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Tierra Grande

Journal of the Real Estate Center at Texas A&M University

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Laser lights and fireworks illuminate the Houston skyline during the Sept. 20, 1997, Power of Houston show. As many as one million spectators witnessed the event. This image was captured by *Houston Chronicle* photographer Jerry Powers.

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BENCHMARKS

In the January issue of *Tierra Grande,* "RAMs Attract Older Homeowners" described the reverse annuity mortgage (RAM)—newly legalized in Texas by the constitutional amendment that also allowed home equity loans.

As mentioned in the article, RAMs are not popular with lenders because the loans require cash outflow for an indefinite period, and the loan is not paid off until the borrower ceases to occupy the home. However, the Federal Housing Administration provides insurance to reduce the risk of holding such loans, and the Federal National Mortgage Association (Fannie Mae) buys the loans from loan originators. Participation from these organizations makes the loan viable.

However, Fannie Mae has decided to delay entering the Texas RAM market until it is certain that a RAM following Fannie Mae criteria can be legally offered in the state. The problem arises from the long and detailed list of qualifications placed on RAMs by the constitutional amendment. In some cases, these requirements force the lender to take on risks greater than those associated with RAMs made in other states.

For example, it is not clear if the lender can demand specific performance or repayment of the loan following the death of the borrower. In addition, other requirements make the loans less appealing to borrowers as well, such as the ban on accessing credit line accounts funded by a RAM. Such accounts are more popular than periodic payment plans, yet cannot be offered in Texas.

Until Fannie Mae begins to buy Texas RAMs, borrowers probably will be unable to find lenders willing to make such loans. For this to happen, the constitutional provision will need further modifications. Therefore, it looks like it will be several more years before RAMs will be a reality in Texas. Readers who would like to see RAMs available in Texas should contact their legislator. ⊞

Manufactured Housing Mail

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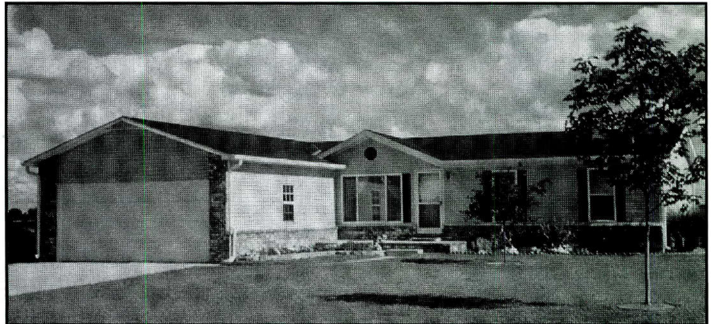
Readers gave the last issue of *Tierra Grande* an overall grade of *B* or excellent. Using the new "Reader Rapid Response" section on page 24, readers divided their *A, B* and *C* grades evenly. They also were divided over whether or not they liked the article on manufactured housing.

Oscar Durham of Fredericksburg said he disliked the manufactured housing article but added, "the truth sometimes hurts." Ann Taylor also disliked the manufactured housing article, labeling it unrealistic. She added, "Unscrupulous developers are turning Texas developments for mobiles into future slums of America."

Manuel Garcia-Nunez of El Paso thought the manufactured housing article was the best one in the April issue. He said, "If, in fact, manufactured housing represents one-third of new single-family units . . . more information is needed to keep the public aware of its advantages or disadvantages. You are commended for publishing (the article)."

A Houston real estate broker whose primary interest is in developing boutique subdivisions for garden homes and manufactured homes added her thanks for a "very useful



publication." The Texas Manufactured Housing Association called the article "wonderful" and requested 300 additional copies of the magazine.

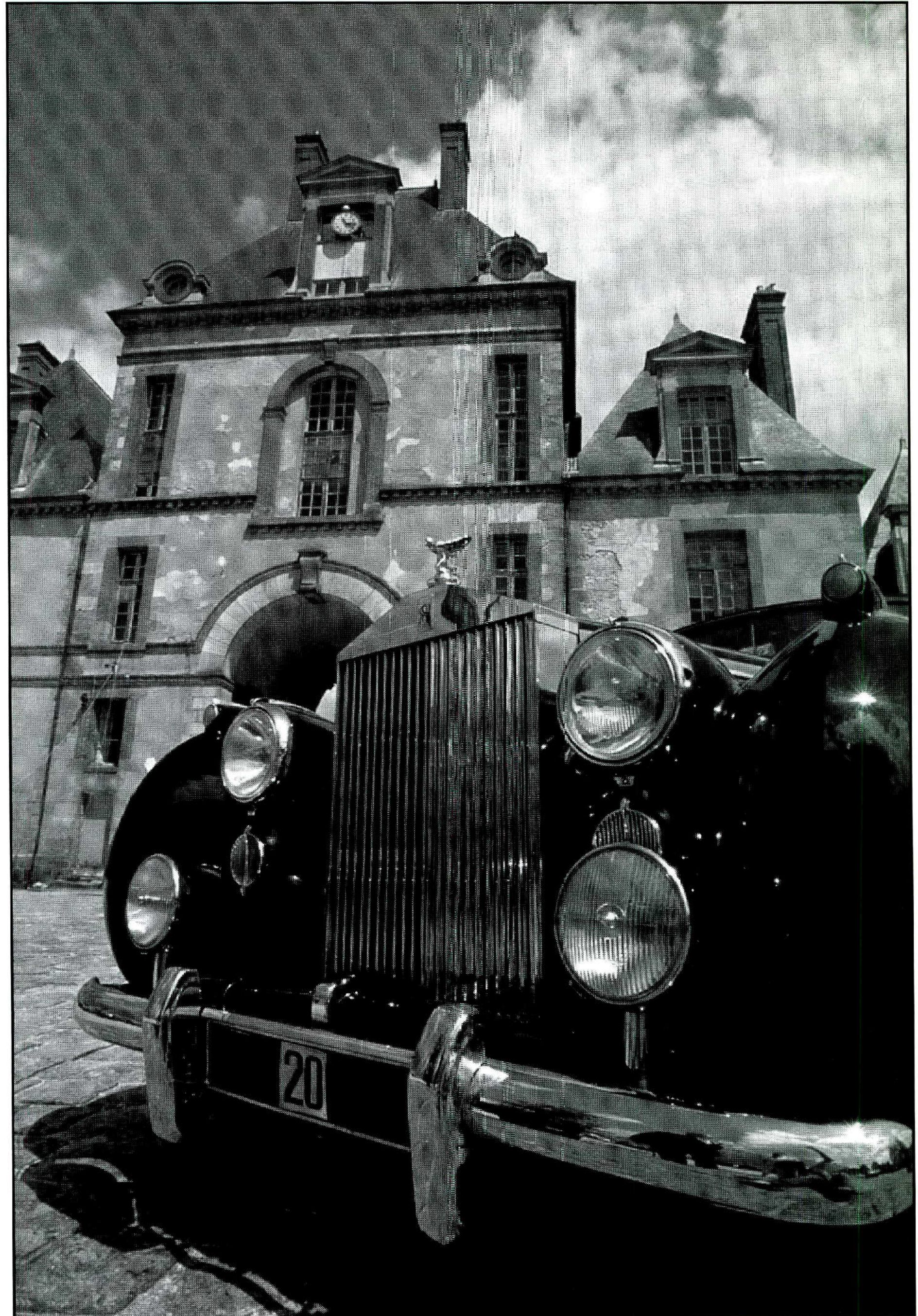
The editors want to know which articles readers like and dislike. Use the form on page 24 to fax opinions about this *Tierra Grande* and to suggest topics for future issues. ⊞

Paragraph 7(D) of the recently-revised promulgated contract contains a new provision entitled "Acceptance of Property Condition." The buyer may accept the property in its present condition or tender an option fee for the unrestricted right to terminate the contract within a specified period.

The provision raises two questions. Why the option, and what is the minimum amount of tender required to make it enforceable? Both the U.S. Supreme Court and Texas courts have addressed the issues.

In *Cubertson v. Brodsky*, the buyer entered a real estate contract where $5,000 was placed in escrow. The buyer had the right to conduct a 60-day feasibility study. If the property proved unacceptable, the buyer had the right to terminate the contract and have **all** the earnest money refunded. The court held

(see Benchmarks, p. 23)



Royal Treatment Builds Customer Loyalty

By Michael Abelson

What will become of the real estate agent in the future? With all the information on the Internet, will consumers merely seek help with real estate legalities and do the rest themselves? Will the traditional agent survive or eventually disappear?

Real estate is a competitive industry. In head-to-head competition, agents seek ways to conduct business better and faster, and technology allows many to compete. Future competition also will include other industries. For example, mortgage bankers plan to "capture" the consumer first and then refer them to real estate agents for a fee. The computer software industry is working on programs that will provide the consumer services now offered only by the real estate professional.

The key to competing effectively in this intense industry is to always keep an eye on the consumer.

Real estate professionals have always been sensitive to the needs of their clientele, the consumer. In the past, agents have effectively identified **who** wanted to buy or sell, **when** they wanted to buy or sell and **what** their specific needs were in the process.

In the future, more must be done. An Abelson & Company national study of industry trends found that the number one agent trend (from 35 trends studied) was "successful agents get more successful." In other words, expect even more competition among top agents. To earn and keep a client's business, licensees must **know**, **understand** and **serve them better than anyone else.**

Know the Consumer King

The consumer in the year 2000 and beyond will differ in age, culture, ethnicity and socioeconomic characteristics.

Age will have a dramatic affect on home-buying preferences. Those 69 years old or older represent more than 10 percent of the 265 million estimated U.S. population. Most of these almost 30 million people are financially conservative and less likely to spend money on housing. Those 51 to 68 years old account for 16 percent of the population; their primary interests are comfort and security. This 41 million-person cohort has money to spend; so focus on comfort and security when helping them identify and then enjoy their new surroundings.

Some 33 million Americans are 42 to 50 years old. These baby boomers are interested in meeting or surpassing their parents' lifestyles. They want times at least as good as those

they experienced in the 1950s as children in the post-World War II economic expansion. They have the money to spend and are willing to spend it on "creature comforts."

The 20-to-41-year-old cohort (some 90 million U.S. residents) have experienced good economic times most of their lives and are interested in homeownership. Many have the resources and are willing to spend it on housing.

The less-than-20-year-old age group is the largest cohort—some 69 million or 26 percent of U.S. residents. These "children" will want more from life because they have experienced what is sure to be the longest peace time economic expansion in U.S. history. Expect them to want homeownership when they reach home-buying age.

Only one-third of any of these households have children less than 18. One-fourth live alone. These two facts suggest that many future home purchasers will be focused on their individual and personal needs instead of on the more traditional family-with-children dwellings.

Culture and ethnicity also will have an increasing effect on home purchasing needs. Four million people moved to the United States from 1990 to 1995, and more than 50 percent moved to California, Florida or Texas. Florida (with 640,000) and Texas (with 165,000) had the greatest net influx. Of the estimated 200,000 to 300,000 illegal aliens migrating to the United States, 40 percent went to California, 15 percent to Florida and 10 percent to Texas. The remaining 35 percent migrated to the other 47 states.

There is a benefit to these migration patterns. Nearly 50 percent of those migrating to the United States in the last ten years are 25 to 44 years old, prime home-buying age. Eight in ten immigrants believe homeownership symbolizes being integrated into the American culture and values.

The proportion of the entire U.S. population, and some states in particular, is changing culturally and ethnologically. For example, in 1980 one in five U.S. residents was a minority. In 1995, that number was one in four. In 1995, one-third of the children in the United States were African-American, Hispanic or Asian. Some 61 percent of all Hispanics living in the United States call Texas, Florida or California home.

Socioeconomic information also helps us better know the consumer king. More people will obtain college degrees, attend some college or receive equivalent education. This will impact wealth. The median household income of college graduates is $55,000 a year—76 percent more than the median income for all households. The total purchasing power of the top 20 percent of U.S. households (many being more educated) equals the middle 60 percent of the population's earnings. The high earners will generally be more knowledgeable and have more confidence they can effectively use the information flowing along the Internet. These consumers will in all likelihood be more knowledgeable about the real estate transaction or have the confidence they can master it.

Technology and changing work values also affect homeownership and buying habits. Technology leads to less need for mobility and more virtual offices located in the home. A recent study by Atlas Van Lines found that 75 percent of those who turned down a move did so to be geographically closer to their families. This was the number one reason for refusing relocation—up from the number three (at 55 percent) reason just a few years ago.

This demographic information leads to several conclusions. Age, ethnicity and socioeconomic characteristics will affect homebuying. Different age groups have different needs, desires and values. Their home-buying needs and willingness to spend earnings on housing differ greatly. Ethnic background proportions will change, especially in California, Florida and Texas. This will affect the importance of homeownership and the specific values used in the homebuying and selling decision.

Socioeconomic status, driven to some extent by education, will affect how willing a person is to use a real estate professional, do it on their own via the Internet or by other means. Technology and cultural values will affect the willingness to move. Increased technology use and the virtual office leads to a diminished need to relocate. All of these factors point to the need to know the consumer well, to better capture those with home buying and selling interests and to serve them effectively.

Understand Consumer Expectations

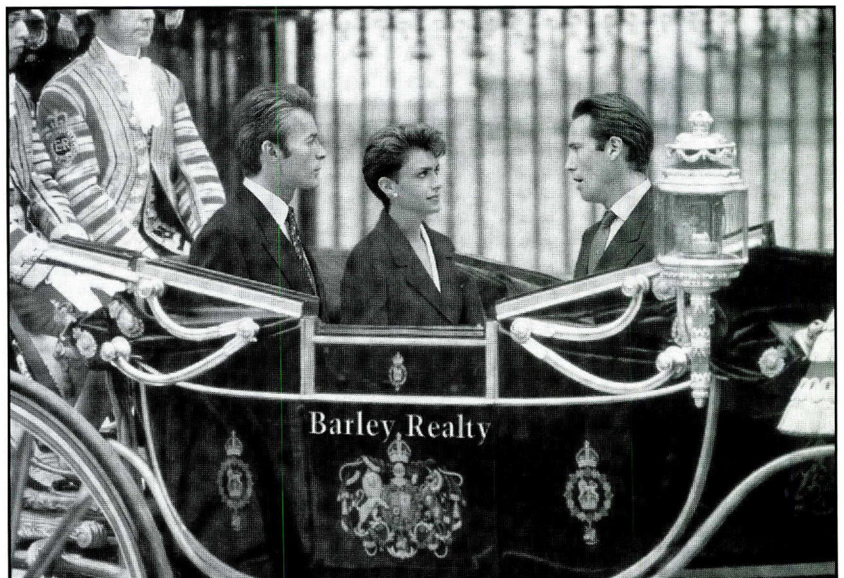
In addition to knowing the consumer of the future through demographic data, it is helpful to better understand the consumer's expectations of the real estate professional.

