

Commercial BUZZ

Straight From the Experts: The latest BUZZ in Commercial Real Estate

Starve a Cold, Feed a Recession

New head of Colliers Houston unveils plans to reposition company amid downturn, by Teresa Talerico for REDNews

The economic downturn? J. Patrick Duffy has been there, done that.

President of Colliers International in Houston, Duffy brings invaluable experience to the firm, which he has overseen for five months: He spent 25 years at the Colliers office in Tampa Bay, Fla., serving as president since 1991. He also helped that office weather the national recession, which slammed places like Florida and California long before it hit Texas.

"I arrived here in January, and . . . this firm had had one of the best Decembers it ever had," Duffy says. "So they were all flying high, and all I kept hearing was, 'Houston's immune.' And my response was, 'The world has the flu, and Houston will catch a cold.'"

Sure enough, Texas started sneezing. That month state Comptroller Susan Combs announced that the financial crisis had officially arrived, bringing with it an expected 111,000 projected job losses for the first three quarters of 2009 and a projected increase of only

1.8 percent in gross state product, compared with a 4.2 percent increase the previous fiscal year. In March, the Texas unemployment rate rose to 6.7 percent, climbing from the March 2008 rate of 4.6 percent.

Lucky for Houston, Duffy packed his Florida-spawned recession-fighting strategies when he moved here, and he's using them to reposition Colliers' Houston office in the wake of the recession.

Overall, Duffy says, brokers must become even more focused on serving as consultants to their clients, who are struggling to recover and downsize without sacrificing productivity.

"If you look at the real estate more holistically, you do a better job for the client, the client's more successful and everybody wins," he says. "A great real estate broker . . . (becomes) a consultant - it is much more of a consultative approach, and it's highly focused on what that company is trying to achieve."

For example, in Florida Duffy and his team adopted a "show and tell" approach by using the latest technology - digital maps and other graphic tools - to share helpful visual information with clients. He hopes to incorporate that here.

In Houston, Duffy has implemented other changes, too: He hired a marketing director, who helped re-brand the office's marketing materials. He also plans to hire three new veteran brokers, each of whom has at least 14 years in the business.



Pat Duffy, President of Colliers International in Houston

Expanding Colliers' retail niche is important, Duffy says. The company is well known for its industrial success. Right now he estimates that the company's Houston revenue relies mostly on industrial and office, at 40 and 25 percent, respectively. He wants to balance the ratio of the firm's office, retail, industrial, land and investment revenue, so that each category generates about 20 percent.

He also plans to grow the office's property management portfolio. Currently, it manages about 4.2 million square feet. Duffy hopes to bring that up to 10 million or 15 million by the end of 2011.

"That's going to be a major part of our growth," he says.

Duffy had to hit the ground running. Job losses in Houston totaled 6,300 in the year before February 2009; industrial and office markets experienced negative net absorption in the first quarter of this year; and the petroleum-dependent city saw the fall of oil prices from \$150 to \$50 per barrel. Businesses have downsized or shut down altogether - in their wake, vacancy rates are on the rise.

"You can look at job growth and job shrinkage, and it has a direct impact on the need for commercial real estate," Duffy says.

Duffy says when he got here, he immediately recognized the symptoms that led to Florida's downswing. One of them was an increase in subleases.

"I said, 'I've seen this play, and the flare just went off that this market has slammed on the brakes.' Because that was the first thing we saw (in Florida), and we saw that in 2007," he says.

But Duffy refuses to make it a "doom and gloom" environment at the office.

"When I got here, I was seeing things I had already seen, and I frankly kept my mouth shut," he says of his arrival in Houston. "It would not have been very positive input for these guys. And as a practical matter - good market or bad market - your attitude can affect your behavior and vice-versa. The last thing I wanted to do was take the steam out of anybody's engine."

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Straight From the Experts: The latest **BUZZ** in Commercial Real Estate

Residential Market Ups & Downs



by Ray Hankamer

Mike Inselmann of MetroStudy spoke to the Urban Land Institute at its recent luncheon. Supporting comments were made by **Ted Nelson**, President of Newland Communities, and by **Will Holder**, President of Trendmaker Homes. Although the focus of the remarks was on the residential market, it is the return to health of residential real estate/homebuilding which will eventually lead commercial real estate back to robust health, according to leading economists.

