Seldin On Change
AN ERA OF TRANSITION

by Maury Seldin, CRE

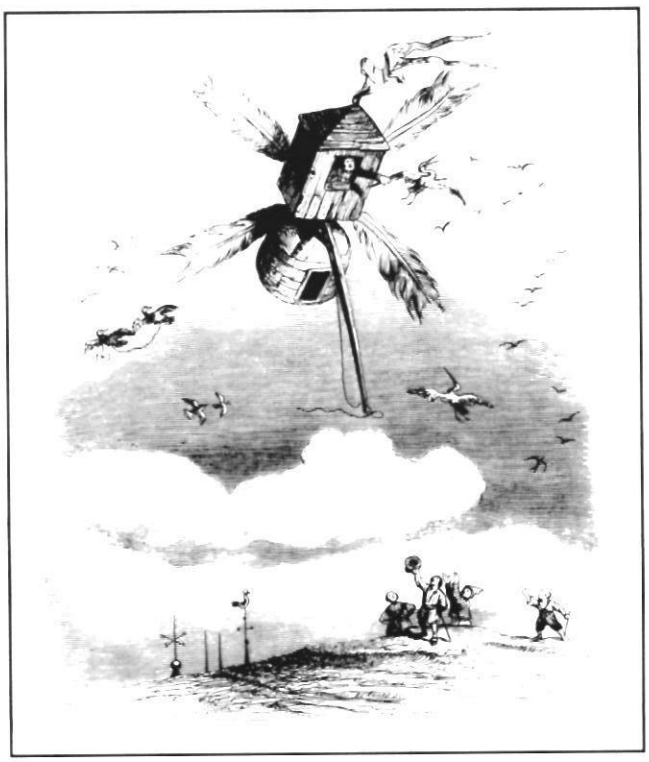
The next few years are likely to bring about dramatic changes in real estate investment. These may well be of the magnitude of those experienced in the last half century. We are in an era of transition, and only the character of the transition and the emerging real estate investment opportunities are uncertain.

If one considers the forces at work and the trends of the post-World War II era, there can be little doubt that we will not have a mere extrapolation of recent trends. Real estate investments will be remarkably different, and that is the point of this commentary.

Types Of Real Estate

One way to look at transition is to view the changes in what was produced by type of property. Mass production of detached housing, on-site and off, produced the substantial boom of the 1950s. The ever-increasing size of unit has turned around.

The '60s and early '70s brought a great boom in construction of garden apartments for rental, followed in the '70s by a boom in high-rise construction. How many apartments are being built today for rental? Not many and most of those being built are subsidized.



The most recent boom was condo construction which may be at the end of its era. What comes next? Figure 1 shows the wide swings in construction by type of unit.

It is not intended here to forecast what the change will be, but to consider how the existing stock may be used more intensely. Maybe conversions, especially of one-family units to two, is where the action is. There also may be hundreds of thousands of illegal conversions because the market is moving faster than the local political leadership who are charged with regulatory responsibilities.

This article is the fifth in a series by Dr. Seldin, which will focus on the problem of change in the real estate industry.

