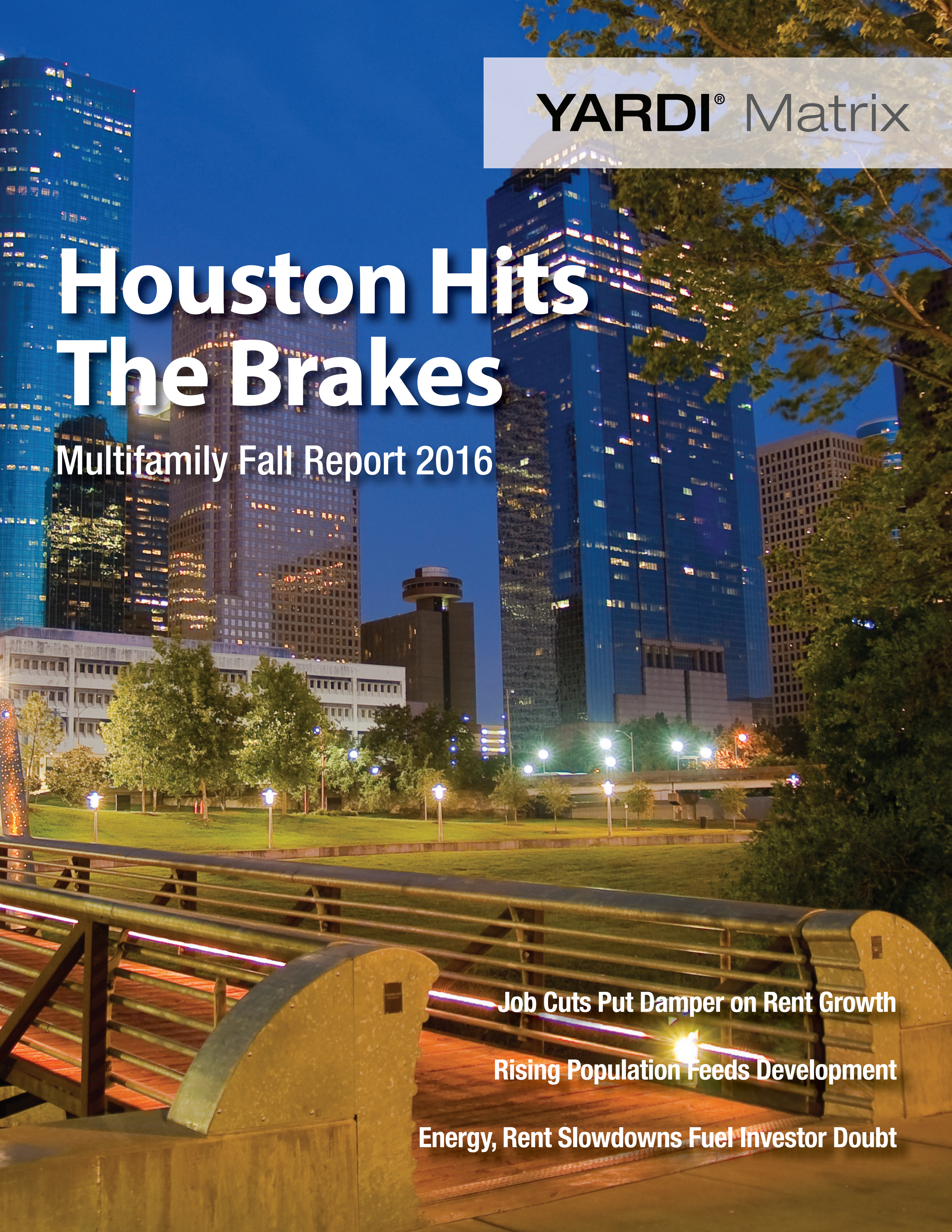
YARDI® Matrix

Houston Hits The Brakes

Multifamily Fall Report 2016



Job Cuts Put Damper on Rent Growth

Rising Population Feeds Development

Energy, Rent Slowdowns Fuel Investor Doubt

Market Analysis

Fall 2016

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Employment Staggers in Bayou City

Traditionally an energy-driven market, Houston is trying to reshape its economy as the drop in oil prices has decimated job growth in some segments and put a damper on the housing market. There are pockets of progress, though. The metro's first-rate health-care system, growing hospitality sector and international investment are starting to gain momentum.

