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Boomers, Echo's and X's: Generational and other Structural Shifts and Their Impacts on Future Demand for Real Estate in the Coming Decade

Prepared by:

Nina J. Gruen
Principal
Gruen Gruen + Associates
ngruen@ggassoc.com

Alan Billingsley
Director
Head of the Americas Research
alan.billingsley@rreef.com

Acknowledgements to
RREEF Research Staff:

Ross Adams
Bill Hersler
Andrew J. Nelson
Alex Symes
Brooks Wells

1. Introduction

Demographic changes have long been acknowledged as important determinants of economic growth and real estate market demand. Fortunately, the reliability of demographic forecasts can be quite high, because a goodly proportion of the age cohorts you are forecasting are already residing in the U.S. Gruen Gruen + Associates has utilized demographic forecasting as a key component of their real estate analysis for over forty years.

In the 60s, 70s and 80s, these market forecasts were a major component of almost all of the real estate studies we prepared for both private and public clients. By the late 80s, up until the 2008-2010 Great Recession, there was a major shift away from demography-based market studies to, at best, looking at recent market comparables. Development decisions, for the most part, were based on only two criteria: financing and entitlement.

The Great Recession has prompted the private sector real estate investors and developers, whether REITs or development companies, to once again evaluate how demographic change will impact future demand patterns. As an indication of this shift, Nina Gruen, Principal Sociologist of Gruen Gruen + Associates, has worked collaboratively with Alan Billingsley, Director, Head Americas Research for RREEF/DB Real Estate. This publication has been produced by RREEF and distributed by RREEF to its staff and client base. We are very pleased to be able to distribute this paper to our friends and clients.

Some changes anticipated in the 2010s are ongoing or evolutionary. These include ethnic and racial composition of the population, which will become ever more Hispanic, Asian and mixed-race while also becoming less Caucasian. Immigration will continue to provide fresh supplies of workers of various nationalities. Not only will the country continue to attract workers for low-skilled job opportunities, but the U.S. will continue to attract foreign nationals for highly advanced science, math and technology opportunities. High knowledge-based centers, such as Silicon Valley, Seattle, Austin, Boston and Raleigh, will continue to attract the best and brightest from around the world, while other desirable metros will also attract this talent. The population overall will continue to become more international. In addition, as women continue to move through the U.S. workforce, the economy will continue to benefit from this increment of highly educated and skilled workers. At the same time, there will be continued downward pressures on birth rates, particularly among the professional classes, as many women defer births into their years of lower fertility or remain childless.

Other demographic changes will be unique to the coming decade. The most dramatic and discussed is the progressive aging of the Baby Boomer generation into age cohorts that have typically suggested retirement in the past. The biggest wave of population moving into a life stage of working "empty nesters", pre-retirees (part time employment), and fully retired in modern history is about to occur. Also much discussed, the children of these Baby Boomers, often referred to as "Echo Boomers" or "Generation Y," are emerging into adulthood as they progress through college, begin their first job and occupy their first independent home. Finally, "Generation X", which is the product of diminished births between these two generations, will be entering their prime work and family-raising years. How each of these unique generations behaves, lives, works and utilizes space will greatly impact the economy and its demand for real estate in the coming decade. These ongoing and unique new demographic changes that will impact the United States over the course of the coming decade are the subjects of this paper. In addition to describing these anticipated changes, we attempt to identify and anticipate their lifestyle preferences. Investment strategy needs to be cognizant of the impacts of the magnitude and differing preferences each of these demographic waves will have on property performance.

This paper focuses on how demand drivers will change for institutional quality real estate over the next decade, and how we will incorporate these in making investment decisions in the institutional real estate market. While the demographic changes facing the United States over this period will have broad social and political implications, institutional investors tend to buy at the high end of the market, whether office, retail, industrial or residential. As a result, this paper is focused on the demographic implications from the more educated and affluent portion of the population that drives demand for high value properties. This population will provide the key drivers of this knowledge-based economy, which will be the drivers of demand for the institutional segment of the real estate investment market. It does not attempt to address real estate demand implications for the broader market.

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2. Continuing Trends in Demographic Change

Population growth over the next decade should approximate that experienced during the 2000s, producing about a 10 percent total increase for each of the decades. This is a continuation of a long term trend of a flat to modestly declining birth rate, increasing life expectancy and continued immigration.

This steady population growth belies rapid changes in its composition as the U.S. becomes increasingly multi-racial. As shown in Table 1, this trend is projected to continue in a pronounced way. During the next decade, the population of white Americans is estimated to increase by 8 percent, below average for the United States. Similarly, the African American population is forecast to grow by approximately 11 percent, only marginally above average. Hispanic, Asian, and multi-racial residents together are estimated to account for 81 percent of the 2010-2020 growth, with each of these groups growing by approximately one-third. The Hispanic population is estimated to achieve the largest absolute gain and increase from 16 percent of the total U.S. population in 2010 to 19 percent in 2020, according to the U.S. Census Bureau. This growth is due to two factors: higher immigration and birth rates of this demographic group. Asians are also continuing rapid gain in their share of the population, although currently accounting for less that 5 percent of the total. Those who identify themselves as "multi-racial," a relatively new census category and even smaller portion of the total, are the fastest growing group. This further emphasizes the "melting pot" that increasingly characterizes U.S. society.

