COLORADO SPRINGS, CO

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 2Q16 | OCTOBER 2016

PAYROLL JOB SUMMARY	
Average Payrolls	278.5m
Annual Change	7.0m (2.6%)
RCR 2016 Forecast	7.0m (2.6%)
RCR 2017 Forecast	8.0m (2.9%)
RCR 2018 Forecast	7.6m (2.7%)
RCR 2019 Forecast	5.2m (1.8%)
RCR 2020 Forecast	4.2m (1.4%)
Unemployment (NSA)	3.9% (Aug.)

2Q16 PAYROLL TRENDS AND FORECAST

Colorado Springs payroll job growth decelerated in the second quarter, slowing from 1Q's robust 8,300-job, 3.2% rate to a 7,000-job, 2.6% year-on-year pace. Slower growth was largely due to the business services sector, which tumbled to a -100 (-0.1%) job y-o-y decline, following 900- and 1,300-job gains in 1Q16 and 4Q15, respectively. Job cuts among non-professional and non-technical workers were entirely responsible for the loss. Otherwise, super-sector trends were closely comparable to conditions observed in 2H15 and 1Q16 when Colorado Springs created payroll jobs at 3.0% to 3.5% annual rates.

Seasonally-adjusted payroll data were weaker. This series recorded a net effective 200-job loss during 1Q16, and a below trend 1,100-job advance during 2Q. Preliminary August data suggest that headcounts were essentially flat year-to-date (+800 jobs), down sharply from the 5,900-job gain posted during the 2015 January-August period.

RED Research's COSP payroll model achieves a 95.9% adjusted-R^2 (S.E.=0.6%) employing the rate of change of U.S. payroll growth as the sole independent variable. The equation foresees slower job growth through the winter quarter 2017, followed by faster job creation from 2Q17 to 3Q18. The trend corresponds to an expected rebound in U.S. economic growth during this period. Slower growth is likely to ensue in keeping with an anticipated slowdown in national trends in the forecast period out-years.

OCCUPANCY RATE SUMMARY	
Occupancy Rate (Reis)	96.6%
RED 50 Rank	8th
Annual Chg. (Reis)	+0.9%
RCR YE16 Forecast	96.6%
RCR YE17 Forecast	97.2%
RCR YE18 Forecast	97.1%
RCR YE19 Forecast	97.3%
RCR YE20 Forecast	97.4%

2Q16 ABSORPTION AND OCCUPANCY RATE TRENDS

Apartment demand weakened during 2Q16, as renters occupied a net of 83 previously vacant units (Reis), down from 246 and 122 during the year-earlier and prior quarters, respectively. The 2Q16 metric was the second fewest units absorbed in any second quarter since 2005. Absence of new supply and dwindling inventory of vacant units, especially among more affordable product (only 314 class-B&C units were vacant), were largely responsible. Average occupancy was 96.6%, up 90 basis points year-on-year.

Similar conditions were found in Axiometrics's survey of 84 larger stabilized, same-store assets. This sample was 95.9% occupied during 2Q16, a 110 bps y-o-y increase. Class-C posted the highest occupancy (97.2%) for the 7th consecutive quarter, followed by classes-B (95.7%) and –A (95.4%). Class-A (+140bps) and class-B (+130bps) recorded y-o-y occupancy gains; but class-C declined -20bps.

RCR specified relatively weak demand and supply models (due to the short COSP data history), using as independent variables occupancy change (+) and inventory growth in the former and occupied stock growth and lagged occupancy (+) in the latter. Forecasted demand consistently exceeds supply, a relationship that has been largely maintained since 2009. Occupancy gains in 2017 promise to be significant, with relative equilibrium reigning thereafter.

