The future of the real estate industry

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It's been a wild ride. Property markets went through their biggest cycle since the Great Depression. For 135 months straight, house prices went up, as did commercial property prices. Residential household wealth nearly tripled from $10 to $30 trillion. Households and firms borrowed aggressively; often under conditions that only made sense for banks provided that prices would continue to rise. They did not.

What followed was not merely a deep recession. What transpired was a system-wide financial crash the likes of which we have never seen in modern times. More than 10 trillion dollar in property value was wiped out in addition to 8 trillion dollars in the stock market. Millions of people lost their jobs and nearly five million households lost their homes in foreclosure.

Real estate risk had spread throughout the financial system via complex securitization products housed in opaque special purpose vehicles, but with ultimate recourse to banks' balance sheets. Real estate risk was not only held by highly levered banks but also by highly levered shadow banks like Fannie Mae and Freddie Mac or mortgage REITS, money market funds, primate mortgage insurers, and other insurance companies like AIG. Many of these firms were wiped out when house prices came down, all others were debilitated.

The housing bust in America had reverberations in Europe where it took down several banks and forced governments into expensive bailouts. Those bank bailouts raised the scepter of sovereign insolvency which then triggered the European sovereign debt crisis. The loss in value in the sovereign debt paper further weakened the banks.

While the panic has subsided, the debt overhang problem in Europe remains unresolved today. Irish, Spanish, Greek, and recently Danish property markets have declined heavily, while the other shoe still has to drop in several other property markets around the world. This downward price pressure in these housing markets will continue to weight on the banks in these countries for the near future.

Five years to date, we look back on this period with disbelief and the feeling of dizziness that grasped the markets; but also with wonder about how it could ever have come this far. Were we collectively asleep at the wheel or were we too greedy to stop the party while the music was still playing?

These past five years have seen a stop-and-go recovery in real estate markets. Households de-levered their balance sheets by slowly paying off their debts or through foreclosure. They were in no mood to spend, especially given the weak labor market. Non-financial firms are flush with cash but reluctant to invest and hire given the lackluster demand from consumers.

More recently, however, the news has been decidedly more upbeat, and it is real estate that is leading the recovery. After a nationwide decline by about 35%, house prices have gone up at a respectable pace of 12% per year over the past 12 months. House price appreciation has been above 20% in markets that got clobbered the hardest, like Las Vegas, Los Angeles, Phoenix, and Miami.

Home sales are up. Institutional investors have been aggressively buying properties in foreclosures supporting house prices. Household formation rates are up as young people start to find jobs and are able to move back out of their parents' homes. Construction is rebounding as have home builders share prices.

Securitization activity is resurging in the commercial mortgage-backed security and collateralized loan obligation markets. The Dodd-Frank Act and the ensuing rule-making is enabling a return of securitization of the healthy kind.

Banks balance sheets have improved increasing their appetite for commercial real estate lending.

New York City is seeing some of the most exciting construction activity in a long time with the completion of the World Trade Center tower and the development of the Hudson Yards.

It surely looks like we have turned the corner.

So here we meet in New York City at this inflection point in the housing cycle. Like the Economist magazine's article titled "houses that saved the world," written in 2001, we find ourselves in a similar situation today in 2013.

Despite the rocky past and maybe because of that past, I believe it is an opportune time to consider a career in the real estate industry. I see several potent long-run trends coalesce with a strong cyclical upturn.

Together, they are creating a job market in real estate that we have not seen for the last 7 years, and a job market that offers more stability than the one in the previous boom.

What are those potent long-term trends? Let me emphasize 4: *Urbanization, Globalization, Consolidation, and Financialization*.

