Economist's View

# Cities Will Rise Again

By Dr. Peter Linneman

During the summer of 2020, the media began to report a mass urban exodus to the suburbs as people used their involuntary savings to buy homes that provided more living space in the age of lockdowns and social distancing.

Think of the scale of justice as an analogy to what is occurring in cities. On the right side of the scale, are the positive urban attributes, including culture, art, food, shows, sports, events, a diversity of people and neighborhoods, etc. During the pandemic, however, most of the amenities on the right side of the scale went away.

On the left side of the scale, we have the long-time negative attributes of cities, such as crime, congestion, pollution, smog, etc. And crime has risen during the pandemic.

But this is far from the death of big cities.

## History of Rebuilding

Cities will suffer as long as people have little they can do safely in cities. While this favors the suburbs in the near-term, history shows that societies rebuild cities after wars and devastation, à la post-WW II, Beirut, and San Francisco after earthquakes. If the 1967-1980 period of severe urban decline could not kill New York, Chicago, Boston, Philadelphia, or D.C., nothing will. Cities will rise again.

Cities like New York face the biggest near-term problem because they offered the most vibrant amenities pre-COVID. These cities were the most vulnerable to shutdowns compared to smaller places that did not have as many urban amenities to lose pre-COVID. In addition, cities that are spread out, like Houston, are more durable in the face of COVID than New York.

Once we have widespread vaccinations, people will start to return to cities to see a show, have dinner, or visit a sport venue. With more social and economic activity, safety and comfort levels will rise. Just as wildebeests on the Masai Mara are safe when they stay with their herd, people are safer when others are out and about in much greater numbers. Windows will be unboarded, and urban amenities will rise again, resulting in a rebalancing of the scale.

The good news for cities is that, with the new Congress and Administration in power, we anticipate that over the next two years, considerable federal aid will flow to large urban centers. While this federal aid will be couched in terms of lost local tax revenues and higher costs associated with COVID, we suspect it will go well beyond these amounts and help fill the long-standing unfunded budgetary holes. In fact, with CARES 3, most states will be notably better off than prior to the pandemic. This aid will benefit urban real estate as it reduces the near-term pressures to raise taxes and reduce services. CPE

*—Dr. Peter Linneman is Principal and Founder of Linneman Associates Professor Emeritus at the Wharton School of Business, University of Pennsylvania. Follow Dr. Linneman on Twitter:* ***@P_Linneman***

Economist's View

# Asset Price Inflation to Continue

By Dr. Peter Linneman

As the Fed has embarked on QE Infinity, which has increased bank reserves by over $1.1 trillion, equal to 67 percent, the fear of inflation arises. Some argue that there was no notable inflation from 2009 to 2019, even though the Fed increased bank reserves by $3.2 trillion (379 percent) via QE 1-3. Over the last decade, the Consumer Price Index rose by just 1.8 percent per annum. However, this does not mean that there was no inflation, which is defined as the average price increase of all—not just consumer—prices in the economy.

While consumer prices increased only modestly, asset prices showed notable inflation. Thus, unlike in the 1970s, when asset values languished and consumer prices soared in response to monetary expansion, the most recent decade was marked by asset price inflation and muted consumer price inflation.

## Who benefits and who doesn't?

The dynamics of asset price inflation in a world of low consumer price inflation merit understanding. The rise in asset prices benefits those who already own assets but bestows no benefit on those who do not. Those who do not already own assets fall into three non-mutually exclusive categories: the young, the lower-skilled and the big spenders. Meanwhile, those who already own assets are generally comprised of the negative of these categories: the older, the higher-skilled and the savers.

A world of asset price inflation with little consumer price inflation does not rob non-asset owners of day-to-day purchasing power but does severely challenge their ability to acquire assets (e.g., single-family homes). Meanwhile, the day-to-day purchasing power of asset owners is unchanged, while their ability to accumulate wealth increases. It also allows owners to selectively liquidate assets to invest in human capital, particularly their health and the education of their children. This led to substantial price inflation from 2009 to 2019 for these two components of consumer outlays and squeezed many non-asset owners who could no longer afford these items. In short, asset inflation with no notable consumer price inflation widens the wealth gap and effective income inequality.

## Food for thought

This will happen again over the coming decade, as the modern banking system—unlike that of the 1970s—is designed to channel money to large capital users rather than consumers. The system is positioned to lend hundreds of millions of dollars for asset-backed loans to investors for buyouts rather than thousands of dollars for small business and consumer loans. The prices that rise in the face of monetary expansion are those favored by those receiving the money.

To grasp this simple fact, consider which prices would rise if 100 percent of the QE Infinity injections were given to teens. Streaming services, video games, smartphones, makeup, etc., would see skyrocketing prices as teens poured this new-found money into their preferred items. Meanwhile, the prices of gold, homes, books and senior housing would see little change. In short, inflation over the next decade will be concentrated in investable assets, as that is where banks will disproportionately direct their capital. This means that we expect further cap rate compression over the coming decade. CPE

*—Dr. Peter Linneman is Principal and Founder of Linneman Associates Professor Emeritus at the Wharton School of Business, University of Pennsylvania. Follow Dr. Linneman on Twitter:* ***@P_Linneman***