## Economic Update

There's a popular conviction that Houston lags the nation going into a recession, leads the nation coming out, and sustains a shorter and shallower period of job loss in between. The nation is now far enough into the recovery to test that belief. The Great Recession began in December '07 and lasted 18 months, making it the longest recession since World War II. The recovery began in June '09. The U.S. economy, in fits and starts, has been in recovery for almost two years now. The dates of the recession were set by the National Bureau for Economic Research (NBER), the group that determines peaks and troughs of all U.S. business cycles. NBER examined national trends in gross domestic product, industrial production, income, employment and wholesale and retail trade before setting the dates of the recession. Unfortunately, comparable data are not available on a monthly basis at the metro level. To measure local business cycles, analysts rely on trends in employment, an indicator most people readily grasp. In this analysis, employment is the primary indicator used to measure the onset, depth and end of the recession in each metro area.

The Great Recession began in December'07, but job losses began much earlier in many metro areas. Houston, however, did not report job losses until September '08, nine months into the recession. It was an unfortunate coincidence that the recession and Hurricane Ike arrived in Houston the same month. Given the magnitude of the nation's financial problems, it was inevitable Houston would be impacted. Houston was the last of the nation's 20 largest metro to report job losses.

All things being equal, one would expect the largest metros to suffer the greatest jobs losses. But not all things were equal, and some of the smaller metros sustained job losses disproportionate to their sizes. Houston, the nation's sixth most populous metro, lost 121,200 jobs while Miami, Atlanta, Detroit, Phoenix, Riverside, San Francisco, Seattle and Tampa—all with fewer residents than Houston—lost more jobs than Houston. Job losses are calculated from the month of peak employment in each metro area to the month in which the employment declines stopped in each metro.

Another measure of the depth the recession in each metro area is the percentage jobs lost during the downturn—the larger the percentage, the deeper the recession. Among the nation's largest metros, job losses ranged from 3.2 percent in Washington, D.C. to 13.5 percent in Riverside, with the average being 7.5 percent. Houston's job loss was 4.6 percent. Only three metro areas—Washington, D.C., Boston, and New York—lost a smaller share of employment than did Houston.

The recession that first hit the metro areas at different times also ended at different times. Houston, along with Chicago, Dallas, and St. Louis, began to post gains in January ’10. By January of this year, all metro areas had begun posting job gains. Measured from peak employment to trough, Houston suffered the shortest employment downturn – 16 months. The average downturn lasted 30 months, with Los Angeles suffering 42 consecutive months of job losses.

Fewer people applied for unemployment benefits, a sign that layoffs are dropping and employers may be hiring more workers. The four-week average of applications declined to 389,500 against the peak of 659,000 during the recession. It has dropped by 7 percent in the past 8 weeks. Employers added a net total of 216,00 jobs last month, per the Labor Department and the unemployment rate fell from 8.9 to 8.8 percent. Private employers added more than 200,000 jobs in both February and March, the biggest two-month gain since 2006. Per Jennifer Lee, an Economist at BMO Capital Markets, “Businesses are hiring, perhaps not at lightning speed, but they are hiring. And the jobless rate is inching lower. We’re nowhere near ‘normal’ but we’re taking steps in the right direction.”

The latest employment report from the U.S. Bureau of Labor Statistics indicates that all of the nation’s 20 largest metro areas have begun to add jobs. Job growth is at a snail’s pace in some metros and a rabbit’s race in others. Four metros—Boston, Dallas-Ft. Worth, Houston and Washington, D.C.—have recouped more than half of the jobs lost in the recession. According to a survey by the Federal Reserve, the U.S. economy improved in every region of the country this spring, but higher oil prices remain a concern. Factories were busier, consumers spent more and companies boosted hiring in all 12 of the regions surveyed.

