BACK TO BUSINESS IOWA PODCAST

A partnership of Iowa State University Extension and Outreach and America's SBDC Iowa

SEASON 1 | EPISODE 30: Real Estate Discussion with Economist Peter Orazem

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Description: *Dr. Peter Orazem, professor of economics at Iowa State University, examines recent economic indicators regarding employment and business health in relation to the private and commercial real estate markets.*

[music]

Steve Adams, host 00:10
Hello, and welcome to the Back to Business Iowa podcast from Iowa State University Extension and Outreach. This podcast is a collaboration between Iowa State University Extension and Outreach and the programs including Community and Economic Development, Farm, Food and Enterprise Development, and the Iowa Small Business Development Centers. These podcasts cover relevant topics for businesses and individuals related to education, research and technical assistance during and post COVID-19.

Steve Adams, host 00:55
I'm Steve Adams, field specialist three at Iowa State University Extension and Outreach, part of the Community and Economic Development unit and your hosts for these podcasts. In this podcast we'll be discussing the effects of COVID-19 on the Iowa real estate market. Our special guest today is Dr. Peter Orazem. Dr. Orazem is a member of the Iowa State University economics department. Dr. Orazem, thank you for joining us today.

Peter Orazem 01:22
Thanks for having me. It's a real privilege.

Steve Adams, host 01:25
Well, Peter, before we get into the heart of today's topic, would you provide us some detail on your background and your primary areas of academic research and instruction?

Peter Orazem 01:36
Yes, I'm a university professor of economics. I've been at Iowa State since 1982, and I'm the director for the program for the study of Midwest markets and entrepreneurship. And my primary area of research is in labor economics. But as part of my most recent research, we've been focusing a lot on the factors that affect rural economies and rural economic development, and what are the things that allow firms to enter rural markets, given some of the disadvantages of being in what we call thin markets—markets that don't have large concentrations of labor, or venture capital, or a customer base—and our focus is to try to come up with strategies for Midwest economies in the current economic climate.

Steve Adams, host 02:36
Well, as someone quite interested in labor, can we kind of start our discussion there? Because if people are unemployed, they can't afford to pay rent or mortgages, and how would you say Iowa has fared from an employment standpoint during the pandemic?

Peter Orazem 02:51
Well, Iowa's done relatively better than the US economy as a whole. But this pandemic was a very unexpected development. I mean, going into March, the unemployment rate in Iowa and nationally was very low. Nationally, we lost 25 million jobs in a month, which was unprecedented. And Iowa went from virtually full employment to losing about 12% of our jobs in that first month. And we've since regained, we're now about seven and a half percent below where we were in 2019. And the US economy as a whole is about 9% below where they were in 2019. So we've made some of the way back, but US economy is still 16 million jobs below where we were in July of 2019.

Steve Adams, host 03:50
I noticed was it today or yesterday that unemployment claims for this past week had gone up again. Do you see that trend kind of continuing?

Peter Orazem 04:00
Well, one of the problems with reopening the economy is, it also allows the virus to spread. And that would have been expected. But certainly in some places, the spread of the virus was much faster than people expected. And so now we're beginning to see some of the reversal of the opening up of the economy. Less so in Iowa, although it may happen, but certainly in some of the places like Texas and California and Florida.

Peter Orazem 04:36
Iowa, if you look at some of the sectors, our manufacturing has done much better than the US economy as a whole. And in some places, we've actually done better. We actually have more people employed, for example, in food manufacturing now than we did a year ago. And nationally, food manufacturing is down about 3%. So there's some sectors that have actually been able to expand even as other sectors have been hammered.

Steve Adams, host 05:04
I noticed in a research paper you provided to us that you said on the positive side, manufacturing, particularly non-durable manufacturing actually gained jobs in Iowa, while losing 5% of the jobs nationally. Could you kind of explain to our listeners what non durable manufacturing is?

