Houston Multifamily

NORTHMARQ

Sales Activity Surges, Despite Rise in Construction

Highlights

- The Houston multifamily market closed 2020 with a surge in new deliveries of apartments, pushing the vacancy rate higher. Construction is expected to be active in 2021 as well, but renter demand for apartments should accelerate as the economy gains momentum.
- Vacancy ticked up 30 basis points in the fourth quarter, reaching 6 percent. For the year, the rate rose 50 basis points, but current vacancy levels remain below the market's cyclical high from a few years ago.
- After a decade of annual gains averaging between 3 percent and 5 percent, Houston apartment rents declined in 2020. Asking rents dipped 1.8 percent, ending the year at $1,082 per month.
- Multifamily sales activity accelerated in the fourth quarter. The median price rose in 2020, advancing 4 percent from 2019 to $137,800 per unit, while cap rates compressed to an average of 5.2 percent.

Q4 Snapshot	Houston Market
Market Fundamentals	
Vacancy	**6.0%**
- Year Over Year Change	**+50 bps**
Asking Rent	**$1,082**
- Year Over Year Change	**-1.8%**
Transaction Activity*	
Median Sales Price Per Unit (YTD)	**$137,800**
Cap Rates (Avg YTD)	**5.2%**
Construction Activity	
Units Under Construction	**21,919**
Units Delivered YTD	**12,265**

*In transactions where pricing is available

Houston Multifamily Market Overview

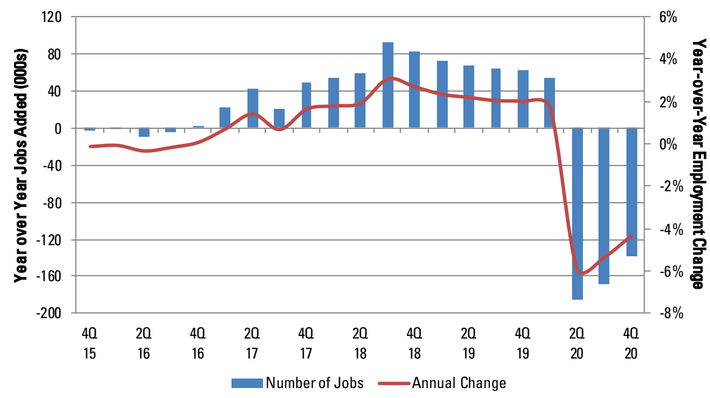
New supply growth outpaced renter demand in Houston in 2020, particularly late in the year. Apartment deliveries accelerated during the fourth quarter, resulting in a rising vacancy rate despite positive net absorption. While vacancy trended higher in 2020, the current rate is still 100 basis points lower than the Houston area's recent cyclical peak recorded in mid-2017. Despite net jobs losses associated with COVID-19, absorption of apartments totaled nearly 8,500 units in 2020, with the fourth quarter posting the strongest demand of the year.

Investment activity gained momentum in the fourth quarter, with more multifamily properties changing hands. Sales of apartment properties doubled from the third quarter to the fourth quarter, but still did not approach levels recorded one year earlier. While transaction activity levels lagged the pace established in recent years, prices rose slightly, and cap rates fell in 2020. In transactions where pricing was available, cap rates averaged 5.2 percent during the past year. Cap rates were quite consistent throughout 2020.

Employment

- All major markets posted job losses in the first half of 2020, and the pace of recoveries has been uneven. In Houston, the employment rebound gained momentum late in the year. Area employers added back 51,700 jobs during the fourth quarter, up from a gain of 33,500 jobs in the third quarter.
- Despite recovering more than 85,000 jobs in the second half of the year, the Houston market shed 138,000 jobs in 2020. This represented a decline of 4.3 percent for the year; the U.S. labor market contracted by 6.2 percent in 2020.
- The Texas Medical Center's TMC3 life science facility is forecast to break ground in 2021, which will be a source of significant job growth and economic activity in the coming years. The facility is forecast to include 3.7 million square feet of commercial development and should support 23,000 net new jobs.
- **Forecast:** Employment in Houston is expected to recover fairly quickly in 2021, with growth forecast to total 2.8 percent. Growth is anticipated to total approximately 85,000 net new jobs.

