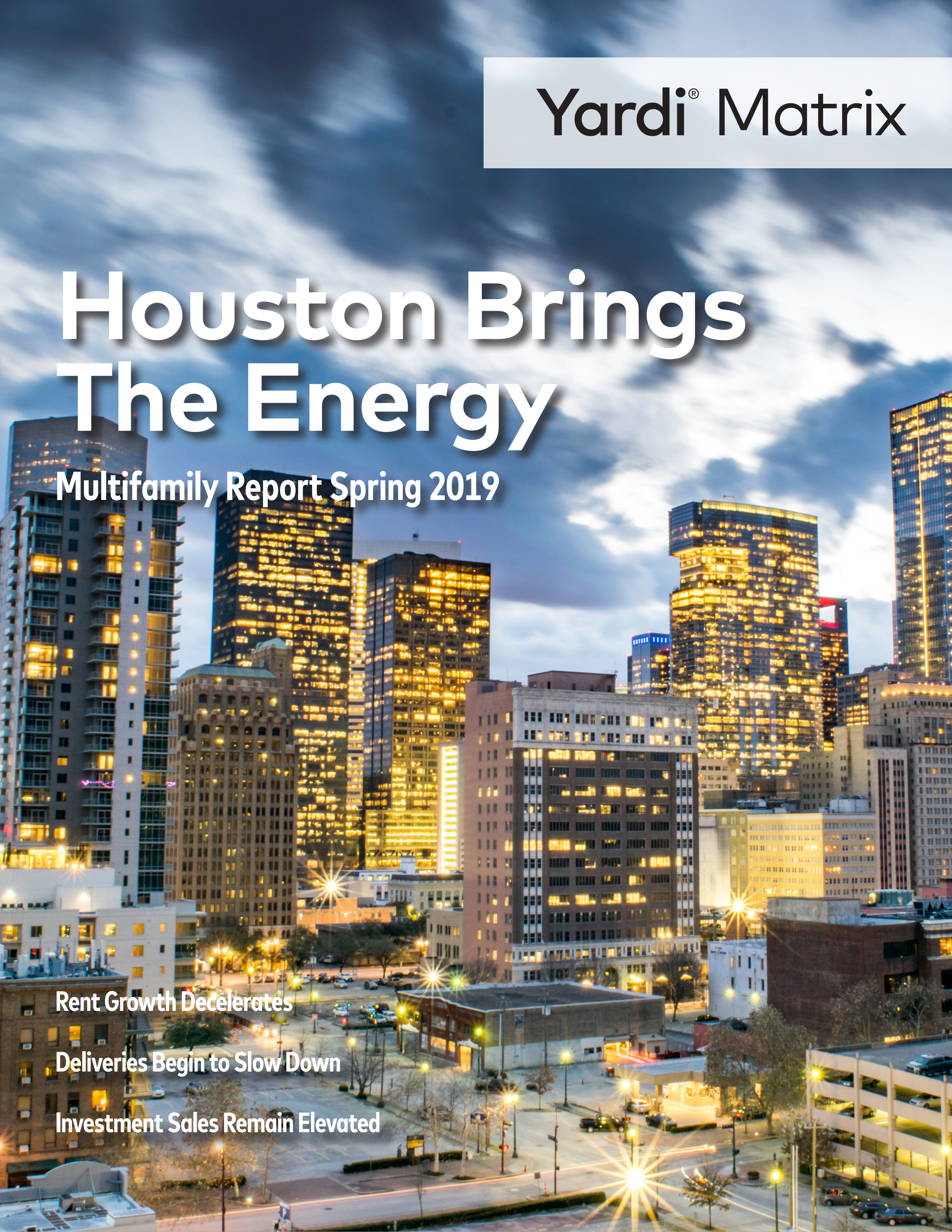
Yardi® Matrix

# Houston Brings The Energy

## Multifamily Report Spring 2019



**Rent Growth Decelerates**

**Deliveries Begin to Slow Down**

**Investment Sales Remain Elevated**

## Market Analysis

Spring 2019

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# Job Growth Outperforms Nation

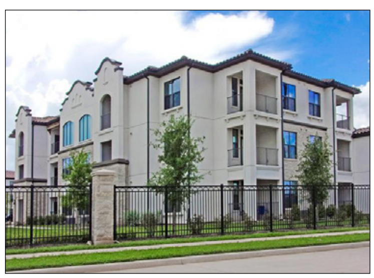
Underpinned by rebounding employment gains and a robust demographic expansion, Houston's multifamily market preserves its potential. Following three years of substantial deliveries, the metro's rent growth is on a downward trajectory. At 92.4% as of February, down 140 basis points year-over-year, Houston's occupancy in stabilized properties as of February reflected a sluggish demand, leading to remounting fears of overbuilding.

