

Mid-Year
2002

RESIDENTIAL DEVELOPMENT LEADS DFW



Dan Mahoney
Vice President
HSM Development, Inc.

Real estate trends start and end with the creation of quality jobs. The Dallas and Fort Worth area added between 75,000 to 125,000 jobs each year from 1993 and 2000. In the last year and a half (2001 & 2002), the D/FW area experienced a contraction of more than 36,000 jobs. What does this tell us about real estate? It stands to reason that real estate activity would slow down as well. However, this doesn't seem to be true according to DFW Real Estate Report published by Chicago Title and RMS Information Services. The dollar volume of real estate transactions in the DFW area increased 14.1% in the first half of 2002 compared to 2001. As for the housing sector closings, it was no exception.

Housing continues to set new records with 38,211 housing starts in the DFW area and record starts are occurring nationwide. Who's buying all these homes? Relocations to the D/FW area aren't as prevalent as they were in the late 1990s because of an in-place, capable workforce available to potential area employers. The primary incentive to purchase residential housing can be summed up with the best financial terms in forty years and the perception of residential real estate as a safe investment. The changing demographic of an aging population, which is interested in different types of housing, is part of the equation. The demand for new and used home purchases seem to be coming from the rental housing and step-up or down housing market sector, who feel the time is right to change their housing style. Additionally attractive to home purchasers are the amenities in the homes, communities and schools. The home purchasers are buying in the newer communities along the outer ring of the growth cities of the 1980s and 1990s; such as: Keller, Corinth, Frisco, Prosper, Rockwell, Flower Mound and McKinney. Also, they are transforming and renewing the inter-cities of Uptown Dallas, and Downtown Fort Worth by purchasing higher density housing types in mixed-use communities.

Resent trends through the first half of 2002 does show a slight decline in new housing starts, but a continued rise in house closings for the DFW area. This condition has resulted in a reduced supply of available housing and a need to increase the supply to keep pace with demand. Developers are looking for affordable land adjacent to the expanding infrastructure of fringe cities.

According to the North Central Texas Council of Governments (NCTCOG), 58% of the developed land in the 16 county DFW area is residential. Residential land uses are nearly three times the land area used for industrial, commercial, and institutional uses combined. Residential land within the NCTCOG area supports a population of over five and a half million people. It is estimated that over 150,000 people a year have moved into the area over each of the past three years and at least 100,000 per year over the past six years. If we keep this pace of growth, the D/FW area will add between 1 and 1.5 million people per decade to its population. The NCTCOG projects that by 2040 the DFW area will double in population to 11 million. For the real estate community, this is a great challenge as to where to shepherd this growth. For community leaders, it is an even greater challenge as to how the new growth will be financed and served.

The average number of persons per housing unit (single family, multi-family, etc) is 2.56. To accommodate the housing needs for the projected growth, the DFW area needs to build between 39,000 to 58,500 housing units a year for a population increase of from 100,000 to 150,000 per year. Metro/Study reported 39,260 housing starts and 37,615 closings last year. Using NCTCOG's figures of 16 residential acres for every 100 peoples, we will need to convert between 6,200 to 9,400 acres to residential land each year for the next four decades. That is ten to fifteen square miles per year or an area the size of Las Colinas to accommodate the demand for housing.

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Where will the growth take place? We know that in this part of Texas the growth will take place generally upstream of the existing infrastructure or to the north and west of our central cities of Dallas and Fort Worth. The cities of Denton, Frisco, Keller and McKinney will become major cities over the next couple of decades. The cities adjacent to the Dallas Fort Worth International Airport: Fort Worth, Dallas, Irving, Coppell, Grapevine, and Grand Prairie will benefit from commercial and industrial development. The North Texas Toll Road Authority, Texas Department of Transportation, DART and the Fort Worth "T" have the challenge of providing transportation to an area trying to get people from home to work and back again. The City of Dallas, North Texas Water Commission and Trinity River Authority are responsible for the water demand of a limited resource, which is projected to run short when the area reaches a population of 7.5 million people. Land development will take place in concert with federal, state and local regulations, which are using increasingly more stringent policies enacted for the benefit of the general population. Community policy makers will look for opportunities to combine land uses and densities to place housing closer to work places; such as Addison Circle, Las Colinas Urban Center, Uptown Dallas, CentrePort, Mercer Crossing and Downtown Plano. Mixed use development planning will help to reduce the demand on our resources and make for a more efficient urban environment.

