

Houston Multifamily

Absorption Positive but Cooling, Fueling Vacancy Uptick

Highlights

- > The Houston multifamily market recorded some softening during the third quarter, but current vacancy and rents are not dramatically different than levels from one year ago. There is uncertainty surrounding the pace and the timing of an economic recovery, which is expected to weigh on market sentiment in the coming quarters.
- > Apartment vacancy in Houston ticked up 10 basis points during the third quarter, following a 20-basis-point increase in the second quarter. At 5.7 percent, the current vacancy rate is 40 basis points higher than one year ago.
- > After posting minimal increases in recent periods, local asking rents fell 0.8 percent during the third quarter, ending the period at \$1,096 per month. Year over year, asking rents in the Houston metro are up just 0.2 percent.
- > Sales of apartment buildings remained modest during the third quarter, and transactions year to date are lagging 2019 levels by nearly 45 percent. In transactions that are closing, prices have inched higher from the 2019 median price, while cap rates have compressed slightly.

Houston Multifamily Market Overview

Key performance measures in the Houston multifamily market softened during the third quarter, but conditions were stronger than originally forecast, suggesting a shorter and more modest downturn in fundamentals. Vacancies have only crept up 20 basis points thus far in 2020, and the current figure is lower than during the third quarters of 2017 or 2018. Vacancy levels have been supported by renter demand growth, although net absorption slowed in both the second and third quarters. Rents have ticked lower but will likely stabilize in early or mid-2021 when the employment market begins to ramp back up.

Q3 Snapshot

Houston Market



Market Fundamentals

Vacancy	5.7%
- Year Over Year Change	+40 bps
Asking Rent	\$1,096
- Year Over Year Change	+0.2%



Transaction Activity

Median Sales Price Per Unit (YTD)	\$138,000
Cap Rates (Avg YTD)	5.1%



Construction Activity

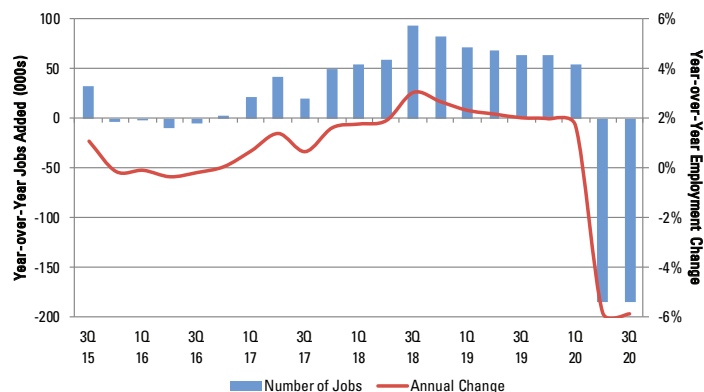
Units Under Construction	22,223
Units Delivered YTD	5,412

The local investment market is showing signs of settling into place. Sales velocity has slowed from levels recorded throughout last year and in early 2020, but activity in the third quarter was nearly identical to the second quarter. Prices have proven resilient, and the median per-unit price recorded thus far in 2020 is a bit higher than the median in 2019. While cap rates edged slightly higher during the third quarter, the average for the year is still just 5.1 percent, continuing the prevailing trend for the past several years of cap rate compression.

Employment

- > All major metro areas were negatively impacted by the coronavirus outbreak, and the Houston labor market has also been slowed by a sharp decline in oil prices. Year over year through the third quarter, employment in Houston has contracted nearly 6 percent with a net loss of approximately 185,000 positions.
- > The local labor market has bounced off its lows. In March and April, area employers cut more than 360,000 positions as the economy shut down. Since forced closures have been lifted, employers have added back nearly 130,000 positions.
- > While most sectors have cut workers, the professional and business services sector has posted modest year-over-year gains. During the past 12 months, professional employment has grown by 1.4 percent with the addition of approximately 7,000 net new jobs.
- > **Forecast:** Employers are expected to continue to add back workers in the fourth quarter, but the market will record job losses in 2020. Total employment is forecast to dip approximately 5.5 percent in 2020.

Employment Overview



The professional and business services sector has posted year-over-year gains

Vacancy

- > Vacancy in Houston rose 10 basis points during the third quarter, reaching 5.7 percent. This marked the second consecutive quarterly vacancy increase following declines in four of the preceding six quarters.
- > Year over year, vacancy in Houston is up 40 basis points. Local vacancy was in a gradual improvement cycle from mid-2017 until the first quarter of this year.
- > Year to date, vacancy in Houston is up 20 basis points. Net absorption has been positive, totaling approximately 3,000 units, but move-ins have not kept pace with new construction. Absorption was most pronounced in the first quarter before slowing during the past six months.
- > **Forecast:** After recording annual vacancy declines in both 2018 and 2019, the apartment vacancy rate in Houston is on pace to rise this year. Vacancy is forecast to end 2020 at 6.4 percent, identical to the rate at the end of 2017.

