Hurricane Harvey – Industry Impact

The pillars of Houston's economic base—upstream energy, the Houston Ship Channel, chemicals and refining, health care, corporate headquarters, and aerospace—emerged largely unscathed. That's not to say these sectors weren't impacted.

Thirteen Gulf Coast ports either closed or dramatically reduced operations during Harvey. The Houston Ship Channel remained closed for a week but is now open with a few restrictions due to shoaling and debris in the water, according to Port Houston. Both major airports are now open.

Harvey shut down or curtailed operations at 20 coastal refineries, about one-fourth of U.S. capacity, according to IHS Markit. As of this writing, 13 are at or near normal operating rates. Five of the seven are restarting or ramping up their runs.

Operations at the region's chemical plants are slowly returning to normal. At one point, over half the nation's olefin capacity was shut down. Many of these plants serve other plants in Houston. They were also shut down so no significant price spikes or shortages occurred. Plant restarts continue but constraints on railroads, pipelines and export capabilities are limiting output.

Of the 89,400 office, industrial, multi-family and retail properties that Xceligent tracks in Houston, only 7,155 were in Harvey-affected areas.

CBRE reports that only 40 of the region's 1,200 office buildings suffered damage. Since Hurricane Harvey was a rain event versus a wind event (like Hurricane Ike), few buildings lost windows. Most reopened soon after flood waters receded.

The institutions in the Texas Medical Center learned from Tropical Storm Allison years ago and moved critical systems out of their basements. Though flooding occurred in neighborhoods around TMC, the hospitals by and large remained open.

NASA's Johnson Space Center closed out of concern for JSC employees' safety. Flight control for the International Space Station continued to operate.

Post-Harvey Impacts

Harvey's short-term impacts have already begun to appear. The Houston Purchasing Managers Index (PMI), a short-term leading indicator for regional production, registered 46.5 in August. Readings below 50 signal economic contraction in Houston over the next three to four months. Respondents to the PMI survey noted short-term disruptions to their industries due to Harvey but expect activity to increase as the region recovers.

Single-family home sales in August fell 25.4 percent compared to August the previous year. Only a handful of closings took place the last week of the month. Activity should pick up again in the fall. Going forward, potential homebuyers will likely inquire about a neighborhood's flood history as often as they do about its schools.

Houston will likely report employment losses for September. The Federal Reserve Bank of Dallas forecasts the Houston and Beaumont metros combined will lose 42,000 to 74,000 jobs. Most of the losses will be recouped in October as employees displaced by Harvey return to work and hiring for repair and reconstruction efforts kick in. By November, the region should surpass pre-Harvey employment levels.

The fourth quarter will see a jump in retail sales as households replace furniture, clothing and appliances lost to Harvey. Sales of construction materials should rise as well. All will lead to a one-time jump in sales tax collections, but that jump will quickly fade as retail sales and construction activity returns to pre-Harvey levels early next year.

Houston's construction sector had struggled lately. There was virtually no office construction, little industrial and retail activity, and multi-family construction had finally begun to slow. This implies there is slack in the system to be picked up by Harvey. However, contractors have complained of skilled labor shortages for some time, so the pace of rebuilding may be slower than hoped for.

Fuel prices rose briefly after the storm but should return to previous level over the next few weeks. As noted earlier, the region's refineries are coming back on line.

Harvey will have no lasting impact on long-term population or economic growth. As noted earlier, the engines of Houston's economy—energy, chemicals, trade, corporate operations—emerged from Harvey intact. Economic growth drives employment growth and employment growth drives population. If Houston' long-term growth slows, it won't be due to any impact associated with Hurricane Harvey.

Houston's Energy Jobs

When it comes to energy jobs, Houston employs about 26 percent of the nation's workers in oil and gas extraction, according to data as of April 2017 from the Greater Houston Partnership. In fact, oil and gas extraction jobs are the most prevalent in Houston for energy-related jobs, which includes upstream, midstream, downstream, manufacturing and services. The Houston area in 2016 had nearly 4,800 energy-related firms that employed more than 250,000 people – about 9 percent of the local workforce. Oil prices peaked at $108 per barrel in June 2014 before plunging 75 percent over the next 18 months, devastating the local energy industry. Around 81,100 jobs were lost in Houston's upstream energy sector between December 2014 and December 2016.

The Institute for Regional Forecasting at the University of Houston stated the oil industry is slowly recovering. The average salary in 2016 for a worker in the energy sector in Houston was about $140,000, which is more than double the metro average wage of $64,000. Forty out of 134 U.S. publicly traded oil and gas exploration and production firms call Houston home, and 10 of those are in the top 25,. Others in the top 25 have significant operations in Houston. Of the global integrated oil companies, two-thirds have operations in the Bayou City and employ thousands of full-time workers, such as

Exxon Mobil, Shell Oil, and Chevron. More than half of the 167 oil field service firms based outside of North America have offices in Houston and employ thousands in the Bayou City. For example, London-based TechnipFMC has more than 4,000 employees in Houston. Additionally, 14 of the 20 largest oil pipeline operators and 11 of the top 20 natural gas pipeline companies have corporate or division headquarters or ownership interested based in Houston. Meanwhile, the 10 refineries in the Houston area process about 2.2 million barrels of crude oil per calendar day. That's about 40 percent of Texas' total production and 12 percent of total U.S. capacity.

