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What's Constraining Urban And Economic Growth?

OCTOBER 26, 2017 | BY CARRIE ROSSENFELD

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SAN DIEGO—Chronic under-investment in urban **infrastructure** such as education, transportation and other assets is a mistake because such investment is the only way to sustain growth, said **economist Sam Chandan**, Ph.D., chair of the **NYU Shack Institute of Real Estate**, at the **17th Annual** **Trigild** **Lender Conference** here last week. **Millennial** migration and **retail**malaise were among the other topics addressed at the conference, which also featured keynote speakers **Peter Muoio, Ph.D,** EVP and chief economist at **Ten-X**; and futurist, author and journalist **Michael Rogers.**

Chandan kicked off the conference with his keynote presentation, "An Unexpected Journey," examining **commercial real estate** and general **economic** trends. Chandan, who has keynoted the conference for a decade, said the titles of his past Trigild presentations over the years—including "The Hunt for Liquidity," 2011; "From Expansion to Recovery," 2013; "An Appetite for Risk," 2014; and "Signs of the Apocalypse," 2016—are especially telling. Ultimately, he said, everything matters to the real estate market, especially the underlying performance of the **economy** and labor market. "Moderate economic growth, improving labor markets and higher interest rates imply flat appreciation."

Chandan also said that no expansion dies of old age. Yet, as GlobeSt.com **previously reported**, according to Muoio, we are approaching the longest economic expansion in modern history, and the cycle's longevity is in itself starting to have an impact on the way commercial real estate investors are thinking.

"Preliminary third quarter deal volume is down—about 35% from a year ago," Muoio said at the conference. He attributes this slump to a pricing gap between buyers and sellers. At this point in the cycle, "buyers and sellers are not looking at each other in the same way." An uncertainty over "how long the expansion can persist along with higher rates" is a key reason behind the drop-off in deal volume since last year and the sideways movement of pricing.

According to Chandan, "when a critical mass of people in the market think we have gone too far, we will hit our inflection point. The loans we make when we are the most confident perform the worst. The cycle happens because we take risks."

Rogers: "What the future can bring and what is lost in the process are where we have our work to do."

Central to the US economy—and the real estate market—are our cities, where a multitude of challenges are going unaddressed, said Chandan. "Our urban cores are the engines of innovation where the most productive real estate is located." While there is some growth in cities, "there is chronic under-investment in urban infrastructure, such as education, transportation and other assets. The only way to sustain urban growth is to invest—the current lack of investment will ultimately constrain economic output and growth in the US."

In the long term, said Chandan, "the convergence of changing behaviors and patterns of space use, coupled with chronic under-investment in urban infrastructure, is impairing real estate's production function, American competitiveness and the generational-growth outlook."

Amidst the turbulence, the labor market remains a key generator of economic expansion—and, there is no shortage of jobs, said Muoio. "We have been adding jobs at a healthy pace. The healthy labor market translates into increased spending. Consumer confidence is elevated, and consumers are spending at a record high."

Added Chandan, "We have a lot of jobs, but no one to refill them. Not enough people have retooled and developed the needed skills to remain relevant in this workplace. The academic systems have not kept up, with more Americans now irrelevant in the labor force."

Rogers said, looking forward, **technology** will both destroy jobs and create new ones, both for professional and blue-collar workers. Many of the entry-level jobs in professions like law, accounting, advertising—the jobs that have traditionally been the way young people begin their careers—are also the tasks that can most easily be automated. "At one time, we needed more workers to make stuff, but now we can increase output without adding more people, so we can grow without having to hire more people," said Chandan.

Added Rogers, "As we face a sea of automation, education needs to be redefined. Collaboration and open-ended creative problem solving are now key skills."

A big topic of conversation at the conference was the slow death of **retail**, with enclosed malls the biggest concern. "No one has cracked the code on repurposing obsolete malls," said panelist **Brian Olasov**, executive director of **Carlton Fields**. Confirmed closings of **JCPenney** and **Sears** stores brought US retail mall vacancy rates to 8.3% in the third quarter, Muoio said.

According to Muoio, brick-and-mortar stores continue to be hurt by the accelerating growth of e-commerce and the shift toward spending on experiences. As a result, he said "**e-retail** is growing at a rate of growth 11% annually, and overall department-store sales are down 37% since 2001, with recession like levels of closures. People are spending differently and tend to spend on experiences, not products."

According to Rogers, physical retail venues still provide something that online shopping cannot. “We need to redefine retail. The physical store is about building relationships, not just selling things.” With this in mind, he said, retail will make a comeback.

According to Chandan, we also need to ask some hard questions about the **housing** narrative. Will Millennials always want to be urban? Will the current rental bias hold? While demand remains strong in the urban core, “Millennials will not always be childless and 25, and proximity to public schools and stability will become a priority.”

Muoio confirmed that the appetite for renting may be waning. “The flow of people into rentals is down per household. We are at the back end of **apartment** cycle with a diminishment in demand plus increase in supply. Increased **development** will cause a rise in vacancies, as supply additions outpace absorption. This will be exacerbated in the event of a downturn.”

On a positive note, the current number of Millennials living at home represent an untapped demand source, sustaining long-term prospects, Muoio said.

Rogers, who was at one time a futurist in residency for the *New York Times*, discussed the virtualization of the world during his keynote. “Virtualization is the biggest global shift since urbanization,” he said. With urbanization, we created new models and we are now doing the same thing with virtualization—building the infrastructure that sits on top of the physical world.”

Today, he said, “more and more of our work, what we care about and how we interact are going to move into the virtual world. By the early 2020s, we will be connected to the internet 24 hours a day, seven days a week.”

Younger Millennials are able to create and maintain meaningful virtual relationships, since they grew up with a virtual social life, Rogers pointed out. “That will translate into skill and comfort in working in virtual environments, with coworkers who may be on the other side of the country or the planet.”

With an eye on the future, businesses must invest in research and development to keep abreast, and create prototypes, he said. “What the future can bring and what is lost in the process are where we have our work to do.”