THE RISE OF THE SUN BELT

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INTRODUCTION

The ongoing and rapid growth in the U.S. Sun Belt has been an extraordinary boon to commercial real estate investors. The region stretches across eighteen states in the Southeast and Southwest and includes seven of the ten largest U.S. cities, as well as many mid-size metropolitan statistical areas (MSAs) *(Figure 1)*.[1] The Sun Belt now holds about 50% of the national population (326 million), which is expected to rise to about 55% by 2030.[2] Over the past decade, the region accounted for 75% of total U.S. population growth (15 out of the total 21 million).

FIGURE 1: The Sun Belt Region & Major Cities

Source: Moody's Analytics, Q4 2018. 1) The Sun Belt region analysis is based on the totals from the 18 states it spans. 2) There are 27 markets with a population over or near 1 million, and the seven largest cities are Los Angeles, Houston, Atlanta, Dallas, Phoenix, San Francisco, and Riverside.

Over the next decade, Sun Belt population growth is expected to accelerate by another 19 million (+13%), whereas non-Sun Belt states are forecasted to rise by only 3 million (+2%) *(Figure 2)*.[3] All ages are drawn to the area more and more for its business-friendly environment, lower cost of living, quality of life, and mild climate. Clarion Partners anticipates the ongoing rise in both workers and residents will continue, from both in-migration and natural births, driving the expansion of live-work-play environments.

### FIGURE 2: Sun Belt Population Growth Outperformance
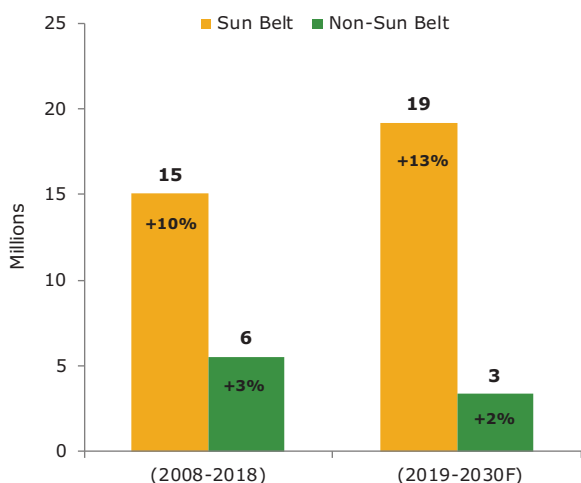
Source: Moody's Analytics, Q4 2018. Notes: 1) Based on population totals from the 18 Sun Belt states. 2) The U.S. population in 2019 is 326 million. 3) Through 2030, Texas, Florida, and California, followed by Arizona, North Carolina, and Georgia, have been each been forecasted to grow by 4.9, 3.4, 2.4, 1.6, 1.6, and 1.5 million respectively.[3]

