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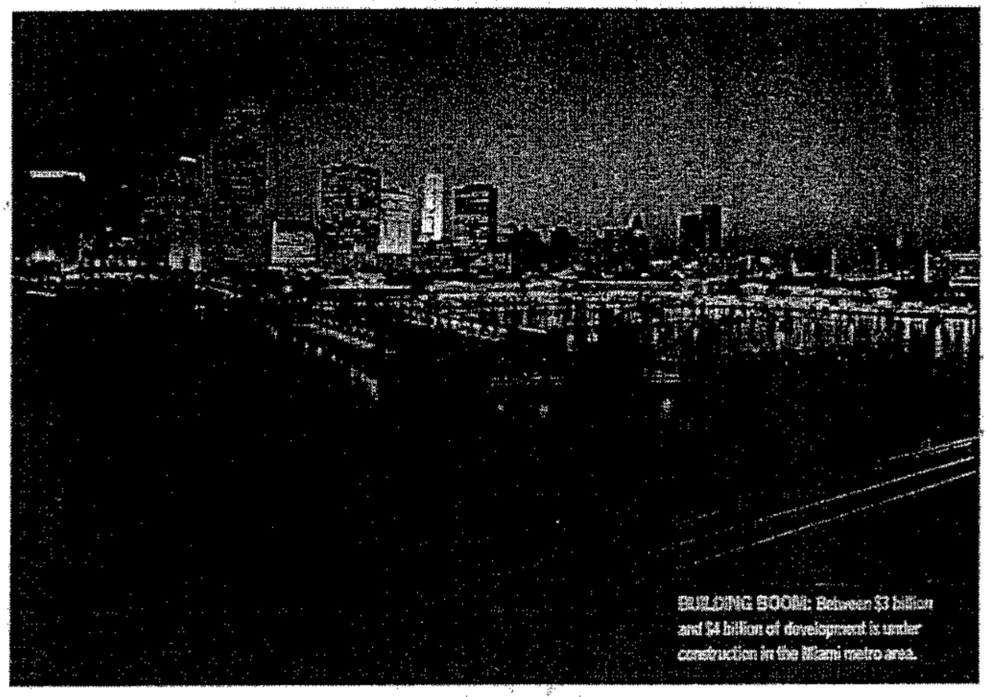

BUILDING BOOM: Between $3 billion and $4 billion of development is under construction in the Miami metro area.

Miami Makeover Attracts Investors

While the city ushers in a new era of fiscal responsibility, mixed-use and condo conversion activity continues to be hot. **By Hortense Leon**

In June, Miami Mayor Manny Diaz visited the Manhattan Institute's Center for Civic Innovation to deliver a message: his city's government has been restructured and is more efficient than in years past. As a result, Miami is taking its place among the most respected cities in the U.S.

During Diaz's tenure, the city's bond rating has climbed from junk to investment status, although a budget shortfall is forecast for fiscal year 2005. In addition, the cleanup of city government — once famous for mismanagement, malfeasance and general buffoonery — has sparked a turnaround, elevating Miami's image into one of respectability and fiscal responsibility, say the mayor's supporters.

But do changes at city hall really matter to developers who are in the process of developing an estimated $3 billion to $4 billion of new construction in and near downtown? Yes, says Michael Cannon, managing director of Integra Realty Resources of South Florida, an appraisal and real estate consulting firm. "Investors wouldn't come here unless city government was revamped."

Miami's newly minted reputation for integrity and efficiency in city government does not negate the fact that the city has been named the poorest of the 100 biggest U.S. cities in a report by the Brookings Institution. This dubious distinction was based on the fact that Miami had the lowest median household income — $23,483 — in this group of 100, according to the 2000 U.S. Census.

Grand Plans

Although most developments are condominium projects with varying amounts of retail, one developer is planning office space downtown. MDM Development Group, the developer of Metropolitan Miami, a mixed-use complex that will include 1,500 condominiums and 222,000 sq. ft. of retail, has received approval from the city of Miami to build a 500,000 sq. ft. office tower. It replaces the original plan for 10,000 sq. ft. of office space.

In June, MDM was negotiating with three potential office occupants — law firm Steel Hector & Davis, which gave MDM a letter of intent to buy a 100,000 sq. ft. office condo; accounting firm Morrison Brown Argiz & Farra, which is negotiating to buy 40,000 sq. ft. of office space; and insurance group Aon, which has existing offices in Miami and also is negotiating to buy a 40,000 sq. ft. office condo. MDM is planning to rent out an additional 300,000 sq. ft. of office space.

