The Linneman Letter

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Market Close-up: Atlanta Multifamily

Overview and Economy. Driven by the shutdown, the Atlanta multifamily vacancy rate jumped from 5.4% in the first quarter of 2020, to 8.2% in the second. However, the area's 40th percentile real rent increased by 5% in 2020 to $1,300 per unit. There were initially 2,500 more apartment units scheduled for completion in 2020 than in 2019, but delays will limit delivery to 1,300 fewer units year-over-year. The National Multifamily Housing Council (NMHC)'s Rent Payment Tracker showed an increase in missed or delayed rent payments nationally, with 76.4% and 86.2% of apartment households paying September 2020 rent by the sixth and thirteenth of the month, respectively. Programs such as the Atlanta COVID-19 Emergency Rental Assistance Program (announced August 20) are designed to provide rental, utility or security deposit assistance to more than 6,700 City of Atlanta residents.

The MSA continues to grow, reaching an estimated population of six million in 2019, up 14% since 2010 (1.6% per year). The MSA population is slightly younger than that of the nation, with median ages of 36.6 and 38.2 years, respectively, while the local median household income ($69,464) is 12% higher than the national median ($61,937).

MSA employment increased by approximately 71,000 jobs (2.5%) in 2019 and peaked in January 2020. As a result of the shutdown, the MSA lost 337,000 jobs (11.5%) between January and April 2020, subsequently regaining less than half of lost jobs through July. Year-over-year through July 2020, the largest job losses occurred in leisure and hospitality (48,300 jobs, 15.5% loss) and professional and business services (32,200 jobs, 5.9% loss). Government and education and health services weathered the shutdown relatively well, with year-over-year job losses through July 2020 of 0.1% and 0.4%, respectively.

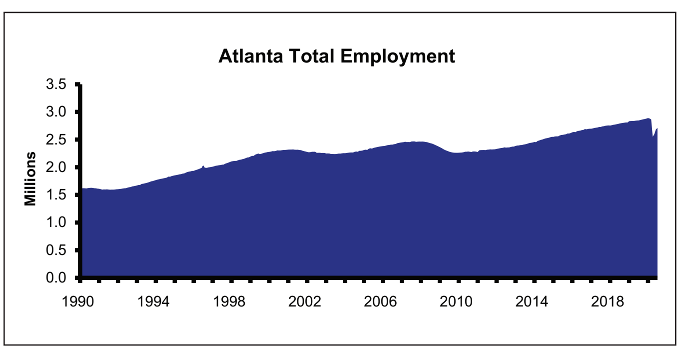
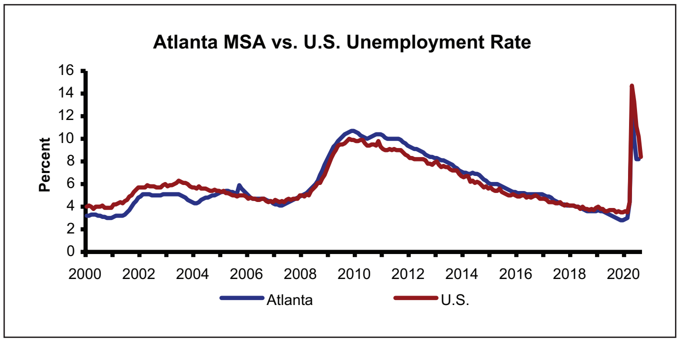


figure 1

In previous issues, we have discussed a covariance analysis that was first published in the *Spring 2007 Wharton Real Estate Review* and updated regularly in this publication. The analysis examines how various economic indicators behave in individual metropolitan areas based on national economic changes. Specifically, for each MSA, we estimated an equation, which summarizes how a 100-basis point (bp) change in national employment affects local job growth. The equation consists of a constant ("alpha") for each market and a "beta," which is a multiplier applied to the national percent change in employment. The alpha indicates MSA growth that is independent of national growth. If there is no national job growth, the alpha is the expected annual percentage change in MSA employment. The beta for the U.S. as a whole is defined as one. An MSA with a beta of 1.0 registers (on average) an increase of 100 bps in employment growth around its trend plus alpha when national employment rises by 100 bps. A beta that is less than 1.0 indicates that the MSA does not boom (or bust) relative to its trend to as great an extent as the national economy, while a beta of greater than 1.0 indicates that such an MSA experiences swings of greater magnitude (compared to the local base) than percentage changes at the national level.

