

DFW Market "As Good As It Gets":

for Institutional Investment

RealShare | DALLAS/FORT WORTH

BY DIANE VELASCO

The DFW market is "as good as it gets" for institutional investment opportunities, according to a panel of commercial real estate experts who convened at the RealShare Conference in the Hilton Dallas/Plano Granite Park on Nov. 16 to share insights, trends and predictions on market sectors.

"We believe in the DFW market because we are seeing job growth here rather than job replacement, and it has the ability to maintain this growth," said Pam Boneham, managing director for Barings Real Estate Advisers, part of a global investment group with \$284 billion under management. "This is as good as it gets - additional land and ability to create supply are keeping things cost effective in DFW."

Job growth and abundant supply were echoed by most as key components for continued investment in DFW and around the state. With 122,000 jobs created in 2016, Texas is number one in the country by percentage of growth and number two, behind New York, in total number of jobs created, according to Steve Pumper, executive managing partner with

Transwestern Investment Group, who moderated a panel of institutional investors.

The sheer strength of the job market makes the Lone Star state shine, keeping companies like asset management firm KBS focused on DFW and Austin, said Ryan McManigal, vice president and asset manager.

"Our largest portfolio is here in Dallas, and 97% is leased space, which is driven by job growth," he said. "We are focused where we think jobs will continue to grow, including Austin and other smaller markets around the country, such as Nashville."

Abundant supply, compared to many other major metropolitan areas, is another strong draw for office, industrial, multi-family and mixed-use investors.

Beyond strong fundamentals driving corporate relocations, Dallas, in particular, is growing due to its overall desirability - from mild weather to parks and arts, said David Cohen, managing director at Ready Capital Structured Finance.

"I see a lot of cities all over the country, but nothing like Dallas," he said. "It has tremendous suburban growth, but also the work, live, play environment in both Uptown and Downtown is very desirable."

The experts weighed in on each sector of the commercial real estate market.

Office - Creative Space, Amenities Key Demands



The power and influence of technology for today's modern worker is driving an upswing in demand for office flex space on the leasing side, said Joshua McLeod, vice president of Regus, one of the world's largest providers of office space.

"With the acceleration in business cycles, which impact how businesses operate and their levels of



Brad Davey



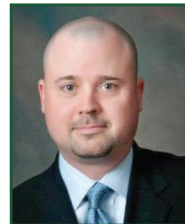
Colin Fitzgibbons



David Cohen



Pam Boneham



Jason Geer

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RealShare 2016 Panelists



Joshua McLeod



Patrick Hackett



Roger Davis



Ryan McManigal



Steve Pumper



Tony Creme

staffing, companies are looking for more flexibility,” he said. “Also, knowledgeable workers work more than eight hours a day, and they don’t necessarily work those in the office. Corporate buyers know they have to build office space that inspires office workers.”

Demand is rising for collaborative, open work areas, not just traditional space, as well as for amenities such as rooftop decks and outdoor common eating areas like food halls.

“We are seeing a greater percentage of square footage being allocated to amenities now than there ever has been,” said Colin Fitzgibbons, vice president of KDC Real Estate Investment & Development, a leader in build-to-suit space.

Another trend is a de-emphasis on parking space as companies encourage workers to walk, bike and Uber their way to work.

“On a smaller scale, we’re seeing a lot of build-to-suits for creative companies and technology companies,” said David Cohen, managing director of Ready Capital Structured Finance.

Leasing momentum and rent growth remain strong.

“Our exposure to the Dallas office market in the last six years has been on the value side – we’re watching value office rents increase as the top of the market increased too,” observed Patrick Hackett, vice president of acquisitions for real estate investment management firm Stockbridge Capital Investment. “There’s plenty of new supply – the market is showing broad-based growth.”

Industrial – The “New Retail”



DFW is a core market for industrial investments, said Roger Davis, director of Northwestern Mutual Real Estate Investment. The firm considers DFW a top-five market.

“We’re bullish on industrial, especially on warehouse space,” he said. “Industrial is now our second priority, behind apartments – it’s the new retail.”

“The industrial sector is not overheated in DFW and the vacancy rate is still very attractive, according to Pam Boneham. “Additional supply is coming online, but not as much as in the last two years,” she added.

She predicts the industrial sector will continue to see good returns in rent growth in 2017 and 2018, though not as much of a spike in rents as the market has experienced in the past two years.

Hackett said Stockbridge has been a big buyer of industrial this cycle, and he is excited about its prospects going forward.

“We’ve seen recent new trades go beyond replacement cost, something we track pretty closely,” he said. “We have turned toward some of the Class B products, which are enjoying growth in small business, and we’re seeing better rent growth without the competition from new supply.”

Growth in this sector is reflecting demand for data centers, driven by the explosion in smart device technology, said Tony Creme, senior vice president with industrial developer Hillwood.

“There are three smart devices per human being on earth, and that’s driving demand for large data center space,” he explained.

He cited FaceBook’s plans to triple the size of its Fort Worth data center to five buildings totaling close to 2.5 million square feet rather than three buildings totaling just 750,000 square feet. The social media giant sees 45 billion messages and two billion photos posted across its platform daily, Creme said.

Multifamily – Factors in Its Favor



Several factors bode well for the immediate future of multifamily as an investment class, Davis said.

“Lenders are tapping the brakes on construction lending, starts and permit levels are down 50 percent and, with two-year delivery schedules, it’s looking good for multifamily,” he said.

Fifteen new projects coming to Uptown Dallas will create some softness in that market and some surrounding markets, but because of continued job growth, the supply will be absorbed in 12 to 18 months, Boneham said.

The challenge is predicting sustainable rent growth as rents reach up to \$5 per square foot.

“Definitely the big question is how many \$3 to \$5 renters are there?” said Jason Geer, managing director of Invesco Real Estate. “It’s not the millennial

demographic that can afford those rents.”

Still, Dallas rents are conservative compared to major markets like San Francisco at \$8 per square foot, and DFW offers good opportunities in suburban markets that are not overbuilt, where millennial are choosing to live, work and play, the panelists noted.

Retail – The “Wild Card”



Despite growth in jobs and household incomes in the area, the DFW retail sector is as impacted by digital shopping trends as other markets are, making investors more cautious.

“The e-commerce revolution means retail is now the wild card,” said Brad Davey, senior vice president with real estate investment firm Clarion Partners.

The firm looks for power centers with grocery anchors and experiential businesses that offer something shoppers can’t get online.

Boneham noted even traditional grocers are facing new threats from Amazon and Walmart, which have begun offering online grocery shopping capabilities.

“We remain interested in investment in well located retail, but now we evaluate additional aspects,” she said. “Credit worthiness of tenants is changing in ways we didn’t expect.” ●

Concerns for the Future

Top concerns, not just for DFW, but for the economy as a whole going forward included ineffective federal monetary policy in the event of another economic downturn, tighter trade policies that would hurt imports (impacting warehouses and other industrial space) and cyber terrorism or other black swan event that would disrupt supply and demand, especially any that might turn healthy development into a glut of product.

The good news, panelists agreed, is the overall strength of the Texas economy.

“There’s a lot of power and momentum behind this economy,” said McLeod with Regus. “The demand trend is there for at least up to three years.”