Yardi® Matrix

Houston: On Recovery Road

Multifamily Report Summer 2019

Occupancy Continues to Slide

Rent Growth Trails U.S. Average

Investment Activity Remains Solid

Market Analysis

Summer 2019

Contacts

Paul Fiorilla
Associate Director of Research
Paul.Fiorilla@Yardi.com
(800) 866-1124 x5764

Jack Kern
Director of Research and Publications
Jack.Kern@Yardi.com
(800) 866-1124 x2444

Author

Laura Calugar
Senior Associate Editor

Diversifying Economy Fuels Demand

Underpinned by favorable demographic trends and steady employment, Houston's economy has improved significantly. During the past four years, the metro's multifamily market has been through a lot.

Houston gained 82,900 jobs in the 12 months ending in June, of which 17,600 were in professional and business services. Additions in office-using sectors have prompted improvements in the metro's slowly recovering office market. Alight Solutions signed for 180,000 square feet in a new build-to-suit property in The Woodlands, while the 754,000-square-foot Bank of America Tower opened with an 88% preleasing rate. The construction and manufacturing sectors also gained a combined 25,300 jobs. Developments underway include Texas Medical Center's 37-acre expansion, as well as the airport's $1.2 billion overhaul. Moreover, about half of the 239 projects under Harris County's $2.5 billion flood bond package are underway.

More than $5.1 billion in multifamily assets traded last year, a record level. The metro's rate of deliveries began its path to moderation in 2018, following two years of intense development activity. The uptick in completions has put downward pressure on occupancy in stabilized properties, leading to a drop of 90 basis points year-over-year, to 92.7% as of July. We expect the average Houston rent to advance 1.9% in 2019.

Recent Houston Transactions

Aventura on Briar Forest

City: Houston
Buyer: Boston Capital
Purchase Price: $53 MM
Price per Unit: $132,946

Urban Palms

City: Houston
Buyer: Turner Impact Capital
Purchase Price: $51 MM
Price per Unit: $76,834

Briarwest

City: Houston
Buyer: Ojala Holdings
Purchase Price: $50 MM
Price per Unit: $133,104

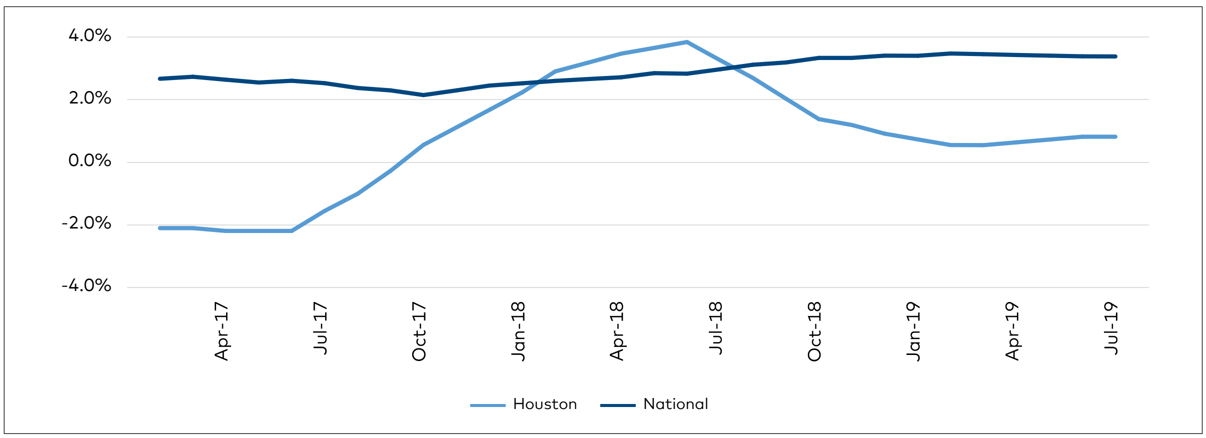
Vargos on the Lake

City: Houston
Buyer: Berkshire Property Advisors
Purchase Price: $43 MM
Price per Unit: $156,377

