The Future of Real Estate

Predictions by the U of M Network

MICHIGAN
REAL ESTATE CLUB

Tom Wackerman

President, ASTi
U of M, BA ‘79

Well, my predictions in 2016 were kinda-sorta right, but who could predict COVID and an isolationist focused administration in Washington. Here are my updates:

Incentives

Incentives are now focused on the most contaminated sites in Detroit, but not because the Detroit market has stabilized as I predicted in 2016. The key driver is that the **amount of funding has decreased and the demand has increased,** forcing municipalities and EGLE to pick projects to support. Detroit is still the leader in using and managing incentives, but after a long pause, other communities are now seeing an **increase in requests** for incentives, largely driven by increased construction costs and a continued **desire for downtown** (and therefore impacted) properties. With the increased scrutiny of EGLE (see below) the **costs and timeline for many remediations has increased**, making incentives critical for the successful redevelopment of contaminated properties. In the absence of additional funding sources for incentives, competition will increase and some contaminated properties will not be able to move forward with development, making **suburban and rural sites** (or at least uncontaminated urban sites) **more attractive**.

Environmental Remediation

Rather than building on the last 20 years of presumptive environmental clean-up experience, EGLE has reverted to a site-specific, negotiated approach to closure, especially for properties at or near former gas stations, dry cleaners and manufacturing facilities. This has resulted in more investigations, **long delays** in getting EGLE approval, and more uncertainty as to acceptable controls. This has made development on urban and contaminated properties more costly and caused extensive delays. This trend will continue for the foreseeable future, with redevelopment of contaminated properties no longer able to rely on the approach prescribed in the regulations, but rather looking to the most recent **EGLE approvals for the latest guidance**.

Environmental Assessment

For contaminated properties, assessments will continue to be driven by the potential for **vapor intrusion into buildings, rather than actual site conditions.** This will result in more assessment costs focused on documenting obligations **to protect human health** in buildings. For urban sites, this will result in use of presumptive remedies rather than an assessment to determine actual need, making vapor controls a standard practice.

Joseph S. Vig

CEO, JS Vig Construction
U of M, BBA '91

In 2016, my predictions focused on the adaptive reuse of buildings, and "smart" building controls and systems. I discussed the impact of regulations on the **design scope and cost** of projects. Also, I observed that the lack of **skilled tradespeople** was having an increasing impact on construction industry pricing and project delivery.

Post Covid, in 2021, each of these trends discussed above have been **accelerated**. Supply-chain shortages and material price increases are **forcing architects, engineers and contractors to rethink the most basic building design assumptions**...from the building frame to building envelope to mechanical/electrical systems. When I started in Michigan commercial/industrial real estate in 1991, the formula was simple...maximize FAR, steel frame, masonry façade, simple membrane roof and basic lighting, plumbing and HVAC. Thirty years later, the sophistication of buildings has increased dramatically to **improve energy efficiency, indoor air quality, creativity of façade design, sustainability of site development, user comfort and user safety**. I expect innovation to meet these objectives will continue to generate new and exciting designs, while trying (sometimes unsuccessfully) to preserve core architectural design principles...just as 1960's postmodern design trends brought us a wide range of architectural outcomes (good and bad).

The increasing sophistication of building design will combine with the reduction of skilled tradespeople to create a **trend toward off/on-site manufacturing** and sub-assembly of building components and systems. Panelized walls and unitized window systems will evolve into **pre-manufactured offices**, **toilet facilities, laboratories, data centers, food service operations**, etc. Modular construction has been available for some time, but automation and new manufacturing technologies will make the process more cost effective and precise. The skilled-trade workforce and old-school professionals (like me) will resist these trends toward "manufacturing" buildings. But, if the sub-assemblies can be efficiently transported and staged at the jobsite, then they will **ultimately reduce building costs, improve quality and dramatically reduce project schedules.**

JS Vig Construction Company has completed over 1600 commercial, office, industrial, educational, hospitality and technical facilities. Recent projects range in size from $5 million to $50 million, including several dozen prominent projects at the University of Michigan.

