



# How Our National Economic Transformation Informs Real Estate Decisions

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PROVIDING STRATEGIC VISION, ANALYSIS, CAPITAL AND DEAL ACCESS TO DEVELOPERS, INVESTORS, LENDERS, ATTORNEYS AND PUBLIC AGENCIES FOR OVER 25 YEARS.

*Recently I was engaged in a conversation with a successful investor and portfolio manager, who informed me that he is expecting U.S. GDP to expand from 4 to 6% this year. I asked him how he came to that conclusion. It was based, he answered, on his discussions with CEO's and foreign investors, among others. He indicated that there was a significant swelling of optimism throughout the globe.*

*I'm delighted to hear it. The problem that I have, which I posed to him as a question, is "how"? With the economy at virtual full employment, that the prospects of immigrants filling available jobs is in peril, and with the likelihood that AI (artificial intelligence) may strip away jobs, in what way are we likely to grow?*

*This is not just an abstract question. The President and Congress have steadfastly declared that the new tax bill, while exploding the federal debt, would soon have the impact of shrinking it when the economy starts to grow by 3% GDP, once these same CEO's start to reinvest in America.*

*Economic growth is the engine for investment, development and lending. Our impressions on how we are faring as an economy go directly to the decisions we make on when, where and how we invest in real estate.*

## Less Investment in U.S. Assets

As a sanctity state, our nation has benefitted from global economic decline and uncertainty. Global economic uncertainty has diminished, although political uncertainty remains.

Notwithstanding the recent stock market correction, the global economy is on a roll, mostly because of financially stable markets and positive economic growth. Most of the indices, including stocks, GDP, home prices, etc., have been on a stratospheric climb, reflecting continued optimism.

In contrast to the trend of the past few years, this probably means that there will be less investment in U.S. assets than in previous years. Record low capitalization rates in real estate assets are reducing enthusiasm to invest in apartments and commercial properties. Many will say "no thanks" to these high asset values as they are now more comfortable with risk-adjusted returns abroad.

## The Outliers Matter

Compounding this global equalization, there is uncertainty, both in the short and long term.

Most economists are predicting a continuation of the ten-year economic growth cycle. And even if, or when, that cycle breaks, most predict a "soft" landing.

Here is what bothers me: they have mostly factored out "outliers", better known as those events that are not likely to happen, but if they do, watch out. Outliers might include, nuclear war, epidemic, terrorist strike, cyber hacking, etc.

In most years it is quite proper to factor out the outliers. They usually don't happen. But this is a unique year. It feels like this is the year that an outlier is not an outlier, what with shaky global politics on so many fronts. It may not be prudent to disregard the outlier.

What I would be watching is the stock market, particularly the Dow average. The reason is that the index is on a roll. When I started writing this paper a couple of weeks ago, the Dow had risen to above 26,000. Just last year at this time it was at about 19,000. That is a great year. Even though there is an apparent correction taking place, the index is still hovering well above 24,000.

The stock market is not the economy. But what concerns me is that such a correction could domino throughout our economy by causing people and businesses to lose confidence, stop spending, cut vacations and pare down those recent pay raises.

While the economic fundamentals are currently strong, if another outlier event occurred, or if the economy weakens, that could spell trouble, precisely because there is now global competition for investment dollars.

To be sure, this has not happened yet. In fact, the new tax bill seems to be having the current effect of causing companies and people to behave better, economically speaking.

But this is a run that will inevitably stop.

### Bricks and Mortar Consequents of a Long Term Economic Revolution

All of this to say that the economy is not likely to consistently grow by 3%, and certainly not greater (unless we measure economic growth and productivity in new ways, as some are arguing). More production is required to accomplish these higher levels of growth. More production requires more labor. Between AI and border walls, it looks like we are going to have less labor.

For the real estate sector, I think that it is more important to understand and act on the long-term changes that will impact our businesses. We are witness to tremendous economic changes, and they are being well reflected in our real estate choices, our land uses and overall valuation.

For example, the construction of new employment space has lagged over the last ten years of economic growth, certainly relative to other cycles of prosperity over recent economic history. Amid prosperity, companies have concentrated on efficiency, including downsizing and stripping out support jobs.

This is the bricks and mortar consequence of the revolution which is really in play: that of AI and advances in information technology including computers and robotics.

In real estate economic terms this translates into fewer workers utilizing less space. This doesn't even measure sociological changes which have minimized personal space for

shared space, and 'everywhere' working environments (home and car) replacing destination working environments.

### How We Are Advising Our Clients

This is generally what we are advising our clients in the various sectors which we serve:

Investors: Stay the course in investing in quality assets but be wary of overpaying. When there is a repricing, there will be better buys, and the strong demographics that suggest continued rental demand will remain strong. This is a good time to be fettering away resources or taking some chips off the table to prepare for attractive investment opportunities ahead.

Developers: Continue to search out underdeveloped properties that have redevelopment, adaptive reuse, mixed use and increased density potential. In a world of changing opportunities and where many formerly strong land uses have been made vestigial, there is opportunity for forward looking entrepreneurs.

Lenders: Be wary of loan requests which pro forma stasis economic conditions. There will be cycle changes. Also, question occupancies by historically reliable tenants (e.g. NNN tenants) across all asset classes which could become collateral damage in a changing economy.

The real revolution taking place in society is not necessarily the Trump revolution. Rather, we have now entered a long trending period in which economic revolution is dramatic, often disruptive, and is certain to result in alterations to how we live and work. A measured, informed and forward-thinking perspective on these transformations will surely cause better business and investment decision making.



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