

Culture change or fad? Twin Cities population shifts toward central core

by Bill Clements

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All that talk in recent years about “transit-oriented” and “mixed-use” developments appears to be more than just talk: Regional planners now have the data to back it up.

Planners for the Metropolitan Council released the information, which points to a statistically significant trend of more people in the seven-county metro region moving closer to the central core of cities and to more accessible transit options in higher-density areas. The land-use data also project a fast acceleration of the shift in the next 20 years.

It’s contained in a study that considers the 2005-10 period and looks forward to 2030.

(The projections to 2030 are based on land-use estimates in the comprehensive development plans, referred to as “comp plans,” that metro cities last updated with the Met Council in 2008).

This move toward smaller houses and multifamily and transit-oriented housing closer to cities “is not a flash in the pan,” said Ryan Jones, director for the Twin Cities of Metrostudy, a construction industry group that studies and tracks new home building. “However, it’s not going to be the absolute for everyone.”

In other words, whether the shift is a long-term cultural change or a fad is still in question.

The shift started in the late 1990s, said John Kari, a Met Council planning analyst. It got a boost after the start of the Livable Communities Act and its programs “that really helped communities see the synergistic potential of walkable, connected land uses particularly with transit,” he said in an interview.

And it’s significant.

“This is the major change in planned land-use expectations that we’ve seen since we’ve been doing local comp plans since the ‘70s,” Kari told the council in a recent presentation.

Key to this concept are “mixed-use” developments, which Kari and research manager Libby Starling have defined as “connected and integrated” developments that serve two or more purposes — retail, commercial and residential. They do not have to include residential.

“A lot of communities don’t know exactly what the mixture [of mixed-use] will be in future,” Kari said, “but this is where they want to see development, where they expect it to go — and it’s more likely to be higher-density development.”

The land-use study data found that 5,625 acres in the metro area were taken up by mixed-use development in 2010, and projected that number will soar to more like 55,000 acres by 2030.



Robb Bader is vice president of St. Louis Park-based Bader Development. Three Bader generations work in the same office and these days are focused on developments closer to city cores and transit options — like the Ellipse, a year-old mixed-use development on Excelsior Boulevard in St. Louis Park. It has been 100 percent leased for months. (Staff photo: Bill Klotz)

The data also show that transitway corridors in 2010 took up 8.4 percent of the region's land area. But by 2030, it's expected that transitway corridors will be home to 31.6 percent of mixed-use acres and 22.7 percent of high-density acres.

The bottom line, Kari told the Met Council, is that the new major transit corridors — like the Hiawatha, Central and Southwest light rail lines — are being built in established highway corridors.

"You put two and two together, and you can see that where we are investing in new infrastructure is in the transitway corridors," Kari told the council. "We are out of the highway business [out of building new roads]."

In the interview, Kari wondered whether the trend will stick: "As we come out of this recession, it will be very interesting to see how the market responds. Is that a permanent shift toward more permanent attached and smaller single-family detached housing?"

He thinks it just might be.

"The transit system really complements the highway corridors," Kari added. "Like when we had the railway- and water-transportation systems, I think our highway and transit systems will work together to give us a real transportation network.

"And where they overlap are the places that will see real growth."

An example of a successful mixed-use, close-in development is the Ellipse on Excelsior Boulevard in St. Louis Park, which opened on Sept. 1, 2010. It's within a half-mile radius of a planned stop along the Southwest Corridor LRT line and just off Highway 100.

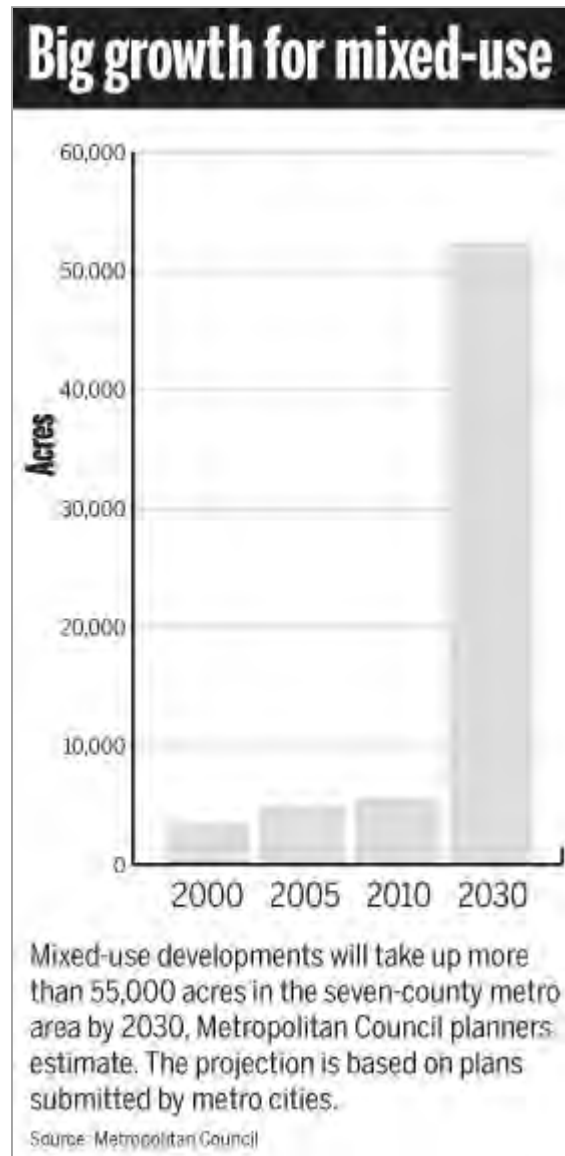
Robb Bader, vice president of Bader Development, an arm of St. Louis Park-based Steven-Scott Management, said the 132 rental units in the Ellipse have been 100 percent leased since February — and the four retail spots have been filled and open since June 1.

"We had confidence in the residential lease-up; we knew that would be a good area," Bader said. "The commercial, we were pleasantly surprised at how quickly that leased up."

Bader said his firm is in initial discussions with St. Louis Park officials about beginning a second phase — Ellipse II, which would be a 50- to 60-unit rental development next to Ellipse I.

Rents at Ellipse I range from about \$1,100 for a 550-square-foot studio to about \$2,300 for a 1,400-square-foot two-bedroom plus den.

"We certainly know that the rents need to justify construction costs, and right now that is happening close in to the city so that's where we are building — along with many other people trying to get projects going," Bader said.



The numbers on the left of the chart represent the existing and expected acres that "mixed-use" developments took up in the metro area in 2000, 2005 and 2010 — and estimates for 2030. The projections to 2030 are based on land-use estimates contained in "comp plans" that metro cities last updated with the Met Council in 2008.

He added that while access to transit was an important factor for where his firm built the Ellipse, “We still believe that the Minnesotan is really a vehicle-driven person. We’re not quite there yet in terms of transit.” (Submitted chart: Metropolitan Council)

Kevin Locke, community development director for St. Louis Park, said the city’s planning goal is “to make people places and not car places. It’s not that we don’t accommodate a car — most of us still drive cars.

“But we can do our best to focus more on the pedestrian and the residents and less on the car.”

Jones of Metrostudy said the “resurgence” of the multifamily rental market is “a combination of the fears about the economy and with home buying.”

He suggests that the shift is part of a cycle.

“These types of cycles happen all the time — before it was more out of the city and into the far-out suburbs, and now it’s moving back into the city,” Jones said. “But just when you think you’ve got it all figured out, it starts to change again.”

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URBANLAND

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Reinventing Real Estate

By Jim Heid

The still looming waterfall of maturing commercial mortgage-backed securities, the slowly thawing capital markets, and the ongoing uncertainty about where the next market will come from have left real estate professionals searching for solid ground. Entering the third year of the broad recession, the industry has retrenched, reorganized, and is struggling to recapitalize. But is the industry retooling?

Why the next 24 months will matter more than the past 24 years.

The March 2008 collapse of Bear Stearns signaled the end of real estate's extended bull run. The September 2008 trifecta of the Lehman bankruptcy coupled with the Washington Mutual and Wachovia bank weekend fire sales shook the real estate industry to its core. The still looming waterfall of maturing commercial mortgage-backed securities, the slowly thawing capital markets, and the ongoing uncertainty about where the next market will come from have left real estate professionals searching for solid ground. Entering the third year of the broad recession, the industry has retrenched, reorganized, and is struggling to recapitalize. But is the industry retooling?

For years the industry has accepted *real estate* as the all-encompassing term for both what it does and what it creates. By definition, real estate is "all land and improvements that are immovable." But the increasing complexity of how the industry goes about its business and, more important, the positive impact it can have on the broader society, defies the static nature of this one-dimensional definition. Recently, industry leaders are shifting the discussion from the topic of real estate to the *built environment*. The latter term provides a more apt, multidimensional view of the industry's scope, encompassing "the manmade surroundings that provide the setting for human activity."

Changing how the industry thinks about what it does as less "immovable land and improvements" and more "providing the setting for human activity" is anything but subtle. It creates a very different call to action and, if the industry chooses, positions it to be one of the most positive forces of the coming decade for resolving the complex challenges associated with human settlement.

From Commodity to Responsible Real Estate

After World War II, real estate development changed from an industry of locally focused entrepreneurs who took great pride and responsibility in their communities, to one of a global nature that delivered a range of "products." As companies sought to make these products conform to a formula or easily replicated template-

be they garden apartments, grocery-anchored shopping centers, subdivisions, or suburban office parks—they provided diminishing returns in terms of their contribution to the natural environment and society.



The past 20 years were instructional because they made manifest, more than at any other time in history, the good, the bad, and the ugly of the real estate profession. The ongoing evolution of the industry, and a sampling of its products, is portrayed in the figure at left.

The four categories represented on this continuum define the choices the industry has made collectively, and the mileposts of its potential. Each category has varying degrees of complexity, contribution to society, and, many would argue, risk and reward.

Commodity real estate results when the industry focuses only on maximizing efficiency—creating, replicating, and rolling out product regardless of region or community setting. A one-size-fits-all solution, it is the widget end of the business. The entire national landscape is pockmarked with its legacy and the environmental and human impacts left in its wake. It could be said that it represents the worst the profession has to offer, and as such is the basis for so much derision toward what the industry does.

Trophy real estate is where some of the industry's greatest innovation—and most photogenic projects—have evolved. But too often it is a "look at me" creation—dismissive of underlying social and environmental needs. Due to its showmanship rather than substance, much of this class of real estate lies in distress, overleveraged and underwater, because it was built up on promotion and fleeting status in lieu of a deeper sense of purpose.

Investment real estate is the more stable product class, emerging when real estate is viewed through the same lens as a stock or bond. A tangential interest in societal contribution may have been involved in its creation, but it is largely a product of financial engineering, efficiency of design, strong delivery, asset management, and branding. It may serve as a good neighbor or corporate citizen for communities, supporting employment or housing choice, but it is rarely a game changer in terms of the larger built environment.

Responsible real estate builds on the lessons of all previous categories while upping the ante. It is the best that the industry can be, representing the innovation and creativity often found in trophy real estate, coupled with the financial discipline and strong execution capacity associated with investment real estate. But it adds a third dimension—a true recognition of the real estate industry's role and responsibility to positively shape the built environment. It is not a "look at me" outcome, but a conscious and deliberate response to the need for economic return and creation of social good. It works seamlessly with its existing context and respectfully with its community partners. It delivers long-term value—not just to its investors, but to its host community as well.

Will This Be the Decade of Real Change?