Max Olive
Principal,
Bullet Group Partners
U of M, BBA '16

The Future Is Affordable

The largest wealth gap dividing Millennials and Gen Z – America's youngest generations – and Baby Boomers is **home ownership**. Accelerated by the Covid-19 Pandemic, Millennials have realized the benefits of a single-family home that weren't available to them in their urban mid-rise apartment they leased after undergrad: room to **grow a family**, a **backyard** to entertain guests, and the **wildly important home office** that any successful white-collar employee needs in today's professional climate.

The problem? Battered by higher costs of living than ever before, your average thirty-something is scrambling to put together the funds necessary for a down payment. **11 million Americans spend more than half their income on rent**, with the overwhelming majority of this demographic concentrated in America's largest urban cities.

Exacerbating the issue, developers have less room to increase housing stock, even with demand soaring. Labor is increasingly expensive. Anecdotally, in my local market, labor prices have risen in the realm of 20% over the past year. With the **lack of skilled tradesmen and women available**, it's difficult to see a long-term reversal of this trend. Even if prices of material continue to level off, it will be **exceedingly costly to build single-family homes** – or anything, for that matter.

What's the **solution**? I believe that **Uncle Sam** will step in and offer a tax credit or federal abatement to builders of single-family homes. Arguably, the most popular tax incentives in the history of our country came in the form of Low-Income Housing Tax Credits (LIHTC). **Single-Family Housing Tax Credits**, or whatever the solution may be, will dominate the housing market for new middle-class housing within the next five years. **Home ownership is largely what defines the middle class**, and I believe that policy makers will focus heavily on making sure that more Americans are afforded the opportunity to purchase a home

See this tribute about Max's class experience.

Brian Swett
Director, Cities &
Sustainable Real Estate,
ARUP
U of M, BBA '08

- In the next few years, the real estate industry will begin in earnest a sincere movement to build **net decarbonization by 2050**, largely through electrification and led by commercial buildings and smaller residential. Asset decarbonization will become a transitional risk that will be underwritten carefully in transactions going forward.
- **Urban mixed use** (including life science) will continue to drive the development opportunities in growing cities, where creative value capture and P3 **(Public Private Partnerships)** approaches will be utilized to unleash challenging urban sites.
- Human centered design focusing on the full diversity of end users will drive urban planning and infrastructure, as the era of the **single occupancy vehicle** comes to an **end** with a far greater appreciation and support for **mobility options** and **health and wellness in our public realm**.

Jeff Hauptman
CEO, Oxford Companies
U of M, BA '92

1. **Office Space**

It's time to **move past** the simplistic and sensational **"The office is dead!" predictions.** Many traditional office landlords who don't learn and change from this pandemic will be in pain, similar to how auto companies are approaching electric vehicles. We're at a point of **"evolve or die."** The next question is, "how will office use evolve? Where are opportunities for growth?".

It's going to take **innovative leadership** a few years to refocus on the user experience and figure out their product's competitive advantages and disadvantages. For example, we've learned that **mentoring, connecting, and building trust and loyalty still benefit from face-to-face interaction**, and our spaces will evolve to reflect that. Tenants will demand more comfort, such as **outdoor space**. Landlords (and lenders) will also need to find new ways to be flexible, offering tenants the ability to commit to **shorter leases** and **less fit out**.

Our property at 777 Eisenhower in Ann Arbor was previously 300,000 square feet of office space surrounded by surface parking lots. Phase 1 of our strategy is adding a sushi restaurant and coffee shop to the lobby. Phase 2 will be creating a Business Improvement Zone and adding housing to the neighborhood to **increase density and walkability.**

These changes are undoubtedly expensive to pursue, and profits may be suppressed for several years, but again, our mantra is "evolve or die." Markets that have invested in quality-of-life (like Ann Arbor) will have a head start on attracting a spectrum of remote workers.

2. **Development**

Construction costs will continue to drive rents up or **tenants will learn to settle for fewer bells and whistles** – or they'll relocate to markets that are more affordable. But as long as we limit immigration and tell high school students they should go to college and not enter into the trades, **labor costs** will continue to increase faster than CPI.

