

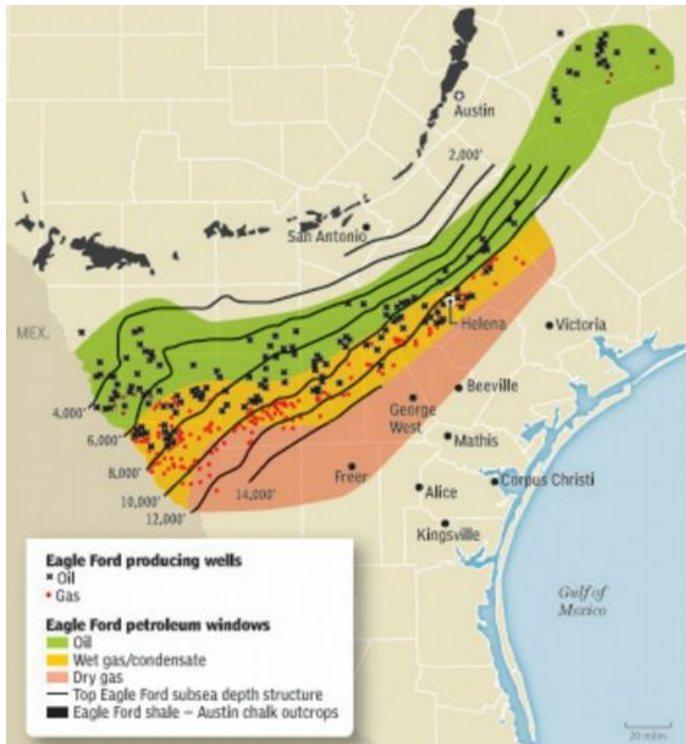
Eagle Ford Shale Brings Hotel Demand, Development to South Texas

April 8, 2013 / By J. Carter Allen



A grouping of oil or gas deposits underlying a common geographical region is called a “play,” and exploiting these reserves is serious business. The Eagle Ford Shale (EFS), reportedly the largest contiguous oil and gas play in the world, extends from the Texas/Mexico border in Webb and Maverick Counties 400 miles northeast.

EAGLE FORD SHALE



Activity associated with the EFS has stimulated enormous, rapid growth in jobs, population, and businesses in South Texas, putting pressure on the region to create more lodging options for near- and long-term needs. This article explores the impacts of the EFS on the economy and hotel markets across South Texas.

Rapid Growth, New Developments

The discovery of vast deposits of oil and gas across the EFS and the development of new, efficient means to extract them have met with rising energy prices worldwide, leading to a proliferation of energy-resource-related activity in South Texas. Initial production was primarily of natural gas, but low interest rates, a weak dollar, and the growth of emerging markets coming out of the recent recession have led to higher oil and condensate prices, making the exploitation of these reserves feasible. According to Karr Ingham, an economist with the Texas Alliance of Energy Producers, crude oil output in Texas increased by 21% year-over-year in 2011, and an additional 18% in 2012.

Several projects are proposed or underway to improve the transportation infrastructure used to move these energy reserves. DCP Midstream is investing \$1 billion to open a 720-mile pipeline that ties resources from the

Summary

Oil and gas operations have escalated in South Texas since 2008, with energy companies arriving across the massive Eagle Ford Shale in droves. Facilities to accommodate this influx remain scarce, priming some areas of South Texas for a lodging boom.

6 Comments

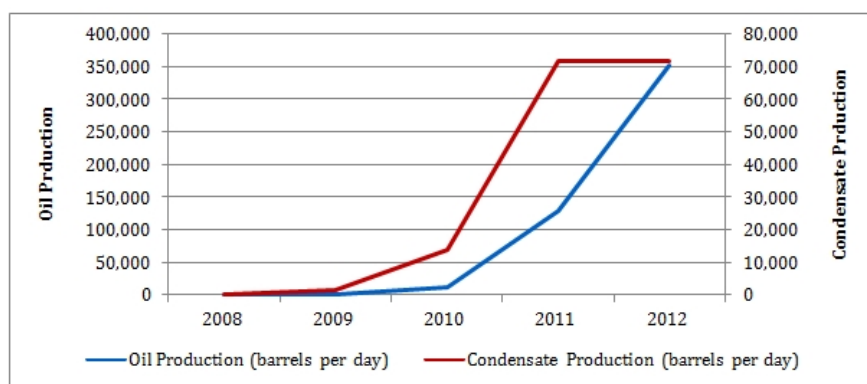
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EFS and the oil-rich Permian Basin to the Gulf Coast; the Sand Hills Pipeline is expected to be completed mid-year 2013. In 2012, NuStar Energy expanded its network of pipelines and gathering points throughout the EFS by acquiring assets from TexStar Midstream Services for \$425 million. NuStar plans to spend \$400 to \$500 million in 2013 and 2014 to expand the natural gas pipeline, refurbish facilities, and integrate the crude oil network into the company's existing system. Additionally, rail ports across South Texas are expanding to push crude past pipeline bottlenecks and move fracking sand into the various drilling operations throughout the Eagle Ford Shale. In response to the rise in railcars, the Port of Corpus Christi, Port San Antonio, and the Hondo Railway west of San Antonio have significantly increased their systems of track over the past twelve months.

