Yardi® Matrix

Houston's Post-Harvey Boost

Multifamily Report Winter 2018

High Demand for Temporary Housing

Development Targets Core Areas

Rents Hit Positive Figures

Yardi® Matrix

Market Analysis

Winter 2018

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Bayou City Embarks on Healing Process

The Houston apartment market is still struggling to recover from the 2015 oil price drop. Despite its havoc, Hurricane Harvey provided a short-term boost to fundamentals, as demand for living space from residents displaced by the storm temporarily increased multifamily occupancy.

Job creation in the manufacturing sector was a significant force for the positive shift in Houston's economy, with the metro adding 13,300 new positions in that industry alone. On the other hand, Houston continues to struggle in other sectors, such as construction, transportation and hospitality, which lost more than 20,000 jobs combined. But the energy market has begun to show signs of improvement. Oil prices are on the rise, inventories of petroleum products are declining and energy companies are reporting profits after years of losses. Following Harvey, most refineries along the Texas Gulf Coast have resumed operations. Moreover, state officials have requested federal assistance in the amount of $61 billion to repair and rebuild public infrastructure in the wake of the hurricane.

The outlook for the multifamily sector will brighten as residents in need of housing absorb new supply. Due to flood-damaged units rendered uninhabitable and delays in deliveries caused by lack of workforce and building materials, rents showed positive growth for the first time in more than a year. However, we expect rents to contract by -0.7% for 2017, as renters return to storm-ravaged homes.

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: $227,912

Remington Park

City: Houston
Buyer: American Realty Investors
Purchase Price: $57 MM
Price per Unit: $132,399

The Lodge at Shadowlake

City: Houston
Buyer: Knightvest Capital
Purchase Price: $55 MM
Price per Unit: $105,818

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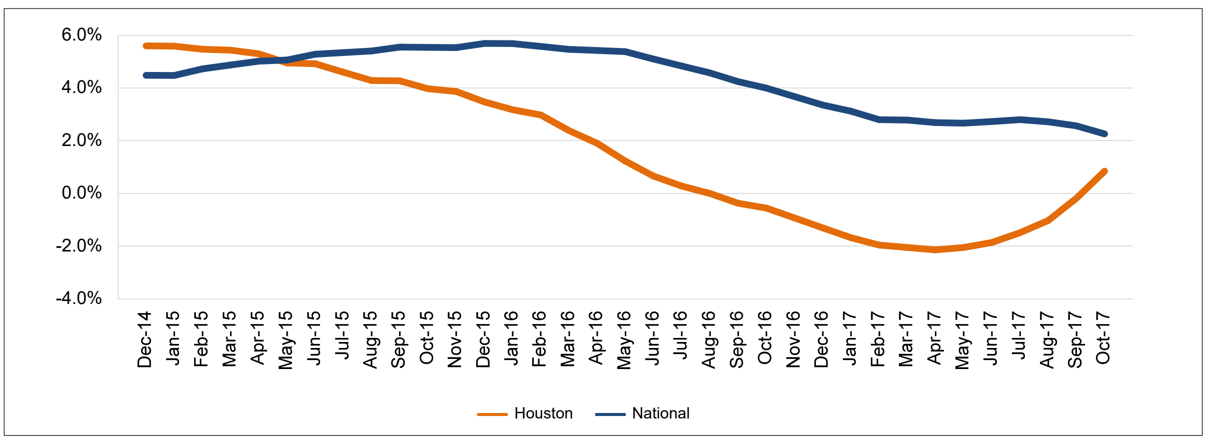
Rent Trends

