Demographics and Data Are Driving Change

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Although the commercial real estate industry has changed significantly in its 25 years, Diana Reid believes the next 25 years will be even more transformative. Reid, who retired from PNC in April 2019, said at CREFC's Monday panel that changing demographics and the growth of data will lead this transformation. In 2020, the millennial generation, which she defines as those between 22 and 39 years old, will constitute over 50% of the workforce. In addition, how the industry extracts insights from data will change, as it increasingly turns to emerging technologies, such as artificial intelligence.

Talkin' 'Bout My Generation

Millennials are the largest generation since the baby boomers, and Reid believes their preferences will have a drastic impact on a CRE asset's worth. Citing the live, work, play movement, she thinks that real estate will be repurposed in tenant mix and in use to fit what millennials value. Because of this, she questions taking only a historical approach to valuing real estate. "You can't just look backwards." Reid wonders if the industry models in use today can be predictive and anticipate these trends.

Michael Eglit, managing director of real estate debt strategies at Blackstone, piggybacked on Reid's point later, after ruminating on how much investors' appetites have changed. "Who is using space and how is it being used in the next five to 10 years?" After being hot commodities 10 years ago, retail and office have fallen out of favor with investors. Eglit said that those who were once active buyers in those areas are now focused on industrial properties and apartments. According to its head of real estate finance, Gregory Michaud, Voya Investment Management is asking these same questions when deciding whether to put a loan on a property. Like most other companies, Voya underwrites its commercial real estate loans with 10-year terms.

A lot can happen in 10 years, as people age and reach different milestones. “As an investor, demographics is destiny,” said Brian Furlong, managing director at New York Life Real Estate Investors. He thinks that baby boomers and millennials are both pigs in the python, affecting the world around them as they make their way through life stages. The average age of a baby boomer is 62 years old. A typical 10-year loan on a commercial property will have to take into account the needs and wants of baby boomers in their 70s (and 80s if the loan gets refinanced again). What will they do when they retire? Furlong theorizes that they will want to move south to cheaper places with low taxes. As they age, he thinks they will seek out good healthcare and a growing life-sciences industry, which is an expanding subset of office space. On the flip side, the average millennial is 32 years old. When they are 42 and 52 will they still be living in urban centers or are they going to start families and migrate to the suburbs like generations before them? Furlong believes a shift could occur.

Technologic

John Vecchione, vice president of risk analytics at CoStar, has spoken with clients about their technology infrastructure. He finds the main issue is that companies have lots of databases that are housed all over the place. This setup is decentralized, inefficient, and unscalable. Vecchione believes the solution is one system with a single analytical component up front that would funnel in from the back end an unlimited amount of data.

Furlong agreed that data is important, but that data processing is not always helpful to judgement, especially when determining what would make a good investment opportunity. The issue is that most people aren’t good at data processing. Those who are really good at using data “can run circles around everyone else.” He pointed to Amazon as a company that harnesses data better than other retailers. For instance, the company has data on how much an item should cost to get people to click. But will everyone in the industry be big data consumers in a few years? “Don’t hold your breath,” he said.

At one point in the panel, Michaud turned to Vecchione and asked if artificial intelligence could really work for commercial real estate. He said that he has been getting emails about it from people wondering if artificial intelligence could really take hold of analyzing commercial real estate. Vecchione explained that CoStar heavily uses machine learning, a type of artificial intelligence, for quality assurance. Using images, it can verify different aspects of a property. In an industrial warehouse, for example, CoStar can verify the number of bays and how high they are off the ground. "As far as it taking over the whole industry anytime soon, I don't see that happening."

Trepp CEO Annemarie DiCola, who moderated the panel, chimed in that her company has also been turning to artificial intelligence. Her two main takeaways are that the data itself needs to be good quality for it to work and that humans must play a part. Subject-matter experts need to question the output and verify that the artificial intelligence is indeed working as intended. Vecchione commented that this has been CoStar's experience as well.

Overall, the panelists seemed to concur that demographics and technology are two aspects of CRE that are likely to spur change in the industry. The degree and speed of that change, however, remains far from certain.