HOUSTON, TEXAS

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q15 | July 2015

1Q15 PAYROLL TRENDS AND FORECAST

PAYROLL JOB SUMMARY

Total Payrolls	2,961.5m
Annual Change	95.4m (3.3%)
2015 Forecast	78.9m (2.7%)
2016 Forecast	63.7m (2.1%)
2017 Forecast	51.9m (1.7%)
2018 Forecast	44.0m (1.4%)
Unemployment (NSA)	4.2% (May)

Houston job creation trends during the first quarter were consistent with 2014's robust 97,500-job add as establishments hired at a 95,400-job, 3.3% year-on-year clip. Business, health care, food and lodging services remained the principal growth catalysts, collectively expanding at a 43,100-job, 4.4% annual rate, up from 4Q14's 4.1% advance. The key mining and extraction sector continued to expand vigorously despite lower oil prices, adding workers at a 6,400-job, 6.0% rate. But a sharp slowdown in construction hiring signaled that the Bayou City economy may not be immune to energy issues in the future.

Preliminary 2Q15 data suggest that the future may have arrived. Year-on-year growth decelerated to a 61,100-job, 2.1% pace, slowest in four years. Cuts in construction and mining headcounts were largely responsible.

RED Research responded by specifying the simplest forecast model possible, using only 2 lags of the independent variable, current metro personal income and U.S. payroll growth and the first lag of U.S. payroll growth as equation variables to achieve a 96.6% adjusted-R^2 without path dependence. It now projects steady growth deceleration through 2018 to the mid-1% annual rate area followed by a firming trend in 2019. Forecast period annual gains are likely to decline to the 40,000 to 70,000 job range.

1Q15 ABSORPTION AND OCCUPANCY RATE TRENDS

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	94.2%
RED 50 Rank	47th
Annual Chg. (Reis)	-0.3%
RCR YE15 Forecast	92.8%
RCR YE16 Forecast	93.3%
RCR YE17 Forecast	93.2%
RCR YE18 Forecast	92.3%

Apartment demand strengthened during 1Q15 as Houston households leased a net of 3,027 units, up from 2,255 during the seasonally stronger fourth quarter. This was the second highest winter quarter net recorded in Reis's 17-year data series. The availability of a plethora of new product located in the preferred neighborhoods was in part responsible: developers delivered 3,161 units. As a result, average occupancy was essentially unchanged at 94.2%.

The winter supply bump represents the leading edge of a wave of new product set to crest in 2015. Reis project that another 17,000 units will debut before year-end. The service expects supply to moderate after 1Q16, allowing occupancy to level off in the mid-92% range by 2017.

Although RCR models indicate that supply is unlikely to moderate materially over the forecast period, the absorption model suggests that the probability that demand will nearly keep pace through 2018 is high. Data analysis indicates that metro demand responds positively to supply, but only with a material lag. As a result, occupancy is likely to plunge about 140 basis points by year-end, but stabilize in the 93%-93.5% range in 2016-2018. The risk to occupancy will come if developers fail to taper supply after 2018.

1Q15 EFFECTIVE RENT TRENDS

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	$868
Annual Change	5.2%
RED 50 Rent Change Rank	7th
RCR YE15 Forecast	4.8%
RCR YE16 Forecast	4.2%
RCR YE17 Forecast	3.7%
RCR YE18 Forecast	3.4%

Metro rent trends gained momentum during 1Q15, elevating Houston to a rare perch among the hottest markets in the country. Sequentially, effective rents advanced $9 (1.0%) to $868 (Reis), raising the year-on-year comparison to 5.2%, the fastest gain posted in Houston since 1999 and the 7th fastest 1Q15 increase recorded among the RED 50.

Reliable Axiometrics data from 57 REIT-owned Houston properties tell a somewhat different story. These properties achieved the fastest rent increases in 2012 and 2013, averaging y-o-y gains in the 6% to 10% range, followed by moderating growth in 2014 (4%-5%), 1Q15 (3.8%) and 2Q15 (3.4%). Supply pressure was the evident catalyst as 2015 rent growth among recent construction class-A product ground to a halt. Rent trends in the supply-rich Montrose submarket were weakest (-1.7% new, -1.3% overall), bettered slightly by well-supplied Braeswood (2.2%/2.9%).