At the turn of the millennium, responsible real estate represented the fringe. It was often cloaked in the simplest of green trappings—resource-efficient technologies, a location awaiting transit, and entitlement-extracted impact fees that were spun as social equity. As the industry enters the next 24 months, this could

be the moment when real change in the built environment is created. The industry has already developed the tools and skills to create complex capital stacks and technologically sophisticated buildings. It regularly wrestles with complex site planning challenges and even more complex operating agreements. But just as important as what the industry has learned to do is how markets are changing to leverage these increasingly sophisticated skills.

Demographic trends, not just government policies, are shifting the industry's energy to transit-focused and walkable locations instead of the cheapest available sites at the edge of communities. Perceptions of status-both by consumers and tenants-are moving from trophy designs to smaller footprints, more environmentally responsible operations, and healthier indoor environments. Social equity, more broadly defined and measurable than ever before, is being thoughtfully incorporated and discussed as part of initial project programming and capitalization rather than being negotiated during the public entitlement process.

The next 24 months provide the industry with a strategic opportunity to build on what it does well, while adding the additional skills needed to emerge from the downturn as a powerful force for solving many of today's most challenging problems. No other industry has the collective capacity, problem-solving skills, and ability to move others from pontification to execution. Industry professionals must be prepared to get the next generation of development done right when the market rebounds.

While similar predictions for change have been heard at the end of previous downturns, there are three reasons why this time can be different:

- **The changing calculus of value.** Buyers and tenants in the next cycle will be calculating costs and value in a more multidimensional way than ever before. Quality of life, walkability, access to cultural facilities and events, a smaller environmental footprint, and even being part of the "urban vibe" are among a more complicated set of variables that will help users determine perceived value.
- **A leveling of the playing field.** The cost differential for developing responsible real estate rather than commodity real estate is real. It is not only about first costs, but emotional and intellectual investment as well. To help move from policy to reality, a number of forward-thinking government agencies are bringing risk capital and know-how to the table to help level the playing field for developers who choose to focus on responsible rather than commodity real estate.
- **A movement from niche to portfolio.** For years, green building and socially responsible development was the niche of a few forward-thinking individuals. Today, responsible real estate investment is rapidly moving into the mainstream, fueled by institutional investors who see green as a proxy for increased long-term value-an insurance policy against future obsolescence, a sign of higher-quality construction, and a more holistic definition of their fiduciary responsibility.

The destruction of real estate values increasingly correlates with geography. The axiom of "location, location, location" is taking on a new dimension because this past cycle demonstrated an increasing relationship between loss of market value and the least environmentally responsible locations. The calculus buyers once used to determine their housing choice-the farther I drive the more square feet I can purchase-has given way to a more complex analysis. The relationship between increased cost of place-housing cost plus transportation burden-has become more evident in an era pushing toward \$4-a-gallon gasoline. More than just dollars and cents, people are rethinking the time spent in their cars as a virtual tax on their quality of life or family time.

In *Foreclosing the Dream*, William Lucy's 2010 chronicle of trends, demographic changes, and forecasts that can be derived from the current housing crisis, he writes, "Household spending on transportation averages 18 percent, but varies by location. Outer suburban residents average 25 percent of household income for transportation, compared with only 9 percent for households in compact development settings."

Concentric rings circling major urban centers can be used to illustrate measurable value losses based on distance from the core. Almost everyone has a friend or relative in the suburbs whose home value has been halved. As these homeowners consider future purchasing decisions, the safety or volatility of their investment is now another measure of value, perhaps more than granite countertops and that extra bedroom. Similarly, suburban office complexes, far from transit and centers of human activity, are some of the most distressed asset types, either because of increased vacancy rates or loss of asset value.

When the market recovers, it will be accompanied by a new paradigm of households and tenant values. While a core of starter and move-up families remains, it will be flanked by two ends of the demographic spectrum:

- new generation-Y buyers and renters who want the vibe, hipness, and quality of life that accompanies urban center and first-ring suburb locations or new urbanist centers; and
- empty nesters who now want to move back closer to the center of activity, culture, and education.

Value will not be measured in square feet, but in the number and range of activities accessible by foot within five minutes of one's front door. The WalkScore phenomenon-with calculations available at www.walkscore.com-and its increasing role in real estate listings is evidence of this new calculus of value.

New programs such as the U.S. Department of Housing and Urban Development's (HUD) tripartite Sustainable Communities Initiative are a radical approach by the federal government to promote collaboration among agencies and integrate into a holistic view formerly competing and destructive policies affecting transportation, land use, and the environment. The result will focus policy, intellectual power, and funds on making communities places where the whole is greater than the sum of its parts.

At the same time that policies are changing to support more responsible forms of development, government agencies are putting real money where their mouths are. In some progressive corners of the country, these agencies are going beyond just drafting policies in the hopes that the market will fall in line with their thinking. Instead they are bringing real, at-risk dollars to the table to help level the playing field between complex urban settings and path-of-least-resistance exurban sites.

California's Strategic Growth plan dedicates over \$1 billion of its \$2.5 billion budget to infill infrastructure and transit-oriented development. These monies are available to both nonprofit and for-profit developers to help balance the costs of complicated core development versus greenfield sprawl. The Bay Area's Metropolitan Transportation Commission is offering \$31 million in climate innovation grants for planning scalable transportation projects that can reduce greenhouse gas emissions in the region. And at the Urban Land Institute's annual Fall Meeting, the ULI Responsible Property Investing Council toured a number of innovative projects underway or completed in Washington, D.C.'s core. With the mayor's office providing a range of tools-including creative capital structure and matching predevelopment funding-developers are able to offset the increased costs and risks associated with responsible urban development.

Green certifications under the Leadership in Energy and Environmental Design (LEED) program progressed at a rate of nearly 1 million square feet (93,000 sq m) per day last year-an indicator that green building is gaining increased traction in the market. New tools such as the LEED for Existing Buildings Volume Program-simplifying certification of multiple buildings by an organization-also are helping portfolio managers improve existing building stock in greater numbers than ever before.

TIAA-CREF, as the owner of 43 million square feet (4 million sq m) of office buildings, as well as a large portfolio of other commercial and multifamily real estate assets, is one of America's largest institutional real estate investors. In 2007, the company's Global Real Estate group created a dedicated unit called Strategic Initiatives charged with implementing green strategies across the company's entire real estate portfolio. Since 2002, the firm has been an Environmental Protection Agency (EPA) Energy Star Partner, and was recognized by EPA in 2003 for mandating that its entire office portfolio be benchmarked through this program.

In conjunction with these efforts, and in response to growing demand among its clients for investments with environmental/social/governance initiatives, TIAA also formed a dedicated Socially Responsible Investment team in 2006, with separate corporate social real estate (CSRE) and new \$50 million green building technology partnership (GBTP) venture capital investment programs, managed by Cherie Santos-Wuest, director of global social and community investments. The CSRE portfolio strategy can be characterized as a triple-bottom-line strategy, in which portfolio investments endeavor to produce risk-adjusted market-rate returns; measurable social impact, including jobs, income, and community revitalization for low-income residents; and environmentally sustainable construction and practices across portfolio investments.

The dedicated CSRE strategy now totals over \$512 million in commitments. TIAA's history of socially responsible real estate investment began in 1985 with a primary focus on affordable housing. "Back then,

affordable housing was considered to be the sum total of socially responsible real estate investments," says Santos-Wuest. "Today, the basic attributes that make for sound real estate investment have evolved and expanded to include investments in workforce housing, transit-oriented and urban development, and sustainable development initiatives."

It is one thing to dedicate a portion of one's portfolio, or entire portfolio, to responsible real estate. But does it add value, or at least match the returns of investment real estate?

In their study "Income, Value, and Returns in Socially Responsible Office Properties," Gary Pivo and Jeffrey Fisher examined 1,200 office properties in the National Council of Real Estate Investment Fiduciaries (NCREIF) database-accounting for total market value of about \$100 billion-to determine whether elements now considered cornerstones of responsible real estate development added asset value. The study, published in the July/September *Journal of Real Estate Research*, found that with some exceptions, over the past ten years, properties that were Energy Star labeled, close to transit, and located in redevelopment areas "had net operating incomes, market values, price appreciation, and total returns that were higher or the same as conventional properties, with lower cap rates."

The real estate industry is at a powerful inflection point in this painful recession, but therein lies the opportunity. To harness the potential of this moment, the industry must be willing to work differently and fix the institutionalized impediments hampering broader adoption of responsible real estate as a core class. This moment presents a wonderful opportunity to retool the profession, reteach company teams, and expand the definition of value. If the industry more deeply embraces the potential of its collective skill set and its responsibility to society, it has the chance of a lifetime to become *the* profession that positively reshaped the built environment.

See *Six Recommendations for Making the Most of the Recession*

[<http://urbanland.uli.org/articles/2011/mar/heidsixrecession>] for changes in practices, the author states, that will lay the foundation for a more successful outcome when the market returns.



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URBANLAND

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Planning Communities for 2020

By John Martin

At the bottom of each cycle, there are those who identify niche opportunities, imagine concepts, and innovate with communities and housing products that get people back into the market. As the industry emerges from the recent recession-and works to imagine what people want, can afford, and will buy and rent-it ponders this question: what will planned communities look like in the future?

What has changed in the master-planned community development industry and what has stayed the same?

Developers have learned much during the industry's past five decades: that it is a cyclical business, that the market becomes overheated in every cycle, that prices soar and peaks are reached, that demand and prices drop dramatically, and that the tyranny of the urgent obsesses the industry, and it suffers for years. During a market run-up, the true drivers of demand are disguised as the industry produces and sells to meet demand. Then, in the downturn, it become paralyzed and the recovery takes a long time.

Yet, at the bottom of each cycle, there are those who identify niche opportunities, imagine concepts, and innovate with communities and housing products that get people back into the market. As the industry emerges from the recent recession-and works to understand the drivers of demand and imagine what people want, can afford, and will buy and rent-what will planned communities look like in the future?

The first step in envisioning future communities is to identify how households will change in this decade and what it means for master-planned communities in 2020. For this forward look, I analyzed the September 2010 working paper "Updated 2010–2020 Household and New Home Demand Projection" by the Joint Center for Housing Studies (JCHS) at Harvard University. There will be over 10 million more households occupied by people age 55 to 74 at the end of this decade than there are now. Together, the two ten-year age groups from 25 to 44 are adding a total of only 1.9 million households in the next ten years, and there will be 2.3 million fewer households with people in the age group 45 to 54.

As generation Y-those age 14 to 31 in 2011 and 23 to 40 in 2020-grows older and forms new households, demand for family housing will increase. The question to consider is whether the industry should build communities for this market, whether these households will be absorbed into the single-family detached housing located in the planned communities built over the past five decades, or whether they will choose to live in infill locations closer to amenities and services. The dramatic change to acknowledge in this decade is

the loss of those nearly 2.3 million households age 45 to 54-the age at which people typically buy move-up housing and second homes.

An examination of the rise in the number of older households, plus the increase in single-person households and couples without children-which combined will grow by almost 9.5 million by the end of the decade-makes it is easy to see that demand for planned communities in the United States will be different than that previously experienced.

U.S. household growth by race/ethnicity is another guide to how communities should be planned in the future, with minorities projected to account for 70 percent of net household growth between 2010 and 2020.