Vacancy Trends

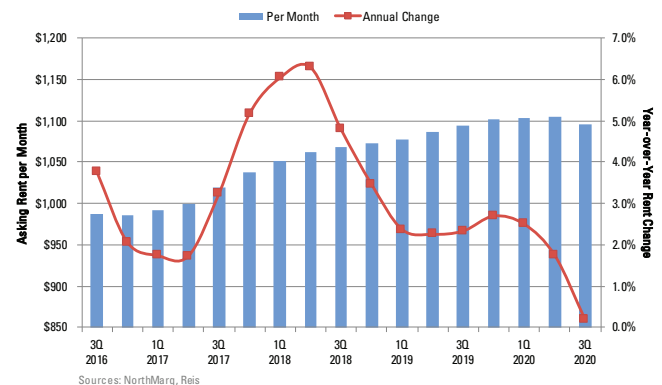


Year over year, vacancy in Houston is up 40 basis points

Rents

- > Local asking rents dipped during the third quarter, mirroring the larger national trend. Asking rents in Houston fell 0.8 percent during the third quarter, ending the period at \$1,096 per month.
- > Year over year, asking rents in Houston have inched up 0.2 percent. Annual rent growth had been in the 2-percent range since the beginning of 2019, before slowing in recent quarters.
- > While rents in Class A apartments have crept lower, modest gains have been recorded in mid-tier and lower-tier buildings. Combined Class B and Class C average asking rates have increased 1.8 percent year over year.
- > **Forecast:** Rents are forecast to decline 1.5 percent in 2020, offsetting about half of the gains recorded in 2019. Asking rents are forecast to end the year at approximately \$1,085 per month.

Rent Trends



Class B and Class C average asking rates have increased 1.8 percent year over year

Development and Permitting

- > Development in Houston has gained momentum in 2020, following a decline of nearly 40 percent from 2018 to 2019. Year to date, developers have delivered approximately 5,400 units to the market.
- > New apartment supply growth is on track to persist for the next few years. Developers have dozens of projects totaling more than 22,000 units currently under construction. Nearly 15,000 units are scheduled to deliver by the end of 2021, although some projects or phases could be slowed a few quarters in response to reduced demand.
- > Multifamily permitting has slowed in 2020. Developers have pulled permits for approximately 14,600 multifamily units through the first three quarters of this year, down 7 percent from the same period in 2019. The strongest permitting activity occurred during the first quarter, and levels have dropped off in each of the past two quarters.
- > **Forecast:** Developers are expected to bring approximately 9,500 apartment units online in 2020, up from last year's total but more consistent with long-term trends. Looking ahead to 2021, completions are likely to total approximately 10,000 units.

Development Trends

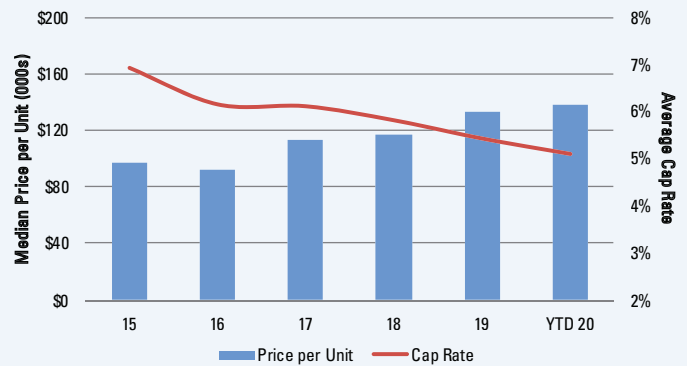


Year to date, developers have delivered approximately 5,400 units to the market

Multifamily Sales

- > Sales activity slowed during the second quarter and transaction levels in the third quarter closely tracked figures from the preceding three months. Year to date through the third quarter, sales velocity is down approximately 45 percent from the first three quarters of 2019.
- > In transactions where sale prices are available, the median price thus far in 2020 has reached approximately \$138,000 per unit, 4 percent higher than the median price in 2019.
- > Year to date, cap rates have averaged approximately 5.1 percent, 30 basis points lower than in 2019. During the third quarter, cap rates inched higher, but cap rates have generally been trending lower during the past several years.

