

the big idea

BRIGHT SPOTS IN A DARK MARKET

Lone Star State Outshines other Real Estate Markets

As many parts of the country are battling unfavorable economic and housing market conditions, the Lone Star State continues to shine amid the gloomier national outlook. Although Texas historically has not been immune from national economic slowdowns, there are several factors that have enabled Texas to weather the current down-cycle better than many parts of the country including a more stable and affordable housing market, a rapidly expanding demographic base and workforce, booming local industries including energy, trade, technology, and transportation logistics, and an overall business-friendly environment. These favorable market and demographic fundamentals, combined with an increasing shift away from greenfield projects, which have traditionally dominated the Texas development landscape, towards more compact development projects (including urban and suburban infill, mixed-use, transit-oriented development, and traditional neighborhood development), has led RCLCO to pursue a physical presence in Texas.

To be sure, Texas markets have not been immune to the real estate downturn. There are certainly signs of a slowdown in the Texas housing market (from 2006 to 2007 housing starts decreased by 19.3% for the state), however home inventory levels in major Texas metropolitan areas have remained relatively stable over the past twelve months. Some of this stability is due in part to its relative affordability (% of income spent on housing: 16.6% in Austin, 14.2% in Dallas, 16.6% in Houston, and 17.6% in San Antonio) and its gradual, sustainable appreciation that occurred over the past several years, much of which is driven by low barriers to entry for new development including plenty of available land and relatively low land prices. While many hot markets experienced unsustainable appreciation reaching 20% annually and higher, Texas metros experienced annual appreciation rates ranging from 3% to 5% on average, depending upon the metro area (from 2003 to 2007 average annual appreciation: Austin 4.7%; Houston 4.4%; Dallas 3.5%, San Antonio 11.6%) and the submarket within the metro (some in-town areas of Dallas, Houston, and Austin experienced appreciation rates of 10% or higher), resulting in less downward pressure on prices after the National housing slowdown began (price appreciation continues to

moderate in Texas, but remains positive in most metro's favored growth corridors). In addition, as the nation's housing markets cooled and national homebuilders began dialing back production, permits and new home deliveries in Texas began to decelerate which allowed new home production to stay in balance with reduced demand as a result of the subprime mortgage crisis, which certainly had a strong effect on demand at lower price points across the state.

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In addition to a relatively healthy and affordable

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housing market, Texas' booming population (for the past two years, the population growth rate in Texas has been more than double the national rate and is expected to continue on that trend) and low unemployment, (unemployment rates range from 3.6% in Austin to 4.2% in Dallas, well below the national rate of 5% as of April 2008), speaks to its ability to retain and attract a talented and diverse workforce. This workforce, estimated at nearly 10.3 million as of year-end 2007, is also among the youngest in the nation, with 25% to 29% of the population in Dallas, Houston, San Antonio, and Austin (Austin has most significant concentration with 29% of any major metro in the nation) concentrated in the 18-34 age range (only 15 markets nationwide have concentrations at 25% or higher). This large labor force combined with its affordable housing markets, low taxes, regulatory certainty, and quality of life has propelled Texas past New York as the state with the most Fortune 500 headquarters (58) in the nation, enhancing its ability to retain its existing workforce while attracting new talent. These fundamentals have allowed the state to compete at a very high level and lure industries and corporate headquarters from other economic powerhouses such as California and New York, where the cost of doing business and the cost of living continue to escalate.

Not only has Texas been successful in attracting in-

dustry and employers, but it is also emerging as an attractive retirement destination for many of the same reasons industry is choosing Texas including its affordability and quality of life. The retirees drawn to Texas include Texas natives returning home as well as retirees seeking close proximity to family members, children, and grandchildren that have been drawn to the area for employment opportunities. This influx of retirees (6.8% capture of all U.S. retirees migrating to another state in 2005, surpassing Arizona and California to become the 2nd highest in the US next to Florida) is opening opportunities for second-home, pre-retiree, and active-adult communities in the Texas Hill Country and other areas in close proximity to major metropolitan centers.

In the past ten years, the emergence of new development concepts, more commonplace in many other markets across the country, are bucking the conventional mindset in Texas whose metropolitan areas have been largely unconstrained by physical or natural barriers to development, resulting in a rapidly sprawling pattern of growth in most urban areas. Despite aggressive toll-road building programs, traffic congestion continues to be a major problem for most of the large Texas metros, resulting in a growing reflection of demand from the outer fringe towards areas closer to job centers and key retail nodes. It can be further argued that increasing energy costs, while a boon to



job growth in energy-heavy cities such as Houston and to a lesser extent Dallas-Fort Worth, will impact Texans' transportation costs and further fuel this trend. This reflection of demand has not necessarily reduced the demand for high-quality, well-conceived development projects in outlying regions of metro areas, but has fueled demand for more strategically located and/or compact developments that offer a more mixed-use, walkable alternative to conventional subdivision development found in most areas of the state. This trend is most evident

