INLAND EMPIRE, CA

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q17 | May 2017

PAYROLL JOB SUMMARY

Average Payrolls	1,429.2m
Annual Change 1Q17	46.7m (3.4%)
RCR 2017 Forecast	50.0m (3.6%)
RCR 2018 Forecast	41.9m (2.9%)
RCR 2019 Forecast	26.8m (1.8%)
RCR 2020 Forecast	22.2m (1.5%)
RCR 2021 Forecast	22.4m (1.5%)
Unemployment (NSA)	5.3% (3/17)

1Q17 PAYROLL TRENDS AND FORECAST

Year-on-year payroll comparisons indicate that the Inland Empire labor market regained momentum in 1Q17 after exhibiting distinct decelerating tendencies in the second half 2016. Metro payrolls increased at a 46,700-job, 3.4% annual rate, representing a significant reversal of 4Q's four-year low 35,500-job, 2.5% performance. The renaissance was attributable to hiring surges in the IE's two most dynamic subsectors: construction and trucking and warehousing. Collectively, subsector headcounts increased at a 17,300-job, 9.4% y-o-y pace, fastest since 4Q15, the peak quarter of growth in the current cycle. Rebounding logistics growth also stabilized the closely related business services sector wherein payroll counts stabilized after a Great Recession-sized –7.0% y-o-y plunge during 4Q16.

The seasonally-adjusted series also suggests job creation regained momentum in early 2017. After a weak January, IE employers added 14,500 jobs during the three months ended in April, up from 11,600 in the same period of 2016.

RED Research's Empire payroll model produces a constructive forecast. The 96.2% adjusted-R^2 (SE=0.6%) equation employs US payroll and GDP growth and the spread between Baa-rated bonds and the 10-year Treasury as independent variables. A projected rebound in national economic growth and wider credit spreads is expected to boost metro growth through 2018. By contrast, a forecast of a late decade slowdown results in weaker metro job gains in the second half of the 5-year forecast interval.

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	97.3%
RED 51 Rank	3rd
Annual Chg. (Reis)	+0.2%
RCR YE17 Forecast	97.4%
RCR YE18 Forecast	97.7%
RCR YE19 Forecast	97.7%
RCR YE20 Forecast	98.1%
RCR YE21 Forecast	98.1%

1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Apartment demand weakened in the first quarter, reflecting rising price sensitivity among tenants in all class segments. Reis report that renters vacated a net of 234 units, including 181 class-A units. This compares to net absorption of 336 vacant units in the comparable period of 2016. Developers delivered no new product to market, limiting the impact on the metro occupancy rate to less than 0.2% sequentially. Market occupancy stood at 97.26% at quarter end, ranked third highest among the RED 51 peer group.

Axiometrics surveys of 200 stabilized, same store professionally managed properties found lower 94.9% occupancy, down -0.2% year-on-year. The class-C (96.4%) segment maintained the highest rate, while classes-A (94.6%) and –B (95.0%) trailed. Fontana (96.3%) and Palm Springs (96.1%) submarkets posted highest occupancy, while North and South Ontario (94.4%) were at the bottom of the table.

Supply levels are expected to remain readily digestible for the balance of the decade. RCR expect the metro Reis inventory to increase only about 3.2% over the next five years or an annual average of about 880 units. Although our demand model projects that occupied stock growth will fall below long-term metro average it is expected to consistently overbalance supply, contributing to a steady, gradual increase in metro occupancy to the low 98% area.

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	$1,239
Annual Change	4.9%
RED 51 Rent Change Rank	9th
RCR YE17 Forecast	4.8%
RCR YE18 Forecast	3.5%
RCR YE19 Forecast	2.7%
RCR YE20 Forecast	2.4%
RCR YE21 Forecast	2.6%

1Q17 EFFECTIVE RENT TRENDS

Rent trends were moderately weaker in the first quarter as average unit effective rent increased $8 (-0.7%) sequentially, down from $11 (0.9%) gains in each of the prior and year-earlier quarters. The IE was the only major market in Southern California to record a sequential advance. Expressed on an annual basis, rents increased 4.9%, the fastest rate among the Southland metros and second fastest among the eight California RED 51markets.