The author's national study gives some insight on what the consumer will expect in the year 2000. The top five consumer trends were 1) "Consumers gains access to the MLS," 2) "Access of home purchase information directly to the consumer increases," 3) "Consumers demand a better/more knowledgeable professional agent," 4) Consumers "increase demands further on the agent" and 5) Consumers "will more astutely negotiate fees."

Add to this information the fact that the consumer is becoming more educated, generating more wealth (probably in most cases from time-consuming efforts), and is readily using high technology and information-intensive tools, and numerous conclusions result.

Consumers will:

- increasingly demand more from the real estate professional;
- be more knowledgeable about real estate and the real estate transaction;
- have increasing direct access to real estate related information;
- be more educated and better able to see through real estate sales approaches that are rich in marketing but poor in substance;
- be technologically more sophisticated and able to use technology to save time, effort and increase efficiency;
- have less tolerance for deviations from their expectations because they are being better taken care of by other service industries;



Real estate professionals are in the business of offering a high-quality service in exchange for a high-quality fee.

- want the profession to streamline the selling and buying process to be more efficient;
- want "value-added" from the agent and the broker and, if not satisfied, will negotiate payment either in the current or future transaction commensurate with what they receive;
- go somewhere else (such as technology) if their needs in the transaction are not met;
- be aware of and more likely to use legal remedies to deal with awkward issues; and
- be more used to change and expect others to change more quickly.

Serve the Consumer King

Some believe calling the consumer "king" means giving consumers everything they want. This interpretation leads the real estate professional to do anything to get the sale—not an effective way to do business. After all, the real estate professional is in the business to offer a **high-quality service in exchange for a high-quality fee.**

To meet the consumer-real estate professional relationship objective of offering a high-quality service in exchange for a high-quality fee, agents should consider establishing two goals.

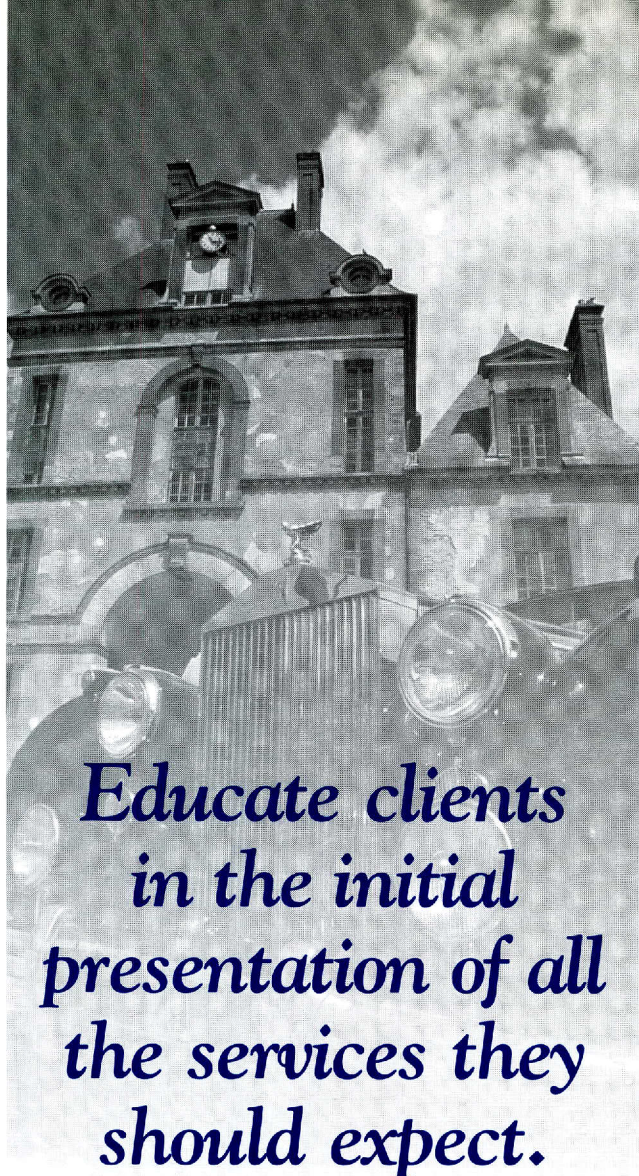
First, offer the consumer a true **value-added quality service.** This quality service requires the real estate professional to be dynamic and flexible enough to change with the market environment. Agents will also have to be more knowledgeable and more sophisticated about technology, techniques and service available to the consumer.

Value-added means offering the client something they either cannot or will not do themselves. Numerous examples or techniques to offer value-added quality service follow.

Consumers can read information on the Internet. This does not necessarily mean they know what they should be reading. **Provide clients with a list of Web sites that supply the information they need.** Listing and selling clients may need different lists. Make a list of ten to 20 sites that assist the consumer. To stay current with the latest information, change your list every several months. This signals the consumer that you are aware and that you will continue to be up-to-date on the best sites.

Giving the consumer specific sites saves time, and it gives clients the impression that their agent values their time. If clients do not have access to the Web, do not force technology on them.

Agents also need to educate people on what services the real estate professional offers. This way the consumer sees the need for the agent, understands how the agent adds value and becomes aware of the real estate professional's role. Generate a different list for both the listing or buying presentation. Include all services available through the agent and their company. Some services will be available through traditional transaction fees, and some may be offered for an additional fee. Educate the client in the initial presentation of all the services they should expect. Many buyers and sellers underestimate the responsibilities and tasks of the real estate professional.



Educate clients in the initial presentation of all the services they should expect.

"Farm" a specific target market. A real estate office or multi-office firm concentrates on many niches within a certain sphere of influence. Serving niches creates better knowledge of the market, creates more marketing synergies (such as more lawn signs) and creates a reputation or image in a market where word-of-mouth marketing is effective.

Provide full and complete disclosure of industry relationships, as well as with related businesses throughout the process. With all the talk about agency relationship, it is important to inform the consumer of the many different scenarios in buying and selling. The consumer needs to know what the agent will be doing to serve them so they have the appropriate expectations. If "cross selling" between the real estate office and a mortgage company is likely, for example, tell the consumer. Clients need to be aware of these relationships so that they do not feel coerced or manipulated into using a specific company. This also helps to prevent conflicts of interest before they arise.

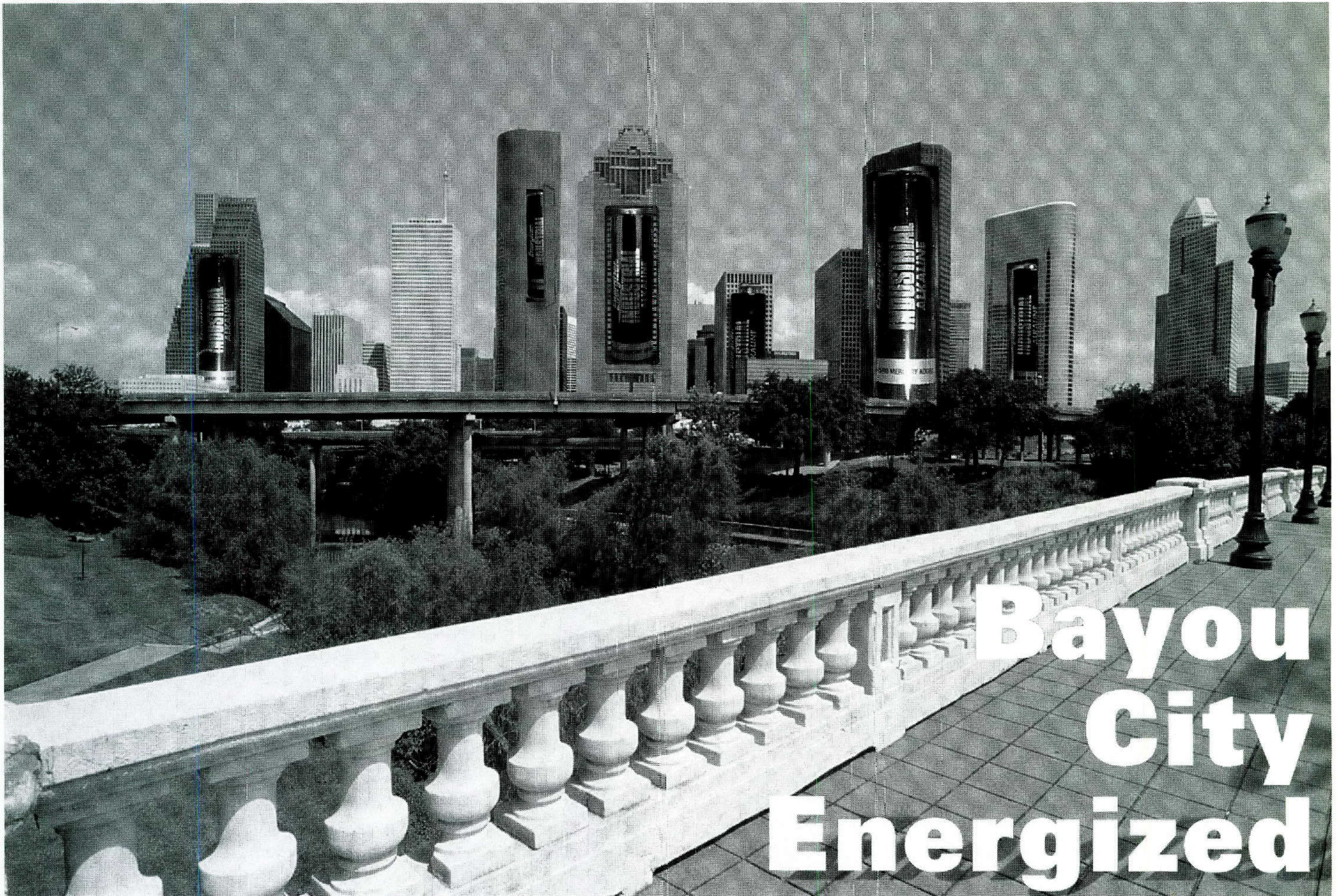
The second goal of **offering high-quality service in exchange for a high-quality fee is to manage information in the real estate relationship**. After all, this is primarily what agents do as quality service providers.

Agents of the consumer are information buffers. They tell the consumer what they need to know and "shelter" them from the rest. Take all the information, and interpret it so it can be used effectively. Demonstrate true insight or "aha's" in the relationship where the consumer's eyes light up and the agent's wisdom shows.

Be high tech and high touch. **Use technology to save the agent's and the consumer's time while offering a more efficient and effective service.** While technology does not sell real estate, people do, this adage may change in the future. Delegate those responsibilities that others can perform, but do not detract from a relationship with the consumer. After all, this is still a relationship business, and whomever the consumer has a relationship with is the one to whom they show more loyalty.

Offering a high-quality service in exchange for a high-quality fee is the only way the real estate professional in the future has an opportunity to survive and potentially thrive. Knowing, understanding, and serving the consumer king is a necessity. ■

Dr. Abelson is associate professor of management at Texas A&M University and is president of Abelson & Company. This article is based on research published in the Abelson Trends Report™ *and comments published in the book Abelson co-authored with Tom Dooley and Stefan Swanepoel entitled* Real Estate Confronts Reality. *For additional information or to purchase the* Abelson Trends Report™ *or* Real Estate Confronts Reality, *contact Dr. Abelson at 888-ABELSON (223-5766).*



Houston Markets Keep Going and Going and Going

By Mark G. Dotzour and Candace Rhodes

In monitoring Texas real estate changes and trends, the Real Estate Center staff regularly tracks newspaper and other business publication articles. This column is based on real estate information published in the *Houston Chronicle* and the *Houston Business Journal* in recent months. It provides an overview of Houston's commercial and residential market trends.

Houston's economy has expanded rapidly in the last few years. The city has benefited from strong national growth and a boom in oil and natural gas extraction. These growth trends should continue with some moderation. According to the Texas Workforce Commission, employers added 89,100 jobs to the Houston area between February 1997 and February 1998, a 4.8 percent gain. Houston's unemployment rate dropped to 4.1 percent during February, down from 4.6 percent the previous month. The city's economy is expected to have a 3.0 to 3.5 percent growth rate in 1998. Meanwhile, 1998 job growth rate is expected to be near 3 percent and the population growth close to 2.5 percent.

The energy sector is the main determinant for continued growth. During 1997, oil, gas and other energy-related sectors provided approximately 9,000 new jobs. But in January, oil prices dipped to their lowest level in four years. If prices remain depressed, oil company profits which soared in 1997 could decline quickly. Economists are concerned this will put a damper on local job growth.

Job gains were especially strong in manufacturing, construction, trade and the service industry. For the work force to grow much more, people must move to Houston to fill those jobs, according to Al Ballinger, data manager for the Center for Public Policy at the University of Houston. Employers also are finding that they have to pay more to attract and keep the experienced and qualified workers.

Houston real estate recorded a boom in 1997. The office vacancy rate hit its lowest point in more than a decade, prompting landlords to raise rents and developers to start constructing more buildings. The city ended 1997 with an office vacancy rate of 13.7 percent, a marked improvement from 19.3 percent the previous year. More than 7.7 million square feet of Houston's empty office space was filled in 1997. This was a big increase from 1996 when the city, with 138 million square feet of office space, filled just 2.8 million square feet. Cushman and Wakefield reported the average annual rental rate for a Houston office building in 1997 was $13 per square foot, up from $11.71 at the end of 1996. In prime office buildings, rates were much higher. Besides new construction, many previously vacant buildings are now being refurbished and reopened.

Downtown showed considerable improvement in its office market as the vacancy rate for prime downtown buildings dropped to less than 10 percent during the year. As much as two million square feet of empty downtown space was leased in 1997. There also are plans to build the first downtown office tower in more than a decade. It will contain more than 1.2 million square feet of office space.

West Houston, which includes the energy corridor, also is posting a growth surge. As of February 1998, approximately 5.7 million square feet of office space was in the planning or construction phase. This included both build-to-suit and speculative office space. The west Houston market has led the city

in major corporate relocations. Class A buildings were reported to be 98.5 percent full in west Houston with only 138,550 square feet available for lease. For all classes of office space in west Houston, the vacancy rate was reported to be 8.3 percent for the first half of 1997, down from 21.9 percent in 1992.

The new year has proven successful as well. More than 1.2 million square feet of office space was filled from the first of January until the end of February, according to Core Data. The city-wide average rent for all classes rose from $15.12 at the beginning of the year to $15.93 per square foot at the end of February.