Rent Trends

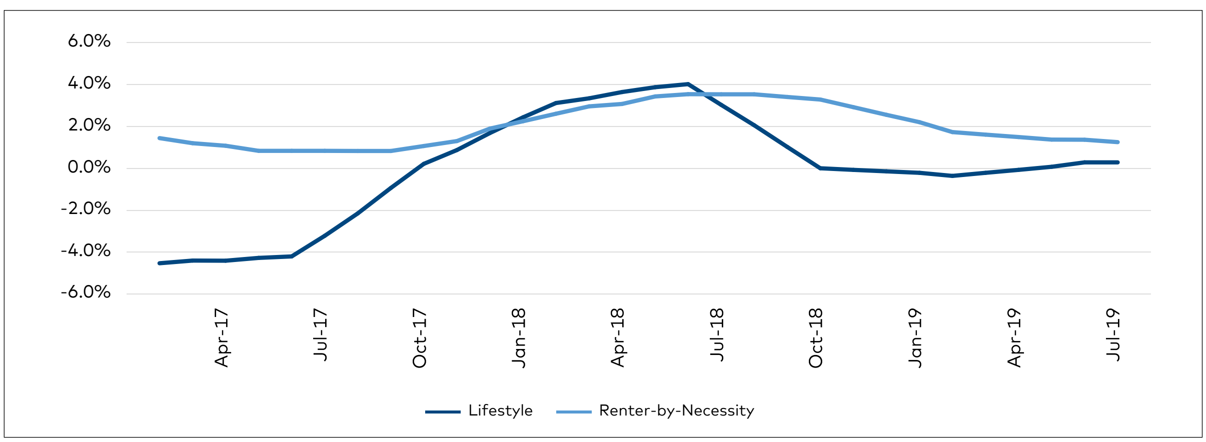
- Rents in Houston rose only 0.8% year-over-year through July, severely lagging the 3.4% national rate. Houston joined Miami (2.4%) as the only major metros in the U.S. with rent growth below their long-term averages. Bayou City experienced an unexpected boost in the wake of Hurricane Harvey, but rent gains in the market are back to the level they were at the end of 2017. That's still better than what they were at the beginning of the oil price drop in 2015-2016. The average rent was $1,117 as of July.
- With recent completions and multifamily projects underway catering mainly to high-income residents, demand for workforce housing has pushed rent growth in the Renter-by-Necessity segment—up 1.3% year-over-year, to $888. Lifestyle rents inched up 0.3% to $1,396. Occupancy in stabilized properties was down 90 basis points year-over-year through July, to 92.7%.
- Eastern suburban submarkets such as Conroe–East (4.9% to $935), Porter (4.5% to $1,250), Baytown (4.2% to $964) and Galveston (3.8% to $1,094) saw the strongest year-over-year rent increases due to high demand for their Renter-by-Necessity stock. Despite contractions, core submarkets in West Houston remained the most expensive in the metro—Museum District (-2.2% to $1,951), West End/ Downtown (-0.1% to $1,852) and River Oaks (-1.2$ to $1,722). Given Houston's consistent pipeline and high levels of deliveries since 2015, Yardi Matrix expects rents to improve only 1.9% in 2019.

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)