What do these changes mean for the planning, design, development, and marketing of planned communities in the future? First, the industry must appeal to all age groups, household types, and racial/ethnic groups because communities will be more diverse and intergenerational. The definition of planned communities must therefore expand to include not only new developments with a variety of residential housing types, and the services and amenities to support them, but also existing communities making the transition to serve the needs of the changing population in existing infill and edge locations.

During the "Master-Planned Communities 2020: What Does the Future Look Like?" panel at the ULI Fall Meeting in October, Perry Reader, president of Crosland in Florida, said the original cornerstones of Celebration-a sense of place and community (both social design and desirable gathering places), education and lifelong learning, health and wellness, and technology-are a great place to start in the reinvention of master-planned communities for 2020. Those cornerstones are as appropriate today as they were in 1996 when the industry looked out 15 years to 2010. Since that time, developers have learned the importance of the following:

- Enrolling and partnering with the public sector, the existing community, and environmentalists in the planning process.
- Understanding how future markets will differ from those of today and how people will want-as well as need-to live.
- Being environmentally sensitive and adopting the principles of sustainable development and green building, as well as the methods to implement them.
- Identifying future niche markets and aligning residential products, amenities, and services to address what people want and need as they enter different life stages with changed lifestyles.
- Considering the entire existing community as a potential support system to serve small-scale projects that cannot provide needed amenities and services as a part of new development.
- Planning neighborhoods based on the principles of neighborhood crafting, in which aesthetically pleasing places are created in consideration of homes and commercial space being part of a whole rather than individual structures.
- Designing more compact and affordable homes that integrate seamlessly into neighborhood and village fabrics, with plan interiors that expand to incorporate privacy and outdoor living spaces.
- Creating walkable community environments that feature safety, connectivity, security, public realms, and amenities that are shared by all residents.
- Structuring a diversified product program that addresses consumer segmentation so a wide variety of markets are served.
- Delivering on all promises made through marketing and sales.
- Having a compelling vision and big idea that answers the developer's question, what do we want to create?-a vision that inspires everyone involved to create places that enrich and enhance all who live, work, and play there.


The panel drew several conclusions during its session on the future of the market, each of which needs to be addressed by the industry as follows:

- There will be more renters-both of single-family homes and other kinds of dwelling units-so developers need to figure out how to take advantage of the shift.
- Niche marketing will increase dramatically. Numerous niches exist that the industry has not even begun to understand, and each will have its own nuances. Developers need to consider how they can make money by satisfying one or several of these niches. For example, master-planned communities have not done a good job of dealing with the aging population and how to design for it.

- Ethnic diversity will increase, which will make the industry's current understanding of this niche seem trivial. People in the industry think they understand "the Asian market" or "the Hispanic market," but, in fact, the Asian market is 50 different markets, as is the Hispanic market. Ten years from now, the United States will be even more of a melting pot. Developers need to consider the different needs of the first, the second, and the third generation of immigrants when developing product.
- Fewer people will be commuting by car to work five days a week. Developers need to think about how this is going to affect master-planned communities, houses, apartments, and offices.
- The women's market will require particular attention. It is widely acknowledged that women make the decisions about where they and their families live. And the power they hold in the market is going to grow as their rising wages increase their purchasing power.
- There will be more of a merger between product and services, meaning the merger of a place to live and facilities that provide desired services, be it health care, education, technology, or a sense of community. Developers need to determine which services to provide, how to merge them with the housing product itself, and how to turn that combination into an income stream long term.
- The amount of mixed-use space in master-planned communities will increase because it will boost absorption in both large and small planned communities, allowing the developer to exit sooner. Mixed uses also help create the cool places where so many people want to live. Some mixed use has the potential for value creation, allowing developers to get more money from the pieces in a planned community. For example, people will pay more for the right kind of housing if a restaurant is next door, or to live in a housing project if a daycare center and a school are nearby.
- There will be more global partners and global players in the U.S. master-planned community market. Historically, there have been few—mainly homebuilders and developers from the U.K. or Canada. However, developers need to consider what the impact will be in ten years when the U.S. market has more global players.
- There will be more business model changes as developers work with their homebuilder partners, apartment partners, not-for-profits, churches, businesses, and other partners. The relationships will change and new ways to finance projects will be found. Financing will be a problem, so new relationships with builders and others are going to be important.
- The way planned communities are created is going to change, with developers getting customers, cities, and communities engaged in the development process a lot earlier.
- The industry—which in a lot of ways is prehistoric and dinosaur-like—is going to mature, with developers becoming more sophisticated, and customers benefiting because of it.
- The environment will become more and more important. In 2020, in a world where gasoline may cost \$10 per gallon, changes are coming in how communities are created, how they are planned, and how they handle energy use.
- Severe water shortages are on their way, so dramatic changes are coming in the way water is used in communities ten years from now. Developers should get ahead of the curve now to try to understand the implications of this change.
- The shift to a 24/7 world has implications for a master-planned community where people are active all day and night. Amenities will need to open around the clock, facilities will need to be lighted at night, and safety and security will have to be provided.
- More people will be moving back to the cities because that is where the jobs are, but some companies will be moving away from cities in order to expand.
- The industry is going to be more socially responsible, both for the sake of profits and because it is the right thing to do.
- Planned communities will be denser, becoming taller and taking different shapes and sizes. Consumer segmentation by community developers and homebuilders in planned communities will increase. Segmentation by builders will also increase, with more large, public, national builders entering the market, as well as small and regional builders that can do niche products.
- There will be more branded communities as customers look for trust and reliability. Life stage marketing will increase as developers better understand how to own the relationship with the customer. Because developers work hard to obtain customers, once people move into communities it only makes sense for developers to know what they are going to want five, ten, or 20 years down the road.
- Developers will have to build more flexibility into communities because when 2020 arrives, they will need to be thinking about 2030 and 2040. Developers must ask how their buildings can change over years and decades to have a longer lifespan for customers.

These are exciting times for everyone in the master-planned community business. The real estate industry needs to take these new ideas and look forward. But it also needs to look backward to some of the best planned communities that were built in this country before the Great Depression of the 1930s. Great cities existed 90 to 120 years ago to look back on and learn from as the industry moves forward.



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Housing in America

THE NEXT DECADE

John McIlwain





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Author's Note

Many aspects of the housing market and legislation discussed in the first two sections of this report continue to evolve rapidly. Accordingly, this report addresses the housing market as of March 2010.

Introduction and Executive Summary

The housing markets in the United States are at an inflection point. As the economy recovers from its current turmoil, markets will stabilize, but the old “normal” will not return. Once-nascent trends will emerge as major drivers, creating new markets in new places. Those who fail to understand these new trends will miss opportunities or find themselves building what is no longer in demand.

The first part of this report reviews the current state of the market. Home prices are stabilizing and even beginning to rise in many parts of the country, but overwhelming challenges remain. National housing prices will fall another 10 percent in 2010, until they stabilize in the second half of the year or in early 2011. This projection assumes that job losses come to an end and unemployment begins to decline during 2010.

The biggest challenge to the housing markets today, besides unemployment, is the growing number of homes with mortgages that are “underwater”—that is, with principal balances higher than the current values of the homes that secure them. By the end of 2010, some 40 percent of all homes with mortgages are predicted to be underwater.

The second part of this report looks at the need to reestablish the private-market residential finance system. Today, virtually all housing finance is supported by the federal government through the U.S. Treasury Department, the Federal Reserve, Fannie Mae, Freddie Mac, and the Federal Housing Administration (FHA). To restore the private-market system, Fannie Mae and Freddie Mac need to be reformed or replaced, and the rules governing how mortgages are originated and securitized need to be changed in order for investors to return in large numbers.

Part three looks at long-term trends that are emerging. After the recession, demand for housing will increase. Four demographic groups will drive housing markets for the next decade, each of which is large and facing a unique set of challenges. They are:

- Older baby boomers, who will constitute a senior population unprecedented in size;
- Younger baby boomers, many of whom will be unable to sell their current suburban homes to move to new jobs;
- Generation Y, which will be renting housing far longer than did past generations; and
- Immigrants and their children, who will want to move to the suburbs but may find housing there too expensive even after the current drop in prices.

The population of the United States is projected to grow rapidly during the coming decade. This will produce strong demand for housing once the economy recovers and unemployment drops. However, it is probable that the homeownership rate, currently 67 percent, will fall to levels not seen in two decades. This will produce a strong market for rental housing in the years ahead.

Workforce housing will remain a challenge. Many in the moderate-income workforce will find their incomes constrained and housing in the communities where they work out of their reach despite the current market declines. They will look to the outer suburbs for housing, which is where the least-expensive homes will be found, but the cost



in time and money of long commutes will eliminate any savings. Many who live there will do so not by choice but by necessity.

The movement toward sustainable development will continue in the decade ahead. Interest in energy-efficient, healthy, and environmentally friendly homes will become a dominant trend, given volatile energy prices and the evolution of local, state, and federal building codes. By the end of the decade or shortly thereafter, virtually all new homes will produce most if not all of the energy they use, and the “net-zero-energy” home will be the standard.

The age of suburbanization and growing homeownership is over. The demographics of the next decade indicate that the market for urban living will continue to grow. There will be regional winners and losers as markets recover, and the strongest markets will be found in places that provide a vibrant 24/7 lifestyle. Many central cities will experience strong demand for housing. People who want an urban lifestyle but either do not want to live in a “big city” or cannot afford to will look to live in the many suburban town centers that have been emerging in metropolitan regions across the country.

Shifts in markets present opportunities for those who understand the trends. Over time, a new mode of metropolitan development will emerge, presenting opportunities and stiff challenges. ULI will play an important role in identifying the new markets and working with all levels of government, facilitating development that responds to the new markets and is sustainable in a world challenged by a changing climate and energy demand.

The Next Two to Three Years: Watch Out for Wishful Thinking

The housing markets in the United States are in a state of turmoil not seen in 80 years. Foreclosure rates are at historic highs. Home prices have fallen dramatically and, while stabilizing in some places, are still falling in others. Despite some promising signs, it will take another year or two for all the problems the markets face to resolve themselves, if the economy continues to recover through 2010 and 2011. Reflecting this uncertainty, Moody’s Economy.com forecasts that home prices will fall another 10 percent in 2010 before they stabilize, bringing the decline close to 40 percent from the peak in 2006. Much of this continued drop can be expected in those states already hardest hit.

Home prices had fallen 28 percent by the end of 2009 from their July 2006 peak, according to the S&P/Case-Shiller Home Price Index. By some estimates, U.S. homeowners have lost \$6 trillion in value since the market’s peak. Much of the decline in housing prices, along with many of the foreclosures, occurred in five states—California, Nevada, Arizona, Michigan, and Florida; markets in many other states have experienced only modest declines, and some markets are rising.

There was some encouraging news at the end of 2009: the Case-Schiller Index rose during the last two quarters of that year and the rate of new foreclosures declined. There was an increase in sales of new and existing homes, leading to a decline in the

inventory of unsold homes to around a seven-month supply by the end of the year. The recovery of the stock market, predictions that the recession may be ending, and reduced job losses all suggest that the worst might be over.

However, the situation remains complex and troubling in 2010. Home sales dropped unexpectedly at the start of 2010, showing how fragile these markets remain. As discussed below, the current slowdown in foreclosures may be temporary and there is reason to be concerned about the level of ongoing government support for housing. There was an unprecedented level of government intervention in the housing markets during 2009, such as the homebuyer tax credit, for example, but much of it is scheduled to end in spring 2010.

