BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *Tampa-St. Petersburg Metro Area*

2H/20

Positive Demographic Trends Provide Bright Long-Term Prospects; Tampa-St. Petersburg Properties Attract National and Canadian Investors

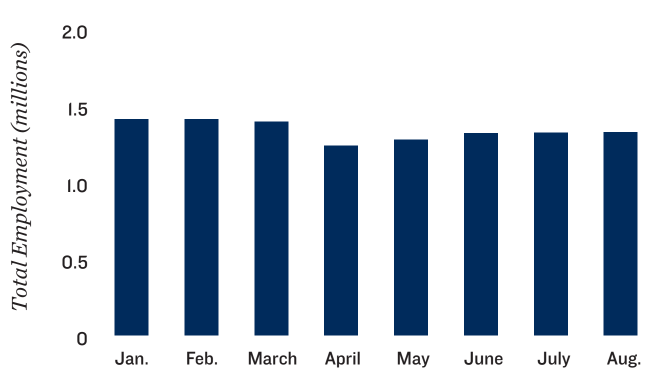
Jobs return as businesses open. Employers added nearly 90,100 workers between May and August as more sequestration orders were lifted. As a result, the 6.7 percent unemployment rate in August is less than half the recent high of 13.8 percent posted in April and sits below the national rate. Total jobs in the metro, however, are still down 75,100 positions from the end of 2019, with losses in all sectors except government. This segment gained almost 1,400 positions since the year began. More jobs throughout the metro should return in the coming months as additional restrictions are lifted and schools reopen. The loss of many small businesses, however, will keep unemployment elevated from the 2.8 percent posted in February. Hospitality was especially impacted by the pandemic. Employment in this segment is still down 22 percent or 35,800 jobs so far this year.

Demographic trends bode well for Tampa-St. Petersburg. The relocation of residents to the Sunbelt will continue to benefit the metro. Population gains at nearly twice the national rate brought 5,800 new residents to the region in the past quarter. Although the pandemic slowed movement from the prior period's 7,800 people, net migration in 2020 is expected to top 30,300 residents for the eighth consecutive year. Household growth is also at a pace well above that of the U.S., bolstering housing demand. Incomes are also rising, up 4 percent year over year, which should benefit retail sales. Although purchases declined in the second quarter, if no further closures are necessary to prevent the spread of the coronavirus, spending should pick up in the coming quarters.

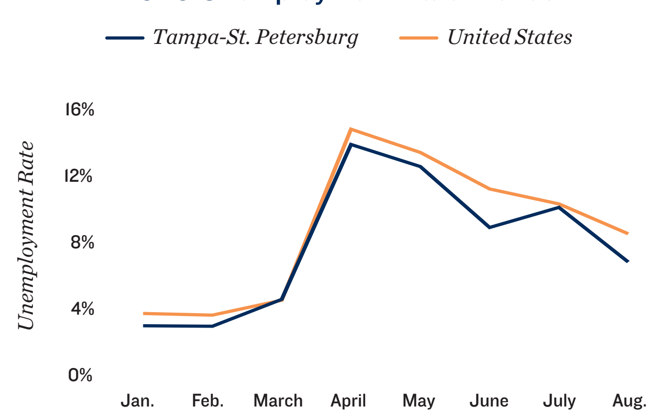
Headwinds brewing on the horizon. The coronavirus is prompting changes to household and business decisions that will affect commercial real estate. Additional people working from home prompted households to consider more appropriate living quarters, including home purchases. Search criteria are moving away from commuting distance to larger square footage; areas for a home office and online schooling; affordability; and outdoor space. These factors are shifting demand to the suburbs, which could benefit Class A/B suburban garden-style properties in Pasco County. The higher amount of staff working remotely has companies reconsidering space needs as leases expire. Office buildings with ample parking and no elevator are gaining favor by tenants and investors. Fewer workers in downtown office towers has hurt nearby retailers. Stores have also been impacted by the growing trend toward online shopping and the closure of nonessential retailers during the pandemic. More stores and malls have added pickup capability to accommodate online orders. Although additional retailers are expected to go dark this year, the boost in e-commerce has propelled the need for last-mile industrial space.

