

### UPAYROLL JOB SUMMARY

|                           |              |
|---------------------------|--------------|
| <b>Total Payrolls</b>     | 2,982.2m     |
| <b>Annual Change</b>      | 62.5m (2.1%) |
| <b>2015 Forecast</b>      | 58.6m (2.0%) |
| <b>2016 Forecast</b>      | 37.8m (1.3%) |
| <b>2017 Forecast</b>      | 71.6m (2.4%) |
| <b>2018 Forecast</b>      | 83.7m (2.7%) |
| <b>Unemployment (NSA)</b> | 4.7% (July)  |

### 2Q15 PAYROLL TRENDS AND FORECAST

Payroll employment growth decelerated dramatically during the second quarter, falling from 1Q15's 95,400-job, 3.3% year-on-year performance to a 62,500-job, 2.1% pace. The decline was directly attributable to the effects of declining oil and gas prices as job growth in related industries (construction, manufacturing, wholesale trade and engineering services) declined from a robust 24,400-job, 3.6% rate in 1Q to a 4,000 (0.6%) job pace in the spring. By the same token, consumer services continued to expand at a brisk clip as retail trade and health care and leisure services added workers at a 40,800-job, 4.7% annual rate, up from 1Q's 36,300-job, 4.2% advance.

Early summer data were no better. Expressed on a seasonally-adjusted basis Houston created a net of only 400 jobs in July and August, down from 19,300 in 2014.

**RED Research** specified a 97.7% adjusted-R<sup>2</sup> (S.E.=0.3%) forecasting model using U.S. payroll growth, the rate of change of the federal funds rate and the y-o-y change of West Texas Intermediate crude prices as independent variables. Our WTI model projects sub-\$65 oil through 2016. As a result, corresponding job growth remains below 2%. Full-blooded expansion returns in 2017 as WTI recovers in the forecast out-years, triggering a return to gains in the high-2% to low-3% region in 2018 to 2020.

### OCCUPANCY RATE SUMMARY

|                              |                  |
|------------------------------|------------------|
| <b>Occupancy Rate (Reis)</b> | 94.3%            |
| <b>RED 50 Rank</b>           | 45 <sup>th</sup> |
| <b>Annual Chg. (Reis)</b>    | -0.1%            |
| <b>RCR YE15 Forecast</b>     | 92.5%            |
| <b>RCR YE16 Forecast</b>     | 92.6%            |
| <b>RCR YE17 Forecast</b>     | 92.8%            |
| <b>RCR YE18 Forecast</b>     | 92.5%            |

### 2Q15 ABSORPTION AND OCCUPANCY RATE TRENDS

Decelerating job growth didn't deter renters as households leased a net of 3,072 vacant units, according to Reis, up from 2,880 during 1Q and on par with absorption of 3,105 units during the comparable period of 2014. On the supply side, developers delivered 3,051 units, in line with recent trends, yielding a 10 bps occupancy rate gain to 94.3%.

Axiometrics surveys of 301,108 stabilized units in larger, professionally-managed properties found average occupancy of 94.8%, up 30 basis points year-on-year. Class-B assets continued to record the highest average occupancy (95.1%), trailed by classes-C (94.5%) and -A (93.9%). Class-

C properties posted the strongest y-o-y advance (250 bps), while class-A reported the weakest results – competition from new supply sent class-A occupancy tumbling -110 bps. Absorption at new construction assets continued as a subdued pace averaging about 12 units per month.

**RCR** specified a 93.1% ARS (S.E.=0.3%) occupied stock growth model using a lag of the vacancy rate and current nominal GDP and rent as independent variables. The model forecasts steady annual absorption performance averaging 12,700 units/year. Unfortunately, supply promises to average 15,250 units annually, causing occupancy to drop.

### EFFECTIVE RENT SUMMARY

|                                |                  |
|--------------------------------|------------------|
| <b>Mean Rent (Reis)</b>        | \$875            |
| <b>Annual Change</b>           | 4.4%             |
| <b>RED 50 Rent Change Rank</b> | 14 <sup>th</sup> |
| <b>RCR YE15 Forecast</b>       | 4.6%             |
| <b>RCR YE16 Forecast</b>       | 3.5%             |
| <b>RCR YE17 Forecast</b>       | 3.6%             |
| <b>RCR YE18 Forecast</b>       | 3.4%             |

### 2Q15 EFFECTIVE RENT TRENDS

Average Houston rents rose \$7 (0.8%) sequentially to \$875, according to Reis, representing the smallest quarter-to-quarter advance recorded since 1Q14. Year-over-year growth slowed considerably, falling from 5.2% in 1Q15 to 4.4%. Higher tier assets had the better of it as asking rents for class-A units increased 4.5% y-o-y; class-B&C only 3.3%.

