REAL ESTATE CENTER
Solutions Through Research

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Special Report

Real Estate Review and Outlook 1992

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The Real Estate Center was created in 1971 by the Texas Legislature and placed at Texas A&M University.

The Center conducts a comprehensive program of research and education to meet the needs of many audiences, including the real estate industry, instructors and the general public.

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Summary

- The Texas economy is expected to rebound slowly in 1992, but this forecast is based largely on improvement in the national economy.
- Construction activity slackened in 1991, mainly because of slowdowns in most nonresidential sectors and flat residential activity.
- Although prices showed signs of rising, home sales volume maintained the pace set in 1990.
- During the past five years, the mortgage banking industry has become the dominant originator of conventional home loans in Texas. Because of this, mortgage credit has remained available despite the problems of the thrift industry.
- Although rural land values appear to have bottomed out, no imminent recovery is foreseen.
- Recent actions by the Texas legislature are expected to have an adverse impact on real estate, including a significant reduction in the number of licensees and greater tax burdens on homeowners.
- Both the Texas and national economic recoveries seem timid. One reason is that a fundamental, post-Cold War restructuring is superimposed on the business cycle. Thus, the economy is not only recovering but changing as well. Because Texas underwent recession much earlier, it is ahead in both the cycle and transition process. Business planning for the recovery should recognize that many past policies will be inappropriate in the future.

This annual publication offers the views of Center researchers and administrators on current trends and implications for the near future. These ideas are not based on econometric models or statistical techniques but are derived from reviews of data trends and the results of individual studies on more specific aspects of the industry. The main purpose of the publication is to clarify the information at hand and to provide the reader with some ideas to consider when planning for the new year.

Texas Economy

Texas fared much better than the nation during the recent recession in terms of both employment and output. The state was virtually unaffected by the national downturn as it began in late 1990. However, during early 1991, growth in the state's economy stalled. Growth subsequently picked up as the nation's economy improved, but the pace was noticeably slower.

The pace of job growth in the U.S. economy began to decline in late 1989 and early 1990. At the same time, Texas was adding jobs at an increasing rate. While the rate of employment growth in the state peaked in July 1990, it remained positive throughout the remainder of the year and continued to exceed overall growth in the United States.

As in the nation at large, much of the growth in Texas output during the past two years has resulted from rising exports. Texas accounts for nearly 9 percent of U.S. exports, and the state experienced rising exports in the first half of 1991.

Oil and gas exercise a modest but diminishing influence on the Texas economy, accounting for approximately 10 percent of overall economic activity. The rig count peaked in December 1990 and has fallen steadily throughout 1991. The decline resulted from depressed natural gas prices, as well as sharply decreased horizontal drilling.

The Texas economy is expected to rebound slowly in 1992 (Table 1). The Center for Business and Economic Analysis projects that the state's personal income will increase gradually through the year. The total for 1991 is estimated to be 4.7 percent higher than for 1990 and should rise another 5.5 percent in 1992. However, these forecasts are predicated on continued improvement in the national economy.

Reflecting the impact of the national recession, nonfarm employment rose by only 1.5 percent in 1991. The hardest hit sector was manufacturing, where the collapse of natural gas prices and cutbacks in defense spending caused a 1 percent decline in the number of jobs. While the sector will continue to be weak in 1992, the national recovery, should it materialize, would enable the state to

Table 1. Economic Trends and Forecast for Texas

	1990	1991	1992
State			
Personal income ($ billion)	$ 284.7	$ 298.0	$ 314.4
% change	8.0	4.7	5.5
Nonfarm employment (000)	7,032	7,138	7,281
% change	2.8	1.5	2.0
Unemployment rate (%)	6.2	6.3	5.9
Oil price ($/barrel)	$ 20.65	$ 21.76	$ 22.75
Natural gas price ($/mcf)	$ 2.00	$ 1.66	$ 1.95
Drilling rigs count	340	316	331
Local nonfarm employment (000)			
Austin	377.3	383.2	391.4
Dallas-Fort Worth	1,961.2	1,961.5	1,981.5
Houston	1,596.5	1,636.0	1,678.9
San Antonio	520.6	521.3	529.3
Local employment growth (%)			
Austin	5.5	1.6	2.7
Dallas-Fort Worth	7.4	0.0	1.0
Houston	7.9	2.5	2.6
San Antonio	7.1	0.1	1.5

Source: Center for Business and Economic Analysis, Texas A&M University

post a 2 percent gain overall in employment, an increase of 144,000 jobs compared to 1991.

