Byron Carlock:

Developers really have the ability to change the nature of our cities. We're really in the community betterment business. And I would love to see that moniker come back to the developer community. In times of ideological polarization or misunderstanding, it's always been common across history, that we can agree on things of beauty.

Matt Slepin:

Hi, this is Matt Slepin, welcome to leading voices in real estate. Today's episode, recorded on November 4th is a conversation with Byron Carlock, leader of the US real estate practice for price water house coopers, and the primary author and spokesperson for the annual emerging trends in real estate. Which is a publication produced by ULI and price water house. This episode interrupts our normal twice a month schedule. Since I wanted to have an immediate conversation about the cycle turn that we're experiencing in real estate. And with Byron talking about this downturn within the context of the longer term trends. Said differently, having been through more than a few of these downturns during my career, I wanted wisdom that focused both on the outlines of what we know to be a virtual shutdown in the real estate capital markets. Alongside pretty good fundamentals in most parts of the business, a wall of capital ready to be deployed, and then the outlines of the inevitable next cycle. Which, hint, hint, are pretty good. No better person to have on this show than Byron, who I heard speak on this subject in two different rooms in [inaudible 00:01:24] and Dallas two weeks ago.

A few things about leading voices. First, thanks to all, we recently passed one million downloads, which is a goose bumping, awesome milestone for this project. Thank you for listening and sharing. When I started the podcast 130 episodes and five years ago, I could not imagine that this would have been such a long lived and all consuming project. I'm proudest about the library we've built and conversation with amazing leaders from across the real estate universe. And I'm absolutely blessed to have had the conversations I've had with so many awesome leaders. My conceit is that some of the magic of these people have rubbed off on me and I'm hoping for some of that wisdom from our conversations to also have rubbed off on you. I'm trying with the show, both to let leaders hear other leader's leadership stories and most importantly to provide pathways for young people to find inspiration into the different nooks and crannies of the real estate business. And I do believe that the archive we've created is an incredible resource to that end.

Any chance any of you can share these conversations with those young people looking to spread their wings or get into the business. And I know we all have those generous conversations. Please, get them to check out the archive. We're porting the library over to the ZRG website in a few weeks, and probably after the first of the year we'll open up a survey for your thoughts and feedback. Since I must admit, I program the show a bit in my own head. So, I look forward to your input.

voices gets awesome reviews and is among the highest rated business podcasts. But when I looked at the Apple podcast app a few weeks ago, people have not been recently rating us. So, if you have a few minutes, please go onto your podcast app, Apple or otherwise, and please, rate the show. It's really helpful to drive listeners in our influence. As always, if you liked the episode, besides rating the show, please share this and other favorite episodes with a friend, with multiple friends. And if you have comments or questions or need services in the human capital arena, please feel free to email me at mslepin@zrgpartners.com. Next episode's still off schedule, this is conversation with Ross Perot Jr., an interview that I had while at ULI a few weeks ago at their headquarters. Ross's Hillwood company is in Dallas. Another one of those conversations that just blew me away. So much fun. Enjoy the show, and keep in touch.

Byron, I am thrilled to do this. This is an emergency episode. I came back from both the Fischer center conference two weeks ago having heard the chairman or the president of San Francisco fed. I came back from ULI last week having heard you speak twice from emerging trends standpoint. And it looks like, a: we're about to be in recession, we are in recession. Transaction volume in real estate is scarily slow, maybe shut down, except for deals that need to be done. And at the same time I think there's a really bright future. So, I want to put all those things together but it's an emergency to talk about where we're at. And what better person to have on the podcast than you today. So, thank you for being here.

Byron Carlock:

Happy to be here, Matt, and thank you. Those are the big questions, for sure.

Matt Slepin:

Well, let's delve into them. But first, introduce yourself, introduce where you sit at PWC, and introduce what emerging trends has been now for 44 years, I think, and I've probably read every one of them.

Byron Carlock:

Thank you. Matt, it's a pleasure to be with you. I'm Byron Carlock and I lead the national real estate practice across our various lines of service at PWC. I'm in my twelfth year there, having come from industry. I do happen to be a CPA, but I'm not in the business right now, signing reports. We spend more of our time, my practice time is basically real estate strategy, capital markets, MNA, special situations, sensitive matters. Those are my billable times, the remainder is administering the practice and keeping our global network alive. Which is really interesting right now because as you pointed out, this is an odd time for the industry going into a downturn that's mostly capital markets driven. Certainly not demand driven, we've got healthy demand for most of our sectors. Even those going through transformation. And we're heading into a downturn, transaction volume, as you mentioned earlier, has slowed dramatically. Debt underwriting has gotten very tight and constricted. And so this is a debt driven downturn, not an equity or demand driven downturn. There's actually plenty of dry powder, maybe $400,000,000,000 in the private equity real estate space right now. And a keen desire to invest more in real estate for those that view it as we've grown up in this industry knowing that it's a pretty good inflation pitch. So, these are interesting times.

Matt Slepin:

There hasn't been a more interesting time. And it's also interesting for you and me, at our age in the business, we've been through four or five of these things. So, we've seen it before although every one is different. Any comments on that?

