red capital group

EAST BAY, CALIFORNIA

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 3Q15 | NOVEMBER 2015

PAYROLL JOB SUMMARY

Total Payrolls	1,087.7m
Annual Change	22.0m (2.1%)
RCR FY15 Forecast	23.7m (2.2%)
RCR 2016 Forecast	24.3m (2.2%)
RCR 2017 Forecast	22.9m (2.1%)
RCR 2018 Forecast	17.7m (1.6%)
RCR 2019 Forecast	10.8m (0.9%)
Unemployment (NSA)	4.3% (Sept.)

3Q15 PAYROLL TRENDS AND FORECAST

After sliding to the slowest growth rate in nearly four years the East Bay labor market regained traction over the summer, adding payroll positions at a 22,000-job, 2.1% year-on-year rate, up from 2Q's 20,200-job, 1.9% performance. Faster hiring was observed in the business and leisure services sectors (led by their tech and food services components), which expanded at a collective 13,800-job, 4.8% pace during 3Q15, following 2Q's 9,000-job, 3.2% add. Retail trade headcounts also grew at a robust rate, rising 2,400 (2.2%) jobs, up from 1,300 in 2Q.

Seasonally-adjusted data also were redolent of a rebounding job market. This series recorded a 8,800-job net pick-up July to September, representing an increase of more than 200% over the net job creation observed during the first half of 2015 (2,600). Likewise, 4Q15 got off to a strong start with a 3,400-job gain in October.

RED Research made a modest adjustment to its East Bay payroll model, adding a nominal GDP variable to an equation using U.S. payroll and metro personal income growth as independent variables. The 97.1% adjusted-R^2 (SE = 0.4%) equation projects continuing healthy job creation at 2% or faster rates through 2017. Job gains are projected to gradually decelerate afterward as the U.S. recovery losses steam following its eighth anniversary.

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	97.5%
RED 50 Rank	3rd
Annual Chg. (Reis)	+0.3%
RCR YE15 Forecast	97.4%
RCR YE16 Forecast	97.5%
RCR YE17 Forecast	97.4%
RCR YE18 Forecast	97.2%
RCR YE19 Forecast	97.0%

3Q15 ABSORPTION AND OCCUPANCY RATE TRENDS

With a vacant inventory of only 3,742 units (Reis), the East Bay apartment market is in a de facto state of full occupancy. Net occupied stock growth is likely to be directly attributable to new supply, of which Reis identified none in the third quarter. As a result, net absorption plunged to just 15 units, the lowest tally recorded here since 2009. Metro occupancy remained unchanged sequentially at 97.5%.

Axiometrics surveys of 208 stabilized, same-store properties recorded a lower 96.2% 3Q15 occupancy rate, down -60 basis points year-on-year. Class-C assets posted the highest occupancy rate for the third consecutive quarter (96.8%). Classes-B and –A followed with 96.2% and 96.1% metrics. Among submarkets, Concord (96.8%) chalked down highest occupancy followed by San Leandro and North and East Alameda County (96.4%). Only West Contra Costa failed to top 95.7%. Three properties in lease-up absorbed an average of 23 units per month, down from 26.

RCR used the rate of change of inventory and job growth, personal income growth, S&P500 returns and a lag of vacancy to construct an econometric demand forecasting equation for the East. Bay. The 94.1% ARS (SE=0.2%) model expects demand to keep pace with supply through 2017 before slower payroll growth leads to a modest shortfall in 2018-2019, causing occupancy to decline about 50 bps.

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	$1,641
Annual Change	6.3%
RED 50 Rent Change Rank	7th
RCR YE15 Forecast	5.8%
RCR YE16 Forecast	4.1%
RCR YE17 Forecast	4.6%
RCR YE18 Forecast	3.2%
RCR YE19 Forecast	2.4%

3Q15 EFFECTIVE RENT TRENDS

Reis report that average East Bay rents increased $21 (1.3%) in sequential quarters, down from 2Q15's $35 (2.2%) surge. Rent trends decelerated in both the class-A and -B&C segments but the slowdown among the latter group was more pronounced. Class-B&C asking rent growth slowed from $33 (2.3%) in 2Q15 to $18 (1.2%) in the latest period. Reis expect rents to rise at a 3.8% compound rate through 2019.

Axiometrics data are considerably more bullish, finding average year-on-year growth of 14.1% among the stabilized same-store properties it surveys. In this case, class-A properties notched the fastest growth — 17.8% — topping classes-B (13.7%) and –C (12.5%), benefiting from demand from the affluent group of tech industry employees working across the Bay Bridge. Naturally, North Alameda submarket posted the fastest growth, while East Alameda was the sole submarket to fail to achieve a double-digit gain.

