An increasingly prosperous U.S. population is expected to grow by about 60 million people (nearly 25 million households) between 2000 and 2020, or 42 million over the next 14 years. This growth will bring with it both substantial challenges and opportunities, significant infrastructure and real estate requirements, and the attendant demand for consumer and business goods and services. The Southwest region of the U.S. is especially well positioned to benefit from this expected growth.
Based on research done with Wharton colleague Albert Saiz (see “Forecasting 2020 U.S. County and MSA Populations,” Wharton Real Estate Review, Fall 2006), the Southwest region of the U.S. will lead the nation in population growth through 2020, based on demographic, fiscal, climatological and geographic variables. Demographic trends coupled with economic growth are the driving forces for long-term real estate development opportunities in the region.

The presence of immigrants, a large working population and a moderate climate propel the region’s projected growth. People move to the Southwest for a better quality of life, and companies are relocating there in search of an educated work force and lower operating costs. For residents and businesses, the Southwest has become an increasingly attractive destination.

The education and skill level of the population are indicators of long-term growth. Research by Glaeser and Saiz (2003) has shown that in the last century, educational achievements have been an explanatory factor for urban population growth. We find the same to be true for states and regions. In essence, regions with better educated populations grow faster. Specifically, metropolitan areas with better educated workforces are more productive, and in turn, attract population inflow. Similarly, accessibility to markets and transportation nodes are important for growth as well as a competitive political environment and low local tax burdens.

Cities attract high-income residents due to attributes such as good schools (public and private), proximity to shopping, and a strong social network. Lower income residents are attracted to a metropolitan area by a good public transportation system, decent public schools and low rents.

A key advantage of the Southwest is good weather. Americans are increasingly leaving cold, damp and snowy areas for sunnier and drier climates. This attraction to areas based on physical and social environment represents a critical shift from people following jobs to jobs being relocated or created where people want to live.

The age distribution of the local population is also a key element of growth. Very young and very old populations tend to grow more slowly because of the low reproduction rates and greater number of deaths. In the Southwest, 63% of the population is between 18 and 65 years, providing a relatively large work force. Furthermore, population growth in the Southwest region was approximately 15% between 2000 and 2006, with California leading the region and housing a total of 12% of the total U.S. population. Las Vegas and Phoenix were in the top five fastest growing MSAs from 2000 to 2002. Other metropolitan areas in the region experiencing rapid growth include Denver and San Diego.
Economic Trends

The Southwest region is economically diverse and growing rapidly. California and Texas combined contribute approximately 20% of the country’s GDP. The per capita income of the region ranges from $30,000 to $50,000 per year. The population growth of the region is creating major urban centers in Phoenix, Houston, Dallas, Las Vegas, Los Angeles, Denver and Albuquerque.

If it were a country, California would be the 10th largest economy in the world, driven by manufacturing, technology, finance, agriculture, Hollywood and Silicon Valley. Even after the ‘dot-com’ bubble, Silicon Valley remains one of the top tech research and development centers in the world.

Texas, second to California, is one of the fastest growing economies in the nation, and is home to six of the top 50 Fortune 500 companies. It is the largest goods exporter in the country, generating more than $100 billion per year in multinational trade.

In Colorado, the federal government is a major regional economic force. Agriculture is also an important economic contributor. Only in the latter half of the 20th century have the industrial and service sectors expanded. Scientific research and high-technology companies are also relocating to Colorado. Denver has become the ‘Wall-Street’ of the Rockies.

Nevada is best known for gambling, with tourism as its economic driver. Las Vegas, Reno and Lake Tahoe attract thousands of tourists on a daily basis. Mining remains an important industry, with gold being the most important mineral. In 2004, 6.8 million ounces of gold worth $2.84 billion were mined in Nevada, accounting for 8.7% of global gold production.

Known for its “granola”/holistic lifestyle, New Mexico’s major sources of economic activity include timber mills, livestock and mineral extraction. However, high-technology industries including lasers, data processing and solar energy sectors are a growing presence. Federal government spending is also a major driver of the New Mexico economy, with $2 spent in New Mexico for every dollar of federal tax revenue collected from the state. The U.S. government also accounts for more than 25% of the state’s jobs.

Arizona, also known as the Grand Canyon State, was once the largest producer of cotton in the U.S. Today however, focus is moving toward the high-tech sector, which employs approximately 10% of the state’s job base. High-tech jobs also account for the state’s second highest private sector employment level after Wal-Mart. High-tech employment is led by software and computers, electronic component manufacturing, aerospace manufacturing, architectural and engineering services, telecommunications, and instrument manufacturing. Arizona is the fastest growing state in the Southwest, with 3.6% population growth since 2005, exceeding the growth of the previous leader, Nevada.
Denver Metropolitan Area

Denver, the capital of Colorado, is located just east of the southern Rocky Mountains. Denver-Aurora is the 26th most populous MSA in the country, with approximately 2.4 million people, and the 10th largest downtown district in the U.S. The median age is 33 years, and 66% of the population is between 18 and 65 years of age.

