Marcus & Millichap

Office Research
Market Report
Orlando Metro Area

Second Quarter 2017

Demand Flourishes for Quality Space In Orlando Office Market

Class A vacancy plummets as tenants seek quality space. Orlando led office-using hiring in Florida during the last 12 months as more than 9,400 positions were added to staffs. To recruit and retain the new talent, employers have been leasing up top-tier office space across the market. As a result, net absorption of Class A space has outpaced all other asset classes, compressing the vacancy rate in this asset class nearly 900 basis points during the last 5 years. Metrowide, tightening vacancy has spurred speculative construction and completions will reach an eight-year high at year-end. Several companies have already begun to pre-lease space, including international tech firm ServiceNow. The company penned a 60,000-square-foot lease in the Central Florida Research Park and is scheduled to move in during the summer of 2017.

Asking rent moves higher. Steady office space demand will match the absorption of speculative construction this year, keeping vacancy flat as deliveries begin to lease. Lake County and the Tourist Corridor will receive the bulk of development. Asking rent will record a fifth consecutive annual increase but remain about 3 percent below the previous high set in 2008, signaling room for additional improvement.

Office 2017 Outlook

632,000 sq. ft. will be completed

Construction: Deliveries will rise from the 433,000 square feet completed in 2016. Approximately half of this year's completions will be medical office space.

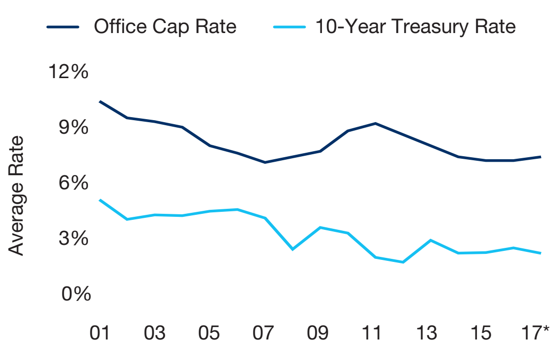
0 basis point change in vacancy

Vacancy: Net absorption of 550,000 square feet of space will keep vacancy flat at 12.3 percent in 2017. Last year, vacancy plummeted 220 basis points.

2.4% increase in asking rents

Rents: The average asking rent will rise to $21.02 per square foot, building on the 4.4 percent increase recorded in 2016.

Local Office Yield Trends

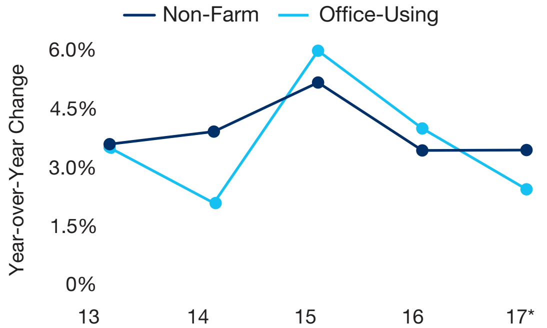


* Trailing 12 months through 1Q17
Sources: CoStar Group, Inc.; Real Capital Analytics

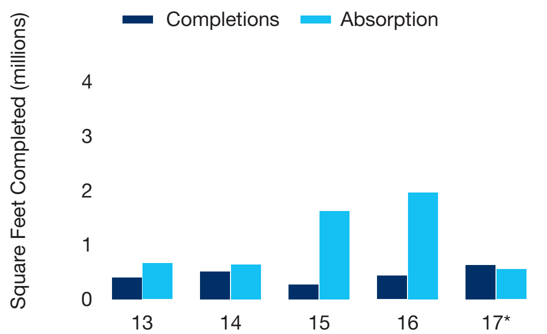
Investment Trends

- Improving vacancy and steady rent gains have garnered investors' attention for Orlando's office properties. Class B assets are a primary target among buyers while a rise in completions this year may generate additional interest and opportunities at the top end of the market.
- Office assets along Interstate 4, starting near downtown and moving north to Lake Mary, dominated transaction velocity during the last four quarters. Here, office properties typically traded with yields in the low-7 to mid-8 percent span based on quality, size and location. Metrowide, average first-year returns rose 40 basis points to the mid-7 percent area.
- Demand for medical office assets has remained steady the previous two years as vacancy tightened below the national rate to 7.6 percent. Medical office buildings typically changed hands with average first-year returns in the low-to mid-7 percent band.

