BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *Orlando Metro Area* 2H/20

Reduction in Tourism Weighs Heavily on Employment While Rise in Construction Poses Headwinds; Favorable Demographic Trends Provide Positive Outlook for Investors

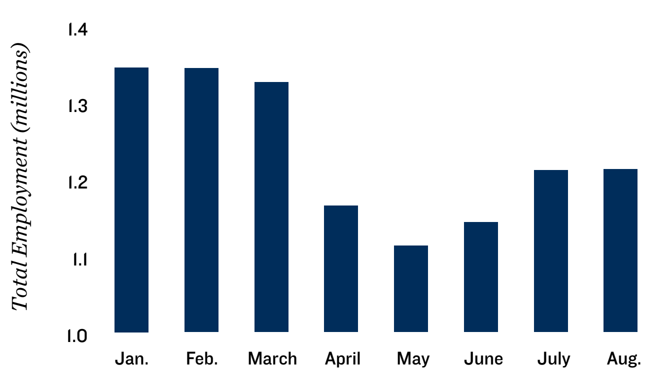
Jobs slowly return after pandemic fallout. Orlando's unemployment rate soared from 2.8 percent in February to 21.4 percent in May, one of the highest rates in the nation. Over this period, roughly 232,600 jobs were lost as stay-at-home orders required the temporary closure of many businesses. All employment sectors contracted during this time frame with the largest drop occurring in the region's sizable leisure and hospitality segment. Since firms began to reopen in May, the metro has regained nearly 100,000 positions cutting the unemployment rate to 11.2 percent in August. The greatest growth has been in professional and business services, trade and transportation, and education and health services segments. As of August, total employment remains 127,800 jobs below the number at the beginning of 2020.

Hospitality segment sustains severe reduction. The metro's dominant tourism segment accounted for more than 162,000 job cuts in the first five months of the year as theme parks, hotels, bars and restaurants temporarily closed. Statewide, tourism dropped 60.5 percent in the second quarter as major venues including Walt Disney World, SeaWorld and Universal parks closed. In addition, many airline flights were canceled. Hotel occupancy in the Orlando metro was among the lowest in the nation in April. As businesses reopen and air travel resumes, visitors are slowly coming back and nearly 72,300 leisure and hospitality positions returned in the June to August period. Elevated unemployment, however, has lowered metro apartment demand and reduced retail sales.

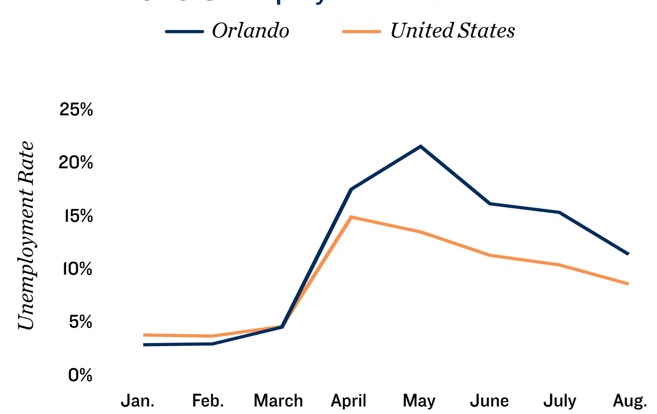
Construction projects moving forward. Developers were bullish on the Orlando metro and are proceeding with developments that were in the pipeline before the health crisis. which could soften fundamentals in the quarters ahead. Convenient interstate and airport access make Southeast Orange County a hot spot for office and industrial development. Of the more than 1.7 million square feet of industrial inventory underway in the submarket, nearly 1.6 million is speculative warehouse and distribution space. The area will also soon house more than 350,000 square feet of office inventory including 175,000 square feet of medical offices. Multifamily construction is shifting outward from Central Orlando into suburban areas such as Kissimmee where more than 4,000 units are underway. The majority of apartments in this area are due in 2021. Retail is the one sector in which developers are more cautious, focusing mainly on build-to-suit, single-tenant facilities throughout the metro.

