Houston Apartment Market Update

Edited by Kathryn Koepke **$399/year** **4th Quarter 2006**

Then and Now

It was just 16 months ago that Hurricane Katrina came ashore, sending hundreds of thousands of New Orleans-area residents toward Houston. Not long afterwards, Houston was on the front page of seemingly every newspaper nationwide. Since then, most Houstonians have put the situation in the back of their minds, even though an estimated 120,000 of evacuees remain, as there has been relatively little news to report over the past few months, save for the occasional personal interest story.

However, things are about to change. FEMA recently announced plans to cease assistance to Katrina evacuees, effective at the end of February. After much debate about when this assistance would end, the date FEMA has set appears to be firm, as pushing the date back would require an act of Congress. Most importantly for those involved in the apartment market, FEMA will no longer provide money for evacuees to pay rent on their apartment units after February. While exact figures are difficult to find, it was recently estimated that two-thirds of evacuees in Texas do not have jobs. Of those who do have jobs, many likely do not earn enough to cover the rent on their apartment.

There is evidence that many evacuees have already vacated their units over the fourth quarter. Areas of town where a large number of evacuees originally landed posted large quarterly losses. The Sharpstown/Westwood area lost 336 units, Alief lost 340 units, and Inwood lost 364 units. Harder hit were the Gulf Freeway and Champion East areas with -598 and -481 units, respectively. Even so, an estimated 11,000 households remain on assistance. With that in mind, absorption over the first quarter of 2007 is likely to be weak once again, as evacuee move-outs continue. Effects are likely to be scattered across the area, but be most pronounced in areas such as the aforementioned two that have a large concentration of Class C and D units. It remains to be seen just how much the apartment market will be affected by the situation at hand.

By: Chris Law

Houston Apartment Market at a Glance

	Class A	Class B	Class C	Class D	Overall	Qtr	Yr
Occupancy	90.48%	89.47%	86.06%	83.40%	88.46%	▼	▼
Rent/Unit	$1,040	$659	$557	$524	$708	▲	▲
Rent/SF	$1.099	$0.812	$0.688	$0.594	$0.831	▲	▲
Absorption	74	-2,042	-2,474	-284	-4,706	▼	▼

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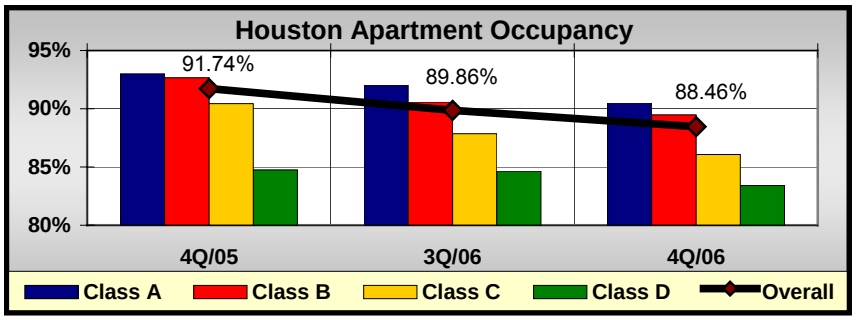
Occupancy & Rent Trends

