Marcus & Millichap

Multifamily Research Market Report

Orlando Metro Area

Fourth Quarter 2016

Soaring Economy, Robust Asset Performance Intensify Bidding in Orlando

Low vacancy drives increase in development. Strong employment gains have increased the number of households, fueling demand for multifamily housing in Orlando. The heightened need for apartments has boosted construction and several larger mid-rise complexes that combine both retail and rental components are under development. Builders are primarily targeting central Orlando and southern Orange County where the completion of numerous Class A buildings has pushed up rent growth over the last four quarters. These areas will end the year with some of the highest average rents in the metro. Despite the highest number of completions in nearly 15 years, strong tenant demand and steady household formation will reduce vacancy for an eighth consecutive year. Low vacancy will boost the effective rent substantially, pushing the average to a record high.

Vigorous employment growth lifts investor demand. The vibrant economy and robust property operations are driving investor interest in Orlando apartment properties. Local and out-of-metro buyers bid keenly, primarily targeting assets located within central Orlando and in Kissimmee. Investors are predominantly seeking Class B/C complexes, where the average first-year return can range up to 150 basis points more than comparable assets in gateway metros. Limited listings, though, have elevated property values over the past four quarters and pushed several investors into secondary and tertiary areas in search of higher yields. Complexes in these locations will typically trade with cap rates in the mid- to high-7 percent span. Despite limited listings, Orlando's healthy demographics have attracted several first-time investors to the market, further enlarging a competitive buyer pool. These investors will typically seek smaller properties with a value-add component offered at lower entry costs. Overall, apartment assets in the metro has traded with average first-year yields in the low-6 percent area during the previous 12-month period. Large stabilized properties typically changed hands with cap rates in the low- to mid-4 percent range during this time.

2016 Multifamily Forecast

5.0% increase in total employment

Employment:

Employers in Orlando will hire 59,000 workers in 2016, a 5.0 percent increase in payrolls. In the preceding year, approximately 50,000 jobs were added. The professional and business services sector led hiring with nearly 15,900 positions.

7,000 units will be completed

Construction:

Builders are on track to complete 7,000 apartments this year. Nearly all of the new inventory will comprise market-rate complexes with more than 150 apartments. In 2015, approximately 4,700 units were delivered.

30 basis point decrease in vacancy

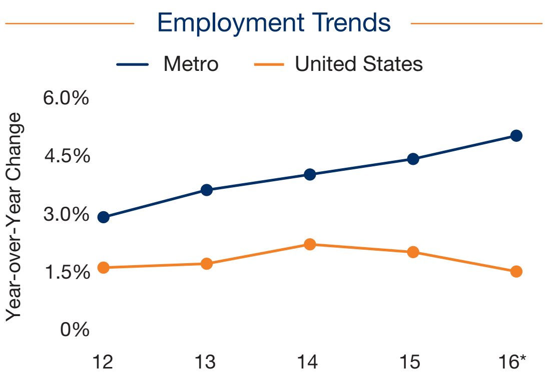
Vacancy:

The vacancy rate will decrease 30 basis points to 3.4 percent in 2016 as more than 6,900 apartments are absorbed. During the previous year, vacancy fell 60 basis points on net absorption of 5,700 units.

6.5% increase in effective rents

Rents:

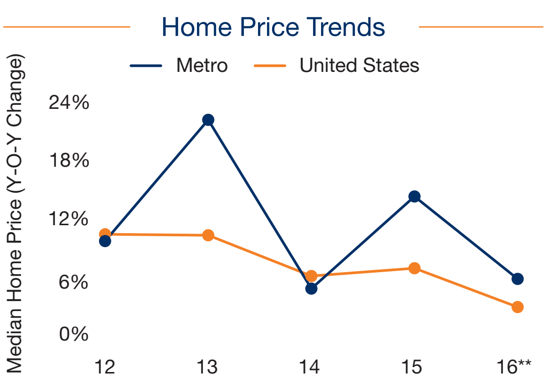
Tightening vacancy and strong demographics will contribute to a 6.5 percent increase in the average effective rent this year to $1,113 per month. In 2015, the average rent jumped 6.9 percent, with the East Orlando submarket registering the highest gain of 10.6 percent.



Economy

- Employers in Orlando hired 55,200 workers during the last 12 months, increasing total employment 4.7 percent. In the previous year, nearly 48,400 jobs were created in the metro.
- The construction sector registered a significant increase in payrolls during the last four quarters with the addition of more than 12,300 jobs as builders constructed apartment and retail properties. The leisure and hospitality sector created the most jobs during the past year, adding 13,600 workers.
- The unemployment rate dropped 40 basis points during the year ending in the third quarter to 4.3 percent, about 70 basis points lower than the national unemployment rate. In the prior year, the rate fell 100 basis points.

