

Houston Apartment Market Update

Edited by Kathryn Koepke

\$399/year

3rd Quarter 2006

Movin' on Up and Movin' on Out

Granite counter tops, crown molding, ceramic tile, 9 - 10 ft. ceilings, and stainless steel appliances. Sounds great, but it's not where you think it is - it's two loops out. As more and more Houstonians seek to escape the hustle and bustle of the inner city, developers are assuring that renters can have their peacefully quite suburban surroundings in style.

Third quarter absorption numbers revealed that while Class B and C apartment demand continues to weaken, recording -1,155 and -2,368 units absorbed respectively, the Class A market is picking up the slack as over 1,770 Class A units were absorbed over the quarter. And while the place to find Class A space has long been the inner loop, the submarkets posting some of the strongest Class A absorption numbers were all out side not just the 610 loop, but the Beltway as well. Pearland had the strongest demand as 241 Class A units were absorbed there over the quarter, followed by 131 units absorbed in Steeplechase, 116 units absorbed in The Woodlands, 112 units absorbed in Katy, and 110 units absorbed in the FM 1960 East submarket. Only one inner loop submarket, the Medical Center, posted strong Class A demand with 184 units absorbed.

Though Class A apartment buildings date back to pre- 1920's construction, recently renovated of course, 40%, or 780 units, of the third quarters Class A absorption were in properties that came on line in 2006. New construction properties with positive absorption include The Landmark of Sugar Land in the Richmond/Rosenberg area, Chalet at Fall Creek in the FM 1960 East submarket, and the Lighthouse at Willowbrook in Champions West. Notably, these Class A properties had the highest absorption of 2006 built communities, and not only are they outside the Beltway, but are at or outside Houston's third loop, FM 1960/Highway 6.

Whether it is in the Loop or two loops out, Houstonians will increasingly have a desire for style. And as the city continues its expansive growth, there will be more and more residents seeking affordable luxury further and further from the city's core. Commuters will sacrifice a reasonable commute for better school districts and a more peaceful suburban setting. As the Grand Parkway comes to fruition in the near future, renters will be seeking homes not just two loops out, but at or beyond the fourth one as well.

By: [Melissa Ray](#)

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Did you know?

O'Connor & Associates now offers online apartment market and property data in all four major Texas markets, Austin, DFW, Houston, and San Antonio. Brokers, lenders, investors, owners, and apartment vendors have relied on our superior research and accurate data for over decades!

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Houston Apartment Market at a Glance

| | Class A | Class B | Class C | Class D | Overall | Qtr | Yr |
|------------|---------|---------|---------|---------|---------|-----|----|
| Occupancy | 92.04% | 90.53% | 87.57% | 84.63% | 89.75% | ▼ | ▼ |
| Rent/Unit | \$1,029 | \$659 | \$556 | \$523 | \$705 | ▲ | ▲ |
| Rent/SF | \$1.093 | \$0.812 | \$0.687 | \$0.593 | \$0.828 | ▲ | ▲ |
| Absorption | 1,776 | -1,155 | -2,368 | -11 | -1,758 | ▼ | ▼ |

