Yardi® Matrix

Houston's Balancing Act

Multifamily Report Spring 2018

Rent Growth Continues

Home Values Reach Cycle Peak

Development Targets Core Submarkets

Market Analysis

Spring 2018

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Bayou City Makes Buoyancy Its Brand

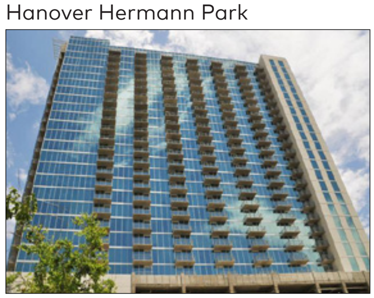
Houston's housing market has been resilient, despite the natural disasters that have severely affected parts of the metro. During the first months of last year, the city struggled with overbuilding and limited rent growth, but the fourth quarter of 2017 displayed stronger performance for the sector, as Hurricane Harvey pushed the multifamily market closer to an equilibrium.

Employment growth was led by professional and business services, a sector that added almost 15,000 jobs. Houston has established itself as a distribution hub, and the need for warehouse product has spiked. Amazon, FedEx, Ikea and Best Buy are among the largest companies that either opened major distribution sites in the metro or plan to do so. Moreover, Houston Airports' five-year, $2 billion capital improvement program might attract more investors to the area. The construction industry is expected to improve steadily, thanks to rebuilding efforts and the development of large-scale projects, including the $820 million Houston Ship Channel marine terminal in Pasadena, Texas.

Despite worries about investing in areas with high flooding risk, interest in local assets has been fairly strong. As construction remains active—with 3,600 units delivered year-to-date, 14,000 underway—rents will likely improve at a moderate clip. We expect rents to rise by 2.3% in 2018.

Recent Houston Transactions

Hanover Hermann Park



City: Houston
Buyer: The Hanover Co.
Purchase Price: $80 MM
Price per Unit: $202,020

The Vista on Genner

City: Houston
Buyer: Dalcor
Purchase Price: $70 MM
Price per Unit: $86,420

Remington Park

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

Knox at Westchase

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

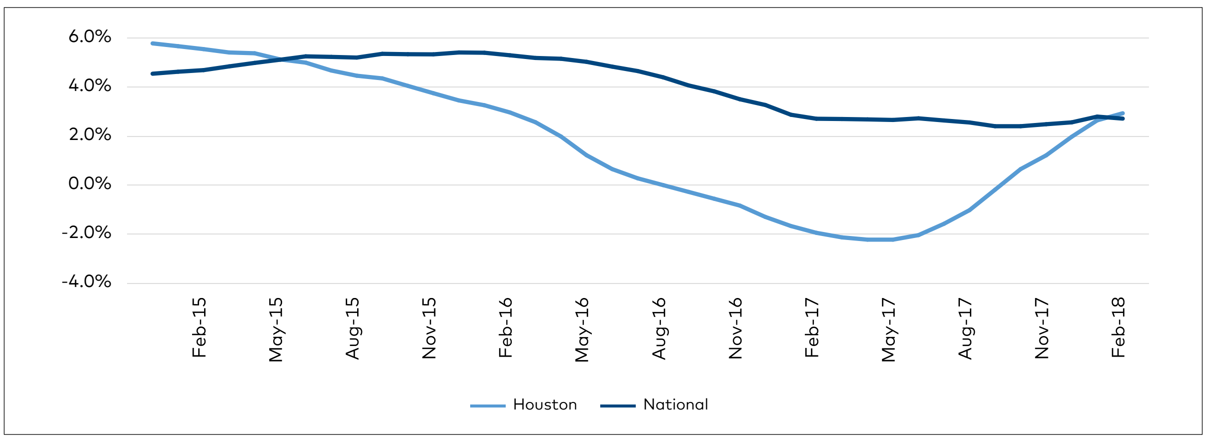
Rent Trends

- Rents in Houston rose 2.9% year-over-year through February, the first time in almost three years when rents increased at a higher rate than the national average—2.7% through the interval. Houston rents had been sliding for 18 months prior to Hurricane Harvey, but reversed course and improved during the last months of 2017. However, at $1,089, the average rent still trails the national figure by $275.

