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# State of Texas' ambitious real estate expansion sends ripple effects through Austin

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Mike Novak didn't know what the Texas Facilities Commission was when he was asked by then-Speaker of the House Joe Straus to serve as a board member for the state agency.

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A rendering of how Congress Avenue could look in a few years, seen from Martin Luther King Jr. Boulevard looking south. Construction is underway on the 14-story George HW Bush State Office Building, front left, and another office high-rise at 1601 Congress, shown at middle center.

Fast forward eight years, and what the Texas Facilities Commission actually does is the No. 1 question Novak gets now that he's running the agency that serves as the real estate management and construction group for the state.

It's a big job — across the state the commission manages about 26 million square feet of office space.

But it's a role the construction industry veteran of more than 30 years agreed to take on for the next three to four years through the $895 million expansion of the Capitol Complex, one of the state's largest real estate endeavors — perhaps the biggest since the Texas State Capitol itself was completed in 1888.

The state reports the expansion will save taxpayers millions of dollars in the long run due to the rising cost of rents in Austin.

“It is a much better bargain for the taxpayers of the state of Texas to have these agencies in our own buildings because if not we are subject to escalation,” Novak said.

To be sure, it will reshape a large swath of Austin's Central Business District, creating more connections between denser office development to the south and the University of Texas to the north.

The commission also controls the fate of one of downtown’s prime blocks for redevelopment, the site of the run-down William P. Hobby Building. The building has more than $50 million in deferred maintenance needs and will more than likely be demolished, potentially clearing the way for a large tower or other dense development.

**FOR MORE: What will become of the decrepit Hobby Building downtown?**

In short, the Texas Facilities Commission is one of the most powerful but under-the-radar real estate organizations in the city. And it’s not one without controversy: The last executive director was fired in January 2018 over allegations of internal disfunction. Its expansive construction projects have also attracted critics who say the state shouldn’t construct new buildings because it doesn’t properly maintain the ones it already owns.

Novak was asked by members of the board that oversees TFC to take on the role of executive director last fall. After initially saying no, Novak resigned from his seat on the board to take the position in November.

Novak also stepped away temporarily from his role as founder and CEO of San Antonio-based construction management company Novak Group LLC.

“My goal is to transform the agency to a whole different level and get through the capitol project,” he said. “I feel we are in a unique season to transform this agency into a new era.”

The former Bexar County Commissioner said he considers the job “another tour of duty in public service.”

The gig requires him to commute each day from North San Antonio to downtown Austin. Luckily, he’s an early riser due to his construction background. He leaves his home every day at 5 a.m. to beat most of the commuter traffic.

**New buildings, private-sector opportunities**

The state will make major real estate moves through at least 2025, including vacating the Hobby Building and two dozen leases across the city.

The state of Texas was already the biggest player in Austin’s real estate market. It leases about 2.5 million square feet of office and warehouse space across the city, according to records provided to Austin Business Journal. It owns and manages another 3.9 million square feet.

The state is also the biggest employer in the Austin area with about 63,000 workers, according to the Austin Chamber of Commerce.

Four buildings will be constructed at the Capitol Complex in two phases totaling 1.5 million gross square feet. It’s a move that will bring an estimated 4,800 more workers to Congress Avenue. Moving into those new buildings will free up more than $25 million in annual lease expenses for the state.

Beyond the Capitol Complex, the Texas Health and Human Services Commission is constructing a new office building at the corner of 46th Street and North Lamar Boulevard. TFC is the construction manager.

Health and Human Services Commission spokeswoman Kelli Weldon said some agencies with leased space will move into the new building when it opens in 2021. The commission expects to retire $7.4 million in annual leases with the 406,000-square-foot building. A second phase that will include a 302,000-square-foot building will open in 2024.

And that isn't all the state of Texas is building in Austin. Although not overseen by the TFC, the Texas Department of Transportation is building a 49-acre campus near East Stassney Lane and Burleson Road to consolidate five buildings in Austin, which will "create greater efficiency and collaboration," TxDOT spokesman Adam Hammons said in an email. Beginning this fall, a 400,000-square-foot office building, a 150,000-square-foot warehouse building, a 62,000-square-foot laboratory building and parking garages will be constructed on the site. It’s scheduled to be completed in August 2022.

Local real estate experts said the state vacating leased buildings across the city will bring additional office inventory to the market as long as Austin's economy stays strong. While the state typically leases in class B or C buildings, which offer cheaper rents and fewer amenities, the state vacating big chunks of space will create opportunities for some landlords to sell or invest in their properties, experts said.

