



Houston Apartment Market Update

Edited by Kathryn Koepke

\$399/year

2nd Quarter 2007

Shifting Tide?

With mortgage rates on the rise, it seems that the rental market is poised to make up for some lost ground. Houston's multifamily market has experienced decreased occupancy levels and sluggish rents over the past few years, while the single-family market has flourished. With historically low mortgage rates and the seemingly endless supply of homes, homeownership had become a reality for many people that otherwise would not have been able to afford such a luxury. Prior to this period of highly affordable homeownership, many of these households would have been living in Class B and Class C properties, which is a key reason why the apartment market has struggled so much over the last few years. However, it does appear that the tide is finally beginning to shift.

Mortgage rates have increased 4% from the 2006 annual average of 6.41%. From the beginning of 2007 mortgage interest rates were at 6.22% and now they stand at their current level of 6.66%, according to Freddie Mac's most recent survey. This is up from 5.23% which was the lowest interest rate recorded in June 2003.

Past real estate transactions could have a negative effect on the Houston single-family market, while helping out the multifamily one. The use of sub-prime loans has led to a sharp rise in the number of foreclosures in the Houston area as a growing number of households are having a difficult time meeting their mortgage obligations. The number of properties in the Houston area posted for foreclosure for the first half of 2007 has doubled from the same period last year, while the number of properties actually foreclosed on more than doubled according to Foreclosure Information & Listing Service. During the 12 months ending May 2007, postings were at 28,100, which are up 55% from the previous 12-month period, and foreclosures were at 11,758, up 84%. These recent problems have caused lenders to tighten their standards, thus shrinking the available households that would qualify to take out new mortgages. This will be a key factor in the anticipated slowing in housing starts and in existing home sales.

With the recent decline in affordability in the housing market to some, it seems like Houston's rental market would be poised to reap the benefits over the next year. Occupancy levels will continue to be fairly soft due to new construction, but positive absorption and recent growth are expected through the end of the year.

By: [Amanda Vasquez](#)

Houston Apartment Market at a Glance

	Class A	Class B	Class C	Class D	Overall	Qtr	Yr
Occupancy	91.02%	89.27%	85.82%	84.79%	88.51%	▼	▼
Rent/Unit	\$1,054	\$662	\$560	\$525	\$718	▲	▲
Rent/SF	\$1.115	\$0.816	\$0.692	\$0.604	\$0.841	▲	▲
Absorption	1,849	122	603	-14	2,560	▲	▼

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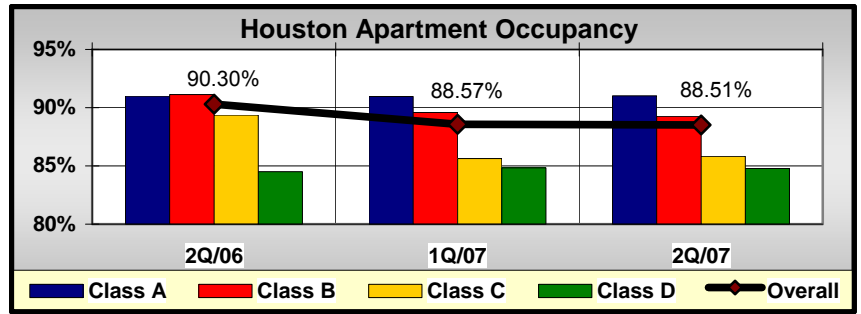
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Metro Occupancy Overview

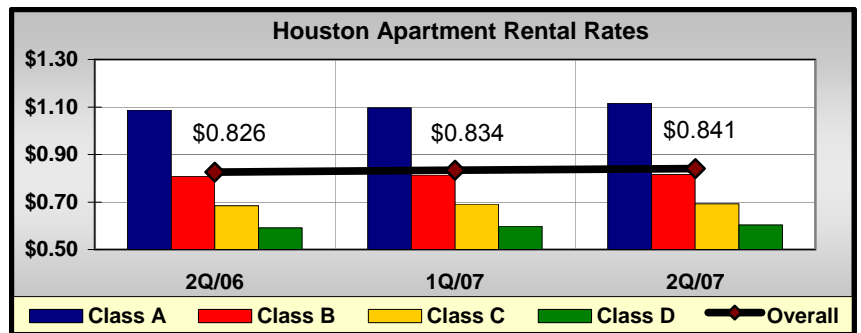
Although quarterly gains were made in the Class A and C markets, overall occupancy fell for the sixth consecutive quarter. At 88.51%, overall occupancy is down 0.06 points over the quarter and 1.79 points over the year. A gain of 0.06 points over the quarter brings **Class A** occupancy to 91.02%, the strongest of all classes. Despite the gain, Class A occupancy remains 0.04 points below last year's level. At 89.27%, **Class B** occupancy is down 0.31 points over the quarter and down a full 1.85 points over the year. **Class C** posted the biggest quarterly increase in occupancy, increasing 0.18 points to 85.82%. Class C occupancy has fallen 3.56 points over the last year, the largest annual decline of all classes. **Class D** recorded the weakest occupancy of all classes at 84.79%. Class D occupancy was down 0.05 points over the quarter, but up 0.28 points over the year.