But not many developers are opting for office space. Cousins Properties of Atlanta and America's Capital Partners of Miami are reportedly scrapping their plan for a high-rise office building in downtown Miami in favor of a residential condominium development.

Mixed-Use Proliferates

A few miles north of downtown, a population explosion is about to take place on a once barren railroad yard. The Miami-based Midtown Group and Developers Diversified Realty — a Cleveland, Ohio-based REIT — are developing a 56-acre site, formerly the Buena Vista rail yard. The Midtown Group is planning 3,000 residential units on half of the site, and Developers Diversified is developing the other half with 600,000 sq. ft. of retail and up to 900 apartments. It is estimated that the two developers of the project, known as Midtown Miami, will invest $1.2 billion over seven years.

"Midtown Miami is widely regarded as the most significant urban redevelopment deal in the country," says Craig Werley, principal of Craig Werley & Associates, a real estate advisory firm in Miami. "Nowhere in the middle of a major city do you have 56 acres" available for development, he says.

Although condos like the ones planned at Midtown Miami are popular, the cost of these units has skyrocketed. Seven years ago, buyers paid $150 to $200 per sq. ft. for a luxury unit, says Gene Berman, regional manager of the Ft. Lauderdale office of Marcus & Millichap. Now, buyers pay $350 to $800 per sq. ft., he says.

Condo Converters on a Tear

Between 15,000 and 20,000 apartments have been converted to condos in the last 24 months in Miami-Dade County, says Evan Kristol, senior investment associate at Marcus & Millichap in Ft. Lauderdale. "Everyone is in the game because of the aggressiveness of condominium converters," he says. "Some apartment owners who have said they will never sell to a converter are selling." At some point the prices are so good that apartment owners can't resist, he adds.

BUDDING RENAISSANCE?: Real estate observers hope the mammoth Metropolitan Miami project will renew the city's core. The complex, to be completed in 2007, includes 500,000 sq. ft. of office space, 1,497 condominiums and 222,000 sq. ft. of retail space.

Kristol recently sold a 180-unit building built in the 1970s and located in Hialeah, a city in Miami-Dade County. The owners had estimated that the building was worth $35,000 to $40,000 per unit, but it sold for more than $70,000 per unit.

"Prices have been so out of hand that a lot of sellers don't want to price their buildings when they put them on the market," says Kristol. Instead, they are putting them out for bid. "Deals are selling above their asking prices. A deal listed at $17 million will get offers of over $18 million today."

There is little land left in Miami-Dade County to build new apartments, says Kristol. "The only new construction you see is in South Miami-Dade, where land is still available, or along the coast in infill locations. But typically, these units are in high-rises and will become condominiums." Marcus & Millichap estimates that 7,200 units will be completed in South Florida in 2004, up 3.5% over the previous year.

Investors are clamoring for apartments. According to New York research firm Real Capital Analytics, Southern California and South Florida accounted for more than 25% of acquisitions nationally in May 2004.

Cap rates in those two markets average 100 basis points lower than in the rest of the country and prices are appreciating at a faster rate, according to Real Capital Analytics. Cap rates in South Florida averaged 6.4% in May, compared with 7.45% nationally (excluding Southern California).

South Florida's average sales price per unit in July 2001 was $78,642 vs. $102,522 in May 2004, a jump of roughly 30%, reports Real Capital Analytics. In contrast, the average price per unit for the rest of the country (excluding Southern California) rose from $61,642 in July 2001 to $70,913 in May 2004, an increase of about 15%.

A Bright Retail Outlook

About 2.1 million sq. ft. of retail was under construction in Miami-Dade County in the second quarter of 2004, according to Marcus & Millichap. This total includes two large retail components of mixed-use, urban infill developments, but excludes Midtown Miami, which had not yet started construction at the beginning of the second quarter. The square footage includes neighborhood shopping centers, mostly in the far western parts of the county. In addition, two Wal-Marts are under construction.

"There was a lot of overbuilding in the 1990s, but now there is less excess space available, so there are more retail tenants chasing smaller amounts of square footage," says Michael Fimiani, vice president of Boca Raton-based Woolbright Development, a shopping center owner.

The vacancy rate for neighborhood shopping centers in Miami-Dade registered 4.4% in the first quarter of 2004, down from 4.9% during the same period a year ago, according to Reis Inc. Effective rents averaged $18.36 in the first quarter of 2004 compared with $17.86 a year ago.

One of the most significant retail projects in Miami-Dade County is Metropolitan Miami, because it is in the core of downtown Miami, says Alina Matas, director of research at the Terranova Corp., a Miami-based retail brokerage. "This area had been neglected and tired."