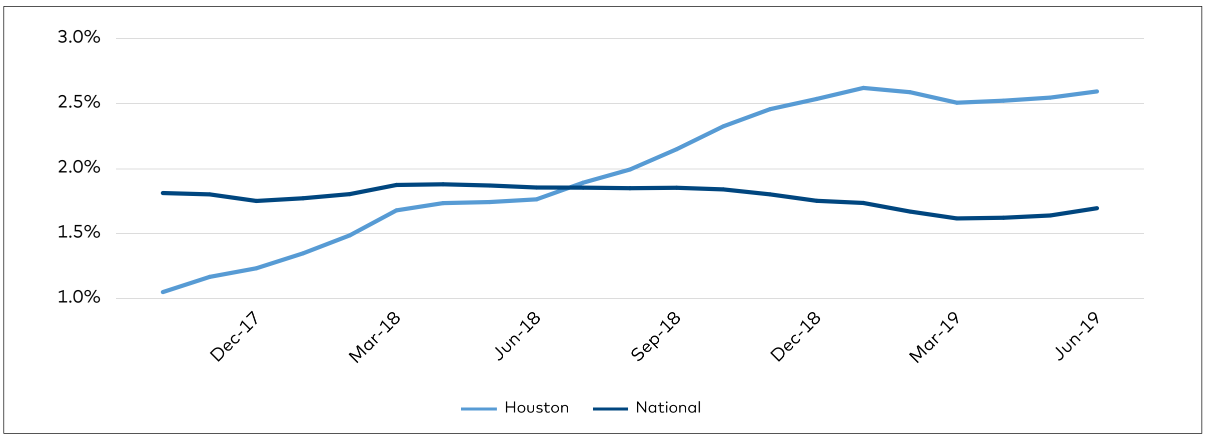


Source: YardiMatrix

Economic Snapshot

- Having gained 82,900 jobs in the 12 months ending in June, Houston was second only to Dallas for job creation in the state. Moreover, the 2.6% year-over-year increase is 90 basis points above the national average, making Houston one of the best-performing metros in the country.
- Growth was led by professional and business services (17,600 jobs), followed by mining, logging and construction (15,300 jobs) and manufacturing (11,000 jobs). The metro's infrastructure is going through changes to accommodate growth. George Bush Intercontinental Airport completed the first building of the facility's $1.2 billion overhaul and The Houston-Galveston Area Council's Transportation Policy Council approved a $100 million down payment to begin the reconstruction of a segment of Interstate 45. The Texas Medical Center is undergoing a massive expansion. In partnership with several research institutions, TMC is building a 37-acre campus, which will likely establish Houston as an international hub for biomedical innovations upon its expected 2022 completion. The campus is set to incorporate research facilities, retail and residential space, a hotel and a conference center.
- Augmented activity at Port Houston is also propelling the metro's job growth. Container volume surged in the first half of 2019, rising 12% compared to the same period last year. Additionally, the facility plans a $39.7 million expansion of its truck gates to handle greater volumes.

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	515	16.2%	17,600	3.5%
15	Mining, Logging and Construction	317	10.0%	15,300	5.1%
30	Manufacturing	241	7.6%	11,000	4.8%
65	Education and Health Services	402	12.6%	9,500	2.4%
70	Leisure and Hospitality	341	10.7%	8,500	2.6%
40	Trade, Transportation and Utilities	630	19.8%	7,700	1.2%
80	Other Services	122	3.8%	7,400	6.5%
90	Government	418	13.1%	6,000	1.5%
55	Financial Activities	166	5.2%	1,100	0.7%
50	Information	31	1.0%	-1,200	-3.8%

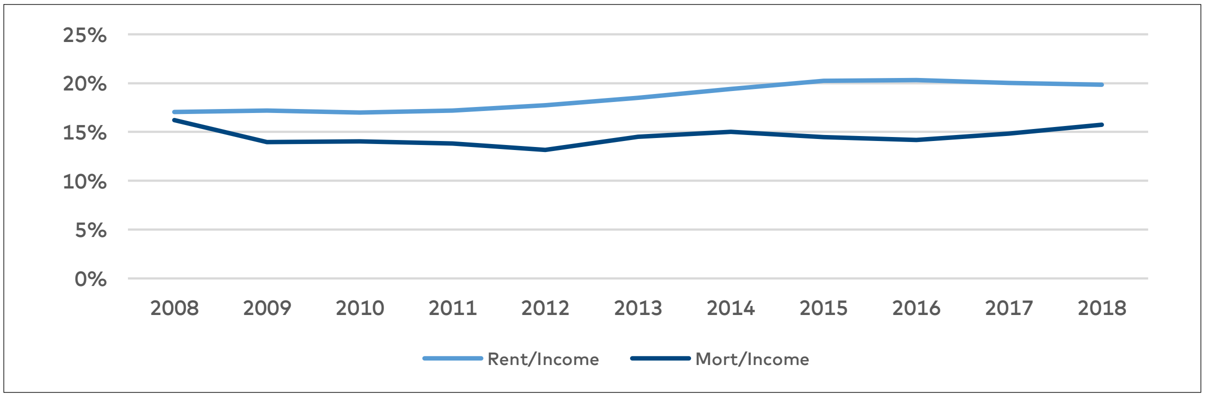
Sources: YardiMatrix, Bureau of Labor Statistics