Nearly everyone agrees on the virtues and need for **affordable housing,** however differing opinions on how to reach that goal will continue to slow us down. Tap fees, EV requirements, affordable housing requirements, etc., while certainly well-intentioned, will continue to be hurdles to development. We need Ann Arbor Planning and Council to step back and study the true economics of development and embrace **public-private partnerships.** Downtown lots owned by the city should be sold and put to their highest and best use – it is a fallacy to assume these lots should be developed by the city just because the city owns them.

3. **Parking** will complicate residential and commercial developments for the next ten years. Historically, parking calculations were easy. Now everyone is trying to figure out:
    - What percentage of the population will own traditional vehicles? What percentage will own autonomous vehicles?
    - Where will autonomous vehicles park when not in use?
    - If people work from home three days a week, will we need only 60% of the typical parking spaces required for a full office.

Monique Becker
Co-founder,
Mona Lisa Development
U of M, BA '15

Sustainability & Infrastructure

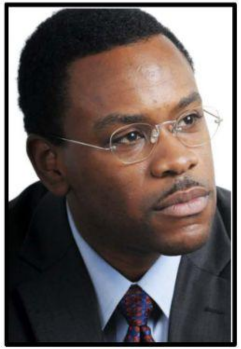
Extreme weather is the **new normal**. From wildfires to hurricanes, tornadoes and floods, the past two years taught us that 100-year events are now annual occurrences. People will begin to more seriously consider climate change and strive to live and invest in places with more **moderate weather**. This **makes Michigan an attractive destination**, particularly, with the abundance of space, freshwater and fairly predictable - albeit variable - weather. This does not necessarily mean that our largest and arguably coolest city, Detroit, will directly benefit. Given the flash flooding and resulting destruction to tens of thousands of homes after thunderstorms, the **aging and failing infrastructure of Detroit** and other Michigan cities will fall under the "cons" list. As the effects of global climate change continue to be felt more regularly, we will see **more environmental migrations** and municipalities with **properly functioning infrastructure** will reap the benefits of new residents.

Innovation over Bureaucracy

Developers are creative - whether brainstorming concepts or on a spreadsheet, we get an idea and then we get the right people in the right place to build that idea to life. That creativity **paired with the determination** to improve our built environment, leads to innovation. Oftentimes, though, the **bureaucracy of today can't catch up** with the innovation of today and novel ideas can quickly become old trends, particularly in the midwest. The coasts often implement new technologies and systems before Michigan, for example. There are myriad reasons for this, but the **elephant - or donkey - in the room is the government**. Michigan has a lot of things going for it: home to the great lakes, an international border, architecturally significant real estate and culture known around the world. However, when it comes to utilizing those assets, The **Mitten is never at the forefront of what is new in real estate**. Rather than lead, we follow because rather than taking a risk on a novel approach that focuses on quality of life and doing something different for the sake of trying something different, many of our elected officials and **bureaucrats opt for risk aversion**, and go on trusting a process that leaves us behind. Don't let process and paperwork bore and belabor innovative ideas to irrelevance. In our increasingly mobile population, whose mobility is only further encouraged by climate change, developers - and even prospective homeowners - will target their investments in places where governments can be agile and creative enough to weather the new weather. In today's world, local **governments must feel like more of a partner** and an advocate for innovative quality of life improvements rather than a barrier to growth.

Zoom into Coworking

Zoom saved us when we needed saving most, but many of us have **learned that nothing beats face to face**. Employers grappled with balancing virtual and in-person working, considering things like the safety of employees, workplace culture and productivity. As we crawl out of the pandemic, it seems the **consensus is part in-person and part virtual**. Given this shift towards increased time out of office and a heightened sense to cautiously control costs in light of the financial hardship imposed by COVID-19, we may begin to see more employers choosing flexible coworking leases. Especially within the next few years, coworking may present the ideal transition from Zoom where employers only need to pay for the amount of space they need to support in-office staff at that time. **Team A is in the office today while Team B "Zooms"** today and is in the office tomorrow. Coworking means less wasted space and less wasted time for business. As employers adjust to the new normal, **expect coworking leases to adjust up**.



