The Future of Cities (and Does the Trump Presidency Matter?)

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Basics: US population now 325 million and already more than 80% urban; growth to 375 million by 2038, and t0 400 million by about 2050. Cities can expect growing need for all forms of improved real estate.
On the world scene, we are 7.2 billion, and more than 50% urban; by 2050, projected to 9 billion and 70% urban – meaning a development need for more than 2.7 billion city-dwellers over next 33 years. Huge challenge & opportunity

Divergent paths for cities visible long ago, even for blue collar workers in 1950s TV shows The Honeymooners and The Life of Riley. Will future be the tech utopia of The Jetsons or the urban apocalypse of Bladerunner?

Effective presidencies can bend the curve somewhat, but over the long haul it is hard to alter powerful demographic forces. There is little sign that Trump has much interest in details of urban policy, but elements of his broader themes do have short-run impacts.

Pre-inaugural Expectations

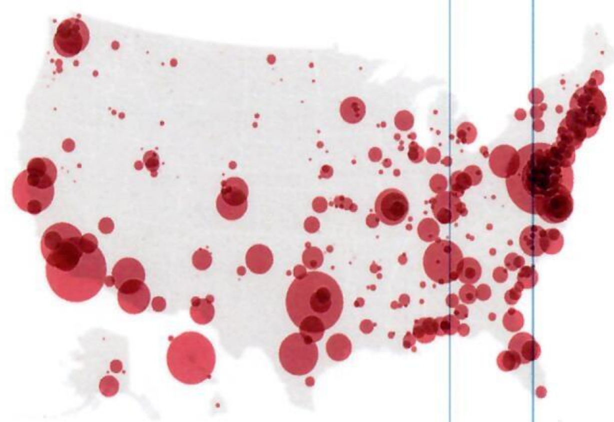
- Disruptive intent, but advantage of one-party control
  - Freda Payne outcome
- Inherent conservativism of constitutional democracy
  - "Rule of law, not of men"
- Program as advertised was stimulative
  - Tension between populism and "pro-business" initiatives; skepticism within the Republican Caucus
- Independence of institutions beyond the Executive Branch
  - Starting with the Fed

Financial markets saw Trump election as surprise to the upside, but getting things done has proved difficult. Strong man run not well suited to US democracy, and political divisions are not only inter-party, but intra-party … and constitutional structure of checks and balances is jealously guarded by Congress, the Judiciary… and the press.

TOP DEFENSE SPENDING LOCATIONS (PERSONNEL AND CONTRACTS)

Top 10 Defense Spending Locations (Personnel and Contracts) (B=billions)

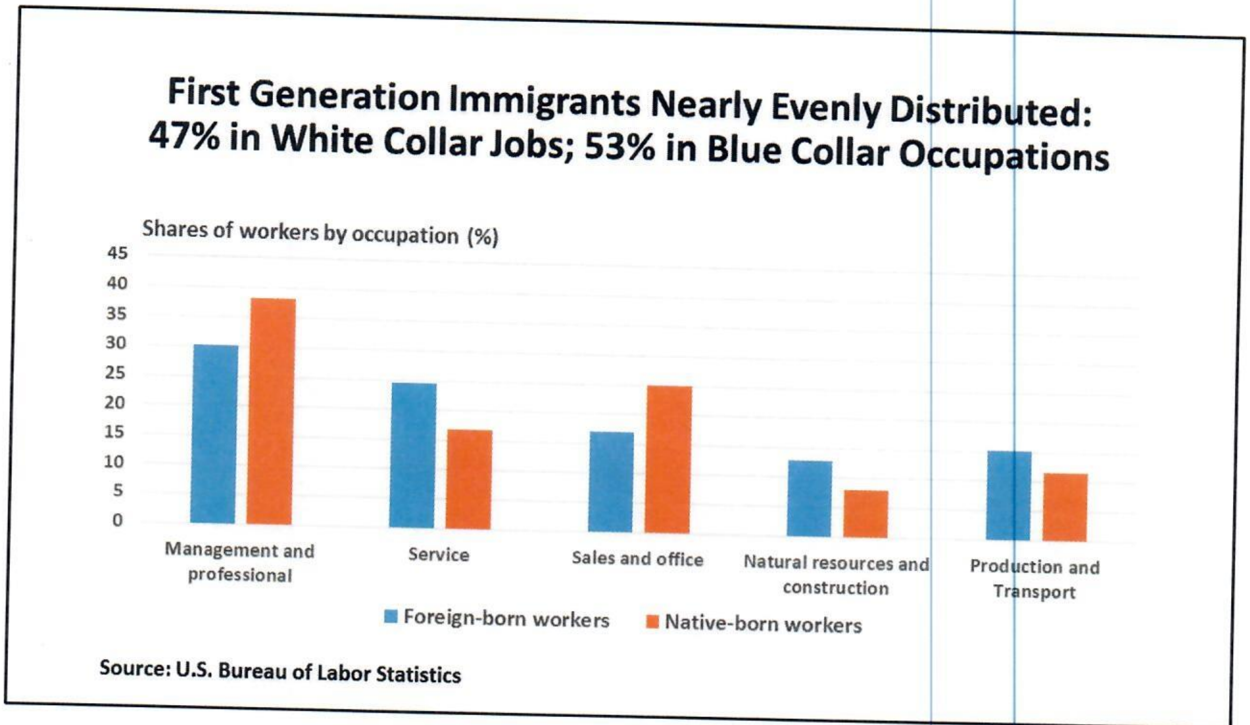
Fairfax County, Virginia	$19.1 B
San Diego County, California	$15.1 B
Tarrant County, Texas	$13.8 B
Los Angeles County, California	$8.0 B
Santa Clara County, California	$7.4 B
Madison County, Alabama	$7.0 B
Honolulu County, Hawaii	$6.7 B
Bexar County, Texas	$6.6 B
District of Columbia	$6.5 B
Newport News City, Virginia	$6.2 B



Sources: Defense Manpower Data Center, U.S. Bureau of Economic Analysis, U.S. Census Bureau, and Chmura Economics & Analytics.

Let's begin with the one policy priority that has been consistent and relatively well-accepted – increased defense spending. Like almost all allocations, defense expenditures are not evenly allocated across the country. The heavily urbanized I-95 corridor – especially the States of Maryland and Virginia – receive the lion's share of military (payroll plus contracting) dollars (even adjusting for population). Next come the sunbelt states of Florida, Georgia, Alabama, and Texas. And then the West Coast, especially California and Washington.