Demographics

Affordability

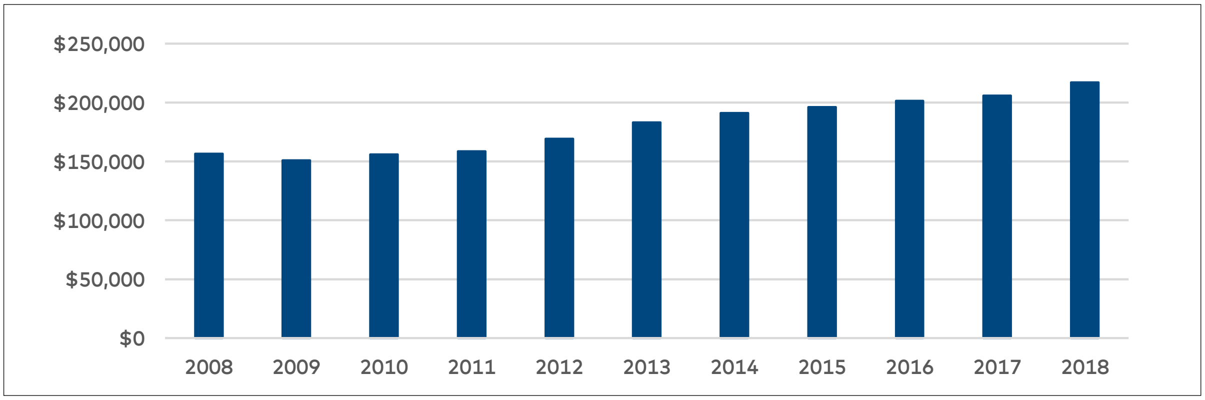
- The median home value in Houston hit $216,970 in 2018, a new cycle high, up 39% compared to the 2008 level. Home prices have continued to increase amidst broad-based employment growth and solid population gains. Homeownership remained the most cost-effective option, with the average mortgage payment accounting for 16% of the area's median income. Meanwhile, the average rent of $1,117 equated to 20%.
- According to research from Texas A&M University' Real Estate Center, the shortage of homes priced below $300,000 remains the biggest challenge facing the Houston housing 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

- The metro added 95,000 residents in 2017, a 1.4% uptick, and twice the U.S. rate. Houston's strong employment market remains a magnet for young professionals.
- Since 2013, Houston added more than 560,000 residents.

