SAN FRANCISCO, CA

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q15 | May 2015

1Q15 PAYROLL TRENDS AND FORECAST

PAYROLL JOB SUMMARY	
Total Payrolls	1,030.7m
Annual Change	45.3m (4.6%)
2015 Forecast	40.6m (4.0%)
2016 Forecast	34.6m (3.3%)
2017 Forecast	28.5m (2.6%)
2018 Forecast	16.5m (1.5%)
Unemployment (NSA)	3.5% (Mar.)

San Francisco establishments continued to hire new employees at a breathtaking clip during the first quarter, adding workers to payrolls at a 45,500-job, 4.6% annual pace, down slightly from 4Q14's two-year high 47,800-job, 4.9% rate. Strong growth was recorded across industries but none surpassed the City's tech and software sectors. Computer system design shop headcounts grew 7,000 (13.7%) year-on-year, up from 4Q's 5,700-job, 11.6% advance as tech service firms, flush with VC cash and sky-high implied market capitalizations, hired aggressively. Information sector firms added another 5,000 workers (9.9%), in large part due to growth in the software and social media markets.

Construction was a notable area of relative softness. After hiring additional employees at a 4,100-job 13.1% rate during the first half 2014, builders added to payrolls at only a 900-job, 2.6% y-o-y rate during 1Q15. The slowdown was attributable to plateauing of multifamily construction, which has reached a practical limit in this metro's challenging permitting and land cost environment .

RCR specified a 96.1% adjusted-R^2 econometric forecasting equation employing U.S payroll and metro personal income growth; metro home price appreciation; S&P500 returns and 10-year Treasury rates as independent variables. The model projects two more years of 3% or faster growth before the San Francisco growth curve returns to a more typical 1.5% - 2.0% trajectory. Annual gains should approach 30,000 or more jobs through 2017.

1Q15 ABSORPTION AND OCCUPANCY RATE TRENDS

OCCUPANCY RATE SUMMARY	
Occupancy Rate (Reis)	96.5%
RED 50 Rank	18th
Annual Chg. (Reis)	+0.3%
RCR YE15 Forecast	96.3%
RCR YE16 Forecast	96.0%
RCR YE17 Forecast	96.6%
RCR YE18 Forecast	97.5%

San Francisco apartment owners encountered seasonally strong apartment demand during the first quarter as tenants leased a net of 576 vacant units (Reis), topping the trailing 16-year and 5-year January-March averages of 21 and 418 units, respectively. Supply of 590 units was largely counterbalancing, however; holding sequential quarter occupancy steady at an average of 96.5%. Over the year, average occupancy declined 30 basis points from 96.8%.

Axiometrics surveys of stabilized, same store properties recorded a 96.2% average occupancy rate, down 20 basis points sequentially but up 100 bps year-on-year. Class-A assets recorded the highest occupancy (97.3%) and the largest year-on-year gain (140 bps). Class-B properties followed with a 96.2% average, up 100 bps y-o-y. The class-C segment posted the weakest results: 95.2% were occupied after a 50 bps advance over the prior four quarters. As vacant units in buildings constructed in 2014 and 2015 grew scarcer (occupancy averaged more than 82% in 1Q), absorption decelerated. New units were absorbed at an approximate per property average of 16 units/month, down from 20 units during 4Q14.

RCR's occupied stock growth model employs apartment inventory, payroll, rent and home price growth rates as independent variables. The model projects that tenants nearly will keep pace with a wave of supply anticipated for 2015-2017. Following the deluge, the model expects demand to exceed supply, sending vacancy lower, perhaps below the 2% threshold by 2019.

1Q15 EFFECTIVE RENT TRENDS

EFFECTIVE RENT SUMMARY	
Mean Rent (Reis)	$2,280
Annual Change	7.6%
RED 50 Rent Change Rank	2nd
RCR YE15 Forecast	4.5%
RCR YE16 Forecast	3.9%
RCR YE17 Forecast	3.9%
RCR YE18 Forecast	1.9%

After a slow 4Q14 when average effective rent increased only $10 (0.5%) sequentially, trends rebounded during the winter: rents rose $43 (1.9%) quarter-to-quarter, according to Reis. As a result, year-over-year trends improved from 7.4% to 7.6%, ranking second among the **RED 50** after San Jose. The class-A sector was almost entirely responsible for the surge. Segment asking rents increased 2.7% sequentially compared to class-B&C's 0.4% advance.

