What to watch in the Texas multifamily sector

BY BRANDI SMITH

Uncertainty be damned. The multifamily market in a number of Texas cities continues to be strong – even "white hot," depending on whom you ask.

"Dallas multifamily vacancies sit at roughly 5 percent with rents roughly 15 percent over pre-pandemic levels," rental housing experts at Greystar told REDnews. "Dallas has also had considerable amounts of pipeline delivery, which have been absorbed at record levels during the past few quarters at over 25+ units per month despite rising rents."

Austin, too, boasts one of the strongest multifamily markets in the state.

"It's important to understand the supply/demand fundamentals," said Marcy Phillips, vice president of real estate development for Ryan Companies. "Sometimes, there can be booms in other primary Texas markets. Austin has weathered this well and it appears there is a long runway as the MSA continues to grow."

There's no shortage of incentive to build here, according to Venkat Avasarala, founder of Stryker Properties.


Schuyler Dugle via unsplash

"Texas is a great market for merchant building due to the availability of cheap land and pro-development cities. This cuts down delays compared to other markets," said Avasarala. "Labor is more easily available and costs less compared to several other markets outside Texas."

Still, there are a number of related factors that multifamily experts are watching closely that may determine whether this demand continues: demand, affordability, interest rates, the rise of build-to-rent and importance of submarkets.

DEMAND

It's tough to bet against multifamily in a market such as Dallas, which added nearly 295,000 jobs in the past year.

"That's three times the typical annual gains we saw before the pandemic," shared Carl Pankratz, president and managing director of Blackacre Commercial. "DFW alone saw a gain of 73,800 in professional and business service jobs."

"People want to live in Austin. They want to live in the CBD, close to work, close to areas of entertainment," Phillips said. "The data shows that people want to live in newer, well located communities. Some of this is due to inmigration."

AFFORDABILITY

A constant concern in the multifamily sector, worries about affordability are especially acute amid record inflation.

"With the substantial increase in gas prices and virtually every consumer good, how much rent can a tenant afford?" questioned Pankratz. "At some point, you reach a cap and excessive rent growth will be curtailed."

"In periods of significant rent growth, we always like to keep an eye on how wages are keeping pace to make sure affordability metrics stay healthy," the Greystar team said. "Resident wage growth in Dallas has been greater than 8% year over year with rent to income ratios completely flat relative to pre-pandemic levels. While rents have moved up significantly, resident wages have continued to keep pace."


Venkat Avasarala


Carl Pankratz


Marcy Phillips

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INTEREST RATES

The affordability of a rental unit is relative to that of a mortgage. Interest rates, Pankratz argued, are important for apartment tenants and homebuyers. With interest rates at 6 percent, he pointed out the monthly payment for the typical 30-year mortgage is much higher.

"A big piece of current apartment demand is fueled by how difficult it is to buy a home," said Pankratz. "Prices are at record levels and the typical potential buyer doesn't have the ability to save over $50,000 for a down payment."

That change could affect different classes of the product in different ways, explained Avasarala. He expects Class A demand to be strong in coming years, buoyed by those high mortgage rates causing more people to rent.

"These tenants are not rent burdened and can somewhat easily absorb the growing rents," Avasarala said. "Coming to Class B &C tenants, I am worried about their continued ability to pay rent dealing with high inflationary conditions and if the recession were to occur, these are the tenants who will be most affected."

Phillips added it's clear that interest rates are impacting multifamily investments.

"Combined with continued high construction costs, deals are becoming thinner and underwriting is getting much tighter," she said. "A rebalance is necessary, however, as it's important to bring supply back to normal levels."

BUILD-TO-RENT BOOM

Supply is coming, but not necessarily in the traditional multifamily product. Build-to-rent properties are delivering quickly and with considerable measure. Avasarala said he's keeping an eye on its long-term viability.

IMPORTANCE OF SUBMARKETS

The evolution and growth of submarkets is of particular interest to Pankratz. He suggested that Fort Worth is seeing substantial increases in value, with an uptick of institutional investors who previously viewed it as too small of a market. Sherman, he said, is becoming the semiconductor capital of the U.S. with new projects announced daily.

"This all adds to a market seeing healthy rent growth and high demand," said Pankratz.

San Antonio, though not a submarket, rarely gets the attention of markets like Dallas and Austin. Still, Greystar says it has also had "impressive occupancy levels, record move-ins and rent growth."

WHAT TO WATCH

Looking ahead, Avasarala called rapidly growing property taxes the No. 1 risk to Texas multifamily development.

"There is no political will to curtail these debilitating tax hikes every year," he said, adding that increasing property insurance premiums and deductibles also pose a threat.

"Expenses are seeing robust gains in virtually every category," echoed Pankratz. "Also, in order to purchase an apartment community over $20mm, you likely had to use bridge debt. The increase in SOFR/LIBOR has been 100bps in several cases, also squeezing potential gains."

"Still," Pankratz said in summary, "there's no other national market I'd rather be in."