Marcus & Millichap

Multifamily Research Market Report

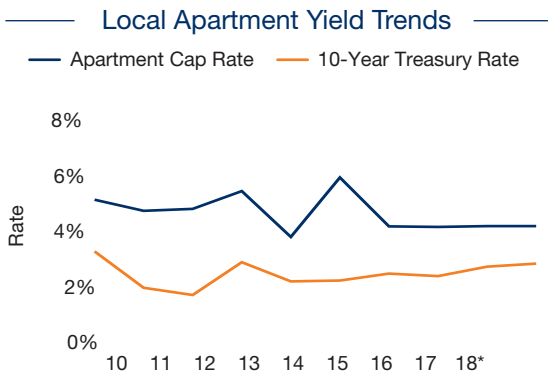
New York City

Third Quarter 2018

Supply Overhang Weighs on Rent Growth; Positive Dynamics Remain in Place

Low unemployment, consistent job growth boosting apartment demand. A broad base of high-wage industries and more than 8.5 million residents are driving significant net absorption of apartments, particularly as single-family homes remain out of reach for many would-be buyers. As the pace of construction soared, net absorption outpaced new supply every year since 2012, fostering a metrowide vacancy rate that reached 2 percent by the end of 2017. This year, development will contract moderately following the cycle high reached in 2017, providing a tailwind to the overall market. However, the exceptional growth in supply has weighed on overall gains in the average effective rent as operators throughout the city opted to provide a heavier slate of incentives to draw renters and fill new buildings. As the year progresses and the market continues to tighten, the sentiment around incentives should moderate somewhat, providing an improvement to NOIs.

East River neighborhoods in Brooklyn and Queens drive development. As rental rates have risen throughout the cycle, construction has expanded meaningfully throughout the city. Those efforts are now being focused on locations in Brooklyn and Queens along the East River, where quick commutes to employment centers in Manhattan offer convenience and value. As popularity has increased over the past several years, the valuation gap between these areas has moderated somewhat, yet it remains wide enough to draw additional renters to the area.



* Cap rate trailing 12-month average through 2Q; Treasury rate as of June 28.
Sources: CoStar Group, Inc.; Real Capital Analytics

Multifamily 2018 Outlook

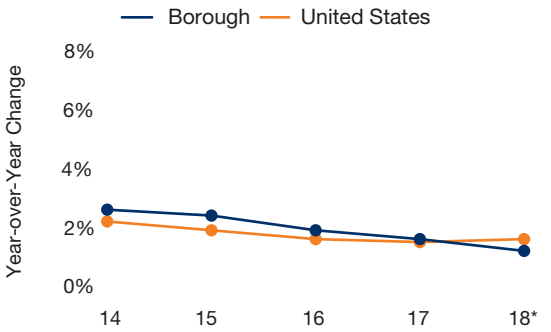
Metro	Vacancy	Y-O-Y Basis Point Change	Effective Rent	Y-O-Y Change
Bronx	1.0%	-10	$1,425	2.0%
Brooklyn	2.0%	-20	$2,150	2.3%
Manhattan	2.1%	-20	$3,510	1.3%
Queens	1.5%	-30	$2,060	3.0%
Staten Island	3.6%	20	$1,550	1.7%
Westchester County	4.1%	-20	$1,945	1.4%

Investment Trends

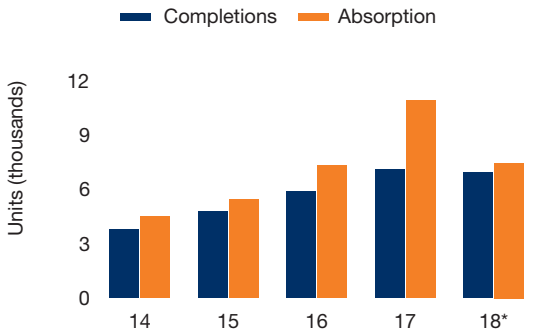
- While transaction activity and dollar volume have declined since 2016, continuing NOI growth has pushed apartment prices to new all-time highs in most core neighborhoods.
- Brooklyn investors remain focused on communities along the East River such as Williamsburg, Greenpoint and Dumbo, where valuations can easily reach above $450,000 per unit. Deal flow remains property-specific farther inland, typically requiring more capital injections to realize the full potential of the asset.
- Buildings around Hudson Yards and Hell's Kitchen are seeing prices move higher as buyers look to position for greater foot traffic and tenant interest in the area. Yields remain higher than the borough average, encouraging long-term hold strategies.
- Investors seeking greater yields should pursue assets in Long Island City and Astoria, where a significant revitalization is beginning to draw broad tenant and investor interest. Cap rates remain roughly 50 to 100 basis points above the metro average for older buildings in these neighborhoods.