Oil prices are expected to bounce back and already topped $50 in mid-October, but the energy sector is in need of consolidation and innovation to strengthen its competitiveness. Known as a global business hub, Houston has the busiest port in Texas. With an economic impact of more than $250 billion annually, international trade remains an important economic driver. Houston also continues to improve its health-care system by adding skilled workforce and investing in well-equiped hospitals, as well as medical research.

Demand for multifamily is still fairly strong, driven by healthy population growth and job increases in better-performing employment sectors. However, as employment stalls in high-paying fields such as energy, renters are shifting from luxury apartments to more affordable options. The heavy amount of new supply in the works—more than 20,000 new units are slated to come online in 2016—is creating further headaches for apartment owners. Rent growth has flattened, and we see little prospect for growth anytime soon.

Recent Houston Transactions

Copperfield North

City: Houston
Buyer: ELRH Investments
Purchase Price: $87 MM
Price per Unit: $89,906

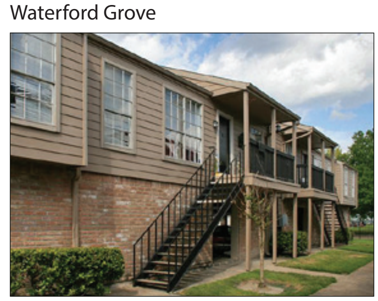
The Preserve

City: Webster, Texas
Buyer: Knightvest Capital
Purchase Price: $57 MM
Price per Unit: $107,069

Holden Heights

City: Houston
Buyer: Francis Property Management
Purchase Price: $45 MM
Price per Unit: $159,574

Waterford Grove



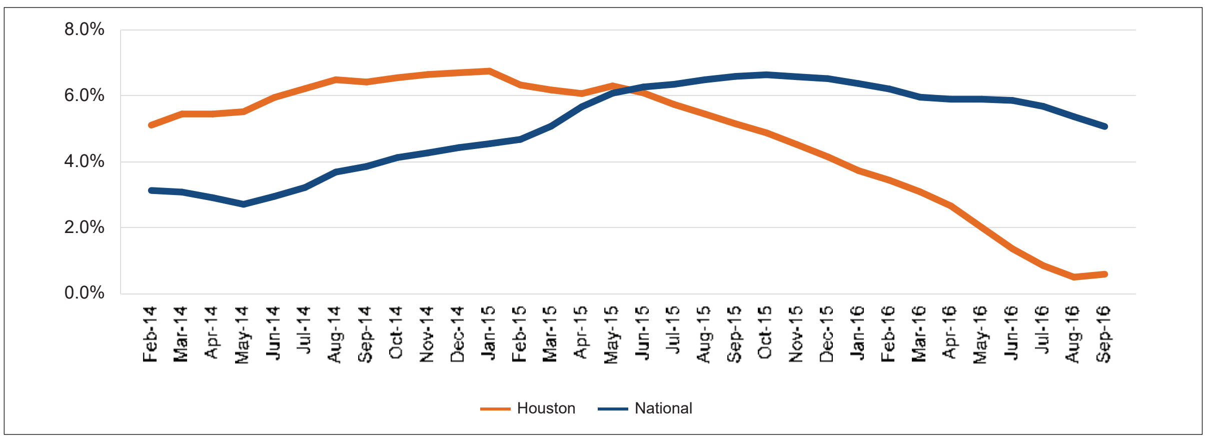
City: Houston
Buyer: Star Pacific
Purchase Price: $43 MM
Price per Unit: $78,647

