Population Growth and Affordable Cost of Living Accelerate CRE Renaissance in the Southeast

Moody's predicts that the demographic shift will intensify over the next few years, with the Southeast realizing the greatest population gains in the nation, notes Wagner.

Patricia Kirk | Jun 13, 2017

With rapid growth across markets in the Southeast, the region has emerged as a diverse, economic powerhouse, resulting in strong commercial real estate fundamentals for all property types. The Southeast's rosy story is the result of a shift in both population and business growth from the Rust Belt to these Southeastern markets and a reflection of the region's desirability.

Collectively, the six states comprising the region—Alabama, Florida, Georgia, North Carolina, South Carolina and Tennessee—would form the sixth largest country in the world from a GDP standpoint, according to the Urban Land Institute (ULI). Over the last three to four years the Southeast has also experienced the greatest population growth in the United States. The Atlanta population increased by 1.6 percent, Miami's by 1.5 percent and the population of Raleigh, N.C. by 2.5 percent, compared to 0.5 percent population growth in Los Angeles and Boston during the same period, 0.25 percent in New York City and Philadelphia and a population decline in Chicago, notes Dan Wagner, Atlanta-based regional research manager with commercial real estate services firm CBRE. Wagner authored a series of recent reports on the Southeast's real estate markets.

Population migration south began 50 years ago. Gartner Lee, president of GCP, an Alabama-based industrial investor, pinpoints the beginning of the trend, saying, “People started moving here for the warm weather when we got air conditioning.” Ratings firm Moody’s predicts that the demographic shift will intensify over the next few years, with the Southeast realizing the greatest population gains in the nation.

“The crux of real estate is population—the more folks, the more demand for goods and services,” Wagner says, noting that population is growing in places with warm weather, coupled with affordability and a desirable lifestyle. This is mainly happening in the Southeast, which is outperforming most metrics across the U.S., with the exception of outliers Las Vegas and Phoenix, which are also experiencing rapid growth.

One group likely to boost population growth in the Southeast over the next few years involves retiring baby boomers, many of whom prefer a warm climate and an urban environment, which is fueling both retail and multifamily development in Southeastern cities, according to a 2016 Market Outlook report from CBRE. The CBRE analysis notes that the region’s rock-solid foundation will support rapid growth and generate continued expansion for the foreseeable future, due to its affordability and desirability for both residents and businesses.

The Southeast boasts low costs of labor and land, great infrastructure and advanced manufacturing and distribution hubs, as well as the presence of a young, educated workforce and low cost of living.

Atlanta, Nashville, Tenn., and Charlotte, N.C., are successfully attracting technology, advertising, media and information firms to their commercial business districts (CBDs) and developing tech submarkets. At the same time, smaller markets like Greenville-Spartanburg and Charleston in South Carolina and Savannah, Ga., are experiencing tremendous industrial expansion, as port capacities grow in response to strengthening consumer demand in both domestic and global markets.

Atlanta in particular is experiencing steady business expansion due to operational efficiencies and low cost of doing business, Wagner says, pointing out that a 2016 KPMG report cited Atlanta and Miami as the top two big cities globally for low cost of doing business. This study looked at labor costs, costs of leasing or owning commercial space, tax burdens and the cost of utilities.

These two Southeast gateway markets combined account for roughly 20 percent of the region's population, but 40 percent of investment in commercial real estate, according to a 2017 CBRE report on the Southeast.

Atlanta

The CBRE researchers note that Atlanta has been adding new jobs much faster than the rest of the nation, creating demand for multifamily product and giving developers and investors confidence in the market. Multifamily vacancy in the city peaked at 11 percent in 2009, according to the report, and has since been cut in half, with rent growth in all Atlanta sub-markets increasing on average 7.3 percent year-over-year.

The main reason for the strong rent growth is that demand is outpacing supply. Developers added 10,900 units during the last 12 months ending in March, according to brokerage firm Marcus & Millichap. As a result, Atlanta's strong multifamily fundamentals are attracting more interest from both domestic and foreign investors than ever before. The average effective rent will climb 5.0 percent in 2017 to $1,115 per month. Last year, a rise of 5.5 percent occurred.

Increases in both apartments and single-family dwellings are generating a boom in Atlanta retail development. The CBRE report notes that existing infrastructure in the urban core is being repositioned for high-end retail. For instance, Ponce City Market, a redevelopment on Atlanta's Beltline, repurposed a historic Sears & Roebuck warehouse as 330,000 sq. ft. of retail space. The success of this project generated more proposals for the Atlanta Beltline, including a $298 million mixed-use project with 220,000 sq. ft. of retail.

Strong industrial expansion is being fueled by increasing e-commerce sales, as well as import and export activity and manufacturing. The CBRE report notes that proximity to the widening Panama Canal has helped to promote e-commerce-related expansions in markets throughout the Southeast.

