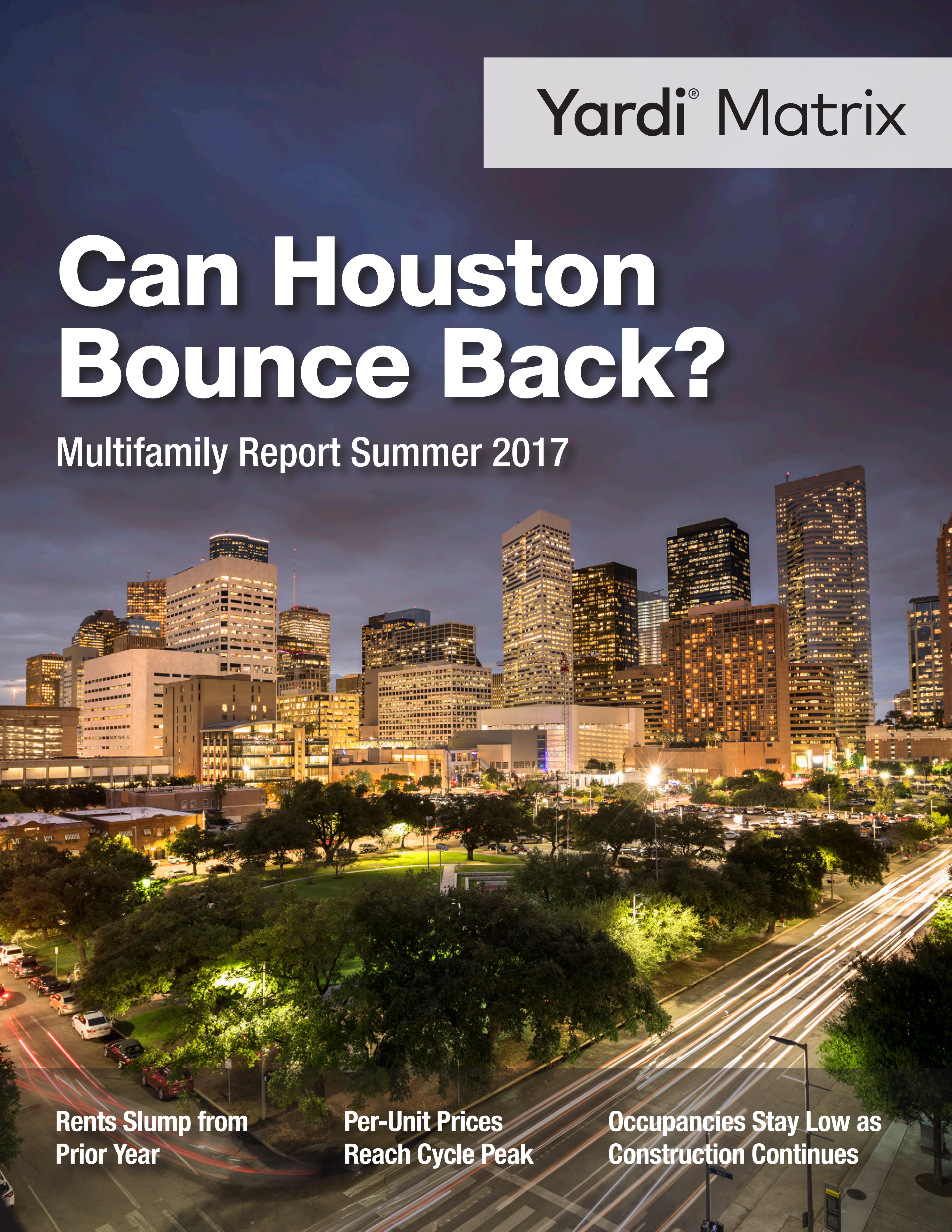
Yardi® Matrix

Can Houston Bounce Back?

Multifamily Report Summer 2017



Rents Slump from Prior Year

Per-Unit Prices Reach Cycle Peak

Occupancies Stay Low as Construction Continues

Market Analysis

Summer 2017

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Oil Prices, Supply Still Influence Market

Houston's apartment market continues to struggle as oil prices remain below $50 a barrel with little prospect that they will rise soon. With the economic slowdown brought about by issues in the energy sector, the local housing market must deal with large amounts of new housing stock and limited rent growth.