Areas around military bases will see some spillover rental housing demand for off-base family residences, but the largest economic impacts will be in contracting and subcontracting for new weapons systems – including ships, planes, missiles, and cyber-warfare tools. Big contractors like GE, Boeing, Lockheed-Martin, General Dynamics will be growing, as well as software and telecoms (including Microsoft and AT&T).

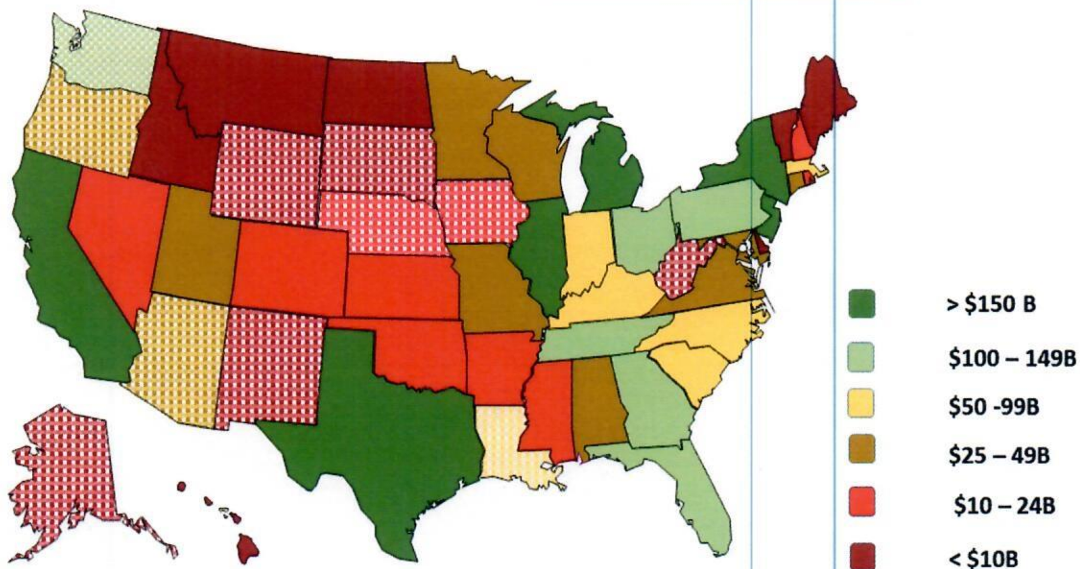


Immigration has been a hot button issue, of course. The debate has been characterized by fairly widespread ignorance of the facts of immigration's diverse economic impact. While certainly the agricultural sector is understand to have significant dependence upon migrant workers – documented and undocumented – urban areas are more prone to seeing concentrations of immigrants.

While much of the political debate is currently being framed around the theme of a "meritocratic" immigration (including EB-5 and H-IB visas), immigrants are nearly evenly distributed amongst blue-collar and white-collar occupations. Generational demography points to an era of labor shortage for the U.S., especially as fertility among the native-born is below the Zero Population Growth threshold and Boomer retirement volumes exceed Millennials and Gen Z labor force entries. If GDP is a function of labor force growth and labor force productivity, restrictive immigration is a potent drag on US economic growth.

Further, immigrants have proven entrepreneurial by and large, and their emphasis on second-generation educational attainment spurs US innovation. "Americans First" is a counterproductive economic strategy over the medium and long term.

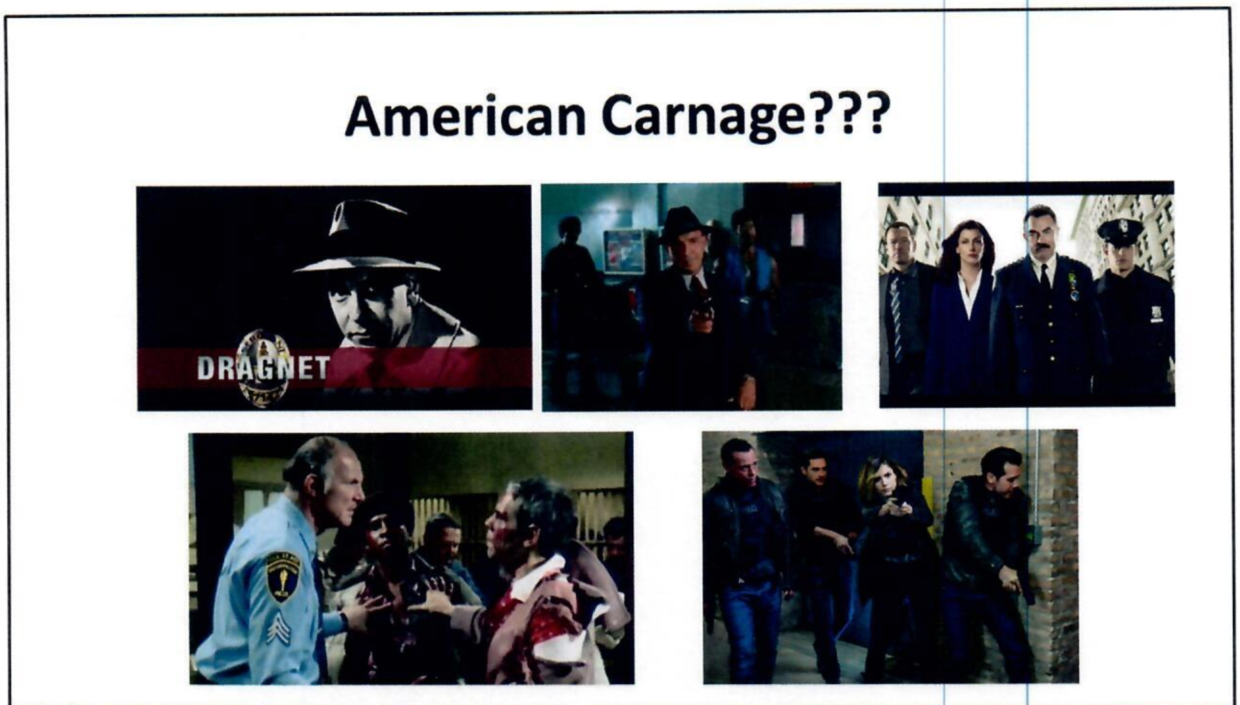
International Trade Volumes by State



Source: U.S. Census Bureau – International Trade Administration

For all the talk about trade deficits, import/export activity is incredibly important to many states. Thirteen states have more than $100 billion in international trade activity annually, and nine states have positive trade balances. Recent visits from congressional representatives and communications from the heads of state in Canada and Mexico have brought this information directly before the president.