Metro Occupancy Overview

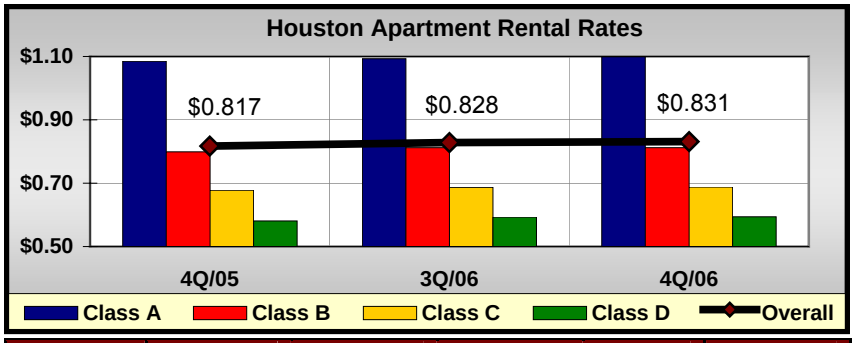
Overall occupancy fell for the fifth consecutive quarter, dropping 1.40 points over the fourth quarter to 88.46%, as all classes contributed to the decline. After a strong third quarter, **Class A** reversed course in the fourth quarter, as occupancy decreased 1.54 points to 90.48%. Class A occupancy has dipped 2.52 points over the past year. Occupancy in **Class B** declined 1.12 points over the quarter to 89.47%, and has decreased 3.19 points over the past 12 months. The **Class C** market posted the steepest quarterly decrease in occupancy, falling 1.80 points over the quarter. Currently at 86.06%, occupancy has also posted the largest annual decrease, at 4.38 points. **Class D** continued to post the lowest occupancy levels, decreasing 1.23 points over the quarter to 83.40%. Class D occupancy is now 1.36 points below last year's level.



Quarter	Class A	Class B	Class C	Class D	Overall
4Q/05	93.00%	92.66%	90.44%	84.76%	91.74%
3Q/06	92.02%	90.59%	87.86%	84.63%	89.86%
4Q/06	**90.48%**	**89.47%**	**86.06%**	**83.40%**	**88.46%**

Metro Rent Overview

Overall Houston-area rental rates continued their upward trend, gaining $0.003 per square foot (psf) over the quarter. Rents have increased $0.014 psf over the past year, and are currently at $0.831 psf. The **Class A** market once again recorded the highest quarterly increase, gaining $0.006 psf over the quarter to $1.099 psf. Class A rents are up $0.014 psf since this time last year. Rental rates in **Class B** remained flat over the quarter at $0.812 psf; however, rents have increased $0.013 psf over the past 12 months. **Class C** rents posted a small increase of $0.001 psf over the quarter to $0.688 psf, and have gained $0.010 psf over the past four quarters. The **Class D** market posted a quarterly increase of $0.001 psf as well, and have risen $0.013 psf over the past year to $0.594 psf.



Quarter	Class A	Class B	Class C	Class D	Overall
4Q/05	$1.085	$0.799	$0.678	$0.581	$0.817
3Q/06	$1.093	$0.812	$0.687	$0.593	$0.828
4Q/06	**$1.099**	**$0.812**	**$0.688**	**$0.594**	**$0.831**

Submarket Performance

Of the 53 Houston submarkets, overall occupancy was highest in the **Sheldon** submarket at 96.55%, while the lowest occupancy was found in the **Brookhollow** submarket at 82.99%. The **Downtown** submarket posted the highest rental rates 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, **Baytown** reported the highest Class A occupancy at 96.58%, while the lowest Class A occupancy was found in **Galveston** at 72.10%. The **Montrose/Memorial Heights** submarket led the way in Class B at 98.63%, while the **San Jacinto/Galena Park** submarket posted the lowest occupancy at 78.07%. The highest Class C occupancy was posted by the **Museum District** submarket at 97.56%, while the **Inwood** submarket posted the lowest at 69.08%. **Conroe** reported the highest Class D occupancy at 100.00%, with **Northshore/Woodforest** recording the lowest occupancy at 68.05%.

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 **Montrose/Memorial Heights** at $0.663 psf. In Class C, **The Woodlands** posted the highest rents at $0.994 psf, while the **Brazosport** submarket reported the lowest at $0.623 psf. The **Highway 288/Almeda** submarket reported the highest Class D rents at $0.840 psf, while the lowest rents were found in **Pasadena** at $0.514 psf.

