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Q&A: NAI Chairman and South Florida Broker Neil Merin on Bubbies, Bubbas and Brightline

NAI/Merin Hunter Codman Exec Expresses Concern About Rise in Sublease Space

Neil Merin, chairman of NAI / Merin Hunter Codman, Inc.

In the 1970s, Neil Merin was making $160 a week running a production line for a toy manufacturer in the Northeast when he quit to move to Palm Beach County for a property manager position that paid 10 percent more.

The new gig would be short-lived.

"The company I went to work for down here went out of business six months after I joined, so I went and got a real estate license and started selling properties in 1976," he explained.

Merin would start West Palm Beach-based NAI / Merin Hunter Codman in 1982, and today he is one of South Florida's longest-tenured commercial real estate brokers.

While he handles all aspects of the brokerage industry, his specialty is the sale and leasing of office and retail properties. Just in the past two decades, Merin has represented tenants and landlords in negotiations totaling more than 30 million square feet and values exceeding $7 billion.

CoStar News: Why has there been so little new office construction in Palm Beach County in recent years?

Neil Merin: » There hasn't been a lot of new construction because the economics are difficult to justify. Rental rates that tenants are currently paying are probably not enough to justify new construction, for the most part. A few submarkets [PGA Boulevard in Palm

Beach Gardens and downtown West Palm Beach] have had significant increases in rents, and you're starting to see signs of new construction there.

Miami got to a point where it can start building three or four towers at a time, and they can get them leased up in four or five years. Normally a developer wants to lease a building up in 24 months after they open it. If Palm Beach County put up two or three buildings, we'd have 10 years' worth of inventory, or at least eight years' worth, and that doesn't work for anybody – except for the politicians and development officials who can tout that they have all this great office space. You have to be careful what you wish for.

I've been here long enough and been through enough cycles to know that sometimes if you have two or even three buildings going up at the same time in West Palm Beach, the whole market collapses because there's too much space.

Story continues below...

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How would you assess the state of the office market in the tri-county region?

» There's an interesting dynamic going on throughout South Florida. There were a lot of half-empty and empty buildings during the recession, and investors bought them fairly inexpensively through foreclosures in 2011, '12, '13, '14 and the beginning of '15. They leased those buildings up quickly, and at low rents, in order to get them full. So you have tenants in now paying rents that are well below market value because the market is now filled up.

We have about a 10 percent vacancy factor across all three counties, and I want to talk about

the historical nature of that number later. So tenants will start to roll over on the lease renewals, and they'll have to pay more rent. That's important from two aspects. One, that will elevate the rental rates closer to replacement costs. But two, it also means a lot of the buildings that were sold empty will sell again now that they're full. There's value in them to raise the rents. In general, investors don't hold properties for 10 years. This isn't New York. Owners do something to it. They get their juice out of it. They take their profit and move on.

So the impact of no new construction is the ability to keep raising rents and therefore increasing the value of existing buildings. But at the same time, keep moving those rents up to the point where new construction will be viable.

What notable office trends are taking place?

» I think the important thing to watch across South Florida is the changing nature of employment or the type of employers that are in the market.

I'll use as an example the western Broward County Sawgrass market. In the early 2000s, that market was dominated by telecom and the cruise lines. Today, if you go out there, most of that market is either involved somehow in the administration of medical or medicine and, unbelievably, software development. Those are two new big users, and they're big employers by people numbers. The wages are good.

Here in Palm Beach County, you're getting hedge fund guys moving here. There's a lifestyle here. There's also enough of them that they feel comfortable with each other. Biosciences is getting a little bit of interest. One of the other hidden drivers in Palm Beach County is aerospace, but not just Pratt & Whitney and the spinoffs from Pratt. Now I'm seeing innovative technology.

I think truly the concept of people being able to work or move companies wherever they want to has become apparent. Technology is part of that. Also the benefits of tax structure and climate.

I did a panel last week for Marcus & Millichap. Somebody from the audience asked, 'Why would people come to Florida?' Off the cuff, I said 'Because everybody's got a bubbie and a bubba.' Everybody's got a grandmother and a grandfather, an aunt, an uncle, a cousin who's in Florida. It wasn't true when I moved here in 1975. Today, everybody knows somebody

who lives in Florida.

The new Brightline train has started service to Miami and now connects the downtowns of West Palm Beach, Fort Lauderdale and Miami. It's scheduled to reach Orlando in the next few years. What kind of effect do you think the train will have on the commercial real estate industry?

» Brightline was really not built for you and me. Brightline was built on the concept of moving 10 to 15 million people a year from the Port of Miami to Disney World and vice versa.

I've ridden Brightline to Fort Lauderdale and back. It's really nice, very convenient. It will cost $40 a day round-trip between West Palm Beach and Miami. So it's not a commuter train. You're not going to spend $200 a week commuting. If I'm a high-powered businessman who needs to get to a meeting, I may look at it as a connectivity point, but if I'm a powerful businessman who's going to employ a lot of people, I'm not going to think it's going to move my employees around because it's just not built for that. Brightline will be a nice little extra shiny button we have, but I don't think it's going to have a major impact on our markets.

Some buildings will tout their convenience to Brightline. Office buildings built near the stations will have the advantage for high-powered attorneys who want to move between their offices, but I don't think it will be a primary factor why somebody locates to an office.

What are your biggest concerns for the commercial real estate industry?

» I'm sensing a slowdown in the expansion we experienced from 2015, '16 and '17. I pulled some CoStar numbers up last week, and I noticed we've had negative absorption for the fourth quarter and the first quarter in both Broward and Palm Beach County. I didn't look at Miami-Dade.

I also noticed the amount of sublease space expanded by about 20 percent in both counties, to the point where there's three-quarters of a million square feet more available without new construction. Because that data came to me a week ago, I haven't had chance to figure out why. I think that there may have been an over-exuberance in the expansion.

Getting back to the office vacancy rate, I've seen a lot of cycles and a lot of inflection points

in the market. When you're down to 9-, 8-percent vacancy, you have a lot of spaces that don't work for people. You don't have a 50,000-square-foot block here or a 10,000-square-foot block there. You may have 1,200 square feet here and 9,000 square feet there. So the choices get very limited, and rents start to escalate rapidly.

We probably can't live with a sustained single-digit vacancy factor in South Florida. Banks and economists would love it, but the truth of the matter is, it constrains our growth. And we are a growth state. There is a pressure that comes with a very low vacancy rate. Because we started this conversation with the imbalance that our rents are not ready to justify new construction, I'll finish by saying we could stymie growth for a while until the economics of office rents and construction become more in line.

Paul Owers, South Florida Market Reporter **CoStar Group**