Houston vs. National Population

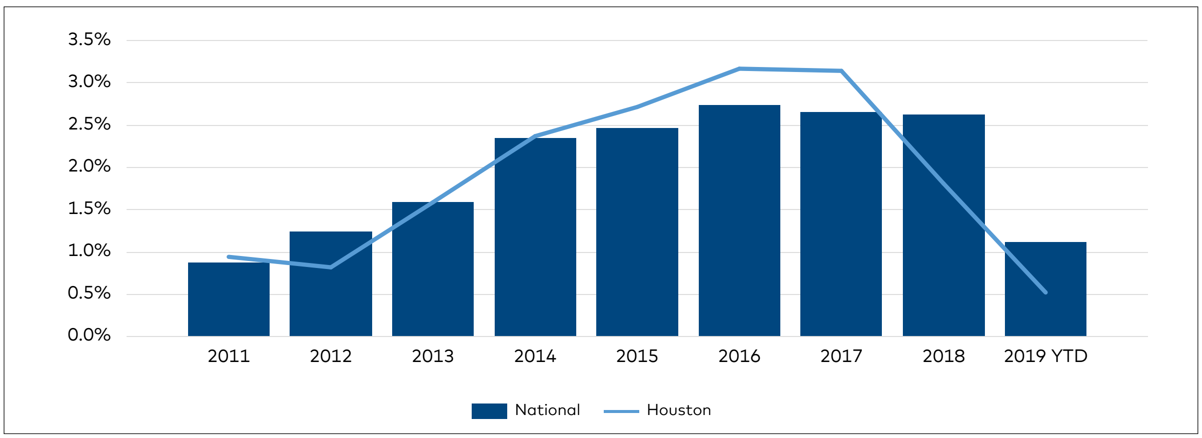
	2013	2014	2015	2016	2017
National	316,234,505	318,622,525	321,039,839	323,405,935	325,719,178
Houston Metro	6,329,553	6,496,862	6,664,187	6,798,010	6,892,427

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

Supply

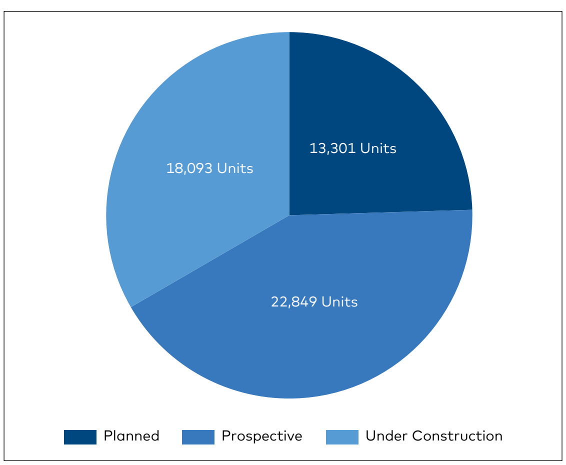
- As of July, 18,093 units were underway across the metro. Most of the upcoming supply is in West Houston and geared toward Lifestyle renters. Only 17 out of the total 76 projects underway cater to the Renter-by-Necessity segment. West End/Downtown—a dense, urban core submarket in the Inner Loop—accounts for almost a quarter of the apartments under construction (4,606 units), followed by Piney Point Village–North (1,282 units) and Katy (1,021 units).
- Houston added 2,712 units in the first seven months of the year, all in Lifestyle developments in the metro's western end. The notable decrease in deliveries comes after five years of significant completions, when almost 80,000 units were added to the stock. Yardi Matrix expects roughly 6,700 new apartments to come online by the end of this year.
- Developers are keen on mixed-use projects that allow residents to live near work and entertainment options. The largest project underway is Palmetto Homes' Centro, a 500-unit community in The Woodlands, close to employment centers, retail options and high-end hotels. The property is adjacent to MetroPark Square, a walkable lifestyle neighborhood on Shenadoah's east side.

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



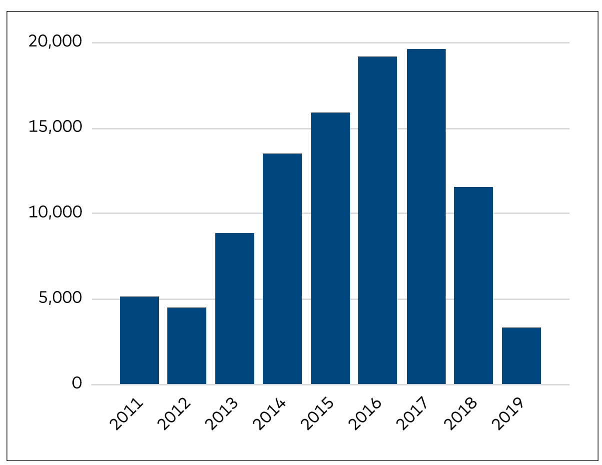
Source: YardiMatrix

Development Pipeline (as of July 2019)