Axiometrics also captured a sharp up move in rent trends in its surveys of 131 larger properties. The service reported a 12.0% year-on-year effective rent gain, up from 10.8% during the previous quarter. This was the largest y-o-y advance posted in two years. In this case, classes-B and –C provided most of the momentum, rising 12.4% and 13.0%, respectively. Class-A rents increased 8.9% year-on-year, reflecting a small seasonal sequential quarter decline attributable to competition from substantial new supply.

Always a challenging market to model, **RCR** elected to structure a simple model relying on payroll growth, the BAA corporate bond yield and two lags of the dependent variable to achieve a 95.6% ARS. The model projects strong rent growth in 2015, followed by progressively weaker metrics in 2016-2018, primarily due to softer job trends and higher interest rates. Trends rebound to more than 3% though in the fifth and sixth years of the forecast.

1Q15 PROPERTY MARKETS AND TOTAL RETURNS

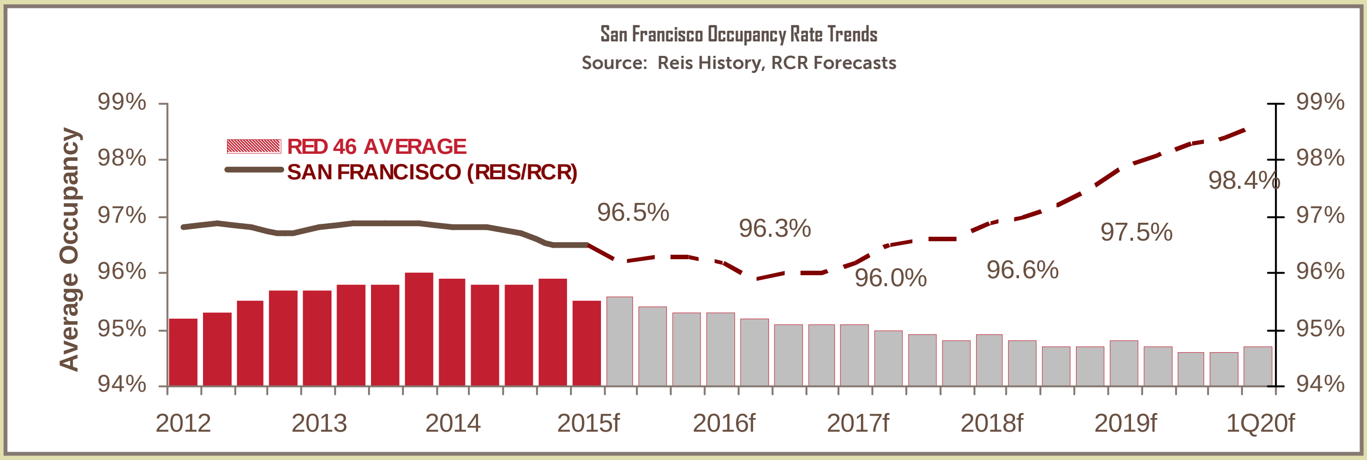
TRADE & RETURN SUMMARY	
$5mm+ / 40-unit+ Sales	7
Approx. Proceeds	$342.7mm
Avg. Cap Rate (FNM)	4.6%
Avg. Price/Unit	$391,248
Expected Total Return	7.4%
RED 46 ETR Rank	14th
Risk-adjusted Index	3.45
RED 46 RAI Rank	39th

