

Biotech in Georgia: the 2003 update

Beata D. Kochut

Shortage of capital makes life difficult for small biotechnology companies, and the ongoing consolidation exacerbates the industry's jitters. Although biotech companies suffered a considerable downturn in equity markets in 2002, the industry emerged a clear winner in the first half of 2003, with major biotech index funds outperforming both the Dow Jones and NASDAQ. While much of the 1999-2000 biotech market craze was caused by the anticipated completion of the human genome project, the 2003 upturn is based on the industry's major players' profits and promising product lines. The 2003 advances, however, compensate for only a fraction of the 2001-2002 losses.

Despite the global economic slowdown and uncertainty in the stock market, publicly traded biotechnology firms saw an increase in product sales (14.8 percent) and revenues (14.8 percent). The net losses more than doubled in 2002 compared to 2001, however.

The number of biotech firms and their employment points to the industry's ongoing consolidation. Only nine new biotech companies were launched in the U.S. in 2002—bringing the total to 1,466 companies—while 24 of the 342 publicly traded firms went out of business, or got absorbed by larger partners. An average biotech firm employed 132 workers in 2002, more than double the average employment in 1992. The average publicly traded company employed 449 workers in 2002, ten times more than the average employment in private biotech firms (45 employees). Out of

1,466 biotech companies operating in the country, only 318 are publicly traded. The biotech scene is still dominated by small, private firms, but it is the larger firms that make profit.

According to Ernst & Young, seven out of eight largest U.S. biotech firms posted net income gains in 2002, and 20 publicly traded biotech firms posted profits each year since 1999. Experts predict that the industry as a whole will turn profitable within the next five years, which should improve access to capital and stabilize stock prices. The consolidation trend is expected to

continue in the coming years, but the industry will continue to count on innovation and research coming from smaller firms.

Stocks and debt make up the main source (72.6 percent) of biotech financing, with debt steadily rising in importance, and providing more than 50 percent of biotech's funding in 2002. But money raised in the Initial Public Offerings has fallen off sharply, dropping from 20.3 percent of financing in 2000 to just 4.3 percent in 2002 as the biotech companies postponed entering the markets. The valuation of the existing biotech firms also fell dramatically in the last two years.

Venture capital is the second most important source (after debt) for biotech financing, and while the money raised in equity markets shrinks, the percentage and sums raised from this source has climbed steadily. In 2002 venture capital provided 25.7 percent of the total biotech funding. The average dollar amount per deal increased triple-fold in the last decade, but the number of deals actually rose more



slowly than that, another sign of the industry's ongoing consolidation. In the first quarter of 2003, biotechnology investment remained basically unchanged from year-end 2002, but investment in medical devices fell. Nevertheless, biotechnology was the second largest venture capital recipient; only software companies did better.

How Georgia Stacks Up

For the second consecutive year, Georgia ranks ninth in the nation in terms of the number of biotech firms, the majority of which are located in the Atlanta-Athens area. Atlanta has developed as a center of the biomedicine and medical devices industry, while Athens is focused on genomics and animal science. Augusta's biotechnology scene is quickly growing in size and prominence too, with its thriving medical establishment providing a base for medical devices and software companies. Other biotechnology firms are scattered around the state, attesting to industry boosters' claims that biotechnology can add to the local

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economies around the state. The fact remains, however, that specialized infrastructure is a must for this continued growth.

Most of Georgia's biotechnology firms are small, and many reside in state, university, or locally sponsored incubators. The shortage of capital, however, forces some of these successful companies to move elsewhere, lured by cash or incentives granted by other states.

In terms of venture capital funding, Georgia's biotechnology and medical devices firms raised over \$427 million between 1995 and 2003, with the average deal raising about \$6 million. By comparison, an average deal in California (the industry giant) netted nearly \$8 million. Compared to the rest of the top twelve biotech states, Georgia ranks seventh in the value of an average 1995-2003 deal, but eleventh in terms of total sum raised. The state is ninth among the top 12 states in terms of an average amount of money per deal invested in biotechnology firms, but fifth in medical devices, which is a strongpoint.