Quarter	Class A	Class B	Class C	Class D	Overall
2Q/06	90.98%	91.12%	89.38%	84.51%	90.30%
1Q/07	90.96%	89.58%	85.64%	84.84%	88.57%
2Q/07	91.02%	89.27%	85.82%	84.79%	88.51%

Metro Rent Overview

Overall Houston-area rental rates gained \$0.007 per square foot (psf) over the quarter, and are up \$0.015 psf over the year to \$0.841 psf. The **Class A** market posted the biggest quarterly rental increase, rising \$0.008 psf to \$1.115 psf. With the quarterly gain, Class A rents are \$0.028 psf above last year's level. **Class B** rents rose \$0.002 psf over the quarter to \$0.816 psf, and have gained \$0.007 psf over the year. Rents in the **Class C** market, at \$0.692 psf, posted a quarterly increase of \$0.001 psf and an annual increase of \$0.007 psf. **Class D** rents increased \$0.006 psf over the quarter, reaching \$0.604 psf. Class D rents are up \$0.015 psf over the last 12 months.



Quarter	Class A	Class B	Class C	Class D	Overall
2Q/06	\$1.087	\$0.809	\$0.685	\$0.591	\$0.826
1Q/07	\$1.097	\$0.814	\$0.691	\$0.598	\$0.834
2Q/07	\$1.115	\$0.816	\$0.692	\$0.604	\$0.841

Submarket Performance

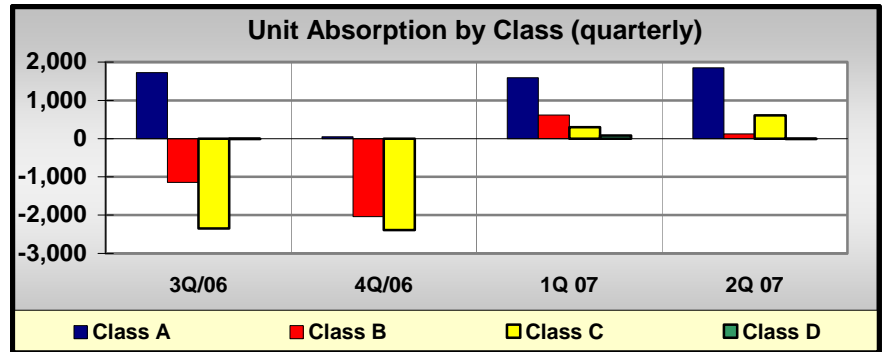
Of the 53 Houston submarkets, overall occupancy was highest in the **River Oaks** submarket at 95.27%, while the lowest occupancy was found in the **Richmond/Rosenberg** submarket at 79.56%. The **Downtown** submarket posted the highest rental rates at \$2.002 psf, while the lowest rents were found in the **Sharpstown/Westwood** submarket at \$0.679 psf.

Of the submarkets with more than one property, **Gulfton** reported the highest Class A occupancy at 99.00%, while the lowest Class A occupancy was found in **Richmond/Rosenberg** at 59.34%. The **River Oaks** submarket led the way in the Class B market at 99.21%, while the **Inner Loop West** submarket posted the lowest Class B occupancy at 73.70%. The strongest Class C occupancy was posted by the **Kingwood/Lake Houston** submarket at 100%, while the **Far West** submarket posted the weakest at 72.51%. **Champions-West** reported the highest Class D occupancy at 99.00%, with **Katy** recording the lowest occupancy at 43.00%.

