YARDI® Matrix

# Houston's Shaky Economy

## Multifamily Winter Report 2017

**Energy Job Cuts Slow Rent Growth**

**Development Targets City Core**

**Transaction Activity Declines**

## Market Analysis

Winter 2017

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# Bayou City Enters Recovery Mode

Houston's multifamily market is still reeling from the oil price collapse in 2015, which resulted in thousands of job cuts and slowing investment activity. Even though in-migration continues due to the metro's growing economic diversity, its high quality of life and favorable cost of living, the rent growth outlook will remain clouded as the ample new supply gets absorbed.

The metro's economy received a boost from hosting the Super Bowl, which generated seasonal jobs in hospitality and tourism. Through increases in consumer spending in hotels, retail and other entertainment venues, the Super Bowl's economic impact has been estimated at $350 million. Home to Texas Medical Center, one of the largest medical centers in the world, Houston benefits from a skilled workforce, and the use of innovative technologies in health care attracts a large talent pool to the metro. The trade, transportation and utilities segment also posted positive results, as Houston develops a well-rounded workforce.

The outlook for multifamily is not favorable, since the development pipeline includes 58,000 units and the local economy remains unstable. With very low rent growth and an occupancy rate that lags the national average, absorption of the 18,700 apartments added in 2016 will be slow. Transactions remain widespread across the metro, while upcoming development is focused on the West End/ Downtown submarket—with 4,800 units under construction.

### Recent Houston Transactions

Domain at Kirby

City: Houston
Buyer: Ilan Investments
Purchase Price: $67 MM
Price per Unit: $227,615

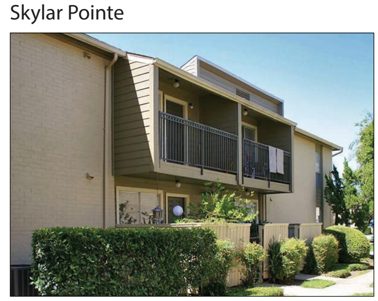
Chandler Park

City: Houston
Buyer: Nevins Adams Lewbel & Schell
Purchase Price: $45 MM
Price per Unit: $103,240

Whispering Pines Ranch

City: Spring, Texas
Buyer: Hayden Properties
Purchase Price: $42 MM
Price per Unit: $139,555

Skylar Pointe



City: Houston
Buyer: ValCap Group
Purchase Price: $39 MM
Price per Unit: $86,859

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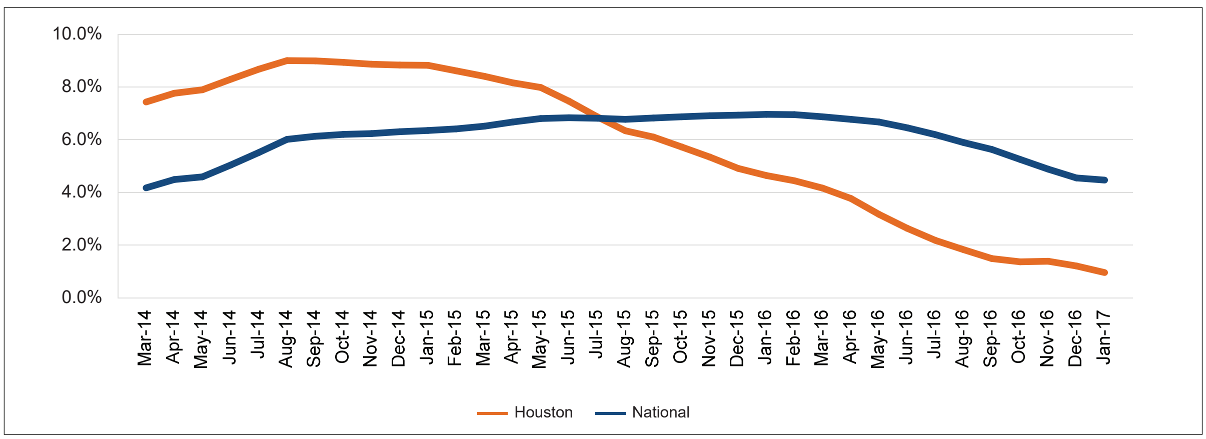
On the cover: Photo by Jodi Jacobson/iStockphoto.com

