SEATTLE, WASHINGTON

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 2Q16 | OCTOBER 2016

PAYROLL JOB SUMMARY	
Average Payrolls	1,646.8m
Annual Change	55.5m (3.5%)
RCR 2016 Forecast	54.4m (3.4%)
RCR 2017 Forecast	63.9m (3.9%)
RCR 2018 Forecast	58.3m (3.4%)
RCR 2019 Forecast	34.7m (2.0%)
RCR 2020 Forecast	20.1m (1.1%)
Unemployment (NSA)	4.0% (Aug.)

2Q16 PAYROLL TRENDS AND FORECAST

Jet City labor markets continued to fly at a high altitude, indeed. Employers hired at a 55,500-job, 3.5% annual rate in the second quarter, representing the fastest year-on-year growth recorded since 1998. Virtually every industry with the exception of aerospace delivered constructive results, led by the information sector, which grew at a 7,400-job, 7.9% year-on-year rate propelled by e-commerce, software and other digital service shops. Growing demand for housing, mortgages and public services fired construction, finance and government hiring, while professional, personal and leisure services headcounts continued to grow at impressive rates.

Seasonally-adjusted data were consistent, showing vigorous expansion in 1Q16 (15,200 jobs) and 2Q16 (19,900 jobs), the latter representing the largest one-quarter advance in 10 years. The third quarter maintained the momentum with a 12,000-job add in July and August.

RED Research used the rate of change of US job growth and financial variables (S&P500 returns, 10-year UST yields and the fed funds rate) to fashion a 95.2% adjusted R^2 (SE=0.56%) forecasting model. Under the baseline macroeconomic forecast the equation projects 3%-4% SEA job growth through 2018, in keeping with expected faster GDP expansion. Hiring is likely to decelerate afterward as slowing consumption spending, higher interest rates and faltering equity returns hinder Seattle growth. .

OCCUPANCY RATE SUMMARY	
Occupancy Rate (Reis)	94.5%
RED 50 Rank	40th
Annual Chg. (Reis)	-1.0%
RCR YE16 Forecast	93.6%
RCR YE17 Forecast	93.7%
RCR YE18 Forecast	94.3%
RCR YE19 Forecast	94.5%
RCR YE20 Forecast	94.4%

2Q16 ABSORPTION AND OCCUPANCY RATE TRENDS

Apartment demand intensified as tenants net leased 1,643 vacant units (Reis) during 2Q16, up from 1,210 and 1,264 in the prior and year-earlier quarters, respectively. But supply pressure remained a persistent theme. Developers delivered 1,514 new units to market, the culmination of a 12-month period in which 8,892 units were completed, more than in any year since 1990. As a result, Seattle occupancy increased 10 basis points sequentially but fell -100 bps year-on-year to 94.5%, 11th lowest among the RED 51.

Larger, stabilized same-store assets surveyed by Axiometrics fared rather better. This sample was 95.9% and 95.3% occupancied in 2Q16 and 3Q16, respectively, up 30bps and down –10bps y-o-y. Class-C (95.5%) posted highest 3Q16 occupancy (6th consecutive quarter), followed by classes-B (95.3%) and -A (95.0%). West Seattle submarket recorded a 97.1% rate, leading a group on 95.6% that included supply-heavy Redmond, W. Seattle and Downtown.

The RCR demand model (ARS=92.4%, SE=0.3%) paints a constructive picture, projecting absorption at annual rates in the 5,000 to 7,000 unit range through 2018. But supply is likely to outpace demand for the next 18 months, sending occupancy down to the mid-93% area. We expect a rebalancing in favor of demand in 2018, giving rise to a recovery of about 100 bps from the cycle trough by 2019.