Employment Overview



Sources: NorthMarq, Bureau of Labor Statistics

Area employers added back 51,700 jobs during the fourth quarter

Vacancy

- Apartment vacancies rose 30 basis points in the fourth quarter, with the rate reaching 6 percent. This marked the third consecutive quarter where the Houston vacancy rate crept higher.
- For the year, vacancy rose 50 basis points as new supply outpaced renter demand. Before rising in 2020, the local vacancy rate had tightened in each of the previous two years.
- Vacancy in Class A apartments rose 80 basis points in 2020, ending the year at 6.8 percent. The Houston area's Class A vacancy rate is generally fairly high due to a consistently strong pace of new development. During the past five years, local Class A vacancy has averaged 6.9 percent.
- **Forecast:** Renter demand for apartments is forecast to strengthen in 2021, but deliveries of new units are also on pace to accelerate. The local vacancy rate is forecast to rise 40 basis points to 6.4 percent.

Vacancy Trends

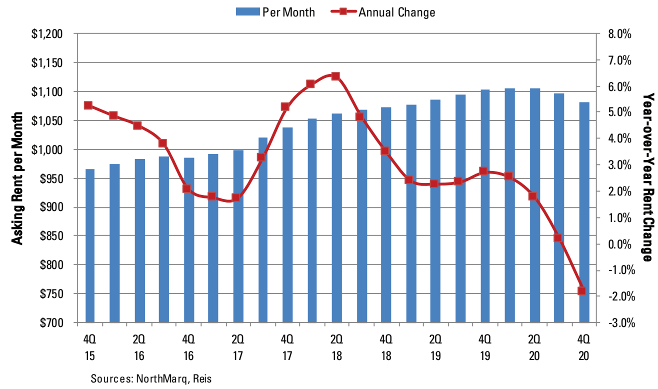
Sources: NorthMarq, Reis

Vacancies rose 30 basis points in the fourth quarter, with the rate reaching 6 percent

Rents

- After holding steady through late 2019 and early 2020, rents have trended lower in each of the past three quarters. Asking rents dipped 1.3 percent in the fourth quarter.
- Asking rents contracted by 1.8 percent in 2020, ending the year at $1,082 per month. Prior to the decline in 2020, rent growth had averaged 4 percent per year since 2011.
- The softening of local rents was most pronounced in the Class A segment. Class A asking rents declined 2.4 percent in 2020, falling to $1,298 per month in the fourth quarter.
- **Forecast:** As the economy strengthens, rents should push higher in 2021. Asking rents are forecast to rise 3.5 percent to approximately $1,120 per month.