Houston added 72,600 jobs in the 12 months ending in February, with manufacturing and professional and business services accounting for almost half of the gains. A NextDecade liquefied natural gas export project might create 5,000 jobs in Cameron County, which could lead to a shortage of skilled workers. Education and health services added 11,800 positions and the sector is likely to perform well going forward, as Medistar plans to develop a 48-story mixed-use tower in the Texas Medical Center.

A cycle peak of $5 billion in multifamily assets traded last year in the metro. Investors had a slight preference for Renter-by-Necessity assets, with rents increasing by 1.7%. Roughly 14,000 units were under construction as of March, with more than 85% of them geared toward high-income residents. As deliveries are likely to top out at 6,150 units for the year, we expect the metro's average rent to rise 2.2% in 2019.

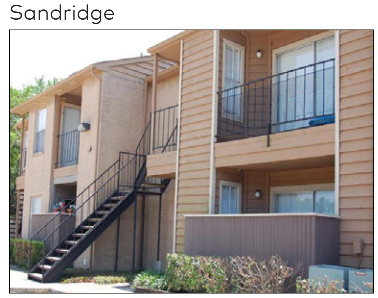
### Recent Houston Transactions

Stella at Riverstone



City: Sugar Land, Texas
Buyer: Cardone Enterprises
Purchase Price: $56 MM
Price per Unit: $159,544

Sandridge

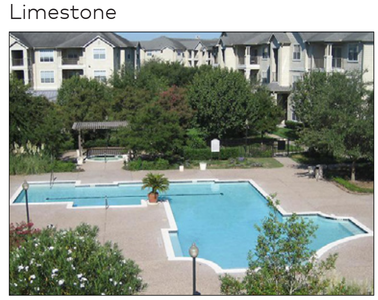


City: Pasadena, Texas
Buyer: GVA Real Estate Investments
Purchase Price: $52 MM
Price per Unit: $102,778

Alexan Ashford

City: Houston
Buyer: Allied Orion Group
Purchase Price: $49 MM
Price per Unit: $157,440

Limestone



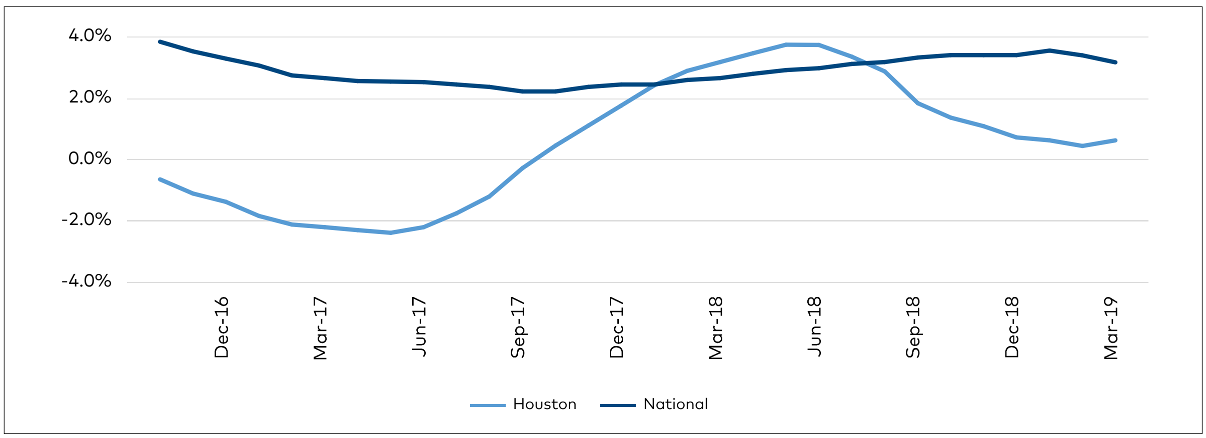
City: Houston
Buyer: 29th Street Capital
Purchase Price: $49 MM
Price per Unit: $111,844