Texas Gains 20,000 Oil & Gas Jobs

Oil companies across Texas added about 20,000 jobs over the past year as oil prices stabilized, drilling rigs returned to the prolific Permian Basin, production grew and the industry started to recover. The number of Texas oil and gas jobs rose to almost 213,000 in July, up 10 percent over the same period last year, according to the latest Texas Petro Index. The number of drilling rigs in Texas oil fields has more than doubled to 464 last month from 206 in July 2016. Drilling permits have jumped by 60 percent, up from 630 to more than 1,000 over the year. And oil production in Texas keeps rising, up almost 6 percent, from 98 million barrels to 104 million. It's the eighth straight monthly increase for the Petro Index since November, which capped a 24 month contraction as U.S. crude prices dropped from more than $100 a barrel in 2014 to $26 last year. Still Karr Ingham, an Amarillo economist who piles data for the Texas Alliance of Energy Producers, thinks the recovery may have a hit a wall. U.S. oil prices have hovered under $50 a barrel for months.

Temporary Work Surges in Area

Since the beginning of 2016, the number of people working in the employment services sector – which covers temporary workers – has spiked by 23 percent, at a time when overall employment in Houston grew by less than 2 percent. Temporary employment is surging in Houston even as it levels off in Texas and around the country, a sign that the region has yet to fully recover from the worst energy bust in a generation. Even as oil production resumes and manufacturing orders come in, local companies are still unsure of their long-term prospects and reluctant to hire people permanently as crude prices remain stubbornly low and the outlook for the industry uncertain.

It reflects a broader trend in U.S. labor markets as companies seek more flexible workforces and increasing use contract employees as a way to more quickly ramp employment up or down as conditions change. This approach has quickly gained traction in the energy sector, with consultants – some former employees – brought on for short-term projects as needed. This just-in-time workforce strategy can be quite helpful for businesses.

In many ways, the recent history of corporate America is a story of businesses inserting more layers between themselves and the workers on whom they depend. It began with outsourcing in the 1980s, as big corporations moved to shed all functions outside their fundamental businesses. Law firms, for example, are good at lawyering, not doing taxes or cleaning floors, the theory goes, so they hired accounting firms and janitorial services to do the work for which they used to employ people directly. That's true across the economy, from universities that let Sodexo or Aramark run their cafeterias to grocery stores that let another company run their distribution centers. Staffing companies, meanwhile, have expanded as companies seek to match their workforce to the peaks and valleys of their business.

Houston's oil industry has long been part of this trend. Exploration and production companies like Exxon and Chevron rely heavily on providers like Halliburton and Schlumberger to drill and frack wells. The service companies, in turn, have their own subcontractors and sub-subcontractors. And now, after laying off thousands through the oil downturn, many of those companies are bringing those people back on short-term contracts. A certain amount of that staffing surge is cyclical. Contractors are the first ones to go in a downturn, and the first ones to come back. But the oil recovery has been underway for more than a year now, and economists expect the recovery of contractors to have given way to more full-time hiring by now.

In addition, companies are getting used to the idea that oil prices may stay relatively low for the long term, forcing them to be more careful about hiring decisions. Contracting could become an increasingly common feature of the industry going forward. And in Houston, it's not just the energy industry: Hospitals have brought on hundreds of temporary workers to accomplish the Herculean task of transitioning to electronic medical records in recent years. Also, in a time of economic weakness, companies deluged with thousands of applicants for only a handful of positions often bring on staffing companies to sort through resumes. Often, they'll offer people temp-to-hire positions that allow companies to make sure they're a good fit.

Texas Unemployment Falls to Pre-Recession Levels

Texas appeared to have a very solid economy just before Hurricane Harvey hit, with an unemployment rate in August that matched its pre-recession low of 4.2 percent in July 2007. Unemployment only fell lower in December 2000, when it stood at 4 percent even. Texas' jobless rate has been dropping since April of this year as the oil and gas industry recovers from the recent bust, the Texas Workforce Commission reported. "Texas has re-emerged as a powerhouse in global oil markets because of the shale gale," said Robert Tye, chief economist at Comerica Bank. "At the same time, Texas has made great strides in attracting non-energy-related businesses and developing a sophisticated service sector, including medical services, to support its rapidly growing population. The report does not capture the impact of Harvey on labor markets because the surveys of employers and households on which the statistics are based are conducted in the middle of the month. When data comes out for September, the state will likely see a jump in construction jobs and a swoon in leisure and hospitality employment, historical data on disasters and unemployment claims filed with the state suggest. Overall, the Dallas Federal Reserve expects the effects to be "negative, but transitory." The state added 5,500 jobs in August, typically a slow month for hiring.

