

# Miami and The U:

*"The story of Miami's amazing condominium recovery.*

*It's party time again."*

**April 2012**

**Prepared By:**



**Craig A. Werley, CRE, FRICS**

President

305.613.5084

[cwerley@focusadvisors.net](mailto:cwerley@focusadvisors.net)

[www.focusrealestateadvisors.com](http://www.focusrealestateadvisors.com)

**Jim Fried**

Managing Director

305.938.8639

[jfried@aztecgroupp.com](mailto:jfried@aztecgroupp.com)

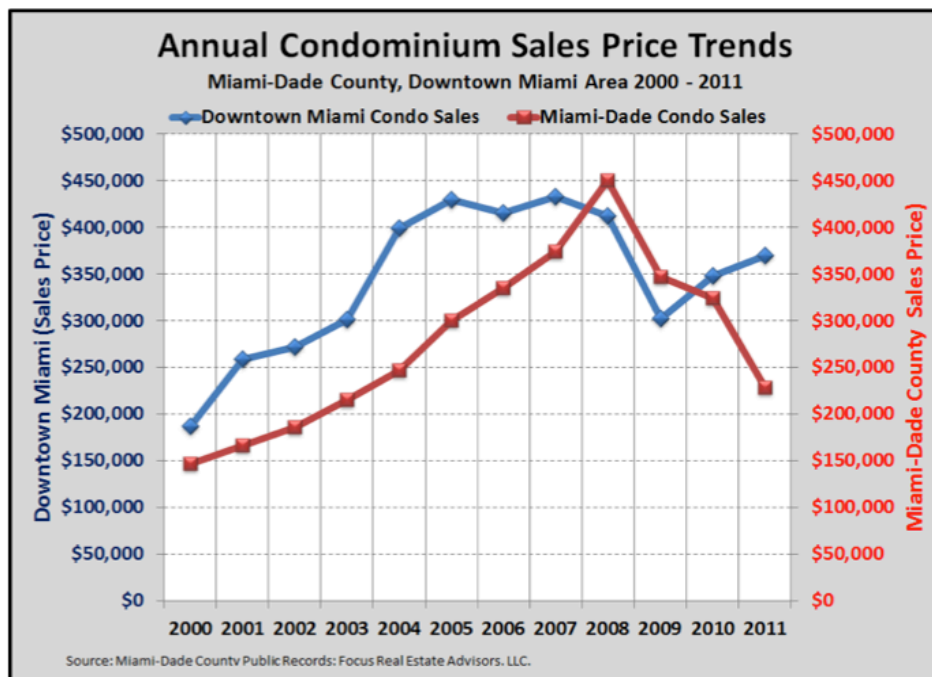
[www.friedonbusiness.com](http://www.friedonbusiness.com)

## Introduction

When Harvey Taylor opened his Publix in the area that has become known as Brickell Village the race was on. One of the world's last urban jewels was finally being developed to its potential. In February 2001 I penned an article for The Florida Real Estate Journal. In that article I said that Miami was about to watch its downtown go through a Manhattanization process.



Over a decade later I have been proven right. The Miami CBD and its surrounding neighborhoods have turned into an urban oasis. New grocery stores have opened, as have new restaurants. Now, almost all of the units that were developed in the “condo craze” of the last decade have been occupied and we’re starting to see significant price appreciation.