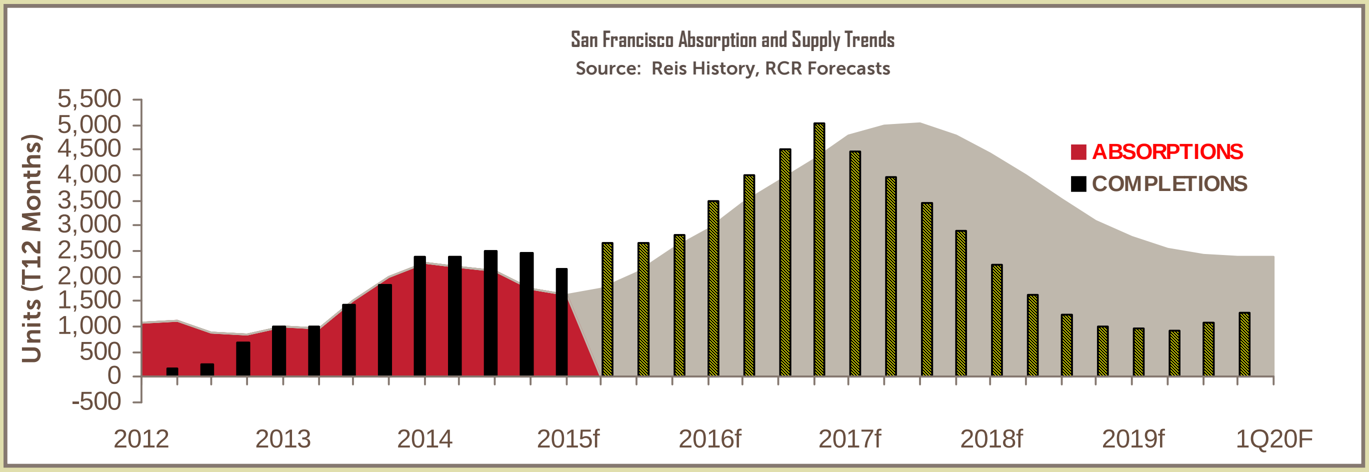
Sales momentum was moderately slower during the first quarter as buyers acquired seven 40-unit or larger properties valued at $5 million or more for total proceeds of $342.7 million. These metrics compare to 11 transactions for $1.3 billion consummated during 4Q14, the latter figure boosted by the transfer of a 75% interest in the large Parcmerced property.

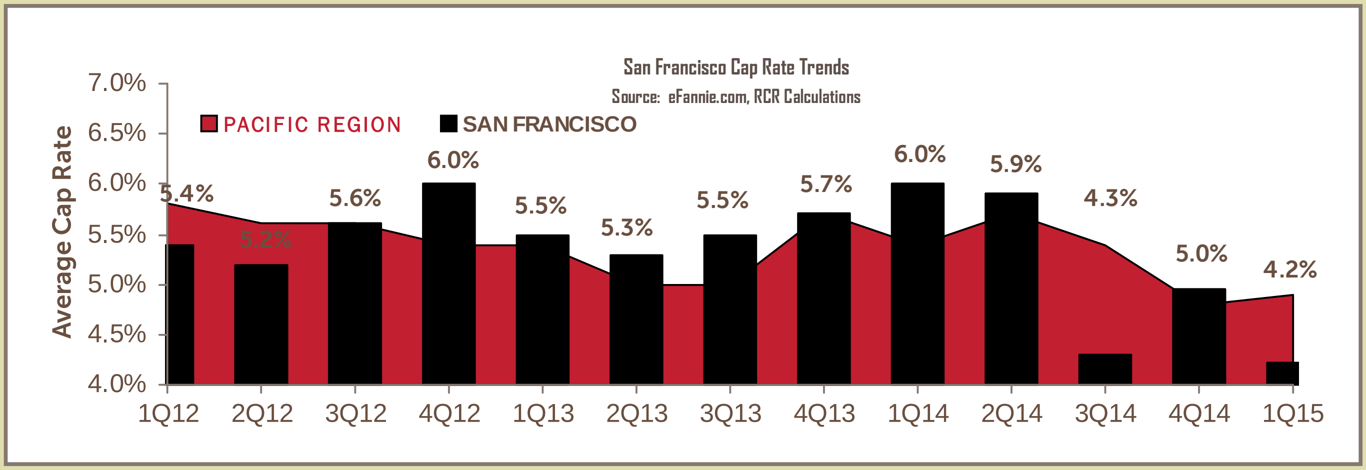
The average price of units traded increased, reflecting the larger concentration of recent construction mid-rise properties in the mix. The average price per unit figure rose from 4Q14's $320,875 figure to $391,249. The advance was attributable to the sale of three properties built since 2011, which traded at prices ranging from $549,000 to $663,000 per unit.

