Austin Workforce Multifamily Report

Summer 2018

Affordable Central Texas, through its private equity open end investment fund, the Austin Housing Conservancy, will be closing its first transaction in late September. We are very excited to be moving from concept to reality and are lining up additional closings for the next six months. We appreciate the support of our Visionary Investors who are helping us launch the fund and now are seeking additional equity to allow us to continue our acquisition pace.

As we started this year, eager to begin the fund, we ran into the double whammy of a lack of offerings in the multifamily sale market and a wall of capital seeking to acquire their first deals in Austin. In addition, the market was experiencing rising vacancy rates and flat rental rates combined with the initial rate increases from the Fed. Incongruously, the first half of the year saw anomalies in normal buying patterns included abbreviated inspection and closing periods, non-refundable earnest money and cap rates dipping below 5%. Fast forward to the end of summer and we are witnessing the selling market's response, with a large number of offerings hitting the market combined with the phenomenon of marketed off-market transactions.

We are very curious to see if the aggressive capital that caused these illogical buying patterns was right or if some normalcy will return to pricing and selling terms. We produce this newsletter using information from other sources and attempt to add an interpretation of the data they provide through a workforce/middle income lens. We hope you find our insights meaningful. For greater detail, please refer to the data sites listed on the back of the newsletter.

Overall Market

Construction:

Deliveries fall below the five-year average during 2018. In each of the past four years, over 8,500 units have been added to stock. Most of these new additions being Class A product.

8,300 units to be completed

Vacancy:

Overall vacancy was higher in the last quarter even with new luxury units coming online. Class B and C properties saw little to no change due to a strong demand of Class A product.

10 bp increase in vacancy

Rents:

Overall growth remains strong as an influx of new luxury units bolster the rates. Class B and C units saw lower growth as more tenants choose to move to these newly developed units.

3% increase in effective rent

Demand increasing for top-tier properties. Class A properties have rebounded from the previous quarter showing a tightening in vacancy as well as increased growth in effective rent. Even with heightened delivery of Class A product we see the gap in effective rents between these high-end units and B, C product continue to expand. This trend is exacerbated by the incredibly high home prices now being achieved in the city of Austin. Families, who typically would be purchasing a home at this point in their lives, are choosing to continue renting and instead upgrade to a newer unit with more amenities. While this has relieved some pressure from workforce Class B and C properties we are still seeing rent growth go well above 3% in that product segment, exceeding the affordability range most middle-income residents are capable of paying.

Continued construction contributes to increasing vacancy. Although a large number of units have been added in and around the Austin metro we are still seeing sales prices increase at rates not seen in many parts of the country. As most product being constructed is meant to attract new Austin residents looking for luxury living around the Austin CBD, pressure has increased on Class B and C properties as renters who could previously afford Class A properties are downgrading. Even new properties added well south of Austin on the I35 corridor are seeing rents start $100 to $200 above what is typically considered affordable for workforce housing.

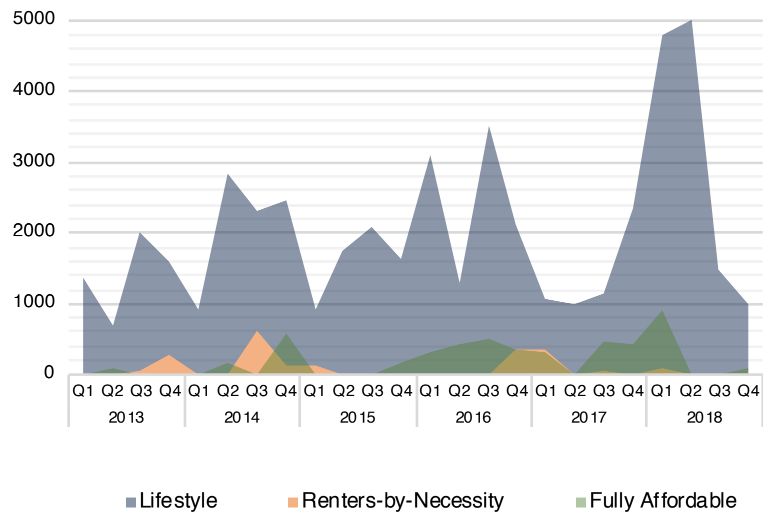
Overall Market Cont.