Long-term outlook keeps investors active. Orlando's recent history of strong population growth and diversifying economy continues to hold the attention of a wide range of investors in assets across all sectors. Sequestration, economic uncertainty, the inability to tour properties and a low inventory of for-sale listings slowed deal flow during the second quarter. Buyers returned as the economy reopened, however. During this period, industrial assets were most often targeted. Class B/C warehouses less than 50,000 square feet throughout the metro were sought. Some of these buildings may be used for last-mile deliveries as e-commerce needs grow.

2020 Employment Trends

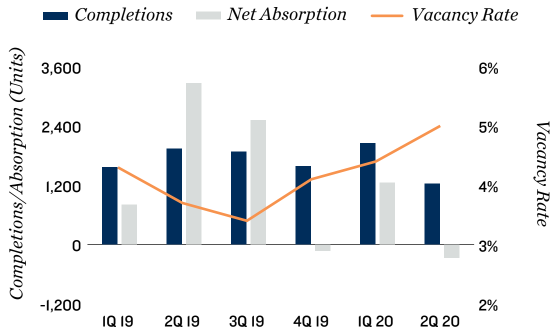


2020 Unemployment Rate Trends

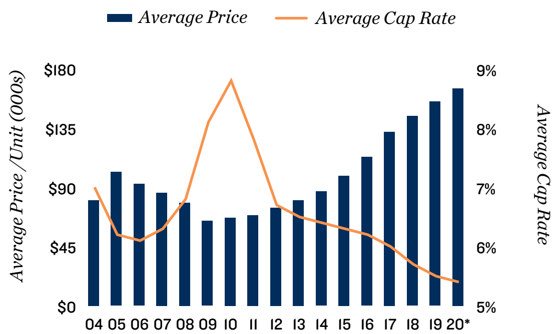


Source: BLS

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

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

APARTMENT

Surge in Unemployment Clouds Rental Outlook in Orlando; Out-of-State Investors Remain Active

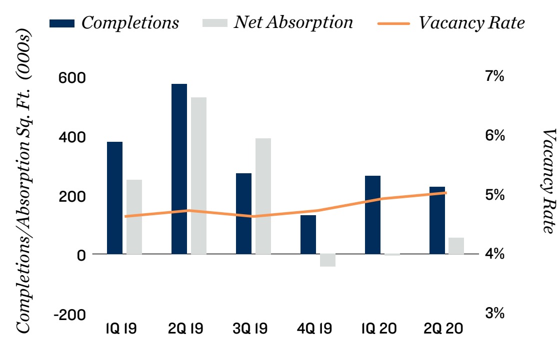
- During the second quarter, developers completed nearly 1,230 apartments, down from 2,050 in the first three months of 2020, due in part to projects temporarily shutting down. Builders also have 18,800 units underway with deliveries scheduled into 2022.
- Vacancy rose 60 basis points to 5.0 percent in the April through June period, the highest rate since 2014 and up from a 30-basis-point increase in the previous quarter. Among submarkets, Central Orlando posted the largest quarterly increase of 240 basis points to a metro high of 8.0 percent.
- The hike in vacancy hampered rent growth. During the second quarter, the average effective rent declined 2.3 percent to $1,262 per month mainly due to a 4.0 percent quarterly decrease in Class A apartments. A 30-basis-point drop in Class C vacancy contributed to average rent in this class rising 0.9 percent during the same period.
- Transaction activity declined by nearly two thirds in the second quarter. Out-of-state investors dominated sales activity, many targeting assets in neighborhoods throughout the city of Orlando.
- In the past 12 months ending in June, properties sold at an average of $165,000 per square foot, up 10.3 percent, with an average cap rate in the mid-5 percent span.

RETAIL

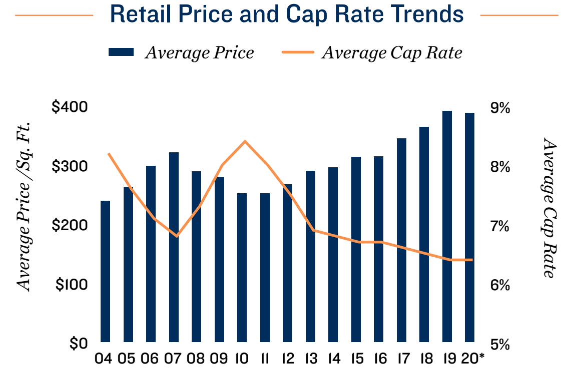
Lack of Tourists, Store Closures Nudge Vacancy Up While Rent Continues to Climb; Investor Interest Remains