- Employment and population growth, along with displaced residents seeking housing, contributed to a significant rise in rental demand. Growth was led by the higher-end Lifestyle segment, which increased to $1,376 in the 12 months ending in February, a 3.2% uptick year-over-year. The working-class Renter-by-Necessity segment continued to consolidate and rose by 2.5% to $852. Average occupancy in stabilized properties was 93.4% as of January, making Houston one of the two metros—along with Dallas—where occupancy did not slide.

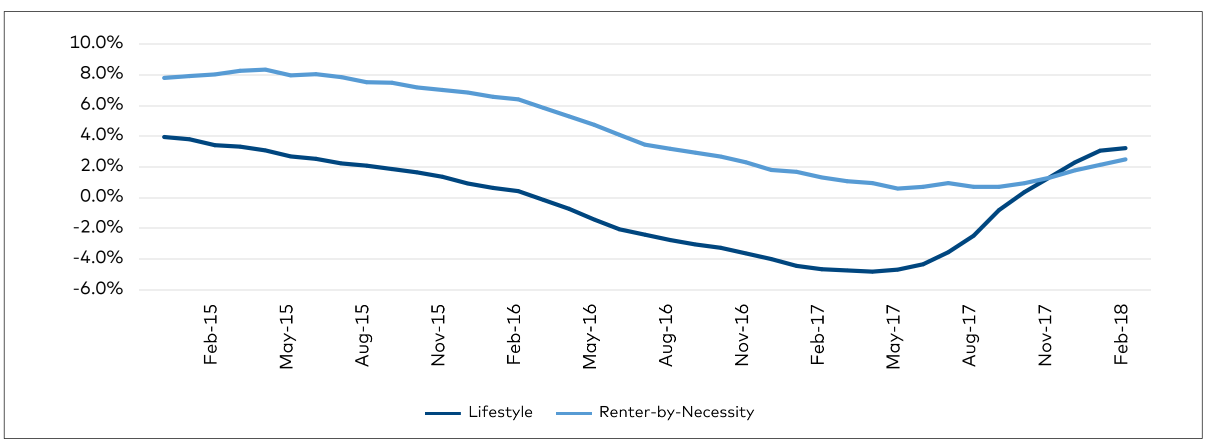
- With sudden demand created in the aftermath of extreme weather events, rents increased in about 90% of the metro's submarkets. Magnolia and Porter—two northern submarkets where Harvey's impact was minimal—had the highest increase in rent year-over-year through February: 9.1% and 7.6%. However, core submarkets such as the Museum District ($1,905) and West End/Downtown ($1,813) remain the most expensive in the metro. Yardi Matrix expects rents to rise by 2.3% in 2018.

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)