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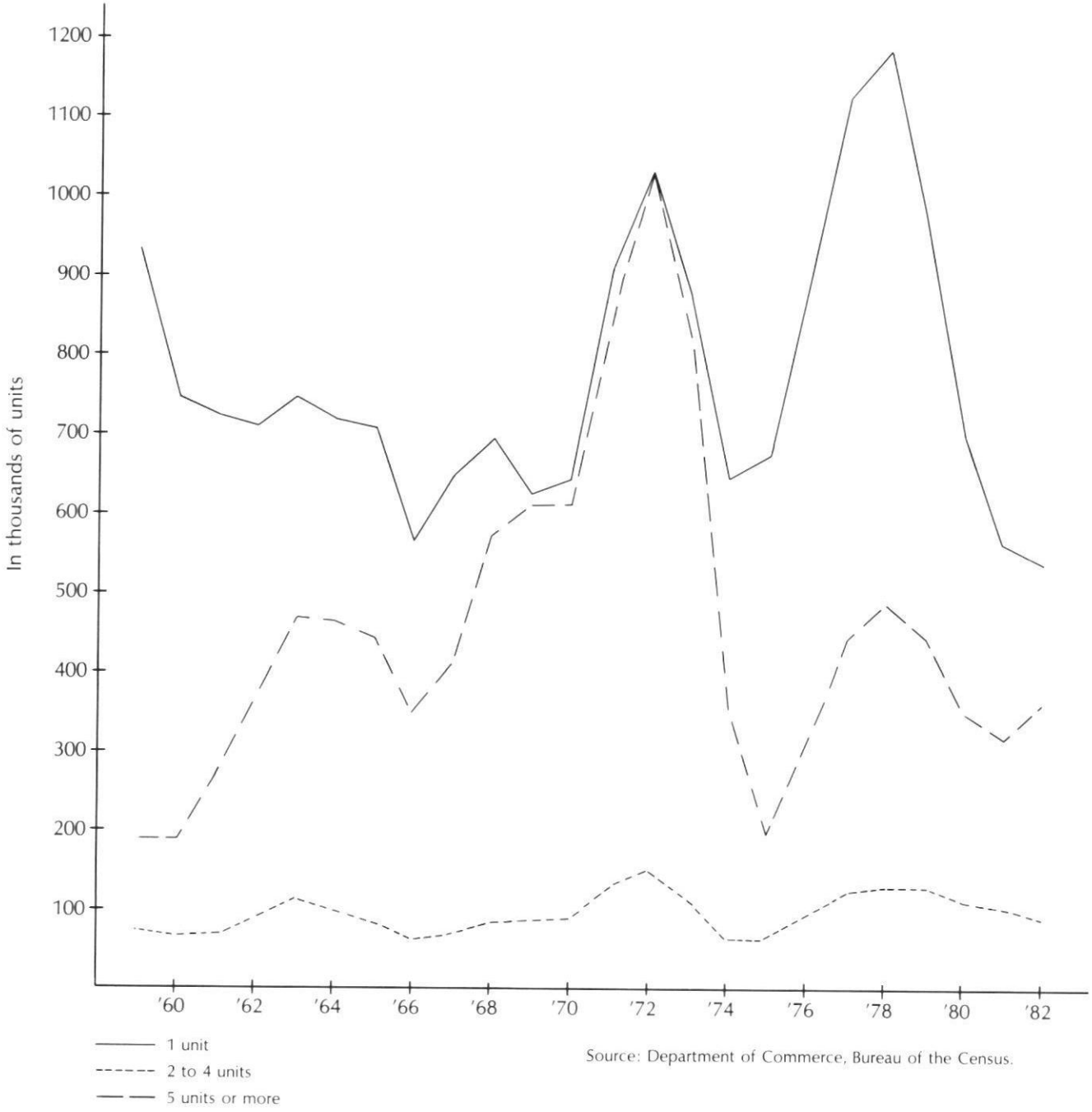
FIGURE 1

New Private Housing Units Authorized (1959–1982)



Source: Department of Commerce, Bureau of the Census.

The action in the construction of retail facilities has also changed. At the end of World War II, there was a continuation of the old style strip developments in suburbia, which were street-front oriented. But it did not take long before the shopping centers were in, and the earlier ones had the street-front orientation. What was different was the setback and parking. Then the design changed substantially, and the stores faced inward. Also, the type of centers which were being built kept increasing in size and changed from neighborhood centers to community and then regional centers. Then came the mini-covered malls, the multi-story malls and, of course, the unique specialty centers of San Francisco, Boston and Baltimore. The only thing consistent about the types of facility being constructed is that they change.

At today's land prices and construction costs, do the numbers work? Maybe they do, if one can find a niche in the market. But how much more net new space is really needed now?

The answer for emerging investment opportunities may not be net additions to space but different space. And it may not be new construction. Conversions or reuse may be where the activity is.

As for office space, a great boom in low rise suburban offices took place and lagged the suburban residential movement. That was followed by the resurgence of high rise, but it was not confined to downtown. And it wasn't just suburban concentration serving local population. Major basic employment types of office buildings were built out of the center city. Some of these clustered near airports; others simply reflected a redistribution of the location of activity, which recognized inter-urbia as a new force of urban development. The skyline transition looked as dramatic as it did in the 1920s.

Now for industry. At the end of the War, the location of industry was at close-in break-in-transportation points. But the changing character of production in our society and the increasing reliance on rubber-wheeled transport moved the location of production including distribution services toward the beltways and interstate highways. In addition, the clustering of production in new varieties of industrial parks provides a spatially different allocation of basic employment activities and a different type of physical facility. Figure 2 shows variations in volume independent of the type of construction.

Considering these dramatic changes, how can one boldly assert that some of the most dramatic changes may now be taking place? Easy, if one looks at the underlying forces. How are they changing?

Underlying Forces Of Household Formation

The demographics which gave us suburbanization have faded. The baby boom which was associated with suburbanization has now passed into the bulge of the young adult population. That population has been marrying later and having fewer children. The labor force participation rate is up and the birth rate which had gone down dramatically with the advent of the pill has been taking a turn.

