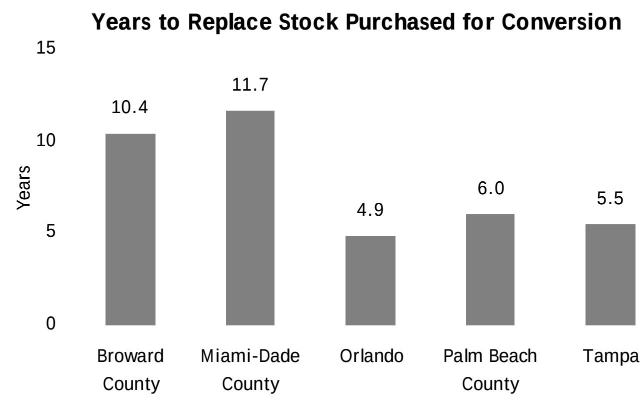
Marcus & Millichap
RESEARCH SERVICES
THE OUTLOOK

Florida Apartment Market:
Effects of Condo "Reversions" on Vacancy Rates Temporary

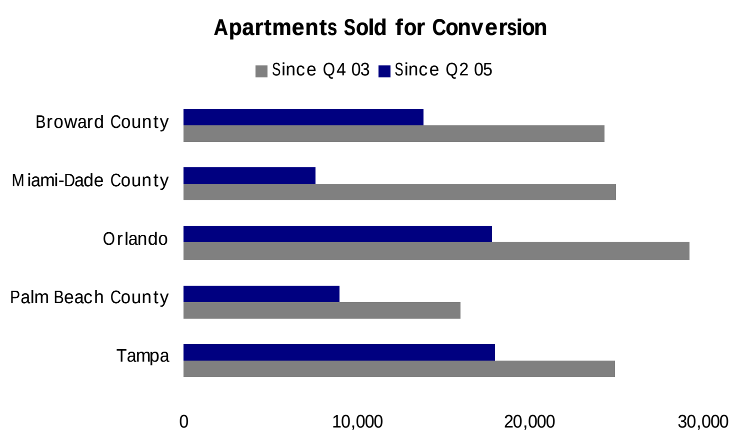
There is little doubt that the condo conversion frenzy is over, and undoubtedly condos will continue returning to the market as rentals in the near term. From the beginning of 2004 to the present day, 120,000 rental units were purchased for conversion in the five major Florida markets included in our analysis. Stated another way, at the current pace of apartment construction it would take between five and 12 years to replace rental stock removed for conversion in the markets surveyed.



Based on average annual completions from 1999 to 2003
Sources: Marcus & Millichap Research Services, Reis, TWR/Dodge Pipeline

The purchase of apartments for conversion to condos kicked into high gear in mid-2005, an important point on the timeline as the local for-sale housing markets in Florida were just reaching their peaks. Since the housing market began losing steam after this point, apartments purchased for conversion after mid-2005 appear most susceptible to being returned to rental stock, thereby negatively affecting apartment vacancy. In Tampa and Orlando, 72 percent and 60 percent were bought since mid-2005, respectively, while in Broward County, 57 percent of the 24,000 units purchased for conversion since the start of 2004 were bought after mid-2005. Miami-Dade County's conversion market caught fire earlier, as only 30 percent of the units were purchased since mid-2005, making it less likely that they will be returned to the rental pool. First quarter results for the Miami apartment market support this notion, as vacancy came in at 3.9 percent, up only 10 basis points compared to year-end 2006. Broward County also fared well early in 2007 with vacancy actually ticking down slightly to 3.8 percent. In contrast, vacancy in Orlando rose 70 basis points to 5.6 percent in the first quarter due to the growing shadow market.

In order to assess the impact of the reversing conversion trend and new condo construction on apartment occupancy in Florida, we first had to make a few assumptions. As previously discussed, units purchased for conversion since mid-2005 are most susceptible to coming back online as rental units. To determine the potential impact of condo "reversions," our analysis assumes that 50 percent of the units bought for conversion since mid-2005 will return to apartment inventory. Of this 50 percent, we assumed that half will be vacant at year end. We are also assuming that 30 percent of the new condos scheduled for delivery this year will be offered for rent, whether by developers or individual investors.



