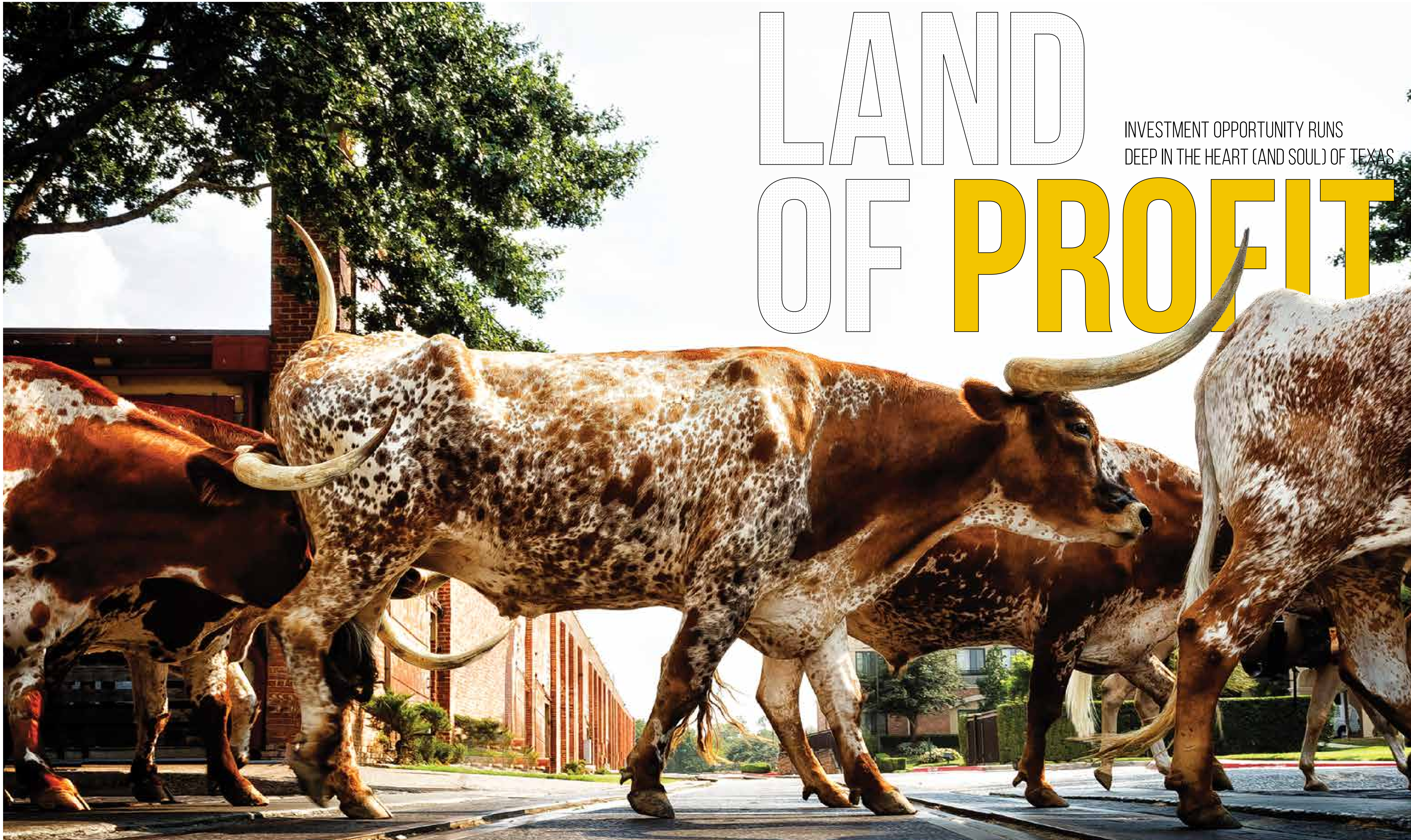


LAND OF PROFIT

INVESTMENT OPPORTUNITY RUNS DEEP IN THE HEART (AND SOUL) OF TEXAS

> *"That's right, you're not from Texas, But Texas wants you anyway."*
>
> ***Lyle Lovett*** *:: singer-songwriter, actor & native Texan*

BY ROBERT SPRINGER

True, Texas native Lyle Lovett wasn't singing about the saga of real estate investors in his '90s classic "That's Right (You're Not From Texas)," yet if he re-recorded it today it could be Texas real estate investors' theme song. A ballooning population, inexpensive land, a highly diversified economy (it's not just about oil anymore) and a housing industry that can't keep up with demand have created nearly ideal conditions for investing in real estate for income.

