Boston Realty Advisors is pleased to present its findings concerning the strength and direction of Metro Boston’s multifamily and investment sales market as we quantify observations made in 2018 and set future expectations for 2019. With a scope of global, national and local trends, we aim to provide a broad summary of market fundamentals related to multifamily housing in Metro Boston. By looking at historical 10-year data, we explore micro and macro trends that affect the marketplace.

In 2018, over $1.01 billion of middle market multifamily investment product changed hands in the Boston area. Population and employment levels grew 0.4% in the past year. Boston remains a booming residential market with a multitude of new developments in the pipeline. Construction of new living facilities dots the region, with a concentration of new activity in infill areas directly surrounding the traditional Urban Core and Cambridge. The last 12 months saw a perpetuating trend of the elevation of the Greater Boston region in business stature, with the arrival of Alexion Pharmaceuticals, PTC, and relocation announcement of MassMutual into Boston’s Seaport District. Amazon eyed Boston as a potential HQ2 location despite the city's unwillingness to provide economic incentives (as other cities were); further indication of Boston’s premier position on the world’s business stage.

In the near-term, middle-market asset pricing may face challenges with the prospect of rising borrowing costs. Lending standards will remain stringent, forcing investors to scrutinize cap rates in the context of higher amortizing debt constants. Notwithstanding, we are anticipating strong debt and equity market liquidity due to attractive fundamentals. However, despite the dovish tone struck by the Federal Open Markets Committee (FOMC) in January, all market players will be vigilantly keeping tabs on the Fed's tone.
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Over 7,000 apartment units delivered in 2018
Massachusetts ranks 3rd as most expensive places to live in America
Boston’s unemployment rate at 2.4%, 130 basis points below national average
7 Boston neighborhoods surpassed $1,000 PSF

3rd
Boston

5th
Cambridge

33%
In transactions $1-$5M last 24 months

$1B
For the first time

3.2%
in economic cycle

5.1%
Average Boston Cap Rate:

10-Year Treasury hits new high of
Multifamily in Boston

• Urban growth driving interest in high-density developments
• Developers are embracing new technologies to promote sustainability and a stronger connection with the environment
• Lack of affordable housing is a challenge yet to be solved
• High demand for class A product
• Land, labor and construction cost remain high

Capital Markets: Debt & Equity

• There remains liquidity in both debt and equity markets
• Low cap rates continue to dominate all areas of the urban core, despite expectations of rising interest rates

We’re still Bullish on Boston in 2019

• Boston’s knowledge-based economy and recent emergence as international investment destination has built optimism in the city
The Metro Boston market encompasses all towns within Interstate 495 (Boston’s second beltway) and therefore, does not include Central and Western Massachusetts, or Southern New Hampshire.

Source: U.S. Census
Though in 2018 Boston slipped out of the top five in terms of foreign investment, it currently has the lowest unemployment rate of the top six at 2.4%. Last year, Boston’s average household income increased 1.8%. Future increases in interest rates are anticipated to be gradual in 2019, followed by further narrowing cap rate spreads. Economists credit Boston’s growth to increasing average household income, low unemployment and strength of the city’s knowledge-based economy.

Source: Bureau of Labor Statistics, REIS, AFIRE
Sales volume in 2015 was the peak for the current real estate cycle when over $2 billion worth of institutional multifamily assets traded on the back of stable interest rates and strong market fundamentals, with over 6 deals trading for over $100 million. Lower cap rate spreads in 2018 may have kept larger multifamily buyers on the sidelines with a limited number of institutional trades.

*2018 includes data for Q1-Q3 only

Source: REIS
Developers were able to fill the void of apartments in Urban Boston during the current cycle. Due to demand and the required economics of high construction costs, the majority were luxury products.

Class A inventory jumped 43% since 2008. Today, there is large variance between Class A and Class B rents, with new product fetching as much as $1.00 more PSF. However, the unique stature of Boston’s historic, well-located brownstones are still attractive to renters.

Source: REIS
Over 7,000 units were completed in 2018 with the vast majority of them Class A market-rate units, representing perceived demand for luxury apartments and the economics of development. Boston has experienced a historically large supply rush in the last 24 months, but it seems this wave may be over; new apartment deliveries are projected to decrease to approximately 5,000 units in 2019 and 3,500 in 2020.