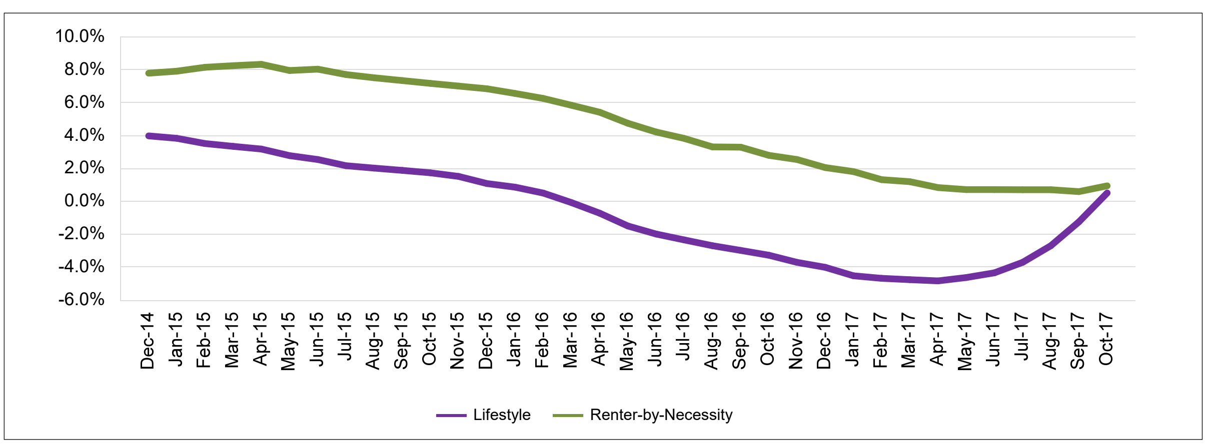
- Houston rents rose 0.8% year-over-year through October, the metro's first positive month since July 2016. The increase resulted from heightened demand as Hurricane Harvey left many Houstonians in need of housing. An initial analysis by Yardi Matrix found that between 45,000 and 72,000 multifamily units had been rendered uninhabitable. Rental rates stood at $1,077, trailing the national average by $281.
- October was the first month in which the consequences of the hurricane could be measured. For at least the short term, the storm has given the metro a lift, and it is likely to reverse Houston's anemic rent growth over the past two years. The aftereffects include stalled construction projects due to property damage, restricted access, temporary loss of utilities or lack of labor or materials for repairs.
- Rents for Lifestyle assets rose to $1,368 in the 12 months ending in October, marking a 0.5% uptick. The working-class Renter-by-Necessity segment continued to strengthen slightly and brought rents to $853, a 0.9% year-over-year increase. Though rents are still highest in core areas such as Museum District ($1,881), they grew at the fastest rates in Pirce Junction—5.2% to $743.
- Despite the increased demand from damaged units, Yardi Matrix expects rents to contract by -0.7% for the year.

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)

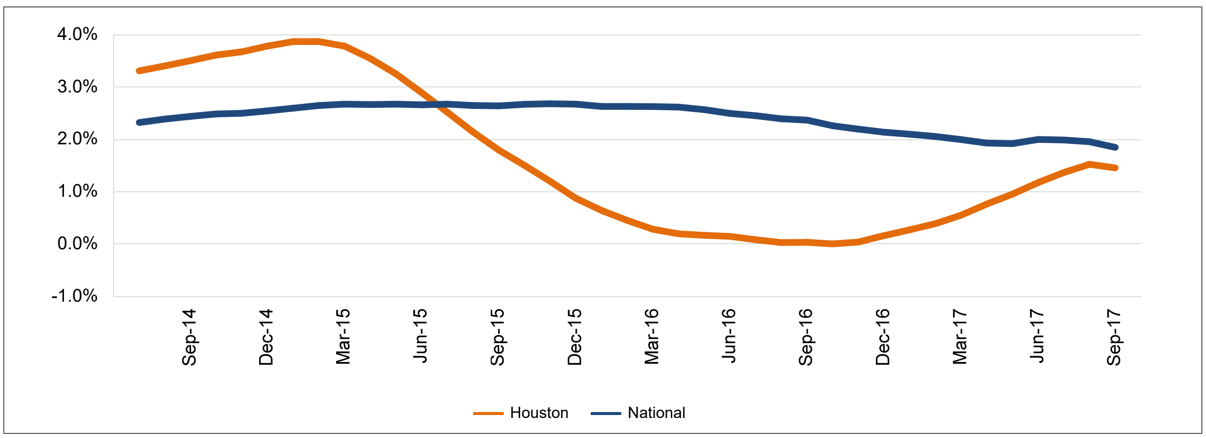


Source: YardiMatrix

Economic Snapshot

- The metro added only 19,500 jobs in the 12 months ending in September. Overall growth was 1.5%, still below the 1.9% national average, due to continued vulnerability of the oil and energy industries. Until Harvey, the local economy was on a steady path to recovery following the oil slump, but the storm unleashed floodwaters that shut down, damaged or destroyed thousands of businesses, putting many Houstonians out of work.
- The manufacturing sector led employment gains (13,300 jobs). Most of the metro's industrial product weathered Harvey with no significant structural damage. Daikin Industries Ltd. completed its $417 million business campus on 500 acres outside Houston, where it is expected to eventually employ about 4,000 people. The traditional health sector also remained strong, adding 9,000 jobs.
- Nearly all job losses (-21,700) can be attributed to Hurricane Harvey, with four sectors accounting for the bulk: construction, transportation, hospitality and information. With operations temporarily suspended, firms had no need for workers, but these losses are transitory and should be eliminated by end-year.
- Houston's office market continues to struggle, with net absorption down and overall vacancy rates up. With the vacancy rate at about 20%, market conditions are likely to favor tenants in the near term.

