Dallas Office:
16660 Dallas Parkway
Suite 1200
Dallas, Texas 75248
(972) 381-1400
www.residentialstrategies.com

Austin Office:
1250 S. Capital of Texas Hwy,
Bldg. III
Suite 400
Austin, Texas 78746
(512) 329-2800
www.residentialstrategies.com

Dallas-Fort Worth Executive Summary

Second Quarter, 2010

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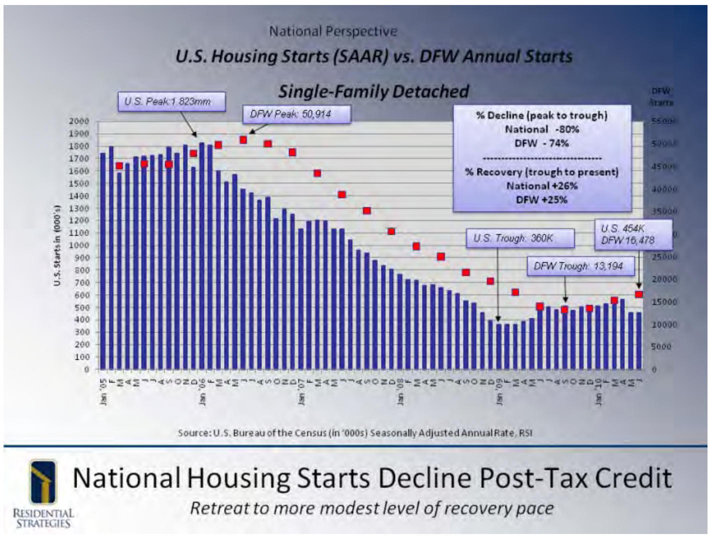
National Housing Conditions



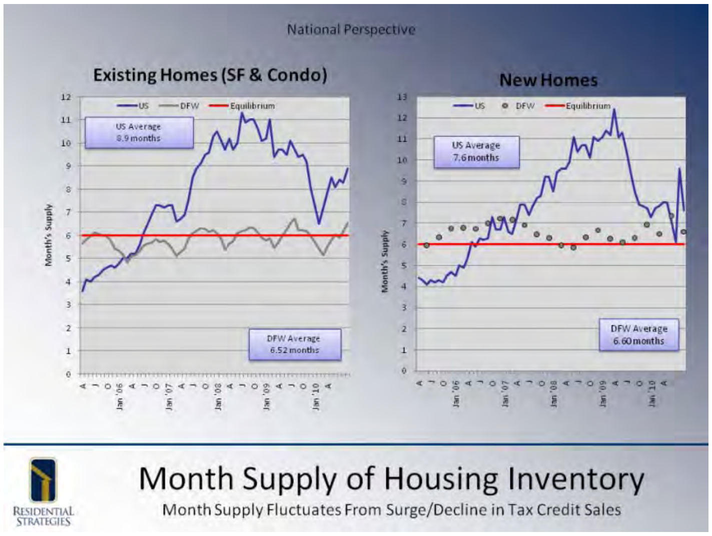
The DFW new home industry entered a new phase of the recovery cycle this past quarter. The tax credit programs that helped carry DFW and the rest of the nation through a weak period of housing demand expired on April 30th. Going forward, homebuilders must now rely on economic growth to create the new jobs that will ultimately become the demand for new housing.

The good news is that the economy is now starting to turn the corner with respect to job formation. But cautionary flags remain insofar as the pace of the economic recovery is happening much more slowly than desired.

Begin by looking at the national chart above depicting US single-family detached housing starts and comparing them to DFW activity. Note that the trough in the U.S. cycle occurred about 18 months ago back in January, 2009, when the annual rate hit a low of 360,000 units. Since then, the market has recovered by about 26%. There have been two interim surges in the recovery cycle: one that occurred last fall with the initial announcement of first time homebuyer tax credits and then again this past Spring with the expansion and extension of the tax credits.

The DFW housing market has largely followed the same trend as the rest of the nation. While the peak to trough decline was only 74% versus the 80% decline nationally, the recovery since last Fall of about 25% parallels that of the US recovery.

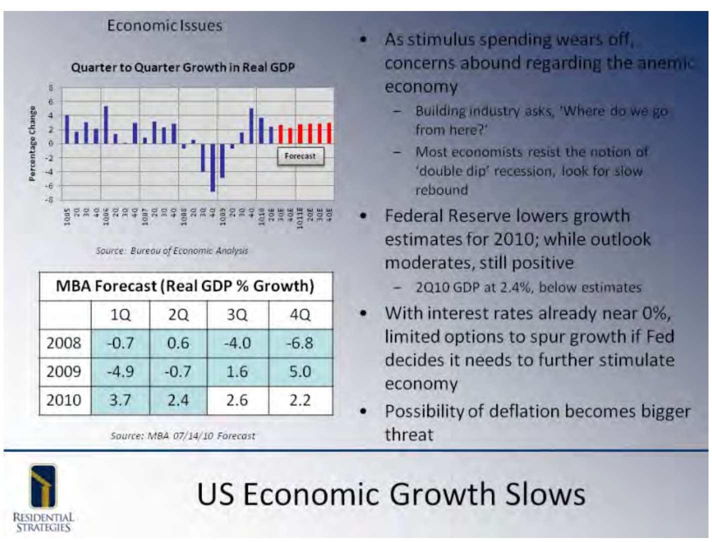
Housing Inventory



The charts to the left show the month supply of new and existing houses for the US and the DFW market. The US month supply is depicted by the solid blue line and indicates the fact that the housing supply across the country is gradually returning to levels considered equilibrium. Although the month supply has fluctuated somewhat in recent months, much of this stems from the ebb and flow of closing activity brought about by the tax credit.

Figures released August 3rd, showed that contracts to purchase previously owned homes fell 2.6% in June, part of the expected post-tax credit slowdown. In absolute numbers, since the first of the year, inventory for existing homes has climbed from about 3.3 million to 4 million houses, while the supply of new homes has actually declined from 232,000 to 210,000 units.

Notice that the Dallas-Ft. Worth market, for both new and existing houses, continues to straddle the 6 month supply level which is considered equilibrium for total housing.



US Economic Growth

So with the tax credit stimulus now gone from the equation, a lot of builders are asking, "What now?" To explore this question, it is important to analyze the current economic condition of the United States. GDP disappointingly increased at a slower rate in 2Q10 compared to the more robust periods of 4Q09 and 1Q10. With these lower than expected figures, the reality is setting in that this slower growth pace has become the new norm. At the Fed meeting in June, and in Bernanke's July's testimony to the Senate Finance Subcommittee, it was revealed that Federal Reserve officials have lowered their estimates regarding the growth outlook for the economy in

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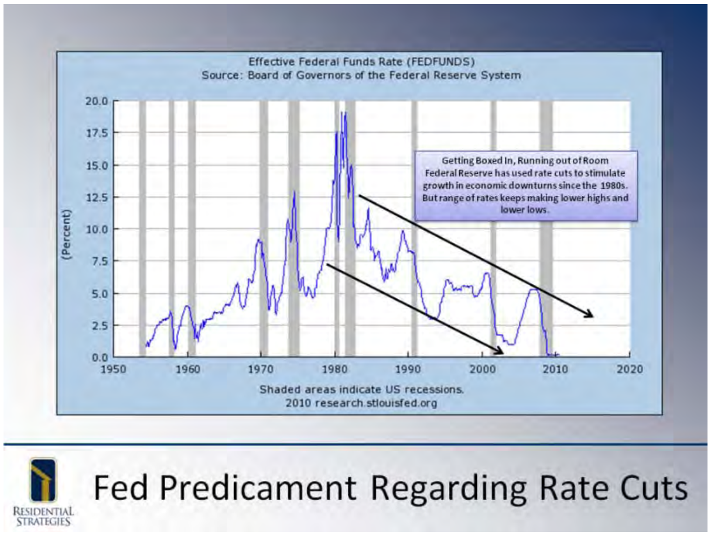
the Second Half of 2010 as well. While it remains anticipated that growth is still in a positive direction, and that the economy will not fall into a double-dip recession, the recovery is happening more slowly than the Obama administration would like.