For many local economies and real estate markets, it is total trade volume rather than the excess of imports over exports that matters in term of jobs and overall economic activity. Goods flowing through the transportation, warehouse, and distribution systems contribute to local economic growth, regardless of points of origin. American consumers have enjoyed restrained inflation due, in part, to ample imports. Moreover, cross-border investment in US commercial real estate has been led by China, Canada, Germany and other nations with which we have negative trade balances – an example of how other countries' trade surpluses get recycled into Foreign Direct Investment into the United States (and not just in real estate).



To the extent that urban affairs have made it to the White House agenda of talking points, the focus has been on law-and-order issues, thinly disguised code for racial and ethnic targeting. The violence in Chicago, mass shootings whether terrorism or isolated sociopathy, and confrontations between law enforcement and the Black Lives Matter movement have been the featured elements in a depiction of "American Carnage," as articulated in the President's inaugural address.

Despite the amply documented reduction in crime which began in the 1990s and is continuing (according to a recent Brennan Center report analyzing FBI Uniform Crime Statistics), the dark picture of urban crime has focused on a narrative of increased murder (true only in four cities: Chicago, Washington DC, Baltimore, and Houston) and the putative risk of violent immigrants shielded by "sanctuary cities".

As in so many other instances, the elevation of "alternative facts" to centrality in political discourse has made for an Orwellian poisoning of rational decision-making.

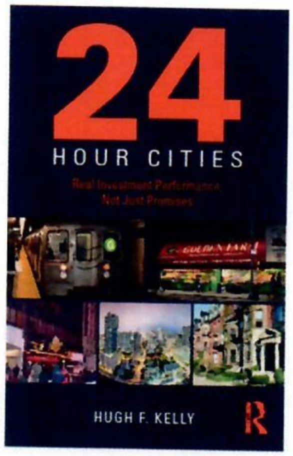
Bad Density: Congestion (including congestion of the mind)

There is "good density" and "bad density." 24-hour cities benefit from the "good density" of agglomeration. But density is not always a good thing. Sometimes we just get in each other's way. If high-paying jobs are available, we have to be able to get to them. Here's a place where the New York region has its issues, for example, especially if you happen to live across the river in New Jersey. All our modes of entry into Manhattan across the Hudson River are at or – more typically – well beyond their engineered capacity.

A solution appeared at hand a few years ago, a second rail tunnel for New Jersey Transit into Midtown Manhattan, but it was vetoed by New Jersey's Governor, who labels it "a tunnel to Macy's Basement." But in fact it was a way for more New Jerseyans to get to Manhattan's economic engine. Without the additional income taxes, income earned in New York but partially payable in New Jersey, the Garden State will depend even more on already burdensome homeowner taxes in the future. Why does that make sense?

And that tunnel will eventually be built, because the need is so acute. Only it will likely cost $20 to $25 billion (if built by 2025), twice what it would have cost in 2008.

The Research Context: Urban Revival of Past Quarter-Century



The Influence of 24-Hour Cities and Vibrant Centers on the Value of Office Properties and Apartments in Large US Markets

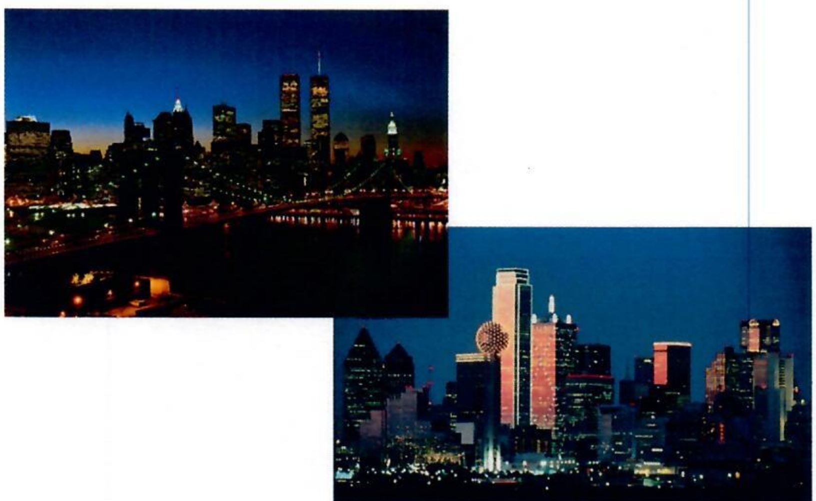
By Hugh F. Kelly and Emil E. Malizia

Journal of Real Estate Portfolio Management, v. 23, n. 1, April 2017

In 1991, it was Joel Garreau's best-selling "Edge Cities: Life on the New Urban Frontier" that set expectations for urban America. Garreau maintained that "every American city that is growing is growing in the manner of Los Angeles," namely, sprawling, mutli-nodal, and automobile-dependent. In 1995, in contrast, *Emerging Trends in Real Estate*" asserted the claim that 24-hour cities would provide commercial real estate investors with superior returns.

Since 1999 (and including several presentations at Homer Hoyt), I have been attempting to examine that claim with appropriate rigor. I'm pleased that the hypothesis has proven statistically sound, and I'm even more pleased that others are joining me in serious research on the nexus between urban attributes and investment performance.

Lots of Room for Debate
Lots of Space Along the Spectrum



That said, this is a really young area of research and I'd love to invite the Hoyt and Weimer Fellows to pursue the many unanswered questions using the range of expertise in our Institute. There is not only lots to discover, but lots to debate about developing an American urban taxonomy (as well as an international one) – what attributes make a difference, how we can find similarities and meaningful differences among cities, and how this translates into business and personal choices, including good financial decisions.

Does Urban Vibrancy Translate Into Real Estate Investment Performance?

My current research (with Emil Malizia of UNC/Chapel Hill) has used a half-dozen attributes (or investment externalities) as a screen for stratifying urban places.