Byron Carlock:

Well it is. I was joking with our panelist the other day, I think the older three of us had been through this is our fourth cycle. And we've seen every one very differently, as you know. And it is fascinating because I think we can say this one's really not our fault. And that's probably a good thing for the industry, but it can quickly have negative ripples throughout the economy. Because, as we know, housing and real estate related activity from construction to mortgage businesses to title companies has a great ripple effect through the economy when it's healthy and can tend to ripple downward when it's not or when it's slowing. And so I think that's what we're going to have to watch and hope that we don't hit too deeply into an unnecessary recession that is being fed, driven, and capital markets driven. But it looks like we're going to be in for a tight couple of years.

Matt Slepin:

Yeah, I bet it is. So, I wanted to talk about couple of years versus six months, eight months, twelve months. We've talked about timing of that, but talk about what it means when the window does shut for the industry for this period of time, call it an interregnum, that's a nice way to think of it. But during that period, what are the ripples for the industry, what are the ripples for layoffs within the industry? What are the ripples across the businesses outside of real estate for this? Let's brainstorm that a little bit.

Byron Carlock:

Sure. Well, Matt, there's so many confluences coming together right now that are creating, sadly, a perfect storm downward. Of course, driven by the fed rate increases, in large- Not 15s and 25s, we're talking about 75s. That's major statement by the feds to constrict the capital markets and the debt underwriting. If the go up big, they don't historically come down big. So, the drops are probably going to be in 25s and maybe 50s as we come down. And so if you map that out, it probably means a minimum of two years before we find an interest rate new normal. And we don't know what that is. I think some of the fed governors have said publicly that they think 5% unemployment is healthy and we're at 3.5%. So, we're going to see some layoffs to get to that 5%, most likely. And then in the real estate industry, it's not a turn on a dime kind of industry.

So, as we watch things slow down we'll see layoffs in the mortgage industry, the title industry, the construction industry, asset management industry. The ripples are pretty large when you consider the contribution that real estate and construction offers this economy. However, that's offset by all cash or increased cash activity. More equity going in to deals, if you're willing to put more equity in, there are lenders that will still lend. Development pipelines are being constricted but yet there's still plenty of demand, and pretty healthy demand. Especially in the housing arena, for either single family or build to rent developments. Logistics is continuing it's march forward and you could argue that demand is still healthy in most markets for distribution space. Especially as big users look for on-shoring opportunities for things that were not readily available during the pandemic when they learned how fragile our supply chain is. So, you're seeing inventories creep up with more space needs in the warehouse industry. And then, of course, the growth of e-commerce, and then we're watching the retail industry continue it's transformation. And there are retailers that are actually doing pretty well and, right now at least, the consumer is still spending, which is good for retail. I'm eager to see what holiday looks like.

Matt Slepin:

Right.

Byron Carlock:

Backing up for a moment, though. This magazine began it's interviews in July and ended in September. And it's a sentiment driven magazine, as you know, in our 44th year. And the sentiment quickly slid down with every fed increase. And so there is not only concern but even fear, in some sectors, that with demand as good as it is in these sectors, that we're creating a recession that may be worse than it has to be. And I hope that's not the case, but I do fear that.

Matt Slepin:

Yeah, so comment on that. What's interesting, but it is the sentiment driven magazine or survey, and I was surprised how fresh it felt reading it last week because I knew that it had been published and the research had been done over months prior to that. But it felt like the surveys you did just came out a week or two ago, not six months ago or four months ago.

Byron Carlock:

So, we did adapt. We did a fresh round of some CEO discussions at the end. And that's why we said the overall sentiment was cautiously optimistic. I think that what we saw in the analysis was strong markets, good demand for most products, but a constricting capital market that made deals get more difficult to do. And if they're going to get done, certainly require more equity. So, I think that's why we said cautiously optimism. The real estate industry is, on the streets, pretty healthy right now, but can tip downward pretty quickly. As you pointed out with the ripple effect, depending on how much capital happens to be available. The good news on the capital side is, there are banks that will lend if you put in more equity. But their underwriting's strict, they are less willing to underwrite trended rents upward.

They're looking more at rent stabilization in most of the product types. But there's also foreign money coming in, especially in the high net worth and ultra high net worth community that still do view US as a safe haven and real estate as an inflation hedge. And so, I think it's going to be interesting to watch capital flows coming in. I think it's going to be interesting to watch if all the banks or just the major ones are as tight on credit. We also, as Mary pointed out in our panel at ULI last week, the non bank banks are having good business because they're able to fill the gap that the money center banks are unwilling to fill.

Matt Slepin:

All right, so the private lenders, so those real estate investment managers who have four quadrants, not all the quadrants are dead and the dead quadrant's doing pretty well right now.

Byron Carlock:

Certainly getting more than it's typical fair share of deals to evaluate. And think about the volume, back you your and my and our age, the volume that Leeman and Baresterns and CIT and GMCA finance and GE capital use to do. These debt funds and non bank banks are filling that gap very well. And, frankly, they're underwriting with some pretty good disciplines. They're underwriting with the expectation of a bit of a downturn and if the deal still works, it's worth funding.