- Roughly 490,900 square feet of inventory was finalized during the first six months of 2020, roughly half of the space added during the same period in 2019. Developers also have 1 million square feet underway and of this sum up to 700,000 square feet could be delivered before 2021, easing annual deliveries from last year's pace.
- Following a 20-basis-point advance in the first quarter, vacancy inched up 10 basis points in the April through June period to 5.0 percent, the highest rate since 2017. The rise was mainly due to the multi-tenant rate jumping 40 basis points during the quarter to 6.1 percent. The Orlando Airport submarket posted the biggest quarterly hike of 560 basis points to 9.2 percent.
- Quality space being marketed contributed to asking rent climbing a quarterly 5.4 percent to an average of $20.73 per square foot at midyear. Year over year, rent is up 9.3 percent, driven by an 11.4 percent surge in single-tenant monthly payments.
- Trading activity plummeted in the second quarter as the pandemic motivated many buyers to step to the sidelines. Drugstores dominated transactions.
- The price of retail assets advanced 2.7 percent to an average of $387 per square foot over the past 12 months ending in June, driven by a 6.0 percent surge in multi-tenant properties. Overall retail cap rates are holding in the mid-6 percent range.

Retail Completions and Absorption



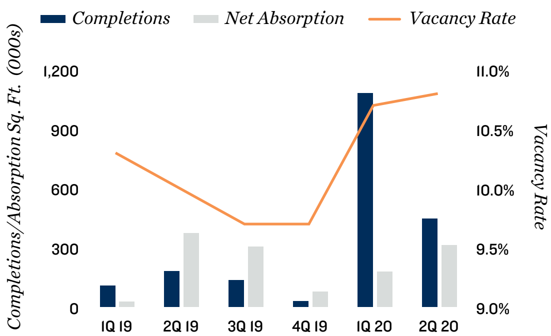
Retail Price and Cap Rate Trends



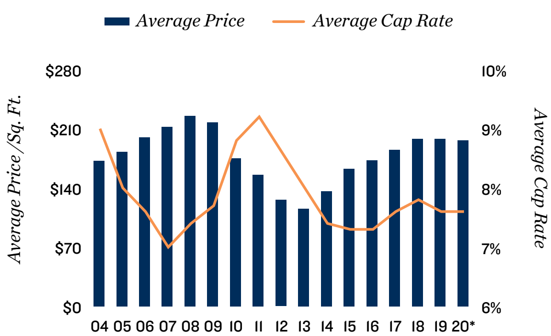
** Through second quarter*

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

Rent Continues Upward Trend, Elevated Construction Pace Could Pose Headwinds; Buyers Focus on Class B Assets

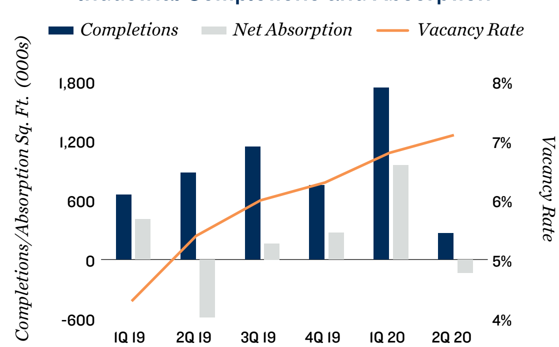
- Construction activity is flourishing. Developers finalized 1.5 million square feet in the first half of 2020, more than the annual total in each year since 2009. Another 1.3 million square feet is underway, and up to 1 million square feet of this inventory could be delivered by year end, including 300,000 square feet of medical offices.
- Even with the jump in deliveries and slower leasing activity during the pandemic, vacancy rose just 10 basis points to 10.8 percent in the second quarter, one of the 10 tightest rates among major U.S. metros. During the second quarter, Class A vacancy posted a 70-basis-point hike, while the rate in Class B/C buildings declined 20 basis points.
- Asking rent for available space climbed 1.8 percent in the second quarter to $23.74 per square foot on average and is up 6.2 percent annually. In the April to June period, Class A rent increased 1.2 percent to $28.18 per square foot, as Class B/C advanced 2.2 percent to an average of $21.35 per square foot.
- Trading activity fell nearly 50 percent quarter over quarter. Class B assets less than 25,000 square foot were sought by both local and out-of-state buyers.
- Over the past four quarters, the average sales price dipped 1 percent to $196 per square foot at an average cap rate in the mid-7 percent bracket.