In spite of supply concerns, the RCR rent model is bullish for the Houston market overall. The modeling exercise found that lagged changes in Houston rents, U.S. and metro payroll, supply and real GDP growth explain 94.3% of changes in Houston rents. Each of these factors is constructive, yielding a robust forecast characterized by 4% or greater rent increases in 2015 and 2016, and an R46 4th ranked 5-year annual compound growth rate of 3.7%.

1Q15 PROPERTY MARKETS AND TOTAL RETURNS

TRADE & RETURN SUMMARY

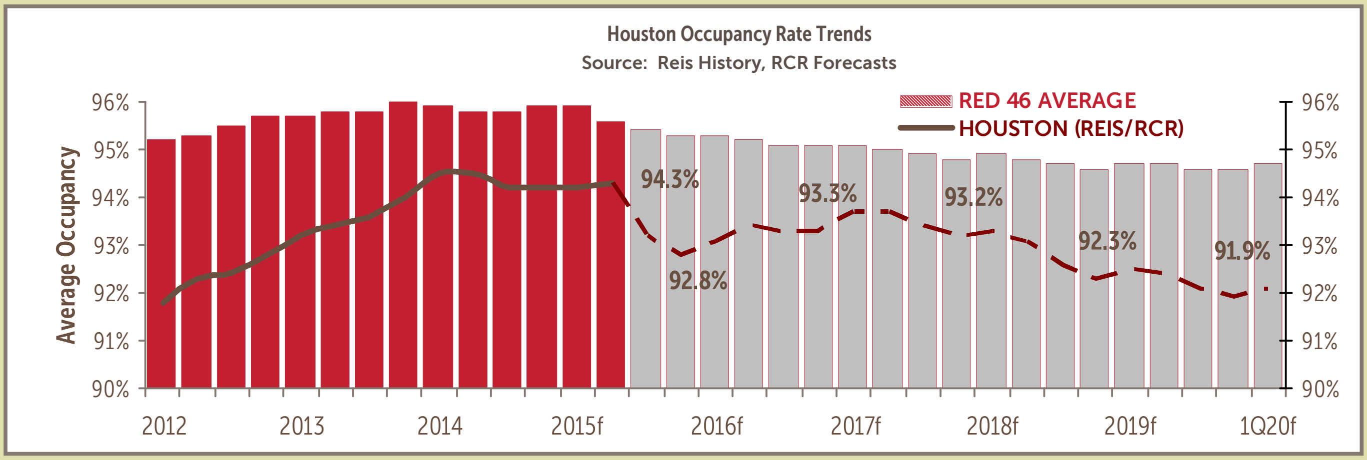
$5mm+ / 100-unit+ Sales	48
Approx. Proceeds	$1.8bn
Avg. Cap Rate (FNM)	6.5%
Avg. Price/Unit	$86,241
Expected Total Return	8.3%
RED 46 ETR Rank	4th
Risk-adjusted Index	11.21
RED 46 RAI Rank	2nd