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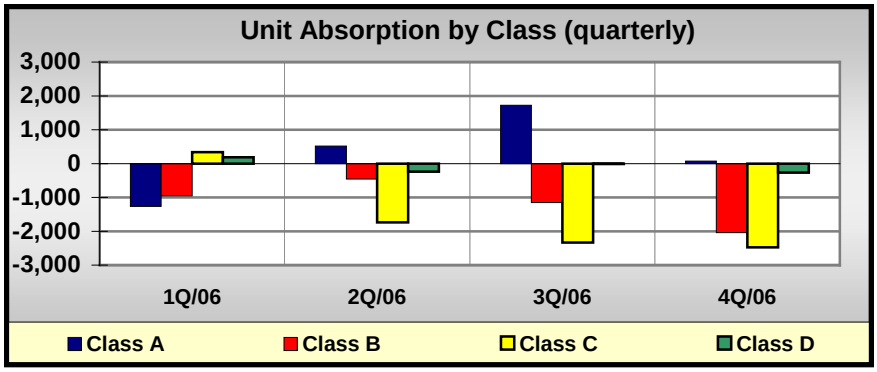
Absorption Trends & Inventory

Metro Absorption Overview

The market rounded out 2006 by recording a fourth straight quarter of negative absorption, absorbing -4,706 units over the quarter. Annual absorption stands at a dismal -10,070 units. The **Class A** market was once again the only class to post positive quarterly absorption, absorbing 74 units. Class A is also the only class to record positive annual absorption, at 1,048 units. **Class B** absorption was well into negative territory for the second straight quarter, at -2,042 units; annual absorption stands at -4,606 units. Demand in **Class C** was the weakest of any class once again, as the market absorbed -2,474 units over the quarter. Absorption over the past year in Class C stands at -6,197 units. The **Class D** market absorbed -264 units over the quarter, bringing 12-month absorption to -315 units.



12-mo Ending	Class A	Class B	Class C	Class D	Overall
4Q/04	7,161	-1,181	-3,010	-849	2,121
4Q/05	10,427	11,369	5,178	289	27,263
4Q/06	**1,048**	**-4,606**	**-6,197**	**-315**	**-10,070**

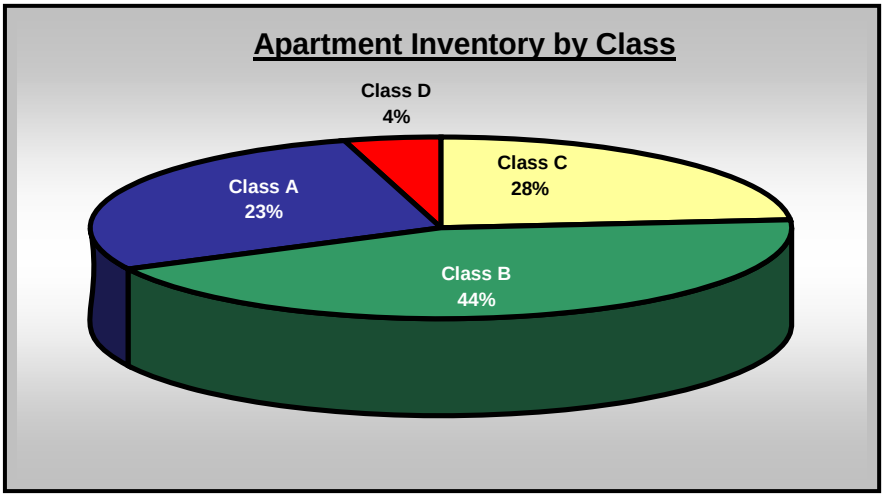
Submarket Performance

Of the 53 Houston submarkets, the **Inner Loop East** submarket recorded the strongest absorption over the quarter at 164 units. The weakest figures were found in the **Gulf Freeway** and **Champions - East** submarkets, which absorbed -598 and -481 units over the quarter, respectively.

The **Montrose/Memorial Heights** submarket recorded the strongest Class A absorption over the quarter at 124 units, while the weakest was found in **Katy** at -74 units. The **Pasadena** submarket posted the highest figures in Class B, absorbing 119 units, while the **Greenspoint** submarket posted the lowest at -238 units. The highest Class C absorption was found in the **Baytown** submarket, which absorbed 88 units, while the weakest absorption was found in the **Gulf Freeway** submarket, at -505 units. The strongest absorption in Class D was found in the **Inner Loop East** submarket at 98 units, while the **Northline/Aldine** submarket posted the weakest at –219 units.

