SOUTH FLORIDA
BUSINESS JOURNAL

May 16, 2024


By Brian Bandell – Real Estate Editor, South Florida Business Journal
May 16, 2024

South Florida has long been known for its development boom and prolific commercial real estate deals. But a drop-off in lending amid higher interest rates has slowed the market – a trend not expected to change anytime soon.

Despite the need for more apartments to accommodate the growing population and ease the supply shortage that's driven up rents, fewer buildings are breaking ground. Some sites with approvals are even sitting fallow because developers can't line up their much-needed loans.

Additionally, structures that could otherwise be acquired and renovated with improvements, whether apartments, office or retail, are rarely trading. And not just because acquisition loans are more expensive now. There also remains a gap between buyers and sellers on pricing with rates in flux.

All of this adds up to less economic activity and capital spending in real estate, one of the largest industries in South Florida. Meanwhile, the chances that the Federal Reserve will lower rates this year declines every time the inflation index comes in higher than expected.

"There are a lot of projects that were announced with approved plans by developers who spent a lot of money to prepare them and they likely will not be built," said Peter Mekras, president of Miami-based commercial loan broker Aztec Group. "The lack of ability to get more equity and their aversion to borrowing at current rates will likely cause them to delay or postpone their plans."

Lending drops for South Florida commercial real estate projects

According to Trepp LLC, commercial real estate lending by major banks in South Florida plunged by 50% to $441.5 million in 2023, leaving it to smaller local banks to pick up the slack. Commercial mortgage-backed securities lending in South Florida fell 65% to $1.28 billion. Lending levels were down by similar percentages nationally, but markets such as New York and San Francisco had even steeper drops than South Florida.

Given the lending environment, commercial real estate sales of at least $1 million fell 30% to $3.43 billion during the first quarter in South Florida, according to property data firm Vizzda. Consistent with prior quarters, industrial properties had the most demand from buyers.

It's definitely more challenging to obtain loans this year without many of the national and regional banks in the mix, but it's still possible, said Jeff Burns, CEO of Fort Lauderdale-based Affiliated Development, who has obtained apartment construction and refinancing loans.

"Lenders are being more selective," Burns said. "If the developer has a solid track record and a long-standing relationship with their lenders and is well capitalized, you can still get financing. Folks that don't have that will have challenges."

That means some developers who overpaid for property and watched construction costs skyrocket are looking to sell, Burns said. That's especially true for developers who can't raise more equity because they syndicated their capital from multiple investors who won't contribute more money. That has created opportunities for well-capitalized developers to buy property, he added.

"I don't think this is bad at all. This is healthy for our industry," Burns said. "There will be a slowdown in multifamily construction starts and that will drive demand [from tenants]. Once demand is higher and owners can increase rates, then more deals will pencil out again."

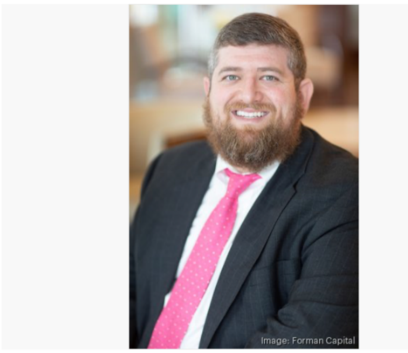
Commercial real estate interest rates scuttle deals in South Florida

The volatility of interest rates has killed many deals because buyers can't get a handle on property values, said Charles Foschini, senior managing director in South Florida for commercial loan broker Berkadia.

The Treasury rate regularly moves 60 basis points in a month, but many real estate deals take 45 to 60 days to close once under contract, he said. When a buyer gets to the closing table, the cost of capital is suddenly higher and their return on equity is noticeably lower, so the deal may no longer make sense, he added.

"The volatility makes it difficult for buyers to confirm financing costs and purchase deals with fixed-rate financing," Foschini said. "That has created a gap between sellers and buyers and, in turn, created a lower volume of sales."

Selling older buildings in coastal areas is particularly tough now because of both higher interest rates and large spikes in insurance premiums, said Virgilio Fernandez, VP in the capital markets team at Colliers in Miami. Anything older than 2000 near the beach is difficult to insure. In many of the multifamily deals that close in South Florida, the buyer puts nearly 50% down and the interest rate is higher than the capitalization rate, so the buyer expects to increase the cap rate by raising rents, he added.



Ben Jacobson, Forman Capital
FORMAN CAPITAL

Many lenders are concerned about apartment rental rates because rents aren't growing fast like a few years ago and expenses, such as insurance, are increasing faster than rents, said Ben Jacobson, a partner of Boynton Beach-based lender Forman Capital. Investors pulled back on buying because the returns aren't high enough and it's not clear rents can be raised much higher.