EFFECTIVE RENT SUMMARY	
Mean Rent (Reis)	$1,360
Annual Change	7.6%
RED 50 Rent Change Rank	1th
RCR YE16 Forecast	5.2%
RCR YE17 Forecast	4.8%
RCR YE18 Forecast	5.5%
RCR YE19 Forecast	4.6%
RCR YE20 Forecast	3.4%

2Q16 EFFECTIVE RENT TRENDS

Reis report that Seattle tenants endured a 14th consecutive quarter of 1.1% or faster sequential average rent growth in 2Q, in this case a $22 (1.6%) gain, down from $24 (1.9%) in the prior period. Rent growth expressed on a year-on-year basis slowed from 8.3% to 7.6%, but Seattle regained its #1 position among the RED 51 in this category; most recently held by Portland. Class-A units were largely responsible, as class asking rents advanced at a 1.7% sequential rate comparing favorably to a 1.1% rate among B&C properties.

Axiometrics surveys of 631 stabilized same-store properties found sample y-o-y rent growth of 9.1% and 7.2% in 2Q16 and 3Q16, respectively. The former figure was the fastest growth observed since 2007. Class-C posted the largest 3Q16 gain (8.6%), with classes-B (7.4%) and –A (5.4%) following. Auburn, Federal Way and Sea-Tac submarkets notched double-digit advances, but class-A supply challenged Bellevue (4.2%), Downtown (5.1%) and North Seattle (5.7%) neighborhoods settled for less.

RCR's 97.2% ARS (SE=0.65%) model produces a robust SEA rent forecast calling for 4% or faster rent growth to linger through 2019, fueled by rapid job and income creation. Trends should lose steam by the end of the decade as the economy weakens. But rents should rise by a 5-year compound rate of about 4.2%, among the strongest in the R47.

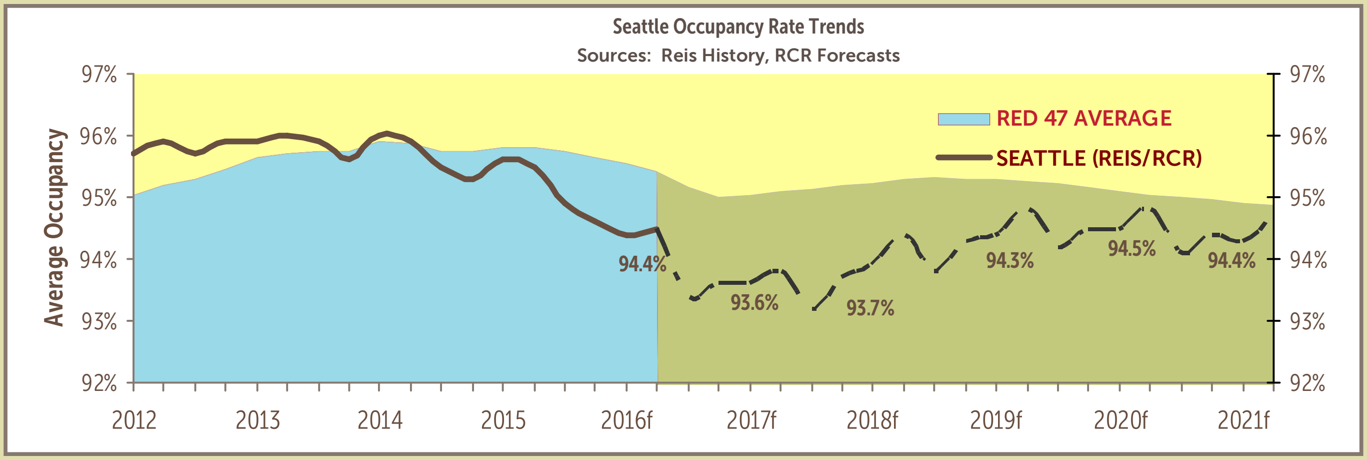
TRADE & RETURN SUMMARY	
$5mm+ / 80-unit+ Sales	20
Approximate Proceeds	$548mm
Average Cap Rate (FNM)	4.8%
Average Price / Unit	$255,481
Expected Total Return	6.4%
RED 46 ETR Rank	24th
Risk-adjusted Index	3.74
RED 46 RAI Rank	30th