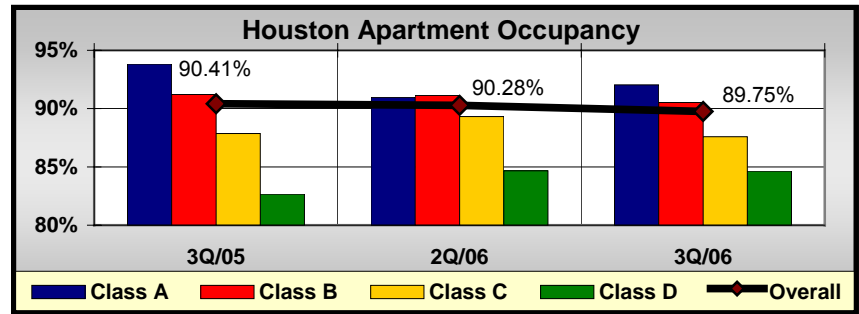


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Occupancy & Rent Trends

Metro Occupancy Overview

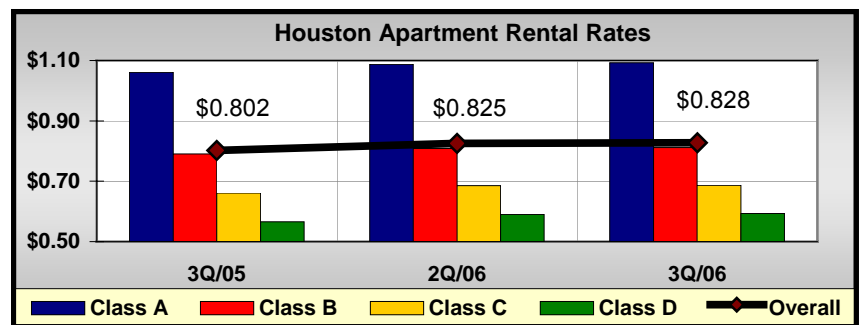
Overall occupancy experienced its fourth consecutive quarterly loss falling 0.53 points to 89.75%, marking the first time in a year that overall occupancy has dropped below the coveted 90% mark. **Class A** occupancy posted the largest quarterly gain of 1.08 points keeping Class A occupancy well above the 90% mark at 92.04%, despite posting the largest annual decrease of 1.77 points. **Class B** occupancy was also able to maintain a 90-plus percentage with 90.53%, dropping 0.61 point over the quarter, and 0.67 points over the year. The **Class C** market had the largest quarterly decrease in occupancy, falling 1.74 points, though dropping only 0.29 points over the year, to 87.57%. **Class D** occupancy remains lowest at 84.63%, despite gaining 1.97 points over the year and losing only 0.04 points over the quarter.



| Quarter | Class A | Class B | Class C | Class D | Overall |
|---------|---------|---------|---------|---------|---------|
| 3Q/05 | 93.81% | 91.20% | 87.86% | 82.66% | 90.41% |
| 2Q/06 | 90.96% | 91.14% | 89.31% | 84.67% | 90.28% |
| 3Q/06 | 92.04% | 90.53% | 87.57% | 84.63% | 89.75% |

Metro Rent Overview

Rental rates for the Houston apartment market continued growing steadily as all four classes recorded increases. Overall rents gained \$0.003 per square foot (psf) over the quarter and are up \$0.026 psf from this time last year. **Class A** apartments recorded the largest increases over the quarter and the year, \$0.006 psf and \$0.032 psf respectively, bringing rental rates to \$1.093 psf. **Class B** rental rates recorded the smallest yearly increase, raising only \$0.022 psf to \$0.812, and gaining only \$0.003 psf over the quarter. Despite a \$0.024 yearly increase, **Class C** rents posted the smallest quarterly increase, \$0.002 psf, bringing average rents to \$0.687 psf. **Class D** rental rates rose \$0.027 psf over the year, and \$0.003 psf over the quarter to \$0.593 psf.



| Quarter | Class A | Class B | Class C | Class D | Overall |
|---------|---------|---------|---------|---------|---------|
| 3Q/05 | \$1.061 | \$0.790 | \$0.661 | \$0.566 | \$0.802 |
| 2Q/06 | \$1.087 | \$0.809 | \$0.685 | \$0.590 | \$0.825 |
| 3Q/06 | \$1.093 | \$0.812 | \$0.687 | \$0.593 | \$0.828 |

Submarket Performance

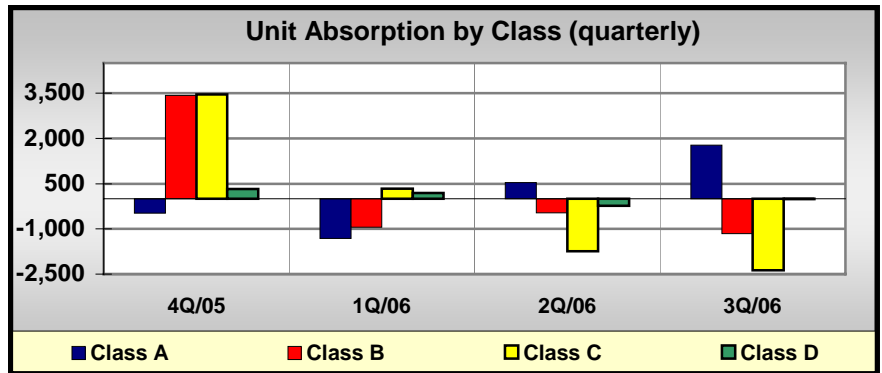
Of the 53 Houston submarkets, overall occupancy was highest in the **Bellaire/ West University** submarket at 96.26%, while the lowest occupancy was found in **Baytown** at 84.16%. The highest overall rental rates were found in the **Downtown** submarket at \$1.535 psf, while the lowest rents were found in **Sharpstown/ Westwood** at \$0.680 psf.