Cap rates mostly fell in the sub-5% range. Recent construction trophies yielded buyers no more than 4%, and less in several instances. Older class-B and –C assets traded at yields ranging from the low 4% area to perhaps 4.75%.

Employing a 4.4% generic class-B purchase cap rate, a model derived 4.9% terminal cap rate and model rent and occupancy forecasts produces an expected 5-year, unlevered total return estimate of 7.4%. The figure ranks 14th among the **RED 46**; first among the Bay Area metros; and third among the "Magnificent Seven" primary markets after New York and Seattle. Risk-adjusted returns are hindered by above average model standard error, limiting the risk-adjusted index to 3.45, 39th among the peer group.

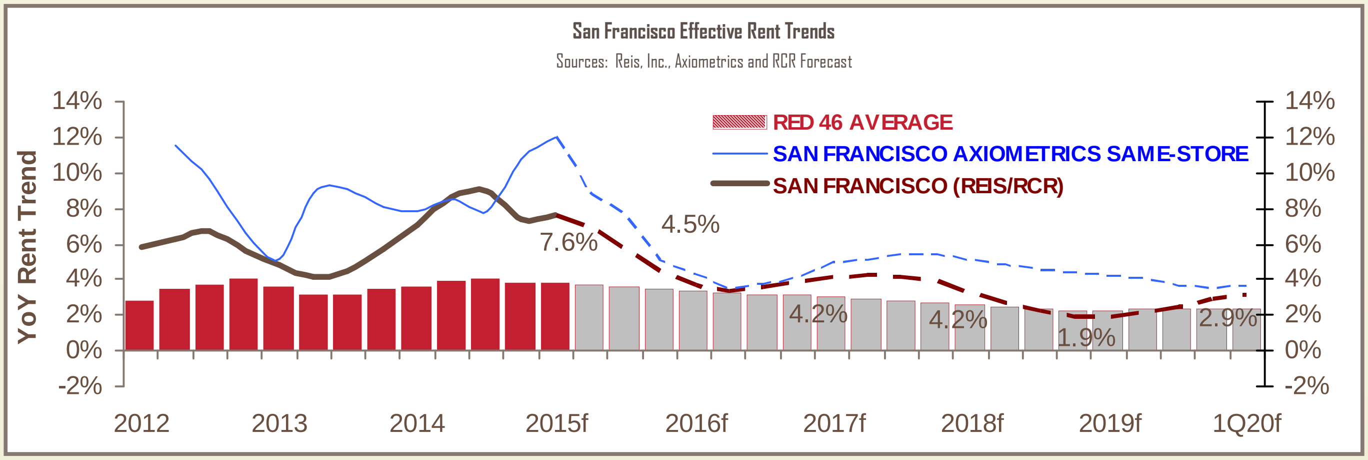






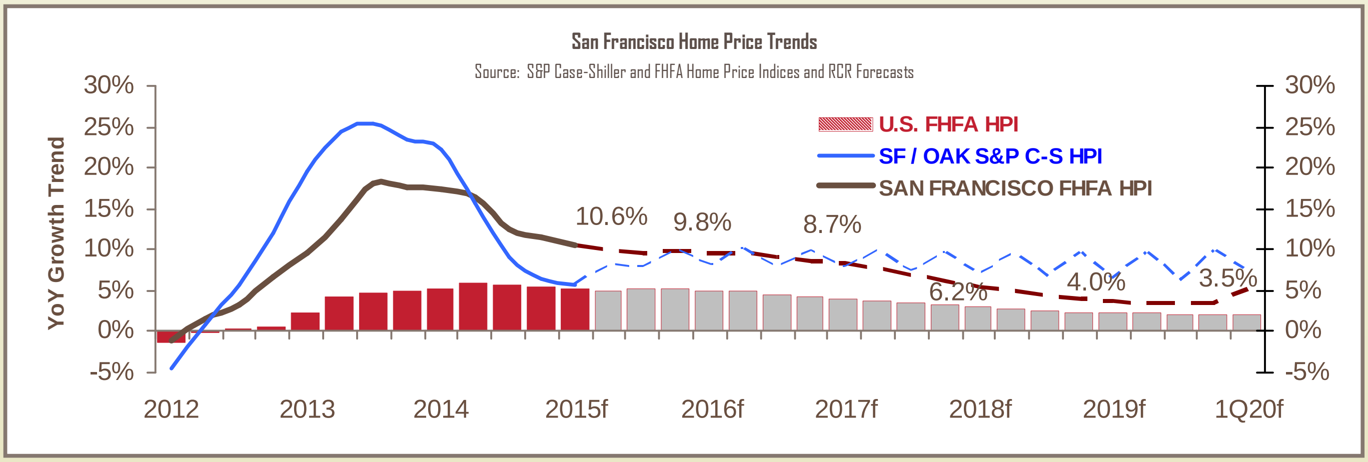
NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/Type (Constr.)	Approx. Date of Transaction	Total Price / (in millions)	Price / per unit	Estimated Cap Rate
Parcmerced (West SF / lake Merced)	B / HR (1944)	10-Nov-2014	$1,310.0	$406,706	6.5%
Skyline Heights (North San Mateo / DC)	C- / GLR 1974	28-Feb-2015	$74.0	$288,984	5.8%
MODE by ALTA (Cent. San Mateo / Hillsdale)	B / GLR (2014)	4-Mar-2015	$73.6	$663,288	4.1%
Etta (Civic Center / NoMa / Lower Nob Hill)	A- / HR (2013)	In Process	NA	Approx. $925,000	3.9%e



