Four Critical Shifts and Their Implications for Commercial Real Estate

by Nina J. Gruen

Portfolio and asset managers, pension fund advisors, and consultants can improve their performance if they take cognizance of four important demographic trends influencing office and retail demand in the Nineties. These four trends include: 1) the significant decrease in the proportion of young adults; 2) the rapid change in the growth of ethnic minorities; 3) the nation's growth is and will continue to take place in our southern and western states; and 4) the continued shift of population and employment growth from center to edge cities and ex-urban locations.

Historically, 250 square feet per office employee was the standard rule-of-thumb ratio. Today, this ratio is working itself down to 160 square feet per employee.

THE DECREASE IN YOUNGER-AGED ADULTS

Between 1990 and 2000, the number of 20 to 24-year-olds will decline by about six percent and the 25 to 34-year-olds by almost 15 percent. This decrease in younger-aged adults will be felt by businesses, builders and leasers of office space alike. If the economy had not been experiencing a lengthy recessionary period since mid-1990, the shortage of young adults entering the labor force would have been even more strongly felt.

THE U.S. IS UNDERGOING A RAPID CHANGE IN THE GROWTH OF MINORITY POPULATIONS

Together, today's minorities make up one fourth of the U.S. population. By 2010, they will represent about one third. The reason for this rapid growth is that 80 percent of all future population growth is expected to come from Black, Hispanic and Asian communities.

But these minority populations will be concentrated in our metropolitan regions and will also be differentially distributed within states. By 2010, non-White youths will constitute 50 percent or more of those under the age of 17 in the following states: Hawaii (79 percent); Texas (57 percent); California (57 percent); Florida (53 percent); New York (53 percent); and Louisiana (50 percent).

GROWTH WILL CONTINUE IN THE WEST & SOUTH

Ninety percent of all population growth has and will continue to take place in the western and southern states. Three states (California, Texas and Florida) will account for about one half of this growth. But this growth is fueled primarily by foreign immigrants and the differential birth rate of minorities. For example, the fertility rate of Hispanic women between the ages of 15 and 44 is 3.91 children, while the ratio of White non-Hispanic women in their fertile years is 1.74. This growth pattern marks a significant change from the Fifties and Sixties where growth in states like California was fueled primarily by migration of younger-aged adults originating from other states. For the last two years, California experienced a net loss of those moving out of the state versus populations moving to California from the other 49. So many more people are moving out of California than moving in, the household movers and truck rental companies are running short of equipment and raising the price for leaving the state. Ryder Truck and Rental Leasing, for example, charges Seattle customers as little as $10.00 (and you can bargain the price down) to rent a California-bound truck. But a San Francisco resident would be required to pay $1,500 to make the reverse commute.

POPULATION & EMPLOYMENT GROWTH OUTSIDE CENTRAL CITIES

Of the new jobs created in the Eighties, 64 percent were located in the suburbs. This trend can be expected to escalate in the Nineties unless the new Administration begins to make a dent in the magnitude of the problems associated with our central cities.

IMPLICATIONS FOR COMMERCIAL REAL ESTATE

Seven out of ten jobs in the Nineties will be white-collar positions requiring some technical skills; without significant educational and on-the-job training, high-growth states like California, Texas and Florida will find themselves with a growing mismatch between the level of skills needed and their potential labor base. Many regions of our country, including California, are in danger of being forced to compete with what in terms of educational and technical training is a "third world labor force" with offshore competition that can offer such labor at far lower costs.

Demand for future office space can be expected to slow for several interrelated reasons. First, the recent downturn in the economy was not just the result of a cyclical recession. At the same time the economy was hit by recessionary pressures, it was also attempting to become more globally competitive by undertaking a major restructuring of its industrial sectors. This was particularly true of the real estate industry. For years, consultants like ourselves pointed out the real estate industry needed to significantly downsize. The argument was only over how much—25 percent, 50 percent, etc. Those companies that have reduced layers of middle-level management, both in the real estate industry as well as other industrial sectors, are unlikely to restaff those functions even when the economy turns around and financing is once again available.

Many of these same companies also have trimmed costs by significantly reducing the number of square feet of space per office employee. Historically, 250 square feet per office employee was the standard rule-of-thumb ratio. Today, this ratio is working itself down to 160 square feet per employee. Future office demand will, therefore, not only be reduced by smaller staffs, but also by less space per employee.

Further, because there is a shortage of a younger-aged trained labor force, many business enterprises will attempt to cost-effectively substitute labor with capital investment.

