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Capital Trends in the Atlanta Real Estate Market

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Smith & Howard's 2017 survey of Georgia's real estate and construction industries revealed strong optimism for continued growth among all real estate market sectors. At our recent event, Georgia's industry experts discussed the market and the survey results, including the financing environment for real estate development in the region.

To gain additional perspective about the real estate capital market in Metro Atlanta, we spoke with event panelist Lance Patterson, the CEO of Patterson Real Estate Advisory Group.

Lofty Expectations

To understand Atlanta's real estate lending climate today, it's useful to take a look back at where it was before the market crash. Prior to 2008, Atlanta was experiencing a robust market that, in Patterson's words, simply became "way too frothy."

"The vast majority of developers and the capital community didn't recognize that we were doing far more deals than needed to be done," said Patterson. "There was a sense that whatever we did would be successful, so why not do more of it?" The result, he said, was a sloppiness in underwriting and decision-making, with the lending community going way out on a limb.

Patterson points to the Buckhead office market, which is often cited as the prime example of what was going wrong not just in Atlanta, but in cities across the nation. Even in the best of times, Buckhead can typically absorb one large, new commercial building every two years. In 2007, construction began on five 500,000-square-foot office buildings at roughly the same time. What's more, four of the five buildings were being developed on 100% speculation.

"Two million square feet at one time is unimaginable," said Patterson. "When the market turned downward, four of them got caught. The one building that was successful had an earlier start and was the only one with any preleased space prior to construction. The same thing happened with many condominium and apartment buildings that should never have been built." The result, he said, was far too many unfinished buildings and vacancies across Atlanta.

A More Disciplined Approach

As Atlanta and the rest of the nation began to recover in 2010, it wasn't just the development community waking up—the capital market, which buys and sells equity and debt instruments, was part of the equation. "The real estate capital market had to do some hard thinking about the mistakes it had made," said Patterson. "There was some very sophisticated institutional capital involved in financing those 500,000-square-foot buildings. The capital market lost a lot of money and had those rock-bottom years to think about mistakes made and changes that needed to be made." As a result, Patterson says, the capital market has become more disciplined with more people involved in the approval process.

"Since 2010, the capital market has remained smart and diligent, said Patterson. "Approval processes take much longer, but there is greater discipline to the entire process. This approach serves as the foundation of where the investment community is today and where we are going to be in the future."

What Does the Atlanta Capital Market Want?

According to Patterson, the real estate capital market is looking for what it has always been looking for: a good partner in a developer, projects that make sense and profit—but with much greater attention to mitigating risks.

One of the examples he cited was the trend toward urban living and the profitable development opportunities that investors are eager to support.

"Urban living is here to stay—it's where young people want to live, work and socialize," said Patterson." Most of the commercial development has been in the urban core, such as Midtown, Buckhead, East Midtown and West Midtown. Whether it is hotels, apartments or office development, capital follows the trends and sees these areas as places to invest in."

Urban living isn't just for young people, though. In fact, Midtown Atlanta is appealing to baby boomers as well. According to Kevin Green, CEO of the Midtown Alliance, residential occupancy is strong and the average age of the tenants surprises many.

"I talked to one multi-family developer who is doing a project close to Piedmont Park and his big surprise was the average age of his tenants is 52," said Green. As more jobs locate in the Midtown and Downtown areas, the Midtown area will continue see an uptick in residents of all ages and an increase in urban living.

The design of office space has evolved. Office building tenants increasingly want a tall office feeling along with long windows, concrete floors and an overall contemporary look. Patterson explained that capital follows these creative trends, and these are the projects investors want. Office buildings may be old spaces converted into contemporary spaces while investors in the apartment market are looking for new development deals.

While suburban apartment development is popular with investors, suburban office development is tougher, and the capital market has moved far away from speculative development—office buildings must have at least 20-25% preleasing to be attractive to investors.

“Prior to the crash, developers were able to sell the capital markets their projects on reputation and past successes,” explained Patterson. “That was 2006. Now you can’t have that conversation; investors want the guarantee of tenants.”

The Atlanta Attraction

Equity sources typically want to diversify, so they look for attractive opportunities around the country. Many West Coast cities are attractive to investors; so what does Atlanta offer to the capital market?

“Atlanta is a top-ten market, clearly a spot capital needs to be in for diversification,” explained Patterson. “As the capital of the Southeast, Atlanta boasts large corporations; a large number of millennials in the exciting high-tech space; universities graduating students who want to stay in the area; three major interstates; and an international airport. Along with all that, Metro Atlanta has become a major industrial distribution center.”

“Companies are looking for big warehouses, and capital would love to do these large industrial deals,” said Patterson. “That’s important at a time when industry giants like Amazon are spreading out; there is a need for large, flat acres of land.” He conceded that 100-acre sites aren’t readily available in Atlanta, so the development is likely to take place away farther out.

Patterson notes great improvement in the health of financing Atlanta real estate development from those bad pre-recession real estate deals. He says that investors in the capital market will need to be cautious of not heeding lessons from the past even as they move toward a positive future. “The capital market will need to remain disciplined. In other words, don’t do things just to do things.”

What’s on the Horizon?

It’s understandable that the current boom is accompanied by a note of caution or skepticism by those who went through the bust of 2008. Some wonder if we aren’t headed for a repeat of those days.

Patterson underscored this caution with the fact that economic cycles typically run for seven years. In 2016, the clock was running out on the seven-year market recovery, and this caused many in the investment community to put the brakes on new development projects in Atlanta. However, there has been a shift in 2017 from investment restraint to a willingness to back good projects.

“While economic cycles tend to run for seven years, that doesn’t necessarily mean that time is running out for good investments in Atlanta’s real estate markets,” said Patterson. “While we may have hit the peak of the latest cycle, that doesn’t mean there is going to be a sharp drop—after a cautious pause in 2016, I see development picking up again, but in a more disciplined, prudent way,”

For more information about Smith & Howard’s real estate services, please contact Tim Agnew of our real estate team at 404-874-6244.

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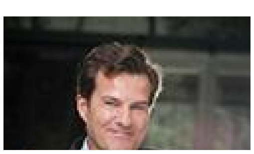

Lance Patterson formed Patterson Real Estate Advisory Group LLC, in 2009 after serving as President and Chief Operating Officer at Barry Real Estate Companies,

where he was responsible for the company's capital market activities and general administration.

His career spans 30 years in commercial real estate finance and includes experience as a banker, capital advisor, developer, loan guarantor and investor.

Over his career, he has forged relationships across the capital markets and enjoys working closely with clients to help leverage great products through appropriate capitalization. Lance is a past Chair of both the Urban Land Institute's Atlanta District Council and the ULI Atlanta Governance Committee, and he is a member of the ULI Atlanta Executive Committee. Lance was also previously chair of ULI's Urban Development-Mixed Use Commercial Silver Council.

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