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Houston Markets Keep Going and Going and Going

By Mark G. Dotzour and Candace Rhodes

In monitoring Texas real estate changes and trends, the Real Estate Center staff regularly tracks newspaper and other business publication articles. This column is based on real estate information published in the *Houston Chronicle* and the *Houston Business Journal* in recent months. It provides an overview of Houston's commercial and residential market trends.

Houston's economy has expanded rapidly in the last few years. The city has benefited from strong national growth and a boom in oil and natural gas extraction. These growth trends should continue with some moderation. According to the Texas Workforce Commission, employers added 89,100 jobs to the Houston area between February 1997 and February 1998, a 4.8 percent gain. Houston's unemployment rate dropped to 4.1 percent during February, down from 4.6 percent the previous month. The city's economy is expected to have a 3.0 to 3.5 percent growth rate in 1998. Meanwhile, 1998 job growth rate is expected to be near 3 percent and the population growth close to 2.5 percent.

The energy sector is the main determinant for continued growth. During 1997, oil, gas and other energy-related sectors provided approximately 9,000 new jobs. But in January, oil prices dipped to their lowest level in four years. If prices remain depressed, oil company profits which soared in 1997 could decline quickly. Economists are concerned this will put a damper on local job growth.

Job gains were especially strong in manufacturing, construction, trade and the service industry. For the work force to grow much more, people must move to Houston to fill those jobs, according to Al Ballinger, data manager for the Center for Public Policy at the University of Houston. Employers also are finding that they have to pay more to attract and keep the experienced and qualified workers.

Houston real estate recorded a boom in 1997. The office vacancy rate hit its lowest point in more than a decade, prompting landlords to raise rents and developers to start constructing more buildings. The city ended 1997 with an office vacancy rate of 13.7 percent, a marked improvement from 19.3 percent the previous year. More than 7.7 million square feet of Houston's empty office space was filled in 1997. This was a big increase from 1996 when the city, with 138 million square feet of office space, filled just 2.8 million square feet. Cushman and Wakefield reported the average annual rental rate for a Houston office building in 1997 was $13 per square foot, up from $11.71 at the end of 1996. In prime office buildings, rates were much higher. Besides new construction, many previously vacant buildings are now being refurbished and reopened.

Downtown showed considerable improvement in its office market as the vacancy rate for prime downtown buildings dropped to less than 10 percent during the year. As much as two million square feet of empty downtown space was leased in 1997. There also are plans to build the first downtown office tower in more than a decade. It will contain more than 1.2 million square feet of office space.

West Houston, which includes the energy corridor, also is posting a growth surge. As of February 1998, approximately 5.7 million square feet of office space was in the planning or construction phase. This included both build-to-suit and speculative office space. The west Houston market has led the city in major corporate relocations. Class A buildings were reported to be 98.5 percent full in west Houston with only 138,550 square feet available for lease. For all classes of office space in west Houston, the vacancy rate was reported to be 8.3 percent for the first half of 1997, down from 21.9 percent in 1992.

The new year has proven successful as well. More than 1.2 million square feet of office space was filled from the first of January until the end of February, according to Core Data. The city-wide average rent for all classes rose from $15.12 at the beginning of the year to $15.93 per square foot at the end of February.

Retail sales are a good indicator of the local economy's health. Houston's retail sales jumped from $25.8 billion in 1984 to $43.5 billion in 1996. Houston added 2.8 to three million square feet of retail space in 1996 and 1997. General trends in Houston include more big box stores and an upswing in the activity of smaller boutique stores that cater to the upper middle class. Redevelopment of land along the city's major corridors also will play a role in future retail development.

The Katy Mills mall is a major development with 1.6 million square feet. It will lead to more small shopping centers, restaurants and stores as the population grows. There also will be a Houston Premium Outlet located in the northeast corner of the Katy Freeway and the Grand Parkway. A Cinemark 17-screen movie theater will be housed among the stores in the 850,000-square-foot building.

Houston also needs hotel space. Studies have shown that Houston is often bypassed for major conventions because of the lack of downtown hotel rooms. Local developer Wayne Duddlesten has teamed with Crescent Real Estate Equities Co. to finance and build a proposed convention center hotel in downtown Houston. The $155 million luxury hotel will be located across from the city-owned George R. Brown Convention Center. It will contain at least 1,000 rooms and large banquet and ballroom facilities. The city, county, Houston Independent School District, Port of Houston Authority and the Metropolitan Transit Authority have approved tax abatements for the project. Harris County Hospital District is the only taxing entity to refuse a tax abatement.

