SAN FRANCISCO, CA

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q17 | June 2017

PAYROLL JOB SUMMARY

Average Payrolls	1,101.2m
Annual Change 1Q17	28.0m (2.6%)
RCR 2017 Forecast	24.4m (2.2%)
RCR 2018 Forecast	27.8m (2.5%)
RCR 2019 Forecast	20.3m (1.8%)
RCR 2020 Forecast	11.1m (0.9%)
RCR 2021 Forecast	10.2m (0.9%)
Unemployment (NSA)	2.6% (4/17)

1Q17 PAYROLL TRENDS AND FORECAST

San Francisco's job growth decelerated for the sixth consecutive quarter, falling to a still robust 28,000-job, 2.6% year-on-year rate from as fast as 3Q15's 51,800-job, 5.1% pace. Slower job creation was the outgrowth of a normalization of economic behavior following The City's earlier VC - fueled start-up Gold Rush. Weakness — such as it is—was centered in the tech services and related industries. The information, finance and business services sectors hired at a 9,200-job, 2.2% pace, down from 1Q16's blistering 28,000-job, 7.3% rate. Likewise, growth in the areas that serve the needs of the tech boom also turned down, none more so than lodging and food service, which tumbled from a 4,000-job, 3.6% growth rate in 1Q16 to a gain of only 100 positions over the four quarters ended 1Q17.

Wage and unemployment data suggest that San Francisco employers will be hard pressed to maintain recent rates of growth. Metro unemployment hit an 18-year low 2.6% in April, a problem that in-migration may no longer solve. Likewise, average hourly wages increased 8.5% y-o-y in April, reaching $43, perhaps an unsustainable upward trend.

RED Research's SF payroll model doesn't expect job creation to return to recent heights but the outlook is promising. After slowing through year-end the 95.5% adjusted-R^2 (SE=0.7%) equation projects that hiring will catch an updraft in 2018 on stronger US job and consumption growth. The rally likely will lose steam afterward but conditions should remain constructive for apartment market owners.

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	95.0%
RED 51 Rank	39th
Annual Chg. (Reis)	-0.2%
RCR YE17 Forecast	94.7%
RCR YE18 Forecast	95.3%
RCR YE19 Forecast	95.2%
RCR YE20 Forecast	95.5%
RCR YE21 Forecast	95.9%

1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Reis data indicate that space demand was off significantly during the first quarter. The service recorded net absorption of 74 vacant units, down from 628 and 681 units in the prior and year-earlier quarters, respectively. Supply exceeded net absorption by 122 units, giving rise to a −8 basis point decrease in metro occupancy to 95.03%. Tenant move-outs in San Mateo and Marin Counties — netting about 154 units —appear to have been a primary cause.

Axiometrics surveys of 151 larger, stabilized, same-store properties found average occupancy of 95.5%, up 10 bps year-on-year. At odds with national norms, class-A (95.8%) properties maintained the highest rate, beating classes-C (95.6%) and -B (95.3%). Five-story and higher elevations (95.1%) remained popular. Lower rent Central SMC (96.1%) and Civic Center (96.2%) posted y-o-y gains, while pricey Haight and Russian Hill (both 93.8%) suffered -100 and -250 bps occupancy rate decreases, respectively.

Reis project further occupancy rate declines over the next five years but the RED Research demand model is more optimistic. SF demand is determined by supply and Bay Area job growth rates (+), offset by the look-back rate of rent and home price growth (-). This equation forecasts sufficient demand to keep occupancy above 95% through 2021 following a supply-driven setback in 2017.

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	$2,838
Annual Change	-1.4%
RED 51 Rent Change Rank	51st
RCR YE17 Forecast	4.4%
RCR YE18 Forecast	5.5%
RCR YE19 Forecast	2.9%
RCR YE20 Forecast	2.3%
RCR YE21 Forecast	3.6.%

1Q17 EFFECTIVE RENT TRENDS

Reis report that San Francisco rents rebounded in 1Q17 after three consecutive sequential quarter declines. Metro rents increased $10 (0.4%) to a $2,838 average. By the same token, year-on-year comparisons decelerated for the fifth straight quarter, falling from −1.3% to −1.4%. On the brighter side, supply-challenged SoMa posted a brisk 4.3% sequential advance and rent concessions declined.