Axiometrics same-store stabilized property data also display a decelerating trend. Recorded gains were faster than Reis, however, as this service recorded y-o-y increases averaging 5.0%, down from 5.9% in 1Q15. In this insistence class-A units struggled, achieving only a 0.4% average y-o-

y advance. Class-C properties were leaders in this instance as class rents rose 7.4%. Class-B units notched a 5.6% advance. Lower average rent submarkets chalked down the biggest YoY gains, led by Baytown (13.2%), while supply burdened Montrose posted the slowest advance (-0.6%).

**RCR** employ payroll, supply, Dallas rent, WTI price and nominal GDP growth as independent variables to specify a 91.0% ARS (S.E.=0.5%) rent forecast model. The equation yields a forecast showing slower rents in 2016, following WTI lower but stronger trends in the out-years. Compound annual growth from 2015-2020 is 3.5%; ranking **R46 #12<sup>th</sup>**.

### TRADE & RETURN SUMMARY

|                                 |                  |
|---------------------------------|------------------|
| <b>\$5mm+ / 120-unit+ Sales</b> | 17               |
| <b>Approx. Proceeds</b>         | \$712.6mm        |
| <b>Avg. Cap Rate (FNM)</b>      | 5.5%             |
| <b>Avg. Price/Unit</b>          | \$81,735         |
| <b>Expected Total Return</b>    | 7.6%             |
| <b>RED 46 ETR Rank</b>          | 12 <sup>th</sup> |
| <b>Risk-adjusted Index</b>      | 10.64            |
| <b>RED 46 RAI Rank</b>          | 3 <sup>rd</sup>  |

