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Post-Pandemic Economic Statistics - Real Estate Market Projections for 2023

Summary/Description:

This is a presentation about the state of the economy and its impact on legal practitioners, suppliers, and advisors to the construction industry. The topics which we will cover will include the state of the global, national, and regional economies, with special emphasis on the real estate sector. This will include an examination of real estate cycles and their impact on revenues and costs, growth and demographic trends, key issues impacting the market and a forecast of prospective issues and opportunities which are likely to impact this sector.

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Target Audience:

Insurance Executives and HR Professionals, Insurance Team Managers, In-House and Outside Counsel, Vendors

I. The Macroeconomic View

Our global economic market has been tremendously impacted and is being transformed by recent and current events in a way that his unprecedented. After the relative tranquility of decades of economic trading and international trade dependence, we are now experiencing an economic weaning period which is changing the global marketplace. This is the result of years long pandemic, trade and tariff wars, and now, the impact of the war in Ukraine. Each of these factors have caused tumult which has reached to the most basic levels of availability of supplies of products, and their cost, and has challenged and questioned our very reliance on the global trading structures as they currently exist.

This is the inflection point of change for the global markets, impacting both supply and demand. We are seeing great movement on where we get our resources, including their costs and distributions. The pressure points have resulted in inflation rates which have not been experienced in decades. Even as the pandemic subsides from its past levels, the fight to protect us from it including huge government subsidies to businesses and individuals, which in turn caused a flurry of demand, has triggered this inflation. The problem has been catalyzed by bad domestic trade policies and now, particularly, by the upheaval caused by the Ukrainian/Russian war.

The questions going forward is how do we adjust to the changes? Do we unglue the economic dependencies that nations and large corporations have built across the globe, from computer chips to potato chips (food), and turn, inward to supply to our demand? And how will a probable recession in the coming year impact the markets?

These questions and many others impact the real estate and construction sectors. The sector has been concomitantly experiencing a shortage of workers and rising costs of product. These have been the primary culprits in rising construction costs: we can't build to demand fast enough. And the costs of building often challenge the very feasibility of the projects. At the same time, residential consumers cannot afford the rising rents and home costs. While commercial firms have been downsizing their need for space, a residual of the pandemic "experiment" is worker flexibility between home and office. This is all occurring as a sort of functional obsolescence is taking place in the commercial sector, as years of oversupply of retail space, now challenged by on-line retailing, have resulted in oversupply of space, and the prospect of changing land use propensities.

II. Slicing and Dicing across the Nation

There are also major demographic changes occurring in our nation, which can no longer be overlooked. The decades long shifting of population to the so-called "sunbelt" states may now be in gradual decline, as costs of living in its major markets (California, Texas, Arizona & Florida) are catching up to the rest of the nation. Rising costs of owning and renting homes are a particular problem for the "millennial" cohort of our population.

Importantly, climate change will impact how and whether people can survive in the increasingly more arid and resource-challenged Sunbelt regions. Any climate map paints much the south half of the U.S. brown, a bad omen foretelling the prospect of movements of people and their jobs, perhaps a return to the cooler, more resource friendly, northern regions. It's a long-term prospect, but it impacts our focus on infrastructure and City building issues going forward.

While the current competition among states, most pronounced at least in the media, as between California and Texas, should ultimately wane as the two states may experience similar resource and climate change challenges. They must adjust to these inevitable changes. This will present opportunity for economic cooperation as opposed to the current environment of cannibalization.

The pandemic and the economy have also turned the real estate market on its head. For instance, a house is no longer just a place to live. It has become, for many, and perhaps permanently, a place to work. This suggests that homes must adjust as to their design, e.g., creating a more productive workplace environment inside the home that just the kitchen table. It may be larger homes, better partitioning between rooms, and certainly the availability of the latest communication and computing technologies.

