2016 Spring Members' Meeting Summary

The Spring 2016 Members' Meeting began with a Wednesday evening dinner at the Rittenhouse Hotel with speaker Adam Grant '65, Professor of Management and Psychology at The Wharton School, speaking on his latest book, "Originals: How Non-Conformists Move the World."

Thursday's day of panels opened with remarks from Spencer B. Haber, CEO of H/2 Capital Partners LLC and Chair of the Center's Advisory Board at Wharton, and Joe Gyourko, Nancy Nasher and David Haemisegger Director, Zell/Lurie Real Estate Center.

Todd Sinai, Professor of Real Estate at The Wharton School, moderated the first panel, The Political and Economic Outlook and Real Estate, with panelists Joe Gyourko and Peter Linneman, Emeritus Professor of Finance and Business & Public Policy at Wharton.

The United States' economy is a few months shy of eight years of expansion, said Sinai. "The whole thing has felt fragile and sluggish. How is the economy doing now and what is your forecast?"

Gyourko said the economy is chugging along with little chance of accelerating; he is not as optimistic as he has been. "We're okay. Not great."

Linneman reminded Sinai that with consumer confidence remaining about average, it's unlikely that the economy would be headed for a recession. "It occurs when you think it can't." He talked about the rebound of employment figures as a positive, and said the economy is "burdened by a slow single-family housing sector that will remain handicapped as long as interest rates remain low."

In the long run, the issue is broader, said Gyourko, who believes there is little probability of a boom in single-family. "Savings rates have to go up a bit, but that's hard to do when there's no interest. This is an issue that's not going away anytime soon."

Discussions then centered on the theory that Millennials are delaying marriage, children and home-buying, followed by the merits of the auto sector.

Last year was a great year for auto, said Gyourko. "The pent-up demand was partially satisfied, and this year it will weaken but still be strong."

“There is a mythology that there’s a sector that drives the economy,” said Linneman. “In good times, auto and housing go up historically. This time, housing is abnormal.” Then he pointed to the energy sector; net oil imports went down and we’ve saved money overall, but 85 percent of what people save on oil has already been spent, he claimed.

Energy costs show up in places other than at the pump, and savings are split across 320 million people, Linneman added.

Sinai then wondered what the Fed policy is in general, now and going forward. Linneman and Gyourko split their opinions over the Fed’s actions, with Gyourko having more sympathy. “They are starting to see the risk of capital misallocation—to administratively control prices. There is not a lot of demand to invest in new projects at any interest, which is why growth is sluggish.” He believes the Fed will raise rates one more time this year, to 75 basis points.

Linneman added that at zero, or artificially low rates, “There’s no urgency to do anything with money… I’ll mis-price or hang onto my money and wait.”

The panel then discussed the risks from abroad especially from China—where there is wasted investment and growth has become risky—and in Europe, where Germany has growth at 2 percent and “they’re seen as the dynamo,” said Linneman. “We see that as unacceptable performance. We are the growth engine, the most certain bright spot, in terms of absolute growth.”

The upcoming British referendum to leave the EU might pose a risk to Europe. “Will it matter to us?” Sinai wondered. Linneman and Gyourko agreed its departure would change the status quo and that is always risky. “The risk to the U.S. is a huge policy mistake that is contagious to us,” said Gyourko.

“Domestically, the biggest risk is from bad policy,” he added. “The U.S. is the strongest major economy out there. The dollar will remain strong, and a sudden, surprise Chinese devaluation is the biggest risk. China is not as economically strong as we thought five years ago.”

The discussion turned to domestic politics and the impending election. They agreed that whichever candidate won, policy would be less interventional and the president would be more pro-market than President Obama. “That means we’ll be good over the long haul,” said Linneman.

The election’s effect on the real estate market will be negligible, according to Gyourko. We’ve already moved back to regional recessions wherein different markets are underwritten differently. “In the crisis, everything moved together and that’s not happening now and won’t happen whoever wins. Supply differs sector by sector and the downturn will come in supply/demand imbalances, worse than we had two years ago,” he predicted.

Linneman agreed that the risk (to investors) of a recession is higher today than two years ago because, in part, nothing was being built then.

Asuka Nakahara, Associate Director, Zell/Lurie Real Estate Center, moderated the second panel that posed the question, What is the Future for Retail?

The panelists were Dana Telsey, CEO, Telsey Advisory Group; Wade McDevitt, CEO, McDevitt Company; Lane Gerson, Co-Founder, Jack Erwin; and Dean S. Adler, CEO and Co-Founder, Lubert-Adler Management.

Significant changes have taken place in the real estate landscape, impacting investors. Mergers, department store meltdowns and bankruptcies have changed how retail performs. “From an investor’s perspective, there has been a transformational change,” said Adler.