The highest Class A rents were found in the **Downtown** submarket at \$2.081 psf, while the lowest were found in **Texas City/Dickinson** at \$0.859 psf. The **River Oaks** submarket posted the highest Class B rents at \$1.047 psf, while the lowest rents were found in **Northline/Aldine** at \$0.662 psf. In Class C, **The Woodlands** posted the highest rents at \$0.994 psf, while the **Tomball** submarket reported the lowest rents at \$0.602 psf. The **Montrose/Memorial Heights** submarket reported the highest Class D rents at \$1.052 psf, while the lowest rents were found in **Champions-West** at \$0.504 psf.

Metro Absorption Overview

For the second quarter in a row, overall quarterly absorption was in the black, as 2,560 units were absorbed. The positive quarterly figure brings annual absorption to -1,020 units. Classes A, B, and C posted positive quarterly figures, with **Class A** recording the strongest absorption, with 1,849 units absorbed. Annual Class A absorption stands at 5,213 units. For the second consecutive quarter, **Class B** absorption was positive, as 122 units were absorbed over the quarter. Class B absorption over the past 12 months totals -2,448 units. Quarterly absorption in the **Class C** market registered 603 units, while absorption over the past year stands at -3,836 units, the weakest of all classes. The **Class D** market absorbed -14 units over the quarter, bringing annual absorption to 51 units.



12-mo Ending	Class A	Class B	Class C	Class D	Overall
2Q/05	8,133	269	-1,705	-723	5,224
2Q/06	5,544	8,905	5,107	307	19,863
2Q/07	5,213	-2,448	-3,836	51	-1,020

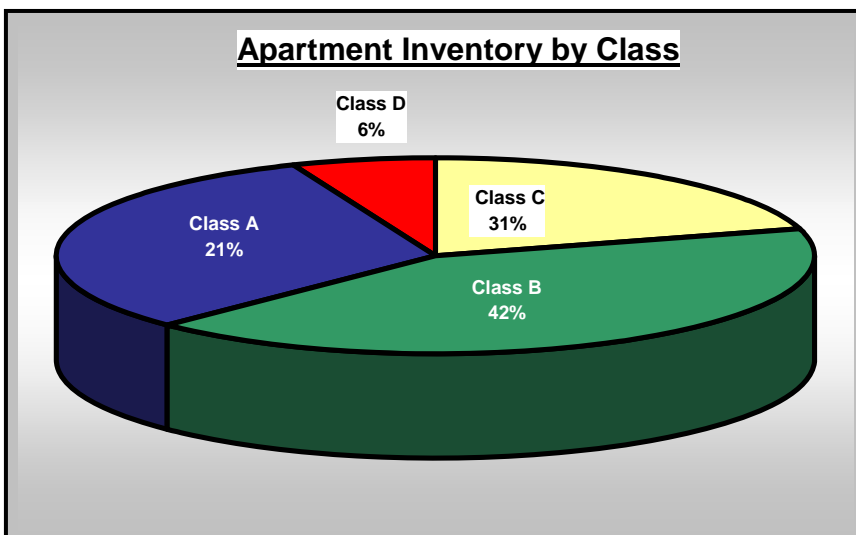
Submarket Performance

Of the 53 Houston submarkets, the **Pasadena** submarket recorded the strongest absorption over the quarter at 303 units, followed by the **Far West** submarket at 282 units. The weakest figures were found in the **Inner Loop West** and **Sharpstown/Westwood** submarkets, which absorbed -358 and -239 units over the quarter, respectively.

The **Montrose/Memorial Heights** submarket recorded the strongest Class A absorption over the quarter at 195 units, while the weakest was found in **Sugar Land/Fort Bend** at -66 units. The **Pasadena** submarket posted the highest figures in the Class B market, absorbing 157 units, while the **Inner Loop West** submarket posted the lowest at -377 units. The highest Class C absorption was found in the **Inwood** submarket, which absorbed 240 units, while the weakest absorption was found in the **Alief** submarket at -165 units. The strongest Class D absorption was found in the **Braeswood** submarket at 97 units, while the **Northshore/Woodforest** submarket posted the weakest at -52 units.

Apartment Inventory

There are a total of 2,577 operating or under-construction projects in the Houston area market (greater than 25 units) with a total of 530,402 units. Approximately 21% of the total units are Class A units, 42% are Class B units, 31% are Class C units, and 6% are Class D units. The chart below displays market inventory by class.