Who dares to speculate on the birth rate of the next decade? Indeed, on the marriage rates or even the correlation.

Marriage rates used to be more closely related to household formation. Now, to some, they seem to be a lag indicator. The key is households, not simply in the demographics but in the willingness and the ability to spend for the establishment of a household.

Household formation is volatile. Jobs and the expectation of increased incomes are strong deterrents. What one expects with the economy is, in some measure, what one expects in household formation.

Let's not forget the demand from the elderly. The population has been aging not only because of increased life expectancy but also because of the demographic bulge. The amount and the affluence of that population will impact its demand for units.

Thus, if there is a great prosperity, a modern day "era of good feeling," we could have a boom for additional units on the order of the post-World War II boom, or could it be greater? It would not simply be demographics as a force in establishing households but it could be households looking for a second or even a third housing unit—the second and third house market. If there is a resurgence of inflation, who among us would want to be left out of homeownership? And with affluence, the second home market would boom.

How much production for new construction exists compared to modernization, rehabilitation, and conversion? Tell us what the lifestyles will be. Do not dismiss a reversal of the birth rate, a movement to nonmetropolitan areas and a change in lifestyles somewhat akin to the suburbanization of the 1950s. It doesn't mean that the user will leave the workforce. What it means is different housing at new locations.

There are indications of a return to old-fashioned values. Family life is on the rise again. Attitudes and expectations change. We could get a strong market for family homeownership. There may be two working parents. But housing may be in smaller metropolitan areas or even nonmetropolitan areas.

If that happens it is associated with a set of scenarios in retail, office, and industrial land uses. The most important is the change in location of employment. We are in a sense beginning to return to the cottage industry—an ability to work at home, if not all the time, then part of the time.

Some of these changes in employment have taken place. And if the population really wants life in smaller communities, then it may be possible for industry, or really employment, to follow. Employees are a resource. So with high tech and other foot-loose industry, there is a wider range of location choices than the old style smokestack industry.

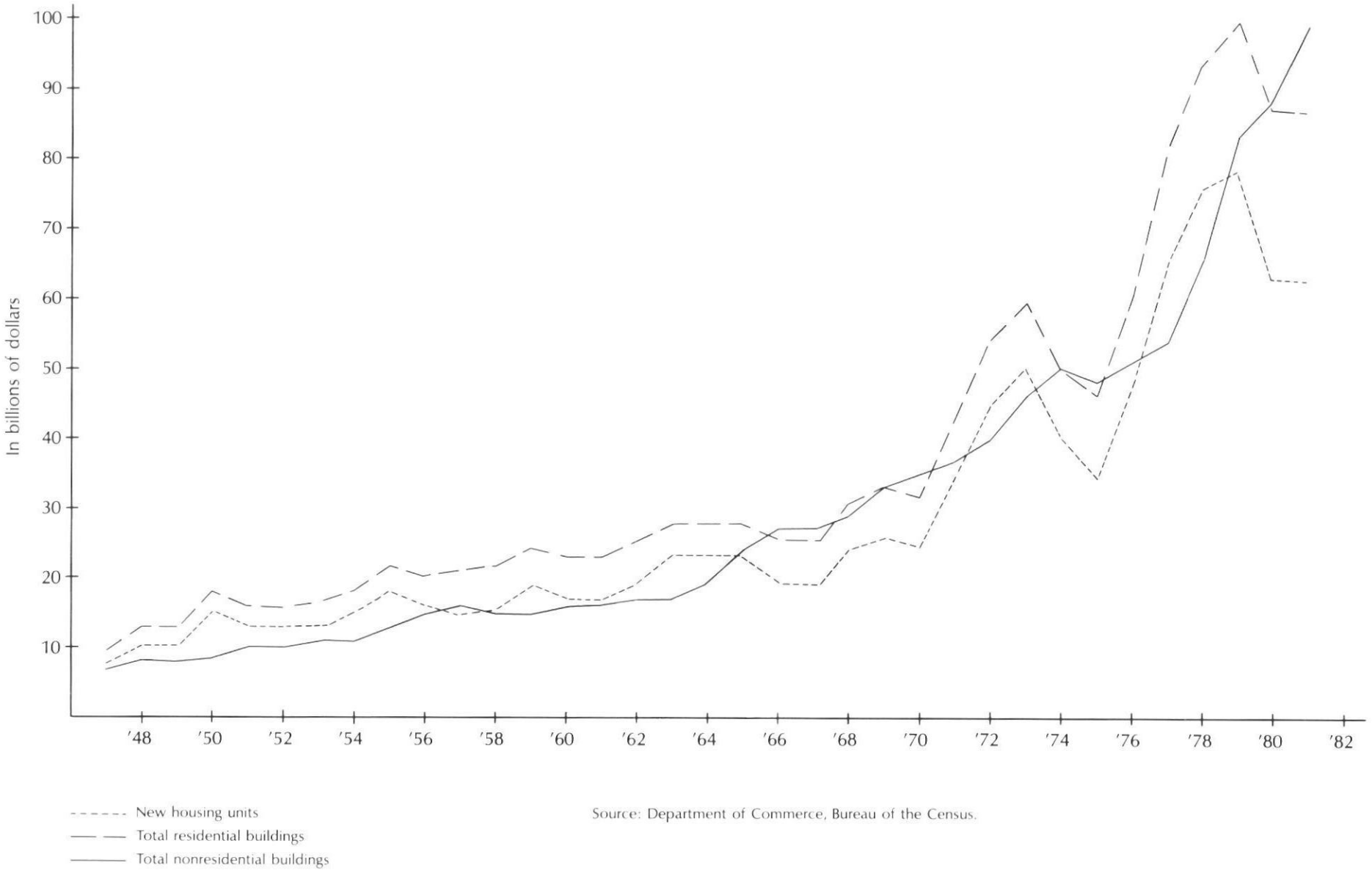
But there is also an alternative scenario. If it takes a long time to get most of that underutilized one-third of our production capacity back to work, and, if some of the facilities will never be used again, then the employment will be in other industries. It could take a long time to get more housing and other spaces developed. If that is the case, then we can do a great deal of economizing in housing and there would be fewer locational changes.