As the Fed debates ways in which to boost the economy, the concern is that they don't have many bullets left in their gun to provide this stimulus. With interest rates already effectively at 0%, the Fed lacks the most effective tool they have used in the past, namely the ability to cut rates.

Interestingly, just this past Spring, the Federal Reserve was in a mode of stepping back from its stimulus policies such as the purchase of Mortgage Backed Securities. In fact, they were even having some discussion regarding the possibility of raising interest rates down the road. At this point, however, the Federal Reserve seems conflicted as to whether they should leave policy alone and let the economy follow its current, albeit slow recovery process, or whether they should intervene yet again and reapply some form of stimulus that would expand the Government's balance sheet to ensure economic growth.

What is becoming less and less of a concern is inflation. Initially, as the Fed had cut rates and pumped up the money supply, there were legitimate concerns that this could lead to a surge in the growth of inflation. However, with excess capacity in most segments of the US economy, a more legitimate concern is that of deflation. With the employment picture still very anemic, and US banks still filled with trouble loans, there have been parallels drawn that compare the US situation to that of Japanese economy in the 1990's and 2000's.

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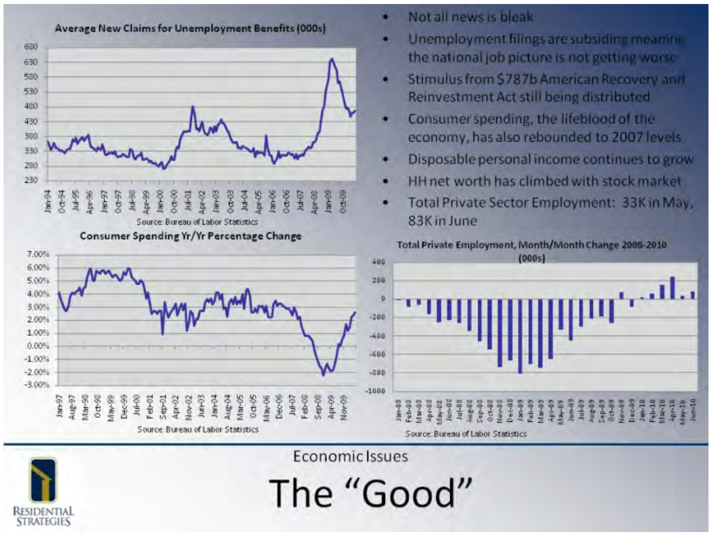
Economic Issues



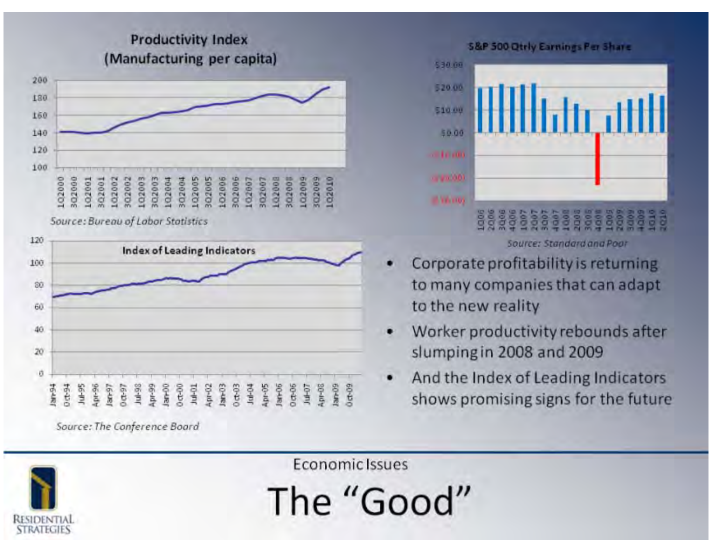
The Good

While the Fed ponders the issues of how to resurrect the economy, the reality is that not all of the news is bad. In the chart here to the upper left, notice that the number of unemployment filings has declined dramatically since 2009. Although the government has lately been debating issues such as extending unemployment claims, the point is that Americans are no longer being laid off at the same pace as they were from 2007 to 2009.

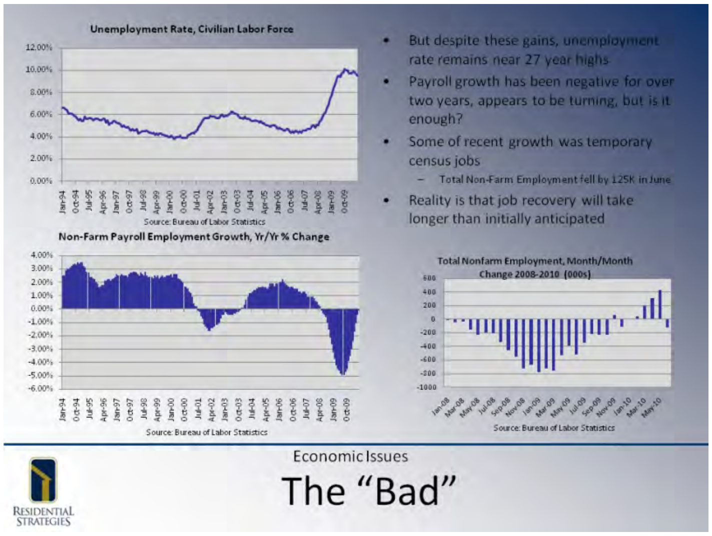
Another note that should be mentioned is that the $787b Stimulus Act that the government has implemented has not been fully distributed through the states.

In evaluating the GDP components, we observe that the Residential Fixed Investment component of GDP continues to be extremely reined in and not the normal leading sector that pulls the economy out of the downturn. But what is good news is that the consumer is spending again. Despite the June figures recently released that showed no advances for the month, the general trend has been that spending has increased gradually since 2007. Additionally, personal income has grown.

Although the stock market continues to fluctuate in recent months, the Dow Jones is well off of lows experienced back in late 2008, and with recent surges, has bolstered household net worth. And finally, although it is still in the infancy of a recovery, there are some indications that private sector employment is starting to grow again.



Much of the recent growth in the equities market can be attributed to increases in corporate profitability, and because of the lack of hiring, the market is seeing huge increases in worker productivity of late. Looking ahead, the Index of Leading Indicators shows promising signs for the future, and this, as previously mentioned, has led most private economists to believe that the economy will avert the much feared double-dip recession.



The Bad

This is not to say that there are not major concerns with the economy. Most important is that regarding employment. The unemployment rate remains stubbornly high near 10%. Under-employment (defined by people working less than 35 hours a week) may be closer to a staggering 20%.

While it appears that unemployment has crested and that the non-farm and private sector employment growth has turned positive, note that total employment did fall in June as many of the temporary census workers were let go. So the question remains, how long will it take for the employment picture to get back to normal? With over 8 million jobs lost during the downturn and only modest growth today, it could be a long haul. Many economists are saying it may take 4 to 5 years for the unemployment rate to get back down to a more reasonable level. For a start, the market needs to be able to produce jobs at a faster rate than the labor force is expanding.

The negative news that continues to surround employment is weighing on the consumer's mind. The Consumer Sentiment survey, depicted to the left and produced by the University of Michigan and Reuters, declined 10 points in July, reflecting the concerns about the slower growth in the economy.

And there are many other issues that have not been discussed. Commercial real estate continues to be a drag on banks' balance sheets. There has also been a lot of criticism of the banking system's behavior of just kicking the can down the road rather than realizing losses. Understand that the FDIC's funding is generally limited to a line of credit from the Treasury Department, so it can't tolerate potential massive bank failures. So for now,

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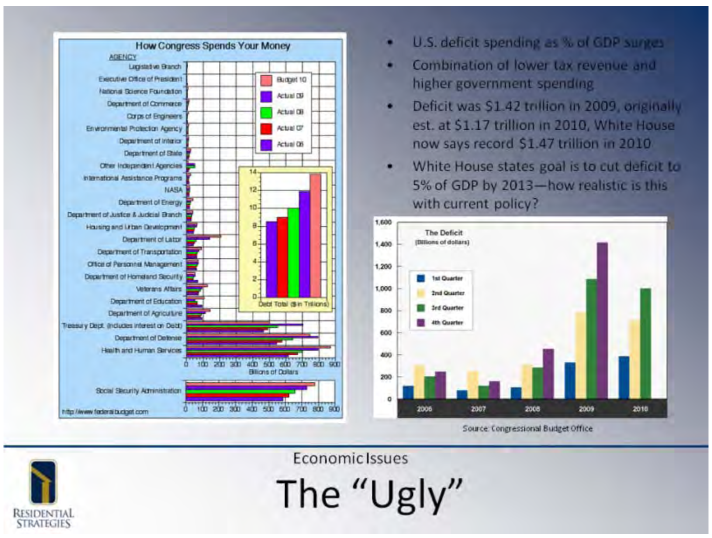
the currently accepted behavior of regulatory forbearance regarding extend and pretend will continue to be the norm.