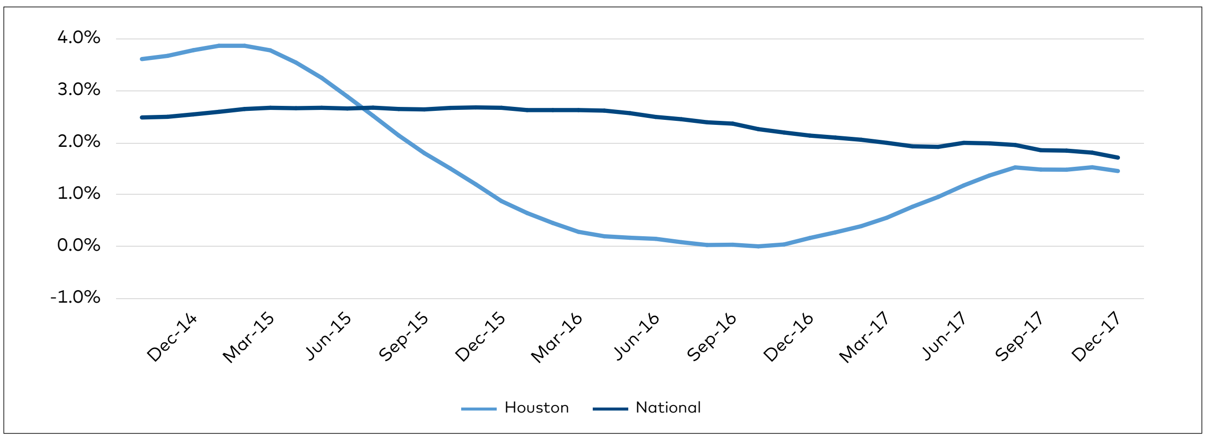


Source: YardiMatrix

Economic Snapshot

- Houston added 46,000 jobs in 2017, a 1.5% rate of employment growth year-over-year and only 20 basis points below the national rate. Despite some job losses in the wake of Hurricane Harvey, Houston is one of the country's top cities for job creation. Professional and business services led growth by adding almost 15,000 positions, but education and health services and manufacturing also added 17,600 jobs combined. Many major employers were active in the area: Ikea inked a 1 million-square-foot warehouse lease in Baytown, Amazon built an 855,000-square-foot fulfillment center in the Pinto Business Park and Norvin Healthcare Properties added the 505,000-square-foot Pin Oak Park medical and office campus in suburban Houston to its portfolio.
- Although it lost 1,200 jobs last year, the construction sector is likely to pick up. Stimulated by the rise of e-commerce and by the rebounding price of oil, demand for industrial space in Houston is on an upward swing. One of the largest projects underway is the 1 million-square-foot Amazon distribution center in Northwest Far. Tariffs on steel and aluminum will definitely have an impact on employment in the metro, where the number of jobs in the energy industry is nearly double the national figure.
- Houston's office market is fighting to recover. In one of the largest recorded transactions, the 4.2 million-square-foot Houston Center traded for $875 million.

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	%
60	Professional and Business Services	487	15.8%	14,900	3.2%
30	Manufacturing	231	7.5%	8,800	4.0%
65	Education and Health Services	396	12.8%	8,800	2.3%
90	Government	423	13.7%	8,000	1.9%
55	Financial Activities	160	5.2%	3,800	2.4%
70	Leisure and Hospitality	316	10.3%	2,800	0.9%
80	Other Services	109	3.5%	1,800	1.7%
40	Trade, Transportation and Utilities	627	20.3%	-600	-0.1%
50	Information	32	1.0%	-1,100	-3.3%
15	Mining, Logging and Construction	300	9.7%	-1,200	-0.4%

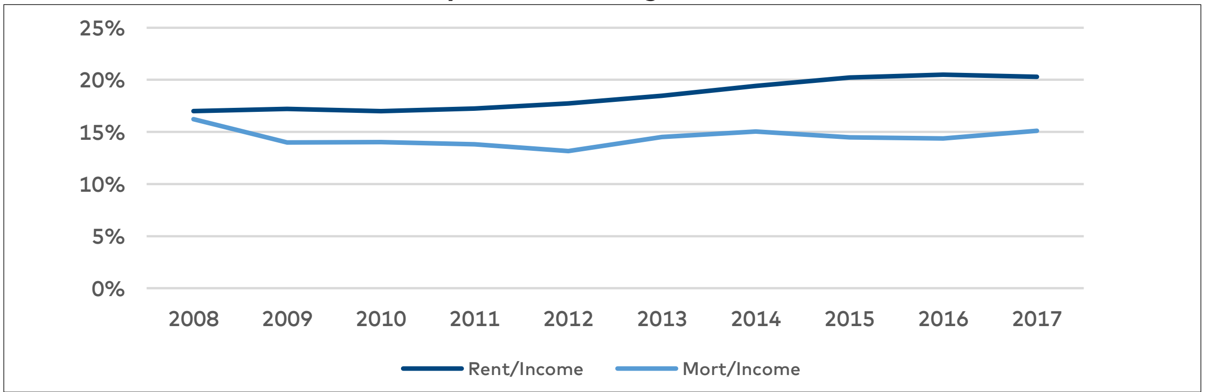
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