The Economy

As this is being written, recent reports indicate that unemployment dropped from 10.9 percent to 10.4 percent and then held steady at 10.4 percent.

FIGURE 2

Private New Construction Activity (1947–1982)



Source: Department of Commerce, Bureau of the Census.

How far down is unemployment going to be driven? Who knows. But one of the great forces which have caused employment to rise, both in the United States and internationally, has reversed itself.

Oil reversed its price trend. The official price at $34 a barrel is history. It is not going back to the few dollars a barrel it was before this whole international disaster started, but it is going down. That down trend will aid a recovery internationally, as well as nationally.

Yes, we are becoming more dependent on the international economy. That means that we have less control today over our own destiny. And we didn't do too well then, at least not in the last quarter century. Before that, except for the Great Depression, our economic prosperity was the great feat of modern times.

The great productivity increase of the earlier eras produced the rapidly rising standard of living. Although we were hurt in the last decade or two with declining productivity, it seems to be turning around.

Sooner or later we had to come to a discussion of inflation. The cartels and productivity are only part of the causes. Also, the deficits, monetary policy, and indexing were and/or are present.

The U.S. deficit is obscene. It is one of the great shames of our time. Can we overcome it? Perhaps, but not quickly.

That is, we can't get to a balanced budget quickly, but since the deficit is so large we could get dramatic drops which would reduce the inflationary pressures.

The drops come not only because of changes in the spending side but also in revenues. A revitalized economy would do wonders for enhancing revenues.

The Federal Reserve Bank shift in emphasis back in October 1979 to watching monetary aggregates went too far too fast. The disruption to the economy was horrendous.

It seems as if they have eased off a bit because of the unemployment situation. And, actually, the emphasis on monetary aggregates is not a bad idea, if, and it is an important if, the inflationary cause is the classic too much money chasing too few goods.

Realistically, however, that was not the cause and the aggregate control was bad medicine. Now, if the other causes of inflation such as cost push, productivity declines, and deficits are diminished, it becomes a different ball game.

The indexing of prices and wages contributes to the spiral. There is some backing away from the indexing. And, if the other forces are also mitigated, inflation could really be brought into line.

Now what does that mean? Does it really mean that we will achieve high levels of income, output and employment with price stability?

We might! But, it could be a long slow road rather than a quick transition after a painful adjustment. However, a successful rapid transition to get the necessary institutional reform could give the economy a boom the likes of which we have never seen.

Will it happen? I don't know. We have a resilient society. Some signals are discouraging yet others give us great hope. Thus, while the character to change is uncertain, we do know that it is totally unrealistic to extrapolate the underlying forces which have been giving us the great changes in recent years. So we will not get more of the same.

The changes in the underlying forces necessary to bring the economy back into line will necessitate some dramatic changes in the supply of real estate. We can expect substantial innovative changes in order to provide real estate investments. What is the character of these changes?

Well, let's consider some recent innovations in real estate investment . . . maybe next time?