A closer look at the gap separating industry giants and the rest of the states reveals that biotechnology is still a relatively open field. Although California has about eight times as many biotech firms as Georgia, states in the middle of the pack (New Jersey, New York, Pennsylvania, and Texas) have between 48 and 69, with Georgia clocking in at about 43. Based on the value of an average deal, however, Georgia raised more money per biotech company in 2002 than California, Maryland, North Carolina, New Jersey, Pennsylvania, and Texas.

The Good News

Despite the brutal market and global economic conditions, life science industries in Georgia have shown much resilience. New companies are coming in: for example, Beocarta, is moving to Rome, and Collgard Biopharmaceuticals is relocating its U.S. headquarters from Boston to Atlanta. Elan Corporation has announced that it will expand its Gainesville facility sometime in the next three to five years. The investment will produce about 100 jobs. In the southern part of the state, a group of scientists plan to purchase a paper mill in St. Mary's, and use it to produce ethanol and other industrial and pharmaceutical compounds. If successful, the plant will replace most of the jobs lost when the paper mill closed.

The biotech and pharmaceutical industry is tracking two Georgia companies with extremely promising product pipelines. Atlanta-based Pharmasset has two HIV-related drugs in clinical trials and two hepatitis B drug candidates in pre-clinical trials. AtheroGenics, another Atlanta firm, is enrolling patients in clinical trials to test its new atherosclerosis medication.

Good news continues in Athens too. The Abeome Corp. has secured \$1.5 million in financing. Prolinia, the cloning company, was purchased by ViaGen Inc., a Texas firm, but

Table 1

U.S Biotech Industry Fundraising

	<u>Value (\$Mil.)</u>						
	1996	1997	1998	1999	2000	2001	2002
Public	4,768	4,860	3,129	9,428	28,930	9,568	7,582
IPO	1,465	688	369	670	6,490	440	445
Follow-on	2,414	1,601	521	5,805	12,651	2,539	979
PIPEs	537	1,283	977	1,433	4,061	1,741	907
Debt	352	1,288	1,262	1,520	5,728	4,848	5,251
Private	552	753	884	1,268	3,075	2,406	2,866
VC	449	569	800	1,084	2,872	2,397	2,688
Other	103	184	84	184	203	9	178
Total	5,320	5,613	4,013	10,696	32,005	11,974	10,448
	<u>Percent of Total</u>						
	1996	1997	1998	1999	2000	2001	2002
Public	89.6	86.6	78.0	88.1	90.4	79.9	72.6
IPO	27.5	12.3	9.2	6.3	20.3	3.7	4.3
Follow-on	45.4	28.5	13.0	54.3	39.5	21.2	9.4
PIPEs	10.1	22.9	24.3	13.4	12.7	14.5	8.7
Debt	6.6	22.9	31.4	14.2	17.9	40.5	50.3
Private	10.4	13.4	22.0	11.9	9.6	20.1	27.4
VC	8.4	10.1	19.9	10.1	9.0	20.0	25.7
Other	1.9	3.3	2.1	1.7	0.6	0.1	1.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Based on Burrill & Co. data.

the company's research staff remains here. Also in Athens, Bresagen Ltd., one of a handful of stem-cell research firms eligible for federal money, announced a Parkinson's disease treatment breakthrough. Meanwhile, the stem cell researchers at the University of Georgia hope to further boost the school's reputation in this field by establishing a regenerative science center.

Perhaps the most exciting news for biotechnology in Georgia comes from Augusta, where plans developed by the Georgia Medical Center Authority and the Medical College of Georgia include biosciences incubator space and a biotechnology research park to house firms that outgrow incubator space. Plans are also underway to develop a cancer research park, scheduled to be ready in 2005. Augusta's strategic approach to growing a bioscience industry counts

on the existing medical establishment to recruit companies and researchers. By providing incubator space for startups and providing facilities for fledgling companies, Augusta is likely to attract existing companies, nurture firms that spin off from academic research, and keep them in Augusta when they succeed.

