

Houston Apartment Market Update



Edited by Kathryn Koepke

\$399/year

1st Quarter 2007

A Look Ahead

After a dismal 2006 where annual absorption totaled -10,023 units, positive first quarter 2007 absorption figures were a welcome relief. The market absorbed a robust 2,539 units over the first three months of 2007, with all classes posting positive figures. The Class A market fared the best over the first quarter, absorbing 1,592 units. Class A absorption nearly kept pace with Class A construction activity, which amounted to six properties containing a total of 1,749 units. And after four quarters of negative absorption in 2006, the Class B market turned the corner in the first quarter of 2007, absorbing 619 units. Absorption in the Class C market was at 246 units, while Class D absorbed 82 units.

Amidst positive absorption in all four classes, overall Houston occupancy slid 0.04 points to 88.49%. The decline in occupancy came as a direct result of elevated construction activity. Already in 2007, 2,213 units consisting of Class A and tax-credit units have been delivered to market, while another 12,705 units are currently under-construction. The areas experiencing the most new construction include Midtown (989 units), Greenway Plaza (869 units), Far West (864 units), and the Medical Center (724 units). With an additional 11,298 units on the drawing board, it appears construction activity will remain elevated throughout 2007.

As the vast majority of the new construction is in the Class A market, we expect Class A occupancy will be pressured over the course of the year. Adding to concerns, is that fact that job growth is expected to slow somewhat to around 2% in 2007. Thus, we expect Class A occupancy to decline slightly, ending the year at around 89.50%. We expect the Class B and C markets to benefit from the tightening in lending practices in the face of the subprime collapse, as a number of individuals will now have to stay put at apartment complexes rather than going through subprime lenders to obtain a home. Additionally, home foreclosures in the area will likely generate additional demand for Class B and C apartments. The lone issue of concern is the ever-changing FEMA rental assistance deadline, which is now expected to terminate in August 2007. Taking into account the varying factors, we expect Class B occupancy to remain relatively stable at its current rate, while Class C occupancy is expected to decline to around 84.75% over the year. Class D should remain the weakest of all classes, hovering between 83% and 84% through the rest of 2007.

By: [Leslie Countryman](#)

Houston Apartment Market at a Glance

	Class A	Class B	Class C	Class D	Overall	Qtr	Yr
Occupancy	90.96%	89.58%	85.54%	83.81%	88.49%	▲	▼
Rent/Unit	\$1,038	\$660	\$559	\$526	\$711	▲	▲
Rent/SF	\$1.097	\$0.814	\$0.691	\$0.597	\$0.833	▲	▲
Absorption	1,592	619	246	82	2,539	▲	▲

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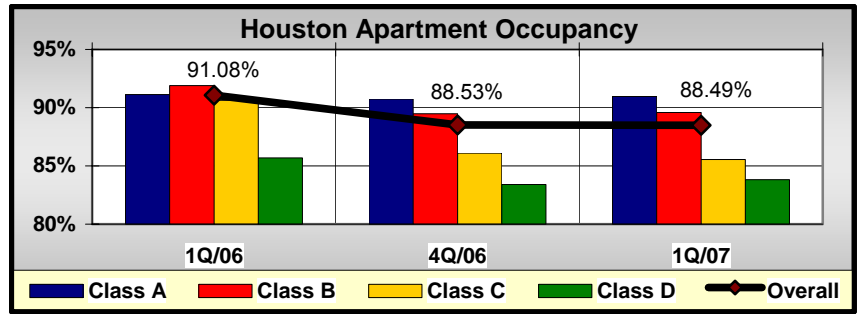
hwiesner@poconnor.com