Movement in the prices of oil and natural gas has led to significant capital investments and job creation at petroleum refineries across the region. Valero has invested \$100 million into its Three Rivers refinery, located in Live Oak County, to expand oil storage capacity, truck unloading capacity, and light crude processing capabilities. Blue Dolphin Energy Company's 15,000-barrel-per-day refinery in Gonzales County began processing crude oil in February of 2012, and according to a filing with the Texas Commission on Environmental Quality, the company plans to expand the refinery to process 25,000 barrels per day of crude.

EAGLE FORD SHALE OIL AND CONDENSATE PRODUCTION BOOM



A U.S. Energy Information Administration report from 2009 estimated there were approximately three billion barrels of "technically recoverable shale oil" and twenty-one trillion cubic feet of "technically recoverable shale gas" in the Eagle Ford Shale. Some experts put the oil deposits at ten million barrels or more. The consensus seems to be that the multi-billion economic impact of energy exploration and extraction in the area shows no signs of abating for years.

South Texas' Employment and Population Boom

The expansion of permanent and contract oil-and-gas-related workforces, along with the increase in temporary construction jobs related to plant and infrastructure improvements, has decreased unemployment throughout South Texas. The following chart shows unemployment rates for counties directly impacted by drilling operations, as well as counties experiencing indirect economic growth resulting from the EFS.

UNEMPLOYMENT DATA

Year	Dimmit County	La Salle County	Live Oak County	Gonzales County	Nueces County	Bexar County	Harris County	State	U.S.
2002	9.2 %	8.4 %	5.4 %	5.0 %	6.1 %	5.8 %	6.1 %	6.4 %	5.8 %
2003	9.4	7.8	5.6	5.0	6.5	6.2	6.8	6.7	6.0
2004	9.0	6.7	5.1	4.7	6.1	5.8	6.3	6.0	5.5
2005	8.2	5.6	5.0	4.1	5.4	5.1	5.7	5.4	5.1
2006	7.6	5.0	4.5	4.0	4.9	4.7	5.1	4.9	4.6
2007	6.4	4.9	3.9	3.8	4.3	4.2	4.3	4.4	4.6
2008	6.7	5.5	4.3	4.0	4.6	4.8	4.8	4.9	5.8
2009	9.9	9.2	6.9	5.5	6.7	6.7	7.5	7.5	9.3
2010	9.2	8.4	6.6	6.1	7.6	7.5	8.5	8.2	9.6
2011	7.0	6.5	5.5	5.7	7.6	7.6	8.2	7.9	9.0
<i>Recent Month - Dec</i>									
2011	5.8 %	5.2 %	4.7 %	4.8 %	6.6 %	6.8 %	7.2 %	7.2	8.7 %
2012	4.8	3.9	3.9	4.1	5.4	5.8	6.0	5.8	7.8

Directly impacted by drilling operations

Indirectly impacted by drilling operations

* Letters shown next to data points (if any) reflect revised population controls and/or model re-estimation implemented by the BLS.

Source: U.S. Bureau of Labor Statistics

Overall, unemployment rates in counties directly impacted by the Eagle Ford Shale declined in 2010 and 2011, as drilling operations increased. The most recent comparative period shows further improvement, and oil and gas companies still struggle to find qualified workers to fill the abundance of jobs. Companies, state associations, and the Eagle Ford Shale Consortium continue to host job fairs across the region, including in neighboring states, in an attempt to attract new workers to the area to keep up with demand. As oil and gas operations continue to expand throughout the region, local employment levels are expected to remain strong. According to a recent report by IHS Global Insight, 576,000 jobs in Texas are linked to shale activity. By 2020, IHS estimates there will be 930,000 jobs related to unconventional oil and gas plays such as the Eagle Ford Shale¹.

The boom in energy production has also spurred overall population growth. The population of the Middle Rio Grande Region, which includes Dimmit County and La Salle County, grew by 8.2% from 2000 to 2010. In a study conducted by the University of Texas at San Antonio, the population of Dimmit, Frio, La Salle, Maverick, Webb, and Zavala Counties is expected to experience an overall 24% increase in population through 2025. This increase in population is creating an unprecedented demand for new roads, water-treatment facilities, sewage lines, schools, housing, and hotels.

