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O'Connor & Associates

Houston Apartment Market Update

Edited by Kathryn Koepke **$399/year** **4th Quarter 2007**

A Look Back

After a bleak 2006 where annual absorption totaled -9,632 units, positive absorption figures in 2007 were a welcome relief. The market absorbed a strong 7,516 units over the year, with all but one class posting positive figures. The Class A market fared the best over the year, staying positive and absorbing 5,316 units. After an awful 2006, the Class B market turned the corner in 2007, absorbing 1,350 units. Absorption in the Class C market was at 869 units, while Class D absorbed -19 units.

Despite positive absorption for the year, overall Houston occupancy dipped 0.44 points to 88.17% to close out 2007. Class A occupancy suffered the largest drop in occupancy in 2007, decreasing from 90.77% to 88.61%. Class B occupancy was the only class to post a positive change in 2007, increasing from 89.46% to 89.78%. Occupancy in the Class C market fell 0.37 points, while Class D occupancy fell 0.05 points in 2007. The decline in occupancy came as a result of elevated construction activity. In 2007, 40 projects totaling 10,070 units consisting of Class A and tax-credit units were delivered to the market, while another 24,614 units are currently under-construction. With an additional 16,935 units on the drawing board, it appears construction activity will remain elevated throughout 2008.

In contrast to 2007's decrease in occupancy levels, Houston rental rates posted an increase for the year. Overall rents increased $0.017 per square foot (psf) to $0.848 psf, their highest level on record. All Classes reported yearly increases in rental rates, with the Class A and C markets enjoying the largest increases. Average rents in the Class A market closed out the year at $1.122 psf, Class B rents are at $0.821, Class C rents are at $0.698 psf, while Class D rents are at $0.607 psf.

All apartment classes enjoyed a modest rent per unit increase in 2007, with the overall rent per unit rate raising $15.37 per unit. The increases in the individual classes ranged from 1.1% in the Class B market to 1.9% in the Class D market. Class A rent per unit increased $19.26 to $1,058.95. The Class B market posted a rent per unit increase of $7.22 to $666.06, which posted a slight 1.1% yearly increase over the 2006 figure of $658.84. Class C enjoyed a 1.6% rent per unit increase for 2007, which was $9.14. Class C rent per unit finished the year at $564.79. The Class D market registered the biggest rent per unit gain of all classes in Houston for 2007. Class D rent per unit increased 1.9% to $533.71.

By: Amanda Vasquez

Houston Apartment Market at a Glance

	Class A	Class B	Class C	Class D	Overall	Qtr	Yr
Occupancy	88.61%	89.78%	85.81%	84.27%	88.17%	▼	▼
Rent/Unit	$1,059	$666	$565	$534	$724	▲	▲
Rent/SF	$1.122	$0.821	$0.698	$.0607	$0.848	▲	▲
Absorption	211	-993	-339	-135	-1,256	▼	▲

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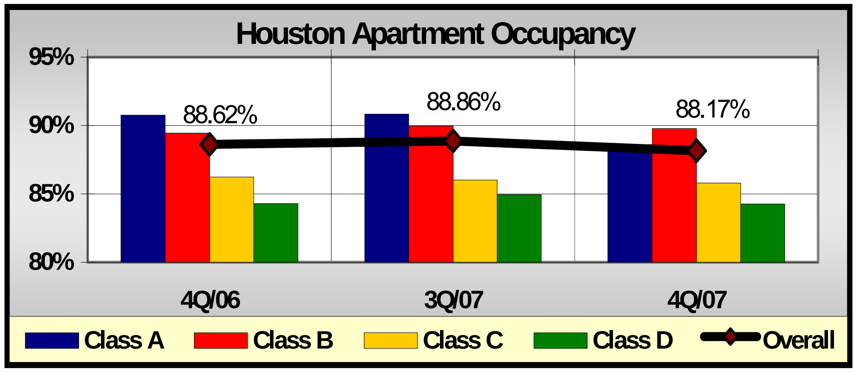
Occupancy & Rent Trends

