

ApartmentResearch

M A R K E T U P D A T E

Marcus & Millichap

Palm Beach County

Third Quarter 2010

FIRST HALF RESULTS BUOY INVESTOR CONFIDENCE

With the best half-year period of job growth in three years, apartment fundamentals in Palm Beach County strengthened during the first half, helping to ease concerns over operational distress heading into the last six months of 2010. As the second half progresses, though, operators of large properties will continue to evaluate the pace of the economic recovery and modify expectations and actions accordingly. While the operating results posted thus far in 2010 constitute a positive trend, job creation will likely slow in the months ahead as private-sector employers maintain a cautious approach to expansion. The recent reduction in vacancy and increase in rents will not likely reverse significantly, but additional improvements and a sustainable recovery in these measures will require stronger job growth and household formation than currently anticipated. Downside risks clearly exist for the second half, but the market may surprise to the upside. A depleted construction pipeline and the metro's relatively small stock of large properties will magnify even slight improvements in renter demand, perhaps lowering vacancy and elevating rents to a greater extent than projected.

Spurred by the stabilization of fundamentals and the realization prices continue to decline from the peak a few years ago, investment activity will intensify over the remainder of 2010. Cash buyers continue to set the pace in the county, seeking to deploy idle capital and act quickly to capitalize on emerging opportunities. Indeed, the presence of a large pool of cash buyers will continue to generate multiple offers for properties, especially smaller complexes that continue to perform well. Cap rates typically start at 8 percent to attract buyer interest, and deals often close for less than \$40,000 per unit, a level below replacement cost and one that supports rental operations. Current pricing also enables buyers to build scale and amass portfolios relatively quickly.

2010 ANNUAL APARTMENT FORECAST



Employment: Many of the government jobs created so far this year will terminate in the second half, but private employment sectors will continue to hire cautiously. As a result, total employment will rise 0.9 percent in 2010 with the addition of 4,400 workers. Last year, 31,700 positions were cut.



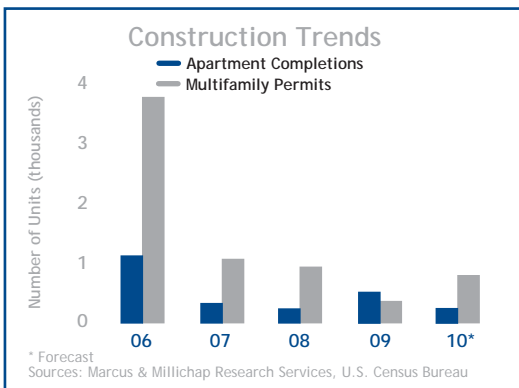
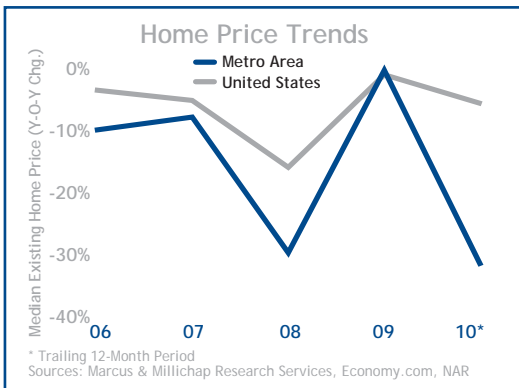
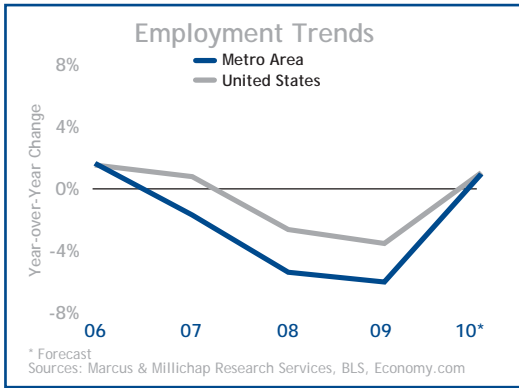
Construction: Developers will complete 217 units this year, all of which came online in the second quarter; 494 apartments were delivered in 2009. Permitting remains anemic, with fewer than 200 units permitted in the past 12 months.



Vacancy: A robust recovery in apartment demand remains a few quarters away, but large-property vacancy will nonetheless fall 40 basis points to 8.8 percent in 2010, after spiking 130 basis points last year.



Rents: Large-property asking rents will increase 1.6 percent this year to \$1,078 per month, following a 4.3 percent contraction in 2009. Also, monthly effective rents will rise 2 percent in 2010 to \$1,001, erasing part of the 5.8 percent loss recorded last year.