Peter Orazem 05:24
Well non-durables are things that you consume at one time, so food is the thing that we do the most in Iowa in terms of non-durable manufacturing. But that could also include things like ethanol production, which hasn't been doing as well. But as far as food production in Iowa, it's held its own. And even some of our durable manufacturing like farm implements have actually done a little bit better than I think people expected. And so if you look at manufacturing as a whole in Iowa, it's a bigger share of the Iowa economy than it is of the US economy as a whole. It represents about 15% of the jobs here in Iowa. And it's fortunate that at least so far, manufacturing hasn't really been hit as hard as some of the other sectors in the Iowa economy.

Steve Adams, host 06:20
Well, we certainly all know that the bar and restaurant industry has just been hammered by this pandemic. But are there some businesses within those industries that are actually thriving, and why or why not?

Peter Orazem 06:33
Well, if you look at restaurants and bars, clearly, most of them were shut down. There's a national tracking service that looks at reservations at restaurants and it literally said that 100% of the reservations disappeared in April. And if you look at the restaurant and bar industry, they lost about

half their jobs in a month and they are still about 25% below where they were in 2019. But if you look within the restaurant sector, there are some parts of the restaurant industry that are actually doing pretty well.

Peter Orazem 07:13
One of the things that we noticed is that stores that sell food, like Hy-Vee or Fareway nationally and here in Iowa, sales at food and beverage stores are up 12%. And so they've replaced some of that lost business that restaurants used to have. And within the restaurants, the ones that deliver and the ones that have drive-up service have held their own or actually expanded. If you look at the stock price, for example, for Domino's and Chipotle, it's up 31% since the start of the year, even though the overall stock market is down slightly. And so within the restaurants you have a growing market share for the businesses that are able to safely provide food services. But the traditional sit-down restaurants are doing very badly.

Steve Adams, host 08:15
Well, we heard from the head of the Iowa Restaurant Association, and I think this was back in April on one of our early podcasts, about making predictions as the months rolled on. And even last week, Yelp mentioned that 60% of all bars and restaurants would probably close permanently. Do you feel like that number is fair?

Peter Orazem 08:37
Well, unfortunately, one of the hard things to predict is when we're going to be able to move past the virus, the COVID-19 and the need to distance. Sit-down restaurants simply aren't suited for this type of business, and some restaurants have been able to transfer their business into a drive-up service. And I think those restaurants, if they're reasonably successful at that, might be able to survive if not thrive in this economy. But the ones that rely on sit-down service, and have been making do with serving outdoors, as we get into the fall and winter months, of course, that business is going to dry up. So the longer that the pandemic holds its sway on the US economy, the more restaurants are going to go out of business.

Peter Orazem 09:35
The other thing is that a lot of restaurants were making do with some of the stimulus monies that came out of the federal government, and it's not clear how much longer that stimulus is going to to be available. And so a bunch of those businesses are going to go away as well. If they're able to maintain where they are, I think maybe 25 or 30% would be a safer guess as to how many restaurants would close based on their current employment numbers. But it could easily be much larger than that if this drags on for a year.

Steve Adams, host 10:12
Well, with those closures, you would have to think that those that survived then will be much more competitive and potentially more profitable. What do you think?

Peter Orazem 10:20
Well, once things open up again. I mean, there's some hope that we might have a vaccine by January. Certainly there'll be fewer restaurants and the ones that are remaining, you're going to have a real large pent-up demand for people to get out of the house and eat something cooked by somebody else. And, and so with less competitors, and great pent-up demand, if you can survive that long you're going to have a great first month.

Steve Adams, host 10:54
Yeah, my wife has been commenting recently about how she's tired of eating her own cooking, so...

Peter Orazem 11:00
Well, I think that's just God telling you to cook some more, there. [laughter]

Steve Adams, host 11:05
Maybe so! You spoke about this a little bit earlier, but on a broader basis, are we seeing an uptick in bankruptcies across the board? Or how do you see that number playing out?