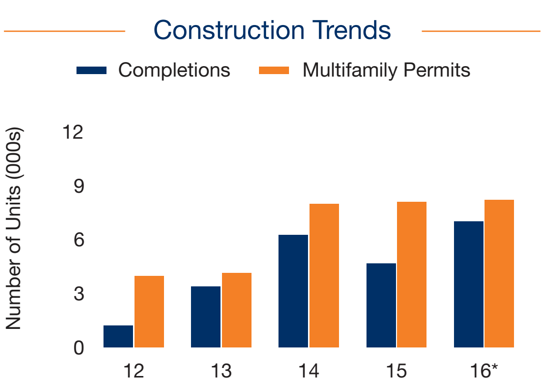
Outlook: Employment will expand 5.0 percent this year as 59,000 workers are added to payrolls. Last year, headcounts increased 4.4 percent.



Housing and Demographics

- Strong employment growth generated a 3 percent rise in the median household income in the last four quarters to $51,700 annually. The median single-family home price during this time climbed 10 percent to $219,000.
- During the 12 months ending in September, household formation climbed 3.2 percent, or by 29,000 households. The increase bodes well for sustaining multifamily housing demand. In the preceding year, the number of households rose 2.6 percent.
- Assuming 10 percent down and traditional financing, the average mortgage payment for an existing median-priced single-family home is about $230 per month more than the average rent for an apartment in the metro. The higher cost of homeownership combined with the need for a downpayment will draw many individuals to rentals.

Outlook: Orlando's growing millennial population and healthy employment market will support apartments in Orlando and extend renters' tenures.



Construction

- Builders completed 6,700 apartments during the year ending in September, with the majority of completions comprising garden-style complexes. In the previous year, 3,900 rentals were built.
- Construction will remain elevated across the metro. More than 9,900 apartments are under construction with completion dates through 2019. Nearly half of these deliveries will be market-rate units in Central Orlando and South Orange County.
- One of the largest projects under construction is the Yard at Ivanhoe in the Central Orlando area. The 630-unit complex will also contain 110,000 square feet of retail space for various shops and restaurants. The development will come online during the first quarter of 2019 and is expected to bring additional projects to the area.

Outlook: After completing nearly 4,700 units in 2015, builders will deliver 7,000 apartments this year. More than half of the new rentals will be in Central Orlando and South Orange County.

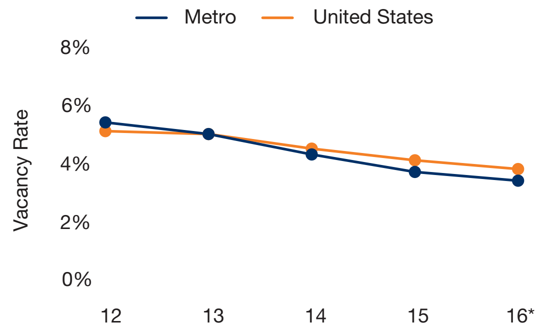
* Forecast
** Trailing 12 months through 3Q

Vacancy

- During the last four quarters, the marketwide vacancy rate ticked up 10 basis points to 3.2 percent as completions exceeded demand. In the preceding 12 months, the vacancy rate fell 80 basis points.
- The largest vacancy decrease over the previous 12 months was in neighborhoods directly west of downtown Orlando. Here, vacancy plummeted 130 basis points to 2.1 percent in the third quarter. The lowest rate of 1.2 percent was found in the University area, after a 50-basis-point decline from one year ago. Units near the University of Central Florida also posted the highest rent of $1,627 per month.
- During the year ending in September, vacancy in apartments built during the 1970s fell 160 basis points to 2.0 percent, one of the lowest rates among all property vintages. Effective rents at units built during this time period registered an increase in the average rent of 7.2 percent to $878 per month.

Outlook: Net absorption of 6,900 units will push down vacancy 30 basis points to 3.4 percent this year. In 2015, the rate fell 60 basis points.

