SAN JOSE, CALIFORNIA

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 2Q16 | AUGUST 2016

PAYROLL JOB SUMMARY	
Average Payrolls	1,078.6m
Annual Change	40.4m (3.9%)
RCR 2016 Forecast	37.6m (3.6%)
RCR 2017 Forecast	37.9m (3.5%)
RCR 2018 Forecast	36.1m (3.2%)
RCR 2019 Forecast	14.8m (1.3%)
RCR 2020 Forecast	0.7m (0.0%)
Unemployment (NSA)	3.4% (May)

2Q16 PAYROLL TRENDS AND FORECAST

San Jose sustained an amazing streak of good economic form in 2Q16, recording its 17th consecutive quarter of 3.8% or faster year-on-year growth. Annual gains totaled 40,400 (3.9%) jobs, up from 39,600 (3.9%) during the first quarter. The business services sector enjoyed its best quarter in three years, adding workers at a 15,600 (7.3%) job pace, boosted by a strong performance in the tech-focused professional and technical services subsector. Only manufacturing exhibited disappointing results as headcounts increased just 700 (0.5%) jobs y-o-y, down from 2,500 (1.7%) jobs posted during the prior quarter.

The seasonally-adjusted data series displayed a considerably stronger outcome, showing a net gain of 14,600 new positions April to June. The 2Q results represented the largest single quarter advance observed since the peak of the dot.com boom in 2000, while the unemployment rate plunged in May to the lowest metric (3.4%) since 2001.

The RED Research Santa Clara Co. payroll model performed well in 1Q16 and 4Q15, recording an average error of about –1,100 jobs per quarter. But 2Q16 was a larger miss as SJ added 6,100 more jobs y-o-y than projected. The 98.3% adjusted-R^2, 0.5% standard error model forecasts steady growth above 3% for two years, followed by rapidly decelerating gains to the 0% area as the U.S. economy skids toward recession S&P500 returns stumble and metro personal income growth stalls in 2020-2021.

OCCUPANCY RATE SUMMARY	
Occupancy Rate (Reis)	96.2%
RED 50 Rank	14th
Annual Chg. (Reis)	-0.9%
RCR YE16 Forecast	95.4%
RCR YE17 Forecast	95.3%
RCR YE18 Forecast	95.2%
RCR YE19 Forecast	94.9%
RCR YE20 Forecast	94.7%

2Q16 ABSORPTION AND OCCUPANCY RATE TRENDS

Reis report that renters absorbed 432 vacant units in 1Q16, up from –29 units during the previous quarter and 368 in the year earlier period. Space demand increased again in 2Q16 to 659 units from 332 in 2Q15. New supply added to inventory amounted to 427 units in 1Q16 and 728 units in 2Q16, causing occupancy to decline less than -10 basis points during the first half. The headline occupancy rate remained at 96.2% for the fourth consecutive quarter.

Data published by Axiometrics were at odds with Reis. The firm's surveys of 235 larger, stabilized same-store properties show a 95.2% 2Q16 average rate, unchanged sequentially but down –130 bps year-on-year. Class-C properties maintained the lead for the 21st consecutive quarter on 96.5%, while class-A (95.8%) exceeded class-B (94.8%) for the second straight time. Central (96.5%) and Cupertino (96.4%) submarkets posted highest occupancy; Sunnyvale (-40 bps) and Central (-50 bps) the smallest y-o-y declines.

RCR modeling exercises find that SJ absorption is principally affected by the rates of change of San Jose inventory (+) and job (+) growth. Both factors will promote demand through 2017, but act as drags thereafter. Occupancy will most likely remain above 95% through 2018, before slowing economic growth and still robust supply growth contribute to rising vacancy in the forecast out years.

