SAN JOSE, CALIFORNIA

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q15 | May 2015

1Q15 PAYROLL TRENDS AND FORECAST

PAYROLL JOB SUMMARY	
Total Payrolls	1,036.3m
Annual Change	53.2m (5.4%)
2015 Forecast	52.0m (5.2%)
2016 Forecast	29.5m (3.2%)
2017 Forecast	21.2m (2.8%)
2018 Forecast	8.4m (0.8%)
Unemployment (NSA)	4.2% (Mar.)

Santa Clara County payroll job creation accelerated for the third consecutive quarter, rising from 4Q14's robust 46,600-job, 4.7% year-on-year rate to a 15-year high 53,200-job, 5.4% pace during 1Q15. Headcount growth was strong across industries but the pace of hiring was notable in the Valley's high tech sector. Computer system design shops added workers at an 8,200-job, 13.4% annual rate, and information services providers (mostly software publishers and internet portals) expanded at a 10,200-job, 16.3% y-o-y pace; representing in each case the fastest rates of growth observed since the e-commerce boom of the late 1990's.

The seasonally-adjusted payroll series also displays accelerating growth. These data record a 16,800-job gain in the January-March period, the largest one-quarter add since 3Q00. Moreover, preliminary data suggest that 2Q15 got off to a roaring start with an 8,400-job net gain in the month of April alone. The April results represent the largest single-month gain posted since July 2000.

RCR's econometrically derived models are inclined to predict that markets tend to revert to "typical" behavior over time, and the San Jose model, right or wrong, reaches that conclusion. The model achieves a 97.9% adjusted-R^2 employing lags of U.S. payroll, income and GDP growth, metro income growth and S&P500 returns as independent variables. The model projects that hiring will remain well above average in 2015-2017 before decelerating significantly (below 1%) during the out-years of the forecast.

1Q15 ABSORPTION AND OCCUPANCY RATE TRENDS

OCCUPANCY RATE SUMMARY	
Occupancy Rate (Reis)	97.6%
RED 50 Rank	2nd
Annual Chg. (Reis)	Unchgd
RCR YE15 Forecast	97.2%
RCR YE16 Forecast	97.5%
RCR YE17 Forecast	97.2%
RCR YE18 Forecast	97.1%

Reis data suggest that apartment demand eased during the first quarter as metro households absorbed 394 vacant units, down from 514 in the previous quarter and 784 units during the year-earlier period. Tight markets, skyrocketing rents and limited new supply contributed to the soft space demand. Notably, supply totaled only 218 units, the smallest add in two years. At the end of the day, market occupancy averaged 97.6%, up 20 basis points sequentially and unchanged year-over-year.

Axiometrics surveys of larger, stabilized same store properties recorded a lower 96.1% average occupancy rate, up 10 bps sequentially and 30 bps y-o-y. Class-C properties recorded the highest average occupancy at 97.2%, followed by class-A (96.3%) and class-B (95.9%) properties. Class-B trends were stronger, however, showing a 50 bps y-o-y advance, followed by class-A assets (30 bps). Absorption of new units continued at a rapid rate. Properties delivered in 2014 and 2015 leased vacant units at an average of 19 units per/month, down from over 25 units during 2014 to 4Q14.

RCR specified an occupied stock growth model employing inventory, payroll and rent growth as independent variables to achieve a 90.3%% ARS. Supply will pose a challenge to market occupancy as delivery of over 10,000 units is expected through 2017. But the model anticipates that demand will nearly keep pace, fueled by robust job growth and moderating rent hikes. Consequently, occupancy should remain above the 97% level throughout the forecast.

1Q15 EFFECTIVE RENT TRENDS

EFFECTIVE RENT SUMMARY	
Mean Rent (Reis)	$1,909
Annual Change	8.2%
RED 50 Rent Change Rank	1st
RCR YE15 Forecast	7.9%
RCR YE16 Forecast	4.9%
RCR YE17 Forecast	4.1%
RCR YE18 Forecast	2.2%

Reis surveys of a broad spectrum of San Jose metro properties found that average effective rents increased $27 (1.4%) sequentially and $145 (8.2%) year-on-year to an average of $1,909, representing the first quarter of sub-9% y-o-y growth in a year's time. Class-A and class-B&C properties were nearly equally responsible for the first quarter y-o-y advance, recording respective asking rent gains of 7.8% and 7.1%.

