PORTLAND, OREGON

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 2Q16 | AUGUST 2016

PAYROLL JOB SUMMARY

Average Payrolls	1,142.7m
Annual Change	33.3m (3.0%)
RCR 2016 Forecast	31.6m (2.8%)
RCR 2017 Forecast	30.3m (2.7%)
RCR 2018 Forecast	25.5m (2.2%)
RCR 2019 Forecast	13..4m (1.1%)
RCR 2020 Forecast	12.8m (1.1%)
Unemployment (NSA)	5.1% (June)

2Q16 PAYROLL TRENDS AND FORECAST

Job creation in Portland MSA continued at a steady pace in the spring, rising at a robust 33,300-job, 3.0% pace, on point with the 2.9% compound annual growth rate observed since 2012. Hiring by manufacturers was considerably weaker (-100 jobs in 2Q16, down from +2,100 in 1Q) but faster annual job gains totaling 4,200 in consumer and socially funded sectors (construction, retail and government) were more than offsetting. Meanwhile, the tech sector continued to chalk down significant year-on-year gains, most notably among software publishers (3.5%), computer system designers (5.3%) and semiconductor fabricators (2.8%). Metals manufacturing was the sole sector experiencing material job losses (-6.7%), reflecting the effects on export sales of a strong dollar.

Seasonally-adjusted data were less sanguine, perhaps signaling that an inflexion point is reached. This series shows only a 900 job April to June advance, down sharply from 8,500- and 10,800-job gains during 1Q16 and 4Q15.

The RED Research payroll model suggests as much, although this has been a recurring and incorrect theme. The 97.7% adjusted-R^2 (S.E.=0.5%) model suggests that the most probable outcome is for strong but moderately slower job growth (2.6% to 2.9%) for the next two years before the centripetal force of the U.S. economy slipping toward recession begins to drag Portland back toward earth in 2019-2020. Our integrated model projects an incipient recovery building in the forecast out-year (2021).

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	95.1%
RED 50 Rank	29th
Annual Chg. (Reis)	-1.2%
RCR YE16 Forecast	94.7%
RCR YE17 Forecast	95.9%
RCR YE18 Forecast	96.5%
RCR YE19 Forecast	96.0%
RCR YE20 Forecast	95.3%

2Q16 ABSORPTION AND OCCUPANCY RATE TRENDS

Space demand was soft as renters absorbed 292 vacant units in 2Q16, according to Reis, fewest in any quarter in four years. RCR's in-sample forecast for 2Q was 406 units. Unusually small supply was partly at fault as developers completed only 349 new units, the smallest inventory add in nearly three years. But households still had plenty of fresh product to choose from — 5,600 units were added to inventory over the previous five quarters — suggesting a degree of lost momentum. At the end of the day, occupancy was statistically unchanged sequentially at 95.1% but 120 basis points lower than the year-earlier period.

Axiometrics surveys of stabilized, larger same-store properties found a brighter picture. Occupancy averaged 95.5% in 2Q16, but down -120 bps YoY, as well. Class-C (96.5%) posted the highest level for the 21st consecutive quarter, followed by classes-B (95.7%) and –A (94.1%), which likewise was low-man on the pole for the same 5-year period.

RCR's statistical analysis finds that inventory and job growth are the largest influences on metro absorption. Both factors are expected to contribute to healthy demand through 2018, with about 9,300 units absorbed during the three-year period. Occupancy should increase to the 96% area by 4Q18, as a result, before receding again in the out years as a period of slow or no job growth ensues.

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	$1,049
Annual Change	7.6%
RED 50 Rent Change Rank	2nd
RCR YE16 Forecast	5.5%
RCR YE17 Forecast	5.5%
RCR YE18 Forecast	5.3%
RCR YE19 Forecast	3.7%
RCR YE20 Forecast	2.6%

2Q16 EFFECTIVE RENT TRENDS

After a sluggish winter quarter rent trends warmed up in the spring. Average effective rent increased $15 (1.4%) sequentially, according to Reis, up from 1Q16's 5-year low $7 (0.6%) advance. The year-on-year comparison dipped from 9.0% to 7.6% nonetheless, but Portland dropped only one place in the RED 50 rankings; slipping from 1Q16 #1 to second. Classes-B&C were largely responsible as asking rents rebounded from 1Q's rare –0.2% sequential decline to a robust 1.2% advance. Class-A stayed the course adding a 1.2% sequential gain in 2Q16 after 1Q's solid 1.3% gain.