Of the submarkets with more than one property, **Spring Branch** reported the highest Class A occupancy at 97.43%, while the lowest Class A occupancy was reported by **Braeswood** at 81.21%. In the Class B market, **Montrose/Memorial Heights** reported the highest occupancy at 99.32%, while **San Jacinto/ Galena Park** posted the lowest occupancy at 81.74%. In the Class C market, **Highway 288/Almeda** recorded the highest occupancy at 98.00%, while **Far West** reported the lowest occupancy at 74.46%. In the Class D market, **Conroe** reported the highest occupancy at 100.00%, with **North Shore/Woodforest** reporting the lowest occupancy at 68.05%.

Of the submarkets with more than one property, **Downtown** reported the highest Class A rents at \$1.924 psf, while the lowest Class A rents were found in **Texas City/Dickinson** at \$0.857 psf. In the Class B market, rental rates were the highest in **River Oaks** at \$1.044 psf, while the lowest rents were found in **Montrose/Memorial Heights** at \$0.663 psf. Class C rents were the highest in **The Woodlands** at \$0.994 psf and the lowest were found in **Deer Park** at \$0.620 psf. In the Class D market, **Highway 288/Almeda** reported the highest rents at \$0.835 psf, while the lowest rents were found in **Pasadena** at \$0.512 psf.

Metro Absorption Overview

Overall absorption for the Houston apartment market continues to record weak numbers, as -1,758 units were absorbed over the quarter. Annual absorption followed suite and is well into the red, as -5,389 units were absorbed over the last twelve months. For the second quarter in a row, **Class A** apartments were the only market to show positive absorption as they absorbed 1,776 units, bringing the 12-month total to 993 units. The **Class B** market posted -1,155 units of absorption over the quarter, and -2,572 units over the year. **Class C** had the weakest overall demand for the second consecutive quarter absorbing -2,368 units. Annual absorption was also weakest with -3,759 units absorbed. The **Class D** market also recorded weak demand as -11 units were absorbed over the quarter, and -51 units were absorbed over the year.



| 12-mo Ending | Class A | Class B | Class C | Class D | Overall |
|--------------|---------|---------|---------|---------|---------|
| 3Q/04 | 7,605 | 439 | -2,485 | -469 | 5,090 |
| 3Q/05 | 13,897 | 9,503 | 1,841 | -34 | 25,207 |
| 3Q/06 | 993 | -2,572 | -3,759 | -51 | -5,389 |

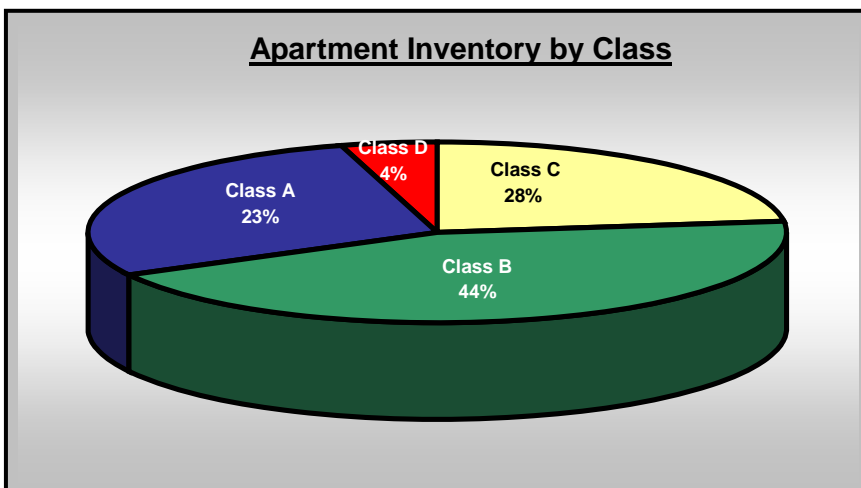
Submarket Performance

Of the 53 Houston submarkets, **Gulf Freeway** reported the strongest absorption over the quarter with 282 units absorbed. Demand was weakest in **Sharpstown/ Westwood**, where -500 units were absorbed. **Alief** and the **Far West** also recorded soft quarterly absorption, as -436 units and -424 units were absorbed respectively.

Within each of the classes, **Pearland** reported the strongest Class A absorption over the quarter with 241 units absorbed, while **Braeswood** reported the weakest absorption with -37 units absorbed. In the Class B market, **Gulf Freeway** posted the strongest absorption, as 134 units were absorbed over the quarter. The **Far West** posted the weakest Class B absorption, with -307 units absorbed. Class C absorption was strongest in **Katy**, with 35 units absorbed, and weakest in **Sharpstown/ Westwood**, with -302 units absorbed. Absorption in the Class D market over the quarter was strongest in **Gulf Freeway** with 154 units absorbed and weakest in **Pasadena** with -72 units absorbed.