On the cover: Photo by Nate Hovee/iStockphoto.com

## Rent Trends

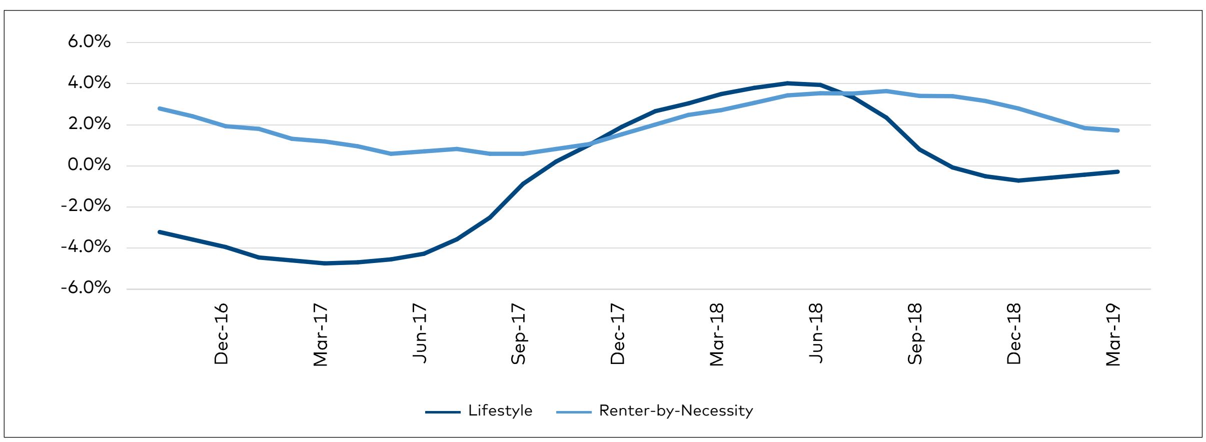
- The average rent in Houston rose 0.6% year-over-year through March, severely lagging the 3.2% U.S. rate. At $1,108, the metro's average rent was $322 below the national figure. Houston was one of the few major metros that saw rent gains below the 2.0% mark. Although decelerating, rent gains were still positive. Following a short-term boost immediately after Hurricane Harvey, absorption is once again under serious strain, due to the heavy supply added over the past three years.
- Renter-by-Necessity assets led rent growth in the year ending in March, up 1.7% to $882. Population and employment expansions, along with temporarily displaced residents, contributed to a notable rise in rental demand for a relatively short period of time. Rents started to slide again at the end of last year. Amid heavy Lifestyle supply delivered between 2016 and 2018, rent growth in the higher-end segment was negative. At $1,384 as of March, the average rent for upscale segments contracted by 0.3%.
- Rents increased at the highest rates in Pirce Junction (11.2% to $832), a submarket that predominantly includes Renter-by-Necessity properties, which are in high demand due to low stock. The northern part of the submarket has qualified as an Opportunity Zone, which could intensify transaction volumes in the area going forward. However, the urban core remains the most expensive, with rents in the Museum District leading the way at $1,947. Yardi Matrix expects rents to rise 2.2% 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)

