Urban Land Institute

Chicago

REAL ESTATE FORECAST 2018

This is a summary of the November 9, 2017 meeting of the ULI Chicago District Council, which gathered at the Union League Club in Chicago to hear a discussion on the "Real Estate Forecast 2018".

The national speaker was Andy Warren, *Director, Real Estate Research*, PricewaterhouseCoopers, who presented on ULI & PwC's Emerging Trends in Real Estate 2018® report. Following Warren's overview, the moderator for a local response panel was David Schreiber, *Managing Director, Acquisitions,* LaSalle Investment Management.

Joining Schreiber on the panel were Elizabeth Holland, *CEO,* Abbell Associates, LLC; Blaise Keane, *Executive Vice President*, Heitman LLC; and Sean Spellman, *Chief Development Officer*, CA Ventures. Their discussion encompassed a host of topics, including where the best opportunities are, trends in capital markets, including sources and flows of equity and debt capital, which metropolitan areas offer the most and least potential, and how locational preferences are changing.

In forecasting 2018, the Emerging Trends report took flight with an aerial theme: "managing the descent safely, keeping in mind the lessons of past bumpy touchdowns."

There remains guarded optimism, similar to last year's overarching sentiment. Of course, it's now a full year closer to the end of the gradual growth that has emerged from the ashes of the 2008 global financial crisis.

"All in all," summed up Andy Warren, "a very positive outlook."

The remark, however, came after he tempered that general statement with this analogy: the economic climate is akin to being given the go-ahead to move around inside a plane, while also being urged to buckle up when returning to your seat. After all, turbulence can strike at any time.

The report distills more than 1,000 face-to-face interviews—including 52 focus groups—as well as 1,600 survey responses across nearly 600 organizations.

When asked to describe the 2018 real estate market, the top word selected, both nationally as well as in the Chicago market, was "competitive." Also in the top five, locally and across the country, were three words that convey the conservative perspective on near-term prospects: cautious, uncertain and measured. Where Chicago diverges from the nation, on this front, is in the fifth-ranked word: "overheated" (the Windy City market's sentiment) versus "growing" (the U.S. consensus).

Of the recovery, which has now exceeded 100 months, Warren described it as "sustainable…slow, not overly exciting…It's a CFO's dream recovery. Slow, steady growth without a lot of volatility."

In his presentation, Warren touched on numerous subjects, including the importance of understanding the implications of the "freelance economy," which includes 57 million Americans overall. Nearly half (47 percent) of Millennials are working freelance, making it the demographic most prone to that ad-hoc approach to wage-earning.

He also cautioned against making stereotyped assumptions about the various generations—Baby Boomers (population: 78.4 million), Generation X (78.6 million), Millennials (79.6 million), and Generation Z (65.1 million).

"It's not what we don't know about these generations that hurts you," said Warren. "It's what you think you know that turns out to be wrong."

For example, early research about Generation Z, generally defined as those born between the mid-1990s and 2012, indicates that this group—having spent their formative years marked by fallout from the global financial crisis—may be attracted to the stability often associated with working corporations.

Another factor to consider: Baby Boomers are working longer than their predecessors. The percentage of 65- to 74-year-olds in the workforce was 17 percent in 1994, climbed to 22 percent in 2004, and grew further to 26 percent in 2014, according to data shared in the report. The arrow keeps pointing up, with 30 percent (or nearly 11 million Americans) in this age group expected to be working in 2024.

Among the myriad rankings that flowed out of interviews and surveys was the evaluation of markets that represent the top real estate prospects—the "ones to watch." On that front, Seattle is ranked first, followed in the top five by Austin, Salt Lake City, Raleigh/Durham, and Dallas/Ft. Worth. Rounding out the top 10: in order, Ft. Lauderdale, Los Angeles, San Jose, Nashville and Boston.

Chicago ranked 42nd of the 78 markets, including 35th for investment and 49th for development. Generally, smaller markets are gaining in appeal, with the top 10 markets now totaling about 36 million in population, down from close to 60 million several years ago.

In Chicago, the hottest property type is industrial, followed by niche, single family and multifamily. Lagging in interest locally are, in order, the office, hotel and retail property types.

The panel discussion featured insights from leaders of Chicago-based firms that all have a national scope.

Spellman, whose firm is the largest student housing developer in the country and active in multi-family and senior housing, said CA Ventures tries to diversify both within each development as well as across portfolios.

"We think there's a lot of runway left in all markets across our portfolio," he said.

Keane explained that Heitman has $40 billion in assets under management across all four major property types. He runs a core fund with $10 billion in assets.

