Marcus & Millichap

Retail Research Market Report

Third Quarter 2016

Orlando Metro Area

Growing Millennial Population Boosts Mixed-Use Construction

Steady population growth and rising household incomes fuel retail sales in Orlando. The median household income has risen over the last four quarters, lifting retail sales and driving the need for retail space. Additionally, the population has continued to increase at a constant pace as millennials flock to the metro and comprise nearly a quarter of the population growth. This age cohort typically favors a live-play-work lifestyle, which has spurred demand for large mixed-use developments and multi-tenant retail properties near housing divisions. Builders remain active, outpacing the five-year average for deliveries. Many developers seek anchor tenants that will attract young professionals to the area. This includes a 35-acre development in Lake Mary that is expected to have 265 apartments, 150 townhomes and an assortment of shops and restaurants to appeal to a variety of consumer tastes. Signed tenants include Earth Fare and 24 Hour Fitness. Even as construction remains above average, heightened demand for retail space will push down vacancies and place upward pressure on rents.

Strong fundamentals and healthy demographics drive investor interest. Many out-of-state buyers, particularly from California and New York, are motivated by the tax benefits offered by 1031 exchanges. These investors are deploying capital in Orlando where average first-year returns are up to 100 basis points greater than their home markets. Here, single-tenant assets changed hands on average in the low-6 percent range after compressing 20 basis points during the last four quarters as investors targeted properties with national branded tenants. However, as listings for these assets within the city remain limited, several buyers are seeking opportunities in secondary and tertiary submarkets. In addition, many investors are making the transition to higher-yielding multi-tenant properties where cap rates average in the low-7 percent range. The majority of these multi-tenant buyers target the South Outlier submarket, where retail space trades with cap rates between the mid-6 to low-8 percent span. The strong demand for retail assets within Orlando will continue to decrease cap rates as investors snatch up what little inventory becomes available.

2016 Retail Forecast

3.4% increase in total employment

Employment:

Employers will increase the employment base this year by 3.4 percent with the creation of 40,500 jobs. During the previous year, 50,000 positions were added.

1.1 million sq. ft. will be completed

Construction:

Builders are forecast to complete 1.1 million square feet of retail space this year, a slight decline from the 1.2 million square feet delivered in 2015. Nearly 43 percent of the new construction will be located in the South Outlier submarket.

70 basis point decrease in vacancy

Vacancy:

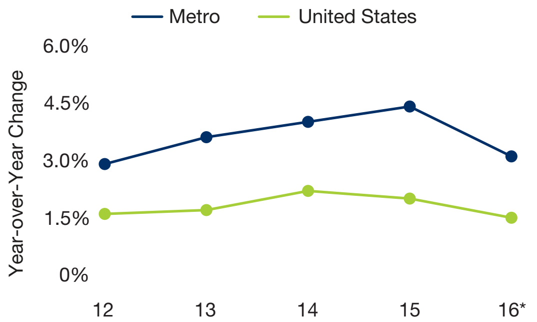
Strong demand for retail space in Orlando will push the vacancy rate down 70 basis points to 5.4 percent in 2016 as net absorption is expected to reach 1.8 million square feet. In the prior annual period, vacancy fell 70 basis points.

4.4% increase in asking rents

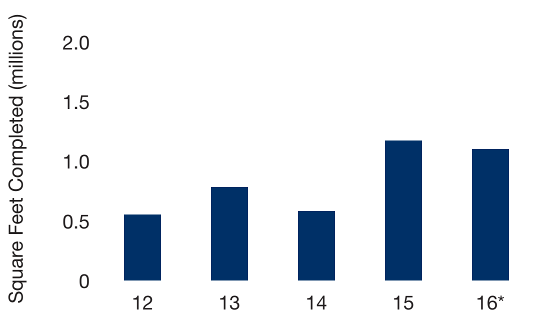
Rents:

As operations continue to tighten, the average asking rent will increase 4.4 percent this year to $16.70 per square foot. In 2015, asking rent climbed 3.2 percent.

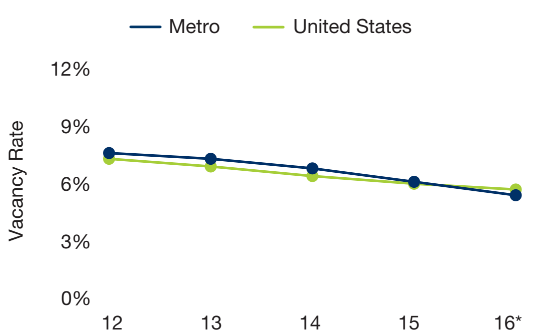
Employment Trends



Retail Completions



Vacancy Rate Trends



* Forecast
Source: CoStar Group, Inc.