RCR specified a rent forecasting equation using income growth, S&P500 returns and lagged vacancy as independent variables. The 98.4% ARS (SE=0.8%) model projects 4% or faster rent growth through 2Q18, followed by gradually decelerating trends to the mid-2% range. Rents are forecast to rise at a 3.5% compound rate through 2019.

TRADE & RETURN SUMMARY

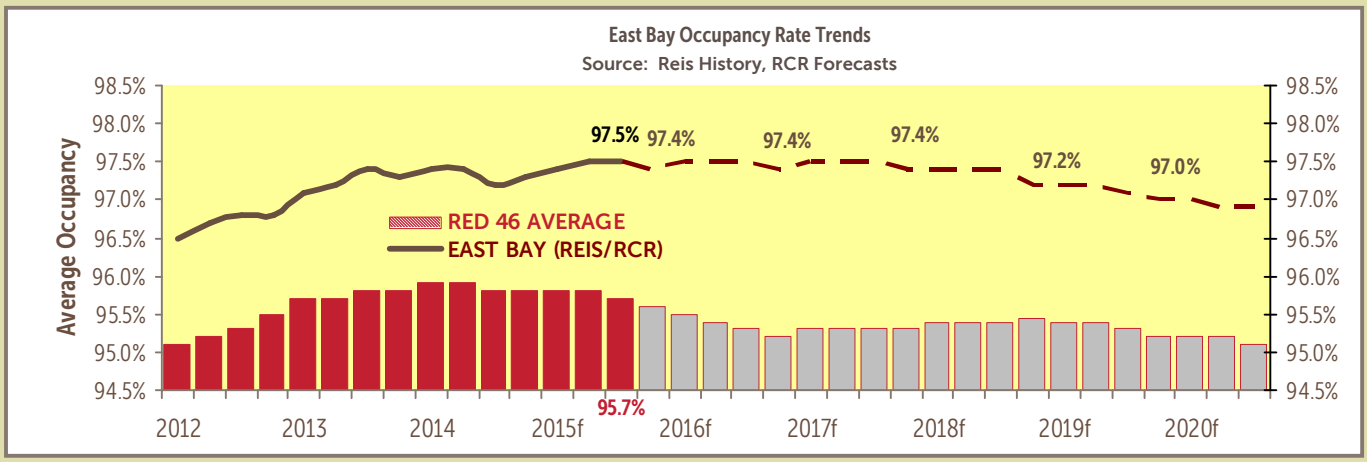
$5mm+ / 80-unit+ Sales	3
Approximate Proceeds	$65.6mm
Average Cap Rate (FNM)	4.8%
Average Price / Unit	$157,194
Expected Total Return	6.4%
RED 46 ETR Rank	33rd
Risk-adjusted Index	3.01
RED 46 RAI Rank	42nd

