Is the Sizzle Back in Commercial Real Estate?

By Troy Anderson

Hip, trendy, and stylish.

Among American metropolises, the Bayou City hasn't normally been associated with those monikers.

But times have changed.

With lots of jobs attracting young, highly educated professionals and after a multibillion-dollar makeover of the city, *Forbes* magazine just placed Houston atop its list of "America's Coolest Cities to Live In."

"I think it's pretty cool, obviously—no pun intended," says Ric Campo, the chairman and chief executive officer of Camden Property Trust, a Houston-based multifamily real estate investment trust. "Throughout the country, everybody is worried about jobs. But Houston has exhibited very strong job growth and population growth. A lot of that has to do with the state. CNBC just listed Texas as the best state to do business in, for the third year in a row."

Against the backdrop of the thriving job market is an increasingly healthy commercial real estate sector in Houston. In the last decade, developers have invested billions of dollars in multifamily housing, as well as in office, industrial, retail, and medical developments.

Now the Houston cityscape features fashionable housing developments and office buildings, stylish bars and restaurants, and a cornucopia of art galleries, museums, parks, and other amenities.

"The downtown is, in my opinion, one of the stronger downtown markets in the country," says Jim

Furr, the regional managing principal at the Houston office of Gensler, an architectural firm with offices around the world. "The development of the Discovery Green (a 12-acre park), along with developments around the convention center and the mid-town portion of Houston and areas on the west side that traditionally have been the business district of downtown, are quite impressive."

As recently as 2009, Houston's commercial real estate market was ranked ninth among 57 United States markets in distress by Real Capital Analytics. But the commercial real estate landscape has undergone a 180-degree turn since then.

Last year, the chief concern was the effect that rising interest rates would have on the property markets, but rates plummeted and those concerns became moot, according to a recent report by Real Capital Analytics, "2102 Predictions for the US Commercial Real Estate Capital Markets."

"Oddly, interest rates are not a major factor of discussion going into 2012 because the general consensus—following direction from the Fed—is that they will remain close to current levels," the authors wrote.

Nationwide, the market is heating up quickly. Investment volume across major property types in the U.S. is expected to grow by 50 percent to $300 billion by the end of the year, according to the report.

The Thriving Energy Sector

"We're in the midst of a very strong real estate market," says Jim Murphy, general manager of the Westchase District, an economic development organization that focuses on a 4.2-square-mile area of West Houston. The area features more than 1,500 businesses, including major employers such as Chevron, Dow Chemical, Halliburton, Jacobs Engineering, MI Swaco, BMC Software, and ABB. "Clearly, this is being driven by job growth. Texas is leading the nation in job growth, and Houston is leading Texas. This is really the epicenter of job growth, largely driven by the energy business."

In what some are describing as "a new energy boom," North America, over the last five years, has become the fastest-growing oil- and natural-gas-producing area in the world. From 2011 until 2020, North American production of crude oil and natural gas is expected to jump from 15.4 to 26.6 million barrels a day.

As the "U.S. energy headquarters," Houston stands to benefit handsomely.

In the Perryman Group's "Summer 2012 Long-Term Outlook" report, the authors wrote that the Houston area is forecasted to more than double its real gross area product in the next two decades—rising from $380 billion to $769 billion by 2031.

During this time, the Houston region will remain a global center for the oil and gas industry, with corporate headquarters, related technology firms, and service businesses contributing to the ongoing growth.

In a recent report, “The Economy at a Glance,” the Greater Houston Partnership, a 2,100-member business organization that represents the ten-county region surrounding Houston, noted that consumer confidence has returned to Houston, with realtors selling 7,575 homes in a single month—the highest one-month total since August 2007, the year prior to the recession.

According to the authors, three factors have helped instill this confidence: job and income growth and the strong performance of the energy sector. The region has reported steady job growth for two and a half years. During that period, the private sector added 221,100 jobs. Among the nation’s 20 most populous metropolitan areas, Houston was the first to recover from the recession. Employment in oil and gas extraction passed its pre-recession peak in June 2010.

The greater Houston region came in as the second most robust area for corporate location and expansion activity in the U.S.

Meanwhile, the price of West Texas Intermediate, the U.S. benchmark for light crude oil, has remained above $75 a barrel for nearly two years. Activity continues to grow in the Eagle Ford oil-shale field in Texas. In the first half of this year, the Texas Railroad Commission issued 2,297 permits to drill in the Eagle Ford shale field. At that pace, the commission will issue more than 4,500 permits by the end of the year, which would be a 63 percent increase over 2011.

This is expected to fuel even greater job growth in what the Greater Houston Partnership describes as the “work center for virtually every segment of the petroleum industry.” Nearly 50 percent of Houston’s economic base employment is energy related.

Surprisingly, many of the jobs in the energy business are not “traditional, sort of blue-collar, roughneck type of jobs. They are high-tech jobs,” Campo says. “So today, when you get a mining (oil and natural gas industry) job in Houston, that means it’s a high-tech job. So you have a fair amount of young people who are into technology coming down to Houston to get jobs in the oil business.”