The state's unemployment rate should decline gradually during the next two years, reaching 5.9 percent on average during the last half of 1992. Oil and gas prices appeared to be firming in late 1991. Prices are expected to improve with oil averaging $22.75 per barrel and gas selling for just under $2 per million cubic feet. The number of drilling rigs should reflect these upward price movements.

Houston led the state in job creation in 1991, although the national recession began to take a toll in mid-year. Growth is expected to resume in 1992, but the outlook varies by sector. Refining and petrochemicals appear to be peaking, and the recovery in oil and gas has slowed. On the other hand, construction is rebounding and services, particularly business services, continues to be strong.

Defense cutbacks and belt-tightening among high tech firms have depleted manufacturing jobs in Austin and Dallas-Fort Worth. Unfortunately, other sectors have suffered as well, so that these cities' diversified economic bases have not provided much protection. Construction and retail trade in the metroplex have stagnated, while Austin's government sector has leveled off in the face of the state's fiscal problems. Projected employment growth in Dallas-Fort Worth will be slow as manufacturing continues to stall. Austin's outlook is a bit brighter and its growth rate is expected to be in line with the state total.

After a year of almost no growth, San Antonio's economy is expected to improve slightly in 1992. Optimism is conditioned on improvement in the national economy, which would boost the city's flagging tourist industry. The prospect of increasing trade with Mexico could also provide needed stimulus to the area.

Construction

Overall, 1991 was a year when construction activity appeared to take a breather after showing signs of recovery in 1990 (Table 2). Residential construction was flat while nonresidential permits dropped significantly. The number of dwelling units slipped slightly, but higher costs resulted in total dollar volume about the same as the previous year. Most of the slippage was in the multifamily sector, which seemed to stabilize after nearly doubling the year before.

Among nonresidential sectors, industrial development continued a major decline from the peak in 1989. Office construction basically returned to the level of activity in 1989 following a substantial increase in 1990. The most positive note came from the retail sector, which continued to expand steadily through 1991.

Table 2. Authorized Construction in Texas
(Percentage Change in Parentheses)

	1989	1990		1991*	
Permits, dollar volume (millions)					
Total	$ 6,343	$ 6,258	(-1)	$ 5,550	(-11)
Residential	3,439	3,879	(+13)	3,880	(0)
Single-family	3,315	3,652	(+10)	3,640	(0)
Multifamily	124	227	(+83)	240	(+6)
Nonresidential	2,904	2,379	(-18)	1,670	(-30)
Hotel/Motel	70	30	(-57)	50	(+67)
Industrial	1,300	321	(-75)	190	(-41)
Hospital	178	122	(-32)	40	(-67)
Office	374	593	(+85)	380	(-36)
Education	61	107	(+75)	80	(-25)
Retail	$ 494	$ 536	(+ 8)	$ 570	(+6)
Dwelling units					
Total	41,314	47,195	(+14)	45,200	(-4)
Single-family	36,658	38,233	(+ 4)	37,500	(-2)
Multifamily	4,656	8,962	(+92)	7,700	(-14)

*Projected from first nine months' data.
Source: Real Estate Center at Texas A&M University

The growth in retail construction reflects a restructuring of this economic sector. Emphasis on new types of commercial establishments and shopping centers, such as discount retailing, changes the nature of the facility needed and mandates some new building. In addition, grocery supermarkets have expanded significantly in the state during the past several years.

Extensive industrial expansion in 1989 represented more than one third of nonresidential permit volume for the year, resulting in unusually high figures for nonresidential activity. This rate of industrial development was not maintained the following year. Rises in the office, education and retail sectors in 1990 failed to offset fully the receding pace of new industrial projects. In 1991, few sectors showed increases, while industrial building continued to slacken. Therefore, slowing industrial building, which may reflect weaker national markets or merely signal that manufacturing firms have all the capacity they need for now, is the reason for the two-year decline in nonresidential permits.

Among local residential markets, the two largest, Dallas and Houston, were mildly expansive, while many on the top ten list issued a lower volume of permits in 1991 (Table 3). The exceptions were Austin and San Antonio, both of which enjoyed double-digit growth during the year. The increases were almost totally in the single-family sector and are indicative of the strengthening housing markets in each city.