Retail sales are a good indicator of the local economy's health. Houston's retail sales jumped from $25.8 billion in 1984 to $43.5 billion in 1996. Houston added 2.8 to three million square feet of retail space in 1996 and 1997. General trends in Houston include more big box stores and an upswing in the activity of smaller boutique stores that cater to the upper middle class. Redevelopment of land along the city's major corridors also will play a role in future retail development.

The Katy Mills mall is a major development with 1.6 million square feet. It will lead to more small shopping centers, restaurants and stores as the population grows. There also will be a Houston Premium Outlet located in the northeast corner of the Katy Freeway and the Grand Parkway. A Cinemark 17-screen movie theater will be housed among the stores in the 850,000-square-foot building.

Houston also needs hotel space. Studies have shown that Houston is often bypassed for major conventions because of the lack of downtown hotel rooms. Local developer Wayne Duddlesten has teamed with Crescent Real Estate Equities Co. to finance and build a proposed convention center hotel in downtown Houston. The $155 million luxury hotel will be located across from the city-owned George R. Brown Convention Center. It will contain at least 1,000 rooms and large banquet and ballroom facilities. The city, county, Houston Independent School District, Port of Houston Authority and the Metropolitan Transit Authority have approved tax abatements for the project. Harris County Hospital District is the only taxing entity to refuse a tax abatement.

There also are plans to redevelop the downtown historic Texaco Building into a luxury hotel. The building is expected to become a Ritz-Carlton with more than 300 rooms. John Keeling of PKF Consulting said the downtown Houston hotel market has become exceptionally strong during weekdays because of guests who are in Houston on business.

The housing market recorded considerable improvements in the past year. In January, Houston area homebuilders recorded the highest monthly sales total for the past 15 years—an increase of 62 percent from January 1997. New home sales were up 11 percent last year from 1996. Houston and the surrounding area had about 22,900 starts last year, up from 20,500 in 1996. Demand is going up, but supply is decreasing. Builders will have difficulty keeping up with demand as a result of increasing sales, a shortage of experienced tradespeople and a tight supply of available lots.

Houston's resale home market has also been strong, reaching a record number of homes sold and a record median price. It also recorded the lowest inventory since 1974, according to the Houston Association of Realtors. The number of properties sold increased 9 percent from 1996. The median price of Houston resale homes also has increased 6.7 percent as a result of the depleting inventory of existing homes. This could force more buyers into the new home market in 1998. This is a result of the added 60,000 new jobs in Harris County last year and the low mortgage interest rates. Because of an increase in demand for new and existing housing, price increases and waiting periods for new home construction are expected.

Apartment construction has increased in the Houston area as well. Apartment starts are growing at an even faster rate in Houston than in Dallas. During the 12 months ending in June 1997, apartment construction was up 78 percent. In the second quarter alone, Houston pulled ahead of the rest of the country with about 3,600 apartment unit starts. Predictions for the coming year are even greater with approximately 14,000 new apartment units slated in Houston, up from about 4,500 in 1997.

Furthermore, demand to live in downtown Houston has increased. There have recently been two apartment projects underway in the downtown area. The Rice, a redevelopment of the historic Rice Hotel, will have 312 units with monthly rents ranging from $650 to $3,000. Forty-five loft apartments were rented in The Rice during the initial leasing period. The first tenants moved in during March. There also are plans to redevelop the old Humble Oil Co. building into a multi-use project including apartments and two hotels. The project will include about 125 apartments and 335 hotel rooms.

The condominium market also has been active in the downtown area. The old 220 Main building has been transformed into condominium homes. Upon completion, 25 units will be available, ranging from $315,000 to $675,000. In addition, the Southern Pacific Building is being converted into 107 condominiums. Prices for the lofts are expected to range from approximately $105,000 to $180,000 per unit. These projects exemplify the strong demand for downtown living.

Another project under construction west of downtown is a mid-rise condominium building called Gotham. It will be adorned with Corinthian columns and nine-foot statues of classical-style figures. Units will range from $190,000 to $475,000. The demand is strong with 25 people already placing $1,000 reservation deposits.

Houston was recognized by the U.S. Department of Housing and Urban Development as a "Best Practice" in the country for providing housing for low-to-moderate-income persons. "Homes for Houston" offers as much as $9,500 to help a qualifying family acquire a new home or $3,500 to help finance a purchase of an existing house. Families of four with incomes of $39,300—less than 80 percent of the median income—can qualify for the program. It is expected to positively impact 25,000 homeowners by the year 2000.

There also has been an increase in homeownership among low- and moderate-income families, including many minorities. Minorities accounted for 28 percent of Houston area homebuyers in 1997, up from just 18 percent in 1992. There has been an increase in mortgage loans made to low- and moderate-income people since the Clinton administration regulators made a fundamental shift in the way they judge a bank's compliance with the Community Reinvestment Act. More banks have begun aggressively searching for low- and moderate-income families—many of them minorities—who want to buy homes.

Fannie Mae also is backing home loans in Houston that will allow buyers to borrow down payment funds. This HouseHouston program has assisted 11,000 people in acquiring affordable homes in the Houston area in the last two years. The new program, called Flexible 97, allows homebuyers to get cash for a down payment either from a family member, through a loan or a grant from a nonprofit agency, or by credit card. These new Fannie Mae loans are available for homes priced at less than $214,600.

Another new Fannie Mae program is the "drive-to-work" program, which makes it easier for low- to moderate-income families with car payments to qualify for a mortgage. Traditional mortgage lending standards disqualified families who had car payments that made up a large part of their debt. The new program recognizes that a car is essential for most working families in Houston. ⊞

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One-Stop Real Estate Shop

Home Buying Streamlined, Simplified and Shortened

By Jack C. Harris

While consumers will search for a bargain, they value convenience, especially when the purchase is complicated. What transaction is more lengthy, costs more and involves as much confusing paperwork as buying a home? Consider the entire process, from the time someone decides they want or have to move, to the time they take possession of the home. If the process could be streamlined, simplified and shortened, the consumer undoubtedly would be better served, and there would be fewer aborted sales. Because much of the process involves the transfer and review of information, the technology of the "information age" should expedite the entire process.

Fortunately, technology is allowing such streamlining to occur. One of the more promising developments in residential real estate is the concept of "one-stop shopping." As observed by John Baen and Randall Guttery in a 1996 *Tierra Grande* article, "Agents increasingly offer support services such as collateral assessments (i.e. valuation) for loan processes, lender property inspections, coordination of required repairs, coordination of property closings and electronic transfers of closing papers to mortgage lenders."

Ideally, one-stop shopping involves all of the services needed to complete a purchase, such as title insurance, hazard insurance, inspections and appraisal. Indeed, brokerage firms are entering each of these fields. None, however, has been as popular as the provision of mortgage financing.

In a recent study, consultant Weston Edwards discovered that 69 percent (93 percent for the largest firms) of responding real estate firms provided some type of in-house mortgage loan service. Brokers are beginning to embrace the concept of one-stop shopping, but the implementation of these systems has been slow.

In-House Lending Appeal

There are two compelling reasons for brokerage firms to involve themselves in mortgage provision. One, the broker may increase the percentage of sales that close by gaining more control over the buyer. Two, the broker may broaden the revenue base by adding new services to the package.

House hunting and obtaining a loan traditionally have been treated as two separate transactions, even though they are unavoidably related. Real estate agents are now trying to make obtaining a loan easier and house hunting more efficient. For example, real estate professionals may get their clients prequalified or pre-approved before starting the housing search. Sales agents also can provide information to homebuyers on

current loan terms and companies that are actively lending in the area, as opposed to the "old way" where most homebuyers were on their own when looking for financing.

Many buyers, particularly first-timers, welcome and tend to follow the advice of the sales agent when choosing a lender. By bringing loan origination into the brokerage office, the agent can strengthen this link. Upon signing a sales contract, the homebuyer may move directly to the loan application stage, saving time and effort searching for the best loan available. Electronic technology can shorten the loan approval process and allow the borrower to follow the approval decision. In addition, some of the cost savings inherent in such technology could result in lower total borrowing-costs.

By becoming more involved in the process, the broker gains more control over the financing decision, which often is crucial to the success of a sale. Consumers, acting on their own, tend to select a loan purely on the basis of the contract rate offered, ignoring the lender's ability to close the loan in a timely manner. Agents, on the other hand, may be more concerned with quality and timely service. In addition, agents who perform part of the origination process, such as collecting loan application information, may be able to earn a fee from the lender.

In recent years, lenders have become more open to nontraditional origination by taking loans from mortgage brokers and real estate agents. The so-called "point-of-sale" origination is completed when the sales contract is signed, and it is an important part of the move to one-stop shopping. The willingness of national mortgage banking firms to make loans through these arrangements has been essential.

Several trends in the real estate brokerage industry stimulate the drive to provide more comprehensive service within the brokerage office. For example, profit margins from the brokerage business have traditionally been small, even in the midst of strong markets, because agents are winning a larger cut of the commission dollar. Developing profitable ancillary business may be necessary for long-range survival. The entry of HFS (now Cendant) as a new industry heavyweight will allow experimentation in combining an array of linked services under one roof.

Available Broker Options

Broker-owners have several paths through which to enter the loan origination business. Each option varies in the level of involvement required from sales agents and the potential for generating revenue.

Possibly the least intrusive way a brokerage office can introduce loan origination capability is through video conferencing. Several real estate companies have developed systems that allow homebuyers to interact with a loan officer via video linkage. Customers are referred to the system at the agent's discretion. Once the agent takes the customer to the video conferencing area in the real estate office and helps them make the link, the loan officer, through video linkage, takes over for loan counseling, loan selection and application.

Computerized loan origination, (CLO), is a similar approach with different technology. With CLO, the agent helps the customer search for and evaluate loan options with information presented on a personal computer connected to a network of lenders. With most of these systems, the agent-assisted homebuyer can initiate a loan application over the network. In some systems, the agent performs the role of loan officer. Others use locally-based loan originators to complete the process. Generally, a fee is charged the homebuyer for using the system, which may be credited when the loan is closed. Sales agents earn fees from the lender for performing origination activities.

Another low-risk way a brokerage office can introduce loan origination services is to rent space to a mortgage broker or mortgage lending institution. This "rent-a-desk" arrangement simply allows the lender to set up shop in the brokerage office in exchange for rent. Sales agents may refer customers to the lender at their discretion. Rent payments do not depend on how many loans are originated. In fact, federal law requires that rent not be related to loan volume but reflect fair market rent for the space.

Rent-a-desk arrangements, if successful, often lead to joint ventures between the lender and the broker-owner. There is a growing trend toward more broker-owned operations while rental arrangements are becoming rare. Because joint ventures are business arrangements, they can be structured in any manner acceptable to the parties. In some cases, the broker may decide to become sole owner of the affiliated lending operation. These affiliated business arrangements are most common within large brokerage firms. Experts estimate that it takes at least 35 sales agents in an office to support one full-time loan officer.

Leading Horses to Water

Clearly, the key to a successful point-of-sale mortgage operation is gaining the confidence of the real estate agents who will introduce their customers to the service. Despite the advantages offered by in-house settlement services, there are several reasons why agents

RESPA, Reform and Referral Fees

There is much frustration within real estate brokerage and mortgage loan industries concerning effects of the Real Estate Settlement Procedures Act (RESPA), a law passed in 1974 to protect homebuyers from overpriced settlement services. Settlement services encompass most of those items that buyers and sellers pay for at closing: loan origination, title and hazard insurance, and inspections.

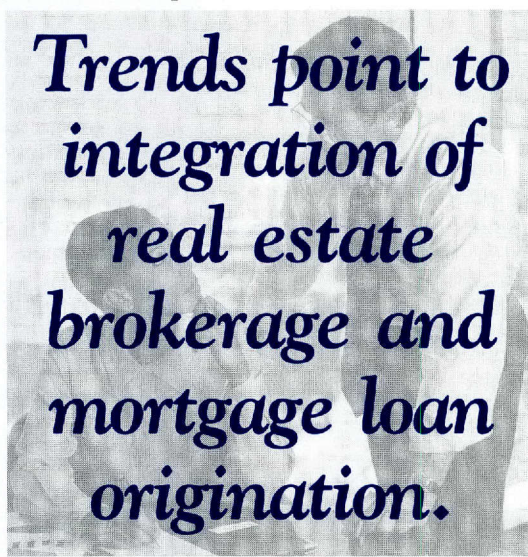
RESPA bans referral fees among service providers that may add to the cost of the service, and it requires disclosures of all fees and situations where the consumer might misconstrue the intent of a service provider. Unfortunately, the proliferation of disclosures and information provided to the consumer at closing has become confusing. The ban on referrals has hampered the development of arrangements designed to provide the consumer better access to information and to make the delivery of settlement services more convenient.

Consequently, there has been pressure to reform RESPA to allow the industry to develop further. Currently, there are efforts to clarify how fees may be earned, without violating the anti-kickback provisions of the law, and to package and price bundles of services that are advantageous to the consumer. In the forefront of this effort are the National Association of Realtors (NAR) and the Real Estate Services Providers Council, Inc. (RESPRO).

RESPRO, formed in 1992, is a nonprofit trade association dedicated to helping affiliated businesses make a reality of one-stop shopping in real estate. Members include broker-owners, mortgage lenders and brokers, title companies and insurance companies. The organization is a member (along with NAR) of the Mortgage Reform Working Group, a collection of settlement service representatives and public interest groups meeting since May 1997 to form a consensus approach to RESPA reform. RESPRO maintains a Web site at http://www.respro.org. A state chapter of RESPRO holds informative conferences throughout the year. For more information, contact chapter president Steven Smith (713-355-5626).

may avoid using them. Originating a loan is more than simply filling in and sending off an application form. It requires knowledge of the loan products available to the borrower and how to best match a borrower with the right loan. In addition, an agent must consider the potential liabilities from the Real Estate Settlement Procedures Act (RESPA) and Truth in Lending Act (TILA).

The agent also may need to learn how to operate specialized equipment, such as video conferencing terminals or computers. Most importantly, agents must have confidence that the service offered will be appealing and beneficial to the borrower and that it will result in a successful sale. Some agents may feel uncomfortable recommending a specific service if there is any semblance of a conflict of interest. If the agent has developed a good working relationship with an outside mortgage provider, it may be difficult to persuade that agent to use an in-house alternative.



