SAN DIEGO, CALIFORNIA

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q17 | May 2017

PAYROLL JOB SUMMARY	
Average Payrolls	1,429.6m
Annual Change	29.1m (2.1%)
RCR 2017 Forecast	32.8m (2.3%)
RCR 2018 Forecast	35.8m (2.5%)
RCR 2019 Forecast	23.3m (1.6%)
RCR 2020 Forecast	18.5m (1.2%)
RCR 2021 Forecast	17.5m (1.1%)
Unemployment (NSA)	4.2% (3/17)

1Q17 PAYROLL TRENDS AND FORECAST

The pace of San Diego payroll job creation was steady in the first quarter. County establishments added to payrolls at a 29,100-job, 2.1% annual rate, compared to 4Q16's 29,800-job, 2.1% performance. Some sector rotation was evident, however, as softer conditions in leisure and education service accounts was offset by strength in financial, business and healthcare services. Expansion in professional and technical services, including software publishing, was particularly notable as headcount growth was the fastest in a year despite a challenging year-earlier comparison.

Seasonally-adjusted payroll data and total employment figures derived from the BLS Household Survey were at odds with the foregoing results. The former found that real job formation in 1Q17 amounted to only 2,900 positions, fewest in any quarter since 2Q11, while the latter recorded a year-on-year gain in reported total employment of a modest 6,470 (0,7%) individuals, smallest since 3Q11.

Although some data suggest the local economy is weaker than indicated by the Current Employment Survey, RED Research's 96.7% adjusted-R^2 (S.E.=0.4%) CES-specified payroll model remains bullish. Moderately faster national headcount growth and double-digit y-o-y S&P500 gains forecast for the remainder of 2017 will boost metro growth this year and next. A softer macroeconomic environment is likely to give rise to weaker local results after, followed by a nascent rebound in year five of the forecast interval.

OCCUPANCY RATE SUMMARY	
Occupancy Rate (Reis)	96.9%
RED 51 Rank	5th
Annual Chg. (Reis)	-0.2%
RCR YE17 Forecast	96.9%
RCR YE18 Forecast	96.9%
RCR YE19 Forecast	96.8%
RCR YE20 Forecast	96.8%
RCR YE21 Forecast	96.8%

1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Multifamily space demand was disappointing during 1Q17, perhaps lending credence to some of the weak economic data. Households vacated a net of 84 units, according to Reis, down sharply from net lease gains of 1,018 and 689 units in the prior and year-earlier quarters, respectively. Absence of new supply was in part at fault, but further weakness in the class-B&C segment was largely responsible as renters are exhibiting increased price sensitivity. Occupancy declined about -0.04% sequentially to 96.89%.

Axiometrics surveys of 361 stabilized, same store properties found somewhat looser conditions. Sample occupancy was 95.3% in 1Q17, unchanged over the year. Classes-C (97.0%) and –B (95.3%) recorded the highest rates, but each experienced year-on-year declines. Class-A (94.5%), by contrast, gained 40 basis points y-o-y. Occupancy in Mid-County submarkets was generally higher, while Downtown (90.5%) and elevator buildings (92.0%) trailed.

San Diego's occupancy forecast is brighter than many other primary markets as supply is unlikely to reach burdensome levels. Total stock is projected to grow about 5% by 2021, about half the rates projected for Denver, San Francisco and Seattle. We project that demand will rise apace, holding market occupancy near the current rate for the duration of the five-year forecast interval.

EFFECTIVE RENT SUMMARY	
Mean Rent (Reis)	$1,626
Annual Change	4.4%
RED 51 Rent Change Rank	10th
RCR YE17 Forecast	4.6%
RCR YE18 Forecast	5.5%
RCR YE19 Forecast	4.3%
RCR YE20 Forecast	3.0%
RCR YE21 Forecast	2.6%

1Q17 EFFECTIVE RENT TRENDS

Weak space demand was accompanied by faltering rent growth. Reis report metro average rent fell $3 (-0.2%) sequentially to $1,626, mirroring a similar setback in 1Q16. Year-on-year growth trends remained intact at 4.2%, ranking 10th among the 51 markets we cover. The class-A segment underperformed as asking rents declined -0.2% sequentially while class B&C posted a 0.1% advance.

