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Two responses to oil prices may balance out

By Chris Tomlinson

July 30, 2015 Updated: August 1, 2015 12:41am

A Hines office tower at 609 Main is under construction downtown. The region's economy no longer depends solely on high oil and natural gas prices

It's not quite the best of times for Houston's economy, but it's certainly not the worst of times. And we should feel as pleased as punch about that.

The commercial real estate market, a good reflection of the larger economy, is truly a tale of two cities, to paraphrase University of Houston economist Bill Gilmer. The dividing line is Main Street, with collapsing oil prices hurting office jobs on the west side while providing the fuel for an emerging renaissance on the east side.

More than 3 million square feet of office space is vacant in the west, while industrial land is 98 percent occupied around the Port of Houston. Developers have 8 million square feet of retail space in the works, much of it to the west, without enough stores to fill it, while the lower and middle classes are taking every new apartment that hits the market anywhere in the city.

Folks in glass-tower energy jobs are sweating the layoffs, while those who wear steel-toed boots are in high demand. These contrasting responses to the collapse of oil prices just might keep the city humming and provide irrefutable proof that the region's economy is no longer dependent solely on high oil and natural gas prices.

The bad news first.

Houston has about 7.5 million square feet of Class A office space available for sub-lease, with half of it in west Houston, according to NAI Partners real estate brokers. Three million square feet is the equivalent of 10 average-size office buildings.

Rents will be going down soon, said Jon Silberman, managing partner at NAI Partners. Engineering and oil field service companies in 2013 and 2014 not only leased the space they needed, but they contracted for what they thought they'd need in 2015 and 2016, he said.

"A fair amount of it is space they were projected to grow in, and they're just not going to grow into it," Silberman said.

In response to Houston's population boom, developers also have been building retail space at a remarkable pace. Matthew Keener, senior vice president for retail at CBRE brokerage, said developers have been adding a healthy 1.5 million square feet a year recently, but there are 8 million square feet on the drawing board for the next two years.

"That's a big bubble," he said. "You are going to see at least a quarter of that fall out as one developer wins over another."

The rapid rise in retail rents from $8 a square foot to as much as $45 in some places was the incentive to overdevelop, Keener explained. Rent has been rising faster than revenues for many retailers.

"We're getting to the point where rents are peaking out," he added.

Now for the good news.

Oil and natural gas are the key inputs for the chemicals business, so lower prices mean higher profits. Industrial properties remain in high demand as petrochemical companies grow along the Ship Channel and on the coast. There is virtually no space available that has access to rail, brokers said.

With more than $20 billion worth of new petrochemical facilities under construction, demand is strong for the skilled trades such as welders and electricians. Those facilities will also employ equipment operators once complete.

"Some of the jobs that are lost in the oil industry will migrate over to the petrochemical industry. That's a natural fit," said Joel Michael, a partner at NAI handing industrial leases.

Workers need places to live. The housing market remains strong, despite a slight seesaw pattern in recent months. The Houston Association of Realtors reported 7,935 single-family home sales in June, setting a record. The single-family home average price reached a record high of $302,942. The average home sold in 43 days.

Looking at all types of homes, transactions were up 3.3 percent over last year, and the total value sold was up 9.5 percent to $2.7 billion. Those impressive numbers are due to a lack of inventory,

which is a result of builders shutting down during the Great Recession. Since developers did not overbuild, the chance of a real estate crash due to job losses on the west side are slim.

"We still expect normalization in the marketplace later this year, and that may well mean these alternating up and down sales months, but the bottom line appears to be that there is no lack of interest in housing in Houston," said Nancy Furst, chair of the association.

Six months ago, many analysts warned there were too many new apartment complexes. But with 89,000 people moving to Harris County last year, they didn't need to worry.

'We have not failed'

Middle- and low-rent apartments remained 95 percent occupied in June, while luxury occupancy has dropped to 91 percent, according to the latest available data from Houston-based Apartment Data Services.

"Where everyone thought we would fail, we have not failed," said Ryan Epstein, CBRE's expert on apartments.

The good news is that the current downturn in oil prices and job losses at energy companies has discouraged developers from delivering more apartments in 2017.

"The pipeline is turning off," Epstein said. "The energy market has governed it, has really helped us slow down to potentially take us for a longer run before the eventual downturn."

Houston area's resilience

Ironically, Houston's resilience can be credited to the moderating influence of the recession and the collapse of oil prices that followed. Houston might just manage a Goldilocks' passage through this recent oil bust, thanks to economic constraints and greater diversification.

There is no doubt Houston's economy remains tied to oil and gas, and we're not out of the woods yet. But if the metro area can further diversify so that other industries can keep the economy above water during the inevitable bust phase of the commodities cycle, then Houstonians will have accomplished something truly important.

So far, so good.

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