

Houston makes top 5 as boom lures foreigners

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Dan Levy



*The Williams Tower at 2800 Post Oak is valued at \$196.6. (J. Patric Schneider / For the Chronicle) Photo: J. Patric Schneider / © 2012 Houston Chronicle
Photo: J. Patric Schneider / © 2012 Houston Chronicle*

International real estate investors are falling in love with Houston, a fast-expanding energy hub that's luring buyers from Toronto to Tel Aviv seeking properties with lower costs and higher returns than buildings in the priciest U.S. cities.

Firms from outside the U.S. acquired \$2.83 billion of Houston office buildings in the past three years, according to Real Capital Analytics Inc. They were the largest net buyers of any investor class, spending four times more than U.S. real estate investment trusts, which ranked second. Last year, Houston for the first time was among the top five global cities in an annual survey by the Association of Foreign Investors in Real Estate that dates back to 1994.

"Houston has gained broad acceptance as a top-tier market," said Greg Kraus, managing director at Atlanta-based Invesco Ltd. (IVZ), a global adviser for pension clients including QSuper Ltd., an Australian fund for public-service workers. "It's reflected in job growth, more gas refineries, more oil out of the Houston port and a true international feeling."

The boom in and around the fourth-largest U.S. city stretches from downtown high-rises and boutique offices in the Galleria district to the "Energy Corridor" along the Katy Freeway, where Texas' Lone Star symbol adorns overpasses and construction cranes swivel beside a rush of commuter traffic.

Sales of offices in Houston rose 32 percent to \$3.89

billion in 2012, the highest in five years. That compares with the 21 percent increase nationally, according to Real Capital, a New York-based research firm.

Offices Favored

Office buildings made up 45 percent of investment by non-U.S. buyers since 2007, data from Real Capital show.

Foreign investors include Toronto-based H&R REIT (HR-U), which paid \$442.5 million in 2011 for Hess Tower downtown, a Houston record at \$524 per square foot, according to commercial broker CBRE Group Inc. (CBG) Munich-based Allianz SE last year spent almost \$227 million for a 49 percent stake in four Galleria towers, and Menorah Mivtachim Holdings Ltd. and Psagot, both based in Tel Aviv, bought One City Center with Hallandale Beach, Florida-based Beacon Investment Properties LLC for \$131 million, according to Real Capital.

In recent deals, Invesco this month completed a \$412 million purchase of the 909-foot (277-meter) Williams Tower. The property, which is 95 percent leased and Houston's third-tallest building, is located in the Galleria district of

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landscaped boulevards, high-end hotels and its namesake mall, the biggest in Texas.

Italian Inspiration

The 2.4 million-square-foot (223,000-square-meter) shopping center was conceived in the 1970s as the anchor of a mixed-use area, said Mark Cover, regional chief executive officer of Hines, the global developer with headquarters in Williams Tower. Barrel-vaulted glass arcades were inspired by Milan's 19th-century Galleria Vittorio Emanuele II, according to owner Simon Property Group Inc. (SPG)

Average rents for the most desirable offices in the Galleria district last year jumped 11 percent to a record \$32.02 a square foot, CBRE said. Downtown rents for Class A space rose 3.7 percent to \$39.60 a square foot, 31 cents shy of a record, as occupancy citywide advanced by 4.3 million square feet, the biggest gain since 2006.

Energy-related job growth is the main draw for overseas capital, said Jim Fetgatter, CEO of the Washington-based foreign real estate investors association, which represents about 200 firms with headquarters outside the

U.S., including sovereign funds. Houston had the nation's fastest-growing large metropolitan economy for two straight years, with a 3.8 percent jump in gross domestic product in 2011, the latest annual period for which Labor Department data is available. Unemployment last year fell to 6 percent from 7.2 percent in 2011.

'Smart Money'

"Houston's energy story is so compelling, and the really big, smart money that knows that industry are all in that town," Dan Fasulo, managing director at Real Capital, said in a telephone interview. "It's cheaper than New York or San Francisco and you can get better immediate returns."

Houston deals last year had a 7.4 percent average capitalization rate, a measure of return that falls as prices rise. That exceeded the 7.1 percent rate for all of the U.S. and 5.1 percent for transactions in New York, the most expensive domestic market, Real Capital data show. The cap rate is a property's net operating income divided by its purchase price.

Houston ranked fifth in the foreign investors association survey, after New York,

London, San Francisco and Washington.

'Reasonable Appreciation'

"Houston has risen to the top of the pile as investors look for good current returns with reasonable appreciation," said Donald Wise, CEO of Seattle-based Metzler Realty Advisors Inc., a self-described former "skeptic" about the city who is now seeking property on behalf of a South Korean client. "It's a good place for knowledge workers to live, and energy production is much broader than it was 30 years ago," said Wise, whose firm is a unit of German private bank B. Metzler Seel. Sohn & Co. KGaA.