Denver’s economy is largely based on its strategic location. Because Denver is the largest MSA within a 600-mile radius, it is the natural location for storage and distribution of goods and services to the Mountain States. The MSA also has a considerable government presence; second to Washington, D.C. Federal agencies attract complementary firms related to energy, defense, and aerospace.

The area’s position near the mineral-rich Rocky Mountains creates a strong mining and energy sector. Initially, gold and silver powered the region, with oil rising in importance. Telecommunication companies in the mid- to late-1990s discovered the importance of Denver’s geographic location, which allows companies to communicate with North America, South America, Europe and Asia, and have a ‘real-time’ satellite link to six continents in the same business day. However, since the new millennium, Denver has lost many high-tech jobs to foreign competitors. Recently, Denver’s economy has picked up, with the 2006 unemployment rate dropping to 4.5%, the lowest since 2001.

Increasing profits have been a driving force behind both the leasing and investment sides of the real estate equation with ongoing strong performance continuing to attract tenants and investment into the area. Absorption levels reached a seven-year high in 2006, vacancy rates decreased, rental rates increased in high-demand areas, sales activity increased and new construction intensified.

The contributing factors to the strong 2006 performance include increases in employment and the completion of Denver’s new rail system where all rail lines lead to the downtown district. With almost 3.8 million square feet of net absorption, an improving vacancy rate and high optimism (as a result of low unemployment) investment in both owned and leased space is likely to increase.

Los Angeles-Long Beach-Santa Ana Metropolitan Area

Los Angeles-Long Beach-Santa Ana is the largest MSA in California, and the second largest in the U.S., with a population of 13 million people. The Los Angeles MSA is home to world-renowned institutions in a broad range of professional and cultural fields and is the world’s leader in the entertainment business. The median age is 33.8 years, and approximately 64% of the population is between ages 18 and 65.
Los Angeles is driven by international trade, entertainment, aerospace, technology, fashion and tourism. To the surprise of many, Los Angeles is also the largest manufacturing center in the U.S. The contiguous ports of Los Angeles and Long Beach comprise the largest port in North America, and are vital to trade with the Pacific Rim. The University of Southern California is the city’s largest private-sector employer.

The L.A. market has solid fundamentals and good job growth, with an unemployment rate of 4.9%. However, with a high cost of living (particularly housing), businesses are challenged to attract and keep employee talent, particularly support staff.

Industries such as entertainment, personal services and international trade sectors are driving the demand for office space. By year-end 2006, Los Angeles posted net positive absorption of approximately 4 million square feet and a vacancy rate of 9.8%. Positive trends will continue through 2007. L.A. is expected to experience an economic growth rate of 3% in 2007. Linneman Associates estimates that over 100,000 jobs will be generated the Los Angeles metropolitan area between 2007 and 2009, which in turn will further reduce vacancy rates. As a result, rents could increase, creating upside potential to prospective investors. With new construction expected to be only 0.5% of L.A.’s total rentable stock, vacancy will fall and rents will rise.

San Diego-Carlsbad-San Marcos Metropolitan Area

The San Diego-Carlsbad-San Marcos MSA is located in the southwestern corner of California, with a population of approximately 3 million. The area is home to many military institutions, including the U.S. Navy, the U.S. Coast Guard and the U.S. Marine Corps. The median age is 33.5 years and approximately 65% of the population is between ages 18 and 65.

San Diego’s economy is largely composed of biotechnology/biosciences, computer sciences, ship repair and construction, telecommunications and software development. Pharmaceutical companies, including Merck and Pfizer, have large research facilities based in San Diego. The economy is also largely influenced by its port, which includes the only major submarine and shipbuilding yards on the West Coast, as well as the world’s largest naval fleet. Major national defense contractors are headquartered in San Diego due to the city’s military concentration.

In the third quarter of 2006, demand for San Diego office space remained strong, with construction activity on the rise. The region’s diverse demographics and low unemployment rate keeps investor interest strong. However, at the end of 2006 the office market was over-supplied with vacancy rates hitting 10%. Yet, landlords are reluctant to reduce rents, hoping that San Diego’s strategic location will result in high future demand.
Las Vegas-Paradise Metropolitan Area

Las Vegas-Paradise is the most populous MSA in the state of Nevada, and includes the Vegas strip, which is outside the city limits. It is a major gambling and entertainment center, and has a population of approximately 1.7 million. The median age is 34.8 years, and approximately 62% of the population is between ages 18 and 65.