EFFECTIVE RENT SUMMARY	
Mean Rent (Reis)	$2,054
Annual Change	3.4%
RED 50 Rent Change Rank	34Th
RCR YE16 Forecast	1.6%
RCR YE17 Forecast	5.8%
RCR YE18 Forecast	5.6%
RCR YE19 Forecast	2.9%
RCR YE20 Forecast	2.0%

2Q16 EFFECTIVE RENT TRENDS

San Jose effective rents advanced sequentially at a sub-1% rate for the third consecutive quarter. Average rents increased $13 (0.7%), down from $57 (3.0%) in the comparable period of 2015. On a year-on-year basis rents gained 3.4%, ranking 34th among the RED 50. The result marked the first time SJ was out of the R50 rent growth Top 5 since 2Q10. Class-A unit deliveries and the Apple vortex boosted Northeast (7.7%) and Cupertino (4.7%) submarkets but Mountain View (0.7%) and Sunnyvale (1.1%) struggled.

Axiometrics data collected from same-store stabilized properties indicate that 2Q16 represented something of a turnaround as average rent rose $53 (1.9%) sequentially to $2,793, approaching 3Q15's peak $2,820 level. Expressed on a year-on-year basis, rents advanced 2.2%, led by classes-C (4.8%) and -A (3.5%). Among submarkets, relatively affordable East SJ (5.7%) posted the largest y-o-y increase while supply heavy Northeast (0.5%) trailed the pack.

RCR used the rate of change of San Jose payroll growth (+) and the sequential change of occupancy (+) as independent variables to specify a 99.0% ARS, S.E.=0.9% rent forecasting model. The equation forecasts a quick return to form as sustained strong job growth stabilizes occupancy in the low-95% range. Rent growth is expected to falter after 2018 as the pace of job growth diminishes.

TRADE & RETURN SUMMARY	
$5mm+ / 80-unit+ Sales	5
Approximate Proceeds	$225mm
Average Cap Rate (FNM)	4.3%
Average Price / Unit	$318,697
Expected Total Return	5.6%
RED 46 ETR Rank	40th
Risk-adjusted Index	1.65
RED 46 RAI Rank	45th

2Q16 PROPERTY MARKETS AND TOTAL RETURNS

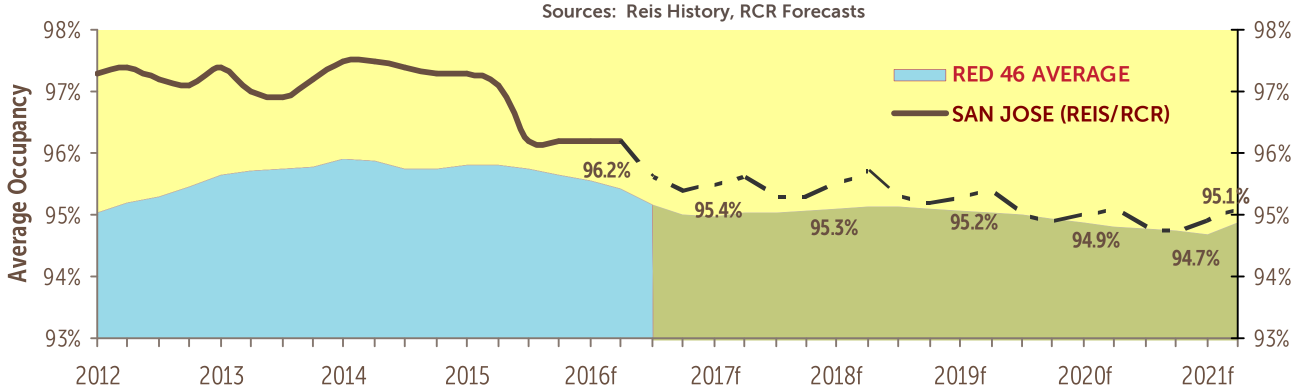
Sales velocity continued at a moderate pace held back by limited inventory and high per-unit costs. A total of 5 properties valued at $5 million or more were transacted in the second quarter, down from 6 and 9 during the previous and penultimate quarters, respectively. Proceeds totaled $225 million, also down from the two previous quarters when assets valued at about $380mm and $1.2bn were acquired. The average price per unit metric declined from nearly $440,000 in 1Q16 to $318,697, reflecting the sale of two San Jose properties that traded at less than $180,000 per unit, an anomaly in this market.

