BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *Atlanta Metro Area*

2H/20

Atlanta's Status as Regional Distribution Hub Mitigates Impact of Health Crisis; Long-Term Demographic Outlook Attracting Out-of-State Investors

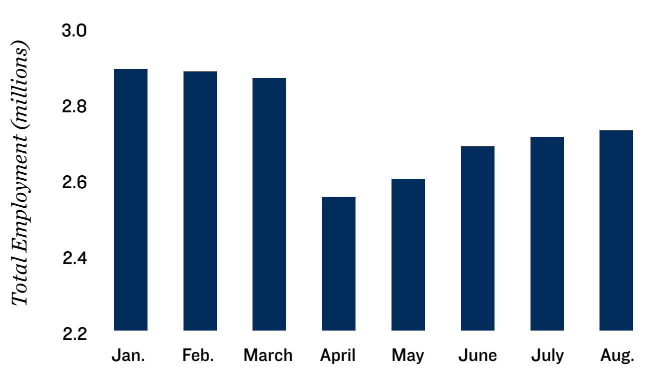
Aggressive reopening places Atlanta ahead of nation. Georgia allowed businesses to reopen before any state that had shelter-in-place orders, though some cities within the Atlanta metro maintained stricter regulations for a longer period to keep slack in the healthcare system. As a result, the unemployment rate of 6.2 percent in August was 220 basis points below the national rate. More than half of jobs have been recovered over the course of four months and several sectors have nearly recovered all positions, including construction; trade, transportation and utilities; and education and health services. Approximately half of the job losses are concentrated in the leisure and hospitality, and professional and business services sectors, which still need to recoup nearly 90,000 jobs.

Metro's position as major distribution hub benefits local economy. With millions of Americans still restricting their movement, the importance of moving products is amplified. The Port of Savannah is reporting record levels of container traffic, and most of those products move from the port into Atlanta distribution hubs, buoying the job market. The trade, transportation and utilities sector, which is the market's largest, is within 9,000 jobs of reaching pre-health crisis levels. A national shift into more online shopping will create additional local demand for industrial space in the market. However, more than 10 million square feet of speculative space is under construction, which could keep vacancy from tightening in the near term.

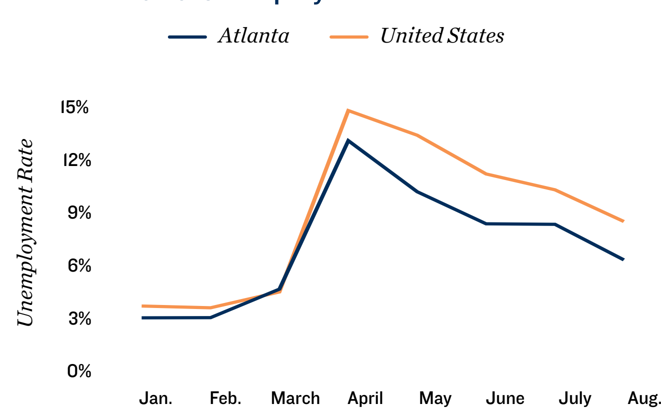
White-collar job market has upside potential. Office-using employment grew steadily during the previous economic expansion before the health crisis pared 78,000 of those positions. Compared with the national average, the return of office-using jobs has been slower in Atlanta. Nonetheless, several companies that had announced expansions in the metro are expected to maintain those commitments in 2021. Microsoft is investing $75 million in a new facility and bringing 1,500 jobs to the market next summer while Google is expanding in Midtown. If a hub-and-spoke work model gains in prevalence among Big Tech, these offices could serve workers who move away from high-priced coastal cities in search of a market with a more attractive cost of living. Home sales in suburban Atlanta neighborhoods are already nearly 9 percent higher than year-ago levels.

Out-of-state capital moves into Atlanta. Institutional buyers will remain interested in newer assets when available. Industrial space, in particular, is drawing attention from some of the nation's largest real estate holders. Smaller buyers, meanwhile, are active in the Class C apartment sector as a housing shortage persists. Renters in this tier are unlikely to have the financial means to make a jump into the housing market while additional demand may stem from workers who have taken a pay cut due to the pandemic. Both occupancy and rents improved at Class C multifamily properties in the second quarter. Retail properties will also draw attention from out-of-state investors as portfolios are repositioned for a post-pandemic world.