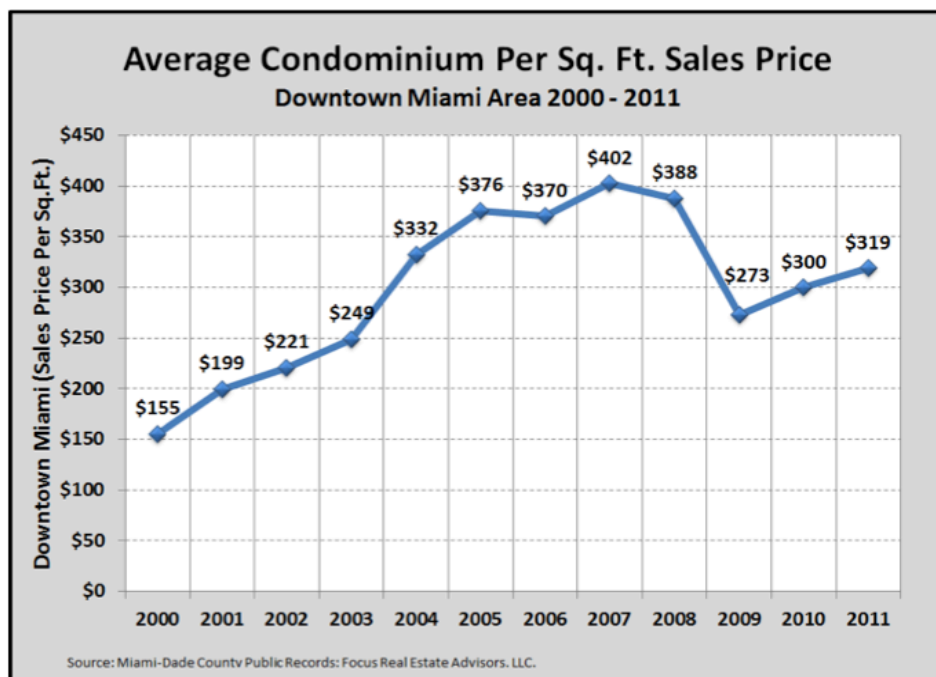


These condo dwellers can now walk to their place of employment, grocery stores and the neighborhood's finest restaurants. Residents can also take advantage of mass transit to public amenities such as the Miami Heat or Miami Marlins ballgames. Furthermore, they can hop on commuter rail transit and visit super regional malls offering a full array of consumer goods. Miami's downtown is realizing its potential as a walkable urban core.

We regularly discuss this topic on my [radio show](#) and our work at the [Aztec Group](#) is focused on taking advantage of this trend as well.

Given the significant changes within the City of Miami over the last decade I decided it was necessary to examine what occurred in the Miami market during the previous development cycle and what the lessons learned over the last 10 years can tell us about the upcoming cycle. As a result I wanted to make sure I had the definitive data source on the entire arc of the last 10 years of condo development in the Downtown Miami marketplace and therefore enlisted the assistance of one of my oldest friends, [Craig Werley](#) of [Focus Real Estate Advisors](#). He is the recognized expert on the Downtown Miami and Brickell area submarkets as Craig and his firm have just completed a recent [Occupancy Survey and Population Study for the Miami Downtown Development Authority \(DDA\)](#) which outlines keys statistics regarding occupancy levels and price points for condominiums in the downtown submarkets. He is the expert and has the data to prove it!

We call our effort Miami and the "U". We use the "U" as the symbol of our analysis for obvious reasons and because the trend in condominium prices, rental rates and all components of demand in the previous development cycle have taken a "U" shaped track since 2007. Many developers in the new project flow that is sweeping the Miami CBD markets seem to think that we're actually experiencing a classic inverted 'J' shaped recovery with significant upside still left in condo prices.



Craig and I reviewed the actual data and interviewed numerous developers and other stakeholders in the marketplace. The results of that analysis and those interviews are contained in the paragraphs and charts that follow.

## **Section I – How did we get here?**

The national developers arrived on the scene at the same time as national banks such as CORUS and I-STAR to create an unstable development environment very quickly. What started out as a market that had significant barriers to entry and few ready to go sites soon became a landscape of poorly located “development sites” that people from out of town and local amateurs were over paying for.

First, let’s examine how we got here. The last submarket bust was the tech boom and bust of the late 1990s early 2000’s. Many of the investors in that melt down lost everything. As they searched for their next investment they sought out vehicles, which would mitigate their risk exposure, thus putting 0% -20% down on a hard asset like a condo seemed like the perfect avenue. Both institutional and individual investors couldn’t resist the returns that conversion to condo and condo development created them. In Miami, high-rise residential real estate emerged as the leading investment vehicle given the potential for consistent long-term appreciation. Historically low interest rates and the use of easy to obtain credit greased the tracks for everyone.

In addition, mortgage backed securities (MBS) let the big institutions play too. Low yields on other investment alternatives made real estate just too hard to resist.