The performance of the Axiometrics same store sample was similar as rents declined slightly sequentially but increased at a brisk 5.0% rate y-o-y (up from 4.9% in 4Q16). Class-A (4.4%) recorded the slowest advance, held back by weakness in the mid– and high-rise segment (3.4%). Class-C (6.0%) notched the fastest growth for the 5th consecutive quarter, while class-B added 5.0%. North Beaches submarket (7.3%) enjoyed the best growth, while class-A heavy LaJolla (2.8%) and Downtown (3.6%) lagged.

RCR's S.D. rent model achieves a 96.1% ARS (S.E.=0.6%) using occupancy change$_{(t-1)}$ (+), occupied stock growth$_{(t-1)}$ (+) and the rate of change of Orange County rent growth (+) as independent variables. The model forecasts a moderate reacceleration of rent growth in 2017-2018 catalyzed by stronger economic growth and tighter markets in Southern California. Rent growth is projected to decelerate after 2019 as the OC and LA economies weaken.

TRADE & RETURN SUMMARY	
$5mm+ / 80-unit+ Sales	12
Approximate Proceeds	$185.3mm
Average Cap Rate (FNM)	4.9%
Average Price / Unit	$195,124
Expected Total Return	7.25%
RED 49 ETR Rank	15th
Risk-adjusted Index	4.04
RED 49 RAI Rank	22nd