Hotel Occupancy and Supply

As some of these counties were ill equipped to handle the large increase in demand for housing and services, hotels have realized very strong performance figures, prompting hotel supply to nearly double in some markets. Blocks of construction and energy workers fill area hotels for months at a time, with many workers preferring hotel accommodations to apartments given their semi-permanent positions in the region. Peak levels of demand have allowed some hoteliers to increase rates, leading to significant revenue growth. The following chart shows estimated revenue per available room² (RevPAR) for hotels in selected cities across South Texas.

SELECTED CITY HOTEL TAX RECEIPTS

Year	Gonzales, TX			Three Rivers, TX			Cotulla, TX		
	Supply Increase	Estimated RevPAR	Percent Change	Supply Increase	Estimated RevPAR	Percent Change	Supply Increase	Estimated RevPAR	Percent Change
2007	—	\$18.19	—	—	\$26.80	—	—	\$25.30	—
2008	7.2 %	17.99	(1.1) %	(12.7) %	37.60	40.3 %	(5.4) %	31.40	24.1 %
2009	21.7	21.64	20.3	0.0	33.78	(10.2)	29.0	35.79	14.0
2010	0.5	34.21	58.1	0.0	50.12	48.4	22.1	69.36	93.8
2011	12.0	46.03	34.5	100.8	50.20	0.2	14.5	92.69	33.6
2012	16.4	55.49	20.5	94.3	69.08	37.6	136.6	110.06	18.7

Source: Texas Comptroller of Public Accounts

SELECTED CITY HOTEL TAX RECEIPTS – CONTINUED

Year	Carrizo Springs, TX			Pearsall, TX			Crystal City, TX		
	Supply Increase	Estimated RevPAR	Percent Change	Supply Increase	Estimated RevPAR	Percent Change	Supply Increase	Estimated RevPAR	Percent Change
2007	—	\$24.52	—	—	\$38.35	—	—	\$19.53	—
2008	3.8 %	29.47	20.2 %	73.8 %	37.91	(1.1) %	(6.6) %	26.29	34.6 %
2009	3.6	27.38	(7.1)	48.9	32.54	(14.2)	15.2	21.53	(18.1)
2010	1.8	48.55	77.3	(15.4)	57.04	75.3	9.0	37.26	73.1
2011	18.3	57.90	19.2	(2.6)	91.34	60.1	0.0	62.74	68.4
2012	605.2	30.91	(46.6)	93.4	91.67	0.4	11.7	43.34	(30.9)

Source: Texas Comptroller of Public Accounts

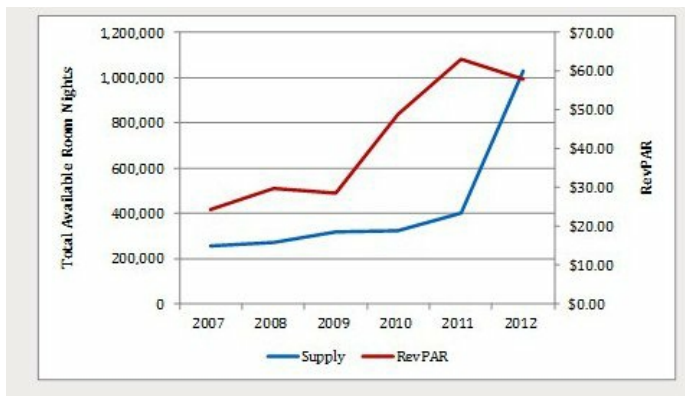
SELECTED CITY HOTEL TAX RECEIPTS – AGGREGATE

Year	Aggregate		
	Supply Increase	Estimated RevPAR	Percent Change
2007	—	\$24.42	—
2008	4.4 %	29.70	21.6 %
2009	18.2	28.57	(3.8)
2010	1.3	48.75	70.6
2011	24.7	62.99	29.2
2012	155.3	57.91	(8.1)

Source: Texas Comptroller of Public Accounts

As shown in the chart below, new supply has lagged behind an enormous growth in RevPAR in these markets.