CURRENT TRENDS

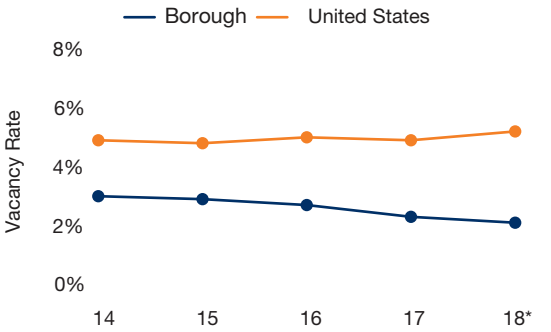
Employment Trends



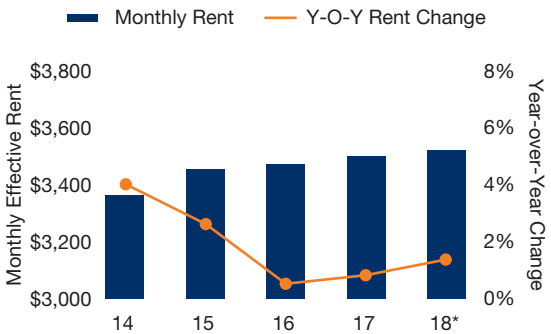
Completions and Absorption



Vacancy Rate Trends



Rent Trends



* Forecast

2Q18 – 12-MONTH PERIOD

EMPLOYMENT:

1.8% increase in total employment in 2017

- Businesses added 12,700 employees during 2017, expanding total employment by 1.8 percent. The borough will create 9,700 positions this year, a 1.4 percent growth rate.
- Since the current expansion began in 2009, more than 161,800 positions have been created in the borough, a 29 percent rise in total employment.

CONSTRUCTION:

4,800 units completed Y-O-Y

- Development declined moderately over the past year as 3,300 fewer units were brought online than the same period in the previous year. Completions targeted primarily Midtown South and Lower Manhattan, which accounted for more than 2,700 rentals.
- Builders will slow construction as the year progresses, with 3,750 apartments set to come online in 2018.

VACANCY:

60 basis point decrease in vacancy Y-O-Y

- A slower pace of construction and net absorption of more than 9,600 units led vacancy in the borough to fall 60 basis points to 2.0 percent over the past year.
- Despite receiving the majority of the new development, Midtown South Manhattan experienced surging demand for units that pushed vacancy down 130 basis points to 2.4 percent during the past 12 months.

RENTS:

1.9% increase in effective rents Y-O-Y

- The average effective rent advanced 1.9 percent during the past year, reaching $3,589 per month. Rent growth was led by Lower Manhattan and Midtown South, advancing 3.2 percent to $4,155 per month and 2.1 percent to $4,097 per month, respectively.
- Harlem recorded the slowest growth over the past year, rising 1.7 percent to $2,170 per month.

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*
25,500

2Q18 POPULATION AGE 20-34
(Percent of total population)
Metro 30%
U.S. 21%

2Q18 MEDIAN HOUSEHOLD INCOME
Metro $80,276
U.S. Median $61,179

FIVE-YEAR HOUSEHOLD GROWTH*
26,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR'S DEGREE+**
Metro 37%
U.S. Average 29%

1Q18 TOTAL HOUSEHOLDS
50% Rent
50% Own

* 2017-2022
**2016

SUBMARKET TRENDS

Lowest Vacancy Rates 2Q18

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Harlem	1.6%	-50	$2,170	1.7%
Lower Manhattan	1.6%	-80	$4,155	3.2%
Upper Manhattan	1.9%	-60	$4,023	1.0%
Midtown South	2.4%	-130	$4,097	2.1%
Midtown	3.6%	20	$4,129	1.9%
Manhattan	**2.0%**	**-60**	**$3,589**	**1.9%**