Table 1: Forecast Population Growth 2010-2020

	2010	2020	Abs Growth	Growth	Share of Total Growth
Asian	14,362	18,755	4,393	31%	14%
Black	39,853	44,389	4,536	11%	14%
White	246,387	266,273	19,886	8%	63%
Total*	309,849	341,383	31,534	10%	100%
	2010	**2020**	**Abs Growth**	**Growth**	**Percent of Growth**
Hispanic	49,530	66,363	16,833	34%	53%
Non-Hispanic	260,320	275,020	14,701	6%	47%
Total	309,849	341,383	31,534	10%	100%

**Note: Sum of Asian, black and white races will not equal total due to other races.*

Source: U.S. Census Bureau, 2008 National Projections.

America is also shifting from families with children living at home to childless households, according to the Joint Center for Housing Studies, Harvard University, and as shown in Table 2. Between now and mid-decade, 82 percent of the growth in households will consist of married couples and partners without kids and single person households. This percentage is likely to be higher if all other households were further subdivided on the basis of those with children and those without. By 2020, childless households are estimated to account for 76 percent of household growth – once again, excluding those that may be included in the "all other household types" category.

Table 2: Projected Distribution of U.S. Household Growth			
	2011-2015	2016-2020	2021-2025
Married + Partners, without Kids	47.7%	38.2%	28.5%
Married + Partners, with Kids	2.6%	8.0%	11.1%
Single Person	34.5%	38.1%	42.3%
All Other Household Types	15.2%	15.7%	18.1%

Source: Joint Center for Housing Studies, Harvard University: Updated 2010-2020 Household and New Home Demand Projections.

Growth in number of households, which approximated population growth during the previous decade, is forecast to resume its long-term trend of outpacing it in the coming decade. Average household size will continue to decline over the coming decade, due to demographic trends discussed below. As a result, households are forecast to increase by approximately 11 percent, while population is forecast to increase by 10 percent, over the next ten years.

3. Demographic Changes Unique to the Coming Decade

While dramatic changes in demographic waves have been with us for some time, their impacts on society, the economy, and lifestyles will be particularly notable in the 2010s. Below, we summarize the expected growth of the population in four key age groups: the Echo Boomers, Generation X, and the Baby Boomers and the Depression and War Era generation.

The Baby Boomer generation has been much examined and discussed over the past several decades, given its size and impact on society. However, to understand their dramatic impact, we need to look at the preceding generation, the Depression and War Era babies,[1] born during a troubled period between 1930 and 1945 that produced an unusually low birth rate. Currently aged 66 to 81, this generation comprises less than 10 percent of the U.S. population, fewer than 31 million persons.[2] Accounting for mortality of this age group over the past decade, this figure would still only be 39 million, or less than 13 percent of the population.

By comparison, the Baby Boomer generation, currently aged 47 to 65, and born between 1946 and 1964, comprises approximately 78 million or 25 percent of the population, twice the size of the previous generation. Of these residents, approximately 72 million were born in the U.S. and about 7 million are immigrants. The tremendous increase in size of this generation over its predecessor has had a major impact on the U.S. during every decade following World War II. This generation will continue to have a major impact for decades to come.

While there is an official definition of the Baby Boomer, there is limited agreement as to either the name or specific age brackets of the other generations discussed in this paper. The Echo Boomers, also known as Generation Y or the Millennials, are largely the children of the Baby Boomers. In this paper, we are utilizing the 1983-2000 birth years, or those currently between the ages of 11 and 28. By a small margin, they are the largest demographic group of about 80 million currently. The high rate of immigration (both legal and illegal) will also continue to add population to this age cohort, given the relative mobility of this age group. This does not just include economic migrants, often from Central America and other economically disadvantaged regions, but also highly educated migrants, often from Europe and Asia.

For the generation that falls between these two "Boomer" groups, we are utilizing the most broadly used name, "Generation X." We define this group as those born between 1965 and 1982, for a population currently aged 29 to 46. They account for about 65 million residents. This cohort's smaller size, and the fact that they will be in their prime working years during the coming decade, will have significant impacts on both the job and housing markets.

[1] A term borrowed from Leanne Lachman and Deborah Brett in their article "Generation Y: America's New Housing Wave," Urban Land, January/February 2011.

[2] Based on 2008 Census estimates.

