

# CASE *in point*

Dallas/Fort Worth Office Market Brief

4TH QUARTER 2011

FEATURE ARTICLE:

## HEALTHCARE THE IMPACT OF REFORM ON COMMERCIAL REAL ESTATE

**Over the last 45 years, there have been a number of regulations and laws that have and will dramatically impact the commercial real estate industry, both nationally and in Texas.**

Beginning with the passage of the Medicare Act on July 1, 1966 which guaranteed government sponsored healthcare coverage for all citizens age 65 and older, healthcare employment increased 331% more than the national employment with an estimated 19 million people becoming Medicare beneficiaries. This significant increase in healthcare employment equated to more than 1 million healthcare jobs in clinics, hospitals, nursing facilities, etc., thereby increasing the demand for medical office space.

Then in 1989, as part of the Omnibus Budget Reconciliation Act, the Stark Law was passed. This law has forever altered the relationship between doctors and hospitals by, amongst other things, prohibiting doctors from making referrals to facilities in which the doctors have a financial interest. The Stark Law had a profound impact on the commercial real estate industry since the act made it no longer possible for a doctor to receive a below market lease rate when occupying hospital owned space, in return for which the doctor would make service referrals to the hospital. The effect of the legislation made hospital owned office space comparatively priced to off-campus space, resulting in new construction of buildings not controlled by hospitals to house doctors adding off campus technical services and out-patient surgery centers.

The latest impact is the Patient Protection and Affordable Care Act, known as Obama Care, signed into law on March 23, 2010 which expanded health insurance coverage for an estimated 32 million uninsured persons. The expanded insurance covered for this additional

segment of the US population will result in a greater demand for healthcare services and a corresponding increased demand for more healthcare facilities. Applying the commonly accepted industry formula of 1.9 square feet of medical space for each patient results in an additional 64 million square feet of new medical space required to accommodate the newly insured population. Additionally, in the next 16-20 years, the baby boom generation will add as many as 4 million people a year to that population segment for which another 2.1 million

square feet of new medical space will be needed. Unfortunately, for healthcare developers and landlords, there are a number of limiting factors for new medical facilities such as; the number of doctors, nurses, and other healthcare professionals; the ramp up time for medical schools to produce more healthcare professionals; lower reimbursements over time for doctors and hospitals for services, and a current supply of 580-615 million square feet of

vacant medical space. In sum, there are a handful of factors that will limit the demand for medical facilities in the short and mid terms.

Although the aging baby boom population, coupled with recent legislation expanding healthcare coverage will increase the need for healthcare facilities, medical office space as well as other product types such as retail, industrial, and office space for health related businesses, the question "How much demand will the new reform create?" remains. Nonetheless, it seems apparent that healthcare will be a vibrant growth industry for commercial real estate for many years to come. ■

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## RENTAL RATES

Quoted rental rates for Class A, B, & C office buildings in Dallas/Fort Worth Metroplex ended \$.13 higher than 3rd quarter at \$19.38/SF. This time last year, the average rate was \$19.33/SF. Average rental rates in D/FW have been modestly falling since early 2008. During this quarter, only 7 of 17 submarkets marked a decrease in average rental rates, the largest led by Lewisville/Denton with a decrease of -\$1.23/SF. The largest increase recorded was Dallas CBD up \$0.71/SF to \$18.73/SF average rate. By class, the average quoted rate within the Class A sector was \$22.04/SF at the end of the quarter, while Class B rates rose to \$17.23/SF, and Class C rates dropped to \$14.77/SF.

## VACANCY

The average vacancy rate for year-end 2011 was 20.7%, down .2% - not a significant difference from year-end 2010's rate of 21.5% (.8%). The highest vacancy reported in D/FW continued to be Dallas CBD at 32%, up another 0.5%, followed by Richardson/Plano at 25.4%. The top three submarkets reporting the lowest vacancy at year-end were North Ft. Worth at 6.6%, South Ft. Worth at 11.9%, followed closely by Preston Center at 12%. Total vacancy rates broken down by class are: Class A at 20.7%, Class B at 21.7%, and Class C reporting 14.9% vacancy.