Axiometrics same-store comparisons conveyed stronger growth. Effective rents in this sample were up 1.2% sequentially and unchanged y-o-y. The former metric was the largest gain in 18 months; the latter the fastest since 2Q16. Class-A properties were largely responsible as stabilized assets notched a 3.8% sequential gain. Contra Reis, neither elevator buildings (0.0%) nor SoMa (0.0%) participated in the rally. Forward momentum largely originated among garden projects in San Mateo County (3.7%).

Modeling SF rents is tricky business as San Jose conditions often have a material impact. RCR settled on a simple 95.8% ARS (SE=1.5%) equation using only San Francisco job growth (+) and occupancy (+) as independent variables. The resulting forecast calls for a reacceleration to above average rents in 2018, as supply wanes and occupancy improves, followed by a roller coaster return to earth by 2020. Compound annual rent growth of 3.9% is projected.

TRADE & RETURN SUMMARY

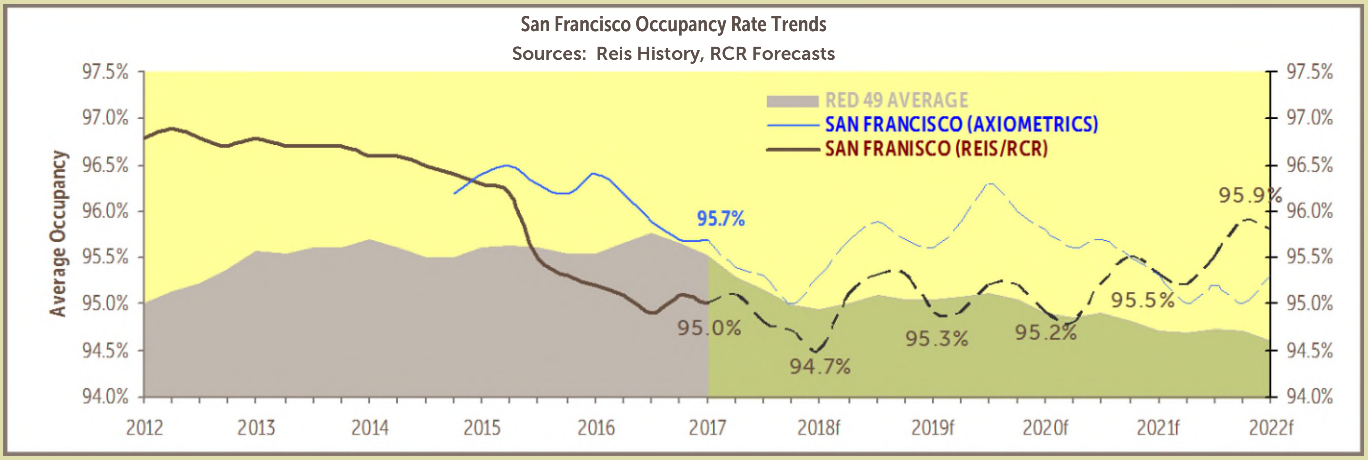
$5mm+ / 60-unit+ Sales	3
Approximate Proceeds	$125.0mm
Average Cap Rate (FNM)	4.8%
Average Price / Unit	$440,143
Expected Total Return	6.9%
RED 49 ETR Rank	29th
Risk-adjusted Index	3.17
RED 49 RAI Rank	37th