According to Inselmann:

- Houston is about the best place in the country to be for the housing industry
- There has been a 79% decline nationally in home starts from the peak
- Houston homes have enjoyed a steady 3-5% appreciation 2000-2009, avoiding the wild cycling of values in other markets-this means a home worth \$200K in 2000 is worth almost \$300K now
- Values in Texas residential real estate overall are only down about 1.5%
- The swinging "appraisal pendulum" effect caused by home foreclosure on value dampens the housing market some

- Job growth drives housing and commercial growth follows
- Nationwide the country has lost 4 million jobs, but jobs only down 1% in Texas
- 12 months ending March '09 has seen loss of 14,400 jobs in Houston
- Loss of homes has forced higher demand for rental homes and higher demand for multi-family
- Houston is now in a 'reasonable place' with regard to inventory of new and used homes
- Residential foreclosures are at a rate of 1,000 per month, far below that of the 1980s, and there is a strong demand for the foreclosed houses, thus minimizing lender losses and keeping comps steady, thereby protecting values of all other homes
- Houston has fallen from having 16,000 new homes under construction to 6,000, but as long as the margins for homebuilders hold, once the residential industry and its supply chain adjust, 6,000 homes is still a volume at which the industry can be profitable
- All Texas markets have a 4-6 months supply of homes in inventory, and this is in balance
- Hopefully we have reached the turning point in Houston and will start to grow from here
- Houston is getting great national press
- Restrictive local government jurisdictions elsewhere slowed the

supply of new home construction, therefore creating high demand and ballooning prices, which now have come crashing down

Will Holder:

- There is pain throughout the residential construction supply system, as suppliers and subs who ramped up for higher volume are now having to shrink back to match current levels of demand
- Everyone is working to get unsold inventory down, to "take the slack out of the rope"
- There has been a slight uptick of late in builder margins
- There have been more people shopping model homes in first quarter of 2009 than in first quarter of either 2007 or 2008... traffic is way up, but buyers are still cautious

Ted Nelson:

- The Houston market still has a very large supply of unsold residential lots
- Our current residential market is in no way akin to the crash of the 1980s
- Margins are beginning to firm up for most homebuilders
- Remember that even if Houston is losing jobs it is still gaining population and that is good for the future of residential and commercial real estate

The Bivins Report

It Was a Very Good Year

Houston's office market hit some of its highest peaks ever last year. So even though things are softening a bit in 2009, the local office market is in fairly good condition.

The overall weighted average rent for all Houston buildings was \$22.20 per square foot at the end of 2008, up from \$21.28 per square foot at the end of 2007, according to a report by Commercial Gateway. That's a significant gain in rents when you are considering broad, market-wide statistics.

Buildings in downtown Houston Class A properties showed huge rental increases last year. At the end of 2008, Class A space in the Central Business District went for \$36.37 per square foot, up from \$33.52 per square foot at the end of 2007, according to the Commercial Gateway report.

Looking back at 2008, the downtown office market became very tight, especially for the Class A market. The vacancy rate for downtown's Class A buildings dipped to 6 percent at the end of 2008, down from 7.8 percent vacancy a year earlier.

Some have expressed concern about the new supply of space being built in downtown - with new towers under construction by Hines and Trammell Crow. But it will be almost two years before those buildings are completed and occupied, so there is no glut on the near-term horizon.

Actually, 2008 was really strong overall. So the market can retreat from that pinnacle a bit, and still be in good shape.

Short-Term Leases Booming

In the Houston industrial market today, many tenants are asking for short-term deals. And landlords are giving them.

Bill Rudolf, senior vice president of industrial services at CB Richard Ellis, said many leases are being done for three years or less, far less than the typical term for warehouse and industrial space. Lease renewals or extensions are being done for one year.

Rudolf told the CBRE First Quarter Press Luncheon that uncertainty with the economy is leading to the shorter term leases. He said in the Houston area, leases of 30,000 square feet to 40,000 square feet seem to be the typical size - larger distribution deals are few.

"Overall, it's not as bad as you'd think," Rudolf said.

Houston's industrial market has been one of the best in the nation in recent years as the energy business created demand for space and pushed the vacancy rate down to 7 percent. But domestic energy exploration is slowing and the oilfield service companies representing the heart of the Houston industrial market will not need to expand.

Dr. Barton Smith's Report Card

Houston's economy will have some B-pluses in 2009, along with its share of Cs and Ds.



That's the general tone of Dr. Barton Smith's outlook for 2009. Smith, an economist at the University of Houston, has been picking winners and losers in the local economy for more than 20 years.

Houston's multi-family housing market should be improving its ability to draw tenants, Smith said. With tighter mortgage underwriting for home buyers, more families are going to be heading for apartments, instead of buying homes. Vacancy in apartments will increase, but multi-family housing will be better able to compete against single-family.

Home builders have cut back on production of new homes significantly. This is good for the housing market, keeping supply in better balance with demand, Smith said. On the down side of that picture, suburban land prices have declined sharply as the need for new housing communities has dwindled.

Smith, at his annual real estate symposium, said Houston's economy will lose 61,000 jobs over the two-year period of 2009 and 2010. That's not good, of course. But for a region with 2.5 million jobs, it is not a large amount.

Smith said Houston's retail real estate market appears to be overbuilt. The industrial market will decline somewhat as oil drilling contracts and office vacancies will be rising.

Smith, who regularly draws 1,000 people to his symposiums, also surprised the audience by announcing he will retire a year from now.



Ralph Bivins, editor of RealtyNewsReport.com, is the dean of Texas real estate news writers. He is former president of the National Association of Real Estate Editors.

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