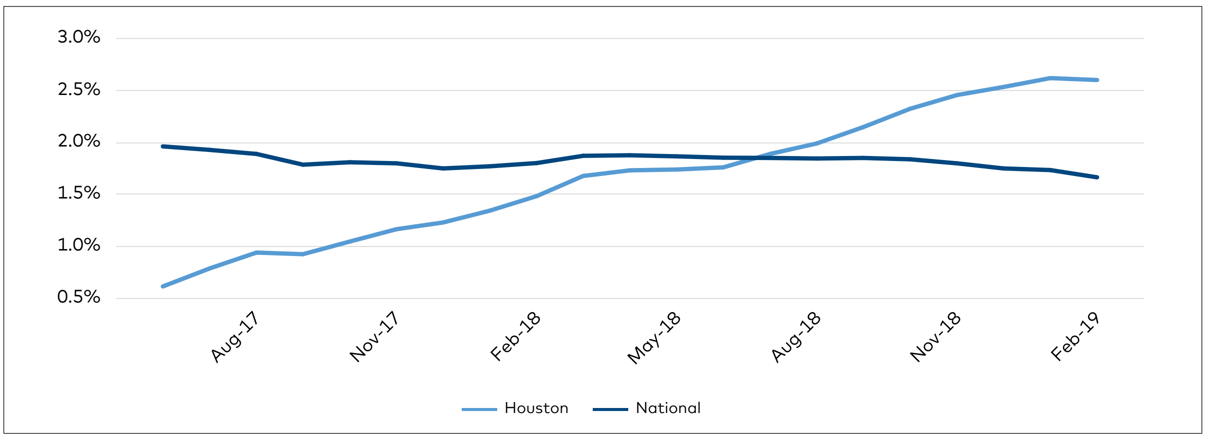



Source: YardiMatrix

## Economic Snapshot

- Following the addition of 72,600 jobs in the 12 months ending in February, Houston's employment growth is once again topping other major metros in the country. Part of the increase could be attributed to temporary positions created to support Hurricane Harvey recovery efforts. However, an improvement in the city's technology sector is set to bring more jobs. A recent Robert Half International study found that 80% of technology leaders in the metro plan to expand their workforce this year.
- Manufacturing and professional and business services drove growth, with 34,100 jobs combined added year-over-year through February. Entergy Texas has broken ground on a 993-megawatt plant, while ExxonMobil and Qatar Petroleum have begun work on a liquefied natural gas export facility, expected to cost more than $10 billion. NextDecade plans to build a similar terminal and create 5,000 jobs in Cameron County. This is likely to be challenging, as employers could struggle to find the necessary workforce in neighboring areas.
- Government-funded infrastructure investments have been put in place in the wake of Hurricane Harvey. Last year, Houston passed a $2.5 billion bond to mitigate floods, with crews already working on 134 projects. Moreover, Texas Central's proposed high-speed train, which would take passengers from Houston to Dallas in less than 90 minutes, may begin construction in late 2019.

**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 | 241 | 7.7% | 17,100 | 7.6% |
| 60 | Professional and Business Services | 504 | 16.2% | 17,000 | 3.5% |
| 65 | Education and Health Services | 401 | 12.9% | 11,800 | 3.0% |
| 15 | Mining, Logging and Construction | 303 | 9.7% | 8,000 | 2.7% |
| 80 | Other Services | 116 | 3.7% | 6,600 | 6.0% |
| 90 | Government | 422 | 13.5% | 6,300 | 1.5% |
| 40 | Trade, Transportation and Utilities | 622 | 19.9% | 4,200 | 0.7% |
| 55 | Financial Activities | 165 | 5.3% | 2,400 | 1.5% |
| 70 | Leisure and Hospitality | 316 | 10.1% | - | 0.0% |
| 50 | Information | 31 | 1.0% | -800 | -2.5% |

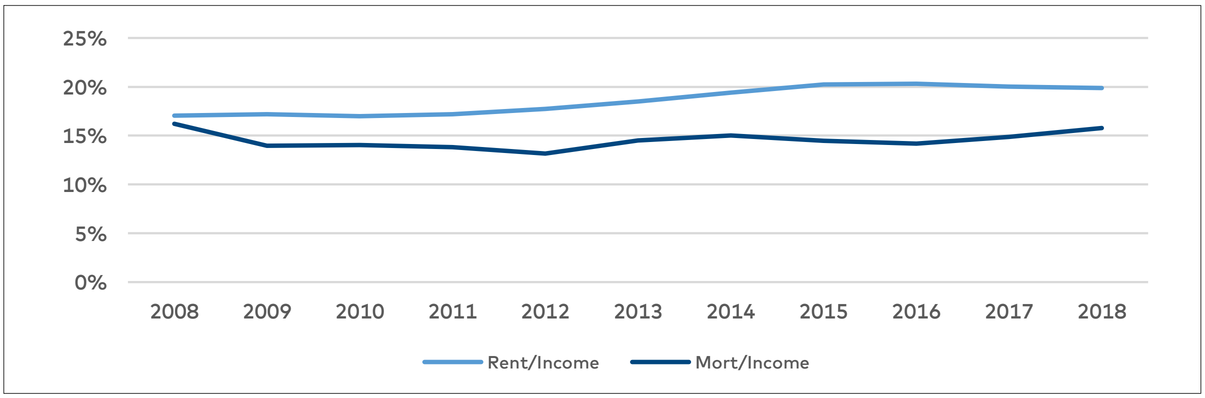
Sources: YardiMatrix, Bureau of Labor Statistics

## Demographics

### Affordability

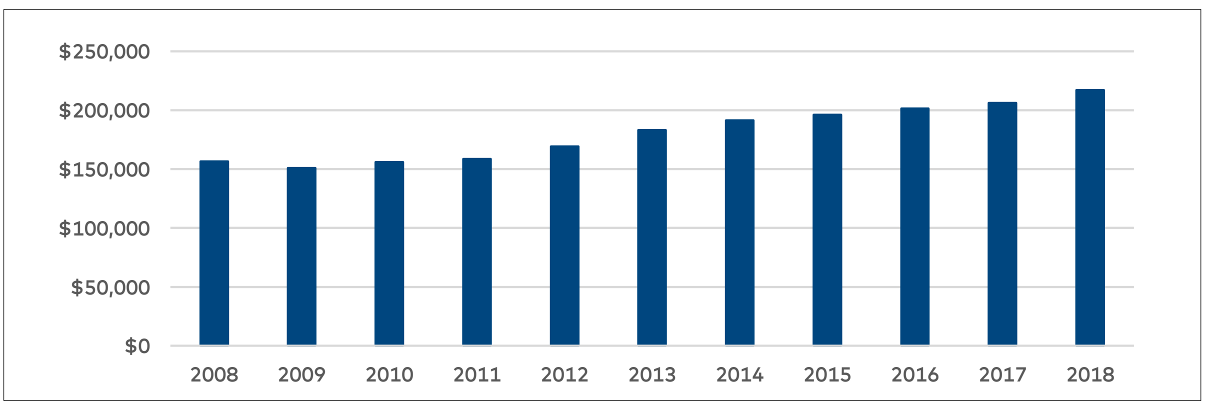
- Houston home prices continued to climb last year, with the median value hitting $217,070, a new cycle peak. Owning remained the most affordable option, as the average mortgage payment accounted for 16% of the area's median income, while rents comprised 20%.
- According to a National Low-Income Housing Coalition report, Houston is the least affordable city in Texas for extremely low-income renters. The issue is poised to become significant, as several affordable communities that flooded during Hurricane Harvey have not been repaired. Private properties with lower rents have also been charging more since undergoing renovations after the Category 4 storm.