The war on terrorism has opened new sources of funding for organizations and companies dealing with bioterrorism. The location of CDC in Atlanta, and infectious disease-related research at the state's universities and biotechnology firms make Georgia a natural candidate for this special federal funding. The resources already in place at the Medical College of Georgia, for example, prepared the way for the creation of the Disaster Medicine Research Institute in Augusta.

Table 2

Total 1995-2003 Venture Capital Investment in Biotechnology and Medical Devices Companies

	Total Investment (dollars)	Number of Deals	Average per Deal (dollars)	Total Investment Rank	Per Deal Investment Rank
California	13,366,425,000	1,674	7,984,722	1	3
Massachusetts	4,286,191,000	601	7,131,765	2	4
Maryland	632,627,000	110	5,751,155	8	10
North Carolina	1,226,760,000	182	6,740,440	4	5
New Jersey	1,267,953,000	157	8,076,134	3	2
New York	569,202,000	95	5,991,600	9	9
Pennsylvania	1,196,476,000	199	6,012,442	5	8
Texas	650,991,000	125	5,207,928	7	12
Georgia	427,154,000	71	6,016,254	11	7
Washington	1,093,494,000	130	8,411,492	6	1
Florida	217,100,000	38	5,713,158	12	11
Connecticut	551,189,000	91	6,057,022	10	6

Source: Based on PriceWaterhouseCoopers Money Tree reports.

Although Georgia's researchers and bioscience companies continue to build the state's reputation in life sciences, many industry leaders cite persistent problems that have to do with the shortage or the lack of capital, specialized infrastructure, research parks, sympathetic political climate, and leadership. Although many of these elements have started to fall into place, the state's empty coffers and uncertain market situation mitigate hopes for a speedy and forceful change.

The Challenges

The shortage of capital is a major hurdle for biotechnology firms nationwide. In Georgia, the dearth is exacerbated because relatively few local venture capital firms specialize in financing the bioscience industry. So a state-run fund that provides fledgling companies with loans and startup money would be a powerful draw for biotech firms. The North Carolina Biotechnology Center, for example, has granted millions of dollars in loans to biotechnology firms willing to locate there. Last year's decision by the Georgia legislature to provide \$3 million in seed capital to biotech firms is only a small step in the right direction.

Incubator facilities at the state's colleges and universities, providing young companies with lab space, equipment, and business expertise, have been an important ingredient in the research-to-market transfer. Today, three such facilities

target the specific needs of biotech companies: the Georgia Biobusiness Center (University of Georgia), EmTech Bio (Emory and Georgia Tech), and CollabTech (Georgia State University). Georgia Tech's Advanced Technology Development Center provides a wide range of services for technology-related companies, and plans to open its own incubator space in the future. Clark-Atlanta University and Kennesaw State University also provide services to bioscience startups.

Making the transition from incubation to self-sustained industry is a major challenge for the state's bioscience industry, so the development of biotech research parks in Georgia is on the agenda of several state, local, and university-based groups. Long-term plans call for developing the Atlanta-Athens corridor along Highway 316 as a bioscience research park, but these plans depend on the interest of potential occupants, commercial developers, and road improvements to 316 itself. Central Atlanta Progress, Inc. and the Georgia Research Alliance are exploring the possibility of developing a biosciences research park in downtown Atlanta that will link the facilities at Grady Hospital, Georgia State University, Morehouse College, and Emory University. The state's bioscience infrastructure also will get a boost with the long-overdue upgrade of facilities at the Centers for Disease Control in Atlanta, where ground was broken earlier this year for the new headquarters building.

Statewide leadership has begun to take shape with the Georgia Research Alliance, Georgia Biomedical Partnership, Metro Atlanta Chamber of Commerce, and the Georgia

Table 3

**Amount of Venture Capital Funds Raised per Deal, 1995-2003
(dollars)**

	<u>Biotechnology</u>	<u>Rank</u>	<u>Medical Devices and Equipment</u>	<u>Rank</u>
California	9,662,134	2	6,478,475	1
Massachusetts	8,665,598	5	5,050,565	8
Maryland	6,966,351	8	3,253,250	11
North Carolina	7,419,732	7	5,653,571	4
New Jersey	9,373,684	3	6,087,952	2
New York	8,960,804	4	2,550,023	12
Pennsylvania	6,376,638	12	5,127,069	7
Texas	6,782,754	10	3,501,867	10
Georgia	6,951,455	9	5,596,367	5
Washington	10,002,296	1	5,781,796	3
Florida	6,403,091	11	5,432,074	6
Connecticut	8,490,111	6	3,676,826	9

Source: Based on PriceWaterhouseCoopers Money Tree reports.