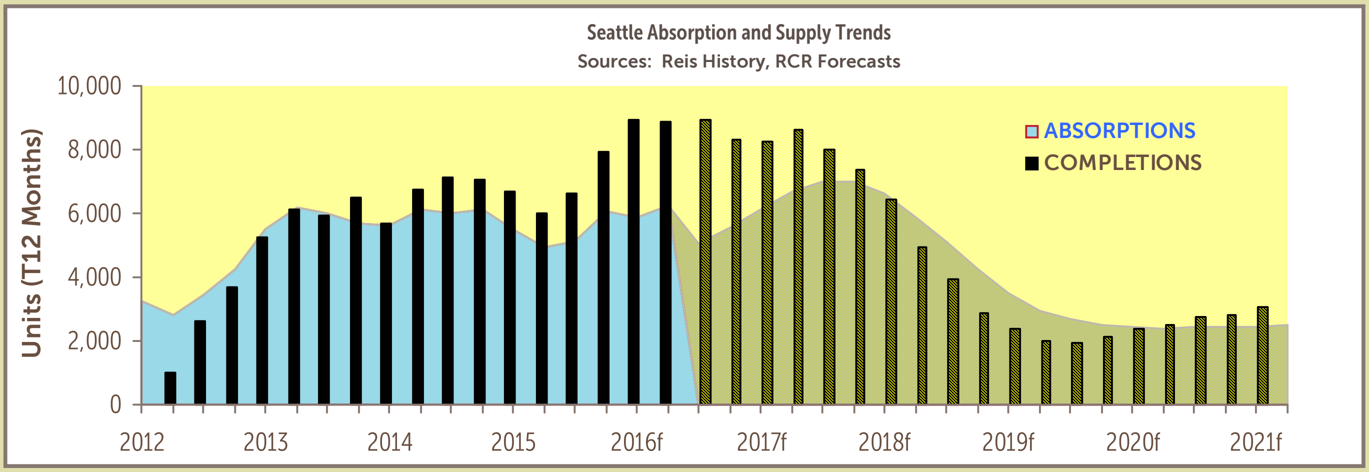
2Q16 PROPERTY MARKETS AND TOTAL RETURNS

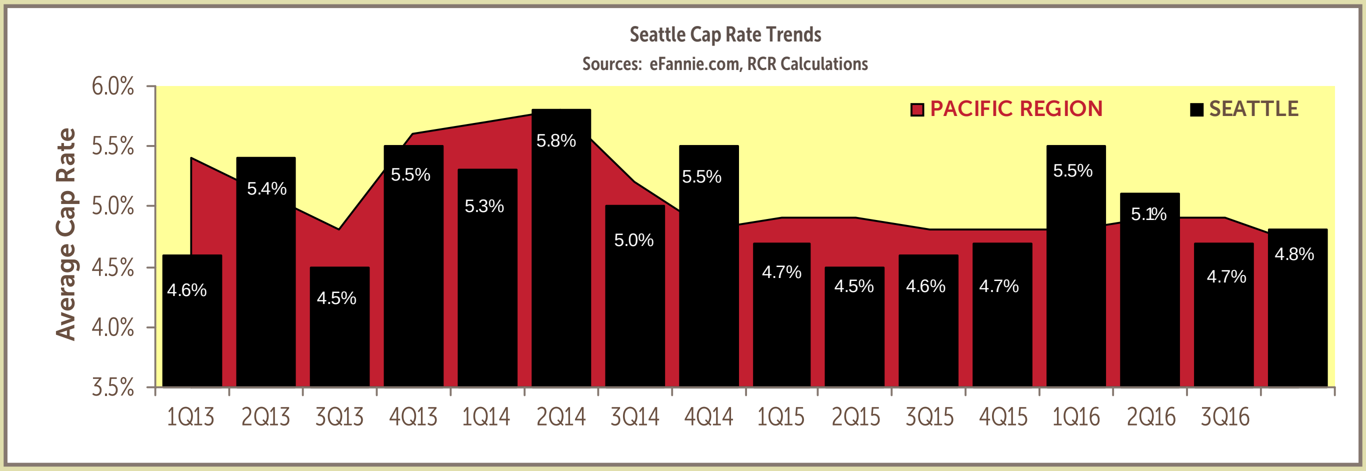
The white hot Puget Sound multifamily property market took what may be described as a breather during the second quarter. Sales velocity declined from 33 and 42 transactions in 1Q16 and 4Q15, respectively, to 20. Sales proceeds fell –47% from $1.0 billion in 1Q16 to $548 million during 2Q16. But the quality of properties acquired improved considerably, raising the average price unit metric 33% from $192,416 (1Q16) to $255,481, a level surpassed in only one previous quarter (4Q13). By contrast, the pace of sales rebounded over the summer, as 33 transactions closed during 3Q16 for total proceeds of $1.05 billion.

