redcapital group

DENVER, COLORADO

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q17 | June 2017

PAYROLL JOB SUMMARY

Average Payrolls	1,435.1m
Annual Change 1Q17	30.0m (2.1%)
RCR 2017 Forecast	31.4m (2.2%)
RCR 2018 Forecast	40.9m (2.8%)
RCR 2019 Forecast	33.3m (2.2%)
RCR 2020 Forecast	27.0m (1.8%)
RCR 2021 Forecast	27.3m (1.7%)
Unemployment (NSA)	2.1% (4/17)

1Q17 PAYROLL TRENDS AND FORECAST

Denver payroll job growth stabilized in the first quarter following a long slide from the 4.4% cycle peak performance recorded two years before. Metro employers added to payrolls at a 30,000-job, 2.1% year-on-year, matching 4Q16's performance. Weaker expansion in the extraction, construction, manufacturing and professional and technical services industries was largely responsible for the soft patch as group growth slowed from an 8,000-job, 2.7% y-o-y pace as recently as last summer to 1Q17's 3,100 (1.1%) advance. The healthcare and computer system design subsectors remained bright spots, however, maintaining full heads of steam, each growing faster than 5% y-o-y.

A developing labor shortage undoubtedly played a role in the metro's slowing rate of job creation. Only 32,700 residents seeking employment were jobless in April (2.1%), -35% fewer than were unemployed 12 months earlier.

RED Research's DEN econometric payroll model produces an optimistic forecast. The 98.3% adjusted-R^2 (SE=0.3%) equation employs the rate of change of US payroll growth, metro personal income and $GDP_{(t-4)}$ growth as independent variables. As our base macro forecast calls for slightly faster US GDP and job growth over the next 12-15 months, the model expects Denver to follow suit with some degree of leverage. Payrolls are projected to grow at a 2.2% rate in 2017, despite a sluggish start during the first five months, and then accelerate to the high-2% area during 2018.

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	94.5%
RED 51 Rank	48th
Annual Chg. (Reis)	-1.0%
RCR YE17 Forecast	93.6%
RCR YE18 Forecast	94.0%
RCR YE19 Forecast	94.1%
RCR YE20 Forecast	93.7%
RCR YE21 Forecast	93.6%

1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Apartment demand slumped in the first quarter. After renters absorbed a net of 1,423 vacant units (Reis) in 4Q16, the movement of tenants took an abrupt turn in the opposite direction as a net of –109 move-outs were recorded. This was the first quarterly decline in occupied stock in eight years. Demand was soft across classes but the trend in class-A was worse, where renters net leased only 38 units in 1Q17, down 1,280 from the prior quarter. Occupancy fell -20 basis points sequentially and -100bps year-on-year to 94.5% as a result, lowest level since 2011.

Axiometrics surveys of 508 stabilized, same store assets found average occupancy of 93.7%, down –20bps y-o-y. Class-C (94.2%) reported the highest occupancy and only y-o-y increase (+20bps); class-A (92.9%) lowest and largest decrease (-70bps). With no recent supply, Denver-South/Glendale (95.2%/+220bps) submarket enjoyed highest occupancy/largest gain, while supply-heavy Denver Central (92.0%) and Downtown (92.5%) trailed the pack.

Denver will be barraged with heavy supply through 2018, pressuring occupancy irrespective of our upbeat economic outlook. Supply relief in 2019 is likely to run concurrent with weaker job growth (+) and still robust home price advances (-), influential variables in our demand equation. Hence, occupancy is likely to slip and struggle to recover.

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	$1,130
Annual Change	3.1%
RED 51 Rent Change Rank	35th
RCR YE17 Forecast	2.3%
RCR YE18 Forecast	2.9%
RCR YE19 Forecast	3.1%
RCR YE20 Forecast	2.8%
RCR YE21 Forecast	2.3%

1Q17 EFFECTIVE RENT TRENDS

Denver rent trends also took a turn for the worse. Average Reis reported effective rent declined $7 (-0.6%) sequentially, the first retrograde motion since 2Q09. The effect on annual trends was material, dropping year-on-year growth from 4.9% in 4Q16 to 3.1%, a "two sigma" plus event. The class-B&C segment bore the brunt of the decline: Reis report that class asking rents fell –0.9% sequentially, while comparable class-A rent declined only –0.4%.

