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Houston Business

A Perspective on the Houston Economy

Houston's Land Market: How Much Planning Do We Need?

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Houston's urban land market is unique—marked by minimal planning, no zoning, and growth at the city limits led by real estate developers who create the local utility districts. Other major American cities operate with more plans, more zoning, and suburban growth allowed only where connections are made available to city utilities. A widely expressed view holds that Houston's lack of zoning and its wide-open approach to development have somehow penalized the city in comparison with places that are planned more thoroughly. There is much evidence to the contrary, however, and it indicates many benefits from Houston's unplanned alternative.

Because Houston's land market is extraordinary, many studies have compared Houston's results with those of other cities. Some studies have highlighted deficiencies in Houston, but many have found Houston's spatial arrangement and land-use patterns surprisingly like other Sun Belt cities. The similarities stem from the overriding role of broad economic forces that shape all cities, and from unique institutions that have grown up in Houston to replace "missing" land-use controls like zoning. Perhaps the most common weakness alleged in Houston's land market is a lack of regional coordination. The strengths most frequently cited are flexibility, responsiveness to the local market and low cost.

HOUSTON AS A TYPICAL CITY

The October issue of this newsletter presented a definition of zoning and discussion of some of its effects. The question addressed in this issue is how the only unzoned city in the United States comes to look much like every other Sun Belt city. The most important factor is simply spatial economic forces that operate to shape all cities. Industry tends to cluster near ports, railheads and other transportation facilities; the highway system develops to accommodate a downtown office complex; commercial strips separate from residential areas to seek out major thoroughfares; and extensive empty areas are left for residential development.

In addition to these economic forces, Houston has developed its own package of voluntary and public land-use controls that partly substitute for zoning. As discussed in the last newsletter, one issue upon which courts, planners and economists agree is that the community should have a strong voice in the land development process. A combination of deed restrictions and existing city ordinances already functions in Houston as an effective land-use control system, and one that broadly works in the public interest. Unlike many zoned cities, Houston's land market operates with minimal governmental participation or public planning.

Deed restrictions or restrictive covenants give Houston homeowners a strong grip on land-use within their neighborhood. These restrictions are usually drawn up by the developer, often in conjunction with the lender, and they limit construction to single-family homes while imposing stringent architectural standards. Such restrictions currently apply to 10,000 or more Houston neighborhoods and will be left in place even if the zoning ordinance now under consideration is adopted. The duration of these restrictions typically is 30 to 40 years, often with automatic renewal unless the majority of residents vote against them. Under a 1985 law, deed restrictions that have expired can be reimposed by a vote of 75 percent of the residents.

Enforcement of these covenants is typically by a neighborhood association, although the city of Houston has the (rarely exercised) power to enforce private covenants. This system operates best in middle-class neighborhoods in which homeowner associations diligently enforce their own covenants and even patrol adjoining neighborhoods. The practical effect *within the neighborhood* is quite similar to zoning. Covenants are more difficult to overturn than zoning and require a court order to be nullified, while a zoning board can simply grant zoning variances. In practice, however, changing the zoning status of a cohesive residential area would be unusual, unpopular and unlikely.

The difference between zoning and restrictive covenants is that zoning is far more amenable to the political influence of neighborhood groups on empty land or land that might be redeveloped *outside the group's neighborhood.* Deed restrictions apply only to the affected land. The fact that zoning gives complete control of residential land to the homeowner and also gives these same homeowners a say in the use of other people's land is precisely the point of departure for those who claim zoning is a partial taking of property.

This difference also explains why zoning, by passing power to the median voter, almost always reflects an exclusionary middle-class bias. Zoning inevitably delivers too much residential land with large lots and strong architectural controls and provides too little room for apartments and amenities for the urban poor or disadvantaged. Houston's 1962 zoning referendum saw the vote among upper- and middle-class white neighborhoods run two-to-one in favor of zoning; among working-class, Black and Hispanic neighborhoods the vote ran three-to-one against.