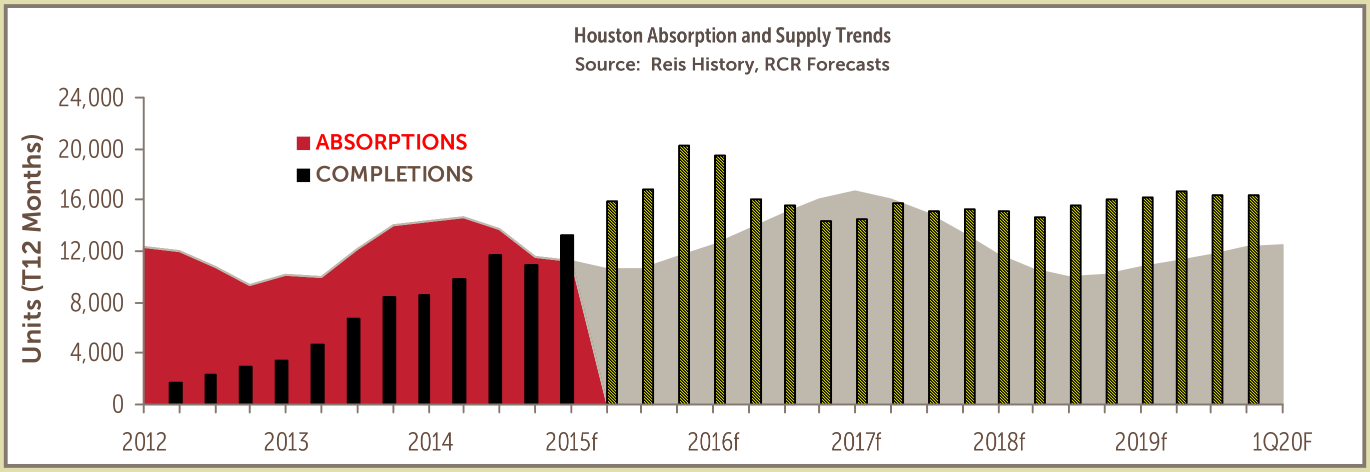
After 4Q14's record tally of 75 sales transactions of properties valued at $5 million or more (aggregate, value of nearly $2.1 billion), investors kept up the pace during 1Q15, closing 78 transactions valued at about $1.8bn. A total of nearly 21,400 units exchanged hands at an average price of about $86,200. These data compare to 20,900 units sold during 4Q14 at a $99,150 average price.

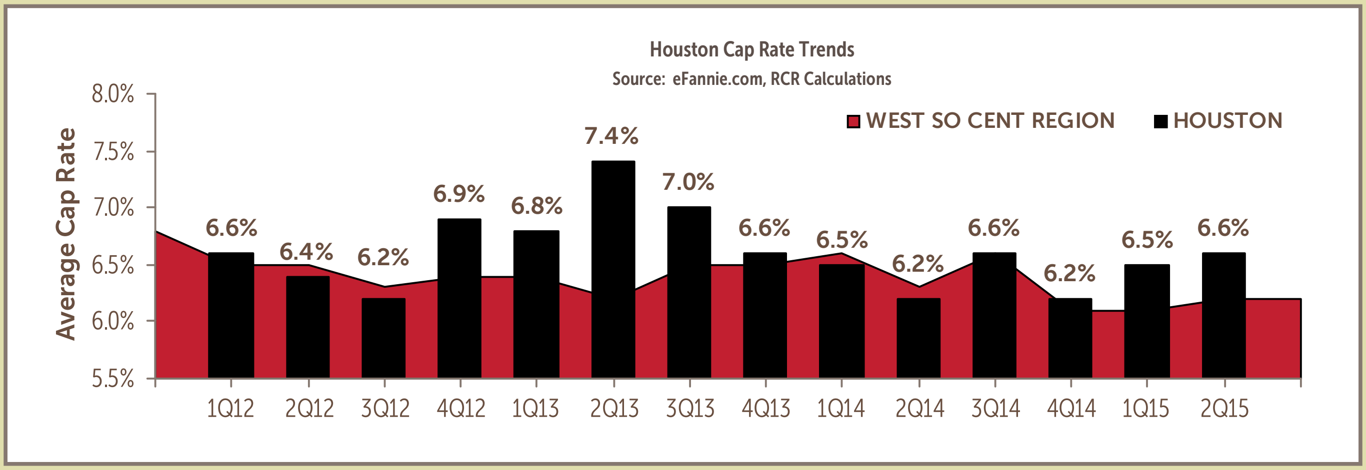
Trade velocity was slower during the spring quarter as investors acquired 55 properties valued at about $1.3bn. Buyer focus shifted to older properties and class-C repositioning situations as the average age of targets increased nine years from 23 during 1Q15 to 32 in the spring.

