

# The Millennial Impact on Real Estate

How America's largest generation is changing  
the property investment opportunity



## The Panelists

**Peter Ciganik**

GTIS Partners

**Andrew Jacobs**

Metropolitan Real Estate

**Michael Schwartz**

RSM US

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## Key Findings

1. Millennials are transforming the urban real estate market
2. As they age, millennials are influencing suburban real estate as well
3. Millennial shopping habits are changing retail and logistics
4. Millennial work habits are reshaping the office landscape
5. Co-working office providers are becoming the biggest lessees

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Managing Director,  
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## 1

## MILLENNIALS ARE TRANSFORMING THE URBAN REAL ESTATE MARKET

Millennials are the largest generation the U.S. has ever seen. Numbering just over 83 million, they represent more than a quarter of the nation's population. And with their spending power, they're changing the way America does business.

They're having a significant impact on the real estate market. Unlike their parents, millennials enjoy life amid the hustle of urban hubs. They gravitate to downtown areas, where they tend to rent rather than buy. "Urban downtowns have revitalized in a number of gateway cities over the last decade," said Peter Ciganik, managing director at GTIS Partners. "Millennials have finished college and found their first jobs and now they're able to set up their own households. Of course, those households will first be rentals. And these people are young, they enjoy the fun of the city."

For the past several years, millennials have flocked to the bright lights of "24-hour cities" and real estate investors have followed. Now, as rents in these places soar, millennials are migrating again—and investors are on their heels. For example, as San Francisco rents have ascended into nosebleed territory, priced-out millennials have shifted across the bay to Oakland and other "18-hour cities," with investors right behind, injecting capital into once-forlorn office, retail and residential properties.

"In New York, we have a client that's investing in multi-family and residential in Queens right now," said Michael Schwartz, a principal at RSM US. "In the 18-hour cities, we're seeing an influx of people who don't want to live in the 24-hour cities because of price. They're moving to cities such as Columbus, Madison, Raleigh and Nashville."

These next-tier cities are now the Goldilocks zone for investors: not too cold, not too hot.



### The Circle of Life

**Andrew Jacobs**  
Metropolitan Real Estate

Millennials aren't the only ones who want to live in a convenient downtown area. There are about 10,000 baby boomers entering retirement age every day in the U.S. and many of them want to downsize their homes and live in the city, where they can enjoy proximity to shopping, entertainment and public transit. Often that means moving from a single-family home in the suburbs to multi-family housing.

"I don't have statistics on this, but I would make an educated guess that a lot of those folks are moving downtown and buying a condominium or a co-op," Jacobs said. "I grew up in the suburbs and my parents grew up in the suburbs and their parents grew up out there. And where do they live now? They live in the city now. So it's absolutely happening."

The irony, of course, is that as baby boomers decamp for the excitement of the city, a millennial couple with a brand-new baby might very well be moving into the suburban house they just vacated.

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“Investors in search of yield need to go to these secondary cities, especially if you’re a high-yield, high-return investor,” said Andrew Jacobs, managing director at Metropolitan Real Estate. “San Franciscans and New Yorkers—young ones—are spending half their income or more on rent. They can’t spend more. The wage inflation isn’t there to support higher rents. So the peak, we absolutely see it.”

## 2

## AS THEY AGE, MILLENNIALS ARE INFLUENCING SUBURBAN REAL ESTATE AS WELL

Millennials are growing up, of course, and as they do they’re getting married, having kids and moving out of downtown areas, primarily in search of better schools for their children. “Unfortunately, downtown public schools in a lot of places have been underfunded for years,” Ciganik said. “And how many people can buy a condo in New York and then send their kids to a private school? Not that many. So moving to a place where schools are good and space is affordable becomes the choice.”

Still, a lot of these suburban-bound millennials can’t afford to buy a house, so they rent. Result: single-family rentals are now the fastest-growing sector of the rental market. Eight million new rental units have been filled over the last five or so years and 5 million out of those 8 million are single-family rental homes, not high-rise apartments.

