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Atlanta

- * *Job losses finally arrived in the Atlanta area economy last year, although the performance remained positive for the year overall. Now, monthly increases in employment are being reported. Inherent assets and long-term prospects remain formidable.*
- * *The **apartment** market has taken a sharp downward turn as robust construction collides with foundering demand. Vacancy is up and rental losses are reported. Development now slows. Long-term prospects, however, seem favorable given underlying demographics.*
- * *The **office** market has weakened substantially; vacancy is high and rising and absorption has fallen negative. A condition of oversupply is apparent.*
- * *The **retail** market sees some modest softening, but underlying demographics seem to support long-term vibrancy. Regional mall development, active in recent years, continues in hot locales.*
- * ***Industrial** is caught in a supply-demand pinch, with new space arriving to face weakened demand while rents falter and sublease space accumulates. Still, optimism, founded on long-term economic basics, persists.*

Well, it's finally happened. That which had been long predicted but consistently avoided--an economic downturn replete with net employment losses--has finally arrived in Atlanta, undermining (at least for the moment) the aura of invincibility that for years has surrounded this hugely successful economy. According to data provided by the U.S. Department of Labor, Bureau of Labor Statistics (BLS), average nonagricultural employment in the Atlanta MSA grew a minimal 0.5% during 2001 (for a net gain of 9,900 jobs). While clearly weakened, this economy was still performing better than many around the nation. However, month-to-month declines in nonfarm

employment proceeded more or less steadily from the mid-year 2001 high. As of April 2002, employment was down a striking 3.1% (a loss of 67,700 jobs) from 12 months earlier, according to preliminary BLS numbers.

However, once again there may be more strength than is apparent. Since January 2002 nonfarm employment has increased 1.2%, representing a net increase of 25,700 jobs, according to the early numbers. As of April, the local unemployment rate was a reasonably low 4.4%, up from 2.8% a year earlier but down from 4.7% at the end of March. The recent losses were broad based, but most pronounced in the wholesale and retail trade and services sector.

Whatever may be occurring locally under the influence of national recession and Nine-Eleven, we would not count this economy out. The juggernaut of expansion produced by the local economy year after year prior to the current downturn was no accident. Atlanta's is the dominant regional economy and population center. A steady draw to business and residents during healthy times, its industry base is broad and diverse, there are numerous areas available for development, and it is affordable relative to the nation's other first-tier metropolitan areas

As a general rule, growth and development have been strongest in the metro north, from Marietta and Cobb County in the northwest, through the Highway 400 corridor in northern Fulton County in the north, to DeKalb and Gwinnett counties in the suburban east, the latter of which also has been a national growth leader in recent years. The massive population growth underway in these areas has made metro Atlanta one of the nation's most active areas for residential development. More recently, significant activity in a variety of types has emerged in the metro south.

General Outlook: This economy is too large, too broad, too important, and too tied-in to the national economy to be bypassed by national recovery, when

it occurs. Indeed, as noted above, a steady stream of employment gains has been underway since the beginning of the year, perhaps a harbinger of recovery. Marcus & Millichap expects "tepid" growth in the first half of 2002 to be followed by increasing momentum in the latter half. "The well-balanced and diverse employment base has sheltered the [local] economy from the total free-fall experienced in many tech-heavy MSAs," states this source. That balance and diversification should continue to bode well for Atlanta over the long term.

Apartment

The market has suffered a dramatic turnaround in the current economic climate. While demand has deteriorated dramatically, development, conditioned over the years by relentless population growth and robust absorption, continues in high volume; this is now a detriment to market health. According to the U.S. Department of Commerce, Bureau of the Census, 16,361 multifamily units were authorized for construction in the MSA during 2001, a very large sum and only slightly below the total of 16,820 recorded for 2000, the highest recorded for this market since 1986! For 2001, local firm Dale Henson Associates Inc. reports the delivery of 15,200 apartments, the most in five years. While construction is by no means disappearing, it is now slowing under the pressures exerted by deteriorating demand and rising vacancy. According to the bureau, the 2,954 multifamily units approved for construction during the first four months of 2002 (including complexes as small as five units) were down 28.1% from the 4,111 approved during the comparable period of 2001. Henson reported a 14% decline in starts in 2001 compared with 2000.