Axiometrics surveys of larger stabilized properties recorded an 11.5% y-o-y effective rent growth rate, down from 11.9% in the prior quarter. With the exception of 4Q14, the first quarter's metric represented the fastest growth in three years. Class-A properties posted the strongest gains (12.6%), followed by class-B (11.0%) and class-C (10.8%). Assets. Average y-o-y gains of 9% or faster were observed in every metro submarket, led by Sunnyvale, where property gains averaged 13.1%.

RCR's rent model includes personal income and payroll growth as independent variables to achieve a 97.4% ARS. The model projects four percent or faster annual growth through the 2017. Rates slow further in years four and five of the forecast, falling to the low– to mid-2% range, before rebounding above 3% in 2019. Overall, rents are expected to increase at a 4.2% annual compound growth rate, substantially faster than San Francisco (3.2%) and Oakland (3.0%).

1Q15 PROPERTY MARKETS AND TOTAL RETURNS

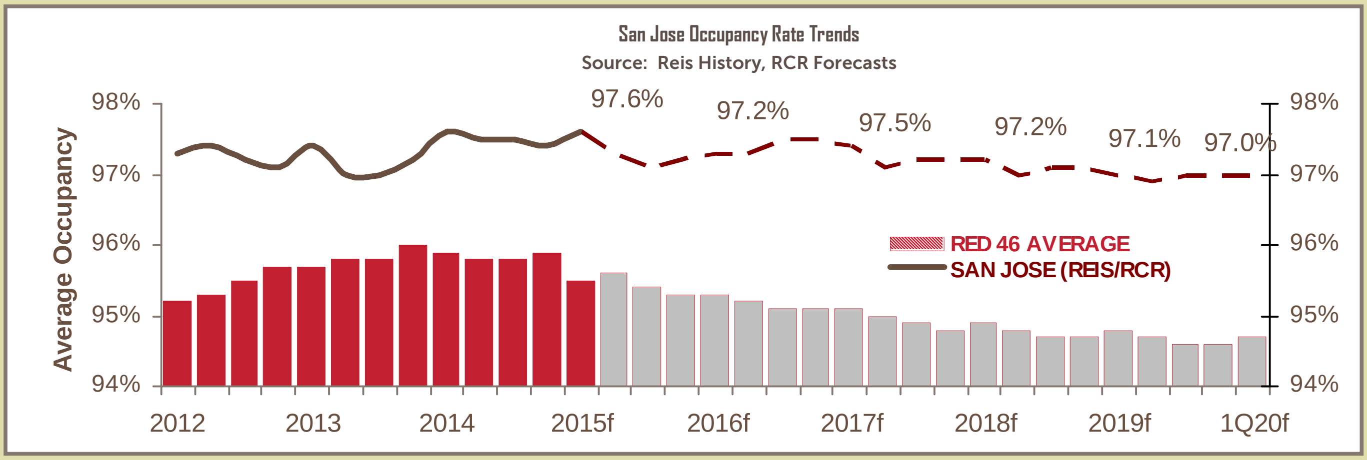
TRADE & RETURN SUMMARY	
$5mm+ Sales	1
Approx. Proceeds	$86.0mm
Avg. Cap Rate (FNM)	3.8%
Avg. Price/Unit	$459,893
Expected Total Return	7.3%
RED 46 ETR Rank	18th
Risk-adjusted Index	3.00
RED 46 RAI Rank	40th