Matt Slepin:

Right. And back to one of your comments from before, it's not a real estate driven problem. Because discipline has been in the market both from equity and from debt. Lots of volume but good discipline. Let's go back to one of the points because I want to unpack this in different directions. So, you talked about two years to a new normal, I did hear the San Francisco fed president talk about two things. One was they were going to start reducing the jumps in rates and I think they're supposed to telegraph that we've read the paper. So there was just 75 basis points a couple days ago but it looks like the next one might be 50 or 25, and then it will moderate to a place. The question is once it moderates to that place, if it's too high does it come back down? But you say 24 months before it moderates to get to the new normal. What's that mean for cap rates and is it a fully knife environment for that full 24 months or might it be 12 months? When do you start to have pricing discovery and everything else about that?

Byron Carlock:

So, I think we're in a pricing discovery period now. And I think there is fear by the investment community that they don't want to commit to an environment that might allow them to catch a falling knife, if you will. But I think that they are also smart to see the demand for product is not causing a dramatic adjustment in cap rates right now. I'd say the bid ask spread is ranging from 5% to 20%, depending on the market and the product type. And cap rate expansion is not 25, 50, or 100 basis points, it's modest at this point with cap rates in the maybe... trading five to 15 wider. Maybe with the expectation that they go 25 bits wider. But we're not seeing as much distress as you might imagine.

But there are many people that believe it's coming and the opportunity funds that have, frankly, been on the sidelines for nearly 10 years are seeing some blood in the water and expecting bigger adjustments than we're seeing just yet. Remember, we also do the PWC investor survey each quarter, watching transactions and the slow down in transactions is causing us to have a darth of data because of the appraisal lag. The appraisal lag in the industry always captures backwards looking data on trades that have happened. When the transaction market slows, it takes a few months for us to be able to calculate what the good data points are for establishing value. That's why you see downward adjustments in value by the major asset managers lag. And so the industries don't always capture what's happening real time. But you can talk to the acquisitions teams at the major investment funds and hear that this period of price discovery is rather robust right now as people try to decide what value is going to look like over the next couple of years.

Matt Slepin:

Absolutely. So, let's think about a different question, which is around transactions versus development and the ripple effects that lack of trading has in the industry, and ripples to the overall economy. And then the ripple effects of less development having both in the industry and economy, because I think they're two different things. So talk about that.

Byron Carlock:

I think they're very much two different things. And the transaction side really looks at acquisition opportunities vis-à-vis replacement cost. And in times of distress, typically, people are able to make better buys vis-à-vis what it would cost to rebuild. On the development side, it's disappointing, to me, to see this downturn happen because I feel like we were in the middle of a re imagination of our build environment. Really thinking about how we want to live in the future in this next 40 or 50 years. Greater planning around the 15 minute lifestyle, you live, work, and walk. Greater planning around more green space and park space and discovering the park premiums and how delightful it is to live in proximity to green space and nice grocery stores.

And I really was admiring what I was hearing cities talk about in their planning. Changing their entitlement processes, changing some of their zoning allowances. We were really on a nice roll. And imagine, if you're a young analyst that's only been in the industry 5 to 10 years and you've never seen a downturn and you were in the middle of these great plans for mix use to improve the vibrancy of our neighborhoods and connect to transit lines and transit oriented development. We were trying to make our top 30 cities much more European, if you will, in the planning and bringing together the triangle of public investment, private investment, and even philanthropy to accomplish those goals. I think, sadly, that's going to take a hiatus and I hope that we revisit it with the same vigor that we were doing as we were coming out of the pandemic.

Matt Slepin:

You didn't mention the housing shortage. There's some underlying fundamentals to those things that will drive that requirement. And you also said earlier that the industry, in terms of stabilized assets, is pretty stable. It's just transaction volume is down and if we, again, distinguish between buying and selling when you don't have to, if you have to you have to, and then developments going much, much slower. Then what does this period of time mean, how long does this period last, and how do companies both plan for the next cycle and then deal with this moment in time. Because some people do have to transact.

Byron Carlock:

There's a lot in that question. I think we have to start with the under supply of housing. And so, I'm hopeful that this downturn does inspire some conversions and some redevelopments. I do think housing finance, because we have a vibrant secondary housing finance market with the GSEs. Hopefully there will be available capital for housing related activity and incentives to think about affordable and workforce housing that help us to normalize some of the deficits that we have in sheer numbers of housing units that we need. We've underdeveloped vis-à-vis historical development numbers to a point that we're cumulatively, probably five or six million units short with the heavy weighting of that toward the affordable and workforce housing.

We're seeing some interesting trends around renewed suburbanization, which had, remember five years ago we're talking that the suburbs are dead. So now we're seeing some life in the suburbs, people have moved further out during the pandemic. They're deciding to make homes there. So now the burden is really about connectivity and infrastructure. And so you're seeing dollars in the infrastructure plans be released to improve regional connectivity. Hopefully that will continue. The improvements in the northeast are making it one grand regional neighborhood, if you will. Depending on how long you want to spend on a train. We're seeing that their interest rates are going to probably slow down the development of regional transit development in places like Texas and Florida that had grand plans for connectivity. But those things are still needed and the fundamentals require them and our lifestyles are asking for them. And so hopefully we will see some policy response. There's talk in the multi-family industry of incentives to bring back low income housing credits. And also offer TIFF related incentives for the urban TIFF, if there can be a 40% set aside for 80% of median income affordability, especially for service workers, nurses, policemen, firemen, teachers. So, hopefully we'll see more of that.

