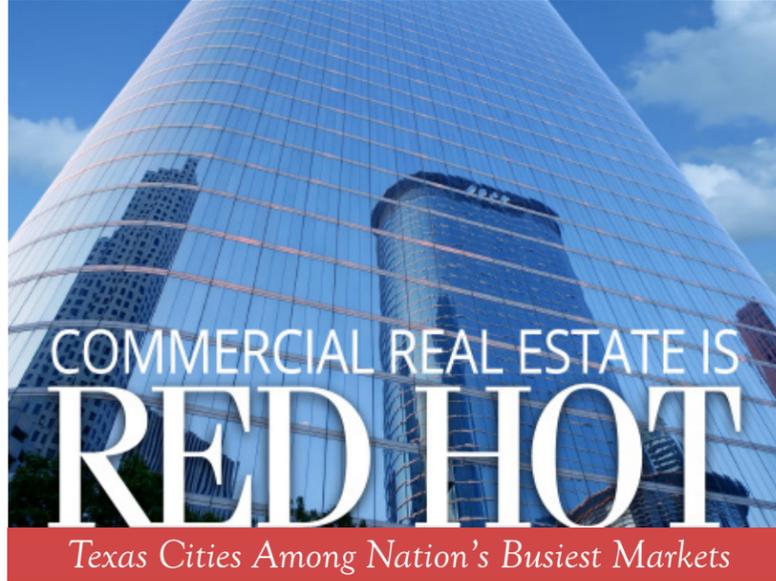




FISCAL NOTES

A Review of the Texas Economy from the Office of Susan Combs, Texas Comptroller of Public Accounts



BY PATRICK GRAVES AND BRUCE WRIGHT

An old joke from the eighties boom in Texas has new currency today: What's the state bird? The tower crane.

The huge construction cranes that are defining and altering our skylines are only one sign of a huge growth spurt in Texas cities, as builders and developers prepare space for hundreds of new and expanding businesses and tens of thousands of new residents.

As the U.S. economy continues its sluggish recovery, Texas is still in the vanguard, dominating recent lists of the nation's hottest commercial real estate markets.

Looking Backward...

Coldwell Banker Commercial's *Top Commercial Real Estate Markets: Market Comparison Report*, released in January 2014, ranked four Texas cities among the nation's 10 fastest-growing markets in the period running from the third quarter of 2012 to the same quarter in 2013. No other state had more than one.

The well-regarded industry resource ranked Dallas and Houston third and fourth, respectively; Austin seventh; and Fort Worth ninth.

"More than 1,000 people move to Texas every day," says Bland Cromwell, partner at Coldwell Banker Commercial Jim Stewart Realtors in Waco. "There are numerous reasons, but primarily it's Texas' business-friendly attitude, low cost of doing business, highly skilled workforce, robust infrastructure and international accessibility — all of these factors are contributing to growth in the state and especially in commercial real estate."

... And Forward

Another industry resource ranks three Texas metros in the top 10 nationwide for real estate growth prospects in 2014.

This report, *Emerging Trends in Real Estate*, is an annual forecast jointly produced by the Urban Land Institute (ULI) and PricewaterhouseCoopers (PwC). The 2014 edition, released in November 2013, is based on more than 1,000 survey responses, mostly from real estate service firms, investors and developers.

Emerging Trends' assessments of commercial real estate include separate rankings for "investment" and "development" property. Essentially, the first gauges the market for existing commercial properties, while the second forecasts the market for new ones.

For investment properties, *Emerging Trends* ranks Houston as the nation's hottest market. Dallas/Fort Worth came in sixth and Austin seventh. California was the only other state with three top-10 markets. For development properties, the same three Texas metros

THE TOP THREE

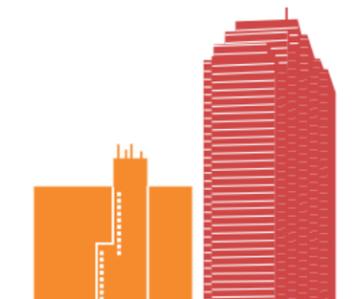
Commercial real estate (CRE) activity bottomed out nationwide in 2010, according to the Real Estate Center's Harold Hunt. In Texas, it was accelerating appreciably by 2012, and has performed well since then.