Vacancy, indeed, is up sharply. Henson puts year-end 2001 metro rate at 8.9%, up from 4.3% a year earlier and the highest recorded by this source since 1992. Reporting by property type this source gives respective Class A, B, C, and D vacancies of 8.9%, 9.2%, 8.4%, and 9.2%. Marcus & Millichap, expecting the rate to continue to increase through 2002, put the January rate at 7.9%. An increase to 8.6% is projected for year-end. However, this source expects the rate of increase to ease in the later part of the year as the pace of new construction coming on line finally slows. For all of 2001 Henson reported net absorption at negative 4,800 units.

Rents, hardly surprising, are losing ground. Henson reports a large average rental concession of \$63 per month (up from the \$14 average reported for 2000)

and likely higher in properties in marketing and lease-up. This source reports an average asking rent of \$814 per month for 2001, up 2.8% from a year earlier. The average effective price, however, declined a substantial 8.6% to \$679. The reported Class A average asking rent was \$960 per month, up 1.8%. The Class A effective price, however, fell 11.4% to finish the year at \$786. According to Reis Inc. (New York) the average asking rental price for first quarter 2002 was \$815 per month, up 1.2% from a year earlier but the same as the value recorded for the preceding two quarters. For The average effective rent, meanwhile, substantial losses are indicated as concessions take their toll.

Generally speaking, development has been strongest in suburban regions within the northern half of the metro area, a large area transcribing an arc from Gwinnett and DeKalb counties in the east through the Roswell-Alpharetta-Highway 400 area in northern Fulton County in the north, to Cobb County and the Marietta area in the northwest. Development has also been notable in closer-in areas such as Buckhead and Midtown.

Apartment Outlook: Henson expects "treacherous" conditions to prevail over the near term; the firm expects vacancy to rise to the 11% to 12% range by year end 2002. Reis forecasts a year-end average of 11.1%. A slow recovery is anticipated for rents. The underlying strength of the economy, including high rates of population growth, should spring to the market's assistance once national economic recovery gets going. Indeed, the market's underlying demographic strength is likely to assert itself once the economy revives.

Office

It's the Classic Crunch--almost like a "B" movie for real estate: a recessionary economy with weak demand runs broadside into a robust cycle of office development with the predictable consequences of rising vacancy, negative absorption, and faltering rents. As run-of-the-mill as this scenario may seem is times such as these, it is nonetheless an unaccustomed experience for this particular market given the persistent strength and resilience it has shown in recent years in defying predictions of oversupply. Indeed, the market had acquired an aura of invincibility.

But the past is the past. For the present, oversupply has become a factor. According to Grubb & Ellis,

first quarter 2002 metro-wide average vacancy was 17.0%, up from 11.9% at the close of 2000 and a rate described by the company as the highest in 10 years. CB Richard Ellis put the quarter-end rate at 19.1%, up

from 13.2% at year-end 2000. According to Reis, vacancy climbed during 2001 to 16.1% from 9.0% a year earlier; as of first quarter 2002 it had grown to 17.5%. These are huge and daunting increases for a market of this size. Indeed, according to Reis's data the volume of vacant stock has more than doubled since year-end 2000, increasing by 11.6 million square feet to more than 22.7 million!

It is the depletion of demand, of course, that has brought about such dramatic changes in occupancy. Tenant interest in new space has "subsided," notes an understated Marcus & Millichap. Net absorption has plummeted to sub-zero depths. According to Reis, the year-end 2001 net absorption total was a striking negative 4.6 million square feet, a total all the more dramatic for the contrast it provides to the plus-6.4 million absorbed during 2000—and the 7.6 million reported for 1999. If the firm's prediction proves accurate, the remaining three quarters of 2002 will produce a net absorption total of plus 23,000 square feet. CB Richard Ellis, which paints a less dire picture of the recent past, also sees an evening-out of net absorption at close to the zero mark. Marcus & Millichap reported 2001 net absorption at minus 765,000 square feet, a sum it attributes to increased sublease availability. Indeed, the accumulation of sublease space, a significant portion of it arising from the dot-com shake-out, has become an important factor here. Grubb & Ellis cites a sublease factor of

7.1 million square feet metro-wide.

