Texas Economic Forecast for 2021

BY RAY HANKAMER

Moderator: Reid Wilson, Wilson Cribbs & Goren. Panelists: John Hammond, Riverway Title; Patrick Duffy, Colliers International; Robert Cromwell, Moody Rambin; Josh Friedlander, NewQuest Properties; Stewart Geise, CBRE Austin; Corey Ferguson, Raintree Commercial; Scott Norton, Texamerica Center.

Takeaway

In spite of the COVID troubles of 2020, there are a lot of "green shoots" in commercial real estate in Texas, and 2021 promises to be a year of renewal and opportunity, with new COVID-inspired efficiencies. Each quarter this year should be better. That said, there will also be a lot of rough spots between borrowers and lenders, landlords and tenants, evictions and rent deferrals/forgiveness, and so on. Overall, it may be '23 or '24 before full return to stabilization. Companies and employees from higher cost of living states are moving to Texas cities, which will create new needs here for transit and other forms of mobility and public services.

- Real estate opportunity funds are raising billions of dollars, and are looking for opportunities

- Even with the onset of COVID early in 2020, most pending real estate transactions DID close as forecast

- Real estate lawyers are busy as landlords and tenants alike face debt stress, and create plans for new development

- Big question which will be answered as we move forward into the year: what kind of space do tenants really want for their employees, and for the continued dynamism of their companies? The trend is not yet clear to landlords or tenants; how will landlords react to tenants' changing needs when the tenants themselves do not know what how their needs will develop?

- Employees may be "elevator-averse" well into the future, and this will impact high-rise office settings; trends are gently pointing away from CBD and to less dense settings in the suburbs; there is a lot of vacant office space on the market; some tenants are even configuring to larger SF in their offices to increase distancing

- By the third quarter we will know better where the economy is going

- Industrial has been the strongest segment in CRE during COVID and

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logistics has held up well, as deliveries + e-commerce have fostered growth; with increased focus on delivered food, cold storage facilities are in increasing demand

• O&G upstream seems to be stabilizing and beginning to "return" with price per bbl at $50...more rigs coming back to work; this will drive industrial occupancy and office occupancy; increased activity in O&G will also affect other businesses such as high-end restaurants, and hotels where industry conferences take place

• Retail in first half of '20 was bad, but by mid-year was beginning to return to normal, with some hit hard and some booming, such as grocery, liquor and pet supplies; the hard hit ones will come back in '21, if they make it; good times are ahead for most retailers; big box spaces vacated by some retailers usually are quickly re-leased/re-purposed; development of retail follows rooftops; retail landlords are both abating and deferring rental payments to keep good tenants who are going through momentary stress—"blend and extend" is a term some are applying to landlord efforts to work with tenants

• Restaurants have been mixed, with those with patio/outdoor seating and drive-thru surviving, and those featuring high-end high-service suffering; new restaurant construction and renovation of existing will see the "COVID features" included for the future, including necessary use of endcaps on strip centers for drive-thru windows

• Multifamily has fared well except for the lower-class projects, where there are rent-stressed tenants

• Office has seen churning of tenants as some have moved to higher class, newer buildings which have lowered their rates; quoted rents have fallen 10-20% in some cases to hold existing tenants in a highly competitive market; it is hard for tenants with leases coming up for renewal to make decisions given uncertainty about their future remote working policies; some landlords and tenants are agreeing on shorter-term lease renewals to give the future time to come into focus; office building operating expenses are falling in some cases, and savings are passed on pro-rata to tenants, resulting in lower monthly rents; occupancy has remained strong in CBDs in spite of large percentages of workers working from home

• Medical real estate development is influenced most by population growth; however, expansion has been slowed as COVID cases have displaced the more profitable elective surgery revenue for hospitals; many smaller practices are leaving the hyper-dense medical centers and are moving to the suburbs, where the patients and their families live; smaller urgent care facilities are taking the place of emergency rooms in some cases

• With regard to investment sales, there continues to be lots of money waiting on sidelines for opportunistic buys

• In addition to lower rental income, office landlords are looking at physical upgrade costs for more distancing and ventilation improvements, and there is the problem of people not wanting to crowd in elevators; there is a significant difference in the acceptance by tenants of pre- and post-2003 era buildings; addition of glass partitions and addition of spacious "collaborating space" may be required in some building to retain and attract tenants

• Houston remains very competitive with the two other coasts in rental rates and cost of living

• The Houston economy is bigger than the economies of thirty-one states, and is growing; we are "in a good place" economically; we have lots of land, and growth is spilling over into Waller and Chambers counties

• With regard to new development, the major Texas cities have a lot of land to grow, except Austin, which has topographical and mobility challenges; proximity to ports (sea and air), to major highways/parkways/loops and to rail drives development in this day of e-commerce and logistics/delivery; Austin city fathers are examining the San Francisco area to see what has worked there; a large mobility project is up for voter approval in Austin; California "immigrants" are transforming Austin, which has a new moniker: "Silicon Hills"

• Repurposing of a large, abandoned government base near Texarkana is creating relocations for many types of companies which depend on rail and highway access and two- to eight-hour driving time to numerous metro areas with populations 450,000 and above; over 12,000 acres are in redevelopment there; successful re-development in spite of inertia which comes from dealing with government bureaucrats

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