## Rent Trends

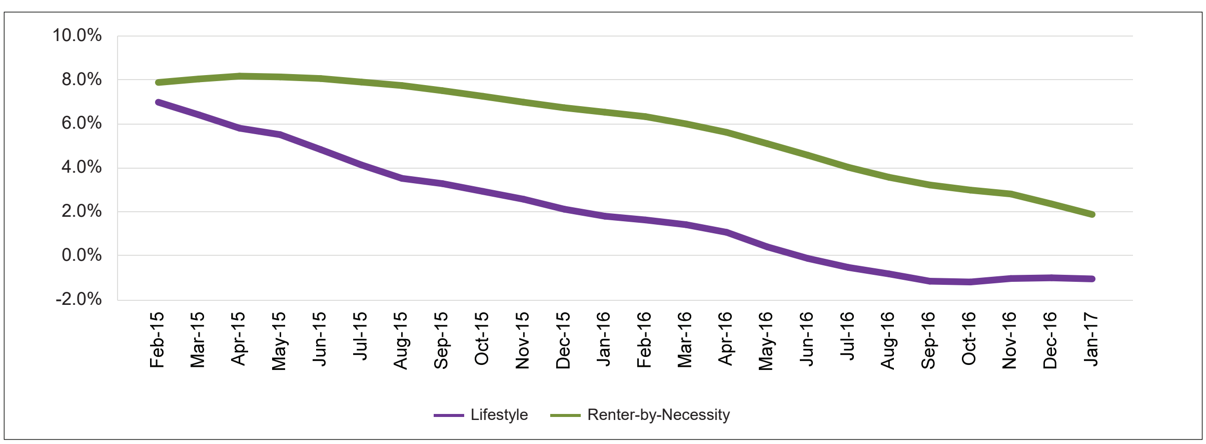
- Rents in Houston rose 0.1% year-over-year through January, falling well behind the 4.6% national pace. Rental rates in the metro stood at $1,049, also trailing the $1,315 national average. The metro continues to face a slowdown, as job losses resulting from the shock to the energy sector weigh on rent growth. Occupancy for stabilized properties was 93.5% as of December, one of the lowest levels in the U.S.
- The Renter-by-Necessity segment has strengthened slightly, with the 1.9% growth year-over-year bringing rents to $839. The higher-end Lifestyle segment posted a 1.1% decrease. Given the recent job losses and significant new supply at the high end, the lifestyle segment may continue to see flat or negative growth.
- Rent increases were led by affordable submarkets such as Lake Jackson/Angleton (7.8%), The Woodlands – East (6.9%) and Galveston (6.8%), which still sit in the lower end of the spectrum in terms of rental rates. Avonak (-5.0%) and River Oaks (-3.2%) posted the largest declines, as rents reached record highs in 2015.
- With healthy population gains and thousands of new jobs being added in health care, hospitality and government, Yardi Matrix expects rents to rebound slightly, roughly in line with national levels, and increase by 4.2% in 2017.

