RED CAPITAL GROUP®

Market Overview

Houston, Texas

Multifamily Housing Update **September 2010**

EXECUTIVE SUMMARY

Just when Houston seemed to put last year's unusually heavy job losses behind it, a series of unexpected headwinds buffeted the Bayou City and clouded the economic outlook. An offshore oil drilling moratorium idled dozens of Houston-based rigs as well as the complex supply and support web that stands behind them. The future of BP — one of Houston's largest employers — is in limbo in the wake of the Deepwater Horizon spill, and one of its cross town competitors, Chevron, is planning to trim some underperforming businesses. Meanwhile, Continental Air, another large employer, will soon merge with United, potentially leading to some redundant staff cuts.

All the uncertainty couldn't come at less opportune time. After losing a net of 66,500 jobs last year, Houston payroll trends are only lately approaching stability. The metro area hemorrhaged positions at a 27,000-job, -1.1% year-on-year pace in 2Q10, but improved to attrition of just 9,700 (-0.4%) jobs during the 12 months ended in July.

The oil and gas industry played a primary role in the spring recovery. Extraction sector headcounts increased nearly 3,000 workers January to July, while the related refining, field equipment, rig equipment wholesaler and field service subsectors added another 2,500. Also, business travel increased commensurately, boosting accommodations and hospitality headcounts by several thousand workers.

But seasonally-adjusted data illustrate the tenuous state of the recovery. Metro headcounts increased sequentially in only four of the year's first seven months, rising 13,900 (0.5%) in all, weaker than the national average. Moreover, as many as one-half of the gains was attributable to temporary Census data collection positions.

The **RCR** payroll model projects that conditions will improve materially by 4Q10, when y-o-y payroll losses give way to growth at a 21,700-job annual pace. Houston should add 47,000 jobs next year and as many as 74,300 in 2012, if the optimistic GDP forecast used in the model is borne out.

Apartment absorption was robust in 2Q, suggesting that job creation was faster than suggested by the BLS data. Tenants leased a net of 3,491 units, according to Reis, the largest quarterly haul since 4Q05. The surge helped to backfill some of the more than 6,000 metro units completed from January to June, raising average metro occupancy 50 basis points sequentially to 87.6%. Close-in Westside "class-A" submarkets were popular with tenants as Montrose, Briar Forest and Bear Creek each recorded more that 600 net move-ins. By contrast, a net of 600 tenants vacated units in three submarkets with class-BC inventories that perch on the Sam Houston outer-belt (Fondren, Northborough and Sharpstown).

Owners put their pricing power to the test by hiking average face rents $9 (1.2%) March to June. Average concession levels increased for the first time in a year, however, holding effective rent growth to $6 (0.8%).

Reis expect occupancy to improve by 30 bps by YE10, followed by a steady demand-led recovery to 90.6% by 2014. Rent levels are projected to rise at a compound annual rate of 2.6% over the period, slightly slower than the 2.7% **RED 50** market average

Acquisition activity intensified in 1H10, as institutional investors bid aggressively for strategically-located class-A properties. A Dallas-based fund manager won two hotly contested auctions for Westside trophies in July, paying more than $100mm for the pair, translating to going-in yields in the low- to mid-5% range.

SNAP SHOT

	Y-o-y change	Projected YE 2010
Vacancy (12.4% - 2Q10)	▲ 90bps	▼ 30bps
Effective Rents ($723 - 2Q10)	▲ 1.4%	▲ 1.8%
Cap Rate (7.0% - 2Q10)	▲ 70 bps	▼ 50 bps
Employment (2,520.3m - 2Q10)	▼ 27.0m	▼ 21.3m