in Houston's Inner Loop as well as Uptown Dallas, Downtown Austin, Downtown San Antonio, and numerous other submarkets connected by transit. With the coming boom from Generation Y, a generation larger than the Boomers (80+million vs. 77 million) which is a huge share of Texas' population base (6.6 million or 28% according to 2007 population estimated by Claritas), the demand for lifestyle oriented and walkable developments will likely increase. Texas metropolitan areas are paving the way for these projects through the development of commuter and light-rail transit systems (Dallas, Houston, and Austin), enhanced zoning measures (Houston excluded) to allow for infill mixed-use developments, and downtown revitalization initiatives.

Finally, immigration and therefore housing appealing to various ethnicities, particularly Hispanics, is going to be a growing opportunity in Texas. For example, much of the housing growth in Texas' future will be driven by immigrants and Hispanics (the US will be the largest Hispanic nation after Mexico by 2040), and Texas will be home to one of the fastest growing Hispanic populations in the nation (since 2000, 43% of Dallas-Fort Worth's and 56% Houston's metro growth is attributed to Hispanics). Understanding home and community features that Hispanics and other ethnic

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groups value is and will continue to be necessary when designing and programming communities and housing products to satisfy ethnic, cultural, and lifestyle preferences. Developers who can adapt their product offerings to meet the demands of these diverse groups will be in a position to take advantage of these growing and underserved market segments.

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ties for creating vibrant new projects, neighborhoods, and communities appealing to the demands of these diverse groups and evolving lifestyles. While RCLCO has been active in Texas for over 30 years, starting with the Woodlands, we have never been more bullish about the future of real estate in Texas. Our ability to apply the insights and experience gained over 40 years and thousands of projects continues to be extremely rewarding for our firm and our clients. Within the past two years alone, RCLCO has been involved with numerous innovative projects that are helping to redefine the development landscape in Texas, including resort/2nd-home developments in Dallas, Houston, and the Hill Country, infill mixed-use projects in Houston and Dallas, hotel residence developments in Houston, transit-oriented development in Austin, multi-family projects in San Antonio, and MPC developments across the state.

Todd LaRue is a Vice President with RCLCO in charge of strategy, advisory, and development services for the Texas marketplace. He will be leading our Austin office and can be contacted at 404-601-0557 or tlarue@rclco.com.



on the ground

REGENT SQUARE



RCLCO was recently engaged by GID Urban Development Group to conduct a market feasibility study for Regent Square, a proposed infill, mixed-use development in Houston, Texas. The twenty-four acre site, formerly an aging and sprawling apartment community which had experienced years of decay, proved to be extremely attractive for redevelopment into a mixed-use community given its direct frontage along Memorial Park, close proximity to the prestigious River Oaks neighborhood, and quick access to Houston's largest employment cores including downtown, Houston Medical Center, and the Galleria. With plans for over 1,000 residential units (condominium towers and midrise apartments), approximately 230,000 square feet of retail, and up to 300,000 square feet of office space, GID is embarking on one of the most significant efforts to reshape Houston's popular Inner Loop area by creating a vibrant, walkable, mixed-use environment, substantially raising the bar for future development in the area. The site has been cleared and development is expected to begin in 2008.

RCLCO's analysis provided several key insights for GID:

- **Condominiums** - RCLCO broke down the market into two distinct target markets—younger professional singles and couples and more affluent empty-nesters and retirees, each with different purchase motivations and preferences—and recommended developing distinct buildings, each targeting the unique requirements of the diverse market audiences.
- **Apartments** - through case studies, RCLCO helped GID identify the specific premiums applicable to apartments in a mixed-use setting, which allowed GID to push average rents upwards of their initial expectations.
- **Retail** - RCLCO helped define a specific trade area in order to drive specific tenant recommendations—despite five other high-end mixed-use projects currently in the Houston pipeline, RCLCO demonstrated that the subject site's trade area has minimal overlap with them, allowing GID more freedom to target a wider variety of retail tenants who are unrepresented in the trade area.
- **Office** - recognizing the strategic location between major employment centers and Regent Square's unique mixed-use setting, RCLCO helped identify opportunities to deliver high-quality office space in a fairly stagnant office submarket (Allen Parkway). Regent Square's location and attributes allow it to not only take advantage of the tremendous amount of new infill residential projects occurring in the neighborhood, but also to deliver a high-quality alternative to the office towers and office parks in the more congested areas of downtown and the Galleria.

minding your strategy

YOU MAY KNOW WHERE THE MARKET IS, BUT DO YOU KNOW WHERE YOU ARE GOING?



