Real Estate in the New Economy

The Market Must Adapt to the Business, Housing and Retail Demands of the Future

Market Perspectives
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The recession is pregnant with a new economy while it is burying the economy of the past. The nation and the world are going to expect much from the new economy, which will be very different from the old. The challenges to the new economy will go beyond the ubiquitous call for environmental sustainability. Equally, if not more importantly, the new economy must power up to provide more and better goods and services at prices that induce increases in effective demands. Only an economy with more powerful productive muscles than its predecessors can relieve the social tensions of unacceptable and great inequalities in wealth, both within and between nations.

The electronic miracles of widespread communications make it dangerously impossible for the inequalities to remain. The strengths of economies are vitiated when only the political tools of income redistribution are used to attempt forcing more equitable distribution of wealth and income. What is needed instead of sole reliance on redistribution is a growing, more productive economy rich in innovation. Returning to business as it was is neither possible nor desirable.

To gain the needed strength, laws must be enforced to keep private production competitive and safe. To properly nurture the new economy, it is also critical that governments provide the social capital and physical infrastructure needed to strengthen the operations of the private sector and provide the goods and services that the private sector cannot efficiently produce.

Trade must continue to grow if the new economy is to gain the needed capacity for the production of income, jobs and real wealth. Inventing, refining, financing, selling and distributing new products will be as important in the new economy as the development of heavy industry was to the Industrial Revolution. Success in this effort will require constant innovation. The innovating firms engaged in these efforts and those that support them will locate in the metropolitan agglomerations that attract and facilitate the transfer of information between workers and capital providers with their unique knowledge of contemporary technology. Regions with maximum growth-spurring magnetism will provide fertile grounds for both exporting firms as well as businesses that serve tourists and other visitors.

Real estate that is best able to serve and prosper in the new economy will be located within regions that offer public and private amenities to entrepreneurial enterprises. What does that mean for the housing, office, retail and hospitality sectors of the real estate industry?

The price of market rate housing will have to stabilize from current levels and not re-inflate in a replay of the price escalating trends of the past decades. Escalating housing prices will make it harder to attract the young professional workers so critical to thriving, innovative business locations. In addition, wage levels can be anticipated to increase with escalating housing prices. Both can be killers of strong economic agglomerations. High housing prices leave workers with the unfortunate choices of long, costly commutes, demanding higher wages or choosing to move from the region. Suburban housing development, affordable to local employees and built near retail, entertainment, and experience-rich urban activity clusters, will also attract residents and help regions achieve their economic potential. But to make new in-city and suburban housing financially viable, as well as inducing region-wide prosperity, local land use regulations must zone more land at higher densities than was the case during the days of the old economy. Minimum suburban densities of 12 to the acre and in-city densities from 14 to several hundred per acre must be allowed in enough desirable locations to keep land prices under half of what they were during the boom years that ushered in the sub-prime mortgage bust.

Office developers and investors should use their political muscle to encourage local land use regulators to zone more land for relatively high density housing, because office occupancy rates will climb when appropriately skilled workers don't have to demand higher pay or leave the area in order to find affordable housing that meets the needs of their household. Residential developers may have mixed feelings about risking political unpopularity by fighting to open up more land and obsolete existing development for new, high density residential development; after all, shortages of entitled land do keep up housing prices and rents. If efforts at increasing entitled residential land fail, think twice about building new office buildings or remodeling old ones; LEED certification may help draw occupants from existing space, but it won't induce new demand. If the region has what it takes to facilitate the cost-effective transfer of information for creative innovation, and a culture encouraging high levels of productivity, then build and invest near transit and close to experiential shopping, entertainment venues and high density housing. It's even better if these new agglomerations make it convenient for their workers to bike to work. In such locations, offices will serve as the workshops of the new economy, housing the support professionals and technical experts that design, refine, finance and sell the next big things.

Existing retail real estate will have to be shrunk in size and adaptively reconfigured to include housing and other uses in order to accommodate the shopping and entertainment demands of the new economy. Consumers are unlikely to go back to the days when they shopped til their credit dropped, and the Y Generation (ages 17-33), whose members make up the largest segment of the population, see the Internet as the 100% shopping location. But as anyone who has dropped into the clubs and new bars and restaurants where "mixologists" have replaced bartenders can tell you, retail venues that offer experiences along with whatever else they are selling can attract crowds of customers. Exciting shopping, food and entertainment developments integrated into mixed use packages that include residential and offices will prosper in the new economy. Even in this economic downturn, the South of Market district (SOMA) in San Francisco has attracted approximately 1.5 million square feet of space since 2008.

As has always been true when new economies develop, existing trade routes often change, as do the logistics of transportation geography. The widely anticipated shift in cargo patterns from the West to East Coast once the Panama Canal is widened is an example of such a shift. The location of warehousing and industrial space has always had to respond to changes in the technology of processing, the availabilities of labor, and the geographic logistics of transportation. The rate of change in these three variables will increase as the new economy matures, altering again the location and structural determining calculus of the highest and best use of warehouse and industrial spaces.

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