REITS and the Changing Landscape of American Real Estate

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For many of us, investing in real estate has always been centered around owning individual units - either in an apartment complex, in a commercial development or a detached house.

When viewing real estate investing through such a narrow lens, we seldom consider the dynamics and profitability of owning other types of real estate, such as a shopping mall, a parking garage, a 30-story office tower, an industrial park, a data centre, not to mention an airport or a hotel. Yet, the transactional volume and total value of residential real estate is only a fraction of the value of commercial real estate.

Most often, an investor's view of real estate trends tends to be myopic, concentrating mostly on their own experiences in their home city or neighbourhood. Investment decisions are therefore often based on subjectively observed localized situations.

However, home-grown trends seldomly reveal vast secular changes that originate in distant markets and only slowly make their way to our neighbourhoods. What is happening in New York, Chicago, Frankfurt or London seems not to have a bearing on our investment decisions at home. But it should. Welcome to Global REIT investing.

In this article I would like to point out some evolving socioeconomic trends that are shaping real estate investing and creating new winners in an ever-changing game of marrying technological breakthroughs with conventional real estate.

Furthermore, I would like to dispel and challenge several myths that do not allow us to see the tidal changes that are happening in real estate investing and are moulding the future of the real estate market.

The Death of the Shopping Mall? No. The Birth of a New Kind of Mall

Today, many real estate investors are steering clear of shopping malls. In the meantime, countless shopping malls are flourishing and are more profitable than ever before. What gives?

When I ask a client or an acquaintance what they think is the percentage of brick and mortar retail sales vs online sales, most speculate that it must be at least 50% given the prevalence of store closures and visible "amazonification" of the retail space.

Yet in 2018 only 17% of total retail sales were conducted on-line. Make no mistake, the growth in online shopping is a fact and it is firmly on course to reach 25% by 2023 (Bloomberg Intelligence) but it is nowhere in the vicinity of 50%. And it may never get there if the mall of the future becomes reality.

Millennials (born 1981-96) and Generation Zs (born 1997-2012) still prefer brick and mortar shopping to online shopping at a ratio of 7:1, with the seven preferring brick and mortar. Millennial and Gen Z spending will account for over 35% of total US retail sales in 2020. They are an important client segment. But that same shopper has a different vision of the mall experience than a baby boomer or a Generation Xer.

For instance, today's young shopper, living in a smaller apartment or home, wants a more compact and more easily accessible grocery store with a greater selection of local and gourmet products. Case in point - year 2018 saw 30% growth in grocery store openings with the majority in a small local format.

The future anchor tenant grocer will therefore be focused on local fresh produce, organic wares and competitive pricing of higher quality craft/gourmet products. The weekly grocery haul has been replaced with a short pleasure trip to a local grocer - most likely after a spin or yoga class, or a day in the office that is now located in the shared office space previously occupied by a large department store. Goodbye Walmart – hello Trader Joe's, Aldi, SoulCycle and WeWork.

The new mall is not only e-commerce proof but is e-commerce friendly - it is a place where you pick up your online order from Starbucks, Panera, Aldi, Whole Foods or Potbelly Sandwich. It is a place where you meet your friends and family for dinner in a chic restaurant or watch the latest movie in a VIP theatre stocked with gourmet food and wine.

It is a place where you sweat in a SoulCycle spin class, take a Y-Yoga class or flex at Orange Theory, all after a day in the office on the upper floor of the mall. All this in the same place where Macys or Sears used to be just two years ago. Yes, retail store space has been converted to office space in the mall of today and tomorrow.

Furthermore, the future mall is in close vicinity to newly constructed multifamily residential units, all conveniently located along the light train commuter line. The traditional Macys or Bloomingdales is no more. Instead, their 40,000 sq ft space has been remodeled to accommodate new office space for the emerging new economy.

Which brings me to my next point:

The Emergence of Shared Office Space

On the eve of writing this article (May 15th, 2019), Canadian investment company Caisse de Depot et Placement du Quebec and WeWork have signed an agreement to jointly create a $3 Billion real estate investment platform to develop and build high quality office properties in high growth commercial hubs around the world.

For those who haven't heard of WeWork - it is an 8-year-old company that is one of the largest tenants in the U.S., providing shared work space for employees of clients ranging from startups to Fortune 500 companies. It was recently valued at $47 billion - the same size as the 125-year-old Bank of Montreal.

WeWork and hundreds of similar small shared office space companies are at the forefront of a structural shift in how real estate is bought, leased and consumed that will leave behind the landlords and investors who ignore this disruption. The office of the future has arrived.

The Emergence of Specialized Industrial Properties

As technology rewrites the rules for retailing it is also giving rise to a brand-new category of tenants and landlords – those who rely on technology output and storage, and those who can provide it.

Data Center REITS build and develop specialized structures that house and operate servers that are at core of businesses such as Dropbox, Shopify, Amazon, Netflix, Google and Microsoft, to name a few. The landlord (the data-center REIT) owns a specialized warehouse, HVAC and power systems that accommodate the ever-increasing needs of tech heavy tenants. Yes, the “cloud” as virtual as it is, is actually based in a physical building!

Cell Tower REITS manage and operate diverse locations that allow cellular network providers to focus on technology innovation and improvements while leaving real estate management to the landlord.

How about e-commerce? Specialized logistics facilities owned by the plethora of industrial REITs allow e-commerce titans, like Amazon, to store and ship all the goods that the consumers bought virtually on-line.

Today e-commerce and high-tech REITs account for close to 30% of the total REIT market. And none of them existed 15 years ago.

The Future of Parking Garages

The apartment of the future, especially one located in the most attractive part of the city, will have less demand for parking spaces and more demand for common use or recreational spaces. As ride sharing continues to gain prominence and advances in technology have brought the idea of ordering up a driverless car for local trips, U.S. REIT residential developers are building garages that are adaptable for future use, with some (located above grade) that can be converted into apartments.

“In the next five years with autonomous cars, you could have far fewer vehicles on the road and less demand for that parking space,” says Ric Campo, chairman and CEO of Camden, one of the largest American residential REITS “We’re going to be able to adapt and reuse those garages.”

In Real Estate the Future is the Past and the Present

The last decade and especially the last 5 years have brought tremendous changes to our way of life – how we conduct business, how we travel, how we communicate with each other, how we date, how we shop, what we watch and how we watch TV, how we commute and what we commute in.

Changes in technology and society are also reshaping our work and living spaces.

However, regardless of all the technological changes, one thing is still constant - we still need a roof over our heads when we sleep, work or unwind. Real estate and the REITs, although more sophisticated than ever, will continue to be important pillars of the economy of the future.

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