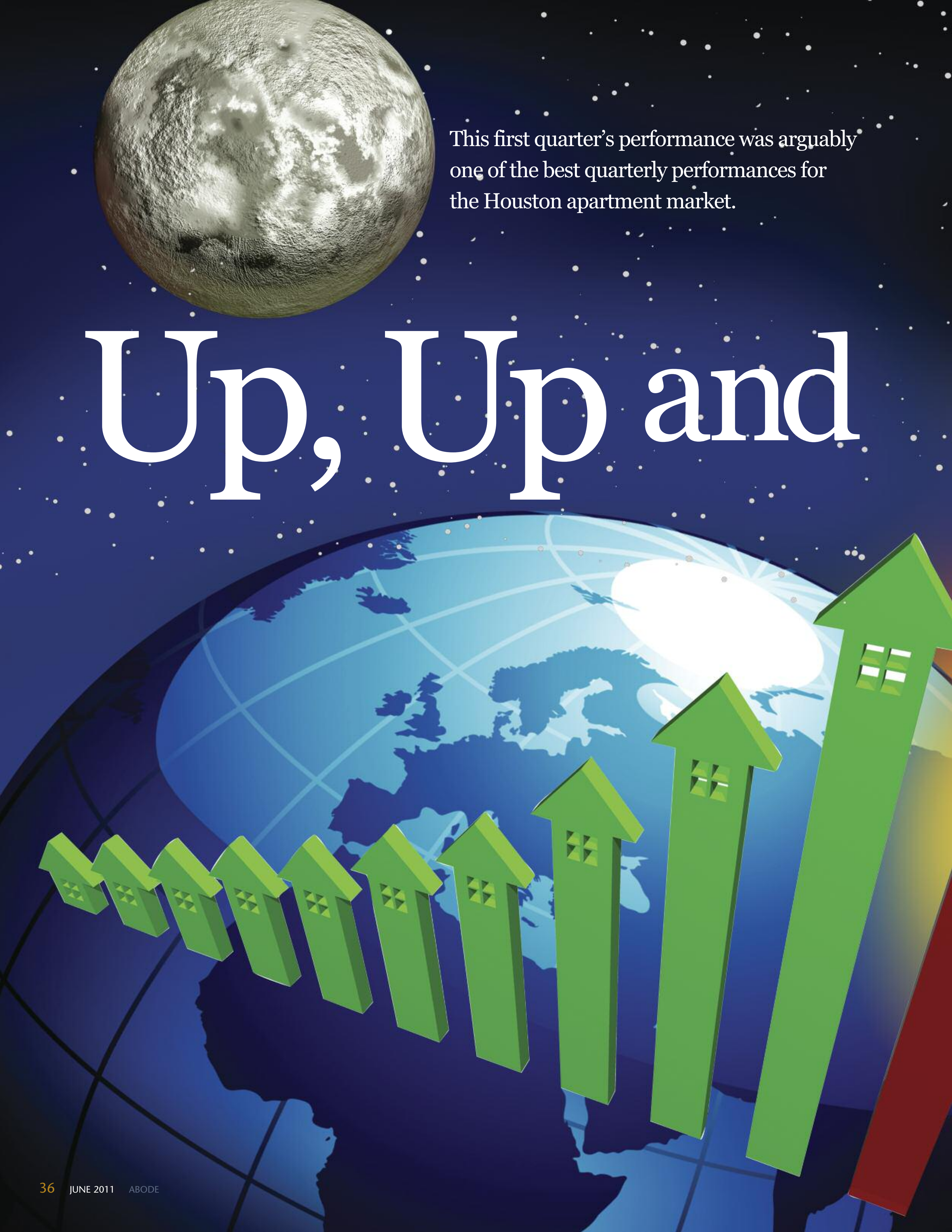


This first quarter's performance was arguably one of the best quarterly performances for the Houston apartment market.

Up, Up and

Away!

The apartment market takes off following the recession and the single-family mortgage crisis as rents head out of orbit.

By BRUCE McCLENNY, Apartment Data Services Inc.