Large properties surveyed by Axiometrics posted much faster rent increases. Average rent among the same-store sample increased 7.3% year-on-year, representing the 8th consecutive quarter of 7% or stronger annual growth. The class-B segment advanced 8.1%, about 180 basis points greater than classes "A" and "C." Fontana (10.6%) also was on the top of this table but performance was solid across submarkets. Only South Ontario failed to exceed 5%.

RCR specified a 96.3% ARS (SE=0.58%) econometric rent forecasting equation for the Empire using the rate of change in stock growth, payroll growth and the Baa/10-year spread$_{(t-3)}$ as independent variables. Only the spread promises to be a consistently positive driver. Consequently, rent growth is projected to moderate gradually over the next four years before catching a modest updraft in 2021 as the inventory growth cycle regains momentum.

TRADE & RETURN SUMMARY

$5mm+ / 80-unit+ Sales	15
Approximate Proceeds	$447.3mm
Average Cap Rate (FNM)	5.2%
Average Price / Unit	$155,095
Expected Total Return	6.7%
RED 49 ETR Rank	37th
Risk-adjusted Index	4.16
RED 49 RAI Rank	18th

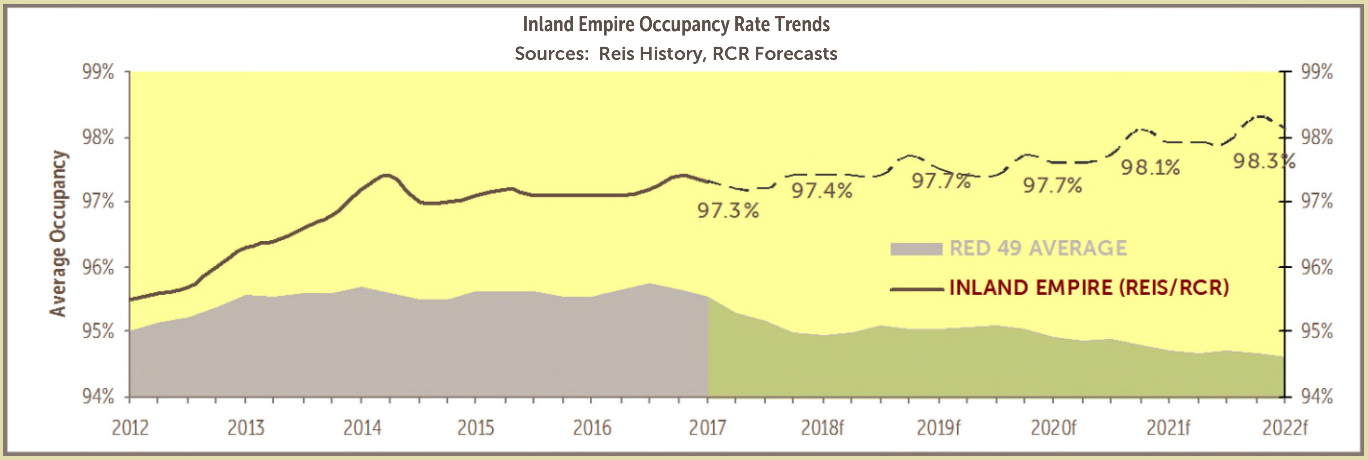
1Q17 PROPERTY MARKETS AND TOTAL RETURNS

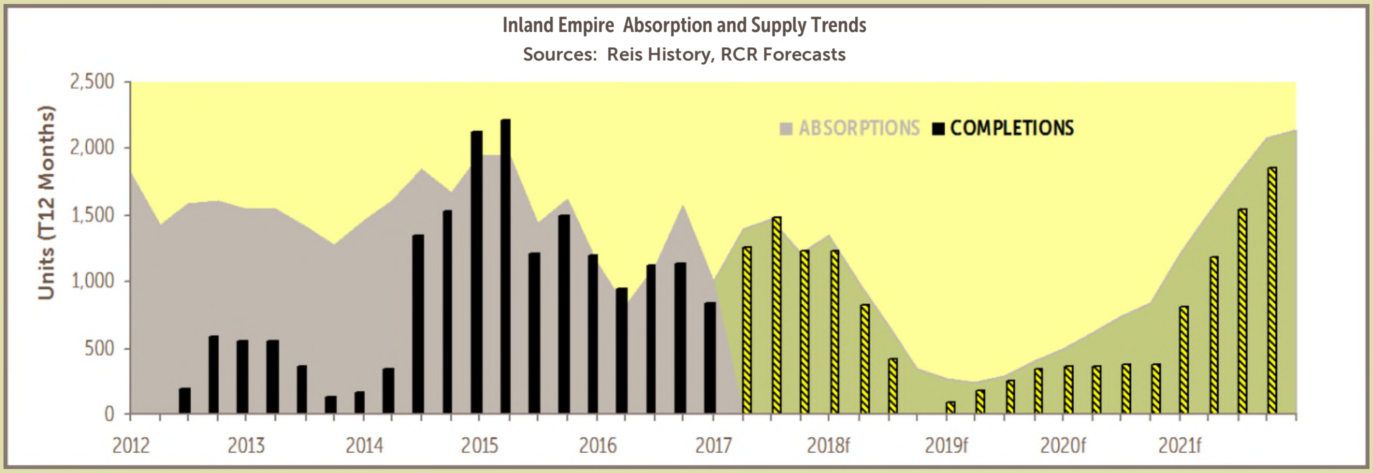
Metro property markets were steady during the first quarter. A total of 15 properties of 80 units or more were closed for gross proceeds of $447.3 million. These metrics compare to 18 transactions valued at $475.8mm during the previous quarter. The average price of traded units was $155,095, up 17% sequentially but down –15% year-on-year. The average price per square foot was $199, representing 27% and 19% sequential and y-o-y gains, respectively, and an Inland Empire quarterly series record high.

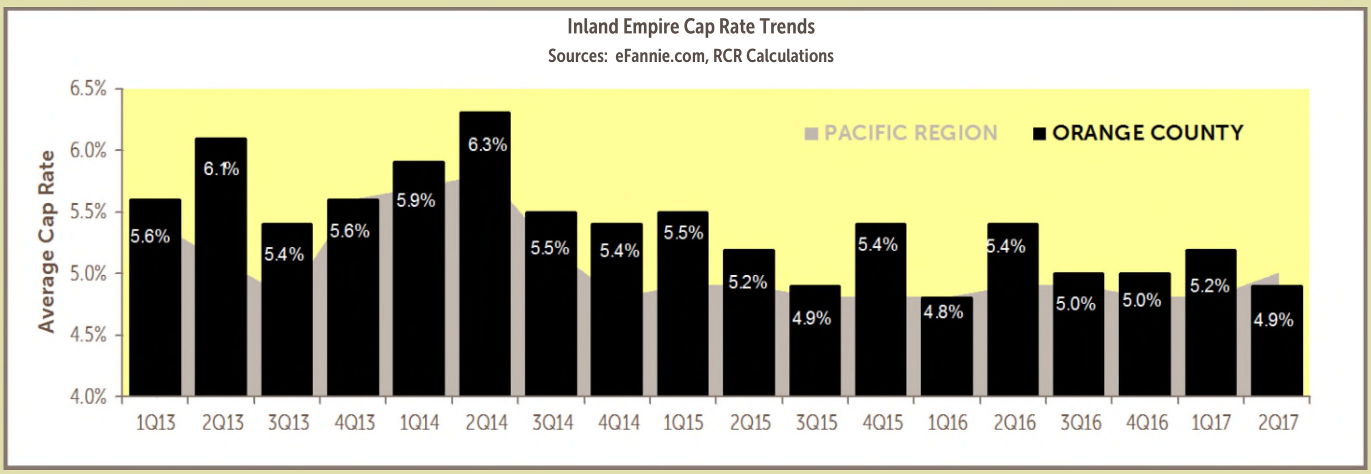
Trade velocity continued apace through the first half of 2Q17. Eight sales were consummated for $109.9mm at average unit and square foot prices of $117,551 and $119.

