Solid First Half Keeps Miami-Dade Recovery on Course

Office vacancy slipped in Miami-Dade in the first half of 2013, offering additional evidence of the market's slow but steady progress toward a full recovery. Vacancy will also decline in the second half of the year, and property owners will make modest headway in raising rents. Under-utilized space remains a key issue here, as it does in nearly all metros. The pace of hiring moderated recently, but jobs that have been created over the past three years have been insufficient to generate widespread and significant new space requirements. Financial services employment, in particular, still has considerable ground to cover to replenish the jobs lost during the recession, but residential real estate finance payrolls could receive a lift from a recovering housing market. Medical fields also continue to emerge as a force for growth, as exemplified in the steady rate of tenants moving into the University of Miami Life Science & Technology Park. Overall, progress in lowering vacancy will not be impeded by construction, which remains minimal. In many instances and locations, residential building is the most feasible use of developable land.

The dearth of office construction may elevate the attractiveness of investments in under-performing assets in strong locations that are priced well below projected replacement cost. Many of these assets stand to capture new tenant demand as the market recovers, though some refurbishment and repositioning may be required. Generally, the investment market is charting a strong recovery. Velocity and dollar volume rose notably over the past year, clearly showing that investors are moving from the sidelines. More capital is flowing into Miami-Dade than at any time since the housing crisis, and owners of well-priced stabilized assets will get a strong reception from investors. Those who own properties that do not have strong prospects to become stabilized in the near term, however, should also take advantage of keen interest from domestic buyers and list their assets. The recent rise in the yield on the 10-year U.S. Treasury has not yet affected cap rates, though the increase may encourage additional investors and owners to act.

2013 Annual Office Forecast

1.6% increase in total employment

Employment: Miami-Dade employers will create 16,000 jobs in 2013, slightly outpacing the 14,400 positions added last year. Office-using payrolls will grow by 6,800 posts, marking a minor deceleration from 2012, when 6,900 new hires were made.

250,000 square feet will be completed

Construction: Developers will complete 250,000 square feet of space this year, a decline from 289,000 square feet in 2012. Over the past five years, an average 1.5 million square feet was delivered annually.

80 basis point decrease in vacancy

Vacancy: In 2013, vacancy will fall 80 basis points to 16.1 percent behind solid demand growth. More than 585,000 square feet of additional space was occupied in 2012, nudging down vacancy 40 basis points.

1.4% increase in asking rents

Rents: Average rents will reach $28.13 per square foot this year, marking a year-over-year gain of 1.4 percent. In 2012, average rents dipped 0.5 percent.

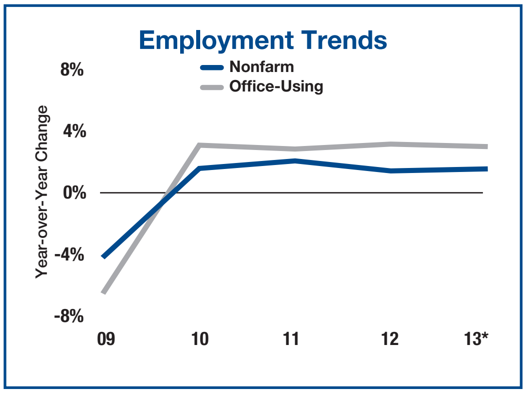
Economy

- Hiring has been sluggish. Employers in Miami-Dade created 6,700 jobs in the first half of the year, led by expanding private-employment sectors. In the corresponding period in 2012, more than 14,600 jobs were added.

- Job creation in leisure and hospitality was strong in the first half of this year, with more than 3,100 positions added. In the first half of last year, 4,400 new hires were made. Retailers also expanded payrolls in the first half of 2013, but construction, and education and health services payrolls contracted.

- A slower pace of job creation is evident in office-using sectors, where 5,200 workers were hired in the first half of this year, down from more than 6,000 positions in the first two quarters of 2012. Job growth in the financial activities sector fell notably, from 1,900 posts last year to 1,100 jobs in the first six months of 2013.

- **Outlook:** Payrolls in the county will expand 1.6 percent in 2013 through the addition of 16,000 positions.



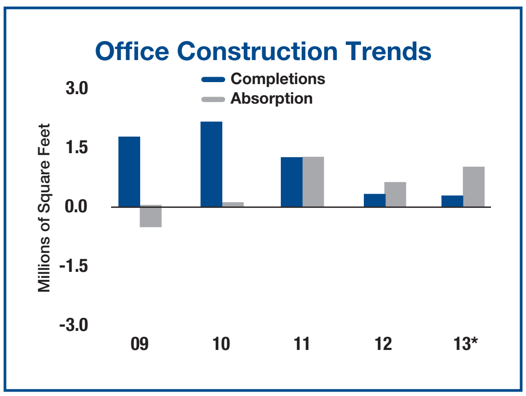
Construction

- Developers completed 114,000 square feet of office projects in the first half of the year and 233,000 square feet over the past 12 months. More than 860,000 square feet was completed in the previous year.

