Marcus & Millichap

Multifamily Research Market Report

Second Quarter 2016

New York City

Investor Allocations Continue Amid Supply Growth

Development activity heating up as tenants seek affordability in outer boroughs. As the New York City labor market continues to advance, the need for rental housing has been pronounced, with the metro vacancy rate falling to one of the lowest levels ever recorded. This has inspired developers to add several mixed-use and multifamily projects to the construction pipeline, with the slate of activity for 2016 scheduled to produce the largest supply injection in more than a decade. Although builders have consistently focused primarily on opportunities in Manhattan, rising real estate values and tenant interest in more affordable options are also prompting more projects in the outer boroughs, particularly Brooklyn and Queens. As these rentals are delivered, several submarkets have seen operations soften as tenant optionality has escalated, prompting an increase in vacancy as the new properties lease up. Although longer-term supply and demand remain out of balance due to the high cost of single-family residences, near-term deliveries are likely to continue to affect asset operations as competition for tenants accelerates. This environment will do little to prevent another year of rent growth, however, as pricing power remains in favor of local operators.

Transaction volume shifting to outer boroughs as investors seek higher yields. Historically low interest rates have continued to motivate buyers to seek out well-located assets in the multifamily sector. While institutions and syndicate investors are overwhelmingly allocating capital to Manhattan, the bulk of deal flow is shifting to Brooklyn and Queens, where cap rates can be nearly 100 basis points above Manhattan. When venturing into Manhattan, private buyers are seeking out opportunities for building and unit improvements, seeking to boost real returns as rental rates rise toward market value. However, intense interest in these properties has prompted many investors to deploy capital in Brooklyn where prices per unit are less than half the cost of Manhattan equivalents. Metro cap rates will average in the mid- to high-4 percent range, with Manhattan stock drifting into the low-4 percent range. Brooklyn and Queens assets will typically exchange ownership in the high-4 to low-5 percent range, depending on quality and location. Robust supply injections over the coming year may prompt more current owners to list, increasing transaction velocity.

2016 Multifamily Forecast

2.1% increase in total employment

Employment:

Local New York City organizations will hire 90,000 new workers this year, expanding total payrolls by 2.1 percent. Over the previous 12 months, 101,000 new positions were created, a 2.4 percent improvement year over year.

30,000 units will be completed

Construction:

Developers will complete nearly 30,000 new apartments this year, dramatically increasing the pace of deliveries from last year, with the majority of new stock targeting Manhattan and Brooklyn. In the previous year, 13,000 rentals were brought to market.

60 basis point increase in vacancy

Vacancy:

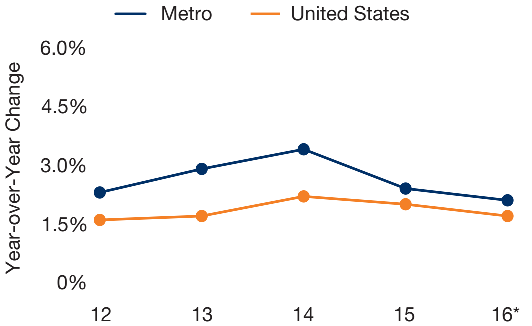
The largest supply growth of the current cycle will foster a transitory shift upward in vacancy to 2.3 percent, up 60 basis points from 2015. In the prior four quarters, vacancy rates declined 40 basis points as the pace of construction slowed.

2.5% increase in effective rents

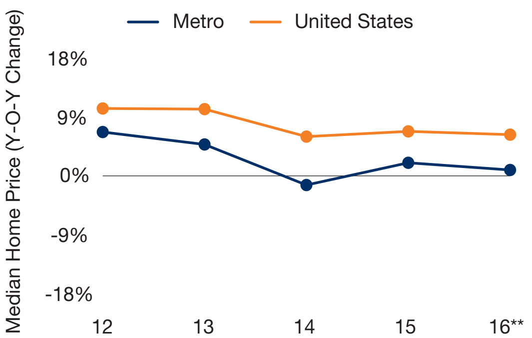
Rents:

Strong growth in net migration and new household formation will ensure sufficient demand to promote average effective rent growth of 2.5 percent to $4,173 per month. Last year, average effective rents tacked on 4.2 percent.

