HADDOW'S REAL NEWS

QUARTERLY MARKET INSIGHTS

SECOND QUARTER 2018

THE MONEY TREE

The flow of capital greatly influences the intensity and direction of real estate cycles. While each rising market is fueled by a slightly different mix of capital sources, one common denominator exists: easy money breeds trouble. Therefore, it is instructive to examine where we stand today.

The two main culprits that drove the last real estate cycle have been muted this time: subprime mortgages and commercial mortgage-backed securities. Banks have been much more restrained due to a stricter regulatory environment and the lingering memory of the financial sector's collapse.

Money was tight as the current development cycle got underway in 2012. This began to change as alternative investments (i.e. stocks and bonds) lost some luster and real estate enjoyed great value appreciation. There has been a fundamental shift from a heavy reliance on debt in favor of equity. The three primary sources have been private equity firms, real estate investment trusts (REITs), and foreign investors.

Private equity funds have dedicated an increasing share of their assets to real estate investment. An inflated stock market and low yields on financial assets explain the appeal. Groups like Blackstone, Carlyle, and Apollo have funneled large sums into real estate. Good results have encouraged others to follow suit.

REITs have flourished since 2010. According to NAREIT, the number of equity REITs in the U.S. grew from 126 to 181 between 2010 and 2017. The market capitalization of these REITs went from $358.9 billion to $1.07 trillion during this period. Consider one local example: Preferred Apartment Communities. This REIT was launched in 2011 by the late John Williams, and already had assets of $3.3 billion at year-end 2017.

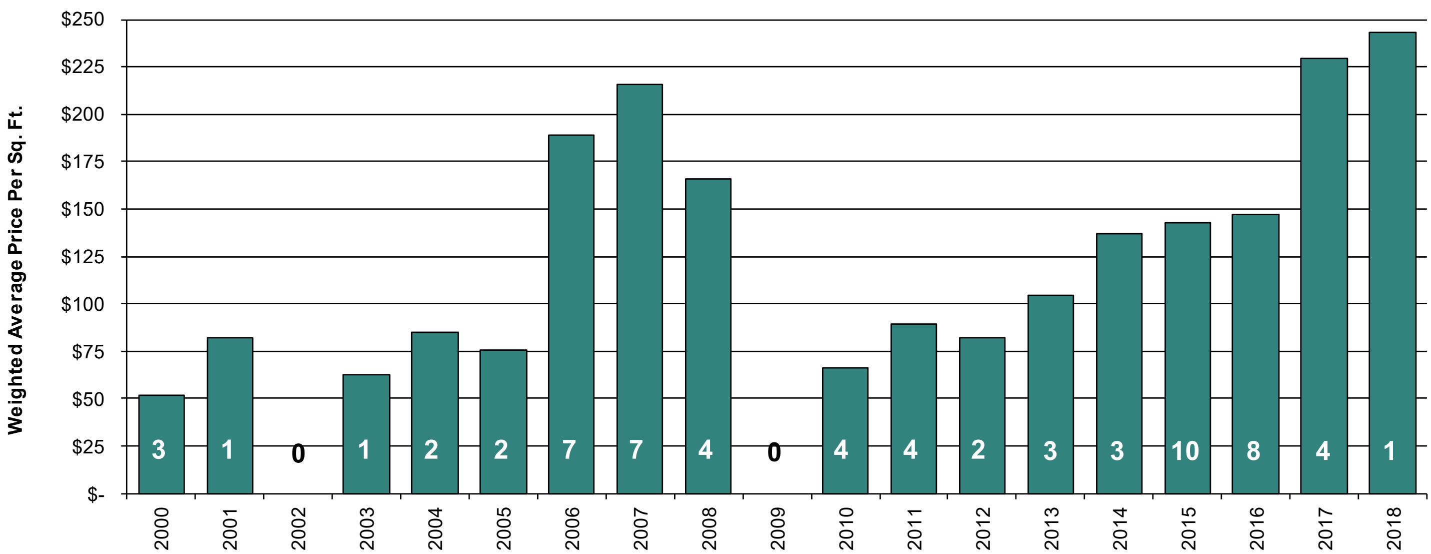
Foreign investors have long been drawn to Atlanta, and a new wave of investment has occurred in this cycle. Groups like Dezhu (Chinese) and Drapac (Australian) have made significant investments in recent months. In spite of turbulence at the federal level, our country is still viewed as a safe haven for long-term investment.

The wildcard this time is the public sector. At least ten new cities have been incorporated in the Atlanta region since 2005. Some of these have made aggressive investments in real estate, including Sandy Springs, Dunwoody, and Peachtree Corners. More established governmental bodies, like Gwinnett County, have dramatically ramped up their direct investment in real estate. In addition, groups like Invest Atlanta and the Development Authority of Fulton County have doled out financial incentives to promote development.

In short, the cast of characters has shifted but the money still flows. The emphasis on equity instead of debt, coupled with greater attention to sound underwriting, have contributed to a healthy balance in today's real estate capital markets. The tendency, however, is to become overheated late in the economic cycle, which causes supply to surge as demand contracts. We need to stay alert to incipient signs of excess.

MIDTOWN LAND PRICES

Since the recession, Midtown has been the leader in apartment development activity, particularly high-rise towers. In recent years, there have been some significant office building announcements as well, most notably build-to-suit developments for NCR and Anthem. Land prices and transaction volume are good market barometers. Prices peaked in 2007 before the market's downturn and are on a sharp rise once again, but the pace of transactions is slowing as scarcity of quality sites is becoming a factor.



Note: The number in the bars represents significant land sales that have occurred in that year. 2018 data are as of July.

THE EVOLUTION OF SHOPPING MALLS

The rise of e-commerce and the changing shopping habits of consumers have impacted the retail industry, especially traditional shopping malls. In metro Atlanta, many of these assets are being repositioned and redeveloped. Some local examples are highlighted below:

- At ***Gwinnett Place Mall***, Northwood Ravin bought the Sears department store and associated parking to redevelop with apartments.
- General Growth Properties is converting vacant retail space into 25,000 square feet of coworking space at ***North Point Mall*** in Alpharetta. Spaces will operate the coworking facility.
- Simon Property Group is launching a partial redevelopment of ***Phipps Plaza*** to accommodate a mixed-use development.
- The owners of ***North Dekalb Mall*** have submitted plans to raze the existing structure and replace it with a multi-use, open-air concept that would include a Costco, hotel, restaurants and housing.
- The former ***Shannon Mall*** was acquired by Rooker and torn down for industrial development and a film studio.