Henry S. Miller Development Company is in the residential lot development sector because of the monumental potential. Developing residential land dictates the urban patterns that will form the future DFW area. Where residential land develops, the market for retail and institutional land development follows. The workplace centers need comfortable commutes from residential communities and commercial development will seek proximity to housing. Emerging cities are faced with the task of facilitating infrastructure to support the growth. The residential developer, because they are the first land use into an area and consume the largest land areas, will shoulder most of the infrastructure requirements. To maintain the environment enjoyed by the citizens of DFW area, it takes the vision and the will of many talented leaders.

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TRENDS - The information contained herein is the result of a survey of participants in the commercial real estate markets of North Texas for the first half of 2002. The respondents include local and national developers, asset managers, loan officers in local and national lending institutions, brokers, as well as consultants, mortgage bankers and individual investors. Some of the data reported reflects a weighted average using the transactions and

total dollar amounts as the basis. Thus, the respondents that were the most active within the period had more influence on the data reported.

The responding group as a whole participated in 389 transactions totaling approximately \$1.31 billion during the first half of 2002. Of the respondents 8.3% were investors, 75.0% were brokers and 16.7% were other real estate professionals.

"Who are the active buyers in today's market?" The following chart reflects the actual buyers, based on the number of transactions, according to the respondents.

ACTIVE BUYERS

End Users	6.4%
Out-of-State Investors	6.3
Local Investors	86.3
Other	1.0

The following table shows the sources of funds used in the transactions (based on the dollar amount of the transactions).

SOURCES OF FUNDS

Local Lender	76.9%
Non-Texas Bank	19.1
Individual/Cash	2.7
Other (Owner-Financed, Gov't, etc.)	0.5
Insurance	0.5
Credit Companies	0.3

Direct capitalization, expressed as a rate, converts a single year's net operating income into a value. The market recognizes three types of "Cap Rates." The "going-in" rate is based on the investor's analysis of the current income at time of purchase. The "stabilized rate" is based on the investment's typical operating year at a stabilized occupancy. The "reversion rate" is the capitalization rate anticipated by investors at the time of resale.

CAPITALIZATION RATES

Property Type	Going-In		Stabilized		Reversion	
	Avg	Range	Avg	Range	Avg	Range
Apartments	8.8%	8.0-10.0%	8.9%	8.0-10.0%	9.4%	8.8-11.0%
Office	10.3	9.0-12.0	9.8	9.0-10.0	10.0	9.5-10.5
Retail	10.0	9.0-11.0	10.3	9.3-11.5	10.7	9.5-13.5
Industrial	9.3	8.5-10.0	9.7	8.5-11.0	10.4	9.0-12.0
Hotel	10.6	5.0-13.0	12.7	12.0-13.0	13.5	12.0-14.0



The capitalization rates reported are more reflective of Class A and B type properties and are broken out as follows: Class A – 41.8%, Class B – 44.9% and Class C – 13.3%.

A discount rate (interest rate to the lender, yield to the investor) is the rate that equates the property's present value to its future income over a period of years and eventual resale. The following table presents the range and the average discount rates, as compared to mid-year 2001. The discount rates presented in the table were allocated by property as follows: Class A – 49.4%, Class B – 41.6% and Class C – 9.0%.

DISCOUNT RATES

Property Type	Mid-Year 2001 Average	Mid-Year 2002 Average	Mid-Year 2002 Low	Mid-Year 2002 High
Apartments	9.8%	9.9%	8.0%	12.0%
Office	10.7	12.3	11.0	15.0
Retail	12.1	11.3	9.5	15.0
Industrial	10.3	10.4	9.5	12.0
Hotel	14.3	13.8	6.0	20.0
Ground Leases	9.0	9.9	8.0	14.0

We asked the respondents to estimate changes in revenue and expenses by property type, which is demonstrated in the following table.

REVENUE AND EXPENSE EXPECTATIONS

The following table reflects market averages and ranges

Property Type	YEAR 1		YEAR 2		THEREAFTER	
	Rev.	Exp.	Rev.	Exp.	Rev.	Exp.
Apartments	1.55%	2.82%	2.30%	3.00%	2.80%	3.00%
Office	-0.78	3.36	0.78	3.20	2.89	3.20
Retail	2.40	2.67	2.78	2.64	2.78	2.64
Industrial	1.63	2.38	2.00	2.38	2.56	2.56
Hotel	4.25	3.20	4.00	3.00	3.90	3.10

for finish-out in office, industrial and retail properties. These are shown on a per square foot basis. Please note that the ranges for industrial reflect both bulk and flex type space. The upper end reflects flex space, with the lower end being more representative of warehouse or bulk type space, which is usually only applied to the office portion.