THE LAND OF MILK AND HONEY — AND OIL AND TECH AND FINANCE

Texas economic numbers are mind-boggling. "I think something like one in three jobs that have been created in the United States have been in Texas the last several years," says Dr. James Gaines, a research economist at Texas A&M's Real Estate Center. "The national economy has just been kind of groping along at a very slow pace. Texas has been growing on an employment basis at almost double the national rate. And that has translated into high demand for housing.

"Anecdotally, we're hearing in all of these markets that a decent property with a decent location will sell in a matter of hours — not days, not weeks, but hours," he says.

Texas is not the boom or bust state of the '80s and '90s. The recent drop in oil prices might slow down growth in a couple of markets, but the state as a whole is so much more diversified economically that its economy shouldn't be derailed if oil remains low for an extended period, Gaines says.

Many of the recently created jobs are relatively high-paying, according to Gaines. Construction work in the oil patch, oil and energy-related service jobs, engineers and other professionals, tech and healthcare have seen good job creation.

Scott Kesner, a broker/owner of Century 21 The Edge in El Paso and chairman of the 95,000-strong Texas Association of Realtors, says the I-35 corridor between San Antonio and Austin has

seen the most growth in the last three years. The stable economy, pro-business climate and lack of state income tax make the state attractive to businesses looking to relocate there. Houston and other Gulf Coast cities are growing fast as well.

"The Legislature is talking about funding more transportation infrastructure and increasing the homestead exemption; they're really being proactive to try to give some tax cuts to the citizens of Texas," Kesner says. "We're just a very business-friendly state."

And it's a landlord-friendly state, too, according to Mark Pantak, a Houston-based private equity investor. "Texas has the best laws to be a landlord or do notes or do apartments or do all of it," he says. "It is one of the most landlord-friendly states. You get in front of the judge and judge (asks the tenants), 'Well, did you pay?' When they say, 'No,' click, boom, you're out. It takes three weeks to evict."

Besides the high demand for housing, low supply is another factor that is pushing up home prices and rents. Houses are in short supply statewide (except in El Paso) and the inventory is three months or less; in some markets it's two months or less. The drop in oil prices has eased the situation a little, Kesner says, but inventory is still very tight.

Builders haven't been able to keep up with the demand for housing, partly due to construction workers leaving to work at better-paying jobs in the oil fields. Construction may pick up if these workers are laid off due to decreasing demand for oil-related construction.

Gaines says that in Texas, unlike in the rest of country, home construction isn't languishing but is close to its long-term norms. "The homebuilding in Texas and in our major markets — Fort Worth, Dallas, Houston, Austin, San Antonio — is up considerably from where it was in 2010 and '11," he says. "Dallas and Houston have led the country in metropolitan areas for the last, I think, four years, maybe longer, in terms of new home starts, as metropolitan areas."

Gaines adds that the cities of Houston and Dallas had more home starts than any state in the country last year.

It's too early to know how the drop in oil prices will affect the Texas economy, but a prolonged drop could have a pronounced effect on the rate of job growth, according to Gaines. Since the energy sector is still very important to the economy, job growth may drop by half from today's 3.7 to 4 percent.

He still thinks home prices will continue to increase, but at a decreasing rate, which could be a good thing, as it could prevent a housing bubble. (Despite the frothy market, Gaines does not believe Texas is experiencing a real estate bubble.)

People from the coasts or other high-cost states are surprised and then pleased how far their real estate dollars go in Texas.

"Even if they take a job that doesn't pay as well, they can still buy a house that's probably twice as big or nice as what they've left, and for less money," Gaines says.

Yet another factor driving demand for rentals are recent college graduates who either don't want to buy a home or simply can't buy a home. It's hard to qualify for a loan and they have a lot student debt. Gaines has experienced this firsthand.