Local nonresidential activity mirrored the statewide experience of significant decline, indicating the widespread nature of the trend (Table 4). The sectors responsible for the declines were offices (Dallas, Austin and El Paso), industrial (Fort Worth and Galveston) and retail (Galveston and El Paso). On the up side, Houston and Beaumont-Port Arthur benefited from strong industrial and office sectors, and McAllen expanded its office and retail sectors.

Markets

While average prices for homes firmed in 1991, sales volume stayed the same as in 1990 (Table 5). The market appears to be growing out of the distressed-sale buyers' market of the past several years. Indeed, listing inventories are down in many areas.

The mortgage markets provide both good and bad news. Interest rates are lower than they have been for many years. On the other hand, qualifying requirements are tougher. Furthermore, the options that served first-time buyers so well in past years are less attractive. Substantial changes in the way Federal Housing Administration (FHA) insurance is priced make low down payment loans less available, while the retraction of savings and loan associations (S&Ls) from the mortgage market has

Table 3. Ten Most Active Texas Markets, 1991*
Residential Authorized Construction

Rank	Area	Dollars (millions)	Percent Change	1990 Rank
1	Dallas	$1,270	+3	1
2	Houston	1,080	+8	2
3	Fort Worth	490	-8	3
4	Austin	280	+23	4
5	San Antonio	140	+32	5
6	Galveston	90	-14	6
7	El Paso	80	-22	7
8	Brazoria	70	-7	8
9	McAllen	44	-28	9
10	Lubbock	37	-5	11

*Projection based on first nine months' data.
Source: Real Estate Center at Texas A&M University

Table 4. Ten Most Active Texas Markets, 1991*
Nonresidential Authorized Construction

Rank	Area	Dollars (millions)	Percent Change	1990 Rank
1	Houston	$390	+22	3
2	Dallas	290	-55	1
3	Fort Worth	170	-50	2
4	San Antonio	120	-17	5
5	Austin	100	-32	4
6	El Paso	43	-43	7
7	McAllen	40	+11	10
8	Brazoria	36	-22	9
9	Galveston	28	-73	6
10	Beaumont	26	+18	11

*Projection based on first nine months' data.
Source: Real Estate Center at Texas A&M University

made adjustable rate mortgages (ARMs) with deeply discounted first-year rates more difficult to find.

This situation may explain the lack of growth in sales volume and increase in average price. Fewer first-time buyers would constrain market growth, both directly and indirectly, by making it more difficult for repeat buyers to sell their current residence. Because first-time buyers generally purchase less expensive homes, a shift to more repeat buyers in the mix of sales would cause the average sales price to increase.

At the same time, these trends could indicate the end of the long buyers' market that has prevailed in most Texas cities. Inventories in many areas are tightening and fewer outright bargains seem to be available. Prospective buyers may take evidence of firming prices as a signal for action. Conversely, sellers must present their homes in the best light for sale if they want to minimize time on the market and obtain the best price.

Houston and Dallas continue to rank prominently among cities favored for real estate investment. In national surveys of top investment markets, Houston is ranked second by Arthur Anderson Real Estate Services Group, tenth by Ernst and Young and eighth by the Real Estate Research Corporation, while Dallas-Fort Worth takes the third, seventh and seventh positions, respectively. In addition, Ernst and Young considers

Table 5. Housing Sales through Texas Multiple Listing Services

Year	Dollar Volume (millions)	Percent Change	Number Sold (thousands)	Percent Change	Mean Price ($)	Percent Change
1981	$5,526	3	79.8	-9	$69,256	13
1982	5,224	-5	68.6	-14	76,198	10
1983	7,224	38	85.2	24	84,755	11
1984	8,184	13	90.7	6	90,279	7
1985	8,227	1	88.1	-3	93,385	3
1986	7,317	-11	81.2	-8	90,166	-3
1987	7,621	4	85.5	5	89,178	-1
1988	7,641	0	90.8	6	84,152	-6
1989	7,814	2	88.0	-3	88,806	6
1990	8,309	8	96.0	9	86,559	-3
1991*	8,602	4	96.0	0	89,600	4

*Totals for 1991 estimated from first nine months' data.
Source: Real Estate Center at Texas A&M University

Table 6. Most Active Local Housing Markets in Texas (Number of Homes Sold)