Local consumers and businesses appear to be spending again and that’s helping to spur local job creation. Employers in the Houston area created 16,900 jobs in March, reported by the Texas Workforce Commission. The increase included substantial gains in retail, manufacturing, healthcare, oil & gas exploration & production, and administrative services such as employment agencies. Houston has recovered more than half of the jobs lost during the recent recession, per Patrick Jankowski, VP Research for Greater Houston Partnership. Between the peak of Houston employment numbers in August 2008 and the worst effects of the downturn in December 2009, the area lost 121,200 jobs. But Houston has regained 54 percent – 65,000 jobs – since the low point. We are in much better shape than we were this time last year. The U. S. economy hasn’t even gained back 25 percent of the jobs it lost during the recession, per Barton Smith, Professor Emeritus of Economics at the University of Houston. From March 2010 to March 2011, Houston-area employers added 51,800 jobs, according to the Texas Workforce Commission, an increase of 2.1 percent. The new jobs, coupled with the fact more residents found work, helped to push the area’s unemployment rate down to 8.3 percent from 8.4 percent in February.

The computer systems and design industry is among Houston's bright spots, with employment higher than it ever has been.  While the well-paying sector with its 25,400 jobs isn't huge, its growth shows that businesses are once again opening their wallets.  Companies delayed upgrading their computer systems during the recession and now they realize they're facing obsolescence if they don't stay on track with technology.  Machinery manufacturing has replaced 57 percent of the jobs it cut during the recession.  Companies that put off large capital purchases now want to replace worn-out equipment or buy new equipment to expand their capacity.

Wages increased more in Houston than in any other metropolitan area in the first quarter of 2011, according to figures released by PayScale, Seattle-based employee compensation data provider.  This could be a sign that Houston is finally turning around.  It is also the second time since mid-2009 that wages had a positive quarterly increase.  Year over year, Houston-area pay increases matched the national average during the first quarter, up .3 percent from the 2010 first quarter.  Wages rose more quickly in Houston than the country as a whole.  Being heavy in oil & gas has helped the area's compensation levels, as success in the energy sector has trickled down to other industries.

The Houston office market continued to make positive strides during the first quarter, but tenants still have the upper hand.  According to Grubb & Ellis, tenants remain in the driver seat when it comes to lease negotiations, but the pendulum will begin to swing toward the landlord's favor as the office leasing market fundamentals continue to improve.  Much of the leasing activity was driven by oil & gas companies that made deals in Class A buildings – the nicest, newest and most expensive properties.  CB Richard Ellis reports that in Q1/11, Houston's office market saw net absorption of 357,911 square feet (sf), mostly Class A space. From Q4/10 to Q1/11, vacancy decreased slightly to 16.0 percent which is still high. Nearly $1.3 million square feet is under construction most of that in downtown's Hess Tower and in BG Group Place.  Overall rental rates rose slightly to $23.17 in Q1/11 from $22.82 in Q4/10. The increased transaction activity in the market has encouraged landlords, and they've recently begun to raise rates and reduce concessions. The Houston industrial market remains one of the top five markets in the U.S.

The number of Asian firms in the Houston region rose by more than 50 percent from '02 to '07, according to data recently released by the U.S. Census Bureau. In '02, Asians owned 31,939 businesses and represented 7.6 percent of all firms in the region; while in '07, there were 48,740 Asian-owned firms, accounting for 9.3 percent of all firms. The share of Asian-owned businesses is larger than would be expected given their share of population. Asians represent 6.1 percent of the region's population, but own 9.3 percent of the region's businesses. Asian-owned firms in Houston reported $17.4 billion in revenue in '07, 2.0 percent of the region's total revenue.

## IRS Issues Guidance on Form W-2 Reporting for Costs of Employer-Provided Coverage

The IRS has released guidance relating to employer obligations under PPACA to report certain healthcare costs on employee W-2s. The guidance also provides temporary relief from compliance for small employers. On March 29, 2011, the IRS issued Notice 2011-28, which provides greater clarity to employers in connection with how to administer new Form W-2 reporting requirements for costs of employer-provided health coverage. This reporting is required under Section 6051(a)(14) of the Internal Revenue Code ("Code"), which was added by Section 9002 of the Patient Protection and Affordable Care Act ("PPACA"). The IRS has requested comments on the Notice, which will be due 90 days after the Notice is officially published in the Federal Register. Notice 2011-28 provides further transitional relief for certain employers as described below. Key provisions from the Notice are summarized below.

*Employers Subject to the Reporting Requirement*

Except as provided in the Notice's transitional relief described below, virtually all employers that provide "applicable employer-sponsored coverage" under a group health plan must comply with the new reporting requirement. Additionally, the Notice provides transitional relief for employers filing fewer than 250 Forms W-2 in the previous calendar year. Under the transitional relief, these small employers will not be required to report until the IRS issues further guidance.