24-hour Drugstores	>18 stores with 10 miles of city center
Population Density	> 9,000 persons per square mile
Crime	< 5,000 crimes per 100,000 people
Transit Commuters	> 10% of total journey to work
Regional Distinctiveness	> 2.5 on Markusen/Schrock scale
Live/Work ratio	> 30% of resident population

Top Tier Cities

Tier One
- New York
- Chicago
- San Francisco
- Philadelphia
- Washington
- Boston

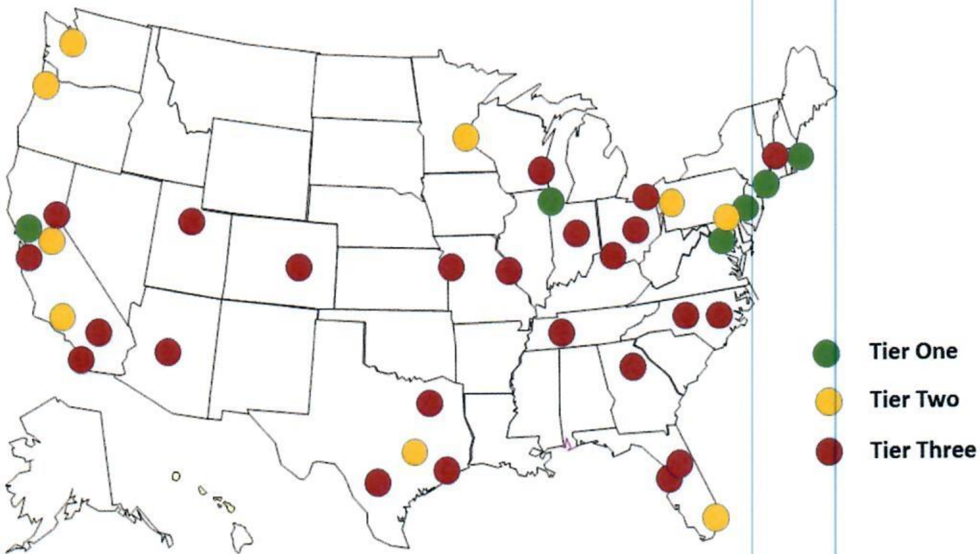
Tier Two
- Seattle
- Los Angeles
- Oakland
- Portland
- Baltimore
- Pittsburgh
- Minneapolis
- Austin
- Miami

This list is drawn from Kelly and Malizia on "18-hour cities" (April 2017) in JREPM. This list differs somewhat from the binary distinction of 24-hour and 9-to-5 cities discussed in the book, where 7 hypothesized 24-hour cities (Boston, Chicago, Las Vegas, Miami, New York, San Francisco, and Washington DC) are compared with seven putatively 9-to5 markets (Atlanta, Dallas, Los Angeles, Phoenix, Philadelphia, Minneapolis, and Seattle).

The more recent research considers a more complex taxonomy, and relies upon a slightly different data set for analysis. Nevertheless there is significant consistency in the markets identified as similar. And, as the follow slides will show, the real estate performance measures remain strongly similar to the results report in Chapter 9 of the book

Rule of research: No point unless you are willing to be surprised! Interested in hearing about what surprises YOU… and what you'd like to challenge!!!