Greed infected the entire system from institutional investors, to the average investor to speculators looking to capitalize on the ability to obtain cheap credit and generate historically high returns.



## **Who was involved?**

In a word: “Everyone”, institutional investors, developers, the government, speculators and perhaps most importantly the lenders that were paid based on the volume and size of the loans they originated. Everybody had a hand in this mess.

- Institutional investors were driven by the need to find an investment vehicle, which would provide desired and required levels of returns. This resulted in a surge in the mortgage backed securities market. These instruments had little due diligence to support their investments. This resulted in an over extension of credit which led to a speculative residential investment frenzy. It reached a crescendo with widespread fraud facilitated by the lack of prudent and sound due diligence and underwriting standards.
- Developers were driven by the lure of cheap credit and easy access to it. This teamed with what is naturally ingrained in their DNA - a desire to build and generate financial returns regardless of the speculative nature of the investments. These conditions resulted in increased speculative development based on little to no due diligence or fundamental underwriting - a recipe for disaster.
- The US Government was driven by its political desire to increase homeownership in the United States. Local governments were motivated by budget deficits and a need to increase revenue. Local officials were motivated by increases in property taxes as exemplified by the fact that they approved almost any project if you had the right land use attorney. The government agencies (whether national or local) did not realize – or perhaps did not care about the fact that they were creating and perpetuating a very unstable situation.
- Speculators were driven by low the cost of credit and reduced underwriting standards. This combined with an investor’s ability to leverage existing assets and the potential to make extraordinary returns fueled a fever. The market became bloated with unqualified and inexperienced investors with little to no regard for supply and demand fundamentals. The overriding belief was that “flipping” residential contracts was a viable way to achieve and maintain wealth.

I have two favorite stories, which best exemplify the market cycle at this point.

The first involves my brother-in-law who lives in Atlanta and came to visit me in Miami one day. He went out on the balcony of my bay front high-rise and pointed to the horizon and asked me to point out the location of a specific condominium building. When I inquired why he told me that his dentist just bought four units at the project and he was considering buying some as well. The point – inexperienced investors drove price appreciation and demand without an in-depth knowledge of market fundamentals and desire to “get rich quick”.

Another true story - One day a client and I made an offer of \$18,500/unit for water front land, which was accepted in principal. The next business day the owner of the land called and informed us the offer was being rejected because he had just received an offer of \$50,000/unit. My client exited the market for good at that point and promptly put all of his sites up for sale. The point - uncontrolled greed and a lack of fundamentals had completely taken over the marketplace!

### **When did all this happen?**

1999 – 2006 - My experience in this market cycle began in 1999 when I met my first out of town apartment developer. He came to town looking for high-rise sites. Up until that point Miami was a market dominated by local entrepreneurs that built high-rises and some local and regional firms that built suburban apartments.

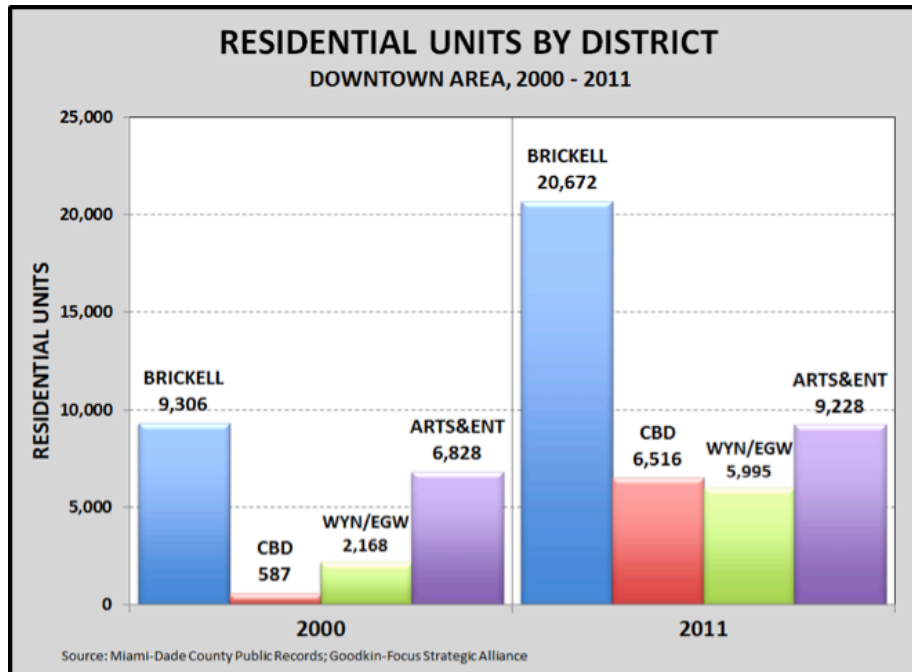
- Early 2002 - Projects were in the ground
- 2003 - The run-up was in full force