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




Sources: YardiMatrix, Moody's Analytics

**Houston Median Home Price**




Source: Moody's Analytics

### Population

- The Houston metro added roughly 95,000 residents in 2017, a 1.4% uptick, double the national average.
- Between 2013 and 2017, Houston's population expanded by almost 563,000 residents, an 8.9% increase.

**Houston vs. National Population**

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| National | 316,234,505 | 318,622,525 | 321,039,839 | 323,405,935 | 325,719,178 |
| Houston Metro | 6,329,553 | 6,496,862 | 6,664,187 | 6,798,010 | 6,892,427 |

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

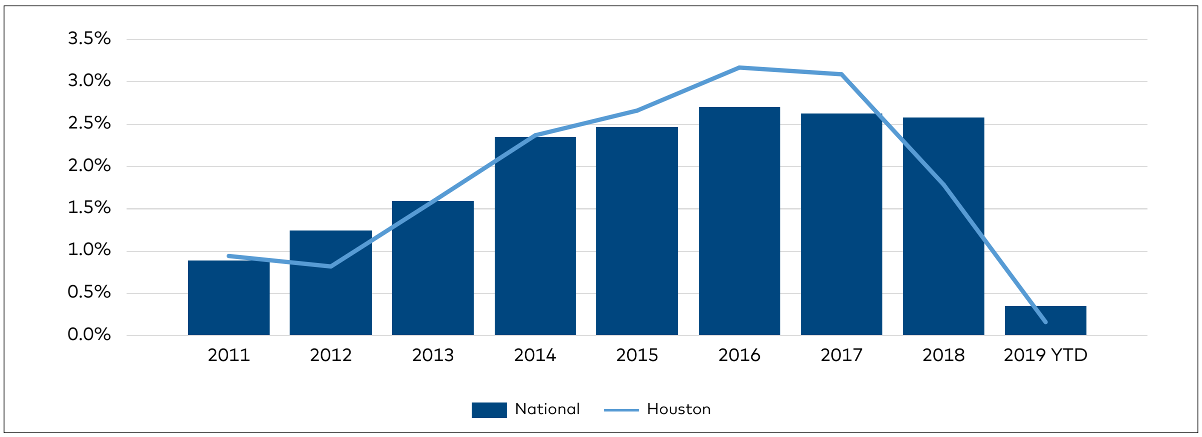
## Supply

- Rental deliveries only reached 819 units during the year's first quarter. Houston added 11,355 units last year, as overbuilding concerns took deliveries from 19,000 units in both 2016 and 2017 to 11,355 in 2018. Most of the properties that came online in 2018 catered to the Lifestyle segment, further pressuring low-income residents. That pressure may intensify, as more than 85% of the upcoming inventory is earmarked for the upscale segment. As of March, 14,160 units were underway.

- Occupancy in stabilized properties slid 140 basis points year-over-year to 92.4% as of February, one of the lowest in the country. The slowdown in absorption partially derives from the return of homeowners to rehabilitated apartments following Hurricane Harvey recovery efforts. Developers are betting on the above-trend employment growth to drive apartment demand going forward.

