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'Big D' Stands for Development

Suburban Growth, Urban Revitalization Spur Dallas

By Harold D. Hunt and Martha Agarwal

Dallas real estate values are testing historic highs in many cases but questions remain as to whether segments of the real estate market are becoming overheated.

The Dallas economy is strong, although some slowdown in job growth is expected by year's end. Total employment has increased by more than 79,000 from one year ago, with the unemployment rate dropping to less than 3 percent for the first time in almost 20 years, according to the U.S. Bureau of Labor Statistics. Dallas property values have increased for the sixth straight year, with most taxing jurisdictions expecting 1998 tax roll gains of 10 percent or more. Many office and retail property values are reported to be at or more than their 1984 peaks. Furthermore, a significant amount of the recent tax base increase comes from new construction that adds more than $1 billion to tax rolls.

Retail Market: Urban Village Blossoms

Changes in several areas of the Dallas retail market are occurring. First, an increasing disparity in performance between super-regional and regional malls continues. The bulk of the area's super-regional malls have had vacancy rates of less than 4 percent for some time. Only Prestonwood Mall, currently undergoing redevelopment, and Southwest Center Mall have vacancy rates of more than 10 percent.

The development of two new super-regional properties is being considered in the Far North Dallas areas of Plano and Frisco where the median annual household income is between $90,000 and $100,000. The regional malls have not been so fortunate. With an average vacancy rate hovering around 35 percent, many owners face deciding whether to renovate and reposition their properties or operate at a loss.

Second, there is a move toward development of small, multi-use properties, called urban villages, that offer a sense of community and a laid-back atmosphere. Here, individuals have an opportunity to shop, live and work in the same area. Retail shoppers seem to be exhibiting a duality of nature. On one hand, their shopping is focused and destination-oriented, attempting to locate a specific purchase as quickly and inexpensively as possible.

On the other hand, they occasionally choose to shop at a leisurely pace just to enjoy the ambiance. Several properties classified as urban villages are currently being developed at Knox Street and McKinney, at Central Expressway and Mockingbird Lane, and in Addison.

As providers of basic goods and services, community and neighborhood centers continue to perform solidly in almost all Dallas sub-markets. The exception is South Dallas, which has been generally bypassed for decades. Although the transportation, image and land ownership problems are formidable in South Dallas, major grocery chains are returning to the area. Change is expected to occur slowly. However, city officials are teaming up with nonprofit organizations and local chambers of commerce to heavily promote South Dallas. The area offers less than 40 percent of the retail space available in North Dallas, on a per capita basis.

Office Market: Fear of Over Production

A 65 percent increase in suburban Dallas office rents during the last five years has spurred an impressive round of new office construction. Thirteen million square feet of new office space was under construction by June, according to Jamison Research, up from three million square feet a year ago.

The majority of new construction is occurring in three areas: Far North Dallas, Richardson-Plano and Las Colinas. These also happen to be three of the hottest employment corridors. The Richardson-Plano area continues to benefit from high-tech and telecommunications sector growth. The strength of Las Colinas is in its access to excellent infrastructure as well as the D-FW airport. The success of the Legacy Business Park is a major factor that continues to keep Far North Dallas viable as well.

With such a rapid increase in construction activity comes concern that too much office space is being produced. Tenants absorbed 2.6 million square feet in the first six months of 1998, approximately twice last year's level and higher than some professionals expected. And, the overall Dallas vacancy rate at mid-year was approximately 16 percent.

Another encouraging sign is that two-thirds of the new office space coming on line is already pre-leased. Keeping pace with the national trend, virtually every premium office property in downtown Dallas has been acquired by REITs, according to the *Dallas Business Journal*. The downtown Dallas office market should continue to benefit from rising demand while supply remains constant.