The economy of Las Vegas is fueled by tourism, gaming and conventions, which in turn drive the retail and dining industries. Several companies involved in the manufacture of gaming machines are located in the Las Vegas area.

A large amount of new construction began in 2006. However, the high construction costs and land prices of 2006 are slowing new pipeline activity. As long as Las Vegas continues to be a destination of choice for shopping, gambling and entertainment, and the population and employment rates increase the way they are, the market will flourish.

Much of the construction demand is occurring on the Las Vegas Strip, with roughly $28.3 billion worth of resort expansion planned through 2010. This includes nearly 40,000 more hotel rooms, almost 1,000 additional timeshare units, and another 3.47 million square feet of convention space, according to the Las Vegas Convention and Visitors Authority. Las Vegas is home to 17 of the 20 biggest hotels in the U.S. and has approximately 39 million visitors annually. The metro area’s hotel market is booming and is expected to continue booming.

Dallas/Ft. Worth Metropolitan Area

The Dallas/Ft. Worth MSA covers over 9,000 square miles and is the fifth most populated MSA in the U.S. The 2005 Dallas/Ft. Worth MSA population stood at 5.8 million. The area is known for its role in the petroleum industry, telecommunications and computer technology. Oil discoveries in the Permian Basin, the Panhandle, the Gulf Coast and Oklahoma have strengthened Dallas’s position as a hub primarily because it is at the geographic center of five oil abundant regions. The median age is 32 years, and approximately 65% of the population is between ages 18 and 65.

The Dallas economy suffered a long real estate recession between 1981 and 1993. Yet its job base continues to grow. The city is headquarters to some of the world’s largest companies, including ExxonMobil, 7 Eleven, Frito Lay and Texas Instruments. Year-on-year employment growth
was up 3.3% in November 2006, while year-end unemployment fell to 4.8%. It has easy development regulations, which keep housing costs low, making it an attractive place to live and work.

In 2006, there was 6.2 million square feet of positive office absorption and vacancy rates fell from 22.2% to 19.8%, dipping below 20% for the first time since 2001. However, low barriers to entry and a constant supply of new office space keeps appreciation down. As a result of REIT privatizations, the Dallas/Ft. Worth office investment market ranked seventh nationally with $4.7 billion in sales volume in 2006.

Houston Metropolitan Area

Houston is the largest city in Texas, and the sixth largest MSA in the U.S. It has a population of over 5.5 million, and spans over 10 thousand square miles. Houston is known for its broad industrial base in the energy, aeronautics and technology industries. Houston is home to the Texas Medical Center, which is the world's largest group of healthcare and research institutes, as well as NASA's Johnson Space Center. The median age is 32.3 years, and approximately 70% of the population is between ages 18 and 65.

Although the area is known for the dominance of the energy industry—in particular, oil—biomedical research, aerospace, petrochemical manufacturing, engineering services, banking and financial services make up a large part of the city's economic activity. Houston is second only to New York City in Fortune 500 headquarters, while the Port of Houston is ranked first in the country and is the sixth-largest port in the world. Houston's unemployment rate is low at 4.5%.

By year-end 2006, Houston's overall office vacancy rate fell from approximately 19% to 15%, and net positive absorption was 1.5 million square feet. Due to low interest rates, investor demand for office properties has been strong. According to Real Capital Analytics, investors spent approximately $2 billion in 2006 to acquire office properties in Houston. Tenant demand has grown due to employment growth, driving up rents.

Phoenix Metropolitan Area

Phoenix is the capital city and the most populous MSA of Arizona. It is the 14th-largest MSA in the U.S., with an estimated population of 3.8 million. The median age is 31 years and approximately 64% of the population is between ages 18 and 65.

Over the past two decades, the region's economy has rapidly diversified, with a large number of high-tech and telecommunications companies deciding to relocate there. Phoenix also benefits from seasonal tourism due to the warm winters and a large golf industry.
The MSA is rapidly expanding, fueled by increases in employment, low costs of living and a favorable tax environment. Office absorption for 2006 was about 3 million square feet. Numerous developers are seeking to capitalize on the current demand, with 4.2 million square feet of construction. There has been a steady downward trend in vacancy rates, with 2006 year-end vacancy at 12%, dropping over 200 basis points from 2005. There is expected to be an increase in rents in order to justify the costs of the new construction taking place.

Conclusion

The Southwest has favorable demographic trends and attractive quality of life offerings. The Southwestern states are ranked among the top 25 with regards to state GDP growth (4% to 9%). In addition, Southwest region metropolitan areas are well positioned for growth. The markets covered in this report have had 25% to 195% population growth since 1980, and are expected to have significant growth through 2020.