Larger, professionally-managed properties appeared to fare better than the average. The Axiometrics same-store sample scratched out 0.5% sequential and 3.1% y-o-y gains, considerable improvements over 4Q16 in each case. Thirty assets delivered since 2015 with <86% occupancy notched a 2.8% advance. Every class participated, led by A (3.6%), with classes-B and –C on 3.4%. Suburban submarkets posted solid annual growth metrics, while infill Downtown (0.1%) and Central Denver (2.2%) drifted.

Occupancy is very material in RCR's 96.3% ARS (SE=0.7%) rent model, which doesn't bode well for revenue prospects. Indeed, trends are not projected to recover to the metro's 4.1% long-term average over the course of the 5-year forecast. Compound annual rent growth of 2.7% (RED 49 #31) is anticipated over the forecast interval: trends may be weaker if rapid home appreciation rates persist.

TRADE & RETURN SUMMARY

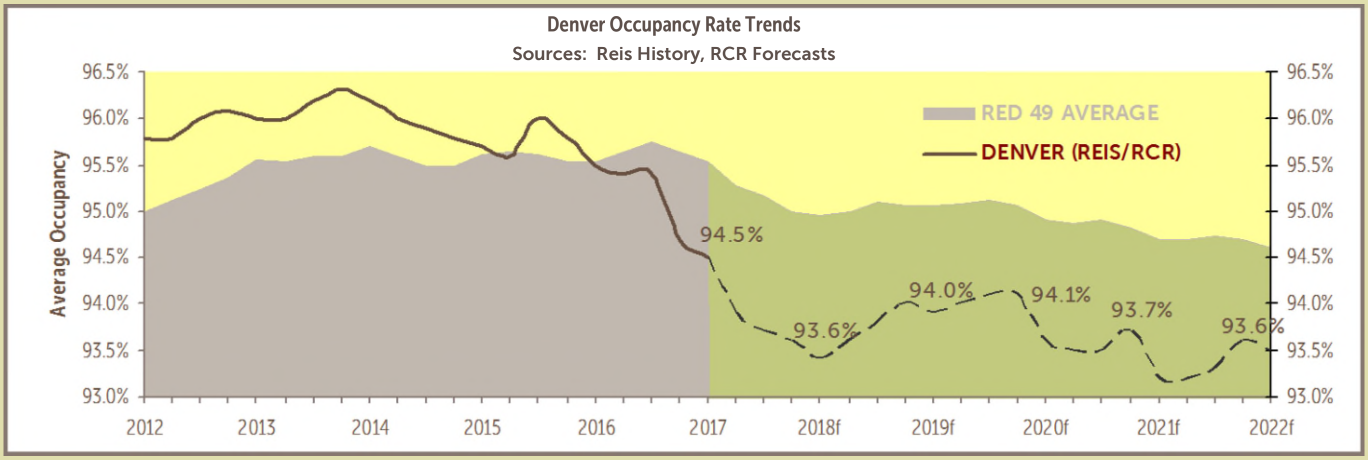
$5mm+ / 80-unit+ Sales	29
Approximate Proceeds	$896.6mm
Average Cap Rate (FNM)	4.9%
Average Price / Unit	$193,477
Expected Total Return	6.3%
RED 49 ETR Rank	40th
Risk-adjusted Index	1.84
RED 49 RAI Rank	48th