- 2005 - In Miami-Dade County condominium sales volume peaked in 2005.
- 2008 - A reflection of the highly localized marketplace, the extraordinary boom in new construction and the long time frame to deliver a huge high rise multifamily building - condominium sales volume in the downtown Miami peaked in 2008 at the same point as U.S. home buying activity was descending to historic lows.

**Where did this occur?**

The oversupply occurred all across Miami-Dade County but was concentrated in the downtown submarkets of: Wynwood/Edgewater, the Arts and Entertainment District (the Omni area), the CBD (primarily in bay front locations) and in Brickell/Brickell Village.





### Why did this occur?

It occurred for number of reasons including:

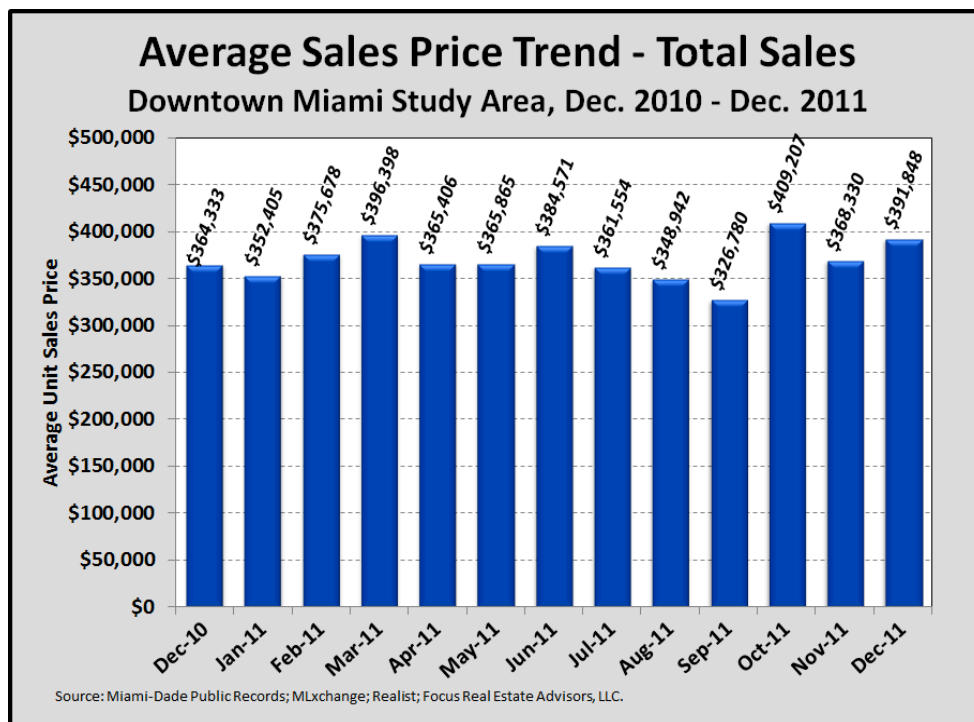
- Credit was cheap and easy to get. This resulted in the size of the pool of buyer being increased dramatically. Little or no deposits were required. Little or no credit history was required. This led to huge demand, which in turn led developers to do what they do - build to meet the demand, albeit speculative. With high-rise condominiums being the preferred product type supply was being delivered in large chunks. When demand fell off to nothing much of the supply was still under construction. A disaster in the making.
- Key fundamentals of institutional investments including the use of strong underwriting standards were sacrificed in an effort to increase investment volume. Lenders would take in certificates of deposit from across the country and then deploy them into risky high-rise development loans. Both I-Star and Corus Bank were crushed by this strategy.
  - By ignoring fundamentals the institutions extended credit to borrowers that were not qualified. The business decisions were based on faulty assumptions, which were based on market aberrations that were described as a shift in paradigm- RED FLAG!
- Speculators ruled the day. Investments were based upon greed and appearances rather than an understanding of the market fundamentals. Limited market analysis was done and any that was done was based on statistics that were flawed. ***The facts were skewed because so many transactions were fraudulent while others were made by households that would not sustain any increase in payments once the initial low interest teaser rate burned off.***