Department of Industry, Trade and Tourism all embracing the bioscience industry as one of their top priorities. Legislative action aimed specifically at the biotechnology industry has thus far produced a bill to grant tax credits to biotech firms that have jobs paying more than \$1,250 a week. A new state law that lowers the required number of employees that a company headquarters must have before it can qualify for tax credits is a major break for biotechnology firms, most of which are small. Yet another bill proposes that eligible pharmaceutical firms could receive tax credits for materials and equipment purchases.

There has been a flurry of activity in Georgia designed to present the state as a hub for knowledge and technology-based industries. The GDITT-sponsored national TV and Internet advertising campaign trumpets Georgia's science and technology industries. The biotech industry has height-

ened its visibility by an increased presence at the annual BIO Convention. A presentation to the state congressional delegation, and a pitch to the biotech companies at the Augusta Showcase are other examples of actions designed to bring attention to the state's burgeoning bioscience industry. The efforts toward hosting the annual BIO Convention in Atlanta are likely to produce even more exposure and interest in Georgia's life science industries.

The efforts to solidify Georgia's image as a hub for bioscience industries translate directly into more highly-paid jobs. Today, each biotechnology job adds an estimated 2.9 more jobs to the labor market. Moreover, jobs in knowledge-based industries, especially biotechnology jobs, will not be easily replaced by foreign competition, since the American university and research infrastructure, on which these industries depend, is unparalleled in the world. ■

Construction outlook for 2004

■ Jeffrey M. Humphreys ■

With less new construction overall in 2004, this sector will not be as dominant. Higher mortgage rates will slow the housing market and high vacancy rates coupled with limited demand growth will postpone recovery for nonresidential construction. Because unsold properties will accumulate very gradually, selling prices will stagnate rather than decline. Occupancy rates for most property types also will not decline much more.

Spending by state and local governments for structures will decrease, reflecting the lagged impacts of several years of weak revenue collections and as well as lower bond prices. Builders will find some relief in the form of minimal pressures on wages as well as lower priced building materials.

In the private sector, the property types with the best prospects are medical facilities, retail developments located next to new subdivisions, moderately-priced infill housing, and second and leisure home developments. Still, the prospects for these relatively strong niches are not stellar. Multi-family housing, office buildings, and hotels will provide the fewest opportunities for new development.

Rents and property values will flatten and could decline slightly in some areas, but the risk of drastic price drops in most areas is minimal. Fortunately, worrisome housing bubbles do not exist in any of Georgia's major cities. It is true that market conditions recently have favored sellers, but the growing number of new homes prevented shortages that could have produced a housing bubble. Although home prices soared in a few prime locations, the existence of a few "hot" areas in a growing metropolitan market is normal. Also, existing home prices are in line with replacement costs, which implies that prices will not fall very much as mortgage rates rise and buying activity cools.

Throughout the state, and in metro Atlanta, suburban and ex-urban development will continue to outpace center-city and inner tier suburban development, but these respective growth rates will converge rather than diverge. Traffic congestion, long commutes and hectic schedules are three of the reasons why, but demographic changes—

the increasing numbers of “echo boomers”—and lifestyle choices also contribute to the urban renaissance. These trends favor firms that focus on developing new in-town properties or on the redevelopment of urban properties, even though the restructuring of the dot-coms has reduced demand for urban real estate.

Single-Family Homes

In 2001-2003, the stark contrast between Georgia’s overall economic malaise and the red-hot housing market was quite apparent. Several forces powered the housing market, but the drawn-out descent of mortgage rates to their lowest level in nearly five decades was the economic lynchpin. The historically low rates were a golden opportunity: renters became new homeowners, and current homeowners refinanced their mortgages or took out equity.