Malik Goodwin
Developer Detroit
U of M, BS Arch' '97,
MArch/MUP '02

My initial predictions/forecasts for the Detroit area were centered on:

Infrastructure and Land Redevelopment Investments: I thought that there'd need to be more of a coordinated and aggressive campaign to get more **industrial sites redevelopment-ready** and more swiftly to market in Detroit. In my view, that still seems like a worthy pursuit to support certain companies in the auto related supply chain, or logistics warehousing arena, though it's not happening any faster. It's **still tough** given the upfront capital expense and overall risk and long-lead timing. Plus, there's more lower cost competitive sites in nearby cities and states along the same transportation corridors, given the economic shifts. There's been, however, a few good examples of this model working out in Detroit proper since the initial predictions, using effective regionally focused **public-private partnerships**, incentives and sheer will.

The **Greening of Central Cities**: I thought that more underutilized areas of the city would continue to be challenged by little or no market activity and investment, lower population density, greater land (and building) vacancy, crime, etc. Some of these areas are greening by default. The City has done a great job of addressing public spaces where it can and has resources to do so. There appears to be even more grassroots actors (with funding support) involved with greening up and maintaining land, and using it as part of their own business, homestead, etc. for functional reasons and as passive and aesthetic landscapes.

Closer relationship between desired educational outcomes and industry needs: People having economic sustainability and some upward mobility opportunity is and will always be important. I had forecasted that the underdelivering workforce development system at the time would likely force employers with entities that train and educate future talent more closely together, though many **businesses were already leading their own training programs**. Candidly, I'm not quite sure if this situation has truly changed or not because I can't get a read on what's actually happening in this market on this matter. The nature of jobs is evolving quickly too. Lots of rhetoric on all sides of this issue.

Flexible and Affordable Housing Policy: I pointed out that the coming demographic trends and population and employment characteristics would influence the shaping of local policy and ordinances. I've been reading more and more about municipalities **revising their zoning laws** to allow for more flexible living arrangements on lands, along with revised enforcement/oversight policies. I'm encouraged to see some advancements being made with the building, delivery and setup of **accessory dwelling units** in certain locales for people who can afford that option, but **disappointed that the supply of affordable** options for people across the spectrum nationally appear to have **dwindled even more** since my initial prediction. My hope is that our allied land development/building, and finance industries can coordinate better and figure this out in the near future, for the benefit of most Americans.

Thanks,
Malik Goodwin

Myles Hamby
Senior Development Manager, Platform Development
U of M, MUP '14

My comments from five years still seem relevant for Detroit today: (1) the spirit of collaboration amongst developers and small businesses is strong; (2) we still battle with a disproportionate wealth and ownership concentrated amongst those from privileged backgrounds, but there has been some improvements; and (3) there has been a strong City-led effort to develop "third places" for people to gather.

The business community and its support network of public and nonprofit entities all work together to advance entrepreneurship. This collaborative spirit is vital and will continue to be important for years to come, especially in **Detroit's tough economic climate**. Access to capital, finding good buildings (all use types), blight, low rents, high construction costs, and uncooperative property owners are a few of many hurdles to overcome. All the statistics show that these issues are **more difficult for communities of color** and those who come from low-income households. It takes longer to get something off the ground in Detroit than most other cities. The city and state government need to collaborate on reducing bureaucracy and improving interdepartmental communication.

In the last five years, the City has invested a lot of money in parks and other public infrastructure to create better public places for people of all generations and colors to gather. Despite those improvements, **blight and trash** in the neighborhoods is still horrendous. We need to hold property owners of blighted properties accountable. **Beautifying our streets creates value**, encourages land owners to maintain their properties at a higher level, and attracts investment.

Social instability is directly correlated with real estate values and development progress. Detroit has some of the highest concentrations of poverty and violence in the country. I don't communicate this as a passive observer. My two godsons who grew up in the city lost their cousin to gun violence this summer. Last summer, their brother was shot several times and fortunately survived. My friend and contractor who worked on my house had his leg amputated this summer because his drunk neighbor opened fire on him. I hear gunshots often when I go to sleep at night. The vast majority of violence is amongst those who live a high risk lifestyle, but **historic racism, inequality, poverty**, and unstable households that pushes them to that lifestyle must be addressed. There are many government programs, nonprofits, and churches that do excellent work to address these issues. But life is hard for many in this city.