Fannie Mae has recognized this trend. In January, the agency announced it would guarantee the billion-dollar rental-homes debt fund of Blackstone, the largest owner of rental homes in the country. Not surprisingly, other institutional investors are getting interested in the rental-home sector.

“There are about 15 million rental homes out there, but most are still owned by moms and



### The Amazon Effect

Peter Ciganik  
GTIS Partners

Despite the fact that millennials like to go out and experience life, e-commerce, with its shop-from-anywhere convenience, is quickly on the rise. So what’s the right real estate play to take advantage of this new paradigm? Should investors look for large buildings close to where lots of people live and convert them to logistics centers that can provide same-day delivery?

“It’s a little harder to convert older retail property into a super-warehouse,” said Ciganik. “When you look at what Amazon does with their gigantic warehouses, those are specifically built for their needs. They’re highly sophisticated but very low in terms of employment. A giant warehouse can be serviced by a few engineers who are basically directing robots that pick all the stuff and ship it.”

On the other hand, he said, there is opportunity for some inner-city buildings to be converted. For instance, Amazon recently bought a 100-year-old building in New York City and repurposed it. This demonstrates that, even if a building doesn’t have 36-foot ceiling clearance and 50-foot bay depths, logistics providers are willing to accept such shortcomings if the property is very close to a large population center.

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## The End of the Office Park?

**Michael Schwartz**  
RSM US LLP

Which properties are positioned to perform well, given the rise of millennials, and which are in trouble? Here's one answer: millennials' preference for downtown workplaces is sucking the air out of suburban markets surrounding large cities. In Chicago, for example, McDonald's and United Airlines have moved back downtown. In Boston, GE has done the same. "These suburban office complexes are really going to hurt," Schwartz said.

For your average socially active millennial, there are few prospects less appealing than a life constructed around work in a suburban office park. "If you're living with Mom and Dad, it might be easy," added Schwartz. "But if your social life is in the city, that becomes problematic."

The suburban complexes that will withstand this trend are those on transit lines that are easily accessible for workers who want to live in the city. Walgreens' corporate headquarters, for instance, is located in the Chicago suburb of Deerfield. It's just three blocks from a train station and employees who live in downtown Chicago can get there in under 30 minutes.

pops," Ciganik said. "Only about 280,000 of these homes are owned by institutions, less than 2%. But it's growing fast. It's actually growing faster than the multifamily REITs back in the early 1990s."

## 3

## MILLENNIAL SHOPPING HABITS ARE CHANGING RETAIL AND LOGISTICS

Millennials prefer to do their buying online—they make over half their purchases there. But they do still enjoy some real-world retail experiences and retailers are evolving to accommodate them.

"There has been a barbell in terms of success," Jacobs said. "There's an experiential nature to retail, especially on the luxury end, and people still like that. We continue to see growth there. On the other end of the spectrum are the discounters. In most cases, discounters are able to undercut online, so we'll continue to see demand for discounters. It's the in-between that's been really tough."

Malls that don't see as many shoppers as they used to are repositioning themselves to attract visitors with new offerings. They're adding restaurants, cafes and bars, because millennials love to mingle. And they're adding medical offices, because "you still have to show up to your doctor's appointment—for now," Ciganik noted.

In many malls, onetime grocery stores have been taken over by health clubs like L.A. Fitness and XSport Fitness. "These malls were built at the intersection of Main and Main for so many years," Schwartz said. "There may be a higher and better use than an enclosed mall but it's still great real estate."

Meanwhile, space for logistics has benefitted from the boom in online shopping. "What's been bad for bricks-and-mortar retail has been good for logistics and industrial space," Jacobs said.

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“Both large distribution centers and, particularly, closer-in distribution buildings have seen extraordinary growth in rents.”