A recent editorial in the *Wall Street Journal* discussed that a primary difference between the recovery that is taking place now and that that occurred back when Reagan was President was that the consumer today does not have the same confidence in the government's ability to make decisions, nor does he see that the decisions that have been made were correct. There is massive legislative reform that is taking place in Washington right now. New bank rules were recently signed into law by Obama that will produce yet another layer of regulation on the banks. And finally, what will happen to tax rates next year when the Obama Administration negates all the Bush tax cuts? Are we going to be a country that continues to produce entitlement programs we can't afford and pay for it by taxing the highest incomes earners, or are we going to begin to tighten our belts and get serious about competing in the global economy?



The Ugly

So that leads us to the ugly part of the equation, namely that of deficit spending and the growing US debt.

While many on the right may criticize the excessive spending that the government has enacted over the past two years to stimulate the economy, most economists realize that this spending was necessary in order to prevent a massive collapse of the U.S. credit system. In 2009, with the inaction of the TARP plan, the US deficit was $1.42 trillion. The most recently released figures from the White House show that 2010 will even eclipse that with a deficit currently estimated at $1.47 trillion.

Going forward it will be interesting to see how the administration tackles the debt issue. On the one hand, the Obama Administration wants to push forward its social programs and pet projects. On the other hand is the backlash from the American public regarding the anger over deficit spending?

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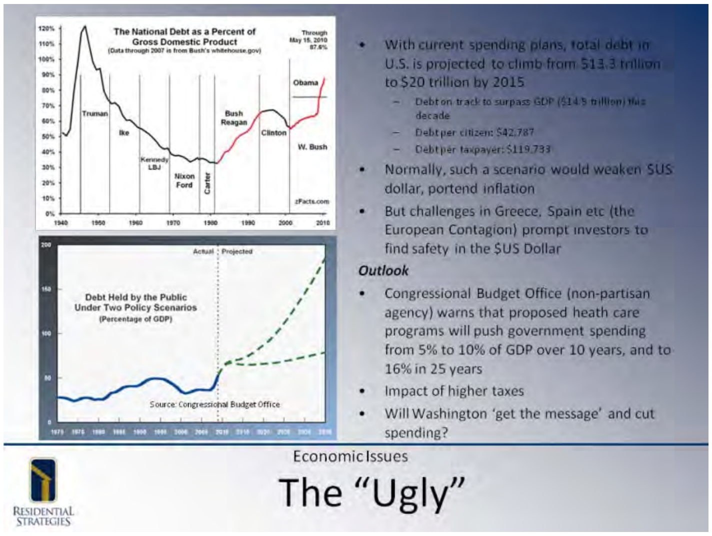
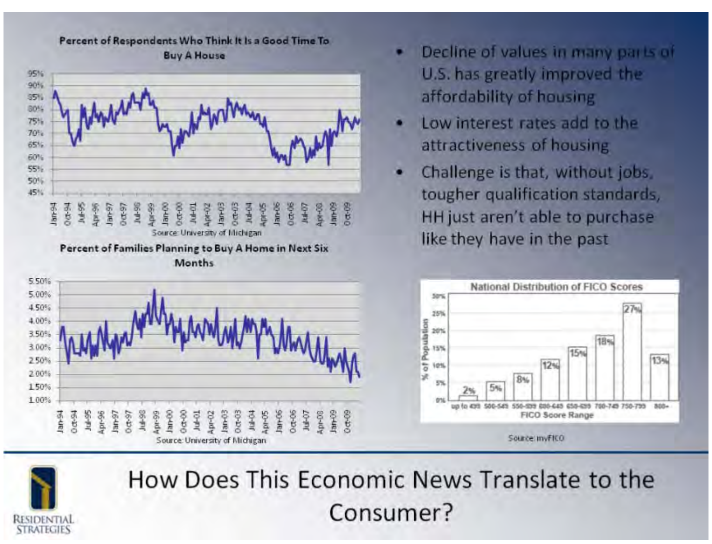
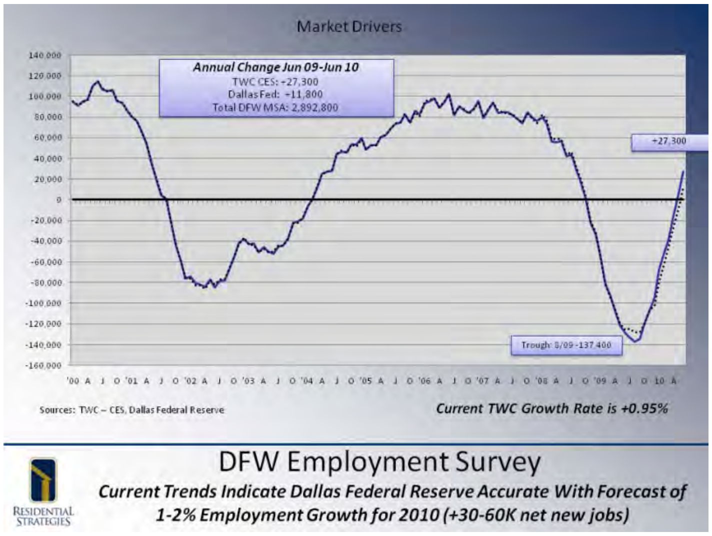


While some say that deficit spending is ultimately just another problem that our children and grandchildren will inherit, the impact may have overwhelming consequences in just the next decade. The mounting debt that is occurring in the United States is rivaling the percentage of GDP that the nation incurred around WWII when there truly was a global crisis at hand. The total US debt currently stands at over $13 trillion and is expected to climb to $20 trillion by 2015 at its current growth rate.

Normally, this growing debt and the printing of US dollars in a weak economy would foreshadow an upcoming period of inflation. The reality is that much of the rest of the world is going through this same sovereign debt challenge, so the US is still considered the safest place to invest dollars. But interestingly, a recent report published by the Congressional Budget Office (a non-partisan agency) clearly warns the nation of the fiscal folly that our current policies are creating. The CBO Report from June says that the current proposed healthcare programs will push government spending on health from 5% to 10% of GDP over the next ten years and ultimately to 16% in 25 years. This on top of other entitlement programs such as Social Security and Medicare which will mushroom as the baby boomers reach their retirement years. The bottom line is that the alarms are now sounding with regard to the fiscal future of the United States. While deficit spending was required to avert fiscal disaster over the past two years, the government must now curb its spending patterns in the years ahead. We see the response to this fiscal crisis in the formation of many political action groups such as the Tea Party. It will be interesting to see how this plays out in the upcoming November elections.