### 2Q15 PROPERTY MARKETS AND TOTAL RETURNS

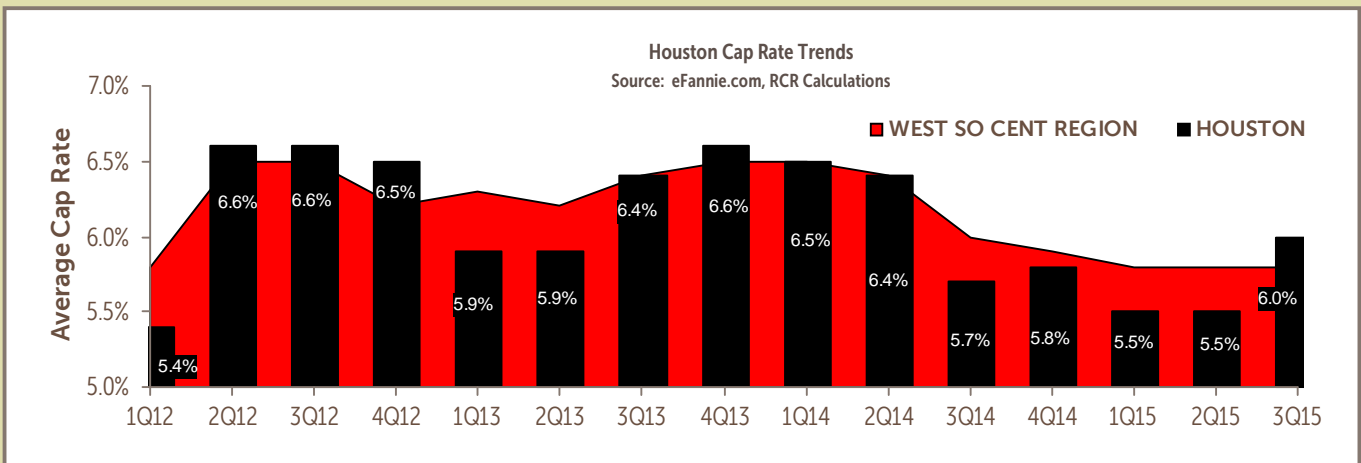
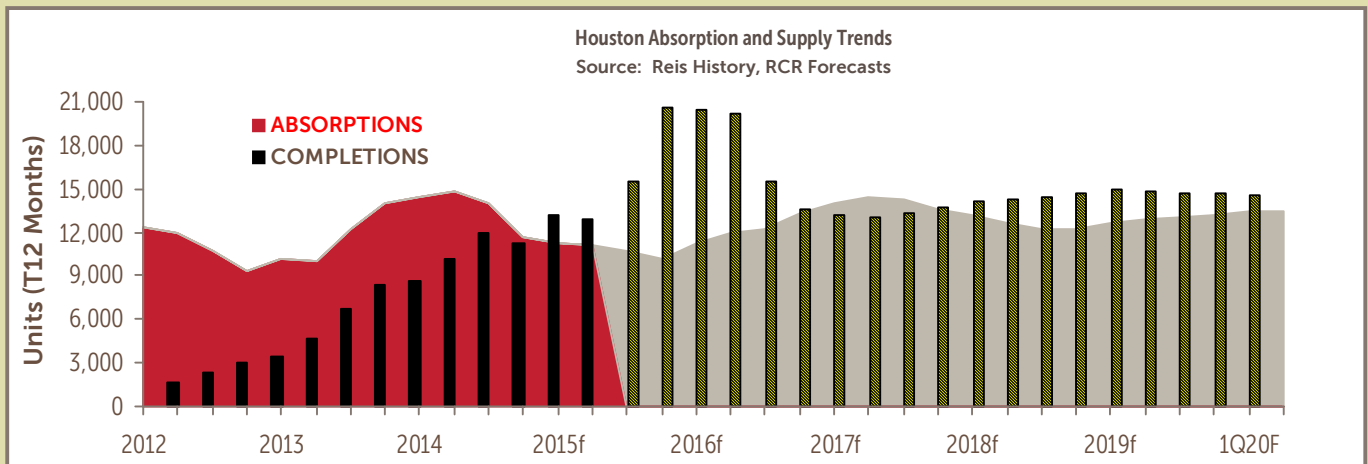
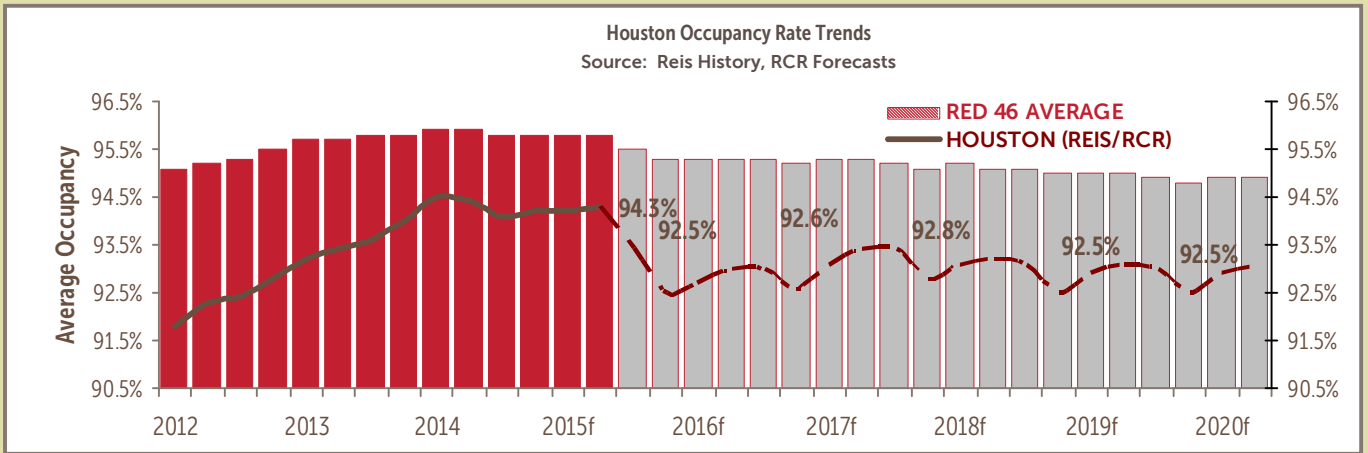
Trade velocity decelerated in the spring as investors grew more cautious following the sharp decline in global oil prices. CoStar report 43 trades of properties valued at \$5 million or more during 2Q15, down from 67 closings in the first quarter. Proceeds of transactions for which pricing data were available totaled \$712.6mm, down from \$857.0mm in 1Q15. Actual total proceeds appear to have approached \$2 billion in each quarter.