*Categories of Coverage for Which Reporting is Required*

Employers must report the cost of all "applicable employer-sponsored coverage," which includes any group health plan coverage that is excludable under Section 106 of the Code, or would be excludable if it were employer-sponsored coverage. The Notice makes clear that employer contributions to an Archer MSA or Health Savings Account, as well as an employee's salary reduction contributions to a health flexible spending account ("Health FSA"), do not need to be reported. Any employer flex credits contributed to a Health FSA, however, would need to be reported. The Notice provides that the following types of coverage are specifically excluded from the reporting requirement:

- Stand-alone dental or vision coverage
- Coverage provided by a federal or state government, or agency of such government, primarily for members of the military and their families
- Coverage for long-term care
- Coverage for HIPAA-excepted benefits (except for on-site medical clinics)
- Hospital or fixed indemnity coverage or insurance for a specified disease or illness, but only if the coverage is a HIPAA-excepted benefit and is paid for by the employee on an after-tax basis

Additionally, reporting for the following types of coverage will not be required until the IRS issues further guidance:

- The cost of coverage under a Health Reimbursement Arrangement
- Coverage provided under a multiemployer group health plan
- Coverage provided by a self-insured group health plan that is not subject to any federal coverage continuation requirements (*e.g*., COBRA)

*Calculating the Cost of Coverage*

The Notice makes clear that the cost of coverage includes both the employer's and the employee's share of the cost of coverage. Additionally, the reportable cost includes any amount that is required to be included in an employee's taxable income, such as imputed income for coverage of certain individuals (*e.g.*, domestic partners or adult children over the age of 27), or amounts includible as excess reimbursements under Code Section 105(h). In determining aggregate cost, the employer may choose to include the cost of any continuation coverage, as long as it applies the same methodology for all plan participants for the applicable calendar year. The Notice provides three methods that an employer may use to calculate the cost of coverage. The employer is not required to use the same method for each of its plans, but it must use the same method with respect to each employee receiving coverage under each respective plan.

*1. COBRA Applicable Premium Method* – Under this method, the reportable cost equals the COBRA applicable premium for coverage for the period based on a calculation made in good faith compliance with the requirements of Code Section 4980B.
*2*. *Premium Charged Method* – For fully insured plans, the employer may use the actual premium charged by the insurer to calculate the cost of coverage.
*3. Modified COBRA Premium Method* – If the employer subsidizes the cost of COBRA, then the employer may utilize a good faith estimate of the COBRA applicable premium to determine the reportable cost. Additionally, if the actual COBRA premium charged by the employer for each period in the current year is equal to the premiums charged for each period in a prior year, the employer may use the COBRA applicable premium for the prior year to determine the reportable costs for the current year.

*Special Considerations for Calculating the Cost of Coverage*

*Changes in Coverage.* If an employee changes coverage during the year, the amount reported on Form W-2 must take into account the change in coverage. If the change occurs during a period, such as in the middle of a month, the employer may use any reasonable method to determine the reportable cost for such period. The Notice provides that using the reportable cost at the beginning of the month or the end of the month, or averaging or prorating the reportable costs are all reasonable methods.

*Changes in Cost of Coverage*. The employer must also take into account changes in the cost of coverage that occur during the course of a plan year.

*Employers Charging Blended or Composite Rate.* The Notice provides that, if an employer charges the same rate for all employees under the plan, regardless of the scope of coverage, the employer can report the same amount for all employees for the period. Similarly, if the plan has different tiers of coverage (e.g., employee-only, family, etc.), and employees in each tier pay the same premium, the employer may report the same amount for each coverage group for the period.

*Determination Period Not the Calendar Year*. If the employer uses a 12-month determination period that is not the calendar year for purposes of calculating the COBRA applicable premium under the plan, the employer cannot use such determination period when calculating the cost of coverage. The reportable cost must be determined on a calendar year basis. In order to convert the COBRA-applicable premium to a calendar year amount, the employer will need to apply rules similar to the rules for calculating the cost of coverage when an employee has a change in coverage during the year, or when the cost of coverage changes during the year.

Sources: Greater Houston Partnership; Houston Chronicle; Kerry Notestine, Shareholder, Littler Mendelson