On the cover: Photo by Oliclimb/iStockphoto.com

Rent Trends

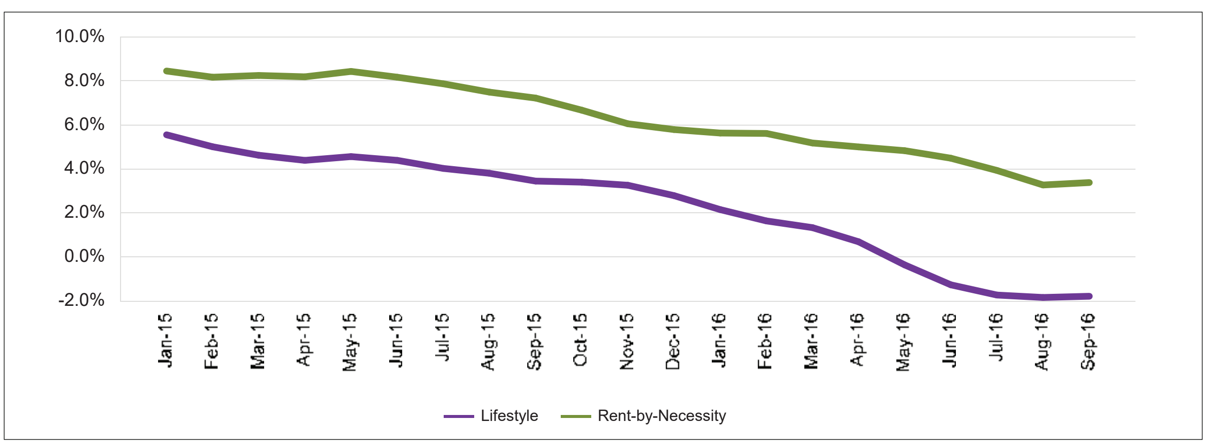
- Rents in Houston rose a weak 0.6% year-over-year to an average of $970 per month as of September, making it the worst-performing metro in the U.S., as rents increased by 5.4% nationally. Significant supply increases, the struggling energy sector and ongoing job cuts put a damper on rent growth. As supply is absorbed and the job losses begin to reverse, the metro's long-term growth should return to stability.
- Rent growth entirely came from the working-class Renter-by-Necessity segment, which rose 3.4% year-over-year to an average of $836, according to the Yardi Matrix survey. The luxury Lifestyle segment slid (-1.8%) to $1,135, underpinning the need for affordable supply given the loss of high-paying energy sector jobs and growth in the unemployment rate.
- Rent growth has mostly been concentrated in less expensive submarkets such as Galveston (7.3%), Greater Third Ward (7.1%), Baytown (6.6%), Alvin (6.2%) and Rosslyn (5.6%). One-quarter of the metro's 56 submarkets -- all of which had average rents of more than $1,000—recorded negative growth.
- We expect population to keep growing and there will be some demand for apartments, but with 94% occupancy and a large amount of supply in the works, rent growth will be flat in the foreseeable future.

Houston vs. National Rent Growth (Sequential 3 Month, Year-Over-Year)



Source: YardiMatrix

Houston Rent Growth by Asset Class (Sequential 3 Month, Year-Over-Year)