FIGURE 1: Decline in Median Single-Family Home Prices in Selected U.S. Metro Areas, 2007–2009

Phoenix	-44.6%
Los Angeles	-41.8%
Miami	-40.6%
San Francisco	-33.1%
Atlanta	-24.8%
Washington, D.C.	-24.6%
Chicago	-24.0%
U.S. Average	-18.4%
Minneapolis	-17.9%
New York City	-17.2%
Seattle	-16.9%
Boston	-12.0%
Denver	-6.6%
Houston	5.3%

Source: National Association of Realtors, 2010.

Furthermore, the decline in home prices and sales has occurred during a time when mortgage interest rates have been at 50-year lows. Most analysts predict they will remain low for 2010, though the scheduled end in March 2010 of the Fed's program to purchase \$1.25 trillion in mortgage securities triggers a concern that rates may start to rise. If Fannie Mae and Freddie Mac can pick up at least some of the slack by increasing their purchases of mortgages, such an increase in mortgage rates may be modest and not destabilize the housing markets. To enable an increase in purchases by the government-sponsored enterprises (GSEs), the administration in December 2009 increased the limits of federal assistance that can be provided to Fannie Mae and Freddie Mac and eased restrictions on the size of their mortgage portfolios.



The Continuing Rise in Foreclosures

The biggest obstacle to stabilizing home prices is the threat of a new wave of foreclosures. In 2008, more than 1.7 million homes were foreclosed on or lost by short sale or deed in lieu. Another 2 million were lost in 2009, and Moody's Economy.com projects that 2.4 million will be lost in 2010, an estimate that may turn out to be conservative.

One in seven households with a mortgage was either in foreclosure or in default at the end of September 2009. The default rate was stable at the end of 2009, due largely to the government's Home Affordable Modification Program (HAMP), but still close to 100 basis points above the 2008 rate and eight times as high as in early 2006.

The problem is that HAMP has produced few permanently modified mortgages. Of the 759,000 borrowers signed up for trial modifications through December 2009, only 31,000 had loans that were permanently modified—less than 5 percent of those eligible. HAMP is deferring foreclosures but may not help homeowners avoid them. Data from earlier modification programs also suggest that half or more of permanently modified mortgages default within a year, though the HAMP experience may be better.

Unemployment is one of the two leading indicators of a mortgage default. While short-term unemployment often does not lead to foreclosure, what is troubling in the current situation is that long-term unemployment has risen to levels not seen in decades. It is this long-term unemployment that none of the current mortgage-modification programs can adequately address, as can be seen in the combination of high levels of unemployment and foreclosures and a severe drop in housing prices in places like Michigan, among others. The other leading indicator is a home being "underwater"—that is, having a mortgage with a loan balance higher than the value of the underlying home.

FIGURE 2: Unemployment Trends in Selected U.S. Metro Areas

	Percentage Change in Number of Jobs, 2007–2009	Unemployment Rate
Washington, D.C.	0.4%	6.1%
Houston	-0.4%	8.2%
New York City	-1.1%	8.9%
Boston	-1.3%	7.7%
Seattle	-3.0%	8.8%
Denver	-3.3%	6.8%
Minneapolis	-3.7%	7.0%
Miami	-4.2%	10.6%
San Francisco	-4.5%	10.3%
Los Angeles	-5.1%	11.5%
Chicago	-5.4%	10.3%
Atlanta	-6.9%	10.1%
Phoenix	-9.6%	8.1%

Source: U.S. Bureau of Labor Statistics, 2009.

Underwater Homes: The Sleeping Giant

The number of underwater homes is the sleeping giant of the housing crisis. In 2005, 48.4 million homes had a mortgage. Estimates of how many of those homes are currently underwater vary from 12 million to 16 million—over one in four. Deutsche Bank Securities projects that 21 million U.S. households will have mortgages underwater by the end of 2010, meaning that over 40 percent of mortgaged homes would be at risk, including homes with prime mortgages, as well as those with Alt-A and subprime mortgages. This is a situation without precedent in U.S. history.

Not all underwater homeowners will walk away from their homes; many will continue to pay their mortgages because they can afford to and expect the value of their homes to rise again, or, perhaps, just because they love their homes and want to continue living there. Nevertheless, if only one in five underwater homeowners decides to walk away from his or her home, it would double mortgage defaults over 2009.

Underwater homes also affect the normal working of housing markets. They limit the ability of the unemployed to sell their homes in order to move for a new job, constraining labor market mobility and economic recovery. They stall the move-up market as well because families are unable to sell their homes to buy the next one, and it can lock older retirees into the suburbs, limiting their ability to move, whether to the Sunbelt, to the city, or to smaller homes in nearby suburban town centers.

FIGURE 3: Foreclosure Rate Trends in Top U.S. Metro Areas, 2008–2009

	Properties with Filings	Percentage of Housing Units	Rate of Foreclosure	Percentage Change from Q3 2008
Phoenix	40,566	2.43	1 in 41	18.6
Miami	53,710	2.23	1 in 45	34.7
Los Angeles	69,403	1.58	1 in 63	32.4
San Francisco	22,876	1.35	1 in 74	22.1
Atlanta	24,787	1.17	1 in 85	13.9
Washington, D.C.	19,318	0.91	1 in 110	9.3
Denver	9,235	0.89	1 in 113	-1.6
Chicago	33,065	0.88	1 in 113	28.5
Minneapolis	9,767	0.74	1 in 136	98.7
Seattle	6,495	0.46	1 in 217	37.8
Boston	7,962	0.44	1 in 229	19.5
Houston	8,482	0.39	1 in 256	-8.1
New York City	24,715	0.33	1 in 299	14.7
U.S. Total	937,840	0.73	1 in 136	22.5

Source: RealtyTrac, 2009.



It is hard for any mortgage-modification program to respond to significantly underwater homes. This would require that principal balances of millions of mortgages be substantially reduced at a cost of billions of dollars. This is unlikely to happen despite a new administration program to encourage this. In fact, there is no politically feasible way to help the vast majority of those who are unemployed or who have underwater homes to avoid foreclosure.

Therefore, it is probable that foreclosures will rise and prices will continue to fall during 2010. Given the size of the challenges facing the market, as well as high levels of ongoing unemployment in 2010 and projections of slow job growth in 2011 and 2012, the housing markets are likely to struggle for the next couple of years. Some markets will regain their health, but caution should be the industry watchword regarding home values in many parts of the country for the next few years.

Making the Transition to the Future: Reopening the Private Capital Markets

Virtually all funds supplied to the residential market during 2010 will continue to be the direct result of federal action, as was the case during 2009. All new mortgages in early 2010 were being bought or securitized by the federal government, and private investors have completely exited the market unless there is a federal guarantee. What was once considered the world's most efficient housing finance system, attracting trillions of dollars of investment from around the world, is now shunned by all, both here and abroad.

Bringing private investment back is essential to restoration of a healthy housing finance system. But how and when this will happen is not clear. The economy must improve and jobs return in order for foreclosures to decline and housing prices to stabilize nationally. The infrastructure of housing finance also needs reform; Fannie Mae and Freddie Mac need to be restored or replaced; and the mortgage system needs to be reworked in order to ensure sound underwriting, restored predictability, and transparency.

Efforts in these areas are at an early stage, and it is too early to predict what the final outcome will be. The result, however, will have a fundamental impact on housing markets for years to come. The cost and availability of debt will affect the ability of millions to buy homes or to afford to rent in new buildings, most especially members of generation Y, who normally would be forming their first households in the years ahead.

The Future of Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac have been in federal conservatorship since summer 2008. They own or guarantee half of the nation's \$11 trillion in home mortgages and together with the Federal Housing Administration are responsible for backing nine mortgages in ten made today, far higher than the three in ten they backed historically.

The government had invested \$112 billion in the companies by the end of 2009 to keep them functioning and has committed to double that to \$200 billion. This allowed the companies to generate \$1.3 trillion in single-family mortgage-backed securities (MBS) in 2009, up 39 percent from 2008. Their single-family portfolios have continued to decline in quality: during the quarter ended November 30, 2009, loans in any stage of delinquency increased to 7.6 percent of their combined portfolios. Most of these delinquencies have been in their single-family portfolios; their multifamily portfolios continue to perform well.

The administration said it would offer a proposal for restructuring Fannie Mae and Freddie Mac in February 2010, but failed to do so; it now says it will not present a proposal until 2011, at the earliest. Thus, little is known about what the administration is thinking. However, it is unlikely that legislation reforming the companies will be enacted in 2010, an election year with a shortened and already crowded legislative agenda. Reforming Fannie and Freddie will be extremely controversial.

The Treasury Department announced in December 2009 that it would continue to provide capital as needed to the companies for the next three years to assure investors of federal backing and enable the companies to continue actively supporting housing markets.

When the companies were placed in conservatorship, they were required to begin reducing the size of their portfolios in 2010. In December 2009, Treasury relaxed this requirement. This will allow the companies to continue buying mortgages, which is especially important if the Fed's program of buying mortgage securities ends as scheduled in spring 2010.

There is little reason for the administration to push for reform of the companies at this time. The federal government is now their conservator, regulator, and primary investor. As such, it is able to use the companies as a virtual federal agency, working with FHA, to keep the housing markets liquid and support the administration's mortgage modification efforts. Yet the companies remain "independent" entities because of the technicalities of the conservatorship law, so their liabilities remain off the federal balance sheet.

The time to reform or replace the companies is not until the housing markets recover and no longer need such active federal support. Proposals have ranged from fully privatizing them to making them federal agencies; neither alternative is likely. If they become federal agencies, their liabilities are added to an already swelling federal debt, a sensitive issue these days. Fully privatizing them, on the other hand, raises the risk that there will be no way the federal government can effectively maintain credit flows to the housing markets during credit crises, which seem to occur with annoying regularity once a decade. Housing is too large a part of the U.S. economy and too politically sensitive for the government not to have effective tools to support it when needed.

Nor is it likely that they will exit conservatorship unchanged. The old model is widely viewed as flawed, given the conflicting incentives of maximizing stockholder value and providing affordable mortgages to moderate- and middle-income Americans.



Many proposals walk the line between privatization and turning the companies into government agencies. The Center for American Progress, a think tank with close ties to the administration, has made a proposal that the administration is expected to study closely. It calls for the creation of a number of government-chartered firms, called chartered MBS issuers, or CMI, which would finance certain types of home loans by selling securities guaranteed by the government; the types of loans eligible would be determined by federal regulators.

CMIs would be privately owned, but regulators would limit their profitability and fees would be charged to cover the risk to the government. The government would set risk standards for both the mortgage securities issued by CMIs and those issued by private entities. CMIs would have to support affordable rental housing and could hold only limited amounts of mortgages and related securities.

Suggesting that the obligations of CMIs be federally guaranteed is problematic. This would mean that their liabilities would be part of the federal debt and subject to annual appropriation, as is the case today with FHA. This would inevitably limit their activities and the amount of housing credit they could supply to the sectors of the housing market open to them; in effect, they would become mini-FHAs.

The proposal that the government regulate the private mortgage securitization market as well as securities issued by CMIs will be very controversial. More federal oversight of the private mortgage market is needed, and there is legislation currently in the U.S. Congress to this effect. Many in the industry, however, are strongly opposed to this.

This proposal is only one of many offered, and several include many of the same ideas. The final nature of reform will not be known for several years.