Cap rates appeared to plumb new depths, falling to as low as the mid-to -high 3% area. Indeed, a recapitalized 15-year old LIHTC property exchanged hands at a sub-2% yield.

Irrespective of the cap rates applicable to value adds, RCR believe that a yield of about 4.4% will clear a fully stabilized institutional quality property. Using this level, a terminal cap rate of 5.3% and model derived rent and occupancy point estimates, we estimate that an investor would expect to earn a 5.6% annual unlevered total return on a San Jose B+ property. This ranks only 40th among the RED 46 peer group, largely due to the weak job and rent environment projected for the out-years. The risk-adjusted index ranks 45th, hampered by high rent model standard error.

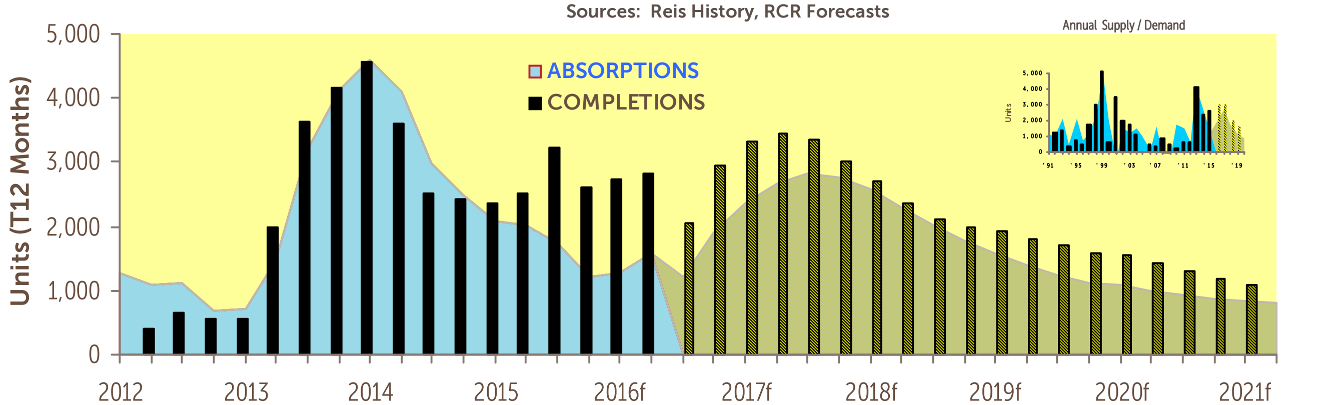
San Jose Occupancy Rate Trends

Sources: Reis History, RCR Forecasts



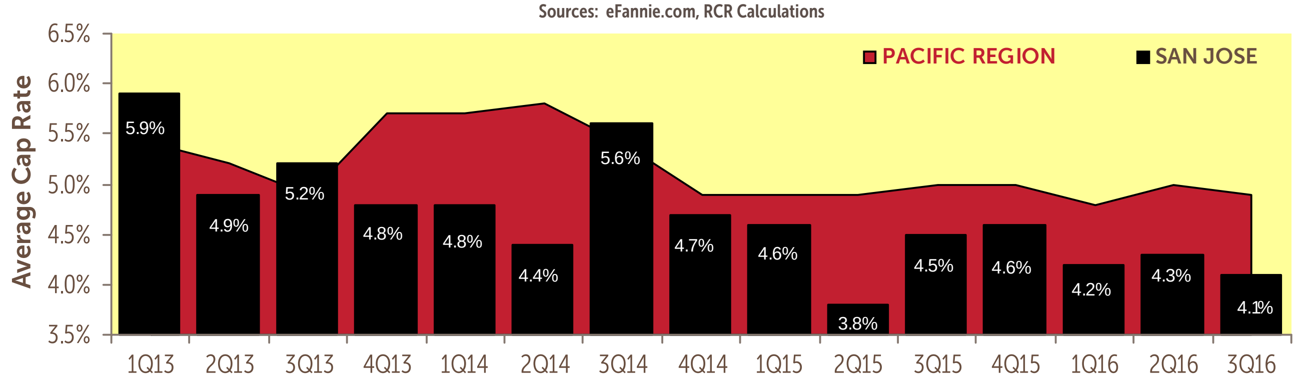
San Jose Absorption and Supply Trends

Sources: Reis History, RCR Forecasts



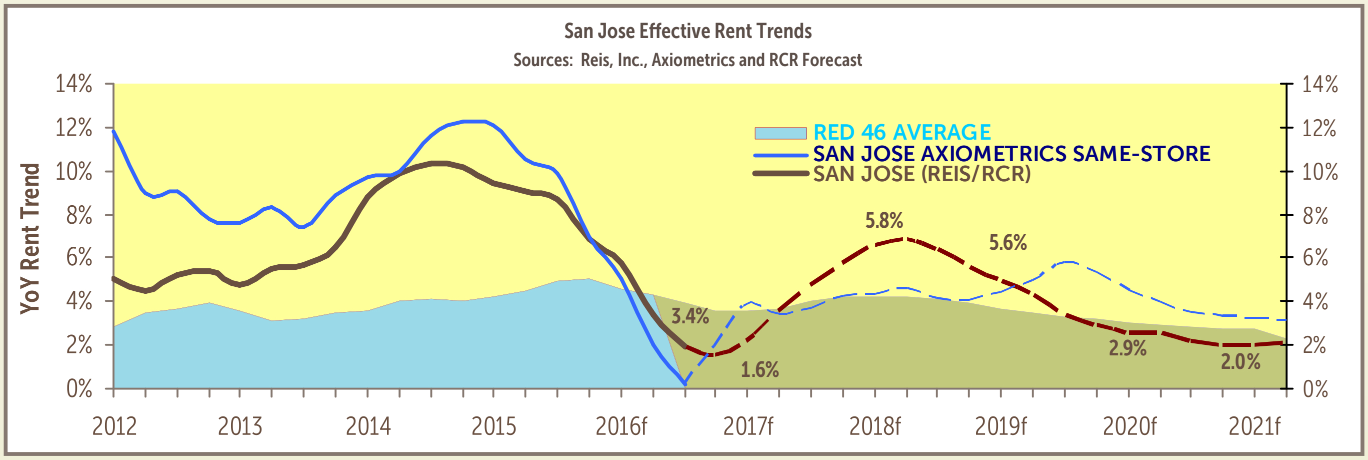
San Jose Cap Rate Trends

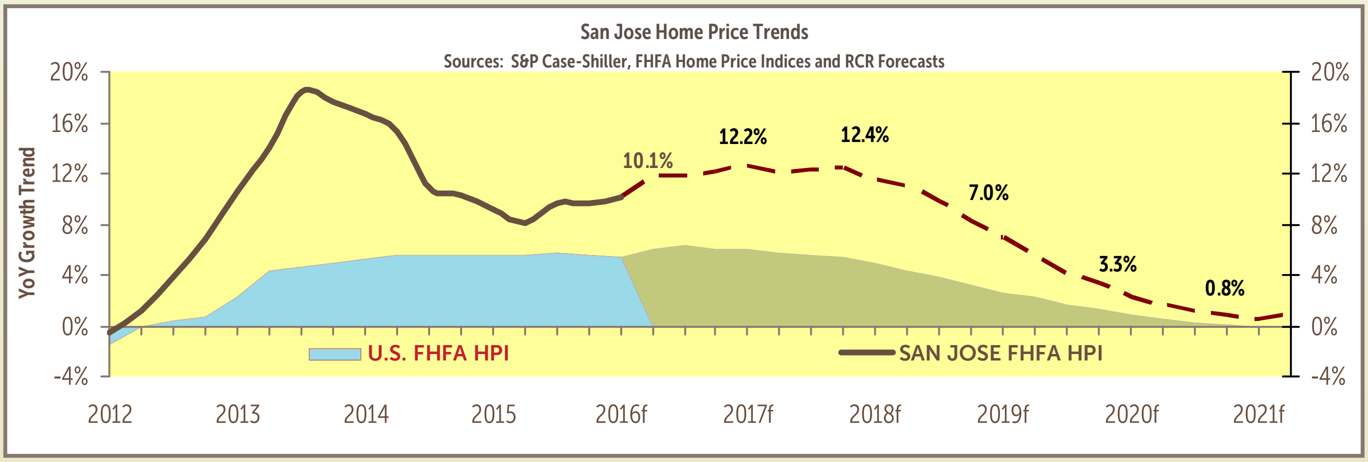