The Dallas central business district (CBD) has not seen new construction in more than ten years, helping to slowly reduce the vacancy rates and increase the performance of class A properties. However, class B space in the CBD is still nearly 50 percent vacant. And, downtown Dallas is becoming much more cosmopolitan. More individuals are moving downtown to enjoy the cultural amenities and convenience.

Obsolete office space is steadily being converted to residential inventory in an effort to produce an environment where people can both live and work. Persistently high vacancies in class B office space, although troublesome, do not reflect the strength of the urban renewal occurring in the CBD.

Industrial Market: Stability Reins

The industrial market is not glamorous compared to retail or office markets. Functionality is of primary importance, with technology playing an increasingly critical role in the construction of new space. For example, ceilings in many new industrial distribution properties are being built higher and aisles made narrower because of the introduction of computerized stacking equipment.

Some companies also are choosing to locate in flex space over traditional office space, finding it cheaper and more functional. One of the major risk factors in industrial investment today is functional and locational obsolescence.

Dallas is fortunate to be part of one of a few super-regional industrial areas in the United States. That, coupled with a continuing consolidation of industrial facilities by corporations, has helped Dallas remain extremely competitive in the industrial market. New construction also has been moderate, primarily occurring in the northeast and northwest sectors. This has led to a stable industrial market where overall vacancy rates have remained near 8 percent for the last three years.

South Dallas has experienced little new industrial development because of inadequate access to the major thoroughfares; however, city leaders are aware of this problem and are attempting to address it through new infrastructure construction. Dallas is on track to complete some eight million square feet of industrial space in 1998, approximately the same level as constructed in 1997.

Multi-family Market: Tops in Nation

In late 1997, a 60 percent jump in apartment construction made Dallas the top apartment building market in the nation. Although overall apartment occupancy has been in the vicinity of 94 percent, new completions are beginning to significantly exceed absorption. Building permits indicate that Dallas is on line this year to construct the most apartments since 1980. Excess supply is largely restricted to class A apartments being built in the northern half of the city. Therefore, the best apartment investment opportunity may involve rehabilitation of well-located class B units.

More units are needed in the downtown area. The Oak Lawn and Deep Ellum sectors continue to increase in popularity for renters desiring to move back to the urban areas. High-rise condos and apartments, primarily located uptown and in Turtle Creek, continue to perform extremely well. More than a dozen high-rise condo properties are currently under construction in the Turtle Creek and Oak Lawn area, ranging in price from $200,000 to more than $2.5 million.

Single-family Market: Phenomenal Frisco

Extremely low interest rates, coupled with a strong economy and significant new job growth, have provided Dallas with a booming single-family housing market. Dallas home sales through May 1998 are up 21.7 percent from one year ago, while total dollar volume is up more than 31 percent. Months of inventory has dropped 27 percent compared to 1997. New building permits have also increased significantly. Through May, 9,649 single-family building permits were issued, a 24 percent increase over the same period last year.

Although most North Dallas suburbs continue healthy residential development, the city of Frisco has recorded phenomenal residential growth. Frisco's population has increased from approximately 2,600 in 1994 to an estimated 23,000, primarily benefiting from a tight supply of new residential space in Plano and Richardson. Another emerging residential area is The Colony, located west of Frisco and east of Lewisville. The Colony originated as an area for small starter homes. However, its 20-plus miles of shoreline along Lake Lewisville provide an opportunity for developers to create high-volume, upscale residential properties. Several developments are already underway, creating a shift in demographics as construction of homes ranging from $150,000 to $500,000 continues.

Single-family housing activity in Dallas has not just been limited to new construction in the suburbs. Existing properties are selling at a brisk pace as well. Unlike many other large cities, Dallas is not experiencing a flight away from the urban areas. Suburban growth and urban revitalization of older residential properties are both occurring at a steady pace.

Overall, most segments of the Dallas real estate market should continue to perform well into the near future. Some concern of overbuilding exists, especially in the office and apartment markets, however, as long as the economy remains strong, the effects of overbuilding should be minimal.

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