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Metro Occupancy Overview

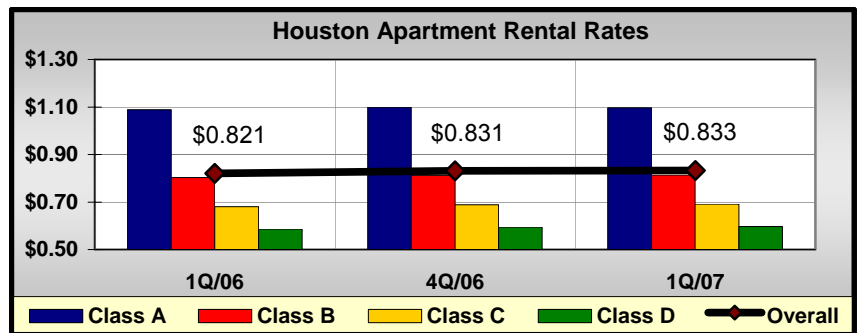
Despite quarterly gains made in the Class A, B, and D markets, overall occupancy fell for the fifth consecutive quarter. At 88.49%, overall occupancy is down 0.04 points over the quarter and 2.59 points over the year. A gain of 0.22 points over the quarter brings **Class A** occupancy to 90.96%, the strongest of all classes. Despite the gain, Class A occupancy remains 0.17 points below last year's level. At 89.58%, **Class B** occupancy is up 0.11 points over the quarter, but down a full 2.31 points over the year. **Class C** was the only class to post a quarterly decline in occupancy, falling 0.55 points to 85.54%. Class C occupancy has fallen 5.08 points over the last year, the largest annual decline of all classes. **Class D** recorded the weakest occupancy of all classes at 83.81%. Class D occupancy was up 0.41 points over the quarter, but down 1.88 points over the year.



Quarter	Class A	Class B	Class C	Class D	Overall
1Q/06	91.13%	91.89%	90.62%	85.69%	91.08%
4Q/06	90.74%	89.47%	86.09%	83.40%	88.53%
1Q/07	90.96%	89.58%	85.54%	83.81%	88.49%

Metro Rent Overview

Overall Houston-area rental rates gained \$0.002 per square foot (psf) over the quarter, and are up \$0.012 psf over the year to \$0.833 psf. The **Class A** market was the only class to post a quarterly rental decline, falling \$0.002 psf to \$1.097 psf. Despite the quarterly loss, Class A rents remain \$0.009 psf above last year's level. **Class B** rents rose \$0.002 psf over the quarter to \$0.814 psf, and have gained \$0.011 psf over the year. Rents in the **Class C** market, at \$0.691 psf, posted a quarterly increase of \$0.003 psf and an annual increase of \$0.011 psf. **Class D** rents also increased \$0.003 psf over the quarter, reaching \$0.597 psf. Class D rents are up \$0.011 psf over the last 12 months.



Quarter	Class A	Class B	Class C	Class D	Overall
1Q/06	\$1.088	\$0.803	\$0.680	\$0.586	\$0.821
4Q/06	\$1.099	\$0.812	\$0.688	\$0.594	\$0.831
1Q/07	\$1.097	\$0.814	\$0.691	\$0.597	\$0.833

Submarket Performance

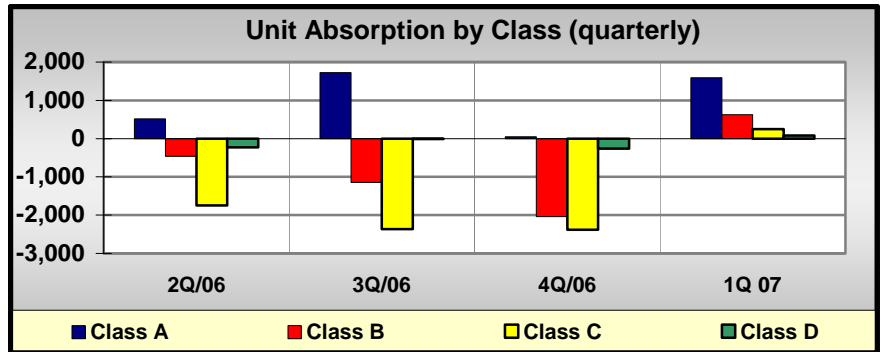
Of the 53 Houston submarkets, overall occupancy was highest in the **River Oaks** submarket at 95.42%, while the lowest occupancy was found in the **Tomball** submarket at 78.63%. The **Midtown** submarket posted the highest rental rates at \$1.558 psf, while the lowest rents were found in the **Sharpstown/Westwood** submarket at \$0.679 psf.