As a result, one-stop shopping has grown only as the systems have become more attractive and easy for agents to use. One way to make the service more attractive is to allow the agent to share in any revenues produced. These revenues are derived from two sources: the consumer, in the form of fees for the service; and from lenders, who pay agents for acting, fully or in part, as loan officers. The problems with these payments is that they may run afoul of RESPA provisions.

RESPA was created to protect consumers from being overcharged when contracting for the services required to close a home purchase. Section 8 of RESPA bans the use of referral fees, or "kickbacks," between lenders and real estate agents because these fees may indicate that agents are being paid to do so, rather than because the lender is a superior source of financing. The advent of CLO systems has persuaded the Department of Housing and Urban Development (HUD), which enforces RESPA, to exempt certain types of referral fees from the ban.

In 1996, HUD made it clear that payment of fees to CLOs by consumers and lenders would not be considered a violation of RESPA if such fees were commensurate with services rendered to the consumer. Such services include: information on loan products, pre-qualification, comparison of current loan offerings, collection and submission of information for a loan application, loan processing and funding. Regardless of the range of services offered, a CLO that allows consumers to consider or apply for the products of only one lender may not be able to earn fees without violating RESPA.

Even when fees can be earned by agents, an on-site origination arrangement must be easy to use and sufficiently attractive to the consumer to overcome agents' resistance. The approach taken by several CLOs is to limit the agent's role to that of which most agents feel comfortable while leaving the more technical aspects to specialists. For example, Mortgage Quote Service, Inc. (MQS), a CLO headquartered in Houston, relies on the agent to introduce the service to the consumer, use specialized personal computer software to compare lenders' rates and products within the network, help the consumer decide on a mortgage product and begin the application process. From that point, a local loan officer completes the application and processes the loan. The system is provided free of charge to participating brokerage firms, yet that firm can share in as much as 20 percent of the lender's commission, depending on the amount of administrative services provided. The software developed by MQS may be installed on existing personal computers and accessed as easily as a Multiple Listing Service browser.

Another Houston-based CLO, Computer Loan Origination Systems, Inc., takes a similar approach by designating the agent a "mortgage service consultant." The agent earns an origination fee by helping the homebuyer choose a loan over the network. The CLO firm then processes the loan. Both CLO companies offer free agent training.

Video conferencing systems and in-house mortgage businesses rely on agents to introduce customers to the service. Once the consumer makes contact with a loan officer, either live or via video linkage, the real estate agent has no further obligation. Because agents provide no loan origination services, no compensation can be paid by the lender without violating RESPA.

An example of point-of-sale loan origination via video conferencing is the LoanMaker System developed by Virtual Mortgage Network. A dedicated computerized video linkage system is installed in the brokerage office. When the time comes for the consumer to arrange financing, the agent invites them to try out the system. Once the system is activated (to reduce computer phobia, the system uses an electronic notepad in lieu of a keyboard), the customer is guided through the process of finding and applying for a loan by a remote loan officer communicating over the system. The customer can see the officer as well as the on-screen presentation of loan options and application forms. In many cases, the customer can apply for a loan and receive a preliminary commitment in one session.

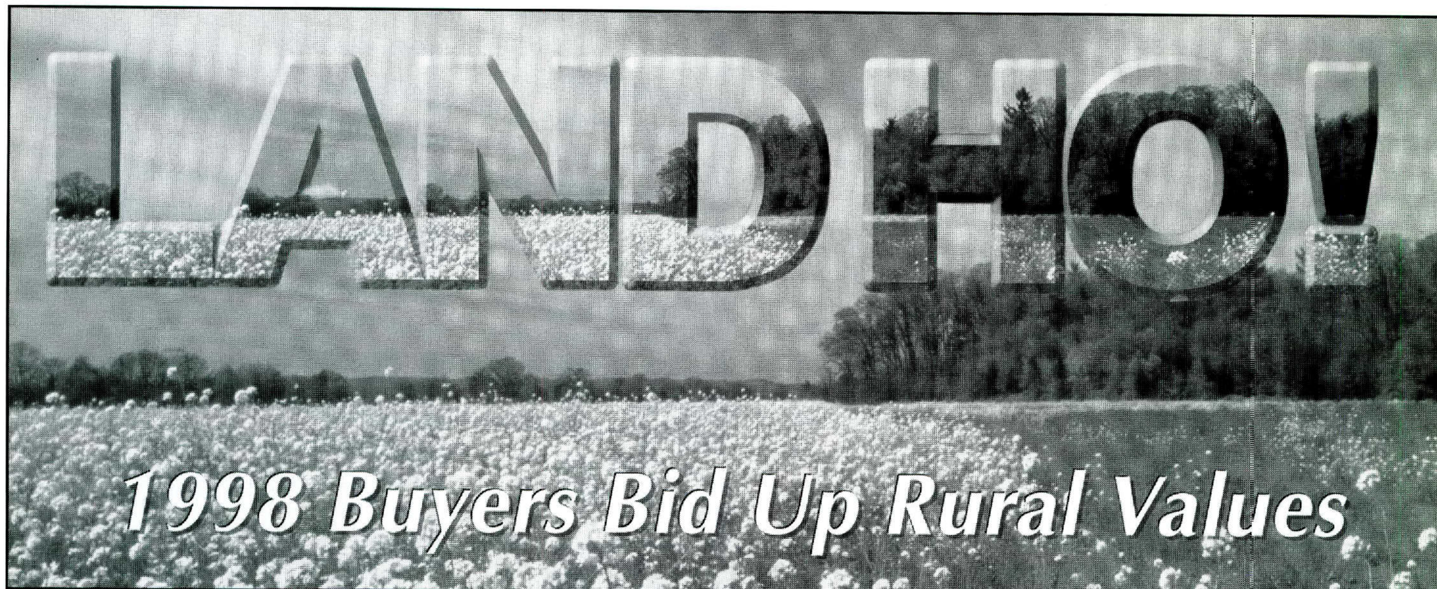
Video conferencing and CLOs attract agents and consumers through dazzling computer graphics and advanced electronic equipment. Rent-a-desk and joint venture arrangements that place a live loan officer on-site have the advantage of personal contact. Therefore, the loan officer must develop good relationships with agents and earn their trust. In his study of point-of-sale origination, Edwards found that many successful ventures accomplished this by hiring the best loan officers currently operating in the market. These professionals were known and trusted by the agents before being hired. Where that is not possible, it will be more challenging to win over agents from their accustomed financing sources.

What's Next?

Most industry trends point to some type of integration of real estate brokerage and mortgage loan origination. Will that mean the end of the traditional broker? Edwards feels that ample room will exist for those who wish to stick with what they do best—selling homes. Furthermore, the mortgage industry is making strides to expedite loan processing so that a broker does not necessarily need to use computerized systems to gain the advantages of speedier loan approvals. And, while large brokerage firms have embraced the one-stop-shopping concept, it has yet to be a proven success.

On the other hand, many broker-owners are discovering a need for additional profit sources. Expanding into services related to home buying is a logical step in this direction. The Edwards study reported that 46 percent of respondents stated they made more money per transaction from loan origination than from the brokerage commission. The technology to make these arrangements work is being perfected and, while there is some regulatory uncertainty, the sense of the law is clear enough to allow loan origination systems to develop.

Dr. Harris is a research economist for the Real Estate Center at Texas A&M University.



By Charles E. Gilliland

With business activity levels running high, Texas land markets continued to post strong results in the first months of 1998. Retail sales exceeded expectations, especially along the Mexico border. As homebuilding swings into high gear, lumber prices will likely increase and labor shortages will emerge. All of this activity continues to propel Texan's personal incomes to higher levels.

Contrasting this flush of prosperity, the petroleum industry recently endured weaker than expected sales because the mild winter depressed demand for heating oil, the Asian economic crisis reduced overall demand and OPEC countries increased their production. No clear-cut long-run trend in oil prices has emerged as OPEC seeks to control production to boost prices. Despite the uncertainty surrounding oil markets, most observers of the Texas economy remain optimistic about 1998 prospects. Considering strong current trends in leading economic indicators and the absence of inflation, the end of the current recovery appears to lie beyond the foreseeable horizon.

Adding to the sense of optimism, some economists suggest that current conditions reflect a permanent shift in the way the U.S. economy performs. Noting the wave of technological advancement adopted during the past two decades, these economists theorize that productivity gains from the computer-driven revolution may spell prosperity for the long term without igniting inflation.

Hot Real Estate Markets

These conditions contributed to feverish activity in general real estate markets throughout the state. Commercial rents ranged higher while developable land and lot prices moved up. This hectic pace has led to a shortage of skilled real estate employees leaving lenders, developers and other real estate professionals scrambling to meet demand for their services. Strong markets have spilled over into rural land markets in some areas. Although some participants and observers are cautious, Texas real estate markets should show continued strength in 1998.

New Farming Strategies

Because nonagricultural buyers dominate much of the Texas rural land market, rural land price trends directly parallel the nonfarm economy. However, larger properties and remote rural land prices are more responsive to changes in the agricultural economy. Currently, farmers are devising new strategies to deal with governmental policies designed to end payments to farmers. Consequently, old patterns of planting have faded as cotton farmers switched to corn and other commodities with lower production costs and higher profit margins.

Experts predict that total U.S. farm income will drop slightly in 1998 from the record highs registered in 1996 and 1997. However, the prospect of continuing growth in food exports should create a strong future for agriculture. Just as favorable conditions attracted producers to the 1997 land market, good operating conditions for most Texas farmers and ranchers should add to an overall bullish outlook for 1998 agricultural operations.

Cash Transactions Galore

Activity in 1997 Texas rural land markets matched the hectic pace reported in the urban real estate markets. Observers cited a multitude of cash transactions with many properties selling to developers. Some larger farms and ranches have been subdivided into smaller tracts for buyers willing to invest from $250,000 to $400,000. Observers reported divisions of large remote ranches into entire sections (640 acres) for resale. Few of the sales involved borrowing, but when buyers needed mortgage money, they turned most often to the Farm Credit Bank because few other lenders have ventured into the market.

Throughout Texas, 1997 buyers looked for quality and location above other property characteristics. However, some of the fragmentation resulting from subdivision of larger ranches has produced strains on the infrastructure of surrounding communities. If subdivision activity continues, it may spark demands for improved roads and schools.

In contrast to land markets in the 1970s and 1980s when legions of professionals invaded rural markets to invest in land, merchants and other businesspersons dominate among the current wave of buyers, bringing cash from businesses that have prospered in recent years. They often do not require mortgage funds, but many purchases involve a 1031 tax-free exchange. These buyers do not particularly care about availability of minerals, a marked change from the lackluster markets of the late 1980s when buyers insisted on obtaining some minerals. However, they are concerned about the availability of wildlife and the potential for establishing an effective game management program. This wave of demand has returned the market to price levels last seen in 1985.

Rural Land Outlook

Observers reported vigorous market activity in the autumn of 1997. The robust economy and two strong years of farm income fueled activity throughout Texas for both recreational and agricultural rural land.

Responses to a Real Estate Center fall survey indicated the following current typical prices and expected market trends for 1998.

Panhandle, South Plains and Rolling Plains (Land Market Areas 1-7)

Typical values of irrigated farmland in this region ranged from $490 to $700 per acre with the highest reported values in the far northern area of the Panhandle. Access to good water drives this market as strong demand for irrigated acreage propels land prices upward. Despite the many woes recited by agricultural observers, buyers continue to gobble up land in this area, prompting observers to predict up to as much as a 5 percent increase in irrigated land values during the next year.

Adding to the strength of markets in this area, retiring Conservation Reserve Program tracts are reentering the program at preferential rental rates. This has kept acreage from coming back onto the market and has contributed to the already short supply of land for sale. Reported ranch land values ranged from $50 per acre for sandy hills in the western Permian-West land market area to $265 in the rolling plains. Rising beef prices promise to boost prices in this area, leading observers to predict a 10 percent price rise in the Abilene area. Irrigated farmland and rangeland markets should remain steady or increase during the coming year.

Western and Southern Rangeland (Land Market Areas 8, 9, 10 and 11)

Strong prices for irrigated land emerged across this entire region with typical prices ranging from $750 to $1,150 per acre. Ranch land values varied from $60 per acre in the Trans Pecos area to $475 per acre in the southern reaches of the Edwards Plateau. Hunting has emerged as the primary driving force for much of this area with good quality property selling readily. In some areas, brush-covered hunting land commands higher prices than surrounding nonirrigated croplands. Prices in this market should remain steady or increase over the coming year with prices in some regions strongly rising.

North Central and Hill Country Ranching Areas (Land Market Areas 12, 14 and 15)

The highly-fragmented irrigated cropland in this region was valued around the $550 per acre range to the north and $1,200 per acre elsewhere. Typical ranch land in this region reportedly commanded values in the $325 to $600 per acre range. Observers expect irrigated cropland to remain steady or rise up to 5 percent in the Hill Country–North. Rangeland values should remain steady to rising between 5 and 8 percent in the southern reaches of the region.

North Texas Prairies (Land Market Areas 22, 23, 24 and 25)

Urban influences drive these markets with values of typical ranch lands ranging from $455 per acre in more remote areas to $2,500 per acre in the Fort Worth area. Fueled by the continuing nonfarm prosperity, these markets anticipate strongly rising land values in 1998, with typical estimates ranging between a 3 and 10 percent increase.

Central Texas Area (Land Market Areas 16, 17 18 and 26)

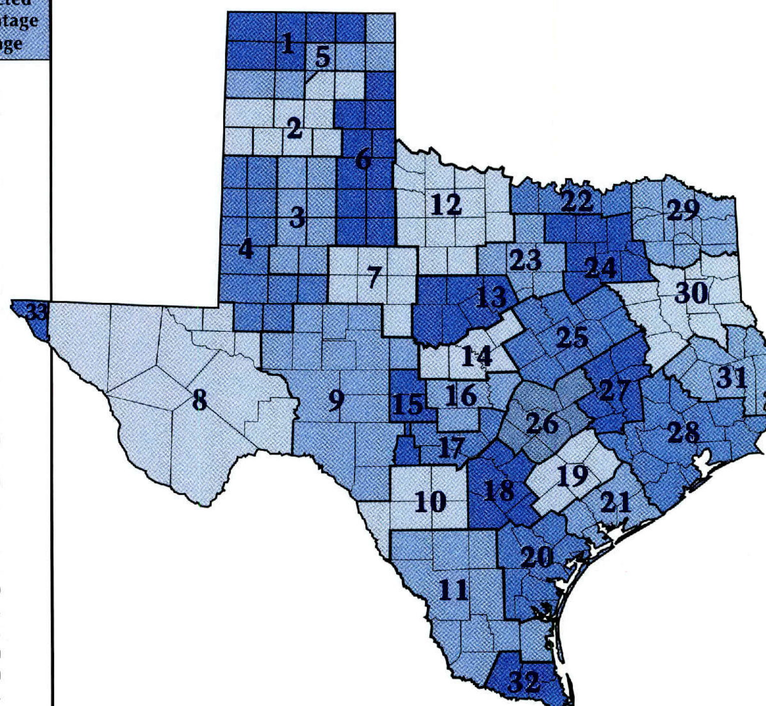
Strategically located near two major urban centers, markets in this scenic area posted strong gains in the past year and indications point to a strong 1998. Irrigated cropland is of limited scope and importance here. Typical acreage in the San Antonio region reportedly sells in the $1,000 per acre range. Ranchlands have enjoyed strong demand throughout this area as urban residents are willing to drive up to an hour or more to recreational properties.