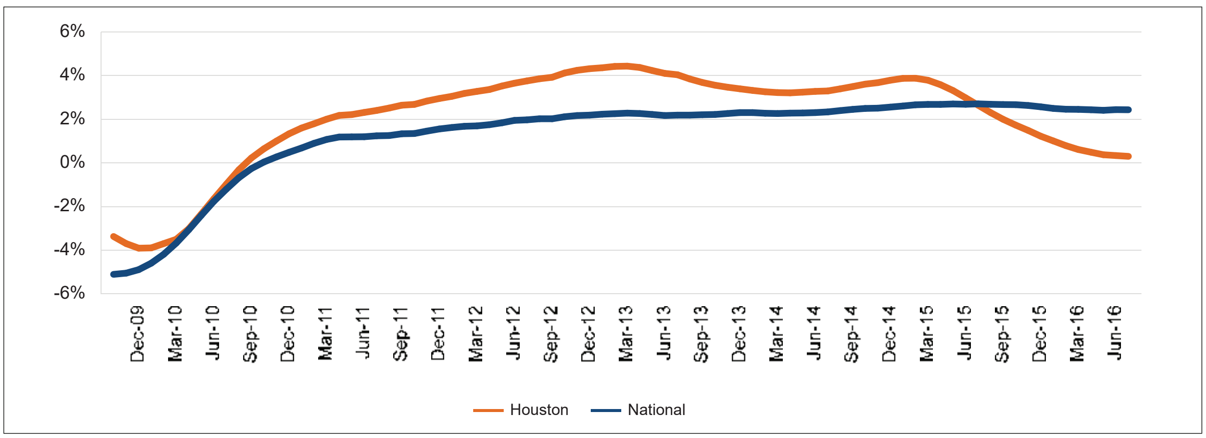


Source: YardiMatrix

Economic Snapshot

- The rapid decline in oil prices had a dramatic effect on the metro's fortunes. After outperforming the nation for several years in the wake of the recession, Houston added a flat 13,300 jobs in the 12 months ending in August. While energy-related sectors experienced thousands of job cuts, other segments such as health care, government and hospitality saw positive growth.
- Employment gains were led by the leisure and hospitality sector, which added 22,400 jobs, a 7.3% increase. Last year alone, the metro's two international airports, George Bush Intercontinental and William P. Hobby, had a passenger volume of more than 55 million, giving a boost to the local tourism market.
- Home to the world's largest medical complex and several universities, Houston's education and health services sectors grew by 14,800 new jobs. With nearly $5 billion in health-care projects currently underway, the sector continues to flourish, attracting skilled workers to the metro.
- On the other end of the spectrum, Houston lost nearly 40,000 jobs in the last 12 months, in segments including manufacturing, which lost 14,000 jobs, and mining, logging and construction, which lost 13,000. Professional and business services were also affected by recent layoffs, shedding 10,000 jobs.

Houston vs. National Employment Growth (Year-Over-Year)



Sources: YardiMatrix, Bureau of Labor Statistics (not seasonally adjusted)

Houston Employment Growth by Sector (Year-Over-Year)

		Current Employment		Year Change	
Code	Employment Sector	(000)	% Share	Employment	%
70	Leisure and Hospitality	328	11.0%	22,400	7.3%
65	Education and Health Services	382	12.8%	14,800	4.0%
90	Government	373	12.5%	7,900	2.2%
40	Trade, Transportation and Utilities	617	20.6%	4,900	0.8%
55	Financial Activities	155	5.2%	3,000	2.0%
80	Other Services	108	3.6%	-300	-0.3%
50	Information	31	1.0%	-2,400	-7.3%
60	Professional and Business Services	464	15.5%	-10,000	-2.1%
15	Mining, Logging and Construction	304	10.2%	-13,000	-4.1%
30	Manufacturing	231	7.7%	-14,000	-5.7%

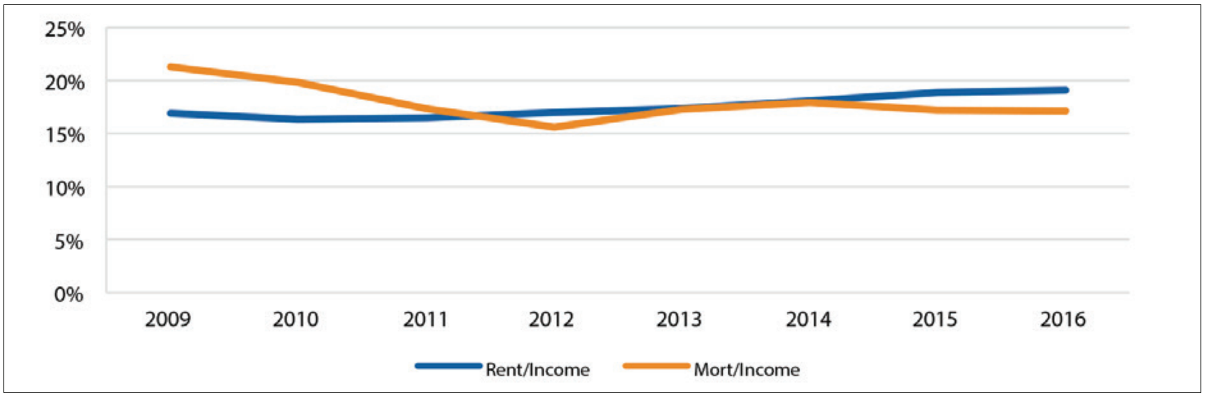
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