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	%
30	Manufacturing	232	7.7%	13,300	6.1%
65	Education and Health Services	393	13.0%	9,000	2.3%
60	Professional and Business Services	479	15.9%	8,800	1.9%
90	Government	409	13.6%	6,400	1.6%
55	Financial Activities	159	5.3%	3,200	2.1%
80	Other Services	110	3.6%	500	0.5%
50	Information	32	1.1%	-800	-2.5%
70	Leisure and Hospitality	309	10.3%	-4,800	-1.5%
40	Trade, Transportation and Utilities	598	19.8%	-6,600	-1.1%
15	Mining, Logging and Construction	294	9.8%	-9,500	-3.1%

Sources: YardiMatrix, Bureau of Labor Statistics

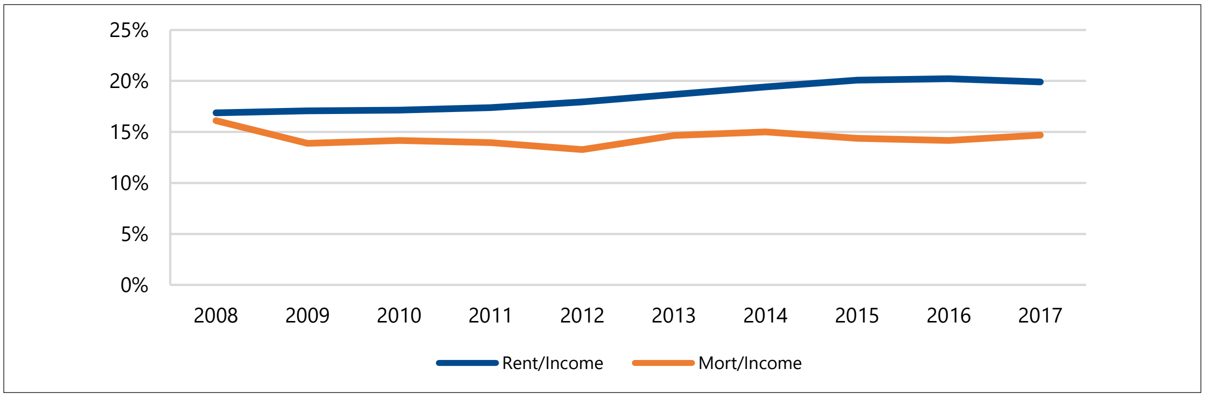
Demographics

Affordability

- The median home price in the metro increased to a new cycle peak during the first half of the year, reaching $203,369. Houston's growth is fueled in part by steady population growth, relaxed zoning and permissive development rules.

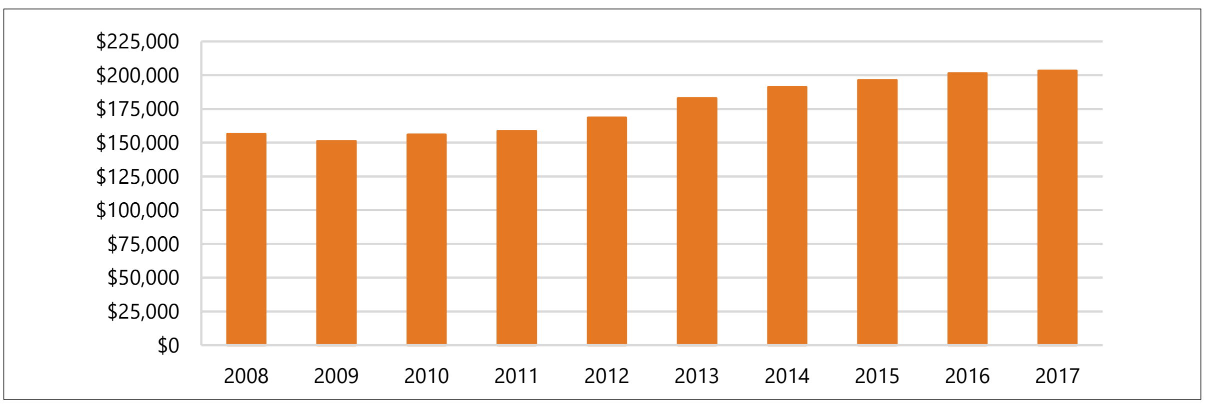
- Owning remains the less costly option, accounting for 15% of the metro's median income. Average monthly rates reached $1,077 in October, with rents taking up 20% of the median income. The rental market continued to rise during the past two months, bolstered by flood victims seeking temporary housing and flood-damaged homes having been pulled off the market.