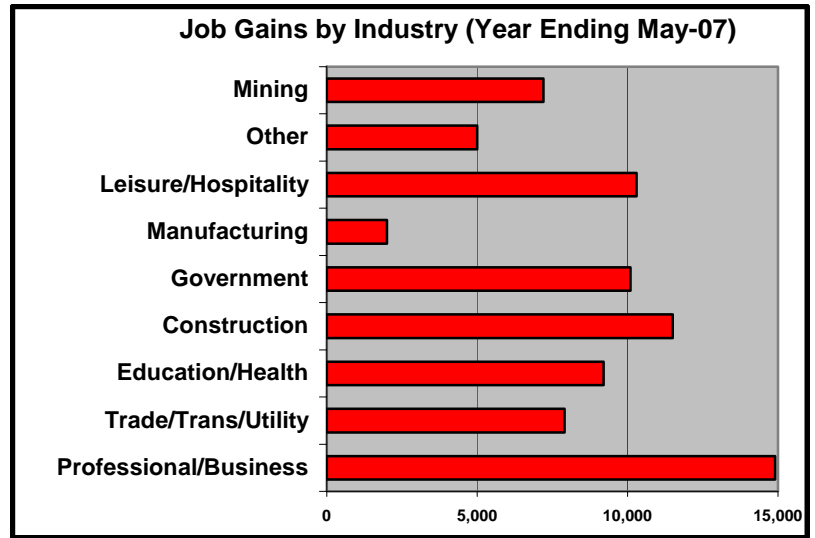
Operating	Projects	Units
Class A	481	126,266
Class B	1,061	224,622
Class C	810	140,575
Class D	159	21,921
TOTAL	2,511	513,384

Under Cons.	Projects	Units
Class A	51	14,321
Class B *	15	2,697
TOTAL**	66	17,018

* Class B projects are primarily Tax Credit developments
 ** There are additional Unclassified (Class U) projects

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA was flat at 3.8%, while the total number of nonagricultural wage and salary jobs increased to 2,518,500 in May 2007, according to the **Texas Workforce Commission**. This month's total is 81,100 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 14,900 jobs over the previous 12 months; Trade, Transportation, & Utilities gained 7,900 jobs; Education & Health Services is up 9,200 jobs; Construction added 9,500 jobs; Government added 9,500 jobs; Manufacturing added 11,500 jobs; Government gained 10,100 jobs; Other Services gained 5,000 jobs; and Leisure and Hospitality added 10,300 jobs; and the Information sector added 100 jobs. The largest monthly gain was in the Mining sector with 7,200 jobs.

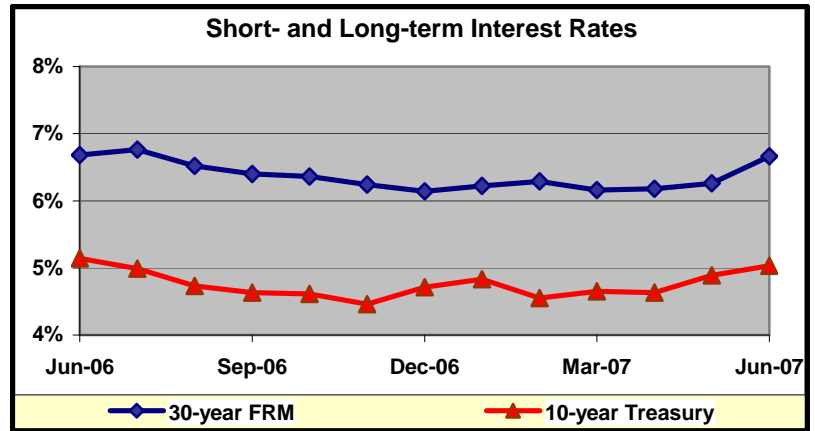


Interest Rates

The yield on the **10-year Treasury** note rose to 5.03% in June 2007, down 0.11 points from its 5.14% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.66% in June 2007. One year ago, the 30-year FRM was at 6.68%. The average for the **15-year FRM** in June was 6.34%, up 0.03 points from a year ago.

The **Prime Rate** in June was reported in the Wall Street Journal at 8.25%, up 0.25 points from a year ago.



