Outstanding!

Multifamily enjoys a banner year in Houston, now one of the country's fastest-growing metro areas.

By BRUCE McCLENNY, Apartment Data Services Inc.

Houston is an outstanding city, according to many recently conducted surveys. Houston took the No. 1 spot on U-Haul's annual migration trend report for the fourth year in a row, and United Van Lines, the nation's largest moving company, ranked Houston as the third most popular city for U.S. families to call home.

Included in these statistics are a substantial number of young professionals coming to H-Town. A survey conducted by MSN ranked the Bayou City as the No. 1 city for recent college graduates to locate. This survey looked at a combination of job growth, affordable living and vibrant 20-something populations. The MSN survey found that the 20-somethings make up 17.6 percent of Houston's population. Another study found that Houston was among the Top 20 "Happiest Cities" for young professionals by weighing the aspects of work/life balance, growth opportunities, compensation and company culture. And to top it all, Forbes Magazine named Houston as America's Coolest City! Forbes defines cool by a variety of measures, like entertainment options and restaurant/bars per capita, diversity of population and net migration. In addition, this Forbes study found that the median age of a Houston resident is a youthful 33 years of age.

All these cool, young, happy, professional Houstonians are contributing to the continued outstanding performance of the Houston apartment market. As of the end of the third quarter, overall rents improved by 6.5 percent, propelled by absorption of 16,134 units over the past 12 months. Such powerful absorption is a result of strong, sustained job growth. The U.S. Bureau of Labor Statistics reports 80,700 net new jobs for the Houston-Sugar Land-Baytown metro area for the 12 months ending August 2013. This represents a 3.0 percent improvement.

Overall occupancy stands at 91.1 percent as of the end of September. Occupancy is somewhat diluted due to properties in lease-up. If the 39 properties

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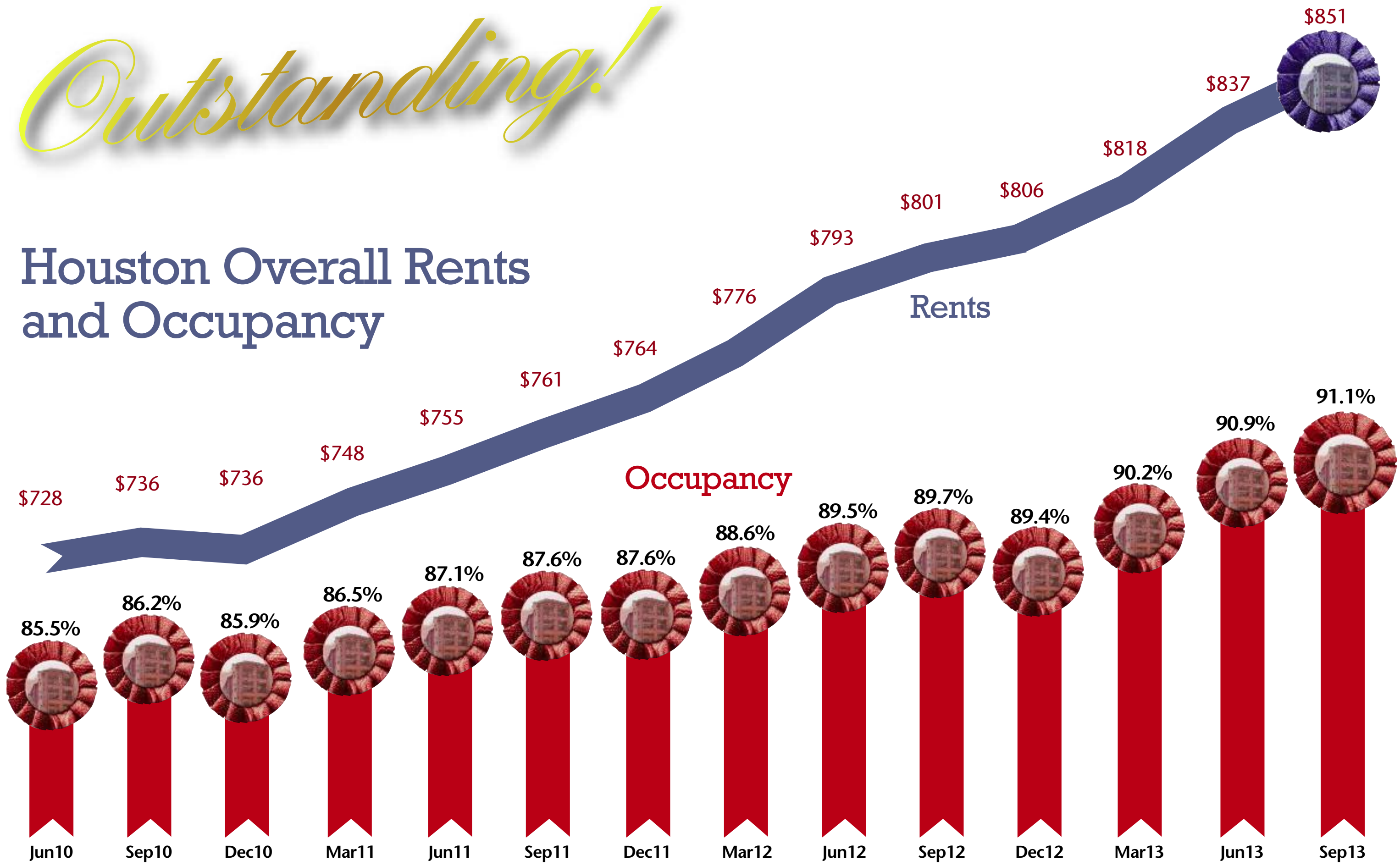
1
FIRST PLACE

