

Orlando, Florida



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Multifamily Housing Update

July 2010

EXECUTIVE SUMMARY

The Orlando area economy labored to find its footing in the spring, managing to reduce the rate of deterioration but showing few signs of tangible recovery. Metro payrolls declined at a 36,200-job, -3.5% rate in 1Q10, and a 13,700-job, -1.4% pace in 2Q10 (preliminary); both metrics comparing unfavorably to respective -2.4% and -0.5% loss rates recorded nationally.

Weakness in the residential real estate market remained Orlando's Achilles heal. Demand for new homes was soft, precipitating a -22.5% 1Q10 year-on-year reduction of construction employment, trimming sector headcounts to a 14-year low in February. Although sales of existing homes increased, the gain was largely attributable to distressed property liquidations, as REO and short-sale activity made up 67.9% of June trades.

Layoffs by manufacturing, trade and business service employers decelerated in the spring, accounting for much of the improvement in year-on-year trends. After trimming a total of 29,700 positions last year, y-o-y cuts in these sectors slowed to a 10,000-job rate in May. The critical tourism sector also contributed, turning a 2Q09 9,600-job setback in the accommodations and food service sub-sectors into a 1,600-job y-o-y advance registered during the twelve months ended in May.

Seasonally-adjusted data were mixed. Following 19 consecutive sequential-month decreases dating to 2007, Orlando payrolls increased in five of the eight months ended in June. But after posting a useful 5,600-job surge in March, payrolls declined in April and gained in May and June largely upon the impetus of short shelf-life temporary Census worker hires.

RED Research's econometric models project that y-o-y losses will continue

through the summer, giving way to modest gains in the fall. After posting a loss of about 13,300 jobs this year, Orlando should see stronger conditions over the next 24 months, adding 18,900 jobs in 2011; 36,500 in 2012.

After a flat 4Q09 performance, apartment demand firmed in the winter. A net of 20 tenants leased units in 1Q10, up from negative net absorption of 154 units in the fall. But supply over-balanced demand, sending occupancy down 30 basis points sequentially to 88.5%, a 21-year data series record low. Conditions in submarkets south of Route 50 generally were tighter, while northern suburban areas continued to struggle to attract tenants.

Same store rent trends were mixed. Seven of Orlando's eleven submarkets recorded sequential quarter declines ranging from -0.3% to -1.4%. Average metro effective rents were up 0.2%, however, rising \$2 December to March to \$808, boosted by delivery of 455 units of luxury supply to the small Maitland submarket.

Reis expect weak market conditions to persist through year-end but foresee a moderate turn-around beginning next year. Vacancy is projected to peak at 11.7% before declining steadily to 8.9% over three years. Rents trends aren't likely to be as robust, however, as the service forecasts stable effective rents through year-end and growth averaging only 1.8% per year from 2011 to 2014, slower than the 2.6% **RED 50** market average.

While NOI growth promises to be sluggish, purchase cap rates remain relatively low in Orlando. We are of the mind that 6.5% represents a good generic proxy. Employing this level, **RCR** estimate expected 5-year unlevered returns of only 6.4% p.a., 60 bps below the **RED 50** average. Orlando's risk-adjusted index (2.45) also falls below the group median.

SNAP SHOT

| | Y-o-y change | Projected YE 2010 |
|-----------------------------------|--------------|-------------------|
| Vacancy (11.5% - 1Q10) | ↑ 1.2% | ↑ 0.2% |
| Effective Rents (\$808 - 1Q10) | ↓ 1.7% | ↑ 0.2% |
| Median Cap Rate (6.1% - 1Q10) | ↓ 2.1% | ↑ |
| Employment (992.4m - 1Q10) | ↓ 36.2m | ↓ 13.3m |

KEY POINTS

- Average Orlando occupancy fell for the sixth consecutive quarter in 1Q10, dipping to 88.5%, the lowest level recorded in the 21-year Reis data series. Supply was largely responsible as completion of 445 units over-balanced net absorption of 20 units.
- The addition of new luxury supply boosted average metro effective rents \$2 (0.2%) to \$808. Same store rent trends were mostly down though: seven publicly-traded trusts reported a -0.6% unit-weighted average real rent decline at their Orlando-area properties.
- Metro employers remained reluctant to add workers. Sporadic hiring was evident in seasonally-adjusted data, but losses expressed on a year-over-year comparison basis persisted through June. **RCR** expect y-o-y gains to develop by late summer, becoming more robust (1.9%) in 2011.
- The tourism industry was a moderate plus factor for the Orlando economy. Hotel occupancy held up well through May, and the addition of a Harry Potter-themed park at Universal and the completion of the Legoland park in 2011 bode well for the future.
- The unemployment rate in June was 11.4%, up 30 bps from May, 50 bps from June 2009.