

The Next Market

The successes of tomorrow's real estate development will be unlike those of the past.

THE EMERGENCE OF GENETICS and biotechnology, the rise of China, the fall of communism, and a host of other factors suggest that relying on the past is not the best basis for predicting the real estate successes of the future. Today and in the future, successful places will have to be created or re-created rather than simply found. Location, location, location is no longer the secret to success.

Real estate and economic development respond to rather than shape the needs of society. Thus, the success of a place is determined by how well it responds to the economic, technical, institutional/cultural, and social fabric of the times.

Economic Shifts

One societal element influencing real estate demand is the economy. The national recession is not solely responsible for the slowdown in demand for office and industrial space. It is largely the result of sec-

ular trends that will continue even as gross domestic product (GDP) growth accelerates and employment growth resumes. The only commercial and industrial developments that will be in demand by basic U.S. businesses are those that help such businesses survive in the face of four interrelated challenges: the international output gap, the internationalization of markets, the global information explosion, and the innovation requisite.

The term "basic industries" as defined by regional scientists and geographers applies to businesses that export most of their products to people who do not live in the region where the goods or services are produced. The microeconomics that apply to export businesses are different and much more complex than those that apply to nonbasic businesses such as housing and some retail and services.

Consider, for example, what has happened to America's goods-producing sectors, which in 1983

provided 19 percent of all private jobs. In 2002, manufacturing provided only 12 percent of nonfarm jobs held by Americans. Many service jobs, which in total accounted for 82 percent of nonfarm employment in 2002, are today basic industries, and are therefore under the same pressures that have scaled down America's once giant manufacturing sector.

The first of these pressures or challenges is the worldwide output gap—at present prices, the capacity and resources available to supply the world with many goods and services exceeds the aggregate demand that exists for them. The output gap slows demand in U.S. office and industrial markets because many places in America have a high standard of living with a cost base to match.

One implication of globalization is that few producers of goods can survive unless they are able to compete on a worldwide basis, which means that, as need be, firms will shift their facilities to the most efficient and innovative workplaces.

Technology Shifts

Technology is a second element influencing real estate demand. With good technology available, successful places will not need to be the most accessible locations. Land use patterns will differ from those of the past. Rather than the traditional pattern of isolated research and development (R&D) buildings, for example, most markets need mixed-use projects that provide an integrated set of office, retail, and housing uses.

Institutional/Cultural Shifts

Institutional or cultural shifts make up the third societal element influencing real estate demand and economic development. Capitalism has

FIGURE 1: TOP TEN BEST-PERFORMING CITIES

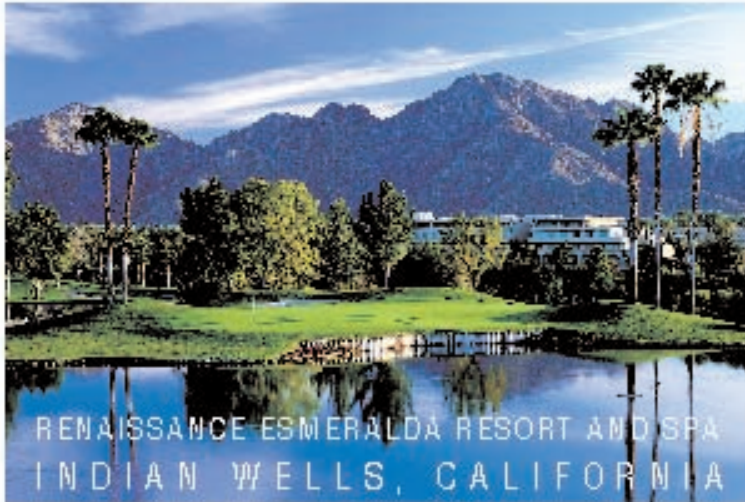
2004 Rank	2003 Rank	Metropolitan Area
1	3	Fort Myers/Cape Coral, Florida
2	2	Las Vegas, Nevada-Arizona
3	43	Phoenix/Mesa, Arizona
4	4	West Palm Beach/Boca Raton, Florida
5	116	Daytona Beach, Florida
6	41	Sarasota/Bradenton, Florida
7	1	Fayetteville/Springdale/Rogers, Arkansas
8	20	Riverside/San Bernardino, California
9	29	Fort Lauderdale, Florida
10	10	Monmouth/Ocean, New Jersey

Source: Milken Institute.

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become the dominant form of economic organization, and international capitalism sets the rules that govern real estate demand and economic development. To achieve success will require constant and creative adaptation.

Social Shifts

The fourth societal element holding sway over real estate demand and economic development relates to shifting demographic and social conditions. The country's population is growing older and more ethnically and culturally diverse, and has a shrinking middle class and a greater proportion of haves and have-nots. When these demographics are combined with the waning ability of nationalism to bind diverse cultures together, the places we live in must take on new responsibilities, providing a sense of neighborhood cohesion and safety. To succeed, they must be fun and safe in ways that minimize barriers to communication among diverse populations.