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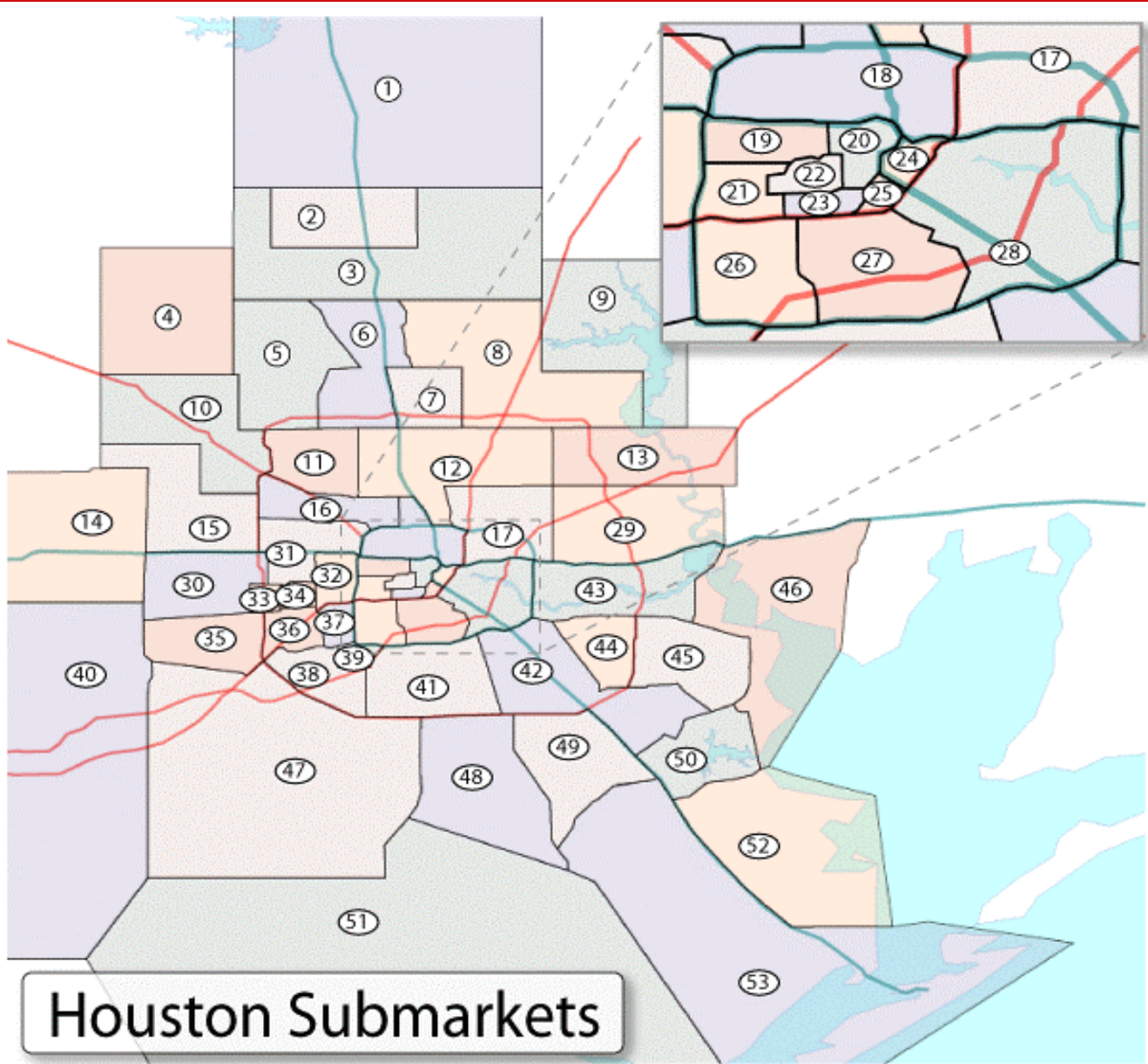
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Houston Submarkets

