

The Need for Alternatives to the Nineteen Standard Real Estate Product Types

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Retrofitting the suburbs is the challenge for the current and future generations of planners, designers and developers just as downtown revitalization was that which defined the efforts of the last. Many obstacles stand in the way of this vision. Among them are the difficulty of rewriting local zoning codes, the obstinacy of local officials, objections from neighborhood groups to change in any form, and the inexperience and sometime hostility of the development community. But the biggest challenge will be obtaining financing.

The best design ideas are worthless unless money can be raised to build them. The massive American (and, more and more) worldwide real estate finance system operates according to well-understood decision-making rules. Those rules once produced older suburbs, and they are currently producing even lower-density communities on the elusive fringe.

Learning how this system works, and how it may be influenced to accept different models, should be one of the top concerns of advocates of change. A brief history lesson is an important place to start.

Real Estate Is Dead, Long Live Real Estate

During the 1980s, the American real estate industry engaged in the largest building boom in the country's history. More office buildings went up during that decade than since the founding of the Republic¹; huge single-story industrial buildings were constructed that could contain multiple football fields; and retailing evolved to produce what we now call big boxes in power centers. The vast majority of this space was built in the suburbs at low suburban densities.²

To finance this building boom, real estate developers borrowed billions of dollars from the savings and loan industry, commercial banks, insurance companies, pension plans, individual investors, and others. Unfortunately... the developers forgot to pay much of it back.

In the most spectacular real estate failure since the Great Depression, the overbuilding of the 1980s resulted in the massive financial hangover of the early 1990s. Much of the S&L industry went bust, a significant amount of the equity base of the banking industry was lost, some of

Take the neighborhood retail center product type. It is today built on a 12-to-15-acre site located on the going-home side of a four-to-eight-lane highway that carries a minimum of 25,000 cars per day. It is shaped in an L, with about 20 percent of its site covered by 100,000-150,000 sq.ft. of one-story stores. The stores will be placed away from the highway, though there may be a couple of out-parcels for fast-food, chain restaurants, or banks. At its ends, it will be anchored by a 45,000-55,000-sq.ft. chain grocery store and a 15,000-25,000-sq.ft. chain drug store. In between will be the outlets of smaller national and regional chains. Furthermore, the drug store, bank, and fast-food restaurants will all have drive-up windows; the bulk of the site will be covered by asphalt; and behind the stores will be a driveway for trucks to deliver goods and haul away trash. In terms of market, such a neighborhood center will serve at least 20,000 households in a two-to-three mile radius, whose incomes will be at or above the national median income level. Virtually everyone will get there by car.

This form of center will be the same, whether located in Southern California, New Mexico, or Virginia. However, at the last moment, the center in Southern California may have Mediterranean tiles added to its roof, the New Mexico center may have fake vigas applied to give it an adobe pueblo look, and the Virginia center will receive a brick Williamsburg facade.

Such a design may seem excessively crude to most architects. But from a finance and marketing standpoint, there is good reason why the neighborhood retail center is less architecture than billboard: it needs to catch the eye of the motorist passing by at 35-65 miles an hour. In the nanosecond the driver can devote to it, it must yell back grocery store!

Predictability, Not Innovation

Resistance to such restrictive formulas has already been tried. When REITS came on the scene in the 1990s, two initially attempted to develop and own mixed-use, walkable places that did not conform to the standard product types. One, Federal Realty, built the notable Bethesda Row outside Washington, D.C., which combined ground-floor retail with housing and office above. With structured parking hidden behind, this was one of the first Main Street projects in the country.

The other was Post Properties. Working closely with Andres Duany and his architecture and planning firm DPZ, it aspired to becoming the first New Urbanist developer. Today its best-known projects include Riverside in Atlanta and Addison Circle in Dallas, both mixed-use

housing projects with some ground-floor retail wrapped around structured parking.

Unfortunately, in the late 1990s both Federal Realty and Post Properties fired their visionary CEOs and reverted to conventional, single-product development. The message was clear: Wall Street did not like experiments.

Today, building a nonconforming real estate development makes financing significantly more expensive and difficult to obtain. Most equity investors and bankers, who may have spent much of the past twenty years specializing in a single product type, will not know how to evaluate the financial projections, and will simply refuse to underwrite the risk. Those willing to invest in something different will insist on a higher level of compensation.¹¹

With financial power vested in Wall Street (not to mention that most zoning codes essentially mandate the nineteen product types) how can anyone even think about building anything else? Do those who want to retrofit the suburbs to more dense, walkable patterns have a prayer of success? If smart growth is needed to contain sprawl, reverse the obesity epidemic, and begin to curb greenhouse emissions, is there any hope?