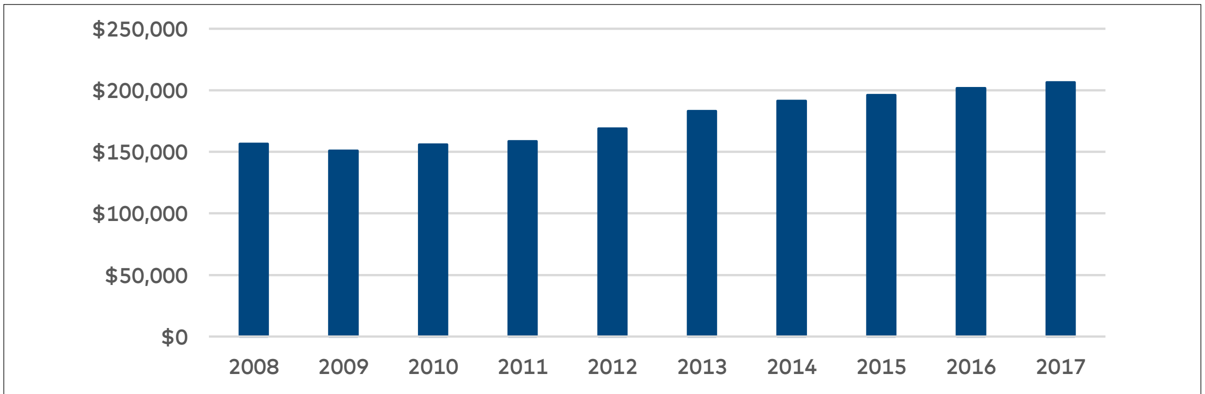
- The median home value in Houston hit $206,564 in 2017, a new cycle peak, up 36.8% from the 2009 mark. Although Harvey's effects were disastrous, the hurricane also contributed to the Houston housing market's new surge. Home prices are likely to continue to increase, since the vast majority of projects under construction are geared toward higher-income residents.
- Though home prices are rising at a faster pace than incomes, Houston remains rather affordable compared to other major metros. Owning is still more affordable than renting, as the average mortgage payment accounts for 15% of the area's median income, while rents equate to 20%.

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, a 1.9% increase, more than double the 0.7% national rate.
- The metro expanded by almost 825,000 people since 2010, a 13.9% uptick. The U.S. growth rate was only 4.5%.

Houston vs. National Population

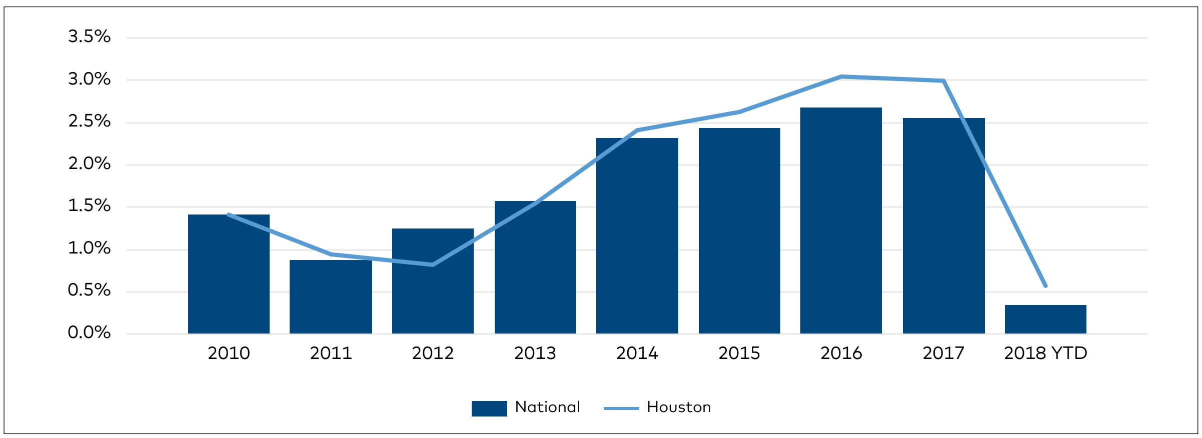
	2012	2013	2014	2015	2016
National	313,998,379	316,204,908	318,563,456	320,896,618	323,127,513
Houston Metro	6,180,817	6,324,167	6,488,046	6,647,465	6,772,470