Fannie Mae and Freddie Mac have always stirred contentious debate in Congress, and at present there is no consensus as to whether the two entities should continue to exist in some form or be replaced. The debate on their future, and how the housing finance system for the United States should be reconstructed, will be complex and likely will disrupt housing markets. For this reason, this should be a period of quiet consideration of alternatives and efforts to build as much consensus as possible. The real debates should wait until the markets have more stability and the economy more strength. In the meantime, it will be best that Fannie and Freddie remain in conservatorship and used aggressively by the administration to do what they can to support housing markets.

Reforming the Mortgage Origination and Securitization Process

Reestablishing a robust private mortgage market will require both strong fundamentals and a reformed mortgage origination and securitization structure that eliminates the major abuses of the past years. The incentives among mortgage originators, securitizers, and rating agencies need to be aligned. One way of doing this is by requiring anyone

originating mortgages and then selling or securitizing them to retain a portion of the risk (or “skin in the game”). This should apply as well to those creating collateralized debt obligations (CDOs) or the like.

H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009, voted out of the House on December 11, 2009, on a largely party-line vote, is one possible approach to this kind of reform. Section 1502 would require regulators to define which loans are considered to have an appropriate level of credit risk, and what constitutes sound credit underwriting and due diligence. Originators of loans sold and/or securitized where these standards were not met and where a third party did not take a first-loss position generally would be required to retain 5 percent of the risk. The fate of these provisions or ones similar to them is now up to the Senate, which is crafting its own financial regulatory bill. Chances of final passage of this legislation are uncertain.

If this or similar legislation does pass, it is likely that most mortgage credit will flow largely into the types of loans deemed sound by regulators; originators and securitizers are unlikely to be willing to retain much, if any, of the risk and thereby add to their liabilities and required capital. The result could reduce the volume of mortgage securities in the market and constrain the flow of capital into housing. Some constraint on this flow would be beneficial because one cause of the housing crisis was a flood of too much cheap capital. Overly constraining capital flows to housing, however, will raise the price of capital and thus the cost of housing. This in turn will reduce housing affordability, especially for lower- and moderate-income Americans. Unfortunately, it is hard to predict how much legislation such as that proposed would reduce the amount of capital available for housing or raise its price, nor is there agreement on the right amount of capital and the right price needed to maintain robust but stable housing markets.

In short, as necessary as reform of Fannie Mae and Freddie Mac is, and as much as regulatory improvements are needed to restore confidence in the American housing finance system among investors here and abroad, these changes will alter the amount and price of capital for the housing markets, affecting who can obtain mortgages and at what prices. This, in turn, will affect housing markets for better or worse for decades to come.

The Longer Term: Expect the Unexpected

Early signs of new trends in U.S. housing markets have been present for years now. These trends will become stronger following the recession and affect where people live, whether they own or rent their homes, and the size and style of the homes they choose. These choices, whether made by desire or necessity, will be very different from those made by people over the years since World War II, the period of the great suburbanization of America. The coming decades will be the time of the great reurbanization as 24/7 central cities grow and suburbs around the country are redeveloped with new or revived walkable suburban town centers.



As stated in *The State of the Nation's Housing 2009*, an in-depth overview of trends in the national housing markets published annually by the Harvard University Joint Center for Housing Studies:

The massive shock to housing markets has raised questions about the future strength of demand. Although demographic trends provide a solid underpinning for the long run, market conditions over the next 5–10 years will surely have an impact. A deep, prolonged recession would likely suppress immigration to levels that are never fully made up. Moreover, such conditions might even lead to enduring changes in household formation behavior.

(The State of the Nation's Housing 2009, Joint Center for Housing Studies of Harvard University [Harvard Joint Center], page 4.)

Andrew Grove, cofounder of Intel, wrote in the preface of his 1999 book *Only the Paranoid Survive*, “Sooner or later, something fundamental in your business world will change.” He continued:

[S]trategic inflection points do not always lead to disaster. When the way business is being conducted changes, it creates opportunities for players who are adept at operating in the new way. This can apply to newcomers or to incumbents, for whom a strategic inflection point may mean an opportunity for a new period of growth.

The housing markets in the United States are at such an inflection point and will not be returning to the old “normal.” In the years ahead, a fundamentally new “normal” will emerge, based on the trends and drivers discussed below.

Demographics as Destiny

Metropolitan growth and decline are driven by demographics. Globally, not only is more than half the population of the world now living in urban areas, but also all future population growth is projected to occur in urbanized areas. In developing countries, the impact is enormous, with over 1 billion people currently living in urban slums of the developing world, a number that is growing rapidly.

The United States has the third-largest population in the world and is adding more people each year than all but six other countries; if current trends continue, the population of the United States will rise to 438 million in 2050 from 308 million today. Of that increase, 82 percent will be attributable to immigrants arriving between 2005 and 2050 and their U.S.-born descendants, according to the Pew Research Center. During this period the non-Hispanic white population, now a majority, will become the largest minority (47 percent) as its numbers increase more slowly than those of other racial and ethnic groups.

The four major demographic waves in the United States to watch are:

- The aging baby boomers, the oldest of whom are now in their mid-60s.
- The younger baby boomers in their late 40s and early 50s.

-
- The children of the baby boomers, variously called generation Y, the millennials, the next generation, the net generation, or the echo boomers—a group that is still growing through immigration. Together with the baby boomers, they account for over half of the U.S. population.
 - Immigrants, their children, and grandchildren, whose numbers are growing more rapidly than “native-born” households.

Older baby boomers. There are 78 million baby boomers, the oldest of whom will turn 65 in 2011. From then on, the population of seniors is projected to grow at a faster rate than the total population of the United States.

The boomers are really two cohorts—the older group, age 55 to 64; and the younger group, age 46 to 54, now in or entering what should be their prime earning years. Between these two, the younger group is larger, accounting for two-thirds of the cohort; only the older one-third is approaching retirement this decade.

The boomers have redefined every age they have entered, and the older ones will do so again. They do not yet see themselves as aging; “60 is the new 50” is their view. Some have begun to retire, but most will push back full retirement for years both because they are working at jobs they enjoy and because they need to rebuild their retirement funds.

In the coming decade, fewer of the older boomers will be moving. Those who have not yet sold their suburban homes find themselves trapped as falling home prices have left their homes worth less than the mortgage—or mortgages—on them. It will take years before home prices rise sufficiently to restore their lost equity. Those who can move are no longer flocking to the Sunbelt, choosing instead to move closer to their children and, more important, their grandchildren.

This older baby boomer cohort is healthier and more energetic than its parents. The move into retirement and life care communities will be deferred for a decade or more unless these housing forms adapt to the desires of this new group of young seniors. As a result, the market for housing for seniors will grow more slowly than expected.

This older cohort is entering an urban phase: a 2009 survey by real estate advisory firm RCLCO found that 75 percent of retiring boomers said that they want to live in mixed-age and mixed-use communities—that is, in urban settings. Not all will want to move to the central city, so walkable, urbanized suburban town centers will see an influx of aging boomers.

This trend can be seen in the early success of urbanizing town centers such as Bethesda, Maryland; Reston Town Center in Reston, Virginia; and White Plains, New York. Many of these projects are now stalled due to the collapse of the condominium and resale market, but many of those boomers who can sell their homes will move to these centers, helping them thrive during the decade ahead.



Younger baby boomers. The younger cohort of boomers is facing very different challenges. They have decades before they need to consider retiring, and their children are likely to be still at home, either because they have not left yet or because they have returned after leaving. Many find their suburban homes now underwater, and even those not underwater will be hard to sell. The older boomers sold their suburban homes to the larger population of younger boomers looking to move up; today, in contrast, the move-up market is much smaller because the younger boomers have members of the much smaller generation X, now in their late 30s to mid-40s, to sell to.

Generation X is also made up of smaller households, is a more urban generation, and is facing distinct economic challenges. The Harvard Joint Center reports:

Real median household incomes in all age groups under 55 have not increased since 2000. In fact, for the first time in at least 40 years, there is a chance that the real median household income for these age groups will be lower at the end of the decade than at the start. Moreover, the severity of today's economic contraction could hold down incomes and wealth for years to come.

(The State of the Nation's Housing 2009, page 12.)

This will suppress prices for suburban homes for years to come, making it hard for the young boomers to move. The reduced prices of these homes and their larger size, however, make them an attractive option for larger immigrant families, though only if prices are low enough to be affordable for this population, which generally has more modest incomes. As the Harvard Joint Center notes:

The housing now occupied by many older white baby boomers will be well suited to the needs of younger and generally larger minority households. With their lower incomes, however, minority households may be unable to afford these homes when they come onto the market. Indeed, the ongoing adjustment in house prices across the country may help improve affordability in the short term, but it is unlikely to bridge the gap completely.

(The State of the Nation's Housing 2009, page 15.)

The younger boomers are facing flat incomes, lost equity in their homes, and a smaller group of move-up buyers. The market for large suburban homes will be weak over the coming decade, and it is likely that there are already enough large suburban homes to meet the market demand for the coming decade despite the growing U.S. population.

The second-home market also will be weak in the coming decade. The younger boomers are at the prime stage for buying a second home, but most will be unable to afford one because of diminished earnings, tight credit, and the lack of equity in their first home on which to draw for a downpayment on their second. Only those second-home markets that appeal to the wealthiest will remain strong, though there may be opportunities for lower-cost but well-designed smaller second homes.

Generation Y. There is no precise definition of generation Y, but generally it is made up of people in their late teens to early 30s and accounts for some 83 million people. It is distinct in many ways from previous generations. A growing number of studies report on this group as it becomes the dominant force in the economy. These studies, ULI panels, and personal experience reveal a picture of a generation that is not revolutionary, but that nevertheless will produce radical evolutionary changes. For instance, there are now more women in colleges and universities than men for the first time in U.S. history, and women are earning 60 percent of the master's degrees. Women are on the way to dominating the workforce.

Stephanie Siejka of RCLCO speaks of WINKs—"Gen-Y women with income and no kids (and typically no spouse or partner, for that matter)." Many more women in this generation are living alone than are their male counterparts.

This is the generation of the online social network and "herding"—the ability to meet at a moment's notice at a social gathering place, such as hip local coffeehouses, bars, or other "third places." They value community highly, and ideas, information (not always correct but often corrected by the widespread online network), and opinions flash among them at speeds that leave older generations unable to keep up. Reputations are made and lost in weeks, and good reports can lead to a sudden surge in business just as fast as a bad report can kill a once-promising enterprise. They move and think quickly and multitask easily, and are also committed to a healthy work/life balance: they will work hard, but not at the expense of time with family and friends.

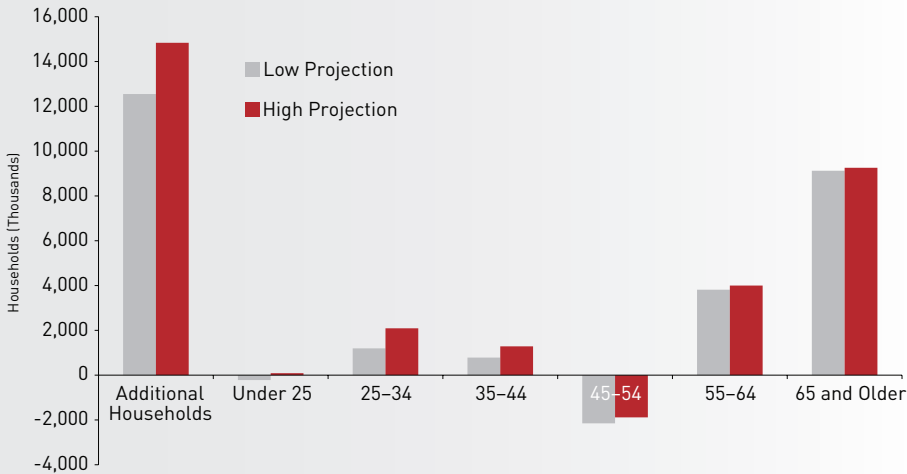
Many are active and socially responsible, and they volunteer in large numbers, looking for ways, especially online, to improve the world. They are acutely aware that they will live through unprecedented changes in the climate and will be affected in unpredictable ways. They also know they are the last generation to grow up with endless supplies of cheap carbon-based fuels. They can expect to live well into their 90s, and they will see a dramatically different world at the end of this century than the one they were born into. They are the greenest generation yet.