Metro Occupancy Overview

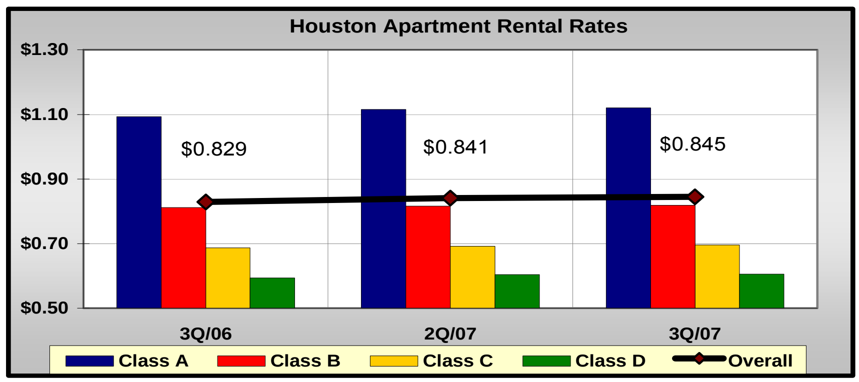
The Houston apartment market experienced a quarterly decrease in occupancy in all classes. At 88.17%, overall occupancy is down 0.69 points over the quarter and down 0.45 points over the year. A loss of 2.24 points over the quarter brings **Class A** occupancy to 88.61%, the second strongest of all classes. With the loss, Class A occupancy remains 2.16 points below last year's level. **Class B** posted the lowest quarterly decrease in occupancy, falling 0.18 points to 89.78%. Class B occupancy has risen 0.32 points over the last year, the only annual increase of all classes. **Class C** posted a decrease in occupancy of 0.21 points to 85.81%. Class C occupancy is down 0.43 points over the last year. **Class D** recorded the weakest occupancy of all classes at 84.27%. Class D occupancy was down 0.67 points over the quarter, but only down 0.05 points over the year.



Quarter	Class A	Class B	Class C	Class D	Overall
4Q/06	90.77%	89.46%	86.24%	84.32%	88.62%
3Q/07	90.85%	89.96%	86.02%	84.94%	88.86%
4Q/07	**88.61%**	**89.78%**	**85.81%**	**84.27%**	**88.17%**

Metro Rent Overview

Overall Houston-area rental rates gained $0.003 per square foot (psf) over the quarter, and are up $0.015 psf over the year to $0.848 psf. The **Class A** market posted a quarterly rental increase, rising $0.002 psf to $1.122 psf. With the quarterly gain, Class A rents are $0.022 psf above last year's level. **Class B** rents rose $0.002 psf also over the quarter to $0.821 psf, and have gained $0.009 psf over the year. Rents in the **Class C** market, at $0.698 psf, posted a quarterly increase of $0.002 psf and an annual increase of $0.010 psf. **Class D** rents increased $0.001 psf over the quarter, reaching $0.607 psf. Class D rents are up $0.012 psf over the last 12 months.



Quarter	Class A	Class B	Class C	Class D	Overall
4Q/06	$1.100	$0.812	$0.688	$0.595	$0.831
3Q/07	$1.120	$0.819	$0.696	$0.606	$0.845
4Q/07	**$1.122**	**$0.821**	**$0.698**	**$0.607**	**$0.848**

Submarket Performance

Of the 53 Houston submarkets, overall occupancy was highest in the **Bryan/College Station** submarket at 95.21%, while the lowest occupancy was found in the **Tomball** submarket at 73.45%. The **Downtown** submarket posted the highest rental rates at $1.992 psf, while the lowest rents were found in the **Sharpstown/Westwood** submarket at $0.684 psf.

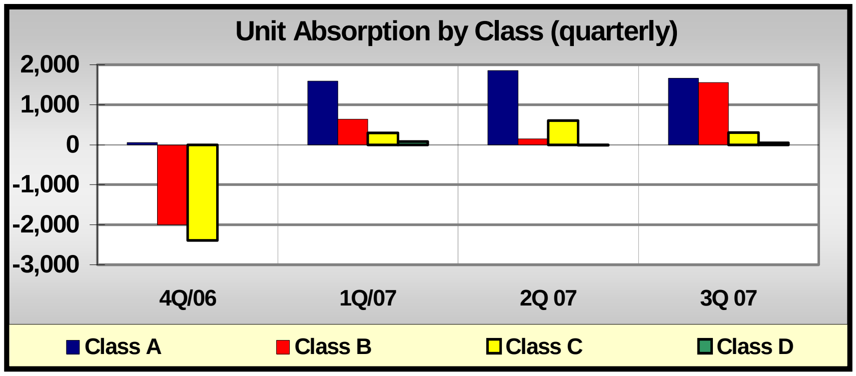
Of the submarkets with more than one property, **Bryan/College Station** reported the highest Class A occupancy at 98.72%, while the lowest Class A occupancy was found in **Tomball** at 48.86%. The **Montrose/Memorial Heights** submarket led the way in the Class B market at 100%, while the **Brookhollow** submarket posted the lowest Class B occupancy at 80.58%. The strongest Class C occupancy was posted by the **Kingwood/Lake Houston** and **Downtown** submarkets both at 100%, while the **Far West** submarket posted the weakest at 75.67%. **Conroe** reported the highest Class D occupancy at 100.00%, with **Alief** recording the lowest occupancy at 48.56%.