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

Supply

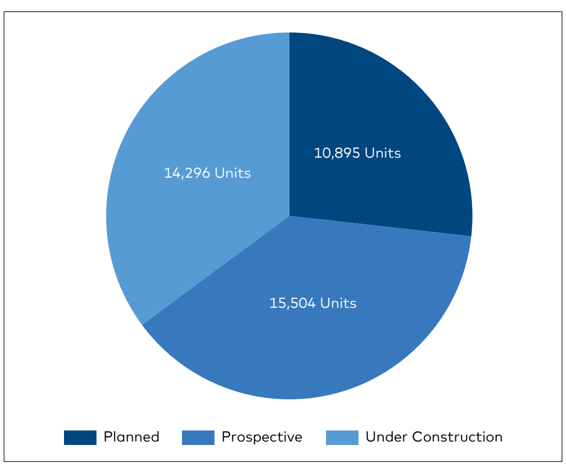
- Apartment deliveries were off to a good start during the first two months of 2018, with nearly 3,600 units coming online, 0.6% of total housing stock. This follows an inventory expansion of 18,689 units in 2017, 3.0% of stock, a new cycle high. Houston looks poised to rebound well and once again become a hotbed of activity, which would benefit real estate investors that are drawn by the metro's healthy demographic growth.
- Houston had approximately 14,300 units under construction as of February, almost a third of which were concentrated in West End/Downtown (4,499 units). Several other western submarkets have substantial pipelines as well, including Avonak (806 units) and East End (725 units), with construction heavily geared toward luxury apartments. Adding prospective and planned projects, Houston's pipeline consists of roughly 41,000 units.
- Central and western submarkets are in high demand, due to their proximity to higher-paying jobs. The largest development underway in Houston is ParkLane Fulshear, a 410-unit community built by Judwin Realty Group in Katy. The asset is slated for completion by year's end.

Houston vs. National Completions as a Percentage of Total Stock (as of February 2018)



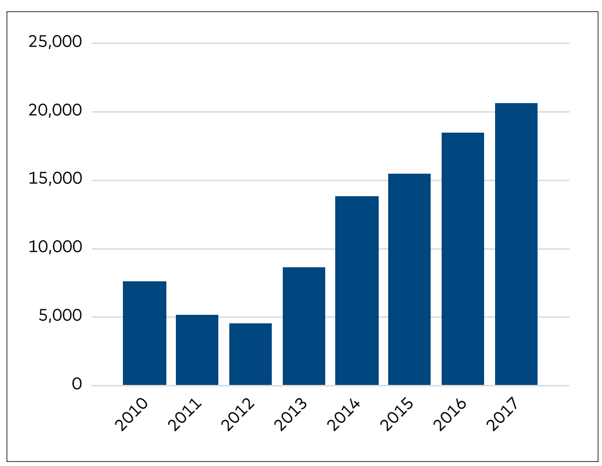
Source: YardiMatrix

Development Pipeline (as of February 2018)



Source: YardiMatrix

Houston Completions (as of February 2018)