Rent Trends

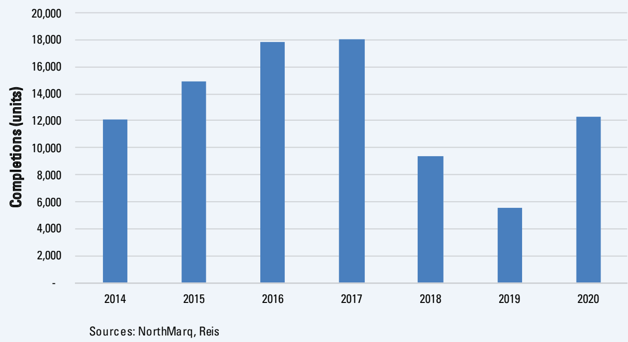


Asking rents ended the year at $1,082 per month

Development and Permitting

- Apartment construction accelerated in 2020, with developers completing projects totaling more than 12,200 units. Completions in 2020 more than doubled levels from one year earlier.
- The development pipeline includes dozens of projects across several submarkets. Approximately 22,000 units were under construction at the end of 2020. More than 6,700 units are under construction in the Montrose/River Oaks submarket.
- Multifamily permitting slowed in 2020, with the fourth quarter posting the lowest total since mid-2018. In 2020, developers pulled permits for approximately 20,000 multifamily units, down 7 percent from the 2019 total. In the fourth quarter, permits for approximately 4,000 units were issued.
- **Forecast:** Developers are expected to remain active in 2021. Approximately 16,000 units are forecast to be delivered, the highest annual total in the market since 2017.

Development Trends



Approximately 22,000 units were under construction at the end of 2020

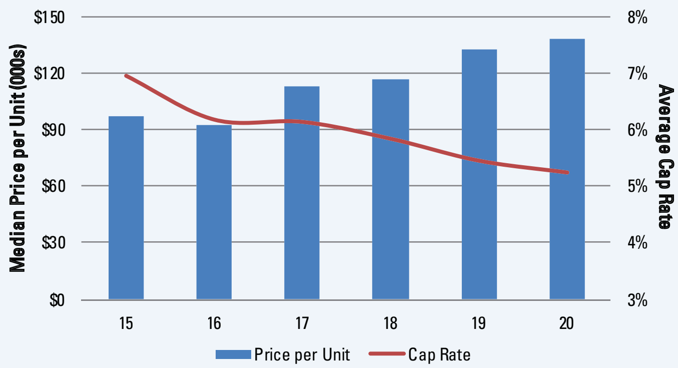
Multifamily Sales

> After slowing for much of the year, sales activity gained momentum at the end of 2020. The number of properties that sold more than doubled from the third quarter to the fourth quarter. Despite the spike to close the year, sales velocity in 2020 was down approximately 35 percent when compared to 2019 levels.

> In transactions where sales prices are available, the median price in 2020 was approximately $137,800 per unit, 4 percent higher than the median price in 2019. At the high-end of the market, a few Class A properties sold for prices between $200,000 per unit to $250,000 per unit.

> In 2020, cap rates averaged approximately 5.2 percent, 20 basis points lower than the average in the previous year. Cap rates have gradually been declining in Houston over the past several years but showed signs of leveling off late in 2020.

Investment Trends



Sources: NorthMarq, CoStar

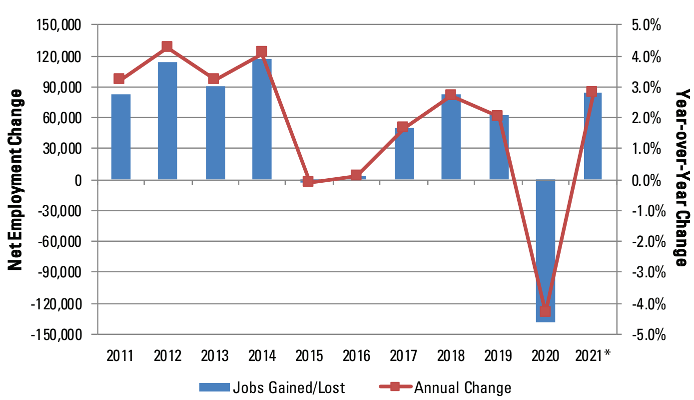
In transactions where sales prices are available, the median price in 2020 was approximately $137,800 per unit

Looking Ahead

The Houston economy is forecast to gain momentum in 2021, but it may take a few more quarters for the local multifamily market to fully stabilize. Area employers are adding back workers at a healthy rate, and the year ahead is poised to be an active one for payroll growth. The local economy could benefit from rising energy prices as national and global growth accelerates. Houston has shed approximately 30,000 energy jobs in the past 18 months and a rebound would support the larger local economy. While renter demand for apartments is forecast to gain momentum, supply growth should be active and deliveries in 2021 should be the highest figure since a strong run of development from 2015 to 2017. The added inventory should push the vacancy rate higher in 2021.