Private investors and private equity concerns were the leading purchasers, while institutions and REITs were largely absent from the fray. Buyers concentrated on older properties to capitalize on the strong performance of

lower rent class-C assets. The average age of apartments sold in 2Q15 was 29 years, up from 25 years in 1Q.

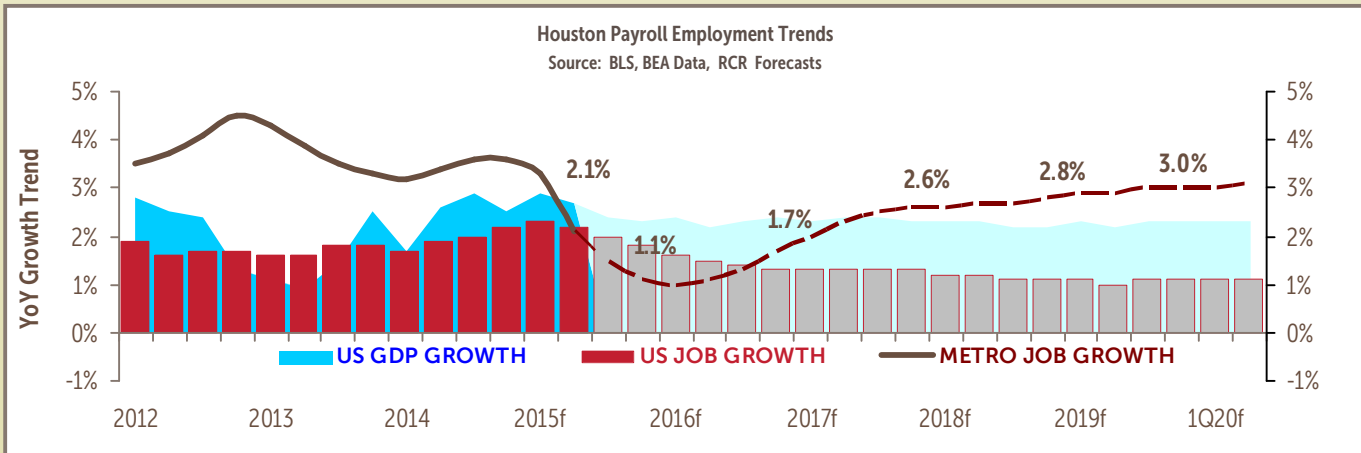
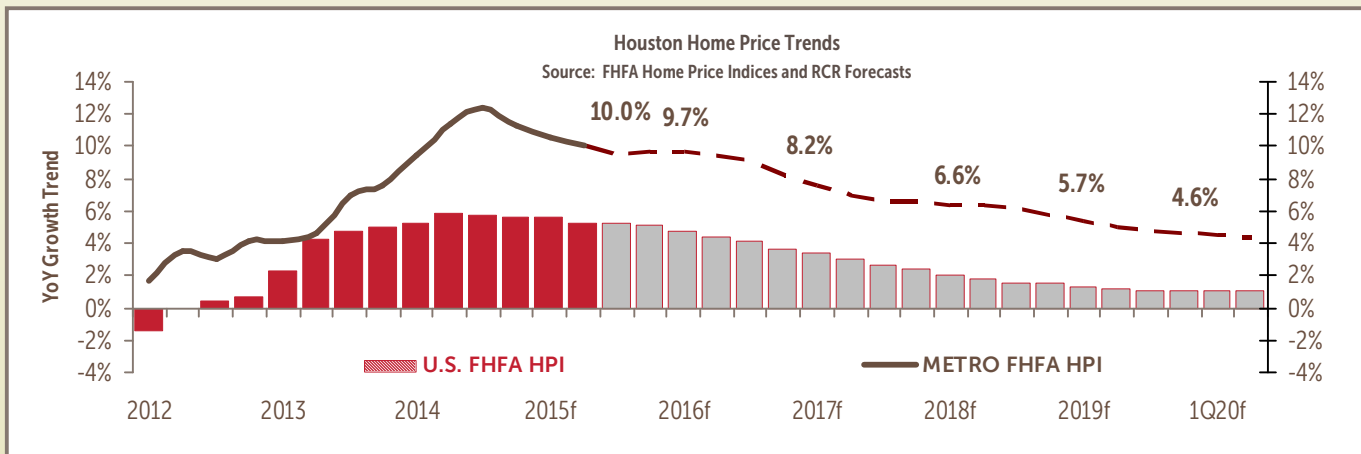
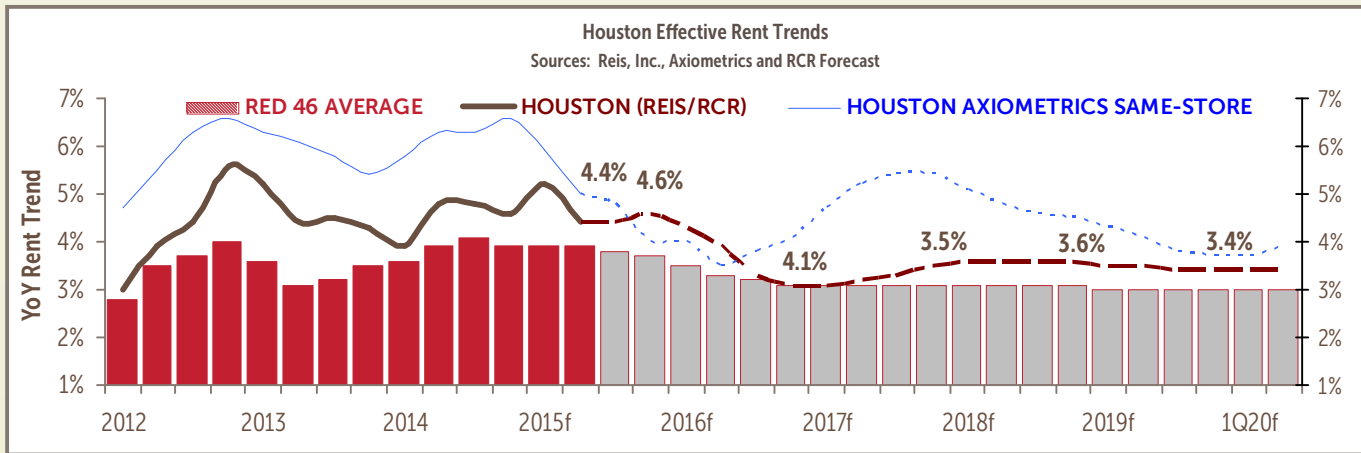
Cap rates for trophy assets can pierce the 5% floor, but most class-B+ and A- properties traded in the mid-5% to mid-6% range. Price per square foot may be a more reliable measure currently, with newer properties trading about \$125/square foot, older assets in the \$70 to \$90/sf area.

