

Forecasting Texas' future:

UNT professor delivers five-year economic outlook



John Baen, Ph.D.

BY BRANDI SMITH

Lively, dramatic and certainly not shy, John Baen, Ph.D., delivered his five-year economic forecast to a packed house at North Texas CCIM's November meeting. The University of North Texas real estate professor moved through topics at a rapid-fire clip, jumping from Greece to the Fed to emergency care clinics.

"There's an awful lot of people who want to hear what I'm about to say, as though I know the future," Baen told the crowd. "You know I don't, but I do have an opinion."

He started by focusing on the international picture, addressing Greece's financial crisis ("It was a non-event two years ago at this meeting, except that right now they're having chaos and meltdowns."), India's decision to eliminate certain cash denominations ("It's just an absolute meltdown. Guess what real estate's doing? Going absolutely through the roof."), Russia's impact on oil and gas ("It's going to make prices go up some more.") and China's attempt to slow down its property market ("You can only have one house per family, so couples are getting a divorce to buy two houses, then getting married again.").

Here in the United States, Baen said the economy is limping along with just 2.3 percent growth.

"We need 2.6 percent growth in order to keep our heads above water and to stay stable," he said. "To spur this economy on, we need to create more capital. The Fed and this country need some inflation. We have plenty of appreciation in Texas, so people are coming here. The rest of the country needs a little higher interest rate; they need some healthy inflation. Healthy inflation. That just sounds hard to say, but it's true."

That "healthy inflation" will likely be the result of increased interest rates in December. According to the minutes of the Fed's November meeting, most officials think a rate increase would be appropriate "relatively soon." That, Baen pointed out, will have an impact on the national debt.

"[It's] still going up. It's not going down at record-low interest rates," he said. "If interest rates go up, it's going to blow up the federal budget."

The Fed's decision could also trigger a violent reaction on the stock market, according to Baen. "Stock market volatility is out the roof right now,"

he said. "How long does it take bad news anymore to travel to the stock market? About a millisecond. There are people playing it by the millisecond."

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Should interest rates go up in December, Baen said he expected the lending market to tighten up.

"The demand for money is going up. They can't print it fast enough for the kind of money we're talking about. You need to go long right now again. Nail them down. Pay a point to nail it down if you have to," said Baen. "A construction loan without a permanent loan commitment right now, I think, is suicide. It's going to cost you some money."

He said other factors that will influence the real estate market nationally, as well as here in Texas, include the oil and gas industry. In what Baen described as "real chaos," he pointed out that in the past few years, 67 such companies went bankrupt and another 130 are pending.

"We have 9,000 wells that have been abandoned because of the oil meltdown. They go off and leave them," he said. "This is Texas and Texas is about oil and gas taxes, which pay for all of your highway projects and everything else. Right now, because production is going down, the state isn't receiving the taxes that allow it to not have a state income tax. We're concerned about that."

"But", Baen added, "oil prices will cycle."

"The price is going to be \$74 a barrel within a year. They're drilling like crazy in West Texas. I think they're going back to work," he said. "It's going to be

OIL PRICES

OK in Texas. It's going to be OK."

As the oil industry rebounds, the rest of the Lone Star state's economy is booming, thanks, in part, to actions made by other states, such as California.

"California lifted its minimum wage to \$15. That is great for Texas. Ours, is \$9, so everybody leaves California and comes here to start their business," said Baen. "It costs less to go broke in Texas."

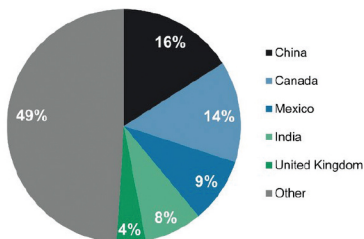
Despite setbacks posed by the oil and gas slump, he asserted the real estate industry is going strong.

"We have 10,686 residential real estate salespeople. They sold 101,000 houses last year, so each one is selling about ten houses," Baen said. "An average house is about \$247,000, so real estate agents are doing really, really well."

He suggested residential home sales have rebounded significantly as lending restrictions following the Great Recession eased.

Home Country

Chinese buyers surpassed Canadians as top foreign buyers of U.S. homes.



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"If you have a pulse, you can get a house," said Baen, adding that many buyers aren't American, but instead come from all over the world.

"One in six or one in seven houses is being bought by foreigners right now. They don't need financing. They're writing a check for it," Baen said.

He pointed to another trend among foreign buyers: the "lifetime home" approach they often have to purchases.

"Instead of going from the starter home to a middle-sized home to executive home, back to middle-sized home, back to a condo, back to the nursing home and then to the cemetery, they're talking about this 'lifetime home.' In other words, a three- or four-bedroom is the starter home and the ending home," Baen said. "There are two neighborhoods in Frisco where there has not been one foreign seller. They keep them forever."

A key result of that is a lack of foreclosures, especially in North Texas.

"They're not selling them on the foreclosure. They're selling before foreclosure," Baen said. "Only 30 of 141 houses went back to the third party. Only thirty. The rest of them made a deal."

"Residential sales play a key role in development," Baen said, because "rooftops come before retail." The retail industry, through, is struggling as sales lag. Baen suggested they are down as much as 35 percent.

"Rents are going to start shrinking, footprints are going to get smaller, older shopping centers are going to get re-configured. The market value is going to go down. The cap rates are probably going to be headed up."

He laid part of the blame on the urgent and emergency care storefronts that seem to be popping up everywhere.

"What happens is they build them on the best corners. It's really expensive construction, really expensive land, really expensive financing," Baen explained. "The rents are extremely high and the rate of return is unbelievably high. Why? Because the risk is so high."

Other sectors appear to be doing well, according to Baen. He described the mini-warehouse business as "as strong as goat's breath" and the office market as "on fire, booming."

On the apartment front, Baen said he suspects the

U.S. is at its peak.

"Rents have been going up. That's awesome. Rental rates at a record high," he said, tempering it with: "Because of bond market changes and interest rate changes, people are already having a little trouble going from a construction loan to a long-term fixed."

As an example, he pointed to Houston, which has seen a 15 percent decline in luxury apartment rates.

"Anything over \$600,000 in Houston right now is down between 12 and 19 percent in sales in the last 90 days," Baen said. "So it's slowing down."

North Texas, though, "is now considered a gateway to investment worldwide like New York, like L. A., like Chicago," according to Baen.

"Dallas has a long way to grow in terms of distribution, particularly air distribution. It's going to be really huge," he said. "DFW Airport is now leasing a lot of land for industrial projects on 50-year ground leases."

Baen hinted that there is tremendous potential about to be uncorked around the Metroplex.

"There are 42,000 lots for sale, under construction or planned immediately between Prosper and Denton, north of U.S. Route 380," he said. "We're talking about a lot of houses out there."

As developers navigate the market in the months and years to come, Baen suggested they keep those factors in mind, as well as one other: location, location, location.

"Underwater homes take on a new meaning because of the new FEMA requirement for flood insurance," Baen said. "Just stay out of the floodplain."

"But," he said, "keep your eye on those large tracts that pop on the market."



"The basis of wealth is still land. It is very, very long term," he said. "Big ranches are in demand, but the prices are not going up and the liquidity has gone down because of the oil and gas business."

"In the end," Baen said, "Texas is the place to be when it comes to the real estate industry: 'We have oil. We have land. We have a positive attitude. We have Texas personalities. We have jobs. It's just looking so good. It's just unbelievable for Texas.' ●