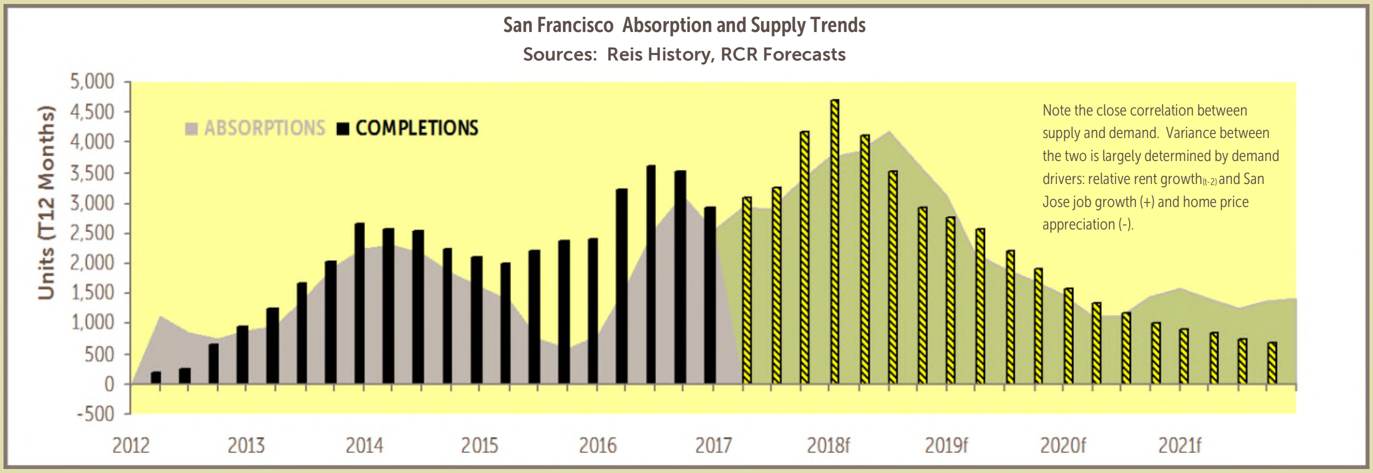
1Q17 PROPERTY MARKETS AND TOTAL RETURNS

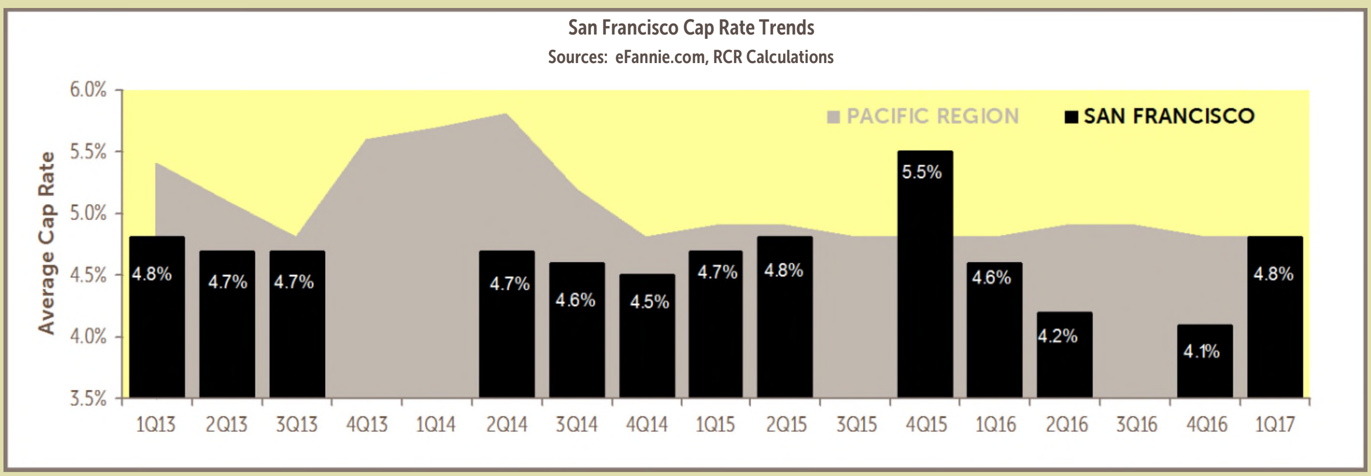
Bay Area arms-length property transactions were few and far between as owners held fast to precious core holdings. With supplies tight traded properties exchanged hands at substantial premiums over previous valuations. Appreciation rates of 20% to 30% per year over the course of the last three or four years were not uncommon.

