UNDERSTANDING HEADLINE RISK
DALLAS NEW SUPPLY

White Oak Partners Research Team | May 2023

- *Decades of underbuilding have contributed to a fundamental undersupply of housing across the country. As a result, new supply, especially in high growth markets like Dallas, is necessary to keep up with demand.*
- *Dallas has experienced tremendous population growth and household formation over the past decade. 2023 will be a record year for new supply in the U.S. with 575,000 units delivering across the country.[1] The Dallas MSA will receive over 36,000 units, or more than 6% of all unit delivered in the U.S, which leads the country.[1] This has caused media headlines to focus on supply as a significant headline risk in Dallas.*
- *However, the recent growth in Dallas has driven a sustained need for new multifamily units. Weak construction activity in 2022 has amplified the need for new multifamily units in 2023. When you combine these two years, it closely nets out to the five-year average of net inventory growth.[1]*
- *Single family inventories remain very low, and the high cost of capital is pushing both buyers and developers from the market. Declining single-family permitting today will continue to affect for-sale inventories for years to come and will likely make many residents renters for longer.[2]*
- *Despite the new supply headlines, 2023 fundamentals are consistent with years when Dallas outperformed other major markets.*

New multifamily supply is a key risk in any economic environment and 2023 is no different. According to RealPage forecasts, the U.S. is expecting a record 575,000 units to deliver in 2023.[1] However, the high level of new supply in many markets is necessary to meet demand. Markets in the Sunbelt, for example, have experienced large inflows of new residents over the past five years and are now expected to have substantial new supply delivering in 2023.

This edition of White Oak Insights will focus on the Dallas MSA due to recent media sentiment around the high number of new unit deliveries rather than its supply/demand fundamentals. The Dallas-Fort Worth MSA is expected to receive over 6% of all the new supply nationally this year and the number of units delivering in Dallas outpaces all other U.S. markets.[3] As a result, new supply in Dallas has become a major headline risk.

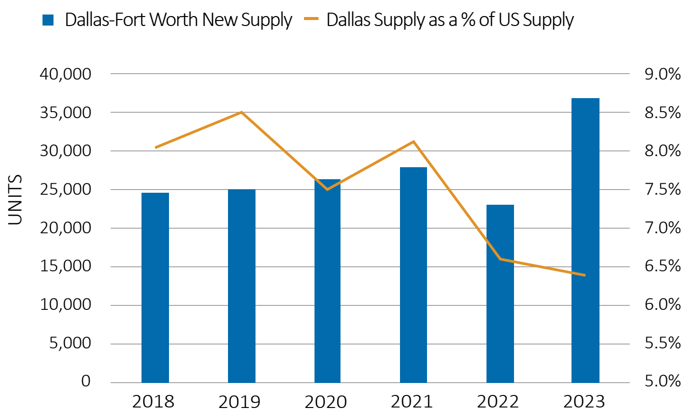
The analysis conducted by the White Oak Research team aimed to address the following question: What would happen if all the 2023 supply in Dallas delivered tomorrow? While this "stressed scenario" is an unrealistic expectation, it demonstrates an alternative view that helps put the near-term supply risk in perspective.

CURRENT ENVIRONMENT

The Dallas-Fort Worth MSA was 95.5% occupied to start 2023, with nearly 900,000 existing units.[1] RealPage projects 36,600 units to deliver in 2023, which is 45% higher than the 5-year average in the market. While this year will be a record year in Dallas for new supply in terms of total units, it is below the recent trend in this market for new supply as a percent of national supply. The Dallas market is expected to receive 6% of all new supply in 2023, which is below the 7.7% average of the past five years. (Figure 1)