Cap rates averaged about 5.2% overall. High quality properties may trade as low as 4% but most gravitate to the 4.5% to 4.8% range. Class-B gardens are priced to yield 5% to 5.5%, and some value-adds may reach so high as 6%.

RCR elected to cut another 10 basis points from the generic B/B+ cap proxy to 5.05%. Using a terminal cap of 5.6% and model derived occupancy and rent point estimates we calculate that an investor would expect to earn a 6.7% unlevered annual rate of return on a 5-year hold. Among the RED 49, this ranks 37th and is slightly below the 7.0% group inventory-weighted average. Low demand volatility boosts risk-adjusted returns to R49 peer group number 18.

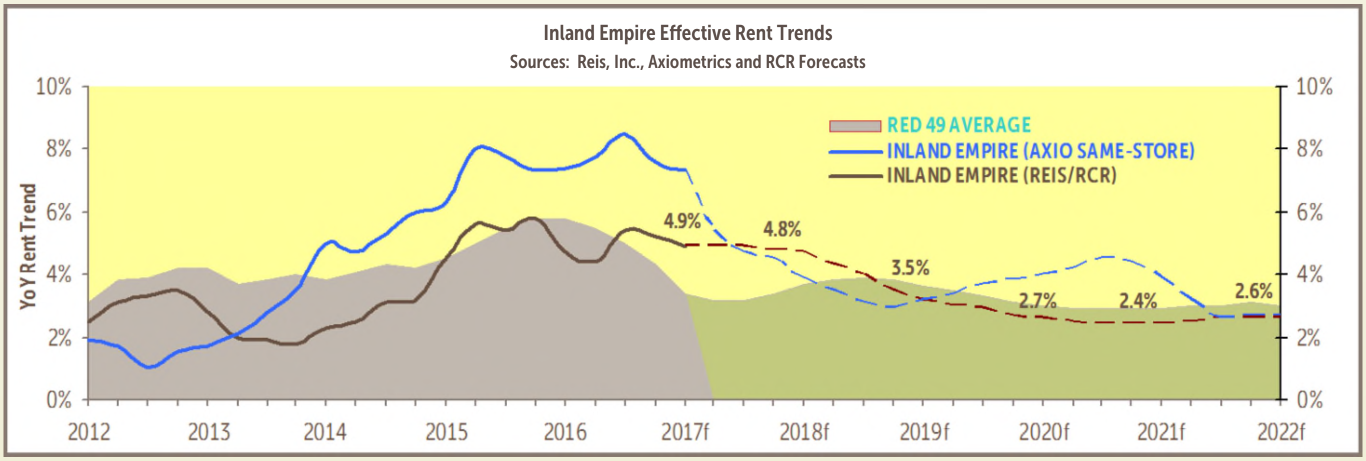