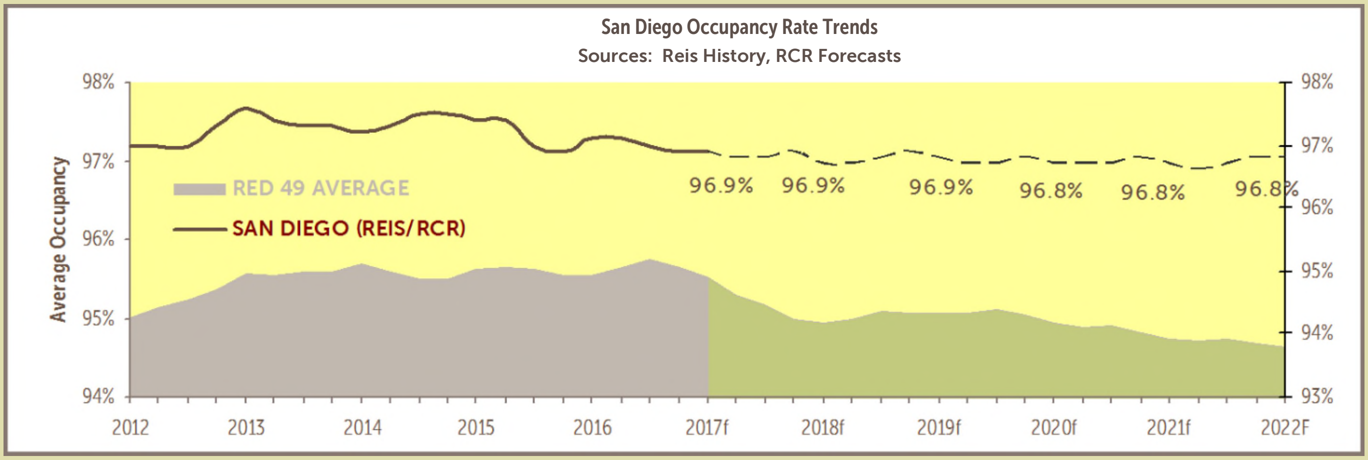
1Q17 PROPERTY MARKETS AND TOTAL RETURNS

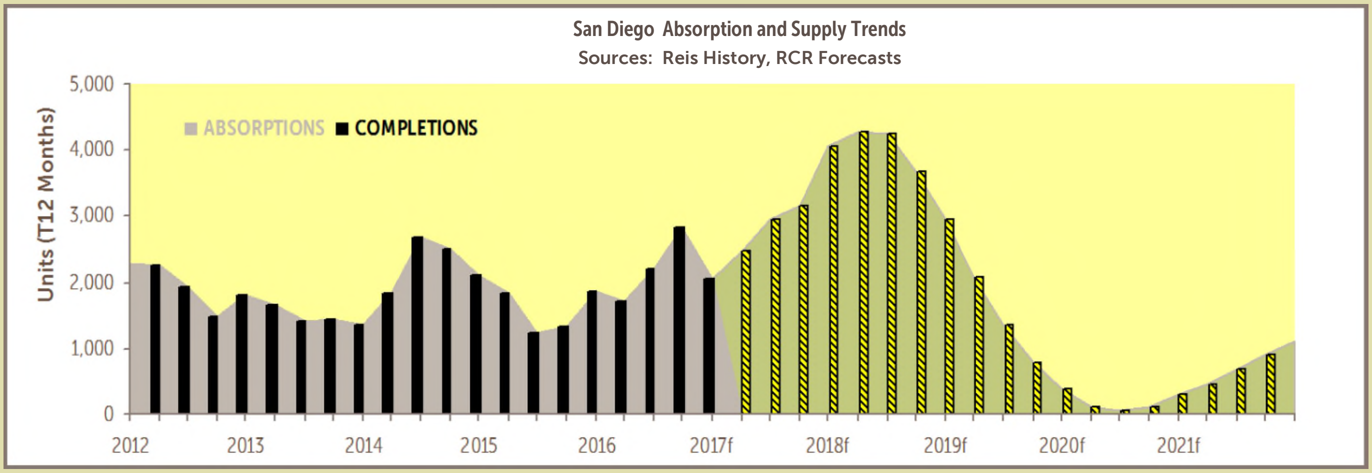
Following 2016's metro series record 86 transactions of multifamily properties valued at $5 million or more for total proceeds of $2,893mm, trade velocity slumped during the first quarter. Only 12 transactions were consummated for about $140mm, according to Real Capital Analytics. The average price of traded units was $195,124. These statistics compare to 15 transactions valued at $675mm, with an average price of $259,295 in 4Q16.

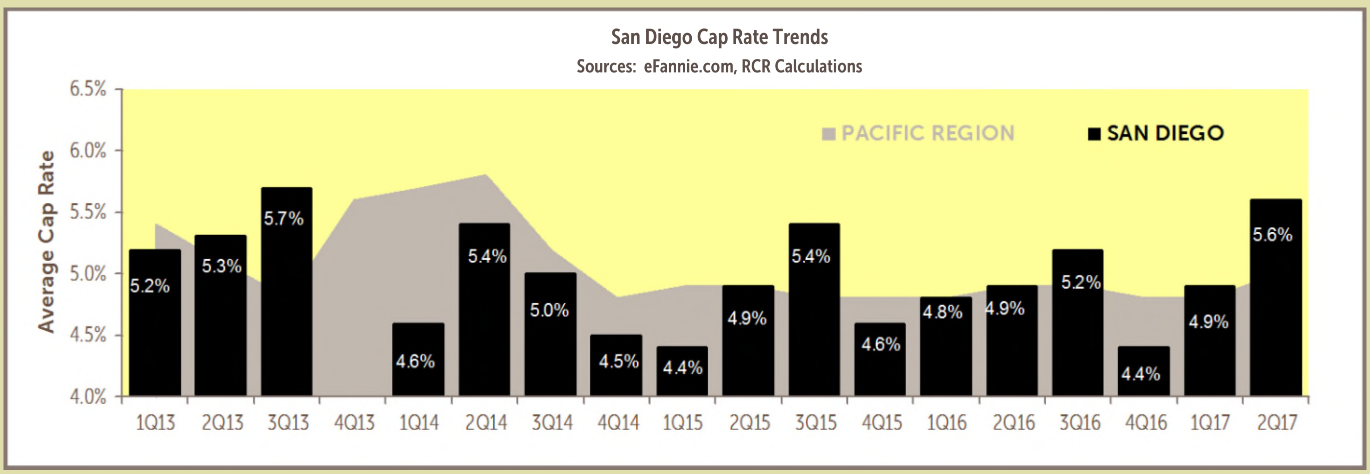
The property market gained momentum during the second quarter. Eight sales closed by May 10 for gross proceeds of $349.1mm. The average price per unit was $285,207.