Lyle Stern, the broker handling Metropolitan Miami's retail component, slated to break ground in June 2005, says Whole Foods Market signed a lease for a 46,000 sq. ft. space at the development, and two more leases are about to be signed.

Mary Brickell Village, a mixed-use complex just south of downtown in the Brickell Avenue corridor, will feature 200,000 sq. ft. of retail development and 350 condos. The project, which has been in the works for years, is scheduled for completion in summer 2005, says Stern, who also is the broker on the project. Among the tenants signed by Constructa Inc., a French company that is developing the project with offices in Miami Beach, are a Publix supermarket, PF Chang's and Bally Total Fitness.

Retail cap rates in South Florida averaged 8.04% in May, compared with 8.53% for the rest of the country, excluding Southern California.

Prices for strip shopping centers in South Florida have been rising faster than any other market, reports Real Capital Analytics. The 15,552 sq. ft. Ratner building shopping center on Miami Beach, with anchors such as Ann Taylor Loft, sold for $812 per sq. ft. in June 2004, one of the highest prices per sq. ft. in the last four years in Miami-Dade.

Office Makes a Comeback

The Miami-Dade office market is showing signs of recovery. Total absorption year-to-date through June was 712,000 sq. ft., compared with 242,000 during the same period in 2003, reports CB Richard Ellis.

The vacancy rate also is on the mend, registering 14.7% for all classes of space, including sublease space, in the second quarter compared with 15.3% during the same period in 2003, reports CBRE. Meanwhile, the average asking rental rate was $23.98 per sq. ft. It has remained virtually unchanged over the past year.

There was 293,839 sq. ft. of office space under construction in the second quarter, with Class-A office completions year-to-date in Miami-Dade totaling 533,000 sq. ft. One building — 2525 Ponce de Leon, a 250,000 sq. ft. Class-A building in Coral Gables — is 41.7% preleased and is scheduled for completion at the end of 2004.

Office developers seem to have little appetite for downtown Miami beyond one tower at Metropolitan Miami. "The 500,000 sq. ft. project planned by MDM should satisfy the need [for office space downtown] and that won't be up for three years," says Michael Klotz, first vice president at CBRE in Miami.

But the office market is improving, emphasizes William Holly, president of Holly Real Estate, a Miami-based brokerage firm. "A couple of large leases are about to happen. Even South Beach, where there was no absorption for 18 to 24 months, is coming back."

Industrial Grows Stronger

Leasing in Miami-Dade's 192 million sq. ft. industrial market in the first half of 2004 accelerated as the economy began to recover, according to CBRE. The industrial vacancy rate dropped from 8.3% in the second quarter of 2003 to 7.4% in the second quarter of 2004. For the first six months of 2004, a total of 2.7 million sq. ft. was leased.

Rental rates averaged $5.82 per sq. ft. in the second quarter, down from $5.91 during the same period in 2003. Landlords are continuing to offer free rent and extra tenant improvements to lure space users.

"There is more optimism in the industrial market this year than last," says Michael Silver, first vice president for CBRE in Miami. "Although there isn't much activity in the 50,000 sq. ft. and larger category, leasing activity has picked up for spaces 5,000 sq. ft. to 40,000 sq. ft."

Codina Development, in partnership with AMB Property Corp., a San Francisco-based REIT, has finished its first spec building at Beacon Lakes, Miami-Dade's newest industrial park. While there are no leases signed, negotiations are continuing with prospective tenants, says Jose Juncadella, senior vice president of Codina Realty Services, which manages and leases the park.

Hotel Fundamentals on the Rise

For the first five months of 2004, the Miami hotel market recorded an average occupancy rate of 74.3%, up 8.8% over last year, while revenue per available room (RevPAR) was $97.55, an increase of 16.5%, according to Hendersonville, Tenn.-based Smith Travel Research. "These increases outperform the average of the top 25 lodging markets in the U.S.," says Jan Freitag, director of Smith Travel Research.

Several large, full-service hotels for Miami-Dade are in the conceptual stage, confirms Scott Berman, a partner with PricewaterhouseCoopers in Miami. He notes that Miami International Airport is looking for a hotel developer and operator to build a hotel at the facility, and is expected to put out a request for proposals before the end of the year. Two earlier RFPs were not successful.

The most ambitious hotel development planned for Miami is Island Gardens, a $426 million mixed-use development featuring a marina, a maritime museum and two luxury hotels. However, Island Gardens — which will be located on Watson Island between the city of Miami and Miami Beach — is facing opposition from Miami Beach residents, who fear the development will create more traffic than the already crowded South Beach can handle. ■

Hortense Leon is a Miami-based writer.