Despite continued job losses in mining, logging and construction, there are some bright spots. Braskem's announced $675 million petrochemical development will create 1,000 new positions by 2020. Education and health services continues to be a cornerstone of the economy, as the health care system benefited greatly from a recent $226 million grant from the National Science Foundation and $528 million in medical research grants from the National Institutes of Health. A major initiative that aims to generate investor interest and attract substantial corporate relocations is the $1.2 billion fund approved by the Texas Transportation Commission, the bulk of which will go toward an extensive overhaul of Interstate 45.

The outlook for Houston's multifamily sector will stay cloudy as new supply is absorbed. The market continues to show some signs of instability, mostly due to negative rent growth and decreasing occupancy in the upscale Lifestyle segment. Nearly 20,000 units are expected to come online this year, while job growth is anticipated to be modest at best. Yardi Matrix forecasts Houston rents will increase by a modest 0.5% in 2017.

Recent Houston Transactions

Villas at Shadow Creek Ranch

City: Pearland, Texas
Buyer: Starwood Capital Group
Purchase Price: $67 MM
Price per Unit: $120,000

Domain at Kirby

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

The Columns at Shadow Creek Ranch

City: Pearland, Texas
Buyer: ECI Group
Purchase Price: $53 MM
Price per Unit: $139,965

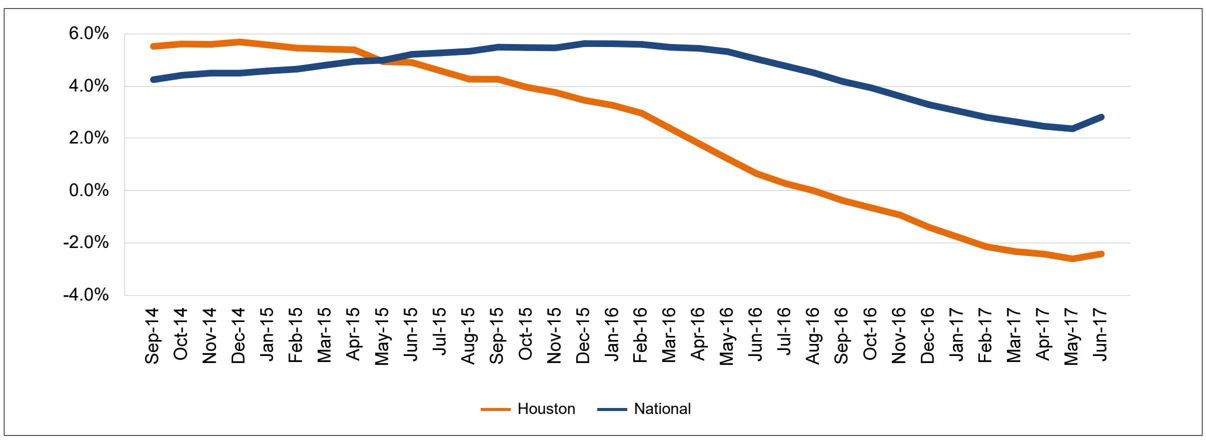
Hidden Lake

City: Houston
Buyer: Starwood Capital Group
Purchase Price: $53 MM
Price per Unit: $120,000

