

M E M O R A N D U M

TO: Friends and Clients of The Apartment Group (TAG)  
FROM: Jeff Price  
DATE: October 21, 2009  
RE: **DFW Housing Shortage**

I have suggested to many of you that DFW will have a shortage of housing stock (both single family and multifamily) in the years to come. First, the single family market appears to be extraordinarily tight given the state of the economy. A recent Dallas Morning News Article (Attachment B) said that DFW has only about a three (3) month supply of new homes. Further, new construction will be constrained by banks' unwillingness or inability to provide construction financing. Multifamily should benefit from a dearth of single family construction, particularly when job generation resumes.

I also believe that multifamily development will be significantly curtailed for some years to come. Following is a graphic (Attachment A) which depicts new multifamily construction (number of units and number of properties) in DFW by year since 1970 for all properties of 100 units or greater. We have projected deliveries for existing construction through 2011. There are a number of trends which are readily discernable:

- The 1980s experienced the largest amount of new multifamily construction, stimulated in large part by the favorable tax treatment of losses.
- TEFRA, passed in 1986, coupled with the economic meltdown of the late 1980s/early 1990s stifled new construction for approximately seven (7) years.
- The 1990s experienced a steady stream of new construction with a peak in 1999-2000 of in excess of 20,000 units. It should be noted that the DFW rental market absorbed an amount slightly in excess of new construction during this time period.
- The 2000s have been relatively steady with about 10,000 deliveries per year with the exception of 2008-2009 in which deliveries peaked at about 20,000 units.

There are a number of conclusions that can be drawn from the foregoing discussion coupled with the current national economic situation.

- History may repeat itself with limited new multifamily construction for the next few years. On one side of the equation, developers will be limited by investor return requirements and a market with depleted rental rates. The formula for generating acceptable returns for a new multifamily project will be difficult to solve largely due to the total cost of the project. Current and future (next couple of years) rental rates may support the cost of new construction, but likely do not support the cost including the land component. Banks will be constrained by an over-concentration in commercial real estate loans and more stringent underwriting criteria. Further, banks will likely impose interest rate floors (many construction loans today have no floors) and require substantial guarantees.