1991 Rank	Area	Sales 1990	Sales 1991*	Percent Change	1990 Rank
1	Houston	32,605	32,000	-2	1
2	Dallas	17,528	17,000	-3	2
3	Austin	7,012	7,300	4	3
4	San Antonio	6,342	6,400	1	4
5	El Paso	4,611	4,100	-11	5
6	Northeast Tarrant County	3,177	3,800	20	7
7	Fort Worth	3,349	3,200	-4	6
8	Arlington	2,549	2,700	6	8
9	Corpus Christi	1,773	2,000	13	9
10	Lubbock	1,670	1,720	3	12

*Projected from first nine months' data.
Source: Real Estate Center at Texas A&M University

these cities the two most undervalued commercial property markets in the country.

At the same time, Texas-style recessions are threatening both the East and West Coasts. Those sagging markets may funnel more investors into Texas as an attractive alternative. On the other hand, the experience may merely discourage investment in real estate generally. At least the threat of dumping by the Resolution Trust Corporation (RTC) seems to be passing, even as the agency has enjoyed increased success in working down its inventories. Overall, the high rating provided by national real estate consulting firms may instill encouragement in mainstream investors.

Finance

In recent years, Texas homebuyers have become increasingly dependent on mortgage bankers for financing. Table 8 shows how mortgage companies have taken over the market for conventional loans, even to the point of being the top originators of ARMs, once a specialty of S&Ls. Considering the problems of S&Ls during this time, the trend is not surprising. Federal reform efforts have reduced both the number of operating associations and the

Table 7. Highest Priced Local Housing Markets in Texas (Mean Price of Homes Sold)

1991 Rank	Area	Mean Prices 1990	Mean Prices 1991*	Percent Change	1990 Rank
1	Northeast Tarrant County	$111,403	$106,100	-5	1
2	Irving	108,104	98,200	-9	2
3	Dallas	104,307	96,000	-6	3
4	Houston	90,678	92,600	2	5
5	Austin	87,564	89,800	3	6
6	Arlington	93,080	88,300	-5	4
7	Corpus Christi	71,745	81,000	13	12
8	Fort Worth	76,384	80,400	5	9
9	San Antonio	79,303	79,700	1	7
10	Bryan-College Station	70,931	79,500	12	13

*Projected from first nine months' data.
Source: Real Estate Center at Texas A&M University

Table 8. Conventional Mortgage Loans Originated by Texas Lenders (First Five Working Days of the Month)

	S&Ls		Mortgage Bankers		Commercial Banks	
Year	Number	Percent of Total	Number	Percent of total	Number	Percent of total
			Fixed Rate Mortgages			
1986	2,474	39	3,597	56	318	5
1987	1,867	26	5,078	71	198	3
1988	2,036	26	5,645	73	76	1
1989	1,090	21	4,153	79	30	1
1990	1,635	17	7,965	83	50	1
1991*	1,280	19	5,606	81	4	0
			Adjustable Rate Mortgages			
1986	1,196	73	330	20	115	7
1987	1,048	55	812	43	46	2
1988	1,030	43	1,316	55	36	2
1989	686	74	185	20	50	5
1990	346	48	371	52	0	0
1991*	181	30	423	70	0	0

*Total for the first nine months.
Source: Office of Trust Supervision

lending capacity of each association. Perhaps more unexpected is the virtual disappearance of commercial banks from the field.

Fortunately for homebuyers in the state, the mortgage banking industry has been able to fill the void, thanks largely to the continuing development of the secondary mortgage market. Future availability of home loans will depend on the ability of the secondary market to absorb more product.

Much of the demand for mortgage securities in the past has come from lending institutions themselves. It became popular to swap whole loans in portfolio for securities to improve liquidity. However, in an effort to increase the ratio of tangible capital to assets, S&Ls have been forced to sell off securities, creating a glut on the market. If the capital markets fail to take up this slack, a shortage of funds for home loans may develop. Of some relief is the apparent easing of federal regulators' efforts to enforce asset write-downs on associations and banks. There may be some leeway for the institutions to return to lending. In addition, the RTC is becoming more active in financing purchases from its inventory of homes targeted to lower-income buyers.