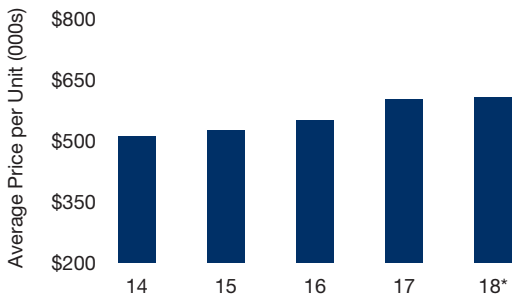
SALES TRENDS

Transactions Tick Lower Amid Soaring Prices For Well-Located Rentals

- The average price per unit soared above $600,000 during the most recent 12-month period as prices in the Midtown West, Tribeca and Wall Street/Battery Park areas exchanged ownership above $800,000 per door.
- Cap rates remain in the high-3 percent to low-4 percent range, with smaller properties and transitioning neighborhoods reaching the mid-4 percent band.

Outlook: Extremely tight conditions and relatively rapid rent growth have buyers focused on transformative projects and locations where capital returns can be much higher than assets already priced for turnkey performance.

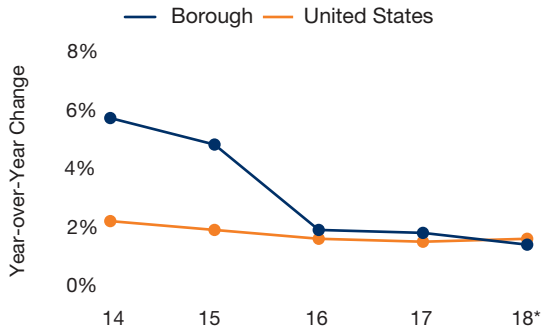
Pricing Trends



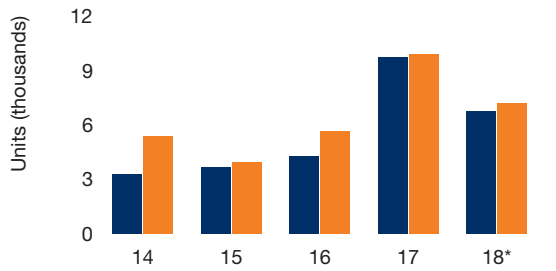
* Trailing 12 months through 2Q18
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

CURRENT TRENDS

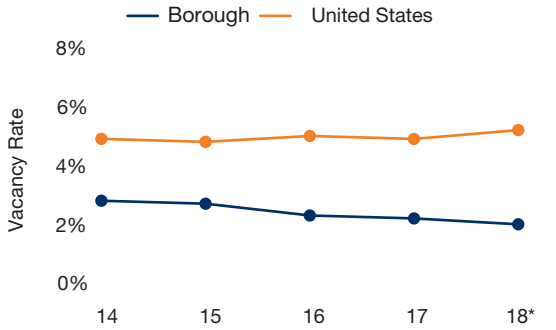
Employment Trends



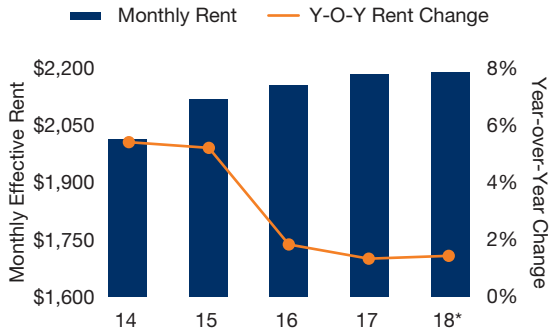
Completions and Absorption



Vacancy Rate Trends



Rent Trends



* Forecast

2Q18 – 12-MONTH PERIOD

EMPLOYMENT:

1.6% increase in total employment in 2017

- Over the past year, Brooklyn employers hired 39,400 workers. More than 29,600 jobs will be created this year, increasing employment by 1.2 percent.
- More than 356,000 people have found work since the beginning of 2009, accounting for a 16 percent rise in total employment.

CONSTRUCTION:

6,100 units completed Y-O-Y

- The pace of construction ticked down modestly over the past year as 6,100 apartments were brought online, helped by fewer deliveries in Downtown Brooklyn, Bed-Stuy and Park Slope.
- Development will reach nearly 6,900 units in 2018, down roughly 3,000 rentals from the prior year. Two projects will deliver more than 710 apartments each.