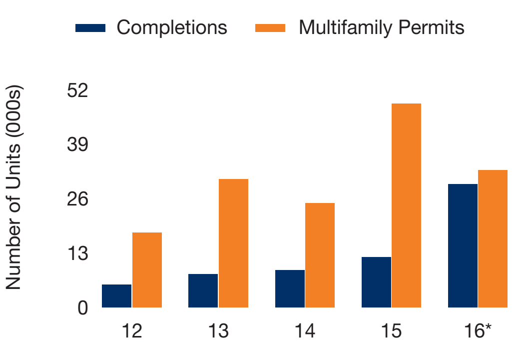
Employment Trends



Home Price Trends



Construction Trends



* Forecast
** Trailing 12 months through 1Q

Economy

- During the first quarter of 2016, New York City organizations created 28,300 new positions, leading hiring over the past year to reach 105,900 jobs and expanding the labor market by 2.5 percent. In the prior four quarters, 134,500 workers were added to payrolls.
- Over the past year, the majority of labor market growth came from the education and health services sector, accounting for nearly 34,000 new jobs as aging baby boomers generate demand for healthcare workers. The professional and business services sector also posted robust gains, adding nearly 28,000 workers to payrolls.
- Along with strong growth in the healthcare and professional sectors, all other metro sectors recorded positive headcount additions. Tourism into New York City prompted leisure and hospitality organizations to hire nearly 9,600 workers over the past year, bringing sector payrolls to more than 430,000 people.

Outlook: In 2016, local firms will create 90,000 new jobs, a 2.1 percent expansion to the labor market, with broad-based growth across all employment sectors.

Housing and Demographics

- Over the coming year, the five boroughs will add more than 37,800 new households, boosting demand for metro housing. Meanwhile, multifamily builders filed for 23,200 permits, while single-family construction firms pulled roughly 460 permits, primarily in Queens and Staten Island.
- During the past four quarters, the average price of a single-family home advanced 0.9 percent to roughly $484,000, continuing the pace of appreciation in housing. In the previous year, home prices climbed 2.2 percent.
- After considering costs for a downpayment, taxes and insurance, the average mortgage payment in the metro is more than $2,500 per month, while the average rent is above $4,085 per month. However, minimum qualifying incomes for mortgages are more than $111,000, indicating that most metro inhabitants will likely be lifelong renters.

Outlook: While the average mortgage payment is less than the average rent payment, the size of a downpayment and the locations of the average-priced home will prompt many residents to continue to seek rental accommodations throughout the metro.

Construction

- In 2015, builders delivered more than 12,000 apartments, with nearly half of all completions coming to market in Manhattan. Construction firms were also be active in the Brooklyn and Queens boroughs.
- Manhattan will receive more than 11,100 rentals, while Brooklyn completions will be nearly 9,200 units. Expected construction in Queens and the Bronx will be 4,400 and 4,000 apartments, respectively.
- There will be four projects each containing more than 700 units coming to market this year, with two sites in Manhattan and one in both Brooklyn and Queens. The largest will be at 626 First Avenue in Manhattan, followed by the 750-unit tower at 333 Schermerhorn St. in Brooklyn.

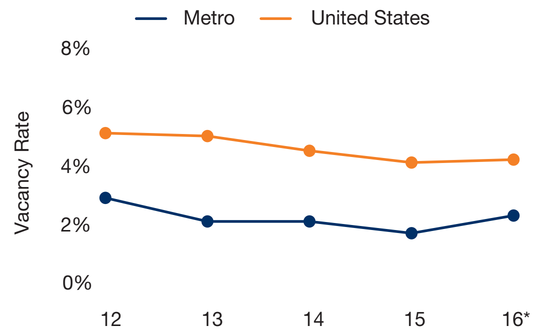
Outlook: Builders will complete 30,000 rentals in New York City this year, with development widespread throughout the boroughs.

Vacancy

- During the last four quarters, the metro vacancy rate ticked up 50 basis points to 1.9 percent as continued development weighed on market operations. In the prior yearlong period, the vacancy rate tightened 30 basis points.
- The vast majority of submarkets in Manhattan recorded occupancy outflows over the past year, with the Upper East Side posting vacancy of 2.9 percent, up 130 basis points. The Midtown East submarket also registered an increase, up 120 basis points to 2.9 percent.
- While operations in Manhattan lagged the broader metro, Queens and Brooklyn outperformed, logging a 100-basis-point contraction to 1.6 percent and remaining unchanged at 1.7 percent, respectively.

Outlook: Accelerating deliveries throughout the five-borough area will foster a 60-basis-point increase in the average metro vacancy to 2.3 percent by year end.

Vacancy Rate Trends

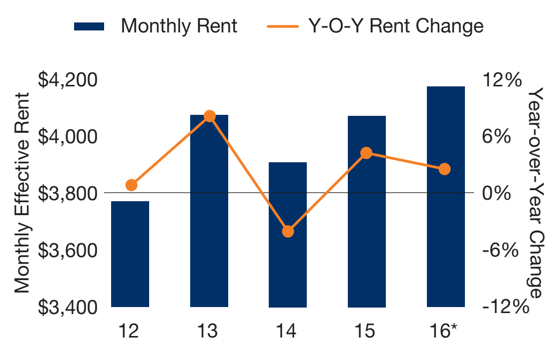


Rents

- Over the past year, the average effective rent tacked on 2.4 percent to $4,086 per month, led by several submarkets in Manhattan with rents above $4,500 per month. In the prior 12 months, the average effective rent gained 0.5 percent.
- While all submarkets in Manhattan recorded average effective rent advancement, the Midtown East and Lower West Side submarkets outperformed the broader borough. The Lower West Side increased 11.0 percent to $5,021 per month, the highest level in the metro. The Midtown East market also recorded strong growth, gaining 6.7 percent to $4,779 per month on average.
- Operators in Queens cut prices in order to attract more tenants, with the average effective rent falling 8.5 percent to $2,415 per month. Nearby Brooklyn bucked this trend, with the average effective rent rising 6.6 percent to $2,556 per month, driven by tenant demand from Manhattan as renters seek greater affordability.