Rent Trends

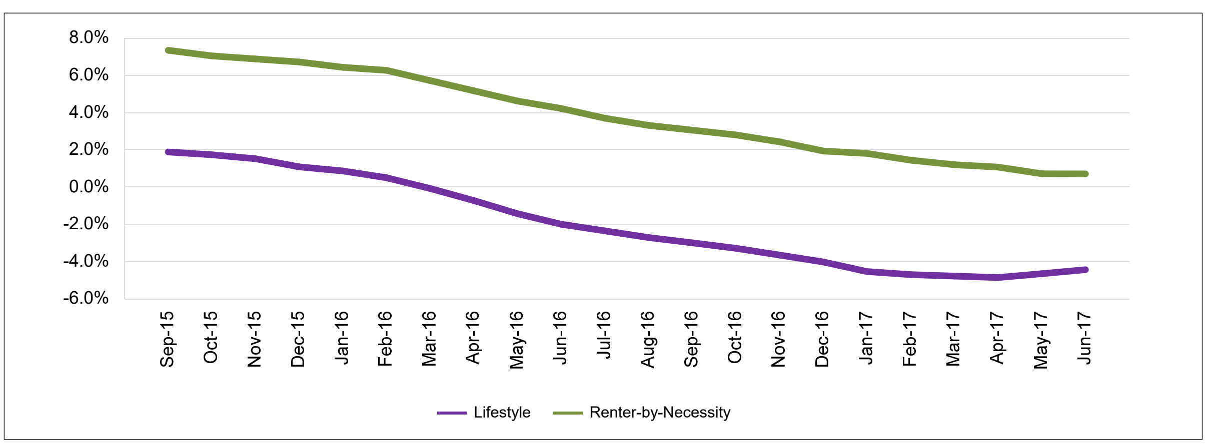
- Houston rents contracted 2.4% year-over-year through June, as the metro's economy is still coping with falling oil prices, which have hampered growth development during the last two years. Rents averaged $1,049, trailing the national figure by $300.
- Houston's average occupancy rate for stabilized properties was 93.1% as of June, which is still one of the lowest rates among major U.S. metros. The high number of completions has pushed the occupancy rate down 60 basis points over the past 12 months.
- Rents in the working-class Renter-by-Necessity segment grew 0.7% year-over-year, to $845, while rents in the Lifestyle segment slid 4.4% to $1,315. The difference in dynamic has been deepened by the recent job cuts, which have lowered demand for upscale properties and generated the need for affordable apartment stock, as renters look for cheaper options. Rents for upscale units will continue to soften this year as supply grows.
- Rent gains were highest in Northwest Harris County (7.6%), where increased demand and limited completions have contributed to the upward trend. Museum District ($1,886), West End/Downtown ($1,721) and River Oaks ($1,627) reported the highest rents. We expect rent growth to top out at 0.5% 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

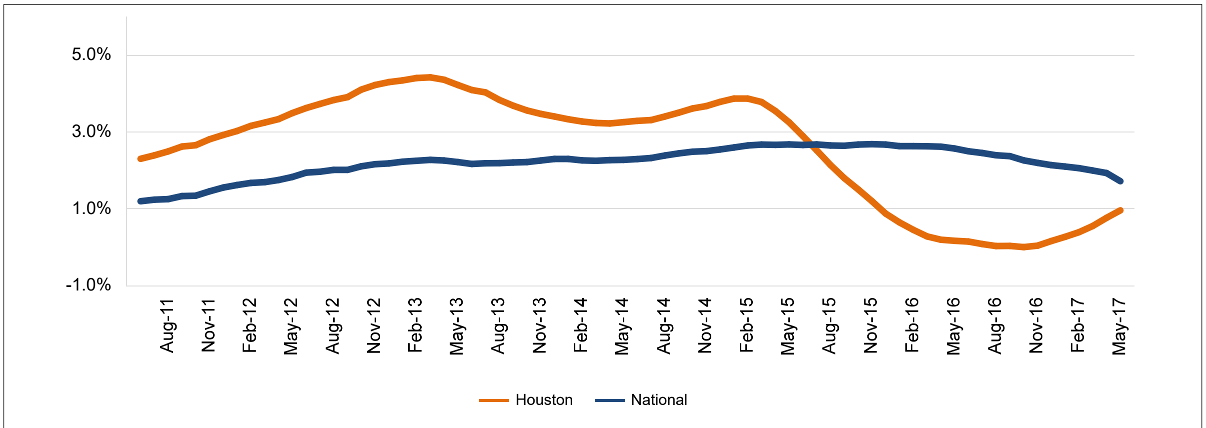
- Houston added 45,300 new jobs in the 12 months ending in June. Overall growth was 1.0%, nearly half the national average of 1.9%, due to the continued weakness of the energy industry. With commercial construction activity still in decline and the petrochemical construction boom winding down, the outlook for the mining, logging and construction segment remains poor, down 7,000 positions year-over-year through June. However, the trend is poised to change, as Braskem's $675 million petrochemical project will lead to the creation of 1,000 new positions by 2020.

- Employment growth was strongest in public services, which added 12,000 jobs, a 2.9% uptick year-over-year. While affected, the local economy is steadily diversifying, with much of the new job growth ocurring in leisure and hospitality, which added 11,900 new positions.

- Education and health services added 9,700 jobs. Houston's health industry has benefited greatly from the $226 million grant from the National Science Foundation and $528 million in medical research funds from the National Institutes of Health.

- Construction activity has outpaced absorption over the past few years, leading to rapidly increasing vacancy, at 22.4% and rising, according to the latest JLL report. However, tempering deliveries point to future stabilization.

