Strong fundamentals anchor healthy multifamily housing

By Susan Danseyar

Photo by Maxine Usdan

Most of the new upper-income condos will be converted to rentals by their foreign buyers, some predict.

The strength of today's multifamily market in South Florida is based on solid rental fundamentals, say industry experts, which point to ongoing strength in 2016, although the lack of income level rise for apartment dwellers remains a concern.

Unlike previous cycles that were fueled by condominium conversions or "questionable lending techniques," the market for multifamily here is based on sound basic principles such as population growth, stronger employment, a more diverse international buyer pool, readily available financing and consistent returns, according to Calum Weaver, senior vice president of CBRE's investment properties division and co-leader of its multifamily investment properties group in South Florida.

In CBRE's biannual report released last week, Mr. Weaver outlined the major factors contributing to South Florida's multifamily rebound and what lies ahead for owners and investors.

Over the past five years, according to the Nielson Demographics December 2015 report, South Florida was the sixth largest-growing metropolitan area in the US with 361,000 new residents, an increase of 6.5%. Over the next five years, Mr. Weaver reports, South Florida is expected to see an additional migration of 377,670 people, a 6.4% increase, with about 70% coming from overseas.

Based on CBRE's observance over the past five years, Mr. Weaver said, many of the new residents from overseas enter the rental market.

There's a strong demand for rental units as more people decide to forgo buying a house, Mr. Weaver said. In the third quarter of 2015, his report states, homeownership stood at 63.7%, near a 30-year low.

Moreover, a strong rental demand has pushed rents to record levels throughout South Florida, and vacancies are quite low, Mr. Weaver said. Most areas have less than 5% vacancy. "In 2015, we witnessed 9,862 newly constructed units," he wrote. "That is only 1.8% of the total rental inventory in the market, a very small number."

An additional 12,400 units are under construction, Mr. Weaver said, but the supply will quickly be absorbed by pent-up rental demand.

He maintains there's virtually no risk that we are overbuilding, pointing out that a different way to look at new construction is to consider the ratio of new multifamily units compared with population increase. Over the past five years, Mr. Weaver said, one unit was built for every 24 new residents in South Florida. Currently, one unit is under construction for every 448 people.

Investors can expect to secure strong, long-term returns, according to Mr. Weaver. "Spurred by positive market fundamentals, local banks to global life insurance companies are all aggressively seeking to provide financing for multifamily properties," he said. The strengthening dollar has not deterred foreign investor interest in South Florida's multifamily market. In fact, Mr. Weaver said, the international buyer pool is becoming more diverse, with CBRE selling apartment buildings in the past 18 months to investors from Algeria, China, Italy, Canada, Argentina, Mexico, Colombia, France and Russia.

Mr. Weaver said another key aspect of future multifamily performance will be the income profile of the new demand. If there's one concern he points to going forward, it's the need for high-paying jobs. According to the US Bureau of Labor Statistics, South Florida has added 230,000 new jobs since 2010, the seventh highest in absolute job creation in the nation. However, financial news outlets have reported more than 54% of renting households in South Florida pay more than 35% of their income for rent.

Calum Weaver: sound principles.

"The average Miami household spends about 43% on rent, the second-highest rate of any major city in America," Mr. Weaver said. "Average wage per workers has not shown any real growth over the past two years, and this is beginning to constrain rent growth."

For Carlos Fausto Miranda, broker/president of Fausto Commercial Realty and Fausto Capital, the biggest area of concern is with the upper-income segments of the market.

The multifamily market is booming in the US and in Miami, and the prospects for 2016 are suggesting ongoing strength, he said. But as always in real estate, "the big picture needs to be broken down, and different market segments can be subject to radically different fundamentals."

The upper-income segments have "a rather ominous wave" of luxury condo deliveries that is threatening to glut markets, Mr. Miranda said. "Although built as condos, most of that product will be purchased by foreign buyers who will offer them as rentals."

Already the influence is apparent, he said, with rents having come to a plateau months ago and in some cases starting to decline. "Long-term we'll be fine, our Miami market can handle it, but we should definitely expect a spillover decrease in cash flow quality in high-end multi-family markets as we absorb all that inventory."

The middle- to lower-income segments paint a radically different, and decidedly more optimistic picture, Mr. Miranda believes. "While our city has focused on building these wonderful palaces in the sky, this cycle has been virtually devoid of construction for middle- to lower-income demographics," he said. "Simultaneously though, demand has only intensified for them, driven by factors such as population growth, re-urbanizing, immigration, household separations and new formations as well as employment growth."

In practical terms, Mr. Miranda said, this means that vacancies have been pushed ever lower in the mid-to-low segments, and this has placed massive upward pressure on rents, while adding to stability of cash-flows. "This combined with the general strength of this real estate cycle, a general optimism for our city's future, and the lack of many better investment alternatives, has fueled demand to acquire multifamily assets and driven prices ever-upwards," he said.

The prospects for the next 12 months remain strong, Mr. Miranda said, although he says the thinning of margins across asset classes and lowering cap rates suggests we're well past the growth stages of the cycle and settling into the maturity. "As interest rates continue climbing, and the global economy slows down, we may experience a mild, and prudent, slowdown in 2017."

Mr. Miranda's prediction is "as developers pull back from luxury development, and existing mid- and low- income multifamily assets become increasingly expensive and scarce, an awareness of the massively underserved mid- to low-income segments will develop."

He said current building costs and regulations make it difficult to develop for these markets, but developers will start focusing on the need and begin thinking of new creative ways to address it.

Photo by Marlene Quaroni

"This cycle has been virtually devoid of construction for middle- to lower-income demographics," said Carlos Fausto Miranda, yet multiple factors are intensifying demand for the missing housing segment.