They value diversity and do not see differences in race or ethnicity as barriers to be overcome; what older generations think of as barriers they do not even notice. Instead, they cluster around educational levels and cultural affinities, which are frequently created by a mix of traditions from other cultures. Consider this the generation of fusion.

It is an unpredictable generation. They have been more immediately affected by the current recession than other generations. Brought up as the "credit card kids," they now find that after college and graduate school there are few jobs and large school loans to pay off. Yet generation Y remains an "aspirational generation," as one member put it, saying, "We want to live differently than our parents and believe we can have what we see on TV."

This generation will be income constrained. The U.S. Census Bureau reports that during the past decade, incomes of those 25 to 34 years old have fallen 12 percent for men and 3 percent for women. This is unlikely to change in the coming decade and will result in most of generation Y living more modest lives than their parents with little money for housing.

FIGURE 4: Projected Shift in Household Numbers, by Age Group, from 2010 to 2020



Source: Harvard Joint Center for Housing Studies, *The State of the Nation's Housing 2009*.

Household formation is suppressed today by high unemployment. Though generation Y is at the traditional age of the highest rate of new household formation, that rate in the United States has fallen by more than half in the past two years. A primary reason for this is that the trend, begun during the 1990s, of people in their 20s returning home to live with their parents has increased due to the recession. Others in generation Y have doubled and tripled up on housing or gone back to school to weather the storm. Once there are jobs for them again, members of generation Y will move into the housing market in large numbers, creating new demand.

As figure 4 shows, even though generation Y is a larger cohort than the baby boomers, it will have a smaller impact on housing markets than did the boomers. This is because the difference in size between generation Y and the boomers and generation X is much less than the difference between the baby boomers and all generations that preceded them. The baby boomers dwarfed all previous generations in numbers. As members of generation Y form households, they will add to demand for housing—reversing the decline caused by generation X—but not to the extent that the baby boomers did. They are also forming households later than previous generations, further reducing their impact on housing demand. Meanwhile, as the older boomers age and move into the 65-to-75 age bracket, they will replace the much smaller “greatest generation” that precedes them.

Generation Y’s attitudes toward homeownership have been changed by the housing crisis and the recession. The number of people trapped by underwater homes that cannot be sold and the millions of foreclosures are tempering their interest in buying their own homes, and they will be renters by necessity and by choice rather than homeowners for years ahead.

They have to pay off school loans, and the “bank of dad” and “mommy money” have disappeared as their parents struggle to rebuild their retirement portfolios. They have lost the confidence of previous generations that homeownership is a way to develop wealth. Instead, they believe that they will have to save for retirement, especially since they have a low level of confidence in the future viability of Social Security.

They say they want to live in urban areas: a 2008 survey by RCLCO found that 77 percent of generation Y reports wanting to live in an urban core, not in the suburbs where they grew up. They want to be close to each other, to services, to places to meet, and to work, and they would rather walk than drive. They say they are willing to live in a smaller space in order to be able to afford this lifestyle.

The ability of most of this generation to afford urban living will be limited, however, and once they have school-aged children, they will look for good public schools. To find them, they will either work to improve the schools in the cities in which they live, which will make a great contribution to those cities, or they will move to the suburbs, as generations before them have. However, they may move to the older, closer-in, and less-expensive suburbs or to compact suburban town centers rather than to low-density culs-de-sac of the outer suburbs.

To get members of generation Y to buy their first home, builders will need to offer starter homes in large numbers at low prices—meaning homes that are small, simple, and on small lots, but that are well designed and built to green energy standards. This is hard to do, except in the outer-edge suburbs. For this reason, many young families will look to live in the older, close-in suburbs where prices have fallen or be forced to move to the outer-edge suburbs where home prices are lowest, regardless of the higher cost in dollars and time of long commutes.

This will be a big change from the past, when people moved to the outer suburbs by choice in order to find a newer, bigger home. Over the coming decade, many of those who move to the outer suburbs will do so reluctantly and will miss the sense of community and the amenities they value. In addition, their suburban homes will appreciate in value slowly, if at all, because their major appeal will be their low price.

This provides a major opportunity for developers to create new outer-edge communities with real town centers and urban amenities. Even on the outer edges, a compact, walkable lifestyle that is affordable will be attractive to income-constrained young families, especially if it provides transportation alternatives.

Immigrants. It is estimated that there are 40 million foreign-born people, both legal and illegal, now living in the United States, accounting for about 13 percent of the population. Their impact, however, is far greater when their U.S.-born children and grandchildren are included. Immigrant households are 50 percent more likely to live in poverty than are other households—even though more immigrant households than native-born ones have at least one worker—and they generally have lower educational levels.



The Latino population, already the nation's largest minority group, is projected to triple in size from its current level by 2050 and, combined with other minorities, will account for over 70 percent of the nation's population growth. Hispanics are projected to make up 29 percent of the U.S. population in 2050, up from 14 percent in 2005.

This growth is increasingly a result of births in the United States rather than immigration. Of the 117 million people added to the population between 2005 and 2050 through immigration, 67 million are projected to be the immigrants themselves and 50 million are projected to be their U.S.-born children or grandchildren. For this reason, the Latino and Asian populations are expected to have younger median ages than the rest of the population as whole.

Experience has shown that immigrant populations move to the national norms in education, incomes, and lifestyles after the first generation. What impact the current recession will have on this trend is unclear, except that it is likely to slow immigrants' growth in incomes and wealth. This in turn is likely to slow their progression to homeownership.

Immigrant populations naturally cluster together. Over the past two decades, these clusters have moved from the central cities, where they tended to gather in the past, to the inner suburbs. It is not clear yet whether they will make the jump to the next ring of suburbs. Latinos tend to favor larger homes because they often have larger and multi-generational families living in one house. This would lead them to favor moving to those suburbs with larger homes, if they can afford them. On the other hand, they frequently like living closer together, not isolated from one another, and with a greater sense of community than most people experience in the suburbs. This suggests that the established cul-de-sac suburbs may not be attractive to them.

The Demand for Housing and the Future of Homeownership

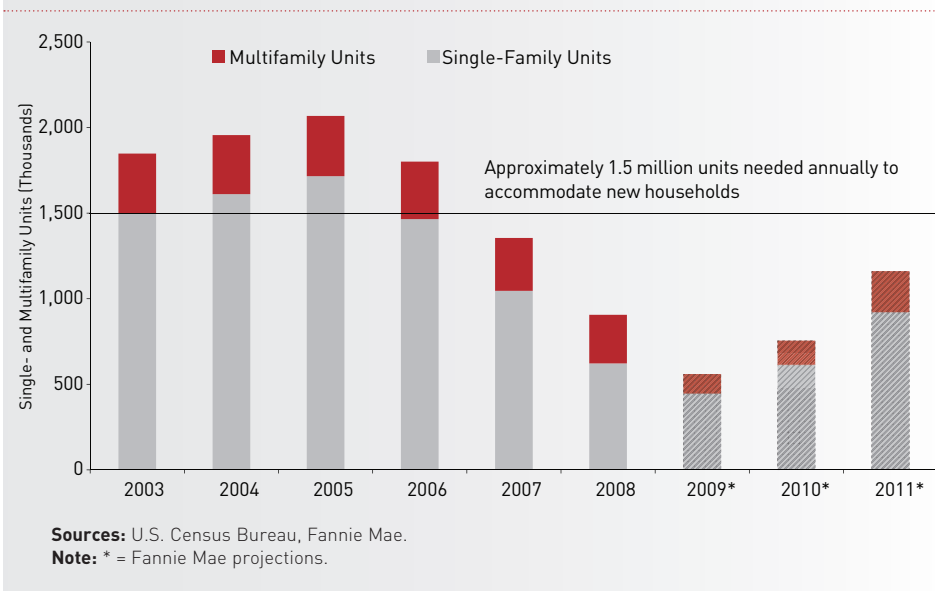
The U.S. population is growing at a rate of 2.5 million to 2.8 million people per year. The size of households, however, has been on a long-term decline: it was 4.6 people in 1900, 3.38 in 1950, and 2.6 in 2000. Recently, however, it has begun to increase slowly due largely to immigration. The fastest-growing segment in household size recently has been single-person households, most of which are made up of women. Going forward, the Harvard Joint Center projects that

[m]arried couples without children (including empty nesters) will be the fastest-growing household type, followed closely by single-person households. While the number of married couples with children will fall by nearly a million among whites, it will increase by more than a million among Asians and Hispanics.

(The State of the Nation's Housing 2009, page 15.)

There will be an ongoing and robust need for housing production in the decade ahead. The Harvard Joint Center projects that from 1.25 million to 1.5 million new households will be formed annually in the coming decade.

FIGURE 5: Construction Starts for Single- and Multifamily Units: Fannie Mae Projects a Slow Recovery



The current recession, however, has dramatically suppressed natural household growth in the past two years. IHS Global Insight, a leading economic consultancy, reports:

According to the 2009 Annual Social and Economic Supplement to the Current Population Survey (CPS), the number of households increased by 398,000 between March 2008 and March 2009. This was the smallest increase since 1983, and the second-smallest increase in the history of this statistic, which dates back to 1947.

(Patrick Newport, "U.S. Household Formation Is Down Sharply," IHS Global Insight's online *Perspectives*, Dec. 16, 2009.)

This compares with an increase of 1.63 million from March 2006 to March 2007 and constitutes a 75 percent drop in household formation over two years during which millions of young adults graduated from high school and college. When jobs return, there will be a surge in housing demand caused by those who would have formed a new household but could not do so, along with those just coming into the housing market.

Over the past decade, housing production topped 2 million homes a year, far greater than demand. This has led to the collapse in production today: only 600,000 homes were started in 2009. This number is projected to rise to 800,000 in 2010, but it is still below what is needed to meet new household demand when the economy recovers. The percentage of new housing production that is multifamily will increase as production returns because most new households will be members of generation Y and immigrants, both of which will be renting in large numbers. This will be reflected in a decline in the homeownership rate.



From 1900 through 1930, homeownership levels fluctuated from 45 to 48 percent, until the Great Depression and World War II brought it down to 43 percent in 1940. Following the war, the great suburbanization of the United States raised homeownership over the next two decades to 62 percent in 1960, driven by a booming economy, rising real incomes, favorable tax laws, a rejuvenated homebuilding industry, and easier financing.

The homeownership rate then fluctuated between 62 and 64 percent for the next 30 years. It only began to climb above 64 percent in the 1990s and the first decade of the current century, spurred by administrations of both parties adopting national policies designed to encourage homeownership, and by a growing flood of low-cost capital flowing into the housing markets. In 2005, the rate peaked at 69.9 percent. It has been falling steadily since then and reached 67.2 percent at the end of 2009. It will continue to fall.