The energy industry’s demand for a highly educated workforce is partially a result of new fracking technologies to unleash natural-gas pockets and oil in previously inaccessible fields of dense rock.

“In the past, the energy companies hired a bunch of geologists and roughnecks to go out and drill oil wells,” says Campo. “Today, [they are hiring] MBAs and technology people to write programs and use technology to become more efficient and manage all these wells and fracking operations happening all over the country and world.” Consequently, the energy boom and the accompanying hiring are driving demand for commercial real estate, Campo notes.

Apartment Properties in Demand

“We’re building a number of properties in Houston—apartment properties,” Campo says. “They are definitely being built to cater to that ‘cool’ factor. What you have is a situation where the ‘cool people,’ if you will—those in their mid-20s to mid-30s—want to live closer to the activity sectors. They don't want to live in the 'burbs in a house. They want to live near the rail and close to museums, restaurants, and bars."

This has created a very strong apartment market in the Houston area. In the second quarter, Campo says, his company's portfolio of properties saw rental increases of nearly 12 percent.

"On the one hand, it's cheap to live here, but it's getting more expensive because the market is so strong," Campo says. "The other commercial real estate sectors are doing very well too. The commercial office market is doing very well. It's doing about as well as it has in 20 years."

Susan Pohl, vice president of acquisitions at the KC Venture Group, LLC, a Kansas City-based real estate investment firm that concentrates on multifamily acquisition, redevelopment, and management, says the company typically buys Class A and Class B properties.

"We can go in and do some cosmetic renovations and really pop the rent," Pohl says. "With the job growth we're experiencing here and the resulting household formation, we are seeing rents go up. Last year, rents in Class A apartments grew by over 6 percent. They are probably going to be closer to that this year."

As other cities struggle to create growth, Houston has maintained its reputation as a bustling area with boundless economic growth possibilities, according to *Site Selection* magazine. In the magazine's 2011 "Top Metro" rankings, the greater Houston region came in as the second most robust area for corporate location and expansion activity in the U.S.

"*Site Selection*'s endorsement of the Houston region as a hotbed for corporate attraction and expansion is another indication that our area continues to resonate with top domestic and global decision-makers," says Jeff Moseley, president and chief executive officer of the Greater Houston Partnership. "We will continue to show that the Houston region is the most attractive place to locate or expand your business in the United States."

Image courtesy Haynes Whaley Associates. Haynes Whaley is the structural engineer for all buildings on this campus. Pickard Chilton is the design architect and Gensler is the architect of record.

ExxonMobil

One of the biggest relocations involves ExxonMobil. In June, the company announced it would expand the size of its campus under construction in Houston to accommodate additional employees from the immediate area and from company locations in Fairfax, Virginia and Akron, Ohio.

The state-of-the-art campus will have multiple low-rise office buildings, laboratories, and conference and training centers. The campus is located on a 385-acre wooded site on company-owned land near the intersection of I-45 and Hardy Toll Road. It will accommodate 10,000 employees. Employees will move to the campus in phases as the buildings are constructed, beginning in early 2014.

Westchase District

In the Westchase District, more than $3 billion has been invested since the mid-1990s, Murphy says. Currently, office occupancy rates are above 90 percent and rental rates range from about $20 to $35 a square foot. “Office space is going to continue to be tight, just because job growth is strong and they are very active now to establish options for expansion,” Murphy says. “They want to make sure they have growth opportunities. They may not want to lease an extra 20,000 square feet, but they want the option to do that. A lot of it is driven by shale plays and the super-heating of the Texas economy, especially in Houston.”

Murphy also expects growth in the retail and industrial real estate arenas. “We had quite a building boom in retail a couple of years ago,” Murphy says. “Industrial is going to improve because of the Panama Canal and Port of Houston expansions. Houston is already the third busiest port in the nation.”

Greenspoint District

Jack Drake, president of the Greenspoint District, a municipal entity created to ensure economic prosperity for Greenspoint businesses 15 miles north of downtown Houston and minutes from Bush Intercontinental Airport and the Port of Houston, says the commercial real estate market is in a growth cycle, with significant reductions in vacancy rates over the last two years.

“Industrial space is relatively tight, and the residential market is showing continued signs of strength,” Drake says. “The opportunity is to be mid-city between downtown and the rapidly growing north reaches of our city and county in proximity to the airport and other business districts by way of the Sam Houston Parkway that encircles the region.”

One of the newest proposed projects in the district is the Pinto Business Park. Hines recently entered a joint venture with Pinto Realty Partners to develop the Pinto Business Park, a 1,000-acre site at the I-45 and the North Belt. The master plan is for 6 million square feet of industrial space, 2 million square feet of office space, and 270,000 square feet of flex space, plus 110,000 square feet for amenities. The development is anchored by a Sysco Food Services 600,000 square-foot facility containing a distribution center, offices, and test kitchens.