Many of the public safety, convenience and morality issues that are addressed by the typical zoning ordinance are already incorporated into an array of Houston's city ordinances. The draft zoning ordinance currently being proposed for Houston, for example, overlaps with at least 18 ordinances that deal with land-use issues. Many of the ordinances regulate a litany of nonconforming uses within the city limits: bars, taverns and lounges; amusement facilities; animals and fowl; junk dealers and scrap metal processors; heliports; abattoirs and rendering plants; tire storage centers; mini-warehouses; sexually oriented businesses; correctional facilities; mobile homes and RV parks; sidewalk cafes; towers; and most recently, bungee jumping operations.

Other ordinances deal with broader issues: maximum dwelling occupancy, development in flood-prone areas, standards for off-street parking and loading, development in the vicinity of the public water supply, tree-planting requirements for public areas and parking lots.

This list surely denies any argument that Houston's unzoned status results in a free-for-all for local landowners. It also explains once more why Houston looks much like other cities. These existing ordinances will be only the starting point, however, for Houston's proposed zoning ordinance. Zoning proponents will try to regulate all this and much more, drawing up separate rules for hundreds of individual neighborhoods.

MUNICIPAL UTILITY DISTRICTS

Another unique and important feature of land development in Houston is the city's extensive reliance on municipal utility districts to provide services to the urban fringe. *Municipal utility districts,* or MUDs, are special districts, empowered by the state and regulated by the Texas Water Commission (TWC), that provide water, sewage and drainage for new subdivisions. MUDs enable developers to finance infrastructure through tax-free bonds rather than out-of-pocket. MUDs must have the city's permission to build within the city or in its extraterritorial jurisdiction, and they must conform to standards that allow easy interconnection to the city system at a future date. The city of Houston tends to favor MUDs because they relieve city taxpayers from the burden of fringe development.

The creation of new MUDs is simple but time-consuming. Districts are authorized by the TWC, usually with boundaries conforming to the developer's property. Bonds can be issued to fund 70 percent of water, sewage and drainage development costs, except for water treatment facilities and some interconnection costs, which can be financed 100 percent. A board of directors is appointed by the TWC on the developer's recommendation. Tax revenue levied by the MUD pays for indebtedness and the MUD's continued operation as a utility. Governance of the MUD passes to residents of the development over a two- to seven-year period as the project is finished. Ultimately, bondholders bear the financial risk, although MUD residents can find themselves subject to onerous taxes if the development is not completed on schedule.

The key feature of MUDs is that they allow development throughout the Houston vicinity. In Austin and Dallas, for example, the primary vehicle for fringe development is connection to the municipal utility. The cost of building main lines is high, which tends to confine development to the perimeter of Austin and Dallas. A 200-acre parcel of developable land in Harris County can almost always be regarded as a candidate for a new subdivision; near other cities, however, this parcel is not a candidate for development unless it lies within easy access of city utilities.

MUDs have numerous effects on Houston's land development, but probably the most important is their ability to increase the supply and reduce the cost of developable land. One study of comparable lots in mid-price subdivisions in Houston and North Dallas that were developed in the late 1970s near the peak of the oil boom found lots prices \$3,700 cheaper in Houston. Dallas lots, however, come with utility connections under historical-cost pricing, while each Houston subdivision creates its own utilities. Once the future periodic charges to Houston residents for MUDs were included, the full-cost comparison still showed Houston lots \$1,500 cheaper.

A second effect of MUDs is their contribution to urban sprawl. The jury is still out, at least among economists, as to how much urban sprawl really costs, but scattered development will increase transportation cost and the cost of other utility services. Historically, there has been a lack of regional planning to limit negative external effects such as land subsidence due to unrestricted water removal, regional flood control and water quality. In recent years, however, regional agencies have coalesced to address these issues and have corrected many of the excesses of the oil boom. The MUD, as a vehicle for development, in no way precludes regional planning.