There may be. Although it may not be possible to change the multi-trillion-dollar real estate market, it may be possible to manipulate it through a strategy of co-optation.

Alternative Types

If the suburbs are to be retrofitted, alternative standard product types need to be invented that are mixed-use, integrated into a complex urban framework, and allow access by multiple transportation modes especially walking. Below are some such possible new standard real estate products, along with built examples from the city of Albuquerque.

For-Sale Housing/Office over Retail. Built up to the sidewalk of a walkable street, its ground floor will have rental retail space, while it will have for-sale housing or office space above. Parking can be located in an adjacent or immediately accessible structure, either above ground, underground, or between the retail and for-sale housing or office. Lower-density projects might use surface or tuck-under parking.

One example is the Gold Avenue Lofts, which fits 32 for-sale housing units, nine for-sale offices, and 11,000 sq.ft. of rental retail on an 11,000-sq.ft. parcel in downtown Albuquerque. Cars park in an immediately adjacent garage with direct access to the units by a dedicated elevator. While the density is 160 units to the acre, four times higher than anything ever built in the market, much lower densities could also be encompassed in this product type.

The Nineteen Standard Real Estate Product Types 1st Quarter, 2005

These real estate products are the easiest and most acceptable to the conventional investment community. They are generally single product type, stand-alone developments with self-contained parking, though some mixed-use developments are now possible.

Income Products		
Office	Industrial	Retail
Build to Suit Office Mixed Use Urban Office/Retail/Restaurant Medical Office Multi-Tenant Office	Multi-Tenant Bulk Warehouse Build-to-Suit Industrial	Grocery Anchored Neighborhood Center Big Box Anchored Power Center Lifestyle Center
Rental Apartments	Miscellaneous	Hotel
Garden Apartments Urban Apartments	Self-storage Mobile Home Park	Budget Motel
For-Sale Products		
Entry Level	Move-Up Housing	Luxury Housing
Retirement	Resort/Second Home	Hotel
Includes a variety of segments, e.g., assisted living, independent, etc.)		

Burying the Big Box behind Retail and Office/Housing. This type locates a big-box retailer in the middle of a block and surrounds it with individually designed buildings with retail on the ground floor and either office or housing above. Parking for the big box, retail and office users can take place off site, while parking for those who live there can be located immediately adjacent or underground.

An example of this type is the Century Theater Block in downtown Albuquerque. It includes a 50,000-sq.ft., fourteen-screen movie theater surrounded by seven buildings, totaling 60,000 sq.ft., with rental retail on the ground floor and rental office space above.

High-Density Rental Housing surrounding a Parking Structure with Retail at Grade. Pioneered by Robert Shaw, formerly of Post Properties, this is a four-story stick-built apartment building that buries an immediately adjacent parking deck. The first floor can have rental retail to serve

the built-in market above as well as a local or regional market.

An example is West Village in Uptown Dallas. This project includes 176 rental units and 130,000 sq.ft. of specialty retail.

Retail with Office or Artists Lofts above. This product pairs rental retail on the ground floor with rental office or live-work space above. Developers have long struggled with what to do with the floor or floors above Main Street retail space. Artist loft space is inexpensive to build, provides activity 24 hours a day, may spin off a retail gallery, and can result in rents that make it feasible.

An example of this type is the historic San Ysidro Block in downtown Albuquerque. This has five rental retail spaces on the ground floor and 22 artists work lofts on the second floor.



Subhead

There are undoubtedly many other types that might help establish alternatives to the sprawl-producing nineteen standard products. But all will need to be documented from the perspective of market acceptance, design and most importantly, financial performance. To be considered conforming, the real estate and finance industries will also need to be educated about how these products work.

The most hopeful indicator that such a strategy may bear fruit is that a significant number of consumers who want such alternatives. Market research by firms such as Robert Charles Lesser & Co. and Zimmerman-Volk has shown that between 30 and 50 percent of target populations want to live in mixed-use, walkable places.¹²

Even more powerful is research involving visual preference surveys that has been conducted by Tony Nelessen. This involves showing people multiple images of walkable

places and conventional sprawl and then asking them to rank the desirability of each. Without exception, during hundreds of surveys across the country, Nelessen has found that people selected the walkable places.¹³

Despite such findings, the sprawl-producing nineteen standard types continue to maintain an iron grip on the development process. Worse, while born in America, they are now being exported to the far corners of the world. The second beltway around Paris looks like a slightly smaller version of the third beltway around Houston, complete with big-box retailers and office campuses. Glorious Prague, closeted from Western real estate practices until the fall of the Iron Curtain, now has a freeway from Germany that is flanked by a super-regional mall, a power center, car dealerships, and fast-food restaurants. Of course, the greatest need for alternatives may come from China, home to a current building boom that makes the

1980s American boom look miniscule.