Based on limited data, cap rates applicable to class-A assets range in the low– to mid-4% neighborhood. Class-B gardens trade in the 4.6% to 4.8% area. Older class-B and class-C properties are priced to yield from 5.0 to 5.5%.

RCR elected to employ the same class-B/B+ purchase cap rate proxy as 4Q16: 4.5%. Using model derived rent and occupancy point estimates and a terminal cap rate assumption of 5.0%,we estimate an investor would expect to earn a 7.25% unlevered rate of return on a 5-year hold. This ranks 15th among the RED 49, slightly higher than Orange County. With respect to risk-adjusted returns, San Diego ranks 22nd owing to above average rent volatility.

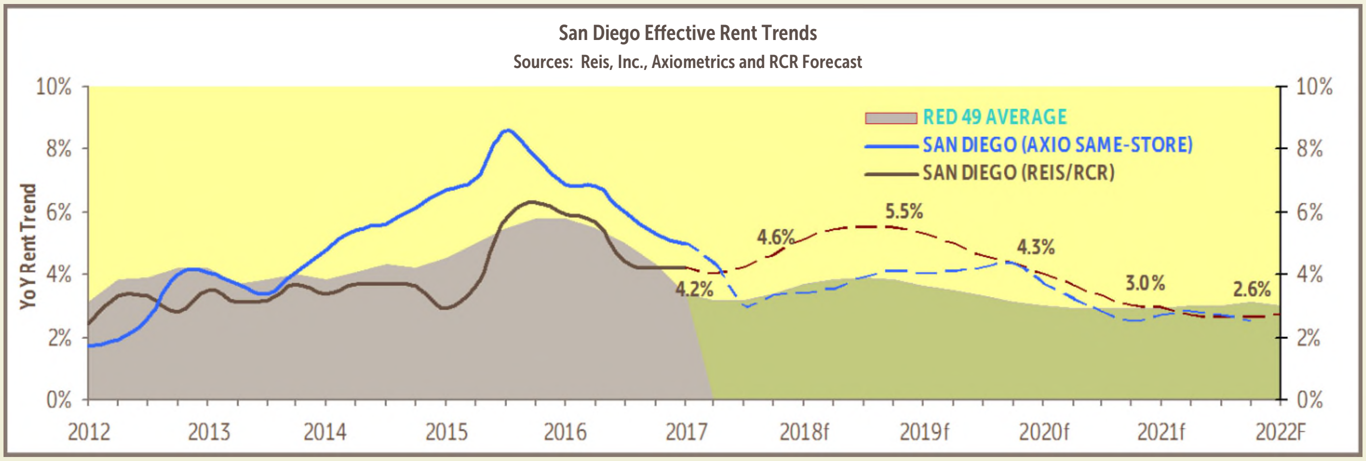


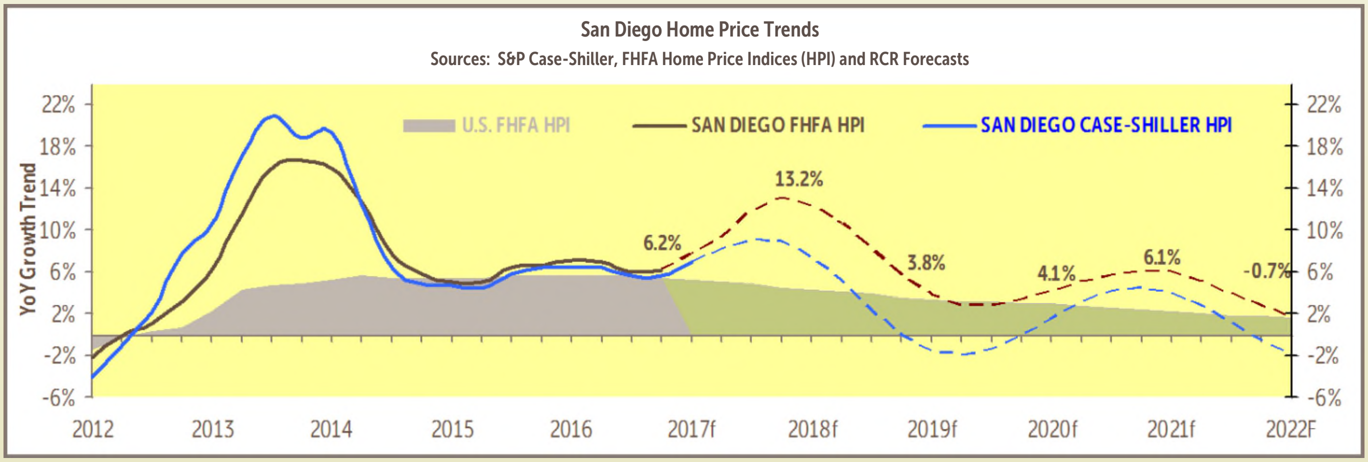