The strong demand for scenic acreage in the northern reaches of this region resulted in an estimated $1,350 value

Texas Median Land Values
Fall 1997

Land Market Area	Rangeland Value Per Acre	Rangeland Projected Percentage Change	Irrigated Farmland Value Per Acre	Irrigated Farmland Projected Percentage Change
1 Panhandle–North	$150	0	$700	5
2 Panhandle–Central	150	0	500	0
3 South Plains	100	-	500	0
4 Permian–West	75	0	550	0
5 Canadian Breaks	150	0	500	0
6 Rolling Plains–North	150	0	550	0
7 Rolling Plains–Central	183	10	600	-
8 Trans-Pecos	-	-	-	-
9 Edwards Plateau–West	258	8	675	0
10 Edwards Plateau–South	475	4	975	0
11 Rio Grande Plains	475	0	1,150	0
12 North Central Plains	325	0	550	0
13 Crosstimbers	-	-	-	-
14 Hill Country–North	525	8	900	5
15 Hill Country–West	250	5	600	-
16 Highland Lakes	1,150	2	600	-
17 Hill Country–South	700	4	600	-
18 San Antonio	500	3	1,000	0
19 Coastal Prairie–North	-	5	650	5
20 Coastal Prairie–South	575	0	800	0
21 Coastal Prairie–Middle	700	5	650	5
22 Texoma	580	5	-	-
23 Fort Worth Prairie	-	-	-	-
24 Dallas Prairie	-	3	-	-
25 Blacklands–North	450	0	1,000	0
26 Blacklands–South	1,075	6	-	-
27 Brazos	800	3	1,200	5
28 Houston	-	0	450	0
29 North East	338	2	550	0
30 Piney Woods–North	-	-	-	-
31 Piney Woods–South	-	-	-	-
32 Lower Rio Grande Valley	700	10	1,100	0
33 El Paso	-	-	-	-

Texas Land Market Areas



Source: Real Estate Center at Texas A&M University

for a typical acre of Hill Country land. In the southern reaches, ranchland was reportedly valued in the $500 per acre range. Market participants are likely to find it difficult to locate quality properties for sale as supplies remain tight with demand strengthening. Therefore, rangeland values should climb from 2 to 6 percent in 1998 as urban incomes continue to grow.

Coastal Prairies (Land Market Areas 19, 20 and 21)

Agricultural producers in this area suffered through poor growing conditions during the past two seasons. Irrigated farmland typical values ranged from $650 to $800 per acre. Reflecting the poor crop conditions, these values barely exceed the typical ranchland values of $525 to $700 per acre. However, strengthening rice markets and a good spring have engendered optimism among farmers in this area. This situation has led observers to expect rising prices throughout much of the area, with projected stable-to-increasing prices, up as much as 5 percent in 1998.

Brazos, Houston and East Texas (Land Market Areas 27, 28, 29, 30 and 31)

These regions reflect influences from urban centers, timber producers and row-crop farming. The generally positive state of these factors has sparked widespread optimism. Supplies of quality land lag behind the strong demand for acreage. Properties are selling well. Look for cropland and rangeland prices to remain steady or increase by as much as 5 percent during 1998.

Lower Rio Grande Valley (Land Market Area 32)

A typical acre of irrigated cropland was valued at $1,100 per acre in the fall of 1997. However, Valley irrigated cropland faces an uncertain future as lingering effects of drought have brought Falcon and Amistad Reservoirs to low levels. Some farmers may even find it difficult to acquire enough water to last through the summer growing season. This persistent problem has dampened demand for irrigated cropland, at least temporarily.

Typical Valley rangeland is valued at $700 per acre and faces brighter short-term prospects. While irrigated cropland should see little or no price change in 1998, rangeland should increase in value by as much as 10 percent.

Land Markets Issues

Landowners have identified a series of legal or political issues that may present problems for future land markets. First,

Congress is struggling to renew the Endangered Species Act with its land use restrictions more or less intact. Landowners and potential land buyers view those restrictions as a source of uncertainty with regard to their ability to use and enjoy their land

Second, potential EPA moves to extend their authority over agricultural operations has become a concern. Third, the environmental treaty negotiated in Kyoto, Japan, calls for a dramatic reduction in pollution. Some agricultural interests have projected that it could impose severe cutbacks in agricultural fuel usage after the turn of the century. Current plans do not call for ratification, but agricultural leaders are expressing concern.

Property taxes surfaced repeatedly as a major issue throughout Texas. Concern about property taxes may reflect sizable boosts in tax rates as well as recomputed agricultural use values. This issue will likely wane as time passes unless the tax burden continues to escalate.

Water rights form another area of concern for all Texans. As plans for allocation and management of the Edwards Aquifer become clearer, an active market for water rights will probably appear. Observers have identified a number of transactions where rights to water have transferred without land. If this market matures, some irrigated land will become dryland as owners sell their water rights. In some locations, brush land values are approaching non-irrigated cropland values because of strong demand for hunting and recreation. Consequently, owners of this non-irrigated cropland may allow the surface to return to native brush.

Reflecting the distress in the lower Rio Grande Valley irrigated land markets, the specter of drought looms as the spring moves into summer. The painful 1995 bout of dry conditions remains a grim reminder of the havoc nature can visit on farm and ranch lands. Further, previous El Nino weather patterns have been followed by drought in the midwest. The dry conditions of 1995 may have left some areas especially vulnerable to a reemergence of a rainless summer.

Despite this litany of concerns, the fundamentals remain in place for Texas land markets to move upward in 1998 and in the foreseeable future. Market observers and participants remain optimistic about prospects for strengthening land values.

Dr. Gilliland is research economist with the Real Estate Center at Texas A&M University.

Riding the West Texas Techno Wave

Midland an Island in a Sea of Oil and Gas

By Mark G. Dotzour and Chris Price

Midland is referred to locally as "Tall City." At one time, it had the tallest building between Dallas and Los Angeles. Today, Midland's economic stature stands tall, fueled by increased oil and gas-related activities in the Permian Basin. Enhanced technology in both exploration and production have lowered the cost of finding and producing oil and gas. The number of operating oil-gas rigs in Texas has increased substantially since 1995, and Midland has participated in the industry upswing.

During the past few years, the Midland economy has improved significantly, and local employment has been on the rise. The Midland-Odessa metropolitan statistical area posted an average annual 1990-97 growth rate of approximately 1.4 percent. The first-quarter 1998 Manpower survey indicates that the Midland labor market will continue growing as long as local employers are positive about hiring potential. The survey reported that 43 percent of local employers planned to hire additional workers in the second quarter, and only 3 percent planned reductions. On the national level, 30 percent of companies surveyed anticipated increases in their workforce and 5 percent expected decreases.

Approximately 5,300 more jobs exist today in the Midland-Odessa MSA than one year ago—a 5.3 percent increase. The construction sector had the largest job increase, 17.3 percent, a clear signal of increased real estate demand. Also posting significant growth numbers were oil and gas (7.1 percent) and the service industry (6.8 percent).

Population is on the rise in Midland. The current population, 98,045, is expected to top the 100,000 mark by 2000, as estimated by the city's engineering and development department. That would be an 11.8 percent increase from the 1990 census of 89,443.

Local home sales are at the highest level since 1990, and the boom should continue through 1998. Contributing to the recent upswing are low interest rates, the bullish stock market and stable oil prices. Local real estate professionals are reporting low inventories and high demand spurred from a growing retirement community, the normal oil company transfers and an increasing number of diversified industries coming into the area. Much of the growth in new housing development is focused in the west and northwest quadrants. City officials say that water and sewer facilities are adequate to support future growth.

A large tract has been purchased in the northeast with plans to develop a 55-acre lake and build as many as 1,500 homes in an upscale waterfront development. However, a timetable for this project has not been announced.

Similar to many Texas cities, Midland had high levels of apartment construction in the early 1980s. From 1980-83, nearly 6,000 apartment unit building permits were issued in Midland County. The subsequent downturn in the oil and gas sector reduced apartment demand and absorption. Consequently, no new apartment communities have been built in Midland for nearly 15 years. However, the city council recently approved plans for a 288-unit luxury apartment development in the northwest part of the city.

Midland has had substantial retail development in recent years. Much of this activity has been in the northwest quadrant to support new growth in that area. In addition, Midland serves as a retail hub for smaller communities in the region.

The office market is concentrated in two areas: the central business district and a north central office park near the Midland Airpark. A significant amount of office space is available for lease in class A, B and C buildings. Class A rental rates are currently quoted in the $8 – $10 per square foot range, according to Keith Barlow of Barlow Appraisal Associates. The amount of contiguous space available at low rental rates creates an attractive opportunity for future economic development in the community.

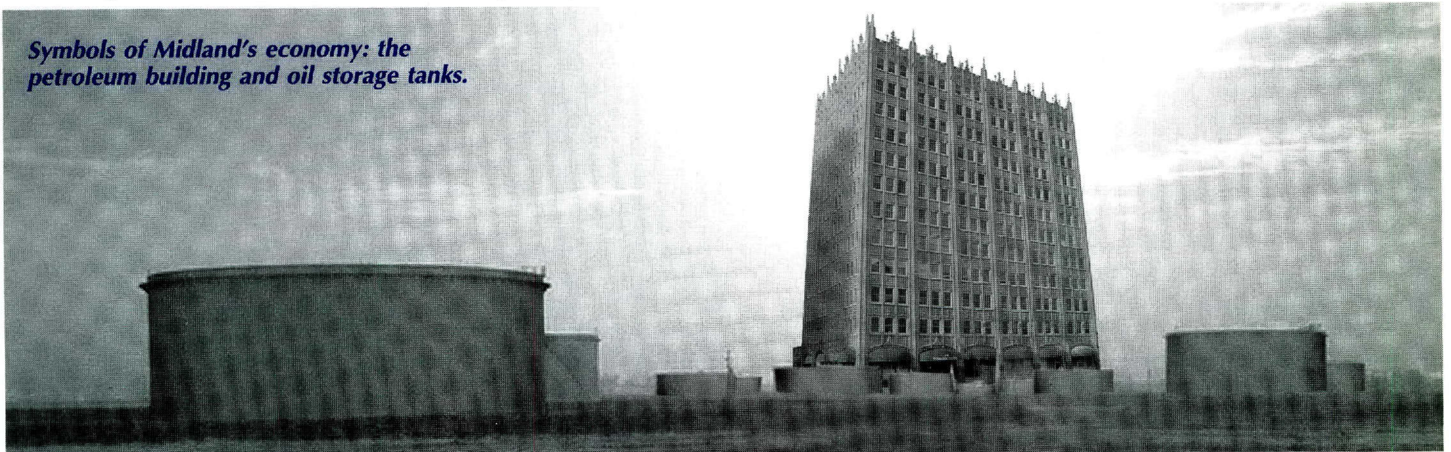
Midland has some significant proposed and ongoing projects that will boost the area's economy. The new terminal at the Midland International Airport is scheduled for completion in early 1999. Revitalization efforts include the construction of Centennial Plaza, a new park for downtown events.

A tentative agreement reached recently between the Colorado River Municipal Water District and the Lower Colorado River Authority will allow more water to be held in West Texas reservoirs. This will assure Midland and other area municipalities of more water security into the future.

The proposed La Entrada al Pacifico corridor is a highway linking the Mexican Pacific port city of Topolobampo and the industrial city of Chihuchua with a Texas border crossing at Presidio. If completed, it is expected to pass through Midland-Odessa and connect to major markets in the United States.

The overall economic outlook for Midland is strong. The city will always be heavily involved in the oil and gas business, but continued diversification and area development will help smooth out the local business cycle and spawn new growth.

Dr. Dotzour is chief economist and Price is a graduate assistant for the Real Estate Center at Texas A&M University.



Symbols of Midland's economy: the petroleum building and oil storage tanks.

Amarillo: High Plains Hub

By Mark G. Dotzour and Joshua N. Hulen

No, Amarillo is not the birthplace of Oprah Winfrey. She just happened to broadcast her show from Amarillo for a month in the spring, bringing an economic mini-boom to local retailers, lodging and restaurants.

Amarillo is the hub of the Texas beef cattle industry. More than 88 percent of all beef consumed in the state is raised in surrounding Panhandle counties. Natural gas also is a vital component of the local economy because the city is located near the massive Hugoton gas fields. The only remaining helium plant in the United States is north of town near Masterson. Another major employer is Pantex, which is busy disassembling nuclear weapons.

The city is strategically located for shipping and transportation. Not only does Amarillo benefit from the intersection of I-27 and I-40, it also serves as a rail hub for Burlington Northern Sante Fe. Amarillo's economy is benefiting from diversification, as it continues to develop into the center for retail, medical, manufacturing and other services for a five-state region.

The growth of the economy and a receptive business climate have not gone unnoticed around the state and nation. A Dun and Bradstreet study published in *Entrepreneur* magazine rated Amarillo as the number one mid-sized city in the United States in which to own a business. Texas Business rated Amarillo as having the best pro-business climate in the state, and ranked it third for business relocations and expansions.

Employment trends also have been favorable. Total Amarillo employment increased 2.9 percent in March 1998 from the previous year. Unemployment, 5.2 percent in 1990, dropped to 2.9 percent in 1997. Service employment was the fastest growing sector with 4.8 percent growth, followed by construction, finance, insurance and real estate sectors with growth rates of 4.3 percent each.

Job creation has grown by 20 percent in the last seven years, and the most recent Manpower employment survey indicates that job prospects for the next fiscal quarter look positive. The survey indicates that 20 percent of employers planned to hire additional workers while only 6 percent planned to decrease their workforce. On the national level, 30 percent of companies planned to increase hirings and 5 percent expected decreases.

The Amarillo population has grown with the economy. In 1970, census figures indicated that the city's population was 144,369. In 1997, the population reached 206,878—an annual growth rate of more than 1.5 percent.