The Atlanta MSA has an employment beta of 1.51 and an alpha of 0.29, indicating that employment growth is highly pro-cyclical and that when U.S. employment growth is zero, the MSA experiences job growth of 0.29% per year. The MSA's break-even U.S. job growth rate is -0.19%, meaning that as long as U.S. job declines are not worse than -0.19% per annum, the MSA's job growth is expected to remain positive. The MSA's R-squared statistic of 0.89 indicates that the forecasting model for MSA employment growth explains future job growth with a strong 89% "fit."

Our model projects that the Atlanta MSA should have lost 8.9% of jobs given that the nation lost 6.3% of its jobs during the Great Recession. In actuality, during the Financial Crisis, the MSA lost 8.4%. U.S. employment grew by 17.6% from the bottom through February 2020, while the MSA's employment increased by a strong 27.4% from the bottom, modestly below our predicted 31.2%. Between February and April 2020, the U.S. lost 14.5% of jobs, while the MSA lost 11.5%. As the economy partially reopened, national employment increased by 7.1% from the low in April through July 2020, implying expected job growth of 10.3% in the MSA. However, the Atlanta MSA saw actual growth of 6.2% over the same period.



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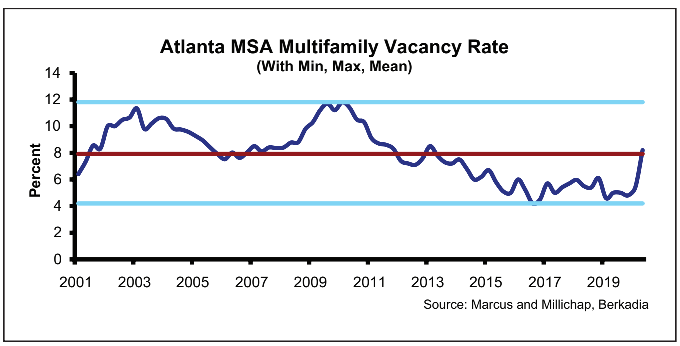
Atlanta's unemployment rate previously peaked at 10.7% in November and December 2009 and reached a low of 2.8% in November and December 2019. The MSA unemployment rate was as low as 3.0% in February 2020 but spiked to 12.8% in April before dropping to 8.2% in July. By way of comparison, the national rate dropped to 3.5% in February 2020 but reached 14.7% in April 2020, before dropping to 10.2% in July and 8.4% in August.

Absorption and Vacancy. Shutdown fears have put a halt to new construction projects. The MSA's brokerage-reported vacancy rate increased over the last year by 320 bps, to 8.2% in the second quarter of 2020. This is just 30 bps higher than the average long-term vacancy rate of 7.9%. The NCREIF vacancy rate of 8.1% in the second quarter of 2020 reflects an increase of 160 bps and 70 bps over the last year and quarter, respectively. This will not recover any time soon due to the widespread job losses resulting from the Covid-19.

Rental Rates and Leasing. According to NCREIF, the average second-quarter 2020 multifamily real rent in Atlanta stood at $16.10 per square foot per year, representing an 11.8% increase year-over-year. However, the full repercussions of the shutdown were not fully felt at that time. The current NCREIF rent is 79% and 35% above the historical (since 2001) low and average, respectively, and on par with the high seen in September 2019.

HUD reported that real rents (2019 dollars) paid by the 40th percentile renter in the MSA averaged $1,300 per unit in 2020, up by 5.0% from $1,239 per unit in 2019. This is 18% above the 35-year real average of $1,105 per unit. Expect this to soften.