LOOKING BACK: A SLOW BURN

Houston's version of the 2008-2009 recession lasted 17 months, from August 2008 through December 2009. According to the Greater Houston Partnership, Houston lost 135,400 jobs during the downturn. The 2008-2009 recession was not as severe as the mid-1980s recession that lasted almost five years and caused approximately 220,000 job losses. Houston's economy is much more diverse and dynamic now. Thank goodness better times have returned.

As of the end of March, the Houston/Sugar Land/Baytown metro area registered a 12-month net addition of 51,800 jobs. This level of job growth is more in line with Houston's normal job growth during non-recession/non-boom years. Another positive development can be found in the Baker Hughes Rig Count. It registered 1,720 in March, a 21.3 percent increase over the 1,419 rig count a year earlier.

RENT AND OCCUPANCY BLAST OFF

The graph on Page 38 depicts overall average rent and occupancy for the greater Houston apartment market for the last 12 quarters beginning June 2008. The movement in the rent level closely matches the timing of the local recession mentioned above. Rents continued to rise after the beginning of the recession in August 2008, assisted by Hurricane Ike. Rents peaked in December 2008 at an overall average of $726 per month as the impact of Ike waned and the job losses began to mount.

The damage to rent and occupancy levels caused by the recession was confined to 2009. By December 2009, overall occupancy had deteriorated to 83.9 percent, driven down by new construction deliveries of more than 15,600 units, overwhelming the absorption of nearly 3,000 units. Overall rents responded similarly, falling throughout 2009 and finally bottoming-out in December at $709 per month.

In 2010, a job growth of 46,300 propelled overall occupancy from 83.9 percent to 86.1 percent. Amazingly, the single-family crisis has created unprecedented demand for apartments that has moved occupancy to at least twice the power or rate traditionally associated with job growth. Before the 2007 mortgage meltdown, the local industry had come to rely on a conversion ratio of one additional apartment unit occupied for every six to seven new jobs created. In 2008, job growth of 19,500 resulted in the absorption of 8,321 units, a 1 to 2.3 ratio. In 2008, Houston experienced negative job growth, losing 107,400 jobs, and the market still produced a positive absorption of 2,963 units! In the past when Houston experienced negative job growth, the market always responded with negative absorption. The 46,300 jobs of 2010 produced an absorption performance of greater than 15,000 units, which calculates to a 1 to 2.9 ratio.

The first quarter of 2011 saw a continuation of the new demand paradigm, as 5,406 units were absorbed. This outstanding level of absorption pushed overall occupancy to 86.8 percent and gave the market the power to raise the overall rent level to $734 per month. This level of rent established a new overall market high! The previous market high was achieved in December 2008 at $726 per month. This first quarter's performance was arguably one of the best quarterly performances for the Houston apartment market.