## 4

## MILLENNIAL WORK HABITS ARE RESHAPING THE OFFICE LANDSCAPE

Millennials like open-plan, fully digital, creative office spaces. This opens opportunity for some property investors but presents challenges for owners of old-school office buildings. “We have a building where Goldman Sachs and Facebook are tenants,” Ciganik said. “What attracted them to the building is that it has high ceilings, it’s all glass, so there is a lot of light, and it has redundant fiber. It’s heavily connected.”

With white-shoe firms as well as TAMI tenants (technology, advertising, media and information) moving to the open-plan, connected office, the downtown office landscape is shifting. “In New York, traditionally the highest office rents have been in the Plaza District, Park Avenue from 42nd Street up to 59th Street,” Jacobs said. “Now we’re seeing higher rents not only below 42nd but below 34th Street in what we call Park Avenue South. I would say the buildings are physically inferior but the rents are higher.”

The first to move in were startups seeking affordability and raw spaces—“midblock, nasty buildings with loft spaces,” Jacobs said. Now many companies that employ millennials are looking for similar office space. “I heard a Midtown landlord say recently, ‘We’ve got plenty of old crappy buildings in Midtown,’” Ciganik added.

In Chicago, companies once wanted space with a view of the Lake Michigan. Now they want to be near transportation. “Millennials want to be closer to the L, so the West Loop has really expanded,” Schwartz said. “And you’re also seeing a lot of residential development in the West Loop.”

These trends are impacting traditional office hubs. As leases expire, tenants that no longer need so much space are downsizing. Who needs law libraries and conference rooms nowadays? In

New York, tenants are leaving once-prestigious addresses to go downtown or to Hudson Yards. It all spells trouble for those 1960s and 1970s buildings in Midtown that can’t simply rearrange their interiors due to architectural limitations. Those formerly expensive buildings, with their deep cores and low ceilings, are emptying. “And, for investors who have purchased those assets at 3%, 4% cap rates in a rising-rate environment, that will be challenging,” Ciganik said.

## 5

## CO-WORKING OFFICE PROVIDERS ARE BECOMING THE BIGGEST LESSEES

Co-working providers are now a force to be reckoned with. WeWork, the \$17-billion startup, added hundreds of thousands of square feet worth of new Manhattan leases in 2016 and will soon be among Manhattan’s top 10 tenants.

This has spurred investment in office properties that appeal to co-working providers. But there are risks in entering long-term leases with startups like WeWork. Does their credit hold up for the term or more when the investor wants to sell the building? “The jury is still out on the concept,” Schwartz said. “To underwrite those properties now, a lot of our clients are taking a bit of a risk.”

“We just signed on WeWork as a tenant and we were hesitant to do it for more than a part of the building,” said Ciganik. Although co-working providers have bolstered their reliability by branching out to sign deals with corporations that need overflow space, they are still particularly vulnerable to recession, because they rely on users who rent space on a daily basis.

“It’s a convergence of asset classes: office and hotel,” Ciganik said. “You would never think of them as having a common operating element. But you check into a hotel for a day to sleep. And you check into WeWork for a day to do your office work.” ■





# Expert Q&A

Michael Schwartz  
Principal,  
RSM US LLP

## How will rising interest rates impact underwriting standards?

**Michael:** First of all, rising interest rates have already been incorporated into a lot of investments. However, underwriting standards are still being scrutinized.

The question is: Have we learned from our mistakes? Did we learn from the RTC bailout in the early '90s, the blip in 2001 and, of course, the recession?

I think underwriting standards have improved so much that we have seen some debt players walk away from loans more in the last three to five years than they did in the seven or eight years leading up to the crash. And they're tightening standards. You're seeing loan-to-value ratios on some buildings as low as 50%—75% still being standard nowadays—where they were 85% to 90% back leading up to the crash.

And you see it on the residential side, too. A lot of folks can't qualify. They're renting. So maybe we have learned the lessons of the past. ■

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Privcap is a digital media company that produces events and thought-leadership content for the global private capital markets. Privcap Media offers communications services to market participants.

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