RED CAPITAL GROUP®

Market Overview

Houston, Texas

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Multifamily Housing Update **February 2011**

EXECUTIVE SUMMARY

Bayou City employers added 8,900 (0.3%) workers year-over-year in the fourth quarter, the first gain observed since 4Q08. Job formation was particularly strong among durable goods manufacturers, health care and leisure service providers. Combined, the sectors created 17,300 jobs y-o-y in 4Q10, comparing favorably to the 13,300-job advance in the previous quarter. Additionally, annual construction job attrition decelerated sharply from –11,100 jobs to only –3,200 jobs.

Data from the BLS's household survey show more robust job growth in the metro area as total employment rose 15,210 (0.6%) in 4Q10. But the unemployment rate edged higher—from 8.2% in December 2009 to 8.3% in December 2010—due to faster growth in the area's labor force.

The outlook for the Houston metro economy is uncertain. The Manpower Employment Outlook Survey reveals that 11% of area firms plan to add workers in 1Q11, on par with percentage of companies that expect to shed jobs. By contrast, companies were comparatively optimistic in the September survey as 18% planned to expand and only 9% predicted contraction.

Still, the **RED CAPITAL Research** (**RCR**) econometric model projects a modest 19,100 (0.8%) job gain this year and a strong 53,400 (2.1%) job advance in 2012. Economy.com expect more robust payroll growth averaging 3.5% per year in '11 and '12.

Area home prices rose but sales activity fell during the fourth quarter. The National Association of Realtors report a 2.7% y-o-y increase and the FHFA purchase only-home price index advanced 0.8% y-o-y in the fourth quarter. The Real Estate Center at Texas A&M University count 12,619 single-family home and condo sales during the fourth quarter, down –18.4% from 4Q09.

Stout apartment demand and limited supply contributed to a sharp 80 basis points sequential increase in occupancy from 88.5% in 3Q10 to 89.3%. Property managers net leased 4,116 units and developers completed only 393 units from October to December. Tenant demand (12,212 units) was particularly strong for Class-A assets last year. By contrast, managers of Class B/C properties net leased 2,292 units during the year.

Rent trends also rebounded during the fourth quarter, even as concession remained nearly unchanged. Following a 1.7% y-o-y increase in 3Q10, the average effective rent rose at a 2.7% annual pace in the fourth quarter. By comparison, the size of the average concession package edged only slightly lower from 7.7% of asking rent in 4Q09 to 7.5% in 4Q10. With regard to y-o-y asking rent growth, Class-A trends (+3.3%) far outpaced the 0.8% increase observed among Class B/C properties.

Reis foresee a robust 5.4% increase in effective rent this year, reminiscent of 1999 and 2000 gains, fueled by favorable supply/demand fundamentals. The service predicts that developers will add only 1,918 units and property managers will net lease 8,013 units during the year.

Real Capital Analytics identify 68 transactions involving properties priced at or above $5 million in 2010. Sales volume totaled $1,228.1 million and the average price per unit was $79,984. Based on an assumed 5.5% going-in yield, **RCR** calculate 9.9% expected rate of total return, ranking 17th highest among the **RED** 50. But high levels of historic occupancy trend volatility contribute to a below average measure of risk-adjusted return in the group.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (10.7% - 4Q10)	↓ 160bps	↓ 120bps
Effective Rents ($728 - 4Q10)	↑ 2.7%	↑ 5.4%
Cap Rate (6.0% - 4Q10)	↓ 100bps	↓
Employment (2,534.2m - 4Q10)	↑ 8.9m	↑ 19.1m

KEY POINTS

- Metro vacancy decreased 80 basis points sequentially and 160 basis points year-over-year to 10.7% in 4Q10. Strong demand was largely responsible. Tenants net occupied 2,427 Class-A units and 1,691 Class B/C units during the fourth quarter.
- Effective rent increased 0.8% sequentially to $728 in 4Q10. As a result, annual effective rent trends improved from 1.7% in 3Q10 to 2.7%. The size of the average concession package fell from 7.7% of asking rent in 4Q09 to 7.5%.
- Reis predict that vacancy will fall 120 basis points and effective rent will surge 5.4% during 2011. The source forecasts solid fundamentals thereafter as vacancy falls to 7.8% by December 2015 and the average effective rent advances at a 3.0% annual pace from 2012 to 2015.
- According to the National Association of Realtors, the median price of a single-family MSA home increased 2.7% year-over-year from $150,000 in 4Q09 to $154,100 in 4Q10.
- Real Capital Analytics estimate sales volume of $1,228.1 million in 2010.