### 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)

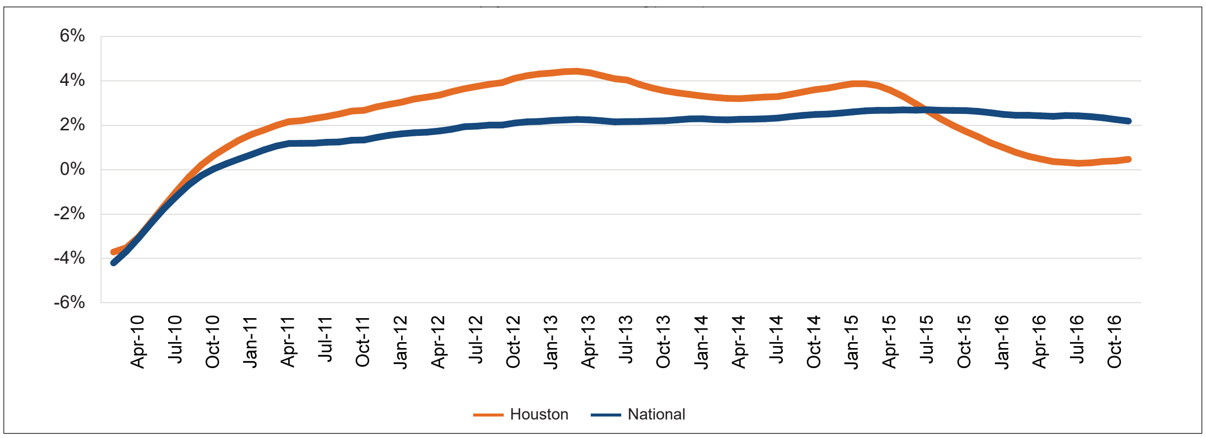



Source: YardiMatrix

## Economic Snapshot

- The metro added 16,100 jobs in the 12 months ending in November. Overall growth was 0.5% , trailing the national average of 2.2%. Even though energy prices have stabilized, the mining, logging and construction segment continued to bleed jobs, down 20,600 positions year-over-year.
- The hospitality and tourism segment led employment gains (16,700). The Super Bowl's economic impact on the metro was estimated at $350 million. The event increased demand for seasonal jobs and drove sales for the local entertainment industry. Tourism was strong, with 55 million passengers traveling through the Houston airports in 2016 and the number of visitors expected to remain high in 2017.
- Education and health services added 14,500 jobs. Houston's health-care system has benefited greatly from the Affordable Care Act, which generated substantial investments in hospitals, new jobs, as well as an influx of a talented workforce in the metro over the past five years.
- Health care drives leasing activity in the office market, though construction of new properties has slowed due to limited demand. The vacancy rate for office buildings has shot up to about 20%, and nearly 12 million square feet of space was available for sublease, according to Newmark Grubb Knight Frank.

### 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 | 324 | 10.7% | 16,700 | 5.4% |
| 65 | Education and Health Services | 391 | 12.9% | 14,500 | 3.9% |
| 40 | Trade, Transportation and Utilities | 630 | 20.8% | 10,500 | 1.7% |
| 90 | Government | 401 | 13.2% | 9,100 | 2.3% |
| 55 | Financial Activities | 153 | 5.0% | -100 | -0.1% |
| 50 | Information | 31 | 1.0% | -300 | -1.0% |
| 80 | Other Services | 105 | 3.5% | -2,600 | -2.4% |
| 60 | Professional and Business Services | 465 | 15.3% | -3,900 | -0.8% |
| 30 | Manufacturing | 231 | 7.6% | -7,200 | -3.0% |
| 15 | Mining, Logging and Construction | 300 | 9.9% | -20,600 | -6.4% |

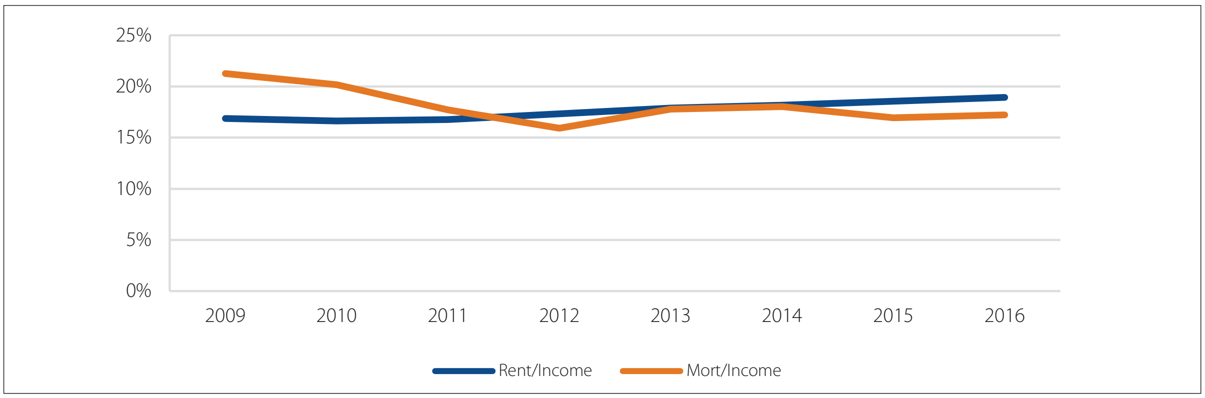
Sources: YardiMatrix, Bureau of Labor Statistics