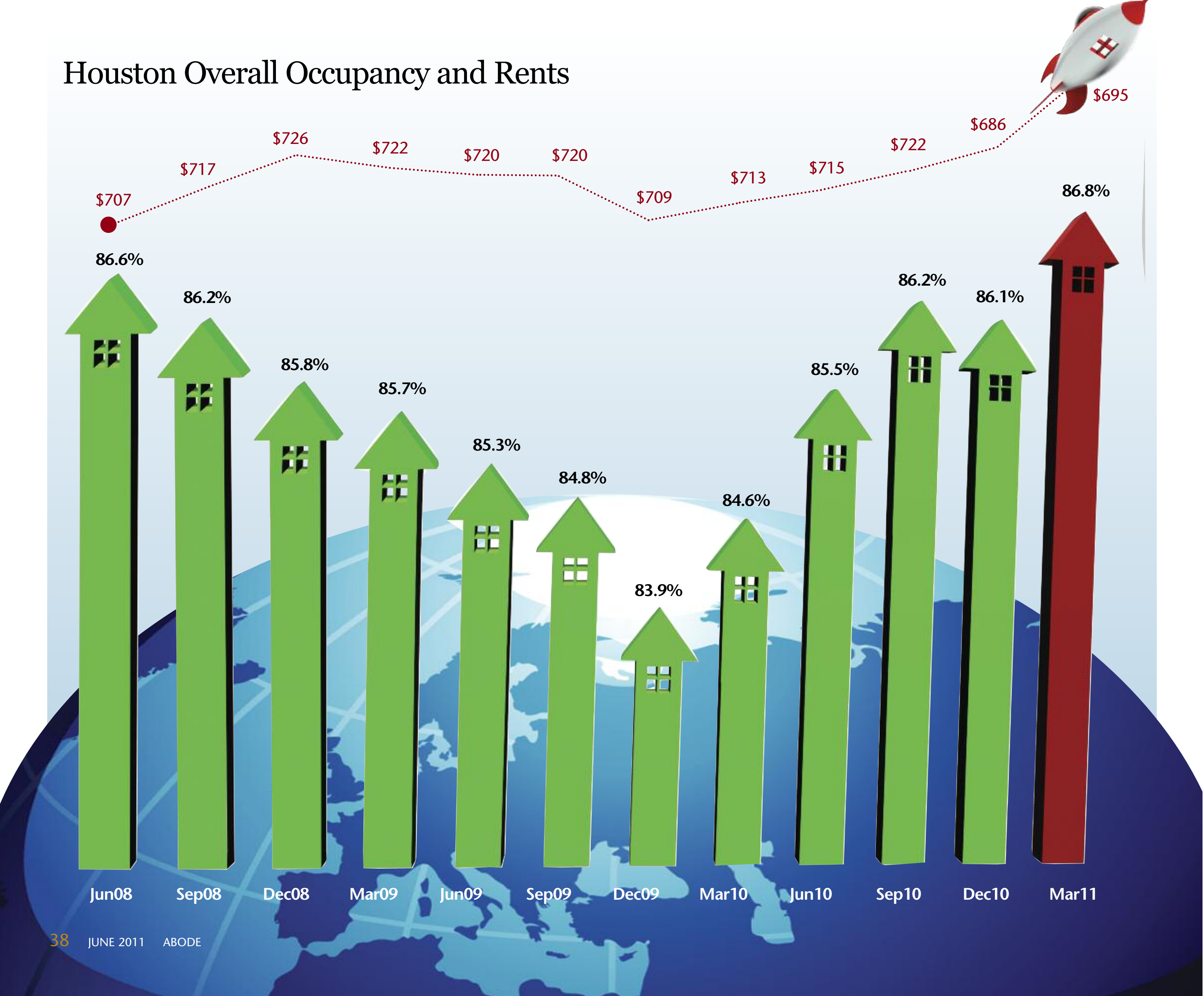
CLASSIFICATION ANALYSIS

The table on Page 41 provides a snapshot of conditions by class as of the end of March. This table breaks out the performance of each class and shows how each segment contributed to the overall market's performance over the last 12 and three month periods.

2010 AND 2011 CONSTRUCTION

New construction units delivered in 2010 and 2011 are filtered out of Classes A and B to create a separate classification. Since January 2010 there have been only 5,486 units introduced into supply, of which more than 3,800 are attributable to 2010 and the remaining 1,600 units to the first quarter of 2011. This is a very puny number for new supply. Rarely can the Houston apartment market be accused of under-building, but the recession and the credit crisis have buried new construction financing.

Rent trends for this group cannot be accurately calculated due to the continually increasing number of new units being introduced. The rate per square foot of this new construction group is significantly lower than Class A, as 27 percent of the units are of the affordable variety. Occupancy, of course, is very low at 43.4 percent since 17 of the 26 properties under construction are in the early stages of lease-up. The 636 units of absorption for the last three months seem small, though when compared to the total units of 5,486, the absorption performance represents 11.5



percent of the total units. Similar calculations for the other classes result in percentages of less than 1.0 percent. The strength of the 2010 and 2011 construction group's absorption performance is better illustrated by comparing the percentage of units absorbed to the total, rather than just the number of units absorbed.

CLASS A WITHOUT NEW CONSTRUCTION

Taking new construction units out of Class A provides a stabilized picture of this product type. Class A's occupancy level of 93.5 percent is the highest occupancy recorded for this group over the last 12 years. The last time stabilized class occupancy was this high was in April 2001 at 93.3 percent. As Class A occupancy gets stronger, the importance of absorption as a measure of market performance diminishes. The focus of this highly-occupied class group is to maintain high occupancy or not lose occupancy through negative absorption, so the 676 units of absorption for Class A is not a concern. Over the next 18 months any positive absorption, regardless of how slight for the Class A Without New Construction group, will be magnificent!