Axiometric's comparison of stabilized same-store properties recorded a 9.3% y-o-y increase, boosted by a seasonally-aided 4.3% sequential quarter gain (PORT posted a 7.5% surge in 2Q15). Class-B was strongest, notching a 10.6% y-o-y hike for the 11th consecutive quarterly lead; classes-C and –A followed at 9.2% and 4.3%, respectively.

RCR used metro income (+), occupied stock (+) and inventory (-) growth and Baa bond yields (-) as independent variables to specify a 94.5% ARS (S.E.=0.6%) rent forecasting equation. The model generates a constructive forecast calling for 5%+ annual gains though 2018. By contrast, Reis project 3.7% and 2.7% gains in 2017 and 2018. But an economic downturn in 2019 will weigh on rents, too, holding gains to 2% - 3% in the forecast out-years.

TRADE & RETURN SUMMARY

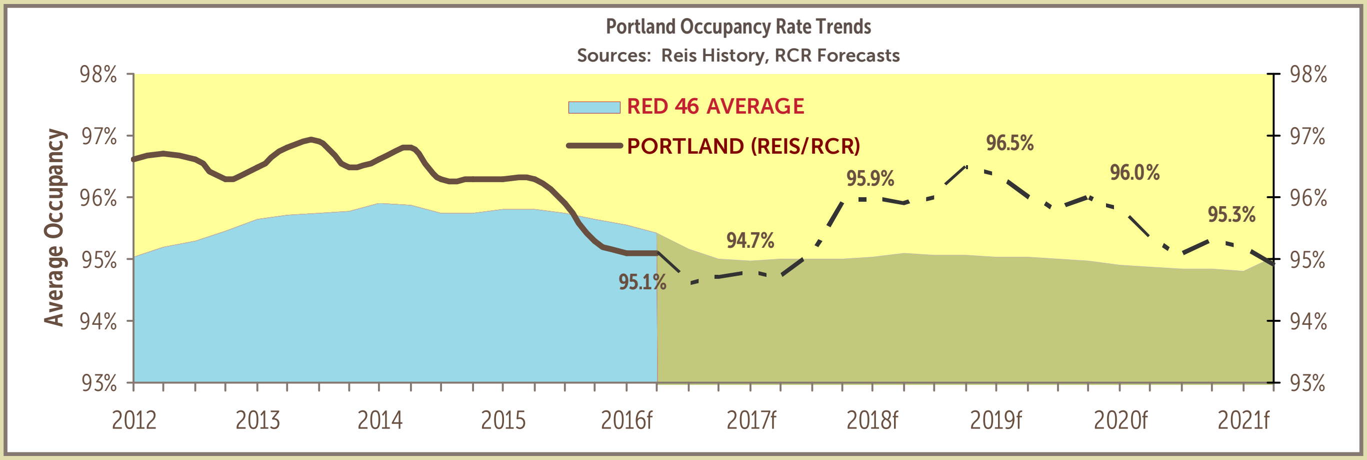
$5mm+ / 80-unit+ Sales	12
Approximate Proceeds	$334mm
Average Cap Rate (FNM)	5.2%
Average Price / Unit	$146,924
Expected Total Return	7.8%
RED 46 ETR Rank	8th
Risk-adjusted Index	4.62
RED 46 RAI Rank	26th