Offshore and domestic private equity players were aggressive buyers in the first half. Class-A West Side institutional quality assets were priced to yield in the low-5s. Standard 15—25 year-old class-B garden product traded in the mid–5% to 6% range; class-B-/C assets from 6.5% to 9%.

In light of the strong bid for Houston assets, we trimmed 10 basis points from the class-B+ cap rate proxy to 5.5%. At this level; a terminal cap rate of 6.1%; and model derived rent and occupancy forecasts, RCR estimate that an HOU investor would expect to earn an 8.3% 5-year unlevered total return, ranked 4th among the R46. Model error is below average, propelling risk-adjusted returns to 2nd spot.

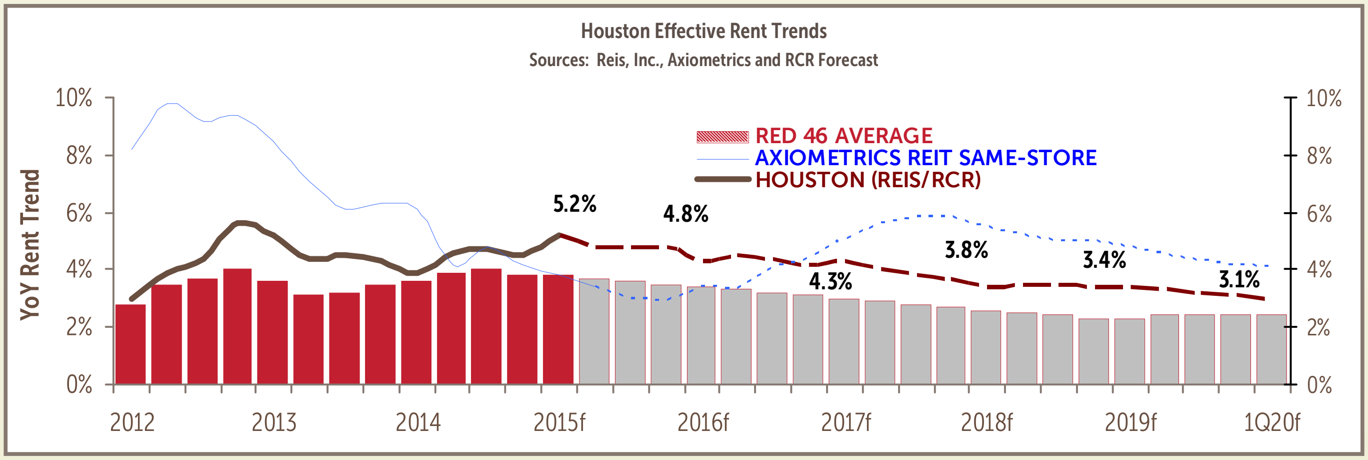


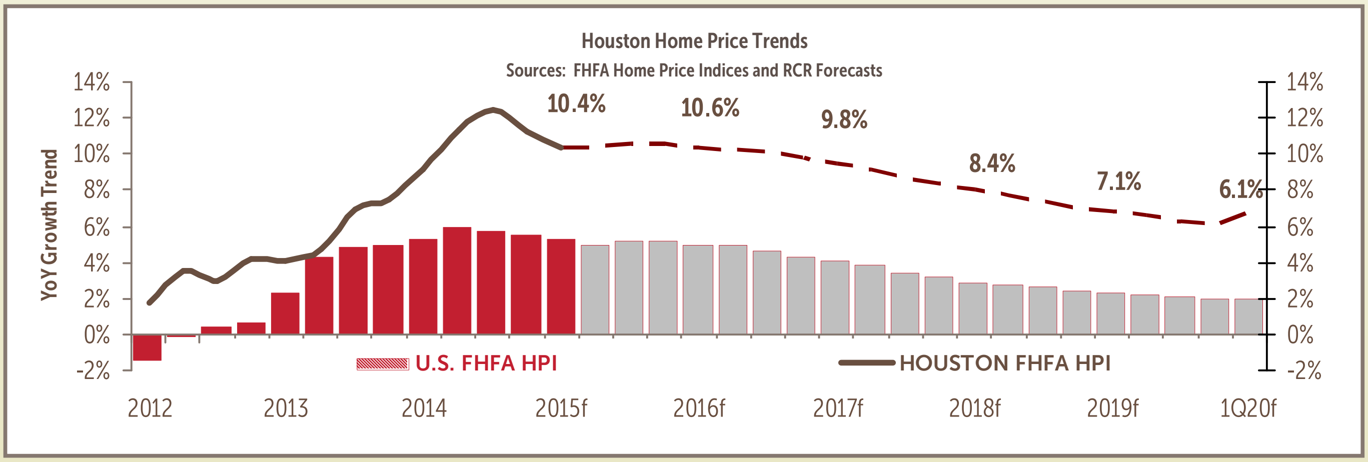


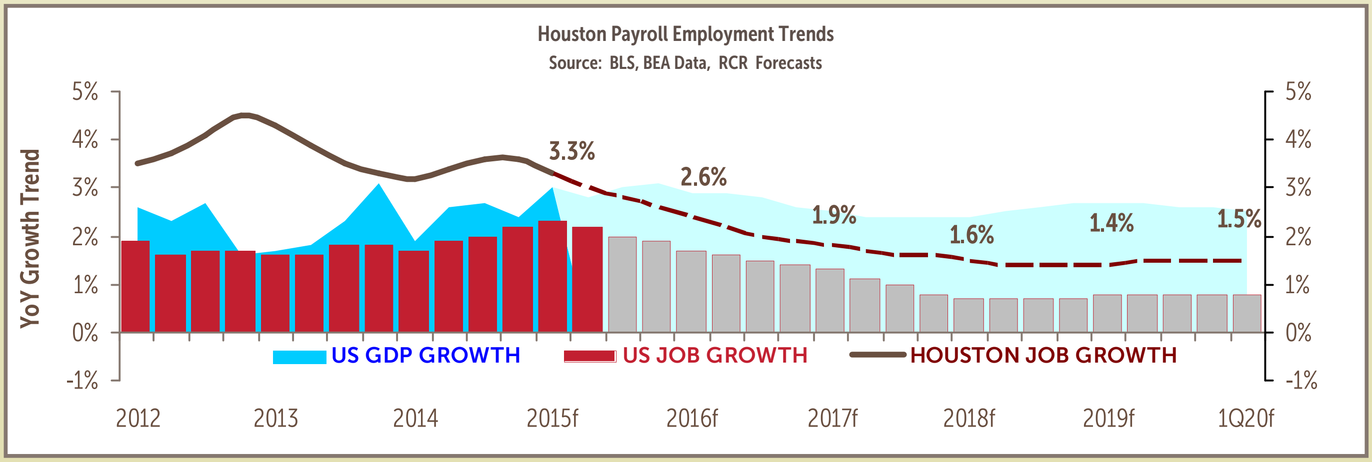


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price / (in millions)	Price / per unit	Estimated Cap Rate
Villas Hermann Park (Braeswood/W. Univ.)	A- / GLR (2000)	21-Jan-2015	$58.3	$182,313	5.0%
Park Woodland (Montgomery Co,/Conroe)	A- / GLR (2012)	20-Mar-2015	$63.5 (Alloctd)	$156,715	5.3%
Vista del Sol Apts. (Pasadena)	C+ / GLR (72/09)	30-Mar-2015	$7.5	$28,409	10.0%
Broadstone Post Oak (Montrose)	A / MR (2014)	8-May-2015	$70.7	$260,000	3.9%/6.0% p.f.
The Ranch at Shadow Lake (Briar Forest)	B / GLR (1998)	25-May-2015	$65.7	$105,288	6.0%