I am encouraged by trade groups like up for growth, that are educating our city leaders and town planners on the benefits of rethinking our historical planning processes, entitlement processes, zoning regulations. Hopefully that will inspire some more development as well. But all of that does require capital and so I hope that the capital market responds so that we don't go further in the whole on housing units.

Matt Slepin:

You just touched on a point that I really care about, and it comes up all the time in leading voices. I'll use the words that I've used before which is, and it fits with up for growth, and they're doing an amazing job, but if I look at the English language, two of the dirty words in the English language are landlord and developer. Can those two words define our business? And how do we reclaim those words, and you're in the public here, how do we reclaim those words to at least be neutral, if not horribly negative in the public consciousness. Because we're here to work those problems, right?

Byron Carlock:

We are and I have to say, starting two years ago we began to see this growing sentiment of the industry being willing to bear the gauntlet of social responsibility and how to improve some of these problems. I think the "greedy landlord" perception is, sadly, miscast. And I hate to see it that way. But developers really have the ability to change the nature of our cities. I started my career with the [inaudible 00:21:38] organization and Mr. Crow used to say, "People think we're in the development business, we're really in the community betterment business." And I would love to see that moniker come back to the developer community.

I've been reading a lot of the philosopher Roger Scruton, I don't know if you've ever read any of his work. And he's said in times of ideological polarization or misunderstanding, it's always been common across history that we can agree on things of beauty. Architecture, green space, culture, music, gathering spaces. And you look at the development of the Roman Colosseum, you look at what the Habsburg's did across the Austria Hungarian empire, focused on music and culture and gathering places. Across history, what the Medici's did in Italy. Those things are worth studying because in times of political polarization that we're experiencing right now, we have these needs in the city, that frankly, the developer is the best person to solve. And I'd love to see that energy taken away from political polarization and criticism of the landlord developer, and look at the developer as a solution provider to some of these social issues by re-inspiring us. ESG may be the trigger that gets us there because I think ESG issues are going to be the governor on what is quality and what is not. And it will also force us in to things that have to be re-developed and repurposed and maybe even demolished. And so, maybe we can use that concept of city beauty, aesthetics, architecture, and better planning to change the perception of that developer landlord.

Matt Slepin:

Totally true. And add affordable housing, forget affordable because that's so suggests subsidized. Workforce housing, housing that is affordable to most people in to that mix and then you, actually, you've just redefined and defined the three mission statements of the urban land institute. We're both governors, at ULI we both care. That may be our venue to get some of this stuff done. I use the podcast to accomplish the same thing we talk about all the time on this show.

Byron Carlock:

Right. And we're hearing more about the term "attainable housing." Yeah, the acknowledgement that it's gotten more expensive in our cities and it's probably not going to come down any time soon. But what are things we can do to create attainable housing? And you're already hearing the innovations of co-location in apartments. Renting a room instead of the whole apartment. Changing the configuration, things we've learned from the college housing industry. A common living room, a common cooking area can be segregated from private space and create a more efficient way to rent to create attainable housing. I like those ideas, I think that's interesting. I like what they've done in Detroit around the idea of four for one and three for one on lots where you demolish a single structure and you're able to put four town homes. In some cities we are finally seeing the breakdown of nimbyism around mixed use. So that every parcel of land is not just dedicated to one particular use.

Matt Slepin:

Right.

Byron Carlock:

But it's more thoughtfully planned to be more inclusive. Those ESG principles are going to guide us to this next phase of re imagining our built environment.

Matt Slepin:

Absolutely true. Let's talk about the length of time and how the different parts of our industry deal with the pain. But then also talk about the planning for that future and also we're cognizant that the planning for the future comes within the context of still a wall of capital wanting to invest in real estate. So, how do we plan for that during this period of time, not just get lost in sadness?

Byron Carlock:

Well, first of all, let's refuse to get lost in sadness because there is the fundamental demand on the streets. That means when supply and demand is out of balance, probably better to have demand out of balance so that we can fund the solutions. And the good news is there's capital to do so, there just may not be as much debt to do it.

Matt Slepin:

Right now.

Byron Carlock:

So we're going to probably have... That's right. So, I do think this is a debt driven downturn, as we established earlier. And we've got to watch the capital markets open up. What does it take to get there? We overstimulated the economy during the pandemic. So, that's two years of overstimulation and it's going to take, probably, two years to burn off some of that overstimulation. While capital is thoughtfully deployed instead of recklessly deployed with debt that was probably too cheap to start with. And maybe that's a controversial statement, but I'm sure you, as did I, had a mortgage at some point that was greater than 10%.

Matt Slepin:

I had a 13 and 3/8 and I thought it was the best mortgage I could possibly get.

Byron Carlock:

I remember getting a 12 and thrilled. And then when I was able to refinance it at 8.5 I thought I had struck gold.

Matt Slepin:

Exactly.

