95.4% | 5 Average Rent: \$1,029 |
| 3 Median Age: 35.64 | 6 Unemployment: 6.12% |

NOTABLE: William Penn named the city Philadelphia, which is Greek for brotherly love. Philadelphia was the original capital of the United States. The city was used as the location of the First Continental Congress during the Revolutionary War, as well as the Second Continental Congress. During the war, the Declaration of Independence was signed in Philadelphia's Independence Hall, and the Constitutional Convention was held there after the war. Unsuccessful lobbying after the war to make Philadelphia the permanent U.S. capital resulted in the departure of the federal government in 1800.

FAST FACTS

SMALL WONDER:

Cloverly Apartments a 29,300-square-foot, 52-unit apartment complex, sold in early 2008, despite a tighter market. Located on West School Hose Lane, the property features studios and one-bedroom units.