Sources: Marcus & Millichap Research Services, Real Capital Analytics, Reis

Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics, Reis, National Association of Realtors, TWR/Dodge Pipeline

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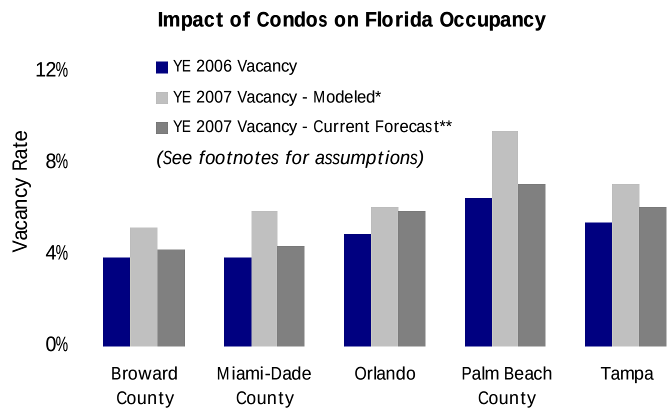
For the demand side of the equation, we took a conservative approach, assuming that the homeownership rate among new households formed in 2007 will fall in line with the current figure. The current homeownership rates, however, are bolstered by long-time residents who did not face the challenges that first-time homebuyers do today.

Based on the results of our analysis, it appears that the "gloom and doom" headlines as of late are likely overblown. There is, however, reason for investors to proceed with caution over the near term, as potential increases in vacancy came based on our assumptions came in between 70 basis points and 340 basis points for the year. These figures do not, however, take into account that vacancy rates already reflect some degree of condo-related supply corrections, or that homeownership rates among newly formed households are not expected to reach current levels.



In Miami, our year-end 2007 inventory forecast includes the addition of 2,000 units originally slated for conversion, almost 3,000 new for-rent condos and an additional 400 traditional rental apartment units. The resulting metrowide vacancy rate came in 50 basis points above the year-end 2006 figure, but at 4.4 percent would still be well below the national average. Based on our original assumptions, Broward County's vacancy rate should end 2007 in the high-4 percent range. However, growth in prime renter age cohorts in the metro area suggest renter-household formation should account for a greater-than-average share of growth, keeping vacancy in the low-4 percent range this year.

Due to its relatively small size and comparatively low share of renter-to-homeowner households, vacancy in the Palm Beach County market is most vulnerable to condo "reversions" or shadow stock. While the market could register an upward correction in vacancy of 290 basis points to 9.4 percent by year end, a much more likely scenario is that vacancy will rise by less than 100 basis points. To start, renter household formation in Palm Beach County is expected to come in above 22 percent, which represents the current share of renters in the market. By taking into account population growth forecasts for prime renter age cohorts, a more likely scenario is that vacancy will end 2007 at just over 7 percent.

Based on the large number of condo conversions and significant ground-up condo construction, rental supply corrections will inevitably affect vacancy rates in the major Florida apartment markets. Even when using somewhat conservative renter-household formation figures for 2007, however, all of the markets in our analysis should work through this year's condo-related supply additions within the next 18 to 36 months. While investors need to be cognizant of the fluctuations in vacancy that are likely to take place over the near term, they should not lose focus of the long-term outlook, which remains very favorable. In addition to land constraints in many Florida markets, home prices have skyrocketed in recent years, and even a moderate downward correction is unlikely to significantly improve housing affordability. Furthermore, would-be subprime and first-time home buyers are expected to find it increasingly difficult to secure financing, making it more likely they will remain in the renter pool.

**Assumes 50% condos purchased for conversion since 2Q05 return to apartment inventory, 25% are vacant, and 30% of new condo supply in 2007 is offered for rent. Current renter/homeowner household composition applied to household growth forecast for 2007. **Adjusted renter-household formation percentage for Palm Beach County, Tampa, Orlando and Fort Lauderdale (Broward County) based on current forecasts for household growth among the 20- to 29-year-old and 60-plus age cohorts.*

Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics, Reis, National Association of Realtors, TWR/Dodge Pipeline

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