

National Real Estate Advisors

What it takes for cities to stay viable in and after a pandemic

Jonathan A. Schein, Institutional Real Estate, Inc.'s senior vice president and managing director of global business development, recently spoke with **Jeffrey Kanne**, president and CEO of National Real Estate Advisors. An excerpt of their conversation follows.

What originally attracted National to the urban core and your build-to-core strategy?

We believe the urban core is the center of the modern economy. Starting about 30 years ago, a real transition in the economy took place that made brains and experience the driving forces behind economic growth. Because humans are social animals, the growth gets concentrated in urban environments that offer great transportation systems, educational institutions, civic institutions and other aspects of modern life that are attractive to educated and talented people. The more jobs and the more talented people you have in one place, the better that place becomes, both for employers and employees. That economic vitality then helps to buttress all of the institutions in that urban core, like the symphony, zoo, transportation networks and government.

In terms of, why build-to-core strategy? Just as we want to be in the forefront or in the middle of the modern economy, we also want to have the most modern, state-of-the-art buildings we can possibly build. And you don't get those by buying existing buildings; you get them by building your own buildings. A long time ago, we decided, rather than compete for the most recently completed modern building with all kinds of other institutional investors, we would build our own building. That way we knew they would be modern and state-of-the-art.

What do you see as the near-term changes to urban environments, and what do you expect to result from the COVID-19 pandemic?

The biggest near-term challenge is going to be the fiscal viability of local govern-

CONTRIBUTOR



Jeffrey Kanne
President and CEO
National Real Estate Advisors, LLC

Jeff Kanne is the founder, president and CEO of National Real Estate Advisors, LLC. National manages approximately \$5.6 billion in gross assets for approximately 60 pension fund investors and employs a single real estate investment strategy: a build-to-core investment strategy whereby National invests at the beginning of the development process, primarily in urban core, high-rise and mixed-use projects across the United States, and also in data centers, ultimately transitioning the assets to core real estate holdings. Jeff's various experiences include being a former Peace Corps volunteer in rural West Africa; a lumber trader; a lawyer in a major Washington, D.C., law firm; and many years at the helm of a law firm he founded. He has broad and diverse experience in the real estate investment and development process, with particular insight into legal, finance and construction aspects.

ments and local transportation networks, unless the federal government gives enough money to the local urban governments around the country to pay for the deficits they are incurring because of lack of sales tax. Cities depend on a generous amount on sales tax revenue and property tax revenue, which is going to be challenged, as the subway systems and bus systems all over urban America are empty. If that hole doesn't get filled, there are going to be layoffs, services are going to be cut back and safety may be compromised, which will make the urban core less attractive. That is the first challenge cities are going to have — convincing everybody who fled that it is safe to come back. Cities are going to have to market themselves. City planners are going to turn their attention to figuring out ways to make the city feel safer.

Does history offer us any trends that we can point to in order to give some indication of what the future might hold for cities?

The story is very simple. No matter what happens to a city — whether it is a pandemic or a bomb or a siege or a fire or earthquake or hurricane — they are very likely to be quickly repopulated. People are in cities for very fundamental reasons related to human existence, and those

reasons are not going to go away. People are social, and cities are efficient — they have a lot to offer that you can't enjoy or get access to if you are remote. It is the place to attract employees or find the right employment. As soon as people feel safe, they will migrate back to the city. And I don't think it is going to take very long. For example, the Black Plague, when it hit Florence, killed almost two-thirds of the population. Three or four years after the plague had ended, Florence was fully occupied again. History has shown us in all kinds of ways that cities continue to thrive as soon as they are safe, and they adapt. They get better. We have pandemics to thank for the creation of the public sewer systems, for instance, which was probably the biggest innovation in public health in the history of the world.

Where do you see the opportunities and challenges resulting from this pandemic for both the urban core and your build-to-core strategy?