Byron Carlock:

So, I mean, we've been spoiled with 2% and 3% rates and I think that the one question is: Where is home lending interest rates... what are home interest rates going to be as they level out? What is that number? And we don't know but we will adapt to it just as you and I did when we had 12 and 13% mortgages.

Matt Slepin:

Right. And let's just play with that, just for a minute, because it probably settles down, I'm going to make up a number, at 5 or something. And that feels-

Byron Carlock:

Even if it's 6.5, it's historically low on the median.

Matt Slepin:

Get to the historic low, what is historic mean mean in this world because we're getting back to historic mean and we've been on a sugar high for something different.

Byron Carlock:

I think the sugar high analogy is a good one and I've asked my research team to help me think through, across the cycles, where we land. And I think we're going to see normalization plateaus. You just mentioned five, that may end up being this cycle's normalization plateau. Some cycles have had higher normalization plateaus that are probably more in the 6.5 to 7.5% range, if we look at it over a 30 or 40 year period. But I hope to be able to come back to you with some good data as we look at this in chunks of say, let's look at 20 year periods. And we're just... this last period, these last 10 years of consistently falling rates has spoiled us and we'll have to ween a bit off that. And, frankly, it will let a little bit of the air out of the tires of housing affordability on the existing housing stock. And it will be aided by some behavioral changes as the boomers continue to sell their residences to a very eager buying population in the gen z and millennial set. But at the same time, we're seeing housing preferences change away from ownership to renter-ship, as we discussed last week at ULI. And so maybe those confluences will come together to help us normalize quicker, but I think on the period of time, I have a hard time seeing it being shorter than two years.

Matt Slepin:

Makes sense. And I want come back to the trends across sectors and trends upon urban versus suburban, we'll do that in a few minutes. We haven't talked about global. One thing I have found interesting, like our presidents skewered for our inflation rate, but our inflation rate is normalized across the globe at the moment. So, it's a global trend, and even the global trend of 50/50 political dysfunction is pretty global as well, which is just fascinating. Any comments from your research and what you know because you have a world view versus a US view around this moment in that two year period here and elsewhere.

Byron Carlock:

Great question. I think the Ukraine really exasperated that discussion. I think we are watching ourselves like turtles de-globalized now to reduce global dependence. And we see the difficulties in Europe as a really, really rough patch for that continent. And it comes on the heels of Brexit and the separation of the Euro denominated economies. At the same time, [inaudible 00:29:19] is really two different economies because the Middle East is booming because of high oil prices. And Asia is still growing and developing. And so 50 years of globalization after World War 2 is now being slowed, whether it's temporarily or permanently, by this movement toward nationalism and de-globalization. We are certainly very much tied together with the economies of the world and our central banks seem to be acting, generally, in concert in trying to slow growth right now. But I'm not sure we know that difficulties in other parts of the world are going to effect us as badly as we might have previously thought. We're trying to get more control of our own supply chain, we're trying to get more control of our home fiscal and monetary policy. Fiscal policy we've got, that's a bottle of wine discussion, but I think on the monetary side, we're definitely going to have slow growth until it's rivaled.

Matt Slepin:

Yeah, it's interesting, the next podcast, which I recorded when I was in Dallas is with Ross Perot Jr. and we were talking about the different trend around de-globalization and repatriating some of those functions in to the states. Which you need to do to secure the supply chain to be more flexible when stuff happens like this. I'm guessing that trend is going to be positive for US real estate, positive for US factories, industrial, logistics, employment. Comments on that?

Byron Carlock:

I think so. I mean, I think no one knows better than Ross Jr. in his logistics business and I can only imagine that it's really aiding that in many ways. We are seeing it in demand for logistics space in the on shoring. Manufactures had moved so much abroad and now they're bringing it back. I do think the de-globalization trend is something we don't want to necessarily acknowledge is as big a trend as it is, but I think the walls that China is building between us right now is straining the relationships. I'm chairing fundraising for the national coal war center in Arkansas, and I think you could argue we're in another Cold War right now. And in times of Cold War, we hunker down and focus on our own economies as opposed to the interconnectedness of global economies. So, I think Ross Jr. is correct.

Matt Slepin:

So, let's go back through the kind of sectors of real estate. We've talked a lot about housing, we've talked about multi-family, we've talked about industrial. Which people have said is slowing but still is going to be a good sector, so I think those two sectors will be strong coming out. And we'll talk about that. Office, I want to spend only two minutes on, because that's a restructuring sector and there's no doubt about it.

Byron Carlock:

So, let's march through those because I think... Let's start with retail which was certainly the bottom of the heap of the last two years, or maybe even three years, and it's coming back in a nice way with transformation as, really, retail delineates between service oriented retail and experiential retail and commodity retail. The commodity retail continues to probably be too much square footage per person in the country, and so we're seeing continued struggles with some of the big boxes and department stores. But those retailers that are offering an omne channel experience that gives you a great reason to visit a store but also the convenience of buying online, those brands are really figuring out who they are and how they relate to you and I as consumers and doing, actually, pretty well.

Then the service retail, we're realizing, is really a geographic consideration. You want a grocery store within reach of your residence or office. You want health outlets, you want dry cleaners, and nail salons, and hair salons. So service retail is really continuing to do well serving their micro populations, if you will.