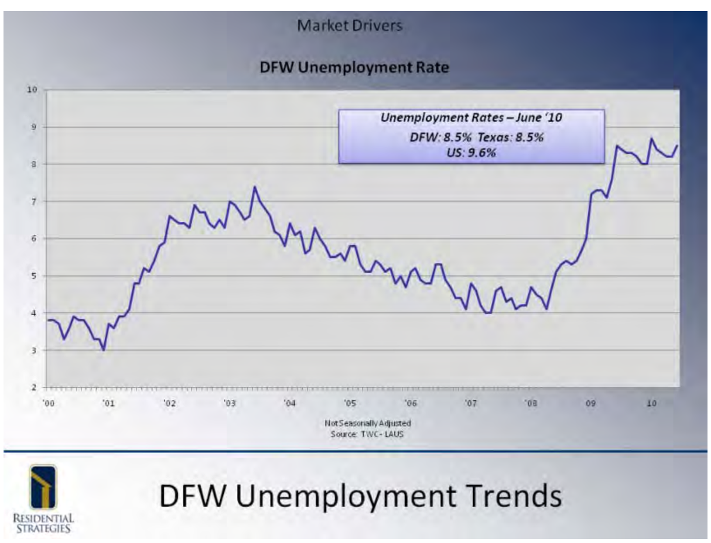


So how do these troubling economic issues translate to the consumer and his purchasing patterns of new homes? The turmoil that the US housing industry has gone through in the last four years has done one positive thing, it has lowered housing prices and made housing a lot more affordable for most households. In the chart on the upper left, you can see that the American consumer thinks that it is a much better time to buy a house today than it was four years ago. The challenge is that, with a weak economy and tougher mortgage qualification standards, although housing prices are lower and interest rates very attractive, just not as many Americans can afford to buy a house today. The plight of the American consumer's balance sheet dictates his purchasing behavior. So until the economy improves and we see substantial growth in new employment, expect sluggishness nationally in the housing sector.

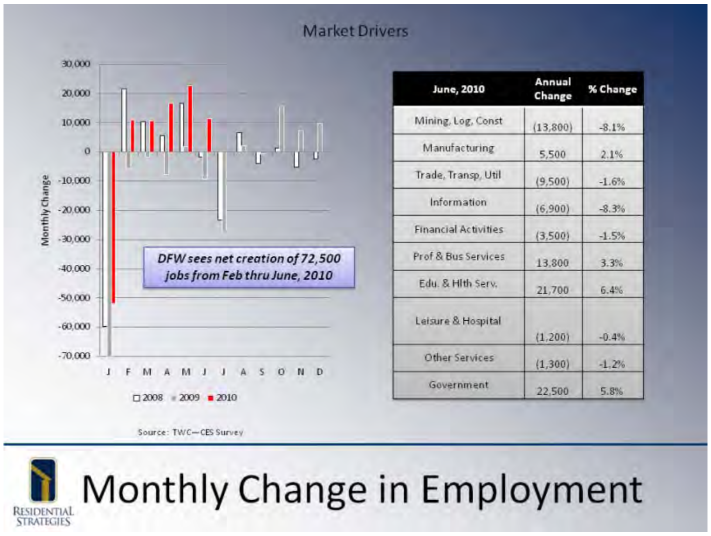


DFW Employment

From an employment standpoint, the DFW market has turned positive in recent months and is performing much better than most of the nation at large. As shown in the chart to the left, after bottoming at an annual loss of about 137,400 jobs about a year ago, the DFW employment picture has turned positive with over 27,300 jobs created for the area during the last 12 months according to the Texas Workforce Commission. This represents an annual growth rate of almost 1%. It now appears that the Dallas Fed's prediction of a 1-2% growth rate in employment was spot on, especially with the critical job growth the area experienced in the First Half, 2010.



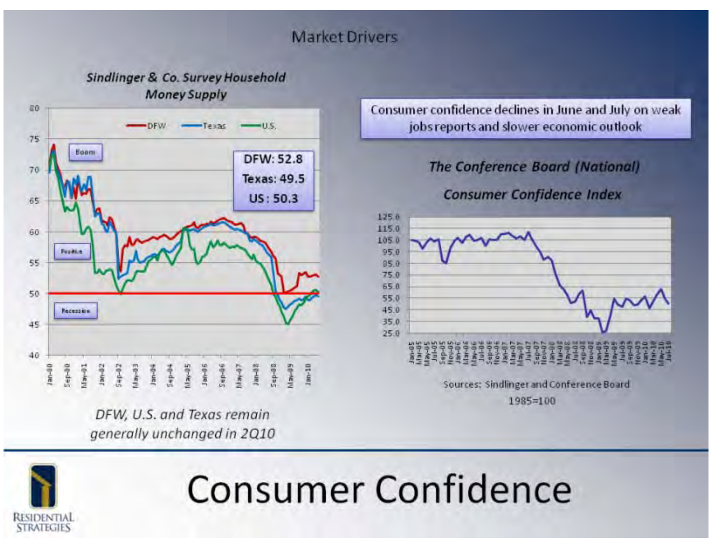
The DFW unemployment rate appears to be very similar to that of the rest of Texas at 8.5%, but still below the national rate of almost 10%. Thus, while job growth has commenced, it appears that it will still take several years for the unemployment rate to moderate back to levels which are considered acceptable by historical standards.



From a timing standpoint, it appears that the expiration of the housing tax credits is coinciding with the point in time when job growth has returned to DFW. This is certainly good news. The chart to the left provides the month-to-month change in employment in the DFW area. The 2010 monthly increases are depicted by the red bars on the chart. Note that from February through June, DFW had pronounced gains in employment with over 72,000 jobs created for that five month period.

As expected, much of the growth came from the public sector with both education and health services and government jobs representing most of the growth that has occurred.

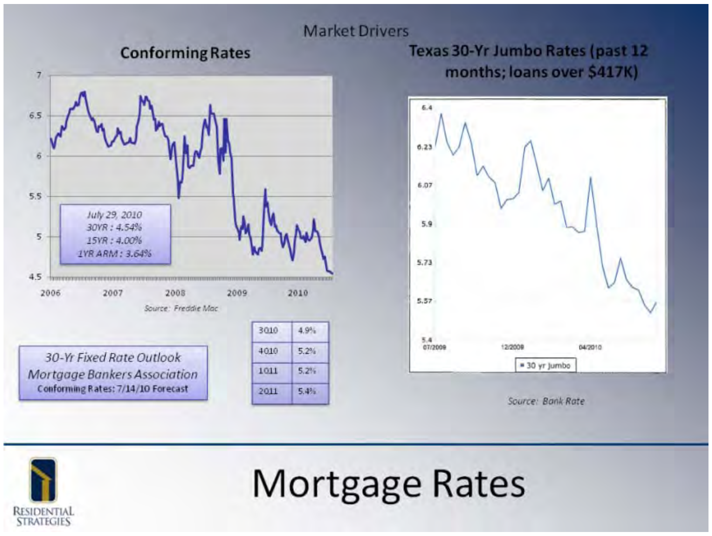
But also observe that there were positive gains in the professional and business services sector as well as manufacturing; both key indicators that the non-public sector of the economy is starting to be revived locally.



Consumer Confidence

As presented earlier, consumer confidence declined in the University of Michigan survey. Likewise, confidence was weak in June and July according to the Conference Board Survey of Consumer Confidence.

According to the Sindlinger & Co Household Money Supply, confidence also remains in somewhat of a holding pattern of between recessionary and positive thinking as the consumer waits for some more positive news regarding the economy and job formation.



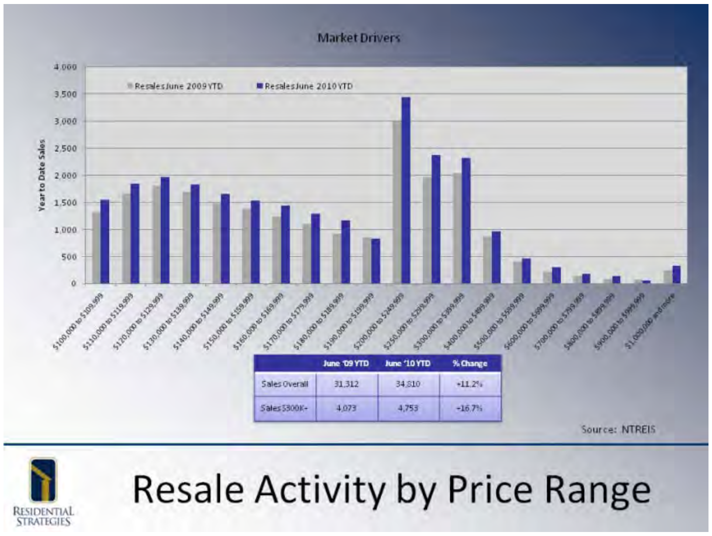
Mortgage Rates

With the Fed Funds rate remaining effectively near 0%, and the US seen as a safe haven for many global investors in this time of credit uncertainty, it is not surprising that investors have showed up en masse to purchase Mortgage Backed Securities. As a result, conforming rates have fallen dramatically. As shown in the chart on the left, (at the last reading on July 29th) the 30-year conforming rate had declined to 4.54%. Likewise, the jumbo rate is running about 100 basis points over the conforming rate and is in a declining trend as well at a 5.57%.