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	%
90	Government	419	13.7%	12,000	2.9%
70	Leisure and Hospitality	329	10.8%	11,900	3.8%
60	Professional and Business Services	478	15.7%	11,600	2.5%
65	Education and Health Services	389	12.8%	9,700	2.6%
30	Manufacturing	232	7.6%	8,700	3.9%
80	Other Services	112	3.7%	2,700	2.5%
55	Financial Activities	156	5.1%	1,500	1.0%
50	Information	32	1.0%	-700	-2.1%
40	Trade, Transportation and Utilities	600	19.7%	-5,100	-0.8%
15	Mining, Logging and Construction	303	9.9%	-7,000	-2.3%

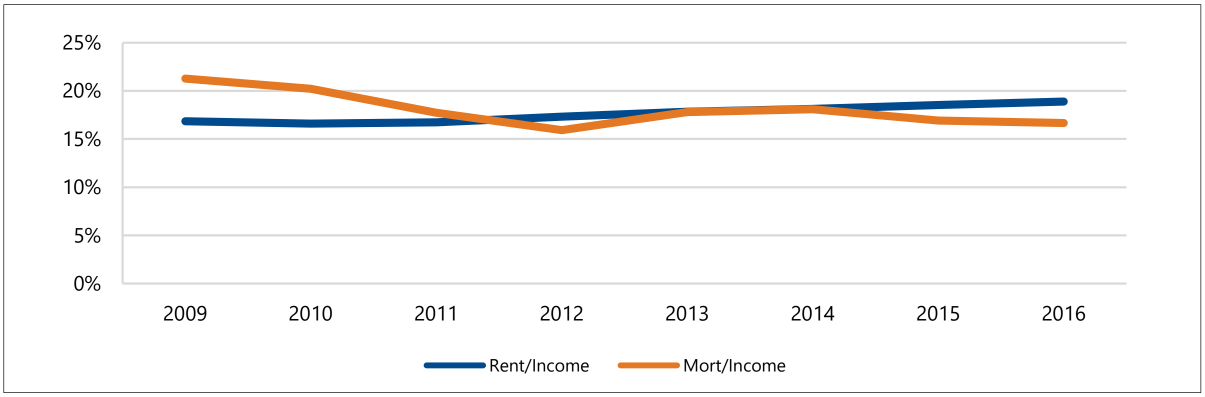
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

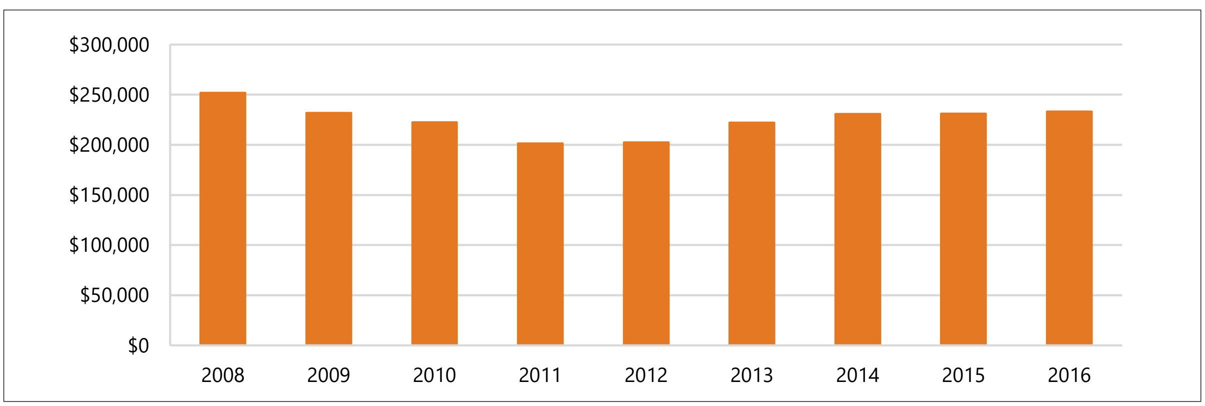
- The median home price in Houston rose to $233,307 in 2016, a new cycle peak. Owning remains the less costly option, taking up 17% of the metro's median income. Renting in Houston accounted for 19% of the median income, as average monthly rates reached $1,049 in June.
- Despire the oil slump, there are thousands of apartments still underway across the metro. The construction pipeline has changed what has been traditionally known as a relatively affordable market to one that is increasingly less so. By and large, developers have been replacing older housing units that have lower average asking rents with newer, more expensive units, raising concerns about the threat of waning affordability.