The halcyon days have ended. The forecast calls for an 8 percent decline in the number of new single-family homes authorized for construction, and the drop in actual starts probably will be one or two percentage points higher. This amount of homebuilding will still exceed the level that prevailed in the mid-1990s, but it may be some time before the homebuilding industry revisits the lofty peaks attained in the last two years. Mortgage rates will be drifting higher throughout 2004, too. Moreover, pent-up demand is largely satiated, and there are few potential buyers.

Although the housing market definitely will cool down in 2004, conditions will not shift drastically. Mortgage rates will rise gradually, and can climb by at least a full percentage point before they lose their allure. Also, even a modest upturn in employment and personal income growth will partially offset the impact of higher mortgage rates by giving more people the wherewithal to buy homes.

More positively, the state’s increasing numbers of permanent and seasonal residents will reinforce demand for vacation and retirement homes. Older Georgians will continue to be a mainstay in the housing market. A large proportion of the elderly own their homes, and have built up substantial equity and have relatively stable sources of income, making this part of the market less sensitive to fluctuations in economic conditions and mortgage rates. Because many retirees choose to live in Georgia’s mountains or on the coast, these areas already see high demand for retirement homes. Georgia’s military bases help the state attract retired military personnel, too. Although older homeowners now absorb only a small percentage of the market, the fact that they are living longer and have more financial resources certainly will create a major impact.

For the last few years, people’s doubts about the stock market appear to have increased the appeal of purchasing second homes as an investment. In 2004, the relative appeal

of the stock market may increase, which would reduce investors’ interest in residential real estate. Nonetheless, the reduced federal income tax on home sales and improvements in telecommunications that allow people to conduct business while on the go will keep them interested in buying second homes.

Although speculative overbuilding currently is not a major concern facing Georgia’s homebuilders, inventories are expected to increase as demand tapers off. As the costs of carrying a finished home escalates, builders’ margins will narrow. But many years of robust housing sales drastically reduced the number of desirable older homes on the market, so new construction therefore may account for much of a diminishing volume of total sales.

Housing will be less affordable in 2004, as the negative effects of higher mortgage rates more than offset income growth. Construction costs will be well behaved, however. Shortages of available lots will drive up housing costs in some prime areas, but are not expected to have a substantial impact on overall activity. Rents are expected to decline, reducing the pressure to buy a home. There will not be much appreciation in most areas because of reduced demand and the ample number of new and existing homes on the market. Compared to last year, house-price performance will favor buyers over sellers; however, higher mortgage rates will make it harder for buyers to purchase as much house in 2004 as they could in 2003, which implies that demand for inexpensive and mid-priced homes probably will be firmer than demand for homes at the upper end of the market.

Multi-Unit Residential Construction

After three years of dwindling demand, things will improve. But an oversupply of apartments and condos will postpone any rebound in rents and prices until 2005. Initially, it was demand for multi-unit housing that faltered, creating a tenant’s market. Supply-side problems, however, increasingly are to blame for the property glut. When the recession hit, Georgia already had too many of these large projects underway. Also, some developers were unable to resist the abundance of inexpensive capital made readily available by creditors flush with cash and short on alternative investments.

The prospects are better for retirement housing, which will benefit from a strong demographic push and the substantial equity that many older homeowners have accumulated. Retirees increasingly will prefer communities that offer many levels of health care and different types of housing. Assisted living facilities are becoming more popular, but in some parts of the state, particularly metropolitan Atlanta, too much new capacity has temporarily saturated the market. Increasingly, universities will develop retirement housing for nostalgic alumni.

Apartment and condo developers will see slightly more business in 2004, and popularity of in-town living should continue to grow, but market saturation will keep prices and rents in metro Atlanta on the decline.

Public attitudes will continue to be an impediment to high-density housing and mixed-use development in the suburbs. Several suburban Atlanta counties have moratoria on building new apartments, and homeowners will remain adamant until they understand that market forces are shifting: high-density and mixed use development—especially when combined with transportation options—increasingly will help nearby homes to appreciate faster than would otherwise be the case.