Despite lower interest rates and home prices, first-time buyers apparently still face significant obstacles. Much of the problem comes from a mortgage lending industry that has had to reduce its exposure to default risk after years of record foreclosure rates. Deposit-based lenders have been forced to abide by stricter regulations on the risks they may accept. Secondary market purchasers of ARMs have restricted the use of discounted first-year terms as means for qualifying buyers with marginal income. Reform has made the use of FHA insurance more costly, thus restricting the usefulness of the program for cash-poor buyers. On the other hand, the RTC is making available both homes and financing for moderate income buyers and Fannie Mae has sponsored programs whereby buyers may supplement their down payments from a number of sources. However, the challenge for the home mortgage industry is to devise policies that make homeownership accessible to a broad range of households without inviting financial irresponsibility.

Possibly because of economic uncertainty or the increasing maturity of the population, homebuyers appear to be getting more conservative in their financing choices. Fewer borrowers are willing to take on the risks of ARMs, even though ARM borrowers have enjoyed declining payment burdens for a number of years, as Figure 1 shows (there is less advantage in an ARM when fixed rates are so low). Loans with relatively short maturities continue to gain popularity. The reduced amount of interest paid during the term is the advantage of these loans. If buyers are becoming more conservative, this would be consistent with the declining attractiveness of homebuying as an investment and a return to fundamental life-style motivations as the primary impetus for becoming a homeowner.

Real estate development activity remains suppressed by a massive amount of surplus space. The rebound may be hampered by a more stringent screening process by lenders. S&Ls, a major construction lender during Texas' boom days, are out of the market while they deal with the results of past lending decisions. Memories of recent failures haunt the market. Sensible restraint and time spent absorbing the lessons of past mistakes are beneficial. However, good projects that supply a demonstrated demand should not be dismissed summarily in the name of prudence. Better methods for distinguishing the promising venture from the frivolous are needed.

Rural Land

The recent market statewide provides evidence that the long slide in Texas land prices has abated. However, analysis of sales does not point to an imminent recovery. Rather, local changes suggest that regional weakness persists and that any broad-based rise in land prices will be gradual.

In the 1970s and early 1980s, all land categories found ready buyers. The subsequent market decline throughout the 1980s caused buyers to change their focus. Quality has assumed a much greater importance in the 1990s. The result is a two-tier market with high quality properties attracting strong bids while unexceptional and poor properties generate little or no interest. Clearly, this renewed emphasis on quality will strengthen prices for good properties and weaken prospects for average-to-poor tracts.

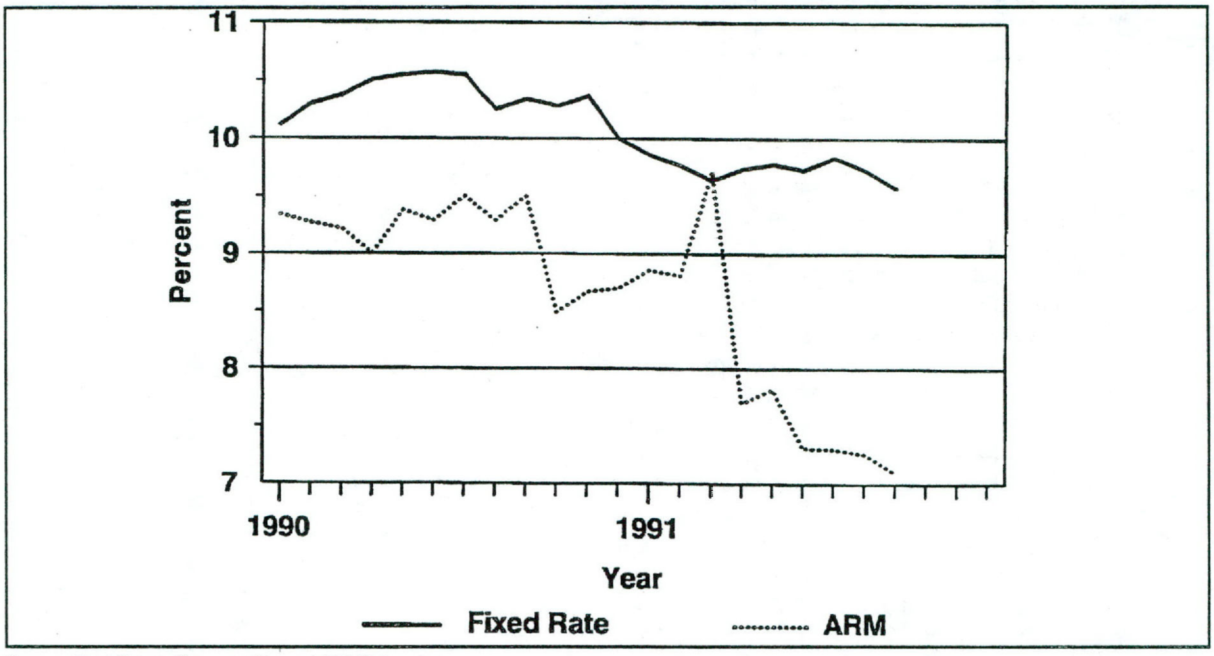
The farm program adopted in 1990 and disappointing harvests threaten to reduce agricultural incomes. Some farmers may experience financial difficulties when faced with the unfolding operating environment. This may give potential buyers of farmland a reason to wait, but any long-term effects of these changes are uncertain. Although price declines do not appear imminent, the recovery in farmland areas may waver.