There is much romance to being a revolutionary outsider. But those of us who wish to bring real change to suburbia by retrofitting have a choice to make. We can stay outside the world of Wall Street-dominated real estate finance, discuss, and (occasionally) design and build precious, expensive alternatives. Or we can work hard to develop new product types that the mainstream can understand, accept, and prosper by developing and owning.¹⁴

Notes

1. 1.2 billion sq.ft. in the thirteen largest metropolitan areas vs. 910 million sq.ft. in the same thirteen areas since the eighteenth century. See Robert E. Lang, *Edgeless Cities: Exploring the Elusive Metropolis* (Washington, D.C.: Brookings Institution Press, 2003), p. 54.
2. Robert Lang estimated that 69 percent of new office space was built in the suburbs during the decade of the 1980s (see Lang, *Edgeless Cities*, p. 54). But his statistics are conservative since they only include speculative, multitenant office space. They do not count owner-user office space, which in the experience of this author, has and continues to be built in the suburbs, though there is no data available to confirm this.
3. Importantly, the Japanese economy had an even worse financial hangover from the 1980s economic and real estate boom. Unfortunately, the Japanese government did not take the same drastic measures the RTC did in the United States. These included taking over bankrupt financial institutions, writing down their real estate assets, and aggressively putting them back into circulation. Many economists think this failure to act, particularly with regard to the real estate bust of the late 1980s and early 1990s, was a major contributor to the stagnation of the Japanese economy through 1990s and into the early part of this decade.
4. This has now increased to where it is larger than the market for corporate debt. In 2004 U.S. corporations issued \$1.2 trillion in new debt, compared to \$1.4 trillion of new commercial and residential real estate debt. The real estate figure is rather impressive considering there was no secondary market for real estate debt twenty years earlier. See Gretchen Morgenson, "Wanted: Credit Ratings. Objective Ones, Please," *New York Times*, Feb. 6, 2005.
5. Cohen and Steers is the largest family of REIT mutual funds. See FAQs about REITs at www.cohenandsteers.com
6. Christopher B. Leinberger, *The End of Real Estate, Urban Land*, 1996. Available at www.cleinberger.com.
7. William J. Bernstein, *The Birth of Plenty: How the Prosperity of the Modern World was Created* (New York: McGraw-Hill, 2004). See chapter four, *Capital*, p. 133.
8. This list was developed by the author using various real estate industry financing sources, such as NetFunding.com. The list changes over time as products become overbuilt, thus falling off the list; the market becomes undersupplied, thus coming back on the list; or new products are created, such as lifestyle retail in recent years.
9. In a discussion with the president of a regional-mall REIT in 1999, the author asked why his company would not even consider building a mixed-use (housing over specialty retail), walkable Main Street component in the parking lot of a flagship mall. The president pulled out a recent front-page story from the *Wall Street Journal* that took his company to task for having a construction company that built and remodeled the company's properties. The story reported that investors thought the firm was not sticking to its knitting, which ought to consist only of developing, owning and managing malls. Getting into the separate business of constructing them was considered a diversion. According to the president: "If Wall Street will not let me construct my own malls, they would flay me for building mixed-use developments."
10. There is no commonly accepted terminology that precisely defines the character of different parts of U.S. metropolitan areas. In 1995 the author defined these as urban, suburban, and semi-rural, using floor-area ratios as a guide. This definition was first used in an article in *Urban Land* entitled "The Changing Location of Development and Investment Opportunities". The article is available at www.cleinberger.com. Also see Lang, *Edgeless Cities*.
11. This is done by increasing the rate of return for the equity invested, or by increasing the interest rate of the construction or other loan.
12. Most of this research is proprietary for individual clients of investment firms. In the case of Robert Charles Lesser & Co., which the author has been Managing Director of for 25 years, consumer research in Atlanta, Detroit, Albuquerque, El Paso, and other cities, using the same survey instrument, showed that between 31 and 37 percent of a scientific sample from throughout the metropolitan area wanted to live in walkable communities. The availability of such communities in those metropolitan areas is probably under 5 percent of the housing stock.
13. Anton Clarence Nelesen, *Visions for a New American Dream: Process, Principles, and an Ordinance to Plan and Design Small Communities* (Chicago: American Planning Association, 1994).
14. Christopher B. Leinberger, *Building for the Long-Term, Urban Land*, 2003. Available at www.cleinberger.com.