REGIONAL GROWTH IN HIGH & LOW TAX STATES

The Sun Belt boom is primarily driven by an exodus from high-to low-tax states. Overall, the region offers either low or no corporate, individual, or property taxes, unlike many non-Sun Belt states further North, where the burden is increasingly onerous to many businesses and households. The regional influx by people and corporations is motivated generally by greater economic opportunity and affordability. Within the Sun Belt, California is the main outlier, given that it has both high taxes and domestic out-migration, however, also has a dynamic labor market with many vital industries.
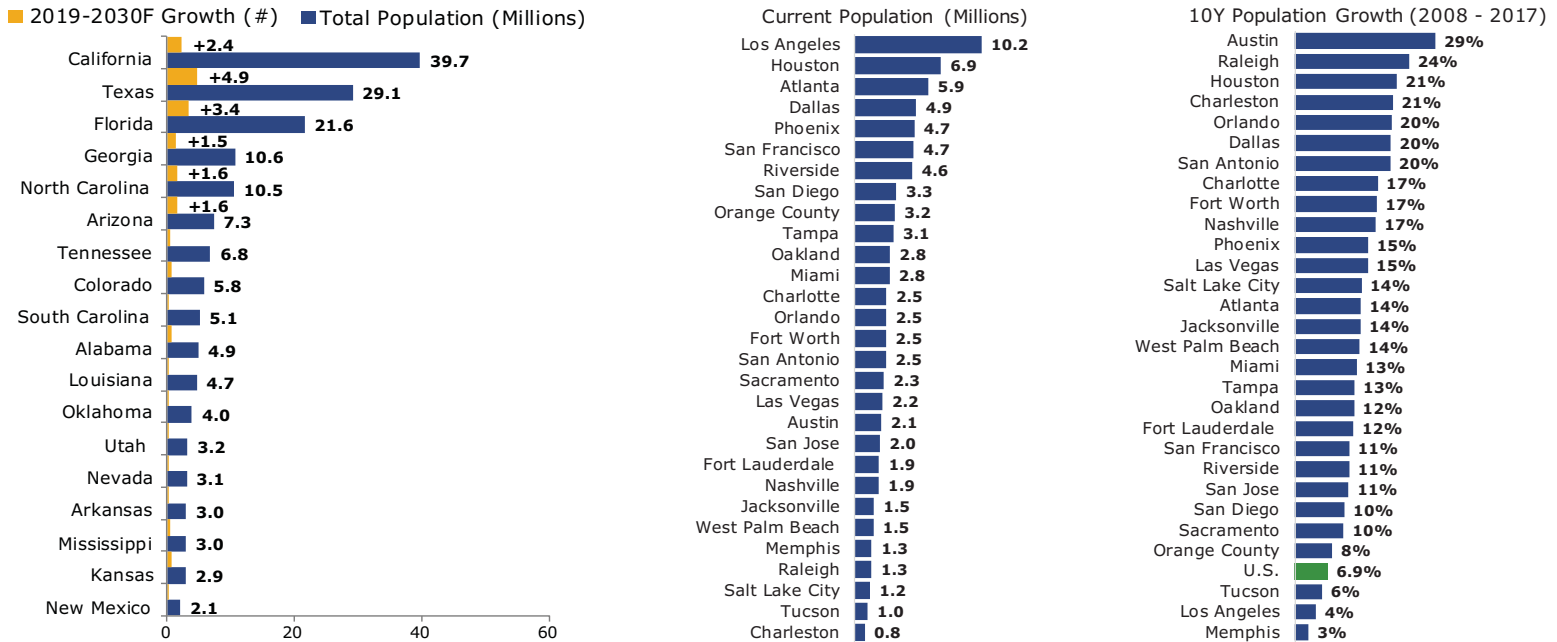
Over the past decade, national relocations to the Sun Belt, measured by domestic migration, totaled nearly 5 million, largely driven by outflows from the non-Sun Belt region, in particular, states in the Northeast and Midwest *(Figure 3)*. Both regions recently reported comparable international migration and natural population growth (births minus deaths), but it is likely non-Sun Belt states' population growth will be driven more by international in-migration in the future.[4]

FIGURE 3: 10-Year Cumulative Domestic Migration by Select State
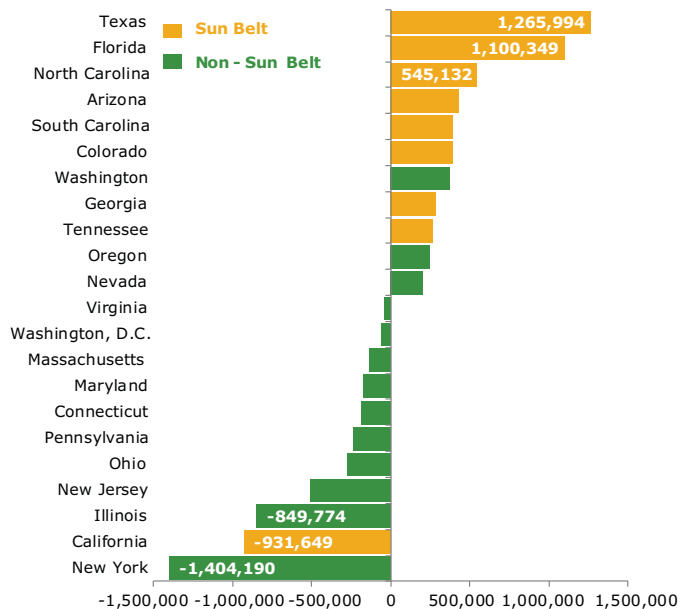
Source: Moody's Analytics, Clarion Partners Investment Research, Q4 2018. Notes: 1) Total growth the sum from 2008 to 2018. 2) Tax rates vary by state.[5]