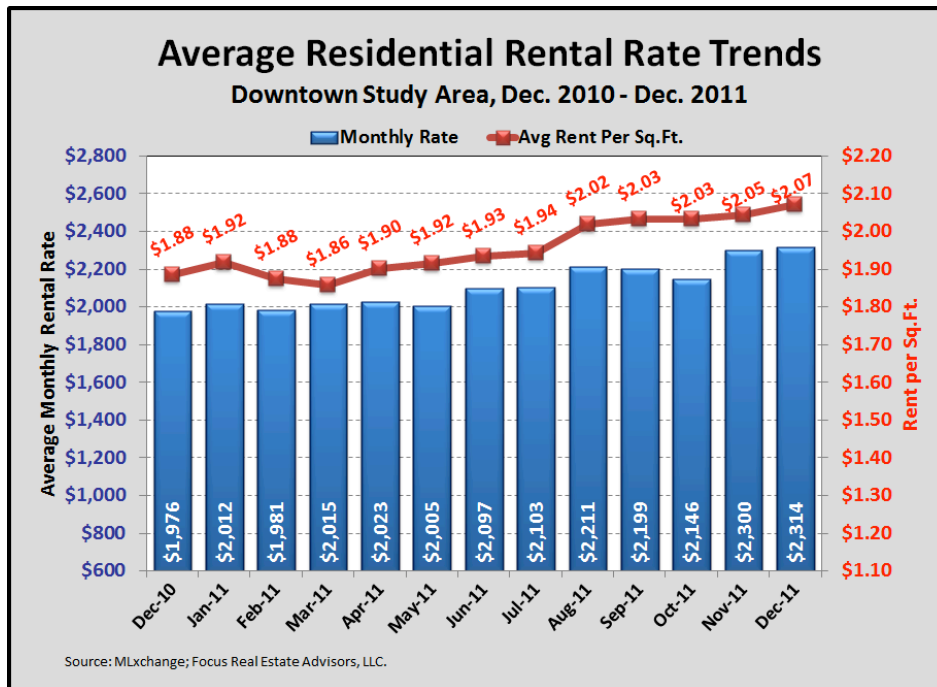
Eventually the market began to stall and a clearing process took effect. As prices dropped investors (those using sound fundamentals) began to realize the downtown Miami submarkets were ripe with value plays and as a result purchased

vacant and distressed units. Cash purchases by both domestic and foreign investors placed further pressure on prices, which led to an increase in investors in the marketplace. Savvy individuals acquired the condo units and began to realize lease/rental rates that allowed them to cover their mortgage payments. The fact that the financial markets were in trouble and credit was essentially frozen did not matter to the foreign unit buyers, as cash was king once again.

**Where are we today?**

Submarkets in and around the Miami CBD have reached normal stabilized levels of occupancy - approximately 94% today. Sales prices and rental rates have experienced year-to-year increases. Sales prices have increased 11% on a year over year basis and rental rates have increased more than 13% on a year over year basis. "The market is responding favorably to our strategy of making improvements to the properties to achieve market pricing. We are not "dumping" units - rather we are getting solid pricing as we successfully execute our strategy." - Victor Ballestas Regional Manager - [ST Residential](#).