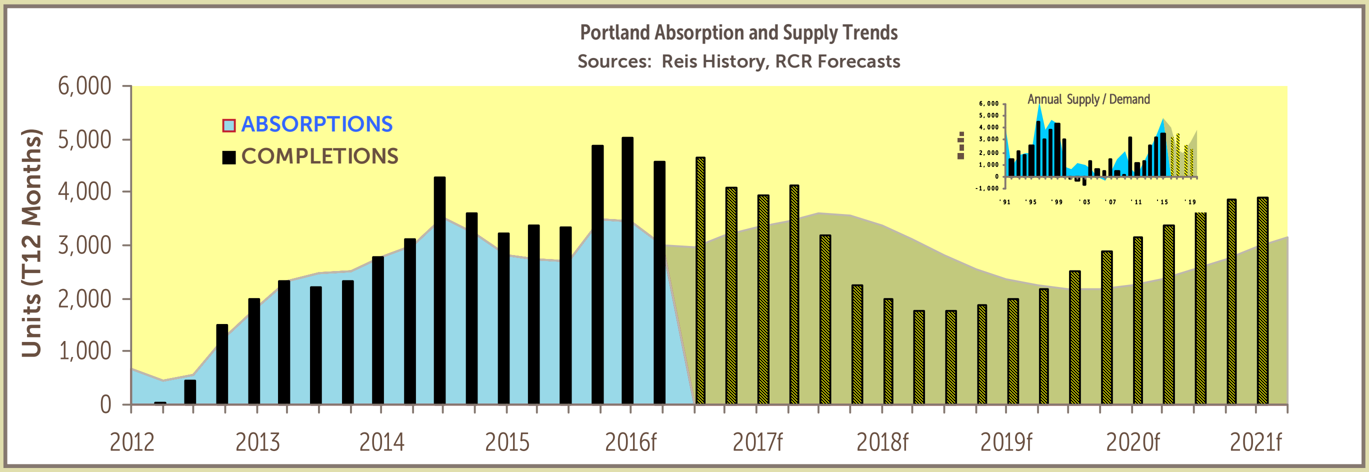
2Q16 PROPERTY MARKETS AND TOTAL RETURNS

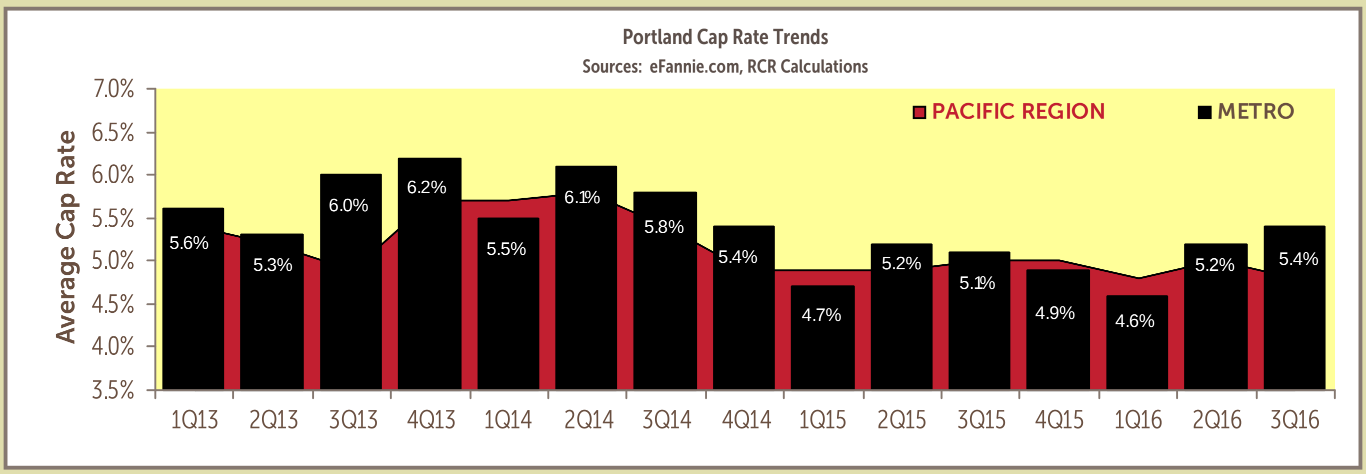
Sales velocity was on even keel during 2Q16 as investors closed on 12 properties valued at $5 million or more, comparable to 13 sales recorded during each of the prior two quarters. Proceeds totaled $334.2mm, down from $412.5mm and $409.8mm during 1Q16 and 4Q15, respectively, largely due to a heavier concentration of suburban class-C/B– properties in the mix. Likewise, the average price per unit declined –22.6% sequentially to $146,924, the lowest level in more than one year. Third quarter sales through August appear to be moderately slower but the $/unit metric recovered to the 2016 metro norm at $185,658.