Outlook: The average effective rent will increase by low single digits as greater development activity feeds through into the market.

Rent Trends

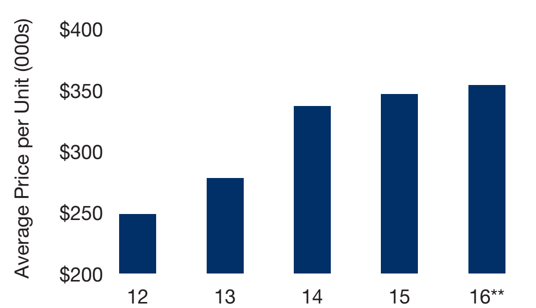


Sales Trends

- Historically low interest rates have continued to support transactions in the New York City metro, with dollar volume reaching nearly $11 billion over the past year. While Brooklyn assets made up the majority of closed deals, dollar volume in Manhattan exceeded $6 billion, more than double Brooklyn volume.
- The average price per unit for closed transactions was near $353,000, with large disparity between the boroughs. While Manhattan complexes exchanged ownership above $615,000 per rental, similar stock in Brooklyn traded near $282,000 per door. Queens' properties closed near $235,000 per unit.
- First-year yields have fallen into the mid- to low-4 percent range, with outer borough deals closing at or above 5 percent. Prime assets in Manhattan will extend toward the lower-4 percent range, while Brooklyn and Queens will typically exchange ownership between the high-4 to low-5 percent range.

Outlook: Amid abundant commercial credit and low interest rates, investors will continue to allocate capital to well-located multifamily assets due to the long-term supply and demand for housing in the metro.

Sales Trends



* Forecast
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Sources: CoStar Group, Inc.; Real Capital Analytics

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Capital Markets

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

- The U.S. economy is resuming its steady pace of growth following an extended period of financial market volatility to start the year. Recent reports have highlighted a stable consumer environment, particularly as the labor market continues to improve. Advancement in commodity prices has reduced strain in the sector, helping oil-related economies bounce back. Meanwhile, commercial credit availability remains robust, prompting a positive outlook over the coming months.
- Developer activity remains robust, with deliveries for 2016 expected to top 285,000 units, the most new apartments delivered in a year since the 1980s. Lenders have begun to more closely monitor development activity and are now tightening funding for new projects in markets they believe face overdevelopment risk. With builder activity concentrated in just 10 major metros nationally, those markets are receiving the greatest scrutiny. Lenders will likely continue evaluating each project carefully, which will benefit the sector by reducing risks of overdevelopment.
- The capital markets environment continues to be highly competitive, with Fannie Mae and Freddie Mac underwriting loans up to 10 years with maximum leverage of 80 percent. Pricing will typically reside between the high-3 percent range to the low-4 percent range, depending on deal size. Portfolio lenders will also price in this range but will typically require loan-to-value ratios closer to 65 percent. Floating bridge loans and financing for repositionings are typically underwritten with loan-to-value ratios above 80 percent, while pricing at 250 basis points above Libor for recourse and extending to 450 basis points above Libor for non-recourse deals.

Local Highlights

- Related Companies' 10 Hudson Yards recently opened its doors, the first delivery in the 17 million-square-foot campus that includes office and retail space. Retail stalwart Coach has already pre-leased more than 730,000 square feet at the tower, with Related Companies set to join the firm as well. Other leases have been signed by L'Oreal, Boston Consulting Group, Intersection, Sidewalk Labs and VanyerMedia.
- Thor Equities is planning a 623,000-square-foot office and retail development on the Red Hook waterfront in Brooklyn. The four-story project will feature more than 600,000 square feet of office space, with the rest composed of retail and restaurants.
- A recent study performed by the city has recommended a 17-mile route proposed streetcar line between Williamsburg, Brooklyn and Astoria, Queens. While talks are still in early discussions, the project would reduce travel times between the two neighborhoods by nearly 50 percent.
- Fetner Residential's Via 57 West will come online later this year. The 38-story, 709-unit project in the Lincoln Square submarket of Manhattan will contain multiple amenities including a 22,000-square-foot courtyard, poker room, gym, indoor half-basketball court and outdoor lounges with river views.