EFFECTIVE RENT SUMMARY	
Mean Rent (Reis)	$786
Annual Change	4.8%
RED 51 Rent Change Rank	11Th
RCR YE16 Forecast	2.9%
RCR YE17 Forecast	3.1%
RCR YE18 Forecast	3.8%
RCR YE19 Forecast	3.4%
RCR YE20 Forecast	3.7%

2Q16 EFFECTIVE RENT TRENDS

Metro effective rent continued to rise at a brisk clip in the second quarter. Average rent increased $7 (0.9%) sequentially to $786, topping the prior quarter's $6 (0.8) gain but falling short of 2Q15's $12 (1.5%) surge (Reis). Expressed on a year-on-year basis, rents advanced 4.8%, down from 5.6% in each of the prior two quarters; nonetheless the third fastest annual growth rate observed in the 17-year data history. Both classes-A and -B&C made substantial contributions. Asking rents among the former advanced at an 0.8% sequential rate, while the latter increased 0.7%.

Trends recorded in the Axiometrics sample of larger, professionally managed complexes were considerably stronger. All properties recorded an 11.1% y-o-y increase, up from 10.0% in 1Q, representing the fastest COSP gain ever observed. Among classes, "A" chalked down the biggest advance (12.6%), followed by "B" (11.6%) and "C" (8.7%).

By way of rent model, RCR used metro payroll growth$_{(t-3)}$ (+), metro occupancy (+) and the GDP deflator (-) as independent variables to specify an 88.7% ARS (S.E. 0.6%) forecasting equation. The model projects slower growth through mid-2017, before an economic rebound propels rents higher in 2018. Over the course of the 5-year forecast interval rents are expected to rise at a 3.3% annual pace, 26th fastest rate among the RED 47 peer group.

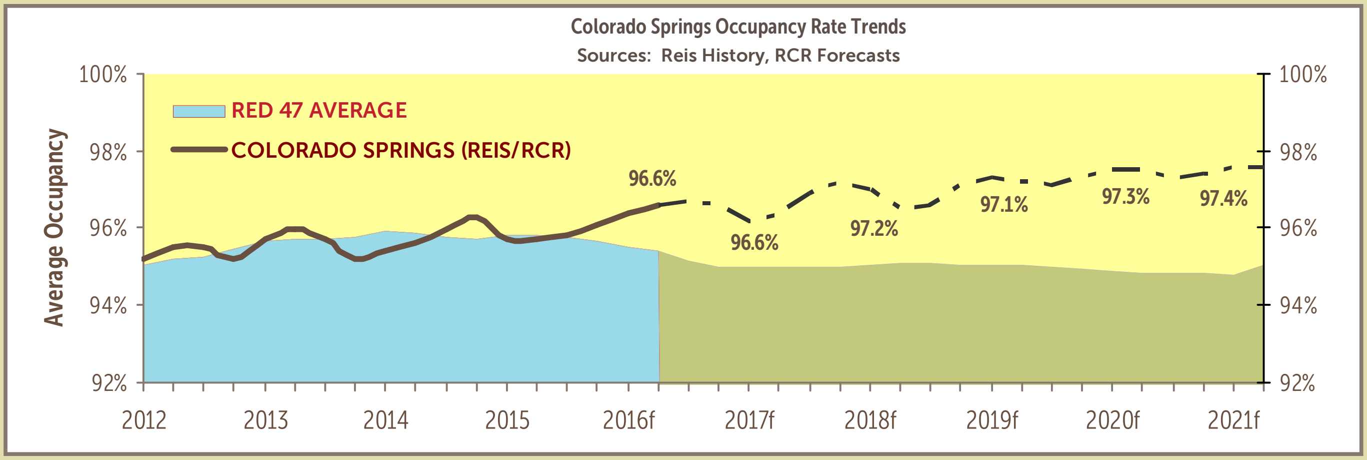
TRADE & RETURN SUMMARY	
$3mm+ / 80-unit+ Sales	4
Approximate Proceeds	$50.6mm
Average Cap Rate (FNM)	6.0%
Average Price / Unit	$65,433
Expected Total Return	7.0%
RED 46 ETR Rank	15th
Risk-adjusted Index	3.16
RED 46 RAI Rank	36th