ECONOMY

- ◆ In the first six months of 2010, local employers added 4,300 jobs. Unlike metro areas where the government sector accounted for most or all of the jobs created this year, private-sector employers in the county hired 2,500 workers in the first half.
- ◆ Among the private sectors expanding in the first two quarters, trade, transportation and utilities employers created 2,100 positions, and education and health services added 1,300 jobs.
- ◆ The unemployment rate decreased 20 basis points year to date through June to 11.9 percent, including a 70 basis point drop in the second quarter. The county's work force expanded in the past six months, but the number of employed grew at a slightly faster rate, leading to the decline.
- ◆ **Outlook:** Many of the government jobs created so far this year will terminate in the second half, but private employment sectors will continue to hire cautiously. As a result, total employment will rise 0.9 percent in 2010 with the addition of 4,400 workers.

HOUSING AND DEMOGRAPHICS

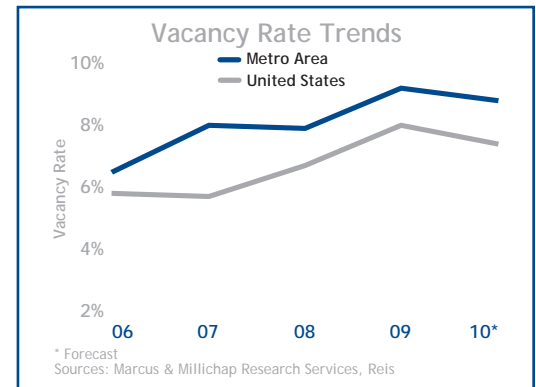
- ◆ Permits for 1,400 units of single-family housing were pulled in the 12 months ending in the second quarter, an increase of 46 percent from a year earlier. Builders accelerated activity in the first half of 2010 in order to fulfill demand generated by the first-time homebuyer tax credit.
- ◆ Approximately 22,000 existing single-family residences sold in the county over the past year, up 52 percent from the preceding 12-month period. Sales of distressed homes, however, pushed down the median price 10 percent to \$209,600 during this time.
- ◆ A soft job market and the difficulties of residents in other areas to sell homes and relocate remain drags on household creation. In the past year, the estimated number of households in the county declined by 300, although 400 new households were projected in the second quarter due to a strengthening economy. An average of about 5,800 households were added annually in the three years prior to the recession.
- ◆ **Outlook:** The probable creation of new households in the second quarter contributed to stronger demand for multifamily rentals, but a more vigorous pace of household growth depends upon a quickened pace of the national economic recovery.

CONSTRUCTION

- ◆ In the 12 months ending in the second quarter, developers put into service 711 units. During the preceding year, only 205 units came online.
- ◆ Thus far in 2010, the 217-unit Worthing Place in the Boynton Beach/Delray Beach submarket was delivered. One project, the Heritage at Boca Raton, with 248 units, remains under way with completion slated for next year.
- ◆ The supply pipeline remains thin, as about 1,500 units are planned. In addition, permits for 192 multifamily units were issued in the past 12 months, a 69 percent drop from the preceding period.
- ◆ **Outlook:** Developers will complete 217 units in 2010, all of which came online in the second quarter. Last year, 494 apartments were delivered.

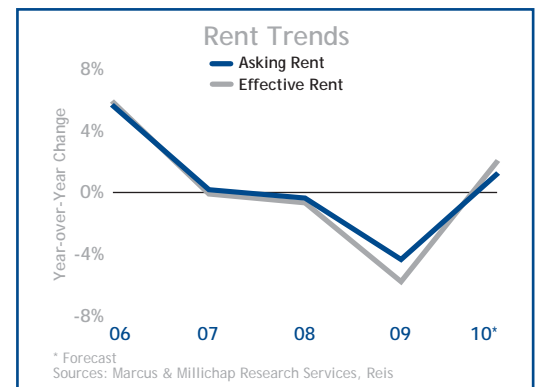
VACANCY

- ◆ A recovery in tenant demand, primarily in the Class A sector, supported a 60 basis point decline in countywide large-property vacancy over the first six months of the year to 8.6 percent. In the second quarter alone, the rate fell 20 basis points.
- ◆ The Class A vacancy dipped 20 basis points in the second quarter to 7.7 percent. The rate is also 140 basis points less than at year end, as all seven submarkets recorded positive net absorption this year. In aggregate, 530 units became occupied in the first half of 2010.
- ◆ Class B/C vacancy of 9.3 percent is up 10 basis points higher this year, though the rate fell 30 basis points in the second quarter as the labor market and household formation improved. A somewhat slower pace of job growth in the second half will limit the extent of additional reductions in vacancy.
- ◆ **Outlook:** A robust recovery in apartment demand remains a few quarters away, but large-property vacancy will nonetheless fall 40 basis points this year to 8.8 percent, after spiking 130 basis points in 2009.