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 125,000 residents in 2016, marking a 1.9% increase, well above the 0.7% national average.

- The metro's population expanded by 825,000 since 2010—up 13.9%. The national growth rate was only 4.5%.

Houston vs. National Population

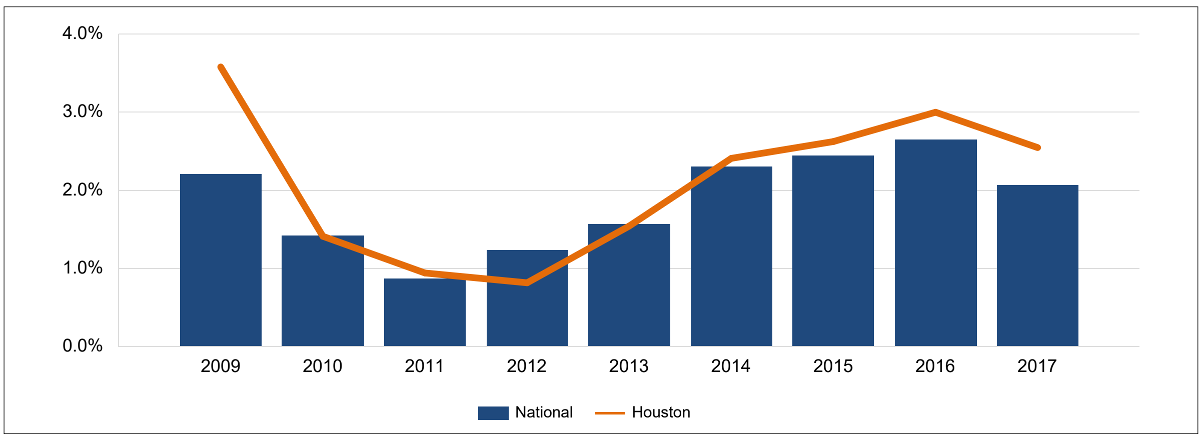
	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
Houston Metro	6,180,817	6,324,167	6,488,046	6,647,465	6,772,470

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

Supply

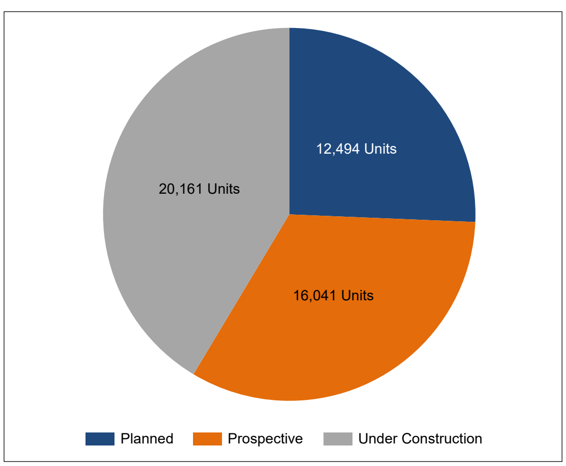
- Multifamily development remained strong during the first 10 months of 2017 with more than 14,000 new units coming online, adding 2.3% to the stock. Before Harvey, there were concerns that supply was outpacing demand, but the hurricane helped to create demand for unused units, albeit to a lesser extent than expected. Moreover, builders are now concerned about the cost of materials, the availability of labor and potential drainage requirements that may be enacted.
- More than 20,000 units were under construction as of October. Houston's occupancy rate for stabilized properties was 93.2% as of September, but the lingering effects of Harvey's damage will likely boost multifamily occupancy in the near term.
- Houston's West End/Downtown submarket remains by far the most attractive to developers, with 4,225 units under construction as of October. The largest development underway is CWS Capital Partners Marq 31, a 453-unit community in River Oaks. Most Houston submarkets have been affected by Harvey, so delays in deliveries are likely to occur in part due to the difficulty in obtaining aid that comes from insurance and government sources.

