

Does the Return of the Cranes Signal a Housing Revival in South Florida?

The presence and health of birds often signal the health of an environment. An abundance of waterfowl, for example, can signal that the surrounding wetlands are healthy. An unhealthy canary in a coal mine indicates the presence of toxic gases. One “bird” that indicates the health of the real estate development industry is the construction crane, and it appears to be making a comeback.



After what many considered an overpopulation of cranes and high-rise condominiums during the housing boom, the construction crane nearly vanished from the South Florida skyline during the Great Recession. During the peak of the South Florida construction boom, 147 cranes filled the Miami skyline. Now there are four.

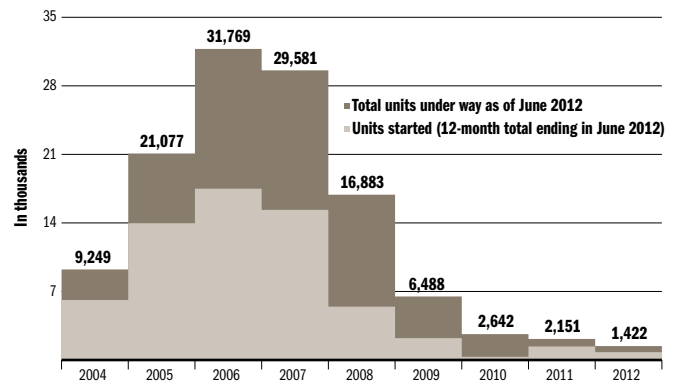
But it appears that the South Florida crane may be making a comeback. According to Ron Shuffield of Esslinger-Wooten-Maxwell Realtors International, “Thirty buildings have been announced. At one point [last cycle], there were approvals for 60,000 condo units, but only 23,000 units were actually built. Many of the deferred projects are now getting built.” In addition, a Miami city commissioner recently gave a press conference during which he projected that 17 cranes will be assembled in the downtown area by the end of 2013, most of them to be used in building condominiums. (See the sidebar for a look at the state of rental properties in the nation and South Florida.)

In Miami-Dade and West Palm Beach counties, condo completions peaked in 2007 at 16,220 units, then fell to 1,140 units completed in 2011, according to CBRE Econometric Advisors/ Dodge Pipeline (Pipeline). Currently, 1,422 units are under construction compared to 29,581 under way in 2007 (see the chart). Altogether, as of June 2012, the number of units in South Florida in some stage of planning stands at 8,263—an increase of 26 percent over June 2011, though still a far cry from the 73,150 units on the drawing board in June 2005, according to Pipeline’s numbers. While not all of the units in the planning stages will ever break ground, it seems that the mood has changed as more projects are being considered. (See the sidebar for a picture of how sales of new and existing properties are faring.)

Fueling at least some of the recent and projected condominium construction in Miami is renewed in-migration to Florida. After experiencing a dramatically slowed period of population growth postrecession—down to about 140 people a day—Florida