"I've got a 25-year-old daughter and that's why she's not buying a house," he says. "I think that there's an entire pool of people who either don't want to buy or can't buy. That makes it very attractive for the investors."

HOUSTON

BOOM, BOOM, BOOM

New arrivals to Houston – as with those in Dallas-Fort Worth – don't really know where to live, so they rent. The city has been on an apartment building boom, according to Shadrick Bogany, an agent with Better Homes and Gardens Gary Greene, with between 20,000 and 30,000 units being constructed this year.

It's cheaper to own than rent in Houston, so newcomers rent first and then transition into buying a home. "I was talking to a guy the other day and he said he's building some townhomes and is renting them for $4,000 a month. I'm like, being a native, 'Wow, that's a lot of money,'" Bogany says. "But we've got a lot of oil money coming into town. A lot of growth here and so, you get people who come in here and don't know Houston."

Sellers have the upper hand in Houston, according to Bogany. "I would say stay anywhere between $100,000 and $200,000 and the closer you can get to $100,000, the better off you're going to be," he says. "I have first-time homebuyers looking to buy a house because they see how expensive renting is, and they are competing with investors who are coming in writing a check. So, if I am a seller, I'm going to take that investor writing the check versus taking the opportunity to deal with somebody who's got to go get a loan."

Multifamily rents are strong as well, Bogany says. A two-bedroom apartment will rent from $1,500 to $1,600 a month, so apartment complexes would seem like an attractive investment. Complex owners know this, of course, so it's hard to find one for sale.

AREA SNAPSHOT

Select Neighborhood Pricing: El Dorado/Oates Prairie – 3BR, 2BA, 1,700 square feet for $150,000

Tip: Don't pay too much or you'll risk negative income. – *Shad Bogany*

Sweet Spot: : $100,000 to $200,000 (closer to $100,000 is better)

Places to Consider: Woodlands, First Colony, Riverstone, Summerwood, Town Lake, Katy, north of I-10, Barker Cypress, EaDo (east end of downtown Houston), outside of 610 Loop, River Oaks

AUSTIN

HOTTEST OF THE HOT SPOTS

Texas' capital city has the state's hottest and most expensive real estate market. It's getting increasingly difficult to find a single-family home in the city for less than $200,000. Investors are increasingly looking to the suburbs to find more appealing deals.

Close-in Kyle and Buda are two of the more popular places, according to Joe R. Stewart, owner of Joe R. Stewart Realtors.

"Ten minutes out – nobody ever wanted to live there," he says. "Well, guess what, that's the new little Austin. In those areas, you can find homes in the $180s and in the upper $200s."

Stewart steers investors away from multifamily, as there's too much of a price premium on them. "Multihousing units, it's got to make sense," he says. "That's all I'm going to tell you because the people that own them know they have a goldmine."

Austin is becoming another sprawling city like Houston, according to Stewart. Bastrop, about 40 minutes outside of Austin, has renters standing in line to secure housing. People want to live close to Austin but can't afford to buy, and there are so many in this situation that they end up competing for a rental.

Downtown Austin has some real estate prices that are more typical of San Francisco than the Texas Hill Country. Stewart knows of a couple who bought a 1,500-square-foot house for $210,000, put in about $40,000 to fix it up and sold it six years later for $600,000. "Why?" he says. "Because the closer to downtown, the prices skyrocket, and you know what – it doesn't make any difference what the house looks like."

"A young couple out of college, they don't care how small it is. They just don't care. As long as they're downtown, then they have the city and it's affecting the city."

AREA SNAPSHOT

Select Neighborhood Pricing: Buda – 4BR, 2.5BA, 2,000 square feet for $180,000

Tip: In 10 years Georgetown will be a metropolis of its own. – *Joe Stewart*

Sweet Spot: $200,000 or under

Places to Consider: Round Rock, Buda, Kyle, Leander, Cedar Park, Georgetown, Bastrop

HOW TO PLAY TEXAS

Experts say Texas is not currently a fix & flip market. It's also not really a big duplex or fourplex place, and apartment complexes are hard to find in hot markets. Instead, the Lone Star State is all about single-family homes.