FIGURE 1

Dallas-Fort Worth New Supply as a Percent of National Supply



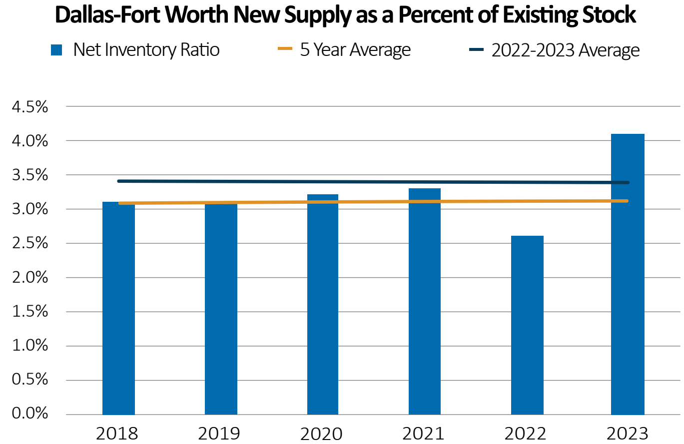
Sources: RealPage, White Oak Partners

For additional perspective, consider that Dallas had a lull in construction activity in 2022 resulting in net inventory growth of 2.6%. This is the only time in the past five years that net inventory growth was below 3%.[1]

The lack of new supply in 2022 helps bridge the gap with record supply in 2023. Combining 2022 and 2023, the average net inventory growth is just 30-basis points above the 5-year average for the market, effectively bringing the supply picture over the past 24-months consistent with recent historical performance (Figure 2).

FIGURE 2

Dallas-Fort Worth New Supply as a Percent of Existing Stock



Sources: RealPage, White Oak Partners

HOW DID WE GET HERE?

Projects delivering in 2023 are based on decisions that took place years ago. Typical development timelines suggest many of these developers began site selection and permit applications two to three years ago. A look at demographic and migration trends during this period can offer insight on why Dallas needs more housing.

The population in the Dallas MSA increased by 10% from 2016 to 2021, outpacing the U.S. average of 3.5% for the same period, according to the Census. The metro's key renter cohort, consisting of residents aged 20-34, grew 8.5% compared to the national average of 1.4%. Strong population growth coupled with a growing young demographic led to robust household formation during this period, as households grew by 11.9%, bolstering the need for more apartments.[4] This trend in Dallas seems to have been accelerated due to the COVID-19 pandemic as more residents left coastal gateway markets for the business and tax friendly Texas city.

In short, the underbuilding over the past decade coupled with rapid household formation has left the market starved for more housing of all types. With single family-home values up 38% over the past five years, multifamily development is necessary in large quantities to house Dallas residents.[5]

STRESS TEST

The analysis presented here assumes that all 36,600 units of the new supply projected to deliver in 2023 are delivered at once in the beginning of the year. If this scenario occurred, the occupancy in Dallas would decline from 95.5% to 91.4%. Because demand remains dispersed across the year as it is typically represented, seasonality is reflected in this analysis. Based on future demand expectations from RealPage, it would only take 9 months for the Dallas market to reach 95% occupancy (Figure 3).

FIGURE 3

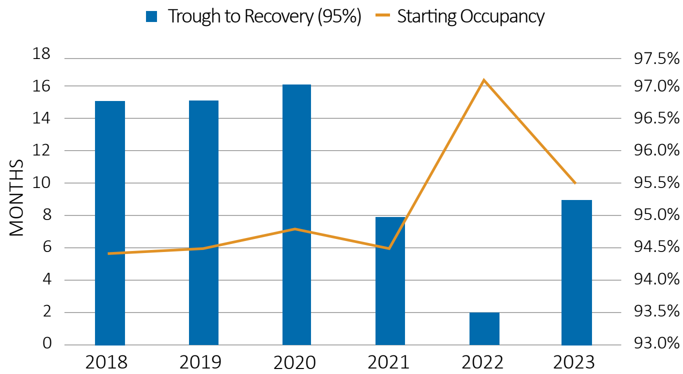
Starting Occupancy	Stressed Occupancy	Trough to Recovery
95.5%	**91.4%**	**9 Months**

The relationship of front-loaded supply versus the demand projection is interpreted as the time it takes demand to 'catch-up' to the front-loaded supply. This analysis can be explained as supply and demand fundamentals represented as a function of time, rather than a ratio. In the case of Dallas, the market takes approximately 9-months to return to 95% occupancy, which represents a stabilized market occupancy. The stressed scenario implies the market will recover in Q3 2023, ahead of the typically slower winter leasing season.

HISTORIC LANDSCAPE

The same stress test was carried out for previous years in Dallas to demonstrate how 2023 market fundamentals stack up to years where the market provided robust multifamily returns.