Holistic development approaches that provide stable housing and other services are vital. Neighborhood real estate development needs to **partner with churches and nonprofits** that offer wrap-around services. Some organizations and developers are modeling this, but there is a need for a lot more.

Clarke Lewis
Senior Development Manager, Platform Development
U of M, MArch/Cert. RE Development '16

The **Sharing Economy** was shaken up, tossed upside down and we are still figuring out what side companies and trends are landing. By one example, **people's trust in having others shop for them (especially with grocery delivery**) has grown tremendously over the past 18 months. This new found trust will propel the sharing economy forward and open up new growth potential. On the other end, coworking operations, **ride sharing** and others have found themselves changing strategies, **struggling** to return to pre-pandemic heights. I still view this as a movement that is largely technology driven, but I believe the **real estate industry will play a bigger role**. There is the need for space these companies have, but the industry will break further into alternative asset classes such as **coworking/ turnkey office space** when seeking out additional upside and investment alternatives. Real estate companies that can emerge with operational talent and infrastructure in this space will benefit the most.

Housing and Affordability. The affordability crisis will **only worsen in the near-term**. There are too many factors that are prohibiting the ability to deliver enough housing supply, which in turn makes everything worse from an affordability perspective. Rising construction costs, supply chain of building materials and increased demand is making it more difficult to deliver additional affordable options. **Longer-term** however, can be **more promising**. Affordability is a topic and issue that is at the forefront of any housing development conversation these days and it's being discussed at all levels. There will be more funding and programs around implementing more affordability, as well as more creativity. I believe workforce housing will be addressed in some alternative ways including the development of **duplex, triplex and quadplex type housing** that is cheaper to build and if streamlined like the SFR (single family rentals) market, could provide great additional housing options. Housing will continue to thrive in general and people will continue to put additional weight into their living arrangement.

Jason Braidwood

President, KDG
U of M, BBA ‘96/
MUP ‘03/MBA ‘04

A half-decade ago we had confirmed the paradigm had shifted: **young workforces sought active mixed use environments first, jobs second**. And employers followed. Uber and AirBnB had taken hold, soft goods retail continued its slide, and institutional capital had discovered **coworking**. Fast forward a beat and the very definition of office – parking and commute included – is in question. And rightfully so. The inefficiencies plaguing the sector have been laid bare. We know CFOs will respond. But will we? A few thoughts as we collectively navigate these remarkable times.

1. Remote Work.

It took me about 35 years but I finally figured it out. Golf doesn’t check any of the boxes one lists as life’s priorities: family, work, and health. A five-hour round via a beer-filled cart, travel time to and from the course, greens fees – all for $50 in lost wagers, five extra pounds, a honey-do list and 150 emails greeting me at home. I mean, really?

Trips to the office are going through a similar reckoning. I said it in March 2020 and it’s more apparent now – **folks will get hooked on a lack of commute**. “It’s my time to catch up on calls and decompress.” Give me a break. Commuting has to be the **single-most wasteful use of time and money in the country. The roads. The parking garages**. And oh my goodness, the time. And why do we primp and preen and make the drive each day? For the culture that a mountain of B-school texts and case studies tell us is necessary.

And indeed it is. But across the entire firm? Five days a week? At 200 square feet and parking space per employee? No way. There is no way that Zoom will not strike the **right balance between culture and efficiency**. And if just 50% of the white collar workforce takes Fridays off, that’s a 10% permanent reduction in office square footage, and conceivably a 10% reduction in parking needs. Maybe the scariest part for us office developers? Day after day, with every new variant and delayed return to the office, Corporate America is getting used to it. **I see this playing out in three key ways**:

> Middle-sized firms will demand the flexibility to ramp up or ramp down **staffing**. This will occur via **shorter lease terms and more reliance on coworking**. Larger firms will own corporate campuses rather than be subject to landlord tenant relationships.