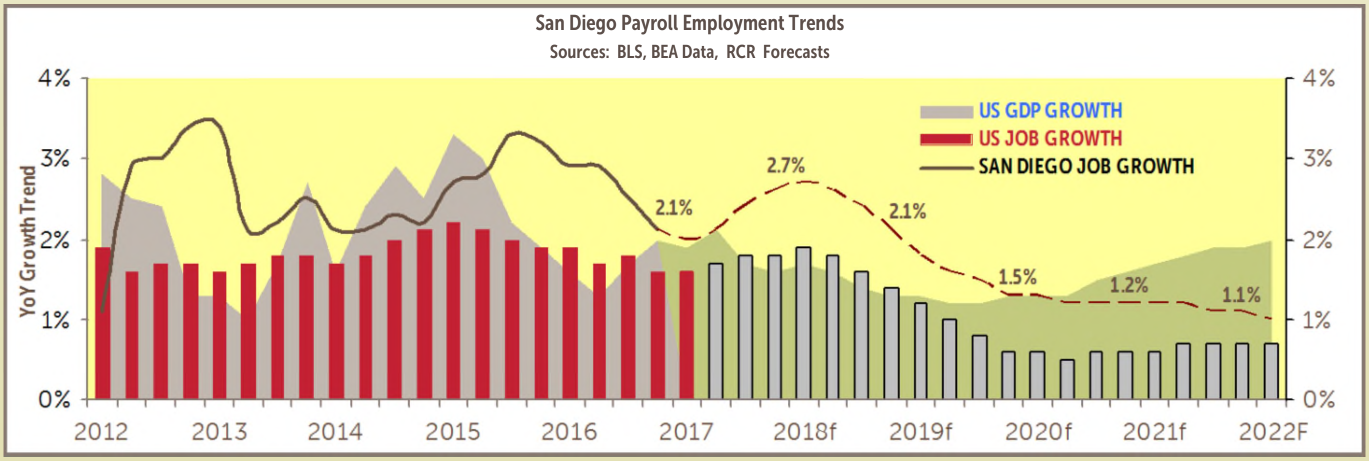


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
LOFT2015 (Ocean Beach / Pt. Loma / Five Points)	B- / SR LR (2008)	21-Nov-2016	$28.0	$333,333	4.69%
Terrace Gardens (Escondido / Central Escondido)	B– 55+ / WF LR (1985)	17-Dec-2016	$35.5 (recap)	$157,788	5.35%
Morning View Terrace (Escondido / Central Escondido)	C+ 55+ / WF LR (1987)	17-Dec-2017	$12.9 (recap)	$150,061	5.41%
La Mesa Palms (La Mesa / Spring Valley)	B / WF GLR (1965)	12-Jan-20147	$19.0	$237,125	4.7%/5.4% p.f.
Vue Oceanside (Oceanside / Tri-City / MiraCosta)	B- / GLR (1975)	21-Apr-2017	$30.0	$220,588	4.1%/5.5% p.f.
Carmel Pacific Ridge (Mission Valley / Moreno Mission)	A+ / WF MR (2013)	4-May-2017	$232.0	$435,272	4.6%