## Demographics

### Affordability

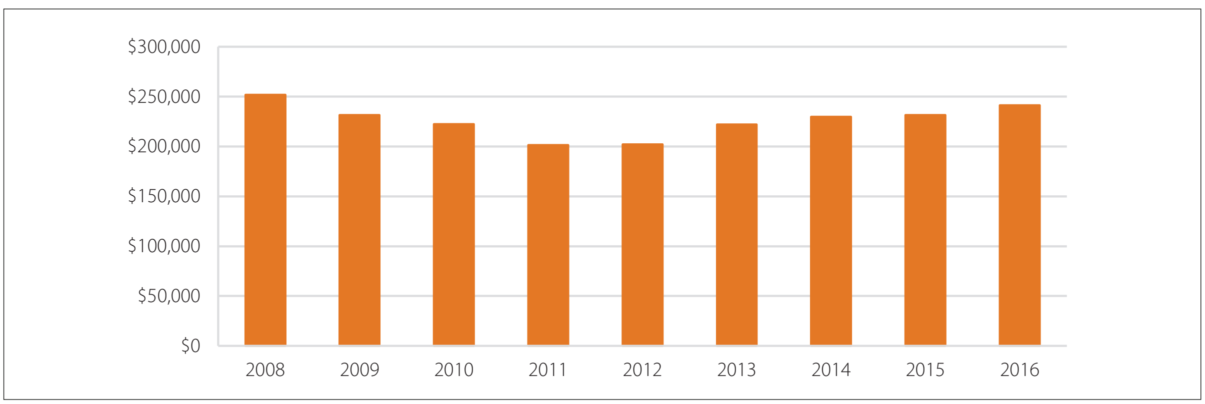
- The median home price in the metro rose to $241,000 in 2016. Owning remains a less expensive option to renting, as the average mortgage payment comprised 17% of the metro's median income. Renting in Houston accounted for 19% of the median income, as average rents reached $1,049 in January.
- Traditionally known as a relatively affordable metro, Houston is becoming less so, as new high-end apartments hit the market, despite the recent economic downturn. That instability, especially in the energy-related workforce, may prevent potential homebuyers from investing until the market regains jobs.

**Houston Rent vs. Own Affordability as a Percentage of Income**




Sources: YardiMatrix, Moody's Analytics

**Houston Median Home Price**




Source: Moody's Analytics

### Population

- Houston added 160,000 residents in 2015, a 2.4% increase, well above the 0.8% national average.
- Over the past five years, the metro added 600,000 residents—a 9.9% increase.

**Houston vs. National Population**

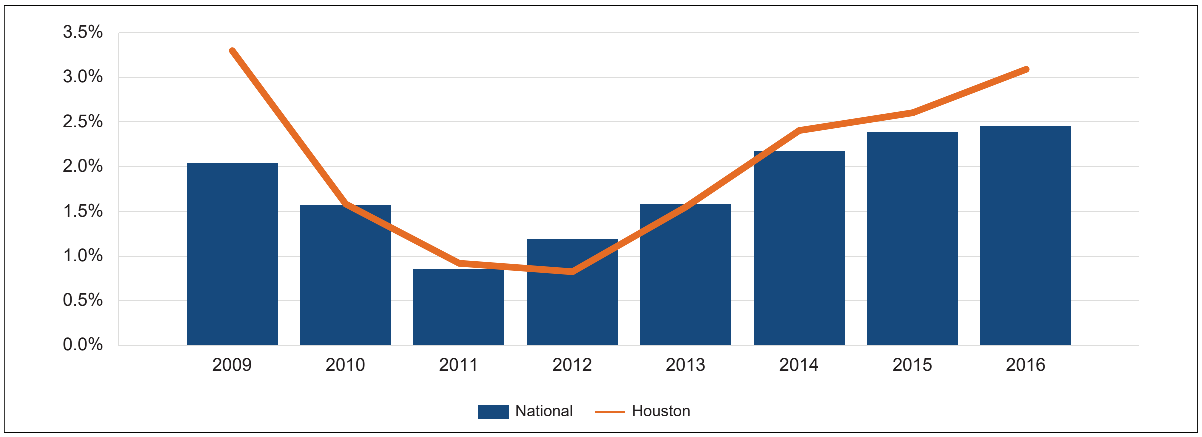
| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| National | 311,718,857 | 314,102,623 | 316,427,395 | 318,907,401 | 321,418,820 |
| Houston Metropolitan Statistical Area | 6,059,752 | 6,185,988 | 6,332,710 | 6,497,864 | 6,656,947 |