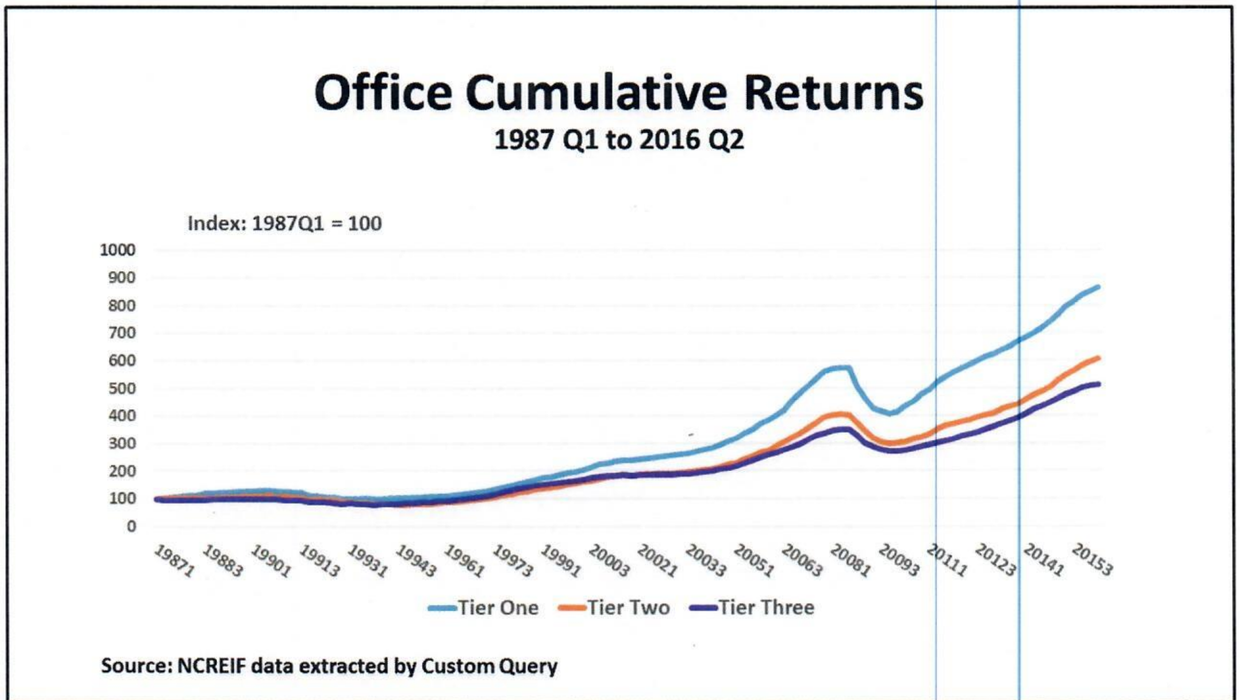
Stratifying US Cities by Vibrancy



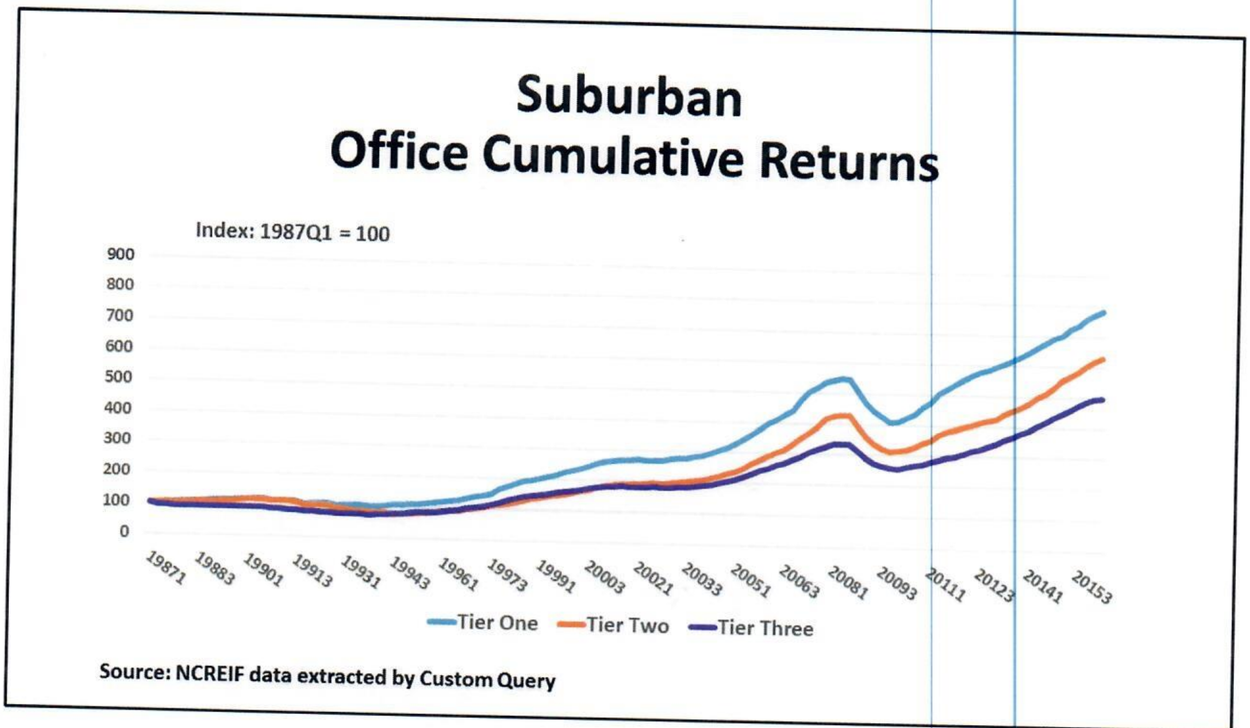
Source: Based on Kelly & Malizia, JREPM, April 2017

Mapping the locations of the three tiers shows the coastal markets generally exhibiting higher levels of vibrancy, but not exclusively so. It also invites a re-examination of putatively “18 hour cities” (listed in the most recent “Emerging Trends” issues) such as Nashville or San Diego, which fail the screening tests we have applied.

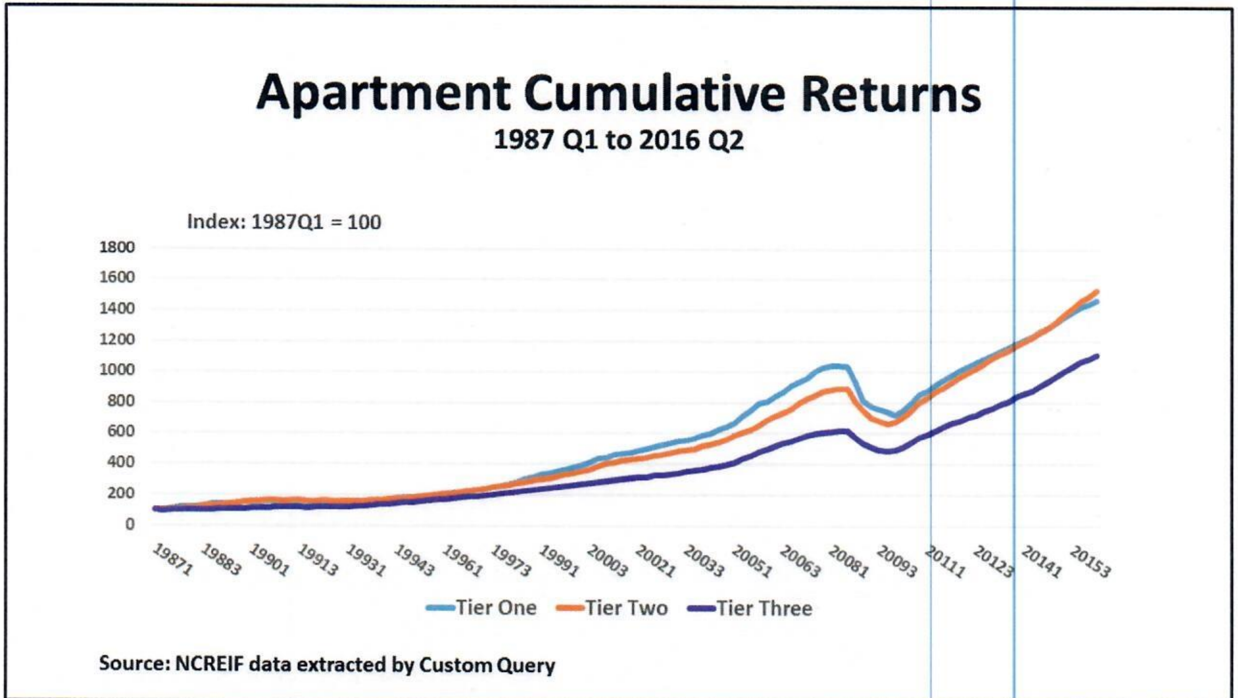
Also, it should be noted that several cities are making significant progress, but have not yet hit the numerical markers we consider disponible. Dallas and Houston are among the cities worthy of a closer look, in my opinion.