Here are some reasons why three major Texas metro areas have become national leaders in CRE:



HOUSTON

The Silicon Valley of oil and gas is home to three major oil companies, several large petrochemical facilities, numerous energy-related service businesses and 25 Fortune 500 corporate headquarters. Other drivers include engineering, healthcare, distribution and trade, including one of the nation's busiest ports.



DALLAS/ FORT WORTH

The Metroplex is a national leader in financial services, transportation (especially airlines) and distribution, and hosts several major corporate HQs. Healthcare and defense contracting are important as well, along with some high tech and



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— **BLAND CROMWELL**,
Partner at Coldwell Banker
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R. BYRON CARLOCK JR.,
National real estate
practice leader
PricewaterhouseCoopers,
Dallas
*Co-author of the Emerging
Trends in Real Estate report*

again made the top 10, with Houston third, Dallas/Fort Worth sixth and Austin 10th.

R. Byron Carlock Jr. of Dallas, PwC's national real estate practice leader and a co-author of the survey report, echoes Cromwell's summary of the state's strengths. He cites broad-based job creation; healthy energy, high technology and healthcare sectors; and proximity to natural resources and distribution infrastructure. A strong commercial real estate market "is a logical follow-up," he says.

Jobs Drive the Commercial Market

Texas' economic growth continues, providing the hiring climate that drives commercial real estate expansion. "It doesn't happen if you don't have job growth," says Harold Hunt, a research economist at the Texas A&M University Real Estate Center in College Station.

During the 12 months ending in March 2014, Texas produced more than 310,000 non-farm jobs, according to the Texas Workforce Commission. California, with a 30 percent larger workforce, was only slightly ahead with 325,000 new jobs, according to the U.S. Bureau of Labor Statistics.

Texas' recent resilience is, of course, due in large part to its energy renaissance. "We would not be doing nearly as well without it," Hunt says. But as Cromwell and Carlock both note, the state's entire suite of advantages continue to buoy its markets.

Trending Now

The first quarter of 2014 is past, and Carlock says commercial real estate is already outpacing predictions. Are there any roadblocks ahead?

In the short term, Hunt notes that Texas' general construction contractors are having difficulty finding enough qualified labor to keep pace with demand. He also says that greater certainty about federal regulation in general and fiscal policy in particular would make investors feel more confident about the real estate market.

Low interest rates are certainly a factor in the positive outlook for commercial real estate, but most economic analysts and real estate professionals expect them to rise this year. They don't anticipate serious market disruptions, but uncertainty about rates could cause problems over time.

And a major "correction" — that is, a decrease — in oil and gas prices would certainly affect Texas markets. Other potential impediments over the long term include the adverse effects of healthcare reform and water scarcity.

At present, though, there seems to be little danger of sudden disruption in Texas' commercial real estate markets.

"We had a four-year period during the recession with no new construction, so some of this now is catch-up," Hunt says. "We're not worried about overbuilding."

To keep current on developments in Texas real estate, visit the Texas A&M Real Estate Center's RECON site.

telecommunications. And then there's "Jerry World" (aka AT&T Stadium), home of one of pro sports' most valuable franchises.



AUSTIN

The state capital boasts one of the nation's highest quality-of-life ratings, along with a young, well-educated, tech-savvy workforce that continues to attract both established firms and upstart entrepreneurs. The influx of West Coast and high-tech émigrés seeking relatively low business and living costs continues unabated.

