

State of the Market 28: Three twenty-first century arrivals

By David A. Smith

The most potent forces of economic and societal evolution sometimes arrive in the most innocuous and unannounced ways. Amidst an eventful decade, and a financially tumultuous last two years, three new visitors have arrived, all of whom seem certain to be with us forever:

- Urbanization
- Transparency
- Immediacy

All three phenomena are sweeping: global, not merely domestic; and pervasive, not sector-specific. Nevertheless, they are remaking real estate as an asset and multifamily rental housing as an investment and business. As they have taken up permanent residence, we had best understand them sooner rather than later, so that we can harness them to our advantage.

Urbanization

Want a practical definition of the city versus suburbs or rural? Try this one: when your typical living and sleeping space shares a surface (floor, wall, or ceiling) with people you don't know.

In the country, in the suburbs, we live in detached structures, echoes of the rugged-individualist homestead. The yard with white picket fence is emblematic of an American ideal, an ideal that found its expression in Levittown and America's expanding suburbs. That ideal reached its peak about 1925, and has been steadily overtaken, in America and around the world, by *homo urbanis* – city-dwelling man. A majority of humanity now lives in cities. The urbanization continues at a record pace – in terms of total city-



I'm from the future and I'm here to help you.

dwellers, we are adding the equivalent of four Bombays a year.

Proximity of physical space and technology of construction lead to interconnectedness. Cities are complex systems, a point brought dramatically home last month when a single large underground pipe in Weston burst, contaminating the drinking water of 2,500,000 residents of greater Boston simultaneously.

Interconnectedness in turn has a global dimension. With information, IT, and financial networks flung around the globe to link low-cost labor markets with high-demand consumers, an earthquake in Bangalore can knock out directory assistance in Bismarck, or the bankruptcy of Lehman Brothers one day can stop in its tracks an enormous mixed-use project in Shanghai the day after.

Real estate implications

For the last thirty years, America too has been urbanizing. We see it now in the migration back to sun, sea, and CRA, as Americans move to coasts, to Florida and the southwest, and to the bright lights of

our big cities. That leads to these likely permanent forces in American real estate:

- **Permanent migration south and west.** The population of states like Indiana, Michigan, and Ohio may never again be as high as it is now. Recessions dislocate people, and macro-shocks – deep recessions and catastrophes like Hurricane Katrina – dislocate them permanently.
- **Rural depopulation.** America's rural areas have been depopulating for decades, driven both by green revolution advances in agriculture and by the rise of cities as information and network engines. With depopulation, we need to retire less-functional housing configurations – that weather-beaten high-ceilinged wood-frame homestead will give away to the compact RHS 515, the purpose-built LIHTC mixed-income complex, and the resident-owned mobile home park.
- **The value of quality rental apartments.** Apartments of high quality, secure tenure, and controllable occupancy cost enable labor mobility, which is both a component of national economic competitiveness and the historical salvation of families thrown out of work in one place, only to move to another.
- **Workforce rental housing.** Above 60% of AMI and below the market rental, we need to create quality apartments for key service workers ... and the more we think about interdependent cities, the more categories of service worker appear key.
- **Transit-oriented housing.** Locate high-density high-rise housing (both occupant-owned and rentable, including particularly workforce housing) within walking distance of metropolitan rapid transit. To do this requires retrofitting urban zoning, and in some cases using eminent domain for economic development both to capture transit rights-of-way and to enable parcel aggregation and rationalization. It also takes coordinated activity among

agencies and some meaningful non-recoverable capital (for the green space and infrastructure).

- **Preservation and adaptive reuse.** In low-growth areas, sensible investment drives toward multifamily preservation (including public housing) and revitalization. In high-growth area, preservation can be accompanied by adaptive reuse.
- **Evolving new legal and tenure forms.** In the US, we under-use such legal and financial innovations as affordable co-operatives and shared ownership/ shared equity.

Boil it all down, and it means one survival principle: As Peter Senge like to say, "See the system."

Urbanization = interconnectedness

Transparency

Seduced as we have been by the speed and immediacy of our gadgets, we have forgotten that, as memorably said by Scott McNealy, CEO of Sun Microsystems, "You have zero privacy anyway. Get over it." From Tiger Woods texting fiercely on the practice tee, to Fabulous Fabrice Tourre's cynical Goldman messages, to those University of East Anglia embarrassing climate change emails, to any Facebook user now shocked to discover the company was peeping at and potentially selling their 'private' posts, it is constantly brought to us that if it's electronic, truth will out and be outed – if not today, then tomorrow or a decade hence.

Real estate implications

At first blush, multifamily real estate might be immune to transparency challenges, until you start listing the implications, as the list grows and grows:

- **Code violations and REAC scores.** Between the Freedom of Information Act (FOIA), government sunshine laws, HUD's REAC scores, building code violations and so on, an extraordinary amount of current-

condition information about any given property seeps into cyberspace, where it can conceivably be scraped, correlated and assembled. No longer are a property's sins between the sinner and his regulator confessor; now everybody can know.