The other three panelists discussed the proliferation of bricks and mortar stores that also have strong online presences, giving consumers the option to buy online and pick up in the store. Such omnichannel retailing is driven by those younger consumers who crave a “true four-dimensional experience,” said McDevitt. “They want [shopping] to be experiential, so the challenge is to create a compelling destination and opportunity.”

“This integration of channels allows for personalization, and provides them the access they want,” added Telsey.

The experience of browsing in a store with helpful salespeople “has been lost over time,” stated Gerson, who said that Jack Erwin, an online provider of high-end men’s dress shoes, provides a “curated online experience.”

The group discussed the relative merits of store size, location and type of retail, agreeing that those characteristics vary by market. Overall, the restaurant /food business is a good example of ongoing success. Innovative, unique offerings have made inroads in the market, displacing some older brands. “Food is one of the biggest drivers of demand,” Adler summed up. “You can find community in restaurants, cafes and coffee shops… you have choices while allowing for socialization.”

Nakahara wondered about the impact of technological advances: “What about drone delivery and self-driving cars? What is impacting retailers?”

Again, the consensus was that the answer varies by market and target consumer. “Technology has enabled ease of purchase… and can provide something unique that wasn’t there before,” said Gerson. He cautioned against the proliferation of data that can muddy the waters. “Differentiate what you want out of technology and be discriminating.”

“Use technology to be both on the defensive and on the offensive in being competitive and getting relationships with your customers,” said Adler.

No matter the business, being aware of your target consumer and market is critical. “Be thoughtful. This marketplace is intimacy on a larger scale,” said McDevitt.

“Stick to the fundamentals, add creativity and entrepreneurship, and provide something unique,” advised Adler.

The day’s keynote address, Strategic Perspectives on Global Opportunity in the Private and Public Sectors, was presented by Kenneth M. Jacobs, Chairman and CEO of Lazard, guided by Gyourko.

The United States is a driver in the world economy for the first time since the mid-1990s, thanks to falling energy prices, high general productivity and slowing healthcare costs. Europe, China and the rest of the world is a “mixed bag,” and Jacobs feels we are relatively isolated from its issues.

“While our economy was recovering, we did what needed to be done, and now that the economy is in pretty good shape, debt should come down over time, and the rest of the world is getting the benefit of a U.S. recovery,” he said.

Discussion turned to the state of global mergers and acquisitions, which have had a slow first quarter, due, in part, to the current disinflationary, deflationary backdrop that has not been seen since the 1930s and ’40s. However, many cross-border deals have been done, and Jacobs predicts they will increase, even though they are complex.

Gyourko suggested that the drop in energy prices will cause distress, although Jacobs believes it will be contained in certain pockets of the country.

Globally, Jacobs believes stress and bad fiscal management always will exist in many areas, although some, such as the Middle East, are less important economically than they have been in the past. Politically, however, that area of the world is more important and its issues are “generational and won’t ever clear up.”

Gyourko moved the conversation to American politics. “Are we overemphasizing this political cycle or do you see it as a risk?” he asked.

“It feels like heated rhetoric, and is at a level we’re not accustomed to, but it won’t make that much difference,” Jacobs replied. He went on to explain that the federal government really isn’t a large part of the economy—only about 20 percent. The fact that the government hasn’t been able to reach consensus on so many issues over the last eight years leads to less long-term predictability. Individual cities are more vibrant, however, and many of them and many states are better governed.

The European Union situation—immigration, the possibility of Britain exiting the union, the aging population, no fiscal policy to speak of—creates unexplored territory, making it difficult to determine if the EU would survive if Britain leaves. Jacobs doesn’t understand how Japan can sustain a market the way they do and it is hard to figure out what is happening in China.

“That amazingly capitalistic country, cloaked in communism, has a high energy level, inventiveness, innovation and is well in their transition from manufacturing to service-based economy,” said Jacobs. “Their approximately 6 percent growth is counterbalanced by the fact that no one seems to know where all the debt is.” Brazil, India, Russia and other emerging markets have seen market changes, and all are unpredictable.

They closed the conversation with a discussion of regulatory changes and Jacobs’ prediction that financial institutions will look different over the next few years, with many of them changing to resemble utilities. “Some will do banking functions with low risk and look simpler. Other, smaller institutions will provide risk capital. Assuming Brexit doesn’t happen, Europe will see super-regional institutions, and we may end up with only two global banks at the end,” he said.

Spencer B. Haber moderated the next panel, Risk and Reward in a Volatile World: Where are Investment and Capital Markets Headed?