Matt Slepin:

Yeah.

Byron Carlock:

And then I think we've all been surprised at the amount of health and wellness users that have taken vacant retail in most every city. Industrial we talked about the on-shoring and the growth in e-commerce. Residential we've talked about as we look at the various pockets of opportunity in residential. From co-location apartments to build to rent communities, that was a category that didn't even exist 10 years ago. We look at changing preferences for single housing product, the McMansion has lost it's luster for several years and in the Charleston courtyard house and higher density multi site developments are quite popular. Student housing is continuing it's transformation. So, I mean, all levels of housing give us lots to talk about, lots of home. Hotels are one that we have not talked about and they're enjoying a nice resurgence. And I think business travel has resumed, leisure travel's been off the charts. People are eager for those kinds of experiences. And then the alternative spaces got a lot of play in the survey, around life sciences, data centers, self storage, student housing (which I mentioned). We have a long way to go before they are part of the four major food groups of office, industrial, retail, and multi-family, but they're becoming more important allocations inside the real estate portfolios.

Matt Slepin:

Hey, comment about that, which is interesting, one of my thesis is that real estate is becoming increasingly institutional business and increasingly technologically driven and sophisticated in terms of companies that do the business. If we then start applying that to these niches, I bet more niches will keep popping up to be dealt with in the disciplines we've learned in the real estate business. And then investment will go in to those niches. Each of those niches are coming, I'm wondering which ones are going to come next.

Byron Carlock:

That's a great question. I think the cyber industry's really driving the demand for data centers and data privacy and security. Life science is still clustered in Boston and San Diego, very important for the research and development across all scientific modalities. [inaudible 00:35:06] trying very hard to be a more important player in life sciences and pharma development. And then a lot of the research hospital markets like Dallas, with UTC Southwestern, trying to break in to life sciences. New York, with Cornell, trying to break in to the life sciences and really growing in New York. But it's the future of our health and wellness and so I think it's a legitimate subset of the industry, albeit a small percentage of our total inventory.

Matt Slepin:

Yep. It's interesting, we had Tim Shell in from biomed on the podcast a couple months ago, we talked all about this. And people in office, where it's challenged, think they can just change their office in to life science, which is a no go for most properties in most locations.

Byron Carlock:

Right. Which is the downside to that investment, by the way. I think the price per square foot of data centers and life science makes you have to think twice as to any fear about who the alternative user would be if that user went out. But yes, there is clear demand for that product.

Matt Slepin:

So, talk a little bit about the re imagination and the reuse and the obsolescence of office and then what that overhang is going to mean because the obsolescence factors means that a lot of people are going to lose a lot of money. Pricing is going to be discovered there, at a price that could be nearing zero. And then how that will ripple down in to the industry.

Byron Carlock:

Man, I think the best way to talk about it is in two buckets. One is changing utilization patterns and the second is product relevance. So, let's talk about changing utilization patterns first. You may remember during the pandemic we watched office sublet percentages just go through the roof. As CFOs said "Oh, my goodness, productivity is fine. People are working from home. Do we even need an office?" And then all of a sudden as that wore on we began to realize it's not either or, it's both and. We've got to have office for several key important, strategic reasons. And mostly related to our people and our interpersonal activities. Mentoring, one-on-one, training, product introduction and teaching, group collaboration, white boarding, business planning. Those things are just not done effectively on a Zoom call. We managed through the pandemic with great productivity, but we missed on that interpersonal connectivity. And our younger workers don't know what that is. They're almost three years in to not having that kind of connectivity and that's a shame. And you and I got a lot of water cooler teaching and just learning in the bull pen and we want them to have that. So, that's on the behavioral side, so I think that we will normalize around, perhaps, smaller square footage headquarters locations with lots more sitting area, living room style furniture enjoying bigger collaborations space, higher tech, AV equipment.

I was with an office landlord about four weeks ago and he said if we go down to his loading dock, it looks more like a furniture store than an office building because people were literally dumping their cubicles in to the dumpster and replacing the spaces with living room setups and bigger conference tables and very residential feels in the office so that people would come back together for more social and team building justifications.

Matt Slepin:

It's interesting, if you can take your laptop in your house from the office room that you have over to the kitchen through the day, you're going to be unfettered in the same way in the office so it does kill the cubicle.

Byron Carlock:

That's right. And the cubicle has been such a part of our business existence for the last probably 40 years, if not more, it's now becoming obsolete. Which leads me to the product side. Some product is, in fact, obsolete. And we need to wake up and face it. 80% of our office stock was built in the 80s or before, and some of it cannot be retrofitted to current requirements that are coming for environmental standards. Environmental is a key attribute of leasing and investment decisions now and those buildings that don't meet the quality standards either become b or c tenancy for a lower level type of user, or they need to go through major redevelopment or even demolishment. And so the office sector will go through this course of identity change, if you will. Some will be converted to residential. The way office building cores for the larger floor place office buildings, it's very hard to do without cutting a new core and adding a lot more plumbing and electrical. But some buildings will be able to do that. And then some are going to have to be totally repurposed or demolished.