Economy

- During the first half of 2016, Orlando employers added more than 27,200 jobs, bringing the 12-month total to 50,100. As a result, the unemployment rate dropped 70 basis points over the year to 4.3 percent. In the previous annual period, nearly 46,800 positions were created.
- The robust tourist industry drove the need for workers at bars, restaurants and hotels, which pushed up employment in the leisure and hospitality sector by 5.5 percent with 13,000 workers added during the year ending in June. The largest percentage growth was posted in construction at 15.6 percent with 9,400 jobs.
- As the population rose 2.9 percent over the last four quarters, retail spending climbed 3.4 percent. In the prior year, the population rose 2.6 percent while sales jumped 7.4 percent.

Outlook: Employers will increase staffs by 3.4 percent, or approximately 40,500 jobs, in 2016. In the previous year, the workforce expanded by 50,000 positions.

Construction

- In the last 12 months ending in June, builders delivered more than 1.2 million square feet of retail space. Nearly 40 percent of this construction was in the South Outlier submarket. In the previous year, 829,000 square feet was finalized.
- During the first half of the year, nearly 626,000 square feet of retail space was completed. One of the largest projects delivered was a 152,000-square-foot Costco on Gardens Park Boulevard in the Orlando Central Park Submarket.
- More than 6.1 million square feet is in the planning pipeline with potential completion dates through 2018. This includes the 3 million-square-foot The Hills I, which is forecast for delivery in 2018. Located in the Lake County submarket, the mixed-use development will contain retail, office and medical space, along with 4,000 residential units.

Outlook: After completing 1.2 million square feet in 2015, builders will deliver 1.1 million square feet this year. Despite the slight decline, construction remains nearly 415,000 square feet above the previous five-year average.

Vacancy

- During the last four quarters, vacancy shrunk 40 basis points to 5.8 percent. In the prior annual period, vacancy fell 100 basis points on net absorption of 1.9 million square feet.
- Many submarkets registered steep drops in the vacancy rate over the last 12 months ending in June. Strong tenant demand amid limited completions in the University Research submarket slashed the rate 270 basis points to 5.1 percent during this time period. The Lee Road submarket had the greatest decline of 340 basis points to 14.0 percent.
- Vacancy remains tightest in the St. Cloud submarket where only 7,000 square feet of retail space was added in the last five years. Here, the rate declined 200 basis points to 1.4 percent during the year ending in June.

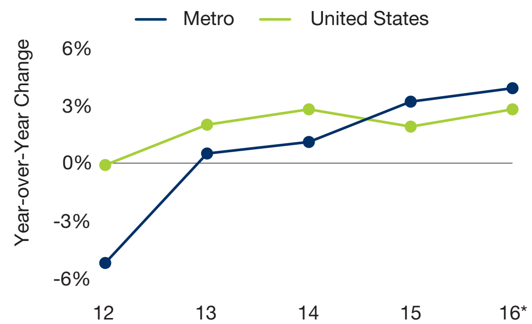
Outlook: This year vacancy will tighten 70 basis points to 5.4 percent as net absorption reaches 1.8 million square feet. In 2015, vacancy fell 70 basis points.

Rents

- As operations tightened during the last 12 months, the average asking rent for retail space rose 8.2 percent to $16.72 per square foot. In the prior year, asking rent fell 0.8 percent.
- Multiple submarkets posted double-digit rent growth in Orlando during the last four quarters. The largest increases were in the Orlando Airport and Winter Park submarkets, rising 72.4 percent to $31.76 per square foot and 30.9 percent to $29.24 per square foot at midyear, respectively. The West Outlier submarket gained 22.2 percent to $15.98 per square foot during the same time period.
- Heightened demand for multi-tenant properties pushed the average asking rent up 5.6 percent over the last four quarters to $16.14 per square foot. Higher rent could be found in University Research area at around $24.26 per square foot. On the other hand, single-tenant assets jumped 10.4 percent to $17.21 per square foot in June.

Outlook: The average asking rent will move up 4.4 percent this year to $16.70 per square foot. In 2015, rent advanced 3.2 percent.