FIGURE 4
Trough to Recovery



Sources: RealPage, White Oak Partners

**Trough to Recovery is calculated as the amount of time it takes a market to reach 95% occupancy assuming all supply during a calendar year is delivered on January 1st.*

The following shows historical supply and absorption data from 2018 to 2022 and compares it to the 9-month recovery period in 2023 (Figure 4). The year 2022 particularly stands out as it experienced substantially weaker demand than previous years but has an extremely short recovery period. This is because its starting occupancy was significantly higher than in previous years. Similarly, occupancy in 2023 is higher than the period from 2018 to 2021, providing a small cushion to help mitigate downside risk to new supply.

WHAT DOES THIS MEAN FOR DALLAS?

The objective of this analysis is to provide context to the very nuanced issue of new supply risk, which requires more than just reading the most recent headlines. It is often the case that key risks—which should be understood—can be overstated. For example, Figure 4 displays the resiliency the market showed in 2022 as the high starting occupancy provided a cushion to weather a year with historically low consumer sentiment and lower than average demand for housing. Occupancy declined from 97% to 95% from 2022 to 2023, and this was widely reported as the market experiencing softness. However, this is a simple overreaction that could be explained as an intentional operational decision rather than fundamental weakness. Even if operational decisions did not cause this, an occupancy change to 95% is much more reflective of the stabilization of a market rather than softness.

Despite new supply concerns, an ongoing housing shortage provides support for continued strong multifamily performance in Dallas. Data suggests that the 2023 multifamily supply and demand fundamentals in this market are consistent with the previous five years. While new supply concerns appear more pronounced this year, similar headlines have persisted over the past five years. Regardless, performance in Dallas was strong during this period. Asking rents grew from $1,128 to $1,528 from the beginning of 2018 to the end of 2022, representing a 40% increase during this five-year period.[1]

MARKET COMPARISON

The conclusion reached in this analysis for Dallas is not necessarily reflective of other similar markets. Phoenix has experienced similar trends as Dallas, including strong population growth, a red-hot for-sale market, and negative media sentiment around new supply. However, the same stress test shows Phoenix as more vulnerable to its new supply.

If all the new supply is delivered in Phoenix at the beginning of the year, occupancy will decline to 86.3%. The recovery period for Phoenix to reach 95% occupancy is 14 months, meaning it will take demand more than a calendar year to catch up to one year's worth of supply. There are a couple of factors to consider here. First, current occupancy is just over 93%, which means the starting point is below that of Dallas. Second, Phoenix is getting hit with more new supply than Dallas. While Dallas will be receiving more total units, Phoenix is receiving more units as a percentage of its existing stock at 7% net inventory growth compared to 4% growth in Dallas.[1]

SINGLE-FAMILY HOUSING IN DALLAS

While multifamily expects to have a record supply year, single-family construction has been declining steadily in Dallas as the increasing cost of capital has put many developers on pause. Approved permits for single-family homes in Dallas declined by 34% in December 2022 from the previous year.[2] In addition, rapidly increasing interest rates have caused the average single-family mortgage payment to balloon, pushing many buyers to the sidelines. Single-family inventories are low to begin with, and the knock-on effects in the for-sale market will keep many residents as renters longer. As such, demand for multifamily in Dallas is poised to benefit from challenges in the for-sale single-family market for years to come.

CONCLUSION

The purpose of this analysis is to provide an alternative view to supply-side risk at the macro level. The market analysis becomes more useful when paired with a concentrated bottom-up approach to risk analysis. Despite new supply concerns, the ongoing housing shortage provides support for continued strong market fundamentals in Dallas. Additionally, the comparison of data between similar markets helps provide context for the supply picture and should be considered when developing a market selection strategy. When evaluating Dallas' performance in recent years, the data suggests that current market fundamentals are consistent with prior years when Dallas produced strong risk-adjusted returns.

Sources:

1. RealPage Analytics
2. Census Building Permits Survey (BPS)
3. Dallas is the Nation's Most Active Construction Market | RealPage Analytics
4. Census American Community Survey (ACS)
5. United States Home Prices & Home Values | Zillow

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