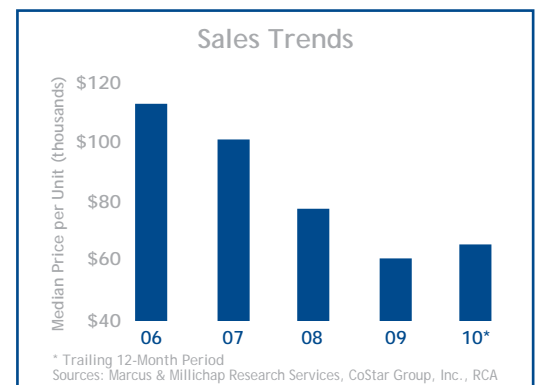
RENTS

- ◆ The Class A sector continues to drive increases in overall countywide rents. Year to date, large-property asking rents have climbed 1.3 percent to \$1,075 per month, including a 0.6 percent advance in the second quarter. Effective rents rose 1.2 percent to \$993 per month in the first half of the year.
- ◆ Thus far in 2010, Class A asking rents have jumped 2.2 percent to \$1,275 per month, as property owners have capitalized on greater demand for high-end units. Class B/C asking rents lag, rising 0.2 percent year to date to \$914 per month, including a slight uptick in the second quarter.
- ◆ Despite the recent advance in effective rents, concessions ticked up from 7.5 percent of asking rents at the close of last year to 7.6 percent of asking rents at the end of the second quarter. Concessions will continue to ease over the remainder of 2010, with more significant burn-off expected in 2011.
- ◆ **Outlook:** Large-property asking rents will increase 1.6 percent this year to \$1,078 per month, after contracting 4.3 percent in 2009. Monthly effective rents will rise 2 percent to \$1,001, erasing part of the 5.8 percent loss recorded last year.



SALES TRENDS**

- ◆ In the past year, transaction velocity accelerated 30 percent. Cash buyers, especially local operators who sold at the peak of the market, continue to assume a prominent role.
- ◆ The median price of properties sold in the last 12 months rose 11 percent to \$65,300 per unit, based on a limited number of transactions. At the current level, though, the median price is 42 percent less than the median price recorded at the market's peak four years ago.
- ◆ Cap rates for small, well-performing properties are estimated to start in the 8 percent range.
- ◆ **Outlook:** Prices remain well below the peak level recorded prior to the recession and should continue to attract local apartment investors as valuations become better aligned with rental fundamentals.



** Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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CAPITAL MARKETS

By WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ Mixed economic indicators, stock market volatility and concerns surrounding the European debt crisis continue to drive investors to safety. As a result, the yield on the 10-year U.S. Treasury has declined since peaking at 4 percent in April; as of late July, the yield had fallen to 3 percent.
- ◆ Capital markets loosened over the past year, with life insurance companies ramping up lending and CMBS showing renewed signs of life. Nonetheless, the agencies remain the dominant sources of multifamily lending. This trend will continue through 2010 as the GSEs' multifamily portfolios outperform their residential mortgage operations, reducing the likelihood of drastic government-mandated changes to their apartment lending arms.
- ◆ Multifamily loan originations increased 37 percent in the second quarter but remained below levels reported during the same period last year. Fannie Mae and Freddie Mac's origination volume followed a similar pattern, rising in the second quarter but falling short of year-earlier levels.
- ◆ Loan-to-values range from 60 percent to 75 percent for portfolio lenders and push up to around 80 percent for best-of-class, agency-financed deals. All-in rates for five-year agency loans fall into the low-4 percent range, while 10-year loans price between 4.75 percent and 5.15 percent. While life companies will compete at these levels for best-of-class deals, most portfolio lenders are 100 basis points to 225 basis points higher.

SUBMARKET OVERVIEW

- ◆ Planned development would expand the stock of large rental properties in the metro by 2.8 percent, but none of the projects has a scheduled start date. By submarket, Boynton Beach/Delray Beach has the largest potential supply growth, with 660 units.
- ◆ Plans to develop the 850-acre Briger tract in northern Palm Beach County into a biotech cluster that would include housing and commercial development have been forwarded to a state agency for review. A build-out would occur over 20 years.
- ◆ Some of the reduction in vacancy in the Century Village submarket over the past year may be ascribed to a surge in demand for Class B/C units so far in 2010. Year to date, lower-tier vacancy has decreased 170 basis points to 7.6 percent, reflecting a 1.8 percent rise in occupied units.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Boca Raton East	5.3%	-220	\$1,130	-5.2%
2	Boca Raton West	7.3%	-60	\$1,068	-6.4%
3	Green Acres/Palm Springs/Lake Worth	7.9%	80	\$932	-3.6%
4	Century Village	8.1%	-100	\$850	0.5%
5	West Palm Beach/Palm Beach	8.7%	-80	\$955	-3.4%
6	North Palm Beach	9.2%	-50	\$899	-3.3%
7	Boynton Beach/Delray Beach	10.7%	300	\$1,080	2.7%