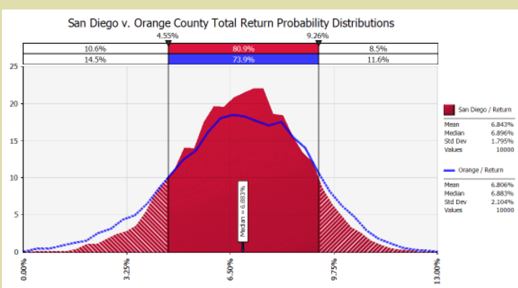

San Diego Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecast
RED 49 AVERAGE
SAN DIEGO (AXIO SAME-STORE)
SAN DIEGO (REIS/RCR)
YoY Rent Trend
4.2%
4.6%
5.5%
4.3%
3.0%
2.6%
2012 2013 2014 2015 2016 2017 2018f 2019f 2020f 2021f 2022F

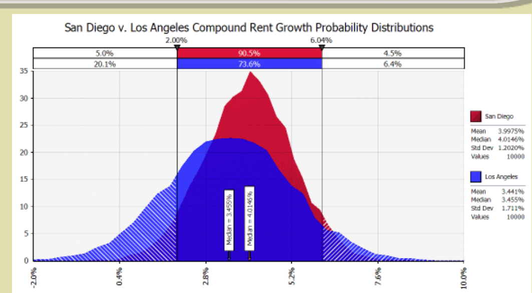

San Diego Home Price Trends
Sources: S&P Case-Shiller, FHFA Home Price Indices (HPI) and RCR Forecasts
U.S. FHFA HPI
SAN DIEGO FHFA HPI
SAN DIEGO CASE-SHILLER HPI
YoY Growth Trend
6.2%
13.2%
3.8%
4.1%
6.1%
-0.7%
2012 2013 2014 2015 2016 2017f 2018f 2019f 2020f 2021f 2022F


San Diego Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
US GDP GROWTH
US JOB GROWTH
SAN DIEGO JOB GROWTH
YoY Growth Trend
2.1%
2.7%
2.1%
1.5%
1.2%
1.1%
2012 2013 2014 2015 2016 2017 2018f 2019f 2020f 2021f 2022F

SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent			Physical Vacancy		
		1Q16	1Q17	Change	1Q16	1Q17	Basis Point Change
Balboa Park/West I-15	2.3%	$1,191	$1,277	7.2%	1.2%	2.8%	160 bps
Clairemont	4.2%	$1,645	$1,806	9.8%	4.2%	5.0%	80 bps
Downtown San Diego	5.7%	$1,967	$2,061	4.8%	11.5%	9.8%	-170 bps
El Cajon / Santee	0.0%	$1,180	$1,280	8.5%	1.3%	1.1%	-20 bps
Escondido / San Marco	0.6%	$1,365	$1,461	7.0%	1.4%	1.5%	10 bps
La Jolla/University City	1.4%	$2,028	$2,188	7.9%	2.7%	2.6%	-10 bps
La Mesa/Spring Valley	0.5%	$1,529	$1,586	3.7%	1.4%	1.6%	20 bps
Mira Mesa	-0.2%	$1,955	$2,013	3.0%	3.6%	3.1%	-50 bps
Mission Bay/Pacific Bch	0.0%	$1,707	$1,738	1.8%	1.5%	2.3%	80 bps
National City/Chula Vista	2.0%	$1,356	$1,499	10.6%	1.6%	2.3%	70 bps
North Beaches	0.2%	$1,704	$1,746	2.4%	1.1%	1.5%	40 bps
Ocean Beach/Pt. Loma	4.9%	$1,456	$1,750	20.2%	1.1%	5.1%	400 bps
Oceanside	1.2%	$1,354	$1,597	17.9%	3.7%	3.4%	-30 bps
San Diego/East of I-15	0.0%	$1,179	$1,307	10.8%	2.2%	2.2%	0 bps
Vista	1.8%	$1,382	$1,507	9.0%	4.0%	4.2%	20 bps
Metro	1.3%	$1,558	$1,623	4.2%	2.9%	3.1%	20 bps





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