Houston boomed a century ago after the 1901 Spindletop oil discovery, 70 miles (112 kilometers) east, which shifted the infant American petroleum industry westward to Texas. Today, new methods for extracting oil from rock and advances in gas production, such as hydraulic fracturing, have exploited reserves in North Dakota's Bakken shale and elsewhere, and deepened Houston's status as the U.S. energy capital, said Barton Smith, a retired economics professor who taught at the University of Houston for 40 years.

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Output Soars

U.S. oil output last year soared to 6.41 million barrels a day on average, the highest level in 15 years, as the \$94-a-barrel price encouraged exports, according to Energy Department data. The 14 percent advance was the biggest annual gain since the industry began in Pennsylvania in 1859.

The U.S. expansion is boosting traffic along the Houston Ship Channel to rising markets in Latin America, adding to freight hauled by railroads such as the Burlington Northern Santa Fe LLC unit of Warren Buffett's Berkshire Hathaway Inc. and prompting the world's biggest oil companies to expand in Houston, Smith said.

"There's so much oil and natural gas, and a good part of it will come to Houston," Smith said in a phone interview from his Houston home.

The promising outlook has helped Houston overcome a history of excessive building, according to Wise. From 1980 to 1984, almost 81 million square feet of offices were added in the city, including five of the tallest towers, CBRE data show. The boom left 47 million

square feet empty and a 28 percent vacancy rate by 1987.

'Long Memories'

"Institutions have long memories of volatility, and Houston was a poster child for preconceived notions established in the '80s," Invesco's Kraus said. "You had this boom-bust perception."

U.S. tax rules that motivated recklessness and helped create the 1980s savings-and-loan crisis no longer exist, he said.

Planners and developers in the city, about 600 square miles (1,550 square kilometers) in size, are now more careful and lenders are stricter in their underwriting, said Cover of Hines.

Still, the ease of putting up new buildings, compared with cities such as Boston or San Francisco, where permits are harder to obtain, is an "outsized risk," according to Cover. About 9.6 million square feet are being developed in the metropolitan area, the biggest pipeline in 30 years, with Irving, Texas-based Exxon Mobil Corp. (XOM)'s 3 million-square-foot campus, 30 miles north of downtown in the Woodlands, the largest

project, CBRE said. Miner's Tower

Royal Dutch Shell Plc (RDSA), based in the Hague and Europe's biggest oil company, is adding two buildings to its Energy Corridor campus, and Melbourne-based BHP Billiton Ltd. (BHP), the world's largest mining company, has plans for a 30-story Galleria tower. Signed leases in projects under development include agreements for 126,000 square feet by Modec Inc., a Tokyo-based oil-platform builder; 108,000 square feet by Chertsey, England-based Forum Energy Plc; and 150,000 square feet by Calgary, Alberta-based Talisman Energy Inc., CBRE said.

"Houston is firmly in the low-barrier camp," Green Street Advisors Inc. said in a Feb. 7 report. "With improving local fundamentals, supply is creeping back into the picture." Green Street, a research firm based in Newport Beach, California, still counts Houston as one of its top U.S. markets, with a labor outlook expected to be "robust for at least the next few years."

Marriott Hotel

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With commercial real estate booming, residential projects with 2,500 apartment and condominium units are planned for downtown, along with a 1,000-room hotel to be run by Marriott International Inc., said Ric Campo, CEO of Houston-based Camden Property Trust (CPT) and chairman of Houston First Corp., which runs convention, parking and theater facilities for the city.

"We build in Houston because we need what is built," Campo said in an interview at the George R. Brown Convention Center, which sits between the Toyota Center arena and Minute Maid Park stadium, both built since 2000 and home to professional sports teams. "Investors understand that you can get exceptional rates of return."

Not far away, the boom is symbolized in a renewed stretch of Main Street, which had "more police calls than any other block downtown" when Hines in 2007 began the 46-story BG Group Place, the city's biggest tower in a decade, according to Cover. The 973,000-square-foot high-rise was built on the site of a derelict hotel notorious for prostitution, he said.

Sovereign funds are among probable bidders for the

tower, which is 97 percent leased two years after opening, Hines said. BG Group Plc (BG/), a Reading, England-based natural gas exploration company, is the largest tenant. Bloomberg News parent Bloomberg LP also rents space in the building.

"Occupancy is getting tighter," Cover said from his office on the 41st floor, looking down at a formerly decrepit structure being renovated for an upscale hotel. "It's having the desired effect. This is going to be a very good outcome."