Certainly for those households that can qualify for a home purchase, financing terms, apart from equity requirements, remain especially attractive. The Mortgage Bankers Association did lower its long-term outlook for mortgage rates which had been in the 6% range, now to under 5½% for the remainder of 2010. Nonetheless, they do see slight increases in mortgage rates in the upcoming 12 months.

Resale Activity

With regard to the existing home market, DFW resales continue to improve after bottoming in fall, 2009. For the 12 months ended June, 2010, the area MLS recorded 90,356 existing home sales, up about 5.5% compared to one year ago. The month supply of listings, which is seasonal in nature, stands at a 6.52 month supply, similar to the month supply seen at this same time last year. Realtors say that the DFW resale market remains steady in the new post-tax credit era.



	June '09 YTD	June '10 YTD	% Change
Sales Overall	31,312	34,810	+11.2%
Sales $300K+	4,073	4,753	+16.7%

Looking at the resale activity by price range year-to-date, and comparing it to the same period in 2009, note that overall sales are up over 11% for this year. Of note, sales of houses priced over $300K have increased by almost 17%. This is especially important for the high-end production homebuilders that have had to contend with the buildup of inventory in the market at the higher price points. Much of this excess inventory is now being mopped up and should help margins next year.

New Home Closings

Another interesting statistic of note is the new home closings share of market. In many parts of the country, we have seen a noticeable shift away from new home sales and back to the existing market especially as a result of foreclosures. While this trend has occurred in DFW as well, it is perhaps not quite as pronounced as it is in many of the coastal markets. The new home closings share of market is a calculation of the percentage of new home closings as they relate to the combined total of MLS sales and new home closings that RSI tracks. As one can see, back during the peak of the market, new home closings represented almost 30% of all the home sale activity in this market. This high percentage reflects the growing nature of the DFW market and importance of new housing stock to the area. Of late, that percentage share of market has shifted lower to about 15%, certainly a reflection of the impact that the foreclosure activity has had on the market. But notice that that share shifted slightly upward in 2Q10, perhaps an indication that the foreclosure rate maybe in the process of topping out.

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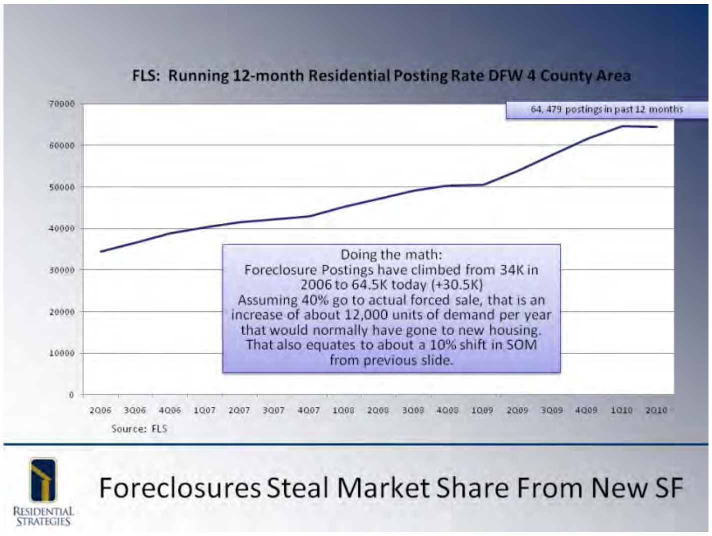


Foreclosures

The running 12 month posting rate of foreclosures in DFW remains unchanged from the 1Q10 rate at just under 65,000 units. Recall that about 40% of these postings, or about 25,000 units actually go to forced sale. This represents about a 12,000 unit increase compared to the forced sale rate of 2006 and accounts for most of the shift in market share of new home closings compared to all transactions.

	Dallas	Ft. Worth	DFW
$ Volume Starts (in billions)	$2.33	$1.07	$3.33
Median New Home Price	$219,586	$183,527	$202,381
Annual Starts	10,625	5,853	16,478
Annual Closings	11,095	6,197	17,292
Finished Vacant Homes	2,784	1,620	4,404
Month Supply	3.0	3.1	3.1
Homes Under Construction	2,855	1,421	4,276
Month Supply	3.1	2.8	3.0
Vacant Developed Lots	50,399	26,804	77,203
Month Supply	56.9	55.0	56.2
Lots Under Development*	2,261	978	3,239

** Includes lots with suspended development*

Dallas-Ft. Worth Housing Vital Signs (3Q09 – 2Q10)

DFW Housing Vital Signs

The annual start rate for DFW now stands at 16,478 – with Dallas accounting for about 64% of activity and Ft. Worth at 36%.

With the increase in activity that occurred during April as a result of the tax credits that were in place, the annual start rate moved up to 16,478 units. Closings increased as well, with the annual rate up to approximately 17,300 units. New home inventory remains at a healthy 6.6 month supply while the market is still faced with an oversupply of lots at about 56 months of supply.

Market Conditions

The increase in start and closing rates in the metroplex certainly provided reason to be optimistic this Spring. However, once the tax credit deadline approached at the end of April, many builders experienced a significant decrease in traffic and sales. This is an odd time for homebuyers, as interest rates continue to be attractive with 30-year rates at less than 5%, but challenging economic conditions, at least at the national level, continue to weigh on the buyers' mind, keeping many on the fence and unwilling to make a decision about purchasing a home. While our industry awaits better economic news and a more favorable mindset among homebuyers, builders remain disciplined in their building activity and have kept inventory levels healthy.

Beyond housing inventory, the lot supply in the most desirable areas of town is getting tighter by the day – and with development financing so hard to come by, the timeline of new lot deliveries in needed areas is not certain. As we look forward to what the remainder of this year will bring, we are anticipating a somewhat slower pace of starts and closings as the market adjusts to a more stabilized demand level after the tax credit era of last fall and this past spring. RSI is hopeful that the job growth seen in DFW since February will continue and provide a more stable source of demand through the remainder of 2010.

Starts, Closings & Lot Deliveries

On a year over year basis, starts are up about 19% compared to the rate of about 14,000 annual units a year ago. The closing rate is still lower than it was a year ago by about 14% and the rate of lot deliveries saw an even greater decline this quarter, now off more than 80% compared with a year ago.

Fewer than 1,500 lots were delivered to the DFW market between 3Q09 and 2Q10. Start activity by price saw the most change in the $151,000 to 200,000 price bracket where activity was up 41% compared with the rate posted through the second quarter of last year.

Note at the upper end of the market at $300,000 and above that starts were basically flat, which is a positive sign after a significant slide in activity levels in the last 18 months.

Quarterly Starts & Closings

This chart displaying the quarterly rate of starts and closings shows that builders closed about 530 more houses in the second quarter than they started, with quarterly starts at 4,460 units and closings at 4,989. Obviously, with much of the focus during the Second Quarter being on closing units that were tied to the tax credit, this surge in closings was expected.

Median New Home Prices

As the start rate for product at moderate price points, from $200,000 to $300,000 increased over the last four quarters, the median new home price showed a slight improvement in 2Q10 and moved to $202,381. This level is still about 2.5% lower than the year-ago price, but overall, pricing has remained steady in DFW throughout the last three years.

Total Housing Inventory

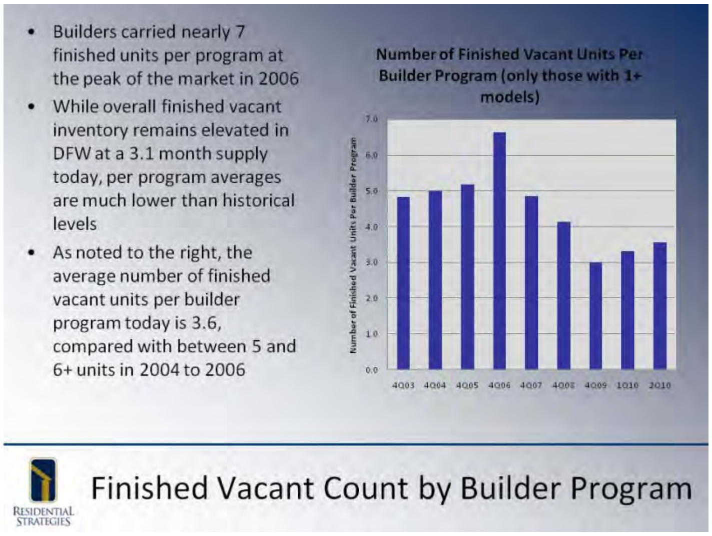
Total housing inventory, which is the aggregate of under construction, finished vacant and model units, has decreased slightly in 2Q10, but is relatively on par with the level seen over the last three quarters. The absolute count stands at approximately 9,500 units, where the finished vacant and under construction inventory levels are nearly equal.

