



*CITY HIGHLIGHT, JUNE 2006*

## **MIAMI CITY HIGHLIGHTS**

Jeremy Larkin, Yancey Sumner, Kirk Felici

### **Miami Office Market**

The Miami office market is experiencing single digit vacancy rates this year, which will continue to drop throughout the year as limited new inventory will be added. Totalling slightly more than 76 million square feet, this sector witnessed vacancy rates drop below 8 percent. The improvement was generated by expanding business and no new rental product being delivered to the market. There are currently 2.8 million square feet under construction, including the 1 million-square-foot Capital at Brickell and the 230,000-square-foot Latitude One projects. Based on current schedules, the first new product to market will be delivered in the second half of 2007.

Vacancy rates for all office building classes range from slightly above 9 percent for Class A space to below 8 percent for Class B and C space. The average quoted rental rates range from just shy of \$30 per square foot for Class A space to the low \$20 range for Class B and C space. There were no leases more than 25,000 square feet signed in the first quarter of this year.

With few new projects delivered last year and no significant deliveries scheduled for 2006, the office market is expected to see continued rising occupancy levels and rapidly increasing rents. Construction and land costs have risen dramatically, requiring rents of 20 to 30 percent above current rent rates to justify construction. Given this, few new projects will be announced. Miami's expanding service economy will absorb virtually all available space, permitting landlords to aggressively increase rents this year. Once these increases are realized and the economics to develop become favorable, developers will be identifying, acquiring and announcing new projects in most major submarkets. The one current exception is The Green Companies, which has broken ground on Dadeland Centre II in the Dadeland submarket. This 16-story office building will total an estimated 110,000 square feet. When complete in the third quarter of 2007, this will be the first Class A office building since the 130,000-square-foot Dadeland Centre was completed in 2001.

The office condominium market witnessed dramatic expansion as buyers finally embraced this concept. New and conversion projects are underway in every submarket and are being sold at record price levels in record time. Certain submarkets are witnessing oversupply (such as Coral Gables) as sales activity slows and price increases moderately. Other markets, such as South Miami and Aventura, continue to have virtually all new product absorbed by buyers prior to construction starting. In South Miami, the Richard Brandon Companies are following the successful development of the 65,000-square-foot Plaza 57 office condominium with the 80,000-square-foot Plaza 62 office condominium, which will be located across the street from South Miami Hospital. This six-story project is expected to be delivered in 2007 and is 70 percent sold.



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Investment activity remained stable with record low cap rates and a moderated supply as redevelopment and condominium converters took center stage. Grand Bay Tower in Coconut Grove, totaling 164,000 square feet, and Baypoint Office Tower in Midtown Miami, totaling 138,000 square feet, each sold for \$240 per square foot to buyers who immediately announced a conversion for each project to office condominiums.

This coming year will witness savvy investors pursuing quality assets in each submarket, purchasing properties at record levels. If rent growth expectations are achieved, they will refinance or sell these assets at levels that dwarf the prices to be paid in the coming year.

— *Jeremy Larkin is president of Miami-based NAI Miami Commercial Real Estate Services.*

### **Miami Industrial Market**

For 2006, the Miami industrial market is seeing availability absorbed and little new speculative inventory added. Totalling slightly more than 205 million square feet, this sector witnessed vacancy rates drop below 4 percent, finishing the first quarter at 3.9 percent. The improvement was a combination of factors including a vibrant local economy and limited delivery of new inventory totaling only 55,000 square feet. Currently, there is approximately 2 million square feet of warehouse space under construction, which will add less than 1 percent to inventory if all projects are delivered prior to year-end.

Land prices, at record levels, will continue their rise with prices approaching the mid-teens for developable land. Rents will realize above inflationary growth as Miami's economy continues to expand. The condominium market continues at a healthy, but more stable pace.

Rental rates are currently averaging around \$6.85 per square foot for industrial/warehouse projects and \$12.75 for flex space. Quoted rates are averaging approximately 10 to 20 percent higher respectively. With the improving occupancy rates and land/development costs, rental rates are expected to climb dramatically for the remainder of the year. Large lease transactions for the first quarter this year include Arch Aluminum & Glass moving into 144,000 square feet in the Gratigny submarket and Glass Alum's 55,000 square feet lease in Airport West.

For the past 3 years industrial developers and brokers have warned of the impending shortage of useable industrial land. This year the warning became a reality as the supply of developable land all but evaporated. With the record land prices combined with rising construction costs, the estimated cost to develop new product is approximately \$125 per square foot. With the current rental rates, development cannot be economically justified. The exception is the small bay (1,500 to 3,000 square feet) condominium warehouses where units can be sold at profitable levels.



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Those few developers holding large land banks, such as Codina Development (who recently merged with Florida East Coast Industries) with its Beacon Lakes project and RReef's Turnpike Distribution center in Northwest Miami-Dade, are finding it difficult to do build-to-suits for the best of credit tenants. Only those users with an absolute necessity for expansion are considering paying the current prices to justify new construction. Land prices are now in excess of \$10 per square foot, and the only market in which prices may be in the single digits is in deep South Miami-Dade/Homestead.

Investment activity remains at a strong, stable pace with record low cap rates and a moderated supply. Only speculators who are paying record prices with the thought of flipping the property within a few years or condominium converters/developers are actively pursuing purchases currently.