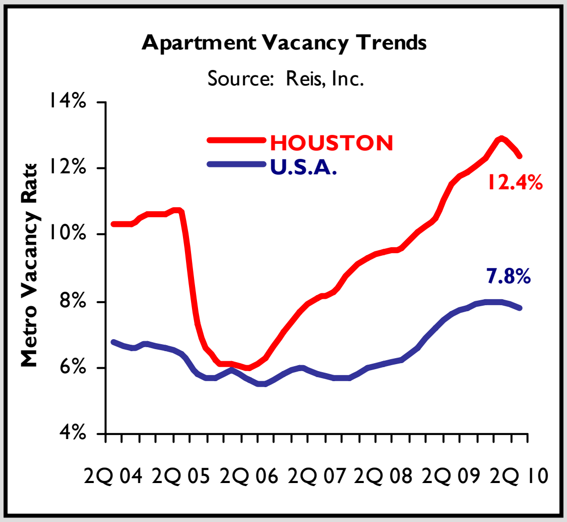
KEY POINTS

- Exceptional interest in Westside class-A assets fueled a solid 2Q occupancy rally. Overall, tenants net leased 3,491 units, trimming average metro vacancy 50 basis points sequentially to 12.4%.
- Owners hiked average face rents $9 q-o-q in 2Q, but high vacancy at projects in lease-up contributed to a more liberal rent concession environment, limiting effective rent gains to $6 (0.8%) q-o-q and $10 (1.4%) y-o-y.
- Interest in Houston multifamily assets increased as institutional investors concluded that the Bayou City's economy is poised for rapid growth. First half 2010 sales totaled 28 trades for $451mm, according to Real Capital Analytics, up 65% and 56%, respectively, from the comparable period of 2009.
- The metro labor market recovery unfolded in fits and starts. After declining at 100,800-, and 76,400-job annual rates in 4Q09 and 1Q10, year-on-year payroll losses slowed to a 27,000-job pace in 2Q, and further to 9,700 jobs during the 12-months ended in July.
- **RCR** estimate 8.7% expected total returns from metro assets, ranking **RED 50** #6.

2Q10 VACANCY TRENDS

- Reis report net absorption of 3,491 units, up from 1,362 and –190 in the prior quarter and year-earlier period, respectively. Occupancy increased 50 basis points sequentially to an average of 87.6%.
- O'Connor & Assoc. estimate that tenants net leased 4,685 units in the April-June period, raising average occupancy 49 bps to 86.53%. MPF posted an 88.7% mid-year rate, boosted by 11,300 1H10 net move-ins.
- Tenants preferred recent construction class-A units, particularly in Westside infill neighborhoods. Competitively obsolescent properties in out-of-favor submarkets continued to experience tenant attrition.
- Reis project occupancy to reach 87.9% by YE10 and climb steadily to 90.6% by YE14. The service expects average annual absorption of about 5,900 units to outpace average delivery of roughly 2,900 units.

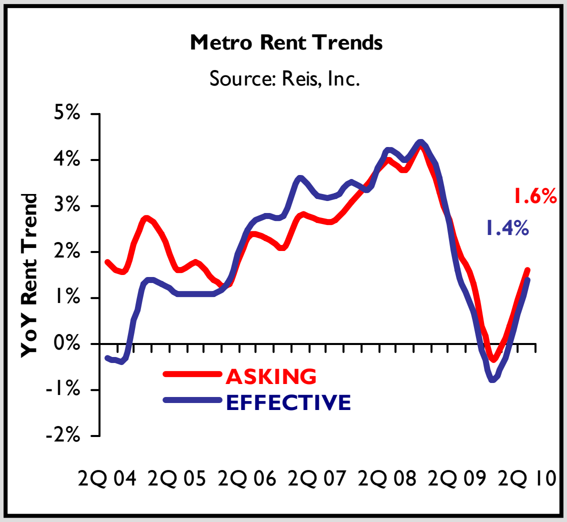
RANK: 49th out of 50



2Q10 RENT TRENDS

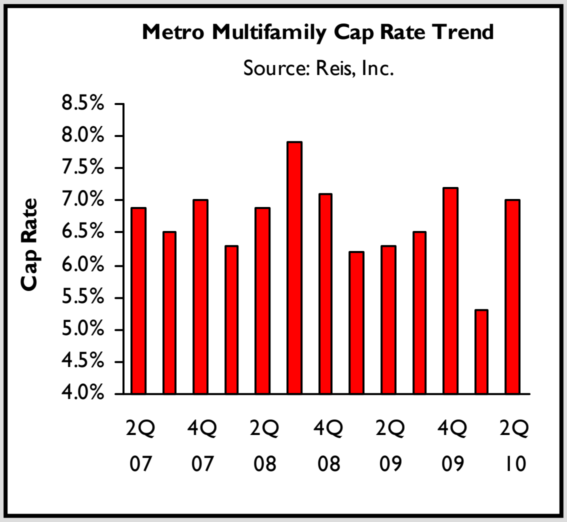
- Delivery of 12,391 new units over the 12-month period ended in June and constructive household income growth trends helped raise average metro asking rents $10 (1.6%) year-over-year. Moderately higher concession levels held effective rent gains to $10 (1.4%) though.
- MPF recorded a 0.3% sequential quarter effective rent advance in 2Q, but a –3.7% y-o-y decline. These data are in line with the results disclosed by public real estate trusts (8,536 Houston units) that show unit weighted average rents declining –4.6% y-o-y and –0.5% q-o-q.
- The Montrose / River Oaks submarket posted the fastest rent growth in the metro area, advancing $35 (3.2%) to $1,123 from March to June.
- Reis expect mean effective rent to reach $727 by YE10 and $806 by YE14.