Looking ahead through 2030, the overall surge in population should continue in the three largest U.S. states – Texas, Florida, and California, followed by Arizona, North Carolina, and Georgia.[6] Given recent expansion trends, future growth is also likely to take place in a handful of mid-sized cities *(Figure 4)*. For example, Raleigh, Charleston, Orlando, San Antonio, Charlotte, Denver, Fort Worth, Nashville, Jacksonville, and West Palm Beach have reported sizable gains over the past ten years, which should persist in the future.

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FIGURE 4: Sun Belt Region: Total Population & Growth History/Forecast

■ 2019-2030F Growth (#) ■ Total Population (Millions)

State	Total Population	2019-2030F Growth
California	39.7	+2.4
Texas	29.1	+4.9
Florida	21.6	+3.4
Georgia	10.6	+1.5
North Carolina	10.5	+1.6
Arizona	7.3	+1.6
Tennessee	6.8	
Colorado	5.8	
South Carolina	5.1	
Alabama	4.9	
Louisiana	4.7	
Oklahoma	4.0	
Utah	3.2	
Nevada	3.1	
Arkansas	3.0	
Mississippi	3.0	
Kansas	2.9	
New Mexico	2.1	

Current Population (Millions)

City	Population
Los Angeles	10.2
Houston	6.9
Atlanta	5.9
Dallas	4.9
Phoenix	4.7
San Francisco	4.7
Riverside	4.6
San Diego	3.3
Orange County	3.2
Tampa	3.1
Oakland	2.8
Miami	2.8
Charlotte	2.5
Orlando	2.5
Fort Worth	2.5
San Antonio	2.5
Sacramento	2.3
Las Vegas	2.2
Austin	2.1
San Jose	2.0
Fort Lauderdale	1.9
Nashville	1.9
Jacksonville	1.5
West Palm Beach	1.5
Memphis	1.3
Raleigh	1.3
Salt Lake City	1.2
Tucson	1.0
Charleston	0.8

10Y Population Growth (2008 - 2017)

City	Growth
Austin	29%
Raleigh	24%
Houston	21%
Charleston	21%
Orlando	20%
Dallas	20%
San Antonio	20%
Charlotte	17%
Fort Worth	17%
Nashville	17%
Phoenix	15%
Las Vegas	15%
Salt Lake City	14%
Atlanta	14%
Jacksonville	14%
West Palm Beach	14%
Miami	13%
Tampa	13%
Oakland	12%
Fort Lauderdale	12%
San Francisco	11%
Riverside	11%
San Jose	11%
San Diego	10%
Sacramento	10%
Orange County	8%
U.S.	6.9%
Tucson	6%
Los Angeles	4%
Memphis	3%

Source: Moody's Analytics, Clarion Partners Investment Research, Q4 2018. Note: Population is as of 2017 and growth is from 2008-2017.

SIGNIFICANTLY BETTER BUSINESS SETTING LEADS TO PRIVATE SECTOR GROWTH

- **Lower Taxes a Win-Win.** More and more companies are domiciled in the Sun Belt. A pro-business culture, largely enabled by fewer and less onerous taxes and regulations, has spurred significant private sector growth. Today, Texas, Florida, and California boast the most Fortune 500 Companies (outside of New York, Illinois, and Ohio).[7] Over the past decade, total employment in the Sun Belt region grew by 12 million (+20%) versus 9 million (+12%) in the non-Sun Belt. Furthermore, reduced state and local tax (SALT) and mortgage interest deductions no longer favor homeownership in high-cost states like California, New York, and New Jersey, driving housing prices down in such states.