There also are plans to redevelop the downtown historic Texaco Building into a luxury hotel. The building is expected to become a Ritz-Carlton with more than 300 rooms. John Keeling of PKF Consulting said the downtown Houston hotel market has become exceptionally strong during weekdays because of guests who are in Houston on business.

The housing market recorded considerable improvements in the past year. In January, Houston area homebuilders recorded the highest monthly sales total for the past 15 years—an increase of 62 percent from January 1997. New home sales were up 11 percent last year from 1996. Houston and the surrounding area had about 22,900 starts last year, up from 20,500 in 1996. Demand is going up, but supply is decreasing. Builders will have difficulty keeping up with demand as a result of increasing sales, a shortage of experienced tradespeople and a tight supply of available lots.

Houston's resale home market has also been strong, reaching a record number of homes sold and a record median price. It also recorded the lowest inventory since 1974, according to the Houston Association of Realtors. The number of properties sold increased 9 percent from 1996. The median price of Houston resale homes also has increased 6.7 percent as a result of the depleting inventory of existing homes. This could force more buyers into the new home market in 1998. This is a result of the added 60,000 new jobs in Harris County last year and the low mortgage interest rates. Because of an increase in demand for new and existing housing, price increases and waiting periods for new home construction are expected.

Apartment construction has increased in the Houston area as well. Apartment starts are growing at an even faster rate in Houston than in Dallas. During the 12 months ending in June 1997, apartment construction was up 78 percent. In the second quarter alone, Houston pulled ahead of the rest of the country with about 3,600 apartment unit starts. Predictions for the coming year are even greater with approximately 14,000 new apartment units slated in Houston, up from about 4,500 in 1997.

Furthermore, demand to live in downtown Houston has increased. There have recently been two apartment projects underway in the downtown area. The Rice, a redevelopment of the historic Rice Hotel, will have 312 units with monthly rents ranging from $650 to $3,000. Forty-five loft apartments were rented in The Rice during the initial leasing period. The first tenants moved in during March. There also are plans to redevelop the old Humble Oil Co. building into a multi-use project including apartments and two hotels. The project will include about 125 apartments and 335 hotel rooms.

The condominium market also has been active in the downtown area. The old 220 Main building has been transformed into condominium homes. Upon completion, 25 units will be available, ranging from $315,000 to $675,000. In addition, the Southern Pacific Building is being converted into 107 condominiums. Prices for the lofts are expected to range from approximately $105,000 to $180,000 per unit. These projects exemplify the strong demand for downtown living.

Another project under construction west of downtown is a mid-rise condominium building called Gotham. It will be adorned with Corinthian columns and nine-foot statues of classical-style figures. Units will range from $190,000 to $475,000. The demand is strong with 25 people already placing $1,000 reservation deposits.

Houston was recognized by the U.S. Department of Housing and Urban Development as a "Best Practice" in the country for providing housing for low-to-moderate-income persons. "Homes for Houston" offers as much as $9,500 to help a qualifying family acquire a new home or $3,500 to help finance a purchase of an existing house. Families of four with incomes of $39,300—less than 80 percent of the median income—can qualify for the program. It is expected to positively impact 25,000 homeowners by the year 2000.

There also has been an increase in homeownership among low- and moderate-income families, including many minorities. Minorities accounted for 28 percent of Houston area homebuyers in 1997, up from just 18 percent in 1992. There has been an increase in mortgage loans made to low- and moderate-income people since the Clinton administration regulators made a fundamental shift in the way they judge a bank's compliance with the Community Reinvestment Act. More banks have begun aggressively searching for low- and moderate-income families—many of them minorities—who want to buy homes.

Fannie Mae also is backing home loans in Houston that will allow buyers to borrow down payment funds. This HouseHouston program has assisted 11,000 people in acquiring affordable homes in the Houston area in the last two years. The new program, called Flexible 97, allows homebuyers to get cash for a down payment either from a family member, through a loan or a grant from a nonprofit agency, or by credit card. These new Fannie Mae loans are available for homes priced at less than $214,600.

Another new Fannie Mae program is the "drive-to-work" program, which makes it easier for low- to moderate-income families with car payments to qualify for a mortgage. Traditional mortgage lending standards disqualified families who had car payments that made up a large part of their debt. The new program recognizes that a car is essential for most working families in Houston.

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