CoStar reported only three transactions in the first quarter, down from 10 in the comparable period of 2016. Pricing information was available for only one of the trades: the acquisition of a 49% interest in a renovated class-C project on the Richardson Bay waterfront in Tiburon. A cap rate of 3.9% was reported, producing a value 85% above the previous exchange only 39 months earlier.

Lacking clarity on San Francisco cap rates, RCR elected to hold fast on 4.2% for the purchase cap rate proxy, second lowest among the R49 after New York. Employing a 4.7% terminal cap rate and model derived occupancy and rent point estimates we calculate that an investor would expect to earn a 6.9% annual unlevered total return on a 5-year hold. This ranks 29th in the peer group, down from 2nd before our demand model was adjusted to better reflect the impact of San Jose job and home price trends on forecast SF absorption. Risk-adjusted returns slip to RED 49 #37 due to high rent volatility and rent model standard error.

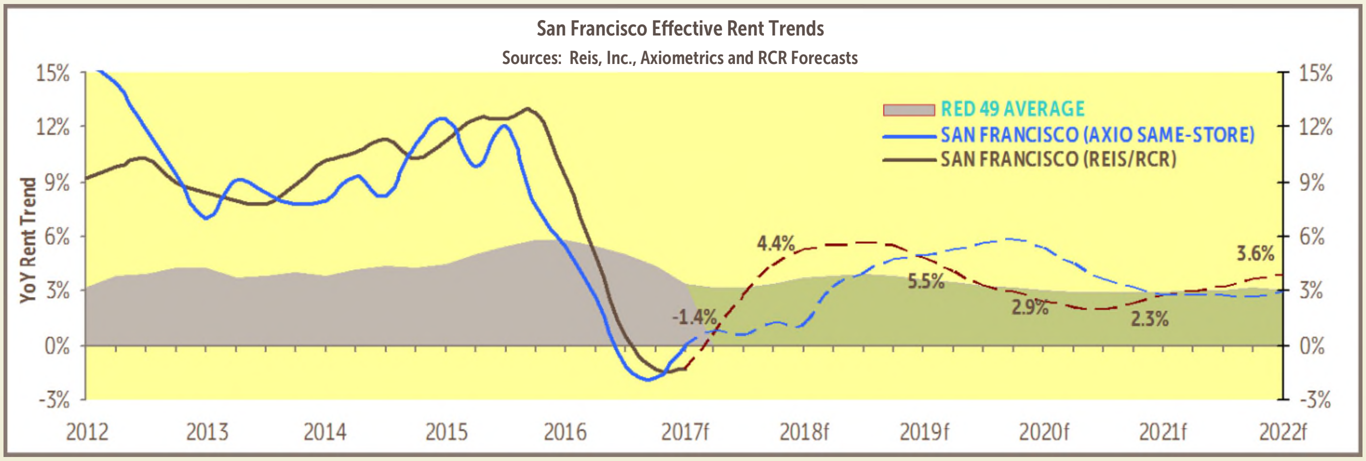


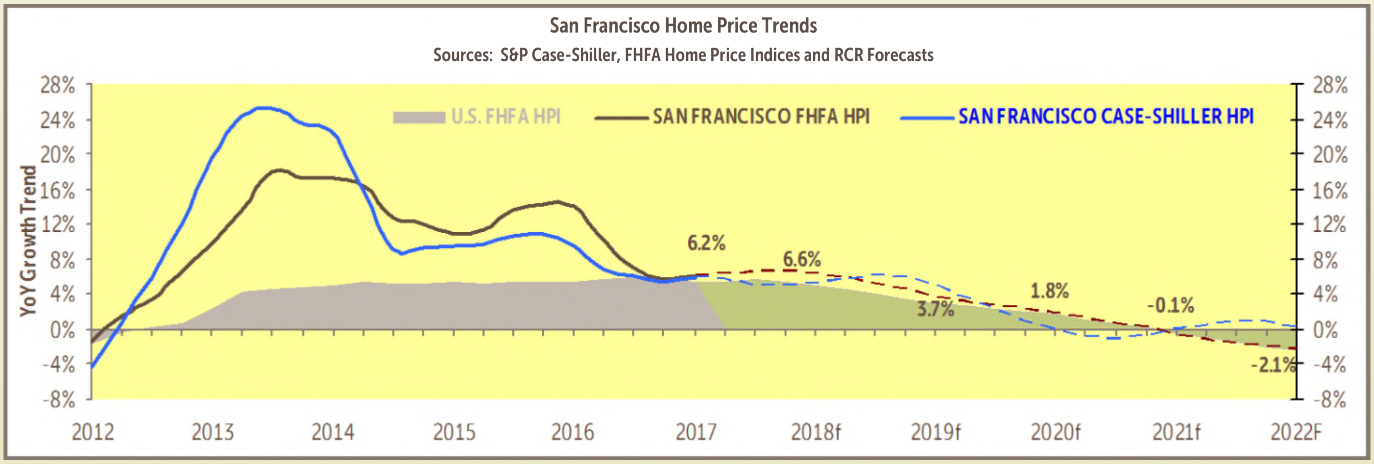


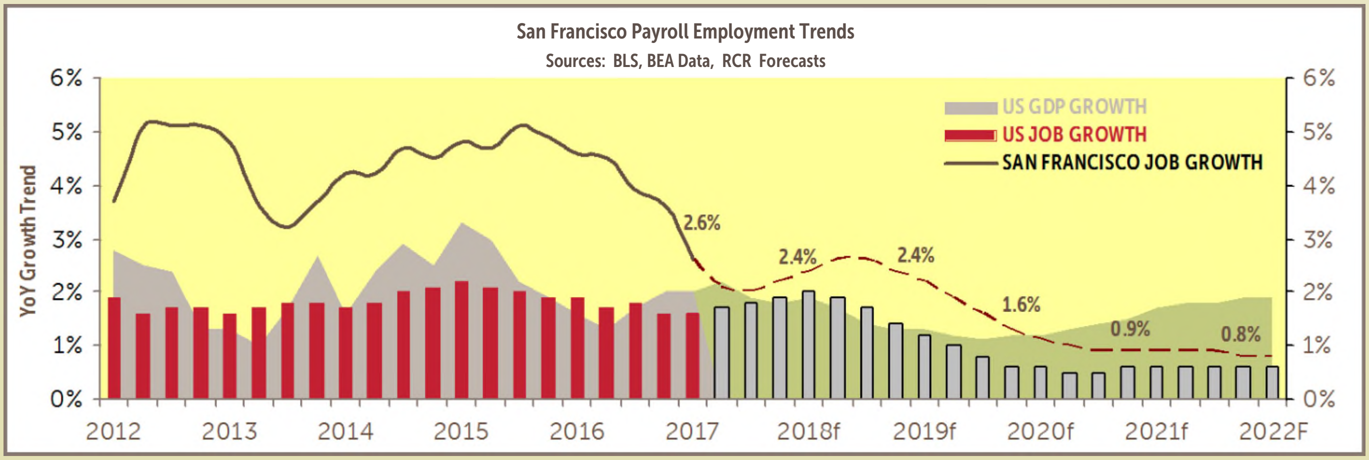


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
The Cove at Tiburon (South Marin / Tiburon)	B-/LR Marina (1963/16)	5-Apr-2017	$255.0 (	$897,887	3.9%