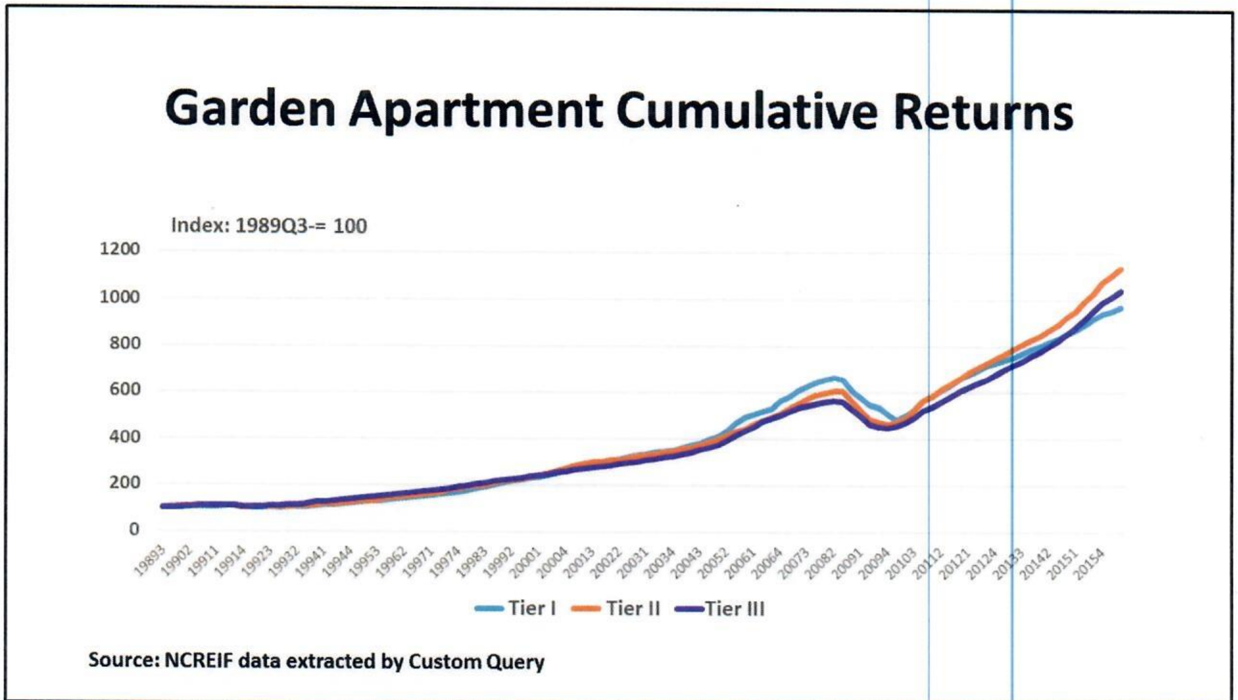
Over time, it is evident that office investments in the NCREIF portfolio are stratified in a rank order consistent with the urban attributes we have identified. This graph shows the cumulative returns data at the metro area level.



While it might be expected that CBD office buildings might account for the tiered returns, it is important to note that the "24-hour city" character of core cities extends to the performance of its suburbs. This is consonant with my findings that strong downtowns support larger numbers of so-called "Edge Cities." It also suggests that regional economic planning focus on building strong intra-regional urban networks, rather than allowing a Balkanized, "beggar-thy-neighbor" economic development competition to motivate business location incentives.



There is a different picture in the apartment sector, though. While, prior to the Global Financial Crisis, returns to the multifamily property type roughly display the same stratification as do offices, since 2011 Tier Two metros have caught up with (and recently have surpassed) Tier One markets in cumulative total return. This may reflect the exceptionally high prices and low cap rates prevailing in the Tier One markets in this recovery. It may also reflect a greater "diversion of demand" from the single-family to the multifamily sector in Tier Two metros.

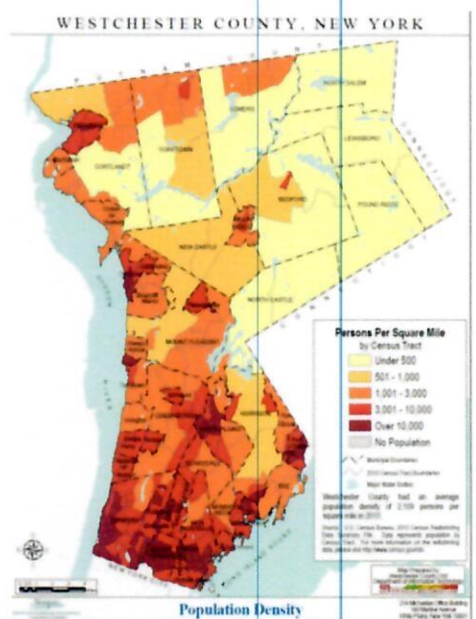


That diversion of demand might also account for the recent ***reversal*** of the rank order of cumulative returns in the garden apartment category that is typical of lower density metros, especially in suburban counties.

Where the office data suggest that factors other than price are at work (I would hypothesize that it is productivity that underlies value in office buildings), it appears that price is very much a variable when it comes to rental apartment demand. And tightening occupancy and the associated rent growth in the garden apartment sector – taking in much of the displaced demand from households squeezed out of single-family homes in the housing bust of a decade ago – seems to be driving superior returns in the Tier Two and Tier Three metros.