One factor in this decline is demographics. The Harvard Joint Center notes:

[D]emographic forces—especially the shift toward minorities, who have much lower ownership rates than whites—in fact worked against homeownership gains. Indeed, if homeownership rates by age, race/ethnicity, and household type had remained at 1995 levels, demographic trends alone would have reduced the homeownership rate by a full percentage point over this period.

(The State of the Nation's Housing 2009, page 13.)

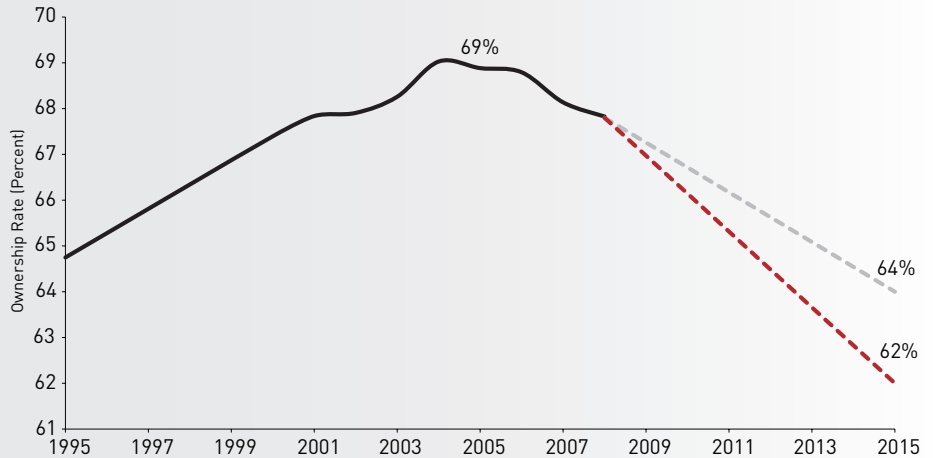
The recession has accelerated this decline, largely through the influence of rising foreclosures and the drop in new household formations noted above.

As the economy recovers, it is unlikely that the homeownership rate will return to 69 percent. There are many who believe that U.S. housing markets will return to the same condition as before the recession. Among other things, they look to generation Y to revive the homeownership market because many of its members are at the prime age to become first-time homebuyers. However, as noted above, this generation will rent far longer than previous generations. Other factors, such as constrained credit flows to the housing markets in the years ahead and generally flat or declining incomes, will also act as a drag on the homeownership rate.

For all these reasons, the homeownership rate is likely to fall back to the low 60 percent range, where it was before 1990. This is also the range predicted by Sam Zell, the billionaire Chicago real estate investor, at a ULI meeting in New York City in January 2010. Arthur C. Nelson, director of the Metropolitan Research Center at the University of Utah, has also suggested that this is where the rate will finally settle.

To put this in perspective, homeownership rates in the European Union range from the low 40 percent range to 85 percent in Spain. There appears to be no magical rate that produces a stable economy and community, and the experience of the 30 years from 1960 to 1990—when the country prospered despite a homeownership rate in the low

FIGURE 6: U.S. Homeownership Peaked in 2004; Where Will It Stabilize?



Sources: Harvard Joint Center for Housing Studies, *The State of the Nation's Housing 2009*; ULI projections.

60 percent range—should be reassuring in this regard. Further, an unduly high homeownership rate can act as a drag on labor force mobility, especially today when many workers are unable to sell their homes to move to areas with jobs.

A school of thought exists that extols the virtues of homeownership for community stability and for educational and health benefits for children. However, new studies are raising questions about these results, suggesting instead that it is housing stability that is the key factor in producing positive outcomes, not whether a home is owned or rented. In short, there is no reason to believe that a homeownership rate in the low 60 percent range should be of national concern.

If, on the other hand, a confluence of circumstances conspires to produce a homeownership rate in the 50 percent range, this will be a game changer for the United States. The most likely cause for such a low homeownership rate would be a prolonged or double-dip recession, followed by a slow recovery. What the impact of this would be on the economy, local communities, and people is hard to predict, but it likely would be problematic at best.

Unfortunately, the decline in the homeownership rate will have a disparate impact on different racial and ethnic groups whose homeownership rates already differ widely. For example, in 2004 the homeownership rate was 76 percent for the white population, 60 percent for Asians, 49 percent for African Americans, and 48 percent for Latinos.

As the overall homeownership rate declines, this disparity is likely to grow because disproportionately large numbers of African Americans and Latinos were victims of predatory lending practices: by some estimates, almost half of all loans in default are



held by African Americans. Both African Americans and Latinos already have lower levels of income and wealth and higher unemployment rates than the white community, so the impact of these high rates of default and foreclosures is likely to significantly lower their already low levels of homeownership. This raises questions about the future efficacy of programs designed to use homeownership as a way to build the wealth of members of these communities.

Affordable and Workforce Housing

Home prices are reaching levels of affordability not seen in years. The median sale price for existing homes nationally was \$164,900 in March 2010, down from \$221,900 in 2006, according to the National Association of Realtors. Likewise, the U.S. Census Bureau reports that the median price for a new home has fallen to \$216,600 from \$247,900 in 2007. Nor are prices expected to rise rapidly in the future. The rate of appreciation likely will revert closer to long-term norms—a disappointment to those who came to believe that the double-digit annual price increases experienced in the decade before 2006 were “normal.”

Robert Shiller, a Yale economist and cocreator of the Case/Shiller index, has shown that over the long term, housing prices generally rise about 0.75 to 1 percent per year over the rate of inflation. Nic Retsinas, director of the Harvard Joint Center, expects a somewhat better performance, projecting that home price growth will average about 1.5 percent above inflation over the next decade. This would equate to an average increase of about 3.5 percent per year—based on the Federal Reserve’s long-term inflation forecast of an average 1.7 to 2 percent. These rates of real growth reflect a return to an older “normal”—a normal that precedes the past decade during which prices rose and fell at unprecedented rates.

Whether the coming decade will be a period of steady growth in housing prices, albeit at the more moderate rates of the past, remains a question. On one hand, the population is expected to grow steadily in the years ahead, and once job growth returns, household formation will also recover. Urban markets are expected to be strong, so they may show above-average rates of price growth. On the other hand, affordability will be a problem for the large group of generation Y and immigrant first-time homebuyers. Housing prices in the outer-ring suburbs, which have been hard hit by foreclosures, are likely to remain flat for years to come, and large homes in the second-ring suburbs may not appreciate much due to a shortage of move-up buyers. Therefore, the rate of price appreciation will depend largely on location of the home, as it has historically.

For many Americans who are already homeowners, this means their homes will rise only modestly in real value over time. This will be especially troublesome for those whose homes are underwater, because it may take them many years to regain equity in their investment.

This raises as well the issue of whether homeownership is a good way to build wealth. Some studies show that over the long term, the value of a home does not grow as fast as investments in the stock or bond markets, though many of these studies do not take

into account the leverage of a 70 percent or higher mortgage and the forced savings of paying down an amortizing mortgage.

Nevertheless, with only gradual appreciation to look forward to, and the high transaction costs of purchasing and selling a home taken into consideration, home buying as a way to build wealth makes sense only for those who plan to stay in place for ten years or more. Few in generation Y will be able to do this for many years; instead of necessity, they will be moving from place to place as they build the foundations of their careers.

Modest price increases in the years ahead would seem to be good news for people looking to buy their first home. The problem is the location of those homes that have lost the most value: it is those on the outer suburban edges and in certain hard-hit inner-city neighborhoods that have become the most affordable. First-time homebuyers will find themselves once again forced to “drive until they qualify,” leaving behind the communities in which they work in order to obtain a mortgage.

This is a false economy, as has been demonstrated by recent studies by the ULI Terwilliger Center for Workforce Housing: the savings in home price are often more than offset by the greater cost of transportation to jobs and to all the services it takes to support a home and lifestyle. The Terwilliger Center’s recent Priced Out studies of home prices in the Washington, D.C., and Boston metropolitan regions and the San Francisco Bay Area show that for members of the moderate-income workforce, housing remains largely unaffordable in the urban areas and closer-in suburbs where many of them work. Absent aggressive local policies to provide for a mix of housing in the closer-in suburbs, those in the workforce who fail to take into consideration the cost of transportation will continue to move far from the communities in which they work to find what they believe will be a more affordable home.

There is, however, a growing awareness among many people, especially members of generation Y, of the false savings involved in buying a less-expensive home far from jobs and services. As the cost of gasoline continues its inexorable rise in the years ahead, this false economy will become more obvious. For this reason it is probable that many people in the market for a new home to buy or rent will be willing to pay more for housing if it significantly reduces their costs of transportation. The Terwilliger Center’s Cost Calculator for the San Francisco, Boston, and Washington, D.C., metropolitan regions is designed to enable people to directly calculate this trade-off between housing and transportation costs and provide a more comprehensive estimate of the total “cost of place” in deciding where to live. It is expected that this will help more members of the workforce understand that they can in fact afford a somewhat more expensive home closer to work because of savings in transportation costs.

The Future of Rental Housing

The rental vacancy rate in the United States was 8 percent at the end of 2009, the highest level since 1980. At the same time, rents fell 3 percent. These conditions are projected to continue through 2010 and into 2011 as units started in 2007 and 2008 come

on line. Multifamily starts are down almost two-thirds from their peak of two years ago. In contrast, the years 2012 through 2014 may be very good for the multifamily housing market. If the economy has recovered by then, as many economists predict, and unemployment falls back to 6 or 7 percent as expected, it will spur demand for rental housing—and housing in general—because household formation should rebound. There will be little new multifamily product on the market, however, due to the low rate of starts today. Some experts predict increases in rents in 2012 of as much as 4 to 6 percent; a similar strong increase in rents is expected for 2013. This represents only a 1 percent annual increase from 2007 levels, so even these higher rents should generally be affordable to the members of generation Y and immigrants who will constitute the primary market.

Longer-term trends also favor both rental housing and multifamily housing in general. The falling homeownership rate, the wave of gen-Yers deferring homeownership, and growing urbanization will increase long-term demand for rental and multifamily housing.

The Greening of Housing: From Here to Net Zero in Ten Years

The movement toward greener, more energy-efficient construction has been gaining momentum since before the recession. Most green buildings, however, have been commercial structures, and among residential buildings, most of those certified green have been multifamily. The certification of single-family homes has been growing more slowly. While the number of homes that have met one green standard or another is now over 1 million, that is still less than 1 percent of existing homes. Most standard homes built today, however, are far more energy efficient than ones built only a decade ago, even without a green certification.

Anecdotal evidence from builders still in the market suggests that homes that meet a green standard are selling better than those that do not, so long as any premium in price is modest and offset by energy savings. This is despite the fact that most homebuilders remain skeptical about the benefits of building green in marketing their homes. Surveys show that more than 50 percent of homebuyers want a green home, but most are unwilling to pay much more for it. The challenge is to develop technologies that reduce energy use at no extra cost and to promote other sustainable practices that cost the same as or less than standard practices. Many of these technologies are available today, though they are not yet widely known or understood.

What is considered green is evolving and standards for certification are changing—especially regarding energy efficiency—a trend that will continue. Local building codes are requiring more efficient homes, and provisions for a national building code are contained in the current cap-and-trade legislation pending in the U.S. Congress. Energy prices are expected to remain volatile, which will add support at the local, state, and national levels for tougher standards for energy use in homes and all construction. This volatility will also increase market demand for homes that use less energy, especially among members of generation Y, which is expected to produce the largest wave of new households in U.S. history.

