BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *West Palm Beach Metro Area*

2H/20

Investors Hit Pause as They Reassess the New Climate; Though Companies and Young Professionals Still Drawn to the Market

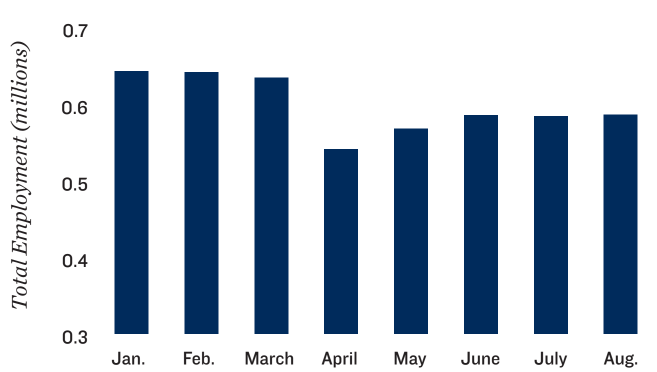
Employment growth faces long and uneven recovery. Nearly 102,000 jobs were lost from February through April as lockdowns and restrictions curtailed movement and closed businesses. Job losses brought the unemployment rate in Palm Beach County from near a record low of 3 percent at the onset of the crisis to a new high of 14.8 percent in April, though it has since been cut by more than half to 7.1 percent as of August. As more businesses reopen, employers have been bringing back workers, growing employment by 51,700 positions from the trough of the downturn, representing 51 percent of lost jobs. The leisure and hospitality sector faces a longer path to recovery with many vacation and travel plans to the metro still on hold. Nonetheless, nearly 48 percent of the 44,800 jobs lost in the sector have returned as of August.

Office tenants continue to relocate to Florida. A favorable business environment, lower taxes than other markets and a higher standard of living continue to draw companies to Palm Beach County, particularly financial firms from the Northeast. This trend could accelerate as the pandemic shifts demand to low-density suburban offices incorporated into mixed-use or a live/work/play atmosphere that meets workers' needs. Class A office space with modern amenities, including touchless entry and upgraded air filtration, will be highly sought by local and migrating firms as they adapt to a post-pandemic work model. The residential areas of West Palm Beach and Boca Raton are prime targets among tenants and investors, and new space entering these areas will be in high demand.

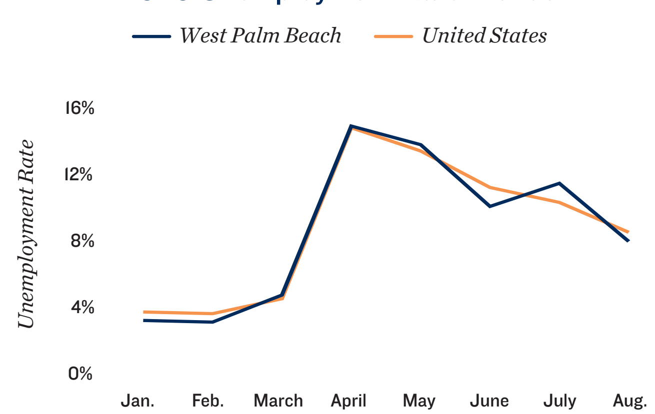
Shifting demographic trends changing market's image and drawing newcomers. Palm Beach County has become increasingly popular among young professionals as the market sheds its outdated image and provides more entertainment and nightlife. The Brightline commuter rail has helped to bring more life to West Palm Beach, while recent development in Delray Beach and Boca Raton has increased the attractiveness for renters and the younger cohort. Developers have been following these trends and capitalizing on the high rent that can be achieved, filling the pipeline with roughly 4,000 apartments. With a supply wave on the horizon, upward pressure will be placed on vacancy over the coming quarters, though long-term demand drivers remain in place and will help to fill new units.

Hurdles remain in getting deals across the finish line, though sentiment holds strong. Transaction velocity slowed considerably across all major property types in the second quarter with uncertainty surrounding future cash flows and valuations. As the economy steadily reopens and more residents return to work, greater clarity around rent growth assumptions will bring investors off the sidelines, particularly as the demographic and economic drivers hold stable in the market. Private investors dominate the buyer pool, drawn by initial yields that are often higher than other areas of South Florida. With a sizable inventory of suburban assets that are growing in demand among residents and employers, investors will continue to eye the areas of West Palm Beach, Boynton Beach and Boca Raton for their attractive yield profile.