Depression and War Era Generation

This generation, small in population, was somewhat privileged, entering adulthood in the 1950s and 1960s, a period of exceptional growth in the U.S. economy. Too young to be directly involved in the War, they clearly benefited from the post-World War II rebuilding effort. Unemployment was exceptionally low and prospects for advancement were outstanding. During their adult careers, they saw tremendous improvements in material quality of life, science and technology. Probably as a result of a shortage of talent, this was the first generation in which some women rose to executive and other positions of power in the workforce. Also, racial minorities made some advancements.

Having led generally satisfying careers, this generation has largely retired, given their age range currently between 66 and 81. A significant number at the lower end of this age range remain in pre-retirement or semi-retirement mode, however. With childhood memories of more difficult times, this generation seeks comfort, and has generally saved and invested. Most are aging in their long term family homes, but many have been more adventurous. Empty nester urban or inner suburban housing, residence clubs, condominiums associated with prestige hotels and second home communities in mountain, desert or beachfront destinations are products that were largely invented for this generation. A portion of this generation has migrated to Sun Belt states, generally where cost of living and taxes are lower, but more importantly where the climate is more desirable. Others will choose amenity-rich urban settings.

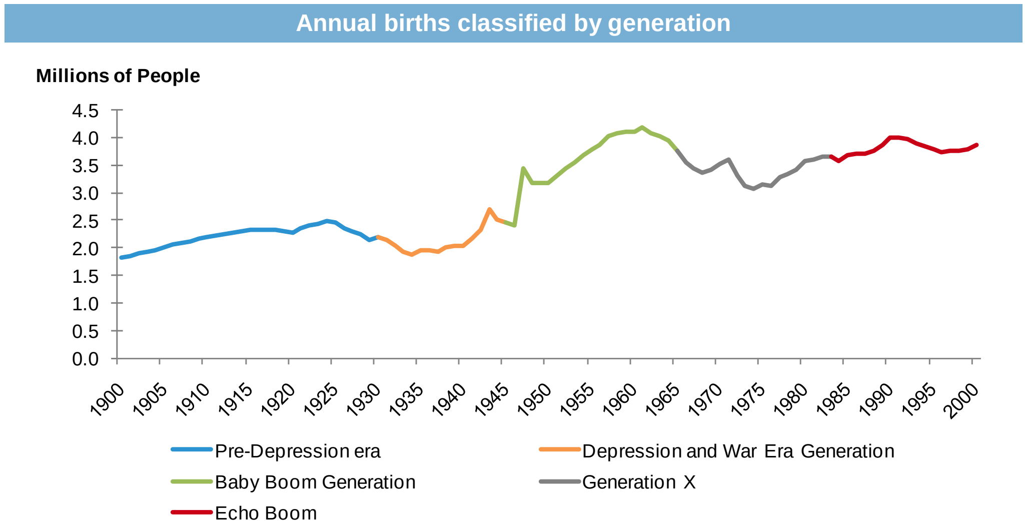
During the coming decade, most of those still stubbornly working will move into permanent retirement. The oldest within this generation will hit the age of increasing health concerns, so that housing providing various levels of care will be in demand. Most, however, will remain in their current homes as long as is practical. Given the small size of this demographic group, demand for senior care facilities, generally targeted towards those over 80, will taper off.

Baby Boomer Generation

The oldest Baby Boomers, those between 60 and 65 currently, will be in their 70s by the end of this decade. Since most of these will enter retirement, this will result in the largest ever U.S. retiree cohort. Many of this generation, however, will not retire at the traditional age of 65, some because they have lost value in their securities and homes as a result of the Great Recession, while other Boomers do not feel they are “old” at 65. The Boomer generation is less interested in age segregation than were the previous generations, which bodes ill for seniors-only residential products targeted to active adults. The second home market will benefit, as with the previous generation, despite the fact many Boomer households are not experiencing the same “wealth impact” from their primary homes as did the previous generation, but these are unlikely to be explicitly age-restricted. Resort-style communities of mixed ages and often mixed primary/second home lifestyles will likely continue to be popular. Some of these may be in resort destinations. However, availability of high quality medical care will become an increasing priority for this generation, a distinct advantage of major urban areas.

In-town living in mixed-age environments will become an even more important lifestyle for Boomers than it was for the previous generation, who largely pioneered the back-to-the City movement for empty nesters. Higher density walkable mixed-use suburban locations with retail, food service and entertainment activities will also attract an increasing proportion of Boomers[3] as they decide to trade down in size but not in amenity value, and wish a less urban setting.

[3] Ania Wieckowski, “Back to the City,” Harvard Business Review, May 2010.



Source: U.S. Census Bureau, 2008 National Projections.