The highest Class A rents were found in the **Downtown** submarket at $2.070 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 $0.666 psf. In Class C, **The Woodlands** posted the highest rents at $0.994 psf, while the **Tomball** submarket reported the lowest rents at $0.624 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.

Absorption Trends & Inventory

Metro Absorption Overview

For the first time since the fourth quarter 2006, overall quarterly absorption was in the red, as -1,256 units were absorbed. The negative quarterly figure brings annual absorption to 7,516 units. All Classes posted negative quarterly figures except Class A. **Class A** recorded the strongest absorption, with 211 units absorbed. Annual Class A absorption stands at 5,316 units. For the first time in four quarters, **Class B** absorption was negative, as -993 units were absorbed over the quarter. Class B absorption over the past 12 months totals 1,350 units. Quarterly absorption in the **Class C** market registered -339 units, while absorption over the past year stands at 869 units. The **Class D** market absorbed -135 units over the quarter, bringing annual absorption to -19 units, the weakest of all classes.



12-mo Ending	Class A	Class B	Class C	Class D	Overall
4Q/05	10,379	11,394	5,229	263	27,265
4Q/06	1,026	-4,579	-6,001	-78	-9,632
4Q/07	**5,316**	**1,350**	**869**	**-19**	**7,516**

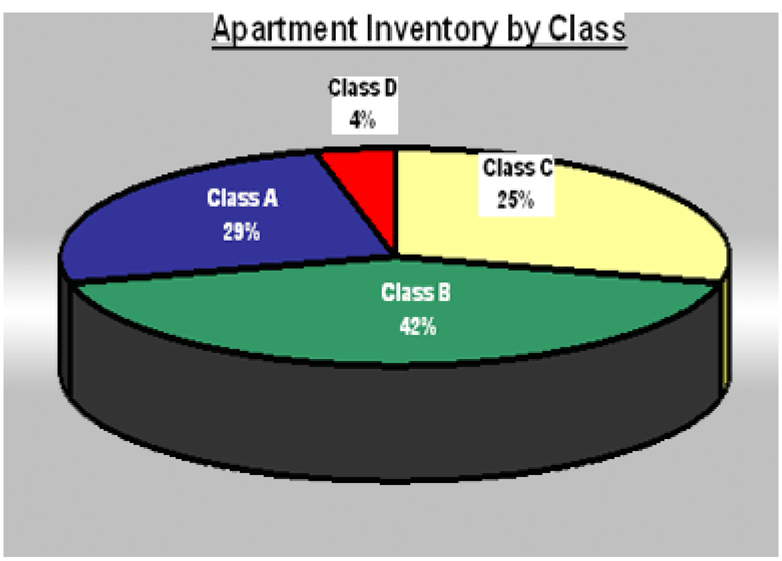
Submarket Performance

Of the 53 Houston submarkets, the **Far West** submarket recorded the strongest absorption over the quarter at 145 units, followed by the **Inwood** submarket at 125 units. The weakest figures were found in the **Inner Loop West** and **Pasadena** submarkets, which absorbed -488 and -218 units over the quarter, respectively.

The **Greenway Plaza** submarket recorded the strongest Class A absorption over the quarter at 104 units, while the weakest was found in **Steeplechase** at -94 units. The **Far West** submarket posted the highest figures in the Class B market, absorbing 173 units, while the **Inner Loop West** submarket posted the lowest at -589 units. The highest Class C absorption was found in the **Sharpstown/Westwood** submarket, which absorbed 97 units, while the weakest absorption was found in the **Deer Park** submarket at -232 units. The strongest Class D absorption was found in the **Northshore/Woodforest** submarket at 73 units, while the **Pasadena** submarket posted the weakest at -93 units.