Outstanding!

Houston Overall Rents and Occupancy



Analysis by Classification

As of September 30, 2013	Supply	Occupancy	Rent ¢/sq ft	Rent $/month	Rent 12-Month Trend	Rent 3-Month Trend	Absorption (Units) 12 Months	Absorption (Units) 3 Months
2012, 2013 Construction	17,146	58.1%	147.0	$1,398	–	–	6,785	2,210
Class A (w/o '12 & '13)	72,780	95.1%	155.6	$1,480	7.4%	6.0%	-221	-292
Class B (w/o '12 & '13)	161,845	95.2%	104.4	$929	6.4%	7.2%	1,459	-75
Class C	248,035	91.8%	79.4	$669	5.6%	5.7%	6,113	1,395
Class D	70,366	84.0%	62.1	$526	2.5%	0.5%	1,998	556
Overall	**570,172**	**91.1%**	**97.4**	**$851**	**6.5%**	**6.1%**	**16,134**	**3,794**

Surprisingly, the fundamentals for 2013 so far are beating the superlative performance of 2012! Rent growth over the past 12 months is 6.5 percent, which is 100 basis points or one percentage point better than 2012. The 2013 absorption through September is 16,134 units, which is significantly better than the 14,664 units that represent a full 12 months of absorption for 2012.

opened over the past 12 months are filtered out of the occupancy calculation, then overall occupancy would be 92.1 percent. The relationship between supply and demand remains in control, with approximately 10,000 units delivered into supply over the past 12 months and more than 16,000 new units occupied during the same period.

HISTORY OF OVERALL MARKET CONDITIONS

The graph on Page 36 looks back 14 quarters to June 2010, when Houston was first emerging from the 2009 recession. During 2011 Houston produced 81,200 new jobs, and the overall rent level advanced by 3.7 percent, moving from $736 to $764. Occupancy moved from 85.9 percent to 87.6 percent, driven by 13,682 units of absorption.

Job growth during 2012 registered 105,700 net new jobs, and rents advanced by $42, from $764 to $806, a 5.5 percent improvement. Occupancy in 2012 improved from 87.6 percent to 89.4 percent, paced by 14,664 units of absorption.

With only nine months down, 2013 is progressing even better than 2012. Overall rent has improved by $45 and now stands at $851. Occupancy has moved from 89.4 percent to 91.1 percent, driven by 16,168 units of absorption. Houston's 2013 apartment market deserves all the accolades, from cool to outstanding!

CLASSIFICATION ANALYSIS

The overall statistics cited above are an aggregate expression of each class of product. It is important to understand that there are significant differences in performance between the classes. Classes are determined by a bell curve distribution of market rate. The chart on Page 36 illustrates how the overall performance at the end of September 2013 is distributed and highlights how classes differ in rates or trends.

The new construction units delivered in 2012 and 2013 have been filtered out of classes A and B to create a separate classification. There are only 17,146 units within this category, as development of new product has been slow to get started. The occupancy of 58.1 percent is low but understandable, since most of the properties in this class are in lease-up. Rent trends for this group cannot be accurately calculated due to the continually increasing number of new units being introduced.

CLASS A WITHOUT NEW CONSTRUCTION

Taking new construction units out of Class A provides a stabilized occupancy picture of this product type. This group's occupancy is 95.1 percent. The 12-month rent trend is a very strong 7.4 percent. The three-month trend of 6.0 percent is still very good, yet marks a small tap on the brakes from the 12-month trend. Over the past 12 months, rent has increased by $71 per month and 7.6 cents per square foot.