Sources: eFannie.com, RCR Calculations

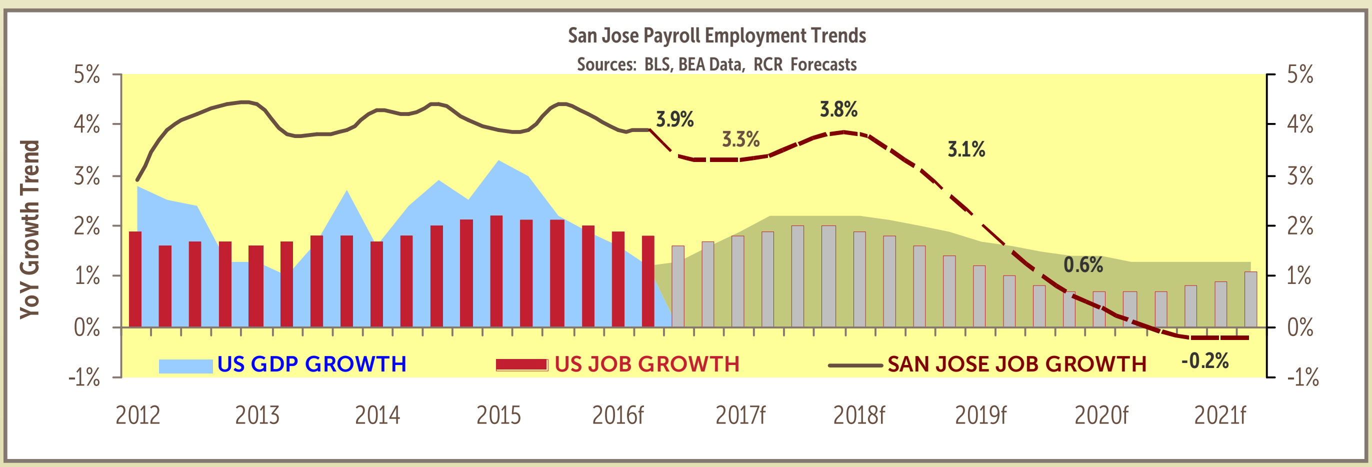


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price / (in millions)	Price / per unit	Estimated Cap Rate
Parc at Pruneyard (Campbell/Bonnett)	C+ / WF LR (1968)	20-Jan-2016	$99.8	$395,952	4.6%
Sofi at Los Gatos Creek (Central/Greylands)	C / WF LR (1971)	26-feb-2016	$55.5	$486,842	3.6%
Avana Almaden (South San Jose/Fox Chase)	B- / WF LR (1988)	30-Jun-2016	$150.5	$380,051	4.4%
Monte Vista Gardens (Santa Clara/Sierra)	LIHTC / LR (2001)	24-Jul-2016	$53.0	$368,056	1.5% pre-tax