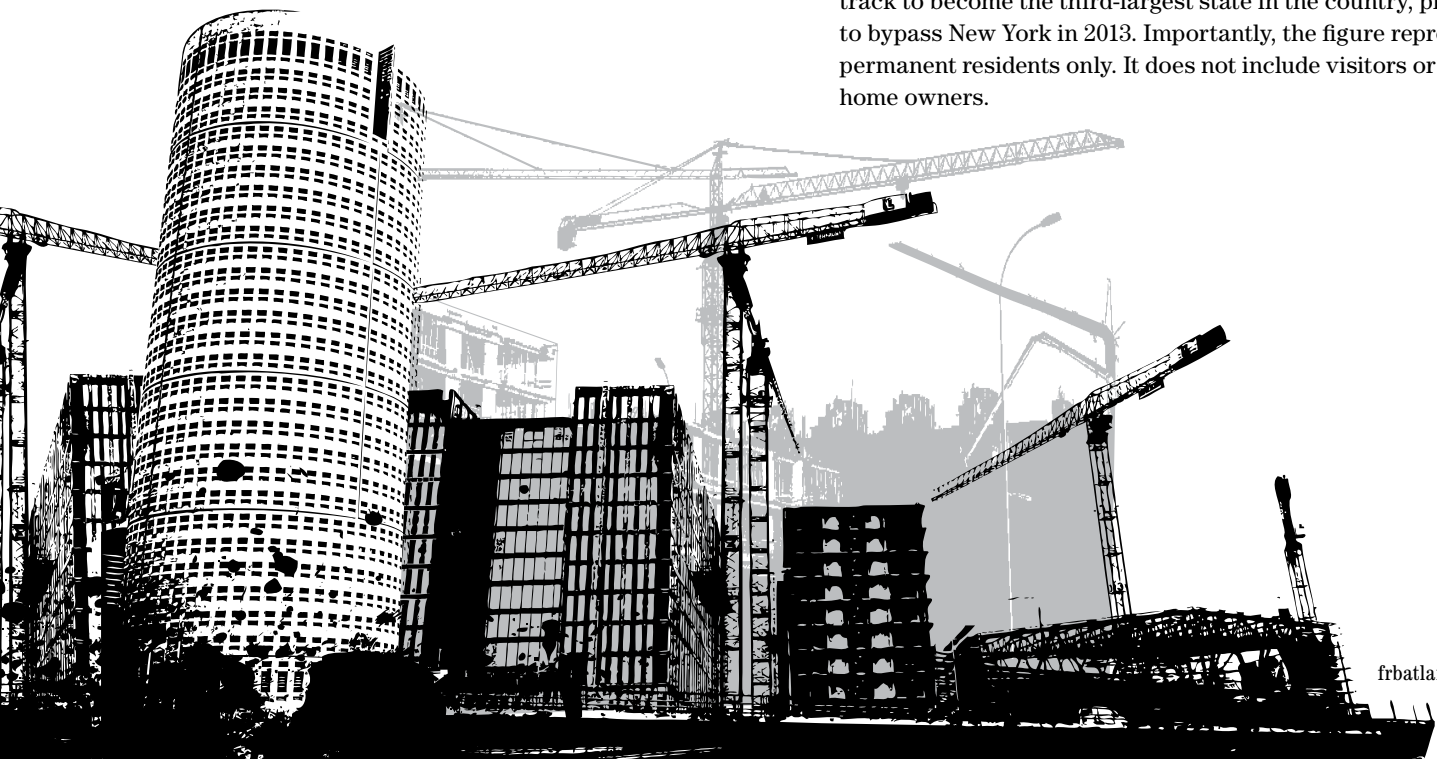


Condo Starts and Total Under Way: Miami and West Palm Beach



Source: Dodge Pipeline (via C.B. Richard Ellis Econometric Advisors)

is seeing significant growth again, of about 700 net new residents a day, according to Shuffield. (See the second-quarter 2011 issue of *EconSouth* for a discussion of Florida’s population slowdown.) With a population nearing 20 million, Florida is now on track to become the third-largest state in the country, projected to bypass New York in 2013. Importantly, the figure represents permanent residents only. It does not include visitors or second-home owners.



Trading Down and Out: A Quick Look at Recent Rental Market Trends

Over the past few years, the occupancy rate for multifamily properties has by industry standards remained high, hovering at around 94 percent. Strong demand for multifamily rental units has been driven by both demographic trends and the recent housing crisis. To be more specific, household formations by the cohort that is between 24 and 34 years of age and dampened buyer sentiment coupled with tight underwriting standards have combined to create a strong demand for multifamily rental units. (Listen to a podcast with housing expert Ron Johnsey from Axiometrics, available at frbatlanta.org/podcasts/.)

As a result of these strong occupancy trends, multifamily rents have been increasing steadily. However, annual rent growth has been moderating for Class A properties at a national level since the summer of 2011. Rents for all asset classes are now growing between 4 percent and 4.9 percent (see chart 1). While there has been a pickup in the amount of new apartment units in the planning and construction pipeline, not that many new units have been delivered to market.

If renter demand is strong and the supply of multifamily units has not changed much, why then is effective rent growth slowing? The prevailing thought is that one of two factors has contributed to this trend. Renters are either “trading down” from Class A properties to Class B and C properties, or they are “trading out” of multifamily altogether. By trading down, renters choose to forgo the newer, more expensive properties with more amenities and nicer finishes in better locations and instead opt for the older properties that often have fewer amenities, stan-