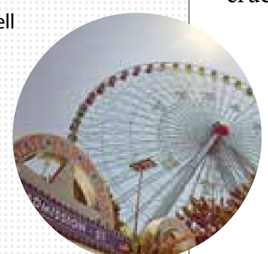
"In this market you're just not going to steal a house," says Kesner. "You're just not. You're not going to get it for nickels on the dollar, but there are still good, solid investments to buy."

DALLAS/FORT WORTH

A MARKET AS HOT AS THE TEXAS SUN

The Dallas-Fort Worth Metroplex is the fourth largest metropolitan area in the country with more than six million residents. Another million people are projected to call DFW or The Metroplex home by 2020.

The DFW market is hot, says Nick Mullens, an agent at Century 21 Mike Bowman. Most new homes are selling before they're finished, and Mullens recently had six offers on a house 24 hours after it went on the market. "Now most builders won't even sell to investors because they're getting full price retail for them," he says.



"In all of 2014, our average sale price of Century 21 Mike Bowman was 104 percent of list," he says. "So, we averaged 4 percent over. Next best was 100."

DFW is essentially one large market once you leave the cities themselves, Mullens said. There are highway loops that ring both cities, and Mullens says that staying outside those loops is the best bet for investors.

The 1 percent rule is pretty accurate for rents but is really "the bottom of the threshold," Mullens says, with closer to 1.2 percent being the sweet spot. Higher property taxes in some cities make doing their due diligence vital for an investor's bottom line. "So, if you're an out-of-town investor you need to talk to somebody that knows the market because you need to find the cities with the right tax rates," Mullens says.

Some Texans are moving back to the urban cores of Dallas and Fort Worth, but Mullens says his investors stay away, due to higher prices and HOA fees.

"The most popular investment now is the single-family home," he says. "Multifamilies are going up fast, especially in Fort Worth."

AREA SNAPSHOT

Select Neighborhood Pricing: Mansfield – 4BR, 4BA, 2,300 sq. ft. for $210,000

Tip: 1990 or newer homes tend to rent better as shifting soils and the tough Texas sun can damage homes quickly

Sweet Spot: $100,000 to $250,000

Places to Consider: Fort Worth (the entire city), Denton, Keller, Mansfield, Lewisville, McKinney, Plano, Frisco, Little Elm

"Texas is still a very good market, relative to a lot of other markets for the income growth, income potential, the rental potential, for price appreciation," says Gaines. "You'll have to know the local market. It's too difficult to do a broad generalization and say Texas as a whole, or even Dallas, Fort Worth as a whole, or Houston as a whole, because there are going to be good pockets within each of these markets."

According to Gaines, the best rental market opportunities are in the class C or even D properties. Even though prices are increasing, there's a growing differential between houses on the middle and high end and those that are less than $150,000. The lack of increase in home sales in the $150,000 and below market is true throughout the United States, not just in Texas, Gaines says.

"It's off, like, 50 percent, year over year," he says. "So a lot of people who would have bought homes in that price interval are forced into the rental market."

Gaines and other experts say that local knowledge and due diligence are two of the keys to finding deals in such a hot market. It's crucial to keep in mind that a lot of investors love Texas right now.

SHORT-TERM RISKS

While Texas is a great place to invest for income, it's by no means risk free. Knowing and mitigating the risks could mean the difference between a good investment and a great one.

Low oil prices comprise the principal near-term potential hazard for investors in Texas, especially in markets like Longview, Midland and Odessa, which have experienced rapid growth due to the shale oil boom, according to Ingo Winzer, founder and president of Local Market Monitor. Local Market Monitor analyzes conditions in 300 U.S. markets, using such economic data as home values and growth in employment and population. Winzer says a prolonged drop in the price of oil will lead to a reduced demand for housing as laid-off workers move elsewhere to find jobs.

"There will be less effect in Dallas and Houston, which participate in the financing and management of the shale oil boom; Houston may actually benefit because its large petrochemicals industry will have lower costs," Winzer says. "San Antonio and Austin have very little stake in the oil business."