2020 Employment Trends

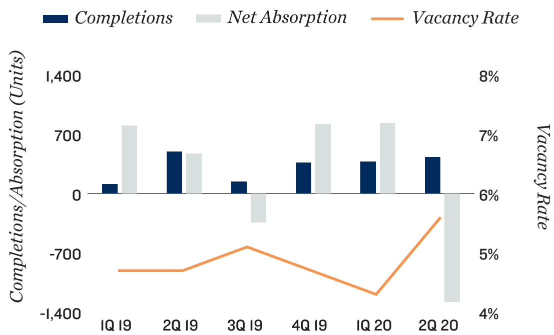


2020 Unemployment Rate Trends

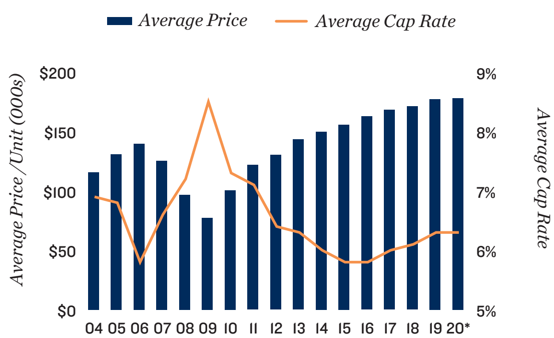


Source: BLS

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

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

APARTMENT

New Class A Complexes and Surrounding Amenities Attracting Young Professionals

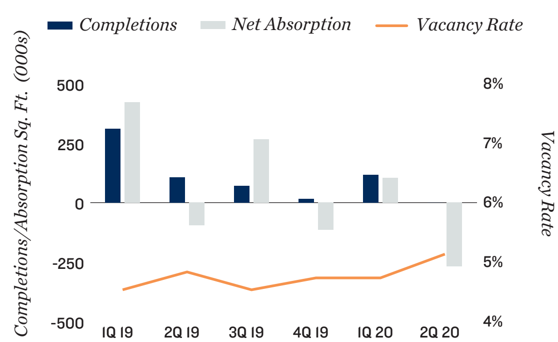
- Developers completed 800 apartments during the first half of the year, a more than 200-unit increase from the same period one year earlier. Approximately 4,000 units remain underway across Palm Beach County.
- Absorption turned negative in the second quarter, falling by more than 1,300 units as move-outs outnumbered move-ins, pushing the vacancy rate up 130 basis points to 5.6 percent at midyear.
- Softening demand weighed on rental rates, leading to a 2.7 percent decline to the average effective rent in the second quarter to $1,660 per month. Class C rent was relatively unchanged at $1,330 per month, while Class B units recorded a 4.4 percent reduction to $1,620 per month. Class A rent fell 3.2 percent to $2,184 monthly.
- Pricing has held stable over the past year, averaging $178,000 per unit. The average cap rate increased 10 basis points to 6.3 percent.
- High rents in Boca Raton led the area to be a hot spot for the development of large high-end complexes that can draw more young professionals who prefer to rent, attracting investors to the submarket. The Brightline commuter rail, coupled with surrounding entertainment and nightlife, also attracts the younger cohort.

RETAIL

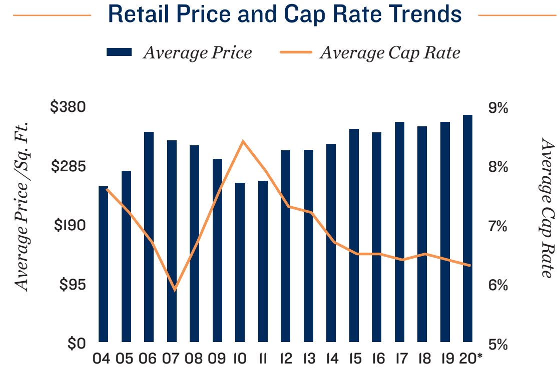
Healthy Spending Habits Maintain Positive Outlook; Some Segments Facing Greater Investor Interest

- Construction came to a halt in the second quarter with no new space added to the market. Just over 230,000 square feet was completed over the yearlong period, down considerably from the 540,000 square feet built during the prior period.
- The net absorption of negative 283,000 square feet in the second quarter lifted the vacancy rate 40 basis points to 5.1 percent. The multi-tenant segment registered a 10-basis-point increase to 4.3 percent.
- The average asking rent increased 2 percent in the second quarter to $24.48 per square foot. On a year-over-year basis, rents were up 5.1 percent, though an uncertain economic outlook and challenges in the retail sector will lower rent growth.
- Retail properties sold over the four quarters ended at midyear registered an average price of $364 per square foot, while the average cap rate was in the low-6 percent territory, a 10-basis-point decline from the previous yearlong stretch.
- Shopping centers in suburban areas of West Palm Beach, North Palm Beach, and Royal Palm Beach/Wellington were a primary target of investors prior to the downturn. A strong consumer base in these areas will keep investors active, targeting pandmeic resilient tenants including grocers, pharmacies and drive-thrus.