In other words, these trends present future opportunities in the form of highly segmented niches of demand for retail and residential uses.

The social capital of a community—the political and legal infrastructure and culture of personal relationships within which business is conducted—is an essential factor in economic development. In a world of freely moving physical and financial capital, only social capital remains tied to specific locations. The process that allocates resources to the built environment and determines how and where buildings and land uses are built is a key output of social capital. In many places today, business plays a relatively small role and neighborhood residents play a much larger role in planning and building decisions. If a minority of residents or narrowly defined interest groups can prevent the land use and built environment from changing and growing to meet new demographic and economic circumstances, this does not bode well for making the

changes needed to stay competitive and vibrant.

Characteristics of Successful Places

While the importance of physical access to markets has diminished, for a builder to succeed regionally, it is increasingly important to provide affordable housing for service workers and create a critical mass of consumers. Consider, for example, the Milken Institute's rating of best performing metropolitan areas in 2004 presented in Figure 1 (page 102). The Milken Institute ratings take into consideration growth in jobs, wages, and salaries over the five most recent years.

As the examples in Figure 2 indicate, successful places frequently are those in which housing prices have not been speeding past wage and income growth, and in which sufficient supply growth permits housing mobility.

Office Space Development Opportunities

In addition to the decline in office demand based on productivity increases, expansions to overseas locations, and the slowdown in demand for some high-tech products, the increase in home offices also cuts into demand for office space. Many firms have replaced secretaries with voicemail and middle-level managers and associates with electronic tools and software. Salespeople who once had their own, often empty, offices now frequently share them.

Successful office developments of the future will not be leased or sold based on image and ego satisfaction, but on how well they enable space users to be more productive and satisfy their customers with innovations that produce better products and services.

Demand from smaller users of office space is increasing, while larger users are shifting to fewer individual offices and smaller cubicles, with more shared and conference space. This changes floor plate and design requirements.

FIGURE 2: HOUSING AFFORDABILITY IN 2004 BEST-PERFORMING CITIES

Ratio of Median Housing Price to Median Income

	National Average	Fort Myers, Florida	Phoenix, Arizona	West Palm Beach, Florida
1Q 2000	2.79	2.10	2.49	2.20
1Q 2001	2.91	2.20	2.64	2.20
1Q 2002	2.94	2.40	2.52	2.30
4Q 2003	3.32	3.00	2.66	3.00
1Q 2004	3.24	2.90	2.71	3.10
Percentage Change in the Number of Homes Sold from 1Q 2000 to 1Q 2004	32.30%	95.20%	41.00%	37.10%

Sources: National Association of Home Builders Housing Opportunity Index.

No one structural or locational development can capture the opportunities that exist in the challenging office markets to come over the next few years. The viability of development must be evaluated from the perspective of the kind of office users that might become occupants, and only those projects developed

- ▷ that are located and built with or near other activities that will enhance productivity and attract and hold talented labor;
- ▷ that are located where a culture of innovation exists and can be enhanced by what is built; and
- ▷ that attract small (under 50-person) gazelle firms that can compete because of their entrepreneurial and technical skills.

The resurgence of the economy will also create demand for office space that provides locational, display, and amenity advantages to service firms and professionals serving local rather than basic markets.

Industrial and Warehouse

To examine industrial and warehouse demand through the lens of the workforce that will be employed in these buildings presents an even tougher picture than that of future office opportunities. Fortunately, the measure of the opportunities that exist in industrial and warehouse markets is not in the growth of

potential employment. More appropriate indicators of demand are storage, processing, and freight movement.

A large part of the demand for industrial and warehouse space stems from the need to relocate and retool such space so that the buildings take advantage of the latest technologies without which many existing warehouse structures have become obsolete. Warehouse uses also need to understand and take advantage of the shifting pattern of labor availability; otherwise, some firms may find themselves far from the labor forces they need.

The measure of warehouse demand is in the volume of inventory and shipments that will be processed in the future, and those volumes are increasing. Warehouses will not just store—they will transform what comes in the door before it is shipped back out. This transformation will vary from processing goods to increase their value to breaking down bulk shipments into smaller lots destined for different locations. Warehouses therefore must be located for logistical efficiency and built for processing efficiency. Manufacturing is becoming increasingly capital intensive due to the communication, control, and processing equipment needed to offset China's low-cost workforce advantage.

As is true for office space, the small-firm gazelles that do not want to move to China and can stay competitive through their hands-on management and a combination of technical and entrepreneurial skills also constitute an opportunity. Industrial activities that are non-basic, serving local markets with combinations of services, distribution, and goods-enhancement, will also continue to provide development opportunities.

The new rules call for the development of places and buildings that respond to the demands created by many diverse subgroups wishing to stay ahead of their competitors. The future does not belong to those who seek to recapture their profitable past. The winning firms and places will be those that develop in anticipation of the way markets will evolve in the future. **UL**

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