Renovation and Repairs

The refinancing of home mortgages is a major source of funds for home-improvement projects, so the dramatic decrease in refinancing is not a good sign for the home improvement industry. Less appreciation in the value of homes also will curtail spending on home-improvement projects. Still, those who own older homes are likely to invest in repairs and improvements. Adaptive re-use and conversion of obsolete commercial properties into residential lofts and mixed-use spaces will continue to help the industry, too.

Nonresidential Construction

Overall spending for new nonresidential construction will decline again in 2004. The commercial real estate industry is especially vulnerable to sudden deterioration in underlying economic conditions, which increases the risk associated with such investments. It probably will be at least 2005 before rents begin to increase significantly, and until that happens, speculative projects will be scaled back now that both interest rates and risks are rising. Spending for publicly funded structures will wind down as state and local governments' monthly revenue collections have continued to disappoint.

Weak revenue collections mean that school construction may not rise very much in 2004, but the pause probably will be very brief. In many jurisdictions, special local option one-cent sales taxes may provide some additional funding for new school construction. Slight increases in the property tax base also will help to support school construction, but efforts to limit the power of local authorities to reassess property may restrain spending.

Slow growth in office-based employment will be the primary factor restraining demand for new office space, but foreign investors' interest in office buildings will also continue to wane. Moreover, many companies that recently

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Table 1

NEW RESIDENTIAL BUILDING UNITS AUTHORIZED FOR GEORGIA, 1990-2004

	Total New Residential	Percent Change from Previous Period	New Single-Unit Residential	Percent Change from Previous Period	New Multi-Unit Residential	Percent Change from Previous Period
1990	41,251	-18.2	33,009	-6.1	8,242	-46.2
1991	37,580	-8.9	33,592	1.8	3,988	-51.8
1992	44,566	18.6	42,087	25.3	2,479	-37.8
1993	53,874	20.9	47,599	13.1	6,275	153.1
1994	64,860	20.4	52,530	10.4	12,330	96.5
1995	72,225	11.4	55,027	4.8	17,198	39.5
1996	74,874	3.7	59,397	7.9	15,477	-10.0
1997	75,123	0.3	59,596	0.3	15,527	0.3
1998	85,401	13.7	67,879	13.9	17,522	12.8
1999	89,581	4.9	71,530	5.4	18,051	3.0
2000	91,820	2.5	68,852	-3.7	22,968	27.2
2001	93,059	1.3	71,531	3.9	21,528	-6.3
2002	97,523	4.8	75,529	5.6	21,994	-6.3
2003*	84,500	-13.4	73,500	-2.7	11,000	-50.0
2004*	79,000	-6.5	69,500	-5.4	9,500	-13.6

*Indicates forecasted value.

Source: Data for 1990-2002 were obtained from the Construction Statistics Division, Bureau of the Census. Values forecast for 2003-2004 were obtained from the Selig Center for Economic Growth, Terry College of Business, The University of Georgia (September 11, 2003).

downsized their white-collar workforces have yet to fully adjust their real estate holdings. Raw land prices are unlikely to fall significantly, however. Improvements in this subsector will lag improvement in the overall economy by at least two years. As leases expire, the abundance of subleased space—part of which represents space given up by failed dot-coms—gradually will diminish, making it a little easier to rent newly finished space. Accordingly, rents will decline much more slowly in 2004 than they did in 2003. Nonetheless, with Atlanta's office vacancy rate at 20 percent,,it will be difficult to justify new projects.

Because very few companies will be relocate or expand in the coming year, new industrial construction will remain depressed. Also, the restructuring of many technology industries, recent declines in corporate profits, and moderate growth of consumer spending will restrain orders for warehouses. The markets for most industrial products will expand, but not quickly enough to provide immediate stimulus to demand for new industrial space. Virtually no privately funded speculative structures will be built in 2004. In short, better prospects for industrial space probably will lag improvements in the overall economy by a year or more. ■

On the Road Again

Hospitality Industry Forecast

In 2004, spending by vacationers will outpace spending by business travelers. As the economy continues to expand, the lodging industry's health will improve, but its performance will continue to lag the overall economy by about two years. The steep and prolonged drop in international visitors to the U.S. is especially problematic for full-service hotels, particularly those in gateway cities such as Atlanta.