Asking Rent Trends

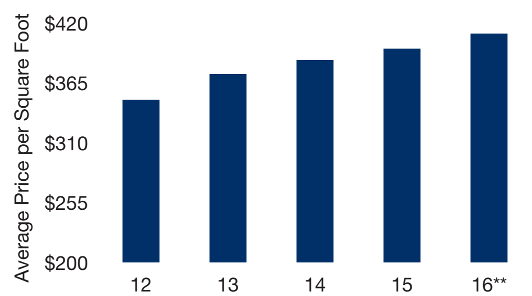


Single-Tenant Sales Trends**

- Investor interest remains strong for single-tenant assets as evidenced by a 30 percent increase in transaction velocity over the last four quarters. While the majority of sales consisted of restaurants and fast-food establishments, transactions for convenience stores more than doubled. In the previous year, sales dropped 10 percent as limited listing pushed buyers into multi-tenant assets.
- The average price per square foot climbed 5 percent during the last 12 months to $410. Assets in the Tourist Corridor and South Outlier submarkets sold up to $150 higher per square foot, while more affordable assets could be found in the areas of Kissimmee and Metro West.
- The average first-year return declined 20 basis points to the low-6 percent range during the year ending in June. Well-located convenience stores traded with cap rates between the mid-4 to mid-5 percent range.

Outlook: As listings remain limited in the city, single-tenant buyers will begin to seek assets in outlying secondary and tertiary submarkets. In addition, several investors seeking higher yields will begin to move to multi-tenant assets.

Single-Tenant Sales Trends

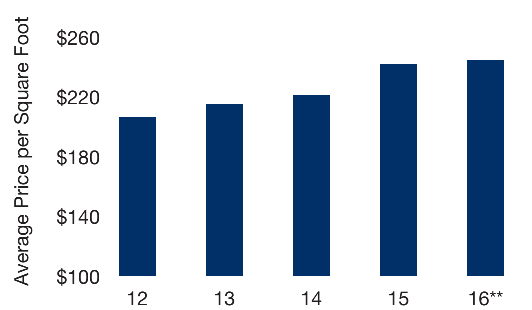


Multi-Tenant Sales Trends**

- As single-tenant listings remained limited in Orlando over the last 12 months, some buyers turned their attention to multi-tenant assets, boosting transaction velocity by 35 percent.
- The average price climbed 5 percent during the year ending in the second quarter to around $244 per square foot. The Lake Mary and Lake County submarkets registered higher prices, while more affordable areas include the South Outlier and South Orange submarkets.
- The average cap rate fell 30 basis points over the last four quarters to the low-7 percent range. Newer shopping centers averaged between mid-5 to mid-6 percent.

Outlook: Out-of-metro buyers, particularly from coastal areas, will flock to Orlando seeking multi-tenant assets with higher yields than their home markets.

Multi-Tenant Sales Trends



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

Capital Markets

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

- Global capital markets have remained stable over the past few weeks, even as Brexit and the continued devaluation of the Chinese yuan have induced bouts of volatility into stock and bond markets. Meanwhile, U.S. economic data has proved resilient, with increases in retail sales and steady hiring supporting a measured pace of growth. Additionally, higher bond prices have lowered prospective yields, boosting the appeal of commercial real estate.
- As the current economic cycle has continued, retail vacancy descended to 5.8 percent by the end of the second quarter. A focus on net-leased construction for pre-leased tenants and mixed-use developments has limited development activity in relation to prior cycles, supporting robust increases in average asking rents. Builders will deliver 46 million square feet of retail space this year, with more than two-thirds of new supply slated as single-tenant structures. This environment will sponsor a fourth straight year of average asking rent growth, with advancement projected to exceed inflation over the same period.
- Capital markets remain highly competitive, with a broad assortment of fixed-rate products available through commercial banks, life-insurance companies and CMBS lenders. Loans are generally offered at terms up to 10 years at maximum leverage of 65 to 75 percent. For 10-year terms, rates will typically reside in the high-3 to mid-4 percent range, depending on leverage and underwriting criteria. Floating bridge loans and financing for repositionings are typically underwritten with LTVs above 80 percent, while pricing at 300 basis points above Libor for recourse deals and extending to 470 basis points above Libor for non-recourse transactions.

Local Highlights

- Blue Origin, an aerospace manufacturing company, is building a 475,000-square-foot manufacturing plant at the Kennedy Space Center Exploration Park, directly east of Orlando. The project is forecast for completion in 2018 and is expected to employ more than 300 high-wage workers, in turn stimulating retail spending.
- Fast-food restaurants are gaining momentum. Nearly 75 of these establishments are in the planning pipeline throughout the metro. This includes Checkers and Dairy Queen, which are looking to open 30 locations each. Additionally, McDonald's is expected to remodel numerous stores to appeal to evolving consumer tastes.
- Construction is expected to soon begin on a large mixed-use development on the corner of Kirkman and International Drive. The project, named iSquare Mall + Hotel, will consist of a four-story, 350,000-square-foot mall and 539 hotel rooms. The complex is designed with luxury features including an ice-skating rink and helicopter pad. It aims to attract high-end retailers. The iSquare Mall + Hotel development is expected to be completed in 2018.

National Retail Group

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