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's population increased by 1.8% in 2016, at a rate more than double the 0.7% national average.
- The metro's population expanded by 125,000 in 2016 alone, up by almost 600,000 residents since 2012.

Houston vs. National Population

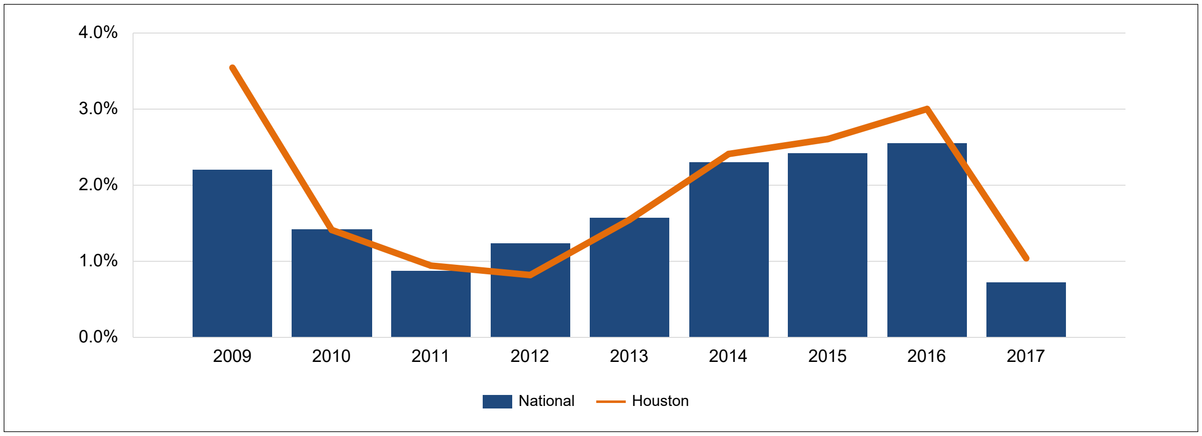
	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
Houston Metro	6,180,817	6,324,167	6,488,046	6,647,465	6,772,470

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

Supply

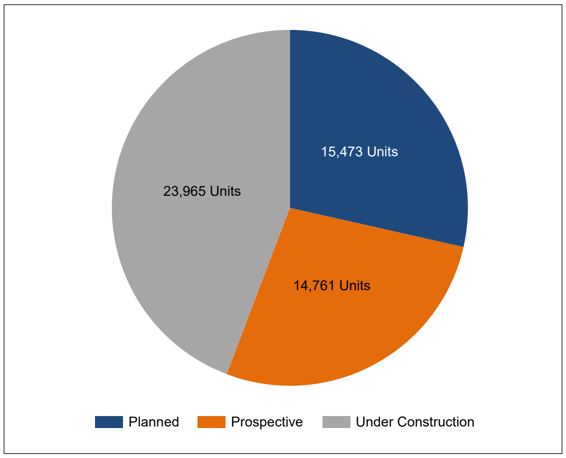
- Apartment deliveries were off to a relatively slow start during the year's first half, with only 4,750 units coming online year-to-date through June. However, construction activity stayed robust, and completions are expected to pick up during the year's second half. Roughly 19,000 units are set to be added in 2017, representing an increase in total stock of 3.2%.
- About 24,000 units are under construction, while more than 54,000 units are in various stages of development as of mid-year. Houston's occupancy rate for stabilized properties was 93.1% as of June, one of the lowest among major U.S. cities.
- Central, eastern and southern submarkets are in high demand as job growth was steady in these areas, while western submarkets received the largest impact from energy industry cuts. Five submarkets have more than 1,000 units under construction: West End/Downtown (4,787), River Oaks (1,310), Museum District (1,288), Bunker Hill Village (1,205) and Avonak (1,186). The largest development currently underway in Houston is Marq 31, CWS Capital Partners' 453-unit project, which is scheduled for completion later in 2017. Absorption has been speedy so far: 198 units were already pre-leased as of July.