**RCR** maintain a 5.5% generic cap rate proxy. With a terminal cap rate of 6.3% and model derived occupancy and rent point estimates, we derive a 7.6% expected unlevered total return on a five-year hold, ranking 12th in the **RED 46**.



## NOTABLE TRANSACTIONS

| Property Name (Submarket)                    | Property Class/ Type (Constr.) | Approx. Date of Transaction | Total Price / (in millions) | Price / per unit | Estimated Cap Rate |
|----------------------------------------------|--------------------------------|-----------------------------|-----------------------------|------------------|--------------------|
| Broadstone Post Oak (Montrose/River Oaks)    | A+ / MR (2014)                 | 12-Apr-2015                 | \$70.7                      | \$260,000        | 3.9% / 6.5% p.f.   |
| The Ranch at Shadow Lake I&II (Briar Forest) | B / GLR (1998)                 | 26-May-2015                 | \$65.7 (reported)           | \$105,280        | 4.5%               |
| Alta Verde Apts. (Interloop/South Houston)   | C- / GLR (1979)                | 30-May-2015                 | \$69.0 (allocated)          | \$27,935         | 6.5%               |
| Preserve at Colony Lakes (Fort Bend Co.)     | B+ / GLR (2004)                | 25-Jun-2015                 | \$49.3                      | \$117,381        | 6.5%               |
| Alanza Brook (Briar Grove/Westchase)         | A- / GLR (2003)                | 1-Sep-2015                  | \$48.4                      | \$144,077        | 6.3%               |