Apartment Inventory

There are a total of 2,479 operating or under-construction projects in the Houston area market (greater than 25 units) with a total of 503,407 units. Approximately 23% of the total units are Class A, 44 are Class B, 28% is Class C, and 4% are Class D. The chart below displays market inventory by class.



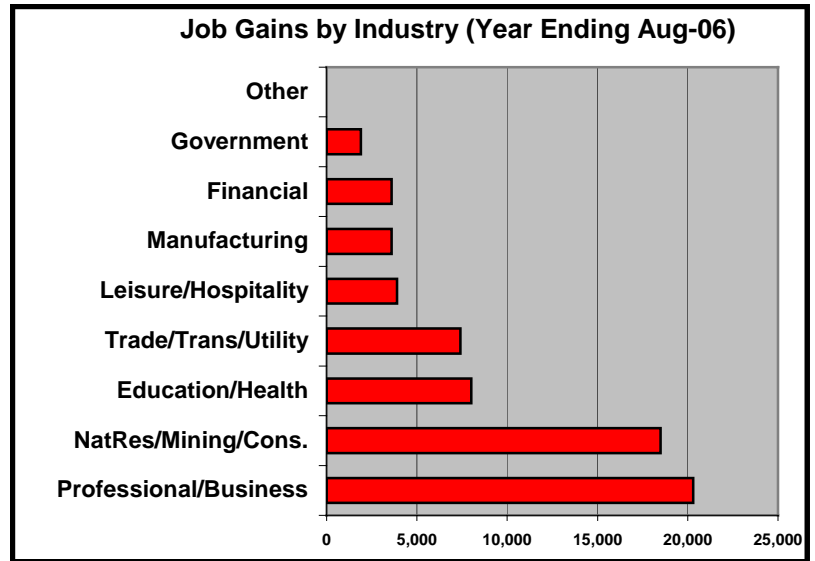
| Operating | Projects | Units |
|--------------|--------------|----------------|
| Class A | 446 | 116,784 |
| Class B | 1,057 | 222,719 |
| Class C | 816 | 141,719 |
| Class D | 160 | 22,185 |
| TOTAL | 2,479 | 503,407 |

| Under Cons. | Projects | Units |
|----------------|-----------|---------------|
| Class A | 30 | 8,864 |
| Class B * | 18 | 3,240 |
| TOTAL** | 48 | 12,104 |

* 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 decreased to 5.1%, while the total number of nonagricultural wage and salary jobs increased to 2,422,100 in August 2006, according to the **Texas Workforce Commission**. This month's total is 65,400 jobs more than at this time last year. Of the nonagricultural employers, Professional & Business Services gained 20,300 jobs over the previous 12 months; Natural Resources, Mining, & Construction gained 18,500 jobs; Education & Health Services is up by 8,000 jobs; Trade, Transportation, & Utilities added 7,400 jobs; Leisure & Hospitality added 3,900 jobs; Manufacturing gained 3,600 jobs; Financial Activities also gained 3,600 jobs; and Government added 1,900 jobs. The only industry to lose jobs over the year was the Information sector with -1,800 jobs. The largest monthly gain was in the Trade, Transportation, and Utilities industry with 4,000 jobs.

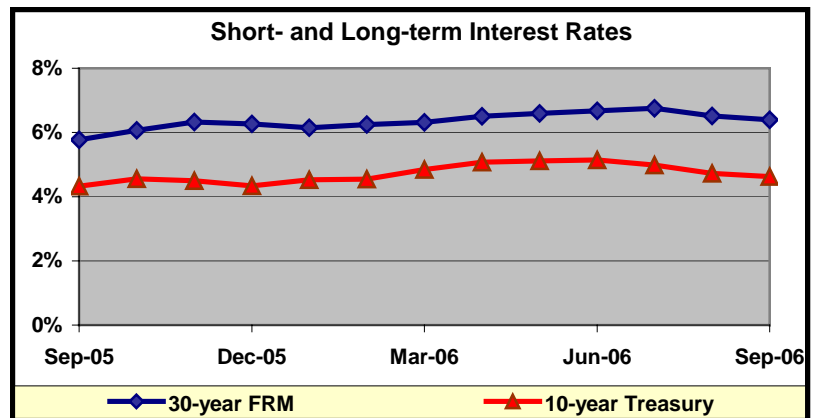


Interest Rates

The yield on the **10-year Treasury** note rose to 4.62% on the first business day of October 2006, up 0.23 points from its 4.39% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.40% in September 2006. One year ago, the 30-year FRM was at 5.77%. The average for the **15-year FRM** in September was 6.08%, up 0.72 points from a year ago.