- An additional 243,000 square feet is under construction and slated for delivery in the second half of 2013. Collectively, the buildings were 45 percent pre-leased at the end of the second quarter. The largest building slated to come online in the second half of 2013 is the 80,000-square foot Class B Doral Park Centre, which is 20 percent pre-leased.

- The Brickell CitiCentre is the largest project underway in South Florida. The project's initial phase, which includes up to 240,000 square feet of office space, is slated for delivery in 2015. A 742,000-square foot office tower is planned in the project's second phase.

- **Outlook:** Developers will complete 250,000 square feet of space this year, an amount that will expand office stock a mere 0.3 percent.



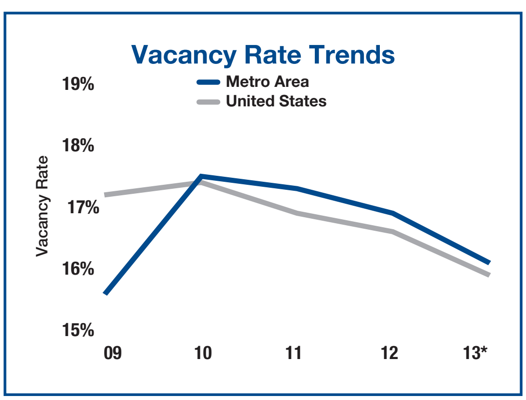
Vacancy

- Vacancy in Miami-Dade ticked down 30 basis points in the first half of 2013 to 16.6 percent. In the past 12 months, net absorption of 395,000 square feet also reduced countywide vacancy 30 basis points.

- Tenants continue to move into layouts in the Brickell submarket, where high vacancy has persisted over the past four years. Significant progress was made in the past year as net absorption of 259,000 square feet sliced vacancy 330 basis points to 18.5 percent at midyear. More than 139,000 additional square feet was occupied in the first half.

- In the Coral Gables submarket, the vacancy rate of 18.0 percent at midyear was 120 basis points lower than the level recorded in the corresponding period in 2012. Year to date, net absorption totals 45,000 square feet.

- **Outlook:** Net absorption of 976,000 square feet will far exceed additions to stock, yielding an 80-basis point decrease in vacancy to 16.1 percent.

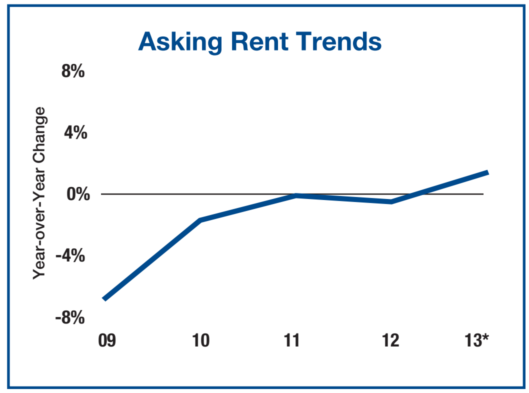


*Forecast

Sources: Marcus & Millichap Research Services, CoStar Group, Inc.
Vacancy includes all marketed space.

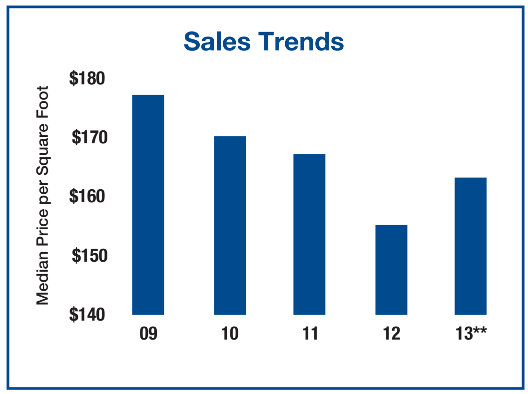
Rents

- Though strong demand pushed down vacancy during the period, average rents in the county were unchanged from April to June at $27.72 per square foot. Average rents are also down 0.1 percent year to date, following a slight 0.4 percent rise in the final half of 2012.
- Sublease space accounts for only 2.7 percent of all vacant space in the county, down from an average 5.5 percent of vacant space during the recession. The limited amount of sublease space, which is offered to lease at rents lower than direct space, will minimize competition for tenants and help owners gain traction implementing higher rents.
- Approximately 2.1 million square feet of space was leased in the first two quarters of the year; the total includes renewals and new commitments. In the second half of last year, about 2.3 million square feet was leased.
- **Outlook:** Average rents will increase 1.4 percent in 2013 to $28.13 per square foot, the highest year-end reading in four years.