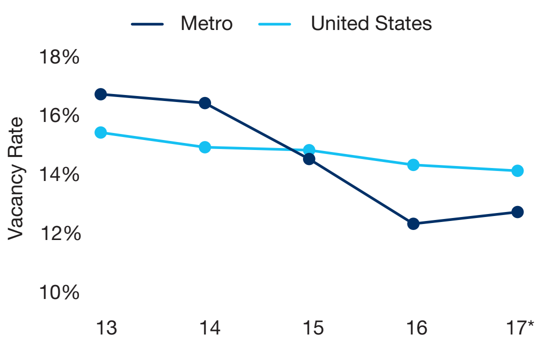
Employment Trends



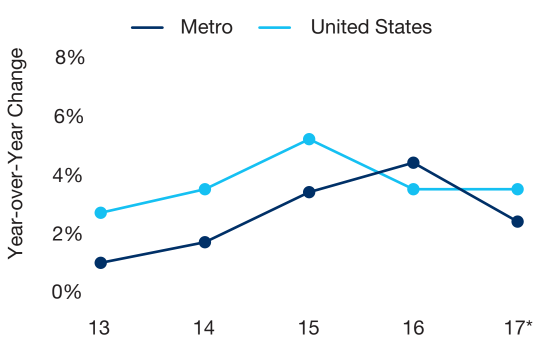
Completions and Absorption



Vacancy Rate Trends



Asking Rent Trends



* Forecast

YEAR OVER YEAR

EMPLOYMENT:

3.5% increase in total employment Y-O-Y

- During the year ending in the first quarter, around 41,300 workers were added to staffs. Approximately 9,400 of these positions were office-using.
- Hiring was led by leisure and hospitality sectors as nearly 12,000 jobs were created in the last 12 months. During this same time, the unemployment rate fell 20 basis points to 4.3 percent, below the national rate.

CONSTRUCTION:

467,000 square feet completed Y-O-Y

- In the last four quarters, nearly 467,000 square feet of office space was completed. The prior year, roughly 295,000 square feet was delivered.
- More than 630,000 square feet of space is under construction and scheduled for completion through 2018. Approximately 280,000 square feet of these deliveries will be medical office space.

VACANCY:

110 basis point decrease in vacancy Y-O-Y

- Nearly 1.2 million square feet was absorbed since last April, slashing vacancy to 12.7 percent by the end of the first quarter. One year earlier, vacancy plummeted 190 basis points.
- Vacancy in Class A space fell 140 basis points during the last 12 months to 12.9 percent. Class B/C vacancy dropped 90 basis points to 12.7 percent.

RENTS:

4.8% increase in the average asking rent Y-O-Y

- Space demand has driven rent growth with the average asking rent climbing to $20.68 per square foot in the first quarter. The previous year, rent ticked up 2.1 percent.
- Single-digit vacancy in Lake County fostered above-average rent growth in the area during the last four quarters. Here, asking rent surged 14.6 percent to $17.08 per square foot.

DEMOGRAPHIC HIGHLIGHTS

2017 FORECAST JOB GROWTH
Metro 3.4%
U.S. Average 1.4%

*POPULATION AGE 20-34
Metro 22%
U.S. Average 21%

**SQ. FT. PER OFFICE WORKER
Metro 205
U.S. Average 210

2017 OFFICE-USING JOB GROWTH
Metro 2.4%
U.S. Average 2.2%

POPULATION OF AGE 25+
*PERCENT WITH BACHELOR DEGREE+
Metro 28%
U.S. Average 29%

**OFFICE SQUARE FOOTAGE
13% Urban
U.S. Average 32%
87% Suburban
U.S. Average 68%

* 2017-2022
**1Q17

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q17

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Asking Rent	Y-O-Y % Change
Lake County	7.5%	-770	$17.08	14.6%
Osceola County	9.6%	-140	$25.19	1.4%
Orange County	12.8%	-30	$21.07	5.5%
Seminole County	14.1%	-300	$18.69	2.5%
Overall Metro	**12.7%**	**-110**	**$20.68**	**4.8%**

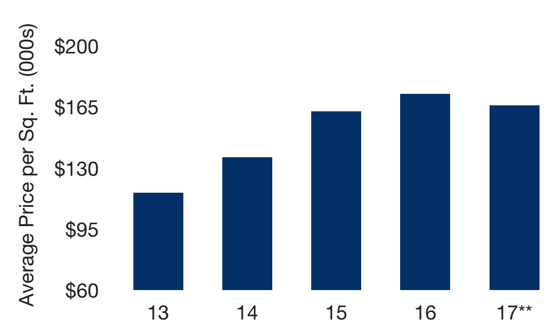
SALES TRENDS

Diverse Buyer Pool Increases Competition For Orlando Office Properties

- During the last four quarters, transaction velocity rose 21 percent for Orlando's office assets. Sales of medical office buildings held steady during this time.
- Class B properties changed hands at an average price of $150 per square foot while Class C assets averaged $103 per square foot. More trades within these classes lowered the average price year over year.