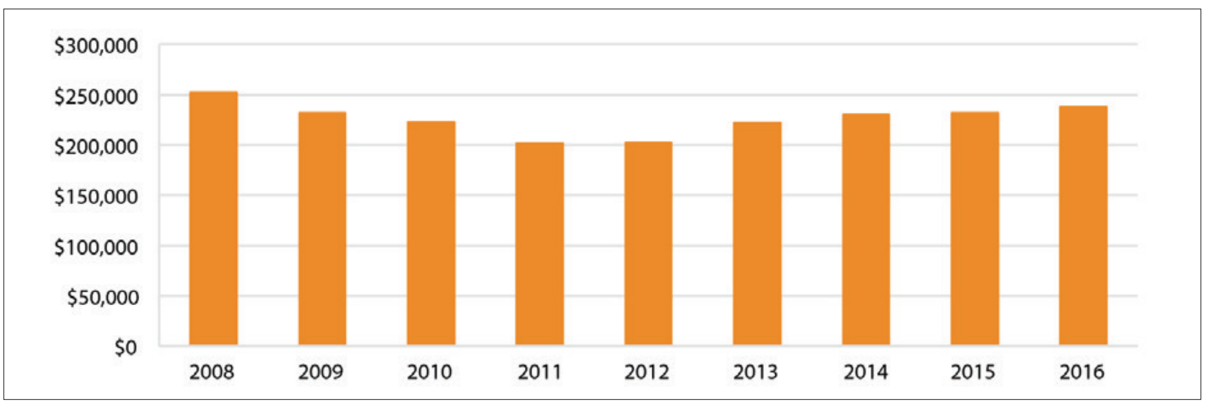
- Median home prices rose to $237,926 in 2015, reaching a peak for the current cycle. The average mortgage accounts for 17% of the area's median income of $60,900. Affordability issues are expected to arise, especially for workers affected by cuts in the energy sector and manufacturing.
- Despite steady growth in home prices, renting an apartment is more expensive than owning, as rents, averaging $970, account for 19% of the area's median income. Rents are highest in West End/Downtown, far above the metro's average at $1,669.

Houston Rent vs. Own Affordability as a Percentage of Income



Sources: YardiMatrix, Moody's Analytics

Houston Median Home Price



Source: Moody's Analytics

Population

- Even with flat job growth, the metro's population increased by 160,000 in 2015.
- Houston's 2.4% population growth was triple the national average of 0.8%.

Houstion vs. National Population

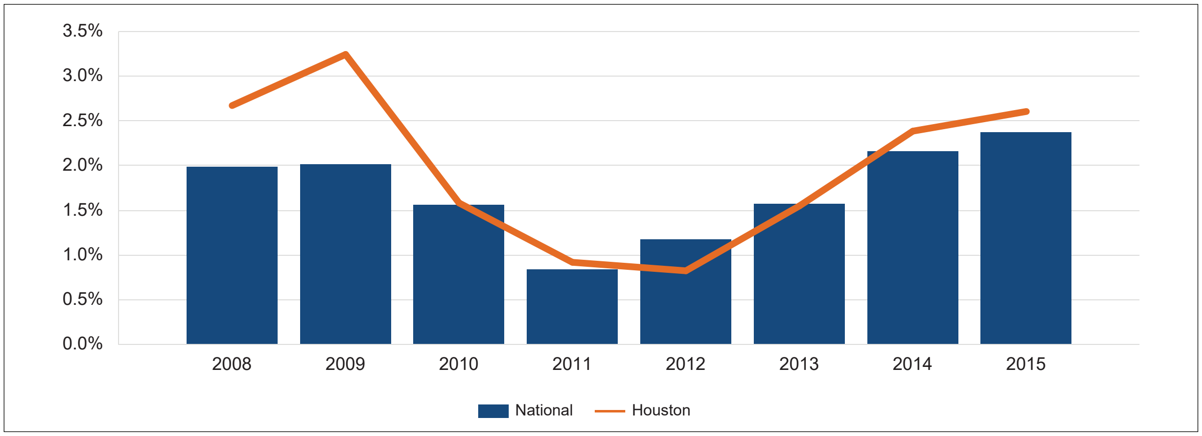
	2011	2012	2013	2014	2015
National	311,718,857	314,102,623	316,427,395	318,907,401	321,418,820
Houston-The Woodlands-Sugar Land, TX Metropolitan Statistical Area	6,059,752	6,185,988	6,332,710	6,497,864	6,656,947