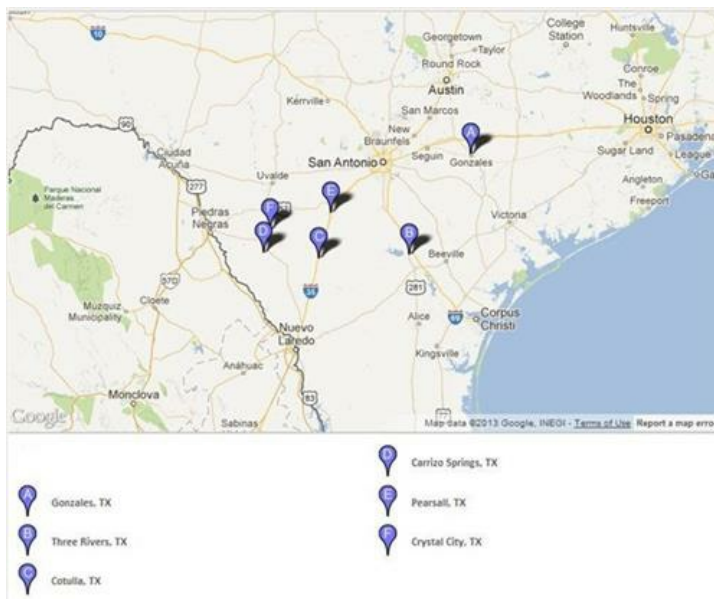
AGGREGATE – SUPPLY INCREASES LAGGED BEHIND REVPAR GROWTH



The city of Carrizo Springs illustrates some of the opportunities the region’s oil boom has brought to local hotels, as well as some of the precautions potential hoteliers need to observe. After two consecutive years of double-digit RevPAR growth, the city realized an increase in available room nights of over 600%, causing RevPAR to decline. The 2012 increase primarily resulted from two lodging developments: a 300-unit modular lodging complex built by Target Logistics Management for Halliburton and a 256-unit complex built by Remote Lodging & Logistics.

Overall, hotel revenues grew substantially in 2010 and 2011 in these hotel markets, concurrent with the expanding demand related to the Eagle Ford Shale. Though each market realized an increase in available room nights in 2012, all but three posted strong RevPAR growth. The tremendous amounts of new supply that entered the Carrizo Springs and Crystal City markets caused overall RevPAR to decline in 2012. The following map shows the locations of the cities researched for this article.

MAP OF SELECTED CITIES



Despite recent and proposed increases in hotel supply, performance figures show that certain markets are ripe for hotel development. It is crucial for hotel developers to gain intimate, market-specific knowledge of the demand generators, competitors, and value projections for their proposed hotel investment, purchase, or new build. While opportunities abound, they also pose unique challenges to developers looking to build in markets directly benefiting from oil-and-gas-related demand. Larger cities such as San Antonio, Corpus Christi, and Houston are also experiencing strong lodging fundamentals, based on a solid foundation of diverse economic drivers and bolstered by indirect demand created by the Eagle Ford Shale.

Conclusion

The Eagle Ford Shale has had an unprecedented impact on the South Texas economy. There is no shortage of

hard data to document the population, employment, and economic growth throughout the region; however, hoteliers, investors, and developers need to proceed with caution, as rampant construction of new hotels and rooms may end up serving only a short-lived need, should economic conditions experience a downturn, or drilling restrictions inhibit growth. Furthermore, the myriad of potentially competitive properties such as RV parks, converted apartment buildings, and corporately built “man camps” pose unique challenges to hotel developers looking to build in these markets.

The lifespan of the EFS is open to conjecture, with most developers seeking quick paybacks because of the uncertainty surrounding the sustainability of the demand. Harold Hunt, a research economist at Texas A&M, estimates the boom will last at least another 16 years; Thomas Tunstall, a research director at the University of Texas at San Antonio’s Institute for Economic Development, believes it could take 20 to 25 years to reach capacity. Most experts agree that, given the continual rise in prices of oil and gas, exploration and extraction of these resources will continue for at least the next decade. The prospects for the EFS thus make South Texas fertile for well-advised, carefully calculated hotel projects that can profit from the current boom and be well adapted for market dynamics in the future.

¹ “America’s New Energy Future: The Unconventional Oil and Gas Revolution and the U.S. Economy – Volume 2: State Economic Contributions.” HIS Global Insight. Retrieved March 10, 2013.

<http://www.ihs.com/info/ecc/a/americas-new-energy-future-report-vol-2.aspx>

² Estimates were calculated by dividing total tax receipts by the total number of hotel rooms in each city as reported to the Texas Comptroller of Public Accounts.

About **J. Carter Allen**



HVS Managing Director Carter Allen oversees all hotel consulting and valuation assignments for the firm’s Houston office. Carter graduated from the University of Houston’s Conrad N. Hilton College of Hotel and Restaurant Management with an emphasis in Hospitality Finance and Development. He also served as President of the school’s student chapter of Hospitality Finance and Technology Professionals. Carter’s hands-on hospitality experience spans front-line work at The Houstonian hotel and operations and management internships with JW Marriott and CenterPointe Hotels.

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