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



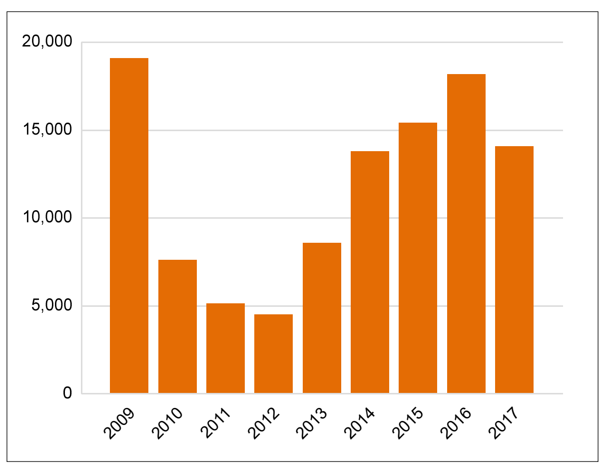
Source: YardiMatrix

Development Pipeline (as of October 2017)



Source: YardiMatrix

Houston Completions (as of October 2017)



Source: YardiMatrix

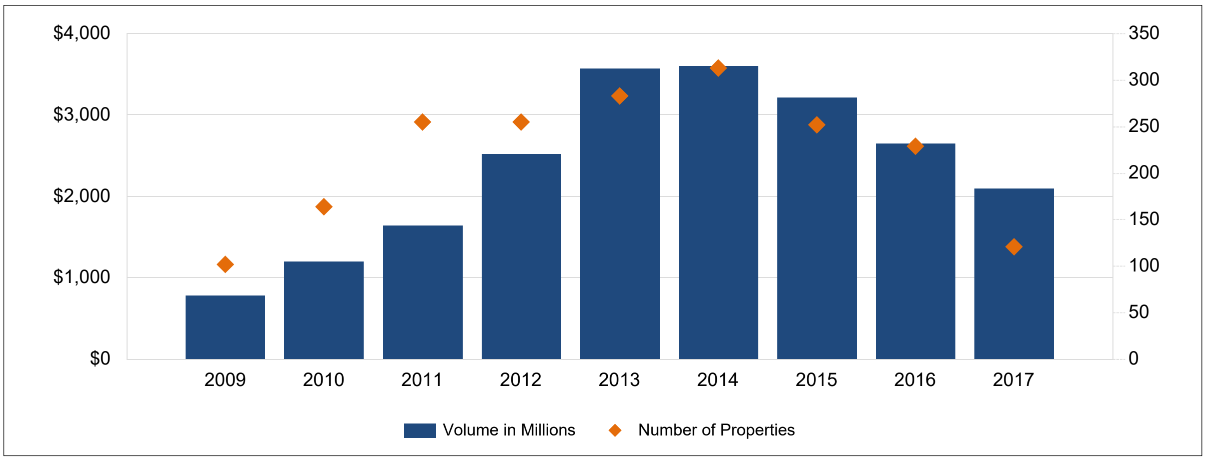
Transactions

- Despite the slump on oil prices two years ago and the recent natural catastrophe, investor appetite has remained relatively healthy, with $2.1 billion worth of assets changing hands year-to-date through October. However, transaction volumes have moderated over the past two years. Per-unit prices in Houston started the last quarter of 2017 at $97,506, marking a new cycle high, but still below the $135,622 national average.

- A relatively small number of multifamily units were seriously damaged by Harvey, so some sellers whose properties remained dry may look to cash in. Nassau Bay/Seabrook continues to be the most sought-after submarket of the metro in the 12 months ending in October, with roughly $254 million in transactions.

- Connecticut-based Starwood Capital was the most active buyer, acquiring 14 assets in the metro since November 2016. Starwood paid $2.8 billion to Milestone Group for a multi-state portfolio of 78 assets.

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



Source: YardiMatrix

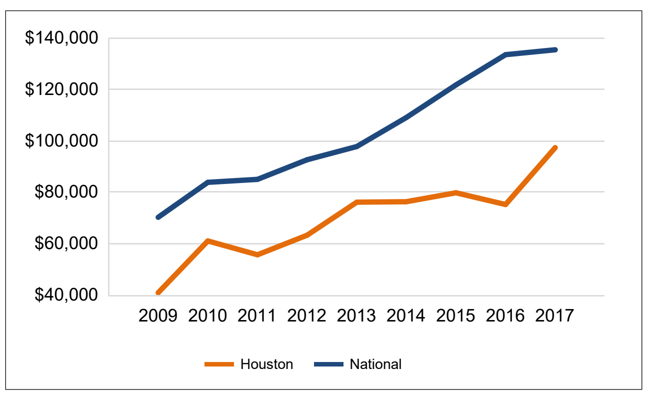
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Nassau Bay/Seabrook	254
Missouri City	172
Royal Oaks Country Club	136
Bammel	129
Addicks	106
Cinco Ranch–South	103
Jersey Village/Salsuma	100
Rosslyn	90