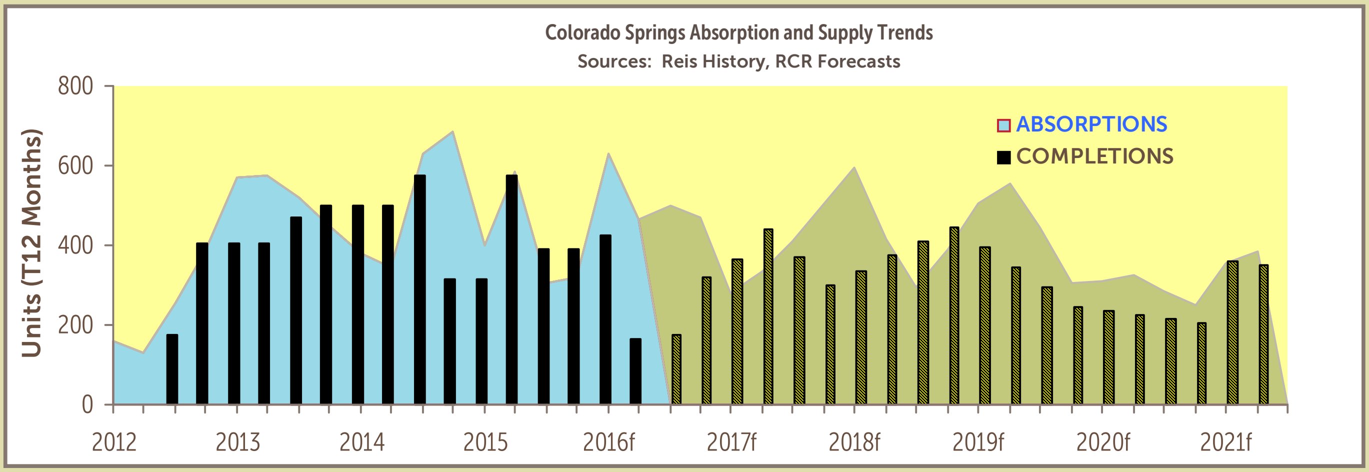
2Q16 PROPERTY MARKETS AND TOTAL RETURNS

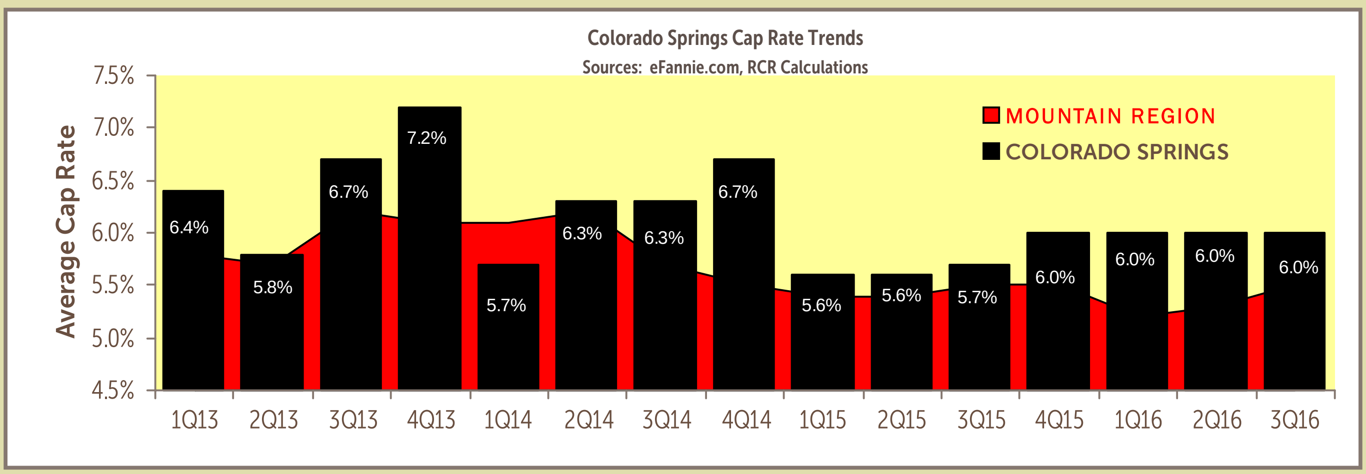
Sales velocity during the second quarter was deliberate as four investment sales were transacted, down from seven during the prior quarter. Proceeds totaled $56.6 million as compared to $118.3mm during the first quarter. With respect to the price paid per unit the second quarter recorded an average of $65,433, down sharply from $119,212 during 1Q16. As for preliminary 3Q16 results, five transactions were closed for total proceeds of $83.4mm. The average price per unit was $75,474.

