

Palm Beach, Florida

Multifamily Housing Update

October 2006

EXECUTIVE SUMMARY

Employment growth in Palm Beach cooled to 2.8% in 2Q06, following a 17-month period of three percent or greater over-the-year growth. Payroll growth fell 80 basis points from 1Q06 and 210bps from 2005. June payrolls totaled 586,600, an increase of 17,200 (3.0%) y-o-y.

The slowdown was largely attributable to decreased hiring in the employment services sector. Sector job creation fell to 3,900 (7.8%) in 2Q06, a sharp drop from a 4,900-job (10.4%) average in 1Q06. On the other hand, expansion in the health care services heated up. Employers hired a net of 2,400 workers for a growth rate of 7.7%, 90bps higher than in 1Q06.

June unemployment was down 90bps y-o-y to 3.5%. But recent trends were less auspicious: unemployment increased 50bps from May, due to rapid expansion of the labor force and moderately slower job creation trends.

RED forecast payroll job creation of 19,000 in 2006 and 21,000 in 2007. Although payroll growth cooled in 2Q06, recent data suggest that a rebound is developing.

Metro occupancy averaged 96.8% in 2Q06, 140bps above the average of the 50 metro areas tracked by **RED** CAPITAL (**RED** 50), ranking 14th overall. Metro occupancy was up 180bps from the comparable period of 2005, but fell 10bps quarter-over-quarter. Palm Beach ranked fifth among the **RED** 50 with respect to y-o-y occupancy rate improvement.

The over-the-year vacancy improvement was primarily attributable to the conversion of 6,020 apartment units (10.6% of inventory) to condominiums. Only 604 units were converted to condo, however, 1,393 fewer units than in 1H05.

Absorption totaled 265 units in 1H06, a 64.7% decrease from the 751 units absorbed in 1H05. Reis project slower absorption (average of 119 units per quarter) through 4Q07, generating a 30bps decrease of vacancy by year end, followed by a 10bps increase to 4.0% by YE07. **RED**'s rental demand forecast is more optimistic, yielding an estimate of 2.2% demand growth in 2006 and 2.3% growth in 2007.

Y-o-y effective rent growth in 2Q06 outpaced asking rent trends for the ninth consecutive quarter. Effective rents increased 7.4% while asking rents advanced 6.5%. Owners reduced concessions, accounting for the faster growth of effective rents. The value of the average concession package in 2Q06 was 5.6% of asking rent.

With constrained supply growth the apartment market will continue to tighten. The current supply outlook is constructive, with a projected total of 1,033 units forecasted for 3Q06 - 4Q07. There are 7,445 units in the condo pipeline, however, posing a risk to the apartment market should unoccupied units enter the rental pool. All things being equal, **RED** forecast effective rent growth of 7.3% in 2006. In 2007, **RED** anticipate rent growth to trend toward historic averages as income growth is unlikely to sustain recent rent trends. **RED** forecast effective rent growth of 3.0% in 2007.

At a Reis indexed average of 5.6%, Palm Beach cap rates are below the national and regional averages. Over the past several quarters, condo converters exerted upward pressure on property prices, which may begin to ease as the housing market cools. **RED** anticipate a stable cap rate trend in the near-term and given Palm Beach's solid fundamentals and positive economic outlook **RED** assign a cautious "Accumulate" ranking.

SNAP SHOT

	Y-o-y change	Projected 2007
Vacancy (4.2% - 2Q06)	↓180bps	↓20bps
Effective Rents (\$1,036 - 2Q06)	↑7.4%	↑3.0%
Cap Rate (5.6% - 2Q06)	↓110bps	↔unch
Employment (586.6k - 2Q06)	↑17.2k	↑21.0k

KEY POINTS

- Vacancy decreased 180 basis points between 2Q05 and 2Q06 to 4.2%, attributable to the conversion of 6,020 units to condo over the 12-month period.
- Effective rents increased 7.4% year-over-year in 2Q06. Asking rents increased 6.5% over the same period.
- The Reis estimated average cap rate fell 110 basis points between 2Q05 and 2Q06 to 5.6%.
- Payroll job growth slowed to 3.0% in June as 17,200 jobs were created, year-over-year. In 2005 growth averaged 26,900 or 4.9%.
- **RED** forecast the creation of 19,000 jobs (3.3%) in 2006 and 21,000 jobs (3.5%) in 2007.



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