- Although interest rates are increasing, we are still seeing a large influx of out of state capital grow their footprint in central Texas. Rarely seen purchase practices such as non-refundable earnest money and shortened closing windows have driven prices to levels well above what has been seen in other Texas metros.

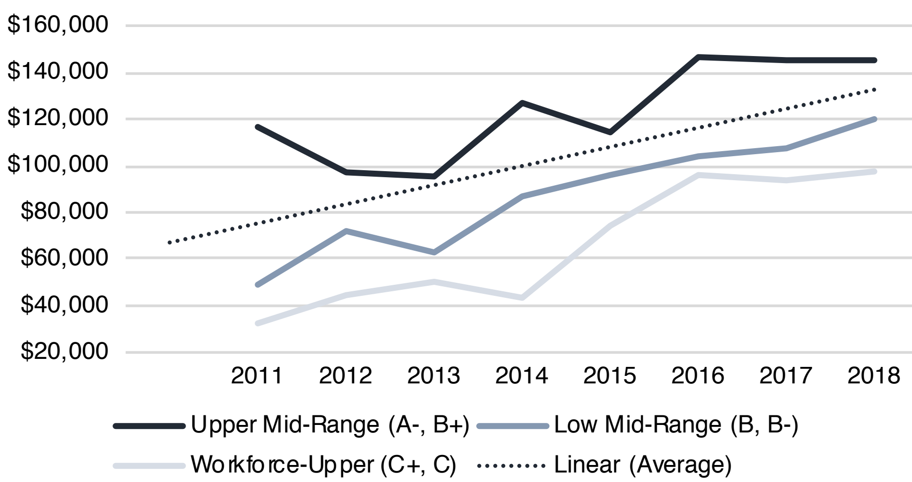
- Approximately 40 percent of sales over the past year went to out-of-state investors, with buyers from the West Coast contributing to the bulk of these trades. These buyers expect to add value to these properties through renovation pushing rents higher and further exacerbating affordability.

- East Austin saw a large increase in apartment sales over the past year driven by numerous redevelopment projects as well as major employers moving to the area. This is driving growth in the area well above the rest of Austin and pushing out many workforce residents out of a historically inexpensive area to live.

