THE REAL DEAL

June 2007

Vultures circle over Miami

Investors say condo market hasn't bottomed yet

By Steve Cutler

With home sales in South Florida stagnant, inventories swelling and foreclosures rampant, large institutional investors should be poised to grab some incredible bargains by taking unsold condo units off developers' hands in bulk.

Not quite yet, say real estate analysts.

"We're all sitting on a volcano that's ready to blow at any minute," said Jack McCabe, whose Deerfield Beach-based firm, McCabe Research & Consulting, advises high-net-worth investors. "But the deals out there don't make sense yet."

That premonition is echoed by Glenn Caddy, whose Fort Lauderdale-based firm, Madison International Venture Partners, invests principally in pre-construction and condo conversion properties. "You can get good deals now, but I think you can get better deals in about six months' time," he said.

Market-watchers say institutional investors and hedge fund managers are visiting South Florida to research alliances, but that so far few deals have been made.

As depressed as south Florida's residential situation is, it has yet to find its bottom. There's an expectation that in the not-so-distant future, a wave of defaults will occur among people who bought properties but can no longer afford to close on those deals, or because buyers will choose not to take ownership in a declining market.

"Do you buy at 75 percent of perceived market value when next year it may put you in a position where you're losing money?" McCabe said.

Some see this period as a moment of great opportunity. Analysts say that regulators are beginning to pressure lenders and any institution that has bad debt. Because banks don't want to have foreclosures on their books, they are energetically trying to move their underperforming assets.

Real estate indicators in the Miami area are down across the board. Condo sales have dropped 45 percent over a year ago, and prices are down 18 percent compared to this time last year, according to the Miami Herald. Second-home sales, a multibillion-dollar industry in South Florida, fell by 20 percent in 2006.

Analysts expect that a large number of foreclosures will continue to put downward pressure on prices of new and existing homes. Fort Lauderdale and Miami are the cities that top the list of national foreclosure rates. There were 987 residential foreclosures in Miami in the first quarter of 2007, according to PropertyShark.com, a 31 percent increase from the fourth quarter of 2006.

All this means that there might be particularly good possibilities for investing in foreclosures, because struggling lenders are trying to get properties off their books.

"Once the word gets out that a lender has sold a portfolio or a new condo development project sells at sub-par debt value, that's going to be the kicker," said McCabe. Sub-par debt value refers to when lending banks are forced to sell properties for less than the amount they originally loaned to build those condos. "I think it's going to open up a floodgate of deals."

According to Lewis Goodkin, president of Goodkin Research Corp. in Miami, "Sales have largely come to a halt, but everybody is being quiet. If a guy is sitting with a new condo building with 300 units and he's got 200 sold [but not yet closed], he doesn't want to do anything to upset those 200 buyers. The last thing he wants to do is tell everyone in the market, 'come in, and we'll discount our units to you.' He's trying to keep those people in place."

So far, instead of slashing prices, overstocked developers are offering to pay the first year's mortgage principal and interest for new buyers, upgrade units, pay home association fees or offer perks like a two-year lease on a Mercedes at closing. Brokers are sometimes being offered 8 percent commissions to move units.

"The problem is," said McCabe, "everybody's offering the incentives, so they're really not working and haven't increased sales."

The majority of the condo towers built during Miami's boom years will be completed in 2007 and 2008. These comprise roughly 20,000 units. A large number of these condos -- some analysts say up to half -- were bought by speculators who paid deposits but who will very likely walk away from their deposits.

"The smaller investor will be able to buy some bulk units at the end of the cycle, where we've had closings, and see them significantly discounted by the builder or the lender," said Goodkin.

The large investment groups Goodkin works with, he said, tend "not to buy a building from a developer, because there's not enough a developer can do to make it attractive. They're looking at the lender side, as opposed to waiting for the individual buildings to go under. They buy significantly discounted loans from lenders."

Some enterprising real estate professionals have begun preparing for the impending investor onslaught, creating vehicles to match buyers with desperate sellers. "We started in 2005 to position ourselves for this situation," said Peter Zalewski, principal of Condo Vultures. Condo Vultures is a firm that provides market intelligence on over-leveraged owners who are desperate to sell. It offers subscribers access to a database of South Florida court foreclosure listings and homes that have been on the market for at least 100 days and have gone down at least 10 percent, or $100,000, in asking price.

"I'm working with three funds from around the country who want to buy in Florida," said Zalewski. "They see what the demographic projections are [and they] see it as a three- to five-year hold if they can come in at least 30 percent below appraised value."

In 2005, when the last census was done, the population of the three counties that make up the greater Miami area was 5,007,000. That population is projected to rise to 7,429,000 by 2030. Miami currently ranks second in the world (and first in the United States) for the most buildings under construction that will be taller than 500 feet, with 22, according to an organization called the Globalization and World Cities Study Group.

"Those funds are looking for an inexperienced developer who got his hands on some land or an apartment complex and once the market collapsed, his mezzanine loan is coming due, and he's not able to refinance," Zalewski said. He said a fund from the Midwest recently talked with developers considering selling their interest in properties in Orlando, Miami-Dade and Palm Beach counties, and looked at homes that belong to lenders who have foreclosed on their owners.

Properties "are a spectacular opportunity now," he added, citing banks' efforts to get foreclosures off their books.

Zalewski figures the residential market will be stagnant for a year or so, find a bottom and begin a very gradual improvement by 2009 and 2010, "as it gets closer to equilibrium in terms of supply and demand."

Meanwhile, he helps to nudge it to the bottom.

Condo Vultures' database helps locate clusters of distressed sellers, he said, "and once we figure out where the clustering is, we try to pit the guys in trouble against the other ones who are in trouble and create a selling frenzy."

Once a lowball sale occurs, the race to the bottom begins, and, said Zalewski, "If they don't sell to us cheap, somebody else will."

Most hedge funds are taking their time before sinking their teeth into South Florida real estate. "They're kicking the tires," said Zalewski. Still, there have been some notable market plays lately.

In March, billionaire financier Carl Icahn offered $22 a share -- $965 million -- for control of WCI Communities, a luxury home builder with hundreds of condominiums along the Florida coast and 10 new residential developments set to open this year. Despite plunging sales orders, WCI's management asked Icahn to boost his bid.

Meanwhile, the commercial real estate market has been humming. Vacancy rates in the office market are 3 to 4 percent in most of Miami-Dade County, compared to 20 percent three years ago.

Some commercial investors think the run-up in the residential market was based on bad fundamentals.

"I don't call people who invested in residential 'investors,'" said developer Ron Gottesman, principal of NR Investments. "I call them 'gamblers.' Investment is based on income, and the residential speculation was never backed up by income."

Gottesman recently sold off some of his portfolio and is putting his money into the commercial market. He recently purchased Park Centre, a 58,000-square-foot office building in the new city of Miami Gardens, and intends to put another $2 million into renovations.

Few residential developers are buying land these days, despite declining costs. Due to the oversupply of condominiums, said Michael Lerner, principal of MCZ Development, "we haven't seen a lot of opportunities for developers -- unless you're in the land-banking business." Lerner is referring to the practice of amassing properties for future use.

MCZ did make a purchase in 2006, buying the massive, two-tower, 16.5-acre Flamingo South Beach condominium resort, which it is renovating. Lerner feels Miami Beach is a special market, though.

"There's not going to be any more product built there," he said.