1Q17 PROPERTY MARKETS AND TOTAL RETURNS

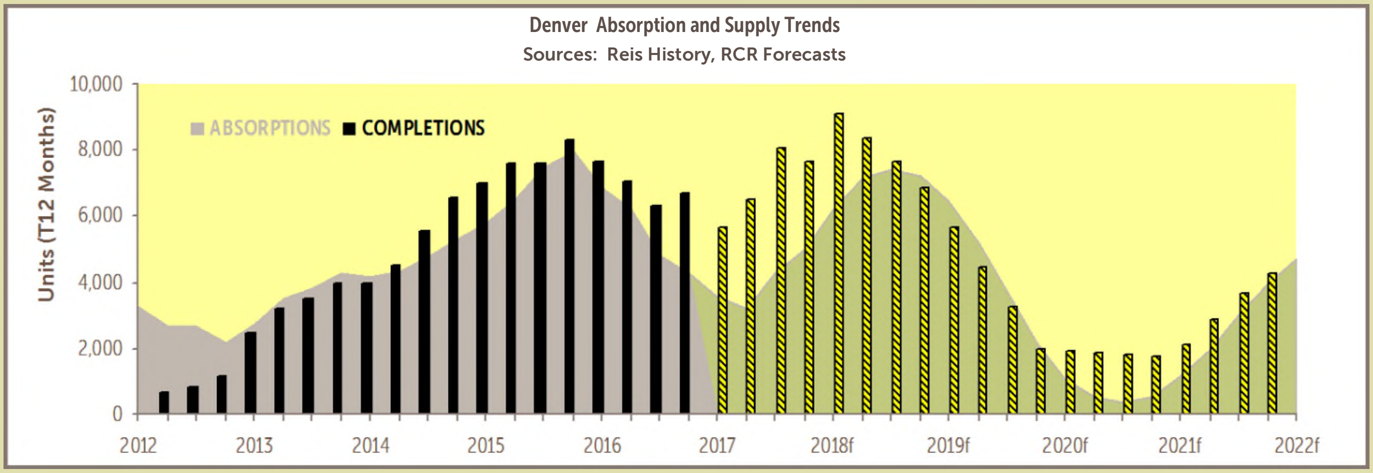
Sputtering Reis reported rent trends didn't put off investors. Buyers closed on 29 single-asset purchases for proceeds of $896.6 million in 1Q17, up slightly from 4Q16's 28-trade velocity, but a seasonal –45% sequential decline in respect to volume. The average price per unit metric was $193,477, down –5% sequentially and –6% year-on-year. Incomplete 2Q17 data were largely consistent with 1Q17.

Private and institutional investors were the dominant forces, accounting for 95% of year-to-date sales proceeds through mid-June. This compares to the historic average of 85%. Private equity/REIT share fell from 14% to only 5%. Cap rates appeared to rise, however, as some class-B+/A assets exchanged hands at going in yields in the high-4% region, up from the mid-4s last year. Value-add yields crept up as well, reaching the mid– to-high 5% range, perhaps 30 basis points above average 2016 levels.

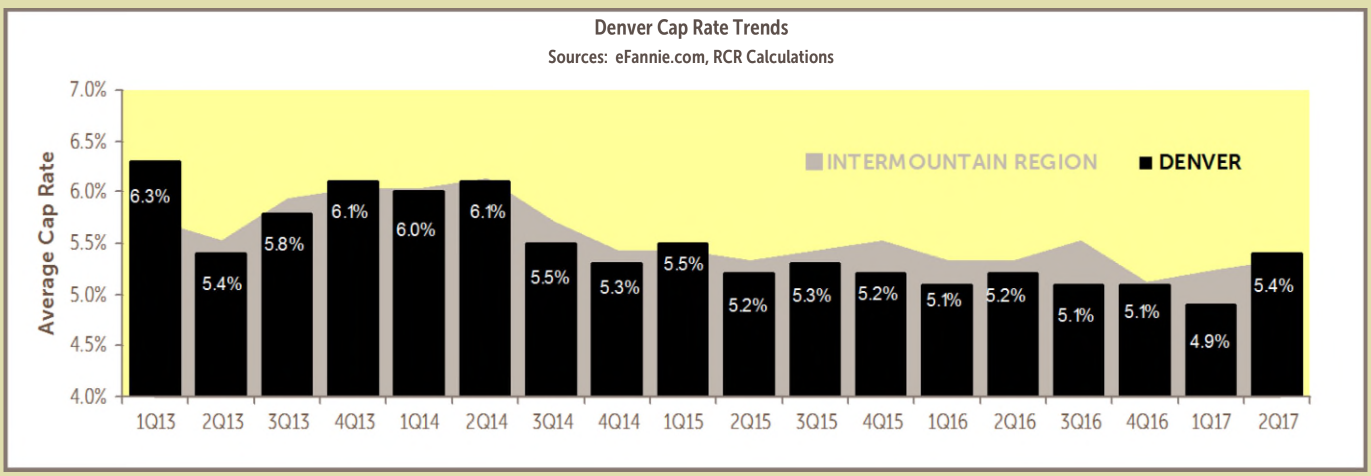
Reflecting recent trade, RCR bumped the B/B+ cap rate proxy 30bps to 5.0%, highest since 4Q15. With terminal yield of 5.6% and model derived rent and occupancy point estimates we calculate that an investor would expect to earn a 6.3% annual unlevered return over 5 years, ranking 40th among the RED 49. Moreover, above average rent and income volatility dents Denver's risk-adjusted return outlook: the metro ranks only #48 of 49 by way of RAI.



