External Affairs Alert
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The CRE 2014 Top Ten Issues Affecting Real Estate

Energy, jobs, and the far-reaching influence of the Millennial generation are the issues that will have the most significant impact on real estate both near- and long-term, according to The Counselors of Real Estate® organization. The CRE Top Ten Issues Affecting Real Estate, developed annually by The Counselors of Real Estate External Affairs Committee, considers independent research; qualitative interactive feedback from members via polling at the association's spring conference; and a member survey. **David J. Lynn, Ph.D., CRE, CEO** and Founder, Lynn Capital Management and **K.C. Conway, CRE,** Chief Economist USA, Colliers International, lead The Counselors' External Affairs Committee and led development of the 2014 Top Ten Issues Affecting Real Estate list.

The CRE 2014 Top Ten issues Affecting Real Estate

1. Energy: The U.S. is becoming increasingly energy independent. Changes in U.S. energy production are impacting jobs, income growth and the quality of life – key determinants of real estate value and successful investment. The mix of energy types produced--crude oil, natural gas and alternatives such as wind and solar energy--provide investment opportunity and risks. The impact of energy production changes varies by state and community depending on access to resources, regulatory trends and other factors; however, many communities involved in increased energy production are experiencing a jobs boom with related housing and services growth for workers. Uncertainty in the energy sector created by dueling reports from environmentalists and the oil and chemical companies provide investors with opportunities. The potential for relatively low natural gas prices (now one-fifth the cost of Europe and Asia) in combination with other factors has improved the outlook for manufacturing and could significantly advance the expansion of rail, shipbuilding and related industries should gas exports increase.

2. Jobs: The job market is expected to remain strong in 2014. If the U.S. economy grows by the forecasted 2.8%, the number of new jobs likely to be added will continue to number 200,000 to 250,000 per month. Strong job creation is expected to have a positive impact on the residential and multifamily sectors. The types of jobs being offered should move up the quality scale, raising average wages and boosting purchasing power for consumers as well as the ability of landlords to extract rents. Demand for office space may also increase, but employers continue to pare per-employee space requirements, carefully considering space needs because of changing technology and noting the younger workforce's preference for living in cities and working in open format workspaces. Job reductions, however, in retail and branch banking, largely due to changes in consumer behavior and online technology, will take a toll on housing, may benefit the apartment sector and could negatively impact commercial real estate. Service sector jobs may absorb some of those displaced. Communities and neighborhoods that once valued big-box stores may be well served by courting schools, physical therapy services and even independent and assisted living facilities for senior citizens drawn to a retail/lifestyle/entertainment environment.

3. The Millennials: The Millennial generation, born after 1980, represents 27 percent of the U.S. adult population--and their influence is far-reaching. This group is the first to fully embrace new technology, including the Internet, eCommerce, mobile communications and social media. Their practices are poised to change the way society interacts, receives information, shops and lives. Millennials show a strong preference for urban living and working, value mass transit and “work, live, play” communities where residents of all ages, ethnicities, and income brackets live side by side. They carry high levels of student loan debt, drive fewer cars, marry later, and often choose smaller living spaces than the typical homes in the suburbs that appealed to their parents a generation ago. Their preferences are already having an effect on both city and suburban residential, multifamily, office and retail sectors.

4. Healthcare: A wide range of newly constructed healthcare facilities will be needed to treat the large numbers of newly insured Americans under the Affordable Care Act. Providers will increase market share by constructing specialized consultative care or treatment facilities, many in non-urban locations, providing wide-ranging services at a considerably lower cost. Some big-box stores are being converted to house clusters of medical offices in “medical malls.” Considerable consolidation of hospital and healthcare organizations is underway, with an enormous impact on real estate – mergers and acquisitions create both excess properties and an increased demand for updated facilities. These new entities are building satellite healthcare centers, urgent care and diagnostic facilities. Pharmacy chains are installing wellness clinics in stores and some large employers are building health clinics within their companies. All of these factors will spur development of different forms of housing and expanded retail centers, serving not only an aging population but those seeking access to the medical assistance and products to which they are now entitled.

5. Globalization: In the next five to ten years, expect a remaking of the global supply chain emanating from eCommerce and expansion of the Panama Canal; advancing technology; availability and cost of energy; and political strife. As traditional pathways for goods and materials change – decoupled from political boundaries and increasingly automated -- the resulting “efficiency” will potentially cause widespread labor strife from Europe to Asia, and even to the U.S. west coast. Energy will continue to influence globalization as energy dominance by the Middle East decreases. More U.S. energy production could disrupt manufacturing activity in Europe and Asia, adding to labor strife and a possible return to protectionism. Historically, political strife has been the primary impediment to globalization. Unresolved wars in Afghanistan and the Middle East, the situation in Ukraine and continued volatility in resource-rich nations, such as Africa, could put globalization into hibernation. An additional factor is increasing manufacturing technology, which has the potential to revolutionize production, warehousing and purchasing over the next decade. The reality of 3-D printing technology is perhaps the most significant development, with its ability to produce on-site goods and materials to exact specifications without manufacturing plants or inventory warehouses.