Retail Completions and Absorption



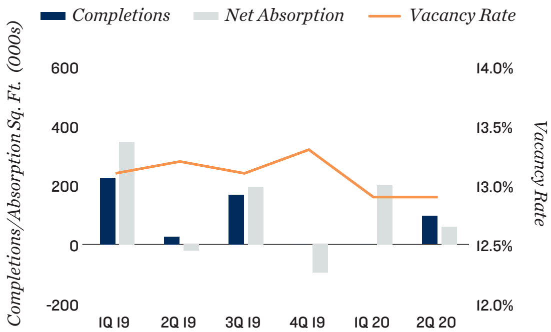
Retail Price and Cap Rate Trends



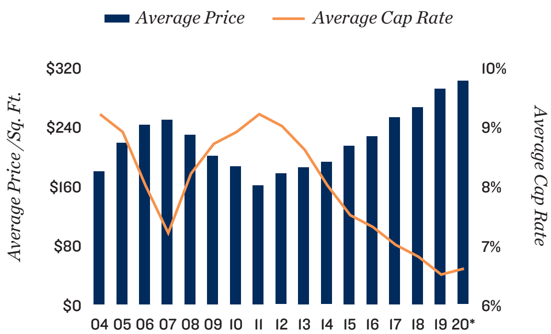
** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

Office Completions and Absorption



Office Price and Cap Rate Trends



** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

OFFICE

Shifting Demand for Lower Density Builds Optimism Around Suburban Offices

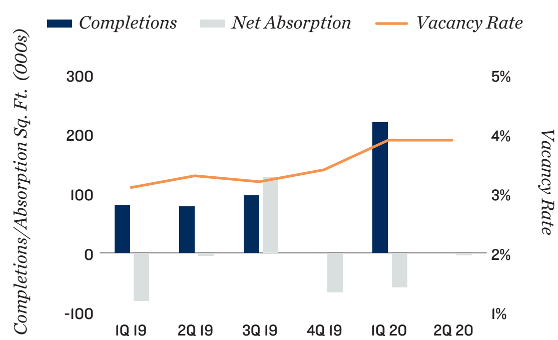
- Deliveries in the second quarter totaled 96,000 square feet, bringing supply growth over the past year to 263,000 square feet, moderately trailing the prior period. Approximately 1.2 million square feet is underway, headlined by One West Palm at 372,000 square feet, though some of the space could be converted to apartments.
- Net absorption of almost 260,000 square feet in the first half of the year kept the vacancy rate at 12.9 percent in the second quarter, a 30-basis-point decline from one year earlier.
- The average asking rent increased 2.3 percent in the second quarter to $31.77 per square foot. Class A properties achieved an average rent of $38.35 per square foot, up 2.0 percent from the first quarter.
- Office assets recorded an average price of $300 per square foot over the past year and an average cap rate in the mid-6 percent territory.
- Shifting preference for low-density suburban office properties will keep private investors interested in the submarkets of Boca Raton North, West Palm Beach, and North Palm Beach. Several financial firms have announced moves to the market recently, providing a positive outlook for the sector and investors.

INDUSTRIAL

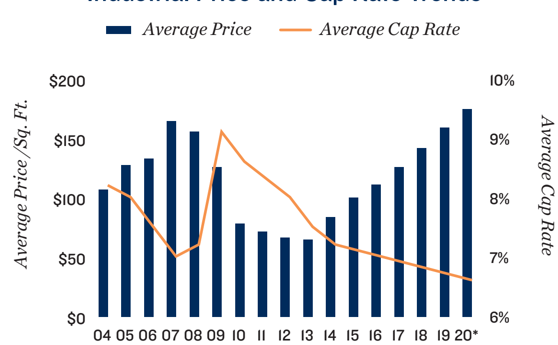
New Supply and Curtailed Demand To Weigh on Property Metrics in the Near Term

- The delivery of a 220,000-square-foot warehouse in Jupiter in January accounted for the entirety of supply growth over the first half of the year. Approximately 886,000 square feet is underway in Palm Beach County at seven properties.
- Softening demand has pressured vacancy to climb higher in recent quarters, resting at a still-tight 4 percent at midyear. Several larger move-ins occurred though with Niagara Bottling taking 115,000 square feet in Jupiter and Home Depot now occupying 78,000 square feet.
- The average asking rent inched up to $10.58 per square foot in the second quarter, marking a 3.6 percent increase from a year earlier. Properties proximate to residential and retail development can achieve a premium, including areas of Boca Raton that can rent for more than $15 per square foot.
- The average price recorded in the market rose to $175 per square foot recently, while the average cap rate declined 20 basis points to 6.6 percent.
- An anticipated rise in vacancies over the coming quarters creates opportunities for investors to renovate older inventory across Palm Beach County and upgrade to align with current tenant demands.