INDUSTRIAL

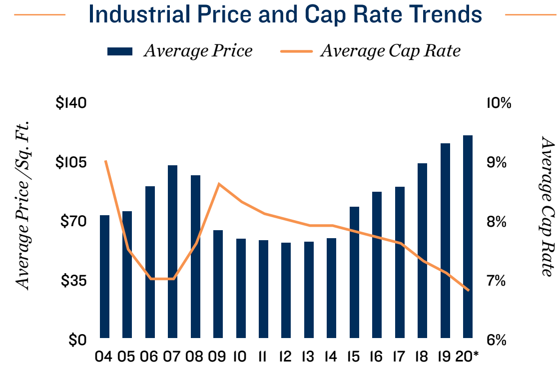
Rise in Speculative Construction Puts Pressure on Vacancy; Investors Remain Keen on Industrial Assets

- Almost 2 million square feet of inventory was completed in the first six months of this year, slightly higher than the prior two quarters. Developers also have 2.8 million square feet of primarily speculative warehouse and distribution space underway. Up to 2.5 million square feet could be finalized in 2020. Annual deliveries are on track to post a fourth consecutive year above 2.5 million square feet.
- Elevated speculative construction has increased available space, raising vacancy 30 basis points in the second quarter to 7.1 percent, the highest rate since 2015. Three months earlier, vacancy ticked up 50 basis points. A surge in deliveries in Southeast Orange County pushed vacancy in the submarket up 320 basis points in the past four quarters to a metro high of 9.5 percent.
- Rising vacancy has not inhibited rent gains. Average asking rent climbed 2.7 percent to a new high of $6.95 per square foot in the second quarter, up from a 0.3 percent advance in the prior three months.
- Investors remain active in the metro's industrial sector. Aside from a large portfolio sale in February, transaction activity held steady quarter over quarter.
- Competition for buildings pushed the average asking price up 9.7 percent in the past four quarters to $120 per square foot at midyear. The average cap rate dropped 40 basis points year over year into the high-6 percent bracket.

Industrial Completions and Absorption



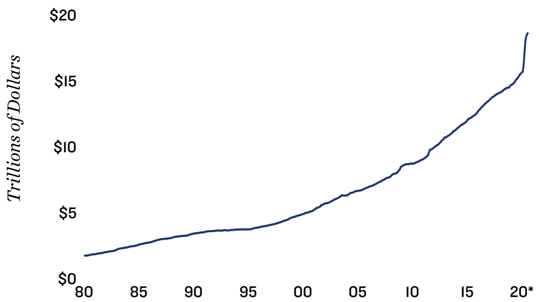
Industrial Price and Cap Rate Trends



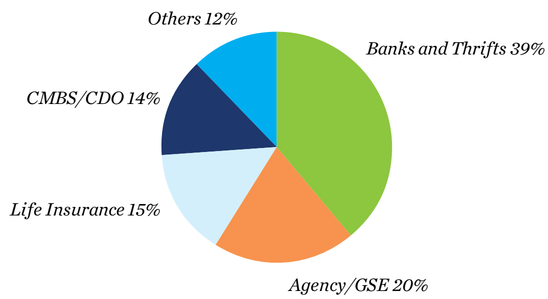
* Through second quarter

Sources: CoStar Group, Inc.; Real Capital Analytics

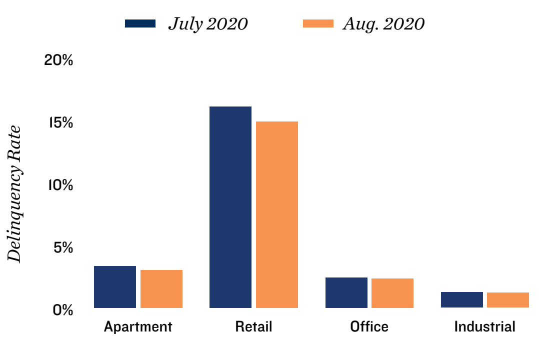
Fed Sharply Increases Money Supply During Health Crisis



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.

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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