Sources: U.S. Census, Moody's Analytics

Supply

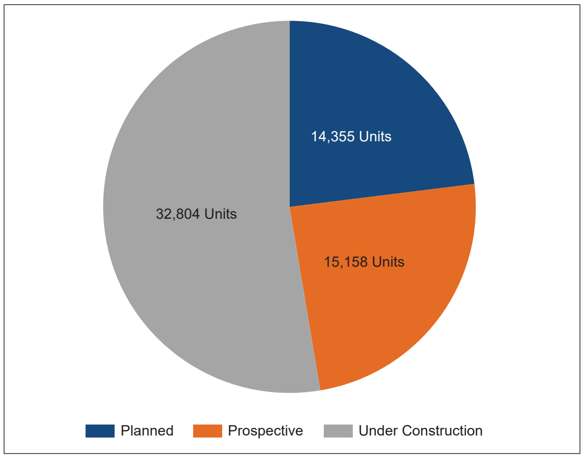
- Despite uncertainty regarding major economic drivers, Houston's high population growth is fueling new development across the metro. Demand comes mostly from the west side of the city's core, which is seeing the greatest growth in population and employment. With more than 15,200 units added in 2015, current stock rose by 2.6%, slightly above the 2.4% national rate.
- However, development is set to grow. More than 20,000 units are expected to come online in 2016, and more than 60,000 units are in various stages of development, including nearly 33,000 currently under construction. With 14,400 already in the planning and permitting phase, construction is expected to remain strong in the upcoming years. The state's development-friendly culture is a blessing in times of growth, but creates issues of oversupply when the economy stalls.
- Supply growth is led by the West End/Downtown submarket, with nearly 6,000 units currently under development. Other submarkets with a large pipeline include Piney Point Village-North (1,833 units), Museum District (1,512 units) and Louetta (1,471 units). The 463-unit Market Square Tower in the West End/ Downtown submarket is the largest project under construction, set for completion by mid-2017.

Houston vs. National Completions as a Percentage of Total Stock (as of September 2016)



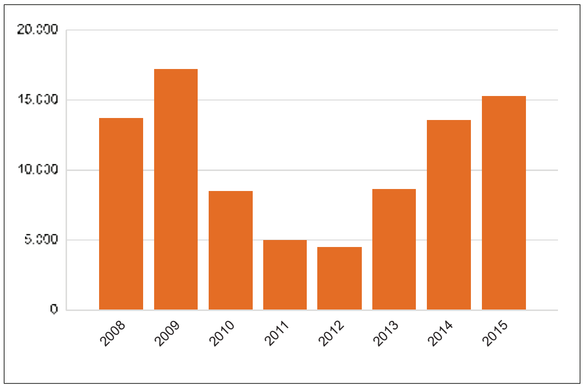
Source: YardiMatrix

Development Pipeline (as of September 2016)



Source: YardiMatrix

Houston Completions (as of September 2016)

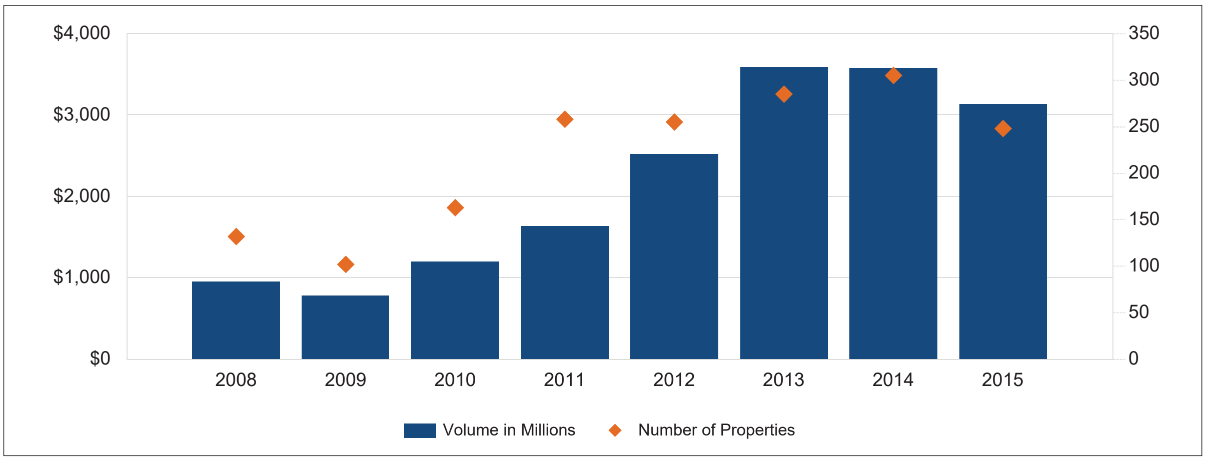


Source: YardiMatrix

Transactions

- More than $3.1 billion worth of properties traded in Houston in 2015, falling behind recent years but still healthy by historical standards. Houston's economic development and global connections made it a poplar target for investors, but caution now abounds due to questions about rent growth and energy prices.
- At $79,670, the average price per unit reached a new high for the current cycle, but remains well below the $117,397 national average.
- The two busiest submarkets over the last 12 months were Jersey Village/Salsum ($205 million) and Nassan Bay/Seabrook ($158 million). West Bellaire ($152 million), Louletta ($109 million) and Rosslyn ($106 million) rounded out the top five. Copperfield North was the most expensive property to change hands in Houston this year. ELRH Investments acquired the 964-unit property from JRK Property Holdings for $87 million.

