

EXECUTIVE SUMMARY

National Economic Trends

- The pace of economic expansion was considerably weaker in the fourth quarter 2007. Real gross domestic product advanced at a 0.6% seasonally-adjusted annual rate, significantly below trend and comprehensively slower than the 4.9% surge recorded in the third quarter. The housing downturn was largely to blame: residential fixed investment fell 25.2%, as developers cut production in order to stem a sharp rise in unsold home inventories. Personal consumption advanced at a 1.9% rate, down from 2.8% in 3Q07, and import levels fell 1.9% on sluggish domestic demand. The decline in spending was felt most acutely at retailers exposed to the housing industry, especially building supply, home furnishings and department stores, which registered declining sales year-over-year. Even export growth, which ignited the economy in the third quarter, decelerated significantly, dropping from a 19.1% burst in 3Q07 to a more modest 4.8% advance.
- January and February payroll data suggest that the economy continued to decelerate in 2008 and raised the prospect that GDP growth will be negative in the first quarter. Establishments trimmed 22,000 and 63,000 jobs, respectively, in January and February, the first seasonally adjusted losses recorded since August 2003. On a year-over-year basis, payroll employment rose 0.6% in February, the slowest annual comparison observed in 48 months. New orders for manufactured goods fell 2.5% in January, following a 2.0% increase in December. This decline was primarily attributable to reduced demand for cars, trucks and other transportation equipment, which fell 13.0% following a 10.1% gain posted in December.
- National City Bank economist Dr. Richard DeKaser forecasts GDP growth to decelerate to 1.9% in 2008 but rebound to 2.5% in 2009. Similarly, the rate of payroll growth is expected to fall to 0.6% this year, and accelerate to 1.1% in 2009.

Texas Region Economic Trends

- Texas non-farm employment increased 239,200 jobs in 2007 or 2.9%. The state's performance was a moderate deceleration from the 325,700-job, 3.3% growth registered in 2006.
- Texas unemployment averaged 4.3% in 2007, down 60 basis points from 2006 and 30 bps below the national average. The state extended its advantage over the nation in March when Texas unemployment declined to 4.2% while the national rate increased to 5.2%.
- Texas job growth decelerated moderately in the fourth quarter, slowing to a year-over-year 264,200-job, 2.6% rate. Further slowing in construction, finance and transportation pushed year-over-year growth to 239,200 (2.3%) in the first quarter 2008.
- The **RCR** payroll employment model generates an optimistic forecast for the Texas economy. The model projects that the Lone Star State will produce between 165,000 and 204,000 jobs in 2008 with a point estimate of 184,000 (1.8%). The model yields a moderately faster, 190,000 (1.8%) job forecast for 2009. The confidence interval for that year ranges from 143,000 to 236,000 jobs.

Total Return Analysis

- San Antonio remains one of the most compelling investment opportunities among the **RED 50** markets. With generic going-in cap rate of 7.0% and constructive rent and occupancy forecasts from Reis, **RED CAPITAL** Research calculate generic most probable 5-year holding period returns approaching 10%, highest among the **RED 50**. The four other major markets in Texas offer expected total returns in the low- to mid-7% range, considerably above the **RED 50** average.

Investment Rankings

- San Antonio exhibits the economic characteristics of a growth market coupled with the going-in yield and low-volatility qualities of a high-yield market. Although **RCR** are not convinced that Reis's rent and occupancy forecasts are achievable metro assets merit an enthusiastic "**Accumulate**" rating. Dallas, Fort Worth and Houston are prototypical growth markets capable of rapid demand and supply expansion. While **RCR** are generally wary of recommending investments in commodity markets, asset pricing and apartment market and economic fundamentals have improved to such a degree that we feel compelled to make exceptions for these metro areas. We now rank Dallas and Houston among markets in which investors can begin active buying programs and assign "**Accumulate**" rankings accordingly. Fort Worth is only a step behind but higher historical volatility and owned housing affordability relegate it to the ranks of the "**Opportunistic**" group. Austin assets are richly priced and NOI volatility is high, but we like the fundamentals nonetheless: **Accumulate** Austin assets with extreme caution and with a view toward value and price.