Construction: Historical and Forecasted



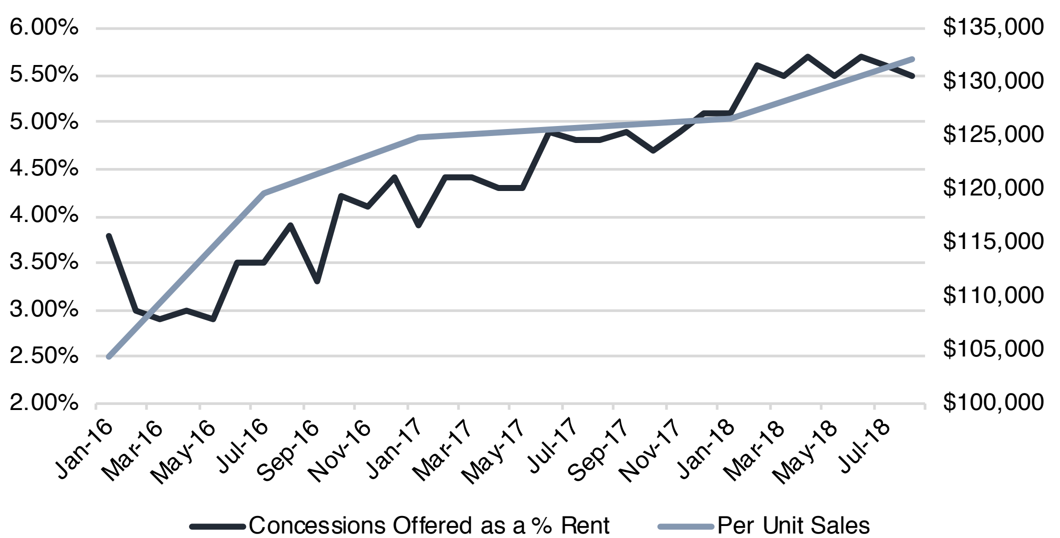
Workforce Per Unit Sales

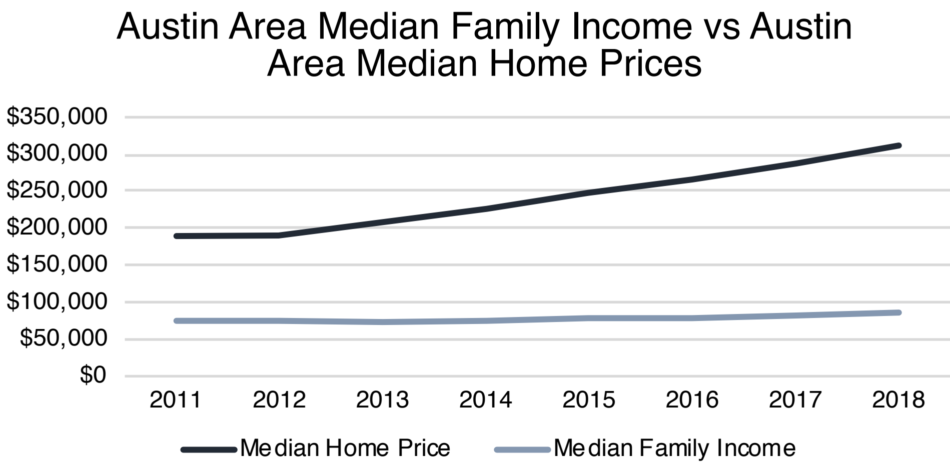


The seconder quarter saw an increase in transactions as 18 properties traded hands. The overall average increased to $138,941 per unit, driven by Class A properties. Although we have seen less product on the market compared to the same time last year, we expect sale volume to increase greatly in the next two quarters as more sellers put their properties on the market hoping to take advantage of the exuberant prices being paid. This stands to hurt the workforce units as the new owners will have to greatly increase rental rates to stabilize the property, pushing out more renters who are incapable of affording the increases.

Concessions vs Per Unit Sales

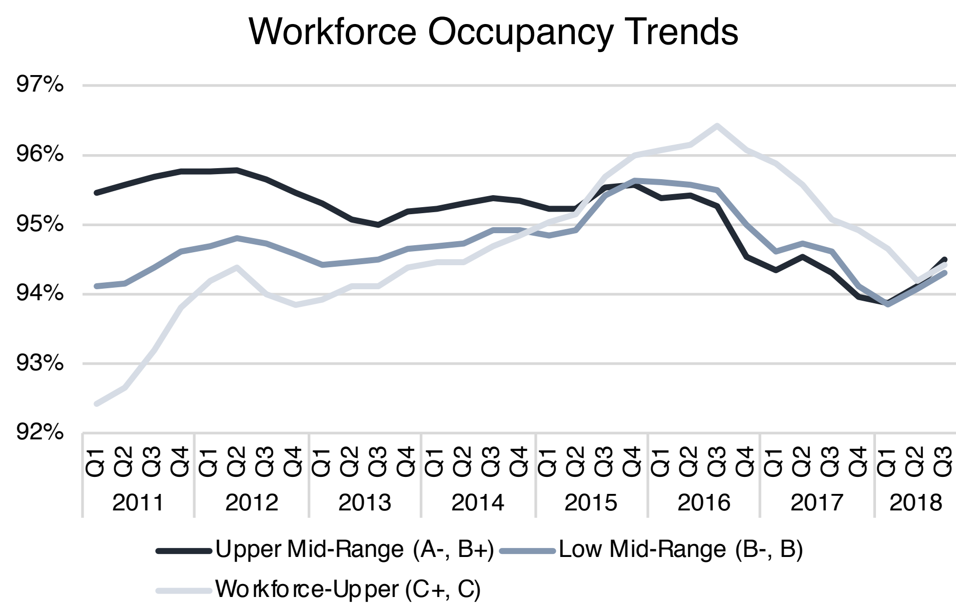
Strong demand has created a dip in concessions offered to tenants. This comes on the heels of a large influx of new product which typically entails an increase in concessions offered during lease up, further proving that demand in the Austin area is climbing at rates not seen in other parts of the country. This will continue to challenge the affordability issue for most renters considered part of the workforce.