Many homebuilders have relied on the herd mentality when building a business plan; that is, they watch what others are doing and follow them. The problem with this is most builders are focused on the now and are blind to changing conditions until after they happen and stay frozen until something moves the market. On May 17th, with Phoenix mired in the worst selling market since 1995, one homebuilder took reservations for 106 homes that have yet to be built, from buyers that camped out for up to three days. Becoming a market leader does not happen by pure luck.

Good strategic planning can put your company on a better foothold to plan for the future; when it comes to strategic planning for real estate companies, RCLCO literally wrote the book. For example:

- Are you preparing for the coming echo-boomer market, which will be turning 25 in 2012? Do you know where they want to live?
- Have you considered if your company would run more smoothly by using a decentralized Project Orientation style of management, or by using a more centralized Process Orientation strategy?
- Should your diversification plan move your company into more markets, or have you broadened

development efforts to include income-producing properties in order to create long term cash flow opportunities?

Planning is also an ongoing endeavor. Two years ago, some large builders touted even-flow production schedules and national purchasing contracts as ways to greater production efficiency. What is the right move for today and the new realities of the slower market?

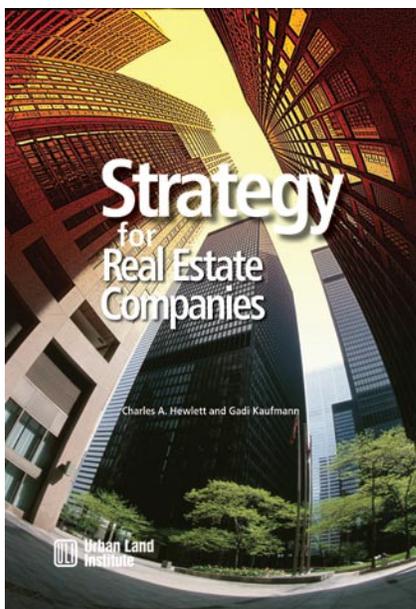
There may never be a more important time as now to take stock in where your company is and where it should be going. Talk to one of our Managing Directors and let us organize a strategy session for your company. We may not tell you what you want to hear, but we will tell you what you need to hear. That's our promise.

Eric Brown is a Managing Director based in our Los Angeles office.

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RCLCO in the Community

THE COMMUNITY ECONOMIC DEVELOPMENT INSTITUTE (CEDI)

The Community Economic Development Institute (CEDI) trains and empowers residents of America's inner cities in sustainable economic development principles and practices. In doing so, the organization helps them create communities based upon their own visions. In May 2008, two members of RCLCO's Atlanta consulting team assisted the CEDI in educating community members on the key factors that developers and retailers consider when locating new stores and commercial centers. The residents of Atlanta's southside neighborhoods will put this lesson to use as they work with the Annie E. Casey Foundation to attract development to a 31-acre site near their homes, Turner Field (home of the Atlanta Braves baseball team), and the future Atlanta Beltline (a planned network of parks and transit encircling the city). With the help of RCLCO, the surrounding neighborhood may one day see its vision become reality.

RCLCO Vice President, Jonathan Bartlett; and Senior Consultant, Geoff Koski volunteered to lead a CEDI training session at The Center for Working Families conference center in southwest Atlanta. This session highlighted four key elements to commercial site selection—demand, supply, site features, and building space. A thorough understanding of these considerations helped the institute participants better understand not only what types of commercial development they can expect to attract to the redevelopment site in their neighborhood, but also why the current commercial offerings in their vicinity evolved as they did. Their hope is to use this lesson to improve their future surroundings.

"People felt like they really learned something," commented CEDI director Kathryn Brice.

After leading the participants through the basics of retail site selection, Bartlett and Koski facilitated a "real world" learning experience, in which the class divided into small groups to choose the most likely location for a new CVS pharmacy. The groups applied the RCLCO principles of site selection to three pre-determined sites, and, with the help of aerial photographs, decided upon an optimal location.

To promote economic development, the Annie E. Casey Foundation purchased 31 acres on University Avenue in Atlanta and presented neighborhood leaders with two goals: 1. help them realize a return on their investment, and 2. employ community involvement in the planning. The CEDI class evolved out of a desire to get residents to the point of meaningful engagement in the development plans. Indeed, graduates from the 2007 CEDI class are already leading some of the discussions regarding the site's development, such as types of housing, commercial presence, and technology needs. RCLCO helped train that class as well. Senior Associate, Chris Volney, played a facilitator role. Volney observed that, "this RCLCO/CEDI partnership demonstrates our commitment to contributing to the community."

With the knowledge supplied by RCLCO, CEDI participants will have the ability to shape the future of their neighborhood and their city.