Rents have tumbled. "The availability and effective cost of space are extremely favorable to prospective tenants, providing they are willing to make decisions," states Cushman & Wakefield. However, lack of tenant interest in expansion or relocation is a noted aspect of the current doldrums. CB Richard Ellis reports a general flatness in lease rates: a first quarter average asking price of \$20.38 psf NNN is reported, down 30 cents from year-end 2001. While reporting an increase in asking rents in 2001, Marcus & Millichap notes as well an underlying decline in effective prices arising from "mounting concessions and increased tenant improvement allowances." This source reports an average metro area asking rent of slightly above \$20 psf.

The northern suburbs have dominated office development in recent years and continue to do so. Here, the major interchanges between I-285 (the "Perimeter Highway") and I-75 and I-85 have been primary nodes of office development. Areas leading in activity in recent years also include Atlanta's northside suburbs (the Highway 400 corridor) and suburban Gwinnett County in the metro northeast. Meanwhile, the closer-in markets—downtown, Midtown, and Buckhead—particularly in locales proximate to MARTA light rail stations, have seen increased activity due to severe suburban traffic congestion. In addition, for a 436-acre plot spanning acreage in south Atlanta and the town of East Point, Bentley Group is planning a \$500 million mixed-use project slated to include 800,000 square feet of office space, 650,000 of retail, and more than 1,000 residen-

OFFICE MARKET OVERVIEW, 1Q 2002
METROPOLITAN ATLANTA
(in square feet)

Submarket	Inventory	Vacancy 2001 / 2002	Under Constr.	Rent
Downtown	21,270,935	6.9% / 15.1%	0	\$20.43
Midtown	14,231,974	16.9% / 20.9%	0	\$23.39
Buckhead	13,840,642	8.1% / 16.5%	0	\$24.97
Northwest	26,600,534	14.1% / 18.0%	241,900	\$19.64
Central Perimeter	26,133,127	12.9% / 17.3%	942,458	\$21.81
North Fulton	18,138,524	18.2% / 27.9%	433,285	\$18.56
Northeast	13,925,316	21.6% / 23.9%	298,383	\$16.88
Northlake	14,349,786	8.3% / 11.6%	120,960	\$16.92
S. Atlanta	5,074,511	26.8% / 27.0%	658,500	\$16.34
W. Atlanta	1,039,615	38.6% / 29.9%	0	\$20.22
TOTAL	154,604,964	13.8% / 19.1%	2,695,468*	\$20.08

* Down from 6.0 msf a year earlier.

Source: CB Richard Ellis

tial units, reports *The Atlanta Constitution*.

Office Outlook: “The Atlanta office market is not likely to experience a significant and sustainable turnaround until late 2002 and into 2003,” states Grubb & Ellis. As a first sign of recovery, the firm expects to see reductions in sublease availability. Long-term economic fundamentals and an easing in the pace of construction give cause for optimism.

Retail

Despite the current recession and its significant impacts on the local economy, residential development, a major support for retailing and retail real estate, continues in Atlanta. Still, the recession has had its effects: “Although the local retail real estate market has enjoyed healthy growth from 1995 to 2000, the recession has sent vacancies upward and taken a toll on all property types, particularly local power centers,” reported GlobesSt.com as first quarter drew to a close. However, the setbacks now endured by the market, while genuine, seem less than dangerous—except, of course, for that substantial number of stores forced to close as the weaker economy adds to the body count in the war between big-box retailers.

Retail development, in any case, has been astronomical in recent years. Slowing now, it remains nonetheless substantial. A late 2001 report from Marcus & Millichap predicted the delivery of approximately 8 million square feet of new product in 2002, possibly including two new regional malls as major national developers (Taubman and Rouse in the north, Simon/North American Properties and CBL in the south), compete to build in the hot suburban north (the Highway 400 corridor) and in the emerging south (Henry County). A still larger completion sum was reported by this source for 2001, which also saw two regional mall deliveries. Build-to-suit big-box development by major retailers such as Wal-Mart, Target, Ross, BJ’s, and Lowe’s also has been a significant component of recent activity.