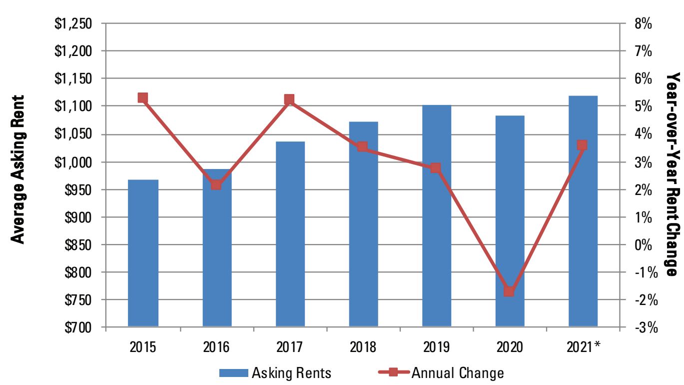
Multifamily investors in Houston began to move off of the sidelines in late 2020, setting the stage for a more active period of investment in 2021. The prevailing market sentiment has brightened in recent quarters, with most investors signaling that the stresses in the local economy are easing and Houston is moving back into expansion mode. While there will likely be supply-side pressures lingering in the next few quarters, an accelerating pace of renter demand should continue to support investment in 2021. Cap rates have been on an extended run of compression over the past several years, but that trend could come to an end if interest rates push higher in 2021.

Employment Forecast



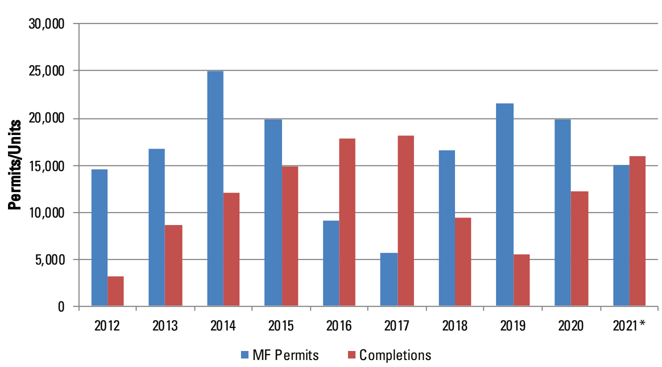
* Year End Forecast
Sources: NorthMarq, Bureau of Labor Statistics

Rent Forecast



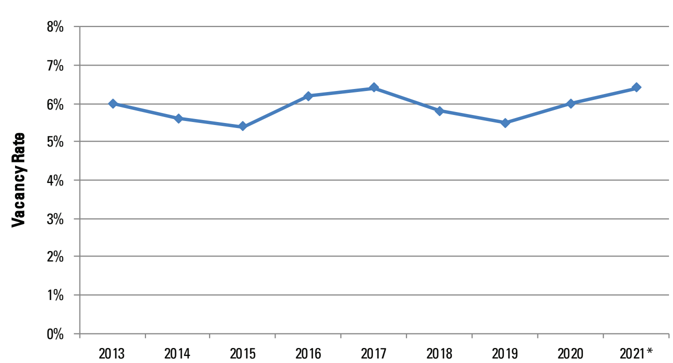
* Year End Forecast
Sources: NorthMarq, Reis

Construction & Permitting Forecast



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

Vacancy Forecast



* Year End Forecast
Sources: NorthMarq, Reis

About NorthMarq

As a capital markets leader, NorthMarq offers commercial real estate investors access to experts in debt, equity, investment sales, and loan servicing to protect and add value to their assets. For capital sources, we offer partnership and financial acumen that support long- and short-term investment goals. Our culture of integrity and innovation is evident in our 60-year history, annual transaction volume of more than $14 billion, loan servicing portfolio of more than $61 billion and the multi-year tenure of our nearly 600 people.

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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