



by Brandon Houston
Midway Companies

Building for Long-Term VALUE



*Administaff Headquarters
185,000 SF, Class A+ Office*

The ability to lease or own a custom-designed facility for business operations is an important factor to enhancing bottom line performance.

In today's business environment, companies strive to gain a competitive advantage utilizing every available resource. One such resource is the development of innovative real estate solutions. Almost every business needs real estate, and companies seeking to portray their carefully crafted brand image with customers, clients, employees and shareholders must determine if their current real estate portfolio is not only satisfying their utilization needs but also providing this intended effect. Most CEOs agree real estate is an integral part of a company's business strategy. Companies contemplating a build-to-suit (BTS) project for a new facility must be thorough in their analysis and understand the economic drivers and risks associated with the process.

Over the past few years, the outlook for BTS activity has been promising. The economic growth forecast for Houston and throughout Texas has been strong and is expected to continue. Major factors contributing to this growth are increased energy activity, improved manufacturing output, and growing medical needs. As demands on the world's energy supply increase, many energy companies will expand their business operations to meet society's needs. This includes the development of new

expands and grows, the need for more robust medical care will become even more prevalent, resulting in the development of new hospitals, medical office buildings, surgical centers and health and wellness facilities.

Although the economic outlook has been above average the past several years, there are many challenges, which need to be analyzed in detail to provide a holistic view of the economy. Current challenges for the BTS market include rising energy prices, rising interest rates, rising

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office buildings and research & development laboratories. Along with energy, manufacturing will continue to bolster output to keep pace with energy upstream and downstream companies seeking to explore, produce, and refine oil in remote places. This will cause more manufacturing companies to look at upgrading their facilities or relocating to facilities that allow for improved manufacturing processes and operations. Also, as any society

construction prices, rising land prices, national security threats, and natural disasters. Although rising energy prices are good for energy companies and energy related companies, it does negatively impact building operations. As fuel costs rise and become more volatile, the operating costs for facilities escalate. Interest rates also play a major role in determining the final decision for a BTS project. Should the Federal Reserve continue its mod-

est increase in interest rates, it will cause risk adverse companies to forgo or delay BTS projects. Construction pricing will continue to escalate, as countries like China and India continue their modernization efforts. On average, construction pricing is expected to increase 15%-17% this year. This increase will inevitably cause companies to rethink new construction projects resulting in leasing or buying existing spaces. For many years now, land prices have been escalating making it more difficult for large companies to find sizable land tracts



Southwest Bone & Joint Clinic; 38,800 SF, Class A+ Medical Office

at attractive prices. Land is still available in hot markets, but demand for those tracts is driving up prices causing some companies to look at other alternatives. Finally, national security and natural disasters, as exemplified by 9-11 and the recent hurricanes, will play into future real estate decisions. In this Post-911 and Katrina world, security and disaster recovery is at the forefront of the political debate and in company boardrooms. Companies will look at operating disaster recovery locations and redundant facilities to ensure business operations are not impacted should another terrorist attack or natural disaster strike. Even with these challenges, the BTS market performed well in 2005; however, some of these challenges may influence the 2006 market performance and beyond.

In 2005, Houston BTS projects contributed to over one-half of the annual absorption and two-thirds of the



Tornier; 20,000 SF, Office / Warehouse

new construction for office/industrial product types. The hot areas for the businesses looking at BTS opportunities were the Southwest, Southeast, and Northwest submarkets. The Southwest submarket has been popular for many years due to its land availability, educated labor pool, and aggressive tax incentives. The Southeast

market is picking up steam due to the increased activity at the Port of Houston, which is becoming more popular with manufacturers, large retailers (e.g. Wal-Mart), and distribution companies as a major entry point for foreign goods. The Northwest market continues to be popular for its labor pool and accessibility to Beltway 8 and the Highway 290 corridor.

Overall, Midway Companies (Midway) believes the future BTS market is favorable and there will be many opportunities for companies to embark on BTS projects within the near future. In 2006, we believe BTS projects will be a large part of the total construction activity and absorption rate. The same three submarkets that were popular in 2005 we expect to be popular in 2006. While rates are still relatively low, albeit rising, the BTS market will continue to stay healthy as profitable companies (especially privately owned firms) will opt for the opportunity

their profits, real estate demand will increase from both oil service and manufacturing firms. Also medical firms (both service and manufacturing) will absorb more space as this industry continues to grow over the next decade.

In summary, companies seeking a BTS project should fully understand the benefits, risks, and processes for developing a new facility. Many times companies set out on an ill-defined path, which causes delays, budget overruns, and a poorly designed facility. Assembling the right project team, establishing the right expectations, and identifying the associated risks are critical to achieve success for any BTS project. There are many ways to develop a quality facility, but at the center of the project needs to be the overall goals and objectives for starting the venture. Companies see great value and competitive advantages in designing facilities that meet their specific corporate objectives. As with any custom designed

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to own their own facilities; however, with construction and land prices escalating, some of these firms will be forced to remain in leased space where rates have not escalated to the point that reflects the true value of the underlying assets. This will remain the case as long as landlords' nervousness about the market and their ability to replace existing tenants keep them from escalating base rents, in other words, until greed surpasses fear, rates will remain a relative bargain. As the energy sector continues to grow and oil companies are forced to spend some of

product, companies can expect to pay a premium for the design/construction of the space and the specific service levels required to maintain the facility over the occupancy term. However, given this tight business environment where competition is strong; having the proper real estate solution can enable companies to drive larger shareholder value and bottom-line growth.

*Sources:
Colliers International - Market Report Houston – 4th Quarter 2005.
Grubb & Ellis Research – Industrial Market Trends Houston – 4th Quarter 2005.*

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