- **Strong Job, GDP, & Wage Growth.** The tremendous business expansion has led to faster job, GDP, and wage growth in most metro areas, well above the U.S. and non-Sun Belt averages. Recent and forecasted office-using job growth is highest in Austin, Orlando, Dallas, Houston, Raleigh, Fort Worth, Phoenix, Las Vegas, Tampa, West Palm Beach, Jacksonville, and Charlotte.[8] Muted economic growth, high housing costs, congestion, and dated infrastructure also may worsen outside the Sun Belt.[9]

- **Increasingly Younger Work Force.** About half of the total nonfarm and office-using jobs (a respective 150 million and 32 million) are already located in the Sun Belt. Also, 50% of Millennials currently live in the region.[10] Millennials as a percentage of the population are now highest in San Francisco, Austin, San Diego, Los Angeles, and Charleston. With Millennials expected to be about 75% of the workforce by 2030, we expect Sun Belt markets will continue to capture more jobs as their younger populations continue to grow.[11]

- **Tourism A Large & Growing Force.** Over half of leisure and hospitality jobs are located in the Sun Belt, with California leading by a large margin, followed by Texas and Florida, three of the five "Sand States," along with Nevada and Arizona. A variety of tourist hubs are expected to continue to thrive, especially with the U.S. rentership rate being high nationwide and many living in small and confined urban conditions. Hotel accommodations also offer geographic variety and flexibility in an increasingly mobile world.

MILLENNIALS: IN PURSUIT OF A BETTER QUALITY OF LIFE

- **Shifting Destinations for Millennials & Recent College Grads.** Traditionally, New York, Boston, Washington, D.C., and San Francisco have drawn the majority of recent college grads, but the high-cost and low quality of life in these large metros are driving more young to mid-sized cities in the South and West.[12] These areas also have thriving energy, tech, new media, entertainment, hospitality, health care, and financial services industries.

- **More Affordable Housing Overall.** Major Sun Belt cities have typically reported much lower median home and apartment rent prices, although both have risen in recent years. Most areas in the region are still cheaper by comparison to the gateway cities, and such relative affordability may become more important as young adults age, marry, and have families. These life milestones may be more likely to occur in these regions. Prices in the other major Sun Belt cities generally range between $150,000 and $450,000. Select areas, mainly in California, Texas, and coastal Florida, have become increasingly expensive. Top cities in California report a median home price between $500,000 and $1.4 million – the U.S. is now about $270,000. Available and developable land varies greatly by city and region.[13]

- **Homeownership Rate A Mixed Story.** Surprisingly, many cities in the Sun Belt, such as Los Angeles, San Jose, Austin, San Diego, Miami, and Houston have a lower homeownership rate than the national level (64.8%), ranging between 50% and 60%. This suggests there is still a scalable investment opportunity in rental housing in these cities, as well as those reporting a high percentage of Millennials. Cities in the region leading in homeownership are now Nashville, Raleigh, Jacksonville, Charlotte, and Phoenix.[14]

SENIORS & RETIREES: SAFE HAVEN FOR RAPIDLY INCREASING AGING POPULATION

- **Accelerating Growth of Senior Cohort.** Today seniors account for about 16% of the U.S. population, a share that is expected to rise to about 20% by 2030. The Sun Belt now holds about 50% of the age 65-plus cohort nationwide.[14] Over the next decade, Orlando, Austin, Phoenix, Raleigh, Las Vegas, West Palm Beach, and Jacksonville are forecasted to be the fastest-growing retirement areas.

- **More Than Half of All Purpose-Built Senior Housing Is In Warmer Climate.** Over 50% of all senior housing inventory (1.9 million purpose-built beds) is located in the Sun Belt.[15] Demand for professionally-managed, specialty rental housing catering to the elderly should only continue to grow. While homeownership levels are much higher for the 65-plus cohort, these have recently declined, and we expect many elder Americans will sell long-time homes to generate additional income and reduce housing-related expenses and rent more frequently, whether it be in non- or purpose-built housing. This trend is already well underway.