For example, GCP has acquired six class-A industrial properties, with 11 buildings and a total of 1.6 million sq. ft. of space located from Georgia to Miami over the last 12 months. With e-commerce the biggest driver in the industrial market, Lee notes that his company only acquires industrial product of 100,000 to 300,000 sq. ft. in urban locations near large consumer markets.

Most industrial space inside Atlanta's beltway, for example, is obsolete, as little new class-A development has been built here. The vacancy rate in the sector is projected to be at 7.4 percent this year, according to Marcus & Millichap.

Lee notes that the majority of new industrial facilities built in Atlanta are boxes of 500,000 sq. ft. or larger, located on the outskirts of suburban markets. As a result of its investment strategy, GCP has realized 10 percent to 15 percent year-over-year rent increases over the last few years, Lee says.

He also points out that population growth has increased the availability of labor, resulting in expansion of manufacturing facilities in the Southeast, particularly in the automotive sector. Mercedes, for example, has undergone a $1.3 billion expansion of manufacturing facilities in Birmingham and Tuscaloosa, Ala. Roughly 24 percent of GCP's industrial portfolio comprises automotive-related industrial facilities in both Alabama and Georgia.

“The labor component is extremely important,” says Wagner, noting that occupancy costs are a secondary consideration to labor for the manufacturing sector. “The Southeast has been able to attract companies because population migration from the Rust Belt is bringing in high-quality labor.”

This has been a particular advantage in attracting the automotive sector, he points out, noting that Mercedes relocated its North American headquarters to Atlanta, and Porsche also built a manufacturing facility here. In addition, Kia and Volkswagen have built big manufacturing plants in La Grange and Chattanooga, Tenn., respectively. Meanwhile, both BMW and Volvo have located manufacturing facilities in South Carolina: BMW in Spartanburg and Volvo in Berkley County.

The migration to Atlanta is generating modest office development, which has been stagnant since the recession. Atlanta office vacancy is at the lowest level in 15 years and class-A space is commanding record high rents. In fact, Wagner notes that Atlanta has been forecast as “the most prepared office market in the U.S for a downturn.”

With a lack of available space for incoming and expanding companies, more than 2 million sq. ft. of speculative office space is currently under construction, but the majority of this space already has committed tenants, according to Wagner. While new deliveries are expected to keep vacancies from falling, he projects market rents will continue to rise, as new product will feature higher asking rates due to rising construction costs and strong demand.

In fact, CBRE’s 2016 Scoring Tech Talent report cited Atlanta as a market that features two critical components for long-term growth in the tech industry: high educational attainment and affordability. These attributes foretell long-term sustainability in current growth rates in terms of attracting new companies, as well as organic growth.

Wagner notes that the city is now a top market for firms engaged in science, technology, engineering and math (STEM) activities.

With increasing competition for core assets in gateway markets, many investment firms, especially international investors, are beginning to consider Atlanta because it blends the stability found in core U.S. markets with the long-term growth prospects of the Southeast's largest office market, he says.

Miami

The Miami market, which comprises Palm Beach, Broward and Miami-Dade counties, is also experiencing exceptional population and job growth, along with strong property fundamentals.

The three-county Miami region, with more than 6 million residents, is the state's largest consumer market, and population is projected to grow by 1.2 percent in the coming years, according to CBRE. Tourism, financial services and logistics will continue to drive economic growth, with predicted average job growth of 1.7 percent annually.

Population in Miami-Dade alone increased by 157,000 residents between 2010 and 2015 and is forecast to add another 178,000 residents by 2020. Total employment in the county increased 14 percent during the five-year period, while personal incomes rose by 21 percent.

A boom in multifamily construction generated completions that outpaced demand in recent years, posing the biggest near-term challenge faced by the Miami apartment market. While vacancy is currently low at 4.0 percent and rents continue to rise, deliveries in 2017 are expected to boost vacancy slightly to 5.0 percent, causing rent growth to slow from the 8.0 percent annual peak in 2014 to 2.4 percent this year.

New apartment development has been concentrated in Miami's urban core, so those neighborhoods will be the most impacted by a softening in the rental market.

Meanwhile, apartment property sales rose by 48 percent in 2016 over the previous year, according to data from Real Capital Analytics (RCA), a New York City-based research firm. Pricing also increased, by 36 percent since 2014.

Private capital dominated the market over the past two years, with 70 percent of properties sold to private investors. But CBRE researchers note that the flow of institutional capital into Miami's apartment market surged in 2016 and accounts for 60 percent of investment sales in the local multifamily market so far this year.

Growth in population, jobs, incomes and tourism boosted Miami's retail sales by 34 percent between 2010 and 2015, according to CBRE, which noted that annual retail sales are expected to grow by another 23 percent by the end of 2020. Tourism spending increased by 18 percent during the five-year period. A record 15.5 million people visited Miami in 2015, nearly 11 million of them arriving from abroad.

