MARKET REPORT

Multifamily

Houston Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

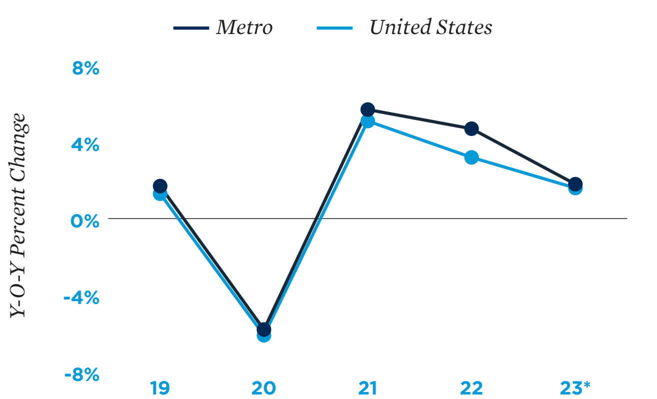
3Q/23

Houston Improving in Relation to Other Texas Markets, but Rising Expenses Pose Challenges

Local multifamily sector is proving sturdier. Houston was the only major Texas market to register a vacancy decline between the first and second quarters of this year. Net absorption of nearly 5,800 units year-to-date through June was also the largest tally in the state, slightly edging out Dallas-Fort Worth and significantly outpacing the two central Texas metros. This foreshadows expectations for the second half of 2023. Sustained demand and relatively mild construction allow Houston to tie Austin's vacancy rate and come within 20 basis points of Dallas-Fort Worth's state-leading metric by year-end. This is notable as Houston has never had a rate within 80 basis points of either market at the close of a year going back to 2018.

Houston is among the costliest markets for insurance. Operating expenses have been increasing in multiple categories, with the cost to insure apartments rising at a particularly fast pace locally amid the ever-present threat of natural disasters. Insurance costs per unit surged by about 47 percent year-over-year in the second quarter. Houston now ranks as the seventh-most expensive major market nationally and the third highest outside of Florida for insurance. This is putting a massive strain on smaller operators, as well as influencing development plans as some builders shift their focus to less costly markets. As of August 2023, about 33,200 rentals had broken ground in Houston with a scheduled delivery in 2024 through 2026, a modest total that accounts for less than 5 percent of current inventory.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.; RealPage, Inc.

Multifamily 2023 Outlook

58,000 JOBS
will be created

EMPLOYMENT:

Employment grew by 38,400 roles year-to-date through July. Signs of softness emerged recently, however, with two of the past four months noting job losses, mostly from construction and service sectors. The overall headcount rises 1.8 percent this year.

15,500 UNITS
will be completed

CONSTRUCTION:

Annual completions exceed 2022's tally by about 450 units, although it will be the second-smallest addition in four years. Houston's 2.1 percent inventory growth trails the other major Texas metros in 2023, helping local vacancy hold much sturdier.

30 BASIS POINT
increase in vacancy

VACANCY:

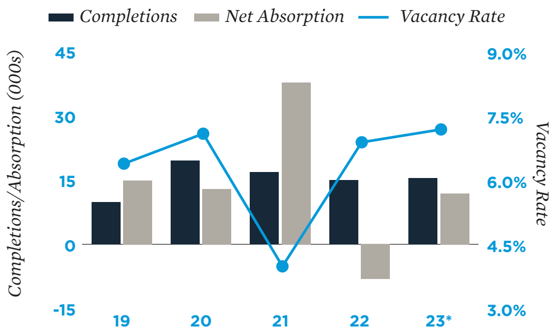
Houston's moderate pace of supply expansion enables vacancy to hold relatively firm, ending 2023 at a rate of 7.2 percent. The three other major in-state markets are projected for vacancy hikes of at least 100 basis points.

3.9% INCREASE
in effective rent

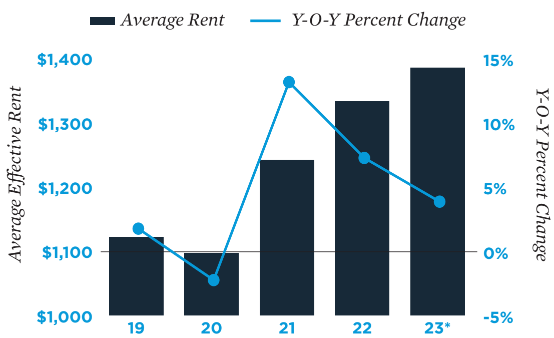
RENT:

Correlating with a comparatively slower construction pace and smaller vacancy increase, Houston also leads Texas in rent growth this year. The local average effective rate will rise to $1,385 per month in 2023.

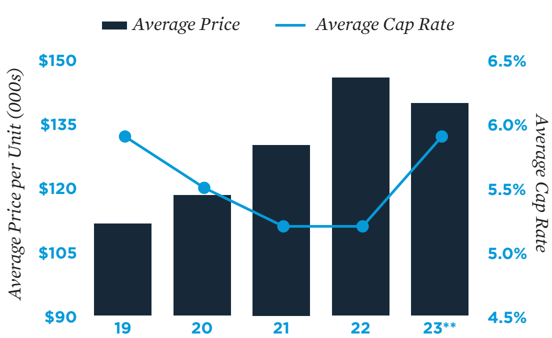
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics; RealPage, Inc.

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2Q 2023 - 12-Month Period

CONSTRUCTION

14,292 units completed

- Cypress-Waller and Rosenberg-Richmond both had annual supply growth of over 12 percent in June 2023. Conroe-Montgomery County, Downtown-Montrose-River Oaks and Katy also had five-plus percent expansions.
- Bear Creek and Spring-Tomball are two areas that feature more heavily on the 2024 and beyond pipeline than they did for recent completions.

VACANCY

210 basis point increase in vacancy Y-O-Y

- The 280-basis-point Class C vacancy jump was partially softened by sub-200-basis-point Class A and B increases. Upward movement in each segment nevertheless pushed the overall rate to 7.1 percent in June.
- Only three of Houston's 35 submarkets had vacancy upswings below 100 basis points: Alief, East Inner Loop and Friendswood-Pearland.

RENT

4.4% increase in the average effective rent Y-O-Y

- Brazoria County and Cypress-Waller were the lone spots with year-over-year average effective rent declines in June. Sub-1 percent gains were also recorded in Champions West, Rosenberg-Richmond and The Woodlands.
- On the flip side, three submarkets posted annual rent growth exceeding 8 percent: Alief, East Inner Loop and Sharpstown-Fondren Southwest.

Investment Highlights

- Higher interest rates and conservative lending worked in concert to subdue trading during the first half of 2023. Deal flow in Houston was down more than 70 percent relative to the same stretch of 2022, and over 40 percent below the equivalent pre-pandemic trailing-decade average. Houston nevertheless remained nationally prominent for multifamily investment, with the number of trades ranking in the top 20 and dollar volume holding a spot in the top 15. A relatively high average cap rate of 5.9 percent during the year ending in June 2023, above Austin and Dallas-Fort Worth by 100-plus basis points, likely helped facilitate deals amid hurdles.
- Transactions year-to-date through July have been heaviest in Inner Loop neighborhoods and north suburbs off-shooting Interstate 45, such as The Woodlands and Spring. Urban core favorites include the Medical Center, Greenway-Upper Kirby and University Place. A collection of 200-plus-unit high-end assets changed hands here, as young professionals buoy demand.
- Institutions setting their sights on areas with the tightest Class A vacancy may look to Brazoria County and Bear Creek, while investors targeting highly-occupied Class B assets could focus on Alief and East Inner Loop.