RetailResearch

MARKET OVERVIEW

Marcus & Millichap

Palm Beach County *Third Quarter 2015*

Retailers Ride Wave of Demand from Strong Employment and Tourism

The improving employment outlook is attracting residents and visitors to Palm Beach County, bolstering the retail market. During the past year, job gains were led by the relatively higher-paying professional and business services sector. These jobs helped to lure more than 35,000 residents to the county. Tourism has surged to a record 6.3 million visitors last year, generating an economic impact of $7.1 billion. New hotels underway in the county will encourage tourism as well as boost employment in the leisure and hospitality sector in the coming years. To support the expanding population and tourists, retailers Wal-Mart, ALDI, Fresh Market and WaWa are among those adding locations in 2015. While some are locating new stores in mixed-use apartment projects downtown, others are following rooftops to the west where a number of large subdivisions have broken ground. Despite positive operations, developers are curbing deliveries temporarily, which will tighten vacancy further and push rents higher this year.

Intense demand for local retail assets has boosted transactions throughout the metro, a trend that is likely to continue as builders complete additional projects. More than half of all trades occurred in the first six months of this year, which pushed cap rates lower for both multi- and single-tenant assets. Though more out-of-state buyers are entering the market, especially from New York and other Eastern metros, local investor numbers remain strong and account for the majority of new shopping center owners. Multi-tenant retail assets traded at an average cap rate in the low-6 percent range, while strip centers in Boca Raton sold near 5 percent. Slightly north, investors seeking higher yields were able to obtain shopping centers in Jupiter at 7 to 8 percent initial yields. While few were available, drugstores and fast-food chains exchanged at first-year yields near 6 percent, 30 basis points below the metro average. Recent construction provides potential for more of these types of listings, though stiff competition will support compressing cap rates.

2015 Annual Retail Forecast

3.5% increase in total employment

Employment: Employers will expand the job market 3.5 percent with the addition of 20,000 positions in 2015. Growth will be led by the trade, transportation and utilities sector. Last year, employment grew by 3.6 percent with the creation of 19,900 jobs.

280,000 square feet will be completed

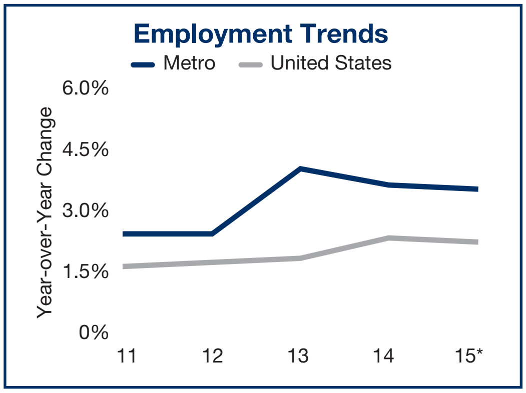
Construction: Developers are forecast to deliver 280,000 square feet of retail space in 2015, more than 60 percent of which is in the Royal Palm Beach/Wellington submarket. Last year, 940,000 square feet was added to inventory.

30 basis point decrease in vacancy

Vacancy: Strong tenant demand from rising retail sales will contribute to vacancy tightening this year. During 2015, vacancy will move down 30 basis points to 6.0 percent on net absorption of more than 600,000 square feet. This follows a 10-basis-point dip last year.

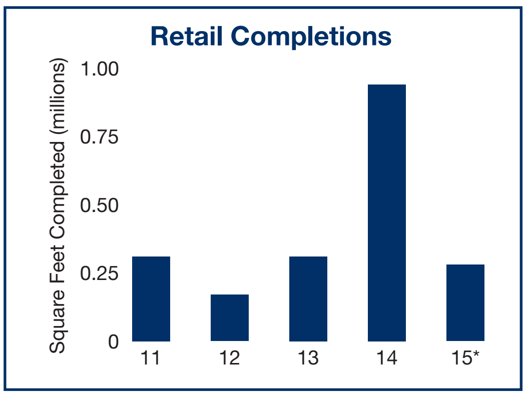
2.0% increase in asking rents

Rents: With vacancy falling, asking rents metrowide will advance 2.0 percent to $18.77 per square foot in 2015, still nearly 10 percent below the pre-recessionary level. Last year, asking rents jumped 3.0 percent on average.



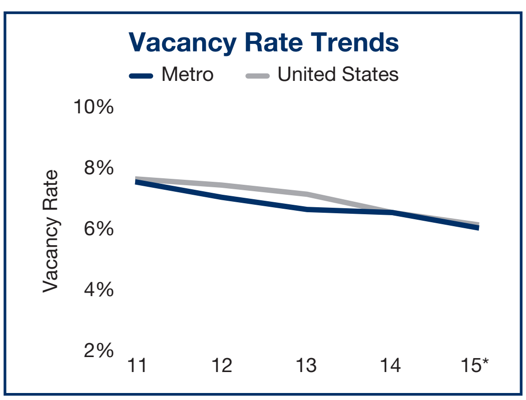
Economy

- Employers in the West Palm Beach metro created 14,900 positions in the past year ending in the second quarter, raising employment levels by 2.6 percent and dropping the unemployment rate to 5.2 percent. During the corresponding period last year, payrolls rose 4.1 percent with the generation of 22,200 jobs.
- The professional and business services sector recorded the largest gain of approximately 6,600 new employees. Education and health services and leisure and hospitality followed with hikes of 2,700 and 2,300 workers, respectively. The public sector posted the sharpest decline of 5,000 jobs.
- The metro continues to add residents. More than 16,000 household have formed in the area over the last four quarters. This growth has contributed to a 3.5 percent increase in retail sales during that time.
- **Outlook:** Employers will expand the job market 3.5 percent with the creation of 20,000 positions in 2015. The greatest expansion will be in the trade, transportation and utilities sector.



