Everything Has Changed': 2023 Brought A Reckoning For Atlanta Commercial Real Estate

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There are a few words to describe Atlanta's commercial real estate scene in 2023: Transitional. Challenging. Sobering.

But perhaps the most representative word for the year that was, above all, defined by the highest interest rates in decades? Purgatory, said RADCO Cos. founder Norm Radow.

"Sellers know they're going to hell, but they're grabbing on and delaying what will happen," Radow said.

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The year started off with some hopeful signs for office when MARTA expanded with a 130K SF lease in Uptown Atlanta, taking space previously occupied by AT&T. AT&T even brought some hope back for a return-to-office trend when it leased 120K SF at 1277 Lenox Park Blvd., a building that it had previously occupied but vacated when the communications giant consolidated its office footprint in Buckhead.

While the office market had been softening in 2022, boosters of the metro area felt economically bulletproof, riding high on an in-migration trend that benefitted Atlanta and other major Sun Belt metros.

And then Microsoft happened.

The tech giant announced in February that it was halting plans to develop a 90-acre corporate campus on Atlanta’s Westside, a project that sparked a redevelopment boom in the area when it was announced in 2021.

Area stakeholders and residents were shocked by the backtrack, expressing concern that the redevelopment momentum would falter and Microsoft’s many promises for the project — including affordable housing — would never materialize.

Microsoft was just the start of a string of anticipated projects and corporate offices getting axed.

Carvana backed out of plans to sublease 570K SF from State Farm at Park Center Building 1 in Central Perimeter in April. Twitter, as it was called at the time, backed out of its more than 40K SF lease at Ponce City Market in May, where it was paying some of the highest rents in the city. NCR listed 864 Spring St. — one of its two new headquarters towers spanning 14 stories — on the sublease market.

“Our year was fine, but it was a hard year,” said David Rubenstein, the market leader for Savills in Atlanta. “Every transaction was difficult.”

The pullback has been concentrated in Atlanta’s technology sector, a sector that is under pressure due to skyrocketing interest rates and a decline in venture capital funding, said John Boyd, the principal of corporate site selection consulting firm The Boyd Co.

“Technology companies, until this economic slowdown, have been flush with cash,” Boyd said. “When these guys are in cost-cutting mode, it has ripple effects.”

Windsor Stevens Holdings Managing Member Rod Mullice, who is developing an apartment project not far from Microsoft's stalled campus, said the failure of Silicon Valley Bank has especially impacted Atlanta’s tech industry, cutting off a prominent source of funding.

Google Maps

A portion of the site owned by Microsoft where it announced plans for a major office campus in 2021.

“The VC community is reeling right now,” Mullice said. “The startup community is in bad shape. We have a bunch of zombie technology companies.”

The tech pullback deflated the office market, and attention has increasingly focused on landlords and their ability to hold on to properties, as an estimated $625M of office loans in the region matured in 2023, according to Trepp.

The sharp rise in rates — 11 times over the past two years — has made it more expensive to pay off those mortgages, if a landlord can even find a lender. That has led to some notable moments of distress.

General Electric Pension Trust and State Street Global Advisors lost the Central Perimeter office building that has served as Autotrader's headquarters to Wells Fargo, and several smaller buildings have faced foreclosure actions from their lenders.

The restrictive lending environment has meant distress isn't contained just to offices. The Sheraton Hotel Atlanta and the W Atlanta — Downtown were turned over to their lenders, while a Sandy Springs apartment complex also nearly wound up on the auction block.

Even Olympia Heights Management, the New York-based developer that had long planned to develop the Southeast's tallest residential tower in the heart of Midtown Atlanta, lost control of its property at 98 14th St. when Benmark Capital foreclosed on the prominent parcel last month.

"No matter how fast [the Federal Reserve cuts rates], the fact is we overshot ourselves in values in 2020 and 2021, and the piper has to be paid," Radow said. "It's not just about the capital markets. Rents are also under pressure. Concessions are up. Delinquencies are the highest they've been. You can't evict anybody. Insurance rates are sky high."

Many developers' aspirations, fueled by the unsustainable growth of 2021, also toppled to earth this year.

Tishman Speyer backed out of plans for a $700M office and apartment project in West Midtown, the Atlanta Business Chronicle reported. Newport RE ceased its redevelopment work on South Downtown after its investors balked at funding any more of the aspirational project, a move that pushed the swath of properties into foreclosure. An auction was recently avoided with Atlanta Ventures looking to buy the portfolio, the ABC reported.