Investment Trends



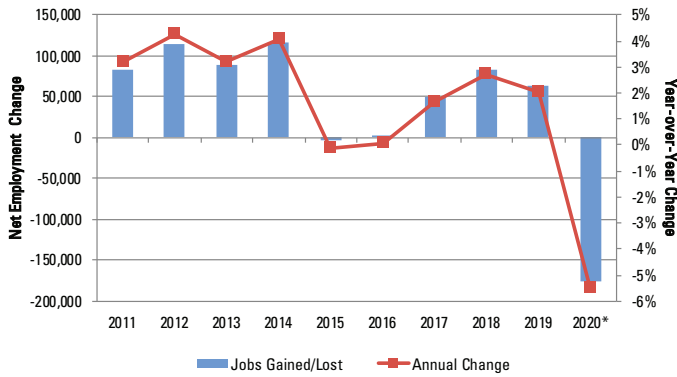
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Looking Ahead

The Houston multifamily market will likely remain in a supply-demand imbalance in the coming quarters. After a slight pause in 2019, apartment developers are slated to bring nearly 15,000 new units to the market in the next 15 months, putting supply-side pressure into the market at a time when the pace of economic growth is uncertain. At this point in the cycle, energy prices appear to have stabilized after extreme volatility in the spring. A recovery in global economic activity would have a near-immediate impact on the Houston market and stimulate demand for rental housing.

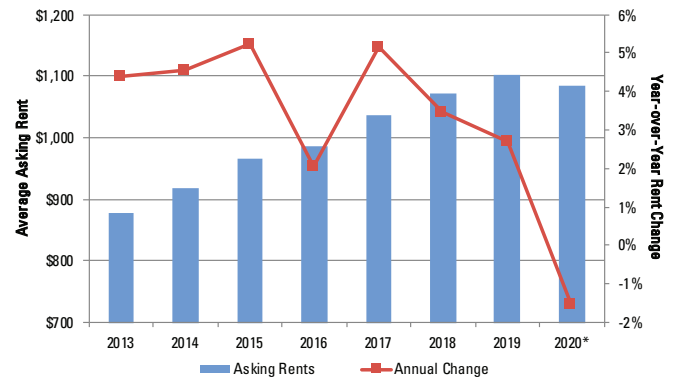
Investment activity levels in Houston have slowed thus far in 2020, and sales velocity has not yet shown signs of regaining momentum. Many investors are likely taking a wait-and-see approach, with new supply increasing and demand levels expected to lag previous periods. As the local economy stabilizes and hiring resumes, more properties will likely begin to change hands. While sales velocity has been modest in 2020, pricing and cap rate trends have proven resilient. With interest rates likely to remain low, cap rates are not expected to move out of current ranges in the coming quarters.

Employment Forecast



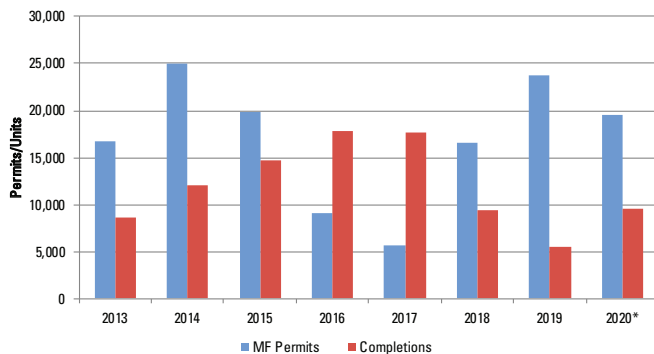
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



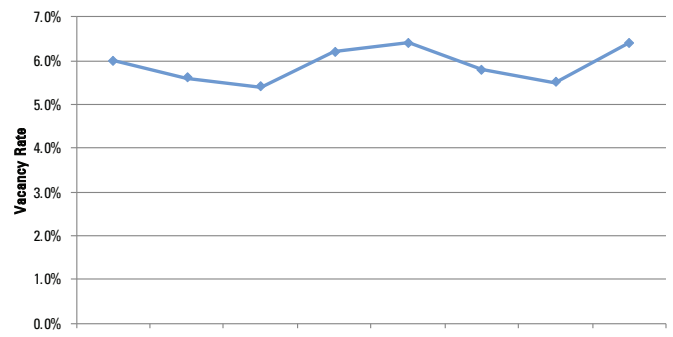
* Year End Forecast
Sources: NorthMarq, Reis

Construction & Permitting Forecast



* Year End Forecast
Sources: NorthMarq, Census Bureau, Reis

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Reis

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For more information, contact:

John Burke

MANAGING DIRECTOR – DEBT & EQUITY
713.333.8824
jburke@northmarq.com

Ray Driver

MANAGING DIRECTOR – DEBT & EQUITY
713.871.5801
rdriver@northmarq.com

Tony Gray

MANAGING DIRECTOR – DEBT & EQUITY
713.622.6300
tgray@northmarq.com

Trevor Koskovich

PRESIDENT – INVESTMENT SALES
602.952.4040
tkoskovich@northmarq.com

Pete O'Neil

DIRECTOR OF RESEARCH
602.508.2212
poneil@northmarq.com

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