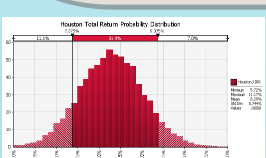

Houston Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecast
YoY Rent Trend
RED 46 AVERAGE
AXIOMETRICS REIT SAME-STORE
HOUSTON (REIS/RCR)
5.2%
4.8%
4.3%
3.8%
3.4%
3.1%
2012
2013
2014
2015f
2016f
2017f
2018f
2019f
1Q20f

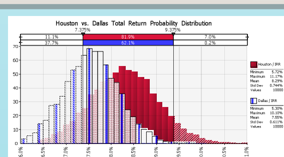

Houston Home Price Trends
Sources: FHFA Home Price Indices and RCR Forecasts
YoY Growth Trend
10.4%
10.6%
9.8%
8.4%
7.1%
6.1%
U.S. FHFA HPI
HOUSTON FHFA HPI
2012
2013
2014
2015f
2016f
2017f
2018f
2019f
1Q20f

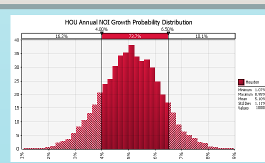

Houston Payroll Employment Trends
Source: BLS, BEA Data, RCR Forecasts
YoY Growth Trend
3.3%
2.6%
1.9%
1.6%
1.4%
1.5%
US GDP GROWTH
US JOB GROWTH
HOUSTON JOB GROWTH
2012
2013
2014
2015f
2016f
2017f
2018f
2019f
1Q20f

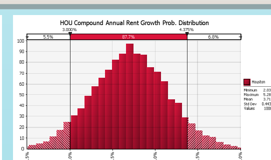
SUBMARKET TRENDS (REIS)

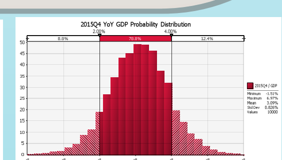
Submarket	Effective Rent			Physical Vacancy		
	1Q14	1Q15	Change	1Q14	1Q15	Change
Alief / Kirkwood	$661	$692	4.6%	7.4%	7.3%	-10 bps
Baytown	$612	$631	3.2%	10.4%	7.3%	-310 bps
Bear Creek / Katy	$910	$942	3.4%	3.7%	6.3%	260 bps
Braeswood / Bellaire	$1,111	$1,135	2.1%	4.9%	5.3%	40 bps
Briar Forest	$869	$910	4.7%	4.2%	5.3%	110 bps
Briar Grove	$910	$952	4.6%	3.6%	3.7%	10 bps
Champions / FM 1960	$757	$778	2.7%	6.4%	4.9%	-150 bps
Clear Lake / NASA	$832	$862	3.6%	3.8%	3.5%	-30 bps
Cloverleaf	$654	$681	4.2%	7.3%	5.5%	-180 bps
Cypress / Fairbanks	$862	$904	4.9%	3.1%	4.1%	100 bps
Far NW / Montgomery	$871	$919	5.5%	7.1%	11.5%	440 bps
Fondren / Westbury	$612	$629	2.9%	6.0%	4.9%	-110 bps
Fort Bend County	$1,017	$1,066	4.9%	3.8%	4.6%	80 bps
Imperial Valley	$574	$594	3.6%	11.2%	8.9%	-230 bps
Interloop / South Houston	$725	$769	6.0%	4.3%	3.6%	-70 bps
Inwood / Near Northwest	$666	$695	4.4%	7.6%	5.6%	-200 bps
Montrose / River Oak	$1,304	$1,398	7.2%	6.6%	10.6%	400 bps
North / Northeast Houston	$733	$767	4.7%	5.1%	4.4%	-70 bps
Northborough	$638	$658	3.1%	8.4%	6.7%	-170 bps
Pasadena / Deer Park	$654	$676	3.4%	5.9%	4.3%	-160 bps
Sharpstown	$650	$672	3.4%	6.5%	5.5%	-100 bps
Spring Branch	$717	$759	5.9%	4.0%	4.6%	60 bps
Spring / Humble	$843	$880	4.5%	3.4%	2.7%	-70 bps
Metro	$825	$868	5.2%	5.5%	5.8%	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