

# What To Look Out For In 2017's Real Estate Market

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The real estate market can be volatile and unpredictable in any given year, and 2017 looks like it will be no exception. While politics grabs the headlines and creates the most unpredictability, other factors are also creating uncertainty. This article reviews the issues that will affect real estate in 2017, and we begin with the biggest factor of 2016: the political arena.

## Politics

We will soon have a real estate developer in the White House, and that will have a profound effect on the market. What's to expect other than general support of real estate projects? A quick look at the president-elect's statements during the campaign indicate that stimulating America's economy will be his top priority. It seems that real estate will lead the way in his plans, and two fields stand out as possible areas of special attention.

The country's infrastructure needs updating and appears to be an area on the development front that can give some quick "wins" as the market (i.e., need) is determined and the buyer (government) typically has the money to pay for it. The possible downside to infrastructure improvement as an economic vehicle is that permitting requirements can be expensive and time-consuming, and can quickly bog these projects down. However, look for a hands-on approach and personal involvement to speed up the process much like the negotiations to keep some of Carrier's jobs in the United States. As a developer, the president-elect has familiarity with public-private partnerships (P3s) and the P3 model offers several attractive characteristics: they are highly visible (they typically involve public meetings and news coverage and can show that something is being done), they lower the risk for the developer (as the government picks up a good portion of the cost), and they reduce the cost to government (as the developer shares in the cost). Certainly expect an infrastructure and P3 push, and we may even see some combination of the two.

Politics will affect different areas of the country differently in 2017. Look for the Trump campaign's focus on "heartland issues" to carry over to the White House, and look for projects that focus on rural America, especially those that create jobs, to receive a good deal of attention next year. The major metropolitan areas on the coasts will certainly receive their fair share of coverage, but cities will now have to compete with rural America for attention and dollars. In addition to infrastructure, look for renewed construction on industrial projects in less-populated areas, especially those that create manufacturing jobs, as one of the possible outcomes of the election.

Politics will also impact state and local government, but probably in a different way than the federal government. Republicans now hold 31 governorships and control 32 state legislatures throughout the country. The prediction at the state level? Look for reduced state spending and expenditures unless that particular state can come up with creative ways — such as the P3 structure — to spend tax dollars. The same can be said for local governments, especially those in urban areas, but for different reasons. Cities have been hit with declining tax bases for several years, but citizens increasingly ask for more services. Look for local government to come up with creative ways to find funds for additional services without raising taxes, and expect these creative ways to impact businesses and real estate projects.

### ***Bank of America Corp. v. City of Miami***

A case pending in the United States Supreme Court is a good example of local government looking for additional revenue without raising taxes. The City of Miami sued Bank of America for violating federal fair housing laws by, in the words of the Eleventh Circuit Court of Appeals opinion, "... steering minorities toward [] predatory loans" and causing "minority-owned properties throughout Miami to fall into unnecessary or premature foreclosure, depriving the City of tax revenue and forcing it to spend more on municipal services (such as police, firefighters, trash and debris removal, etc.) to combat the resulting blight." The City of Miami won at the Eleventh Circuit, and its win is being appealed to the United States Supreme Court by Bank of America. The ramifications of a win at the Supreme Court cannot be overstated as lenders might be forced to make lending decisions with an eye toward whether their actions are creating "blighted areas." The actual outcome of a win for the city is a little harder to predict. On one hand, a win for the city may produce increased and more efficient lending in traditional minority neighborhoods. However, it is also possible that a win might produce an avoidance of minority neighborhoods by lenders (presuming that doing so does not impact other laws). And considering the possible monetary scope of an opinion in favor of the city, the financial impact on lenders nationwide cannot be discounted.