Denver Occupancy Rate Trends
Sources: Reis History, RCR Forecasts



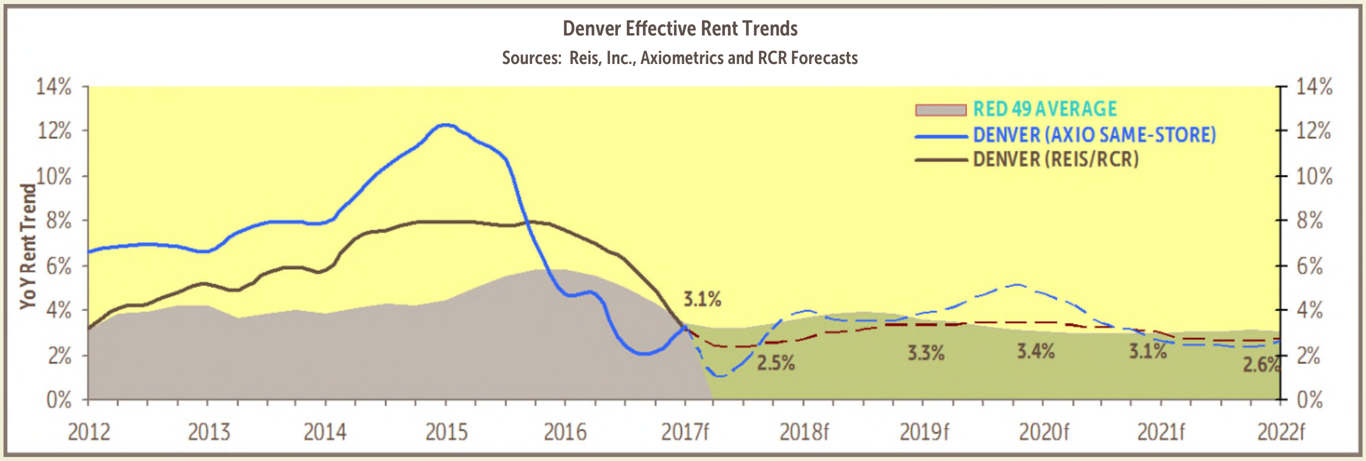
Denver Absorption and Supply Trends
Sources: Reis History, RCR Forecasts