Interest from institutional buyers has helped to compress cap rates for high street assets in the market to between 3.5 percent and 4.25 percent. Nearly 2.3 million sq. ft. of retail space was under construction in the city in 2016 and millions of additional square feet are in the pipeline or planned, according to CBRE.

Office development in Miami has been constrained since the recession. Wagner notes that the only major office inventory added since 2010 was at Brickell City Centre. This $1.05 billion, 5.4-million-sq.-ft. mixed-use project in the heart of Miami's financial district includes 260,000 sq. ft. of office space in two towers.

As a result of limited new construction, vacancy dropped to under 12.0 percent by 2016, and asking rents are predicted rise to $17 per sq. ft. in 2017 and nearly $18 per sq. ft. in

2018, according to CBRE, which noted that sustained high absorption levels are now sufficient to launch a boom in office development.

Strong office fundamentals also generated private and institutional capital investment from across the U.S. and around the world, with third quarter 2016 sales up 41 percent year-over-year.

The outlook for the market's industrial sector is also positive. The industrial sector is benefiting from both Miami's close proximity to the expanded Panama Canal, as well as the 2 million tons of cargo annually coming through Miami International Airport, the third largest air freight facility in the U.S., notes a CBRE report. Net absorption has exceeded 3 million sq. ft. for the past five years, but new product deliveries have only exceeded 1 million sq. ft. twice during that period. The industry vacancy rate in the market stands at 3.8 percent with a rental rate of $6.87 per sq. ft., according to real estate services firm JLL.

Strong demand sparked a flurry of investment sales, reaching roughly $1.5 billion in 2016, up from $100 million in 2009, and a boom in industrial construction ensued. Now with more than 2.4 million sq. ft. of industrial space under development, the market will soften slightly as vacancy rises over the next couple of years and rent growth is expected to slow down.

But while Atlanta and Miami garner the most attention, several smaller Southeastern markets, including Nashville, Tampa and Charlotte, are also boasting strong growth and highly educated workforces.

Charlotte

Home to 2.4 million residents, Charlotte is the largest metro area in North Carolina, with an economy driven primarily by the financial sector. Charlotte, in fact, is the largest banking center outside of New York City, according to CBRE.

Businesses from across the nation are migrating to Charlotte, attracted by a highly educated workforce, low cost of living, a business-friendly climate and the presence of an airport hub.

The 2016 analysis from CBRE noted that new office and industrial construction in Charlotte has failed to keep pace with absorption levels. Low vacancy and rising asking rates, along with rapid job creation, have put this market into expansion mode.

Dwindling office supply and few options for office tenants requiring large blocks of space are generating construction of both build-to-suit and speculative development. Continued tenant demand is expected to keep office vacancy below 10.0 percent through 2017.

About 50 percent of the U.S. population lives within a one-day drive from Charlotte, making this metro very desirable to large distributors. With record e-commerce activity in recent years, vacancy in the industrial sector here has hit a record low, giving landlords greater negotiating leverage, especially for modern class-A assets with 30-foot high clearance. Asking rents will continue to be aggressive, but may soften as new product is delivered.

Nashville

Nashville is one of the fastest growing markets in the country, with strong job growth, construction activity and high investor interest, according to CBRE's reports. Nationally recognized as a great place to live/work/play, downtown Nashville has experienced record-setting levels of development over the last 10 years. And its blend of affordability, quality lifestyle and strong urban environment is attracting both businesses and labor.

In fact, Nashville stood out in CBRE's 2016 Financial Services and Scoring Tech Talent report for its ability to attract and retain a quality workforce.

Nashville is also a major logistics hub. Besides serving a population of 1.8 million, this market is located just a day's drive away from Memphis, Tenn., Birmingham, Ala., Louisville, Ky., Charlotte and Atlanta.

While size limits its status to a secondary market, Nashville's increasingly high profile and diverse employment base, including a thriving music industry, automotive manufacturing and financial institutions, are attracting increasing amounts of capital investment.

Tampa, Fla.

Located on Florida's Gulf Coast, the Tampa-St. Peterburg market, which includes Hernando, Hillsborough, Pasco and Pinellas counties, is home to Port Tampa Bay, which has helped to define the region as a logistics hub. It is Southwest Florida's economic anchor, with active defense and security industries and a strong financial services sector. In fact, Tampa is home to 10 percent of the nation's Fortune 50 shared-services operations.

Moody's predicts that growth in the Tampa market will keep pace with the rest of nation, as the area reaches full employment. An average 2.1 percent annual growth in employment is already putting upward pressure on wages and resulting in economic acceleration.

The region's biggest challenge in attracting business is the lack of a modern mass transportation system. The Tampa Bay Express, a program aimed at modernizing

Tampa's transportation infrastructure, along with the establishment of cross-bay ferry services, should help the market overcome this deficiency.

Demand for commercial properties here has accelerated in recent years, with sales volume reaching nearly $6.3 billion in 2015, but then slowing in 2016. While investors remain cautious, Tampa is a growing market with competitively priced assets and high-yield opportunities, according to CBRE.

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