> Fourth quarters are traditionally slower-paced times, so a little rollback could happen by year's end. Regardless of the potential fourth quarter adjustment, it should be safe to say that 2013 will stand above 2012 in terms of rent growth and absorption.

Class A continues to take advantage of the opportunity that great job growth and reduced competition are providing by aggressively raising rents on renewals and market rent, a strategy pursued at the risk of causing turnover. Many properties are taking the stance that if occupancy is greater than 96.0 percent, then rents are too low! This strategy is proving justified as the units turned over are being leased quickly to the prospects that accept the new level of rent.

CLASS B WITHOUT NEW CONSTRUCTION

As Class A advances, it provides room for Class B to follow. Occupancy for Class B is currently at 95.2 percent. Class B's impressive occupancy level was partially driven by renters who have been priced out of Class A. With such occupancy comes pricing power, and Class B's 12-month rent trend confirms that, registering an incredible 6.4 percent. The three-month annualized rent trend is even stronger than the 12-month rate, coming in at 7.2 percent. Over the past 12 months, rent has increased by $42 per month and 4.7 cents per square foot.

Earlier in 2013, Class B reached a very important milestone of achieving an overall rent rate greater than $1.00 per sq. ft. Now, Class B is firmly over that threshold with an overall rental rate of $1.04 per sq. ft.

CLASSES C AND D

The occupancy for Class C bottomed out in December 2009 at 84.0 percent as a result of the recession. Since then Class C has steadily gained occupancy, and with the 6,113 units of absorption over the past 12 months, Class C occupancy has achieved 91.8 percent. For Class C to claim the lion's share of all absorption makes the statement that renters are adjusting to the higher levels of rent in classes A and B by seeking the more available and affordable product of Class C.

In response to this strong absorption/occupancy performance, Class C was able to move rents by an outstanding 5.6 percent over the past 12 months. In addition, rent has increased by $29 per month and 3.4 cents per square foot over this same time frame. The three-month trend is holding steady, coming in at an annualized 5.7 percent.

Class D's occupancy hit bottom at 77.2 percent in December 2010. Occupancy now stands at 84.0 percent, driven by a respectable 1,998 units of absorption. Class D has finally gotten a little momentum over the past 12 months with a 2.5 percent gain in rent. However, the trend has flattened out over the past three months. Class D is still a drag on the overall occupancy statistics.

LOOKING AHEAD

Surprisingly, the fundamentals for 2013 so far are beating the superlative performance of 2012! Rent growth over the past 12 months is 6.5 percent, which is 100 basis points or one percentage point better than 2012. The 2013 absorption through September is 16,134 units, which is significantly better than the 14,664 units that represent a full 12 months of absorption for 2012.

Fourth quarters are traditionally slower-paced times, so a little rollback could happen by year's end. Regardless of the potential fourth quarter adjustment, it should be safe to say that 2013 will stand above 2012 in terms of rent growth and absorption.

Currently, more than 18,000 units are under construction, of which 5,000 will begin leasing in 2013. Since there are already 10,200 units introduced in 2013, these additional units will bring the total number of units introduced into supply during 2013 to around 15,200. Considering that the absorption performance for 2013 is already over 16,000 units, supply and demand are well in balance.

The number of units delivered in 2014 will be around 15,000 to 16,000 units. There are 13,000 units presently under construction that will deliver in 2014. Of the 20,000 units that are proposed, expect around 2,000 to 3,000 units to start construction during the remainder of 2013 to be delivered in 2014.

Job growth for 2014 is now expected to be a little slower than in 2013. Dr. Bill Gilmer of the University of Houston's Bauer College of Business is forecasting 65,100 net new jobs for 2014. Applying the conversion ratio of one apartment occupied or absorbed for every five jobs created generates an absorption forecast of 13,020 units. This absorption forecast falls short of matching the new supply being introduced, which in no way should be viewed as overbuilding. There should be plenty of demand for new properties to lease up in a timely manner.

MARKET DIRECTION

Houston is poised for a three-peat! This is not exactly the same as winning three Super Bowls or three World Series, back to back to back, but it is equally impressive. For the past two years, the Houston apartment market has been the best-performing commercial real estate category and achieved champion-esque results in most all aspects of judging success. Houston apartments will have another winning year in 2014!

Overall rent growth for 2014 will not be as good as the "homerun" trends of 2012 and 2013 but it will easily be scored as a triple. Overall rent growth for 2014 should come in around 4.0 percent to 4.5 percent. Class A should realize a 6.0 percent improvement helped greatly by new product deliveries. Look for Class B to improve by 4.5 percent, Class C by 3.0 percent and Class D by 1.0 percent. Overall occupancy for 2014 will be around 90.2 percent. It's an outstanding time to be in the apartment business in greater Houston!

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