### **Drones**

Drones have begun to fundamentally change our lives, and their impact on real estate will be no exception. We are aware of using drones to scout and to sell real estate from an aerial perspective, but these devices are bringing a host of legal issues to the fore. To begin, consider that an owner of fee simple real estate owns, under the historical real estate principle, from the center of the earth to the heavens. If that principle is still viable, then drones that fly over our properties without permission are trespassing. Likewise consider that commercial property owners as well as community associations must now cope with people using drones over their property, including possible liability issues. And while the Federal Aviation Administration has promulgated rules and seems interested in regulating the commercial use of drones, the agency seems to take a much more hands-off approach to noncommercial use of drones. In other words, the FAA is going to let private owners deal with many of the issues that drones present, and real property owners will probably be the ones making law on this front.

### **RideSharing and RideMatching**

Uber, Lyft and other ridesharing/ridematching services have revolutionized the use of automobiles in urban areas. A product of technological advances, these systems combine sophisticated GPS, smartphones with apps that "call" a ride, and social networks to create a connection between riders and drivers; often at a cheaper price than traditional taxi services. In addition to decreasing the need for cars, these ridesharing systems are changing the way we use and plan our cities. For example, future demand for parking lots will probably decrease as ridesharing increases and the need to store cars decreases. Likewise, fewer roads may be needed to handle the reduced number of cars traveling the streets. And those cities and real estate projects that take ridesharing into account when planning (for example, designing a project with pick-up and drop-off lanes so as not to snarl traffic) will become more desirable, especially considering the new group of real estate buyers entering the market.

### **Millennials**

The commentators don't all agree whether it's because of an improving economy, growing up (and older) or other factors, but most agree on this point: the millennials are leaving Mom and Dad's basement and moving out. The probable result? Increased demand for more apartments and homes. But don't expect developers to bring traditional products to market to capture the attention of these new buyers; these shoppers are more environmentally and socially conscious. And because of ridesharing and other social programs, they probably won't be buying cars to go along with the new apartment. They will, however, be technologically savvy and will demand a different product than their parents did.

## Federal Reserve and Interest Rates

It's a foregone conclusion that interest rates will rise, most probably in a moderate fashion. All indications are that we will follow historical trends with an interest rate rise, i.e., that higher rates will make construction of new projects more expensive but will only moderately affect cap rates in the short-term and will not negatively affect long term property performance. But new construction will get more expensive, and this creates pressure when combined with the next point of discussion.

## Construction Labor

One of the persistent themes of our recent election was the issue of immigrant labor in the United States. And it is reasonable to assume there will be increased pressure on immigrant labor in light of the outcome. This is, of course, a matter of concern for the construction industry as some reports place the percentage of foreign-born workers in the construction industry to be around 23 percent. And these reports further state that of this group, the great majority (53 percent) come from Mexico. Again, one of the possible outcomes of the election may be that many foreign born workers leave this country and create a shortage of construction labor. And a shortage of labor leads, of course, to increased labor costs for projects.

## Conclusion

To sum up, the real estate market appears in flux at this time with a political need for increased real estate development from the federal government but possible decreased interest from state and local government, the strong possibility of increased costs, changing social norms as to technology, a possible landmark case involving the Fair Housing Act, and a large population segment with pent-up demand starting to dip its toes into the real estate market.

Two types of projects seem well-positioned to succeed in this environment: infrastructure and mixed-used projects. National level infrastructure projects will fulfill campaign promises of stimulating the economy in a short period of time, and for those projects employing some form of P3 structure, bring the additional promise of containing costs. On the private, nonpublic level, the uncertainty of the marketplace and financing costs, legal issues and changing demographics may compel many developers to hedge their bets with a product that can be repositioned as the market comes into more focus: mixed use projects. In addition to being popular with many urban planners and with cities, these projects can adjust commercial, retail or residential mixes as the market changes and can often do so without wholesale changes to the entire project. As such, they present an attractive vehicle for development in a rapidly changing environment.

The coming year will be unpredictable in many ways, but also offers a good number of opportunities for those watching the tea leaves and making the right bets on politics, technology, demographics and costs. And the best part of 2017 is there will be no general election so the real estate market should come into better focus as the year progresses.

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