2020 Employment Trends

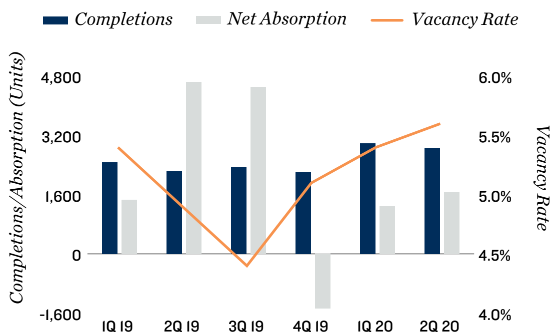


2020 Unemployment Rate Trends

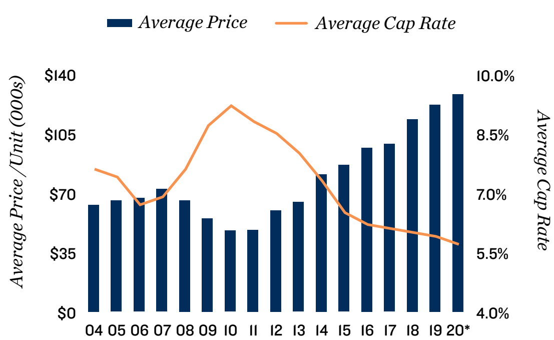


Source: BLS

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

Sources: Real Page Inc.; CoStar Group, Inc.; Real Capital Analytics

APARTMENT

Lower-Tier Apartments Faring Better Than Others; Investors Gravitate to Class C Properties

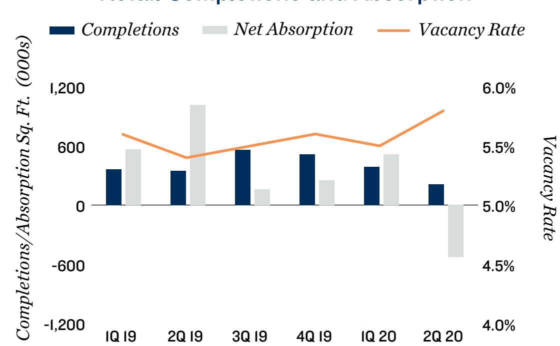
- Developers remained active in the second quarter as 2,900 units were delivered, bringing annual completions to 10,400 apartments. More than 18,000 units were underway at midyear.
- A slowdown in leasing activity amid elevated construction resulted in a 20-basis-point rise in vacancy to 5.6 percent in the spring. Vacancy jumped 70 basis points over the past year despite a 1.2 percent rise in demand.
- Led by a 3.5 percent decline in Class A rents, the average effective rent slipped 1.5 percent to $1,254 per month in the second quarter. Class C rents advanced 2.2 percent as vacancy dipped 60 basis points to 5.0 percent.
- Deal flow remained relatively healthy in the second quarter despite health crisis challenges. During the trailing-12-month period, the average price was $128,200 per unit, up 9 percent year over year. The average cap rate was a cyclical low 5.7 percent during the same period.
- Investor interest in Class C buildings will be sustained in the next few months as renter demand remains healthy. Price exploration for urban Class A units, like those in Buckhead, will take longer to emerge.

RETAIL

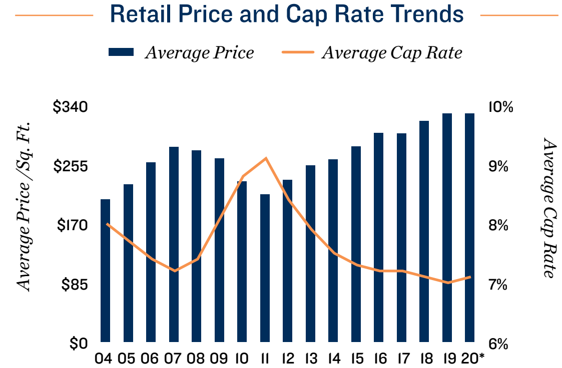
Out-of-State Investors Remain Active in Atlanta Single-Tenant Market for Exchange Deals

- Completions slowed to 210,000 square feet in the second quarter, the lowest three-month total since the same quarter in 2015. Annually, inventory grew by 0.5 percent as 1.7 million square feet was delivered. Approximately 60 percent of the 2.3 million square feet currently underway is pre-leased.
- Vacancy increased on an annual basis for the first time since 2012. In the second quarter, the rate was 5.8 percent, up 40 basis points from the same period in 2019. Vacancy ticked up 30 basis points between March and June.
- Asking rents flattened before the beginning of the health crisis. At midyear, the average rent was $15.28 per square foot, down 0.5 percent in the past 12 months.
- Single-tenant prices dipped 1 percent on an annual basis to $380 per square foot while the average cap rate ticked up 10 basis points to 6.7 percent. Multi-tenant property prices climbed 3.0 percent to $223 per square foot in the most recent 12-month period as buyers focused on quality assets.
- Capital will continue to flow into the metro as investors target areas with the strongest demographic tailwinds, including household growth. Approximately half of purchases are initiated by out-of-state buyers.

