

**“...If there is no risk, there is no reward.” - Christy Raedeke, The Daykeeper's Grimoire**

## Commercial Real Estate-Risk vs Reward

While the commercial real estate market is perceived by some as having efficient pricing structures, life events, pride of ownership, restrictive loan provisions, macro external influences and a need for some to buy into the market regardless of trends cause price fluctuations. Tier-two cities in Texas can have 50 to 150 basis point increases in the capitalization rate for similar type assets in tier-one cities. Class B assets can then have a similar spread as compared to Class A properties in the same market. Retail can be ‘out of favor’ as compared to buyers of office buildings, and warrant a similar spread in capitalization rates for buildings with the same credit rating and lease terms. Appraisals can include a set of comparable sales, that have a 50% to 100%, or even 200% variance. When we look at the survey range for institutional assets conducted by national brokerage and real estate advisory firms, rates for Class A assets in a single market can range as much as 7.0% to 10.0%.

If there were complete clarity in the market, would market participants be more disciplined in their pricing? If submarkets could be ranked on current and historical performance, why wouldn't institutional clients only purchase in the best performing submarkets in the state, rather than tending to flock in the highest priced locals?

The following are the Top 10 Apartment Submarkets (out of 53) relative to current occupancy in Houston, Texas:

| Sub Markets         | # of Apt Communities | # of Apt Units | Average Occupancy | Average Unit/SF | Average Market Rent/Month | Average Market Rent/SF | Under Construction Units | Total Absorbtion Units |
|---------------------|----------------------|----------------|-------------------|-----------------|---------------------------|------------------------|--------------------------|------------------------|
| Inner Loop West     | 16                   | 2,920          | 97.30%            | 809             | \$993                     | \$1.22                 | 722                      | 14                     |
| Sheldon             | 1                    | 110            | 97.16%            | 844             | \$710                     | \$0.86                 | 0                        | 2                      |
| Museum District     | 48                   | 5,132          | 96.58%            | 945             | \$1,677                   | \$1.57                 | 1,081                    | 98                     |
| Tomball             | 33                   | 2,710          | 96.26%            | 864             | \$809                     | \$0.95                 | 0                        | 25                     |
| Friendswood         | 50                   | 3,481          | 96.10%            | 862             | \$757                     | \$0.87                 | 0                        | 25                     |
| Katy                | 181                  | 14,579         | 95.77%            | 912             | \$962                     | \$1.06                 | 840                      | 63                     |
| Heights             | 39                   | 3,887          | 95.69%            | 804             | \$1,071                   | \$1.27                 | 0                        | 53                     |
| Steeplechase        | 218                  | 17,805         | 95.30%            | 906             | \$889                     | \$0.98                 | 0                        | 75                     |
| Sugarland/Fort Bend | 146                  | 13,093         | 95.00%            | 926             | \$959                     | \$1.03                 | 160                      | 55                     |
| Woodlands           | 129                  | 9,601          | 94.76%            | 870             | \$1,035                   | \$1.16                 | 0                        | 43                     |

Source: [www.oconnordata.com](http://www.oconnordata.com)

Capitalization rates being paid for Inner Loop, Museum District and Woodlands apartments are some of the lowest rates of any commercial real estate in any U. S. market. These submarkets have substantial build-out, and locational attributes that warrant tenants paying above average rents. However, the Tomball, Friendswood, Heights, and Steeplechase submarkets do not have any units under construction yet have average rents/SF that should allow above market rent appreciation given their 95% occupancy levels.

What does this data tell us? Market participants willing to take some risk may achieve returns substantive enough to make them look like the smartest investors in the ‘room.’

### Next Month

Year end 2013 market projections will be discussed. Dr. Kenneth Eugene Lehrer will also provide a snapshot view of the economy.

# TEXAS REAL ESTATE UPDATE

## Grandma and the City Sales Tax

Most senior citizens are either Parents or Grandparents and a significant percentage of that group have younger children ages 5 - 15. These seniors usually expend a great deal of time and effort caring for their younger family members. This effort includes, among other things, forgiving themselves of luxuries to expense disposable funds on their children, rearranging their schedules to accompany their children to events, and, of course, seeking to supply the best possible education to these offspring, often at great sacrifice to themselves. As is well recognized, the costs of having and properly raising children and then assisting with grandchildren, in today's economic environment, is not a task for those who either do not have the ability to earn a reasonable income or will not have access to appropriate funding.

With the costs of raising children and sustaining our communities trending upward, it is more than an intellectually reasonable approach for "Grandma" and other senior members of a household to want to supply their local communities with as much funding as possible. In this manner, the local authorities will have ample funds with which to assist "Grandma" in the raising of her children and grandchildren. This would include funds for school teachers, after school community activities, libraries, and, of course, general funds to support the community's hospitals, police, fire and emergency staff; and not to forget roads, water and sewerage services. Equitable fundings tend to both nurture and support a solid community, assist in the development of the area's young and also serve to support activities to retain older residents as opposed to having them leave the area (and take their savings with them) for other locations, thereby depleting the area of contributory senior residents.

To accomplish the above, of course there has to be some form of sacrifice, namely those who are capable of supplying the area government with operational funds needed to supply them via a whole host of methods, including real estate taxes, use taxes, gasoline taxes, highway taxes and, of course, sales tax. It is the duty of the area's voters to elect responsible officials to expend the funds in the most appropriate and beneficial manner. Simple democracy in action.

However, as Grandma seeks to both ask the community to assist in the raising of her children and grandchildren, and undertake her own set of sacrifices to accomplish this task, all too often Grandma forgets that "she" is a very major source of local sales tax. That tax, usually a very small percentage of locally-purchased items, is a major force for the financial stability and growth of most local communities, especially smaller ones, or ones that are located in the suburbs or exurbia locations. Hence, the undersigned trusts this short article will remind Grandma that seeking to purchase items or a series of items on the internet or via other electronic means to avoid paying local sales taxes is a triple threat – it does not support local establishments that hire people and pay the taxes that support the community, the community loses the income from the lack of sales tax and it usually requires other taxes that can be more regressive to be increased to support the locality.

**Simply put – Come on, Grandma**, when you need to shop, think of the long term object of the exercise, ample funds for your child and grandchild and another \$5 (or so) per purchase has multiple beneficial effects, not only for your city, your child, your grandchild, but for your own longer term financial advantage.

*Buy Local - pay the sales tax – it does not cost, but clearly pays in the longer run.*

**Dr. Kenneth Eugene Lehrer**  
**The Sage Group**

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### — About Sage Group —

We are a group of appraisal professionals working together to provide a single source of information and analysis for commercial real estate professionals across the country. Our team is managed by John Fisher, CCRA, LEED AP, W. F. "Buddy" Trotter, Jr., MAI, Michael L. Miller, MAI, Andre Suissa, MAI, Greg Zachary, Senior Appraiser and H. E. "Skip" Preble MAI, CCIM. Dr. Kenneth Eugene Lehrer manages financial services practices. For more information about us or to sign up to receive our newsletter, contact Michael L. Miller, MAI at 713.358.8450 or [mmiller@sageappraisalnetwork.com](mailto:mmiller@sageappraisalnetwork.com).