Lack of financing remains a major concern. Many traditional lenders such as local banks and life insurance companies continue to shun rural land markets. Seller financing and the Farm Credit Bank of Texas remain the primary sources of purchase money for rural land.

Inventories of acquired properties continue to affect local markets. However, most of the lender-owned rural land in the Panhandle has returned to private hands. Lenders in the Hill Country and surrounding area may accumulate more property until widespread markets strengthen. Federal Deposit Insurance Corporation (FDIC) and RTC inventories have not surfaced as a widespread major influence in the rural land market. Although questions remain, most observers do not believe the FDIC or RTC hold significant amounts of rural land.

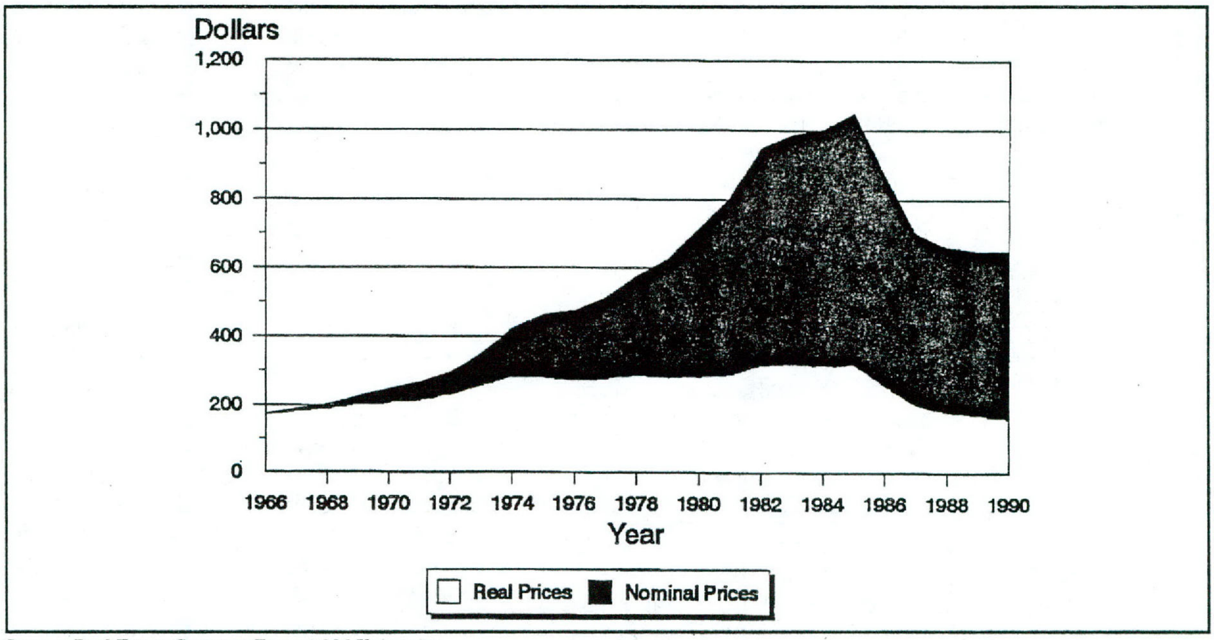
On the positive side, real estate agents and sellers of acquired properties report greater buyer activity in rural land markets. These reports suggest that some buyers believe current prices are a bargain and have moved to acquire land before the market recovers. The fact that real prices have declined to 1966 levels justifies this belief and

Figure 1. Effective Interest Rates on Conventional Mortgage Loans in Texas



Source: Real Estate Center at Texas A&M University

Figure 2. Texas Nominal and Real Median Price per Acre for Texas Rural Land, 1966-90



Source: Real Estate Center at Texas A&M University merits consideration by potential land buyers (Figure 2).