Going-in yields fell in the mid-3% to mid-5% region. Properties at the low-end consisted of recent construction reinforced concrete mid-rises and Sixties and Seventies vintage value-adds. A/B+ assets traded mostly in the 4.2% to 4.6% range. B assets found buyers from 4.8% to 5.4%.

RCR were compelled by recent pricing to trim our purchase cap rate proxy -20bps to 4.8%. At this yield, model derived rent and occupancy point estimates and a 6.0% exit cap, we estimate an investor would expect to earn a 6.4% unlevered annual return on a 5-year hold. This compares favorably to Bay Area markets but falls short of rivals Portland and Denver. Absolute ETR ranks 24th among the RED 47, while risk-adjusted returns slip to peer group #30.

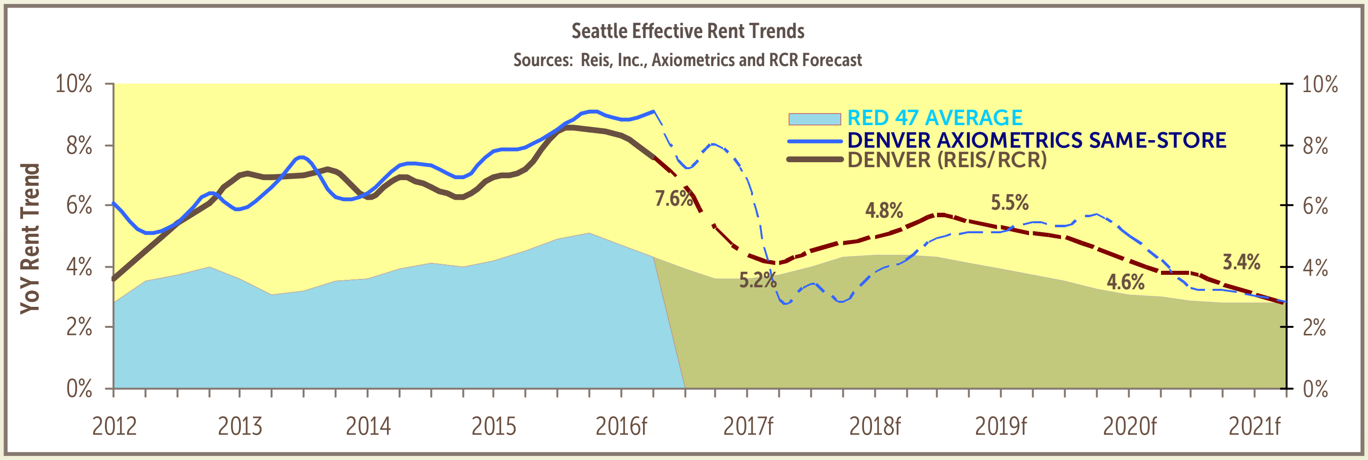


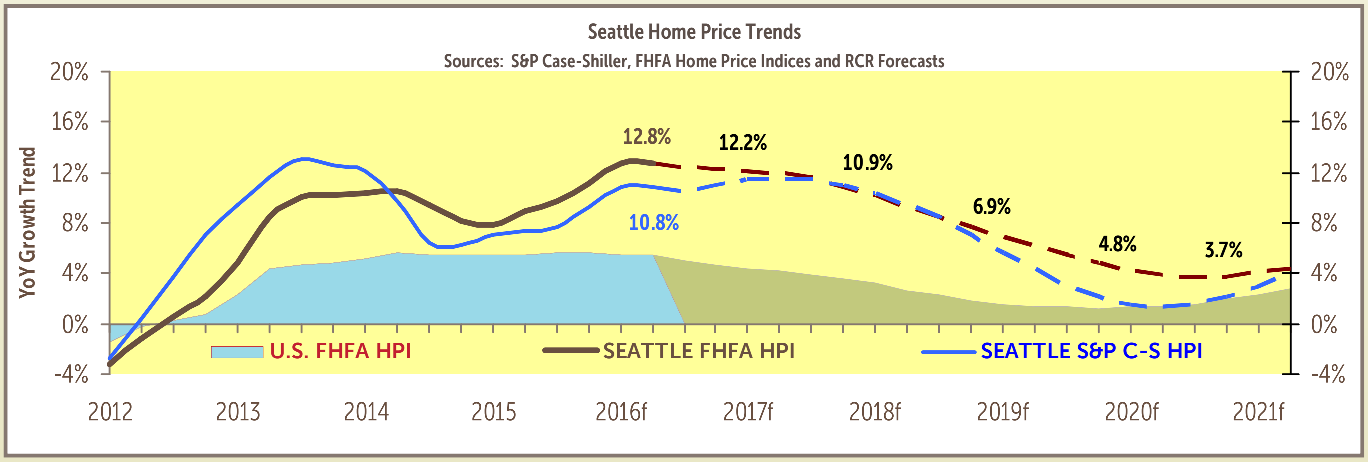


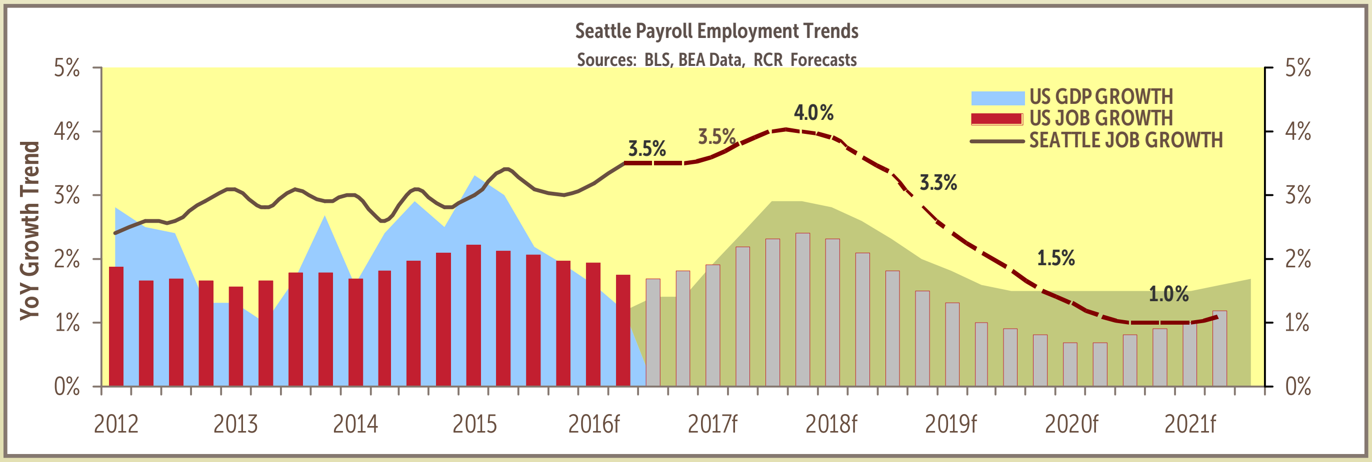


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
North Creek (Everett / Silver Lake)	B- / GLR (1986)	29-Jul-2016	$42.0	$159,091	5.4%
Trillium Apts. (Edmonds/Meadowdale)	B / WF MR (2015)	3-Aug-2016	$21.7	$241,469	4.8%
Capri Apartments (Kirkland/Downtown)	A-/RC MR (2015)	4-Aug-2016	$40.1	$549,685	4.2%/4.5% p.f.
Walton Lofts (Downtown/Belltown)	A+/RC MR (2015)	10-Aug-2016	$76.0	$558,824	4.0%
LIV Apartments (Bellevue/Crossroads)	A MU/WF MR ('15)	15-Sep-2016	$172.0	$377,193	4.6%
Chandlers Bay (Kent/Memorial Park)	B- / GLR (1989)	7-Oct-2016	$52.6	$179,352	5.4%