U.S. Job Openings Surged In June

U.S. employers posted a record number of open jobs in June, a sign that the solid hiring of recent months will likely continue. Job openings jumped eight percent to 6.2 million, the highest on records dating back to 2000, the Labor Department said. Hiring fell, however, and the number of people quitting their jobs also dropped. The data suggest that employers have plenty of jobs to fill but are struggling to find the qualified workers they need. Job openings in construction and manufacturing rose sharply. They also increased in financial services, health care, and in state and local government. The number of jobs in retail fell.

Options for Providing Major-Disaster Assistance to Employees

In light of Hurricanes Harvey and Irma, employers and their employees may be looking for ways to provide assistance to those within their organization affected by these devastating storms. Fortunately, the IRS provides several ways support can be given on a tax-advantaged basis.

1. Qualified Disaster Relief Payments

Section 139 of the Internal Revenue Code ("Code") allows employers to provide tax-free relief payments to individuals affected by a "qualified disaster." A qualified disaster includes any disaster resulting from terroristic or military action, a federally declared disaster, a disaster involving a common carrier, or any other event determined by the Secretary of the Treasury to be of a catastrophic nature. See Code Section 139(c).

"Qualified disaster relief payments" include any amount paid to or for the benefit of an individual:

a) To reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; or
b) To reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or its contents caused by a qualified disaster. See Code Section 139(b).
c)

Qualified disaster relief payments do not include payments for expenses otherwise paid for by insurance or other reimbursements, or income replacement payments, such as payments for lost wages, business income, or unemployment compensation.

The IRS has made the application and administration of qualified disaster relief payments quite flexible. These payments are not subject to income tax, employment taxes, or information reporting requirements and can be made by both employers and employees. Furthermore, there are no substantiation requirements so long as reasonable steps are taken to ensure that the grant amounts are reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary expenses caused by the qualified disaster. See Rev. Rul. 2003-12. Companies can deduct qualified disaster relief payments under Code Section 139 without the administrative burden of establishing a charitable foundation under Code Section 501(c)(3).

2. Employer-Sponsored Private Foundations

For employers, few options provide the administrative flexibility and tax benefits of direct "qualified disaster relief payments," but for employees wishing to contribute to the relief effort, there may be more tax-advantaged strategies. An employer-sponsored private foundation can offer the same kind of tax-free, charitable relief but with the added benefit of providing a tax deduction for individual employees who contribute.

Employer-sponsored private foundations were historically prevented from providing assistance to employees of the sponsor, but in 2001 Congress created an exception for payments to employees affected by a "qualified disaster," as defined in Section 139, as long as certain self-dealing safeguards are in place. The IRS will presume that the payments are consistent with the foundation's charitable purpose and free from self-dealing if:

a) The class of beneficiaries is large;
b) The recipients are selected based on an objective determination of need; and
c) The selection is made by an independent selection committee or through a substitute procedure that ensures any benefit to the employer is tenuous or incidental. See IRS Publication 3833.

Additionally, programs cannot be used to induce employees to follow a course of action sought by the employer or designed to relieve the employer of a legal obligation to provide employee benefits. Employer-sponsored private foundations must register as tax-exempt charitable organizations and comply with specific documentation requirements and other restrictions. Although less flexible than direct "qualified disaster relief payments," employer-sponsored private foundations may be attractive to some companies because of the added tax benefits realized by individual employee contributors.

3. Leave-Donation Programs

In Notices 2017-48 and 2017-52, the IRS provided guidance on one of the ways employees can donate their leave to provide assistance to individuals affected by Hurricanes Harvey and Irma. Under this method, employers may set up a program where employees can donate their accrued vacation, sick, or personal leave in exchange for equivalent cash donations made by employers to Section 170(c) organizations, such as the employer-sponsored private foundations discussed above, for the relief of Hurricanes Harvey and Irma victims. This method is available through January 1, 2019. The IRS provides that employees will be exempt from tax on the forgone income and employers may claim those payments as charitable contributions under Section 170(c) (subject to the applicable limitations) or as business expenses under Section 162. The IRS also ensured that giving employees the choice to participate in an employer-sponsored leave-donation program would not be considered constructive receipt of income. See Notice 2017-48, 2017-39 IRB; Notice 2017-52, 2017-40 IRB. This method allows employees to contribute to the relief effort without facing any related tax consequences. Employers benefit by deducting the payments as charitable contributions or business expenses and reducing their FICA tax liability.

4. Employer-Sponsored Leave Banks

Employers may also set up leave banks that allow employees to deposit their accrued vacation, sick, or personal leave for use by employees adversely affected by a major disaster. An employee is regarded as adversely affected by a major disaster if the disaster caused severe hardship to the employee or the employee's family that requires the employee to be absent from the workplace. A written leave-sharing plan has to meet certain requirements to be considered a bona fide employer-sponsored leave bank. See Notice 2006-59, 2006-2 CB 60. Under this method, donee employees who use the donated leave to address major-disaster-related issues would be taxed on the additional compensation received through this program and donor employees would not be subject to tax liability on their donated leave.

Sources: Greater Houston Partnership; Houston Chronicle; Houston Business Journal; Alvarez & Marsal Tax Advisor Weekly