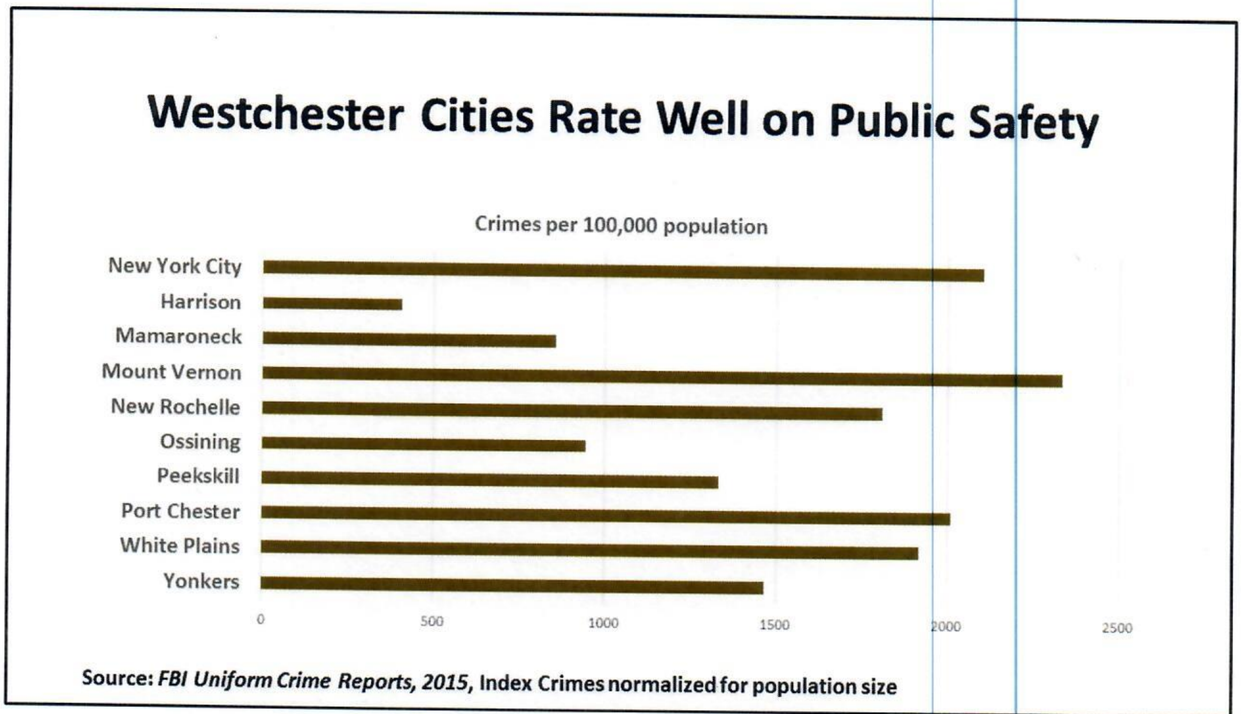
Westchester County Cities Nicely Achieve Population Density Threshold

White Plains, Yonkers, Mt. Vernon, Port Chester and several other locations exceed 10,000 residents per square mile

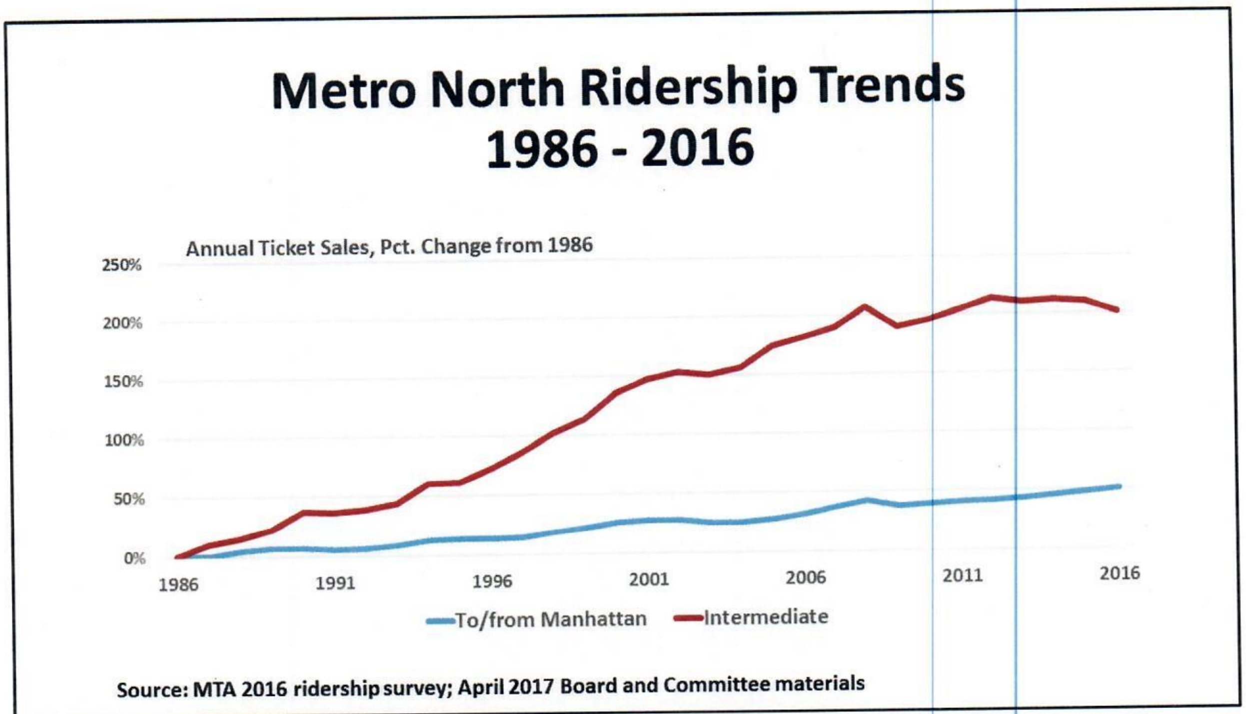


Up until now, my focus has been on major metro areas, and their major subdivisions. However, increasing attention is being given to particular kinds of suburban nodes – the kind of first generation towns that grew up around cities prior to the 1950s transportation revolution (Interstate Highways) and the blossoming of the automobile-oriented residential suburbs. The Urban Land Institute in particular is stressing such places as the "next thing" for commercial development and investment.

I've begun to look at such places through the lens of the vibrancy attributes Emil Malizia and I have been investigating. Westchester County, north of New York City, might be considered a case in point. Several of its cities surpass the population density threshold, for example.



While New York City ranks among the lowest-crime large cities in the U.S., several of the Westchester County cities perform even better on the public safety scale.



Westchester also has three Metro North commuter rail lines – the Harlem, Hudson, and New Haven spurs. While such lines are best known for their access to Manhattan's Grand Central Terminal, ridership originating and terminating OUTSIDE of Manhattan has been growing at a faster pace – suburb to suburb mass transit has been increasing, in other words. And, in absolute terms, the rise in such ridership has equaled the increase in commutation into and from Manhattan.

Also, the downtown walkscores of places like Yonkers, White Plains, New Rochelle, and Mt. Verson are strong, often in the 90+ Walk Score range labeled "Walkers Paradise."

Expansion of this research on a national basis is bound to be revealing.