Drake says the project is further evidence that Houston continues to be a city that, despite its size, welcomes people—especially entrepreneurs looking for new markets and business opportunities.

"It's also a community that is taking its place among world-class cities, with an international airport that flies to 130 destinations around the world, has people from all over the world who speak 110 languages, boasts 93 foreign consulates, contains 13,000 theater seats, has every major sport represented (with its own stadium and Gulf Coast beaches), and offers cruise lines an hour away in Galveston," Drake says.

Katy

Lance LaCour, president and chief executive officer of the Katy Area Economic Development Council, a private, nonprofit economic development corporation, says Katy is growing rapidly and has been ranked as one of the top growth areas in the nation—garnering the No. 1 rating from the Gadberry Group.

Dyna-Drill Technologies Inc. recently announced plans to move its headquarters from North Houston to Katy. Rooms to Go, "America's #1 independent furniture company with the nation's largest furniture inventory," is expanding its distribution facility in Katy. And a 470-acre business park is planned along Interstate 10 and U.S. 90, west of the Grand Parkway in Katy.

"It's a really good, strong commercial real estate market," LaCour says. "We have plenty of land available."

Currently, office rental rates are averaging about $16 to $17 a square-foot. Vacancy rates for office space are under 10 percent, LaCour says.

"The area is doing great, and in the foreseeable future I think it's going to get even better," LaCour says. "Our strengths really focus around our access to the I-10 and our great school district. Most people move to Katy because of the award-winning school district. Our weakness is that Katy has always been more of an owner-occupied market, but we're slowly becoming more of a leasing market."

Market Strength

Bob Cromwell, managing director of Moody Rambin Interests, a Houston-based commercial real estate brokerage and management firm, says office and industrial real estate is strong. "The office side is doing really well," Cromwell says. "It's being driven by the energy business in Houston.

We're the energy capital of the world. All the major oil companies are based here along with the engineering firms and service companies. There might be an oil project along the east coast of Africa, but it's being designed here in Houston. The energy firms have absorbed nearly 1 million square feet of office space in the last 12 months. Industrial is doing very well now too. It's very hard to find a warehouse, and we are starting to see some new construction in that area."

The Energy Corridor

In the Energy Corridor, the third largest employment center in the region, located in West Houston along Interstate-10, one of the biggest projects is a multiphase development of up to 1.5 million square feet of Class AA office space. The Trammell Crow Company and Principal Real Estate Investors announced in April that they had acquired an 18.9-acre site located at the southwest corner of the I-10 and North Eldridge Parkway. The first phase is planned to be a 20-story, 530,000-square-foot office building.

"There has been a flight to quality in the energy sector for recruiting and retention purposes," Cromwell says. "They are moving into new Class A and Class AA space. They have to compete for talent, and they do that by having a quality headquarters."

The Energy Corridor is home

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to numerous companies, including Mustang Engineering, BP America, ConocoPhillips, Shell Exploration and Production, Foster Wheeler USA, ExxonMobil Chemical Company, Worley Parsons, CITGO, and hundreds of supporting engineering firms.

"The business center with the greatest business growth has been West Houston," says Clark Martinson, general manager of the Energy Corridor District. "That includes everything from Memorial City and the Westchase District to the Energy Corridor and Katy. Of those four areas, the greatest growth has been in the Energy Corridor."

Currently, the vacancy rates in the corridor are only 2 to 3 percent, Martinson says, noting, "That's the fullest I've ever seen it."

While the commercial real estate landscape is bright now, Martinson notes that Houston has had "booms and busts before."

"We're in a boom right now," Martinson says. "When will the bust happen? What would cause it? The market is cyclical and building may slow down for awhile but I wouldn't call it a bust. Things are just too strong. When we are in the down side of a cycle we'll stop building new buildings and the ones that were built will fill up, and then we'll wait for another boom and bust to happen."

But David Hightower, executive vice president and chief development officer at the Wolff Companies, a Houston-based land development and investment company, says he believes Houston learned its lesson from the collapse of the commercial real estate sector, savings and loans groups, and other financial institutions in the early 1980s. He's more optimistic that a bust isn't on the horizon.

"I think we've got a number of things that indicate the commercial real estate market is strong," Hightower says. "One is population growth. Texas is forecasted to be one of the leading states in terms of population growth and economic growth going forward."

The state is also "very attractive to capital," Hightower says.

"There is a lot of money in Houston looking for investment opportunities," Hightower says. "We have some of the best commercial real estate development in the world. We create a lot of value for tenants in terms of how quickly projects are built. And we have a very strong workforce." **N**

An award-winning journalist at the Los Angeles Daily News, *the* Press-Enterprise *and other newspapers for 20 years, Troy Anderson writes for Reuters, Newsmax,* Christianity Today, Bankrate Insurance *and many other magazines and online publications. He lives in southern California. For more information, visit www.troyandersonwriter.com.*