"It doesn't happen
if you don't have job
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— **HAROLD HUNT,**
Research economist, Texas
A&M University Real Estate
Center in College Station



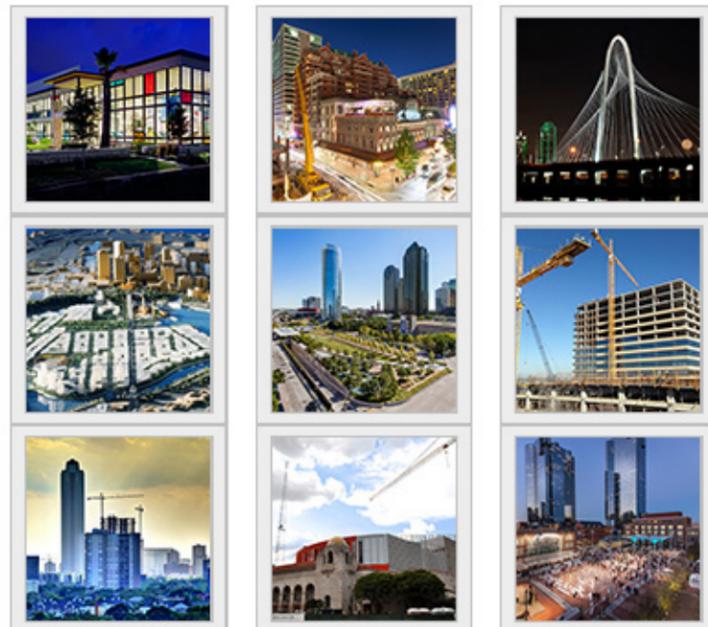
CRE 101

Commercial real estate (CRE) is a catchall term referring to investment-grade, income-producing, non-residential property. The main categories of CRE are office, retail and industrial, the latter including manufacturing and warehouses and distribution centers. Multi-family housing is a commercial asset class sometimes considered residential as well, for obvious reasons. Lodging (hotels and motels), self-storage centers and medical offices are smaller but important categories.

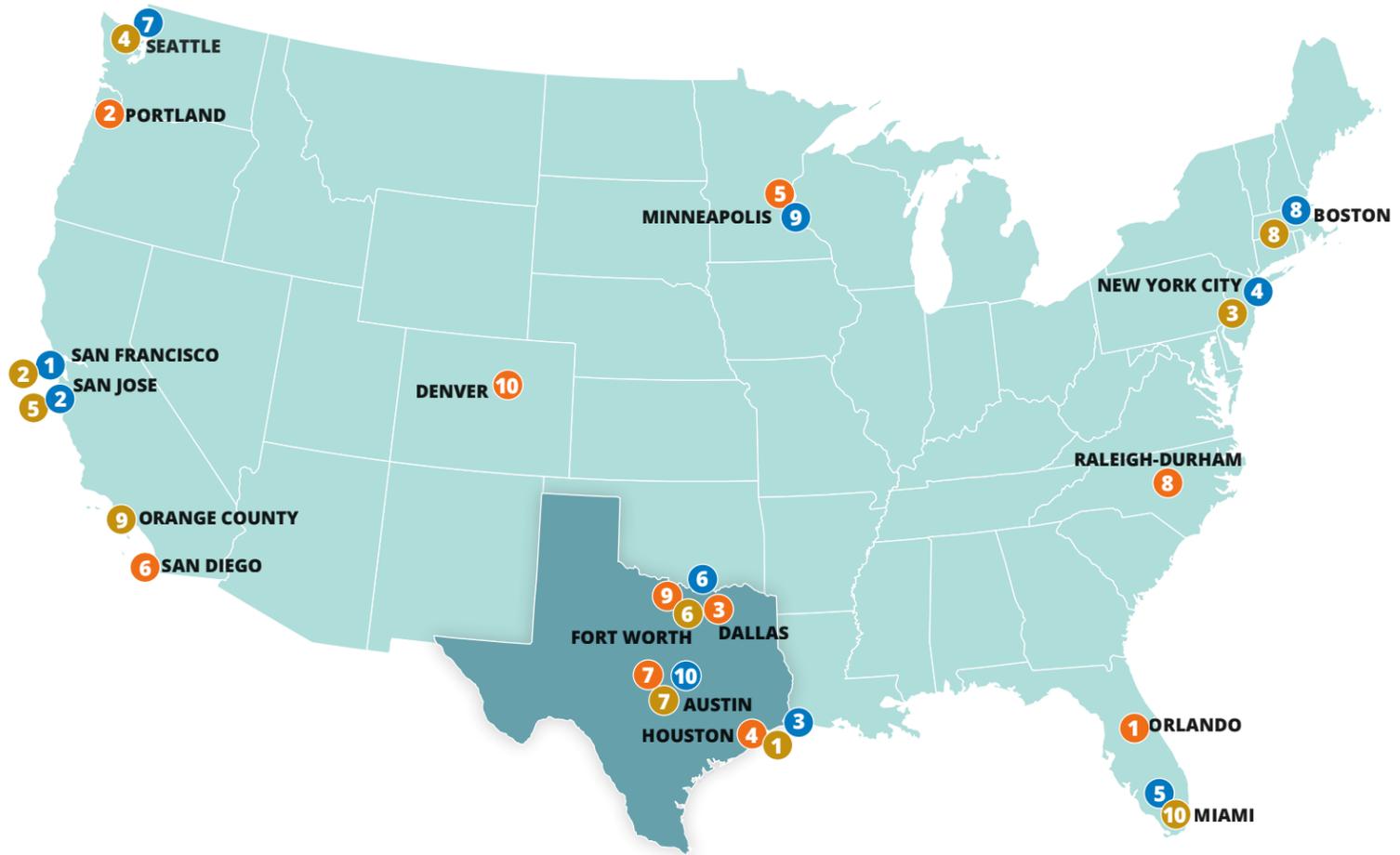
CRE activity is measured by the net change in occupied space, or “absorption” in industry parlance. Absorption reflects how much total space remains available over a certain time period. CRE professionals use these data to track market supply and demand. Recently, Houston and Dallas have become some of the nation’s most “absorbent” markets; there’s a whole lot of leasing going on. Greater absorption increases occupancy rates, or the percentage of rentable space that actually is rented.