Lodging

The forecast calls for the percentage of the state's hotel rooms that are rented to increase slightly in 2004. The gradually restored balance between supply and demand will lead to increases in average daily room rates, but occupancy will rebound much more rapidly than average daily room rates. Thus, higher utilization rather than higher prices will be the primary force behind modest growth in revenue per available room. But room rates will remain very sticky, because occupancy rates will not rise high enough to give hotels the upper hand.

Travelers are much more astute about finding deals, too, and the Internet makes it easy for them to do so.

There are some notable risks in 2004, however. Hotel owners should be positioned for recovery, but be ready to act if market conditions sour. One risk is the resurgence of the SARS epidemic once the winter cold and flu season starts. Also, high natural gas prices could significantly reduce people's discretionary income, and volatile gasoline prices could cut drive-in demand.

The hassles associated with flying will continue to discourage travel, but unless there is a plethora of heightened terrorism alerts, the number of trips can-

celled due to inconvenience alone will decrease. Also, rising costs associated with maintaining tightened security, insurance premiums, and interest rates are expected to squeeze margins, although the slack labor market and process improvements should help to lessen the pressure.

Because Atlanta caters primarily to the business traveler, the region's hospitality industry is ultra-sensitive to changes in corporate profits and sales. Both of these are expected to rise solidly in 2004, but complete recovery of business travel will depend on much more than just improving economic conditions. Additional considerations that will curb business travel include more teleconferencing, tighter corporate travel policies, less pressure on employees who are reluctant to travel, and the significantly longer time that it takes to get through airports. The reduced number of flights also limits trip flexibility, which is crucial to business travel. Improving conditions therefore will provide a significantly smaller stimulus to business travel, which means slower than usual recovery for full-service and convention hotels. Some branded, limited-service, hotels will see increased bookings by business travelers who are switching from more expensive properties, however.

Since September 11, spending by leisure travelers has recovered much more rapidly, but preferences have changed. People now prefer shorter trips by car, which should help in-state hotels that are close to tourist attractions. Rural destinations and smaller attractions seem to be more appealing than the lure of big cities. Historic and/or cultural tours are very popular now, so Georgia certainly stands to gain from this trend.

Households' spending on international trips dropped sharply in 2003 and will decrease again in 2004. The decreased value of the U.S. dollar is one of the factors that will discourage Americans from traveling abroad, but lingering uncertainties about terrorism and SARS will keep people cautious. Since a greater portion of the average American's travel budget will be spent in the U.S. rather than abroad, this could help Georgia's hospitality industry.

Restaurants

Restaurants were hurt by many of the same forces that hurt hotels. Fewer people working, less travel, reduced corporate expense accounts, and consumers' tightfisted attitudes cramped spending for dining out. Nonetheless, it appears that the pull-back in overall spending for restaurant fare was smaller than it was in previous downturns. Apparently, busy people now view eating out as a necessity, and favor modest-priced full-service restaurants.

In 2004, spending for restaurant meals will increase moderately. Positive developments include population growth, slight gains in disposable personal income, convenient locations, more choices, and healthier menus. Over the longer run, busier lifestyles, the increased proportion of singles, more married women in the labor force, and the geographic dispersion of families also encourage eating out. One negative trend for some restaurants' bottom lines is that fewer guests are ordering expensive cocktails with their meals. In this sub-par recovery, inexpensive full-service and quick-service restaurants are expected to do better than pricey full-service restaurants. Bars and caterers will see average gains, hotel restaurants will see below-average gains, and commercial cafeterias' business will grow the slowest of all.

Supply-side problems will continue to challenge restaurants in 2004 because the number of restaurants has grown faster than demand. Fierce competition for customers will limit the industry's profits. Quick-service restaurants also will face more competition from grocery stores, which now offer a wider selection of freshly prepared foods and often have cafes on their premises.

Finding qualified and motivated employees and containing labor costs will be a little easier in the short term, but remains a long-term problem for the food service industry. To cope, some restaurants are hiring older workers, installing more labor-saving equipment, and keeping a lid on costs. ■