In 2019, we are seeing the continued development of new apartments outside the traditional Urban Core. Bozzuto is building 610 apartment units in Quincy slated to deliver in 2020; and Block 8 at Assembly Row is seeking approval for 500 residences, demonstrating continued appetite from developers and sponsors for transit-oriented development.

Source: REIS
After a strong run coming out of the recession, rent growth took a pause in 2016 before picking up in the last two years. Year-over-year gains were 3.6% and 3.9% in 2018 for Class A and B/C rents, respectively. Average monthly asking rents reached $2,825 for Class A and $1,868 for Class B/C, representing a 40.8% variance. One reason for the recent average asking rent increases was the large influx of new luxury deliveries.

Source: REIS
The spread between asking and effective rents was 5.91% in 2018, but it is forecast to widen to 7.01% by 2022 as new supply comes to market. Developers have recognized we are in ‘renters-market’ and are offering enticing concessions during lease up. A ready supply of new apartments coming to market at similar times has made it increasingly difficult to reach stabilization within 12 months. One of the biggest driving factors for renters besides cost, location and concessions are amenities. The recent push to healthier living has made gyms and other wellness features de facto requirements for upscale living.

Source: REIS
In 2018, Urban Core middle market sales volume crossed over $1 billion for the first time ever with 621 transactions. In January, Boston proposed a 6% transfer tax on all property sales over $2 million, an ill-advised way to raise funds for affordable housing. The plan also introduced a 25% “flipping tax” for owners selling assets within two years of buying, potentially impacting liquidity and prices as seen in similar cities around the world, in particular Toronto and Vancouver.

Source: MLSpin
Somerville’s proximity to Boston and Cambridge, coupled with recent rezoning provisions and the Green Line Extension, has driven this market to act as cost-alternative relief-valve. In the last 10 years, Somerville’s multifamily middle market sales volume increased by 21%. Assembly Row has attracted the relocation of Partners Healthcare and Puma North America and will deliver another 500 residential units by 2021. In addition, US2, a 2.3 million SF mixed-use development will add 950 units upon its completion.

Source: MLSpin
In 2018, Boston was ranked the 3rd most expensive city in the nation with over seven of its neighborhoods surpassing $1,000 for average condominium Price Per Square Foot (PSF). Boston’s Back Bay, famous for its historic Victorian brownstones, remains the city’s most exclusive neighborhood, with an average PSF of $1,250, followed by the booming Seaport at $1,230 PSF.

With an influx of new mixed-use development, Fenway has emerged as one of Boston’s premier neighborhoods, with its average PSF reaching $1,044. However, as the appetite for affordability continues to grow, the Urban Core will expand into new territories, pushing north into Lynn and south into Quincy. Markets such as Allston / Brighton, Somerville, and East Boston have already benefited from transit-oriented developments, where low-rise stick-frame construction provides a reduced cost per square foot unlike the traditional mid-to-high rise in downtown.

The Urban Core market encompasses all submarkets within Boston Proper, Brookline, Cambridge and Somerville

* Map represent 12-month increases
* Data excludes shadow inventory

Source: MLSPin
Condo pricing has increased every year since 2012 in Boston’s primary submarkets. However, 2018 saw the expansion of upscale condominium market outside the core. Neighborhoods such as Allston/Brighton and parts of Dorchester have experienced rapid growth attributed by the economic growth of the city, and the positive ripple effect it has had on its surrounding area. Highly anticipated condominium projects include the redevelopment of 105 units at St. Gabriel’s Monastery in Brighton, and The Mark, a 107-unit development in East Boston built by elite developer The Davis Companies.