1. **<u>Urbanization</u>**. Today 50% of the world population lives in cities. By 2050, that will be 70%. To accommodate demand, the world will need to add a city of the size of London every month over the next 40 years. A lot of this growth is taking place in the Third World. In China alone, 400 million additional people will move to cities in the next 30 years. Half of Nigeria's population of 170 million lives in cities and the rate of urbanization is growing rapidly. The four largest cities in the world are Shanghai, Istanbul, Karachi, and Mumbai. Of the top-25 cities in the world, only three are First World Cities: Tokyo is the 14^{th} largest city, New York the 18^{th}, and London the 19^{th}. The much improved economic conditions of hundreds of millions of people in the developing world have given birth to a new middle class that desires better quality housing and modern office buildings and infrastructure.
   The problem is that the Third world lacks the know-how and financing structures that we have relied on to develop the built environment in the First World. The global cities of the future need finance professionals to work on affordable housing development, urban planning, and people who can come up with creative development and financing solutions that are adapted to the local environment. That's where you come in.

2. **<u>Globalization</u>**. Real estate used to be a local business, where each market had its own local champions.
   But alongside the globalization of trade and finance, the last thirty years have seen the birth of large international real estate firms and global RE securities markets.
   These firms develop RE across the globe, use funding sources from one country to finance construction projects in another country, manage internationally diversified real estate portfolios, and hire highly skilled analysts that can navigate the complexities of cross-border investment in real estate.
   Conversely, wealthy investors from Latin America, Russia, China, and Canada seek the safety of the established property markets of New York City and London.
   Both sides of the market need employees who are well trained not only in real estate and finance, but also in issues relating to macro-economic risk management and doing business across cultures. That's where you come in.

3. **Consolidation**. A growing trend is for real estate firms to become much larger and more vertically integrated. A large, modern real estate firm will do its own development, manage a portfolio of properties, and provide a wide range of professional and advisory services. These firms often grow by aggregating external platforms.
   The economies of scale arise when dealing with the increased complexities of compliance and regulation or when dealing with large sophisticated investors such as sovereign wealth funds or large pension funds.
   Larger, global, complex firms will need a more talented and specialized workforce. They need highly trained MBAs to help them with not only with real estate acquisitions, asset management, and development, but also experts in a range of other functions. They may need a highly specialized MBA providing supporting analysis in support of due diligence and litigation, experts in corporate finance, corporate governance, and corporate strategy challenges that arise from running a complex organization. They need in-house credit risk specialists and people who understand the workings of hedge funds and sovereign wealth funds. This is where you come in.

4. **Financialization**. The only source of capital in real estate markets forty years ago was private equity and bank loans. Since then, large public real estate debt and equity markets have developed as major sources of funds. It is now possible for investors to buy well-diversified baskets of mortgage-backed securities and real estate investment trusts in their retirement accounts. The increased prevalence of real estate securities trading in public capital markets has made the asset class much more transparent and more attractive. I foresee further innovation along those lines, for example by introducing securities that allow one to own a small share of a large basket of single-family homes in Phoenix. We have seeing the beginning of this new asset class in 2013. The investment funds need real estate research analysts, portfolio managers, and people in sales & trading. They need people who understand how the monetary policy cycle affects real estate markets, with a sense of financial history. This is where you come in…

   And these are the kind of well-rounded professionals we help develop at Stern.

Stern has much to offer to its real estate students:

- We have a broad and deep curriculum of 7 real estate courses culminating in a Specialization in Real Estate
- We have a Center for Real Estate Finance Research that produces world class research and brings thought leadership to the industry, about a dozen professors at Stern work in this area.
- We have a large network of alumni that mentor our students, give fascinating presentations as Executives-in-Residence, and gather with our students at bi-annual conferences the Center puts on. Our upcoming Fall Symposium on October 18 features 20 top-notch speakers from the real estate industry, including the CEO of Fannie Mae.
- We have a very active real estate student club, that organizes several additional speaker events, participates in real estate case competitions, etc.
- Stern is committed to the real estate industry and the industry is committed to Stern.
- Finally, we have our locational advantage. NYU is in New York City, the real estate capital of the world. But NYU is also in London, in Shangai, and in Abu Dhabi, all important real estate hubs. We want to lever these locations to expand our real estate students' experience at Stern.

In conclusion, real estate is an exciting industry and an exciting asset class and that has turned the corner. There is no better place to study real estate than in New York City, at the only global network university, New York University, at its top notch business school Stern.