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

## Supply

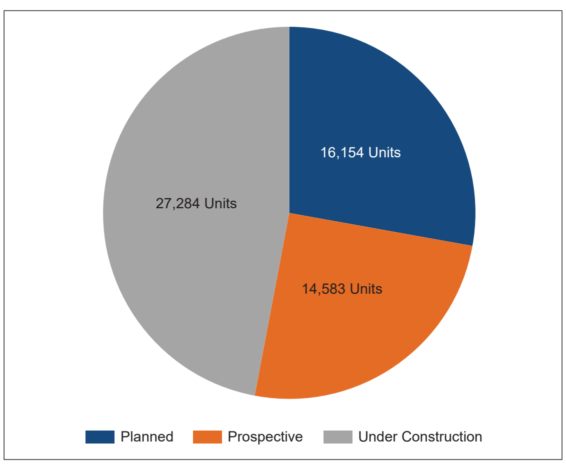
- Multifamily development remains strong despite Houston's weak employment growth and economic setbacks in the energy sector. Healthy population gains and employment opportunities in health care and hospitality drive demand in downtown areas.
- More than 18,600 units came online in 2016, adding 3.1% to the current stock, and the metro's heavy pipeline of 58,000 units points toward construction activity remaining strong in the coming years. Roughly 27,200 units were under construction as of January, while 16,200 units were in various planning stages.
- Despite a high population growth, Houston's 93.5% occupancy rate for stabilized properties as of December was the lowest among major U.S. metros, according to Yardi Matrix. The substantial new development, along with the metro's shaky economy, might lead to weak net absorption in 2017.
- West End/Downtown (4,800 units), River Oaks (1,300 units) and the Museum District (1,300 units) remain the most attractive submarkets to developers, as demand continues to be high in the urban core. The largest community underway is the 463-unit Market Square Tower located in the West End/Downtown submarket and scheduled for completion in July 2017.