Sun Belt Commercial Real Estate Opportunities

In recent years, Sun Belt markets have greatly outperformed in effective rent growth relative to outside markets *(Figure 5)*. The built environment in the region is largely composed of lower-density suburbs and exurbs. Much of the real estate is newer and low-rise construction. Given the higher level of sprawl, the trends toward densification and live-work-play are going strong. At the same time, the fastest-growing markets were largely suburban.[16]

FIGURE 5: Sun Belt vs. Non-Sun Belt Rent Growth History (5-Year)
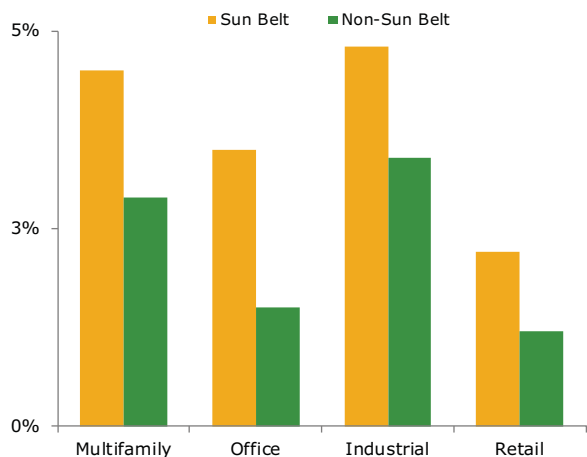
Source: Moody's Analytics, Clarion Partners Investment Research, CBRE-EA, Q4 2018. Note: Based on the 26 largest markets from 2014-2018.

- **Office.** The largest Class A office submarkets by square feet are San Francisco, Los Angeles, Atlanta, Dallas, Atlanta, and Orange County.[17] Many top high-paying, office-using jobs are in corporate headquarters in premier suburbs therein.[18] Due to increasing office space efficiency and the coworking explosion, institutional investors should focus on irreplaceable assets near transit hubs, campuses, and commercial districts, which tend to be in more walkable, mixed-use settings.

– **Multifamily.** Since Sun Belt markets report mixed homeownership rates, some with very high rates of owner-occupied units, we recommend targeting high-growth downtown areas for multifamily housing near younger employment hubs. Local barriers to entry (e.g. zoning and land-use restrictions) should be critically reviewed, as select metros may be at risk of oversupply.[19] Single-and multifamily rentals in master-planned communities are likely be more common for larger households. Many millennials may opt for gated community living as they start or grow families. Much professionally managed and full-service rental housing will cater to the elderly constituency who prefer non-car-dependent, village-style living.

- **Retail.** Urban and suburban shopping formats should target high-street, grocery-anchored, and lifestyle centers with considerable population density and/or in wealthier neighborhoods. Proximity to top job and housing submarkets is crucial. Also, Seniors tend to have higher net worth's and shop more in stores.

- **Industrial.** Four out of six of the largest and most active distribution markets are in the region – Los Angeles, the Inland Empire, Dallas/Fort Worth, and Atlanta. The rapidly growing populations in the Southeast and Southwest, Panama Canal expansion, burgeoning recovery of manufacturing, and U.S. energy boom should all bode well for ongoing demand in the region.

- **Hotel.** Tourism is an important all year-round business attracting millions of both domestic and international leisure and business travelers. Nationwide, foreign spending has also reached record levels. We recommend acquiring or redeveloping high-quality, full-service hotels with top beaches, access to the great outdoors, food & beverage (F&B), corporate events, and meeting spaces.