RANK: 9th out of 50



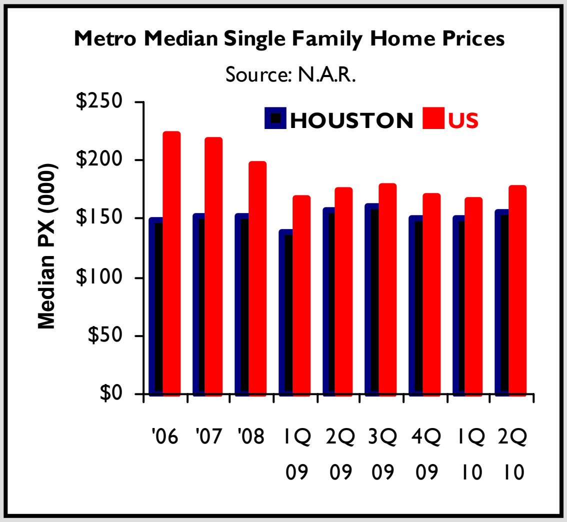
PROPERTY MARKET & CAP RATE TRENDS

- The Houston multifamily property market was among the hotly contested in county. In July alone, three recent construction trophy properties exchanged hands at aggressive cap rates. A Dallas-based investment fund that was the second most active investor in U.S. apartment properties in 1H10 closed on a luxury mid-rise in the Galleria/Uptown neighborhood, paying about $167,000/unit. **RCR** estimate a 5.0% yield. The fund also acquired a 2-year old loft-style mid-rise in Briar Forest, priced to yield of about 5.5%. In the third transaction, investors acquired a 268-unit class-A+ garden project located in a Katy PUD Terms of this transaction were not available.
- **RCR** believe that 6.0% represents a good mid-year proxy cap rate for generic Houston class-A&B institutional quality apartment assets. Using this level to determine acquisition price, we estimate that an investor would expect an 8.7% 5-year, unlevered total return from a Houston investment, ranking 6th highest among the **RED 50** markets. Volatility in Houston is above average, however, lowering our index measure of risk-adjusted returns to a 30th-ranked 2.68.



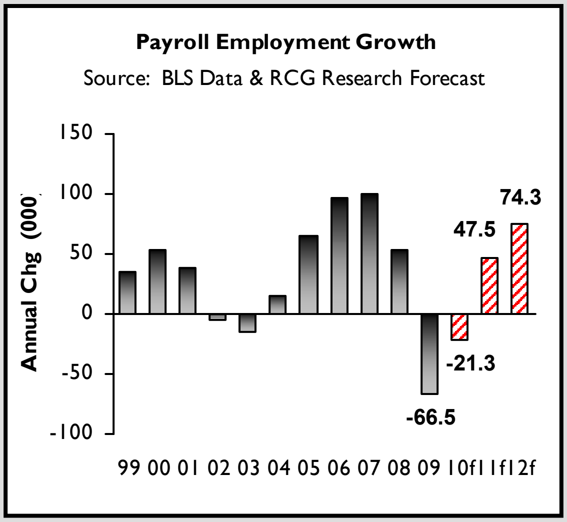
NOTABLE TRANSACTIONS

Property Name	Property Class	Date of Transaction	Total Price (in millions)	Price per unit	Estimated Cap Rate
Uptown Post Oak (Montrose)	A+	Jul-2010	$65.5 (est.)	$167,000	5.0%
Lofts @ Briar Forest (Inwood)	A	Jul-2010	$38.0 (est.)	$108,000	5.5%
Yorktown (Bear Creek/Katy)	A	Aug-2010	$22.1 (est.)	$72,222	6.5%
Lakes @ Cinco Ranch (Katy)	A-	Jun-2010	$16.7	$76,606	7.5%