Of the submarkets with more than one property, **Baytown** reported the highest Class A occupancy at 97.28%, while the lowest Class A occupancy was found in **Tomball** at 52.89%. The **River Oaks** submarket led the way in the Class B market at 99.77%, while the **San Jacinto/Galena Park** submarket posted the lowest Class B occupancy at 77.21%. The strongest Class C occupancy was posted by the **Highway 288/Almeda** submarket at 98.45%, while the **Sugar Land/Fort Bend** submarket posted the weakest at 46.40%. **Brookhollow** reported the highest Class D occupancy at 97.02%, with **Northshore/Woodforest** recording the lowest occupancy at 58.17%.

The highest Class A rents were found in the **Downtown** submarket at \$1.924 psf, while the lowest were found in **Texas City/Dickinson** at \$0.857 psf. The **River Oaks** submarket posted the highest Class B rents at \$1.044 psf, while the lowest rents were found in **San Jacinto/Galena Park** at \$0.684 psf. In Class C, **The Woodlands** posted the highest rents at \$0.994 psf, while the **Tomball** submarket reported the lowest rents at \$0.606 psf. The **Highway 288/Almeda** submarket reported the highest Class D rents at \$0.864 psf, while the lowest rents were found in **Bryan/College Station** at \$0.514 psf.

Metro Absorption Overview

For the first time in over a year, overall quarterly absorption was in the black, as 2,539 units were absorbed. The positive quarterly figure brings annual absorption to -5,834 units. All classes posted positive quarterly figures, with **Class A** recording the strongest absorption, with 1,592 units absorbed. Annual Class A absorption stands at 3,879 units. After four consecutive quarters of negative absorption, **Class B** absorption was positive, as 619 units were absorbed over the quarter. Class B absorption over the past 12 months totals -3,033 units. Quarterly absorption in the **Class C** market registered 246 units, while absorption over the past year stands at -6,255 units, the weakest of all classes. The **Class D** market absorbed 82 units over the quarter, bringing annual absorption to -425 units.



12-mo Ending	Class A	Class B	Class C	Class D	Overall
1Q/05	7,728	-1,693	-3,248	-734	2,053
1Q/06	7,003	10,849	6,685	555	25,092
1Q/07	3,879	-3,033	-6,255	-425	-5,834

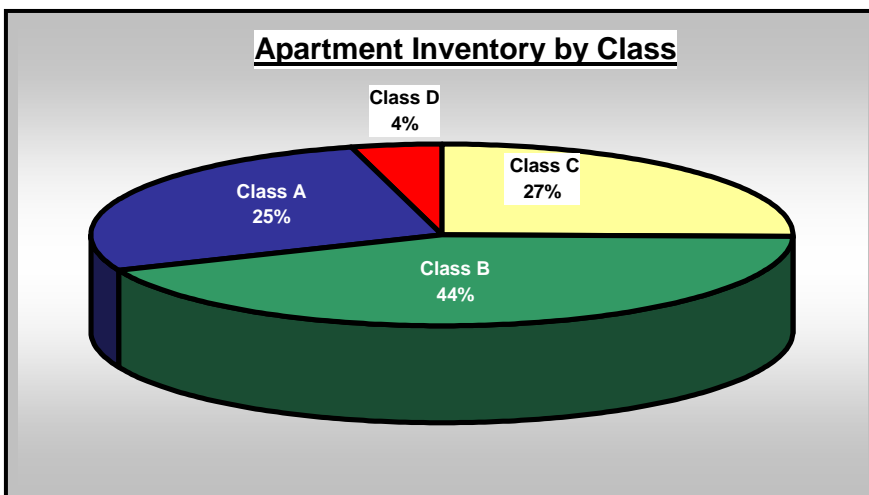
Submarket Performance

Of the 53 Houston submarkets, the **Gulfton** submarket recorded the strongest absorption over the quarter at 587 units, followed by the **Gulf Freeway** submarket at 323 units. The weakest figures were found in the **Alief** and **Champions-East** submarkets, which absorbed -242 and -161 units over the quarter, respectively.

The **Montrose/Memorial Heights** submarket recorded the strongest Class A absorption over the quarter at 238 units, while the weakest was found in **Bryan/College Station** at -27 units. The **Gulf Freeway** submarket posted the highest figures in the Class B market, absorbing 268 units, while the **Alief** submarket posted the lowest at -185 units. The highest Class C absorption was found in the **Gulfton** submarket, which absorbed 457 units, while the weakest absorption was found in the **Champions-East** submarket at -131 units. The strongest Class D absorption was found in the **Highway 288/Almeda** submarket at 93 units, while the **Braeswood** submarket posted the weakest at -71 units.