## NET ABSORPTION

Net absorption (defined as tenant move-ins minus tenant move-outs) for the D/FW office market ended 2011 at a positive 1,837,420 YTD. Tracking YTD, the market leader in net absorption for 2011 was Far North Dallas coming in at 971,124 SF (netting another positive 115,959 SF this quarter). Other market leaders in positive net absorption YTD are Richardson/Plano ending at 466,233 SF YTD, and Uptown/Turtle Creek at 476,962 SF YTD. In all, eight submarkets ended the year with positive net absorption. In contrast, the largest net loss of absorption for 2011 was reflected in Mid-Cities submarket at -307,021 SF.

## NEW DELIVERIES

During the fourth quarter 2011, five buildings totaling 129,917 SF were completed in the D/FW market, bringing the total to 500,111 SF delivered in 2011. Most notable for 2011 included Speedway Town Center Medical 1 & 2 for a combined 128,000 SF in North Fort Worth that delivered in 1st quarter, Forest Park Medical Office Building, a 72,000 SF facility within the LBJ market that delivered 2nd quarter at 75% occupied; 5000 Long Prairie Rd, a 43,447-square-foot building within the Lewisville/Denton market that delivered at 58% occupied; and this quarter's 43,514 SF building at 6675 Mediterranean St in Richardson/Plano.

## NEW CONSTRUCTION

The largest projects still underway at year-end 2011 were the Encana Oil & Gas HQ, a 281,600 SF building with 100% of its space pre-leased, and Baylor McKinney Medical Office Building, a 113,700 SF facility that is 64% pre-leased.

## TOP REASONS TEXAS THRIVES

### OIL PRICES

Rising oil prices – bad for drivers, but good for the Texas economy. When oil prices are high, job growth in Texas historically has exceeded that of the nation. Based on Dallas Fed research, a 10% increase in oil prices leads to a 0.3% rise in employment and a 0.5% rise in GDP for the state of Texas.

### MILITARY SPENDING

Military spending has significantly expanded in the decade since 9/11, and that has been good news for Texas, home to major bases like Fort Bliss and Fort Hood. The Army has relocated about 14,000 troops to Fort Bliss over the past 3 years and plans to permanently relocate an additional 6,000 troops in the next 2 years. In 2009, Fort Hood claimed to be the largest single site employer in Texas, directly inserting nearly \$3 billion annually into the Texas economy.

### NO HOUSING BUBBLE

Texas escaped the foreclosure bust that crushed other states' economies — in 2011 only 6% of Texas mortgage borrowers were in or near foreclosure, according to the Mortgage Bankers Association, while the national average was nearly 10%. While nearby states like Arizona and Nevada face mortgage borrower foreclosure rates of 13% and 19% (respectively) Texas' relatively stable market may have been a factor in preventing housing prices from climbing. One reason is that Texas regulates cash-out and home equity loans to 80% of the homes appraised value, while other states allow cash-out loans or refi's for more than the original mortgage value — driving up home prices and contributing to the eventual burst of the housing bubble.

### A YOUNG, CONSUMER-ORIENTED POPULATION

Texas is one of the youngest U.S. states, with a median age of 33, almost 4 years below the national average. That means it's blessed with a consumption-driven economy, full of young adults. As families expand, their needs create thousands of jobs in retailing and manufacturing.

### HIGH-TECH INDUSTRIES

Texas weathered the recession better than other sectors of the economy, entering the downturn late and improving more quickly as consumer demand returned. Typically, as the economy comes back, so does consumer demand for high tech products — cell phones, computers, notepads, semiconductors, automobiles — have been strongest. Texas is a high-tech state, home to Texas Instruments, Dell, Freescale Semiconductor, AT&T, and ACS.