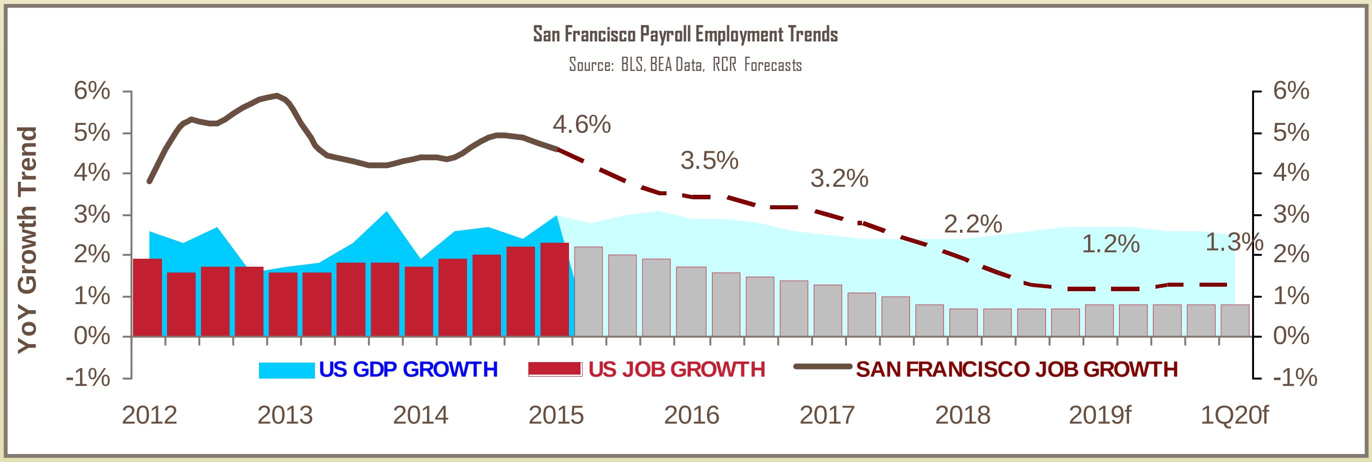
San Francisco Effective Rent Trends

Sources: Reis, Inc., Axiometrics and RCR Forecast



San Francisco Home Price Trends

Source: S&P Case-Shiller and FHFA Home Price Indices and RCR Forecasts

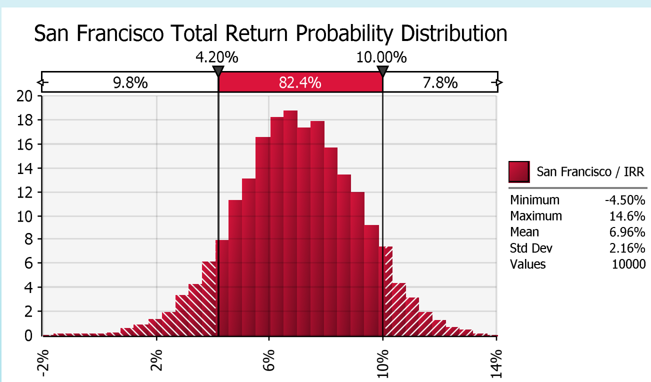


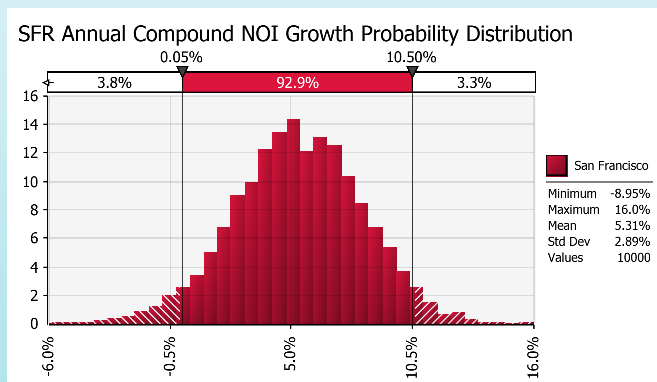
San Francisco Payroll Employment Trends

Source: BLS, BEA Data, RCR Forecasts

SUBMARKET TRENDS (REIS)

Submarket	Effective Rent 1Q14	Effective Rent 1Q15	Effective Rent Change	Physical Vacancy 1Q14	Physical Vacancy 1Q15	Physical Vacancy Change
Central San Mateo	$2,128	$2,267	6.5%	2.1%	2.9%	80 bps
Civic Center / Downtown	$1,710	$1,940	13.5%	3.2%	5.3%	210 bps
Haight Ashbury	$2,297	$2,365	2.9%	3.2%	3.4%	20 bps
Marina / Pacific Heights	$2,446	$2,698	10.3%	1.6%	1.9%	30 bps
North Marin	$1,607	$1,820	13.3%	1.3%	1.3%	0 bps
North San Mateo	$1,782	$2,088	17.2%	3.4%	2.7%	-70 bps
Russian Hill / Embarcadero	$2,822	$3,083	9.2%	2.0%	1.7%	-30 bps
South Marin	$1,936	$2,026	4.6%	1.5%	2.3%	80 bps
South San Mateo	$1,839	$2,013	9.5%	2.0%	2.5%	50 bps
South of Market	$2,546	$2,682	5.3%	4.9%	7.4%	250 bps
West San Francisco	$2,047	$2,166	5.8%	3.7%	3.4%	-30 bps
Metro	**$2,119**	**$2,280**	**7.6%**	**3.2%**	**3.5%**	**30 bps**





FOR MORE INFORMATION ABOUT RED'S RESEARCH CAPABILITIES CONTACT:

Daniel J. Hogan
Director of Research
djhogan@redcapitalgroup.com
+1.614.857.1416 office
+1.800.837.5100 toll free

red capital group

THE FACE OF LENDING