

THE DENIAL INSTINCT

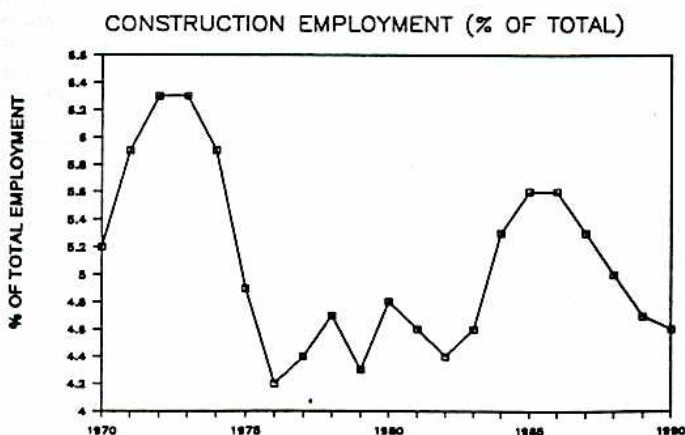
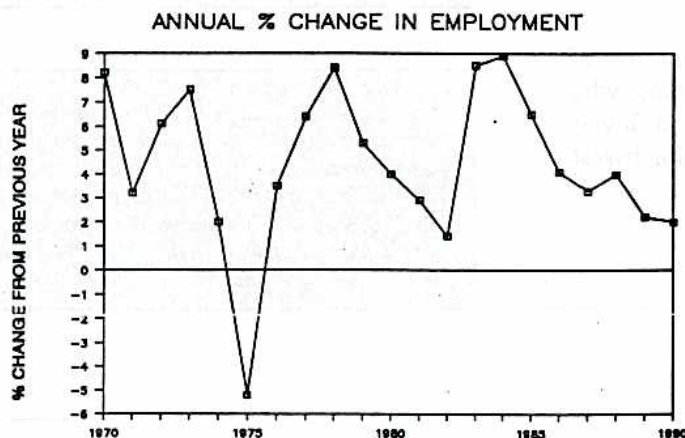
Denial is a common response when faced with unwanted conditions. The tendency is to spurn bad symptoms while fiercely embracing any trace of good news.

The real estate industry has known its share of denial. There was reluctance to accept that savings and loan institutions had no business investing in commercial real estate. Syndications raised tons of money before investors focused on economics. Developers kept building with only their projects in sight, and lenders mortgaged the future for a bundle of fees, not bothered by the detail of loan repayment.

Denial is now thwarting the market's recovery. Many investors refuse to accept the diminution in property values. They would rather strangle on carrying costs and lost opportunities for new

investment than recognize the loss. The problem is that new investment capital will stay parked on the sidelines until the market correction is complete. Prospective buyers are deterred by concerns that real estate values have not yet "bottomed out." This hesitation prevents a needed capital infusion and restricts transaction activity, the lifeblood of a major segment of the real estate industry.

Of course, some properties will recover their lost value as the economy rebounds and a better supply-demand relationship is restored. Some owners are clinging to false hope, however, since original acquisition prices or loan amounts were at levels beyond the reach of even a robust market. These investors should embrace the concept of sunk cost and face the inevitable, which would help real estate stage a comeback as an investment vehicle.



UNDERSTANDING CYCLES

Economic and real estate cycles generally run in tandem, although the two do not necessarily coincide. The accompanying graphs illustrate this point. Atlanta's economy soared from 1970 to 1973, having recovered quickly from the 1969-1970 recession. Construction jobs peaked in 1973 at 6.3 percent of total employment. The Arab Oil Embargo and an overbuilt real estate market then caused a sharp decline in employment and new construction. The economy rebounded quickly, but real estate did not stage such a dramatic comeback.

Atlanta boomed again from 1983 to 1988, with the real estate zenith attained in 1985-1986. Both the Atlanta economy and real estate market should bottom out in 1991, but construction will not come roaring back. Similar to the late 1970s, economic vitality will return well before the real estate sector heals. When construction jobs account for more than 5.5 percent of total employment, the next real estate cycle may be approaching its peak.

ATLANTA'S DOMINANT OFFICE SECTORS

Unlike most major U.S. cities, Atlanta's office market is not dominated by the Central Business District, but by two suburban areas: Northwest and North Central. During the past six years, these submarkets have accounted for 44 percent of Atlanta's inventory growth and 48 percent of net absorption. Although the Northwest and North Central submarkets have captured the lion's share of office activity, there are some fundamental differences between the two areas.

- o The North Central area's physical environment is superior due to controlled development, the high quality of existing office parks, and an excellent internal road network. By contrast, commercial sprawl preceded the Northwest area's office development, resulting in a patchwork land use pattern, traffic congestion, and poor aesthetics.
- o The vacancy rate in the Northwest area has hovered in the 20 percent range for several years. The North Central area's vacancy rate actually fell below 15 percent at year-end 1990 and remains well below 20 percent despite completion of the final phase of Ravinia in April, 1991.
- o Each submarket has experienced slower absorption since 1989, falling well below the historic average (1985-1988) of more than 1.0 million square feet per year. Net growth in occupied space has been stronger in the North Central area, averaging nearly 750,000 square feet annually during 1989 and 1990, compared to 550,000 square feet in the Northwest market.
- o The North Central area has a substantial amount of sublease space available, which partially explains why lease concessions have remained high despite a lower vacancy rate. Conversely, sublease space in the Northwest area is fairly limited.

RECENT ENGAGEMENTS

Three recent assignments reflect the changing nature of our work and the state of the real estate market. **Chase Manhattan Bank** retained **Haddow & Company** to prepare marketing plans for the unsold units in five foreclosed condominium projects located in metro Atlanta. Our study approach included a survey of existing owners, which helped define the target market. Recommended marketing and pricing strategies were tailored to meet the specific needs of each project.

The **Fairlie-Poplar Task Force**, which was created by Mayor **Maynard Jackson**, hired our firm to prepare a revitalization plan for a 23-block area of downtown Atlanta, known as the **Fairlie-Poplar District**. The purpose was to understand the problems plaguing this historic area and to identify property uses that would ensure its long-term vitality. The study concluded that **Fairlie-Poplar** could not recapture its past glory as the center of commerce, but it could be revived by establishing linkages to the activity centers that surround the district, particularly **Georgia State University** and the **Atlanta Market Center**.

Many investors have turned their attention to existing assets rather than new acquisitions. **Dutch Institutional Holding Company** is a prime example. This pension fund group retained our firm to assist in strategic planning for six office buildings in Atlanta, Charlotte, and Washington, D.C. These properties were acquired during the early and mid-1980s. The goal was to provide a good understanding of current and anticipated market conditions, as well as a comprehensive review of the buildings' operating performance.

Haddow & Company is a real estate consulting firm founded in 1989 to serve the various needs of developers, investors, lending institutions, and others. The company's services include market and feasibility studies, investment analysis, development planning, disposition counseling, highest and best use studies, and marketing strategies.



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