The number of model homes was again reduced during 2Q10 by about 50, or 6%. After the month's supply of inventory rose above 7 months last quarter, moved back to 6.6 months at the end of the Second Quarter, which is considered to be an acceptable level.

Finished Vacant Housing Inventory

Homebuilders continued to keep finished vacant inventory at a level of approximately 4,400 total units, which represented a 3.06 month supply at the end of the quarter. Note that the month supply has been above the 2.5 month maximum acceptable level now for most of the last three and a half years. A level between 2 and 2.5 months generally coincides with stronger margins for builders.

While the month supply of finished inventory in the market continues to hover above the desired 2 to 2.5 month supply, the number of finished vacant units per production builder program is significantly reduced from the 2005 to 2006 time frame.



The chart on the right of this exhibit looks at the average number of finished vacant units per builder program with a model from 2003 to 2Q10. While builders typically carried around 4-5 finished vacant units (specs) during the 2003 to 2005 time period, the peak of the market in 2006 brought on much more aggressive behavior – note the spike in the chart at 4Q06. This corresponds to a timeframe when there were about 6.5 finished vacant units on average for each program with a model home.

Today, builders have reduced the number of units they carry at each location to an average of 3.6, which is about half the level seen in 2006, and still below any average seen over the last seven years. The conclusion to draw from this analysis is the increased number of neighborhoods open and active in DFW, coupled with the reduced start rate, keeps the month supply of finished units at an elevated level. However, when digging into the data a little, one can see that the builders are actually being more conservative than ever when looking at the average number of units they keep on hand in each neighborhood. And, as a result, RSI does not have concern with an overall month supply at 3.1 because of the low per-neighborhood averages.

Under Construction Inventory

There were 4,276 units under construction at the end of the second quarter of 2010 – about 3 months of supply.

Note in the chart the spike in activity during 3Q09 and the first quarter of this year, both tied to the original and then extended tax credit deadlines. Aside from those increases, the under construction level has been relatively steady since late 2008 at or near 4,000 units.

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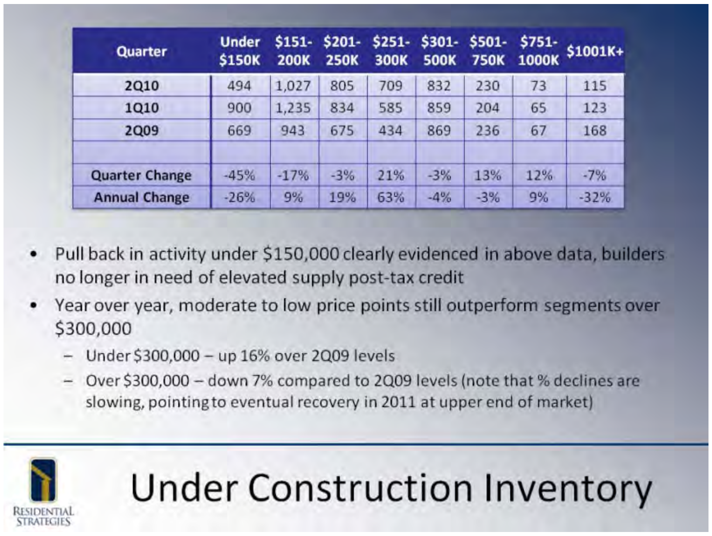


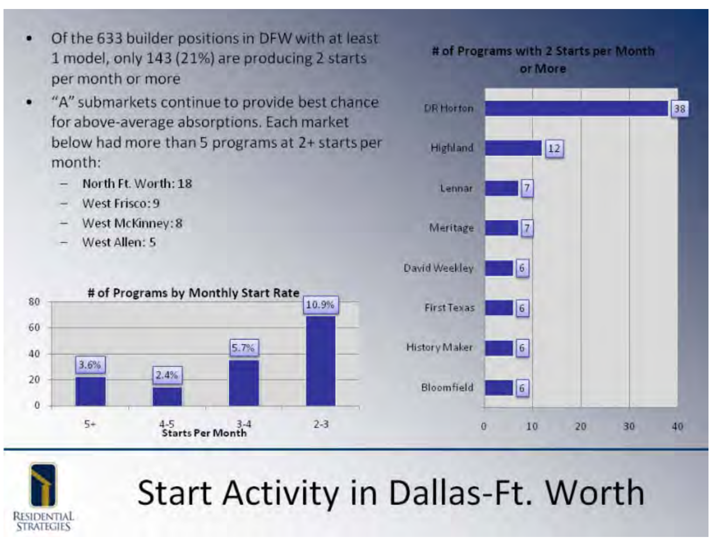
Quarter	Under $150K	$151-200K	$201-250K	$251-300K	$301-500K	$501-750K	$751-1000K	$1001K+
2Q10	494	1,027	805	709	832	230	73	115
1Q10	900	1,235	834	585	859	204	65	123
2Q09	669	943	675	434	869	236	67	168
Quarter Change	-45%	-17%	-3%	21%	-3%	13%	12%	-7%
Annual Change	-26%	9%	19%	63%	-4%	-3%	9%	-32%

This chart details under construction inventory by price point to further illustrate where the bulk of the market activity is occurring.

One can see that the under $150,000 market saw a dramatic 45% decrease in inventory levels compared to last quarter as builders finished up inventory that was targeted toward tax credit buyers and did not replace that inventory to the same extent during the second quarter.

While the upper end of the market is still showing declines in activity, as I pointed out earlier, the rate of decline has slowed, and we should start to see some growth in the over $300,000 market by early next year.

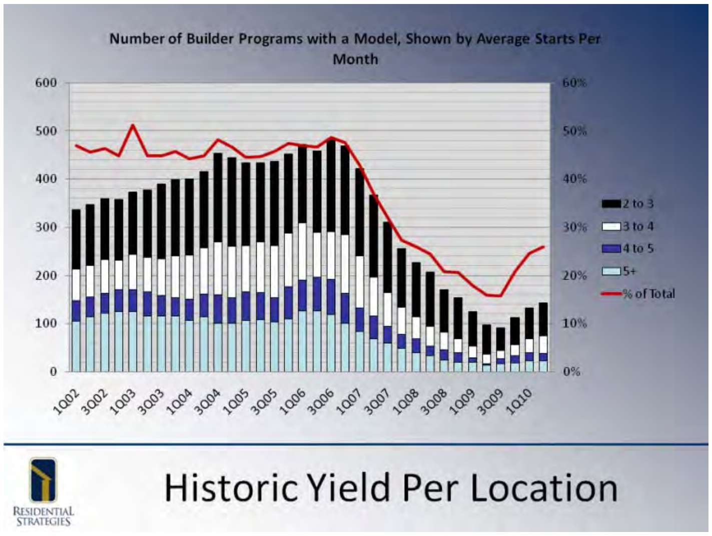
Starts Activity in Dallas-Ft. Worth



RSI continues to monitor the level of activity per builder program – looking for signs of a more significant recovery for the builders through the yields they are able to achieve at the individual program level.

Unfortunately, not much has changed yet in terms of the number of builder programs that were able to achieve 2 starts or more per month with about 21% achieving this rate during the last four quarter period of 3Q09 to 2Q10.