Peter Orazem 11:18
Well, you know, there have been some very prominent bankruptcies in this last couple months. Some of those were firms that were in trouble to begin with, but certainly COVID-19 didn't do them any any favors. If you look at stores, clothing stores, their sales dropped 80% in a month, and they still are about 40% below where they were in 2019. And so some of the most prominent bankruptcies, JC Penney's, Neiman Marcus, J. Crew, Brooks Brothers, Lucky brands, they're all in the clothing areas and they represent a lot of stores at malls and shopping centers around the United States.

Peter Orazem 12:06
On the other hand, because of the stimulus package, actual bankruptcies nationally are down about 23% relative to where they were in 2019. And so some bankruptcies that might have occurred without the stimulus package but would have occurred had COVID-19 not happened, some of those bankruptcies are now deferred because those businesses are able to remain because of their ability to access that stimulus package.

Peter Orazem 12:39
On the other hand, as that stimulus package goes away, we'll see what happens with the current negotiations and in Washington, but it's not going to be as generous as it was in the first round. You're going to see a sudden surge in bankruptcies nationally, and I think it's going to be well beyond the number of bankruptcies that we had in 2019. By the end of the year 2019, we had a record number of bankruptcies in retail, just under 10,000. I think we could well be at three times that by by the end of this year.

Steve Adams, host 13:20
Yeah, I noticed again in your in your research paper that you said that Coresight research predicts that 25,000 stores will close in 2020. That seems astronomical to me, but do you agree with that?

Peter Orazem 13:33
Well, it's really hard to to understand how some of these stores are going to be able to make it without some kind of support. I mean, there aren't very many businesses that are geared up to absorb three to six to 12 months of zero revenue. I mean, if all you have is costs, you're out of business and there are a lot of stories that are in that position. They don't have a year of reserves in order to make up for the loss of revenue over that long a period of time.

Steve Adams, host 14:16
Yes, that's always been kind of one of the rules of thumb that we've heard over the years and doing our small business consulting work, was that most small businesses ought to keep six months worth of cash reserve or liquidity around just to make it through a difficult period of time. But you're right, if it goes out nine or 12 months, even those that did have six months in reserve probably are not going to be able to hang.

Peter Orazem 14:42

Well, not only that, but you had a lot of people who just got caught short. I mean, remember, we were booming four months ago, so there were a lot of people who were expanding, who are now out of business. One of our alumni just switched to a new job, her old firm was in the process of doubling their employment base when the COVID-19 hit, and it completely eliminated their revenue stream. And I think that part of the real difficulties associated with this recession is that there were no signals that this was going to be a problem. And so because of that you didn't have firms able to sort of plan for a reduction in force.

Peter Orazem 15:37
If you look at retail, the total amount of dollars spent in the retail sector in the US hasn't gone down. It's actually up slightly, one and a half percent over 2019. On the other hand, online sales went from 14% market share to 20% market share in one month. And you know, those may be segments of the market share that traditional brick and mortar companies are never going to get back. People are going to be too comfortable now just ordering from Amazon, whose, by the way their stock price is up 58% in this year, that'll tell you something about how Amazon has fared in the context of this.

Steve Adams, host 16:24
Oh, absolutely. I'm a daily walker and I'm always surprised at the number of smiley face boxes I see on people's porches anymore, but...

Peter Orazem 16:33
Yeah, and sometimes those are the only things you can see that are smiling. [laughter]

Steve Adams, host 16:38
How true. Well, we've kind of set the stage now with the outlook for employment and what bankruptcies may look like, but in terms of real estate and commercial tenants, once again you'd kind of touched on it but let's dive a little deeper there. What do you think the commercial real estate market is shaping up to be?

Peter Orazem 16:59
Well commercial real estate depends critically on the strength of the sales of their clients, right? So when retail is doing well, the people who are renting space to retail firms are going to be doing well. If you look at the overall market for property in the US, we haven't really seen any reductions in the price of residential property, and even rental property, at least so far, hasn't declined—in part because even people who lost their jobs were able to access you know, a rather generous stimulus package in terms of unemployment benefits from the federal government. And so I think that some of the shoe has yet to drop on the rental side of the market.