Apartment Inventory

There are a total of 2,483 operating or under-construction projects in the Houston area market (greater than 25 units) with a total of 505,052 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	417	108,190
Class B	1,041	220,098
Class C	815	141,543
Class D	160	22,185
TOTAL	**2,431**	**491,710**

Under Cons.	Projects	Units
Class A	36	10,513
Class B *	14	2,523
TOTAL**	**52**	**13,342**

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

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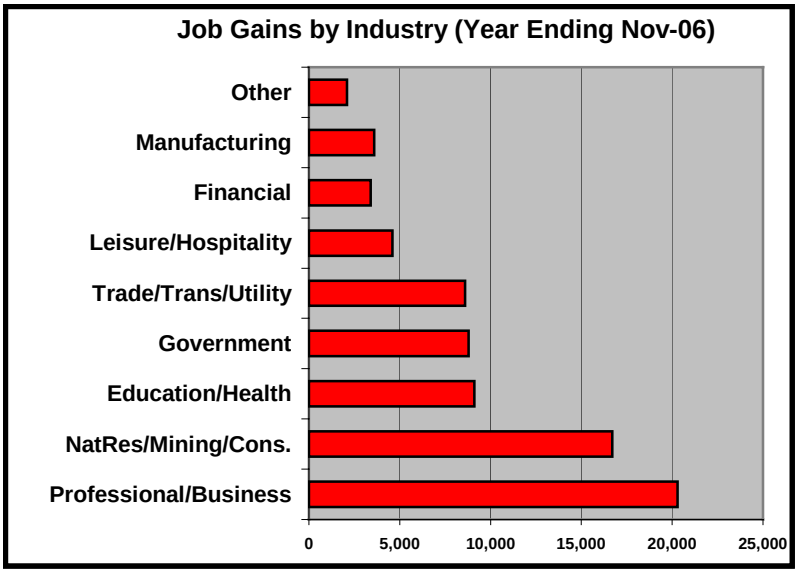
Economic Fundamentals

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 2,466,600 in November 2006, according to the **Texas Workforce Commission**. This month's total is 75,000 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 16,700 jobs; Education & Health Services is up 9,100 jobs; Government added 8,800 jobs; Trade, Transportation, & Utilities added 8,600 jobs; Leisure & Hospitality added 4,600 jobs; Financial Activities gained 3,400 jobs; Manufacturing gained 2,100 jobs; and Other Services added 2,100 jobs. The only industry to lose jobs over the year was the Information sector with -700 jobs. The largest monthly gain was in the Trade, Transportation, and Utilities industry with 8,300 jobs.

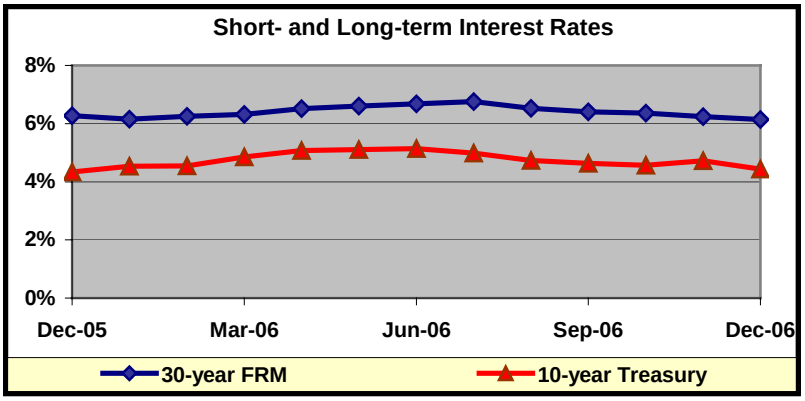


Interest Rates

The yield on the **10-year Treasury** note rose to 4.62% on January 4, 2007, up 0.26 points from its 4.36% yield one year ago.

The **30-year fixed-rate mortgage (FRM)** averaged 6.14% in December 2006. One year ago, the 30-year FRM was at 6.27%. The average for the **15-year FRM** in December was 5.88%, up 0.06 points from a year ago.