Favorable outlook draws investors. The long-term prospects of Tampa-St. Petersburg and the availability of historically low-cost financing continue to attract national and international buyers, especially from Canada. Available financing has more investors focusing on multifamily, necessity-based retail and industrial prospects. In some segments of the market, investors outpace the available supply of for-sale inventory, resulting in a number of properties receiving multiple offers.

2020 Employment Trends

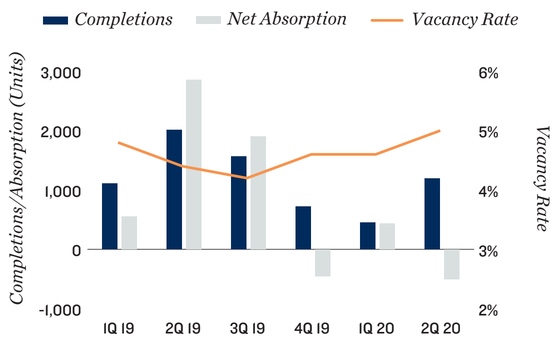


2020 Unemployment Rate Trends

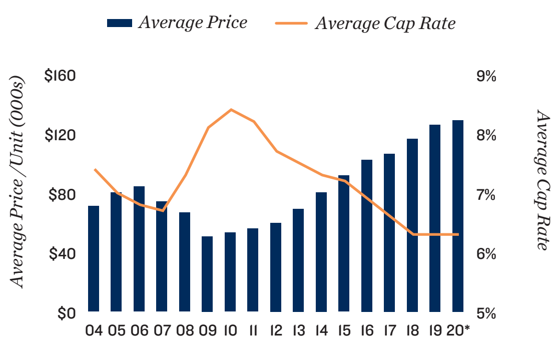


Source: BLS

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

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

APARTMENT

Demand Increases for More Affordable Apartments; Investors Focus on Class C Assets

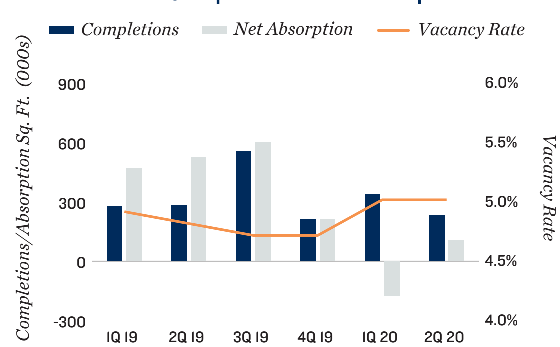
- Roughly 1,200 apartments were delivered in the second quarter of 2020, up from 450 in the first three months. The additions raised the year-over-year sum to 3,900 units, well below the 6,200 rentals finalized in the prior annual period. Developers also have 9,600 units underway with completion dates scheduled into 2022.
- Inventory additions coupled with a tenuous economic outlook resulted in the vacancy rate ticking up 40 basis points from the first quarter to 5.0 percent in June, the highest rate since 2016. In Class A buildings, vacancy jumped 110 basis points quarter over quarter to 6.2 percent at midyear, while renters searching to lower costs tightened the rate in Class C apartments 50 basis points to 3.3 percent.
- The average effective rent contracted 0.7 percent on a quarterly basis to $1,245 per month, compared with the previous period's 1.0 percent gain. During this time, Class A rent decreased 1.9 percent while climbing 1.3 percent in Class C rentals.
- Transaction velocity declined in the second quarter, due in part to a cloudy economic outlook, the inability to tour properties, and a tighter supply of available for-sale listings. During this time, Class C assets were most often targeted at an average price of $127 per unit. Marketwide, the average cap rate for apartments is holding in the low-6 percent span.

RETAIL

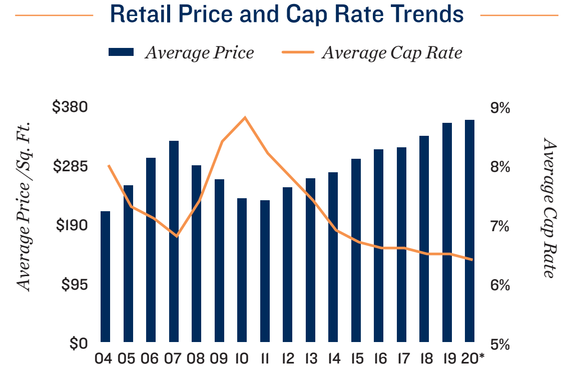
Retailer Demand Keeps Vacancy Historically Tight, Pushing Rent to 11-year High; Single-Tenant Dominates Sales Activity