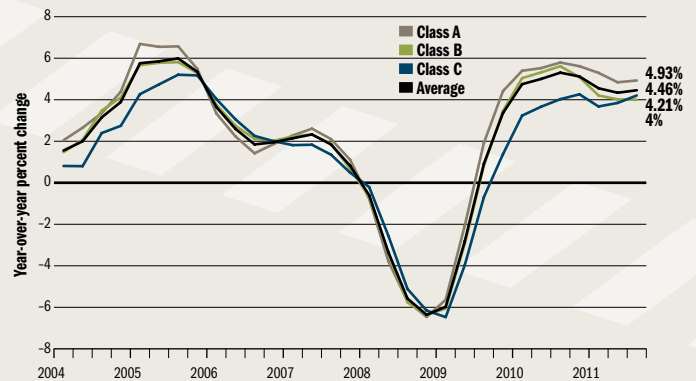
So, the news, at least for South Florida, appears good. Population growth is picking up, and the cranes are returning. But has the environment changed enough that South Florida will avoid another overpopulation of cranes? Could money searching for yield in our current low-interest-rate environment fuel another boom-and-bust? The big question is whether the changes in construction financing as a result of the crash are sufficient to prevent a repeat of the crash that nearly wiped out the crane population. Indeed, financing conditions as well as international demand and population growth are the major factors influencing South Florida condo recovery.

Financing then and now

During the last cycle, a typical condo buyer might have been asked to put down a 20 percent deposit, the developer would bring 10

Chart 1

Effective Rent Growth by Multifamily Asset Class for the United States



Note: Data are through second-quarter 2012.
Source: Axiometrics Inc.

dard finishes, and less desirable locations, and they therefore offer less expensive rent. By trading out, renters essentially decide that it makes more sense, in terms of costs incurred, to either rent a single-family home or become a homeowner.

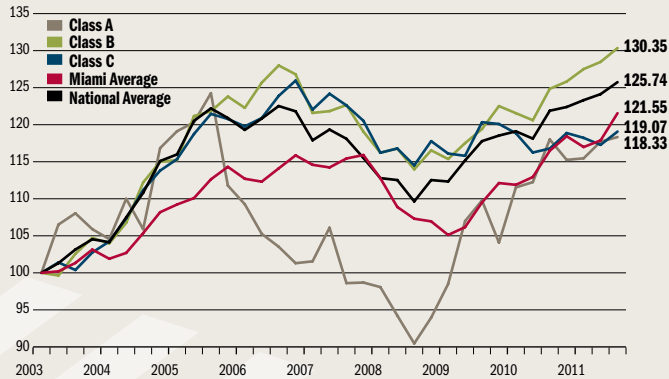
South Florida is no exception

The glut of distressed high-end condominium units in South Florida led many developers to rent their unsold units. The impact of this effectively added to the supply of Class A rental units, which is reflected in Miami’s rent performance. Rent revenues for Miami Class A properties fell from 2006 to mid-2009 in the face of competition from condo rentals. Class B and C rentals, which are not close substitutes for high-end condo rent-

percent equity to the table, and the remaining 70 percent came from debt financing generally in the form of a bank loan. When the construction financing was acquired, building would commence. Early in the cycle, it was not uncommon for a condo unit to sell several times before it was completed—and with each flip, the price typically increased. If there were problems, they were unlikely to arise until the project was completed and it was time to close. But when the market turned and condo prices were no longer increasing, buyers had little incentive to close, given the relatively small deposit that they had put down. Many buyers walked away.

Buyers now seem ready again to enter the market. Peter Zalewski of South Florida’s Condo Vultures Realty says, “There has been no change in mentality between this cycle and the last. People are still buying and retrading as soon as it makes sense for them to do so. The only change is the lack of financing avail-

Chart 2
Miami Market Effective Rental Index by Multifamily Asset Class



Note: 2003=100. Data are through second-quarter 2012.
Source: Axiometrics Inc.

als, fared much better during the recession (see chart 2). More recently, as condo inventory fell, rents have rebounded, increasing 14.4 percent from July 2010 to July 2012.

The past several years' distressed housing market—including the limited access to financing—may have forced many residents (and visitors) into renting. The now-flourishing rental market may be helping to bolster condo development, as the sharp growth in rents may be causing some consumers to reconsider alternatives such as trading down to rent a cheaper multifamily unit or trading out to rent a single-family home or to pursue homeownership. ■

able and the increased amount of skin in the game." So how is this change manifesting?

Construction lending of all forms, including condo construction, at all commercial banks peaked in 2007 at \$560.3 billion. As of December 2011, construction lending stood at \$221.6 billion, a 60.5 percent decrease. Net construction loan charge-offs since 2007 total a whopping \$69.8 billion, compared to \$1.6 billion in the period 2000 through 2006—a period that also includes a recession. For Florida community banks in existence since 2007, construction lending fell from \$10 billion to \$3.8 billion by December 2011—a 60.2 percent decrease. These numbers are consistent with banks being much less willing now than they were before the housing bust to participate in financing construction projects.