Thinking About Urban Regions

The Good News

- Strong Core Cities support stronger Edge Cities
- Urban networks provide a more potent model than urban hierarchies
- The taxonomy of cities is complex, dynamic, and adaptive

The Challenges

- Political balkanization encourages "Beggar Thy Neighbor" strategies
- Cost-aversion hinders investment and hampers operations
- The built environment is slow to change

Correlation of Edge City concentration to office prices per square foot is 0.74, with a statistical significance of >99%

Granting the importance of a cost differential between the high density core and lower density perimeter, costs are not the only factor to consider. – "You get what you pay for". Top line (revenues) is more malleable than "middle line" (expenses) in indicating how a business is doing --- and where it can be most profitable.

Education – and business leadership – can and should play a more vital role, and a more strategic role , in advancing thinking about urban economic geography.

"Easy" Education Solutions Are Often Not Effective

- Schools are places where greater density may prove counter-productive
- Size of schools are as important as size of classes
- Experiment in "one size fits all" measurable outcomes seems to be failing
- K-12 education a primary public good - an investment in our common future

K-12 schools are key – as anyone who has been a residential broker can attest. The management of our urban public education systems needs to be an urgent priority in economic development planning, especially for any city looking to attract and retain what author Richard Florida has termed "creative class workers."

Entry Level Jobs Do Not Need To Be Dead End Jobs

The spread in incomes does not have to be a permanent urban condition, though. Gini coefficients have had a narrower range in the past, and could be narrowed again in the future. We are, in my estimation, at a point where tightness in the labor market and fundamental age demographics could assist in promoting upward income mobility. Many entry level jobs do not require advanced education, and yet could constitute a first step up the ladder. **Real estate offers many such opportunities, as do elements of the services industries and even state and local government employment. In New York City, for instance, many police and fire fighters attend CUNY's John Jay College for Criminal Justice, gaining professional credentials for second careers after their retirement following 20 years of service.**

Even though we might not have great optimism for a forward-looking urban policy in a Ben Carson-led HUD, the Trump agenda for infrastructure and military spending – where lots of blue-collar skills can be developed – may afford a "back door" to income mobility as an unintended consequence.

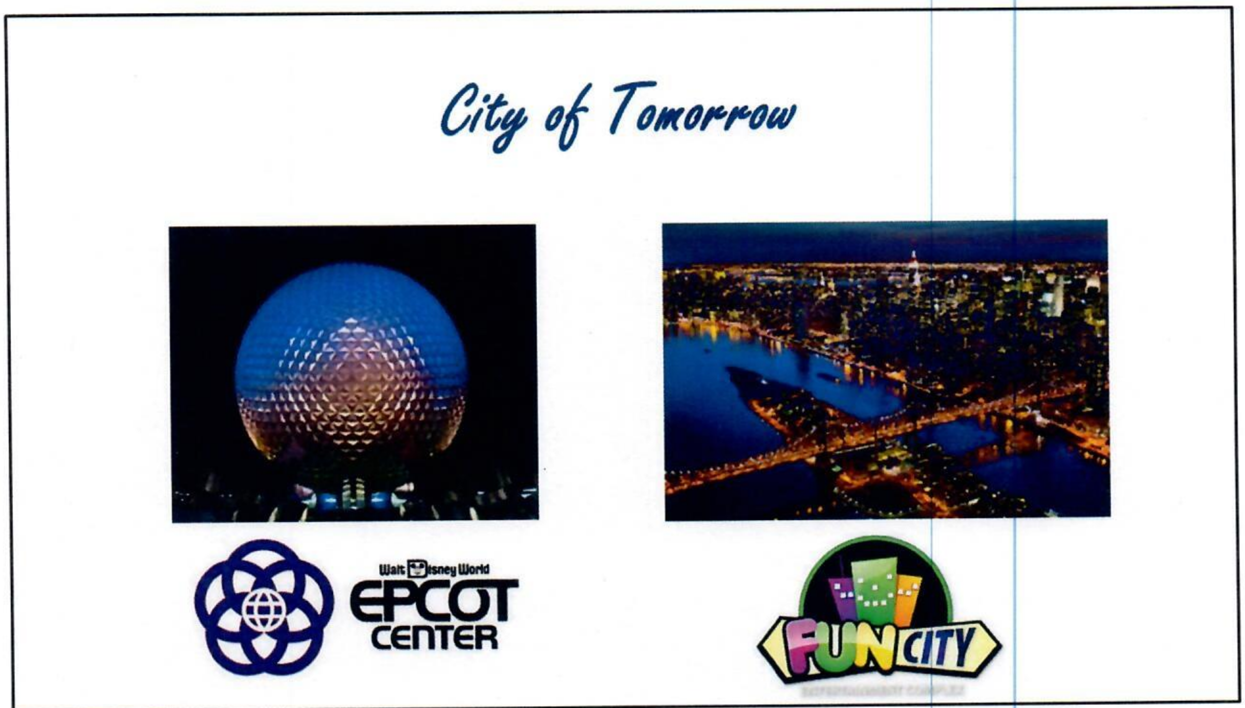
Entrepreneurs Don't Necessarily Require MBAs

Moreover, not only income measures but wealth measures can be subject to upward mobility. For all the university programs in "entrepreneurship", MBAs or even Bas are not a prerequisite for success in small business. Immigrants, in particular, often succeed in business in the first generation, leading to opportunities for advanced education in succeeding generations. The signs of this are all around us, if we would but look

1-800-Got Junk started in Vancouver in 1989 when an incoming college freshman needing a summer job spotted a beat-up pickup truck in a McDonald's drive-through and got the idea to "FedEx" the business. Bought a truck, started business in a week as "The Rubbish Boys".

Where the Research Stands, and Where We Think We Are Going

- Evidence is strong that 24-hour and 18-hour cities have superior productivity for property (and for infrastructure)
- This is, in large part, due to efficiencies derived from mixed-use districting
- Residential density proximate to business districts is a catalytic factor
- Metro areas, however, provide a desirable variety of housing options, leading to the importance of strong transit connections
- More research is needed on economic diversity (incomes and industries), and the consequences for property investment as well as public policy
- Next steps should also include consumer economy factors, and the connection of retail property to office and apartment performance



Many, like Walt Disney, envisioned the successful "cities of tomorrow" as those that were free of the messiness of America's older urban areas.

I posit that messiness is an urban virtue, since this condition challenges cities to identify and solve problems. This "concentrates the mind" and stimulates innovation.

The best cities, in other words, are not the "problem-free" cities, but the "problem-solving cities."