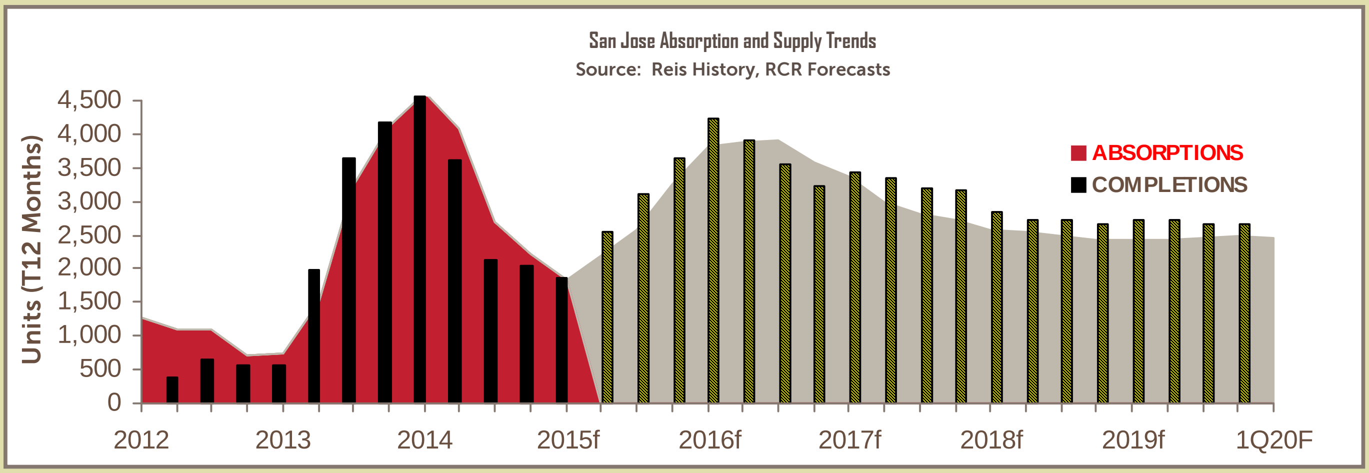
Trade in San Jose multifamily properties was slow year-to-date as few owners were inclined to part company with their scare Silicon Valley assets. Only one property of 40 or more units valued at $5 million or more exchanged hands during the first quarter, and only a single property sale was consummated in April. Both were sold as components of larger portfolio transactions.

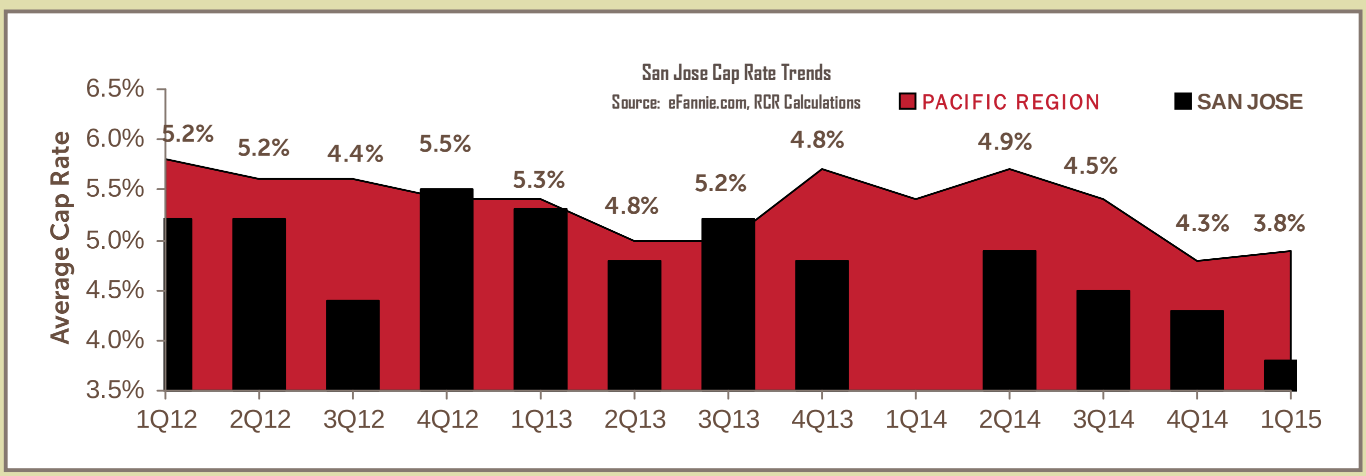
The 1Q15 trade involved a 1969 construction, class-C Mountain View property priced at the equivalent of $460,000 per unit. The April sale related to a 1997-vintage rent restricted San Jose property that was priced at approximately $211,500 per unit.