Apartment Inventory

There are a total of 2,539 operating or under-construction projects in the Houston area market (greater than 25 units) with a total of 520,361 units. Approximately 25% of the total units are Class A units, 44% are Class B units, 27% are Class C units, and 4% are Class D units. The chart below displays market inventory by class.



Operating	Projects	Units
Class A	462	121,199
Class B	1,058	223,855
Class C	811	140,535
Class D	160	22,185
TOTAL	2,491	507,774

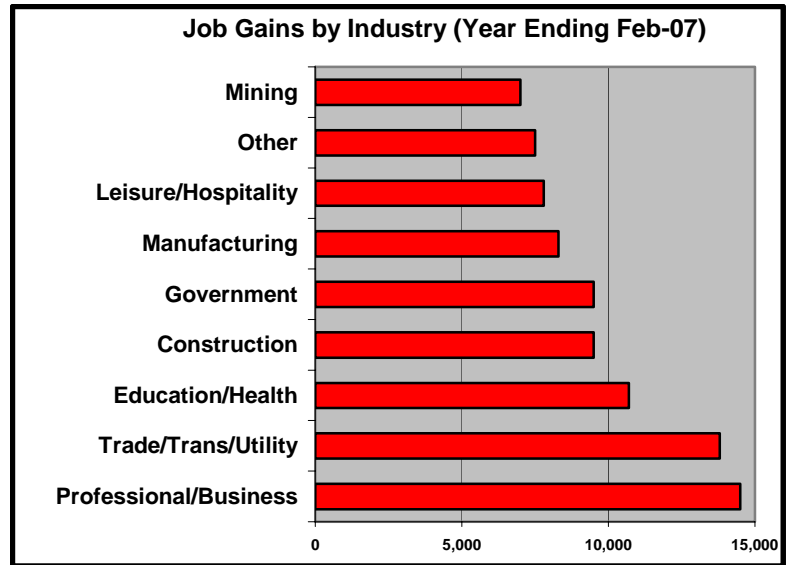
Under Cons.	Projects	Units
Class A	36	10,414
Class B *	12	2,173
TOTAL**	48	12,587

* 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 4.6%, while the total number of nonagricultural wage and salary jobs increased to 2,484,700 in February 2007, according to the **Texas Workforce Commission**. This month's total is 15,600 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 14,500 jobs over the previous 12 months; Trade, Transportation, & Utilities gained 13,800 jobs; Education & Health Services is up 10,700 jobs; Construction added 9,500 jobs; Government added 9,500 jobs; Manufacturing added 8,300 jobs; Leisure & Hospitality gained 7,800 jobs; Other Services gained 7,500 jobs; and Mining added 7,000 jobs. The only industry to lose jobs over the year was the Information sector with -400 jobs. The largest monthly gain was in the Government sector with 6,500 jobs.

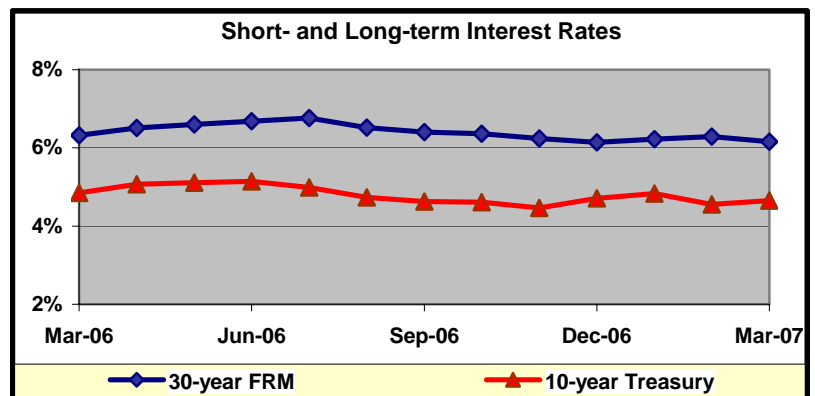


Interest Rates

The yield on the **10-year Treasury** note rose to 4.67% in April 2007, down 0.40 points from its 5.07% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.16% in March 2007. One year ago, the 30-year FRM was at 6.32%. The average for the **15-year FRM** in March was 5.88%, down 0.09 points from a year ago.