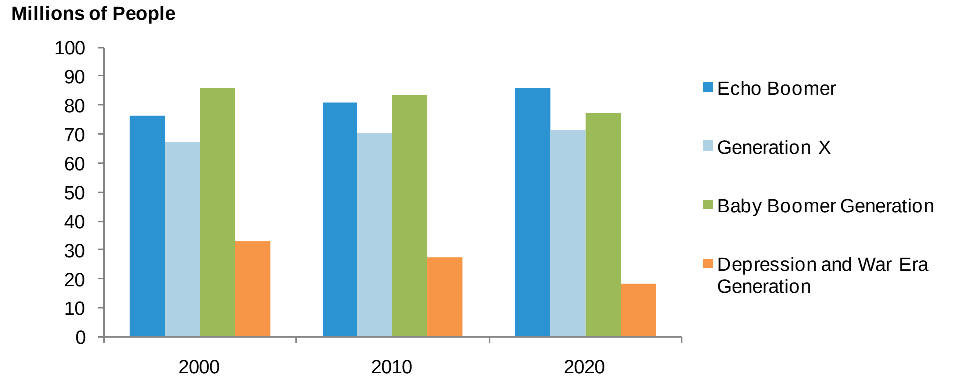
Generation X

Generation X, the age group born after the Baby Boomers, is a smaller group due to a tendency of early Baby Boomers to postpone their family formations. Some of the older members of this generation were born to the younger members of the small Depression and War Era generation. They are in their prime working years, 29 through 46, but grew up feeling disadvantaged in the shadows of the massive Boomer generation. They competed for jobs and felt stymied in advancement by the more senior workforce. In addition, Madison Avenue virtually ignored them in their desire to sell to Boomers. As a result, it has been a somewhat rebellious or nontraditional generation (think "Grunge" or Rap music). However, as they become mature adults, they will benefit from a shortage of experienced and trained labor as the Baby Boomers begin to retire and as the economy begins to add more jobs in the next several years. Some employers may even face labor shortages in some industries. The X's will also be in a better bargaining position for housing – particularly housing in the suburbs, as they form households. Older Boomers face the prospect of a smaller market for these homes, which will moderate or even depress values of suburban housing. While Generation X will be at an age that is more interested in establishing families than the Echo Boomers in the coming generation, they are smaller in number, as will be the total number of children born to this demographic cohort. Generation X is also at the time in their lives when making significant retail purchases is at a high – including products for the home, automobiles, clothing for the family, etc. The volume of retail sales is expected to grow at a slower pace, however, because of the fewer number of Generation X buyers.

Echo Boomer Generation

The Echo Boomers, sometimes known as Generation Y who are currently 11 through 28 years old, will move through their teens, 20s and 30s during the coming decade. At the mid-points of each age range, this generation is about 12 percent larger than its predecessor. This demographic group began to populate colleges and universities in large numbers during the last half decade, and will continue to do so in the 2010s. At the upper end of the age range, many have entered the workforce and established independent households. The recent severe recession particularly impacted this latter group's ability to find work, so that many returned to their parents' home or "doubled up" with friends in high density living relationships. As jobs become available for this group and those exiting university, these young adults are fueling tremendous demand for apartments.

Generational populations
2000, 2010 & 2020



Source: U.S. Census Bureau, 2008 National Projections.

This "youth culture" will benefit cities and other high density suburban environments, as well as rental housing, entertainment and new industries. With their outlook somewhat framed by the Great Recession, this group is highly focused on career and economic growth. They are choosing to locate in cities where they believe they can best meet these goals, while also benefiting from a vibrant urban experience. Diversity of race and ethnic group is embraced by this demographic. A high proportion of this age cohort is currently estimated to consist of minorities and recent immigrant populations (both legal and illegal). This percentage is anticipated to increase throughout the decade due to immigration. Cultural diversity will be further enhanced by highly educated transplants from abroad, including Europe and Asia.

Education will be determinative as to the Echo Boomers family patterns. The relatively affluent professional Echo Boomers will postpone marriage to an even greater degree than their predecessors. With even more career-focused women, they will also postpone childbearing. As a result, they will have fewer children on average than did their parents.[4]

4. Technology Changes that will Alter Demand

While a population growth contributes to demand, technological changes reduce the need for space. In the longer term, advanced technology is likely to greatly reduce physical demand. However, adoption takes time, but gradual reduction in demand for most forms of real estate per capita is expected to be a continuing trend.

Wireless technology is bringing the internet into every aspect of our lives. Consumer surveys once asked, "How much time do you spend on the internet each week?" This is quickly becoming a question that is difficult to answer, given the pervasive access to wireless browsers. This increased communications infrastructure is altering how tenants use real estate. The office is no longer bound to the place, nor is the retail store. Better communication is resulting in precise understanding of the demand for goods and services, and just-in-time manufacturing and delivery is resulting in lower inventories. Advancements are easing communication between people, resulting in a better customer experience, as well as between computers and machines, resulting in delivery of goods and services. Data storage needs are also changing, as stationary computers replace filing cabinets, and as cloud computing replaces on-site electronic storage. The much discussed "paperless office" is on its way.

While these technological advances are widely available, they are not being universally adopted, and infrastructure does not yet support a fully mobile, wireless and paperless economy. These changes will take time as they move from early to later adopter users. Technology will continue to reduce the need for space, but the reduction in demand per person will be gradual over the coming decade.