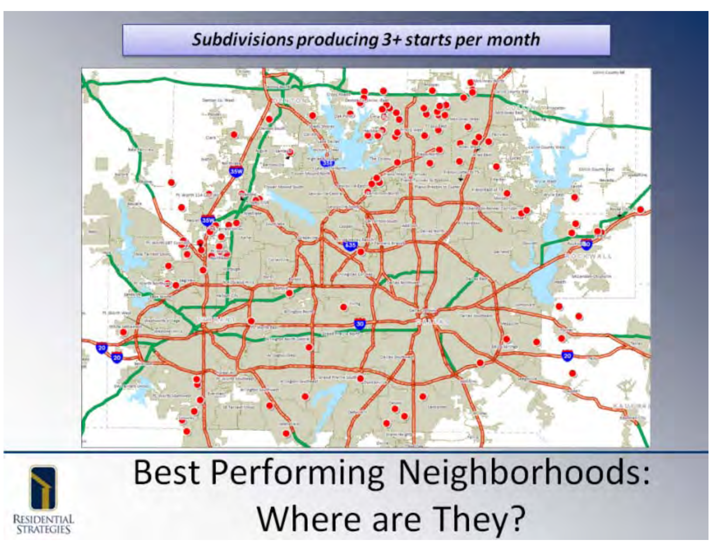
As noted to the right, DR Horton continues to lead all builders with 38 individual programs producing 2 or more units per month. Beyond this performance from DR Horton, Highland Homes' brands had 12 programs that posted this type of activity with Lennar and Meritage following with 7 each.



While the market has not given the builders a significantly higher yield when compared to just a quarter ago, this chart provides a detailed view of how the yield per location has changed over the last 8 years. Note that the columns on the chart represent the total number of programs doing 2 or more units per month, with the individual colors representing the various categories from 2 to 3 and 3 to 4 and so on.

Note that at the peak of the market in 2006, more than 450 programs across the DFW area were producing at least 2 units per month, and that number was reduced to fewer than 100 at the trough of the market in late 2009.

Even though the market is still very challenging from the builders perspective, note that we have seen some improvement since the 3Q09 – with the number of builder programs at 2 units per month or more increasing to about 140.
The red line on the chart shows what percentage these 2+ units per month programs represent when considering all locations with at least one model. This has also shown improvement, after declining to about 15% in late 2009.



Best Performing Neighborhoods

RSI has looked closely at the number of programs that are producing the best results, but we are often asked about the geographic distribution of the best performing neighborhoods in the market.

The map to the left shows the location of all subdivisions that produced at least 3 starts per month from 3Q09 to 2Q10. Not surprising, the highest concentration of these top tier subdivisions continues to be in North Ft. Worth, Frisco, Allen and McKinney.

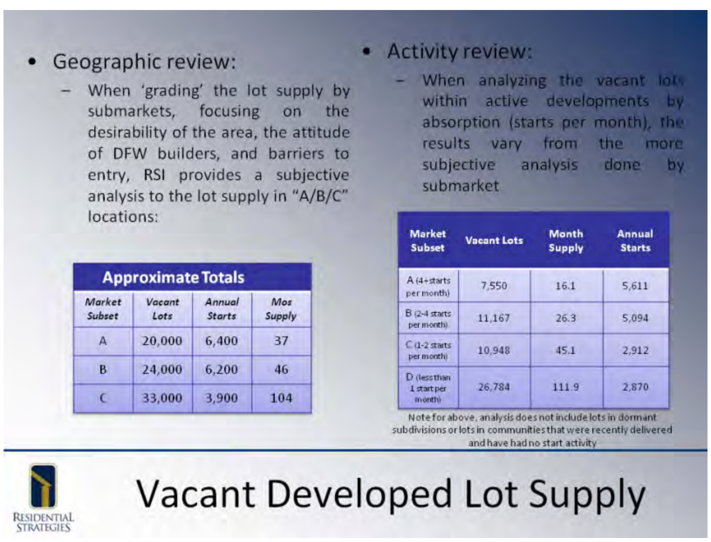
In addition, there are a handful of communities that are producing above-average results in the southern sector of the market including Southwest Ft. Worth, Mansfield, and DeSoto, which are not areas that we traditionally think of as performing well in today's market.

Vacant Lot Supply

The total supply of lots in the market stands at 77,203, a 56.2 month supply.

Since the supply of lots peaked at nearly 100,000 total lots in early 2008, there has been a decrease of about 22% - or more than 22,000 lots.

Vacant Developed Lot Supply



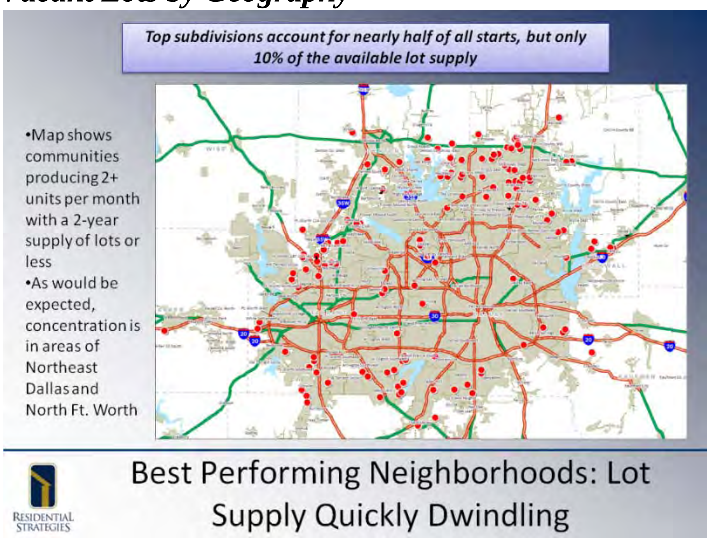
The vacant lot supply can be broken down in many different ways when evaluating the quality of the supply. Note that by geography, which is shown on the left side of the exhibit, "A" markets have only about 20,000 vacant lots on the ground today and those areas are producing about 6,400 annual starts.

"B" submarkets have a slightly higher level of vacant lots at 24,000 and a relatively similar absorption pace at 6,200 units per year. Both those "A" and "B" submarket groups have a lower month supply of lots than the overall DFW average which is currently at 56 months. Note that the "C" market areas continue to languish with more than 33,000 vacant lots and fewer than 4,000 annual starts per year.

To the right of the exhibit, RSI has broken the supply out by the activity within individual subdivisions, regardless of location. Note that subdivisions producing more than 4 starts per month have only a 16 month supply of lots today – which amounts to only 7,550 total vacant lots. Subdivisions producing between 2 and 4 starts per month have nearly a balanced supply at 26 months.

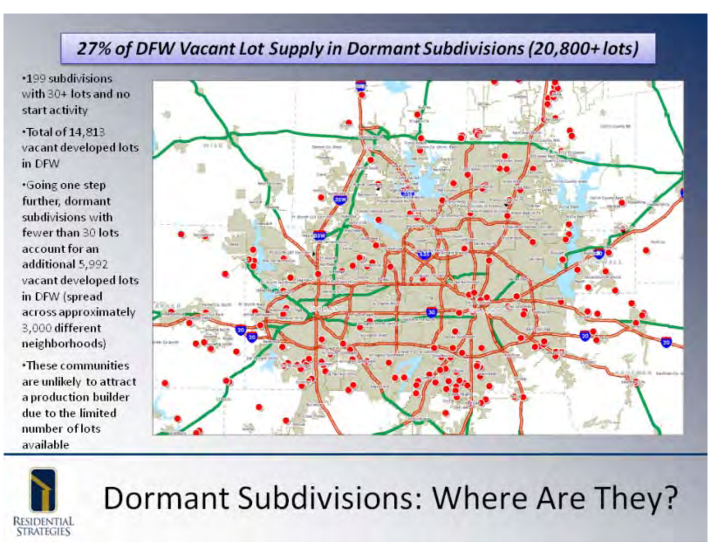
Again, this exercise continues to point to the disparity between the lot supply in the areas that are "working" and the supply in areas or subdivisions that are struggling.

Vacant Lots by Geography



To highlight again the geographic distribution of the best performing neighborhoods, RSI has presented here the location of all subdivisions where there were 2 or more starts per month, but a 2-year supply of lots or less. Note that the subdivisions highlighted on this map account for nearly 50% of all the starts in DFW over the last year, but now have less than 10% of the available supply of vacant lots.