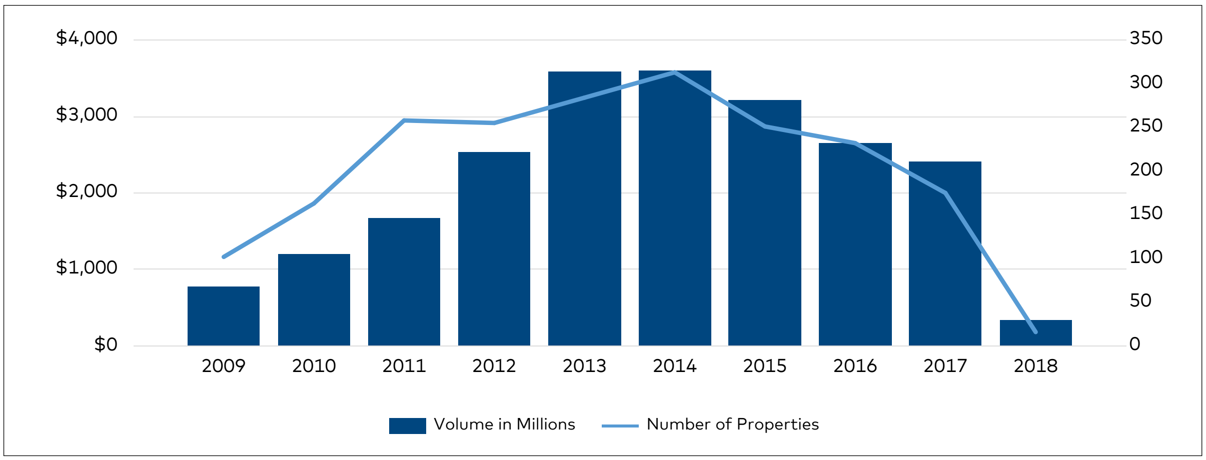


Source: YardiMatrix

Transactions

- Investment sales were strong out of the gate in 2018, with a total of $345 million in multifamily assets changing hands year-to-date. Roughly $2.4 billion in properties traded year-over-year through February, pointing to a recovering housing market following the impact of Hurricane Harvey.
- Per-unit prices in Houston were $99,439 through February, still well below the $151,681 national average. Harvey's aftermath created rare investment opportunities, as owners choosing to sell their damaged properties have seen substantial interest from buyers in search of value-add projects with high yields.
- Western submarkets—such as Royal Oaks Country Club and West Bellaire—were the most sought-after in the 12 months ending in February. However, the largest transaction was The Hanover Co.'s $80 million purchase of Hanover Hermann Park, a 396-unit green building in the Museum District.

Houston Sales Volume and Number of Properties Sold (as of February 2018)



Source: YardiMatrix

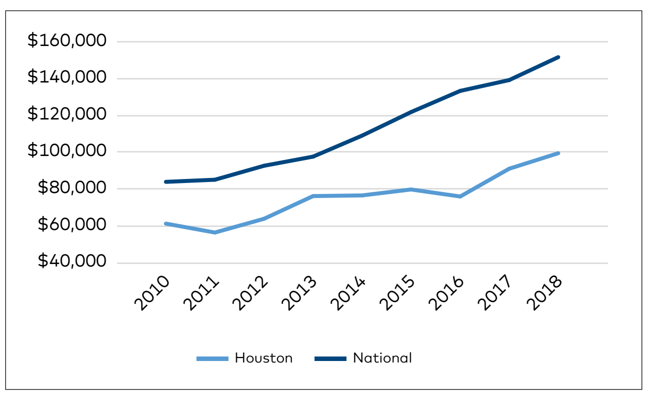
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Royal Oaks Country Club	190
West Bellair	177
Nassau Bay/Seabrook	165
Bammel	128
West End–Downtown	99
Avonak	97
Sugar Land–West	91
Cinco Ranch–South	87