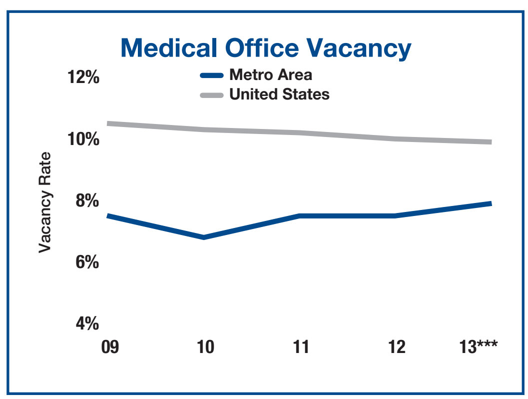
Sales Trends**

- Heightened interest in local properties is sustaining a brisk investment market. Over the past year, transaction velocity accelerated 50 percent, lifting dollar volume to more than $1.1 billion.
- The median price of assets sold in the past year was $163 per square foot, 5 percent more than the median price in the preceding year. In the $1 million to $10 million price tranche, where velocity jumped more than 40 percent, the median price also rose 5 percent, to $165 per square foot.
- Institutional assets typically trade at cap rates starting in the low-7 percent range but, for most properties, cap rates will generally start 100 basis points higher and rise depending on location and tenant quality.
- **Outlook:** Miami-Dade remains a prime gateway market and, as such, will continue to attract interest from foreign investors. Small, leveraged investors, however, will take advantage of the highly favorable spread of cap rates to financing rates to make additional purchases in the months ahead.



Medical Office

- A single 30,000-square foot medical office property was delivered in the first half of this year and only 56,000 square feet was completed over the past 12 months. Planned projects total 420,000 square feet and include a 399,000-square foot expansion of the Baptist Hospital East Campus.
- The vacancy rate was 7.9 percent at midyear, representing a climb of 40 basis points from the end of 2012. Since the second quarter 2012, vacancy has increased 90 basis points as completions exceeded a small decline in demand.
- Approximately 78,000 square feet of space was leased in the first half, encompassing both renewals and the opening of new medical practices. Space for lease in the county is being marketed at an average rent of $27.42 per square foot.
- Investors continue to show considerable interest in medical office properties. Transaction velocity and dollar volume were unchanged over the past 12 months, and prices for top properties generally exceeded $200 per square foot.



*Forecast
**Trailing 12-month period ***2Q13
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics
Vacancy includes all marketed space.

Capital Markets

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

- The Fed could begin drawing down the third round of quantitative easing by the end of this year. Despite the pullback of bond and asset purchases, which total $85 billion per month, investors have already accounted a portion of the tapering into prices. As a result, interest rates will only rise modestly as the Fed reduces stimulus.
- At the end of the second quarter, interest rates on 10-year Treasurys were around 2.6 percent, up nearly 100 basis points from the May meeting of the Federal Open Market Committee. Spreads inched up 25 basis points during that time as banks anticipate a higher cost of capital, leaving average interest rates for office financing approximately 250 basis points above the 10-year Treasury yield.
- Minimum debt service coverage is 1.25x to 1.4x with debt yields of 10 to 12 percent. LTVs hover between 65 and 70 percent. Deals below $5 million are serviced by small life insurance companies and regional banks at 10-year rates close to 5 percent. Financing between $5 million and $20 million is provided by CMBS and life insurance companies at 10-year rates of 5 percent. Above $20 million, debt is provided by life insurance companies at average 10-year rates of 4.5 percent.
- So far this year, CMBS and life insurance companies are the major players in office financing, accounting for over 50 percent of financing for properties over $2.5 million. National banks follow closely, with nearly 20 percent of market share, and international banks account for approximately 16 percent.

Local Highlights

- Including the proposed office tower in the second phase of the Brickell CitCentre, about 1.8 million square feet of office space is planned in the market. The total includes the Crossroads at Dolphin Commerce Center, a 416,000-square foot property to be located across from the Dolphin Mall.
- The planned layoff of 160 workers at HomeServe USA Corp. commenced in the second quarter and will conclude at the end of the third quarter. The company occupies about 20,000 square feet of space in the Miami Airport submarket, where a slight drop in occupied space over the past year pushed up vacancy.
- During the first two quarters, vacancy in the Kendall submarket slipped 30 basis points behind net absorption of about 27,000 square feet. Since the first quarter of 2010, when office-using employers in the county renewed hiring, an additional 394,000 square feet of space has been absorbed in the submarket.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Asking Rents	Y-O-Y % Change
1	Miami-City	7.9%	-40	$27.27	-2.8%
2	West Miami	9.1%	50	$22.34	0.9%
3	Coral Way	10.3%	120	$23.72	-0.4%
4	Coconut Grove	11.2%	-100	$29.15	-2.4%
5	Kendall	11.6%	-80	$25.07	0.7%
6	Miami Beach	11.7%	110	$33.95	3.3%
7	South Dade	12.4%	30	$21.49	1.3%
8	Medley-Hialeah	13.1%	-40	$21.56	-1.1%
9	Aventura	15.9%	440	$36.00	2.0%
10	Northeast Dade	17.8%	0	$21.51	2.7%

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Notes: Employment growth is calculated using seasonally adjusted quarterly averages. Construction, rent and vacancy figures include build-to-suit, flex space and medical office properties unless otherwise noted.