— *Yancey Sumner is senior director with Miami-based NAI Miami Commercial Real Estate Services.*

### **Miami Multifamily Market**

Even as the condominium conversion craze slows down, the flurry of conversion activity during the past few years will continue to have a significant impact on apartment fundamentals and investment activity in Miami this year and beyond. In 2005, 9,253 apartment units in 32 properties were sold to condo converters. Thus far in 2006, 2,507 units in 12 properties were acquired by condominium converters.

Conversions have diminished rental stock to an extent that it would take an addition of 3,000 new units each year for the next 5 years to replenish inventory to its level at the end of 2002. Whether units converted to condos resurface on the market as rentals at a rate and volume sufficient to negatively impact apartment property operations during the long-term remains uncertain. At this time, however, conversion-related stock reduction has had a positive effect on vacancy and rent and will continue to support strong fundamentals this year. Moderate improvements in job growth will also bolster apartment market conditions in Miami. This year, employers are expected to add 21,000 new jobs in the city, a 2 percent increase during this year.

Modest employment growth, combined with continued population gains, is expected to boost renter demand across Miami, resulting in vacancy dropping by 10 basis points by year end, to at least 3.9 percent, if not lower. Marcus & Millichap predicts that effective rents are expected to rise 5.3 percent to \$1,031 per month. Developers are expected to add 2,170 units this year, up from the 1,000 units in 2005.



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In one of Miami's most heated submarkets, North Miami Beach, the vacancy rate fell from 12 percent at the end of 2003 to 5 percent at year-end 2005. But the good news continues for investors in apartment rental properties: vacancy in the area is expected to drop to the low 4 percent range this year. While population-driven demand has contributed to the decline, it has also helped that more than 2,300 units have been removed from inventory for conversion. The submarket's desirable location, along with diminished options for prospective renters, will allow owners to reduce concessions and achieve a 5 percent gain in effective rents to \$1,337 per month this year.

Condo conversion buyers, apartment operators and foreign investors combined to push the median price up 20 percent during the last year to \$87,500 per unit. Cap rates are down 70 basis points during the same time period to 6.1 percent, and continued condo conversion buying could lower the rate more this year.

Underwriters in Miami are levying stringent requirements upon condominium converters, which bodes well for the apartment rental investment market. Currently, obtaining financing in Miami for large-scale projects is difficult. Lenders are wary, because so many condo projects have been announced, and have already pre-sold units.

Conversion-related buying, though, relies upon strong demand in the for-sale housing market, and there is some uncertainty in early 2006 regarding whether demand will remain as vigorous as it has been in recent years. A more likely catalyst for higher property prices in 2006 is the rising cost of new construction and lack of developable land in the market. Both factors underpin our expectation for continued price appreciation.

— *Kirk Felici is the regional manager in the Miami office of Marcus & Millichap.*

## **Miami Retail Market**

The retail market in Miami is extremely vibrant, continuing in single digit vacancy rates this year with some submarkets below 1.5 percent. According to recent reports, Miami's retail space ratios are slightly below 13 square feet per person versus the national average of approximately 20 square feet person. Based on the limited supply of retail space being added this year, this ratio is expected to decline further.

There are several new major retail projects underway or ready to start construction. Developers Diversified Realty's The Shops at Midtown Miami will be a 645,000-square-foot retail component of the mixed-use Midtown Miami development. Announced anchors include Target, Linens 'n Things, Ross Dress for Less, Circuit City and PetsMart. Gables Station and Fifth & Alton, both vertical retail projects, are being developed by Berkowitz Development. Gables Station, located adjacent to Rouse Development's luxury The Village of Merrick Park, will be a 550,000-square-foot, mixed-use retail/office project with 300,000 square feet



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dedicated to retail. Fifth & Alton will be an 185,000-square-foot project located at the main entrance to South Beach on Miami Beach from Downtown Miami.

Several new neighborhood shopping centers are planned by Woolbright Development in West Kendall. Carter Square, to be anchored by Staples, will be 70,000 square feet and replace the former Don Carter Bowling Alley located at the intersection of Kendall Drive and S.W. 137th Avenue. London Square will be a 300,000-square-foot power center, shadow anchored by Costco Wholesale Club. The project will be located at the intersection of S.W. 120th Street and S.W. 137th Avenue. Both projects are expected to be delivered in 2007.

In Homestead, Equity One recently opened its Publix/Walgreens-anchored Waterstone Plaza fully leased with average rental rates for local space in excess of \$30 per square foot. There are multiple new projects planned in the Homestead/South Dade area including several new Publix-anchored shopping centers and a major project by Developers Diversified Realty that is just off the Florida Turnpike at the Campbell Drive (S.W. 312th Street) exit. Land prices are now ranging between \$15 and up to in excess of \$150 per square foot for core, urban areas.

Rental rates currently are averaging in excess of \$22 per square foot with top of the market space leasing for in excess of \$60 per square foot. Construction and land costs have risen dramatically requiring rents 20 to 30 percent above current rates to justify construction. This will result in Miami's expanding retail market absorbing the little remaining available space and permitting landlords to aggressively increase rents. Restaurants and high parking requirement users have been and continue to be, for the coming year, unsuccessful when searching for sites in these submarkets.

Investment activity remained stable with record low cap rates. The majority of the larger projects have traded in the last few years; therefore, the current supply is not investment grade quality and is expected to trade at slightly higher cap rates. This year will witness aggressive investors purchasing properties at record levels. If rent growth expectations are achieved, they will refinance or sell these assets at levels that dwarf the prices to be paid in the coming year.

— *Jeremy Larkin is president of Miami-based NAI Miami Commercial Real Estate Services.*