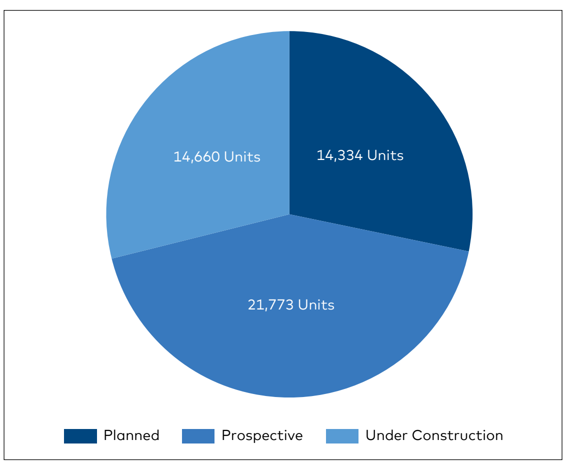
- Urban core submarkets such as the West End/Downtown (3,289 units) and East End (1,045 units) were seeing the most intense construction activity as of March, with average rents in these areas over $1,850. However, the largest project under construction is Judwin Realty Group's first luxury community in the Katy submarket. Upon completion in June, the property will feature 390 units.

**Houston vs. National Completions as a Percentage of Total Stock** (as of March 2019)



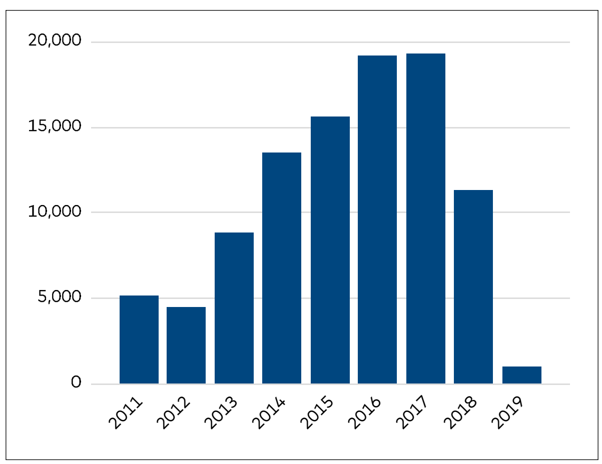

Source: YardiMatrix

**Development Pipeline** (as of March 2019)




Source: YardiMatrix

**Houston Completions** (as of March 2019)

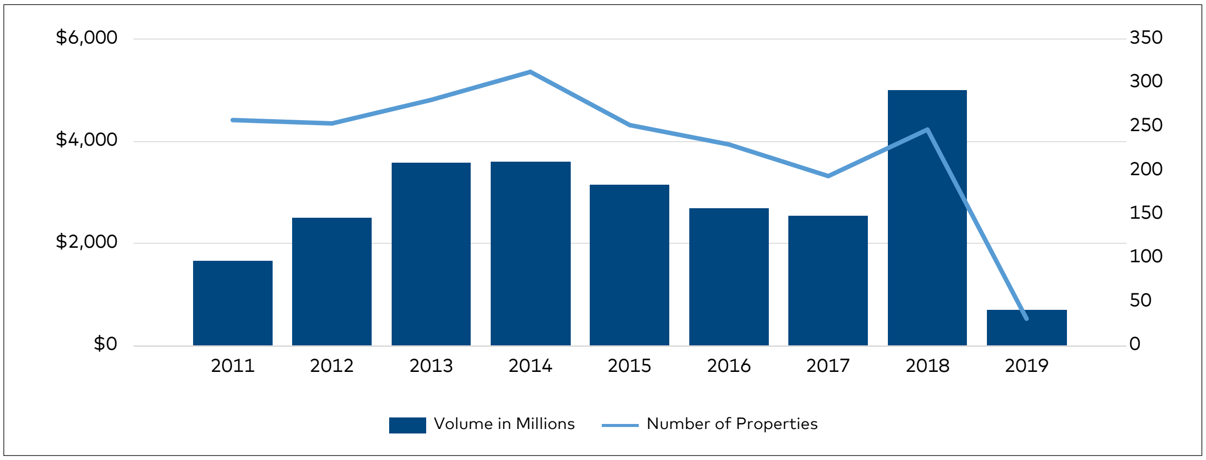



Source: YardiMatrix

## Transactions

- With 31 properties trading for a combined $670 million during the first quarter of 2019, this year is off to a strong start, following last year's highs. Multifamily investment sales crossed the $5 billion mark in 2018, a new cycle peak that came in at just under the combined annual investment volumes of 2016 and 2017, which totaled $5.2 billion. Investors eyed both Lifestyle and Renter-by-Necessity assets, with a slight preference for properties that had value-add appeal. Although on an upward trajectory at $107,825 in 2018, per-unit prices remained well below the $153,928 national average.
- Western submarkets attracted the most capital in the year ending in March, with Jersey Village/Salsuma ($369 million) leading the way, followed by River Oaks ($252 million). FPA Multifamily paid a combined $214 million for Gables River Oaks and Arrive River Oaks, two luxury properties totaling 699 units, which marked the metro's largest multifamily transactions during that timeframe.