Peter Orazem 17:51
But for commercial, there was in one month a 10% drop in the value of commercial property in the United States. And to put that in perspective, it took a full year in the Great Recession for the value of commercial properties to drop 10%. And so commercial properties are being hammered by two things. One is that their clients in the retail sector are doing very badly, and many of them are effectively closed. And secondly, we don't need as much office space because people are working at home. And so that double whammy of lost retail clients and lost office space clients is really showing up in a big way by a relatively unprecedented sudden drop in the value of commercial real estate.

Steve Adams, host 18:51
Yeah, the recent announcement by Google that they are going to allow a good portion of their employees to work from home for another year or so. Again, when you talk about contraction and downsizing, probably less office space is going to be used going forward, wouldn't you think?

Peter Orazem 19:08
I think that this is a permanent change in the demand for office space. And so your it took six years for commercial property to recover its lost value in the Great Recession. I don't know that this is going to be any any shorter than that. I suspect it could be a lot longer, if this drags on.

Steve Adams, host 19:36
Well, here's something I really don't understand, and residential real estate seems to be really hot right now. It's remained quite strong through most of this so far, especially in terms of home values. Is there any explanation behind that phenomenon?

Peter Orazem 19:51
Well, one is is that you know, we have this large infusion of dollars. I think it's estimated by University of Chicago that about 70% of the people who got unemployment benefits actually were earning more with unemployment benefits with the $600 per week additional stimulus than what they were earning when they were employed. And so at least temporarily, you have households that might have been scraping by who might actually be doing better unemployed than they were employed in a booming economy.

Peter Orazem 20:33
And so I think some of the impacts of substantial job loss and substantial loss of business on the residential market hasn't hit yet, because the stimulus is is shoring up the ability of households to pay their obligations. So about 25% of the households that got stimulus money used it for rent, and about 21% used it for mortgage payments. And so if there's going to be an impact on those prices, I think it will be when the stimulus monies disappear. And then the full brunt of the impact of unemployment on those households is going to be felt in the residential market.

Steve Adams, host 21:27
Rents for personal [unclear] have seemingly been quite strong over the last few years. Are we going to see a change do you think in those values?

Peter Orazem 21:36
Yeah, I think in in rental markets, you have about—these numbers just were announced. I think in the last couple days—the Census Bureau announced that about 40% of renters believe that they would have serious problems paying their rent without the stimulus monies that they got, either the $1200 dollars per household or some of the unemployment benefits. In Iowa it's actually higher than that, it's 48%. And so, if we don't continue with that infusion, some of that is going to end up being absorbed by landlords. Evictions, I think just in the last few days, the federal restrictions on evictions have run out, and I think around August 24 or so is when people would have to vacate property. So we don't know yet how many households are receiving eviction notices in this latter part of July, but the numbers could be substantial. And then you're going to see a substantial change in the value of rental property.

Steve Adams, host 23:01
I see some cities around the country have suspended all evictions to protect tenants... is that true in most places or do you see a change because there isn't any stimulus money to keep them paying so evictions, I guess what I'm hearing from you is they are definitely going to go, up there's no chance it won't, correct?

Peter Orazem 23:21
Right, about 17 states suspended evictions, but the deadlines have passed. We just passed the federal date. There's a handful of states that had unlimited suspension of evictions, but it's a minority of the

states. And so I think that the more plausible thing that's going to happen is, for people who are facing problems with paying their mortgage or paying their their rent, they're just going to have to go back to their landlord or to their bank and try to come up with some forbearance, right, some other alternative that allows them to stay in that property. The last thing you want to do is is to actually not try to come up with some kind of a deal.