Source: YardiMatrix

Houston Completions (as of July 2019)



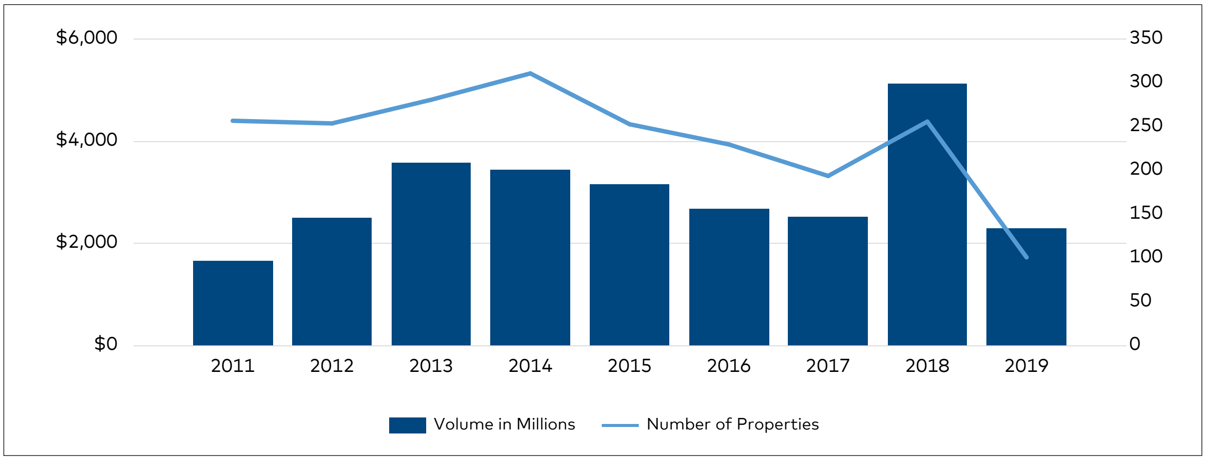
Source: YardiMatrix

Transactions

- Following last year's record multifamily transaction volume of more than $5.1 billion, investor appetite has tempered slightly. During the first seven months of 2019, $2.3 billion in multifamily assets traded in the metro. Although per-unit prices reached a cycle peak of $112,230 as of July, the figure was more than $45,000 below the U.S. average. Investors were drawn by both Class A assets and value-add plays in the 12 months ending in July, with the total sales volume surpassing $4.9 billion. Acquisitions yields for stabilized Class A properties in infill locations range between 4.8% and 5.3% and can go as high as 6.8% for value-add Class C properties in suburban locations.

- Western submarkets—such as Jersey Village/Salsuma ($384 million) and Addicks ($351 million)—were the most coveted. FPA Multifamily purchased two communities for $106.7 million each, while Knightvest Capital spent almost $250 million on six properties in north Houston.

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



Source: YardiMatrix

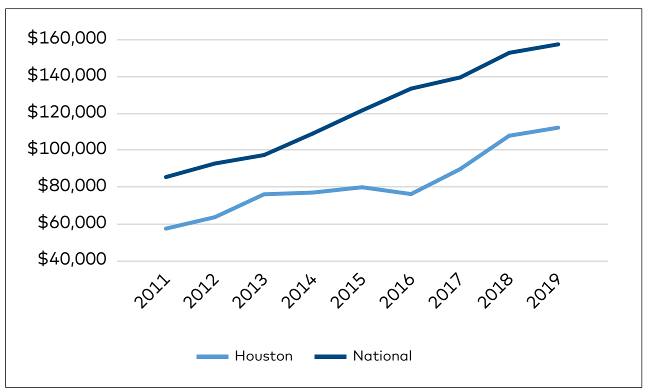
Top Submarkets for Transaction Volume[1]