The **Prime Rate** in September was reported in the Wall Street Journal at 8.25%, up 1.50 points from a year ago.



Apartment Data News Release

O'Connor & Associates is pleased to re-launch the **ApartmentLink**, the best online apartment data source in Texas, previously offered by **Monarch Data**. Some of the upgrades and enhancements made to the platform include:

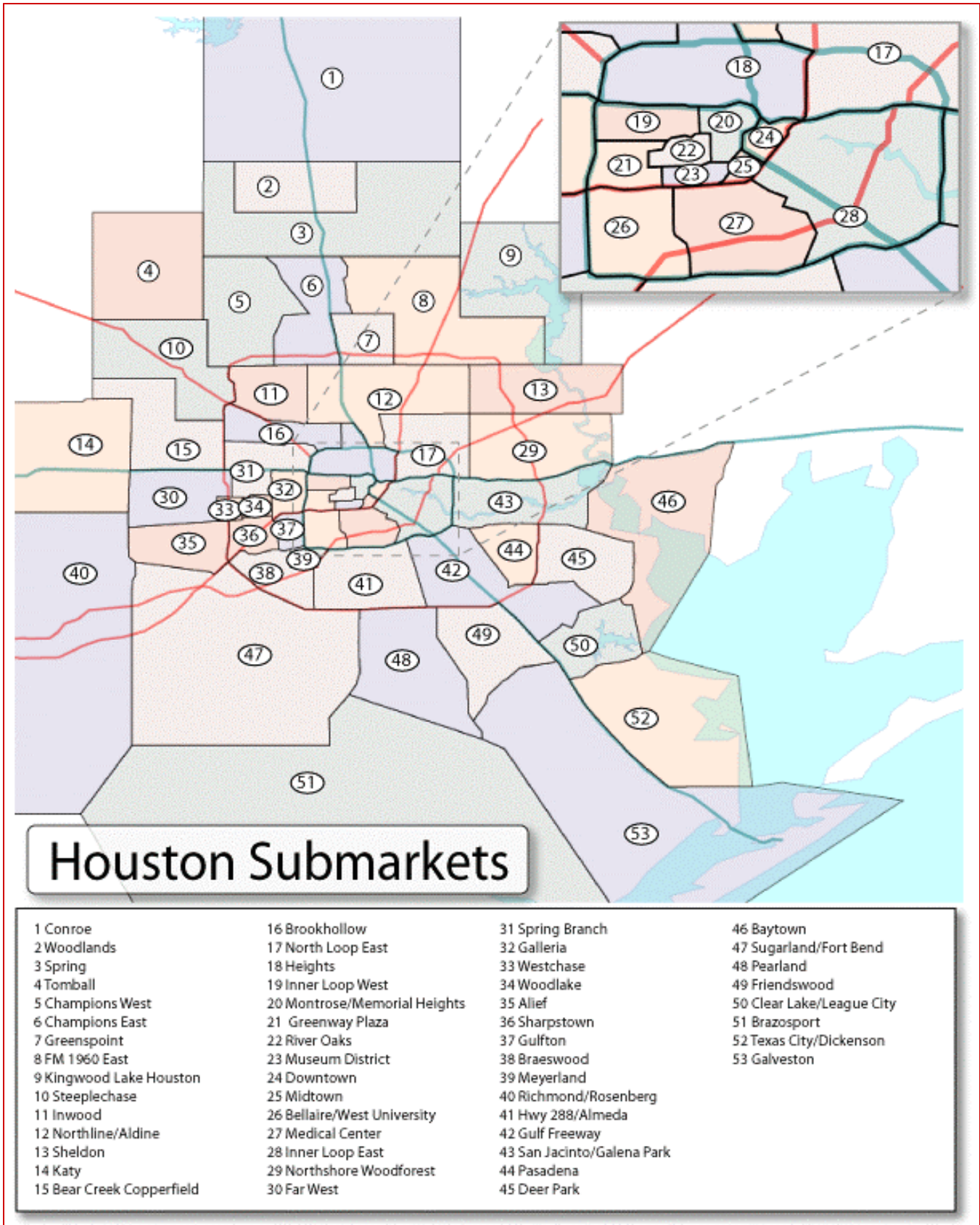
- ◆ Ownership Information
- ◆ More comprehensive data
- ◆ More search options
- ◆ More analytical reports
- ◆ More user-friendly
- ◆ Mapping & emailing options
- ◆ Excel exporting function
- ◆ Monthly updates, real-time data

All this and more now available at your fingertips from a company trusted by apartment industry leaders for over 30 years!

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Austin.....Dallas/Fort Worth.....Houston.....San Antonio



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).