



Real Estate through the lens of a post-pandemic world - By Joe Williams

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I was raised in the late 50's & 60's to parents that had survived the Great Depression and then fought a major World War. Consequently, their views were ingrained on us, their children. To say that their attitude about life was formulated through two major world events was obvious in everything they said and did up until the day they passed. Both of those events reshaped their world as they had known it, and thus ours as well. But, it was easier for us as kids because we were living it in the here and now. Even today, at 68 years old I fully understand the threat of a nuclear war simply because I was helping a neighbor dig a bomb shelter while participating in "nuclear bomb" drills at my elementary school every month. We are what we live.

I was flying back from Phoenix just last week staring out the window at miles of open country contemplating that very thing in an industry I've spent a lifetime watching and impacting. To say that the pandemic has left an impression on all of us is obvious, and I've wondered just how different industries will react now that, hopefully, the worst is behind us. I do think all of us have changed a bit, some more and some less, but this was a worldwide event that is going to rewrite certain aspects of life as we know it. It already has, and here's the aspects in the real estate industry we need to watch.

Connecting the Dots

Far and away the biggest surprise was simply that our working world had been greatly impacted by hardware and software we regularly used, but nobody realized this fully until we got sent home! The facts are that a high majority of people were showing up at the office, grabbing a coffee then sitting down with their cellphone and laptop for 8 hours, then commuting home. All of the sudden when we couldn't come in, we found that same cellphone and laptop still got the job done just fine. Except gone was that commute to and from the office. Meetings either got eliminated or transferred to this new thing called ZOOM.

The truth is we learned new ways to accomplish things, and it was thanks to a new digital world we'd already been experimenting with, but now, totally dependent on. Even Grandma discovered Amazon if she hadn't already. The digital ecosystem got a massive shot in the arm from every corner of the globe and life would forever be modified. Who got impacted?

Traditional office buildings suddenly went dark. From Manhattan to Silicon Valley, bosses everywhere were suddenly juggling their office space needs with an eye toward the "future of work" and exactly what will this mean for their enterprise? This is a good thing. All of the sudden we're all

forced to do a dissection on our operations with an eye toward evaluating every aspect of each department as to its actual spatial needs. Without the pandemic, I doubt any of this would have happened. It opened our eyes to a new way of defining work.

The good news is that a high percentage of companies are going to learn they don't need near as much space as they had. In fact, some departments can operate with everyone working from their kitchens, or study, or even the beach or another country if they so desire. Some this will never work, especially creative-collaboration jobs. But, rarely in the history of work have companies now got the power to grant some incredible advantages for their employees as they do now. The key is flexibility in terms of where one works from is now and forever a standard decision for all office jobs. Not all of them, but what a great exercise to walk through with your team.

And this is not going to be determined overnight. The average office lease runs from three to ten years so many of those leases just now coming up for renewal are the first where these bosses may cut back their space requirements. But make no mistake, an average market is going to see a shrinkage in space needs. How much no one really knows yet without some yearly averages being measured. Honestly, that will probably take a few years.

Retail is not Dead

It's just returning to store shelves a bit. All of the major digital platforms from Amazon down to small specialty internet retailers have seen a slowdown from their pandemic volumes. That's understandable because everyone is tired of being stuck at home. Economists often have a way of underestimating the power of the American Consumer. They're doing it now with all of the recessionary chatter by the media heads. Politics aside, many consumers have more income in their bank accounts than ever before and they are exercising their ability to get out there and spend it. Yes, they could do it on their computer screen from home, but by golly, they're tired of that. Time to stretch our legs, get back out there and sample the restaurants they've had to avoid and get into the stores they've missed. Go fly somewhere, you'll see it first hand at your local airport.

Americans at heart are socially geared to be on the move. And let's face it, a lot of things need to be touched, inspected, tried out in the flesh to make a decision. And yes, the internet suppliers are happy to let you return it, but who really has time for that? Easier to just go look at it in a store, try it out, lay on that mattress, and pick up some ice cream on the way home. That's America in a nutshell, the freedom to get out! So is Amazon going to keep slicing off pieces of that retail pie? Probably, but they're not likely killing off any retail sector except some of the older "big box" operations they've already impacted. Physical & Service Retail, the nail salon and tire store aren't going anywhere and specialty product operators will still thrive in the right locations.