### FRACKING

In 1997 Texas oil engineers and government scientists succeeded in massive horizontal drilling, a process called hydraulic fracturing (Fracking) which injects chemical-laced water into the shale. This system has been effective in releasing previously untapped pockets of natural gas in shale formations, such as the Eagle Ford (South Texas) and the Barnett (Ft. Worth) shale formation. As a result of the new technology, Texas is home to some of the most prosperous new gas fields in the country, rising from 1% in 2000 to 25% in 2010.

### TEXAS EXPORTS

Texas is a BIG export state. Current export levels exceed the pre-recession peak by more than 12%. Texas is a big producer of products that either weathered the recession well or have rebounded quickly, including high-tech goods, oil, and gas as mentioned above.



## SUBMARKET STATS CLASS A, B, &amp; C

SUBMARKET	# OF BUILDINGS	TOTAL RENTABLE BUILDING AREA	VACANCY			YTD NET ABSORP.	YTD BLDG. DELIVERIES	SF UNDER CONSTRUCTION	AVG QUOTED RATES	CHANGE FROM LAST QTR
			DIRECT SF	TOTAL SF	% VACANT					
Central Expressway	105	12,587,250	2,257,846	2,305,081	18.3%	(209,951)	0	0	\$20.73	-.09
Dallas CBD	84	29,467,747	9,147,784	9,424,995	32.0%	(298,338)	0	0	\$19.47	+.03
East Dallas	171	7,783,648	970,395	990,728	12.7%	(17,400)	28,919	110,000	\$17.86	+.21
Far North Dallas	390	38,106,467	6,376,884	6,683,842	17.5%	971,124	0	281,600	\$20.98	+.32
Fort Worth CBD	58	9,582,955	1,231,063	1,258,432	13.1%	(49,472)	0	0	\$22.89	+.20
Las Colinas	244	29,338,374	6,086,878	6,433,742	21.9%	391,475	26,485	0	\$19.53	-.10
LBJ Freeway	165	21,036,635	5,138,281	5,335,907	25.4%	(206,413)	72,000	0	\$17.20	+.04
Lewisville/Denton	148	7,177,272	1,055,664	1,070,796	14.9%	359,581	66,947	100,823	\$19.01	+.88
Mid-Cities	364	20,246,281	3,348,423	3,997,010	19.7%	(307,021)	26,000	45,800	\$18.73	+.15
North Fort Worth	33	1,508,608	100,198	100,198	6.6%	7,226	0	70,000	\$21.24	+.01
Northeast Ft Worth	41	2,181,968	303,229	313,729	14.4%	(13,040)	0	0	\$17.56	-.16
Preston Center	49	4,240,222	500,352	507,939	12.0%	105,652	0	0	\$27.39	-.38
Richardson/Plano	302	23,183,175	5,293,865	5,367,978	23.2%	696,233	16,000	113,700	\$17.83	-.03
South Fort Worth	186	9,616,006	1,116,335	1,145,022	11.9%	61,521	15,843	60,000	\$20.70	-.05
Southwest Dallas	67	2,897,052	446,795	450,795	15.6%	(3,611)	30,290	0	\$15.25	-.12
Stemmons Freeway	124	17,088,883	3,637,168	3,784,793	22.1%	(127,108)	0	0	\$14.50	+.27
Uptown/Turtle Crk	88	10,930,349	1,786,622	1,883,182	17.2%	476,962	0	0	\$27.67	+.07
TOTALS	2,619	246,972,892	48,797,782	51,054,169	20.7%	1,837,420	282,484	781,923	\$19.38	+.13