Gaines says the energy sector is the wild card in the Texas real estate market despite its diversification. Housing prices could actually decline "if the impact of the energy sector is more severe than we think it's going to be. And at this point, it's anybody's guess. I can give you 10 reasons why it could be. I can give you another 10 reasons why it won't be," he says.

Lower energy costs could actually aid job creation, according to Winzer. "The Texas markets have been a good place to invest because of the creation of jobs, which have attracted a large number of in-migrants from other states, and most of these jobs have nothing to do with oil," he says. "The shale oil boom was a bit of icing on the Texas cake, but not the driver of economic growth. Our assessment of investment opportunities in Texas is pretty much the same as before."

Other short-term risks can be mitigated by where the investor buys. While Texas has no income tax, the state's property taxes are relatively high, ranking 15th highest nationally, according to the Tax Foundation, a non-partisan research think tank based in Washington, D.C. And some cities tack on an additional 1 percent or so, directly impacting an investor's income.

SAN ANTONIO

WORTH REMEMBERING

The home of the Alamo is a military town. It's also the seventh largest city in the country – and it's growing. San Antonio is a place where many military personnel are transferred and end up staying because it's a great place to live and offers a low cost of living.

Many military personnel are only in town for a couple of years, and base and post housing is full and has a waiting list, according to David Birdy, director of business development at Birdy Properties. So this captive audience rents.

The city started at the Alamo and has expanded in every direction from there. Like many of Texas' largest cities, San Antonio has a highway ring (two, actually) circling the city center ("like a wagon wheel," says Birdy).

The best investment opportunities are on the northwest and northeast sides of town. Both sides have two military installations, while the northwest part has USAA's corporate headquarters.

Another opportunity is downtown. "We're seeing this trend of younger Millennials who want to move to the inner city, closer to downtown, and we didn't have downtown living," Birdy says. "I mean, we really didn't. And now we've got high-rises, and they're turning every possible warehouse and candy factory that they can into urban living."

Birdy does not recommend the city's south side, despite its proximity to the shale oil and gas areas.

Rents range from $900 to $1,400 per month for a three-bedroom, two-bathroom house. Birdy says the sweet spot for investors is from $100,000 to $160,000.

"It's a big range," Birdy says. "It depends upon what side of town you're on, your closeness to the military bases, your closeness to the medical center area, that would determine the neighborhood and how much it brings price per square foot."

AREA SNAPSHOT

Select Neighborhood Pricing: Northwest Side – 3 BR, 2.5 BA, 1,800 square feet for $135,000

Tip: "Most of our investors enter into the process with an idea of an exit strategy of maybe eight years or 10 years down the road that they'll think about selling it." – *David Birdy*

Sweet Spot: $100,000 to $160,000

Places to Consider: Northwest and northeast sections, downtown

The high price of property insurance is another "gotcha" that may surprise investors from other parts of the country. Hurricanes add to the price of insurance along the Texas Gulf Coast, while hail damage causes the higher prices in Dallas/Fort Worth and northern parts of the state.

LONG-TERM RISKS

The perception that Texas is a development-friendly state is true, Gaines says, but it's "gradually changing." Austin could be the proverbial canary in the coal mine when it comes to the future of Texas real estate.

The city is Texas' version of California, according to Gaines. In most of the state the cost per lot add-on has been fairly minimal, at about $2,000 to $5,000, which Gaines says developers can live with. But developers started getting nervous when the fees in Austin rose from between $15,000 to $25,000 per lot.

Homebuilders are still building in Austin, Gaines says. They're just not building anything under $250,000 to $300,000, causing affordability to be an issue.

"Part of the reason why is the land costs have gotten so expensive, the development, the cost to develop that buildable lot has gotten to the point where it's $40,000-$50,000-$60,000," Gaines says. "Well, you don't build a $100,000 house on that lot."

And the sweet spot for investing for income in Texas real estate is considerably below $300,000.

With a good part of the state experiencing a drought that is as bad as California's, water could be a concern for investors in the medium- to long-term, according to Joe R. Stewart, owner of Joe R. Stewart Realtors in Austin.

"Water is huge, and eventually down the road there is some concern that investors will look at this area, not just Austin, but Texas in general and say 'Do I want to be there, or do I want to go to Raleigh, North Carolina?' " he says.

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