**Houston Sales Volume and Number of Properties Sold** (as of March 2019)




Source: YardiMatrix

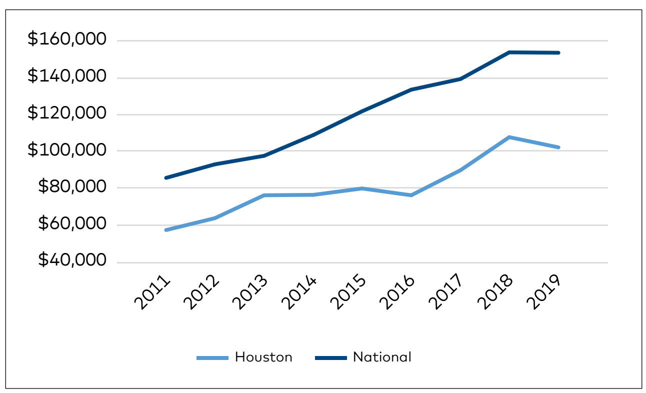
**Top Submarkets for Transaction Volume**[1]

| Submarket | Volume ($MM) |
|---|---|
| Jersey Village/Salsuma | 369 |
| River Oaks | 252 |
| Piney Point Village–South | 248 |
| Royal Oaks Country Club | 232 |
| Bammel | 222 |
| The Woodlands | 196 |
| Louetta | 192 |
| Pearland/Friendswood | 165 |

Source: YardiMatrix

[1] From April 2018 to March 2019

**Houston vs. National Sales Price per Unit**




Source: YardiMatrix

## News in the Metro

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### Houston Apartment Community Changes Ownership

In its first multifamily acquisition in 19 years, Allied Orion Group purchased Ashford Apartments. The community is in the heart of Houston's Energy Corridor.

### Texas Community Receives $26M Loan

Park Texas Apartments' 587 units spread across 51 two-story buildings. The garden-style community is undergoing extensive capital improvements, following damage caused by Hurricane Ike.

### American Landmark Acquires 282-Unit Houston Asset

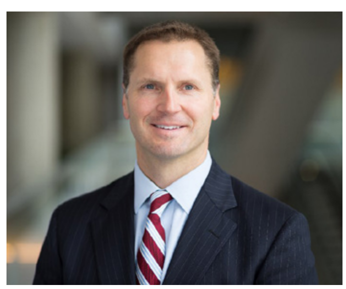
The Class A community located in the South Main area is next to Interstate 610 and came online last year. Sold by a joint venture between Guefen Development and The Rainier Cos., the asset encompasses 282 units.

### 29th Street Capital Expands Bayou City Portfolio

The 438-unit Limestone Apartments, located in the George Bush Park submarket, marks the firm's ninth acquisition in the city and its second investment in the last six months.

### Inland Private Capital Sells Pearland, TX, Property

Goldman Sachs Asset Management Private Real Estate purchased the asset in a transaction that involved a $28.8 million loan held by TIAA.



### Freddie Mac, NEF Launch New LIHTC Fund

The fund's first three investments in Houston and Los Angeles total more than $60 million and come several months after Freddie Mac re-entered the LIHTC market.

## Executive Insight

Brought to you by:

# Finding Value in Houston's Multifamily Market

By Jeff Hamann

Some 14,000 units are under construction across the metro, the vast majority as part of luxury developments. Significant capital deployment is also underway in the realm of value-add acquisitions.

Local multifamily developer and redeveloper Sanmore Investments has been involved in the market's value-add arena for more than five years. Owner Boris Sanchez discusses recent trends in Houston's multifamily sector and how investors can make their acquisitions shine.

*How would you describe the overall appetite for redeveloped multifamily properties in the Houston metro?*

At Sanmore, we have personally seen the demand for our turnkey properties increase to an all-time high. However, in the last six months, that demand has been met and exceeded by the demand for value-add properties. As other areas of the country tighten, Houston's higher cap rates and landlord-friendly laws have become more and more attractive to investors. In addition, we have seen a record number of residential investors turn to commercial for more opportunities, stronger economies of scale and less hands-on management. This is all coupled with Houston's strong economic growth and growing population, creating a red-hot multifamily arena in Houston.

*Given declining occupancy rates in Houston, how can a redevelopment best compete with a newly developed community?*

These are two completely different investments, in my opinion, as one

is creating equity from an already existing property and another is creating a long-term cash flow vehicle for its investors, so it largely depends on the end goal. Further, as builders and rehabbers ourselves, we have always seen slower occupancy in brand-new developments than in rehabbed properties, so that should be kept in mind. Investors looking for a redevelopment play should focus on value—bringing tenants great amenities and services for an affordable rent—as opposed to multiple-month concessions and luxury-styled pools.

