Viewpoint on the Impact of Hurricane Harvey on the Houston Multifamily Market

Looking Past the Headlines

In the wake of Hurricane Harvey, both print and social media have dedicated significant bandwidth to the impact of the storm on the Houston housing market. We have all read predictions of an ensuing boom in the apartment market; the result of single family home losses increasing demand for apartments and lost apartment inventory decreasing supply. It is logical that the apartment market will benefit from the tragedy, but just how much is the question.

First, the Conclusion

Based on data available at this time and what we are experiencing in our portfolio, my viewpoint on the impact of Harvey on the market can be summarized as follows:

- The media accounts of massive losses in the apartment market are overstated as it relates to the *near and long term* loss of supply;
- Immediate and dramatic increases in occupancy and rent growth will be *highly localized* at those properties in or near desirable neighborhoods where flooding occurred;
- Across the overall *Houston market* we should see a return to stabilized occupancy at or above 95% by year end, triggering rent growth by year-end to early 2018, as opposed to our pre-Harvey expectations of late 2018 or early 2019; and,
- Job growth will play heavily into this equation but the jury is still out on what that growth will look like.

Before diving into a more detailed discussion of the Harvey situation, I have to emphasize that *a sustainable recovery of the multifamily market is dependent on the health of the Houston economy*. With job growth we will continue to see improvement in rents and occupancy as new construction fell off dramatically pre-Harvey. Until that faucet opens back up, good things will continue after the impact of Harvey is behind us as long as Houston recovers economically.

Supply Losses are Over-stated

A variety of sources continue to report wide ranges of lost or damaged apartment inventory: From as few as 10,000 units market-wide to as many as 45,000 units which represents between 1.5% and 7% of the existing multifamily stock of approximately 643,000. Most likely the high end of the range includes all units at an entire property where damage was reported; the middle of the range, individually damaged but habitable units; and the lower range uninhabitable units only.

Regardless of how they are calculated, the number of units uninhabitable for 3 to 6 months or more is what really matters. It represents real supply loss and hence the degree to which occupancy increases and rents grow in the foreseeable future. I am firmly of the belief that the lower end of the range is closest to reality and, as a result, reports of wild corrections in the broad apartment market are overstated.

As an example, along the Bayou entire properties were evacuated, but many apartments remained dry and were perfectly habitable once power was restored. Flooding in many was limited to certain buildings and almost exclusively to first floor units. For instance, a 348 unit community owned by our property management company was evacuated in its entirety, but most residents were back in their apartments by Labor Day. Those residents stayed in shelters, hotels, or with friends and family until they could return. Unless a unit is deemed uninhabitable, residents must honor their lease obligations, so most weren't in the market to rent a new apartment. After the water receded the property had 32 units that were deemed uninhabitable, yet they will be brought back on line over the next 90 days. They do not represent a permanent loss of supply, nor increased demand as a result of dislocation.

Likewise, our Bayou Park property has 32 units out of 689 (4%) that cannot be occupied at the moment. The higher published ranges most likely report us having 689 units "damaged", but the reality is that not only is our number lower, it is temporary. Of these units, twenty are due to extensive flooding and will take between 60 and 90 days to refurbish. The balance will be back on line in the next 30-45 days and in the meantime, the vast majority of those residents have either temporarily or permanently moved to new apartments within the property itself.

So why is this distinction so important? Because supply constitutes half of the equation that answers the question at the forefront of our minds: What is the real impact of the storm on market occupancy and rent growth? Prior to the storm Houston's apartment market, comprised of approximately 643,000 units, carried just under 20,000 units of excess inventory: The difference between aggressive pre-Harvey estimates of occupancy at 92% and equilibrium occupancy of 95%. Add to this the 10,285 units of new construction remaining to be delivered in 2017 and the result is excess inventory of just under 30,000 units. If indeed only 10,000 to 15,000 units are off line for an extended period of time, we have certainly accelerated the recovery of the Houston apartment market, but by no means have we taken it to equilibrium overnight.

Demand Increases from Harvey are Highly Localized

Of course the other half of the apartment market recovery equation is demand. Changes in demand largely account for my view that occupancy and rent increases post Harvey will be *highly localized* and most likely not as dramatic across the broad market as today's headlines suggest. Apartment complexes in areas that saw the largest loss of single family inventory will receive the lion's share of gains *provided* they are in desirable areas where displaced residents can afford to stay close to their homes, schools, and neighborhoods. Desirable is the operative word and it goes hand-in-hand with affluence. In these locations many can afford to lease an apartment close by while their homes are being rebuilt, and it is here that we will see 1:1 demand increases due to long term single family losses. The energy corridor is a great example of this and is already a big winner post-Harvey. The Galleria and Post Oak areas have realized full occupancies from dislocations in Bellaire and Meyerland.

An example of this is our Spring Branch property, just east of Beltway 8 and the energy corridor. Here we have seen an increase in occupancy from 95% to 99% over the past 30 days. In September leasing traffic increased 15%, of which 9 prospects were families displaced by Harvey. We were unable to accommodate all of them due to already full occupancy and we expect that to continue, along with rising rents as a direct result for the foreseeable future.

While I believe that increased demand from single family displacement is localized; we will see increased demand across the broad market from job growth. The economist jury appears to still be out as to what the job statistics are going to look like post-Harvey, especially as it relates to the balance of construction jobs versus our core economic driver of oil and gas. The statistics suggest we are close to equilibrium based on our post-Harvey calculations of supply. An increase in demand from net new jobs will accelerate a recovery in the broad market even more quickly than current conditions.

What's in Store?

As of now, it is difficult to determine exactly what impact Harvey will have on rent growth. During the month of September most major owners froze pricing at pre-storm levels so as to not gouge displaced families. In the month of October most owners returned to using revenue management models and are adjusting rent to meet the market. October will be telling with regard to Harvey's impact on localized rent growth, in particular.

My expectation at this point is for absolutely full occupancy in the submarkets of the Energy Corridor, Galleria, and possibly Greenway Plaza. Within these submarkets we could see double digit rent growth if landlords allow supply and demand to run its course. I believe that Downtown, Midtown, Montrose and the Medical Center will see mid to high occupancy and moderate rent growth. This reflects my expectations for post-Harvey performance at Bayou Park and Greenbriar.

Beyond Harvey, the most important factor in the health of the multifamily market is job growth and we can never lose sight of that. Harvey is effectively accelerating a recovery in the market, but the health of the Houston economy is the answer to a vibrant apartment market long term.

This is going to be a very interesting time for us and we're watching market dynamics very closely. I'll provide an update as conditions unfold and we should have enough solid data by year-end to accurately project occupancies and rents in the 2018 Business Plans.

Best regards,

Alison