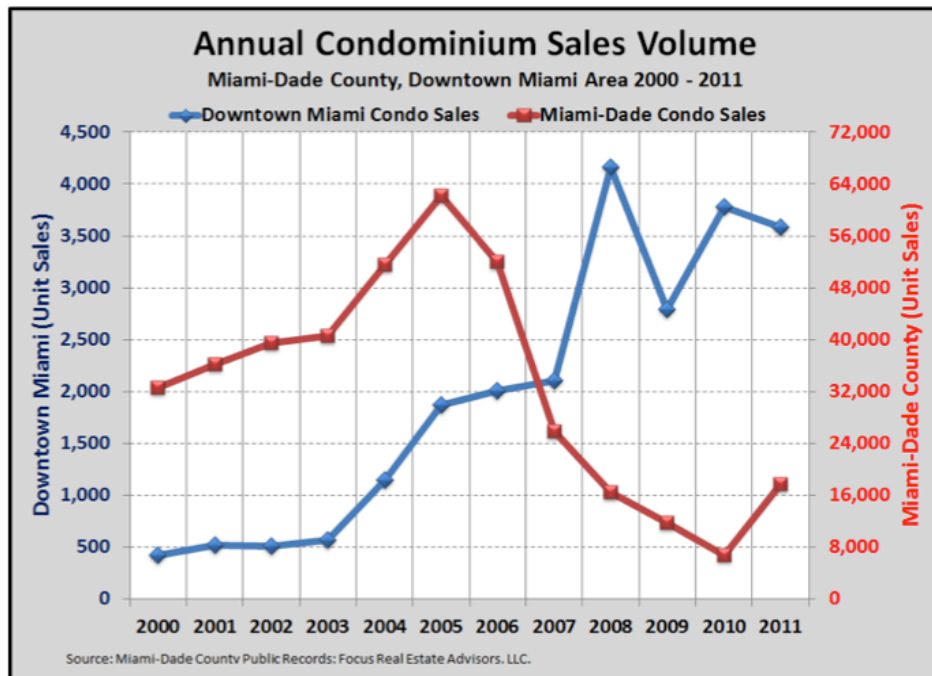


### Where is the momentum taking us?

With residential sales and rentals in the downtown area continuing to be in strong demand and limited remaining inventory the next step is coming into focus, new development.

New proposed projects that would include both rentals and sales concepts are being announced with great frequency. To date our research shows over 3,500 proposed new units across the Miami submarkets that incorporate downtown. "The market in and around the CBD is about 95% sold - new buildings and resales are approaching and in some cases exceeding 2005 price levels. I am very bullish on Miami's future and I have a perspective of 60 years in the local market" – Tibor Hollo; President [Florida East Coast Realty](#).

A number of these projects are ones that didn't get off the ground in the previous cycle and some new sites as well. In a period of a little over 2 years (2010 to early 2012) the market went from completely ignored, to totally overheated, to now being too expensive for most players to make sense of the numbers. Given the limited inventory of remaining unsold new product available, the market has clearly begun transition into the next market cycle.



This time however it looks like the financial institutions and developers may actually hold the line for a little while on new supply. It's difficult for anybody but the most experienced and well moneyed investors to get any type of capital or construction loan. Most of the new condominium developers are using a development capitalization model with historical roots in Latin America. They are requiring a buyer to use his cash in the form of huge deposits to finance the development.

**What does the future hold?**

With national trends continuing towards urbanization, the central core of Miami is positioned to continue to become one of the wonderful live/work environments in the world.

With jobs, shopping and mass transit available, the urban core of Miami will continue to grow and evolve. Discussions of a commuter railway linking Florida's eastern coastal cities to downtown Miami finally seem to be seen taking shape. "As long as the offices and retail continue to be developed and occupied there will be a demand for multifamily in Miami's urban core. In Miami, people now look at location relative to accessibility to office, retail, and transportation in much the same way they looked at waterfront locations in the past. This is like most modern cities in Latin America. Investors are still buying all cash and making money. Demand will continue as long as these dynamics remain in place. We are having excellent sales pace at our [Millecento Project](#)" - Carlos Rosso; [Related Group](#).

In the long-term Miami is continuing its evolution into the urban core that many metropolitan areas such as Manhattan, D.C., Boston, San Francisco and Chicago, all possess.

Will all the current uses soon be joined by gambling? Stay tuned.....