Development/Construction Pipeline. According to Berkadia, there are currently 8,501 units under construction in the MSA, with another 28,879 in the planning phase. Assuming that 50% of projects do not pass the planning phase, there are a total of 22,941 units in the pipeline.



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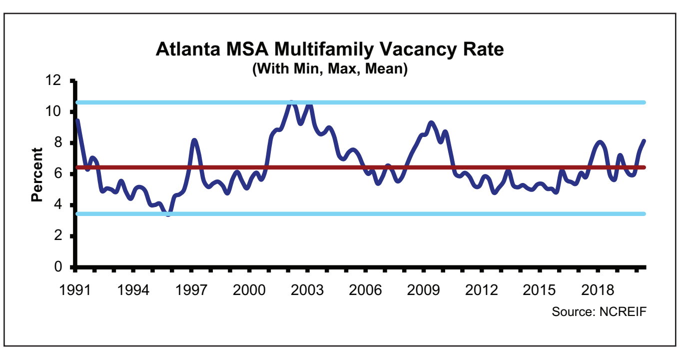

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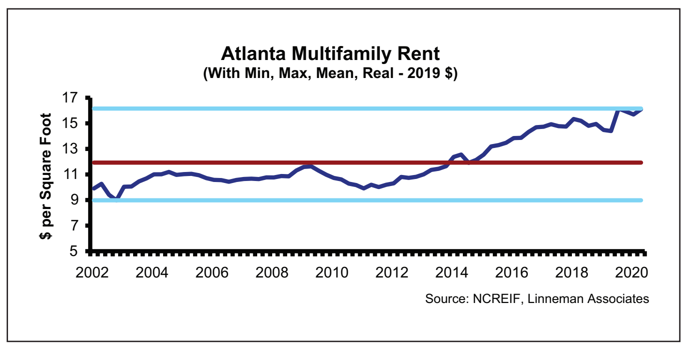

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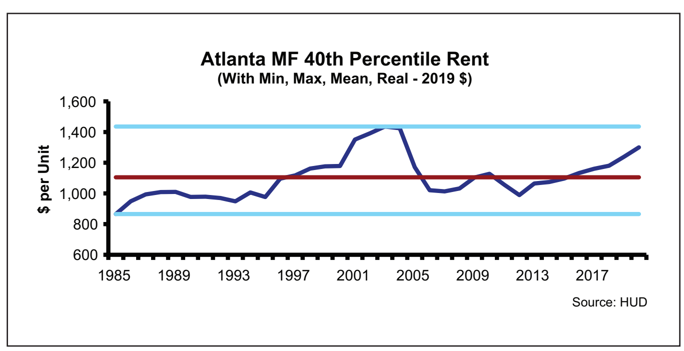

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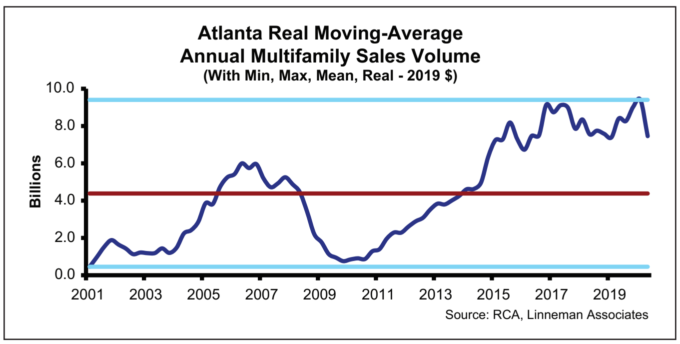
A majority of the construction pipeline is in the urban core, with 83% of units under construction and 62% of units in the planning phase.