Portman scaled back its redevelopment plans for three buildings along Ponce de Leon Avenue across from Ponce City Market that would have included new office space.

"The financing market is crunched right now. It's not even remotely close to being a reality to finance office in any place," Portman Vice President of Development Mike Greene told The Atlanta Journal-Constitution in August.

Lender sentiment hasn't been boosted by the fundaments in the data. Metro Atlanta's office market began setting records for all the wrong reasons this year, with vacancies reaching an all-time high of 23.7% in the third quarter and companies offering more unused office space for sublease than ever before.

Avison Young principal Kirk Rich said those metrics were the fingerprints of a larger confusion gripping the office industry: Exactly how much office space do companies need when workers are still working at home at least part of the time?

"It was a year we thought would [see employees] come back to work, and we thought there'd be clarity around debt," Rich said. "But both of those still haven't worked out."

A number of big office leases executed in 2023 reflected the increase in hybrid work with smaller footprints. Deloitte slashed its office space in half in its move to Promenade Tower in Midtown from 191 Peachtree St., and General Electric's GE Vernova division shrank its office space by 70% in its new lease at 600 Galleria Parkway in Cobb County.

Bisnow/Jarred Schenke
Windsor Stevens partner Rod Mullice

Rich said company leaders are still wrestling with their office footprints, which has forced landlords to be more flexible, even when renewing their existing tenants.

"Before the pandemic, you either did a three-, five- or seven-year renewal, or you didn't," Rich said. "You'd tell them to take a hike. You don't do that now. Everything has changed."

While the metro area and the U.S. economy have thus far avoided a recession, the uncertainty reflected in the office market — where jobs tend to be higher-paying — is reflected in bifurcated economic data, Rajeev Dhawan, the director of the Economic Forecasting Center at Georgia State University's J. Mack Robinson College of Business, wrote in a recent report.

"Job compression in sectors ranging from corporate to transportation resulting in fewer homeowners moving up to bigger and better jobs, combined with a reluctance to take on higher-rate mortgages, has put the nation in a white-collar, middle-class, middle-management 'recession,'" Dhawan wrote.

"This isn't a recession in the traditional definition because job creation is continuing in the healthcare, hospitality and construction sectors," he added. "But that's not balanced growth. During the so-called 'Goldilocks economy' of the late 1990s, two high-paying jobs were created

Courtesy of Kirk Rich
Avison Young principal Kirk Rich

for every one low-paying job. That is not the case now. High-paying job growth is completely stalled. The question is whether or not Federal Reserve rate cuts can spark a reversal."

Experts told *Bisnow* the ups and downs in all sectors will continue into 2024. But there is cause for optimism, driven in large part by signals from the Federal Reserve that it may backtrack on rate hikes in 2024.

The prospect that the Fed may cut rates three times in 2024 will go a long way to alleviating the uncertainty and pressures around commercial real estate values, said Margaret Stagmeier, managing partner with the apartment developer TriStar.

"I do think we're going to have to settle into the new normal, which really was the old normal before interest rates got so low," Stagmeier said. "And I do think the Fed is going to backtrack somewhat. But the low interest rates of the past five years will not be repeated because they weren't sustainable."

The metro area's higher education nexus with Georgia Tech and the historically Black colleges and universities pumping out skilled and diverse talent is still seen as a driver of economic development, buffering the city against a collapse in activity.

During a recent *Bisnow* event focused on the 2024 outlook, K.C. Conway, principal at economic research firm Red Shoe Economics, said that migration into Georgia is now happening from Florida in great part because the cost of operating and owning real estate has jumped.

“What's the No. 1 reason that they're moving out of Florida? It's not because it's a nice place or sunny and all that kind of stuff. The No. 1 [reason is the] expense side, and it's out of control: property insurance,” Conway said during the Dec. 5 event. “Businesses are saying, ‘You know, we can't make it work.’ Homeowners can't make it work. Their property and their monthly property insurance premium exceeds their mortgage.”

But rather than the tech companies that fueled Atlanta's momentum before and after the onset of the pandemic, it is likely to be a different industry that leads the state's recovery, Conway said.

Georgia's boom in electric vehicle manufacturing escalated in 2023, with billions of dollars committed by Hyundai and LG and Rivian securing final approval last month for its $5B plant outside Atlanta. The industry is poised to continue growing, with the Peach State at the heart of it, bolstered by the growing Port of Savannah.

“The new activity will build new economic legacies for our community,” Conway said. “We're in a great position with the right region, the right GDP, the right economic climate. We're not free, no income tax, but we're not really high. We're a business-friendly environment. Let's just not screw it up.”