Construction

- Developers completed roughly 100,000 square feet of retail inventory in the first half of 2015, raising the 12-month total to 510,000 square feet, a 0.8 percent increase in inventory. This is down from 600,000 square feet in the prior period.
- The pace of development is easing in the near term as builders have only 300,000 square feet underway with completions scheduled into 2016. There is, however, more than 1.5 million square feet of proposed space that is expected to break ground in 2016.
- The largest project due for completion this year is Buckingham Plaza in Wellington. The 90,000-square-foot shopping center will raise inventory in the Royal Palm Beach/Wellington submarket with tenants that include Michaels, T.J. Maxx, and Shoe Carnival. A November opening is anticipated.
- **Outlook:** Developers are forecast to deliver 280,000 square feet of retail space in 2015, a 0.4 percent expansion in retail stock. More than 60 percent of this year's completions are in the Royal Palm Beach/Wellington submarket. Last year, 940,000 square feet was added to inventory.



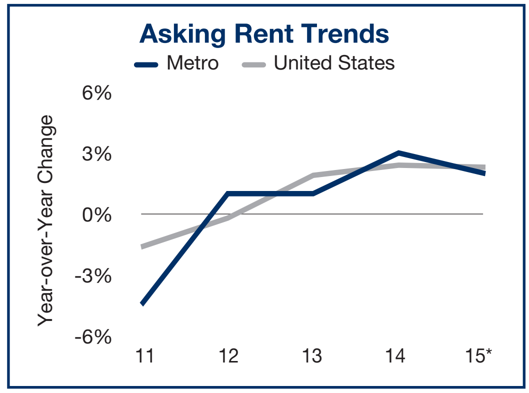
* Forecast
Source: CoStar Group, Inc.

Vacancy

- Vacancy receded 20 basis points in the second quarter to 6.3 percent, raising the 12-month improvement to 30 basis points. Vacancy is down 210 basis points from the recent peak in 2010.
- In shopping centers, which include strip, neighborhood and community centers, vacancy decreased 50 basis points to 6.2 percent year over year in the second quarter. This decline returns the rate to the pre-recession level.
- The vacancy rate tightened in all but one submarket during the last four quarters. The greatest slide was in the Del Ray Beach submarket where the rate fell 90 basis points to 5.6 percent, the second-lowest rate in the metro. The highest rates at midyear were registered in the Boynton-Lantana and West Palm Beach (City) submarkets at 7.1 percent.
- **Outlook:** Strong tenant demand driven by higher retail sales will contribute to improving vacancy this year. During 2015, vacancy will move down 30 basis points to 6.0 percent.

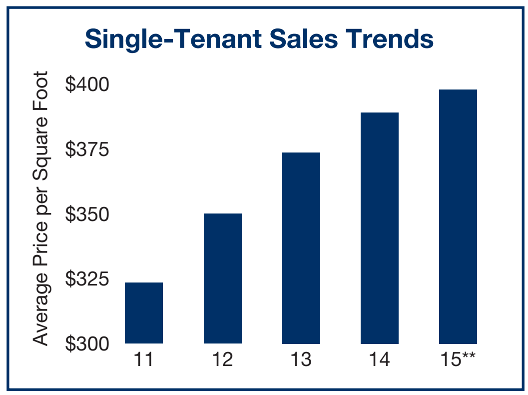
Rents

- Tightening vacancy and the leasing of new inventory has resulted in asking rents climbing 3.2 percent to average $18.72 per square foot year over year in the second quarter. This is up from a 0.4 percent rise in the previous 12-month period.
- Among submarkets, the largest year-over-year rent growth was registered in North Palm Beach at 9.3 percent. Here, the average rent reached $18.71 per square foot in June. Boca Raton has the highest rents, averaging 70 percent more than the metro average.
- Growing tenant demand in shopping centers drove up the average asking rent in multi-tenant properties 7.5 percent to $19.23 per square foot in the past four quarters ending at midyear. This follows a 3.4 percent rise 12 months earlier.
- **Outlook:** With vacancy falling, asking rents metrowide will advance 2.0 percent to $18.77 per square foot in 2015, still nearly 10 percent below the pre-recessionary level. Last year, asking rents jumped 3.0 percent on average.