VACANCY:

60 basis point decrease in vacancy Y-O-Y

- The reduction in concentrated supply growth, coupled with consistently robust net absorption, pushed vacancy down 60 basis points to 1.9 percent over the past year, reaching the lowest level since 2003.
- Vacancy plummeted 380 basis points in Downtown Brooklyn to 5.0 percent as the pace of completions slowed moderately.

RENTS:

2.0% increase in effective rents Y-O-Y

- Intense competition for tenants has sponsored a plodding pace of average effective rent growth, ticking up 2.0 percent to $2,224 per month over the past four quarters, as incentive activity remained elevated.
- Discounting and other incentives weighed heavily on the Williamsburg/Greenpoint/Navy Yard submarket, where rents fell 1.0 percent to $3,215 per month.

DEMOGRAPHIC HIGHLIGHTS

FIVE-YEAR POPULATION GROWTH*
50,700

2Q18 POPULATION AGE 20-34
(Percent of total population)
Metro 26%
U.S. 21%

2Q18 MEDIAN HOUSEHOLD INCOME
Metro $57,562
U.S. Median $61,179

FIVE-YEAR HOUSEHOLD GROWTH*
40,000

POPULATION OF AGE 25+
PERCENT WITH BACHELOR'S DEGREE+**
Metro 32%
U.S. Average 29%

1Q18 TOTAL HOUSEHOLDS
50% Rent
50% Own

* 2017-2022

**2016

SUBMARKET TRENDS

Lowest Vacancy Rates 2Q18

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
Southern Southeast Brooklyn	0.5%	-30	$1,776	2.4%
Ditmas Park/Flatbush	0.9%	-20	$1,978	0.7%
Southwest Brooklyn	1.4%	-20	$1,666	1.5%
Crown Heights/Prospect Lefferts Gardens	1.6%	-50	$1,737	1.5%
Bed-Stuy/Fort Greene/ Bushwick	2.4%	-100	$2,743	1.9%
Park Slope/Prospect Heights	2.4%	-60	$2,639	-0.1%
Williamsburg/Greenpoint/ Navy Yard	3.2%	-90	$3,215	-1.0%
Downtown Brooklyn	5.0%	-380	$3,657	7.3%
Brooklyn	**1.9%**	**-60**	**$2,224**	**2.0%**

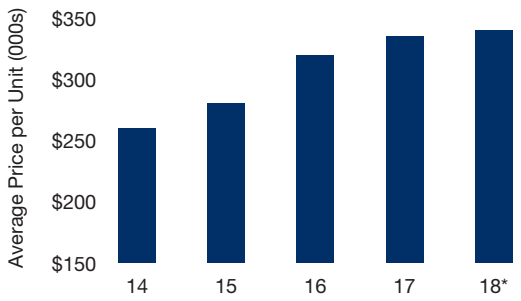
SALES TRENDS

Deal Flow Moderates as Prices Continue To Edge Higher

- The average price per unit advanced over the past year, reaching the $345,000 range. While transaction volume dipped during the year, the Bed-Stuy, Williamsburg and Brooklyn Heights areas remained extremely active.
- A slower pace of transactions did little to affect cap rates, with the average first-year return remaining in the mid- to high-4 percent range.

Outlook: Buyers have primarily focused on areas directly over the Washington and Williamsburg bridges, where commuters have easy pathways into Manhattan.

Pricing Trends



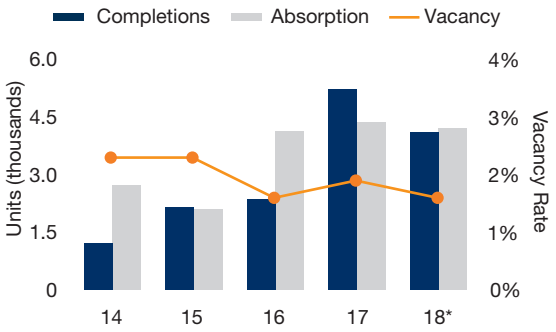
* Trailing 12 months through 2Q18
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

QUEENS

Marcus & Millichap

2Q18 – 12-MONTH PERIOD

Supply and Demand



VACANCY AND RENT:

50 basis point decrease in vacancy Y-O-Y

- A slower pace of deliveries allowed net absorption to rise above completions, contracting vacancy by 50 basis points to 1.3 percent.