Apartment Inventory

There are a total of 2,615 operating or under-construction projects in the Houston area market (greater than 25 units) with a total of 542,393 units. Approximately 28% of the total units are Class A units, 42% are Class B units, 26% are Class C units, and 4% are Class D units. The chart below displays market inventory by class.



Operating	Projects	Units
Class A	519	138,197
Class B	1,075	226,423
Class C	810	140,738
Class D	158	21,893
TOTAL	**2,562**	**527,251**

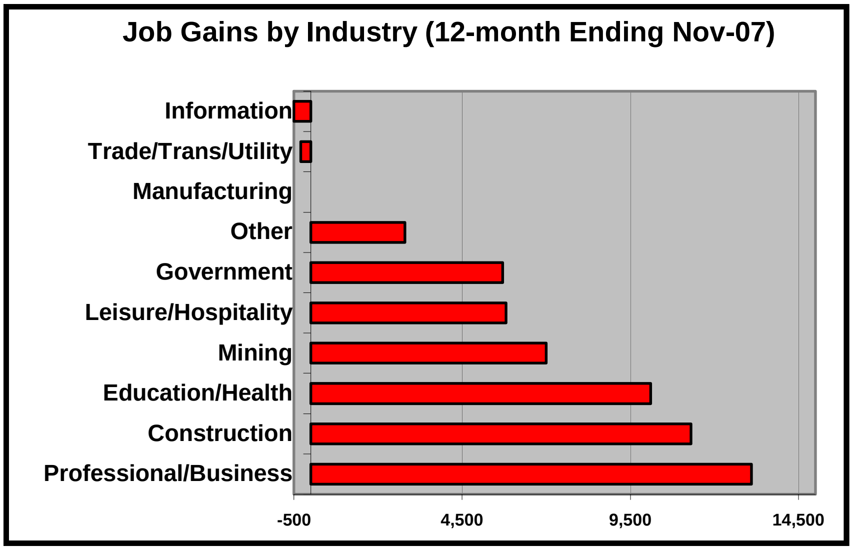
Under Cons.	Projects	Units
Class A	73	21,267
Class B *	20	3,347
TOTAL**	**93**	**24,614**

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

Economic Fundamentals

Job Growth

The civilian labor force unemployment rate in the ten-county Houston MSA was flat at 4.0%, while the total number of nonagricultural wage and salary jobs increased to 2,557,700 in November 2007, according to the **Texas Workforce Commission**. This month's total is 58,800 jobs more than at this time last year. Of the nonagricultural employers, Construction added 11,300 jobs; Education & Health Services is up 10,100 jobs; Mining gained 7,000 jobs over the previous 12 months; Leisure and Hospitality added 5,800 jobs; Government added 5,700 jobs; Other Services gained 2,800 jobs; Manufacturing is at the same level as last year; Trade, Transportation, & Utilities lost 300 jobs; and the Information sector lost 500 jobs. The largest monthly gain was in the Trade, Transportation, & Utilities sector with 5,600 jobs.