### Houston vs. National Completions as a Percentage of Total Stock (as of January 2017)



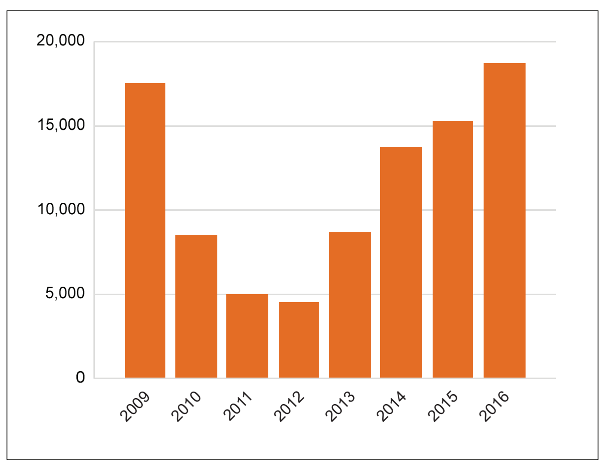

Source: YardiMatrix

### Development Pipeline (as of January 2017)




Source: YardiMatrix

### Houston Completions (as of January 2017)

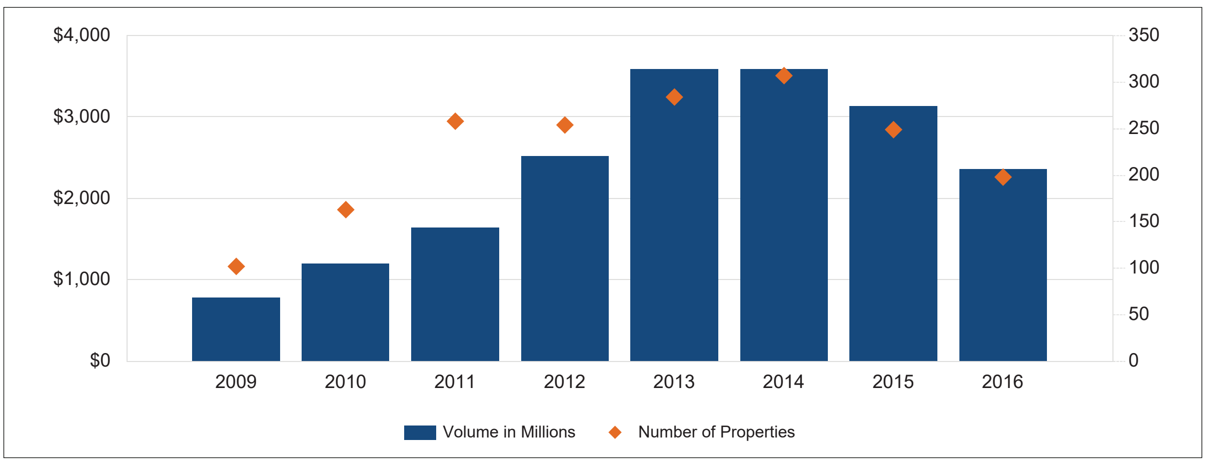



Source: YardiMatrix

## Transactions

- Investment appetite has remained relatively healthy, as $2.8 billion worth of properties changed hands in 2016, although transaction volume declined from the $3 billion-plus level in each of the last three years. Some investors are cutting back on their exposure to Houston due to concerns about overdevelopment and the metro's economic dependence on the energy sector.
- At $79,666, the average price per unit remained well under the national average, but still marked a cyclical peak for the metro. Prices, however, are expected to remain soft due to the heavy new supply.
- Nassau Bay/Seabrook was the most sought-after submarket over the last 12 months, with roughly $166 million transacted in this area. Copperfield North was Houston's biggest transaction of 2016. Robbins Electra acquired the 924-unit community for $86 million, or $93,798 per unit.

### Houston Sales Volume and Number of Properties Sold (as of January 2017)




Source: YardiMatrix

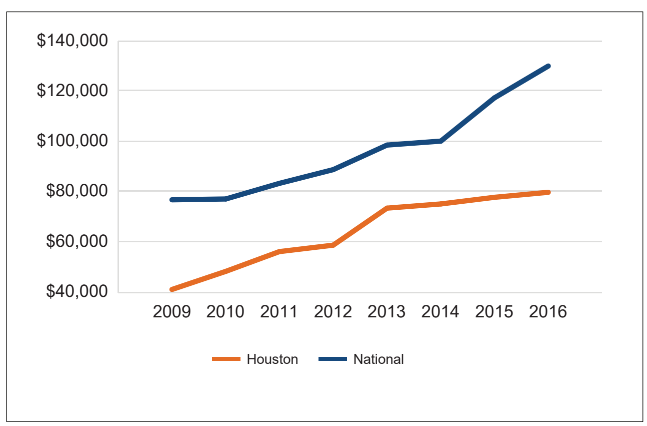
### Top Submarkets for Transaction Volume[1]

| Submarket | Volume ($MM) |
|---|---|
| Nassau Bay/Seabrook | 167 |
| Bammel | 123 |
| Jersey Village/Salsuma | 122 |
| West Bellaire | 122 |
| Baytown | 115 |
| Louetta | 115 |
| Cloverleaf | 111 |
| Reliant Park | 119 |