FINISH-OUT

Property Type	New			Renewal		
	Avg	Low	High	Avg	Low	High
Office	\$21.89	\$10.00	\$40.00	\$11.38	\$8.00	\$20.00
Industrial	6.85	0.13	15.00	2.54	0.25	5.00
Retail	15.50	5.00	25.00	8.00	3.00	17.00

When asked what would be a reasonable exposure time for a property to sell in the open market, the respondents answered as follows:

REASONABLE EXPOSURE TIME (MONTHS)

Property Type	Months	Property Type	Months
Apartments:		Land:	
Class A	7.3	Leased Fee Sites	7.4
Class B	7.9		
Other	8.0		
Office:		Industrial	
High Rise	11.6	Bulk Warehouse	7.5
Class A Suburban	9.9	Office/Warehouse	7.8
Class B	11.1	Tech Flex	10.5
Other	11.7		
Retail		Hotels:	
Regional	10.2	Full Service	14.0
Community	7.6	Limited Service	13.9
Neighborhood	6.6	Economy	13.1
Unanchored	7.5		

The following table reflects the anticipated term of ownership (from acquisition to resale) for certain property types.

HOLDING PERIOD (YEARS)

Property Type	Average	Range	Mode
Apartments	4.1	2.0-5.0	5.0
Office	7.3	3.0-10.0	10.0
Retail	5.8	3.0-10.0	7.0
Industrial	7.3	3.0-15.0	5.0
Hotels	6.8	5.0-10.0	5.0
Ground Lease	10.7	3.0-25.0	10.0



Investment Opportunity in 2002

Industrial properties were viewed as being the best investment opportunity, followed by apartments then retail, land, office and hotel properties. The participants were asked to provide their forecast for the remainder of 2002: 4.8% said great, 9.5% think good, 76.2% say stable and 9.5% anticipate a decline.

We asked the investment community about their acceptable returns when investing in land. The following yield rates reflect primarily unleveraged returns.

YIELDS FOR LAND

Property Type	Average	Low	High
Pad Site	19.5%	8.0%	50.0%
Industrial	15.7	10.0	25.0
Residential Lot Development	23.5	18.0	33.0
Speculative Land Purchase	30.2	20.0	35.0

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Henry S. Miller Commercial - Dallas

5001 Spring Valley Road
1100 Providence Towers West
Dallas, Texas 75244

Phone (972) 419-4000
Fax (972) 419-4099
email: consult@henrysmiller.com

We asked the respondents what they used for a stabilized vacancy and collection loss when analyzing different property types. The following table summarizes their responses, presenting both the average and the mode.

VACANCY & COLLECTION LOSS (AVG & MODE)

Multi-Tenant	Loss (%)	Single Tenant	Loss (%)
<u>Retail:</u>		<u>Retail:</u>	
Strip Center	7.8 / 10.0	Credit	3.1 / 5.0
Neighborhood	6.7 / 7.0	Non-Credit	7.1 / 5.0
Anchored	6.1 / 7.0		
Multi-anchor	5.6 / 5.0		
<u>Office:</u>		<u>Industrial:</u>	
Class A	9.5 / 10.0	Credit	3.6 / 5.0
Class B	11.5 / 15.0	Non-Credit	7.7 / 10.0
Garden (Class C)	12.7 / 15.0		
Small	9.8 / 10.0		
<u>Industrial:</u>		<u>Office:</u>	
Bulk	7.0 / 5.0	Credit	4.2 / 5.0
Flex	9.9 / 10.0	Non-Credit	9.3 / 5.0
<u>Apartments:</u>			
Class A	8.2 / 7.0		
Class B	8.5 / 8.0		
Class C	9.6 / 10.0		

Henry S. Miller Commercial - Houston

3050 Post Oak, Suite 150
Houston, Texas 77056

Phone (713) 626-2828
Fax (713) 626-5277

Henry S. Miller Commercial - Austin

9111 Jolleyville Road, Suite 100
Austin, Texas 78759

Phone (512) 794-9400
Fax (512) 794-9515

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