Mark Myers, Head of Commercial Real Estate, Wells Fargo & Company; Marc Rowan, Co-Founder and Senior Managing Director and Director, Apollo Global Management; and Wesley Edens, Co-Founder, Principal and Co-Chairman of the Board of Directors, Fortress, were the panelists.

Volatility and regulation seem to be at least part of the reason the United States is “okay and the rest of the world isn’t,” said Haber.

The “recipe for disaster—being overleveraged and oversupplied—doesn’t seem to be here,” said Myers. “It doesn’t feel like we are in an economic recession either. The recent market volatility is good for the country and may prolong a good cycle. We have the cheapest source of capital on the planet and the quid pro quo is being regulated, which has rebuilt the health and strength of the banks.”

Rowan agreed with Myers that regulation has served its purpose and volatility is good for business. Edens weighed in, adding that the Fed has stabilized the banks, but it’s hard to borrow. “If you can’t borrow money, it’s hard to start a business, buy a car, buy a house. Equity is the new debt.”

He also talked about capital and debt, saying today is a better time to be a developer, especially in Florida, where there are pockets of demand. “But on the flip side, buying is competitive and a lot of capital is looking for it.”

“Buying assets in Europe will be there for a long time,” said Rowan. “We built infrastructure in Europe… in Spain, Ireland, the UK and Netherlands. In the U.S., it’s spread lending of high-quality assets.”

“Today is a good time,” agreed Myers. “If you have courage and conviction, are careful, cautious, use sound judgment and sweat the details, this is a really good business.”

The day ended with a conversation among Barry Sternlicht, Chairman and CEO, Starwood Capital Group; Eyal Ofer, Chairman, Ofer Global and Global Holdings, Inc.; and Samuel Zell, Chairman, Equity Group Investments, with Peter Linneman moderating The Conversation with Titans.

Linneman opened with a discussion of U.S. politics and how this election cycle is seen around the world. “It doesn’t matter where you go, every conversation starts out wondering what you think about Donald. It’s stunning,” he said. “This generation has abrogated global leadership.”

Sternlicht suggested a positive spin. “This election is good for the U.S. economy,” he said. “Consumers are saving again because everything is so uncertain and we will just adjust to whatever happens.”

Brazil, Venezuela, Germany, Spain, England, Eastern Europe—the politics and economies of these countries and more were then discussed, with the men agreeing that challenges are real, and Ofer quelling the laughter that had opened the segment.

“We’re all laughing, but it’s a serious issue. Every country is lacking leadership. Even the U.S. cannot offer a single decent leader. And the uncertainty in Europe is causing a standstill.”

But there are “phenomenal flows of capital, staggering,” said Sternlicht. “Some of the markets are great.”

The unprecedented scale of migration across Europe is only complicating an already complex situation there. And, as in earlier conversations, the men agreed that China confounds nearly everyone. “When you invest in a place where rules change overnight and with no warning…” Zell began… Sternlicht interrupted with, “It’s impossible where the rule of law is so changeable and they don’t tell you.”

The men shared optimism about the state of the U.S. economy. “The U.S. is living something of a charmed life,” said Zell. “The results are better than they ought to be, considering what is going on in the rest of the world.”

Ofer said this country is the best place to put your money, considering you have to invest somewhere.

In spite of their confusion over the Chinese economy, the men shared an admiration for what that government has done. The country's major overhaul has caused some disruptions, but "they think in semi-millennia, and the beauty of their system is they pre-select the quality of their leadership," said Ofer.

"But the same thing was said about the Soviet Union, which didn't turn out so well," interjected Linneman. "What about domestically?"

High-end residential in the United States is "dead in the water," said Zell. Anything that is oversupplied, tech, pockets of New York and San Francisco, all are areas to avoid, agreed Ofer and Sternlicht.

Ofer reiterated the belief that it's okay to sit tight. "Uncertainty everywhere calls for less enthusiasm," he said. "There is no penalty to wait it out," added Linneman.

"There are always things to do. You just have to find them, and that's not easy right now," said Sternlicht, when Zell asked, "Where in the U.S. and outside is the demand? Every investment decision you make is correlated to a perception of demand."

The men circled back to politics to wrap up their discussion.

"By nature, we're all optimists here. What is the silver lining of the world we're in now?" asked Linneman.

The new sharing economy, which is changing the patterns of consumption, is one, said Ofer. "The speed of change is so rapid that even we will be able to enjoy the outcome of it."

"Every great crisis is what we need to fix things," answered Sternlicht. "Our country grew by people who took risks and caused change."

"The most significant silver lining is the high participation rate in these primaries and in this discussion. It is at an all-time high," said Zell. "The revolution we're going through is maybe not such a terrible thing."

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