Peter Orazem 24:17
I mean, the people who own property, the people who are renting, or banks themselves, they're going to lose money on the evictions or calling the note on an overdue mortgage. The best alternative in most cases is to try to keep the person in the property and to come up with some way of making, say, partial payments or backloading some of the payments and so people can stay in those properties. Without that forbearance you're going to see a massive disruption in the housing market. And that's not just going to be the tenants or the homeowners that are going to be hurt by that—the landlords and banks are going to be hurt as well. And so I would be very surprised if we don't see some federal program to try to limit the number of disruptions in the housing market, because I think that could be a very serious drain on the economy. And that's one drain that's going to persist over a very long period of time.

Steve Adams, host 25:39
Yeah, you mentioned in some cases after the Great Recession, that that stretched out over a six year period, and you said this one might actually be longer, correct?

Peter Orazem 25:49
Yeah. I mean, remember what happened. The Great Recession was driven in part by the huge reductions in housing values. We learned a little bit from that, but one of the things we learned was that if you could get a contract to persist. And I think the Federal Reserve System did a huge effort to try to buy up bad loans. Many of them ultimately proved to be good in the long run, even though they weren't good in the short run. And so the Federal Reserve actually made money by buying up all those toxic assets and waiting long enough for the market to recover. I think you're going to have to see some other similar type of program in the next month or so, to try to make up for the fact that all of these households are going to have trouble making payments on their mortgages or meeting their obligations on their rent.

Steve Adams, host 27:01
Peter, I wonder what you think about the kind of ongoing tension between opening the economy up so that unemployment will improve and people will have more money to spend on rents, mortgages, going out to restaurants, this kind of thing, and the very real consequence of increased COVID cases and deaths. How does one person balance those competing interests from an economic standpoint?

Peter Orazem 27:27
Well, this is a damned if you do and damned if you don't situation. We cannot afford to shut down the entire economy. I mean, people need resources. I mean, all these issues in terms of the housing market that we've been talking about are a result of the loss of 16 million jobs. On the other hand, we had lost as many as 25 million jobs and then started to reopen. Now what you hope is that people will try as much as they can to keep themselves and to keep their neighbors safe by doing some of these simple things that, you know, we've been told from the beginning. And that is to keep our distance, to wash our hands, to wear masks.

Peter Orazem 28:18
But we know that as long as you're meeting with other people, you're exposing yourself to whatever disease they have and vice versa. And so you're going to have more spread of the disease when economic activity is occurring. On the other hand, it's equally untenable to not have people producing

the daily things that we need in order to survive. And so you know, it's sort of interesting. I mean, I was looking at unemployment rates here in Iowa versus Illinois. So Illinois has put these restrictions, saying—now God knows they can enforce this anyway, I think it's a purely political thing—where they say that Iowans who go into Illinois have to quarantine for two weeks. I haven't noticed that they're actually putting any barriers on I-80 to prevent people from driving across the Mississippi.

Peter Orazem 29:29
But if you look at the actual unemployment rate in Illinois, it's just under double the unemployment rate in Iowa and you say, Okay, what is Illinois trying to accomplish by shutting down their economy to such a greater extent than Iowa? Well, they're trying to limit the spread of the disease. And yet the number of deaths per capita in Illinois are triple what they are in Iowa. So at the end of the day, those trade-offs between the economy and the disease are going to be there. But there's no way that we can not have any disease, because we have to have people engaged in economic activity.

Peter Orazem 30:15
And similarly, we can't just go great guns in terms of the type of economy that we used to have because the spread of the disease will be much greater. And so how each locality or each state tries to figure out that trade-off, I mean, that that is not an easy decision. But every state is trying to figure out what they're comfortable with. How much poverty are they willing to absorb in order to limit the spread of the disease, versus how many people do they want to put at risk in order to maintain the economic status of their citizens?

Steve Adams, host 30:57
Well, we're about to see how all that works. I mean we're about to open up the petri dish, so to speak, with campuses reopening and schools reopening. And I think the next 90 days are going to be very telling overall. Yesterday's news coming out of the Federal Reserve was not particularly good. We looked at a 32.9% contraction in the gross domestic product this last quarter. That's the biggest drop I understand since 1958 when it dropped 10%. So we've more than tripled that number of the worst since we started keeping records in 1947. What do you think about all that, Peter?