TOP 10 SUN BELT MARKETS: 5Y EFFECTIVE RENT GROWTH HISTORY

#	MULTIFAMILY	OFFICE	INDUSTRIAL	RETAIL
1.	Sacramento	Orange County	Oakland	San Jose
2.	Las Vegas	San Jose	Riverside	W. Palm Beach
3.	Phoenix	Oakland	Orange County	Oakland
4.	Riverside	Nashville	Atlanta	Miami
5.	Oakland	Atlanta	Fort Worth	Los Angeles
6.	Orlando	Los Angeles	Las Vegas	Houston
7.	Fort Worth	Charlotte	W. Palm Beach	Fort Lauderdale
8.	Atlanta	Austin	San Antonio	Austin
9.	San Jose	Miami	Raleigh	Dallas
10.	Los Angeles	W. Palm Beach	Austin	Fort Worth

Source: CBRE-EA, Clarion Partners Investment Research, Q4 2018. Note: Based on the 26 largest markets from 2014-2018.

Sun Belt Markets Have Consistently Outperformed the NCREIF Property Index

The Sun Belt has seen a surge in population growth for decades from an influx of people seeking growing economic opportunity, a lower cost of living, and retirement in a warm and sunny climate. Clarion Partners believes that the investment outlook for the West and South is now especially attractive. The Sun Belt markets within the NCREIF Property Index (NPI) returns have performed extremely well over the past 20 years *(Figure 6)*.

FIGURE 6: NCREIF Returns Significantly Outperform the Overall Index
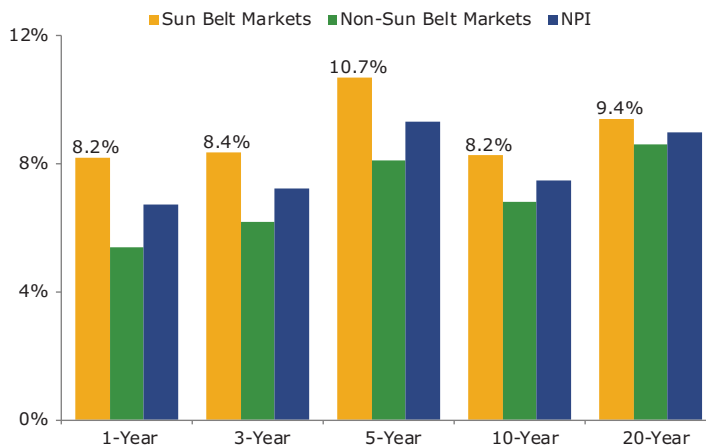
Source: NCREIF, Clarion Partners Investment Research, Q4 2018.

Through 2030, anticipated growth will be outsized in the three most populous states – California, Texas, and Florida. Many Sun Belt areas will become increasingly popular destinations for professionals, families, retirees, and world travelers. Most importantly, the expanding new economy in the West and South may become more important than that in the Northeast and Midwest and will continue to attract top talent. These dynamics should greatly improve and catalyze cultural, institutional, leisure, and intellectual property growth in urban areas, as well as household wealth, likely driving outsized commercial real estate appreciation.

[1] Clarion Partners Investment Research, Q4 2018. Note: A mid-size city is defined as one with a population between 1 to 3 million.
[2] Moody's Analytics. Q1 2019. Note: The 18 states in the Sun Belt include: Alabama, Arkansas, Arizona, California, Colorado, Florida, Georgia, Kansas, Louisiana, Mississippi, North Carolina, New Mexico, Nevada, Oklahoma, South Carolina, Tennessee, Texas, & Utah.
[3] Ibid.
[4] Ibid.
[5] Note: Tax burden only factors in taxes paid by residents/businesses of the respective state.
[6] Moody's Analytics. Q1 2019.
[7] Wikipedia. 2019.
[8] Moody's Analytics. Q1 2019.
[9] U.S. Bureau of Labor Statistics. Q1 2019.
[10] Ibid.
[11] Forbes. *The Millennial Arrival and The Evolution of the Modern Workplace*. 2018.
[12] Ibid.
[13] Moody's Analytics. Q1 2019.
[14] Ibid.
[15] CBRE. 2018.
[16] Ibid.
[17] This includes downtown and suburban markets.
[18] Fortune. *Americans Really, Really Love Sunbelt Suburbs*. June 2017.
[19] Clarion Partners Investment Research, Q1 2019.