Houston Sales Volume and Number of Properties Sold (as of September 2016)



Source: YardiMatrix

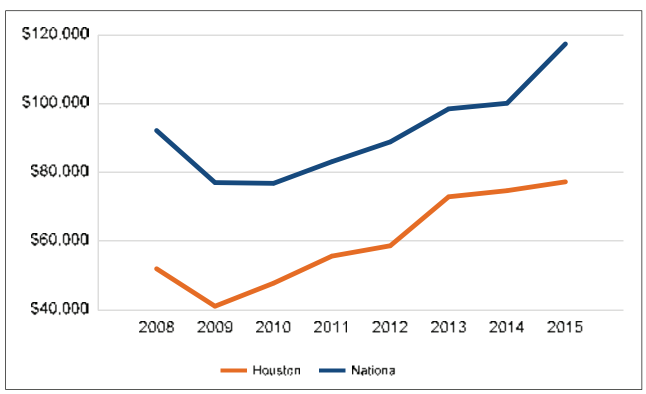
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Nassau Bay/Seabrook	180
Jersey Village/Salsuma	170
Rosslyn	129
West Bellaire	118
Baytown	102
Bammel	102
Louetta	101
Cloverleaf	95

Source: YardiMatrix

[1] From October 2015 to September 2016

Houston vs. National Sales Price per Unit



Source: YardiMatrix

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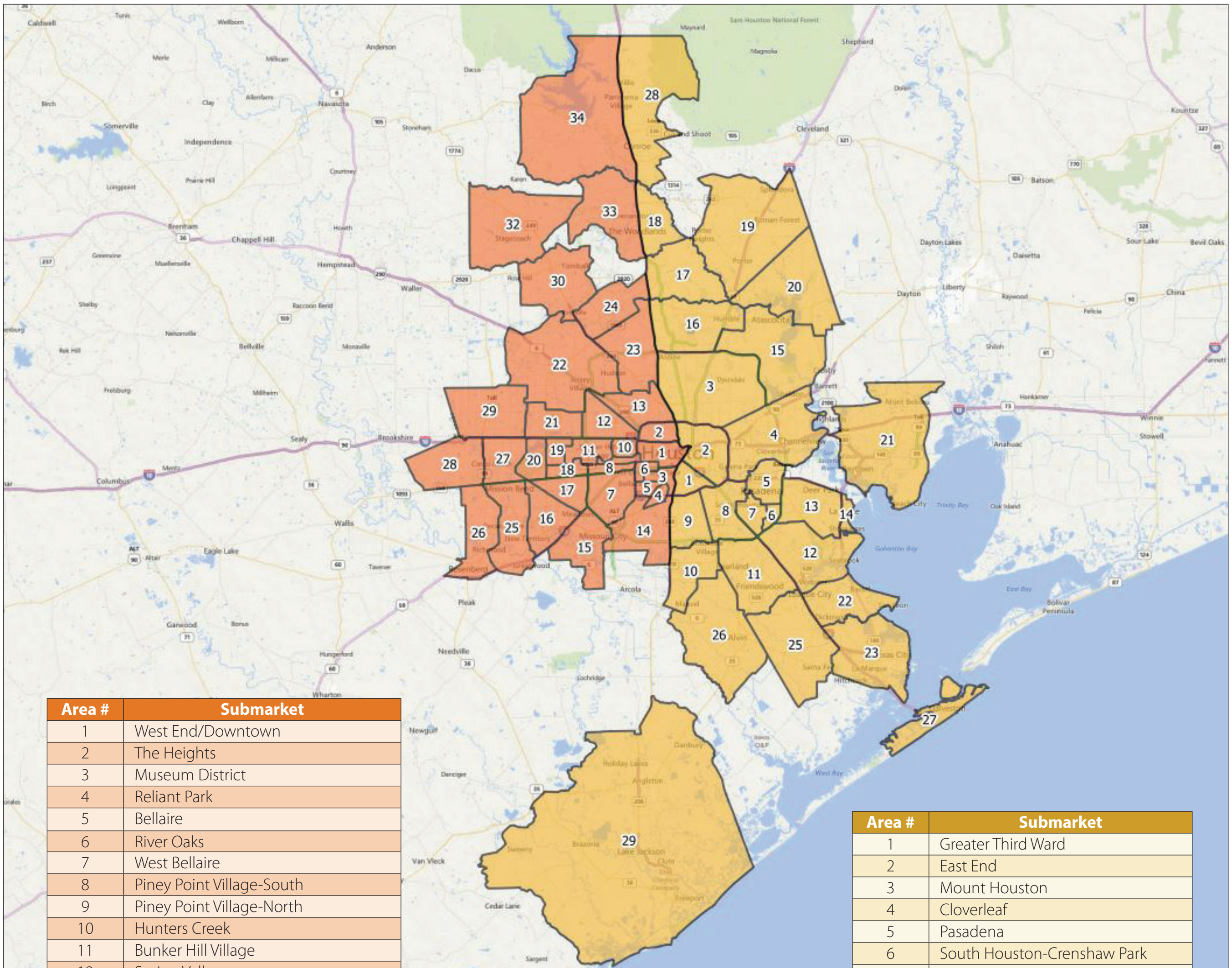
Houston Submarkets