The **Prime Rate** in April was reported in the Wall Street Journal at 8.25%, up 0.50 points from a year ago.



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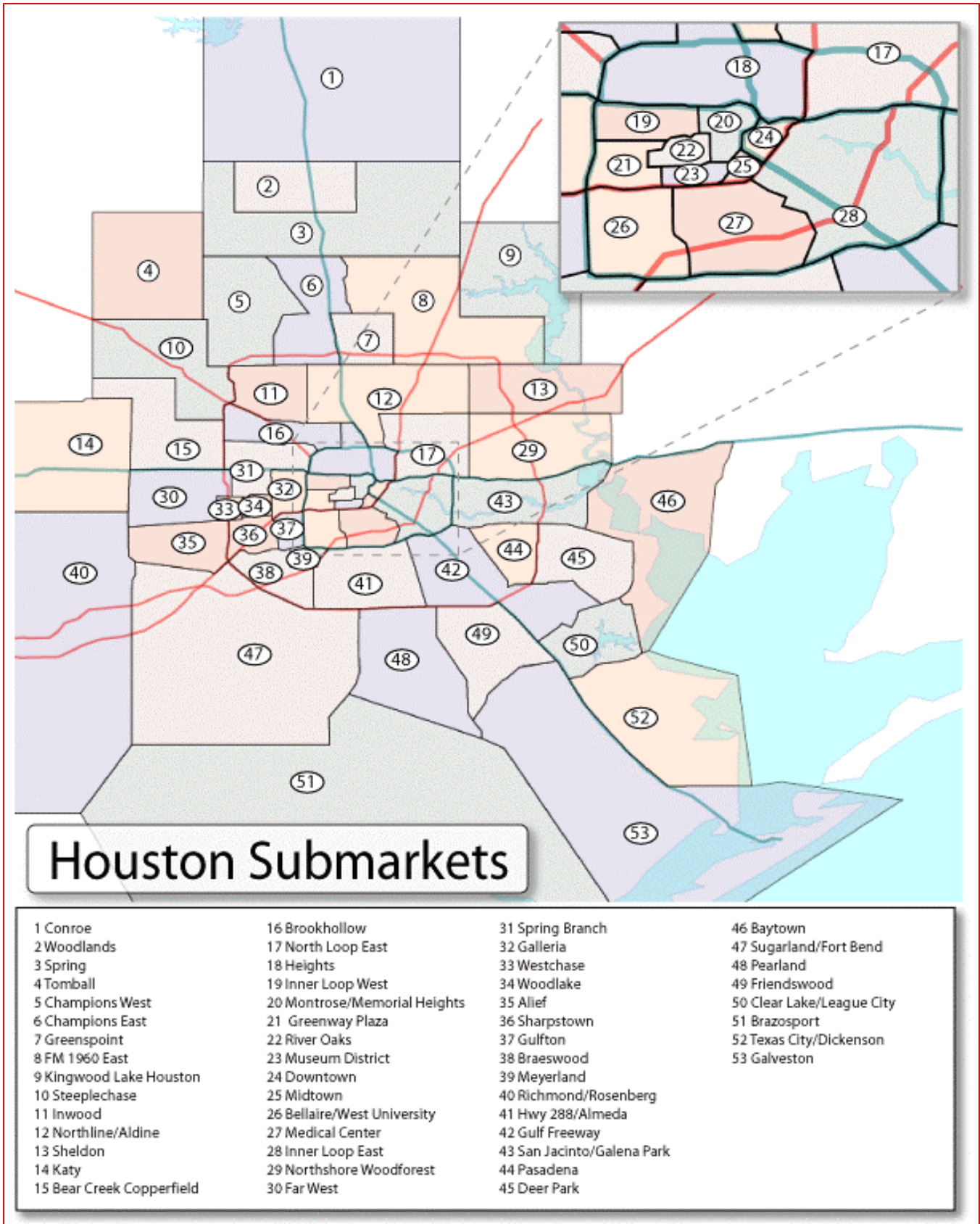
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Data Collection

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).



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