Geoff Koski helps CEDI participants determine the most likely location for a CVS pharmacy.

upcoming events

May 2008

Terry Underwood

May 28, 2008
 ULI - The Real Estate Development Process: Part I
 Market Analysis: Finding Profitability
 Beverly Hilton
 Los Angeles, CA

Charles Hewlett

May 29, 2008
 ULI Strategy Workshop
 Strategy Planning in an Era of Change
 Sacramento, CA

Charles Hewlett

May 30, 2008
 ULI Strategy Workshop
 Strategy Planning in an Era of Change
 San Francisco, CA

June 2008

Adam Ducker

June 12-13, 2008
 ULI MPC Conference
 "Smarter, Denser, Closer"
 Moderator
 Washington, D.C.

Charles Hewlett

June 3, 2008
 ULI Strategy Workshop
 Strategy Planning in an Era of Change
 Phoenix, AZ

Shyam Kannan

June 24, 2008
 PCBC Builder-to-Builder Green Forum
 "Marketing Green Residential Development"
 San Francisco, CA

Bob Gardner

June 24, 2008
 PCBC Builder-to-Builder Green Forum
 San Francisco, CA

Charles Hewlett

June 25, 2008
 ULI Strategy Workshop
 Strategy Planning in an Era of Change
 Baltimore, MD

Shyam Kannan

June 25, 2008
 Pacific Coast Builders Conference
 Measuring the Market for Green Residential
 Development
 San Francisco, CA

September 2008

Charles Hewlett

September 17, 2008
 ULI Strategy Workshop
 Strategy Planning in an Era of Change
 Orlando, FL

Charles Hewlett

September 25, 2008
 ULI Strategy Workshop
 Strategy Planning in an Era of Change
 West Palm Beach, FL

announcements

We are pleased to announce the addition of David D. Dressler Jr. to RCLCO's leadership team. Dave is Managing Director of our Capital Markets Group, based in Los Angeles, California. He has over 25 years experience leading successful investment and real estate companies. Dave's expertise complements RCLCO's established advisory, transaction, and development practices, and enhances RCLCO's full service real estate offerings. We invite you to learn more about our new leader and to reach out to him for your investment, strategy, and advisory needs.



David C. Dressler, Jr.
Managing Director

Areas of Specialization: Public/Private Partnerships, Investment Management, Real Estate and Corporate Finance.

David Dressler is a Managing Director of RCLCO's Capital Markets Group Practice, based in Los Angeles. His work draws upon over 25 years of real estate investment, development and management experience. David is also a member of the Firm's leadership team and is involved in the design and implementation of client service delivery strategies.

Prior to joining RCLCO, David was Principal & Chief Acquisition Officer for MacFarlane Partners. David oversaw the investment and underwriting functions. He was also responsible for MacFarlane Partners urban investment activities in Southern California. Prior to joining MacFarlane Partners he was a managing director with Security Capital Group and a member of its investment committee. While there, he oversaw \$2 billion in multifamily residential property acquisition and development activity, and later served as co-chairman/president of Homestead Village, Inc., a \$1 billion, extended-stay lodging company founded by Security Capital.

David was a regional partner with Trammell Crow Residential Company, a national developer and operator of multifamily properties. He was responsible for all aspects of the firm's property operations in eight Northeastern states, including the development of more than \$800 million in apartment and condominium properties. Additionally, he served

on the firm's management committee.

David began his real estate career as director of residential development for Arvida Corporation, which develops master-planned and resort communities in the Southeastern United States. He also served as vice president and division president of Gulfstream Land & Development, where he oversaw the development of Argyle Forest, a 9,300-acre master-planned community in Jacksonville, Florida.

David holds a masters degree in business administration from Harvard Business School and bachelors degrees in psychology and philosophy from Yale University, where he graduated cum laude. He is the founder and former chief executive officer of International Marine, a fiberglass-sailboat manufacturer.

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about RCLCO

Since our founding in 1967, RCLCO has been at the leading edge of real estate trends and issues. Our impressive record of accomplishments has made us the "first call" for clients seeking strategic advice. We can help you with everything from market research to product programming; financial sourcing to deal structuring; conceptual design to development strategies. We set the highest industry standards by partnering with our clients to answer key questions and solve complex issues--offering strategic guidance that is always market driven, analytically based, and financially sound. Our real estate advisors help clients make the best decisions about property development, planning, and investment, so they can seize the right opportunities for tomorrow ... today. We are real estate consultants, analysts, financiers, developers, and designers--and we are dedicated to offering end-to-end solutions.

In 1985, RCLCO published its first Advisory Newsletter. Since then, subsequent issues have come to represent significant milestones in our intellectual history. Today, our e-newsletter provides over 5,000 real estate professionals with free research, tips, and original articles on various industry trends and issues.