Retail Completions and Absorption



Retail Price and Cap Rate Trends



** Through second quarter*

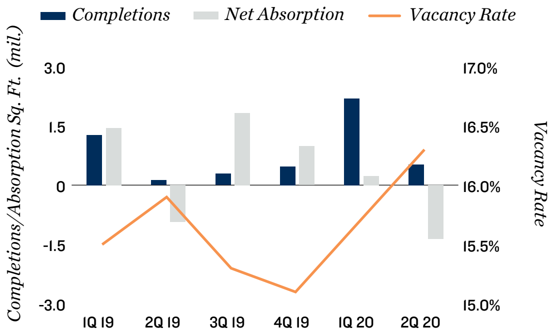
Sources: CoStar Group, Inc.; Real Capital Analytics

OFFICE

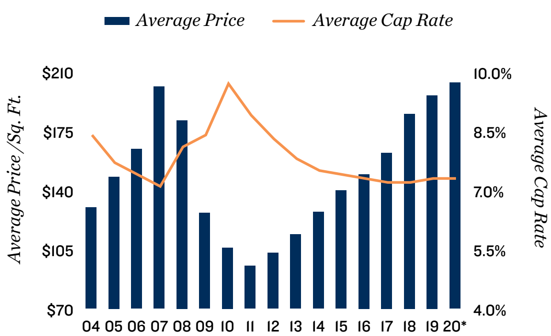
Office Investment Market Begins to Thaw Despite Cloudy Outlook on Impact of Health Crisis

- Builders finalized 520,000 square feet between March and June, bringing annual completions to 3.5 million square feet. Over the past five years, an average of 2.1 million square feet was completed annually.
- Vacancy advanced 60 basis points to 16.3 percent in the second quarter as 1.4 million square feet of space came available. The rate is the highest level since the third quarter of 2014.
- As the quality of space for lease increased, the average asking rent for available space inched higher, though a decrease is anticipated in the second half of the year as sublease space rises. In the second quarter, the average asking rent was $26.12 per square foot, up 0.7 percent from the first quarter.
- Buyers paid an average of $203 per square foot during the 12-month period ending in the second quarter, up 7 percent year over year. The average cap rate rose 10 basis points to 7.3 percent.
- A handful of deals that were in process before the pandemic accounted for a significant share of the transactions in the second quarter. However, third-quarter volume shows buyers are beginning to move back into the market.

Office Completions and Absorption



Office Price and Cap Rate Trends



** Through second quarter*

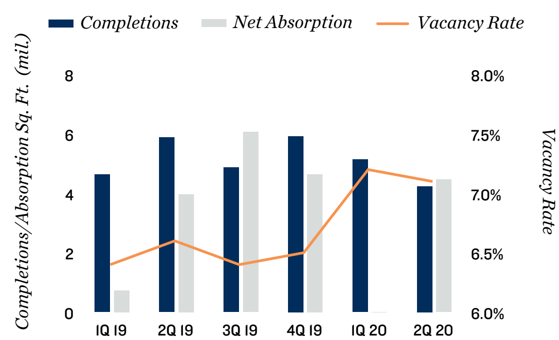
Sources: CoStar Group, Inc.; Real Capital Analytics

INDUSTRIAL

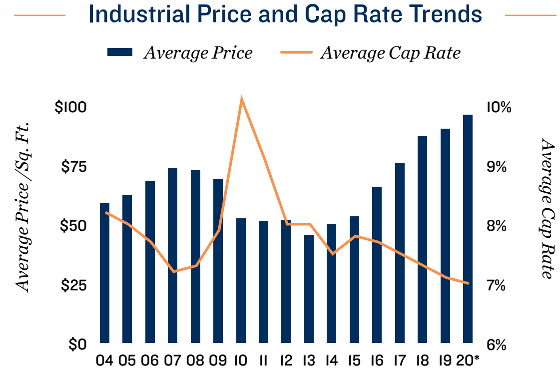
Atlanta Industrial Sector a Beacon of Strength During Uncertain Economic Conditions