- Deliveries dipped slightly quarter over quarter in June with the addition of roughly 233,500 square feet of mostly pre-leased space. Grocery stores have dominated the completions so far in 2020 with Publix and Aldi opening new locations.
- Limited speculative inventory and expanding necessity-based retailers kept quarter-over-quarter vacancy at 5.0 percent in June. In the previous three months, the rate climbed 30 basis points. Single-tenant vacancy inched up 10 basis points to 4.3 percent during the second quarter, while the multi-tenant rate held at 6.4 percent. The full brunt of store closures, however, has not yet fully played out.
- Vacancy holding 110 basis points below the five-year high contributed to rent advancing 1.3 percent to $17.10 per square foot in the second quarter, the highest rate since 2008. The largest increase was in single-tenant properties, where rent jumped 1.9 percent during the quarter to $17.82 per square foot. Multi-tenant rent rose nominally to $15.86 per square foot.
- Assets with necessity-based retailers are the focus of many buyers. Fewer available listings and an uncertain economic picture, however, diminished sales activity in the second quarter. During this time mainly private investors targeted small suburban strip centers. Year over year, retail properties sold at an average of $356 per square foot, up 4.5 percent, with the average cap rate in the mid-6 percent range.

Retail Completions and Absorption



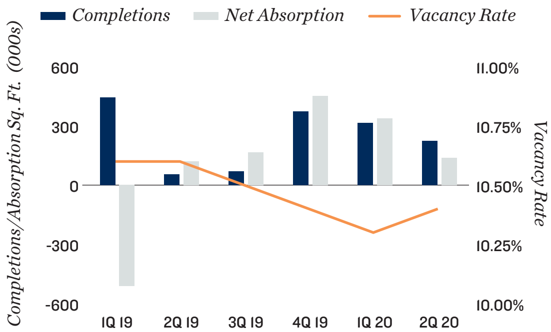
Retail Price and Cap Rate Trends



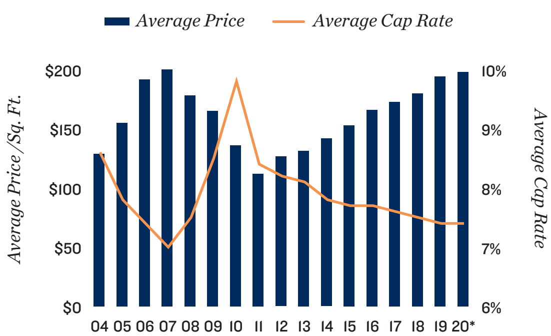
** Through second quarter*

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

Historically Low Vacancy and High Rent Position Office Market for Changes Ahead

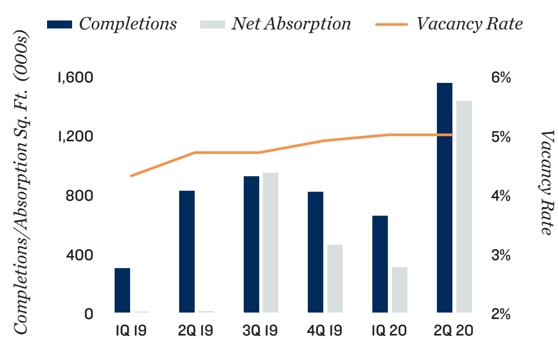
- The office market is in flux as many employees are still working from home. As businesses reopen offices, some firms may need more space for social distancing, while others could permanently provide remote options and reduce floor plates.
- After nearly a decade of reduced deliveries, construction activity has picked up, including more speculative projects, especially in the Water Street Development. Builders completed 540,000 square feet in the first two quarters of 2020 and have roughly 2.1 million square feet underway with finalizations into 2022.
- Vacancy advanced 10 basis points in the second quarter to 10.4 percent but is down 20 basis points year over year. The vacancy rate sits just 60 basis points above the cyclical low reached in 2018. Historically tight vacancy is producing rent gains. Asking rent rose to a new high in the second quarter at $24.39 per square foot, up 0.5 percent on a quarterly basis and 5.1 percent annually.
- Transaction activity in the second quarter was down substantially from the prior three months. The pandemic prevented some building tours, delayed due diligence, and extended the time it took to close. During the past four quarters, assets traded at an average of $198 per square foot, up an annual 5.8 percent. The average cap rate remains in the mid-7 percent band.