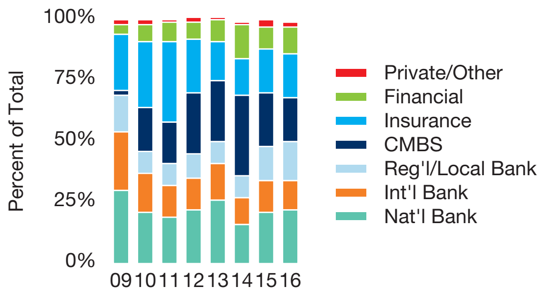
Outlook: Bidding will heat up for Orlando assets as out-of-metro investors compete against local buyers for average returns approximately 100 basis points higher than gateway cities.

Pricing Trends

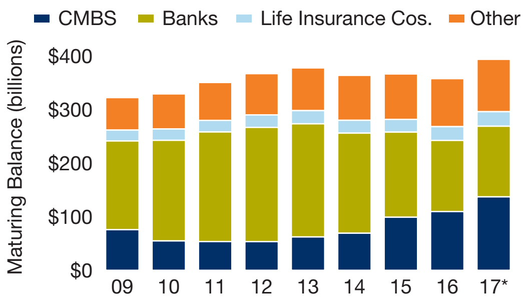


** Trailing 12 months through 1Q17
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

Office Mortgage Originations By Lender



Estimated Commercial/Multifamily Debt Maturities by Lender Type



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

CAPITAL MARKETS

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

- **Monetary policy in transition.** Despite the Fed raising its benchmark short-term rate three times in seven months and signaling another rise before the end of the year, long-term rates have remained stable. The yield on the 10-year U.S. Treasury bond remained in the low- to mid-2 percent range throughout the second quarter of 2017. The Federal Reserve wants to normalize monetary policy and, in addition to rate hikes, will start paring its balance sheet. While short- and long-term rates do not always move in tandem, both actions by the Fed have the potential to lift long-term rates.
- **Sound economy a balancing act for Fed.** With unemployment at the lowest level since 2007 at 4.3 percent, the Federal Reserve will remain vigilant regarding the possible rapid increase in inflation if wage growth takes off. Additionally, business confidence sits close to its all-time high. Businesses finally have the confidence to expand their footprint after years of tepid growth following the Great Recession. Office properties stand to gain significantly from this expansion with increased hiring adding to occupancy, plus expanding economic growth. The Fed, however, must now balance economic growth and job creation against wage growth and inflationary pressures.
- **Underwriting discipline persists; ample debt capital remains.** Overall, leverage on acquisition loans has continued to reflect disciplined underwriting, with LTVs typically ranging from 60 percent to 75 percent for most office properties. At the end of 2016, the combination of higher rates, conservative lender underwriting and fiscal policy uncertainty encouraged some investor caution that slowed deal flow, a trend that has extended into 2017. A potential easing of regulations on financial institutions, though, could liberate additional lending capacity and higher interest rates may also encourage additional lenders to participate.

National Office Group

Visit www.NationalOfficeGroup.com

Alan L. Pontius
Senior Vice President, National Director, Specialty Divisions
Tel: (415) 963-3000
al.pontius@marcusmillichap.com

Prepared and edited by
Catherine Zelkowski
Research Associate | Research Services

For information on national office trends, contact:
John Chang
First Vice President | Research Services
Tel: (602) 707-9700
john.chang@marcusmillichap.com

Price: $250

Orlando Office:

Justin West
Regional Manager
Tel: (407) 577-3800
justin.west@marcusmillichap.com

300 South Orange Avenue
Suite 700
Orlando, FL 32801

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; Moody's Analytics; Real Capital Analytics; TWR/Dodge Pipeline; U.S. Census Bureau.