Source: YardiMatrix

[1] From November 2016 to October 2017

Houston vs. National Sales Price per Unit



Source: YardiMatrix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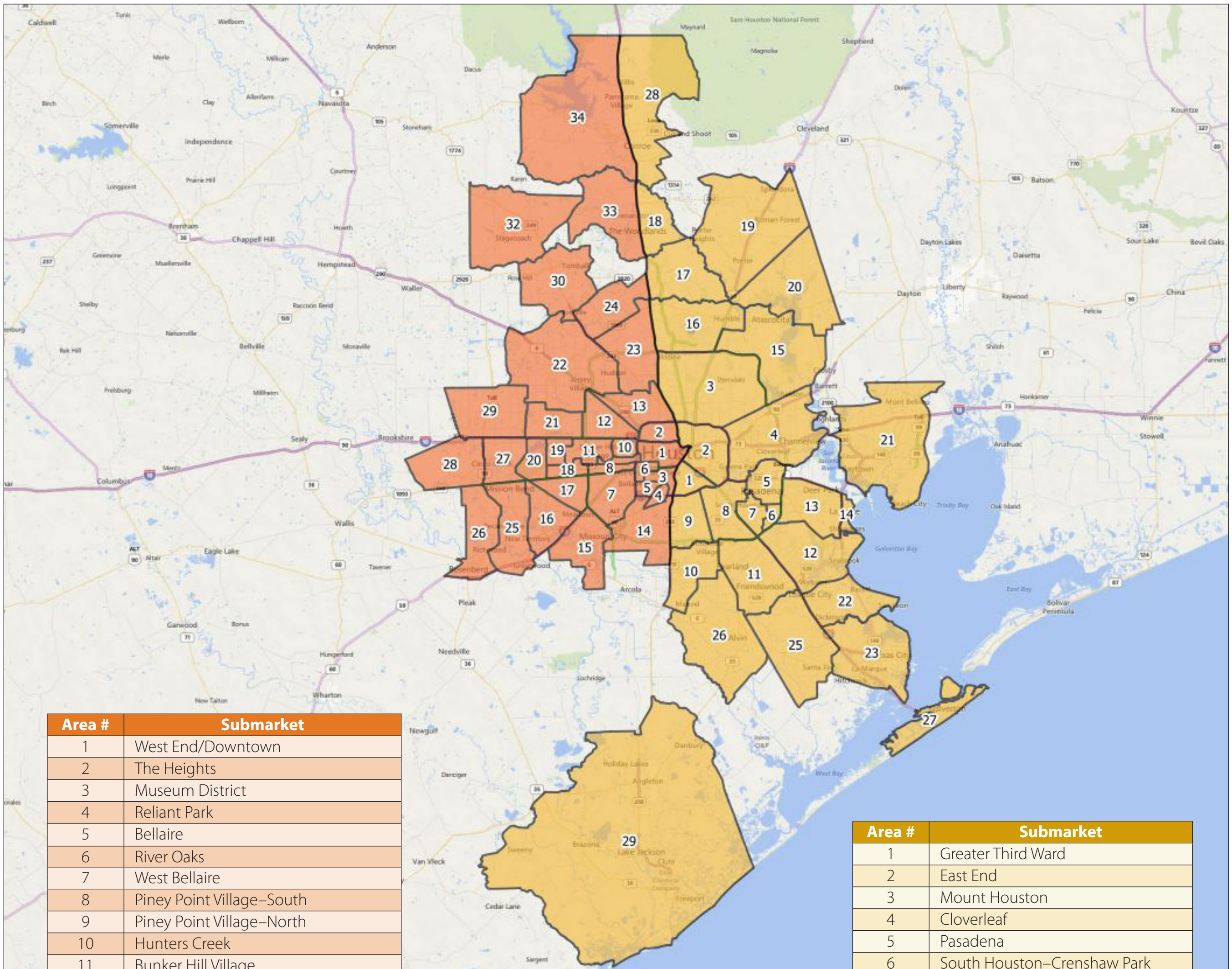
Houston Submarkets



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	Pierce 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.