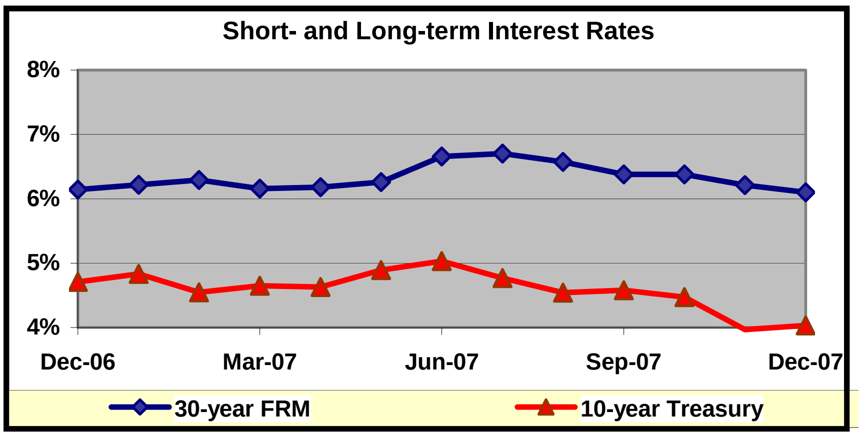


Interest Rates

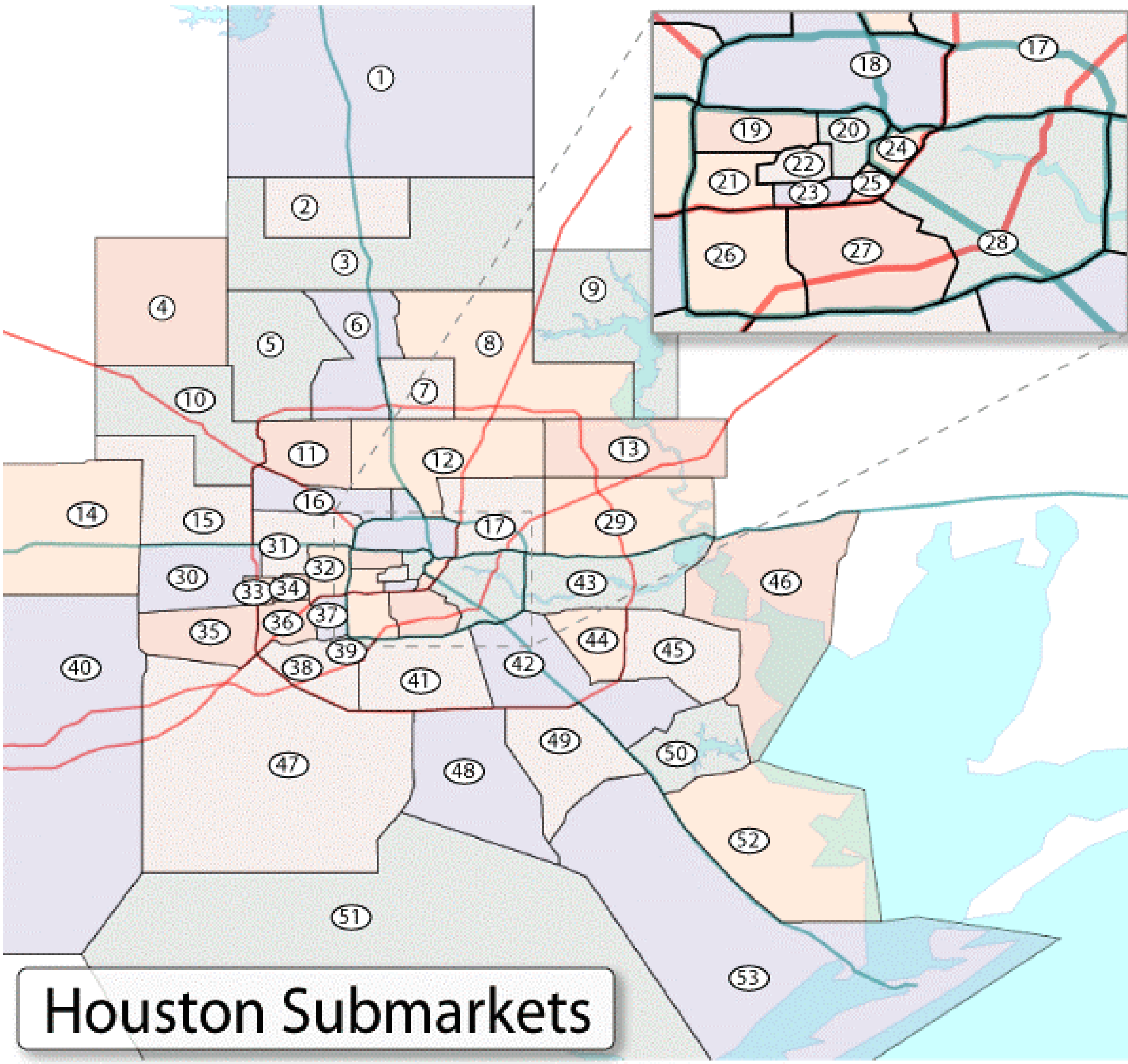
The yield on the **10-year Treasury** note fell to 4.03% in December 2007, up 0.68 points from its 4.71% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.10% in December 2007. One year ago, the 30-year FRM was at 6.14%. The average for the **15-year FRM** in December was 5.75%, down 0.13 points from a year ago.

The **Prime Rate** in December was reported in the Wall Street Journal at 7.25%, the same level from a year ago.



Houston Market Map



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

Methodology

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 Bed, 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).