The **Prime Rate** in January was reported in the Wall Street Journal at 8.25%, up 1.00 points from a year ago.



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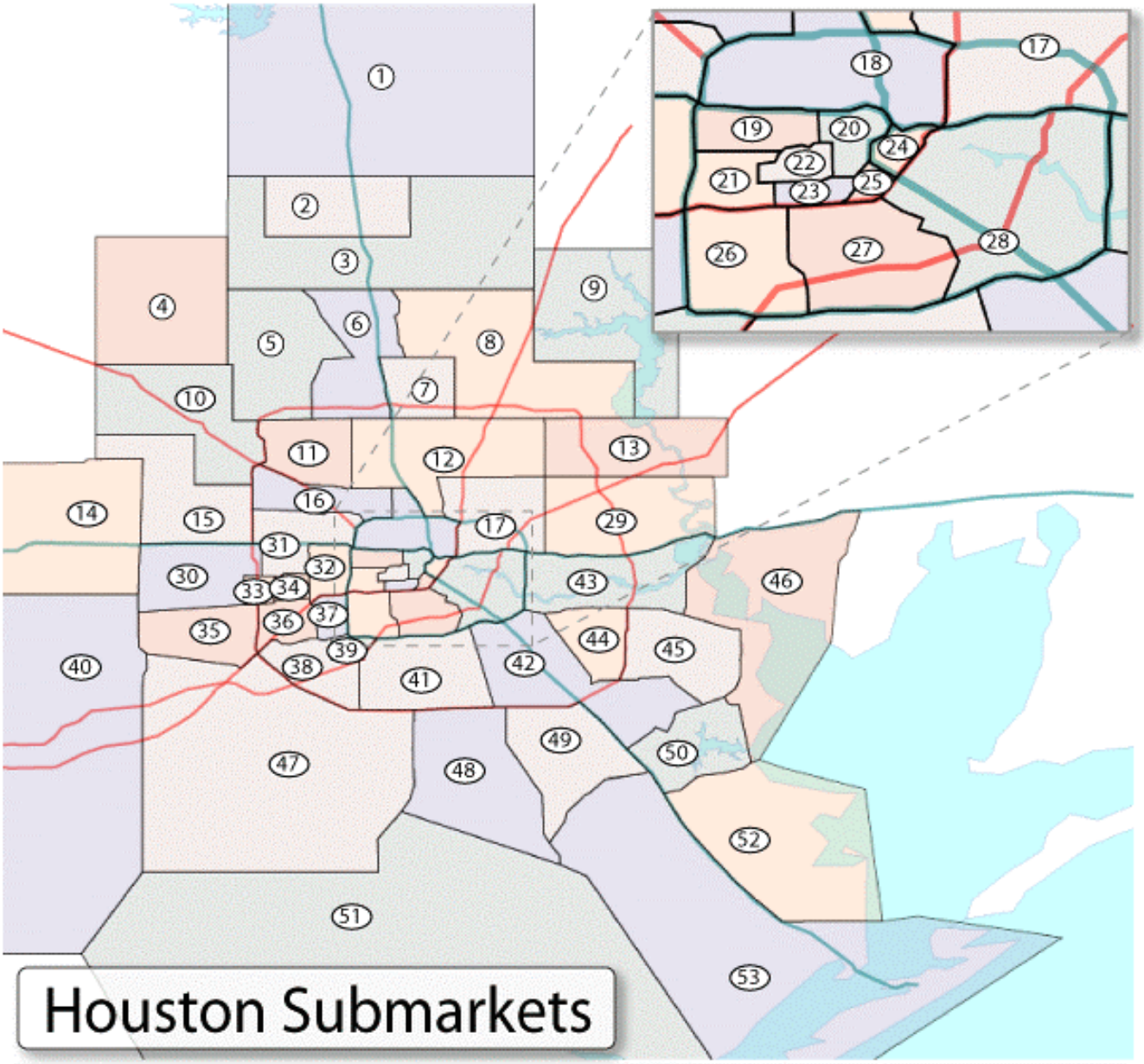
Houston Map



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

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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).

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