Cap rates were sharply divided between modern urban infill assets and suburban value adds. Luxury recent construction infill continues to trade in the low-4% area, while suburban properties are priced to generate mid-5% yields, higher than most larger West Coast metropolitan areas.

We elected to maintain a 4.7% market purchase cap rate proxy that balances infill and suburban norms. At this level, model derived rent and occupancy point estimates and a terminal cap rate of 5.5%, we estimate that an investor in a PORT asset would expect to earn a 7.8% annual IRR over the course of a 5-year hold, R46 #8. Above average model standard errors (i.e. unforecastable events) hinder risk-adjusted returns, on which basis PORT ranks group #26.

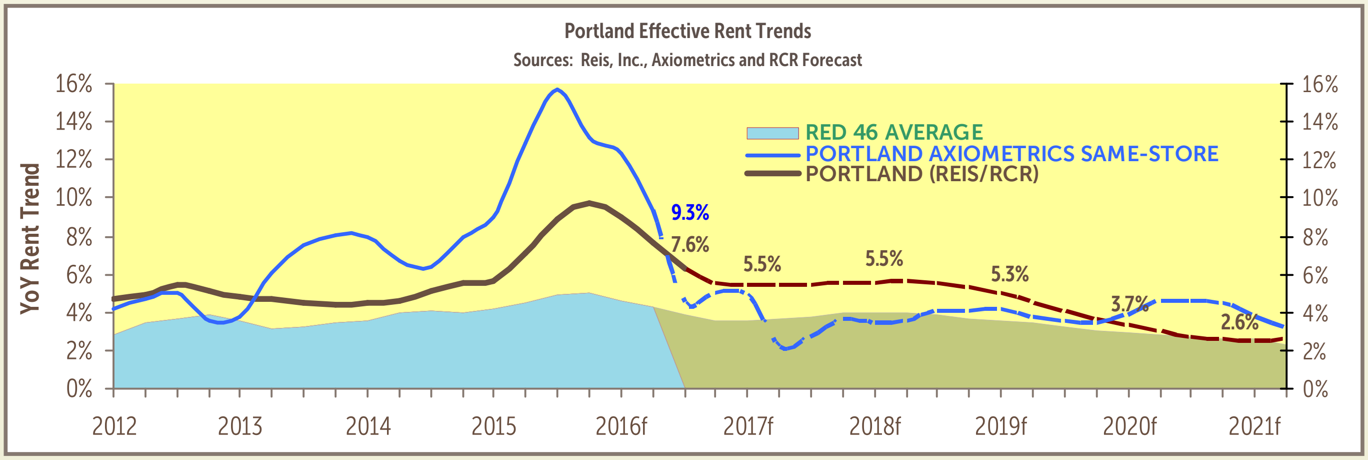


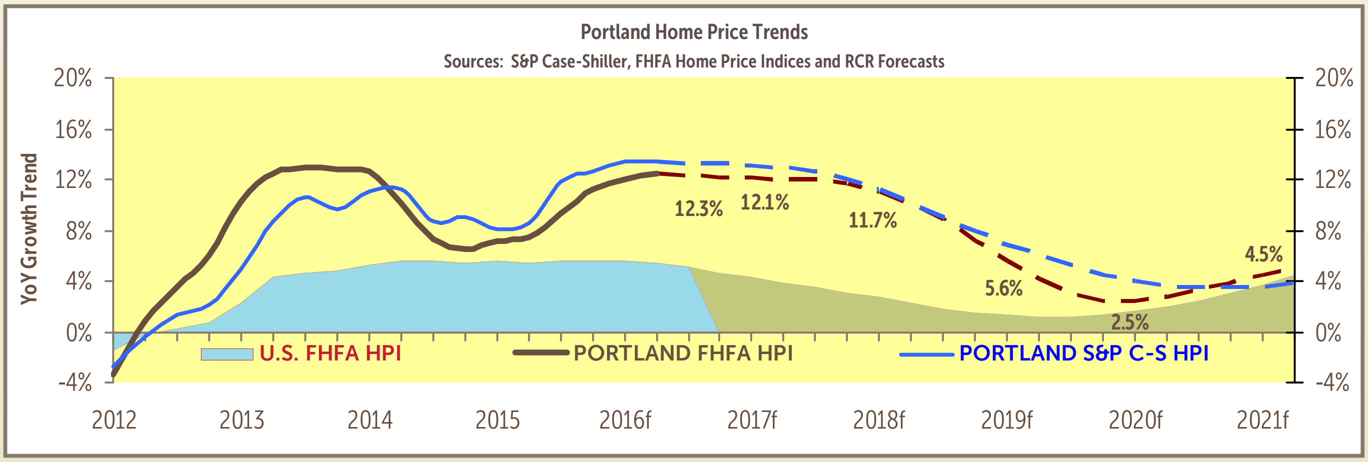


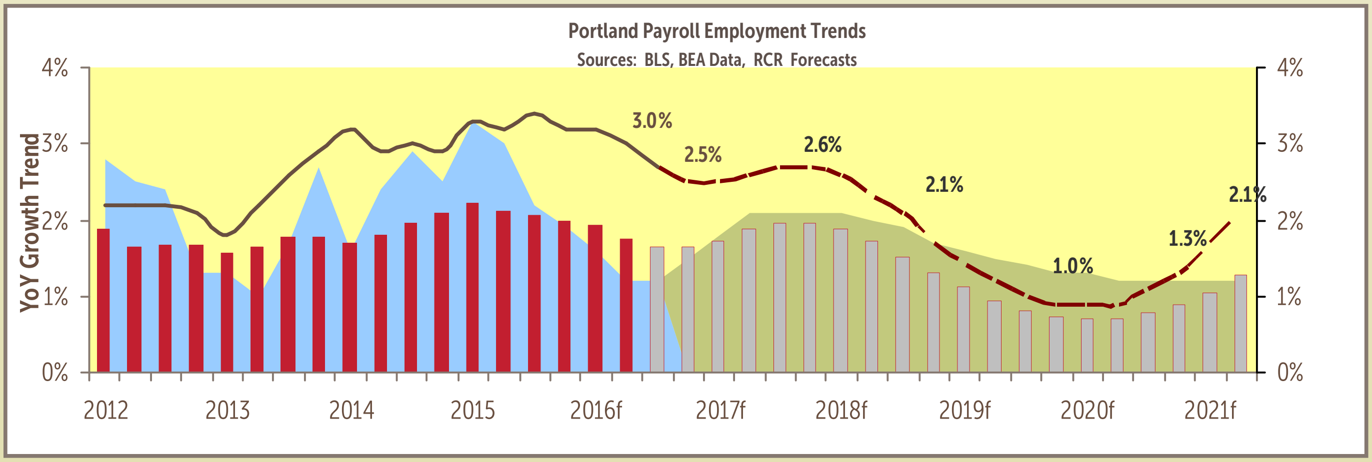


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price / (in millions)	Price / per unit	Estimated Cap Rate
Cook Street Apts. (Northeast / Boise)	B+ / RC MR (2016)	14-May 2016	$69.0	$334,951	4.3%
Boulder Gardens (Milwaukie / Clackamas)	C / GLR (1957)	15-May-2016	$18.0	$114,649	4.6%
Royal Greens (East Gresham / Northeast)	C / GLR (1979)	4-Jun-2016	$10.5	$116,667	5.5%
The Preserve (Milwaukie / Oregon City)	B- / GLR (1994)	11-Jun-2016	$21.5	$159,259	5.7%
The Vue (Northwest / DT / Portland State)	C+ / MB HR (1951)	18-Jul-2016	$64.0	$207,630	5.6%
Portera at Grove (Tigard / Wilsonville)	A / LR 55+ (2015)	17-Aug-2016	$27.2	$242,857	5.0%

