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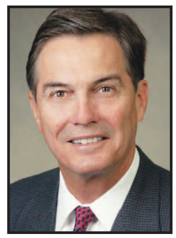
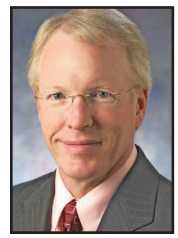
Real estate experts predict little change in 2010


Hubbard


Gilliam


Marshall


Wilson

by Jennifer Dawson HOUSTON BUSINESS JOURNAL

Houston's real estate market may not get much better in 2010, but it's not expected to get much worse.

That's based on market analysis from four experts who spoke last week at an annual BoyarMiller Breakfast Forum focused on local real estate. Roughly 200 clients and guests of the law firm attended the event at The Houstonian Hotel, Club & Spa.

Topics and speakers of the Dec. 4 forum were:

• Office — Rudy Hubbard, managing director of the investment services group at Transwestern;

• Retail — Lance Gilliam, managing director of Moody Rambin Interests;

• Residential — Joel Marshall, senior vice president of Trendmaker Homes; and

• Industrial — Welcome Wilson Jr., president and CEO of GSL Welcome Group LLC.

Following are highlights from each speaker's comments on their area of expertise within the real estate industry, with a focus on what might be ahead for Houston and the rest of the country in 2010.

OFFICE, RUDY HUBBARD

Houston's office market is faring better than those in other parts of the country — a theme touched on by each real estate professional at the forum.

Houston's office market posted a 13.2 percent vacancy rate in third-quarter 2009, which is below the national average of 14 percent, Hubbard said. The local vacancy drops to 12.1 percent when only counting direct space that's available for lease, rather than including available sublease space.

Historically, Hubbard said Houston's average job growth since 1980 has been approximately 36,000 per year. Also, Houston's average net office absorption since 1980 has been approximately 3.5 million square feet per year.

If Houston adds 5,000 jobs in 2010, that will result in 500,000 square feet of positive absorption, he said.

Houston's average office rents for the third quarter were $21.30 per square foot. However, Hubbard said asking rents do not provide an accurate reflection of office rates. He said landlords are getting 75 percent to 80 percent of the asking rates, and that percentage drops when concessions are taken into account.

Hubbard predicts that lower rent rates will prompt more companies to change addresses.

"When rates go down, there is always a flight to quality," Hubbard said, "and Class A space will fill."

Transwestern's investment sales activity, or lack thereof, is representative of the number of local office transactions this year. During the first six months of 2009, Transwestern handled no building sales at all; zero. In the second half of the year, the firm completed four transactions, and is hoping to close a fifth before the clock strikes 2010.

Total office investment sales in Houston for the first nine months of 2009 totaled $109 million, based on deals where pricing was available. By comparison, sales totaled $981 million for the same time period in 2008.

Hubbard provided this predictive timeline for commercial real estate recovery in 2010:

• Prices continue to fall as price discovery continues;

• Occupancy falls as firms downsize staff;

• Layoffs end, but downsizing continues as companies try to save money;

• Rents fall to compete for a smaller tenant base;

• New office projects that started in 2007 and 2008 will be completed; and

• No new construction projects will be undertaken.

OUTLOOK: Local Real estate market expected stay steady/ slow in 2010

RETAIL, LANCE GILLIAM

The retail outlook is based entirely on consumer spending, and Gilliam said all indications are that Americans are not ready to reopen their wallets.

Sales on the day after Thanksgiving, widely considered the busiest shopping day of the year, were better than last year, but not good enough to spur retailers into growth mode.

However, Gilliam believes that some of the strongest retailers — such as Wal-Mart Stores Inc., H-E-B Grocery Co. and Academy Sports & Outdoors — will continue to grow during the downturn. Well-capitalized retailers will improve their locations within trade areas and update stores to their latest prototypes, he said.

Overall, Gilliam expects retailer confidence to return in 18 to 24 months. He said the general feeling is that the recession is over, but the recovery will be slow and jobless.

In the meantime, he doesn't expect any new retail to be built in Houston, as new stores would only serve to take business away from existing sites.

Vacancy rates that range from 10 percent to 20 percent are misleading, Gilliam said, stressing that the statistics must be broken down by property type. While the city's best shopping centers are doing fine, Gilliam said there are a lot of poorly designed retail spaces in Houston — those located in the middle of a block or stretched perpendicular to the street — that need to find different uses.

"Adaptive reuse means it's not really retail," he said.

The retail expert summed up what could apply to many real estate segments.

"It could be worse," Gilliam said. "We could be in Phoenix."

RESIDENTIAL, JOEL MARSHALL

Marshall said new home construction is expected to remain at current low levels until 2011.

Houston will likely end 2009 with 18,000 home starts, according to data that Marshall cited from Houston-based Metrostudy. There are expected to be 17,000 to 20,000 home starts in 2010, with volumes turning up in 2011, he predicted.

There will be more home closings than home starts for a few more quarters as the inventory of new homes is cleared out. Marshall said this will not be a fun time for homebuilders, but it's necessary to correct the inventory levels.

A total of 5,000 new home lots were delivered in 2009, the lowest amount since 1996.

Marshall said the lower number was necessary because there are too many lots in certain parts of town, especially the northeast and northwest.

In some small subdivisions around Houston, there is a 350-month supply of vacant developed lots, according to Marshall, who pointed out that Atlanta and Sarasota, Fla., have a 350-month supply of lots citywide. In comparison, Houston overall has a 50-month supply of vacant developed lots.

According to the Federal Housing Finance Agency, home prices in Houston appreciated 2.4 percent in the second quarter of 2009, outpacing appreciation rates in all other major Texas cities.

Further price appreciation will be stalled, Marshall said, until there is a resolution to the new appraisal system problem.

Changes by the U.S. Congress to the way homes are appraised this year have created a flawed system, according to Marshall, who points out that appraisers are basing home values on sales prices in the area, without allowing buyers and sellers to set market prices.

Said Marshall: "Any time Congress fixes something they make it worse."

INDUSTRIAL, WELCOME WILSON JR.

Absorption rates and rental rates in the industrial sector will be flat in 2010, according to Wilson.

The industrial market in Houston consists of 482 million square feet of space, with another 3.27 million square feet currently under construction.

The amount of sublease space on the market dropped from 1.2 million square feet in second-quarter 2009 to 1.04 million square feet in the third quarter, leaving only 3 percent of the total space available for sublease.

For the third quarter of 2009, 6.9 percent of Houston's industrial properties were vacant. That compares to a 12.1 percent vacancy rate for the same time period in the Dallas-Fort Worth market, which has nearly 747 million square feet in inventory.

Wilson said that the three major drivers for the industrial market are the national economy, trade with foreign countries and the energy sector.

He believes that one of the best indicators for the local industrial market is rig count.

"Rig count will tell us how the industrial segment will do in Houston," Wilson said.

The U.S. rig count stood at 1,137 on Nov. 25, 2009, down from 1,866 on Nov. 26, 2008. However, the rig count on Nov. 25, 2009 was 24 higher than on Nov. 20, 2009, showing a recent uptick and a little bit of hope.