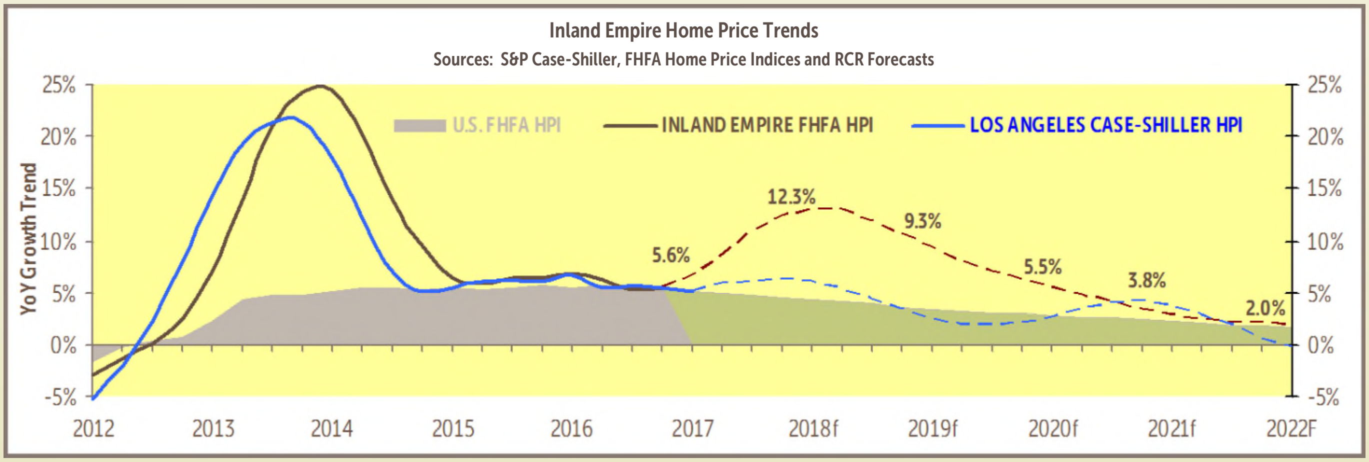


NOTABLE TRANSACTIONS

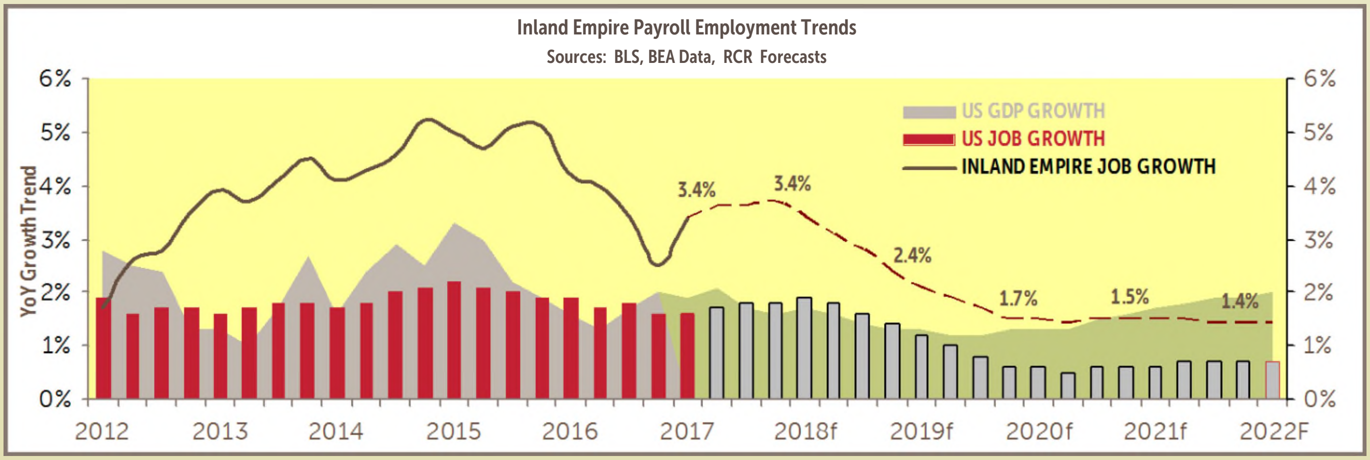
Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
The Highlands Apts. (Colton / Grand Terrace)	B / WF GLR (1986/88)	1-Nov-2016	$92.0	$165,468	5.4%
Lasselle Place (University City / Moreno Valley)	B+ / WF GLR (2005)	17-Nov-2016	$55.0	$181,003	5.5%
Santa Rosa (SW Riverside County / Wildomar)	A- / WF GLR (2008)	12-Jan-2017	$74.5	$232,813	4.8%
Sunridge Alta Loma (Rancho Cucamonga / Alta Loma)	A+ / WF GLR (1988)	27-Jan-2017	$65.2	$263,765	5.0%
Amberwood Villas (Hemet / KPC Towne Center)	B- / WF GLR (1982)	7-Apr-2017	$20.4	$113,111	6.0%
Cantabria Apartments (Perris / Menifee)	B+ / WF GLR (2009)	28-Apr-2017	$43.7	$188,913	4.1%