While vacancy is up it does appear to pose a grave threat generally. Accordingly, Bullock Mannelly Partners reports a first quarter rate vacancy of 9.0% for “all classes” of retail space, up sharply from 2.7% a year earlier and the highest average rate reported by this source in seven years. Additional increases through the remainder of 2002 are anticipated. For the community and neighborhood center Reis also reports a rising trend, albeit a more gradual one.

Vacancy in this segment was given as 8.3% at quarter-end. Rental growth, although slowed, stays positive.

Retail Outlook: Favorable demographic trends should continue to support the market over the long term. Indeed, optimism with respect to long-term trends mitigates the shorter-term concern inspired by the current recession. Thus, regional mall planning in the established hot markets of the suburban north and the growing markets of the suburban south continues effectively unabated. “Based on our first-quarter report, we are calling for slower, more stable growth in the retail sector,” an executive with Bullock Mannelly told GlobeSt.com.

Industrial

“Still Short of a Turnaround.” That’s the first quarter assessment offered by local firm King Industrial Realty of the huge local industrial market. Accordingly, recession continues to take its toll of rising vacancy, negative net absorption, soft rents, and a growing volume of sublease availability (one source describes the market as “saturated” with sublease space).

It’s not merely weak demand that is undermining this market. Construction was extraordinarily active here in the recent term, with tens of millions of square feet arriving on line in only a few years’ time. While construction activity now is slowing, substantial volumes remain in the pipeline, further threatening the market. CB Richard Ellis attributes this to confidence on the part of the development community that business conditions will improve.

According to Reis, 80.4 million square feet of new multi-tenant non-manufacturing space completed construction over the period 1994 through 2001, including nearly 7.4 million in 2001. For the broader market, CB reports 5.4 million square feet under way per the close of first quarter 2002. Cushman & Wakefield Inc, reporting only 2.7 million square feet underway at quarter-end expects the impact of new construction on the market to decrease due to the relatively small sum now being built. Moreover, adds this source, the largest projects in the development pipeline, totaling 1.5 million square feet, are fully pre-released.

According to CB Richard Ellis, first quarter 2002 average industrial vacancy was 13.1%, up from 11.4% six months earlier and from 9.3% per first quarter 2002; this is the highest rate reported by CB for this market in more than a decade. By property type, rates

are reported at 17.3% for flex space, 13.2% for shallow bay distribution space, and 12.4% for warehouse space. A nominally more favorable report from Grubb & Ellis reports vacancy rising to a high plateau, the 11.7% average reported for first quarter 2002 showing little change from recent readings. The most daunting occupancy statistic from our research is King Industrial's 17.6% first quarter rate for the distribution market, a figure representing 73.4 million square feet of vacant space. Vacancy in service center space was 19.6%, representing 3.2 million square feet of vacant product, according to King.

The accumulation of sublease space has contributed to the erosion of rental health. "Across all types of industrial buildings, rental rates have dropped this year," reported *Atlanta Business Chronicle* in May. According to this source, the "average minimum" rate in 2002 to-date is \$4.50 psf; the maximum is \$4.83 psf. CB notes a flat rental performance in recent

quarters. "Those tenants whose leases expire over the next 12 to 18 months will be in a position to take advantage of lower rental rates and other concessions," states Grubb & Ellis.

Industrial Outlook: Harsh conditions or not, optimism persists. Comments Grubb & Ellis: "Increasing tenant demand and a restrained supply pipeline bode well for the 2002 Atlanta industrial market." As noted, CB expects improving business conditions to help drive recovery in the market this year. "Market fundamentals should begin to show incremental signs of improvement as the year progresses, primarily due to vigorous warehouse-distribution leasing activity caused by increased production and larger inventories," comments Cushman & Wakefield. And, states an executive with King Industrial, "This optimistic and enthusiastic broker sees the market turning around the bend."