[4] The less educated and recent immigrants – particularly Hispanic immigrants – are anticipated to have larger families of three -plus children into their second and third generation.

5. Impact on Real Estate Demand

The demographic and technological trends discussed above should have significant impacts on demand for real estate through 2020. Two significant themes run through this outlook: (1) Demand will shift from outer suburban to inner suburban and urban properties, and (2) less space per capita will be required for the main four property sectors, including office, industrial, retail and residential. These impacts on space are trends and are slow moving, but will have an impact on investor returns during the next decade. The following sections will discuss specific impacts to each property sector.

Office

For the high value office space users that institutional investors seek in their properties, location will be an increasingly important consideration. In past decades, such users were often happy to occupy space in suburban office parks, close to the residences of their Baby Boomer senior managers and in jurisdictions that offered favorable taxes. As Generation X moved into the labor force in the last decade, other locational considerations came into play. Some of these employers found that many of the more skilled and creative Generation X'ers preferred to live in urban environments and demanded conveniently located worksites. Since this talent was in relatively short supply, competition for these employees increased. In the coming decade, as the older Echo Boomers comprise the young cutting edge of the workforce, high value employers will focus on CBD and inner-suburban employment centers. Locations close to transit, bike lanes, walkable environments and urban amenities will be in considerable demand. As some high value Baby Boomers continue to work, either full or part time, they will also increasingly demand to work in central and high amenity settings. Younger high tech workers will continue to prefer the open "loft-style" work places pioneered by the previous generation, also located in urban environs. More traditional office space users are also migrating to large plate open work areas. Cost considerations, including rent and taxes, will become a less dominant consideration for these high value firms, particularly as they require less space per employee.

Office Sector Changes in space per worker			
	U.S.	New York	San Francisco
Current level SF per job	116	265	242
Current vacancy	17%	9%	14%
Scenario 1: Reduce 10 SF per employee			
New level of SF per job	106	255	232
New vacancy	24%	12%	18%
Scenario 2: Reduce 20 SF per employee			
New level of SF per job	96	245	222
New vacancy	31%	16%	21%

Note: Current data as of first quarter 2011.
Sources: BLS, CBRE-EA RREEF Research. *As of May 2011*

Suburban office parks, especially those located some distance from high volume transit and urban amenities, will increasingly be forced to compete primarily on price. They will serve a distinct purpose for lower value office space users, including some start-up companies, but will have greater difficulty in attracting the kinds of tenants institutional investors prefer.

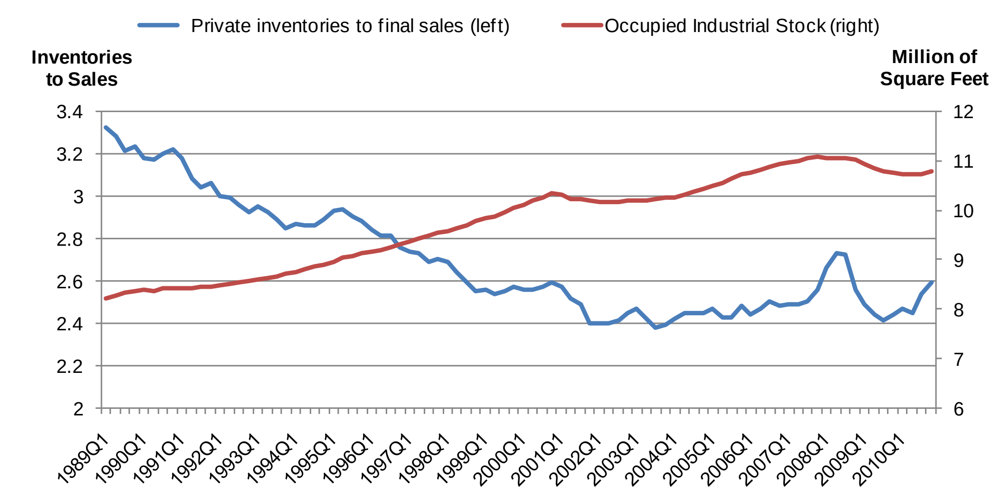
At the same time, most companies will require less office space per worker in the coming decade. A trend that is already well underway, it will extend to late adopters, while early adopters will shrink their space needs further. The paperless office is becoming an increasing reality, no longer requiring file cabinets, while cloud computing will reduce the need for on-site servers and electronic storage. Workers will become increasingly mobile and consequently spend less time in the office. Higher density office, more mingling, and more flexible space will be the focus of space planners. Coffee bars and other public spaces are becoming extensions of the office to work and meet.

As a result of these trends, office investments will require considerable selectivity, with an emphasis on location. Product will matter as well with younger generations, demanding a creative environment and standards of sustainability in their workplace. The aging of the Baby Boomer generation will create growing demand for medical office buildings.