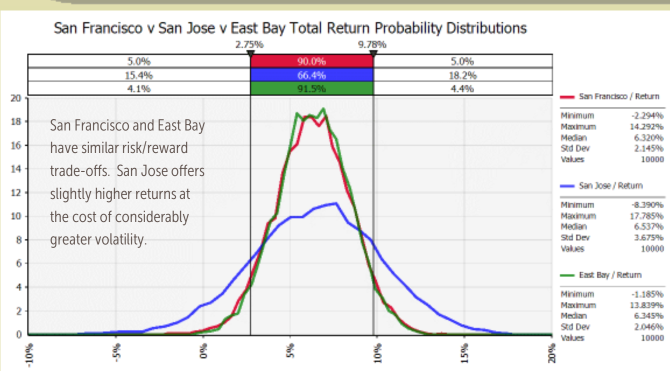

San Francisco Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecasts
RED 49 AVERAGE
SAN FRANCISCO (AXIO SAME-STORE)
SAN FRANCISCO (REIS/RCR)
YoY Rent Trend
15%
12%
9%
6%
3%
0%
-3%
4.4%
5.5%
2.9%
2.3%
3.6%
-1.4%
2012
2013
2014
2015
2016
2017f
2018f
2019f
2020f
2021f
2022f

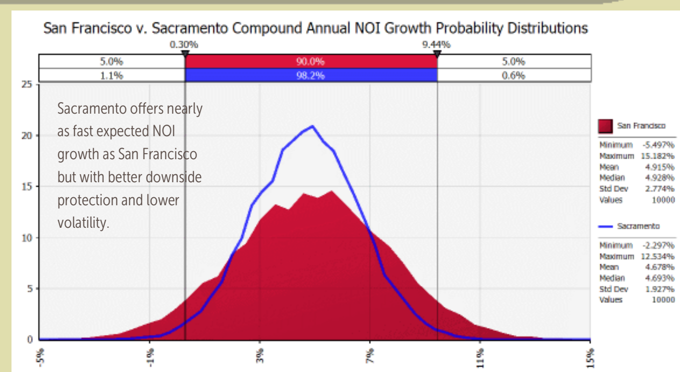

San Francisco Home Price Trends
Sources: S&P Case-Shiller, FHFA Home Price Indices and RCR Forecasts
U.S. FHFA HPI
SAN FRANCISCO FHFA HPI
SAN FRANCISCO CASE-SHILLER HPI
YoY Growth Trend
28%
24%
20%
16%
12%
8%
4%
0%
-4%
-8%
6.2%
6.6%
3.7%
1.8%
-0.1%
-2.1%
2012
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022F


San Francisco Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
US GDP GROWTH
US JOB GROWTH
SAN FRANCISCO JOB GROWTH
YoY Growth Trend
6%
5%
4%
3%
2%
1%
0%
2.6%
2.4%
2.4%
1.6%
0.9%
0.8%
2012
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022F

SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent			Physical Vacancy		
		4Q16	1Q17	% Change	4Q16	1Q17	Basis Point Change
Central San Mateo	0.0%	$2,842	$2,884	1.5%	3.6%	3.5%	-10 bps
Civic Center/Downtown	0.0%	$2,634	$2,652	0.7%	4.4%	4.4%	0 bps
Haight Ashbury	0.0%	$3,093	$3,094	0.1%	7.4%	6.3%	-110 bps
Marina/Pacific Heights	-0.2%	$3,158	$3,151	-0.2%	5.0%	4.6%	-40 bps
North Marin	0.0%	$2,114	$2,145	1.5%	1.5%	1.8%	30 bps
North San Mateo	0.0%	$2,295	$2,262	-1.5%	3.3%	3.0%	-30 bps
Russian Hill/Embarcadero	0.0%	$3,046	$3,102	1.9%	3.2%	3.7%	50 bps
South Marin	0.0%	$2,566	$2,532	-1.3%	2.6%	3.5%	90 bps
South San Mateo	1.2%	$2,706	$2,734	1.0%	5.2%	6.2%	100 bps
South of Market	2.2%	$3,646	$3,801	4.3%	11.3%	10.4%	-90 bps
West San Francisco	0.0%	$2,531	$2,410	-4.8%	2.7%	3.3%	60 bps
Metro	0.1%	$2,828	$2,838	0.4%	4.9%	5.0%	10 bps





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THE FACE OF LENDING