



Multifamily developers take a long-term view of Florida

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Operating results look to ebb, financial profiles will weaken modestly and location will be critical in assessing the strength of multifamily REITs. So says Fitch Ratings.

On one hand, multifamily REITs will benefit from tenants who cannot afford home ownership. On the other, a slowdown in job growth may negatively affect apartment demand.

Compared with much of the rest of the nation, REITs operating in Florida are experiencing more favorable conditions, with low unemployment rates and still high housing rates in key markets, albeit soft rental conditions. Florida's long-term prospects are still strong, and multifamily investors and developers are taking a long-term view of the opportunities.

"Florida is in a correction," said Alan Kaye, managing director for Sperry Van Ness Commercial Realty's Kaye Commercial Investment Group in Fort Lauderdale. "We're back to market fundamentals, but there's still a lot of money coming into the state, and there remains a high demand for well-priced land for development."

Some call it a correction, others call it a shake out. Perry Reader, president of Crosland LLC's Florida Division, falls into the latter group. "Between the condo conversions to the reversion back to rentals, there is a lot of confusion in the market," he noted. "The good locations are still going to rise to the top, despite challenges from rental rates and the capital market."

Crosland LLC, a Charlotte, N.C.-based residential and commercial real estate developer, recently formed an investment fund - with Northwestern Mutual as its partner - that will make an equity commitment to enable about \$225 million of land acquisition, as well as potential land and vertical development totaling \$1.5 billion.

Reader clearly sees multifamily opportunities in Florida. "I don't think that gas prices are going down, so the demographic of people who are entering the workforce or expanding families are still going to be look for locations close to work," Reader said. "They might consider mass transit if it's viable or car pooling from a denser location where multifamily exists."

The way Steve Pogarsky sees it, the multifamily opportunities are where they have always been: in fundamentally strong real estate locations with high-quality physical assets. Seasoned REITs, said the vice president of acquisitions for Madison Apartment Group, the multifamily operating arm of Philadelphia-based BPG Properties Ltd., know where the opportunities are.

"Failed condos is a potential opportunity but a challenging opportunity," Pogarsky said. "There will be distressed sellers whose loans are coming due. They won't be able to get the same proceeds when their interest rate resets. That will create some buying opportunities of quality projects."

Jeff Morris, a managing director in the Orlando office of Jones Lang LaSalle Capital Markets, a integrated real estate and investment management firm headquartered in Chicago, is optimistic about the next wave of development in Florida. With a dearth of newer luxury product resulting from the condo conversion phenomenon, he explained, there is a gap in the rental market.

"When growth does pick back up, new luxury multifamily projects will meet with a lot of success," Morris said. "There are also lots of opportunities to buy apartments below replacement cost. If you look back over any stretch in the last 30 years, if you had an opportunity to buy a well-located, functional apartment product at below the then-current replacement cost, you would have, in all cases, been very successful."

There is also an opportunity to once again develop - or acquire - in prime locations across the state. Kaye recently sold a site in Orlando just outside of Disney to an experienced Orlando apartment developer who plans to build 350

market-rate rental units. The site was planned for condos, but was abandoned when the market slowed.

“As the market exploded, there was a move into secondary and especially tertiary locations,” Kaye said. “People are now leaving those locations and trying to find deals in the primary locations, especially failed deals or deals that have had some problems that can be corrected.”

The predictions for 2008 are scattered. Some multifamily industry watchers see the market correcting itself by mid-year. Others predict a roller coaster, with a gradual return to more vibrant market conditions. Still others don't expect to see much change until 2009, thanks to an exodus out of the state that's driving down the demand for real estate.

“Nationally, we expect transaction activity this year to be down 35 to 40 percent. But Florida is ahead of the curve there,” Morris said. “Transaction activity in some places in Florida last year was off 75 to 80 percent from 2005 levels. In the face of a weakening national economy, I don't think we are going to see a lot of change in 2008, but we should see more transaction activity.”

The unknown is the impact of the shadow market. Kaye predicted it will take two years to burn off the oversupply. The smart money, he said, is rushing to buy market-rate rentals and market-rate developments with a long-term view in mind. The bank pricing rates are a second unknown in the coming months. If the banks start to drop prices, it could push values a little lower for the short-term. “Florida is still a great state; so many people are coming here,” Kaye said. “We just over-bought.”

Some multifamily developers are looking even further down the road to Florida opportunities. “We think there is opportunity for us in a few years to find sites that can be developed into mixed-use projects with a strong sense of place. It's not just a shopping center on this corner, multifamily on that corner, and a little bit of office sprinkled somewhere around it. Strategic areas will have charm and social aspects that make it sustainable,” Reader said. “That's the focus of our fund.”

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