Based on the upward trend of high-density luxury product downtown, Boston’s skyline will continue to evolve. High prices in the Urban Core have expanded the locations where upscale condominiums can succeed. We expect continued growth in non-traditional submarkets from Boston’s growing workforce seeking more affordable transit housing options.
As Boston continues to enhance its profile as a world class city with the influx of new research and venture capital, it is giving way to new ultra-luxury residences. Strong market fundamentals, coupled with foreign investment and increased accessibility, in part due to recent expansion of international flight routes, have helped Boston to gain global attention as a thriving real estate market. There has been an explosion of luxury condominiums resulting in more $2+ million home sales; in a 10-year period sales increased 262%. Today, less than 16% of the housing is between $250,000 and $449,000, down from 54% a decade ago. Notable developments include Pier 4 by world-class developer Tishman Speyer, The Archer Residences, 50 Liberty and One Dalton.
In the past 18 years, the average condominium price in Boston has increased 251%, growing at a rate of 8% year-over-year. The financial crisis of 2007-2008 impacted Boston’s condominium market heavily in 2009 (the only suppression in pricing in the last 18 years) with an average price decrease of 10%, but it rebounded the following year.

2005 was considered the peak cycle of Boston’s transactions, totaling 4,687. In 2018, Boston saw 4,544 transactions, the 3rd highest since 2000 and 2nd highest since 2013, at 4,650 transactions. A ready supply of board-approved / under-construction mixed-use developments such as Fenway Center (Air Rights), Washington Village, and Seaport Square will continue to release luxury units into the market within the next three years.

Source: MLSPin
Since *Housing a Changing City: Boston 2030* was released in 2014, 17,993 units of housing have been completed in the City of Boston. According to the report, Boston must build 69,000 new housing units by 2030 to keep up with anticipated demand. The Seaport currently accounts for 13% of all units under construction, followed by the South End at 11% and Downtown at 9%. South Boston’s ‘Washington Village’ will add 656-units into the market, the biggest multifamily project currently under construction.
There is a disproportionate ratio between apartments and condos in Boston’s development pipeline, with 7,366 apartment units approved compared to 1,934 condo units. Nevertheless, as condo prices dramatically rise at a rapid pace, certain apartment development proposals could potentially convert to for-sale condos.

Source: BPDA
<table>
<thead>
<tr>
<th>Property</th>
<th>Market</th>
<th>Sale Price</th>
<th>Price Per Unit</th>
<th>Number of Units</th>
<th>Buyer</th>
<th>Seller</th>
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<tbody>
<tr>
<td>WATERMARK</td>
<td>Seaport</td>
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<td>$690,029</td>
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<td>Clarion Partners</td>
<td>Skanska</td>
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<td>TROY BOSTON</td>
<td>South End</td>
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<td>Equity Residential</td>
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<td>FUSE CAMBRIDGE</td>
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<td>$522,541</td>
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<td>Wafra Investment Advisory Group, Inc.</td>
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<td>9 DANA STREET</td>
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As we have noted in prior reports, the spread between the 2- and 10-year Treasury bonds is widely considered a bellwether of changing market conditions. Widening spreads typically lead to a historically normal yield curve, indicating an expanding economy. Conversely, contracting spreads may indicate worsening conditions in the future, resulting in a flattening of the yield curve.

On November 8, 2018 the yield on the 10-year Treasury reached 3.24%, which was the high point for the year. At that time, the spread between the 2- and 10-year Treasuries was 58 basis points. For some perspective, a year ago that same spread was 67 basis points. Since November, investors have expressed concerns over the monetary actions of the Federal Open Markets Committee (FOMC). Specifically, they have focused the systematic increasing of the Federal Funds Rate as well as the consolidation of the Fed’s balance sheet in an effort to reduce the amount of liquidity in the market. As a result, yields on both bonds fell steadily, ending 2018 with a differential of only 21 basis points.

Source: Federal Reserve Economic Data
At the September 2018 FOMC meeting, 88% of participants projected a Federal Funds rate in 2019 that is above 2.5% but below 3.25%. This range is driven by the economic data analyzed by the FOMC and not the fluctuations of equity and bond markets. As a result, we anticipate this tension continuing through 2019, which we anticipate leading to increased volatility across asset classes.

Moving into 2019, the Fed softened its outlook on rate hikes by indicating it only expects two rate increases this year, rather than the three it previously projected. The messaging from the Fed regarding the need for additional rate hikes has moderated as it continues to monitor global economic and financial conditions. We believe the Fed may pause interest rate hikes in 2019 until the U.S. and global outlook becomes clearer. Commercial real estate is expected to benefit from a more dovish Fed, as well as the market volatility that disrupts equities and bonds.
CAPITAL MARKETS

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