The pandemic has taught us another thing: people can be untethered to a physical relationship to their work environment. If you can work from your home, then you can probably live most anywhere. This growing "footloose" nature of our changing economy may portend future investment to new towns and small towns, in places that have not enjoyed (or be challenged by) the people and economic growth of the biggest metropolitan areas. I see these as inevitable future trends.

Just the opposite is at work in the office environment, which experienced practically total emptiness during the height of the pandemic, and now many firms are seeing far fewer people come back to the office. This spells a critical inflection points in the office sector, probably resulting in far less construction, and perhaps a downward valuation adjustment in commercial over the coming years. That will cause lower rent, and lower revenues, which will, in turn, challenge not just the feasibility of new construction, but possibly cause an unprecedented level of distress amongst the owners of the built environment.

What is blurry is the timing of it all. When will these movements build enough of a head of steam as to impact our construction and real estate markets?

The retail sector has been challenged over the past decade by the rise of on-line purchasing, which has deeply impacted a sector known to already been oversupplied. Many shopping centers and commercial strip buildings have already been torn down and redeveloped, adaptively reused, or simply abandoned in the face of these challenges. New residential projects have repositioned in formerly commercial spaces, a trend that should continue.

Some sectors have flourished. The manufacturing sector, particularly in the high-cost west coast, has enjoyed significant prosperity. But it is a misnomer to call it manufacturing. The prosperity of this sector has been rooted in the repurposing of these buildings into technology centers, or even warehousing for the consumer retail sector. But most of these tilt-up, inexpensive horizontal structures are not housing companies that build stuff. That has shifted to the inland markets.

The hotel sector is currently experiencing the most prosperous period, perhaps ever. After tumbling the steepest during the recession, when the lights were mostly out, this sector started to roar back in late spring of 2021 as home hostaged persons fled to tourist destinations once they became inoculated from the virus. The travel frenzy hasn't stopped. In fact, it has accelerated as business and conference travel is starting to return, although probably never to its former levels. The result of all of this is that this sector is now in its "gauging" stage as they attempt to make up for the awful vacancies they experienced during the pandemic. The only question that remains is if the current high room rates are permanent, or will come down, particularly If the economy enters recession over the coming year.

III. Critical Current and Future Issues

It is hard to forecast, particularly over the long term these economic and industry-specific issues. But it is fun to try. The best way to approach forecasting is from the vantage point of thinking of the broad-based issues facing us. These must include climate change, technology, and the movement of people.

Climate change is, at least, now a thing, its reality challenged now only by the fringe. It has already wrought bad weather, permanent heat and humidity, sea water rises and increasing misery in a lot of regions. It will cause vast movements of people across the globe, even in the U.S., seeking cooler and more stable climate and overall better quality of life. This will change economies, metropolitan areas including how and where we grow, impact jobs and commerce, etc.

Technology has also greatly impacted our sector. But I believe that we "haven't seen nothing yet"! for example, the changes in transportation technology, particularly advent of autonomous vehicles, has the potential to change the very physical nature of our cities. Why do we need structural parking, or even street parking, if autos can go back to where they came from without a driver, or pick someone else up, never stopping to occupy expensive space? AV has the potential to change the relationship between where we live and where we work (e.g., commuting): think of a car as a train without tracks. If we do not drive them, we can work in them. AV can foster an era of new town construction, or at least expand our metros which can increase housing opportunities. The prospects are endless, unnerving, and transformational.

It will be interesting to see how our electeds react or address all of this in terms of public policy. We are typically miserable at getting in front of these inevitable, big issues and movements, tending to solve them as emergencies, and often too little too late. As to resource allocations, such as water, or addressing housing shortages, radical but doable policy needs to be enacted. On housing issues, so far, our electeds still “nibble along the edges” seldom getting to the heart of how or why we cannot deliver sufficient housing. Even water issues are solvable as engineering solutions, but most electeds still look at water as a resource driven issue. Its not.

Everything is solvable. We just need to broaden our prospective. And act, both individually and collectively.