Second quarter trade was focused primarily on 1970-to-1985 value-add plays. Going in cap rates for assets in this category gravitated toward the low-6% region. Newer garden complexes may be acquired at prices producing mid– to high-5% yields. Investment grade B+/A– product is likely to trade at yields between 5.0% to 5.5%.

For purposes of estimating the expected total return for a typical B+ asset we chose to use 5.5% as the purchase cap rate proxy. At this level, a terminal cap rate of 6.8%, and model derived occupancy and rent point estimates we estimate that an investor would expect to earn an IRR of 7.0% over 5 years, ranking 15th among the 47 U.S. markets we model and forecast (the RED 47). Above average supply and demand model standard error skew risks higher, lowering the *risk-adjusted index* (RAI) to peer group #36.

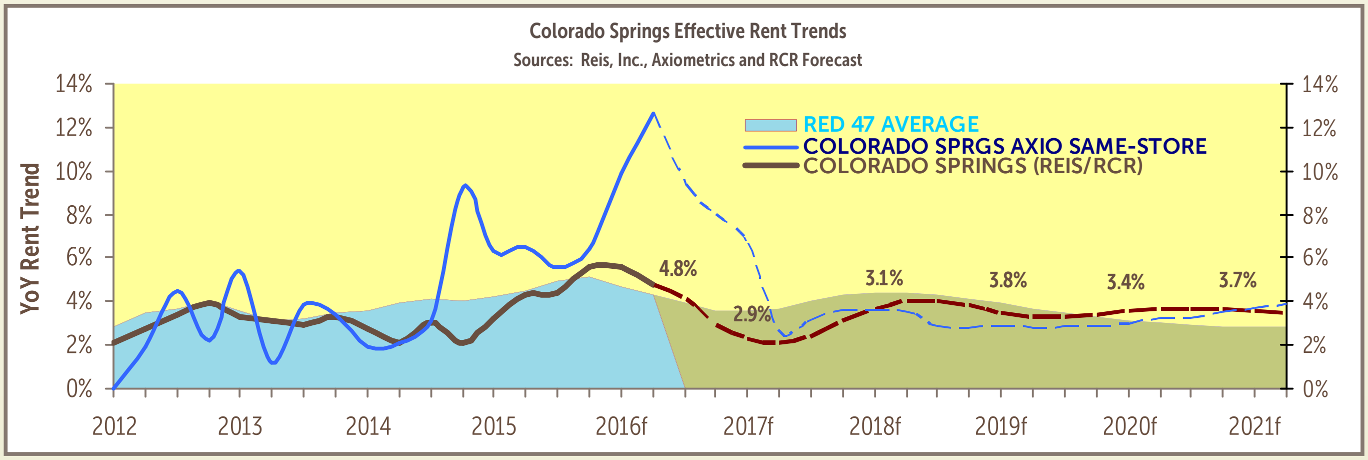


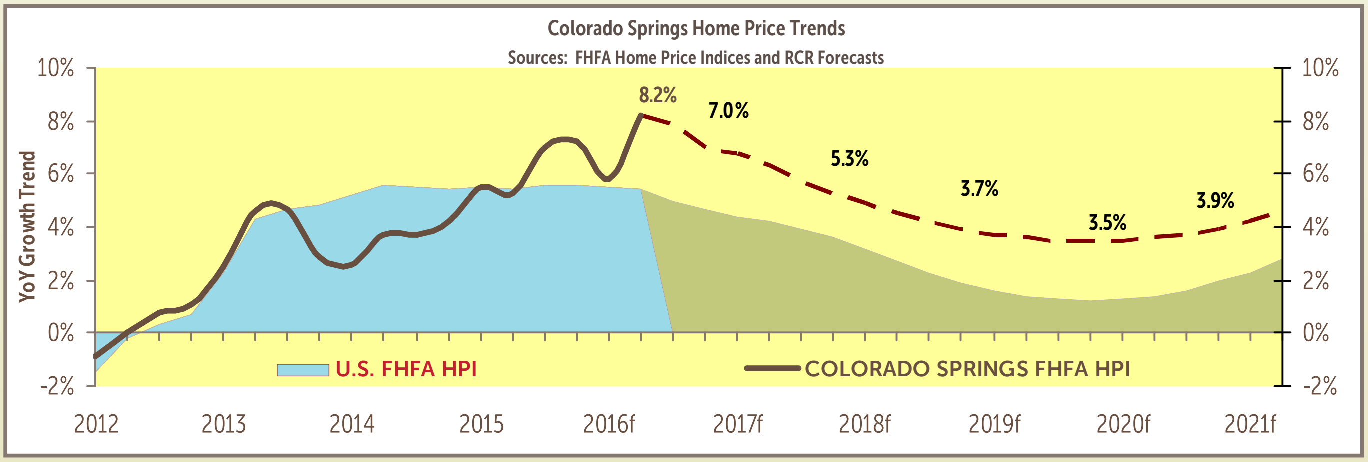


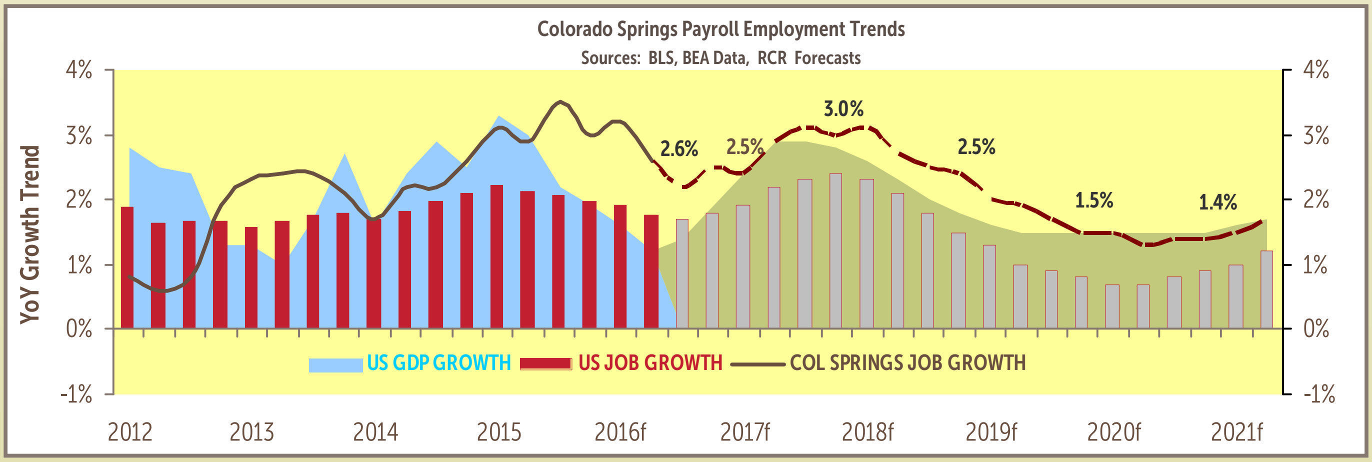


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price / (in millions)	Price / per unit	Estimated Cap Rate
Summer Grove (Far Northeast)	C MI / GLR (71/04)	5-Apr-2016	$19.2	$51,210	6.2%
Stratus Apt. Homes (South / Eastborough)	B- / GLR (1973)	29-Apr-2016	$17.4	$80,440	6.9%
Palo Verde Apts. (South / Eastborough)	B- / GLR (1984)	30-Jun-2016	$6.3	$87,750	6.4%
Cheyenne Crest (Southwest / Stratmoor Hills)	B- / GLR (1984)	12-Jul-2016	$25.0	$120,192	6.4%
Advenir Briarglen (Far Northeast / Briargate)	B- / GLR (1983)	Aug-2-2016	$27.6	$125,227	6.2%