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



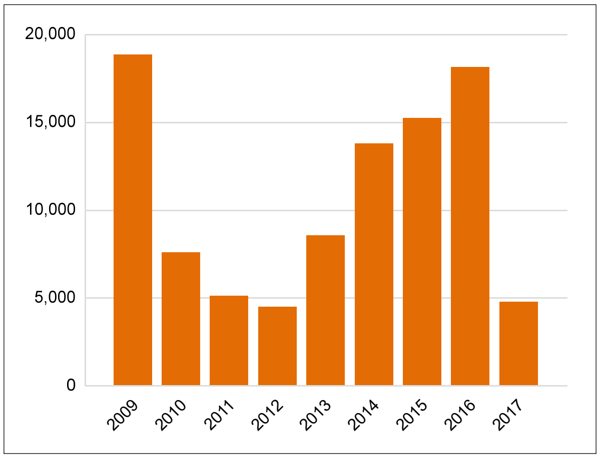
Source: YardiMatrix

Development Pipeline (as of June 2017)



Source: YardiMatrix

Houston Completions (as of June 2017)

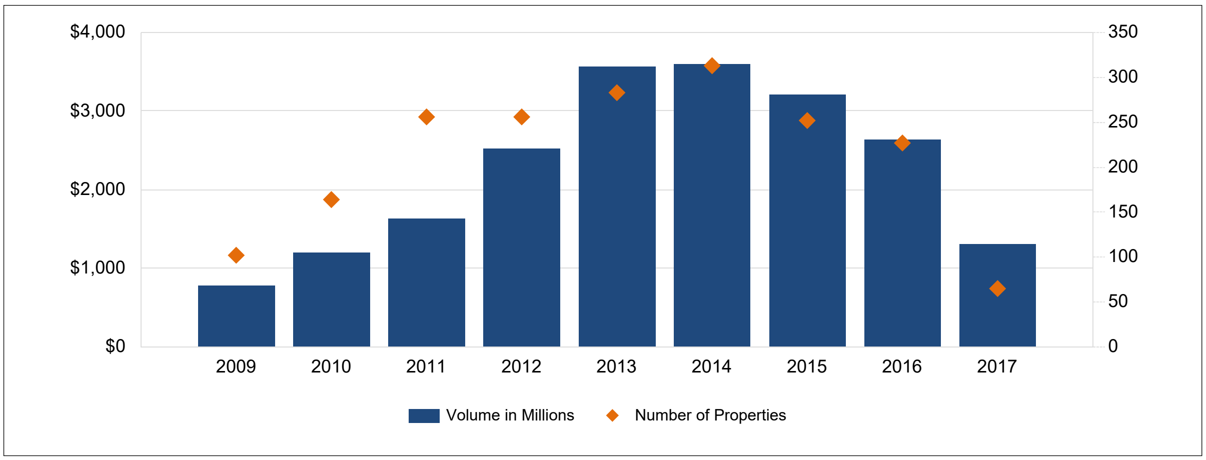


Source: YardiMatrix

Transactions

- Roughly $1.3 billion in multifamily properties traded in Houston year-to-date through June. Transactions moderated slightly over the past 18 months, following a three-year spell between 2013 and 2015 when annual totals were at least $3.2 billion. Despite a slowdown caused by dependence on the oil industry, there are still investors willing to invest in a market with a lot of new, good quality housing stock.
- At $107,020 this year, the average price per unit remained well below the $132,548 national average, but still marked a cycle peak. Prices are expected to remain soft due to extensive new supply that has yet to be absorbed. Nassau Bay/Seabrook was the most sought-after submarket over the last 12 months, with almost $244 million in transactions. Starwood Capital Group purchased Villas at Shadow Creek Ranch in Pearland for $67 million, as part of a portfolio deal that also included properties in Colorado, Florida, Georgia, North Carolina and Texas. Starwood paid Milestone Group a per-unit price of $120,000.

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



Source: YardiMatrix

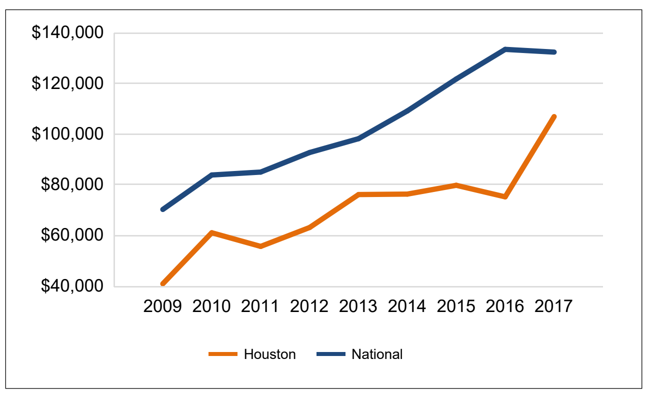
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Nassau Bay/Seabrook	244
Missouri City	172
Bammel	171
Cinco Ranch–South	139
Katy	125
Royal Oaks Country Club	111
West Bellaire	110
Reliant Park	110