INDUSTRIAL

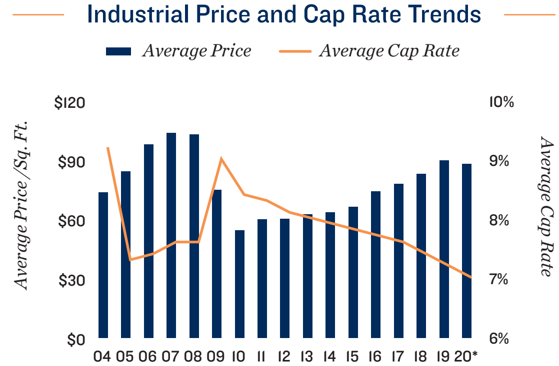
Industrial Sector Benefits From E-commerce Buying; Speculative Construction Poses Challenge

- Developers finalized more than 2.2 million square feet in each of the past three years, well above the 10-year average of 1.2 million square feet. During the April to June period, deliveries totaled nearly 1.6 million square feet, the highest quarterly level since 2006. Builders have another 1 million square feet underway with completions expected in 2020 and more than half of this space is being built on speculation, which could put upward pressure on vacancy.
- Vacancy ended the second quarter at 5.0 percent, unchanged from opening quarter and just 80 basis points above the five-year trough, even though deliveries have soared. East Hillsborough County has the highest rate among submarkets at 7.1 percent in June, down 40 basis points quarter over quarter.
- After asking rent climbed to an 11-year peak in the first quarter, the rate dipped 0.8 percent to an average of $6.09 per square foot at midyear. On an annual basis, rent is up 1.0 percent.
- Trading activity fell markedly quarter over quarter in June as sequestration orders hindered transactions. Suburban Class B/C assets less than 20,000 square feet were the focus of mainly local buyers. Marketwide, properties changed hands at an average of $88 per square foot, up 1.7 percent annually and at an average cap rate in the low-7 percent span.

Industrial Completions and Absorption



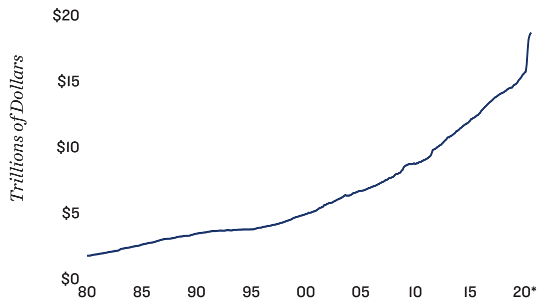
Industrial Price and Cap Rate Trends



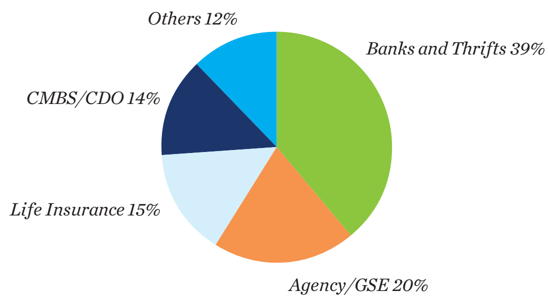
* Through second quarter

Sources: CoStar Group, Inc.; Real Capital Analytics

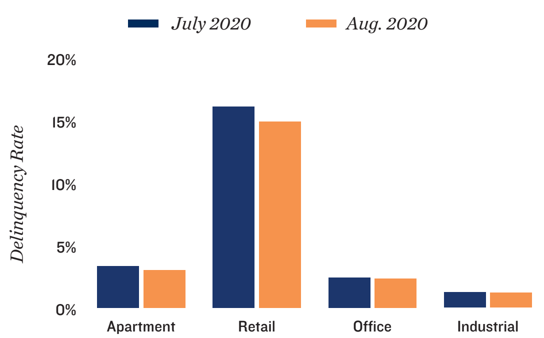
Fed Sharply Increases Money Supply During Health Crisis



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