MARKET REPORT

Multifamily

Philadelphia Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

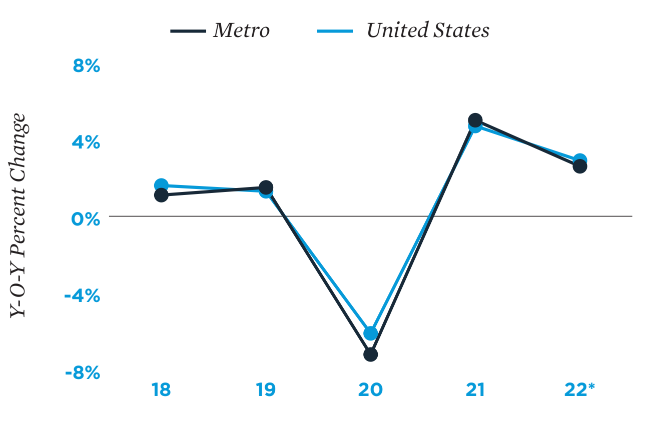
3Q/22

Supply Additions to Accelerate as Renter Demand Approaches Pre-Pandemic Level

Center City retains renter appeal as signs of office return emerge. Though many of Philadelphia's office workers have yet to be called back to offices in the urban core as of August, a myriad urban amenities underscore this district's appeal, prompting a 350-basis-point decline in availability over the trailing year ended in June. Vacancy in the CBD entered July at 4.4 percent, 40 basis points below the pre-pandemic level. Headwinds that could potentially place upward, near-term pressure on availability should be mitigated as major employers implement hybrid schedules, enticing renters back to the core for shorter commutes. Additionally, homebuyers from costlier nearby markets are taking advantage of Philadelphia's lower relative home values, increasing the cost of housing here and exacerbating the affordability gap between rentals and single-family dwellings.

Developers increase construction pace as demand stabilizes. The record-breaking delivery schedule slated for 2022, and a total pipeline that exceeds 21,500 units, indicate supply growth will continue at an elevated rate through 2024. While vacancy remains well below pre-pandemic levels, all submarkets reported increasing availability during the second quarter as historic inflation incentivized some renters to consolidate households. Climbing vacancy will do little to stunt rent growth in 2022, with rates advancing at a notable pace. Beyond this year, however, the rapid pace of supply additions should prompt more concessionary activity in the Class A segment if vacancy continues to advance in this tier.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.; RealPage, Inc.

Multifamily 2022 Outlook

75,000 JOBS *will be created*

EMPLOYMENT:

The return of more area employers to the office should stoke job growth in pedestrian-dependent areas, particularly in Center City and adjacent zones. Philadelphia's employment base will end the year within 0.6 percent of pre-pandemic figures.

7,500 UNITS *will be completed*

CONSTRUCTION:

Rental completions will mark a multidecade high this year, which will expand metro supply by 1.9 percent. Growth will be particularly acute in the CBD, with projects scheduled for 2022 completion comprising 6 percent of stock here.

80 BASIS POINT *increase in vacancy*

VACANCY:

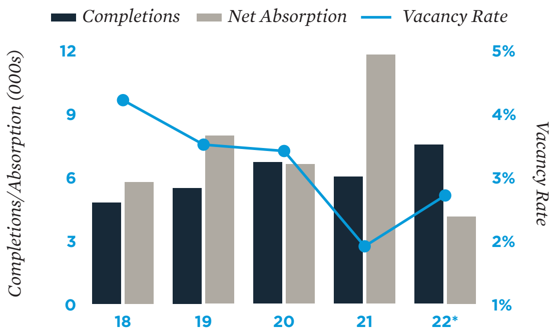
Notable supply increases are advancing stock as renter demand shows signs of moderating, bringing vacancy to 2.7 percent this year. Still, 2022 will be the second year on record to report sub-3 percent year-end availability since at least 2000.

7.9% INCREASE *in effective rent*

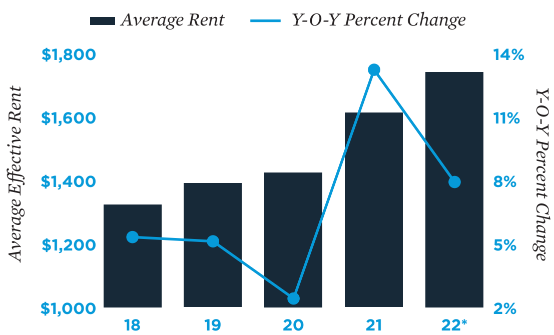
RENT:

Rent growth will ease in the wake of last year's 13.2 percent advance, however, tight conditions should translate to the second-fastest pace of rate growth in multiple decades. The average effective rent will end 2022 at $1,740 per month.

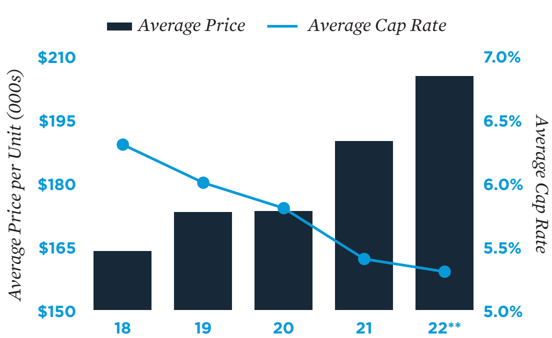
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

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Price: $250

2Q 2022 - 12-Month Period

CONSTRUCTION

5,600 units completed

- Doors added during the 12-month period ended in June were in line with the trailing five-year average, growing supply by roughly 1.4 percent.
- Builders were active in the urban core, with the 1,970 units added during this period expanding stock by 4.8 percent. Supply gains in other zones constituted just 1.0 percent of existing rentals.

VACANCY

90 basis point decrease in vacancy Y-O-Y

- The metro set all-time lows for availability at several points during the trailing year ended in June, closing the span out at 2.2 percent.
- All apartment tiers observed vacancy increases during the second quarter. The Class A sector noted an 80-basis-point increase to 3.6 percent, while Class B availability rose 50 basis points to 2.2 percent.

RENT

14.4% increase in the average effective rent Y-O-Y

- Metro rents observed their greatest advance by dollar amount during the trailing year, jumping nearly $215 to an average of $1,697 per month.
- Nearly all submarkets observed double-digit rent gains over this span. Newark, Southwest Philadelphia and Camden-Cherry Hill led in this metric, with growth ranging from 15.6 percent to 22.5 percent.

Investment Highlights

- Investors set a record for trading activity during the 12-month span ended in June, with transactions exceeding the 2019 annual total by roughly 80 percent. However, following a surge of closings in the fourth quarter of 2021, sales velocity appears to be moderating this year. Mounting capital costs may create additional hurdles to deal flow in the latter half of 2022.
- Aggressive bidding activity brought the average sale price for trades completed over the past year to $205,200 per unit, a 13 percent increase over the previous span. Still, this measure represents relative discounts of 18 percent to Washington, D.C., nearly 35 percent to Boston and 45 percent compared to New York City. This should continue to stoke institutional investment in the Philadelphia metro.
- A 30-basis-point compression brought the average cap rate into the low-5 percent range over the past year, though the metro retains a yield advantage over nearby mid-Atlantic markets. In addition to elevated returns for comparable assets, many of the metro's municipalities boast a friendlier business environment for multifamily investment relative to other markets in the region that institutions may be considering.