The information contained in this report was prepared for general information purposes only and is not intended as legal, tax, accounting or financial advice, or recommendations to buy or sell currencies or securities or to engage in any specific transactions. Information has been gathered from third party sources and has not been independently verified or accepted by RED Capital Group. RED makes no representations or warranties as to the accuracy or completeness of the information, assumptions, analyses or conclusions presented in the report. RED cannot be held responsible for any errors or misrepresentations contained in the report or in the information gathered from third party sources. Under no circumstances should any information contained herein be used or considered as an offer or a solicitation of an offer to participate in any particular transaction or strategy. Any reliance upon this information is solely and exclusively at your own risk. Please consult your own counsel, accountant or other advisor regarding your specific situation. Any views expressed herein are subject to change without notice due to market conditions and other factors.

## SUBMARKET TRENDS (REIS)

| Submarket                  | Effective Rent |         |        | Physical Vacancy |       |          |
|----------------------------|----------------|---------|--------|------------------|-------|----------|
|                            | 2Q14           | 2Q15    | Change | 2Q14             | 2Q15  | Change   |
| Alief / Kirkwood           | \$667          | \$697   | 4.5%   | 7.0%             | 6.6%  | -40 bps  |
| Baytown                    | \$612          | \$636   | 4.0%   | 8.7%             | 7.2%  | -150 bps |
| Bear Creek / Katy          | \$919          | \$946   | 2.9%   | 3.5%             | 5.8%  | 230 bps  |
| Braeswood / Bellaire       | \$1,118        | \$1,141 | 2.0%   | 4.7%             | 5.3%  | 60 bps   |
| Briar Forest               | \$875          | \$914   | 4.4%   | 3.9%             | 5.0%  | 110 bps  |
| Briar Grove                | \$925          | \$966   | 4.4%   | 3.8%             | 3.8%  | 0 bps    |
| Champions / FM 1960        | \$768          | \$780   | 1.5%   | 6.0%             | 4.8%  | -120 bps |
| Clear Lake / NASA          | \$842          | \$867   | 2.9%   | 3.5%             | 3.3%  | -20 bps  |
| Cloverleaf                 | \$661          | \$681   | 3.1%   | 7.0%             | 4.8%  | -220 bps |
| Cypress / Fairbanks        | \$878          | \$909   | 3.6%   | 4.2%             | 4.1%  | -10 bps  |
| Far Northwest / Montgomery | \$882          | \$940   | 6.6%   | 6.8%             | 12.9% | 610 bps  |
| Fondren / Westbury         | \$615          | \$636   | 3.4%   | 5.7%             | 4.4%  | -130 bps |
| Fort Bend County           | \$1,032        | \$1,105 | 7.1%   | 4.2%             | 7.9%  | 370 bps  |
| Imperial Valley            | \$583          | \$603   | 3.5%   | 10.7%            | 8.4%  | -230 bps |
| Interloop / South Houston  | \$733          | \$772   | 5.3%   | 4.0%             | 3.3%  | -70 bps  |
| Inwood / Near Northwest    | \$675          | \$698   | 3.4%   | 6.9%             | 5.3%  | -160 bps |
| Montrose / River Oak       | \$1,335        | \$1,403 | 5.1%   | 8.5%             | 10.5% | 200 bps  |
| North / Northeast Houston  | \$750          | \$770   | 2.6%   | 4.3%             | 4.1%  | -20 bps  |
| Northborough               | \$644          | \$665   | 3.2%   | 7.9%             | 6.2%  | -170 bps |
| Pasadena / Deer Park       | \$660          | \$680   | 2.9%   | 5.6%             | 4.0%  | -160 bps |
| Sharpstown                 | \$655          | \$674   | 2.9%   | 6.1%             | 5.2%  | -90 bps  |
| Spring Branch              | \$719          | \$763   | 6.2%   | 3.7%             | 4.2%  | 50 bps   |
| Spring / Humble            | \$850          | \$885   | 4.1%   | 3.0%             | 2.3%  | -70 bps  |
| Metro                      | \$838          | \$875   | 4.4%   | 5.6%             | 5.7%  | 10 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