> Landlords will respond with **lower TI allowances and shared amenities**. Proprietary coworking models will proliferate. Landlords and tenants will fight over parking, with tenant demands spiking to 6+ per 1,000 SF. Will LL and tenant reps play along?

> Construction costs are up, incentives are down, and no one knows exactly how to work anymore. Confused leaders (all of us at this point) **will opt more for well-located A-/B rehabs over new construction**.

continued...

Jason Braidwood

President, KDG
U of M, BBA ‘96/
MUP ‘03/MBA ‘04

2. Millennial shift.

We all knew the day would come at some point. The country’s largest cohort listened to the biological clock and began **seeking suburban yards and schools.** Note that this was occurring well before the pandemic-related restaurant closures and crime uptick. But also note there remains a **desire – across all demographics – for walkability, activity and collision**. We still want a mixture of uses, creative spaces, and convenience. This hasn’t changed. Across all demographics.

Where does that leave critical urban neighborhoods throughout the Rust Belt? Same as before. Urban developers need to leverage the **authenticity, architecture, in-migration** and **diversity of core neighborhoods to differentiate from ground-up suburban competition**. Overcoming crime, schools and taxes will as always continue to be a challenge. Gen Z is on average 13 years old right now. Hopefully we will be ready with great, unique spaces when we update these predictions in another five years.

3. Hospitality.

A colleague recently told me that the gig was finally up: those in the hospitality sector had been waiting for – dreading – the day **corporate America would wake up to video conferencing**. Maybe poor bandwidth had helped stave off the inevitable, or maybe road warriors just wanted to get away from their kids. Regardless, **business travel will never be the same**. The cost, the hassle, the inefficiencies, the compromises at home. While extended stay should shake out just fine, my colleague predicts a permanent demand curve shift in select service hotels. Intracompany travel represents 20% of the sector; I don’t know how Sunday through Thursday travel is not permanently affected. “**There’s no replacing face-to-face meetings.**” I get it. Airports aren’t closing. But the delta between post-9/11 **travel and a Zoom call is not only measurable in days and hours. It’s measurable in EBITDA, blood pressure and divorce rate.** We will not be traveling to the same degree as prior.

David Steuer
President,
Steuer & Associates
U of M, BBA '83

Five years ago in the 30th forum forecast, I predicted that pre-family consumers would opt for **home ownership over their small rental** as inflation grew. Covid clearly exacerbated the results. Low interest rates have helped boost home prices because most buyers are focused on a monthly payment. Interest rates are likely to climb which will widen the gap between affordability and continued rising labor & material costs. People are becoming disenchanted with the caliber of the housing supply in their price range, while current homeowners are enjoying increases in equity. Accordingly, **current homeowners will likely upgrade their current residence vs buying new**. First time buyers and Developers will gravitate towards **higher density**; partly because of the higher cost of development, as well as the walk-able nature and addition of more community parks.

Upscale rental housing demand will continue to grow as people choose alternative investments to home ownership **that provide liquidity and flexibility**. These rentals will be better suited for longer term residency with amenities such as private entrances/no common hallways, attached garages, and flex rooms for work, exercise, short term guests, etc. New and renovated workforce rental housing will continue to grow since developers can lock current lower interest rates and enjoy appreciation via accelerated inflation, while renters postpone purchasing a residence due to projected future higher interest rates on mortgages.

I predicted **consolidation in the assisted living industry**, as developers rushed to build yet underestimated the operational challenges and related costs. Municipalities are starting to place moratoriums on assisted living due to oversupply. However, people are living longer and there will continue to be an increase in demand for homes that allow people to **age in place**. Senior housing developments with services and amenities are still expected to be a longer term area of **growth to meet the increasing population of the aging.**

Recent increases of violent crime in urban areas may reduce the number of people willing to reside, invest and reinvigorate those communities that need it most.

Homelessness and lack of affordability continue to plague our society. Our Government and charities are losing ground to supply safe, clean affordable housing.

It is expected that the **Government will ultimately provide additional incentives** to better address the unmet need for both rental and owner occupied affordable housing.