Government Policy

The real estate industry continues to bear the brunt of government policy initiatives. During the past five years, the federal government has eliminated most real estate investment incentives from the income tax system, reined in the lending powers of S&Ls and regulated the appraisal business. State government has joined the bandwagon with new taxes, additional requirements for real estate licensees and a school funding reform with far-reaching implications for property values.

The intention of these policies is not to punish the industry at a time when it is trying to recover from years of weak markets. Any malice is inadvertent as these programs are aimed at some real problems. However, that does not make them less damaging.

The federal initiatives of recent years are in response to problems caused largely by excessive incentives in previous years. The state's actions stem from a desperate scramble for new sources of revenue to patch up a badly hemorrhaging budget. The legislature raised taxes on various professions. The effect will be to increase by several times the total amount required for real estate brokers to renew their licenses. At the same time, new mandatory continuing education requirements have been applied to real estate licensees. The combined effect will be to reduce the number of licensees. By the year 2000, the estimated number of real estate agents is 25 percent fewer than there are today.

The school financing reform was mandated by the courts as a way to assure relatively equal educational opportunities to all Texas children. However, the approach taken not only redistributes revenues from rich to poor districts, but also it increases the overall costs of public education (and this solution still may be open to challenge as not being sufficiently far-reaching). This means that property taxes will have to rise, with the largest burden probably falling on single-family homes. The Center estimates that the tax liability on the average home will rise by 14 percent in 1992, with further increases in subsequent years. The system also reduces the linkage between tax increases and improved services that might offset the effects of the higher taxes on property values.

Amid the continuing crisis atmosphere of state government, the major long-term issues important to Texas' future are receiving scant attention. Although still perceived as a "pro-growth" region, the state's ability to attract new industry is flagging. The advantage of low real estate prices and rents is countered by a skewed tax system and high transport costs. A large supply of inexpensive labor is negated by severe limitations on inherent skill levels and adaptability. If Texas is to regain a measure of its former prosperity, these problems must be solved in coming years.

Outlook

Once again this year, the outlook for real estate markets depends on the pace of economic recovery. While the recovery has been steady, it could be threatened by a prolonged slowdown at the national level. Texas is more interlinked with other regional economies than in the past. However, a larger problem could be the pessimism induced by the national media. The reported national recession actually is concentrated in the media centers: the upper East Coast and lower West Coast. The mid-eighties real estate and lending recession in Texas seemed far removed from these regions. Now, these very areas are faced with the stony glare of recession.

The idea of an on-again, off-again recovery may seem odd to someone accustomed to recessions followed by vigorous growth. However, it may be the notion of regular boom-bust cycles that is the anomaly, for it ignores the fundamental changes that appear to be occurring.

The end of the Cold War—which may have begun with Nixon's visit to China in the 1970s—is bringing about a major restructuring of the economy away from those activities befitting a military superpower to those necessary to compete in world markets. These changes are likely to be profound and long lived. Consider how the Cold War has affected the country throughout the last half of the century. In the 1950s, widespread prosperity was produced as the United States stepped in as leader of the free world, gearing up to meet the challenge of communist expansion. The economy of the 1960s was stimulated continuously by unconstrained military and domestic spending. However, there was growing uneasiness. The public began to question the wisdom of involvement in international disputes.

The nation discovered the real cost of these policies in the 1970s, as inflation soared and government attempts at stimulation merely created stagflation. The country was wearying of its burden as protector of the free world. Although the military seemingly made a comeback in the 1980s, the emphasis was on defense rather than on playing world policeman. Tax rates were cut and inflation was brought under control through tight monetary policy, thereby constraining the government's access to unlimited resources. The Cold War was slowing long before the fall of the Berlin Wall because the major adversaries lost the will and ability to shoulder the enormous cost.

The results of this postwar restructuring are shrinkage in established segments of the economy and growth in some of the less-developed areas. In the United States, the shrinkage is in defense-related industries, evidenced by a rising white collar unemployment problem, and in spending on welfare service programs, mainly resulting in fewer federal funds for local governments.

