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Does the stock market have an impact on real estate in the United States? Should real estate investors be concerned if stock prices are going up or down?

The short answer is yes. Stock market price trends affect three major groups whose decisions have significant repercussions for commercial real estate: consumers, corporate managers and investors.

## CONSUMERS

American consumers are the engine that drives the U.S. economy. The money Americans spend on goods and services fuels businesses not just in America but all over the world. When Americans are confident their jobs are secure, they tend to spend freely. When they are uncertain about employment prospects, they spend less and save more.

Trends in stock prices impact American consumers in two key ways. First, when stock prices are rising, companies are likely to expand and hire more employees, giving consumers confidence in the future. Federal Reserve studies have shown that when consumers are confident, the U.S. economy thrives and grows.

The second way trends in stock prices affect consumers is through what economists call the "wealth effect." When stock prices rise, Americans feel richer. Their IRAs and 401k plans steadily increase in value. With their investment portfolios plumping up, they feel wealthier and are comfortable spending money more freely. They buy bigger houses, more expensive cars, travel more and buy vacation homes. Some plan to retire early.

The wealth effect also works in reverse. When the stock market declines regularly for a prolonged period of time, a negative wealth effect can occur. As retirement portfolios contract, consumers may decide to postpone retirement, spend less and put more income into their retirement accounts.

When consumers spend, the real estate market prospers, too. Demand for retail and industrial space increases. Likewise, demand for real estate declines when consumers are more conservative in their spending.

## CORPORATE MANAGERS

Corporate CEOs are paid large salaries for one reason: to ensure the company's stock price increases sufficiently each year to provide an attractive return to the company owners (the shareholders). When their stock price increases, CEOs get generous bonuses and shareholders are happy. Conversely, when share prices fall for a sustained period, shareholders may consider replacing the CEO. Consequently, stock price trends impact decisions of corporate managers.

Stock prices tend to fall when corporate profits fall. When profits fall, managers look for ways to generate more revenue and cut costs. When stock prices fall for a sustained period, companies begin cutting costs in a big way. They reduce travel to attend trade shows, eliminate jobs, close facilities and postpone expansion plans.

Once the company gets "right sized," profits usually start to rise and share prices generally rise, too. Once the CEO feels confident that the company can generate sustainable and growing profits, hiring begins again, boosting demand for new office and industrial space.

## INVESTORS

It is no surprise that stock price trends impact investors in the United States and around the world. When the stock market is robust, generating 20 to 30 percent returns per year, investors pour funds into the market. But when stocks are on a relentless and extended decline, alternative investments such as bonds, real estate and annuities start to look more attractive.

This has been the case in the United States during the past two years as the stock market has swooned. Real estate investment trusts are once again drawing investors who appreciate the tangibility of real estate. Direct investment in real estate is also popular with investors.

Increased investor appetite for real estate was apparent in the Austin office market, which has suffered from a slow local economy and high vacancy levels. Despite the soft market, Class A office buildings have sold for sizzling prices in excess of $200 per square foot.

What drove the sales? Investment opportunity. Quality properties leased to AAA-credit-rated tenants are in great demand in any type of market, attracting investors from all over the world.

Weak stock market performance has increased interest in direct ownership of other property types as well. For example, despite poor crop prices and the weak economy, Texas rural land prices have appreciated in value consistently since 1993. While agricultural use is declining, recreational use is burgeoning. Investment funds clearly are being funneled in this direction.

Direct ownership of real estate has increased in popularity among small investors too, many of whom are realizing that, in these tumultuous economic times, their homes may be the best performing assets in their portfolios. Some small investors, noting this, are buying rental properties or second homes for investment purposes.

The housing market has been exceptionally robust in the past two years, despite negative job growth in many cities. Low mortgage interest rates are one reason for this. However, record housing sales are also partially driven by the investment potential in buying a home.

Academics note that homebuyers get two sources of return on their investment when they buy a home. First, they no longer have to pay rent. Second, some homebuyers get an additional return when houses appreciate in value. The housing market in many U.S. cities has seen significant price appreciation in the past five years.

Unquestionably, stock market trends influence the real estate industry. During the 1990s, investors were infatuated with stocks and the alluring promise of 20 to 30 percent returns per year. Now it is becoming clear that those uncharacteristically prosperous years were an anomaly and not likely to be repeated soon. Real estate is turning investors' heads again, reestablishing itself as a solid investment and an important tool for building wealth.

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