With occupancy at such a historically strong level, rents are responding with amazing strength. The 12-month trend of 5.4 percent is very impressive and even better is the three-month annualized trend of 7.8 percent.

CLASS B WITHOUT NEW CONSTRUCTION

With Class A doing so well, Class B had room to improve. The absorption performance for Class B was exceptional as this class claimed half of all the 12-month absorption. Spurred on by such dynamic demand, the 12-month rent trend realized a very respectable 2.8 percent gain. Over the last three months, Class B's prospects have really improved with the three-month annualized trend scoring a 6.4 percent gain.

Class B's occupancy has just moved past the 90 percent barrier. The last time Class B eclipsed the 90 percent mark was back in 2006, when it was highly influenced by Katrina evacuees. Previous to that episode, Class B found the 90 percent sweet spot in 2003. The highest occupancy that Class B achieved over the last 12 years was in the fourth quarter of 2001 at 93.5 percent. It is remarkable that these analogies are being made and implies that a higher occupancy level is possible.

CLASSES C AND D

Both of these classes have been suffering from the financial distress brought on by the recession. The first clue is their low occupancies. The second is their 12-month rent trend performances. Class C's rent performance was flat whereas Class D's was firmly negative. Even though Class C's 12-month absorption was positive, it was only that way by virtue of its super positive three-month absorption. The good news is that things are looking up for Class C, but unfortunately Class D is still mired in negativity.

As discussed above, the three-month absorption performance for Class C was stellar. Because of such strong absorption in Class C and the superior rent performances from Classes A and B, Class C had the means to move rents at the annualized rate of 1.6 percent.

LOOKING AHEAD IN 2011: OUT OF THIS WORLD!

The Houston Apartment Market is well positioned to have a winning year in 2011! Classes A and B have already set a very strong pace and the prospect for continuation is good. Job growth has come back to what was average prior to the recession, somewhere around 2.0 percent or 50,000 jobs. As recent Census Bureau statistics show, the single-family home market is in a slump and may be for some time to come with the home ownership rate for those under age 35 now at 37.9 percent, down

Analysis by Classification

As of March 31, 2011	Supply	Occupancy	Rent ¢/sq ft	Rent $/month	Rent 12-Month Trend	Rent 3-Month Trend	Absorption (Units) 12 Months	Absorption (Units) 2010 YTD
'10 & '11 Construction	5,486	43.4%	109.5	$1,075	–	–	2,388	636
Class A (w/o '10 & '11)	90,041	93.5%	123.4	$1,153	5.4%	7.8%	4,171	676
Class B (w/o '10 & '11)	220,099	90.5%	88.0	$766	2.8%	6.4%	7,973	2,120
Class C	220,758	83.2%	67.7	$570	0.6%	1.6%	1,344	1,780
Class D	39,156	77.8%	47.1	$396	-2.4%	-2.5%	-166	194
Overall	575,540	86.8%	84.5	$734	2.6%	6.5%	15,710	5,406

from 43.3 percent in 2005. New apartment supply has been stunted due to the limited financing available. There have been 1,871 units delivered in 2011 and presently there are 19 properties under construction representing 3,272 units. With this scenario, there will be approximately 4,500 units delivered to new supply in 2011 and another 800 units delivered in 2012.

Assuming that job growth will finish the year with around 50,000 net new jobs and applying a conversion ratio of one occupied unit for every three jobs, absorption for 2011 will be in the neighborhood of 15,000 units. Overall occupancy by year's end will be around 88.0 percent considering this absorption performance, offset by 4,500 new units of supply.

The overall rent level has the opportunity to realize an improvement between 5.0 and 6.0 percent. With this level of rent growth, Class A will capture a 7.5 percent gain, Class B a 5.5 percent bump, Class C a 3.0 percent improvement and Class D might emerge from negative territory.

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