Investment and Sales. According to Real Capital Analytics (RCA), the MSA's multifamily real sales volume dropped to $405 million across 18 properties in the second quarter of 2020, the lowest volume since 2011, primarily due to shutdown effect. The rolling four-quarter real sales volume was $7.5 billion, comparable to the average of the past 5 years. Transactions will continue to be constrained for the next several months.



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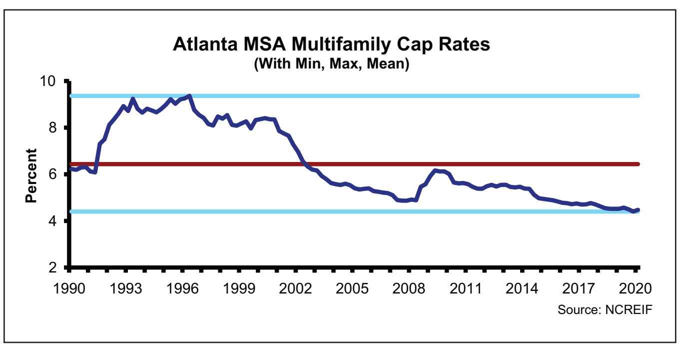

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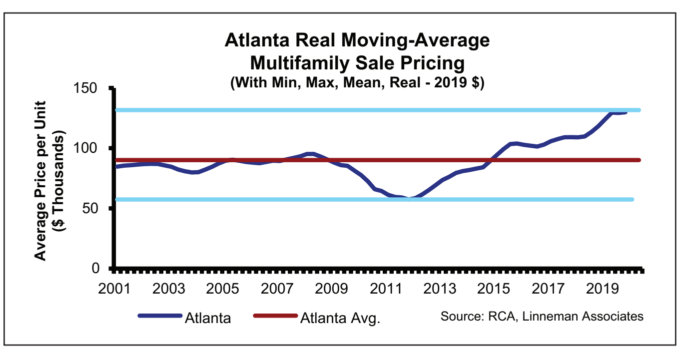

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MSA multifamily cap rates hit a cyclical low of 4.9% in 2007 prior to the Financial Crisis was emerging. In the second quarter of 2020, the average NCREIF cap rate in the Atlanta multifamily market was 4.5%, lower than the historical mean of 6.4% and unchanged from a year ago. The MSA cap rate was 190 bps and 490 bps below the historical average and historic high, respectively.

In the second quarter of 2020, the real price per multifamily unit (2019 dollars) in Atlanta was roughly $140,000, versus $164,000 nationally. Current four-quarter rolling-average pricing is at a 20-year high of just under $132,000 per unit and well above the real long-term (2001-present) average and low of $90,000 and $57,000 per unit, respectively.

Major buyers of multifamily properties over the past two years include Bridge Investment Group ($440 million in acquisitions, seven properties); Cortland ($377 million, four properties); Harbor Group International ($365 million, ten properties); Greystar ($279 million, five properties); and Pollack Shores RE Group ($270 million, three properties).

Major sellers of multifamily properties over the past two years include Radco Cos. ($495 million in dispositions, ten properties); Walden Group ($365 million, 15 properties); Cortland ($341 million, six properties); Crow Holdings ($269 million, four properties); and Morgan Stanley ($252 million, two properties).

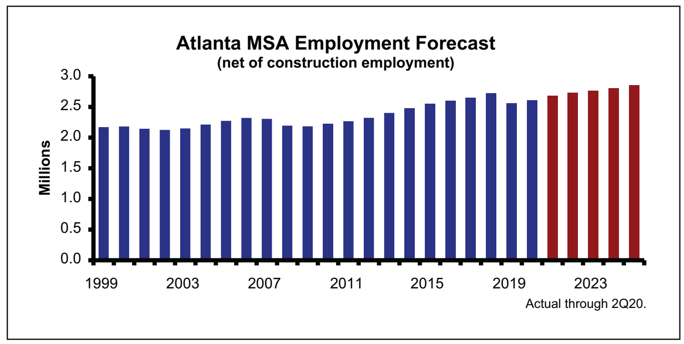
Opportunities and Challenges. As an international hub for logistics, education, health care, and trade, the Atlanta economy continues to slowly bounce back. Employment gains in the months of May through July reflect businesses re-opening.