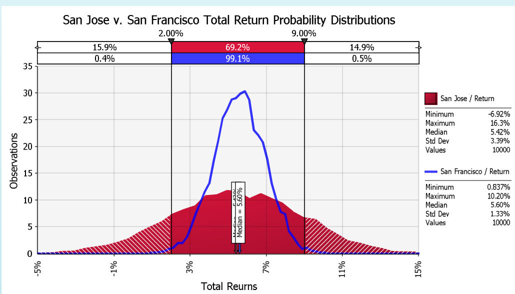

San Jose Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecast
YoY Rent Trend
RED 46 AVERAGE
SAN JOSE AXIOMETRICS SAME-STORE
SAN JOSE (REIS/RCR)
5.8%
5.6%
3.4%
1.6%
2.9%
2.0%
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

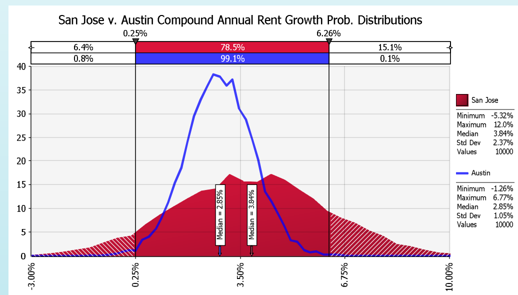

San Jose Home Price Trends
Sources: S&P Case-Shiller, FHFA Home Price Indices and RCR Forecasts
YoY Growth Trend
10.1%
12.2%
12.4%
7.0%
3.3%
0.8%
U.S. FHFA HPI
SAN JOSE FHFA HPI
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

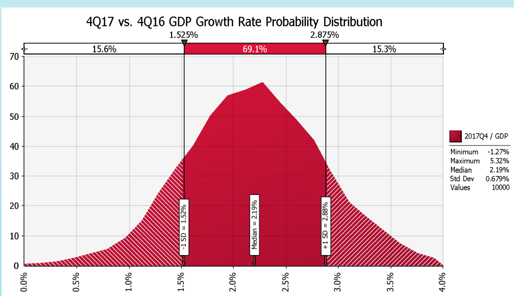

San Jose Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
YoY Growth Trend
3.9%
3.3%
3.8%
3.1%
0.6%
-0.2%
US GDP GROWTH
US JOB GROWTH
SAN JOSE JOB GROWTH
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

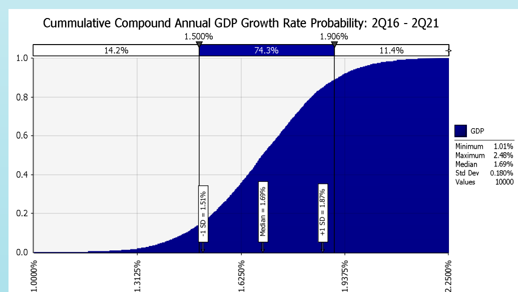
SUBMARKET TRENDS (REIS)

Submarket	Inventory % Change	Effective Rent			Physical Vacancy		
		2Q15	2Q16	Change	2Q15	2Q16	Change
Campbell / Los Gatos	2.7%	$1,610	$1,698	5.5%	1.3%	2.2%	90 bps
Central San Jose	0.7%	$1,680	$1,743	3.7%	4.0%	4.1%	10 bps
Cupertino / Saratoga	3.0%	$2,480	$2,597	4.7%	2.2%	4.3%	210 bps
East San Jose	0.0%	$1,798	$1,850	2.8%	1.0%	1.1%	10 bps
Mountain View/ Los Altos	1.5%	$2,258	$2,273	0.7%	3.3%	4.4%	110 bps
Northeast San Jose	10.6%	$2,209	$2,380	7.7%	3.2%	6.8%	360 bps
Santa Clara	0.0%	$1,939	$2,039	5.2%	0.8%	1.7%	90 bps
South San Jose	2.1%	$1,427	$1,481	3.8%	2.5%	3.5%	100 bps
Sunnyvale	0.5%	$1,987	$2,010	1.1%	2.2%	2.3%	10 bps
Metro	2.4%	$1,986	$2,054	3.4%	2.9%	3.8%	90 bps









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