In some of the European countries, the standards associated with environmental quality become a ranking as to whether or not your building is lease-able, finance-able, or sale-able. And we've heard terms in the US about the brown discount if you can't meet those quality standards. So at some point in evaluating the reinvestment to be at the environmental quality that investors, users, and the capital markets want for transactions or not. It's really math. Do you want to spend the money or do you not? If you don't then you have a decision to make to either convert or demolish.

Matt Slepin:

Two questions about that. You're on a topic I love. One: the brown discount, interesting. Hasn't happened too much here in the states yet but it's going to happen. Second thing is I'm thinking that expertise is required and when expertise is required people can make more money and do more things. If they're sharp shooters knowing how to repurpose one of those buildings.

Byron Carlock:

100% and the ESG industry inside our real estate sub industry is really a vibrant space. We're doing a lot in the firm right now, mostly related to people's new reporting requirements that the SCC is going to require for the public companies. But it's heightened everyone's awareness that they need to be benchmarking against one of the data sets, whether it's Bresby or GRI or well building institute and then really take a look at an honest assessment of who I am and where my building fits along the spectrum. And am I willing to make the investment to make it better, to qualify for the higher tier of environmental compliance.

Matt Slepin:

Yeah, it's interesting. I have a longitudinal study five years ago at ULI in Dallas, I went to the green party, meaning cocktail party, for a green business. Had about five of us in a quiet room, it was in the same room this year. I went right after the governor's dinner and I couldn't walk around. It was all young people and they were so excited. I saw a guy from JLL, he said, "We are hiring," I like to hear that word as a recruiter, "like banshees because we have a dearth of people who know how to do this stuff." It was buzzing, I was thrilled. Questions on the same subject. What do we do about GSC leases?

Byron Carlock:

I think the GSA-

Matt Slepin:

GSA, that's what I meant, not GSC.

Byron Carlock:

The GSA has pretty stringent environmental requirements in their new leases. I think your question is probably more germane as to what they do with the old buildings and the old leases as they come up for renewal. And I think that they will probably require the landlords to meet them somewhere in the middle in order for them to stay or they will vacate and put and RFB out for a new space.

Matt Slepin:

I think that's the truth. Okay, so we've talked about office. I want to move on, talk about two or three other things then we're going to have to wrap up.

Byron Carlock:

Let me make one more comment about office. We've not talked about technology and the way we're using technology beyond Zoom. And one thing that I've noticed a big uptick in interest, just in the last 60 days, has been the Metaverse. And using the Metaverse to try to create another experience for connectivity. It's a little more personal, you're wearing the oculus, you feel like you're in the room, you can tour a space, you can attend a conference. I think it's going to be interesting to see how Metaverse changes the way we use office and maybe enhances the interpersonal experience without solely relying on having more space. I think I just put that out there as something to think about. Our Hong Kong office at PWC bought a block in the Metaverse because in the zero Covid policy of China, our Hong Kong partners that needed to talk to our partners in China were able to do so in the Metaverse because they could not travel in and out of the mainland. And so I think that's interesting and certainly worth exploring.

Matt Slepin:

When you say they bought a block, what does that mean in English?

Byron Carlock:

In capital... I can't remember the neighborhood, but yes. You buy Metaverse real estate, which is not really real estate, it's really a right of views.

Matt Slepin:

To a place in there?

Byron Carlock:

Yeah, just like the NFTs, you're buying digital air, if you will, but you're really not buying it, it's just a usage right, it's a software right.

Matt Slepin:

Okay, listeners, just be aware of this. PWC has bought a block in the Metaverse for their people in Asia to talk to each other and interact in a cool way.

Byron Carlock:

But here's something else that's funny, I was at conference in Europe recently where my Italian partners were talking about Metaverse clothing that are being offered by some of the well known Italian designers. So that you and I can go in to the Metaverse store and outfit ourselves to be appropriately attired in our Metaverse conference room.

Matt Slepin:

I want to make a statement in there to the others who pay us, buy me.

Byron Carlock:

I want to make sure my avatar allows me to be thinner than I actually am.

Matt Slepin:

There's too many stories about that. We'll keep going here. Okay, talk about downtowns versus urban, suburban, small towns. We're going to change to have a multiplicity of those things all work at the same time and that doesn't mean the death of downtowns, I don't think. But in San Francisco, you walk around and you go, "Ooh, death of downtown." So, put some context on that.

Byron Carlock:

Well that's also a pretty interesting topic because one thing we do know is we cannot replace the cultural infrastructure of our urban centers that have been developed over the last 100 or more years, especially in cities like New York and London. But I have to say the leadership challenges plaguing cities like San Francisco and Chicago are really slowing the return to even enjoy those cultural centers. So I think it's going to require a force of will from the business community to encourage city leadership to rethink their role in cleanliness, in safety, in transportation, and reasons to return. You notice in the report this year, San Francisco and Chicago got a really bad rap for those reasons. I think New York would've except that there's great hope that Eric Adams is going to be much more proactive in some of those issues. But I think that's very important. I think London, even with it's challenges, still remains very protective of it's cultural position in society.