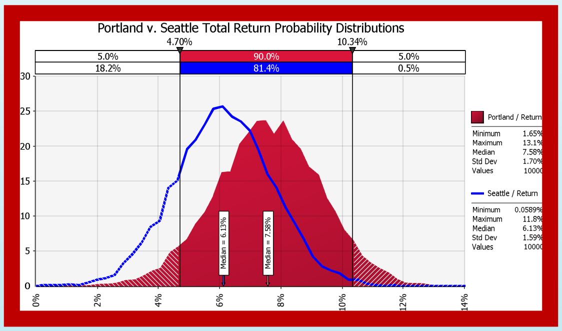

Portland Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecast
YoY Rent Trend
RED 46 AVERAGE
PORTLAND AXIOMETRICS SAME-STORE
PORTLAND (REIS/RCR)
9.3%
7.6%
5.5%
5.5%
5.3%
3.7%
2.6%
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

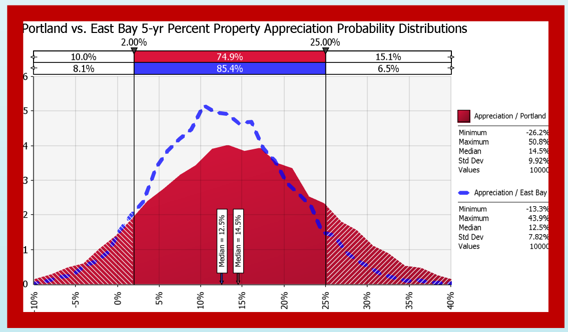

Portland Home Price Trends
Sources: S&P Case-Shiller, FHFA Home Price Indices and RCR Forecasts
YoY Growth Trend
U.S. FHFA HPI
PORTLAND FHFA HPI
PORTLAND S&P C-S HPI
12.3%
12.1%
11.7%
5.6%
2.5%
4.5%
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

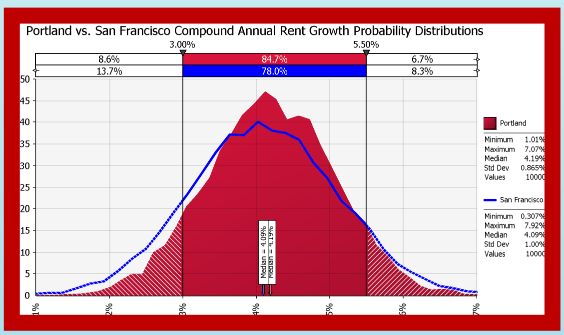

Portland Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
YoY Growth Trend
3.0%
2.5%
2.6%
2.1%
1.0%
1.3%
2.1%
2012
2013
2014
2015
2016f
2017f
2018f
2019f
2020f
2021f

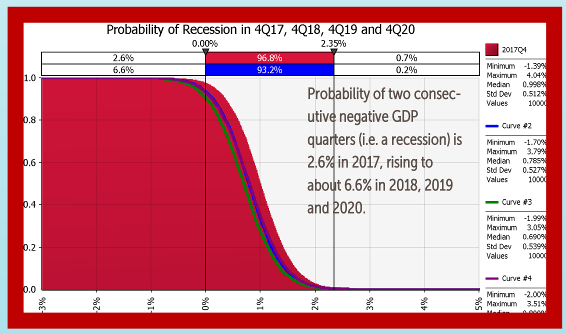
SUBMARKET TRENDS (REIS)

Submarket	Inventory % Change	Effective Rent			Physical Vacancy		
		2Q15	2Q16	Change	2Q15	2Q16	Change
Beaverton	3.9%	$897	$1,001	11.5%	3.1%	4.2%	110 bps
East Gresham	0.0%	$794	$854	7.6%	0.8%	1.0%	20 bps
Milwaukie / Oregon City	1.4%	$827	$937	13.3%	1.0%	2.2%	120 bps
Northeast	28.9%	$1,004	$1,185	18.1%	7.2%	8.7%	150 bps
Northwest	12.1%	$1,260	$1,335	5.9%	6.9%	11.1%	420 bps
Tigard / Oswego	0.6%	$977	$1,073	9.9%	2.8%	3.4%	60 bps
Vancouver	1.5%	$920	$1,004	9.1%	4.7%	5.0%	30 bps
Metro	4.0%	$975	$1,049	7.6%	3.7%	4.9%	120 bps









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THE FACE OF LENDING