The new shiny object

In 45 years of real estate observation, I have never seen such high demand for industrial land and space as we're seeing today. The big driver is the digital revolution simply because as the demand for speed in delivery becomes the key focal differentiator for suppliers, the demand for distribution centers will keep the hammer down for the industrial sector. In March 2021 my hard drive decided to take a permanent vacay right in the middle of a huge project. I was stunned to see Amazon deliver

the replacement part within 45 minutes of ordering. Let me repeat that, 45 minutes! We didn't skip a beat but they had built a million s/f warehouse 35 miles south which made it all possible. Keep in mind, all of this has come about just in the last 3 years.

And this huge industrial demand isn't just for the big guys. The great resignation we're experiencing is attributed to two factors. First and foremost, living through the pandemic redefined what it means to be alive. Regardless of what we read, nearly all of us lost someone who was actually pretty darn healthy simply because Covid seemed to have a different impact in every case. Medical science can't explain the "why they died" of the virus yet but one thing is clear, life is and can be short. So, there's a lot of people ready to get on with life! This is prompting some large-scale population shifts. One need only look at Florida and the explosion of newcomers making their way to the Sunshine State. Texas is exploding as well but for more varied reasons, but make no mistake, the desire to go live life is first and foremost on a lot of American's minds. Small town America close to large metropolitan cities is about to discover this as well. Losing good friends and acquaintances abruptly will do this. If I kicked the bucket in a few years, am I living in the right place to truly enjoy these last years? Young adults ask, "is this where we should be raising our kids?"

Which leads to reason #2 for the great job remix. Again, two years of government stimulus with no place to go to spend all that cash has given would be entrepreneurs and tons of everyday citizens the chance to "move-up" on societies ladder! They want more and for the first time, many have the funds to take a risk. And they're doing it, in droves. Jack has made a mean spicy mayonnaise for years and for years his buddies have told him, "Man you should bottle this stuff!". So now he is! Except he's outgrown his wife's kitchen! He needs space, about 1,500 feet could work perfectly. He's the ideal small warehouse tenant who once he's in place will never leave his landlord. Nancy has been selling handbags on ETSY for years, she needs space too, in fact her internet orders are insane so she might start at 1,500 ft. but could easily triple that in time. This is a universal need industrially that is not going away and the developers who design for this crowd will do quite well.

The Good news and Bad news about houses

Residential Real Estate is now experiencing something it hasn't seen since after WW-II, a severe housing shortage. This scenario has many strange bedfellows attached to the "why". First of all, after the great housing recession of 2007 to 2012, new home builders have been behind the 8- ball doing all they can to try to catch up with the need for new homes. They haven't yet and this latest volley of supply side issues, typical city ordinances being administered by short- handed staffs' or through ZOOM meetings, the new rising rates for construction loans, and land valuations continuing spiral, and, well, you get the picture. This will take years.

Then there's the fact that everybody and their mother refinanced their current homes over the last seven years of ridiculously low rates so homeowners look at us with that "why exactly are we thinking about moving unless we absolutely needed to" look on their face. Even in Texas, where we can't swing a dead cat without hitting an anxious homebuyer, unless that seller is being transferred or retiring, there isn't much for sale. And high escalating prices are the ultimate "Catch 22"! Sure, you can sell and make a wad of money, but you'll need all of that and more to replace what you have. So, selling makes no sense, again unless you have too! In Austin, TX. where a normal

“balanced” market shows six months of inventory, we’re at around 3 weeks! In the old days the average RE agent closed 9 out of 10 contracts they wrote, Now, you write 10 in hopes of getting 2 accepted. The buyers are frustrated. I can’t blame them, we’re exhausted ourselves.