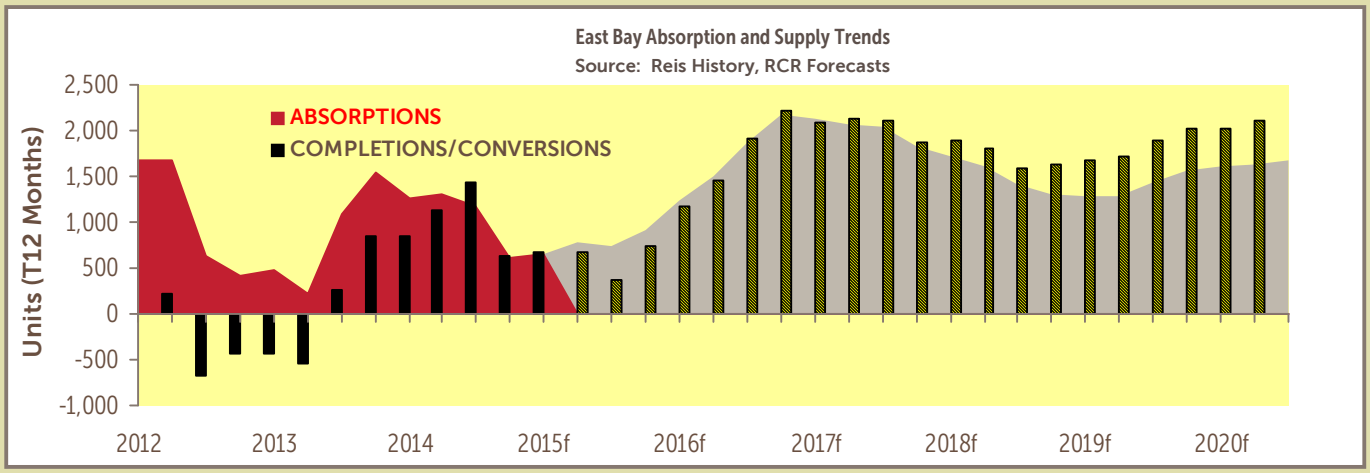
3Q15 PROPERTY MARKETS AND TOTAL RETURNS

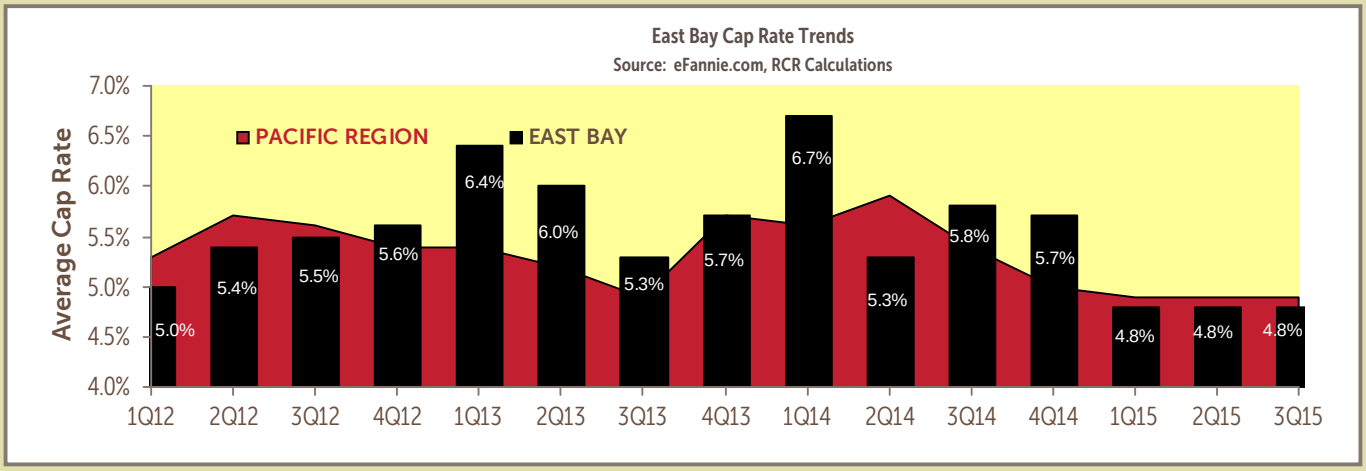
The gears of the investment sales trade ground to a near halt during the third quarter as only two properties valued at $5 million or more exchanged hands, down from 5 and 6 in the last and penultimate quarters, respectively. Gross proceeds totaled $65.6mm, comparing unfavorably to the $192.8mm and $179.4mm totals collected during the year's second and first quarters. The average unit price also declined, falling from $263,439 in 2Q to $157,194 as participating buyers moved down the property quality scale.

Recent transaction going-in yields were highly asset specific and difficult to generalize; but class-A assets appear to continue to command sub-5% cap rates despite the recent rent run-up. Class-B+/B assets traded mostly in the low-5% area. Class-B-/C properties traded in a wider range depending on location, mostly in the 5.5% to 6.5% area.

RED Research are of the mind that investment quality asset cap rates will begin to gravitate toward the 5.0% area following the sharp rise in rents and NOI. Using this purchase cap rate, a 5.8% terminal yield and model derived occupancy and rent point estimates, we estimate that an investor would expect to achieve a 6.4% annual rate of return over a five-year hold, ranking 33rd among the RED 46. Rent volatility and model standard error hinder risk-adjusted returns: East Bay ranks RED 46 #42 on this basis.