## 2011 D/FW SELECT OFFICE LEASES

TENANT	BUILDING	SUBMARKET	SQUARE FOOT	TYPE
Hotels.com	Meadow Park Tower	Central Expy	55,000	Renewal
Kosmos Energy	Offices at Park Lane	Central Expy	100,000	Renewal/Expan
Meckler Bulger Tilson	Ten Thousand N. Central	Central Expy	9,000	Renewal
NeoSpire	Southwestern Plaza	Dallas CBD	25,992	Renewal
James Sowell Co	Thanksgiving Tower	Dallas CBD	20,150	Renewal
Merrill Lynch Co.	2100 Ross Ave	Dallas CBD	47,262	New
Tenant Healthcare	Fountain Place	Dallas CBD	22,121	Expansion
PFSWeb	Renaissance Tower	Dallas CBD	78,000	New
USAA	Addison Circle II	Far N. Dallas	72,950	New
Federal Homeland Bank	5000 Plano Pkwy	Far N. Dallas	70,270	Renewal
1st American Payment	3350 Boyington	Far N. Dallas	69,300	New
Pegasus Solutions	Lincoln Centre	Far N. Dallas	45,000	New
Howard Hughes Corporation	Galleria Tower	Far N. Dallas	20,718	New
Frac Tech	Carter Burgess Plaza	Ft. Worth CBD	45,256	New
Frac Tech	Carter Burgess Plaza	Ft. Worth CBD	23,199	Sublease
Star Telegram	Oil & Gas / Commerce Bldg	Ft. Worth CBD	65,000	New
BBVA Compass	Two Museum Place	Ft. Worth - Southwest	11,000	New
Alcon Labs	Wilcox Plaza at Green Oaks	Ft. Worth - Southwest	87,191	New
Certec Corp	Overton Centre	Ft. Worth - Southwest	9,596	New
Bell Sports, Inc.	161 Corporate Center	Las Colinas	27,606	Renewal
North Texas Commission HQ	Parkway Tower	Las Colinas	5,925	New
Ericsson	2201-2221 Lakeside (former Nortel Campus)	Richardson/Plano	260,000	Expansion
Fossil, Inc.	901 S. Central Expy	Richardson/Plano	535,771	New

## GLOBAL NETWORK REACH

- 200+ markets
- 4 continents
- 1,200+ professionals
- 80,000,000+ SF under management
- \$20.7 billion in brokerage transactions
- 185 million in self storage transactions



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## NEWS ABOUT US

### AWARDS & ACCOLADES

- CASE won the project leasing services for a mixed-use development in Rockwall, Texas near the shores of Lake Ray Hubbard. Known as Harbor Heights, the project will consist of two office towers, multi-family, and retail.
- CASE was awarded the disposition and property management assignments for Northshore Marina at the Hollows, an award-winning marina on pristine Lake Travis in Jonestown, Texas near Austin. The 12.28-acre property has 196 boat slips, 75 Jet Ski ports, a ship store and an office. Our Land Services group will handle the disposition of the marina, while our Property Management Services will handle the management.
- CASE has been selected by Whitestone REIT to lease two buildings: Uptown Tower on Central Expressway and Interchange Office Building on LBJ Freeway total approximately 400,000 SF of office space.
- **ENERGY STAR AWARDS.** CASE Property Management is pleased to report that a record five (5) buildings in its portfolio earned the U.S. Environmental Protection Agency's (EPA) prestigious ENERGY STAR, the national symbol for protecting the environment through superior energy performance. Earning the ENERGY STAR signifies that the buildings use approximately 35% less energy than the average building. The CASE managed buildings earning the awards include 4100 Alpha, 4099 McEwen, 4100 McEwen, 4141 Blue Lake and Signature Place.
- **BOMA 360 DESIGNATION.** Signature Place I & II has successfully qualified for the BOMA 360 Performance Building designation, an honor for commercial properties that demonstrate best practices in building operations and management. The ground breaking BOMA 360 Performance Program evaluates properties in six major areas: building operations and management; life safety/security/risk management; training and education; energy; environment/sustainability; and tenant relations/community involvement. Signature Place I & II is located at 14755 & 14785 Preston Road in Dallas.

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