Given banks' lack of enthusiasm, most projects that hope to get under way must find a different financing formula. One alter-

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native is for the builders and buyers to commit funds up front. For example, a buyer may bring anywhere from 30 percent to 80 percent to the table and then pay in increments as the building moves through the development process. The developer brings 20 percent to the table.

Of course, exceptions to the lack of financing are out there, but they only serve to demonstrate the special conditions under which financial firms support condo projects. Anecdotes from Atlanta Fed contacts in South Florida reveal some creative approaches to financing some of these projects. One such story describes a builder who obtained financing by putting up his art collection to secure a bank loan.

Other than a few special cases, though, players in most projects have to "play with their own money." Such pay-as-you-go financing serves to limit speculative excess in that as

A Time to Plan?

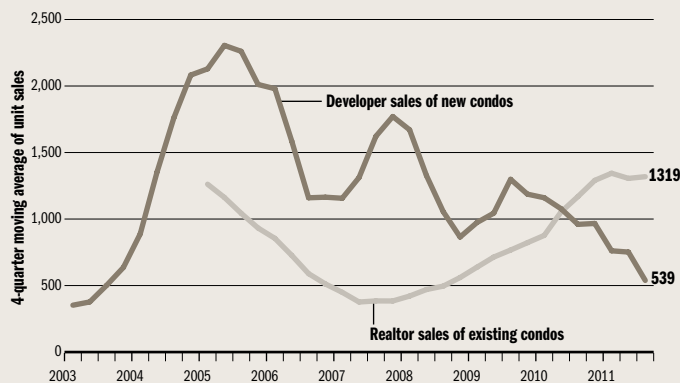
The 26 percent year-over-year increase in South Florida condo units in various stages of planning seems justified given recent construction and sales activity. Though an increase in condo prices may induce additional existing condos to be put on the market, short-run conditions are consistent with the idea that the inventory of readily available condos is low relative to demand. Given the ongoing international demand for South Florida real estate, indications that cranes are migrating back to South Florida are a welcome sight.

The disappearance of cranes during the Great Recession meant that little new construction was underway. In the 12 months ending in June 2007, just before the financial crisis, 15,334 condo units were started in Miami and West Palm Beach, and an overall total of 29,581 units were under way. During the subsequent 12 months, only 5,447 units were started, and the total number of units under way had fallen to 16,883. As of June 2012, only 800 units were started during the past 12 months, for a total of 1,422 units under way.

In line with the lack of new condo construction, developer sales of new condos have continued to fall while sales of existing condos have been on an upward trend. Since January 2009, active listings of condos and townhouses have been on a steady decline and pending sales have trended upwards (see charts 1 and 2).

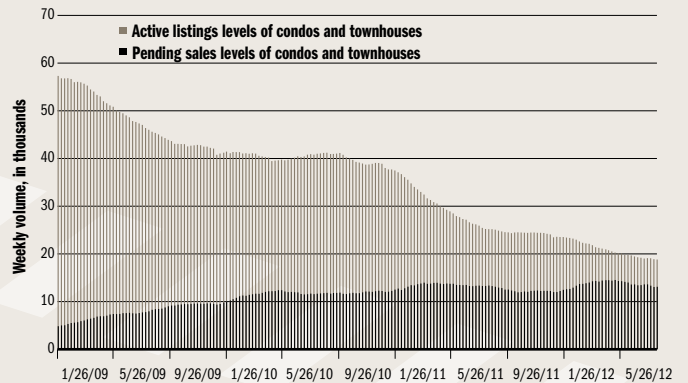
More broadly, housing prices in South Florida are rebounding. June year-over-year price growth by ZIP codes for the Miami, Fort Lauderdale–Pompano Beach metropolitan statistical area indicates that most regions are experiencing positive growth (see chart 3).