Local home sales soared to more than $180 million in 1997, the highest figure in two decades. Another robust year is expected for 1998. Realtors report low inventories and an increase in the number of building permits issued for single-family residences. Most of the residential and retail growth is located in the city's south and southwest quadrants. City officials indicate that water and sewer utilities are sufficient to support continued growth in the community.

As in many Texas cities, apartment construction in Amarillo peaked in the early '80s but halted after the petroleum and ranching markets crashed. Following a 15-year lapse in new apartment construction, a 208-unit complex was built in 1997. According to city planning officials, city-wide occupancy at the end of 1997 was 89 percent, and the average rental rate was $403 for all apartments. Projections for 1998 indicate that vacant property absorption should continue as population growth continues.

The Amarillo retail market was strong in 1997. More than 100,000 square feet of vacant space was absorbed, bringing the city-wide occupancy rate to 92 percent, the highest in 12 years, says Bill Davis of Coldwell Banker Commercial Realty. Rental rates for Class A space range from $8 - $12 per square foot, and local Realtors predict rates will remain fairly stable into the near future. No multi-tenant construction occurred in 1997; however, the outlook for 1998 looks much different. More than 140,000 square feet of retail space is slated for development in the southwest and northwest quadrants, with an additional 500,000 square feet of new construction possible later this year.

The office market remains stable with modest growth in the past several years. According to Steve Rogers with the Steve Rogers Company, the central business district was at an 88 percent occupancy rate in 1997 with rents ranging from $8 - $12 per square foot. Suburban properties posted a higher occupancy rate of 93 percent with rents at similar levels to those in the CBD. The suburban market is primarily located along I-40, west of the CBD and in the southwest quadrant. Occupancy rates for 1997 office properties grew for the fourth consecutive year with the market improving by approximately 4 percent. Rental rates are expected to remain stable until higher occupancy levels are achieved.

Some bright prospects exist for continued growth of the Amarillo economy. The renovation of the Amarillo International Airport, continued development of one of the nation's largest natural gas fields and the relocation of several large national corporations have all proven to be economic opportunities for the city. With the continuing expansion of the Amarillo's economic base and attractive business environment, the prospects for the future are increasingly positive.

Information about employment, housing sales, median prices of housing and building permit activity in Amarillo can be found and downloaded from the Real Estate Center Website at http://recenter.tamu.edu.

Dr. Dotzour is chief economist and Hulen is a graduate research assistant for the Real Estate Center at Texas A&M University.

REITs Red Hot or Just Overheated?

Current Successes Spawn Fears of Another Real Estate Collapse

By Wayne E. Etter

After more than a decade of relative obscurity, real estate investment trusts (REITs) began their climb to renewed national financial prominence in 1992. REITs have raised—and continue to raise—substantial amounts of capital to acquire existing properties and to finance the development of new properties. Some in the real estate industry are wondering whether this activity will lead to overbuilding and another real estate collapse. Such concern is reasonable for those who recall the REIT problems of the 1970s and the general overbuilding in many real estate markets in the 1980s.

What are REITs?

REITs are corporations or business trusts that are managed by boards of directors or trustees. Their shares are fully transferable, and they must have a minimum of 100 shareholders; no more than 50 percent of a REIT's shares can be held by five or fewer individuals during the last half of each taxable year. When institutions own REIT shares, the institutions' beneficiaries are considered the owners of those shares rather than the institution.

REITs must invest at least 75 percent of their total assets in real estate, and they must derive 75 percent of their gross income from real property rent or interest from real estate mortgages. No more than 30 percent of their gross income can be derived from the sale of real property held for less than four years. REITs do not pay corporate taxes if 95 percent of their portfolio income is passed through to shareholders.

REITs are usually described as equity REITs, mortgage REITs and hybrid REITs. Equity REITs own real estate and, therefore, rent is their primary source of revenue. Because equity REITs usually limit their investments to properties in a particular industry or to a particular property type, they are further classified by their investment specialization. Mortgage REITs make real estate loans and earn interest. Hybrid REITs combine the activities of equity and mortgage REITs.

REITs are similar to stock mutual funds; individuals and institutional investors purchase shares that represent an undivided interest in the properties owned by the REIT. Because REIT shares can be traded, they are highly liquid, particularly when compared to direct ownership of real estate or to the partnership interests owned by many real estate investors during the 1980s.

According to the National Association of Real Estate Investment Trusts (NAREIT), there are more than 300 REITs in the United States. Currently, 147 REITs are traded on the New York Stock Exchange, 42 are traded on the American Stock Exchange and 12 are traded by members of the NASDAQ National Market System. Some REITs, however, are privately owned by institutional investors and are not publicly registered or traded.

A Recent History

An explosion of REIT activity has occurred in the last several years. They have become a major source of funding for the real estate industry as shown by the rapid increase in security offerings (see table). Initial equity offerings are shares sold by new REITs; secondary offerings are additional shares sold by existing REITs.

According to NAREIT, the total dollar value of 318 REIT equity offerings during 1997 was approximately $32.6 billion. The table shows annual total equity offerings by REITs were more than $4 billion in only two years between 1982 and 1992. From 1993 to 1996, there was a substantial increase in REITs' total equity offerings, averaging more than $11 billion per year. Nevertheless, the 1997 equity offerings were nearly triple the average amount for the preceding four years and about double the amount of total equity offerings for the entire 1982-92 period.

The number of equity security offerings by REITs for the period is also reported in the table. As was noted for the dollar amount, 1993 to the present is significantly different from 1982-92. The average annual number of equity security offerings for the former period was 25.5; for the latter period, the average was 110.8. But in 1997, there were 318 offerings. Of particular interest is the large number of initial equity offerings in 1993 and 1994. Each initial equity offering represents the formation of a new REIT. Thus, there were 259 REITs formed during the entire period between 1982 and 1997, and 95 of them were formed in 1993 and 1994.

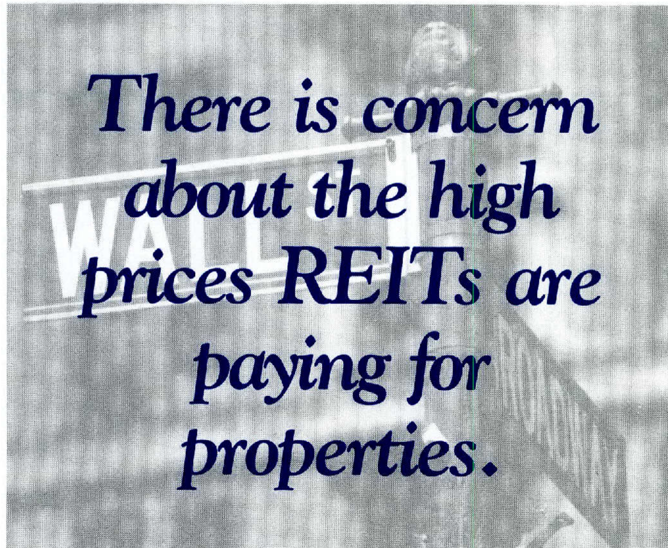
Reasons for Rapid Growth

Several explanations exist for the dramatic growth of REITs in recent years. Initially, they became popular with individual investors because their cash yield was attractive. Declining interest rates made REIT shares attractive, compared to certificates of deposits issued by financial institutions. Rather than replace maturing higher yield CDs with lower yield CDs, some investors bought REIT shares, without regard for the possible risk differences between CDs and REIT shares.

These investors saw opportunity in the depressed commercial real estate markets of the early 1990s. For example, a number of lending institutions were selling distressed properties from their portfolios at prices reported to be as much as 50 percent less than their original valuation. Some REITs, the so-called "bottom fishers," were organized to buy distressed properties. This made it possible for small investors to participate in a market from which they would have been excluded otherwise.

The increasing popularity of REITs caused the creation of new REITs and the expansion of existing ones. The combination of increased demand for REIT shares and the extended economic expansion of the 1990s has resulted in increasing prices for commercial property in the cities where REITs are active.

Developers who needed cash in the early 1990s to pay debts on already-developed properties and to undertake new developments took advantage of the demand for REIT shares by organizing REITs or by trading their properties to existing REITs. This provided developers with the capital for new development at a time when there were few other available sources.



These activities were particularly profitable for the REIT sponsors in the early stages of the economic recovery, as investors were willing to accept yields on their REIT shares that were considerably lower than the yield on the property. Consequently, a property yielding a 10 percent cash return could be purchased for the portfolio, using funds obtained from the sale of REIT shares equity that were sold with a 6 percent dividend yield.

All of this activity made REITs popular with Wall Street firms because REITs provided profitable business for their underwriting departments as well as saleable product.

Pension funds became REIT investors as a result of the Revenue Reconciliation Act of 1993. Prior to the act, a REIT's income was taxable if, during the last one-half of its tax year, more than 50 percent of the value of the REIT was owned by five or fewer individuals. This requirement made it difficult for pension funds to make large dollar investments in a single REIT. However, this restriction was, for all practical purposes, eliminated by the Revenue Reconciliation Act. Since December 31, 1993, REIT shares have been considered to be owned by the institution's beneficiaries rather than the institution. Pension funds became immediate participants in the REIT market. Many of these investors swapped major properties for REIT shares.

REITs in the 1970s

Initial legislation that made REITs possible was passed in 1960. During their first few years, they primarily raised equity funds and purchased income-producing properties. However, a surge of REIT activity in the early 1970s resulted in a major financial crisis. How did this come about?

The rising development activity of the early 1970s presented what appeared to be an extraordinary opportunity for the industry. Because of increasing demand for construction financing by real estate developers, many REITs became construction lenders. New REITs were created for this purpose; some were created by commercial banks to provide construction financing for projects that could not meet the banks' legal lending requirements.

After issuing their initial shares, many REITs that provided construction financing did not raise additional funds in the equity market. Instead, they borrowed short-term funds from commercial banks and in the commercial paper market. This financial leverage allowed the REITs to maximize their earnings and dividends.

Unfortunately, many REITs that financed construction loans paid little attention to the properties' income-producing potential or to the likelihood of their sale when completed. Often, developers' loan requests for the speculative properties were supported by appraisals that justified the loan amount, but the question of assessing the properties' market demand was not considered. Usually, it was assumed that the properties could be rented or sold at the rate or price necessary to make them a success.

Because of the spread between their borrowing and lending rate, REITs were profitable and grew rapidly. The profit potential made it difficult for them to decline developers' proposals, no matter how poorly designed the project was or how much market demand existed for the property. In some cases, the initial construction loan amount was inadequate to complete the property, and additional funds had to be advanced. Some unfinished properties were not worth finishing, and these were a complete loss for the REITs.

As the industry expanded, the supply of unfinished properties and poorly designed and constructed properties increased. Permanent financing could not be arranged for these properties and developers could not repay their construction loans to the REITs. Eventually, the REITs could not meet their payments on their maturing short-term loans and commercial paper. With widespread defaults imminent, the Federal Reserve Bank encouraged commercial banks to provide REITs the funds necessary to avoid a major financial crisis.

REITs: The Present

REITs of the 1990s differ from those of the 1970s, both in terms of their source of funds and in the types of investments

Almost any failure to meet the expected earnings goal results in Wall Street's downgrading a firm's investment attractiveness.

Offerings of Securities by Real Estate Investment Trusts
1982-97

Year	All Offerings		Total Equity		Initial Equity		Secondary Equity		Unsecured Debt		Mortgage-Backed	
	Number	Total ($ Mil)	Number	Total ($ Mil)	Number	Total ($ Mil)	Number	Total ($ Mil)	Number	Total ($ Mil)	Number	Total ($ Mil)
1982	9	435.1	8	430.1	3	315.0	5	115.1	1	5.0	0	0
1983	23	747.0	19	597.0	4	159.0	15	438.0	4	150.0	0	0
1984	18	1,438.4	14	313.4	6	140.4	8	173.0	4	1,125.0	0	0
1985	59	4,270.6	46	3,204.6	29	2,791.9	17	412.7	12	939.0	1	127.0
1986	63	4,668.9	37	1,828.1	20	1,204.4	17	623.7	5	315.9	21	2,524.0
1987	50	2,929.2	27	1,367.4	12	634.4	15	733.0	4	248.0	19	1,313.0
1988	37	3,068.7	26	2,159.2	13	1,374.2	13	785.0	6	335.3	5	574.0
1989	34	2,440.8	26	1,796.6	11	1,074.5	15	722.1	3	150.0	5	494.0
1990	24	1,765.2	18	1,271.2	10	882.0	8	389.2	4	294.0	2	200.0
1991	35	2,288.6	28	1,594.6	8	808.4	20	786.2	3	169.0	4	525.0
1992	57	6,515.1	32	1,973.7	8	919.2	24	1,054.5	9	819.6	16	3,721.0
1993	141	18,326.6	100	13,191.7	50	9,335.4	50	3,856.3	18	1,352.6	23	3,782.0
1994	145	14,721.0	97	11,120.3	45	7,175.8	52	3,944.5	26	2,093.8	22	1,506.0
1995	195	12,493.4	101	8,260.7	8	939.3	93	7,321.4	73	3,444.0	21	788.0
1996	225	17,455.8	145	12,308.7	6	1,107.8	139	11,200.9	76	4,753.9	4	327.0
1997	463	45,270.9	318	32,674.1	26	6,296.5	292	26,377.6	134	10,568.2	11	2,028.0

Source: NAREIT ONLINE, The National Association of Real Estate Investment Trusts

that they make. Currently, a major difference is their use of debt. The REITs of the 1970s were fueled almost exclusively by debt as they borrowed short-term funds at rates lower than they charged for longer-term loans. Their principal source of income was the rate spread between short-term rates and their lending rates. When they were unable to collect interest from their borrowers, they faced default. Equity is the primary source of funds for the REITs of the 1990s. If they are unable to collect the amount of rent and interest that they expect, their dividends will fall and stock prices will decline, but they will not default.

The nature of REITs' current investments is another important difference. Because the REITs of the 1970s had to charge high rates to be profitable, they were forced to finance proposed property developments that were rejected by lenders with lower costs of funds. Accordingly, their portfolios contained many risky properties. In contrast, 1990s REITs have, for the most part, purchased completed properties, many of them at prices below their replacement cost. As the tenant demand for these properties has grown, their rental revenue and value have increased as well.

REITs: The Future

One definite concern for most publicly-traded firms, including REITs, is Wall Street's incessant demand for earnings growth. Almost any failure to meet the expected earnings goal results in Wall Street's downgrading a firm's attractiveness as an investment. Usually when this occurs, the company's stock price falls, and the firm's stockholders lose wealth. Unless the firm's earnings growth is resumed, the firm's managers may lose their jobs. What problems do REIT managers face as they attempt to maintain earnings growth?