Inland Empire Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecasts
RED 49 AVERAGE
INLAND EMPIRE (AXIO SAME-STORE)
INLAND EMPIRE (REIS/RCR)
YoY Rent Trend
10%
8%
6%
4%
2%
0%
4.9%
4.8%
3.5%
2.7%
2.4%
2.6%
2012
2013
2014
2015
2016
2017f
2018f
2019f
2020f
2021f
2022f



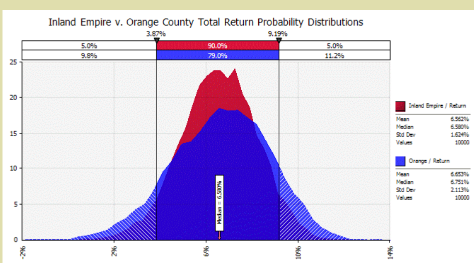
Inland Empire Home Price Trends
Sources: S&P Case-Shiller, FHFA Home Price Indices and RCR Forecasts
U.S. FHFA HPI
INLAND EMPIRE FHFA HPI
LOS ANGELES CASE-SHILLER HPI
YoY Growth Trend
25%
20%
15%
10%
5%
0%
-5%
12.3%
9.3%
5.6%
5.5%
3.8%
2.0%
2012
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022F

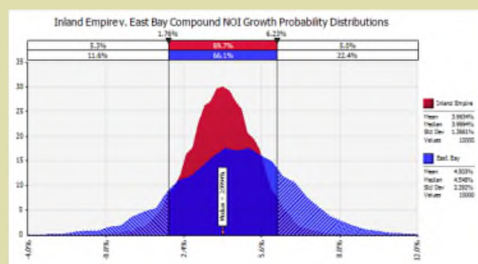


Inland Empire Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
US GDP GROWTH
US JOB GROWTH
INLAND EMPIRE JOB GROWTH
YoY Growth Trend
6%
5%
4%
3%
2%
1%
0%
3.4%
3.4%
2.4%
1.7%
1.5%
1.4%
2012
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022F

SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent 1Q16	Effective Rent 1Q17	Effective Rent Change	Physical Vacancy 1Q16	Physical Vacancy 1Q17	Physical Vacancy Basis Point Change
Colton / Loma Linda	0.0%	$1,263	$1,351	6.9%	2.8%	2.8%	0 bps
Fontana / Rialto	0.0%	$1,062	$1,123	5.8%	2.7%	2.1%	-60 bps
Hemet	0.0%	$838	$946	12.9%	2.9%	3.2%	30 bps
Indio / La Quinta	0.0%	$942	$1,013	7.6%	2.4%	3.0%	60 bps
North Ontario	3.5%	$1,252	$1,423	13.7%	2.9%	3.5%	60 bps
Palm Springs/Palm Dsrt	0.8%	$959	$1,025	6.9%	3.3%	2.6%	-70 bps
Perris	5.5%	$966	$1,112	15.2%	9.0%	2.5%	-650 bps
Rancho Cucamonga	0.0%	$1,522	$1,603	5.3%	2.0%	1.8%	-20 bps
Riverside County	4.6%	$1,259	$1,496	18.8%	1.8%	3.7%	190 bps
Riverside/No. Magnolia	0.0%	$1,125	$1,183	5.2%	3.3%	2.9%	-40 bps
SW Riverside County	0.0%	$1,324	$1,381	4.3%	4.7%	4.4%	-30 bps
San Bernardino	0.0%	$873	$956	9.5%	1.3%	1.6%	30 bps
South Ontario/Chino	6.5%	$1,442	$1,537	6.6%	6.8%	5.6%	-120 bps
University City	0.0%	$1,099	$1,295	17.8%	2.0%	1.9%	-10 bps
Upland	-7.7%	$1,147	$1,260	9.8%	1.4%	2.1%	70 bps
Victorville	-1.3%	$821	$963	17.3%	3.0%	2.7%	-30 bps
Metro	0.6%	$1,181	$1,239	4.9%	2.9%	0.0%	-287 bps





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