Cap rates over the past six months were largely in the high-3% to mid-4% range. Still, relative bargains could be uncovered in some high-dollar transactions. For example, a 1995-construction, class-B garden project near Blossom Hill was priced to a mid-5% yield in December with a pro forma cap rate in the high-5% area.

RCR conclude that generic San Jose class-B/B+ properties will trade at an approximate 4.4% cap rate, on par with San Francisco and about 40 bps below the East Bay norm. Using this going-in yield, a terminal cap rate of 5.0% and model derived occupancy and rent forecasts, we estimate that an investor would expect to achieve a 7.3% 5-year, unlevered total return, 40 bps above the **RED 46** mean and 18th ranked in the group. Volatility hampers risk-adjusted returns, however; San Jose ranks only 40th on this basis.

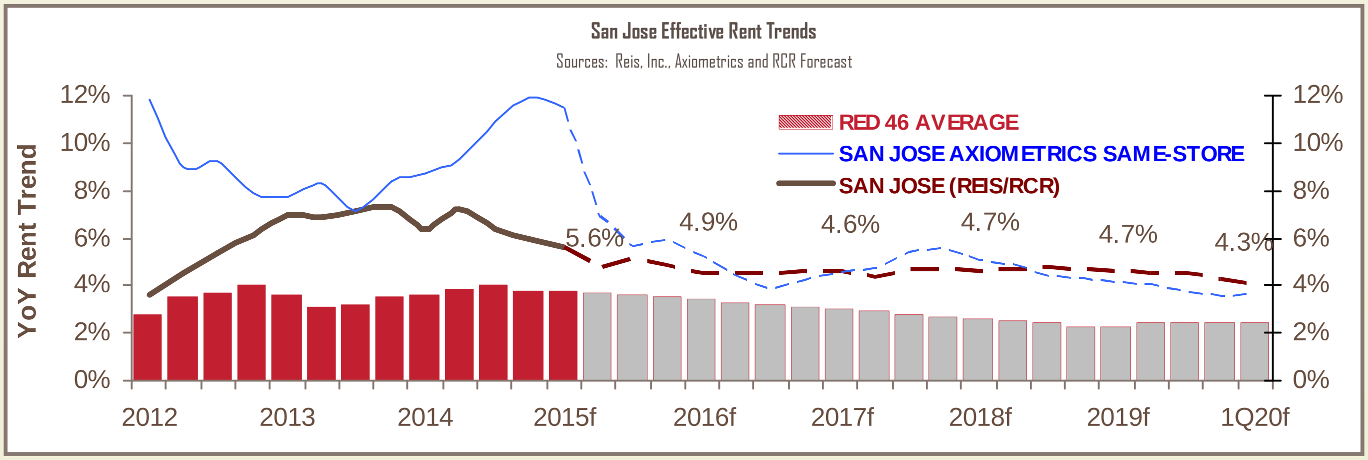


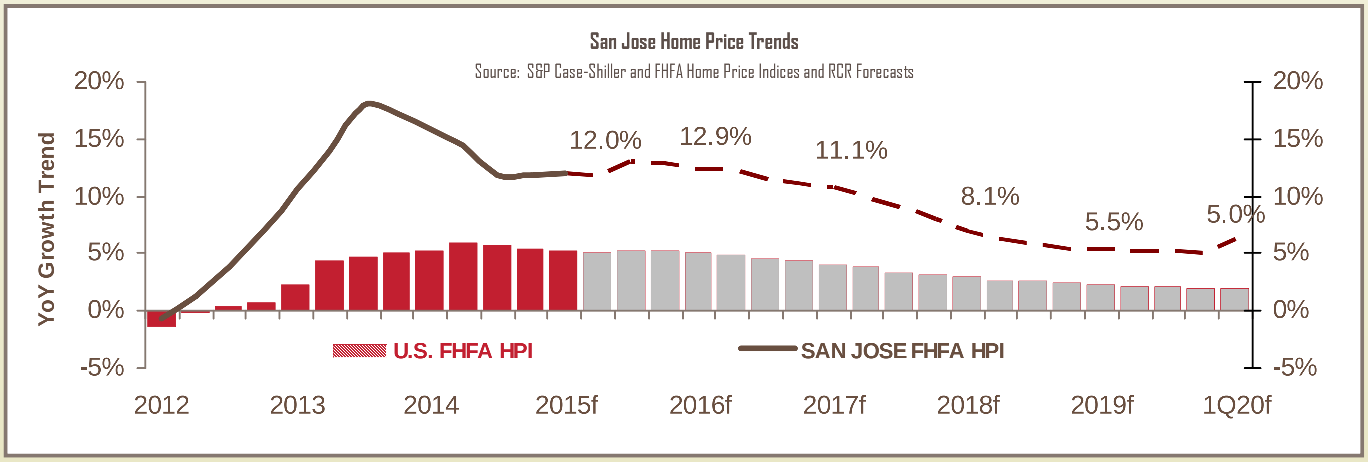


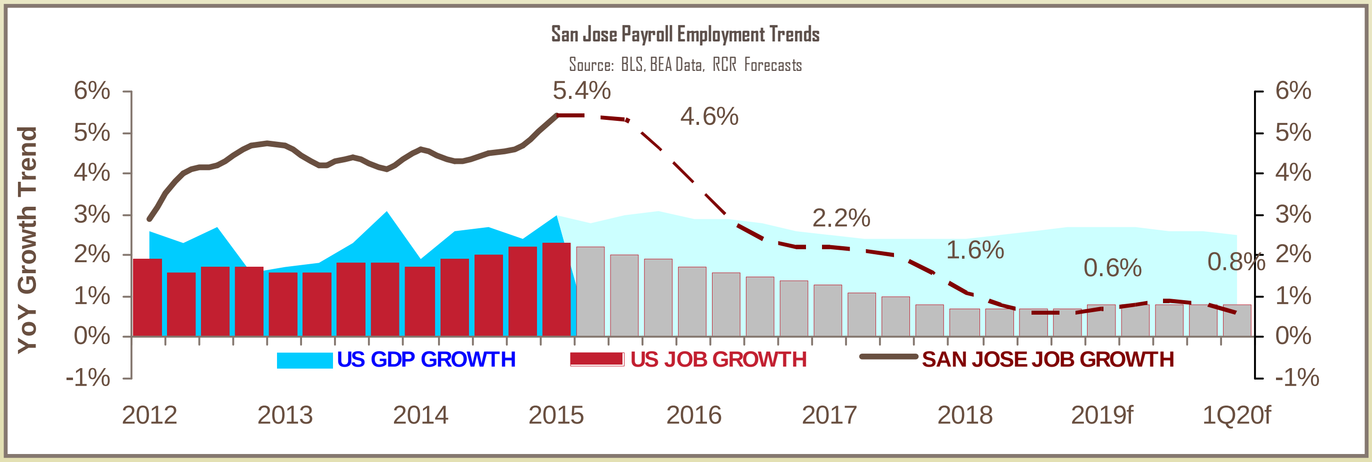


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/Type (Constr.)	Approx. Date of Transaction	Total Price <Appr. Value> / (in millions)	Price <Value> / per unit	Estimated <Underwritten> Cap Rate
Saybrook Pointe (South San Jose)	B / GLR (1995)	12-Dec-2014	$118.0	$364,198	5.3%
Highland Gardens (South San Jose)	C / GLR (1969)	10-Jan-2015	$86.0	$459,893	5.0%
514-unit Garden Apt. (Northeast San Jose)	B+ / GLR (2013)	4Q14	<$176.1>	<$476,000>	<4.4%> (FNM Refi)
28-unit Townhome Apt. (Mountain View)	B+ / TH (1998)	4Q14	<$19.0>	<$678,571>	<4.2%> (FNM Refi)