Area #	Submarket
1	West End/Downtown
2	The Heights
3	Museum District
4	Reliant Park
5	Bellaire
6	River Oaks
7	West Bellaire
8	Piney Point Village-South
9	Piney Point Village-North
10	Hunters Creek
11	Bunker Hill Village
12	Spring Valley
13	Rosslyn
14	Missouri City
15	Suger Land-South
16	Sugar Land-West
17	Suger Land-North
18	Royal Oaks Country Club
19	Addicks
20	George Bush Park
21	Bear Creek Park
22	Jersey Village/Salsuma
23	Bammel
24	Louetta
25	Richmond
26	Rosenberg
27	Cinco Ranch-South
28	Katy
29	Cinco Ranch-North
30	Tomball
32	Magnolia
33	The Woodlands
34	Conroe-West

Area #	Submarket
1	Greater Third Ward
2	East End
3	Mount Houston
4	Cloverleaf
5	Pasadena
6	South Houston-Crenshaw Park
7	South Houston
8	William P Hobby Airport
9	Pirce Junction
10	Clear Creek
11	Pearland/Friendswood
12	Nassau Bay/Seabrook
13	Deer Park
14	La Porte
15	Atascocita
16	Humble/Westfield
17	Spring
18	The Woodlands-East
19	Porter
20	Kingwood
21	Baytown
22	League City/Dickenson
23	Texas City/San Leon
25	League City-West
26	Alvi
27	Galveston
28	Conroe-East
29	Lake Jackson/Angleton

Definitions

Lifestyle households (renters by choice) have wealth sufficient to own but have chosen to rent. Discretionary households, most typically a retired couple or single professional, have chosen the flexibility associated with renting over the obligations of ownership.

Renter by Necessity households span a range. In descending order, household types can be:

- *A young-professional, double-income-no-kids household* with substantial income but without wealth needed to acquire a home or condominium;
- *Students*, who also may span a range of income capability, extending from affluent to barely getting by;
- *Lower-middle-income ("gray collar") households,* composed of office workers, policemen, firemen, technical workers, teachers, etc.;
- *Blue-collar households*, which may barely meet rent demands each month and likely pay a disproportionate share of their income toward rent;
- *Subsidized households*, which pay a percentage of household income in rent, with the balance of rent paid through a governmental agency subsidy. Subsidized households, while typically low income, may extend to middle-income households in some high-cost markets, such as New York City;
- *Military households*, subject to frequency of relocation.

These differences can weigh heavily in determining a property's ability to attract specific renter market segments. The five-star resort serves a very different market than the down-and-outer motel. Apartments are distinguished similarly, but distinctions are often not clearly definitive without investigation. The Yardi® Matrix Context rating eliminates that requirement, designating property market positions as:

Market Position	Improvements Ratings
Discretionary	A+ / A
High Mid-Range	A- / B+
Low Mid-Range	B / B-
Workforce	C+ / C / C- / D

The value in application of the Yardi® Matrix Context rating is that standardized data provides consistency; information is more meaningful because there is less uncertainty. The user can move faster and more efficiently, with more accurate end results.

The Yardi® Matrix Context rating is not intended as a final word concerning a property's status—either improvements or location. Rather, the result provides reasonable consistency for comparing one property with another through reference to a consistently applied standard.

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