Industrial

While the industrial sector is likely to be the least directly impacted by demographic shifts, other events, including technological changes, are expected to produce change that will also favor urban infill locations and reduced space needs. Demand for major logistics facilities is refocusing from sprawling big box warehouses located outside urban areas to more compact technologically sophisticated facilities near ports, rail, airports and population centers. With rising transportation costs including both fuel and congestion, along with reduced space needs, users are becoming less sensitive to rental rates in a preference for convenience to customers and transport.[5] Better tracking of goods will mean that they will ship through more quickly and less space will be required.

Industrial Sector
Inventories to sales vs. occupied space



Sources: BEA, CBRE-EA, PREA Quarterly Winter 2011. *As of May 2011.*

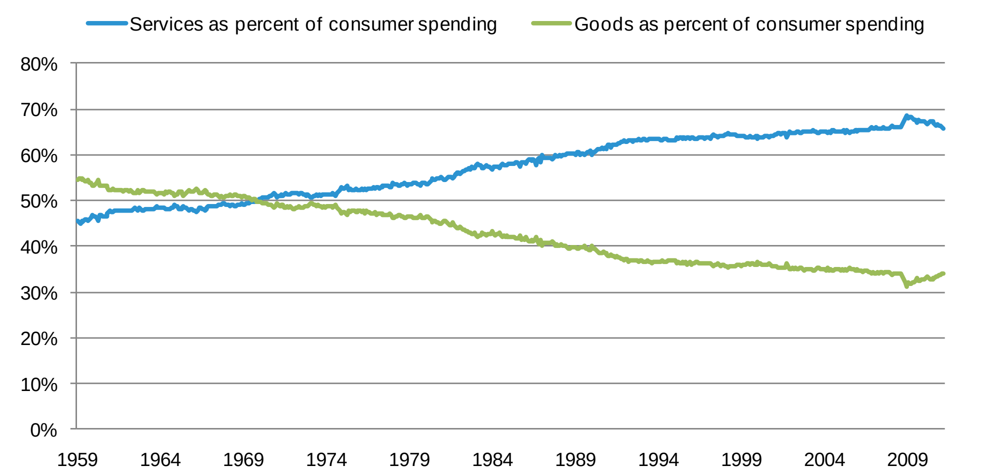
Multi-tenanted small bay warehouse and flex space in infill locations near entrepreneurial housing are other good bets for business service firms and small assembly operations. Many of these businesses rely upon imports and exports, so proximity to transport is important. Technology will continue to be a significant tuner of demand and internet retail will require fast distribution systems in proximity to transport.

Retail

Of the four major property sectors discussed in this paper, retail is undergoing the greatest change, particularly by a radical downsizing of its space needs. Combining this downsizing trend with a refocusing of location to where the future population will live and work, a significant amount of existing retail space will become surplus. Downsizing is being prompted by several trends: (1) increasing online sales; (2) slower growth of total retail sales in the coming decade of a less consumer-driven economy; (3) declining population in their peak retail spending years; as well as (4) non-demographic changes in the retailing industry.

[5] David Twist, "Up Up and Away: The Future of Logistics Real Estate," PREA Quarterly, Winter 2011.

Goods are becoming a smaller share of consumer spending
Goods and services as share of consumer spending



Sources: BEA, PwC Retailing 2015: New Frontiers. *As of May 2011.*

In the near to intermediate term, shopping center space will be limited by below-trend growth in consumer spending, as households struggle to regain their financial footing. These economic factors will be compounded by more direct demographic trends, in which the Baby Boom bulge ages out of prime earning and spending years, to be replaced by the much smaller Generation X cohort. The Echo Boomer group, though larger, is still years away from their prime consumption periods. Retailers have taken notice, and are moving to business models with fewer and smaller store prototypes, a process accelerated by the fall-out from the financial crisis. All these issues are reducing the supportable space needs.

Internet sales, however, present the most significant long-term challenge to traditional retail space needs. As consumers become more comfortable purchasing an ever-wider range of products on-line, from drugstore items to high-end boutiques and art, internet sales will continue to capture an increasing market share, resulting in reduced demand for "brick and mortar" stores, particularly as younger, tech-savvy shoppers account for more and more of the consumer market. Echo Boomers make a significant share of their purchases on-line and should continue to do so in the future as their incomes increase. Venues include traditional on-line outlets for electronics and some non-traditional sites such as Zappos.com for shoes. Currently, approximately six percent non-auto-related retail sales have shifted from physical stores to on-line sales. This is up from approximately 1.5 percent at the beginning of the last decade, demonstrating rapid growth. With internet sales becoming even more convenient as they migrate from computer-based to mobile applications, on-line sales could soon exceed 10 percent of total sales. While this does not negate demand for bricks and mortar retail space, it is largely wiping out some categories, such as books and music, while eating into the space needs for other categories.