So, the math is simple where too many buyers with cash are chasing too little inventory. Wait, wasn’t that the textbook definition of inflation? Well, yes. And any sober look at RE valuation rates across a lot of the USA is scary. Across the nation the new property tax appraisals just got mailed out this spring and there isn’t enough smelling salts available to keep homeowners, especially the poor and elderly from almost fainting at the high numbers. This is a serious problem in the long run. Cities need to seriously scrutinize this new windfall and give back smartly.

Of course, high valuations in residential homes will keep the multi-family market humming right along, with its usual “ups” and “downs” in terms of not enough supply, then classic over-building of units. But this is a pattern by apartment developers and their REIT buyers since the earth cooled. That’s not going to change, even their bankers know the drill. The simple fact is as homes keep going up in value, a large proportion of the population has to rent somewhere. Rising interest rates will only push demand for multi-family higher. That helps the apartment builders but they are fighting the same supply issues, labor shortages, and rising land and material costs residential builders regularly contend with.

So is there actually any good news about this? Depends on how you look at it, but in my mind, I see three trends that are emerging. The first is obvious, density has to increase. You can do this a number of ways, and it’s already happening across the country. Many suburban communities are coming to the conclusion that classic “single family” zoning is not the way to go. So, a good example is many have determined that a “Granny Flat” can be added into your backyard, which technically means you now have two living units on the parcel. No need to add water or wastewater taps as you can use what’s already there. Of course, the devil is in the details but many neighborhoods much prefer this to just “scraping” the lot and building a design that doesn’t fit the character of the neighborhood. All of the sudden Zoning ideas are being expanded and talked about. That’s awesome news!

In places where vertical density already exist, the question becomes can I convert multi-story buildings into single family or multi-family type uses? It already is happening with big box malls who have done some cool conversions into senior living, as well as distribution centers. Old warehouses in a downtown area have become cool condo’s for years now. The key is the older building probably has an awesome location, so it’s just a question of retrofitting from one use to the other. And of course, getting the municipal authorities in sync. Can I convert a high rise in DT Manhattan to an apartment use? Or in Seattle? These are logical question that will take a community effort to see the future for but just the fact that people are asking the questions tell all of us something.

The second movement that is coming is the downsizing of America. Construction and land costs have risen so quickly lately, it is logical to squeeze every s/f of living area into a practical use. I grew up in a 1,200 sq.ft. 2 bedroom, 1 bath house in the late 50’s. We didn’t know any better because all my friends lived in the same thing. Guess what, we’re heading in the same direction over time.

Prices will dictate it. Walk into any IKEA in America and you see the example “model” units inside their store depicting how to live in 3 different sizes from 1,100 feet on down. It is surprising how spacious the design seems, especially on the largest unit. Now, I’m not talking “Tiny Homes”, that’s a fad in my head. To actually live, you need around 650 sq. ft. or more, and there are garden home designs out there that prove that.

To complete the “trilogy” of trends look no further than the modular concepts just starting to take shape. The truth is a building being constructed inside a weather-controlled factory can and often is superior vis-à-vis construction outdoors. Inside that factory, wastage is negligible and if scaled properly can be as precise as the robot assembling it. These concepts are actually used around world, but are very much in their infancy here in the States. And the key is you have to be able to scale this type of development for it to ever become mainstream. But, as surely as the earth rotates around the sun, somebody is going to take the risk and design a whole community around the idea of building modular designs that 1) look good, and 2) are reasonably priced with a 3) Disney approach to the community’s needs and amenities. This will happen, I just don’t know who does it first and where.

Years ago I read an interesting book, *The Black Swan*, written by, Nassim Talab. In the book, Nassim lamented the fact that experts of all ilk regularly make short term predictions that often are proven spectacularly wrong. And yet, everybody, in a short time totally forgets they did that! His theory in fact was that the only predictions that seem to come anywhere near the truth are long term prognostications. As he says, “who saw the Internet?” I like to say, “who saw Covid?”. So I think I should end on a safe positive long term note and that is that real estate in America, at least the valuations of such are likely to continue on an upward trend. And I do think while the pandemic was certainly a seminal event in all our lives, it’s impact on the real estate we own, or hope to own, is going to be felt for a long time to come.

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