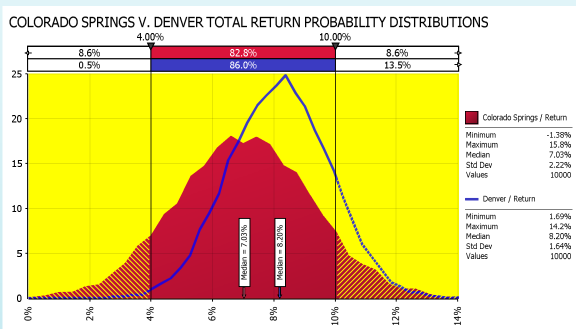

Colorado Springs Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecast
YoY Rent Trend
RED 47 AVERAGE
COLORADO SPRGS AXIO SAME-STORE
COLORADO SPRINGS (REIS/RCR)
4.8%
2.9%
3.1%
3.8%
3.4%
3.7%
14%
12%
10%
8%
6%
4%
2%
0%
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

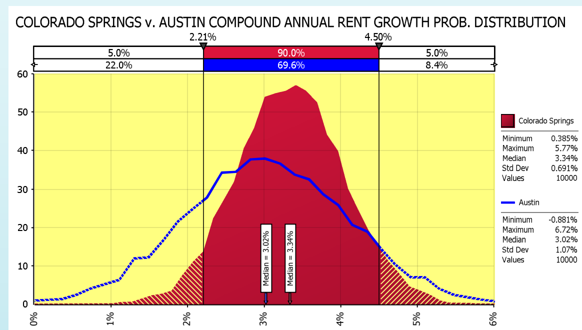

Colorado Springs Home Price Trends
Sources: FHFA Home Price Indices and RCR Forecasts
YoY Growth Trend
8.2%
7.0%
5.3%
3.7%
3.5%
3.9%
U.S. FHFA HPI
COLORADO SPRINGS FHFA HPI
10%
8%
6%
4%
2%
0%
-2%
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

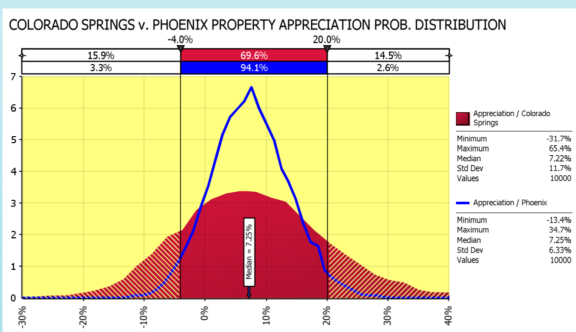

Colorado Springs Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
YoY Growth Trend
2.6%
2.5%
3.0%
2.5%
1.5%
1.4%
US GDP GROWTH
US JOB GROWTH
COL SPRINGS JOB GROWTH
4%
3%
2%
1%
0%
-1%
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

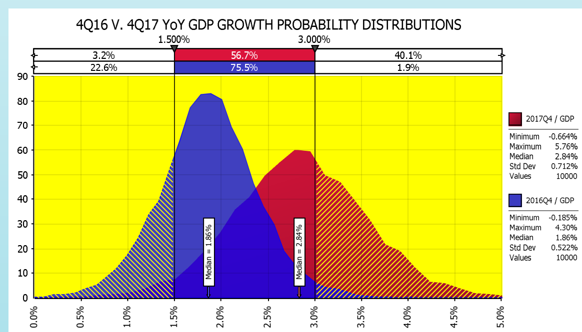
SUBMARKET TRENDS (REIS)

Submarket	Inventory % Change	Effective Rent			Physical Vacancy		
		2Q15	2Q16	Change	2Q15	2Q16	Change
Central	0.5%	$660	$698	5.8%	3.4%	2.7%	-70 bps
Northeast	0.0%	$827	$859	3.9%	3.7%	2.6%	-110 bps
Northwest	3.1%	$833	$889	6.7%	8.3%	8.7%	40 bps
South	0.0%	$614	$654	6.5%	4.9%	3.6%	-130 bps
Southwest	0.0%	$780	$803	2.9%	2.5%	1.1%	-140 bps
Metro	0.5%	$750	$786	4.8%	4.3%	3.4%	-90 bps









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