As with any business enterprise, when demand for space exceeds the supply, it usually leads to higher rents — as in Houston, Dallas and Austin these days — and more income for investors.

RECENT COMMERCIAL REAL ESTATE DEVELOPMENT IN TEXAS



RECENT RANKINGS SHOW TEXAS SUCCESS



Numbers indicate ranking in the respective category. Low number indicates a higher ranking.

NOTE: Coldwell Banker Commercial groups Dallas-Fort Worth as one metropolitan area, while PricewaterhouseCoopers define them as separate cities.

TEXAS TOPS IN 2013 COMMERCIAL REAL ESTATE

In Coldwell Banker Commercial's *Top Commercial Real Estate Markets: Market Comparison Report*, released in January 2014, Texas accounted for four of the top-10 markets.

TOP 10 COMMERCIAL REAL ESTATE MARKETS, 2013*

RANK	CITY	RANK	CITY
1	Orlando, FL	6	San Diego, CA
2	Portland, OR	7	Austin, TX
3	Dallas, TX	8	Raleigh-Durham, NC
4	Houston, TX	9	Fort Worth, TX
5	Minneapolis, MN	10	Denver, CO

*Ranking based on percent changes in vacancy, rental rates and population from third-quarter 2012 to third-quarter 2013, and percent change in unemployment from August 2012 to August 2013.

Source: Coldwell Banker Commercial

SUNNY OUTLOOK FOR COMMERCIAL REAL ESTATE IN 2014

According to the late-2013 report *Emerging Trends in Real Estate*, Houston, Austin and the Metroplex rank among the 10 U.S. metro areas with the best prospects for commercial real estate investment and development in 2014.

PROJECTED INVESTMENT

RANK	CITY
1	Houston, TX
2	San Francisco, CA
3	New York, NY
4	Seattle, WA
5	San Jose, CA
6	Dallas/Ft. Worth, TX
7	Austin, TX
8	Boston, MA
9	Orange County, CA
10	Miami, FL

PROJECTED DEVELOPMENT

RANK	CITY
1	San Francisco, CA
2	San Jose, CA
3	Houston, TX
4	New York, NY
5	Miami, FL
6	Dallas/Ft. Worth, TX
7	Seattle, WA
8	Boston, MA
9	Minneapolis, MN
10	Austin, TX

Source: Urban Land Institute and PricewaterhouseCoopers