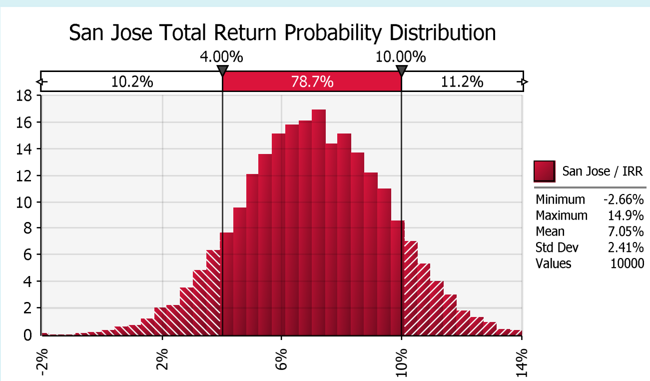

San Jose Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecast
YoY Rent Trend
RED 46 AVERAGE
SAN JOSE AXIOMETRICS SAME-STORE
SAN JOSE (REIS/RCR)
5.6%
4.9%
4.6%
4.7%
4.7%
4.3%
12%
10%
8%
6%
4%
2%
0%
2012
2013
2014
2015f
2016f
2017f
2018f
2019f
1Q20f

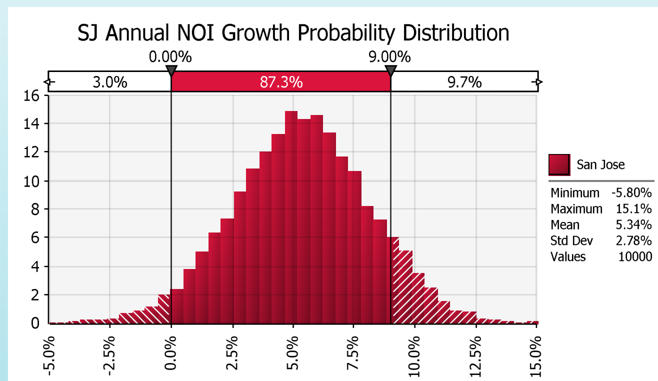

San Jose Home Price Trends
Source: S&P Case-Shiller and FHFA Home Price Indices and RCR Forecasts
YoY Growth Trend
12.0%
12.9%
11.1%
8.1%
5.5%
5.0%
U.S. FHFA HPI
SAN JOSE FHFA HPI
20%
15%
10%
5%
0%
-5%
2012
2013
2014
2015f
2016f
2017f
2018f
2019f
1Q20f


San Jose Payroll Employment Trends
Source: BLS, BEA Data, RCR Forecasts
YoY Growth Trend
5.4%
4.6%
2.2%
1.6%
0.6%
0.8%
US GDP GROWTH
US JOB GROWTH
SAN JOSE JOB GROWTH
6%
5%
4%
3%
2%
1%
0%
-1%
2012
2013
2014
2015
2016
2017
2018
2019f
1Q20f

SUBMARKET TRENDS (REIS)

Submarket	Effective Rent			Physical Vacancy		
	1Q14	1Q15	Change	1Q14	1Q15	Change
Campbell / Los Gatos	$1,487	$1,563	5.1%	1.0%	1.3%	30 bps
Central San Jose	$1,462	$1,659	13.5%	3.1%	4.3%	120 bps
Cupertino / Saratoga	$2,001	$2,407	20.3%	1.6%	2.2%	60 bps
East San Jose	$1,503	$1,641	9.2%	1.8%	1.2%	-60 bps
Mountain View / Los Altos	$2,006	$2,170	8.2%	2.6%	2.0%	-60 bps
Northeast San Jose	$1,908	$2,159	13.1%	4.6%	3.1%	-150 bps
Santa Clara	$1,712	$1,892	10.5%	1.7%	0.9%	-80 bps
South San Jose	$1,340	$1,380	3.0%	1.0%	2.8%	180 bps
Sunnyvale	$1,775	$1,933	8.9%	2.1%	2.4%	30 bps
Metro	**$1,764**	**$1,909**	**8.2%**	**2.4%**	**2.4%**	**0 bps**





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