Many shoppers of all demographic cohorts view and compare products in stores and then search the internet for the best price. Some retailers are catching on to this trend and promise to meet the lowest internet price -- and are redesigning their stores to assume a new role as "branding" showrooms for internet retailing. Shoppers can view and feel the product, as well as obtain information, but order from the retailer or manufacturer on the web. In the longer term, retailers will need fewer and smaller physical stores.

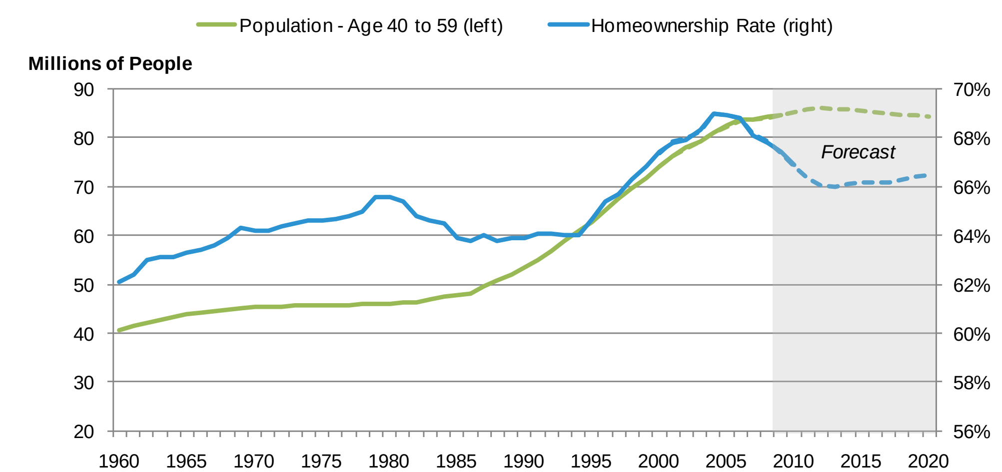
To stay competitive, shopping centers will require a higher percentage – at least one third – of experiential tenants, those that cannot readily be replaced by the internet. Entertainment, food and beverage, and services will continue to locate in retail concentrations. For example, tenants providing higher end/organic takeout meals, high-grade services like health spas, and facilities for pets such as dog hotels, are illustrative of retailers not easily replaced on-line. These stores should locate among a broader retail base that will both compete and compliment on-line sales. For each demographic group, some retailers will continue to draw in a loyal crowd -- such as H&M or Zara for Echo Boomers, and Nordstrom and Bloomingdales for Baby Boomers. Some retailers, such as Target and Costco, manage to maintain loyalty from multiple generations. Such retailers should continue to anchor retail centers. With affluent shoppers of all generations increasingly living and working in urban and inner suburban centers, opportunities will emerge for development of new retail space to serve these residents and workers. The rising ethnicity of many metros will provide additional opportunities to develop specialized retail concepts and niche centers that cater to the particular demands of these groups. Examples include the emergence of Hispanic and Asian grocery chains, and a greater mix of ethnic restaurant in even small towns. America's aging population will fuel the need for even more drug stores, medical uses, and services focused on relatively young retirees.

The trends toward downsizing, reconceptualizing the retailing mix, and relocating retail space to urban and inner suburban centers will result in significant empty shopping center space, magnifying the divide between successful and unsuccessful centers. Some better located centers can be reconfigured and/or redeveloped with higher-density mixed-use residential, retail, entertainment and office uses. Others in outer suburban locations will be more problematic. Some properties can be converted to alternative uses, such as medical clinics and offices to serve rapidly growing health care needs. Schools, churches and other uses could occupy former retail space in the future. Unfortunately for the retail industry, too many centers are slow to recognize or accept the drop in demand for their product, choosing to stay with the same retail orientation and driving down rents in the process, to the detriment of all but the strongest shopping centers.

Residential

Residential demand will face some the same locational and demographic changes in demand experienced by the other property sectors. However, demand in the near term will be heavily shaped by the housing market crisis of the past few years. The Great Recession was largely triggered by a grossly overbuilt housing market. With rapidly escalating pricing and easy (and even fraudulent) financing, home demand was fueled by over-consumption due to its perception as an investment vehicle and the buying of new or vacant homes to flip or rent as an investment. As a result of inflated demand, between 2000 and 2007, twice as many homes were built as new households formed, leaving over 7 million excess homes constructed. Allowing for a healthy margin for vacancy and demand for second or seasonal homes, between 6.0 and 6.5 million excess home existed by year-end 2007. As the recession hit, household formation declined substantially, while additional new homes dribbled onto the market in the few locations where homebuilders continued to be optimistic. With a newly recovering economy, by year-end 2010, excess inventory was estimated at around 5 million homes, after accounting for some demolitions and absorption.