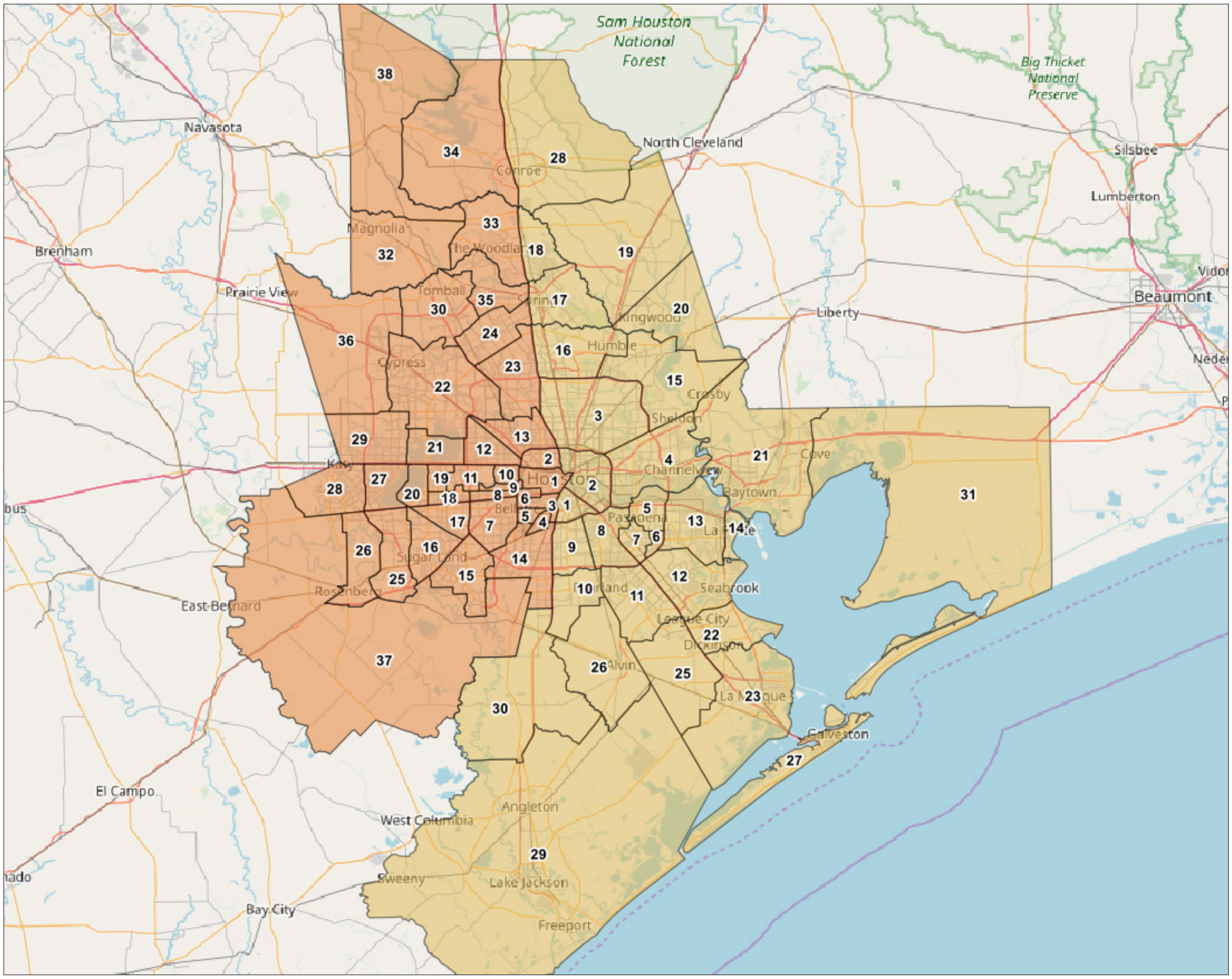
*Which submarket do you see as the most promising for value-add investment opportunities?*

I'm partial to East Houston, which is experiencing unprecedented growth. The Eastside is still laden with opportunity and land for development. The city seems to agree with me, as there are several projects developing in the area, including connecting our second international airport to the METRORail network, for example.

*What challenges do you see on the horizon for the Houston multifamily market in the next five years?*

As more and more investment dollars are poured into Houston, it is imperative that all investors maintain a conservative mind and not overbuild. Although history might prove the "it will fill up eventually" mindset correct one day, we have to be careful and plan for the unplanned. As much as we may or may not like it, Houston is heavily dependent on the oil-and-gas industry, which is tied to the Class A multifamily industry.

## 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.