Finally, consider the implications of the new zoning ordinance on land supply. As mentioned above, one likely effect is to limit the supply of developable land inside the city. Middle-class neighborhoods will press hard to restrict any development or redevelopment in the vicinity of their homes. The MUDs provide the perfect vehicle to escape the city limits and shift this development to the extraterritorial jurisdiction. For a variety of reasons, this is already a longstanding trend in Houston. The new zoning ordinance can only accelerate the process.

Like a balloon with a very slow leak, the Houston economy continues to contract and soften. Job losses are slow enough to be almost imperceptible on a month-to-month basis, but seasonally adjusted data now reflect a loss of nearly 10,000 wage and salary jobs since the area reached its all-time high job level in mid-1991. Losses in oil- and gas-related sectors continue but have slowed in recent months. Local government is the largest contributor among the few sectors that added jobs over the past 12 months (4,100 new jobs), followed by eating and drinking places (3,400 jobs) and health services (2,800 jobs).

RETAIL SALES

When comparisons are drawn between 1991 and 1992, August and September 1992 probably need to be averaged because of the late Labor Day holiday. August retail sales were terrible in Houston, but September was probably good enough to pull the two-month average up to 1991 levels. October 1992 was described as a modest improvement over last year. The mood among retailers remains cautious, and their preparations for the coming holiday season reflect this attitude.

Auto and truck sales in Houston were running 5 percent ahead of 1991 levels through September, but October sales plunged 25 percent below those of last October. Respondents blamed the sharp October slide on a drop on a in the usual seasonal purchases of rental cars.

ENERGY PRICES

Through most of September, light crude prices remained in a narrow range near $21 per barrel. Prices had been expected to firm to $22 per barrel or higher over the winter but instead have fallen to nearly $20 per barrel in recent weeks. Sluggish demand and higher-than-expected OPEC production was blamed.

Natural gas prices have eased to nearly $2.40 per thousand cubic feet, and storage has now been filled to levels similar to this time last year. Prices have probably peaked for the year, unless the winter turns extraordinarily cold. Curtailments caused by Hurricane Andrew, uncertainty over state prorationing plans, and the arrival of the winter heating season spurred the peak prices.

Oil field activity is up, but increases appear to be driven by drilling for Section 29 tax credits for coal seams and tight sands. The credit expires January 1, 1993, and wells must be spudded in before that date to qualify. Perhaps 200 rigs are currently drilling for this gas, and they will continue to inflate the rig count through the fourth quarter. Conventional drilling for natural gas has risen only slightly in recent weeks. Offshore activity continues to improve, with 90 rigs at work, out of 151 operational rigs available and in contrast with only 60 rigs at work in the Gulf in early summer.

REFINING AND CHEMICALS

Late summer gasoline inventories that were too high were pulled into line by Hurricane Andrew and several minor refinery accidents, but continued soft markets in October pushed inventories back above normal levels. Gasoline prices have followed the downward movement of crude oil prices, leaving margins weak.

Petrochemical producers report that their markets remain flat or marginally improved in recent weeks. Hurricane Andrew created some disarray with unit shutdowns, a shortage of liquids and problems in moving railcars. Producers' inability to pass through rising feedstock prices continues to squeeze margins.

REAL ESTATE

New home sales continue to run well ahead of 1991 levels. Caution, however, continues to be the watchword among builders and lenders. New home completions and sales have been steady for four quarters, and the supply of units in all stages of completion is less than six-months worth. Only homes at the top of the market, those priced over $300,000, are selling poorly. In contrast, the existing home market is weak, with the sales rate at the lowest level in two years. The usual seasonal drop in listings has not occurred.

The office market remains stagnant, with rents continuing to decline. Leasing and sales of industrial space should post respectable gains for the year. Apartment occupancy and rental rates edged up very slightly in the third quarter.

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