Standards, markets, and technologies are evolving and a new goal is emerging—the net-zero-energy home. Most definitions of this model describe a home that buys electricity from and sells electricity into the national grid. These homes are heavily insulated and built with smaller, highly efficient heating, venting, and air-conditioning systems. They produce electricity with solar- and sometimes wind-powered systems. Because renewable energy systems like these produce energy only when the sun and wind are available, these homes need to draw power from the grid. On the other hand, they also produce more power than they need at certain times. During these periods, they sell electricity into the grid—often during times of highest demand such as the daytime, which also happens to be the most inefficient and costly time for power companies to supply energy. If the homes are well built, the net energy sold can exceed the amount purchased, thus adding to the overall energy supply in the community.

A few net-zero homes are being built in Europe and the United States. Their cost is somewhat higher than that of standard homes, but this premium will diminish. The pace at which their production increases, and the pace at which the energy efficiency of homes in general increases, will depend on various factors, including the cost of energy, local standards, and national policies seeking to reduce dependence on foreign energy sources and the impact of energy use on the climate. Whatever the pace, this trend will continue until the net-zero-energy home is the standard for newly built homes.

The Urban Century: Reurbanizing the American Suburbs

Many factors are converging to shift housing markets from the traditional American cul-de-sac suburb to a more urban lifestyle. This includes not only those central cities with a vibrant 24/7 downtown, but also the newer form of suburban town center that is emerging in the suburbs of metropolitan regions around the country. Among those factors are the following:

- Married couples without children—including empty nesters—will be the fastest-growing household type in the decade ahead, followed closely by single-person households. Because these households generally do not determine where they live according to the quality of education for their children, they are not drawn to the suburbs for their better schools.
- The aging baby boomers are either staying put in their suburban homes or, if and when they can, selling them and leaving the suburbs to move closer to jobs in the city and to the city's urban amenities.
- The younger boomers have already moved to the suburbs; this large outward migration is now over. Their next move, when it comes, will be either within a suburb or, more likely, to a more urban location as they follow the older boomers back to the city.
- The primary group of move-up buyers for new suburban homes is generation X, a significantly smaller group than the baby boomers. Their ability to sell their existing homes is constrained by the market today, and many find themselves with homes that are underwater. When they do move, they are likely to find that there is already a sufficient supply of modestly priced existing suburban homes to move up to. The market for new suburban homes thus is likely to be quite small.
- Few members of generation Y will be ready to move out to a traditional suburban cul-de-sac for another ten years, at least.



As popular as many 24/7 cities have become, there are many people who want a more urban lifestyle but want to stay close to their friends in the suburbs, do not want to live in the “big city,” or simply cannot afford to live downtown. These people will be looking to live in suburban town centers that can provide real urban amenities—namely, a wide mix of housing, stores, and services; a vibrant, diverse community of people; and an attractive, walkable central area. Those areas that have good public transportation within them and transit links to the city and other parts of the region are likely to be the most successful. For these reasons, there will be an “enormous market for more urban lifestyles within the suburbs,” professor Ellen Dunham-Jones of the Georgia Institute of Technology said at a recent ULI Conference on Sustainable Suburbs.

The trend toward greater urbanization was already well underway in many cities across the United States before the recession. A study released in 2009 by the U.S. Environmental Protection Agency titled *Residential Construction Trends in America’s Metropolitan Regions* shows that there has been a striking move back to the urban core in many markets. In other markets, this reurbanization is small but growing; elsewhere it has been negligible.

The study looked at the 50 largest metropolitan regions in the United States from 1990 to 2007 and concluded that “. . . in roughly half of the metropolitan areas examined, urban core communities dramatically increased their share of new residential building permits.”

For example:

- In 15 regions, the central city more than doubled its share of permits.
- In the early 1990s, New York City issued 15 percent of the residential building permits in its region. During the early part of the past decade, it averaged 44 percent.
- Over the same period, Chicago saw its share of regional permits rise from 7 percent to 23 percent, while the share in Portland, Oregon, rose from 9 percent to 22 percent and in Atlanta, Georgia, from 4 percent to 13 percent.
- The increase has been particularly dramatic during the past decade; data from 2007 show the shift into the central city continuing in the wake of the real estate market downturn.

This acceleration of residential construction in urban neighborhoods reflects a fundamental shift in the real estate market. In fact, if core urban suburbs—that is, those closest to the central city—are included, more than half of all residential permits in New York City, Chicago, and Los Angeles were in the urban core in 2007, the highest level in decades.

Suburban town centers are demonstrating great market resilience. In the Washington, D.C., metro region, for instance, housing prices in places like Bethesda, Maryland, and the Ballston-to-Rosslyn corridor in Arlington, Virginia, have remained stronger through the current recession than those in the outer suburbs, such as Loudoun and Prince William counties.

Public policy is changing as well. Policies at the federal, state, and local levels are beginning to encourage more compact development in an effort to reduce oil use and cut emissions of greenhouse gases by cars and trucks. After all, the greenest energy-efficient building located in an outer-ring greenfield uses more energy than an average building in an urbanized area.

The challenge presented by this reurbanization is that once the economy recovers and household formation resumes, the demand for urban housing will greatly outstrip the supply. This imbalance is likely to continue for the rest of the current decade and beyond. Producing enough urban housing to meet this demand, even in the close-in suburbs, requires infill development, which is time consuming and costly.

The obstacles are well known: hard-to-assemble and expensive land; intense opposition to development from community leaders; overly democratized development review processes; complex and often out-of-date planning, zoning, and building codes; and more complex and expensive construction types needed to obtain economic densities. Efforts are being made at the local level to address these problems, but unless a radical and revolutionary shift occurs in thousands of localities across the country, all too many members of generation Y and immigrants will be forced to move well away from the urban and suburban town centers they would choose were housing there available and affordable.

The challenge for ULI is to help bring about the radical reformation of local rules needed to permit faster and more affordable infill development. ULI also can help the industry better understand the importance and opportunity to be found in building communities on the outer edges that contain real urban town centers and housing affordable to the whole range of the market. Active and farsighted public policies may help these outer-ring suburbs grow into new satellite towns, much like the garden cities envisioned so long ago by Ebenezer Howard.

Regional Winners and Losers

As metropolitan regions urbanize, not all will grow at the same rate. As often happens, even during a time of continuing population growth, some regions will grow slowly or not at all. Which these will be is likely to shift from what has been the case in past decades.

Job growth and population increases go hand in hand, and it is often hard to tell which is the driver and which is the result. The migration to the Sunbelt, for instance, produced millions of new jobs as homes, stores, and other amenities were created for the newcomers.

This trend has seen a sharp shift in the past year. In December 2009, the U.S. Census Bureau reported that the Sunbelt migration had come to a sudden halt. Population growth in four of the fastest-growing states has stopped. In Arizona, population growth has slowed precipitously, dropping the state to eighth in the country in overall growth from first three years ago. Florida, Nevada, and California experienced net out-migration for the first time in decades.



Florida's case is particularly dramatic. It has fallen from being the state with the most net domestic migration for July 2001 to July 2005, to 45th from July 2008 to July 2009, with a loss of 31,179 people to other states. In terms of its total growth rate—including foreign arrivals and departures—Florida now ranks 32nd, down from third in 2002.

Similarly, Nevada has fallen to 17th in total growth after leading the country from 2000 to 2004. It now ranks 36th in domestic migration, losing 3,801 people after adding more than 170,000 from other states from July 2003 to July 2006.

Texas, on the other hand, was the big winner, adding 231,539 people from July 2008 to July 2009, more than any other state, and also more than Florida, Arizona, California, Nevada, and Colorado combined. Other states improved their positions as well. Massachusetts, New York, and New Jersey, for instance, are holding on to more residents than in past years. Likewise, California's net loss to migration dropped to 99,000 people as of July 2009, down from 313,000 three years ago.

Future scenarios may include 60 percent of U.S. population growth in the coming decades occurring in 20 "megapolitan" regions, as noted by Robert Lang, director of the Brookings Mountain West Center at the University of Nevada–Las Vegas. "Imagine a contiguous span of populated land from Portland, Maine, to Richmond, Virginia, the joining of Carolina's Research Triangle with Georgia's Atlanta, the meeting of the Puget Sound and the Willamette Valley," says Charlie Hewlett of RCLCO.

These sudden shifts in migration patterns may be either signs of things to come or temporary blips. What is clear is that cities with strong 24/7 downtowns have fared better during this downturn than those without. The same is true in the suburbs: the inner suburbs and suburban town centers have fared far better than the outer suburbs, demonstrated by stronger home prices and lower foreclosure rates.

The other factor in determining which metropolitan regions will be winners and which losers in migration patterns is the economy of the region. This, in turn, is affected by whether the region is deemed a desirable place to live by those in the top, limited talent pool of educated and creative workers. For this reason, cities such as Seattle, San Francisco, San Jose, Los Angeles, San Diego, New York City, and Washington, D.C., are likely to do well over the longer term. Even Miami, despite experiencing one of the steepest drops in home prices in the United States, is likely to recover over time as long as it continues to be viewed as the capital of South America.

Conclusion

The most difficult issue to predict is the impact of the current housing crisis on those who have suffered the most from it. Six million or more households will have been forced out of their homes by the current wave of foreclosures by the end of 2010—over 15 percent of all households with mortgages—with more foreclosures expected in 2011. This will affect 12 million to 15 million people, including children and young families. Their credit will be impaired for the next ten years and their housing options limited.

The emotional impact of the foreclosures on children and their parents and disillusionment about the “joys” of homeownership will be intense; new attitudes toward homeownership and the American dream will emerge. The need for housing assistance is already greater than what the federal government can meet. State and local governments are cutting budgets and reducing services as tax revenues decline, especially in areas of high foreclosures. The impacts of this crisis will extend well into the future.

About the Author



John K. McIlwain is a senior resident fellow at the Urban Land Institute and the ULI/J. Ronald Terwilliger Chair for Housing. As the senior resident fellow for housing, McIlwain's responsibilities include leading ULI's research efforts to seek and promote affordable housing solutions in the United States and other countries, including development and housing patterns designed to create sustainable future environments for urban areas.

In addition to his research activities at ULI, McIlwain is chairman of the Center for Housing Policy and a past president of its affiliate the National Housing Conference, an umbrella organization in Washington, D.C., addressing low-income and affordable housing issues. He is a past president of the National Housing and Rehabilitation Association. He is currently on the boards of the Community Preservation and Development Corporation and the International Housing Coalition, and on the advisory board of the Capmark Community Development Fund.

Before joining ULI, McIlwain founded and served as senior managing director of the American Communities Fund, a venture fund founded by Fannie Mae and dedicated to investing in hard-to-finance affordable housing. In this capacity, he was responsible for structuring, underwriting, and closing equity investments in more than \$700 million of residential and neighborhood retail developments in lower-income communities around the country. He also structured, negotiated, and closed more than \$100 million in historic tax credit and inner-city equity investment funds with Lend Lease, AEW Capital Management, and the Community Development Trust. Before taking that position, he was president and chief executive officer of the Fannie Mae Foundation.

Before joining Fannie Mae, McIlwain was the managing partner of the Washington law offices of Powell, Goldstein, Frazer, and Murphy, where he represented a broad range of clients in the single- and multifamily housing areas. McIlwain received a law degree from New York University, where he worked for the *New York University Law Review* and was a John Norton Pomeroy Scholar. He received a bachelor of arts degree, cum laude, from Princeton University.

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