"With a long-term, stable tenant moving out of class B and C office space, this gives landlords the opportunity to renovate the buildings to compete with the new, modern spaces being developed downtown," said Eric Hudson, a principal at Method Architecture. "Once vacated and renovated, this also gives landlords the ability to increase lease rates and overall value of their assets. It's an opportunity to adapt older buildings with new technology and even new ways of working (such as coworking). This will allow them to compete with some of the newer developments on the east side."

Charles Heimsath, president of Capital Market Research, said the state's moves are a win-win for the office market. He said it will free up inventory that can either be demolished or repurposed at a lower price than new construction.

For the state, consolidating employment in one location is a smart move and will lead to better efficiency and communication among state employees, he said.

**What landlords think**

The state's construction plan gets mixed reviews from landlords.

Doug Agarwal, the founder and president of Capital Commercial Investments, said he would hate to see the state vacate his building at 8407 Wall St. in Northeast Austin. While the state pays below-market rents, it's a stable tenant that will sign 10-year leases, which reduces the cost of turnover for property owners.

The Department of State Health Services leases all of the 109,000-square-foot building at 8407 Wall St. The state's been in the building for at least 20 years, Agarwal said.

Agarwal is hearing, though, that the state could vacate his building and relocate to another building owned by the state and controlled by the Health and Human Services Commission.

“We are hopeful that the state runs out of room at their new facility, and they decide to stay,” he said. “I won’t know that for another year.”

At 8407 Wall St., the state pays an estimated $10 a square foot for its 10-year-lease, which is set to expire in February 2022, Agarwal said. The market average in the area, though, is around $17.50 triple net, he said.

If the state re-leases, Agarwal said he would like to raise rent to $15 a square foot. But if the state vacates, he said he will have to invest $2 million to $3 million in the building in such areas as the bathrooms, common areas and LED lighting.

Mike Kennedy, former principal at Avison Young now heading up his own real estate agency, agreed that the state vacating space will create an opportunity for landlords to raise rents closer to market rates. It will also give other tenants access to more affordable space, he said.

“While there will be some short-term vacancy, I think it will be filled pretty quickly,” he said.

The Texas Lottery Commission's plan to vacate its large lease at Grant Plaza at 601 E. Sixth Street, just west of I-35, will create an opportunity for property owner Empire Square Group LLC.

The commission has confirmed it has secured space at the Capitol Complex expansion. That means it will leave about 75,000 square feet at Grant Plaza.

J.D. Lewis, a broker at HPI who handles leasing at Grant Plaza, said in an email the property owner is "evaluating the best course of action including redevelopment as a creative office/mixed use project. We plan to start nailing down details early next year."

Connor Greissing, vice president at Stream Realty Partners, said there’s huge redevelopment potential for Grant Plaza, a mid-rise office complex just two blocks north of the Austin Convention Center.

“That building looks like the ones that rent for the highest lease rates in the city of Denver,” he said.

Greissing said the redevelopment of Grant Plaza could be a “great catalyst” for more revitalization along Waller Creek in the Red River Cultural District.

**TFC's next moves**

Novak said the 19 agencies and 1,379 full-time employees that fill the Hobby Building in downtown will be moved to the Capitol Complex in 2022. However, if any of those agencies receive federal funding, they could lease elsewhere and subsidize the cost.

“It is an underperforming asset,” he said of the Hobby Building. “That building isn’t the highest and best use where it is at.”

The building will be sold by the General Land Office sometime in the next two years, Novak said. TFC is expected to transfer the building to GLO by the end of the year or early next year, when GLO will begin the sale process.

The new owners won’t take possession of the Hobby Building, though, until the first phase of buildings open at the Capitol in 2022.

Though no final decisions have been made, TFC has also identified 24 leases in nine buildings totaling 466,109 square feet that could be vacated as part of the Capitol Complex expansion.

This number will continue to be boiled down because not all of those agencies will fit in the first two phases of the Capitol Complex expansion. Priority is given to leases that expire around 2022. Only non-public facing offices will move to the Capitol Complex, according to TFC.

A potential third phase of the Capitol Complex expansion could add at least two more buildings, if it receives funding from the Texas Legislature.

**PLUS: What Novak wants the private sector to know about TFC**

This fall Novak and his team will begin meeting with 130 state agencies to determine their real estate needs for at least the next two years in an effort to make final decisions about which groups will move to the Capitol.

To make the decision, TFC is looking at a number of things such as what state office leases expire first, their compatibility, the functions of state agencies and even where employees of these agencies live.

“It’s all a work in progress. It is driven by the numbers,” he said. “It is like putting together a big jigsaw puzzle right now."

Final decisions on what agencies will move into the Capitol Complex likely won’t be made until after the 2021 Texas Legislature.

“These agencies are then going to have to go to the Legislature and ask for their moving expenses,” Novak said. “All of that has to be sorted out during the next session. They need to have an idea if they need to ask for appropriations to make the move.”

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