"Everyone now wants extremely experienced sponsors, no one wants younger, less-seasoned developers," Jacobson said. "Groups that could have gotten financed two years ago can't now."

Multiple experts said office is the most difficult property type to finance, as some lenders won't even look at it.

Less money for cranes and other vital construction equipment, materials

The combination of more expensive construction loans and higher construction costs has made some developments that looked advantageous a year ago no-gos.

Liam Krahe, managing member of Cohen Property Law Group in Miami, said one of his clients is trying to sell a development site in the Allapattah neighborhood of Miami because he doesn’t believe it can be underwritten by a lender at the current rates. It’s in a great location and the city approved the project, but the construction costs ballooned to $100 million, including $30 million for the parking garage alone, he said.

“It would be impossible to pay back investors at those numbers,” Krahe said.

Many projects have stalled because construction costs have surged, the amount of available loans is smaller because of high interest rates, and developers can't obtain more equity, said Aztec Group's Mekras. Some of them will look to sell the property rather than hold on to it and wait for financing to improve, he said.

"I have a fair amount of land loans on my books that were going to be development projects," Forman Capital's Jacobson said. "One was about to go vertical and couldn't get construction financing. He was going to build a condo but couldn't pull it off. Construction prices were too high."

Florida's new Live Local Act could help groups sell their stalled development sites because it allows greater density for workforce housing without municipal approval, said Colliers' Fernandez.

"Some of these developers projected 100 units but now with Live Local they could build 200 units, so they want to sell based on that value," Fernandez said. "Live Local has actually allowed some owners to unlock more value in their land."

Since most construction loans are at adjustable rates, it's possible the loan's debt service could increase during the multi-year construction period and projects once deemed feasible may not work, said Scott Levine, a commercial real estate acquisition and finance attorney with Rennert Vogel Mandler & Rodriguez in Miami. Developers are trying to gauge what the new normal is for rates so they can figure out what their bottom lines will be, and that's why some condo development has slowed down, he added.

"The high-end projects are doing okay but the rates on construction financing are high so it blows up their pro forma projections," Levine said. "But the demand for the product [condos] still exists."

Commercial real estate lenders still have appetite to finance South Florida projects

While some developers are starved for financing, Mast Capital obtained a $600 million condo construction loan – a record amount – for the Cipriani Residences Miami.

Condos make up the majority of South Florida construction loans because buyer deposits are part of the capital structure, so the loan only needs to account for 50% to 60% of project costs, said George Vail, a principal in the Fort Lauderdale capital markets office of Avison Young. As long as a condo developer has a significant number of pre-sales, loans are available.

"It's difficult to finance an income-producing development versus a condo where you have buyer deposits," Vail said. "Those deposits are essentially free money. They are in the bank collecting minimal interest."

While many of the national and regional banks have sharply curtailed their lending over concerns about liquidity and regulatory risks, many local banks are still lending.

Calixto Garcia-Velez, president and CEO of Miami-based Banesco USA, noted his bank has made construction loans for an office building, an apartment complex and a retail/storage project so far this year. His bank has focused on borrowers with strong finances and experience. It also asks that borrowers place a significant deposit account at the bank.

Banesco will even finance office buildings if there are strong tenants with long leases, like a loan it recently made in Sunrise for an office leased to Ford Motors, Garcia-Velez said. However, the bank will ask for a higher than usual debt service coverage ratio in case the building owner loses tenants or experiences a sudden jump in operating expenses, he added.

"Banks are running away from this space [office] but we are not shy," he said. "We have seen some great deals we've taken advantage of. We are being selective and being cautious and making sure we pick the right deals."

Aztec Group's Mekras said there are plenty of private lenders in the market in South Florida, but their interest rates are several points higher than banks and not everyone is willing to pay those rates.

Marcia Kaufman, CEO of New York-based private lender Bayport Funding, said she's eager to make loans of up to $10 million on smaller South Florida multifamily buildings and developments as long as their cash flow seems sound. She prefers lending in Florida because the laws are more friendly for landlords than in New York, where it's harder to raise rents or evict tenants who fall behind on rent.

Edward Easton, founder, chairman and CEO, The Easton Group
JOCK FISTICK / SOUTH FLORIDA BUSINESS JOURNAL

Edward Easton, chairman of the Doral-based Easton Group, secured financing for three acquisitions in South Florida in the past four months, including an office building. His strategy is buying properties where the rents are below market and set to expire relatively soon, so he anticipates that he can drive the rental rates higher with new or renewed leases. Even if he bought the building at a capitalization rate lower than he would prefer, the higher rental rates would improve the cap rate, he noted.

However, after delivering 1.2 million in mostly industrial space last year, Easton has told his development team to hold off on new projects.

"We are done building because costs are out of control," Easton said. "The market [rent] will go higher because of the slowdown in construction. That bodes well for existing properties."