Mortgage meltdown: Vulture investors

Real estate investors are betting on bargains in depressed markets they think are ready to bounce back.

By Les Christie, CNNMoney.com staff writer
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NEW YORK (CNNMoney.com) -- Real estate investor Matthew Martinez is the point man for a private equity group that plans to invest $200 million in Florida condo developments.

But recent forecasts show many housing markets in the Sunshine State are looking at double-digit drops in home prices. What is he thinking?

"The smart money is thinking about buying there right now," says Martinez. "It may be six to 12 months early, but it's a good time to be searching for deals."

Local housing markets that have fallen far, yet have the potential to recover soon, are ripe targets for "vulture investors," who buy cheap in the hope that prices will rebound.

One area suffering from steep declines is the Miami/Ft. Lauderdale/Palm Beach region, where prices are expected to drop as much as 12 percent. The correction comes after years of intense real estate speculation.

"We believe in the long-term viability of the Florida real estate market, but we're buying on rental economics," Martinez says. "People had been purchasing on condo economics and those numbers no longer apply."

He's looking for 15 percent or higher discounts off previous condo prices to make his purchases viable. He then plans to convert the apartments back into rental units.

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For vulture investors, it's not only about the discounts. In order to hold a real estate asset for the several years it might take to turn around, properties have to generate ample cash flow while they wait.

The mortgage meltdown mess and stagnating housing markets have reduced home ownership, according to the Census Bureau, adding to the number of the nation's renters. As a result, demand for rental housing has grown.

Marcus & Millichap Real Estate Brokerage projects average rents nationwide will jump 14 percent for the three years ending this coming December.

Rents in Florida have jumped. Orlando is expected to finish up 21.2 percent for the three years, Ft. Lauderdale 20.5 percent and West Palm Beach 18.6 percent.

The rent increases should provide a price-safety net, especially for condos, since investors will buy as the spreads between rents and mortgage payments diminish. Today the nationwide median mortgage payment of $1,566 is still 80 percent higher than the median monthly rent of $943, but that's down from a couple of years ago, when the difference was close to 100 percent.

When markets were extremely hot, the investor mind-set was very different than it is today, according to Danielle Babb, who owns properties in the Southwest. "They were looking for flips, now they're looking to buy and hold," she says.

According to Babb, more investors are eyeing various markets but are being extremely cautious. "They're concerned that the market has not yet hit bottom."

Investors will look to buy in areas where home prices are reasonably low and rents reasonably high, according to Babb, with an eye for the long haul.

"What we've got is a market that has reverted to what it was like six years ago. People no longer look at their houses like lottery wins," says Jim Gillespie, chief executive of real estate brokerage, Coldwell Banker.

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But according to Jonas Lee, of Redbrick Partners, a private equity firm that invests in real estate, sellers are reluctant to slash prices.

If owners want to sell quickly, within 90 days, they may have to come down about 15 percent, he says. Lee is also interested in Florida, and the Boston and D.C. areas as well.

Some of the down markets he's not considering include the Central Valley cities of California, where prices in places like Stockton soared for several years. Moody's projects prices there will fall 25 percent.

Lee doesn't like Stockton's prospects because, "It was so overpriced there and there are few constraints on building." If prices start to recover, developers can quickly build again, putting a damper on price growth.

"Investors will look to areas with job growth and low unemployment, especially in smaller communities where there hasn't been big price appreciation and rents haven't gone down," according to Gillespie. "In those places, the return is much greater." ■

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