The real estate market, he said, has experienced some disruption from factors that include the "tumultuous dollar" and social unrest, reflected in part by the political upheaval leading up to and in the wake of President Trump's election. However, there are "certainly signs of re-acceleration," including job and wage growth, Keane added.

Holland's investment firm, Abbel Associates, covers private development, management, and redevelopment, with a focus on office and retail. Referring to the overall marketplace, she said, "We haven't experienced that much of a boom, so there's probably not going to be much of a bust. It has been a very slow recovery."

As for factors that are most prominent in investment decisions, Holland said her company is looking at acquisitions with long-hold periods.

Because of uncertainty in the marketplace, she said, “you have to make sure when you pull the trigger, it’s the right project at the right time.” Another point to consider are potential future uses of property types—Holland pointed to the attractiveness of parking lots for their adaptive re-use prospects, when autonomous cars emerge in large numbers.

Spellman noted the different nature of multi-family, student and senior housing, wherein rents can be adjusted to fill the property and cover costs, and the “binary” nature of other spaces, such as office, which are “either full or empty.”

“There’s more flexibility in our market as long as you build right-sized and diversify,” he added.

Panelists agreed that there is opportunity in secondary markets, though the extent of those opportunities fluctuates from one locale to another. Major metro areas that also happen to be state capitals hold a particular advantage. Some examples are Des Moines, the Twin Cities and Indianapolis, said Holland, whose markets are “virtually recession proof.”

Keane prefers secondary markets that are “verging” on becoming a primary market. He cited Denver as a recent, emergent example from the past 10 to 15 years.

Spellman, meanwhile, touched on secondary markets that are home to large universities, such as Madison and Ann Arbor. Their large student base makes those markets “sustainable for a long, long time.”

E-commerce, led by Amazon, accounts for about 9 percent of retail sales, but “I think the headline about Amazon killing brick and mortar (stores) is overhyped,” said Holland. “…It’s much easier if you are the head of real estate for a company to blame Amazon (for store closures) than it is to say, `I built too many stores.’”

Owing to the requirements dictated by consumer behavior, to survive or thrive as a shopping center, she added, “You better be a destination or you better be convenient.”

Self-storage has risen as a category for Spellman’s firm, which has also entered into a strategic partnership with Amazon via pick-up locations on some college campuses.

Keane said retail is easily “painted with a pretty broad brush,” and that his company focuses on entering that sector in areas that are densely populated with a high average household income.

Looking to changes in 2018, Holland said it appears a new tax law will go into effect and “it will certainly affect tenants on the commercial side.”

Panelists also tackled the specter of rising interest rates, and what that would mean for cap rates and other economic indicators. A key element is whether there is “even a modest rise in inflation,” said Keane, to align with higher rates

Schreiber, the moderator, expressed surprise about the Chicago market being in the lower half of the survey (42nd of 78 markets). He asked panelists for their view of the local market. All spoke favorably about its strengths, while acknowledging some vulnerabilities.

"Clearly the luxury market here is very strong…the supply and demand is very much in check," said Spellman, who added Chicago's central location makes it a key part of companies' national distribution models.

More directly related to his company's forte, Spellman said there is not much room for student housing growth in Chicago because efficient transportation enables students to commute from home to various local colleges.

The city and state's fiscal problems are hindrances to business development, with some institutional investors "red-lining" the state, said Keane. Panelists also cited crime problems, both real and perceived, as negatively affecting business prospects. On the other hand, Chicago's central location, highly educated workforce and ample population base are undeniable strengths, they added.

"We're very frequently hosting investors from around globe...investors across the globe are very favorably inclined toward Chicago," said Keane.

The urban core of Chicago has grown in population by over 50 percent since 2000, which is 1 ½ to three times the rate of growth of all other major U.S. markets, Keane noted. "That's impressive and that has absolutely served all kinds of development," he said.

More recently, noted Holland, Chicago's being in contention for Amazon HQ2 "improved my conversation with investment groups" that are evaluating the city's merits.

And that bid is legitimate, said panelists. Each answered in the affirmative when Schreiber followed up on Holland's reference to Chicago's being on the e-commerce giant's short list of cities for a second headquarters.

"Do we have a shot?" he asked. "Absolutely," replied Holland. "Nobody thought we had a shot at Boeing either and they chose Chicago."

EVENT SPONSOR
ULI Chicago
1700 West Irving Park Road, Suite 208, Chicago, IL 60613
773-549-4972 | Chicago.uli.org | Chicago@uli.org