DEMOGRAPHICS & HOUSING MARKET

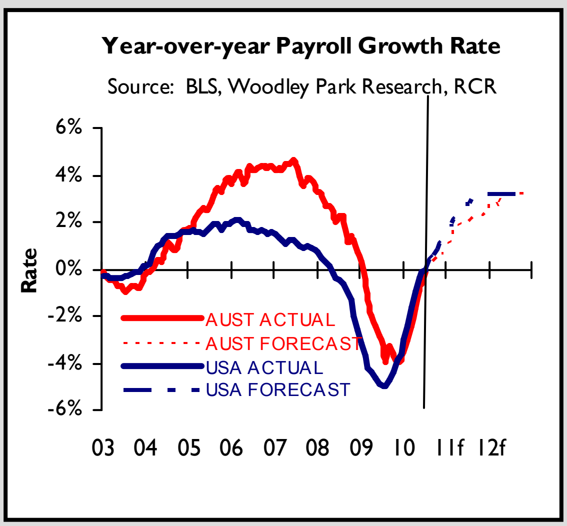
- The Federal Housing Finance Agency report that the 2Q10 Houston All-transaction Home Price Index was 191.03 (1Q00=100), up 0.6% from 1Q but –0.1% lower year-over-year. Over the ten-year period dating to 2Q00, Houston homes appreciated at a 4.0% compound annual rate, faster than the 3.8% national average.
- N.A.R. statistics show a median price of Houston homes sold in 2Q10 of $155,900, down -1.0% y-o-y, but up 3.9% from the 1Q10 median.
- HousingTracker.net published less sanguine statistics, reporting that the median price of metro MLS listed homes fell –1.1% month-on-month and -6.5% year-over-year in August, while the inventory of unsold homes increased 5.1% and 21.3% in the same periods.
- About 9,611 Houston homes (1 of every 232 households) were in a stage of foreclosure during 2Q10, a 14.4% decrease from 1Q (RealtyTrac).



EMPLOYMENT TRENDS

Non-Seasonally Adjusted

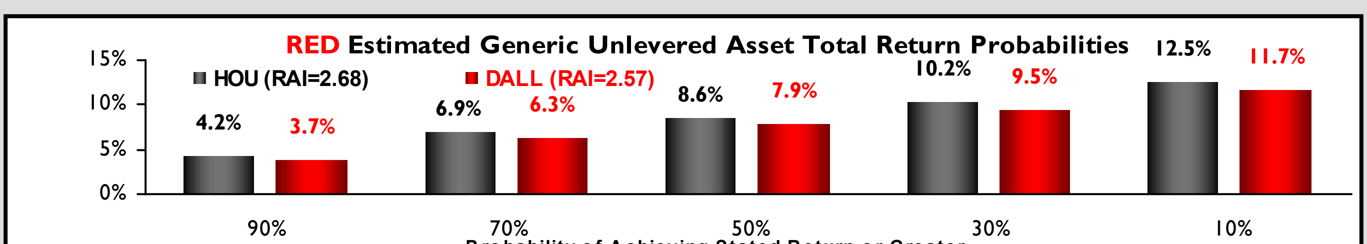
- Metro Houston payrolls declined at a 27,000-job, -1.1% pace in 2Q10, comparing unfavorably to –0.5% and +0.3% rates observed in the U.S. and Texas, respectively. Nevertheless, the 2Q data were a distinct improvement from 1Q10's 76,400-job, -3.0% result.
- Improved performance in 2Q10 relative to 1Q was attributable to improved hiring conditions in the mining/extraction, durable goods manufacturing, business service and government sectors. The forego-ing recorded attrition of 38,400 jobs y-o-y in 1Q but losses at only a 4,200-job pace during 2Q.
- The unemployment rate in July was 8.8%, equaling the existing 21-year data series record high set in February 2010 and again in June.
- Energy exploration and refinement activity seemed to gain momen-tum during the summer. Extraction and refining sector employment increased 2,800 jobs y-o-y in July, and smaller gains were recorded in field equipment manufacturing and technical field services.



Seasonally-Adjusted

- Houston payrolls increased sequentially in each month from February to May, rising 20,200 jobs during the period. Losses were incurred in January, June and July, however, holding the year-to-date gain to 13,900 jobs.
- Temporary Census data collection jobs accounted for as many as one-half of the net 2010 year-to-date gains.

Forecast: After underperforming national year-on-year payroll trends since December, the economic recovery should gain momentum in the fall. Our econometric payroll model forecasts a small -2,900-job y-o-y loss in 3Q10, accelerating to a 21,700-job advance in 4Q. If the economy performs as well as our base GDP forecast suggests, gains should con-tinue to accelerate through mid-year 2012, producing a net add of 47,500 jobs in 2011 and 74,300 jobs in 2012.