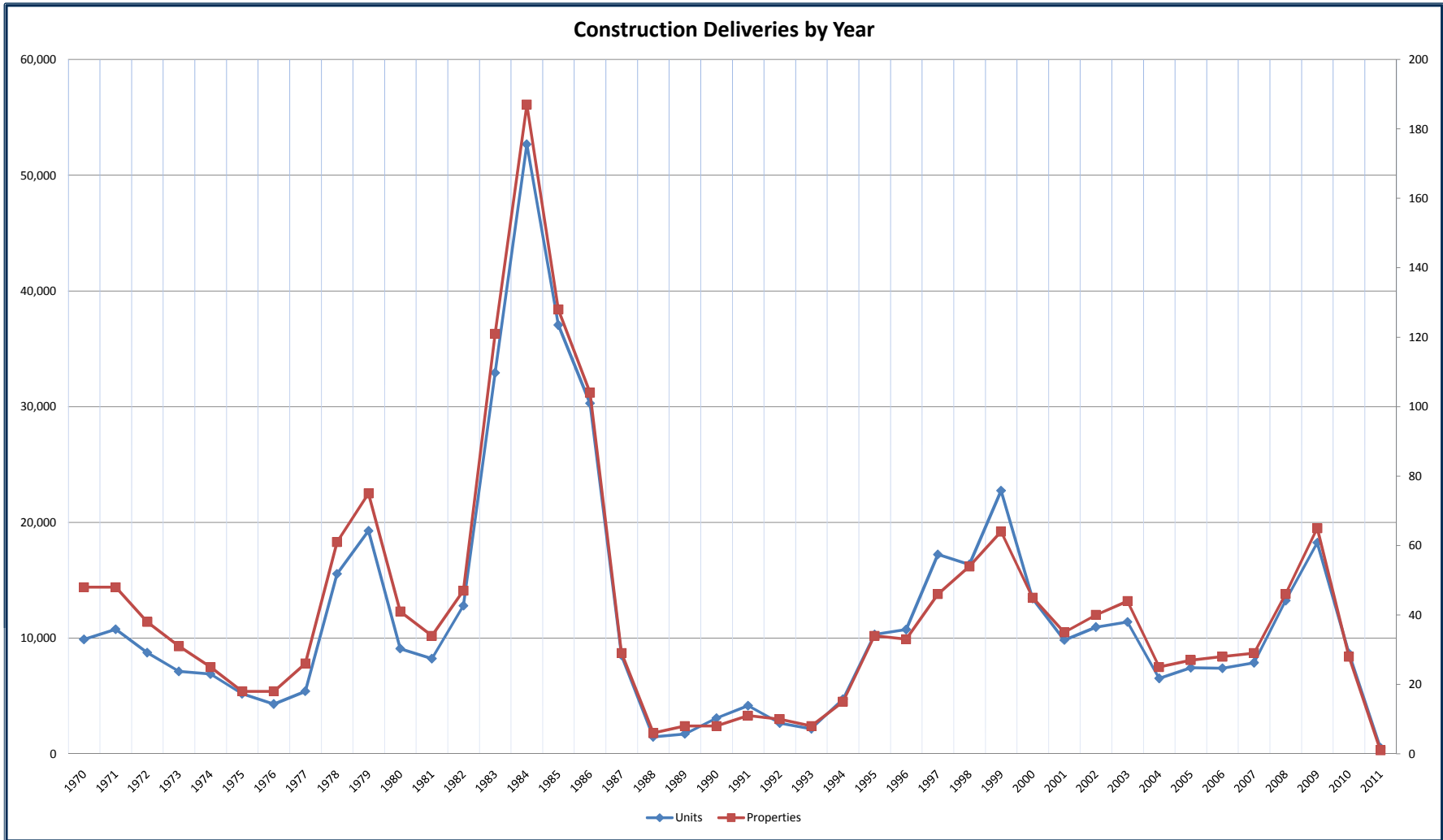
- Upon stabilization of much of the new construction (I define stabilization as the point in which a newly constructed property achieves 90% physical occupancy), it seems reasonable that most owners will begin to unwind some of the concessions currently being offered, resulting in real revenue growth.
- Turnover will likely be high as rental rates improve and lesser qualified residents seek less expensive alternatives. In other words, some residents will return to properties in which they formerly lived before pricing was significantly reduced at higher end projects.

Once the current inventory of new construction is absorbed, owners will be able to begin to reclaim their intended rental rates and over the next few years be able to maintain strong occupancy with increasing rental rates.

So, as a multifamily owner/investor, what do we recommend?

1. Accumulate as many quality multifamily properties as reasonably practical.
2. Secure long-term financing (preferably 10 years) for each project to take advantage of historically low interest rates. Interest rates will certainly rise in years to come. A low interest rate loan may be advantageous to a future sale.
3. Manage well in the short term by putting “heads on beds”. Deal with rental rates at a later date when the market achieves equilibrium and you can comfortably increase rental rates. I am not suggesting that you substantially reduce resident underwriting criteria.
4. If you need to sell a property, consider doing so today for the following reasons:
  - There are very few quality multifamily properties currently in the market.
  - Properties that have traded in 2009 have generally attracted a substantial amount of attention from qualified buyers.
  - If you believe performance will deteriorate during the next year, today may be your peak performance.
  - As previously stated, interest rates are low and in many cases cap rates appear to be tied to interest rates (a spread above the base rate). Cap rates remain in the low 7% range for “Class A” suburban properties (slightly lower for urban assets), and in the short term, appear to be relatively stable. In fact, they may contract somewhat if interest rates trend lower.

TAG is very bullish relative to the future of multifamily in DFW. Historically, DFW has been a very resilient market, absorbing much of what has been constructed. Absent a consistent stream of new deliveries, market occupancy and rent growth should return quickly as the economy recovers and job formation occurs. Please call me if you have any questions or feedback. We are available to assist you in any way you deem appropriate.