Source: YardiMatrix

[1] From March 2017 to February 2018

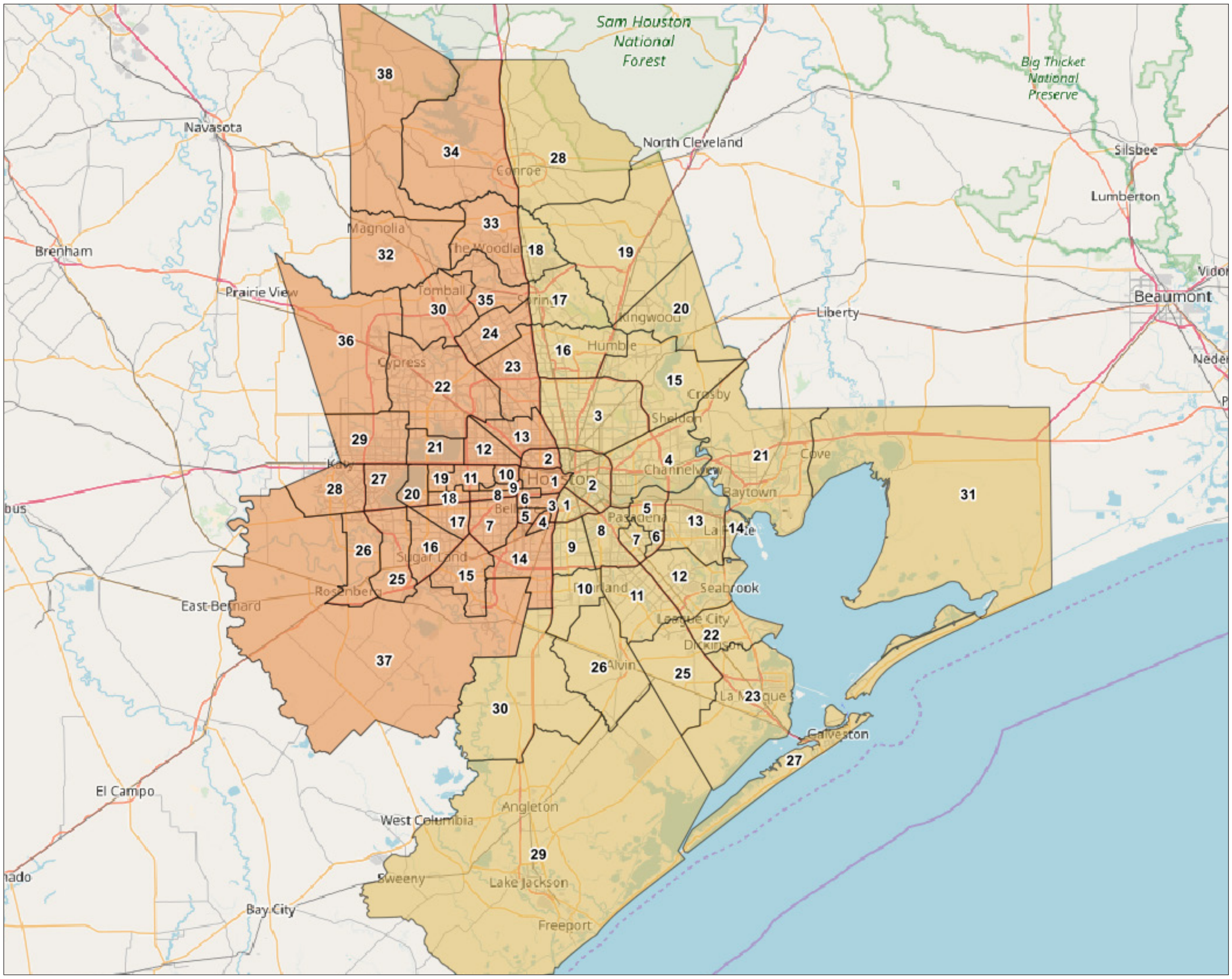
Houston vs. National Sales Price per Unit



Source: YardiMatrix

Photo by lightkey/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

Area #	Submarket
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
35	Avonak
36	Northwest Harris County
37	Outlying Fort Bend County
38	West Montgomery County

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

Area #	Submarket
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	Alvin
27	Galveston
28	Conroe–East
29	Lake Jackson/Angleton
30	Northwest Brazoria County
31	Outlying Chambers County

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.