- Atlanta has among the highest levels of industrial construction nationally. With the addition of 4.2 million square feet in the second quarter, annual deliveries reached 20.2 million square feet. Less than half of the 23.3 million square feet under construction has leasing commitments.
- Demand for industrial space remained healthy in the second quarter as online shopping soared and medical equipment was stockpiled. Vacancy ticked down 10 basis points to 7.1 percent between March and June.
- Sought-after warehouse and distribution space account for a significant share of the metro's industrial inventory. As a result, asking rents advanced 1.3 percent in the second quarter to $4.84 per square foot.
- The average price increased 9 percent to $96 per square foot in the 12-month period ending in the second quarter. First-year returns, meanwhile, contracted 20 basis points to 7 percent.
- Top-tier warehouse and industrial assets will continue to attract institutional capital despite the health crisis. Owner-users are expected to make up a larger share of buyers in the second half of 2020.

Industrial Completions and Absorption



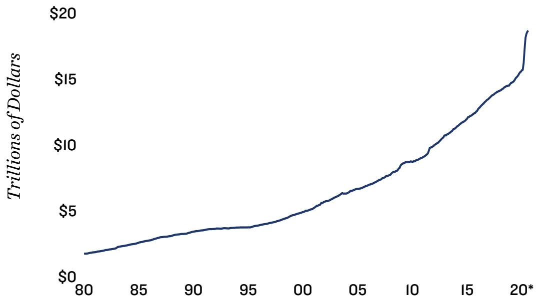
Industrial Price and Cap Rate Trends



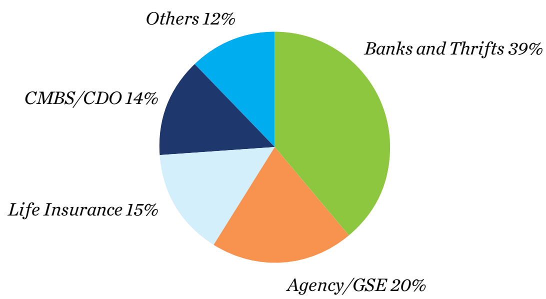
** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

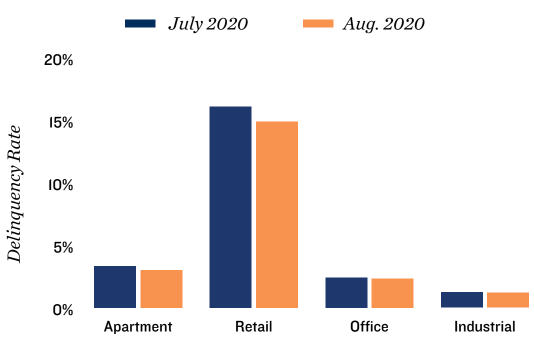
Fed Sharply Increases Money Supply During Health Crisis



Total Outstanding Mortgage Debt**



30+ Day CMBS Delinquency Rate



* Through August

** As of second quarter

Sources: Federal Reserve, Mortgage Bankers Association, Trepp

CAPITAL MARKETS

By TONY SOLOMON, Senior Vice President, Marcus & Millichap Capital Corporation

- **The capital markets are thawing relative to the height of the crisis.** Most lenders have adapted to dispersed working, and more information on the economic damage of the pandemic is affording buyers, sellers, and lenders risk and price clarity for large swaths of the commercial real estate sector. Both property performance and location can impact financing as some areas of the country outperform and the pace of recovery remains in doubt for others. Capital is readily available for assets that perform on or near par with pre-crisis levels, especially industrial assets, which buyers and lenders see as a safe part of their portfolios. Single-tenant retail with national credit tenants are also heavily favored by lenders, followed by grocery-anchored multi-tenant properties. Apartment rent rolls are more heavily examined, though financing remains available from the agencies and banks. Loans are more readily accessible for suburban office, while core buildings are more difficult to leverage. Some lenders continue to operate in the hospitality space, but obtaining financing is challenging.
- **Loan-to-value ratios were already declining prior to the pandemic and average 60 percent.** Freddie Mac is offering rates in the high-2 percent to high-3 percent range for seven-year terms. Debt service coverage is approximately 1.35 times. Life insurance companies will finance below 3 percent for apartments in some cases, and peak at 4 percent for retail. CMBS loans are available, though strict criteria makes deals more difficult to find. Rates bottom in the low-3 percent range for apartment and industrial and rise to 4 percent for office.

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Mortgage Bankers Association; Real Capital Analytics; RealPage, Inc.; Trepp

Price: $250