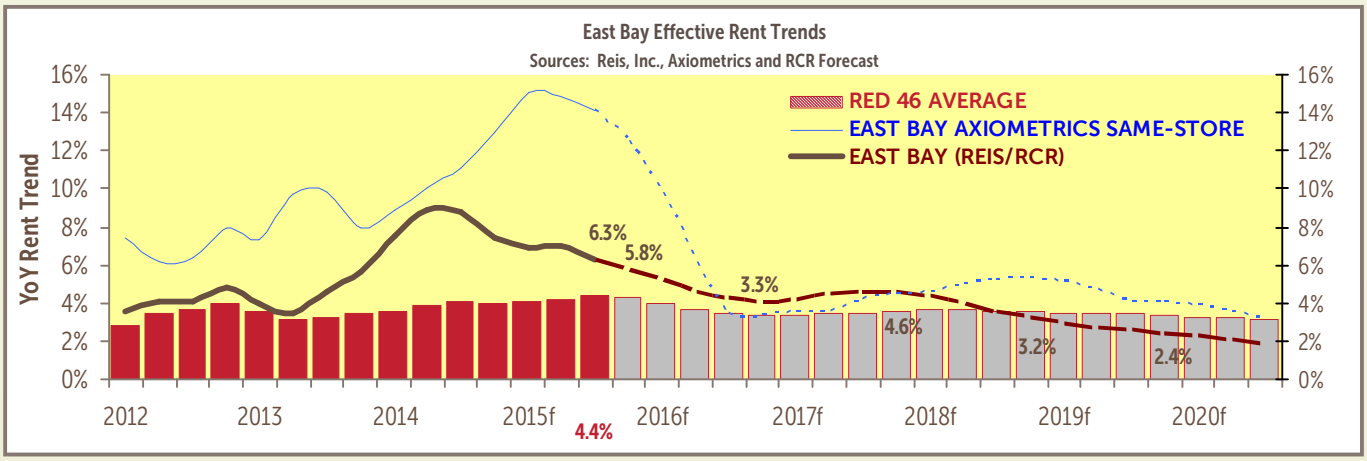


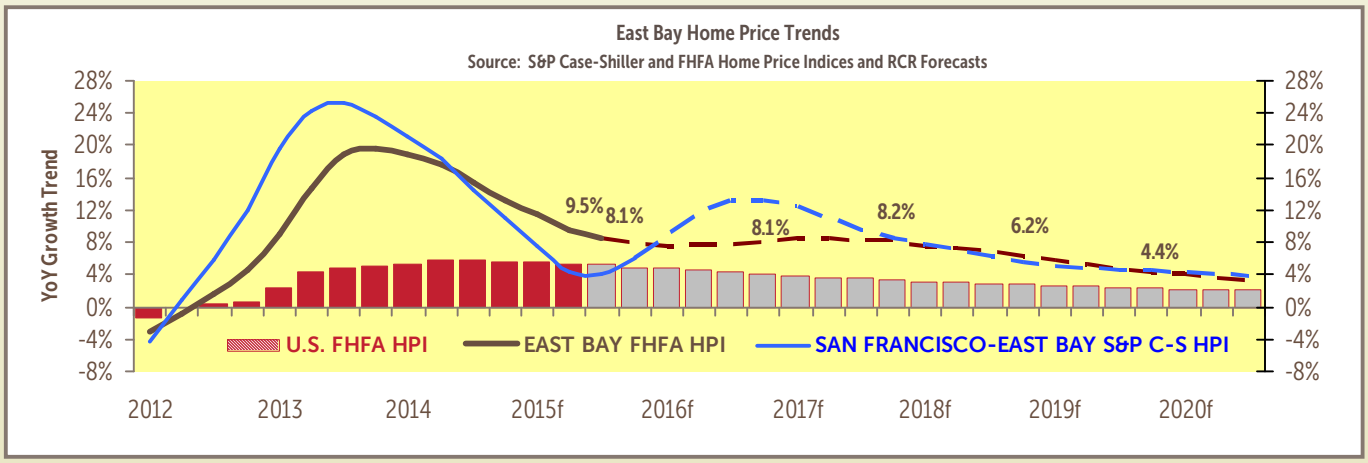


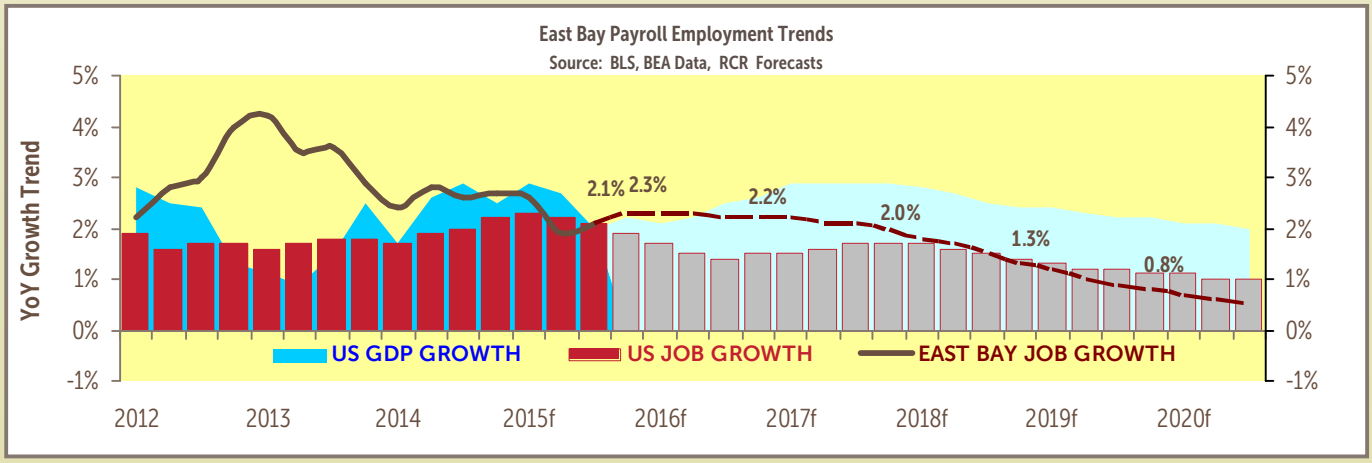


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price / (in millions)	Price / per unit	Estimated Cap Rate
Bayside Apts. (West Contra Costa/Pinole)	B- / GLR (74/06)	25-May 2015	$24.8	$167,566	5.8%
Avana Pleasanton (East Alameda)	B- / GLR (1984)	5-Jun-2015	$53.0	$353,333	4.9%
Arroyo Apts. (San Ramon / Walnut Creek)	A+ / MB MR (2015)	7-Jun-2015	$52.5 (est.)	$525,000	5.2% p.f.
Park Crossing (Solano County / Fairfield)	B / GLR (2006)	1-Aug-2015	$47.0	$235,000	5.3%
Mira vista Hills (East Contra Costa/Antioch)	C / GLR (1986)	18-Sep-2015	$39.2	$139,821	6.1%