With its favorable business climate and low cost of living, Georgia has been increasingly attracting companies since the 1990s. Atlanta is a compelling choice for corporate relocation, given its relatively new infrastructure, access to talented graduates from Georgia Tech, Emory, and Georgia State, and proximity to Technology Square in Midtown, which homes dozens of innovation centers. Fortune 500 companies, including Delta, The Home Depot, UPS, The Coca-Cola Company, etc. have headquarters in the MSA. Microsoft Corp. recently announced plans to open a new workspace in the MSA, occupying a 523,000 square-foot facility in the popular Atlantic Station district. The company expects to create 1,500 new jobs in the MSA. Amazon, which has seen explosive growth during the pandemic, is opening a massive new Atlanta-based packing and shipping center that will bring about 1,000 new jobs to the area. Existing businesses are also expanding and providing more jobs to the MSA. For example, The Home Depot plans to add more distribution centers in three counties, recruiting about 1,800 new employees in total.

Several major infrastructure projects are underway in the MSA, all with the purpose of improving facilities to accommodate anticipated growth in traffic volume. Hartsfield-Jackson Atlanta International Airport has been the busiest airport in the world since 2000 and is undergoing the 20-year ATLNext modernization project, which will add a new fifth gate to Terminal T, a new sixth runway, and an extension of the underground Automated People Mover. In addition, the nearby port of Savannah, which is the fastest growing container port in the U.S., announced a major expansion project that will increase the port's capacity by more than 20% by its completion in 2022.

A large portion of Atlanta's development has been concentrated in the downtown and midtown areas. Some major development projects in the MSA currently include the Midtown Union, Novel Midtown, and the Herndon Square Project. Midtown Union consists of two mixed-use high-rise buildings, providing 355 multifamily units, 610,800 square feet of office space, 210 hotel rooms, and 33,500 square feet of retail space. Completion of both Midtown Union and Novel Midtown is expected in the fall of 2022. Novel Midtown will feature 338 multifamily units, 312,000 square feet of office space, and 5,500 square feet of retail space. Herndon Square is located on 12.3 acres of the former Herndon Homes public housing site on Northside Drive, west of Downtown. This redevelopment will convert the site into a mixed-income community with a grocery store and 674 housing units, of which 45% will be affordable housing for those earning up to 80% of the area's median income. Phase I will be a mid-rise building with housing for seniors, Phase II will have a mix of affordable and market-rate housing and retail, and the final phase will include 32 townhomes.

Outlook. The truth is that no one knows what near-term job growth will be, but we use our best estimates of job recovery nationally and within each MSA. Our employment forecasts are net of construction jobs due to the volatility and short-term nature of that sector. We forecast that the MSA will add an average of 62,000 non-construction jobs per year in 2021-2025. The second-quarter 2020 multifamily vacancy rate stood at 8.2% and is expected to increase notably through year-end 2020 and then begin a 3-year recovery.



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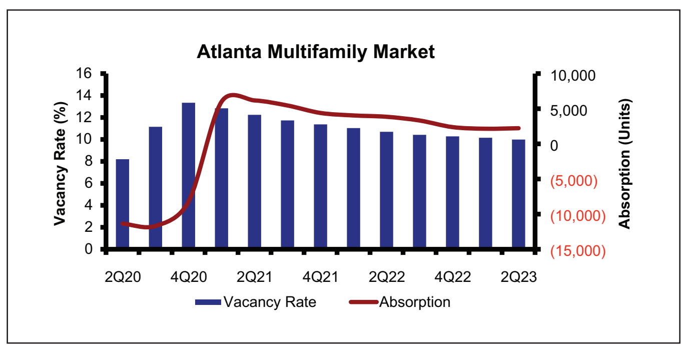

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