Center city office space will never again achieve the type of harmony it exerted in the Fifties and Sixties. Business transactions in those years were dependent upon face-to-face communication. The need to meet face-to-face stimulated the growth of high-rise office space and the signature office building in our center cities. This situation has changed dramatically as travel to our center cities has become more onerous and arriving there less pleasant while, at the same time, technology has become more user-friendly and more greatly substitutable. The telephone answering machine, the cellular phone, the fax machine, and computer electronic mail all have contributed to this ongoing revolution that facilitates geographic dispersion of the office-using sector.

The bottom line is that most new office construction will take place in what **Joel Garreau** refers to as "edge cities." This space will, for the most part, be less elaborate with respect to materials but more responsible with respect to services—such as child care.

In the retail sector, it will be *sine qua non* to learn how to successfully serve ethnic markets. In the 1970s, market segmentation was the byword of success. In the 1980s, successful enterprises focused on smaller market niches. But the shopper of the 1990s must be drawn from more economically, socially, and ethnically diverse populations. Retail centers hoping to enhance retail businesses must aim at the right particle markets to hit their economic targets.

Plain vanilla marketing strategies won't hack it in the Nineties. Savvy retailers and developers in America have already altered their business enterprises to take advantage of the ethnic marketplace. Blacks and Hispanics alone are estimated to have a current purchasing power of over $400 billion annually. **The Rouse Company** Research Department has found that the average white Anglo male spends approximately two percent of his household income on his personal apparel and accessories. The Hispanic male typically spends between two and three percent, and the African-American four to five percent. This means that the African-American male with a household income of $20,000 is likely to spend the same amount of dollars per year for his clothing and personal items as the average White male with an income of $40,000.

To be successful in the competitive Nineties, developers and managers of shopping center space will have to be sensitive to those growing cultural differences. **John Ragland**, Assistant Director of Research for the Rouse Company, suggests this sensitivity must run the gamut from the realignment of food court tenancies to the type of background music that is played in malls. Hispanics and Afro-American shoppers are not typically turned on by endless tapes of Muzak.

We are living in a rapidly-changing America. While demography is not necessarily destiny, it also cannot be ignored except at one's own business peril. An understanding, acceptance and willingness to take advantage of demographic change will separate the winners from the losers in the decade ahead. ❖

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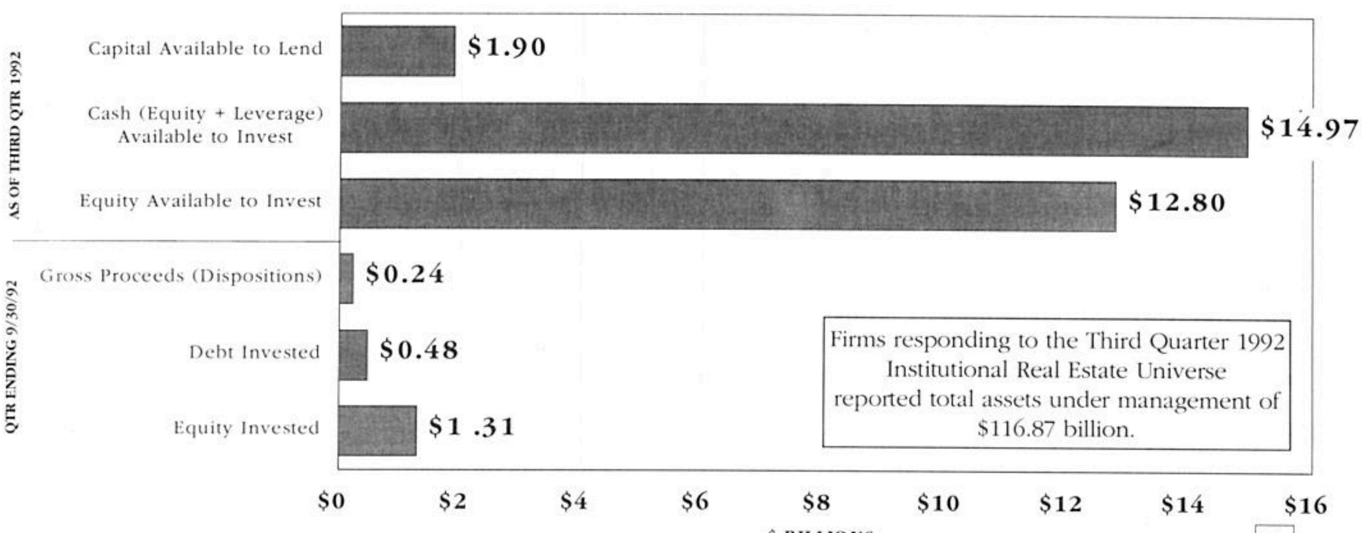
Nina Gruen is Principal Sociologist of the San Francisco-based real estate/land use policy consulting firm of **Gruen Gruen + Associates**.

Real Estate Capital Flows Summary—Third Quarter 1992



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