Texas is farther along in restructuring because its big producers of yesterday—oil and construction—gave up their leadership positions in mid-decade. So far, the recovery has been led by services and small business as well as expansions in specialties related to oil. The process is far from complete, however. Military base closings and the competitive problems of high tech manufacturers will continue to affect parts of the state.

The last several years have provided some view of the direction this restructuring is likely to take. More development in the service sector should be expected, including the emergence of services that will take the position left by basic industries. In other words, certain service industries may become the driving force behind local economies. The modern economic base may depend on exporting expertise rather than finished products.

A number of trends are associated with this economic restructuring. As might be expected after a slump, there is a broad retreat from risk-taking. Such a reaction is expected from those who were burned: lenders and investors strapped with devalued assets. Even the Japanese now realize prices paid for all those trophy properties were too high.

However, the retreat is more than post-recession jitters. There are fewer incentives to take risks. Low inflation makes risk-free assets more attractive. There are no tax advantages for pursuing risky capital gains. In addition, the search for "deep pockets" through liability litigation increases the risk of owning property, especially real property. Add to this list the maturing of the population, naturally making it more conservative. Finally, as homes and other assets decline in value, people become more defensive in both their investing and spending habits.

This latter point is indicative of a vicious cycle acting on real estate. As asset values have fallen because of disinflation and retraction of tax incentives, there has been more emphasis on equity rather than debt financing. In turn, less real estate lending means leaner valuations for property, which encourages more emphasis on equity. Fortunately, there is a point when the speculative premium embodied in property values is completely purged and values become stable. Much—but not all—Texas real estate appears to have reached this point.

Falling values, or even flat prices, tend to favor buyers rather than sellers. Buyers have the time and inclination to sort through the market for quality. As a result, markets become segmented. Good properties command good prices and spirited bidding while marginal properties are ignored. This pattern can be seen in rural land and housing markets. It may indicate that the activities of the RTC will have little impact on market prices because it appears that most of what the agency owns is marginal at best.

Some may welcome an increased level of cautiousness after the excesses of past years. However, in an era of renewed competitiveness from all quarters as well as rapidly opening opportunities for those willing to take an educated risk, there is a need for more entrepreneurship. An overly risk-averse temperament will allow these opportunities to be missed.

The point of all this is to suggest that a restructuring is different from a mere recovery. Success will depend on adapting to new situations rather than waiting for things to return to normal.

At the national level, restructuring means a loss of power by the old elite: the established politician and major corporation executive. The problems of the economy are affecting people on a more personal level—not just the people who lose their jobs in a recession but also those whose pension fund is jeopardized by failed ventures. Something similar to a populist revolt may be in the making. The push for limited legislative terms is a relatively mild sign of rising discontent. Expect more discontent toward a number of government policies. People want the government to work for them rather than for those they perceive as manipulating the system.

At the state level, efforts to replace the revenue void left by the shrinking oil and gas industry may have reached their limit. Existing tax sources may have been pushed to capacity. Further increases apparently are counterproductive. Institution of an income tax, though still politically unpopular, may become more attractive. The economic situation will require more serious efforts to restructure state spending and to decide what programs are essential. As Texas businesses have had to face painful downsizing decisions, so will state government officials.

The state's real estate markets remain overshadowed by surplus inventory left from the building boom of the 1980s. Residential sectors are in relative balance, even to the point of encouraging increased apartment development. Most nonresidential real estate holders continue to struggle with high vacancies. As a result, the real opportunities are in property management rather than in development and construction. Furthermore, economic restructuring may reduce the need for space, at least centralized space. Changing demand will require more innovation from property managers. There will be more emphasis on space conversion to serve new types of operations and ways of delivering services.

In the post-Cold War economy, business success will depend on different factors. It is no longer possible to gain wealth merely by being in the right position. Success will be based on adding something of value to the process, taking a resource and developing its potential in the eyes of the market. Serving particular customer needs will be rewarded. Of less importance will be policies based on what is best for the firm, the industry or the profession.

In the nineteenth century, Benjamin Disraeli observed that the one with superior information will be the winner. That adage was probably never more true than today. The key is getting to the core of the situation: finding out what is happening, determining what is desired and then bridging that gap.

The Real Estate Center is committed to assisting the pursuit of relevant information, to providing the core of understanding that leads to creative solutions. Knowledge is crucial to adapting successfully to the significant changes in store. The Center's research agenda is intended to serve that need. The input of readers is encouraged to help meet this goal.

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