Industrial Completions and Absorption



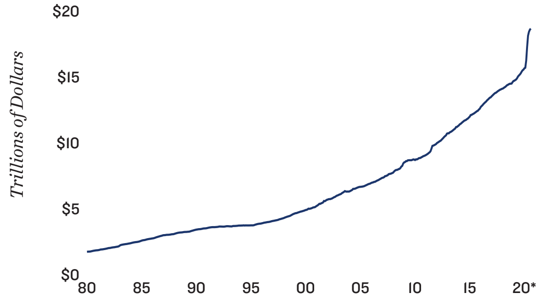
Industrial Price and Cap Rate Trends



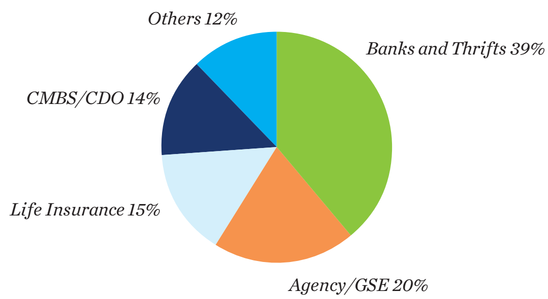
** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

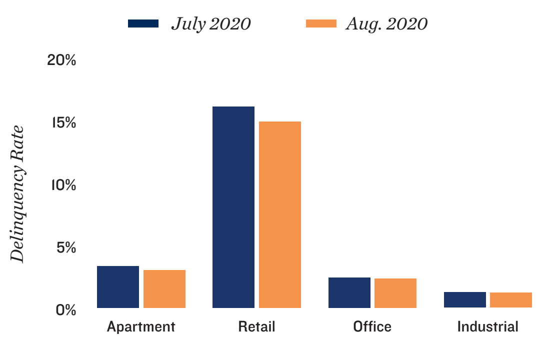
Fed Sharply Increases Money Supply During Health Crisis



Total Outstanding Mortgage Debt**



30+ Day CMBS Delinquency Rate



* Through August

** As of second quarter

Sources: Federal Reserve; Mortgage Bankers Association; Trepp

CAPITAL MARKETS

By TONY SOLOMON, Senior Vice President,
Marcus & Millichap Capital Corporation

- **The capital markets are thawing relative to the height of the crisis.** Most lenders have adapted to dispersed working, and more information on the economic damage of the pandemic is affording buyers, sellers, and lenders risk and price clarity for large swaths of the commercial real estate sector. Both property performance and location can impact financing as some areas of the country outperform and the pace of recovery remains in doubt for others. Capital is readily available for assets that perform on or near par with pre-crisis levels, especially industrial assets, which buyers and lenders see as a safe part of their portfolios. Single-tenant retail with national credit tenants are also heavily favored by lenders, followed by grocery-anchored multi-tenant properties. Apartment rent rolls are more heavily examined, though financing remains available from the agencies and banks. Loans are more readily accessible for suburban office, while core buildings are more difficult to leverage. Some lenders continue to operate in the hospitality space, but obtaining financing is challenging.
- **Loan-to-value ratios were already declining prior to the pandemic and average 60 percent.** Freddie Mac is offering rates in the high-2 percent to high-3 percent range for seven-year terms. Debt service coverage is approximately 1.35 times. Life insurance companies will finance below 3 percent for apartments in some cases, and peak at 4 percent for retail. CMBS loans are available, though strict criteria makes deals more difficult to find. Rates bottom in the low-3 percent range for apartment and industrial and rise to 4 percent for office.

Prepared and edited by

Michael Murphy

Research Analyst | Research Services

For information on national commercial real estate trends, contact:

John Chang

Senior Vice President, National Director | Research Services Division

Tel: (602) 707-9700 | john.chang@marcusmillichap.com

National Multi Housing Group

John Sebree

Senior Vice President, National Director | National Multi Housing Group

Tel: (312) 327-5417 | john.sebree@marcusmillichap.com

National Retail Division

Daniel Taub

Senior Vice President, National Director | Retail Division

Tel: (212) 430-5100 | daniel.taub@marcusmillichap.com

Office and Industrial Properties Division

Alan L. Pontius

Senior Vice President, National Director | Office and Industrial Properties Division

Tel: (415) 963-3000 | al.pontius@marcusmillichap.com

Fort Lauderdale Office:

Ryan Nee

First Vice President/DistrictManager

Tel: (954) 245-3400 | ryan.nee@marcusmillichap.com

5900 N. Andrews Ave.

Suite 100

Fort Lauderdale, FL 33309

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Mortgage Bankers Association; Real Capital Analytics; RealPage, Inc.; Trepp

Price: $250