Year Built	Properties	Units
2011	1	500
2010	28	8,675
2009	65	18,242
2008	46	13,240
2007	29	7,870
2006	28	7,394
2005	27	7,430
2004	25	6,520
2003	44	11,395
2002	40	10,950
2001	35	9,830
2000	45	13,420

Year Built	Properties	Units
1999	64	22,744
1998	54	16,364
1997	46	17,226
1996	33	10,742
1995	34	10,305
1994	15	4,716
1993	8	2,155
1992	10	2,658
1991	11	4,161
1990	8	3,076

Year Built	Properties	Units
1989	8	1,715
1988	6	1,462
1987	29	8,503
1986	104	30,290
1985	128	37,059
1984	187	52,677
1983	121	32,926
1982	47	12,798
1981	34	8,224
1980	41	9,086

Year Built	Properties	Units
1979	75	19,271
1978	61	15,547
1977	26	5,400
1976	18	4,297
1975	18	5,184
1974	25	6,891
1973	31	7,116
1972	38	8,737
1971	48	10,760
1970	48	9,882

\*Property information was taken from ALN Data Systems and contains only properties with over 100 units.

<b>Totals</b>	<b>1789</b>	<b>497,438</b>
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## Dallas-Fort Worth could have new-home shortage in 2010

01:29 PM CDT on Wednesday, October 14, 2009

By **STEVE BROWN** / The Dallas Morning News  
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Forget what you've heard about a glut of new houses on the market.

For three years, Dallas-Fort Worth builders have sold more homes than they have constructed. So the inventory of finished new houses has fallen so low that homebuyers may encounter a shortage when next year's market kicks off.

"For homebuilders to maintain their current sales pace, they are going to have to start 30 or maybe 40 percent more homes than they are starting today," said David Brown, who heads the Dallas office of real estate analysis firm Metrostudy Inc.

"There continues to be a demand for new homes, and we are not adding as much supply."

During the last two years, builders in North Texas have sold almost 13,000 more houses than they have started.

That's caused inventory to drop below 5,000 units – about a three-month supply.

By comparison, there's more than a seven-month supply of new homes for sale in the U.S. as a whole.

And that's after the federal tax credit for first-time homebuyers pulled thousands of new homes off the market, builders report.

"Actually, Dallas never had a severe oversupply of new homes as reported nationally – some overage, but not severe," said Dr. James Gaines, an economist with the Real Estate Center at [Texas A&M University](#).

"Given there's been relatively little to no new construction and the tax credit and price declines have spurred purchases of the existing inventory of new properties, it's not surprising that the total inventory is low."

But having demand that's stronger than supply doesn't mean the housing industry will respond with more construction.

Credit constraint

"I think the prospects for builders to get funding for new-home construction are severely limited, bordering on nonexistent," Gaines said. "Some of the local regional banks that don't have significant

existing exposure may be willing, but what we're hearing is that most of the major institutions don't want to do anything."

Award-winning Texas homebuilder Bill Darling knows he could move more houses if he just had them to sell.

"We should have significantly more inventory, because people are asking for it," said Darling, whose Frisco-based Darling Homes was recently rated the top D-FW area builder by consumer research firm J.D. Power & Associates. "But with our credit lines constrained, it makes it difficult to start houses."

Darling estimates that almost 70 percent of what he builds is already sold, leaving just a few dozen speculative homes to market.

"In other parts of the country, there still is too much new-home inventory," he said. "But there is no question that the lack of inventory has hampered our business plan this year."

Tim Jackson, a Collin County custom builder who is president of the Home Builders Association of Greater Dallas, predicts new-home prices will rise next year unless starts increase.

"We just can't get the funding to start new houses," Jackson said. "I'm fortunate to have a good relationship with a local lender, and they allowed me to start a speculative home four or five months ago.

"But I doubt they would allow me to start another one," he said. "Even if we have a customer who wants to build, they are oftentimes finding it difficult to find construction financing, too."

#### Corporate starts

Some large corporate builders are increasing their starts to meet demand – particularly for homes priced below \$250,000.

During the third quarter, D-FW home starts rose by about 1,000 from the previous quarter, according to the latest statistics from Residential Strategies Inc.

Much of that increase came from D-FW's biggest homebuilder, Fort Worth-based [D.R. Horton Inc.](#), which started 844 houses here in the third quarter, analyst Ted Wilson said.

Wilson said new-home sales in North Texas – which are down about 35 percent this year – will continue to fall until building picks up.

"That usually occurs a couple of quarters after the official bottom in the annual start rate," he said.

Builders are hoping that bottom comes late this year or early next year.