Now, so that's one piece of your question. There is a trend data worth nothing that there was some re-ruralization of America during the pandemic. And the boomerang showed that many people went back and many people stayed. And those that had permission to work from anywhere, stayed out in the Hamptons or moved to Charleston, South Carolina or moved to Florida for coastal living. Or even moved back to small, cute towns as you look at the growth of places like Oxford, Mississippi and Charlottesville, Virginia or other college towns like Ann Arbor where people said, "You know, I was pretty happy when I lived there, I think I'll go back." And so we've seen that and I think that's worth seeing how sticky it is because those towns may be cute but they may also become boring over time and they certainly don't have the access to cultural activities that our gateway cities do.

Matt Slepin:

Right. I think we want to see one seam. We want to see what everyone's doing this or everyone's doing that. The cities back, no one's doing the other thing. But I think we're going to have a multiplicity of those things concurrently working together. And technology does enable it in a better way, hence I get to live in Sonoma.

Byron Carlock:

100% Matt. And let's not be afraid of that. I'm going, next week, to the Prop Tech conference in New York that [inaudible 00:47:00] hosting with Meta prop and I think that's going to be a big topic. Technology is the bridge to give us those choices. We may not live in one place full time. We may have existences in the urban markets for when we need to be there and more rural or suburban markets when we can be there. And we're going to rely on technology and better transit to navigate between the two.

Matt Slepin:

So, let's talk a little bit about prop tech. Prop tech is changing how we do business in real estate. I was on the phone with someone yesterday for a potential future podcast and she said it's not just prop tech, because prop tech and up tech come together in deep ways. They're not separated as we think they are. And it's not just "hey, I have a fancy doorknob that I can sell to apartment communities" because it's deeper than that, it's broader than that, it's across operations.

Byron Carlock:

I think $18,000,000,000 has gone in to 2300 different companies that are being tracked by the MIT real estate center. They're not all going to make it but they're all trying to take a dent in to some area of our industry to make it better, more efficient, more technologically enabled. We're seeing robotic pasta makers show up in the kitchens of hotels. I was walking through an airport the other day that was selling robotically brewed coffee. I think we're watching prop tech have applications up and down the value chain, from lease administration, document scanning, all the way to investor relations. And seeing this movement of paperwork throughout a blockchain process, from entering a lease into a system all the way through the general ledger and then coming out through the K1s. That's going to continue and I think that makes us more efficient. Similarly, in the construction industry, we're seeing better software for managing construction jobs to reduce waste and to measure environmental impact. And we're seeing everything associated with improved systems integrating data, digital smart buildings, internet of things, energy management systems. All that's coming together nicely. We're going to be begin to see where there's more and where there's less application. And venture capitalist and private equity is saying it's real and they're putting a lot of money in to it.

Matt Slepin:

Now that we've had this conversation and we started at this moment of things being locked up, any other comments back to what we do during this period of one year, or you think two years, before we're back in normal cycle time.

Byron Carlock:

Well, so I'm going to suggest three things actually. Number one, don't be afraid of a transaction. There will be bargains, there's always a need to transact for a subset of the market and I think we just have to be diligent in figuring out those opportunities. Number two, it's perfectly okay to call a debt fund and not a bank to get your deal done because there is capital to deploy there. And number three is, let's study the demographics and socio graphics of some of these changes and find new niches and new opportunities that are worthy of exploiting. Because there are some changed behaviors that are going to change the way we use space. We are fundamentally, at the heart of all this discussion we've had today, Matt, we are fundamentally rethinking the way we use space. And out of that change comes opportunity.

Matt Slepin:

Yeah. So, that gets the last question, leading voices, which is always advice for a young person entering the real estate business. Should they stay away because this is a bad business or a bad time in the business, or do they enter now in order to benefit and be involved with all of those changes you're talking about? What's your advice?

Byron Carlock:

Oh, please, Matt. The latter. And go back and pick up an old book called A Pattern Language, about how we should build our towns, cities, villages, and incorporate beauty, architecture, and timeless structures to our lives. I think Pattern Language is something I always ask my analysts to read to remember how the European villages were constructed and what we can learn from in creating space for ourselves today. The other thing I always encourage my young people to read is The Biography of Tramel Prow, he was such a mentor to me. And it's full of pithy wisdom about making our towns better through our industry. And I think I'm watching our industry shoulder these responsibilities to make our towns and cities better, and this is a good time to be in the space. Maybe tumoltuous for a little while, but certainly not as bad as some of the cycles you and I have seen.

Matt Slepin:

No, because the fundamentals still look good and the needs going forward are even greater than they were before.

Byron Carlock:

Indeed.

Matt Slepin:

Hey, Byron, thank you so much for making time today. This was a delightful conversation. Folks, look to our show notes because I'm going to put a highlight on the books that Byron's mentioned. We'll have to do an email with each other to make sure that we get the names of those, but thank you very much. It's been a great conversation.

Byron Carlock:

Thank you, Matt. Take care.

Matt Slepin:

Thank you for listening in to leading voices, and I hope that you enjoyed today's episode. I have a request, if you enjoyed the episode and found it to be valuable, please share it with a friend or two. If they're podcast wary, take their smart phone in your hand and subscribe for them and teach them to listen. You'll change their life. Seriously, thanks for listening and keep in touch. You know you can reach me at matt@terrasearchpartners.com. See you next time.