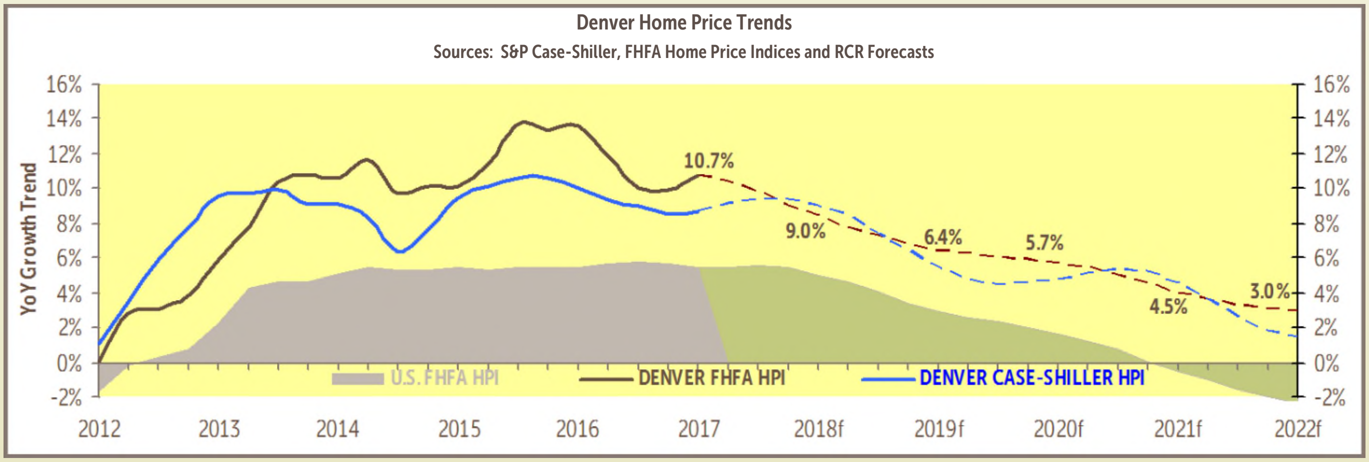


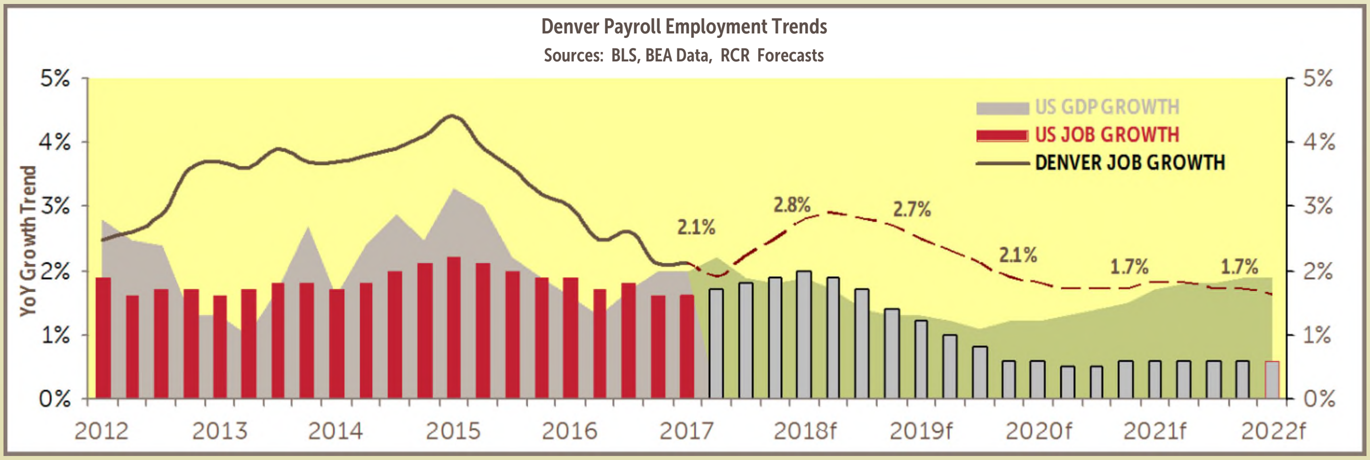
Denver Cap Rate Trends
Sources: eFannie.com, RCR Calculations

NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
Timber Lodge (Northglenn-Thornton / Welby)	C M.I./GLR (1971/2010)	30-Jan-2017	$40.5	$103,910	5.5%
City Block (Downtown / North Capitol Hill)	A- / MR (2013)	4-Feb-2017	$99.5	$329,470	4.4%
Landon Park (Aurora-North / City Center North)	C+ / GLR (1978)	17-Feb-2017	$58.2	$125,431	6.2%
Metropolitan Lincoln Station (Douglas Co. / Lone Tree)	B+ / MB MR (2006)	3-Mar-2017	$99.1	$229,980	4.7%
Griffis Union Station (Downtown / LoDo / Ballpark)	B+ / SR MR (2010)	17-Mar-2017	$126.0	$315,000	4.0%
Green Leaf Stone Cliff (Aurora-So. / Aurora Knolls)	B / GLR (2001)	9-June-2017	$78.0	$197,970	5.5%







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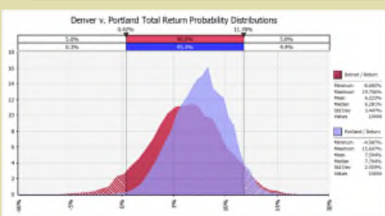
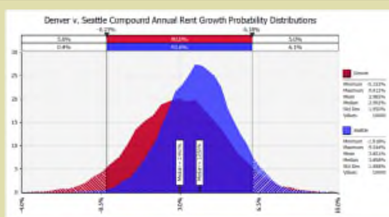
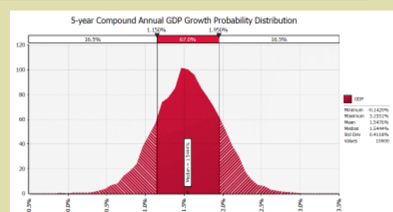
SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent 4Q16	Effective Rent 1Q17	Effective Rent Change	Physical Vacancy 4Q16	Physical Vacancy 1Q17	Basis Point Change
Arapahoe County	0.0%	$1,338	$1,344	0.5%	6.4%	6.6%	20 bps
Arvada / Broomfield	-0.7%	$1,107	$1,101	-0.5%	6.2%	6.8%	60 bps
Aurora-Central-SE	0.0%	$933	$934	0.0%	2.4%	3.1%	70 bps
Aurora-Central-SW	0.0%	$874	$881	0.8%	5.1%	4.9%	-20 bps
Aurora-North	0.0%	$911	$901	-1.1%	2.0%	2.3%	30 bps
Aurora-South	0.0%	$1,176	$1,200	2.0%	6.1%	6.5%	40 bps
Denver-Central	0.0%	$1,505	$1,499	-0.4%	8.1%	8.2%	10 bps
Denver-Downtown	0.0%	$1,255	$1,255	0.0%	8.7%	10.0%	130 bps
Denver-Far Southeast	0.0%	$922	$924	0.2%	3.7%	4.0%	30 bps
Denver-North	3.1%	$1,592	$1,623	2.0%	12.5%	13.5%	100 bps
Denver-Northeast	1.9%	$1,168	$1,197	2.5%	4.1%	4.3%	20 bps
Denver-South	0.0%	$926	$947	2.2%	3.8%	3.9%	10 bps
Denver-Southeast	0.0%	$959	$956	-0.4%	2.9%	2.9%	0 bps
Douglas County	0.0%	$1,258	$1,272	1.1%	6.3%	6.3%	0 bps
Englewood / Sheridan	4.3%	$910	$931	2.3%	4.5%	7.0%	250 bps
Golden / Wheat Ridge	-0.1%	$1,074	$1,070	-0.4%	3.5%	3.5%	0 bps
Lakewood-North	0.0%	$1,023	$1,016	-0.7%	3.3%	3.9%	60 bps
Lakewood-South	0.4%	$1,132	$1,151	1.6%	2.2%	2.4%	20 bps
Littleton	0.0%	$1,053	$1,063	1.0%	5.8%	5.2%	-60 bps
Northglenn / Thornton	0.4%	$1,021	$1,025	0.4%	5.2%	5.6%	40 bps
Westminster	1.7%	$1,108	$1,125	1.5%	4.5%	4.9%	40 bps
Metro	0.1%	$1,137	$1,130	-0.6%	5.3%	5.5%	20 bps







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