1.2% increase in effective rents Y-O-Y

- The average effective rent advanced 1.2 percent over the past year to $2,101 per month as relatively higher price points in new buildings lifted overall pricing in the borough.

CONSTRUCTION:

3,600 units completed Y-O-Y

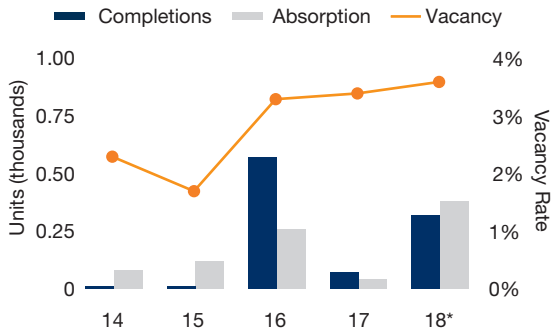
- Developers finished 3,600 units last year, down less than 200 units from the previous yearlong period, when more than 3,770 rentals were completed.
- There are 4,880 apartments underway in the borough, led by sites in Astoria and Long Island City. The first and second phases of Jackson Park in Long Island City will contain over 650 units each.

INVESTMENT HIGHLIGHTS:

- Deal flow contracted moderately, while the average price per unit rose to just above $280,000 per door. Locations in Long Island City made up nearly half of all transactions in the borough.
- Cap rates remain in the low-4 percent band while extending into the low-5 percent range for assets farther away from the East River.

STATEN ISLAND

Supply and Demand



VACANCY AND RENT:

60 basis point increase in vacancy Y-O-Y

- Moderate tenant outflows lifted vacancy 60 basis points to 3.7 percent despite a lack of completions during the past 12 months.

1.3% increase in effective rents Y-O-Y

- The average effective rent advanced 1.3 percent to $1,505 per month as local properties converge with higher-priced options in the other boroughs.

CONSTRUCTION:

0 units completed Y-O-Y

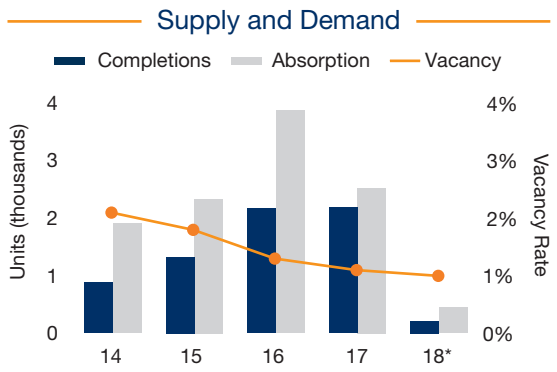
- Developers completed no projects over the last year.
- The future pipeline remains limited. The second phase of Staten Island Urby will come online with 325 units this year, representing the only major completion for 2018.

INVESTMENT HIGHLIGHTS:

- Deal flow contracted over the past year as vacancy rose moderately. All transactions were for properties of 50 units or less and dominated by private investors inside the metro.
- Buyers paid roughly $210,000 per unit on average, ranging from approximately $110,000 to $350,000 per unit, reflecting a wide variety of traded assets.

* Forecast

2Q18 – 12-MONTH PERIOD



VACANCY AND RENT:

10 basis point decrease in vacancy Y-O-Y

- Demand outstripped supply growth over the past year by more than 300 units, trimming vacancy by 10 basis points to 1.1 percent.

1.9% increase in effective rents Y-O-Y

- The average effective rent ticked up 1.9 percent to $1,419 per month, limited by the amount of affordable housing in the borough.

CONSTRUCTION:

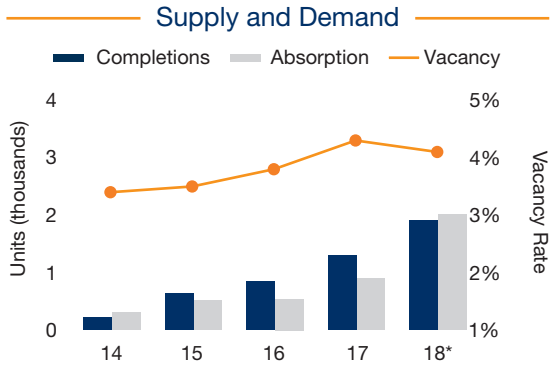
2,300 units completed Y-O-Y

- Development increased moderately over the past year as roughly 200 more units were completed compared with the previous yearlong period.
- The pipeline will slow considerably over the coming year, with fewer than 400 units slated for delivery in 2018. The largest project, at 530 Exterior St., will contain 157 apartments in a 13-story building.