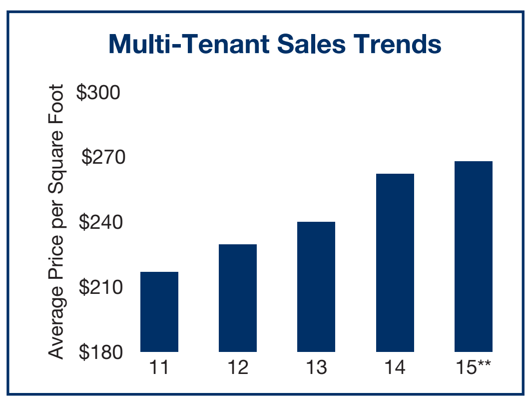
Single-Tenant Sales Trends**

- The transaction velocity of single-tenant assets jumped 28 percent during the most recent four quarters ending in June. Investors have been most active in West Palm Beach; however, properties in Boca Raton and Delray Beach also garnered significant buyer attention.
- The price of assets varied widely throughout the metro by type of tenant. During the past 12 months, some fast-food and convenience stores fetched nearly $1,000 per square foot, while storefront assets traded for an average price of close to $290 per square foot.
- Cap rate for properties trading in the last four quarters are typically in the low-5 to mid-6 percent range. New fast-food restaurants have dipped below the 5 percent threshold for long-term leases to corporate tenants.
- **Outlook:** As prices rise and competition among buyers intensifies in Miami-Dade and Broward counties, more investors will seek assets in Palm Beach County. Fast-food and quick-serve properties will continue to garner significant investor interest.



Multi-Tenant Sales Trends**

- Deal flow jumped 64 percent year over year in the second quarter as increased competition and rising prices of single-tenant assets motivated more buyers to consider less-management intensive multi-tenant properties. Assets in Boca Raton and West Palm Beach were most sought after.
- During the last four quarters, the average price reached nearly $270 per square foot, a 6 percent increase. Properties traded averaged above $300 per square foot in Boca Raton, where small strip centers were targeted.
- Cap rates for assets traded in the last 12 months ending at midyear were typically in the high-5 to high-6 percent range, depending on quality of location, tenant roster and lease term.
- **Outlook:** Additional investors seeking higher yields will escalate competition, especially for smaller strip centers with national credit tenants. Assets in neighborhoods with strong retail demographics or in areas with heavy tourist traffic will be desired.



* Forecast
** Trailing 12-month period through 2Q
Source: CoStar Group, Inc.

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Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- Several macroeconomic headwinds, including the strong dollar and lower energy prices, have recently dropped the yield on the 10-year U.S. Treasury to the low-2 percent range. Despite weakness abroad, U.S. economic data remains robust as existing home sales hit levels not seen since 2006 and retail sales growth indicates a willingness by consumers to spend in areas beyond the essentials. Additionally, jobless claims are just above a 41-year low and more than 200,000 positions have been created in 14 of the last 16 months, providing further evidence of broad strength in the labor market.
- The Federal Open Market Committee has committed to a policy of "lower for longer" as it assuages fears surrounding a possible interest rate increase this fall. The initial policy rate change is expected to be just 25 basis points, the first hike since 2006, with measures remaining accommodative for several years.
- Life insurance firms are underwriting with terms of up to 25 years for retail loans. Their 10-year pricing ranges between 4 and 4.25 percent with average LTVs from 60 to 65 percent. Meanwhile, CMBS lenders are offering 10-year terms at rates between 4.4 and 4.65 percent, with LTVs at 75 percent. Commercial banks are also active in the sector, generally offering shorter-term loans from 3.75 to 4.75 percent for 70 percent leverage. Floating bridge loans for stabilized assets will require LTVs of 70 percent and price with a spread between 250 and 425 basis points over LIBOR, while value-add transactions will be underwritten at 80 percent LTV (60-65 percent of cost) with a 300- to 475-basis-point spread.
- Total CMBS issuance reached $52 billion by the end of the second quarter, representing a sizable uptick from last year. More than $600 billion in CMBS is expected to come to market during the next few years as pre-crisis loans come due, prompting owners to renegotiate their capital structure at much lower interest rates. Many of these owners may choose to list their assets instead, providing investors an opportunity to place capital in highly sought-after markets.

Local Highlights

- The West Palm Beach City Commission has approved plans for a $135 million spring-training facility that will be used by the Houston Astros and Washington Nationals. The new facility will be built on a former landfill and bring opportunities for further development. Construction on the site is expected to start in the final quarter of 2015 for a delivery date of January 2017.
- Transit Village, a mixed-use project, has been granted its last major approval by West Palm Beach's Downtown Action Committee. The transit-oriented development will be connected to a Tri-Rail station that provides access to Broward County and Miami International Airport. This will be the largest project underway in the county and will comprise 33,000 square feet of retail, 420 apartments, 300,000 square feet of office space and a 300-room hotel. The added foot traffic will benefit nearby retailers.
- Developers in Palm Beach County are shifting their focus to the west. GL Homes submitted plans for Indian Trial Grove, a 5,000-acre site comprising nearly 4,000 homes and 225,000 square feet of commercial space. Pulte Homes also plans to build almost 1,000 homes near the west side of Florida's turnpike. As most of the land is currently farmland and low density residential, demand for retail development will sprout as homes are occupied.

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