- | | | | |
|---------------------------|------------------------------|----------------------------|---------------------------|
| 1 Conroe | 16 Brookhollow | 31 Spring Branch | 46 Baytown |
| 2 Woodlands | 17 North Loop East | 32 Galleria | 47 Sugarland/Fort Bend |
| 3 Spring | 18 Heights | 33 Westchase | 48 Pearland |
| 4 Tomball | 19 Inner Loop West | 34 Woodlake | 49 Friendswood |
| 5 Champions West | 20 Montrose/Memorial Heights | 35 Alief | 50 Clear Lake/League City |
| 6 Champions East | 21 Greenway Plaza | 36 Sharpstown | 51 Brazosport |
| 7 Greenspoint | 22 River Oaks | 37 Gulfton | 52 Texas City/Dickenson |
| 8 FM 1960 East | 23 Museum District | 38 Braeswood | 53 Galveston |
| 9 Kingwood Lake Houston | 24 Downtown | 39 Meyerland | |
| 10 Steeplechase | 25 Midtown | 40 Richmond/Rosenberg | |
| 11 Inwood | 26 Bellaire/West University | 41 Hwy 288/Almeda | |
| 12 Northline/Aldine | 27 Medical Center | 42 Gulf Freeway | |
| 13 Sheldon | 28 Inner Loop East | 43 San Jacinto/Galena Park | |
| 14 Katy | 29 Northshore Woodforest | 44 Pasadena | |
| 15 Bear Creek Copperfield | 30 Far West | 45 Deer Park | |

Data Collection

Our in-house research team continuously updates over 100 fields of data for nearly 6,000 apartment complexes in our database. We update at least 90% of properties on a monthly basis to generate accurate market trend reports on rents, concessions, occupancy, etc. Our monthly surveys also update other property-specific data such as fees, policies, management, and owner information. On a less-frequent basis we update amenities, schools, and other data fields that change rarely. We perform current and historical data audit after we close each month's survey to identify any data inconsistencies or incorrectly keyed values.

Research

We monitor various news media, press releases, marketing materials, web-sites, CAD records, permit issuance, and other sources to capture new construction, planned projects, financing, and sales. Our researchers conduct phone interviews with relevant developers, brokers, or lenders to gather information on new construction and sales. We add properties to our database on a regular basis to ensure we offer the most up-to-date and complete apartment database.

Market Coverage

Our online apartment database covers all four major Texas metro markets – Austin, Dallas-Fort Worth, Houston, and San Antonio. The **Austin** market includes Caldwell, Hays, Travis, Bastrop, and Williamson counties. The **DFW** market covers Dallas, Tarrant, Wise, Denton, Collin, Hunt, Rockwall, Kaufman, Ellis, Johnson, Parker, and Erath counties. The **Houston** market includes Harris, Montgomery, Fort Bend, Brazoria, and Galveston counties (Brazos county is also included in the database but excluded from the trend reports). **San Antonio** includes Bexar, Comal, Guadalupe, Kendall, and Kerr counties.

We subdivide each market into submarkets (see map on previous page): Austin has 23 submarkets, DFW has 50 submarkets, Houston has 53 submarkets, and San Antonio has 26 submarkets. The submarkets are based on neighborhood-style areas with defining boundaries such as major roads and other factors that establish a neighborhood. This approach allows the user to view distinct areas of properties that have evolved into their own sections of town and can be identified together.

Glossary

Absorption = Change of Occupied Units, including new construction. Absorption is a proxy for demand.

Occupancy = Percentage of physically occupied units on property.

Pre-leased = Net of percentage of units that have been pre-leased but not yet occupied and units on notice to be vacated.

Rents = Market rents (excluding concessions).

Class = Properties are classified as A, B, C, D, or Unclassified (U) based on various factors, such as age, location, amenities, curb appeal, overall condition, rents, etc. **Class A** properties are generally less than 10 years old, have excellent amenities, prime location, and great appeal, thus they tend to have the highest rents. Older properties built in early 1900s that were converted from warehouses or office buildings, or older apartment projects that have had major renovations may also be classified as A. **Class B** properties are generally 10 to 20 years old, have good locations, good level of amenities, are somewhat less appealing than Class A projects, and are in overall good condition. New affordable projects are also classified as B. **Class C** projects are usually 20 to 30 years old, have few amenities, are in poor locations, and are not well maintained. **Class D** projects are generally more than 30 years old, in poor condition, have no or limited amenities, are in poor locations, and have poor curb appeal. They tend to have the lowest rents per unit (although per-square-foot rents may be high since the units are usually small). **Unclassified** or **Class U** projects are senior housing, student housing, or other properties that have unusual lease terms, include meals with the rent, or other services, so their rents and occupancies are not representative of the actual market. We exclude these from our statistical reports as they skew the averages for the other classes.

Reporting

Occupancy, Rent, and Absorption trend data is based on Operating, Under-construction, and Under-renovation projects, Classes A, B, C, and D (excluding Class U).