The geographic concentration continues along an expected pattern with Northern Ft. Worth and Northeast Dallas providing the highest number, however, Mansfield, Southeast Arlington, Burleson and Southwest Ft. Worth are also home to several of these communities.



Another large component of the lot supply that needs to be identified is that considered to be in dormant neighborhoods. The map to the left shows the distribution of subdivisions where there were 30 or more vacant lots but no start activity.

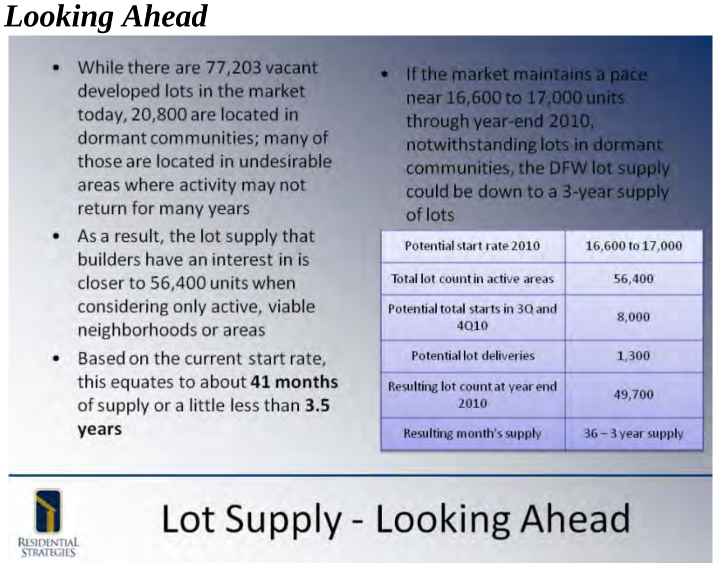
Note that many of these dormant neighborhoods are located in the southern sectors of the metroplex, which have been some of the most challenged areas during the downturn. These 199 subdivisions account for 14,813 vacant developed lots.

Taking a step further to look at those dormant communities where there are fewer than 30 lots with no start activity, you can add an additional 5,992 lots to come to the conclusion that more than 25% of the total supply of lots in DFW is located in dormant neighborhoods. When looking at the total supply of more than 77,000, it's really important to keep in mind that a significant portion of that total is essentially 'out of play' today.

Lots Under Development

To conclude this discussion regarding the lot supply, it is important to understand how little is actually under development today. Note in this chart showing lots that are either at grading and staking stage or streets and utilities stage that only 3,200 or so lots would fall into these categories. So, at least for the foreseeable future, the market will continue to see very little in the way of new deliveries. What new development that is occurring today is being initiated by the large public builders that have significant cash. Independent developers find that lenders are still hesitant about A&D loans and where there may be interest, terms are much more onerous today.

Looking Ahead

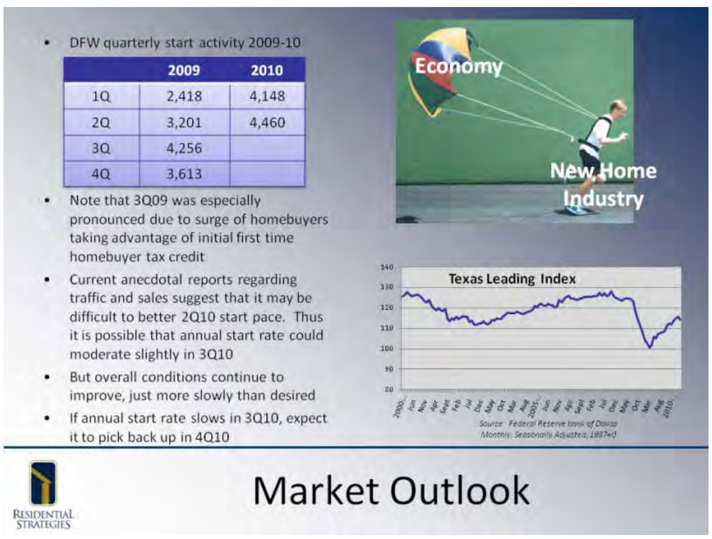


So where does that leave the market for the remainder of 2010? Here RSI has presented what is the most likely scenario for the reduction of the lot supply during the last half of the year.

As was explained previously, with about 20,800 of the 77,200 vacant lots in the market located in dormant neighborhoods, one can discount the total supply of lots, at least in the short term, to about 56,400. These represent lots that are located in active neighborhoods. When removing these dormant lots from the supply, note that the supply of vacant lots stands at about 3.5 years as of the end of 2Q10.

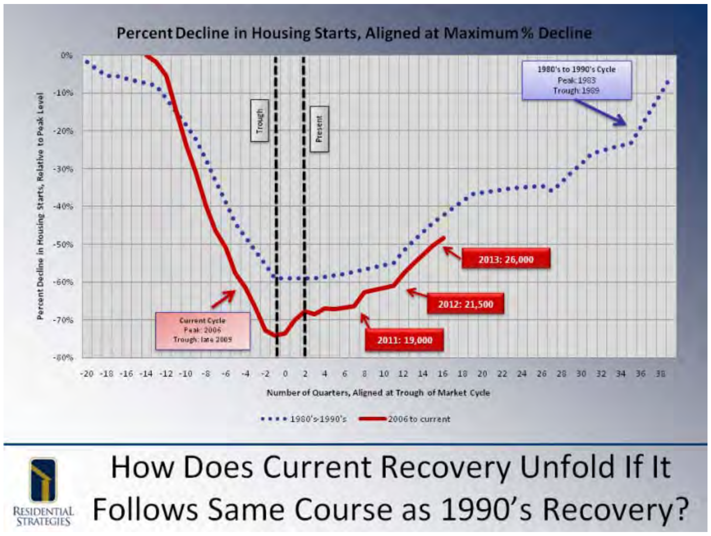
RSI feels that the market will likely end the year with a start rate not too dissimilar to what is seen today – somewhere between 16,600 and 17,000 total starts. If that is the case, and accounting for a small number of new lot deliveries during the Third and Fourth quarters, the market could end up with fewer than 50,000 lots in active neighborhoods by the end of the year. If this comes to fruition, the relevant lot supply will move to about a 3-year supply. Of course, these dormant lots that we have discounted in this analysis could come back into play, however, we know that most builders still have very little desire to return to many of those outer ring markets. As a result, these dormant lots may continue to be unviable for the next several years while the active supply of lots continues to tighten.

Market Outlook



The recovery that is taking place in the DFW market continues to be a modest one. There are favorable signs with regard to employment growth, and the Texas Leading Index seems to imply that the modest recovery will continue through year end. But, the market is still facing headwinds.

Looking at what the annual start rate will do next quarter, there is unfortunately a likelihood that it will decline. As shown in the inset box at the top left, 3Q09 starts were especially pronounced because of the rush to put entry-level units on the ground with the initial introduction of the first-time homebuyer tax credit. With the more modest traffic and sales that are being reported by many builders today, there is a good chance that 3Q10 starts will be at or slightly below the level seen both last quarter and in 3Q09. The hope is that the media picks up on the story that the decline is the result of aberrant numbers from the tax credit and not an intrinsic decline in the housing market. The annual rate to return to growth mode in 4Q10 is expected, as the 4Q quarterly numbers likely will eclipse those seen from the Fourth Quarter in the year previous.



With regard to the intermediate outlook on housing activity, an interesting chart prepared this quarter was to compare the recovery that is taking place in this cycle to the recovery that we saw in the 1990's.

This chart is not RSI's 2011 forecast (that will be provided next quarter). It is simply an indication of what the next couple of years could look like were this recovery to follow the same percentage increases experienced in the past cycle.

Obviously, there is much dissimilarity between this recovery and the last, and the most important statistic that will guide a recovery is how quickly job growth will come back. Nonetheless, it is important to understand that, with the current anemic economic conditions, start growth may well be more moderate in the years ahead much as it was in the early 1990s.

We remain cautiously optimistic about the DFW market and are hopeful that the job growth that we are now seeing will eventually translate into the further steady improvement in traffic and new home sales.

16660 Dallas Pkwy, Ste 1200 Dallas, Texas 75248 (972) 381-1400 www.residentialstrategies.com