Vacancy Rate Trends

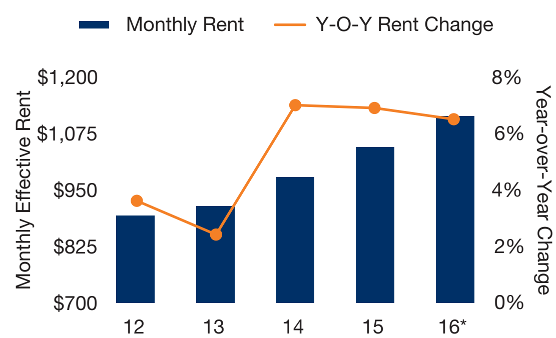


Rents

- The average effective rent jumped 6.6 percent from one year ago to $1,104 per month in the third quarter. Year-over-year rent growth has remained elevated, above 6.5 percent, since the fourth quarter of 2014.
- Apartments east of Interstate 4, in the areas of Casselberry, Winter Springs and Oviedo, registered double-digit rent growth. Effective rents in these locales soared 11.5 percent during the past year to $1,221 per month.
- The largest rent increase across property classes was in the Class B segment, where the average rent jumped 8.2 percent since the third quarter last year to $1,084 per month. Class C apartments rented for nearly $300 per month less.

Outlook: As vacancy remains tight and intense demand persists, the average monthly rent will advance 6.5 percent this year to $1,113. In 2015, the average monthly rent soared 6.9 percent.

Rent Trends

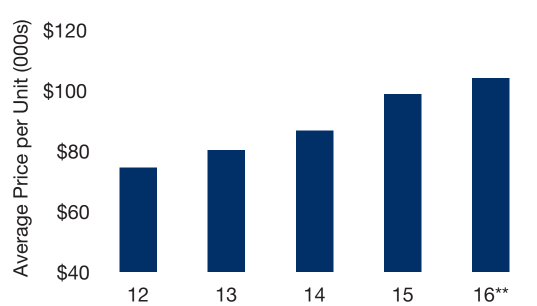


Sales Trends

- Transaction velocity was virtually unchanged over the past 12 months, reflecting a limited number of assets listed for sale. Properties located in the central Orlando area were in high demand.
- The average price climbed 7 percent during the past four quarters to $104,000 per unit. Well-located assets traded around $30,000 to $40,000 more per unit than the average.
- The average first-year return remained flat during the past 12 months in the low-6 percent range. Class A properties traded in the mid-5 percent band, while Class B/C assets changed hands with cap rates in the low-6 to mid-7 percent range.

Outlook: Out-of-metro investors will continue to seek assets in Orlando as returns are relatively higher than in other markets. Buyers will primarily target Class B/C assets in prime locations as vacancy in these complexes tightens, supporting additional rent growth.

Sales Trends



* Forecast
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Sources: CoStar Group, Inc.; Real Capital Analytics

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Capital Markets

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

- The initial reading of third quarter GDP of 2.9 percent and consistent growth in employment are fanning expectations that the Federal Reserve will raise its benchmark short-term lending rate at its December meeting. Other economic data showing steady improvement in the housing market and the stabilization of oil prices around $50 per barrel offer signals that the U.S. economy is growing at a sustainable pace.
- Increasing rental housing demand underpinned a decline in the U.S. apartment vacancy rate of 60 basis points to 3.5 percent year to date through the third quarter, the lowest level this cycle. Apartment builders have responded to growing demand and favorable demographic trends by ramping up construction. Completions will rise to 320,000 units this year and peak in 2017.
- Capital markets remain highly competitive, offering an assortment of fixed-rate products available through commercial banks, life-insurance companies, CMBS and agency lenders. Fannie Mae and Freddie Mac are underwriting loans of 10 years at maximum leverage of 80 percent. Rates will typically reside in the high-3 to low-4 percent range, depending on underwriting criteria. Portfolio lenders will also price in this vicinity but will typically require loan-to-value ratios in the 65 to 75 percent band. Floating-rate bridge loans and financing for asset repositioning are typically underwritten with LTVs 70 to 75 percent of stabilized value (80 to 85 percent of cost) and price 300 basis points above Libor for recourse deals and extending to 450 basis points above Libor for non-recourse transactions.

Local Highlights

- Construction will begin in the fourth quarter on a large mixed-use community in the employment hub of Lake Mary. Griffin Farm Town Center will include 265 apartments, 120,000 square feet of retail space, plus single-family homes and townhomes. The development will create approximately 2,000 temporary jobs and an additional 400 permanent positions. Griffin Farm Town Center will be the first project in Lake Mary's Midtown district and could serve as a catalyst for additional development.
- Working through the planning pipeline is a 12-acre project in Altamonte Springs. Located on the corner of Orange and Pineloch avenues, the Southside Shoppes development will contain a 300-unit multifamily complex named Ecco on Orange. Nearly 8 acres of the center will be dedicated to a variety of shops, restaurants and parking.
- A large redevelopment project has started in downtown Kissimmee. Developers plan to construct more than 200 rentals, 15,000 square feet of commercial space, 50 townhomes, a hotel and a 400-space parking garage. The project is a continuation of the Kissimmee Lakefront Park update that began two years ago. Currently, the area houses a parking lot and an outdoor event space.