One of the biggest challenges I think we are going to face is: How are people going to choose to live? Not so much because of the pandemic, but because of what the pandemic has taught us about what we are capable of. In our firm, we have allowed people to work at home for two days a week for more

than 20 years because people have very long commutes in the Washington, D.C., area, and they found it to be one of the best benefits they had. We learned back then that people who do good work in the office, will also work well at home, and people who won't work hard at home, also won't work hard in the office. Now, many other firms have learned that working from home is a viable option and a valuable employee benefit. There is going to be widespread adoption of work-at-home policies, and it is going to end up being a world where people are expected to be in the office two days a week, maybe three, and the rest of the time they will work at home.

So what does this mean for the office sector?

That means office space is going to be used very differently, and that people are going to want to have bigger homes, whether it is an apartment in the city or a suburban house. A challenge for us is, what kind of apartments are we going to build in Manhattan? Do we need to change our unit layouts? Do we need to provide for more private areas outside of someone's apartment where they can go work? Can we depend on people to go to WeWork, or do we have to take care of that ourselves? Then, of course, in our office settings, do we want to build offices with smaller floor plates where there is more light, more air, but also more opportunities for educational space, for example? I think there will be a big move to use the opportunities when people are in their office to have learning experiences. We are in the process, for example, of hiring a chief learning officer, who will help us continue to have educational programs, which we are going to use when staff are all in the office. We are going to come in three days a week, one of which everybody will be there, and then the other two days there will be teams there. But how do you most effectively organize office space under that kind of a scenario, where one day everybody is in the office, and a couple other days there might be half the people in the office, and then, for two days, there is nobody in the office?

Another big challenge for us is capital. For several years to come, there is going to be a reluctance for institutions to invest in cities. Institutions are followers, not leaders. They don't take risks, and

investing in Manhattan or downtown Los Angeles or San Francisco, after what is going to be a big downturn in those cities, is going to be a real challenge to attract capital until governments are stabilized and residents are moving back in a significant way.

Are you focusing on any particular markets? And what factors, demographics, transportation would make a city attractive for National?

The locations we are in now have been fantastic, but they are going to have tremendous challenges, so we are going to be looking carefully at how they are reacting to those challenges. We pay very close attention to the fiscal health of the municipalities that we invest in, shying away from those without civic peace, civic responsibility and fiscal responsibility. We had already decided we would move into some smaller cities that are big enough to have all of what the larger municipalities have in terms of a civic and cultural environment, where employers are willing to locate some or all of their employment force for cost reasons and lifestyle reasons — for example, Nashville or Charlotte. Remote working is going to make opportunities in these smaller cities even more viable to the extent they can offer employers a well-educated workforce. We don't intend to abandon the larger cities, but we think these smaller cities may have more legs after COVID-19 than they had before.

Are you looking at a new design scenario for working from home in these apartments?

Well, we are going to make sure that every apartment has at least one area besides the kitchen table to work on! That might be one or two two-foot by five-foot nooks in the entry hallway, or we might take another route and decide it is fine for somebody to work at the kitchen table, as long as they also have a place in the building where they can have a private office on a regular basis. That might mean having more private areas, as opposed to communal areas, which is what we have been focused on for the last 10 years or so. And, of course, we will pay more attention to how robust our broadband availability is.

One of your biggest investments is in the data center business, right?

And that business has just taken off like a rocket ship because of remote working. Remote working has really gotten people focused on how essential the internet — and data centers are the heart of the internet — is to our modern way of life and our economy. We are going to continue to grow that part of our business, but we are going to be looking to make sure that all of our projects — whether they are office, retail, apartments — are more than adequately served by broadband access.

CORPORATE OVERVIEW

Led by a management team working collaboratively since 2000, **National Real Estate Advisors, LLC** (National) has honed a specialized build-to-core strategy and established a unique open-end real estate fund to invest in modern assets, located in major U.S. urban markets. The company takes a patient, long-term investment view, developing and redeveloping properties at appropriate points in the real estate cycle, always seeking to create modern, technologically advanced assets for its portfolios, to outperform older properties competing for tenants.

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