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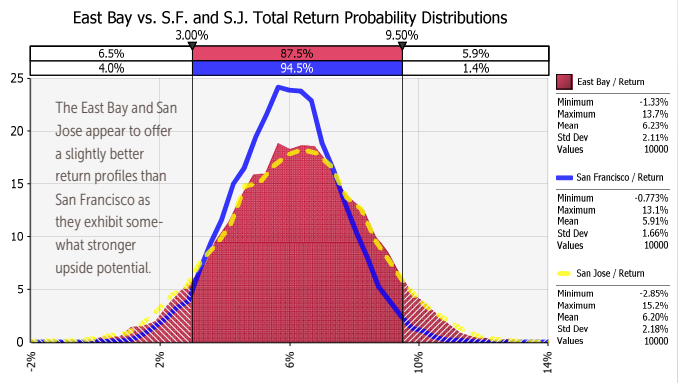
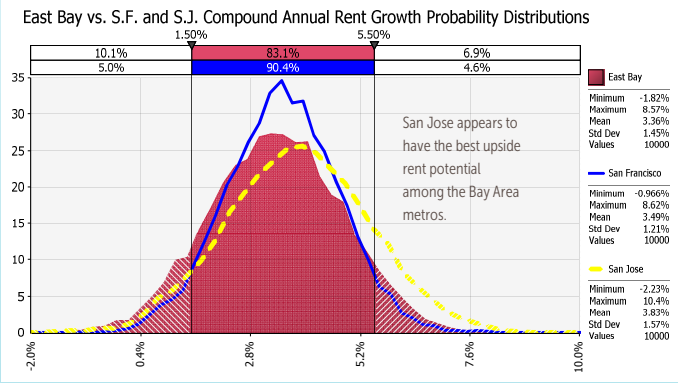
SUBMARKET TRENDS (REIS)

Submarket	Effective Rent			Physical Vacancy		
	3Q14	3Q15	Change	3Q14	3Q15	Change
Concord / Martinez	$1,377	$1,451	5.4%	2.2%	2.1%	-10 bps
East Alameda	$1,701	$1,808	6.3%	2.5%	2.1%	-40 bps
East Contra Costa	$1,308	$1,392	6.4%	3.1%	2.3%	-80 bps
Fremont/Newark/Union City	$1,579	$1,718	8.8%	1.9%	1.6%	-30 bps
North Alameda	$1,706	$1,819	6.6%	4.6%	4.8%	20 bps
San Leandro / Hayward	$1,359	$1,423	4.7%	1.9%	1.5%	-40 bps
San Ramon	$1,599	$1,650	3.2%	2.0%	2.9%	90 bps
West Contra Costa	$1,619	$1,735	7.1%	2.5%	2.2%	-30 bps
Metro	$1,544	$1,641	6.3%	2.8%	2.5%	-30 bps





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