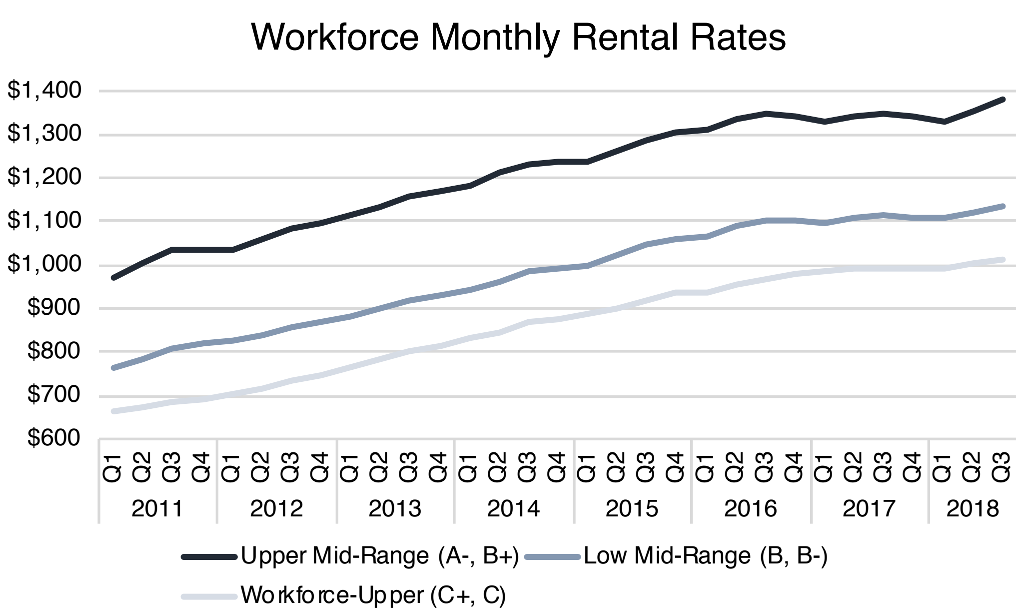




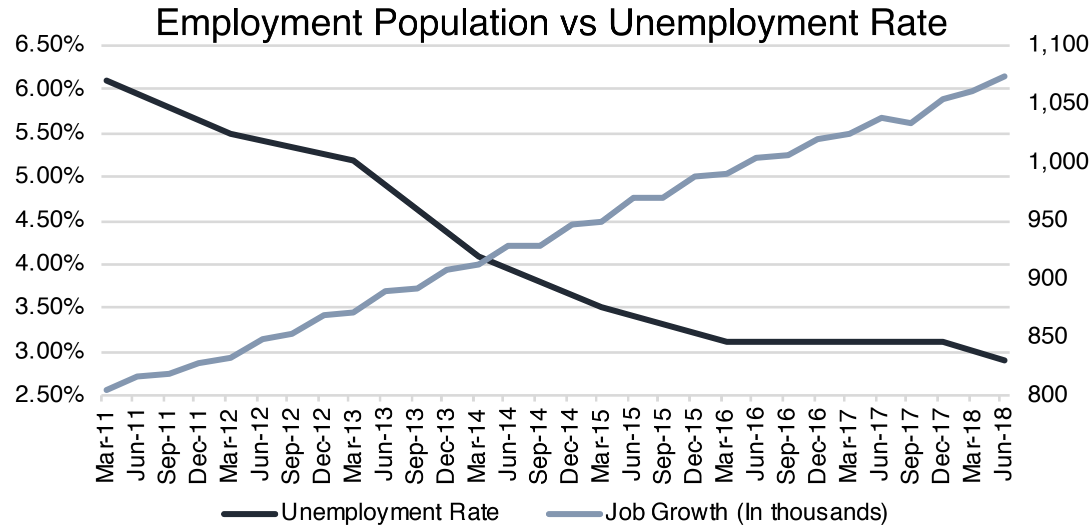
As the population of Austin continues to grow rapidly with 150 people moving to the metro per day we are seeing prices of homes rise at incredible rates. Near the city, we have seen prices more than double since 2005 while median family income has only grown 30 percent. This has created a situation in which prospective home buyers are being forced to continue renting. Many renters, even those who are well above the workforce rent range, are staying put creating a greater demand for apartments and leading to larger increases in rents pushing out workforce individuals.

Occupancy, currently at 92.3%, saw a gain of .90% during the quarter. Unstabilized new units in the 50 properties added during the year kept annual figures down, resulting in a decrease of .08 % since this time last year. Sectors reporting the lowest occupancies were those that received the largest number of new units relative to their total inventory during the year. Areas showing the largest increases in occupancy with low inventory are primarily near the CBD and are the most sought-after units in the city. This new supply isn't renting at rates that are middle income affordable, forcing residents to live in the suburban markets and contribute to traffic issues.