- **Pricing information and open-sourcing.** Once upon a time, house price information was largely controlled by the Multiple Listing Service (MLS), raising the profession of realtor to that of keeper of the sacred scrolls of sales. Today, with Zillow and similar Web sites, we can with about three mouse clicks learn a mountain of comparables information, not just about what's on the market, but what isn't.
- **Google Earth and Google street view.** If you live in a city, Google your house or apartment. Click on Google street view. There is something truly creepy about seeing your own front door, your own sidewalk or driveway or flower bed, and knowing that at this very moment, somebody half a world away knows exactly what they look like.
- **Electronic shopping.** Remember when the only way to see the interior of a house for-sale was a guided tour with a broker? Now many homes have in-house video tours, clickable floor plans and walkthrough pictures. For multifamily apartments, where labor mobility and relocating families are critical elements, your Web site may become more important than your rental office, because people will be forming their initial impressions at a time you're not there, from a location you cannot anticipate.
- **Crowd-sourced evaluations 24/7.** As TripAdvisor is to hotels, there will come crowd-sourced evaluations of apartment complexes. (We already have a few of these for very large and visible properties like Stuyvesant Town.) No longer is brand formed by what you say about yourself, now it's formed by what others say about you. Everybody's eyeballs and keyboard clicks can be equal, and as there are

more residents than property management staff, in the end their view will prevail.

- **Marking to market goes live.** In December, 2007, I wrote about FAS 157 and how it would force entities to mark their positions to market, with likely harm to be done to asset values and hence to financial institution balance sheets. We all know how that little experiment in dynamic valuation worked out. Now it's basically permanent – if not through SEC requirements, then through capital market demands. (Watch how all this plays out in Euroland with Greek bonds.) We all live in a world where every bank is the Bank of Glass (State of the Market 10, July, 2008), from which there is no going back.
- **Dynamic pricing.** We're just around the corner from fully visible pricing of every apartment type in every property in America – and just behind that, from automated dynamic pricing of apartments. (Some pricing bots are already in operation.)

As Lucy once said to Charlie Brown, "It doesn't matter what you believe, as long as you're sincere." In a transparent world, who you claim to be had better align precisely with who you actually are.

Transparency = authenticity

Immediacy

Close kin to transparency is immediacy, as anyone knows who has been transfixed by those deep-sea camera shots of a breached pipe spewing oil a thousand feet below the Gulf of Mexico. In an immediacy world, troubles are not abstract; they are manifest. Crises do not loom, they sweep over us like supersonic jets, one after the other.

Immediacy means that when tragedy strikes Haiti, we first see it on YouTube. When ESPN columnist Bill Simmons wants to tweak LeBron James, he tells his Twitter followers to chant "New York

Knicks!" while James is shooting free throws in the third quarter of Game 5 ... and they do. This is a kind of crowd-sourced wisdom and self-organized network sophistication seen in flocks of birds and packs of wolves, and now available to people.

Real estate implications

As BP learned, a reputation built over decades can be destroyed in days, if not minutes. Real estate is especially vulnerable – as my friend Helen Dunlap used to say, back when she was Deputy Assistant Secretary of Multifamily Housing, 'rats, roaches, and bad plumbing' could define any affordable housing property if the right person saw the wrong thing at the wrong time.

Yet bad things are going to happen to good properties: fires, slips-and-falls, domestic violence incidents, break-ins. Crises expose fissures in organizations and hierarchies; they shine blinding lights through the gap between corporate platitudes and organizational values. Hence, in an interdependent world, what happens to you is much less important than what you do once it's happened. To be ready, your organization needs:

- **A culture of responsiveness.** Invert that organizational pyramid: your front-line employees should be at the top, because they're your sensory organs, your fingertip touch on customers and markets.
- **Empowered local employees.** They have to perceive themselves as sentries, with power to observe, report, and act – and that includes, yelling loudly up corporate ladder.
- **Corporate values and integrity.** How do you get a cohesive response in a chaotic situation? By having a corporate

culture that is bedrocked on values that people know the organization will support. We call it the Recap Right Stuff, and we look for it in every executive we hire. Hire for attitude, train for skill, pay for performance.

- **Networked management structures.** When the crunch comes, outsiders and insiders take their tone from the top. A CEO who seems disengaged, who golfs when tragedy is striking in his realm, rapidly loses customer confidence and trust.

Immediacy = responsiveness

Not Visitors, but permanent residents

Our three new arrivals interact – bring them all together and you have the Haitian earthquake. Urbanization made that earthquake a human disaster. Immediacy meant a rush of money toward it. Transparency exploded and humbled Wyclef Jean's charity, even as his motives were for the best.

Urbanization, transparency, and immediacy are not casual visitors passing through – they are permanent arrivals that are making fundamental shifts in our marketplace. To cope with their power both for good and for evil, we have to greet them with interconnectedness, authenticity, and responsiveness.

Urbanization = interconnectedness

Transparency = authenticity

Immediacy = responsiveness

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