Most corporations achieve growth over time by reinvesting their earnings rather than paying them out to shareholders. REITs, however, must pass through 95 percent of their portfolio income to their shareholders to avoid being taxed. For a REIT to grow, it must sell additional shares. Usually, raising new capital is more costly than using retained earnings.

While the principal source of capital for REITs has been and continues to be equity funds, the data in the table indicate an increase in the use of debt by REITs. The proper use of debt can enhance the shareholders' benefits and enables the acquisition of additional properties.

In the past, much of the REIT growth came from purchasing properties at low prices. As the commercial real estate market has improved, values have increased. The supply of quality properties available at low prices has likely been consumed. New acquisitions will have a more limited potential for appreciation. Further, there are a limited number of suitable properties for REITs to buy, and many of these are already in the hands of REITs. As a result, REITs are developing properties for their portfolios in the search for high levels of earnings growth.

Increasing the income from currently-owned properties is an ongoing goal of REITS. This can be accomplished by increasing rents and reducing operating expenses, as the market allows. They also can achieve some economies of scale in the management of their properties' operating expenses. While a poorly managed property's profitability can be improved when placed under good management, income growth potential has obvious limits. Once an acquired property has been fully leased at the current market rent, further increases will be determined by normal supply and demand interactions.

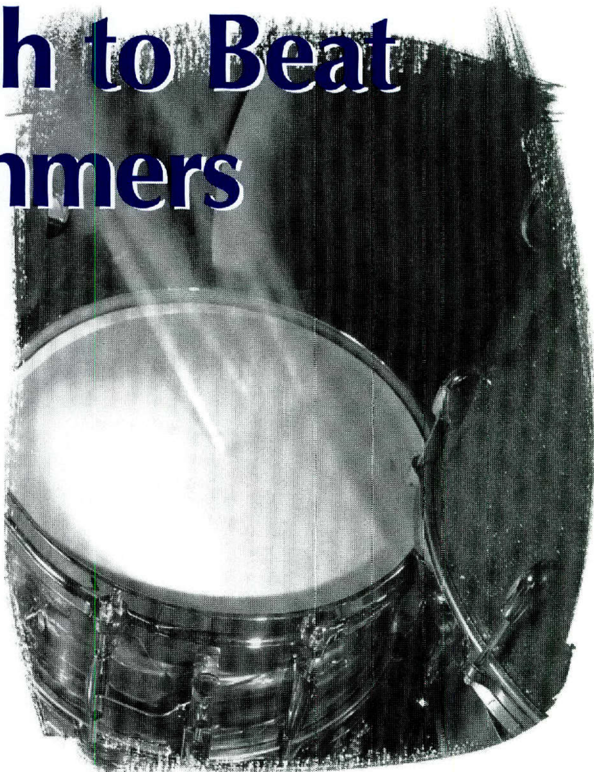
There is concern about the high prices that REITs are paying for properties. In some cases, they have driven other buyers from the market. If these properties perform as the REITs expect, the higher prices should not pose a problem. However, if the properties perform poorly because of supply and demand conditions within a particular market, the expected return will not be achieved, the shareholders will be disappointed and the REITs' share prices will decline.

In evaluating this concern, two points need to be considered. First, REITs are closely monitored by financial analysts. These specialists, employed by mutual funds and pension funds that invest in REIT shares and by investment brokerage firms, are concerned with the quality of REIT portfolios. A negative report by these "watchdogs" will have an adverse effect on a REIT's share price, a consequence that REITs will want to avoid by making sound portfolio acquisitions. Second, REITs have a lower cost of capital than many other real estate investors. This characteristic, which enables them to pay a higher price for real estate than other investors can, will be examined in a future issue. 田

Dr. Etter is a professor with the Real Estate Center and of finance at Texas A&M University. Matthew Sawyer, a graduate student in the Lowry Mays College and Graduate School of Business, assisted with the preparation of this article.

Texas Cities March to Beat of Different Drummers

By Jared E. Hazleton



A former colleague, Dr. Ted Jones, was fond of saying, "The only real estate for which the slogan 'build it and they will come' works is Aggie Bonfire." We all need to be reminded from time to time that it is job growth that primarily fuels real estate development.

The Texas Workforce Commission's revised nonfarm employment numbers for the past two years provide a useful picture of the jobs being added, both across the sectors of the economy and regions of the state, and help explain why some areas have strong construction activity.

Last year, average Texas payroll employment rose 4.2 percent from the prior year's level, compared to a gain of only 2.3 percent for the nation as a whole. In both the state and the nation, jobs were added in every sector of the economy.

Manufacturing employment in Texas increased 2.4 percent, compared to only 0.4 percent for the United States. All of the job gain came in durable goods (those industries producing goods that are expected to last more than one year) while nondurable goods production recorded a slight loss in employment.

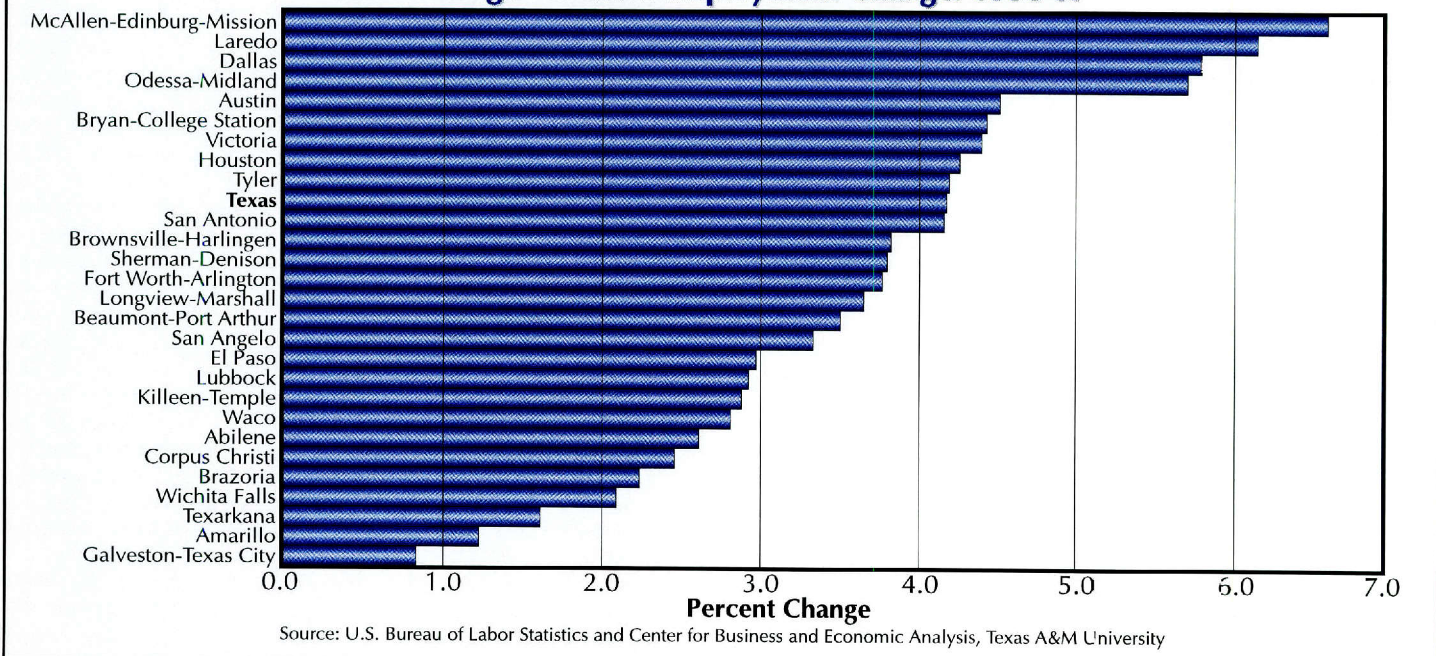
Perhaps the greatest surprise among the state's employment numbers is the strong rebound in the energy sector. Despite sagging oil prices, Texas mining employment rose 5.7 percent last year. How can the industry not only survive but apparently prosper on $16-to-$18-a-barrel oil? The answer may be found in major technological improvements that have lowered the cost of finding and producing petroleum and natural gas.

Above-average population growth, fed not only by natural increase (that is, births minus deaths) but also by inmigration to many areas of the state, helped fuel solid job growth in construction (+5.1 percent), transportation and public utilities (+4.8 percent), trade (+3.0 percent), finance, insurance, real estate (+4.1 percent) and services (+7.3 percent). The growth in services employment is particularly exceptional because the nation in general had only a 3.5 percent rise in jobs in this sector.

On the other hand, the public sector managed only a 1.7 percent job growth in the state with virtually all of that growth coming at the local level. The rise in local government employment occurred mostly in the public schools, in response to rising school enrollments.

It is difficult to speak of a "Texas" economy these days. Different parts of the state march to the beat of different drummers.

Last year, the Lower Rio Grande Valley led the state in job growth, largely because of the strong recovery of the Mexican economy in the aftermath of the 1994 devaluation of the peso. Those cities most closely linked with the



Source: U.S. Bureau of Labor Statistics and Center for Business and Economic Analysis, Texas A&M University

Mexican economy, McAllen-Edinburg-Mission and Laredo posted the highest job growth, 6.6 percent and 6.2 percent, respectively. The Brownsville-Harlingen and El Paso areas, on the other hand, managed employment gains of only 3.8 percent and 3.0 percent, respectively, reflecting the fact that they are less integrated with Mexico than their neighbors.

Anchored at the southern end by Laredo, the I-35 growth corridor bisects the state. While the Austin economy cooled a bit in 1997 after leading in employment gains in 1995 and 1996, the capital city still managed a 4.5 percent job increase. The well-diversified Dallas economy did even better, registering a 5.8 percent employment increase last year. San Antonio managed to match the overall state job growth of 4.2 percent, despite the closure of Kelly Air Force Base.

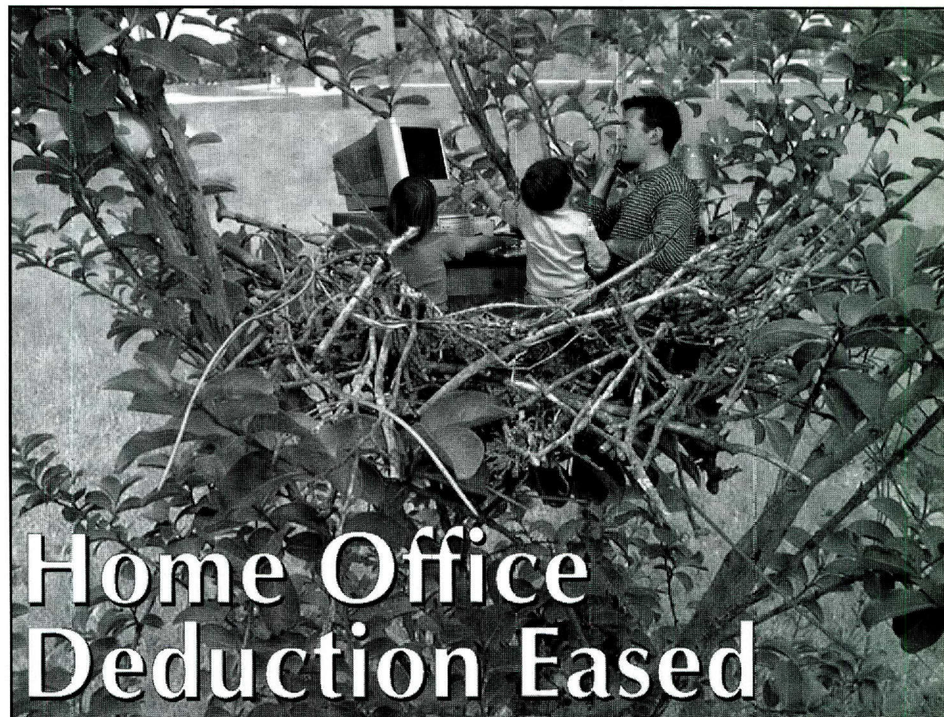
Houston has lagged other major Texas cities in job growth during recent years. But in 1997, nonfarm employment gains in the bayou city totaled 4.3 percent, thanks not only to improvement in the energy sector but also growth in nonenergy sectors, particularly in manufacturing and services. Other areas benefiting from above-average job growth last year included cities as diverse as Odessa-Midland, Bryan-College Station, Victoria and Tyler.

Some of the state's metropolitan areas with slow job growth in 1997 were hard hit by cutbacks in defense spending. These included Texarkana, Wichita Falls and Lubbock. Galveston-Texas City had the unenviable distinction of lagging all other areas of the state in job growth last year but still managed to eke out a 0.8 percent gain.

While Texas has been leading the nation in job growth for most of the last ten years, it is useful to keep these relative gains in perspective. In 1982, Texas accounted for nearly 7.5 percent of the nation's total output and about 7.0 percent of its employment. By 1987, after the plunge in oil prices and the resulting savings and loan and real estate crises, the Lone Star State's share of both national output and employment had fallen to about 6.5 percent.

Today, the state's share of national output and employment is about 7 percent. A decade of above-average growth was needed to bring Texas back to where it was in the early 1980s in terms of employment, but it has not yet regained its 7.5 percent share of national output. That time may come soon, however, if the state continues to record above-average balanced growth as it has in recent years.

Dr. Hazleton is a research fellow with the Real Estate Center and director of the Center for Business and Economic Analysis at Texas A&M University.



Home Office Deduction Eased

By Jerrold J. Stern

Starting in 1999, it will be easier for taxpayers to deduct the cost of a home office. To qualify for deduction, the office must be used exclusively and on a regular basis for either the entire business or just its administrative and management activities.

The "management" provision was added by the 1997 tax act. It enables a home office deduction to be available for any trade or business of the taxpayer as long as there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business. The deduction is not harmed if some administrative or management activities (e.g., billing) are performed by others at different locations.

Offices must be used exclusively and regularly for the entire business or just its administration and management.

Even if the taxpayer also carries out administrative or management activities at sites that are not fixed locations of the business, such as a car or hotel room, the taxpayer's ability to claim a home office deduction is not affected as long as the activities are not "substantial." In addition, a taxpayer's eligibility to claim a home office deduction will not be affected by the fact that the taxpayer conducts substantial nonadministrative or nonmanagement business activities at a fixed location of the business outside the home (e.g., meeting with, or providing services to, customers, clients or patients).