Chart 1
Sales of New and Existing Condos in South Florida



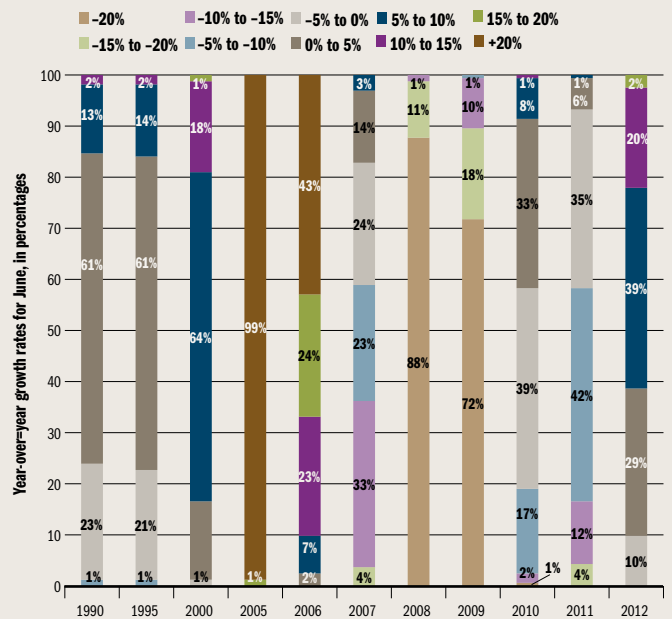
Note: Data are through second-quarter 2012.
Sources: Miami Association of Realtors and CondoVultures LLC/MLS Multiple Listing Service

Chart 2
Active Listings and Pending Sales in South Florida



Note: Data are through August 13, 2012.
Source: CondoVultures LLC / MLS Multiple Listing Service

Chart 3
Miami–Fort Lauderdale–Pompano Beach Metropolitan Statistical Area



Note: Data reflect the percent of ZIP codes per range of house price index change, N=163, and are through June 2012.
Source: Federal Reserve Bank of Atlanta calculations based on data provided by CoreLogic

Overall, conditions appear to be favorable to new development especially in light of sustained demand for condos combined with the dearth of new condos, the downward trend in active listings, and upward movement in pending sales of condos and townhomes in the area. ■

a project is completed, the buyer has more equity and would be less willing to walk away should the market turn during construction. In addition, the pool of potential buyers is much smaller, thus fewer projects will be started in the first place, making overbuilding much less likely.

Greater equity requirements also mean that transactions involve less leverage, which is a significant change from a world where “no money down” was often touted. Given Americans’ love of leverage, who are these potential buyers willing to “pay as you go”?

International demand helps stabilize area

The current rebound in the condo market owes a lot to the South Americans, according to Brad Hunter of the housing research firm Metrostudy. However, he adds, “This time is going to be different, because of the new financing model that has been put into place. South American buyers are accustomed to putting down large down payments. This model poses little risk to developers, since the down payments are large enough to finance the construction costs.”

Foreign investors have helped boost the South Florida economy for a long time. They began in the early 1970s by purchasing condos in the Miami neighborhood of Brickell, then wandered over to the beaches. According to Zalewski, “The good news is that foreign investors think the U.S. is out of the woods, which offers some hope.” Spending by Brazilians in Florida has made such an impression on their hosts that in 2011, *Florida Trend* magazine named Brazil as “Floridian of the Year,” acknowledging the 1.5 million Brazilians who visited Florida that year.

Referring to the uncertainty still lingering in many economies across the globe, Zalewski says, “Keep in mind that as one country disappears from the buying mix (or loses their share), another country always steps up into its place.”

Not all foreign investors are from South America. Canadians make up a large share of international buyers. The relative strength of the Canadian dollar and the high cost of real estate in Canada make South Florida an attractive alternative for Canadian investors. In addition, ongoing financial concerns have led many Europeans to consider buying South Florida real estate. To round things out, Southeast Asians’ demand for condo products is also picking up.

Says Zalewski, “Miami will always be a safe harbor, for both those that urgently need a safe place to house their money and those with great prosperity. Europeans and Latin Americans will continue to come to Miami after stabilization because of the cultural affinity. They can always find what they are looking for.”

Whether the anticipated return of cranes to Miami signals a healthy economy or the first step in another real estate cycle remains to be seen. International demand and larger equity requirements point to activity driven by fundamentals. The challenge will come if the cranes multiply and pressure mounts to



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loosen financing terms, in which case overbuilding may become an issue—again. While it would be nice if the anticipation being felt in Miami could be translated to a rosier picture for the broader economy, factors such as international demand make the South Florida condo market not necessarily representative of the rest of the country. ■

This article was written by Jessica Dill, a senior economic research analyst, and Carl Hudson, director of the Center for Real Estate Analytics, both of the Atlanta Fed.