Source: YardiMatrix

[1] From February 2016 to January 2017

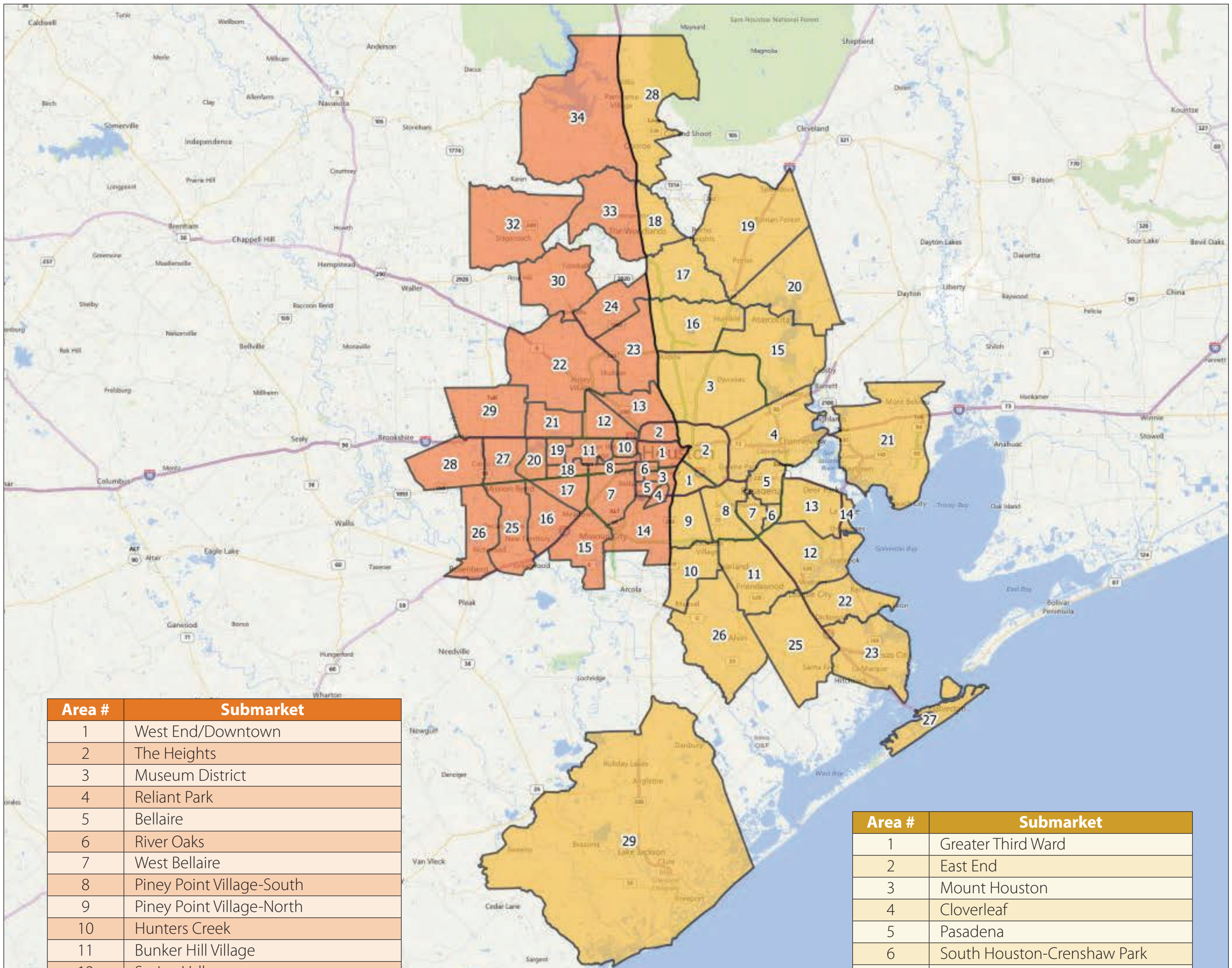
### Houston vs. National Sales Price per Unit




Source: YardiMatrix

Photo by Sean Pavone Photo/iStockphoto.com

## 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.

To learn more about Yardi® Matrix and subscribing, please visit www.yardimatrix.com or call Ron Brock, Jr., at 480-663-1149 x2404.