INVESTMENT HIGHLIGHTS:

- Transactions increased considerably over the past year as buyers pursued assets in the Southeast Bronx and Fordham areas. The average price per unit was in the low-$190,000s.
- Cap rates remain in the mid-5 percent range as buyers bid for higher-yielding opportunities throughout the borough. Cap rates are lowest in Riverdale and Kingsbridge.

WESTCHESTER COUNTY



VACANCY AND RENT:

10 basis point increase in vacancy Y-O-Y

- Vacancy fell 10 basis points over the past year to 4.1 percent as net absorption picked up considerably, overshadowing a rise in inventory.

2.5% increase in effective rents Y-O-Y

- The average effective rent rose 2.5 percent to $1,967 per month, boosted by an influx of Class A units at relatively higher price points than the county average.

CONSTRUCTION:

1,300 units completed Y-O-Y

- The pace of construction increased during the past four quarters, rising from 1,100 units in the latest 12 months.
- More than 2,000 apartments are underway in the county, with slightly less than half underway in Downtown Yonkers. Construction is also elevated in Downtown New Rochelle and White Plains.

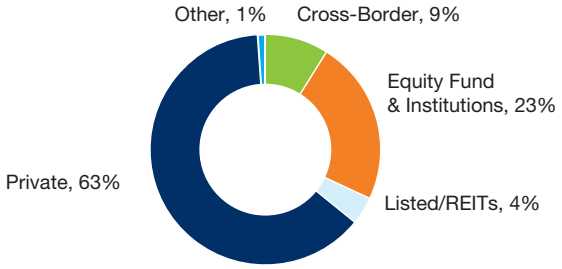
INVESTMENT HIGHLIGHTS:

- Overall deal flow moderated somewhat over the past year, yet investment remained consistent in Yonkers, Mount Vernon and New Rochelle.
- The average price per unit rose to the low-$200,000s, while cap rates were roughly in the mid-6 percent range, drawing a broad array of capital to the marketplace. High-net-worth buyers were the most prevalent.

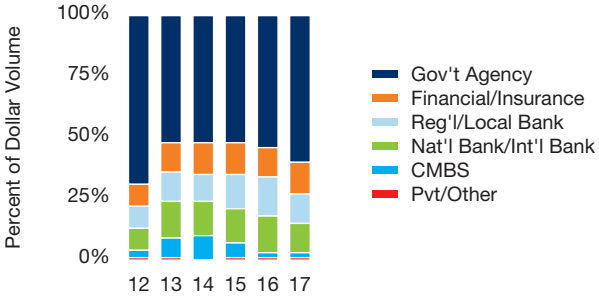
* Forecast

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q18 Apartment Acquisitions By Buyer Type



Apartment Mortgage Originations By Lender



Include sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

CAPITAL MARKETS

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

- **Healthy economy and inflationary pressure drive rate increases.** The Federal Reserve appears committed to normalizing the fed funds rate, but further action could be restrained this year as headwinds could weigh on the economy. Economic growth and inflation have had a dramatic effect on the 10-year Treasury rate, which has more than doubled over the past two years to 2.85 percent. However, capital inflows as investors seek alternative investment options are holding the rate below 3 percent.
- **Borrowing costs rise, cap rates remain compressed.** Debt providers are facing a rising cost of capital, leading to higher lending rates for investors. To compete for loan demand, some lenders may choose to absorb a portion of the cost increases while others will require higher equity stakes up front. More complex and creative approaches to financing properties may begin to emerge as investors seek to reach return objectives.
- **Lending market remains competitive as interest rates rise.** Government agencies continue to consume the largest share, just slightly over 50 percent, of the apartment lending market. National and regional banks control approximately a quarter of the market. Multifamily interest rates currently reside in the mid-4 percent to mid-5 percent realm with maximum leverage of 75 percent. Portfolio lenders will typically require loan-to-value ratios closer to 70 percent with interest rates in the low-4 percent to low-5 percent span.

National Multi Housing Group

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Price: $750

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; National Association of Realtors; Moody's Analytics; Real Capital Analytics; RealPage, Inc.; TWR/Dodge Pipeline; U.S. Census Bureau