A home office deduction is comprised mainly of depreciation, utilities and insurance. For example, if a home has 2,500 square feet and the room used as an office is 250 square feet, then 10 percent of the utilities and insurance is deductible. The office depreciation deduction is 10 percent of the amount that would be a depreciation deduction if the entire home were being depreciated for tax purposes. Supplies and other expenses directly related to the home office are fully deductible.

An alternative measure of the home office percentage is based on the number of rooms in the house regardless of square

footage. Thus, if a home office is one of five rooms, then under this measure 20 percent is the home office percentage for computing deductible utilities, insurance and depreciation.

Property taxes and interest are deductible in full (assuming income is not so high as to phase out some of the taxpayer's deduction) regardless of whether the taxpayer has a home office. However, the basic local telephone service charge, including taxes, for the first telephone line into a home is a nondeductible personal expense. Yet, charges for business long-distance phone calls on that line, as well as the cost of a second line into the home used exclusively for business, are deductible business expenses even if you do not qualify for a home office deduction.

A home office deduction ($10,000, for example) cannot exceed the amount of income ($8,000, for example) produced by the home office activity. If the deduction exceeds income, the excess portion ($2,000, or $10,000 minus $8,000) cannot be taken as a deduction in the current tax year but can be deducted in the future against home office income.

These rules apply to self-employed taxpayers, such as real estate salespersons. However, rules for employees include an additional "convenience of the employer" test. If an employer provides access to suitable space on the employer's premises for the conduct by an employee of particular duties, then, the employee cannot have a home office for tax purposes regardless of the amount of time the employee spends in the home office. Thus, employees who opt to conduct duties at home as a matter of personal preference, rather than out of necessity, are not entitled to a home office deduction.

A potential indirect benefit of the home office deduction is that it enables the taxpayer to have deductible business mileage at 32.5 cents per mile for all auto travel to and from the home and other business locations. Thus, if a salesperson travels a total of 100 miles from home to various locations and then back home, a $32.50 deduction is generated (assuming the home is the taxpayer's principal place of business).

IRS publication 587, "Business Use of Your Home," is accessible from the Web (www.ustreas.gov). For instance, it describes how taxable gain typically results when selling a home for which home office depreciation was deducted. It provides further explanation and examples of home office rules. For specific advice, consultation with an accountant or attorney is recommended.

Dr. Stern is a research fellow with the Real Estate Center at Texas A&M University and a professor of accounting in the Kelley School of Business at Indiana University.

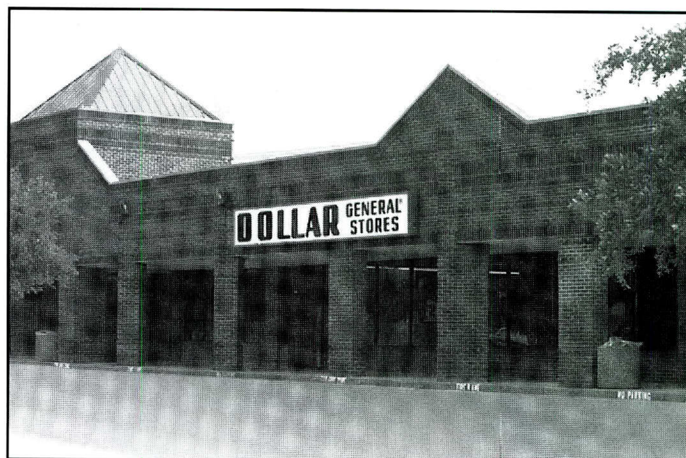
Retail Styles: They are A-Changin'

By Mark G. Dotzour and Mimi Mize

Just as fashion trends change on a continual basis, the retail real estate marketplace is constantly evolving. Property managers and retail investors must be aware of happenings in the retail environment so they can best evaluate the tenant mix of shopping centers. There are many changes currently buffeting the retail sector.

Convenience Discount Stores

Convenience discount stores are once again big business. Dollar General, the fastest-growing U.S. retailer, plans to open as many as 500 stores this year alone. They expect to double the number of stores in their Southeast, Midwest and Southwest market within the next five years. Dollar General focuses on establishing small stores close to the center of town, targeting lower-income families with annual earnings of less than $25,000.



Family Dollar is another rapidly-growing competitor. Strong results announced by retail discounters suggest that lower-income shoppers, who make up a large percentage of the stores' customers, are earning more money than in the past.

Wal-Mart's Response

In response to the success of the fast-growing convenience discounters, Wal-Mart announced plans to test the appeal of much smaller stores, 40,000 square feet, compared to their standard size of approximately 92,000 square feet. Prototype stores will be constructed in Springdale, Sherwood and Bentonville, Arkansas. They are expected to carry a limited selection of groceries and general merchandise, as well as operate drive-through pharmacies.

Meanwhile, Wal-Mart is not deserting their big stores, as they are opening 50 traditional discount stores, ten warehouse clubs and more than 100 supercenters nationally. Toys R US, Inc., another big box retailer, proposes to add 15 new stores in 1998.

Casual attire is gaining popularity in the workplace, and this has increased the growth of U.S. apparel sales. Cashing in on the trend, Nine West Group Inc. plans to convert their stores to "integrated accessory stores" by selling a new jewelry line, sunglasses, leather jackets and eventually clothes. The Limited Inc. also is restructuring. The company will close 200 under-performing stores in their women's apparel chains of The Limited, Lerner, Lane Bryant and Express. In addition, Limited Inc. will close the 118-store Cacique lingerie chain.

Things are changing in the shoe industry as well. "Brown shoes," leather hiking boots and walking shoes, are becoming more popular with the younger buyers who have traditionally driven the footwear market. Brown shoe sales comprise 10 percent of the athletic footwear market and are growing. This trend has reduced demand for sneakers, and Nike announced it would layoff 3.5 percent of its domestic workforce or approximately 450 employees. Woolworth, a major player in the sneaker industry, has unveiled a new company name to escape its five-and-dime image. They will be called Venator Group.

Auto Superstores

Auto superstores are running into some consumer resistance, their greatest obstacle being the nonnegotiable sticker price. A study of superstores by J.D. Power and Associates found customers like the fancy showrooms and customer service but not the higher prices.

With 18 stores, CarMax has yet to post a year-end profit. However, they plan to operate as many as 80 stores by the end of 2001. AutoNation USA has

26 stores, with eight additional stores to be opened this year instead of the 18 planned originally. Driver's Mart Worldwide is a third competitor in this sector with 12 franchised stores.

Musical Instruments

The music business has officially entered into the world of "big box retail" with two major players. Guitar Center, a Sunset Boulevard native since 1964, has 38 stores; it proposes to open eight more this year. The stores are 12,000 to 15,000 square feet, more than four times the size of an average music store. Their strategy is to steal market share from the 6,500 mom and pop stores that have dominated the music business for decades.

The idea of a big box music store is not new. In 1995, Mark Begelman opened MARS (Music & Recording Superstore), and in the past ten months he has opened nine additional MARS stores, each one twice the size of a Guitar Center. Their goal is to operate 60 superstores of 35,000 to 40,000 square feet.

Industry-wide guitar sales increased by merely 1 percent in 1996, and results were expected to remain flat for 1997. The entire musical instrument industry is expected to grow by only 2 percent in 1998.

Movie Theater Mergers

A proposed merger between Cineplex Odeon Corp. and Sony Corp.'s Loew's Theaters Exhibition Group may result in the closing of many under-performing theaters or those in overlapping locations, according to a draft SEC document.

The draft also emphasized the new company would be especially inclined to close older, obsolete locations. Prior to the merger, the two companies had plans to open approximately 480 screens in 31 locations in the next two years.

Mall Ownership Consolidates

TrizecHahn Corp. is selling 20 of its retail malls to Westfield Co. and Rouse Co., 13 and seven respectively. Retail property giants, like Westfield and Rouse, are consolidating the ownership of the nation's malls in an effort to increase returns through economies of scale.

Another approach to increasing mall returns, incorporating elements of entertainment and recreational sports, is being planned for Newark and Columbus, NJ by the duo of Glimcher Realty Trust and Michael Ovitz, former Hollywood superagents. ◘

Dotzour is chief economist and Mize is a graduate student with the Real Estate Center at Texas A&M University.

Concentration Game

Nearly 20 Million Players — And More Make A Move Each Day

By Steve H. Murdock

People continue moving to Texas in large numbers, but a smaller percentage is moving from other states. There are several theories why this is happening. It may be in response to new immigration laws that increase the percentage of foreign-born residents. Perhaps it is the result of a stronger California economy that has reduced the number of residents seeking work in Texas. Or, the shift may signal the beginning of a slowdown in population growth. Whatever the reason, the socioeconomic effects have already begun.

The most recent population estimates for July 1, 1997, show Texas among the nation's fastest-growing states. These data, together with those released earlier, however, suggest that such growth is concentrated in the largest cities and that domestic inmigration of persons from other states to Texas is the most important for real estate.

The latest numbers show Texas' population to be more than 19.4 million. This is an increase of nearly 2.5 million, or 14.4 percent, since the April 1990 census. More recently, the state's population increased by 348,000 from 1996 to 1997. This increase is like adding a city the size of Austin (in 1980) to the state's population in a single year. The 2.5 million increase is roughly equivalent to adding cities the size of Houston and San Antonio to Texas' population in just seven years.

Texas' 1990-97 numerical increase was the second largest of any state. Only California grew faster. In addition, Texas showed the eighth largest percentage increase. For 1990-96, Dallas-Fort Worth and Houston-Galveston-Brazoria had the third and fourth largest numerical increases among U.S. metropolitan areas (behind Los Angeles and Atlanta), adding more than 537,000 and 522,000 respectively.

Texas had the second, third, seventh and tenth fastest-growing metropolitan areas, in percentage terms, in the nation from 1990 to 1996. Laredo has increased in population by 32.7 percent, McAllen-

Edinburg-Mission 29.2 percent, Austin-San Marcos 23.1 percent and Brownsville-Harlingen-San Benito 21.1 percent.

Texas' population growth is extensive. The latest data suggest, however, that the sources of Texas population growth may be changing.

The role of **natural increase** in the determination of Texas' growth remained relatively stable during the 1990s, adding between a 185,000 and 192,000 Texans per year. **Domestic inmigration** to Texas reached its maximum in 1994-95 when it was more than 88,000—25 percent of the state's population increase; it decreased to roughly 56,000, or 16 percent of all population growth in 1996-97.

On the other hand, **international immigration** was at its lowest level from 1994 to 1995 when it was slightly less than 78,000 persons (22.1 percent of the population growth). It increased substantially to more than 101,000 (29.1 percent of population growth) in 1996-97.

Population growth is occurring in a majority of Texas counties. Texas State Data Center estimates show that 215 counties had 1990-96 population increases compared to 156 counties in 1980-90. However, population growth is heavily concentrated. According to census bureau estimates, 24 counties had 80 percent of the state's 1990-96 population increase. Harris, Dallas, Tarrant, Bexar, Hidalgo, Collin, Travis and El Paso counties gained the most.

More than 80 percent of the state's 1990-96 natural increase occurred in 16 counties. Seven counties had more than 80 percent of the state's domestic inmigration, and 12 counties accounted for 80 percent of the 1990-97 international immigration.

Overall, data suggest that Texas' population growth is substantial, and the state is among the most rapidly growing states in the nation this decade. Its relatively high level of natural increase promises continued growth. However, that growth may be changing and becoming more concentrated in a relatively small number of Texas counties. Although any set of estimates must be carefully analyzed, these estimates suggest that domestic inmigration, which provides an important stimulus for residential real estate demand, is slowing and becoming more concentrated in the largest Texas cities. Such patterns clearly warrant careful monitoring by real estate professionals. ⊞

Murdock is a research fellow with the Real Estate Center at Texas A&M University and chief demographer of the Texas State Data Center, Department of Rural Sociology, at Texas A&M University.

BENCHMARKS

(continued from p. 1)

that the option lacked consideration. Unless independent consideration is paid for the option, the contract is revocable during its term.

Thus, a nonrefundable sum is necessary to make the option enforceable. Accordingly, the promulgated forms provide that if the buyer elects to terminate the contract, the earnest money, but not the option fee, will be refunded.

As to the minimum amount necessary for the option, the U.S. Supreme Court in *Davis v. Wells Fargo Co.*, wrote, "A stipulation in consideration of one dollar is just as effectual and valuable consideration as a larger sum stipulated for or paid." The Texas Supreme Court ruled in *National Oil & Pipe Line Co. v. Teel*, "Whether the recital of 'one dollar'—commonly called nominal consideration—is sufficient to support the contracts, we need not discuss, though there is very high authority (citing the *Davis* case) for holding that such recital is sufficient for the purpose."

Thus, nominal consideration is sufficient for an enforceable option as long as it cannot be refunded. ⊞

Coping With Condemnation

What Rights Do Texans Have?

By Judon Fambrough

Condemnation is the right to take private property for public use. *Eminent domain* is the power to take private property for a public purpose. Only entities with the power of eminent domain can condemn property. The following quiz tests how much is known about the process. The questions come from the Real Estate Center report *Understanding the Condemnation Process in Texas*, publication No. 394. The answers are on page 24.

	True	False	
1.	❑	❑	Before a court can be petitioned to condemn land, the condemnor must make a bona fide effort to purchase the property.
2.	❑	❑	The location of an easement sought for condemnation is basically left to the discretion of the condemnor.
3.	❑	❑	If only a portion of a property is to be condemned, the condemnor must pay only fair market value for the part taken.
4.	❑	❑	Texas courts have held that it is within the realm of public use to condemn homes within a city to expand the parking lot of a shopping mall.
5.	❑	❑	Landowners (condemnees) must hire an attorney to represent them before the special commissioners.
6.	❑	❑	Once the special commissioners reach a decision and post the award, the condemnor may take possession of the land and begin construction even though the landowner appeals the decision.
7.	❑	❑	The condemnor cannot enter the property to survey until the special commissioners post the award.
8.	❑	❑	The market value of the land being condemned is determined solely by the current use of the property.
9.	❑	❑	Only when a condemnation is appealed beyond the special commissioners can the issues of public use and public necessity be addressed.
10.	❑	❑	If the landowner hires an attorney and convinces the court that the condemnor's offer was less than fair market value, the landowner can recover the additional compensation plus attorney fees.

Fambrough is an attorney, member of the State Bar of Texas, senior lecturer with the Real Estate Center at Texas A&M University and author of Understanding the Condemnation Process in Texas.

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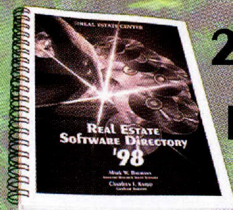

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