Apartment Sector
Population age 40 to 59 versus homeownership rate



Sources: U.S. Census Bureau, Moody's Analytics. *As of May 2011.*

These excess homes are not equally distributed around the country, and are not all where residents of the future will desire to locate. The size and makeup of demographic growth will present significant demand opportunities, as well as challenges. Some locations, including much of Florida, Arizona, Nevada and inland areas of California, will not recover quickly. Due to weak economic growth, many Mid-Western metros will fare poorly as well. In healthier economic markets, particularly along the two coasts, equilibrium should be reached by 2012 or 2013 in most of the primary target metros for institutional investment. This reflects an expectation of net demand for between 1.4 and 1.6 million homes annually.[6]

In the meantime, the U.S. housing market will continue to suffer as excess housing units are absorbed, banks and homeowners adjust to lower values, and foreclosures drag on the economy for another couple years. Moody's Analytics does not forecast a return to more historically normal housing unit permit volume of around 1.9 million units annually until 2013.

The implosion of the nation's housing market combined with generational changes in the population will result in: (1) locational shifts in demand, and (2) reduced demand for homeownership vs. rental. The more successful and educated Echo Boomers, along with some Baby Boomers, will seek urban and inner suburban residential lifestyles. These locational shifts in the most economically vibrant metros will produce relatively near-term demand for new housing, generally in higher density configurations than has been the U.S. norm.

Homeownership rates, which peaked in 2005 and 2006 approaching 70 percent, have fallen dramatically. Over the coming decade, they will likely remain close to historical averages between 65 and 66 percent. In particular, Echo Boomers are anticipated to primarily seek rental housing, given a preference for location over ownership affordability. In addition, recent experience has disenchanted much of the U.S. population with the value of a home as an investment. High amenity locations offering nearby specialty and convenience retail, cultural, entertainment and services will be the preferred location of choice for many Boomer and Echo Boomer households. Home and apartment values will continue to diverge between desirable infill and central city locations compared with more isolated suburban housing.

Rental apartments experienced strong performance in 2010, which was surprising at this early point of economic recovery. Reis, Inc. reports that 227,000 institutional quality units were absorbed during the year, even higher than the previous cyclical record achieved in 2000. This absorption reduced the national vacancy rate by an unprecedented 140 basis points in one year. Many of the age 20-plus Echo Boomers were forced to live with family members or to triple or quadruple up in rentals due to joblessness or job insecurity during the recent recession. As the economy continues to improve and the Echo Boomers are able to find jobs, both they and their parents or roommates are likely to put living separately high on their individual priority lists. The next several years are expected to be a particularly attractive period for rental apartment investment.

Unlike past generations, Echo Boomers and Baby Boomers are likely to prefer age integration, while age segregated communities will be decreasingly popular. While both groups are likely to desire vibrant walkable environments, they will have different product preferences. The higher income Echo Boomers prefer loft-like but smaller sized apartments that include work spaces, near major employment centers. Many prefer biking to work when weather permits. They also prefer modestly high levels of amenity features in kitchens and baths, but have less need for significant closet space or separation of living space.

Products targeting Baby Boomers require larger units, two bedrooms and two bathrooms at a minimum, more closet space, as well as even higher quality, double-sink baths and fully equipped kitchens with high quality appliances. Unlike Echo Boomers, Baby Boomers are serious about cooking. "Hotel-like" services, irrespective of whether the product is an upscale apartment or condo, will be favored by this group.

[6] Moody's Analytics forecasts over 1.3 million net new households annually over the next decade, to which a vacancy and obsolescence factor should be added; George Masnick, Daniel McCue and Eric Belsky of the Joint Center for Housing Studies at Harvard University forecast demand for 1.6 million primary homes annually over the decade (the mid-point of their forecast), including a vacancy and obsolescence factor.

The shift in demand from outer suburban to urban and inner suburban housing will likely result in increased disparity in pricing between these locations, with the preferred locations becoming quite expensive. As a result, the more commodity suburban locations will provide affordable opportunities for others. Generation X will be the natural buyers of these homes as they enter their peak career-advancement and family formation years. However, their numbers will be insufficient to support rising prices. Less advantaged populations, including minorities, will find attractive suburban lifestyle opportunities as they leave deteriorating urban centers behind. A significant portion of the Echo Boomer generation comprises first or second generation immigrants who will form larger households than will their more advantaged and educated counterparts. Housing in suburban locations, whether owner-occupied or rental, will be in strong demand by this large demographic group.

6. Conclusions

Investment in the coming decade of the 2010s will need to be mindful of changes in technology and in generational preferences that will drive the type, quantity and location of demand for commercial and residential real estate. An over-riding theme of this paper has been an anticipated shift in demand from outlying suburban to urban and inner suburban product in all four property sectors. In addition, changes in generational lifestyle or work preferences and technology will impact the nature and quantity of this demand in ways unique to each sector, which should be considered in long-term investment strategies.

Nina J. Gruen is Principal Sociologist with Gruen Gruen + Associates, a firm of urban economists and market strategists with offices in San Francisco and Deerfield, I