RED CAPITAL RESEARCH

Texas Region Report

THIRD QUARTER 2008

EXECUTIVE SUMMARY

National Economic Trends

- Condition in the US economy continued to deteriorate in 3Q08. The -0.5% preliminary estimate of third quarter GDP growth represented the second quarterly contraction in the last four quarters. The decline was largely attributable to a reduction in personal consumption expenditures. PCE advanced 1.2% in 2Q08 but declined -3.7% in 3Q08.

- Payroll employment trends took a dramatic turn for the worse in September. In the first eight months of 2008, a net of 655,000 jobs were trimmed from payrolls. A monthly average of 418,600 positions were cut in September, October, and November. Weak retail sales figures do not bode well for seasonal hiring, indicating that significant job losses will persist through year-end.

- In his latest forecast, National City Bank economist Richard DeKaser predicts that GDP will continue to contract through 1Q09. Mr. DeKaser projects a -4.7% decline in 4Q08 and a -2.6% drop in 1Q09. Consistent with reduced output, establishments are forecast to shed about 2.7 million payroll employees (-1.5%) next year, giving rise to a 7.9% unemployment rate.

Texas Region Economic and Housing Trends

- The Texas economy remained among the strongest in the country, despite facing headwinds from falling energy prices. Lone Star state establishments added a seasonally-adjusted 30,900 positions to payrolls in 3Q08, the largest job gain among the 50 states. Still, the third quarter increase was much slower than the 72,600 gain in the previous quarter.

- State housing trends were relatively firm in the third quarter. The Real Estate Center at Texas A&M University report that the median home price fell -1.2% year-over-year to $145,000 in September. Transaction velocity fell -15% year-over-year as 63,723 homes were sold in 3Q08. The National Association of Realtors estimate a -7.1% sequential decline in sales activity, measured on a seasonally-adjusted basis.

Total Return Analysis

- The expected rate of total return for each of the five major Texas metro areas exceeded the **RED** 50 average in our most recent analysis. At 7.8%, the expected return in San Antonio is the highest of the **RED** 50; Fort Worth and Austin rank third and fifth, respectively. The expected return in Dallas and Houston ranked 18th and 22nd, respectively.

- By contrast, San Antonio was the only Texas metro that produced an above average measure of risk-adjusted return.

Investment Rankings

- **RED CAPITAL Research** (**RCR**) believe that Texas apartment markets produce healthy rates of total return for investors, owing to above average going-in yields and relatively strong forecasts for rent and occupancy. On the other hand, elevated historic revenue growth volatility produces lower levels of risk-adjusted return.

- We assign "***Accumulate***" rankings to Dallas and San Antonio assets as both markets exhibit robust measures of expected total return and San Antonio displays an excellent risk-adjusted return. We are only slightly less enthusiastic about Austin and Fort Worth investments. Austin cap rates are "rich" relative to underlying fundaments, we advise that investors purchase assets priced at a discount. We are cautious about Fort Worth as secondary and tertiary markets are trading at a deep discount. Finally, we provide an "***Opportunistic***" ranking to Houston assets. Reis are skeptical of future rent growth, owing to the significant supply pipeline.