Submarket	Volume ($MM)
Jersey Village/Salsuma	384
Addicks	351
The Woodlands	333
Royal Oaks Country Club	294
Piney Point Village–North	234
Nassau Bay/Seabrook	221
River Oaks	213
Rosslyn	190

Source: YardiMatrix

[1] From August 2018 to July 2019

Houston vs. National Sales Price per Unit



Source: YardiMatrix

News in the Metro

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Boston Capital Expands Houston Footprint

The sale marked the first time the 396-unit Aventura on Briar Forest community changed ownership since 2007. Canadian Imperial Bank of Commerce originated $39.5 million in acquisition financing.

GAIA-Led JV Sells 300-Unit Houston Asset

The company purchased Cashel Springs in 2015, as part of a 1,376-unit portfolio, for $88.4 million. NKF Executive Managing Director Matt Saunders worked on behalf of the buyer.

Bascom Sells 252-Unit Texas Asset

Newmark Knight Frank originated a $23.8 million, 10-year Freddie Mac loan on behalf of the buyer to finance the acquisition of Sierra at Fall Creek. F&B Capital purchased the 252-unit property in Humble.

JV Acquires Houston Rental Property

Excelsa Properties and GoldCor Capital Partners purchased the 392-unit community Bayou Parc at Oak Forest as part of an $86 million value-add strategy in the Southeast and Mid-Atlantic regions of the U.S.

Wood Partners Grows Luxury Portfolio in Texas

Alta River Oaks, a 364-unit property, is located near the company's Alta West Alabama development, which will also open in 2020, with 304 units.

Three Pillars Capital Expands Houston Holdings

The purchase of Camino Del Sol Apartments marks the eighth acquisition the firm has made since forming in late 2017. Greenline Management LLC will handle operations at the property.

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MULTI-HOUSING NEWS

A Closer Look at Affordable Development in Houston

By Laura Calugar

Underpinned by rebounding employment gains and a robust demographic expansion, Houston's multifamily market remains promising. However, the working–class renters might struggle going forward, following three years of heavy deliveries in the high-end segment.

Rick Guttman, founder of local workforce housing development firm Dakota Enterprises, shares his insights on the metro's pressing issues, along with the company's upcoming projects.

How would you describe Houston's multifamily market?

I believe that the direction that the general multifamily market in Houston is going in is very strong. We live in such a dynamic, mobile and diverse city, so different markets perform better than others.

Which areas of the metro are the most and least affordable?

I think this question is a little tougher to pin down. There are areas of town where rent is much higher, such as Midtown, Downtown and the Memorial/Shepherd areas, but those areas also have the newest assets and a demographic that can generally support higher rents. Overall, the Eastside and Southwest parts of the city have the most affordable rents from a raw dollar perspective. Because of the affordable rents and the efforts that developers and community members have made to constantly improve components such as services, entertainment and employment, these areas are seeing growing demand.

How did the most recent natural disasters that hit parts of the metro influence the affordable housing market?

Well, I think that story has been told and its impacts are clear for communities of all kinds. With a tremendous influx of people moving into apartments post-Harvey, rents were driven up in a significant way. For developers, that's obviously been good, while those in our workforce are struggling to keep up with the rising rents. Because Houston has been such a strong employment market, that trend has continued post-Harvey.