Peter Orazem 31:41
You know, I've been at this business a long time and I've never seen anything like this. Obviously, we cannot sustain a one-third reduction in production in the United States for an entire year, so... I mean, certainly toward the tail end of the second quarter, we saw the reopening, we gained back 9 million jobs. And yet, suddenly the disease starts spreading again. And so we certainly haven't resolved that problem and until we have some way of building herd immunity, either we've gone through this long enough that everyone has been exposed or we develop the vaccine, it's really hard to see how we're going to be able to get back to to a normally functioning economy.

Peter Orazem 32:53
But we cannot sustain the United States at one third or two thirds of our previous level of production and so I think we're going to have to absorb a greater risk in order to keep things moving and hope that more diligence in terms of doing the most simple things that we can do to keep ourselves safe become more... that people will adhere to that a little bit more aggressively now that the risks are becoming more apparent. You know, if you kind of hope that people would think of this, as you know, like in wartime so the efforts that people went to in World War Two in order to try to maintain economic activity to support the war effort, you know, we simply have to do the same thing.

Peter Orazem 33:52
On the other hand, if you take a longer historical perspective, I mean, the the Spanish flu, 650,000 deaths in the United States, 50 million deaths worldwide, it atypically hit the working-age population,

people aged 15 to 40, as opposed to people who are at or beyond the retirement age here with this pandemic. It should be less difficult for us to maintain the economy in this pandemic than it was in 1918 through 1920, where they didn't have the benefits of science and the ability to treat the disease. And so, I'm at least hopeful that we'll find ways to live with the disease if we don't have a vaccine. But let's hope that the early promising signs in terms of the testing that they've had, that they've announced in the last couple of weeks, that we might have a vaccine ready by early in in 2021. And maybe 2021 will make us forget 2020.

Steve Adams, host 35:16
I think we'd already want to forget 2020, Peter, but you know, I thought the really frightening thing was that forecast was actually expected to be higher than that 32.9. But, hey, I want to thank you so much for being here today. Your time and your insights have been invaluable. I'm sure our listeners will get a lot out of this. If I want to contact you, or someone else would like to contact you about something that you've said or spoken about today, is there a good way for them to reach you?

Peter Orazem 35:46
Well, probably the best way is by email given that, you know, we really aren't at the office that much, and so, if they want to email me, at pfo— I'm old enough to have a three letter email [laughter]—so pfo@iastate.edu. You can go to the Economics Department website and just scroll down and find my name on the webpage, so it's Peter Orazem. If you do want to phone, I do have access to phone messages. And so you can call me at 515-294-8656. But I'm just not checking that phone message that much, so I think email is the better way.

Steve Adams, host 36:35
That's pfo@iastate.edu. Hey Peter, thanks again. It's been a real privilege to have you on as our guest today.

Peter Orazem 36:45
Oh, thank you. It was a real honor to be asked. I really appreciate it. And for all your listeners, be safe out there, do what you can to keep yourself and your neighbors safe. And hopefully the next time you've ask me to talk I'll be just full of good news to make up for all the bad news that we talked about today.

Steve Adams, host 37:07
Well, we certainly have to be realistic though. So if you have any questions about this Back to Business Iowa podcast, please feel free to contact me, Steve Adams, at stadams@iastate.edu. And as always, thanks for listening. This podcast is a collaboration between Iowa State Extension and Outreach and the Small Business Development Centers of Iowa. We're always serving Iowans, hashtag strong Iowa. So let's get back to business, Iowa. Our justice statement is as follows: this institution is an equal opportunity provider. For the full non-discrimination statement or accommodation inquiries, please go to www.extension.iastate.edu/diversity/ext. Thanks, everybody. See you next time.

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