6. Water: Global demand for fresh water is projected to exceed supply by 40 percent by 2030. While water scarcity is a reality in much of the developing world -- where 780 million people have no access to clean water; 2.5 billion have no access to modern sanitation and over three million die each year from water, sanitation and hygiene-related causes – the U.S. will likely experience serious water shortages as well. Aging water infrastructure, draughts (particularly in the southwest) and reduced water deliveries to agriculture have the potential to cause water-related economic problems. A number of states face severe water challenges; Las Vegas’ Lake Meade, which supplies 100% of the city’s water needs, is projected to have a 50% chance of drying out by 2025. A 2013 U.S. government report showed that groundwater depletion in the U.S. for the years 2000 to 2008 was nearly three times greater than the average rate of depletion for the preceding 108 years -- from 1900 to 2008. Some future projections project 1.8 billion people living in regions with confirmed water scarcity by the year 2025. The implications for real estate are enormous – affecting land value, community desirability, future viability and investment. Consider also that China is home to 20% of the world’s population, but only seven percent of its fresh water. Water may become a political issue as well as a health issue in a relatively short timeframe.

7. Capital Markets: This issue is included in the Top Ten list for the second year in a row. The availability of capital to commercial real estate from 2014 to 2017 will be vital to the health of the industry. The enticement of riding a high-yield wave is luring capital back into real estate, with investment in a wide variety of choices, from agricultural land to commercial mortgage backed securities. A new round of commercial refinancing will begin this year, with an estimated $360 billion in permanent securitized loans needing to be refinanced by year end 2017. While the sheer numbers are larger than the volume that matured between 2010 and 2012, the quality is different – with much of this wave suburban in nature where there is an oversupply of properties. Action by the Federal Reserve will affect the market as investors await extraction of Quantitative Easing, scheduled to be completed before year end. The question is whether or not we are headed for another "bubble."

8. Housing: The housing market appears to be in recovery mode, but home ownership continues to lag. While Case Schiller reports home prices rising by about 13% over last year, not all areas of the U.S. experience encouraging price increases. Despite moderate growth in the economy, U.S. Census data reflects the lowest rate of home ownership since 1995. Credit is again tight, but as the job market improves, home purchases are expected to increase. The multifamily sector may feel downward pressure caused by transition from renting to buying -- at the same time an avalanche of new multifamily units is becoming available as a result of boom development in that sector over the past few years.

9. Manufacturing: Robotics, self-service kiosks and 3-D printing technologies are dramatically transforming manufacturing. The effect on commercial real estate is accelerated at a more rapid and dynamic pace than previously thought, with unintended consequences. Manufacturers, ports and supply chains are embracing automation to increase efficiency and reduce labor costs – for example, a modern auto or textile manufacturing facility utilizing new technology may employ just 20% of the labor force of a predecessor plant a decade ago. Robotics applied to retail services and self-service kiosks are replacing workers in call centers, banks, fast food and retail locations, resulting in erosion of the Labor Participation rate and a smaller working population in the U.S.

10. Agriculture: Agriculture debt is near all-time lows, which has helped push farmland prices to all-time highs. Livestock prices are at similar highs with "producing" animal numbers near all-time per-capita lows. The outlook for land values is mixed, with "more productive" farmland, primarily irrigated, expected to show moderate increases. Ranchland prices are expected to strengthen after lagging behind the feed grain and vegetable producing lands. High water yielding, irrigated farmland areas such as those found in the northwest Panhandle of Texas, Brazos River Bottom and in Kansas and Nebraska appear to hold long term opportunity, but investors should note the strong land prices in the heartland and Midwest, as valuations cannot continue to increase at the same pace. The recent passage of the Agricultural Act of 2014 ("Farm Bill") will help stabilize agricultural returns as well as rural property values. Currently, U.S. consumers spend an average of 6.8% of their income on food, lower than in many other countries, partly due to higher average wages in the U.S. – for example, in Canada it is 9.6%; in Pakistan 50%.

Conclusion

Many other issues were suggested, but, of course, we have limited our list to the ten issues we believe will have the greatest impact on real estate in 2014 and the years that immediately follow. We hope identifying these issues and their implications motivates productive discussion of how individuals, companies, and governments should respond to these and other changes in the investment environment that simultaneously challenge our industry while creating opportunities for growth.

Please direct comments to:

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