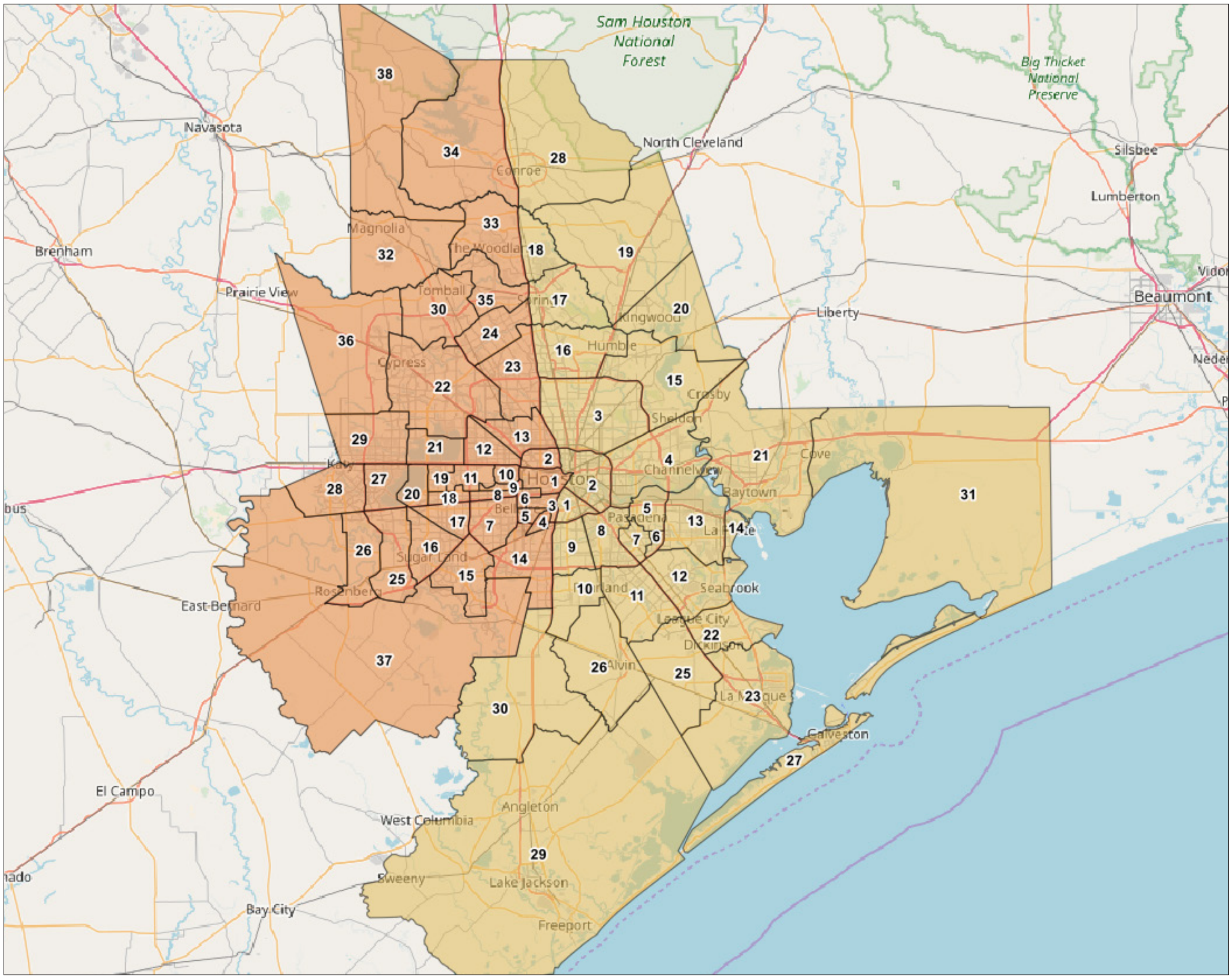
Tell us more about your most recent workforce housing investments.

I had some great successes in the value-added segment of the market primarily focused on workforce housing over the last 10 years and I've decided to place my efforts in creating new developments in areas that have been void of new, quality workforce housing. Our company has completed two ground-up projects thus far. Our third project is about 70 percent complete and we've just broken ground on our fourth project. In addition, we have two or three in the pipeline for development.

Our first and third projects are on the Eastside, near Harrisburg and Wayside Drive, and our second and fourth projects are in the heart of Spring Branch.

(Read the complete interview on multihousingnews.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.

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