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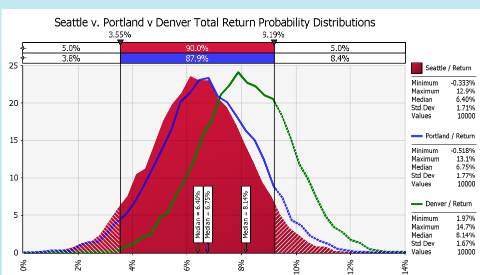
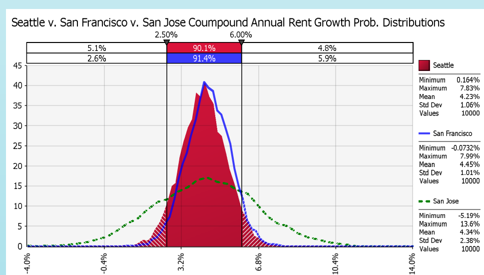
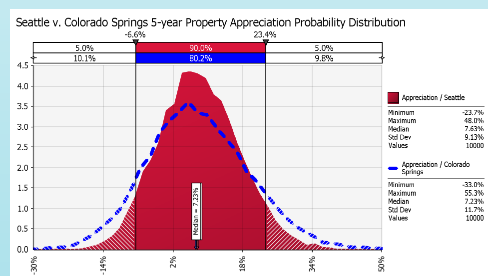
SUBMARKET TRENDS (REIS)

Submarket	Inventory % Change	Effective Rent			Physical Vacancy		
		2Q15	2Q16	Change	2Q15	2Q16	Change
Auburn / Enumclaw	1.6%	$903	$945	4.7%	1.3%	1.6%	30 bps
Beacon Hill / Rainier	5.3%	$1,150	$1,235	7.4%	4.8%	6.7%	190 bps
Bellevue / Issaquah	8.1%	$1,481	$1,628	10.0%	3.9%	6.1%	220 bps
Bothell	1.4%	$1,201	$1,276	6.3%	4.9%	4.5%	-40 bps
Des Moines / West Kent	2.9%	$951	$1,027	7.9%	2.4%	3.7%	130 bps
Downtown / Capitol Hill	9.7%	$1,780	$1,997	12.2%	7.2%	10.6%	340 bps
Edmonds / Lynnwood	2.1%	$1,044	$1,115	6.8%	3.6%	3.9%	30 bps
Everett / Mukilteo	1.6%	$1,012	$1,084	7.1%	2.5%	2.4%	-10 bps
Federal Way	0.0%	$972	$1,047	7.7%	2.3%	1.3%	-100 bps
Kent	1.7%	$1,002	$1,065	6.3%	1.5%	2.1%	60 bps
Kirkland / Juanita	3.7%	$1,557	$1,711	9.9%	2.6%	3.8%	120 bps
North Seattle	4.5%	$1,269	$1,358	6.9%	7.2%	8.3%	110 bps
Redmond	9.6%	$1,407	$1,476	4.9%	1.7%	6.9%	520 bps
Renton	0.6%	$1,050	$1,080	2.9%	2.4%	2.3%	-10 bps
Tukwila / Sea-Tac	0.0%	$831	$898	8.0%	1.4%	1.1%	-30 bps
West Seattle / Burien	4.7%	$1,041	$1,124	8.0%	5.9%	6.4%	50 bps
Metro	4.2%	$1,264	$1,360	7.6%	4.5%	5.5%	100 bps







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