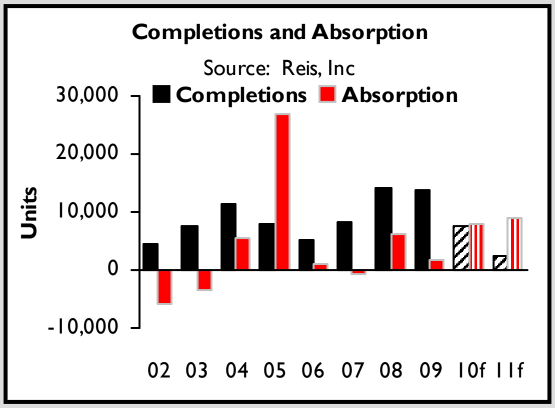


SUBMARKET TRENDS

Submarket	Effective Rent 2Q09	Effective Rent 2Q10	Effective Rent Change	Physical Vacancy 2Q09	Physical Vacancy 2Q10	Physical Vacancy Change
Alief / Kirkwood	$585	$577	-1.4%	12.0%	14.1%	210 bps
Baytown	$556	$543	-2.3%	13.0%	20.2%	720 bps
Bear Creek/Katy	$769	$787	2.3%	9.7%	9.2%	-50 bps
Braeswood / Bellaire	$973	$992	1.9%	11.0%	10.0%	-100 bps
Briar Forest	$759	$747	-1.6%	11.2%	10.6%	-60 bps
Briar Grove	$794	$821	3.4%	7.4%	10.4%	300 bps
Champions / FM 1960	$657	$659	0.2%	18.4%	16.9%	-150 bps
Clear Lake / NASA	$749	$736	-1.7%	11.0%	11.0%	Unchd
Cloverleaf	$565	$573	1.3%	13.0%	16.2%	320 bps
Cypress / Fairbanks	$792	$776	-2.0%	13.6%	10.5%	-310 bps
Far Northwest / Montgomery	$761	$759	-0.3%	15.1%	13.6%	-150 bps
Fondren / Westbury	$557	$570	2.3%	12.7%	13.5%	80 bps
Fort Bend County	$877	$887	1.1%	8.0%	7.4%	-60 bps
Imperial Valley	$527	$525	-0.3%	14.6%	16.9%	230 bps
Interloop / South Houston	$635	$642	1.1%	11.6%	11.6%	Unchd
Inwood / Near Northwest	$593	$590	-0.5%	12.1%	16.3%	420 bps
Montrose / River Oak	$1,090	$1,123	3.0%	8.0%	12.0%	400 bps
North / Northeast Houston	$630	$645	2.4%	10.5%	9.4%	-110 bps
Northborough	$563	$560	-0.6%	16.0%	20.5%	450 bps
Pasadena / Deer Park	$584	$591	1.2%	10.5%	11.4%	90 bps
Sharpstown	$564	$565	0.2%	9.9%	12.8%	290 bps
Spring Branch	$636	$668	5.0%	9.5%	12.4%	290 bps
Spring / Humble	$729	$763	4.7%	14.3%	11.2%	-310 bps
Metro	**$713**	**$723**	**1.4%**	**11.5%**	**12.4%**	**90 bps**

SUPPLY TRENDS

- After reaching as high as 19,800 units in late 2007, the trailing 12-month total of issued 5+ unit structure building permits dipped to 2,628 in March. Permitting accelerated in the spring, however, raising the trailing-12 metric to 3,657 units in July.
- Reis identify four major apartment properties underway in late July, encompassing a total of 1,151 units. Reis added 22 projects to the Houston completed inventory in 1H10 encompassing a total of 6,151 units. Seven projects containing more than one-third of the total units are located in the Montrose submarket.
- Five Upper Kirby projects completed in 2009 and 2010, encompassing a total of 1,510 units, were 70% occupied in June at rents averaging $2,047 per occupied unit.
- A 119-unit Upper Kirby "boutique" mid-rise was about 67% occupied in June at rents averaging $3,245. The first tenants moved in last fall.



Daniel J. Hogan
Director of Research
djhogan@redcapitalgroup.com
614-857-1416

William T. Hinga
Business Development
wthinga@redcapitalgroup.com
614-857-1499

RED CAPITAL GROUP
Two Miranova Place
Columbus, OH 43215
www.redcapitalgroup.com
800.837.5100