Source: YardiMatrix

[1] From July 2016 to June 2017

Houston vs. National Sales Price per Unit



Source: YardiMatrix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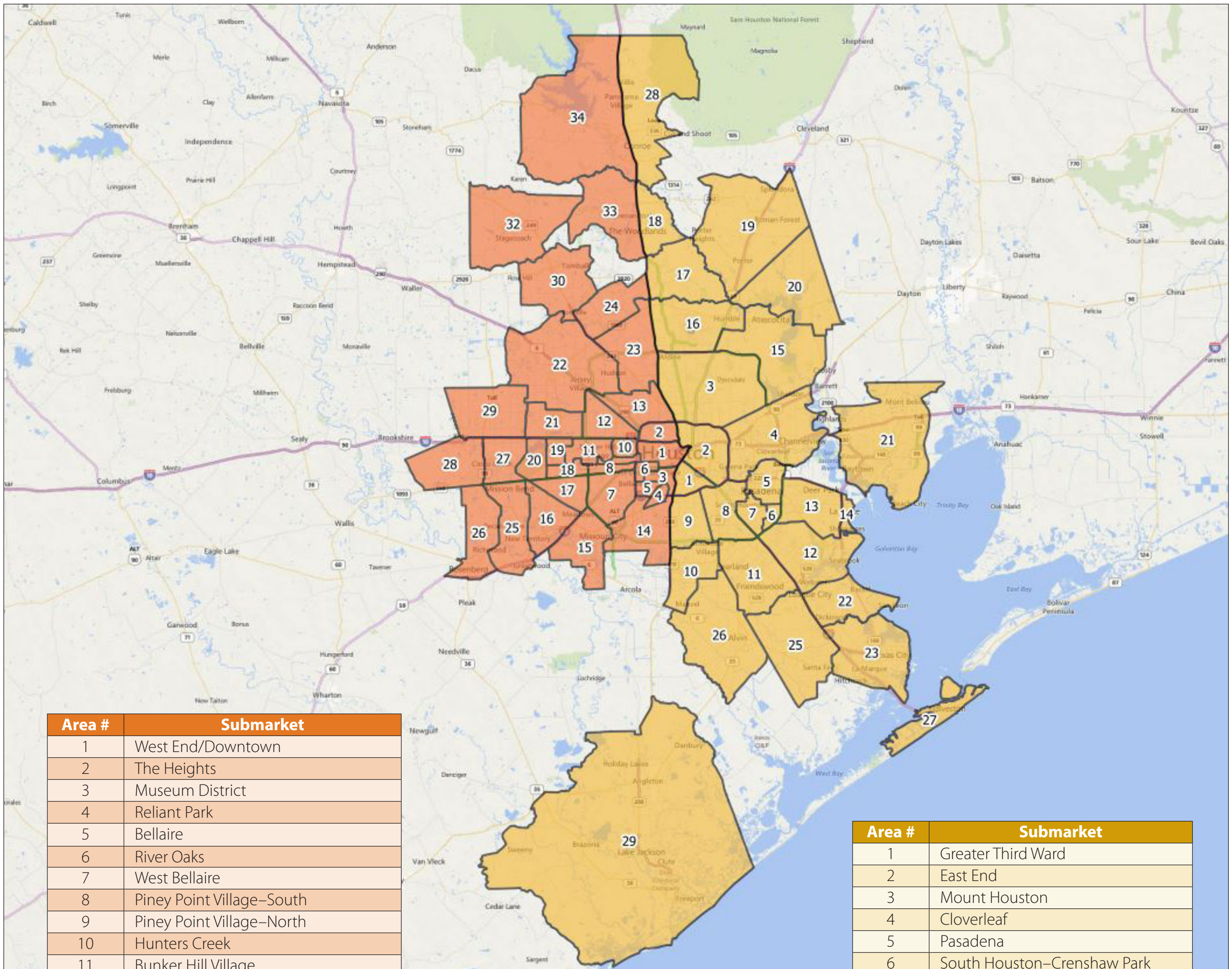
Houston Submarkets



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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