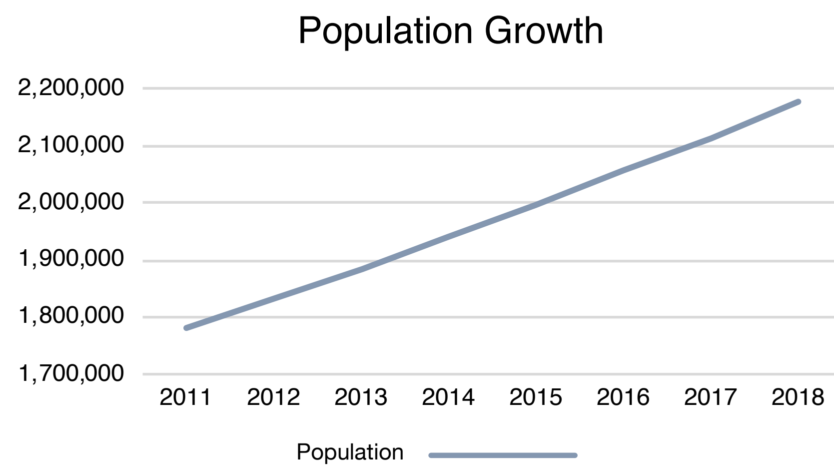


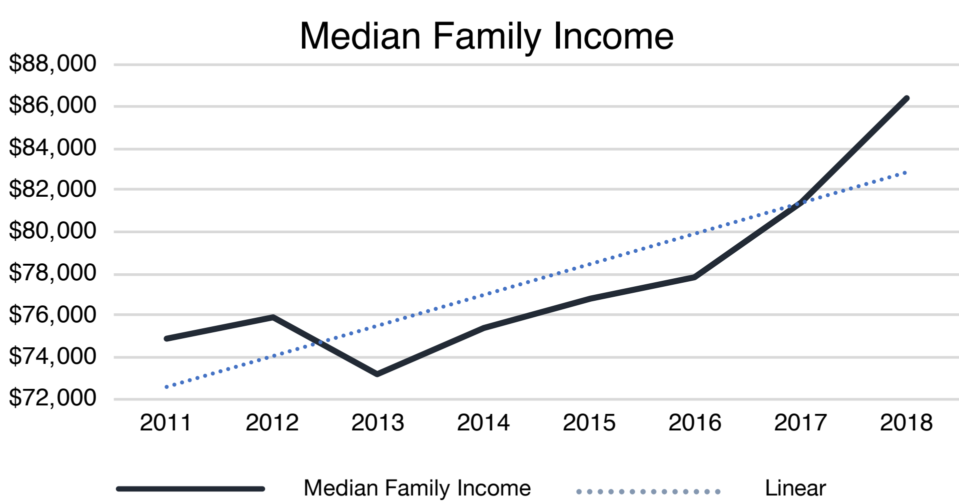
With the latest Eastern shift in new developments at a lower price tag, the rental rates have been less affected by new product. Stabilized Class A product fared better as rents moved upward 2.5% to reach $1.65 psf, or $1,383/mo. Class B also had positive movement in rent with rates up 3% to reach $1.32 psf, or $1,136/mo, Class C posted the least impressive results. Rents were up 2.45% to reach $1.36 psf, or $911/mo.



Austin's employment continues to grow adding 34,600 jobs in the past 12 months which helped push down the jobless rate 10 basis points to 2.9 percent in June. Job creation was widespread over the past year, with the largest gains generated in the professional and business services, leisure and hospitality, and trade, transportation and utilities sectors.

Austin has continued to be the fastest growing city in the country with a growth of just over 2.5%. The Austin-Round Rock MSA population continues to increase at a rapid rate. With growth expected to continue at a similar pace in the coming years, Austin is projected to reach over 3 million people by 2030. With a population growing this quickly, we see a multifamily market that cannot keep up. As this happens, affordability disappears and many of Austin's locals and original workforce are required to move to other areas in surrounding suburbs and cities.





From 2017 to 2018 median family income grew 5.65%. Fueled by the flood of high paid tech talent leaving parts of the east and west coast in search of cheaper living and better quality of life. These high paid workers have filled Class A properties and increased demand for B and C products. A flattening in wage growth is expected to occur in the coming years taking MFI growth back down to 2% annually.

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Sources: Yardi Matrix, Axiometrics, U.S. Department of Housing and Urban Development, Marcus&Millichap Services, Bureau of Labor Statistics, Austin Investor Interests LLC, Austin Board of Realtors.