COLORADO SPRINGS, CO

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 1Q17 | July 2017

PAYROLL JOB SUMMARY	
Average Payrolls	280.0m
Annual Change 1Q17	7.4m (2.7%)
RCR 2017 Forecast	6.1m (2.2%)
RCR 2018 Forecast	6.7m (2.4%)
RCR 2019 Forecast	5.7m (2.0%)
RCR 2020 Forecast	4.2m (1.4%)
RCR 2021 Forecast	2.9m (1.0%)
Unemployment (NSA)	2.7% (5/17)

1Q17 PAYROLL TRENDS AND FORECAST

Colorado Springs establishments continued to add workers to payrolls at a brisk clip in 1Q17, but job growth decelerated materially during the second quarter. Specifically, year-on-year headcount advanced at a 7,400-job, 2.7% rate in 1Q, on par with hiring in each of the previous two quarters, but slowed to a 6,000 (2.1%) job pace in the spring. Second quarter softness was largely attributable to attrition in the critical business services industry, which is CSP's second largest after government. Sector headcounts declined at a 900-job, -2.1% rate. But these losses were counterbalanced by further robust expansion in construction and health care (each 5.5% y-o-y), and the financial services sector (3.8%)

Household Survey data were stronger. The unemployment rate plunged -90 basis points over the 12 months ended in May to only 2.7%, in spite of a 3.1% increase in the labor force. The reason: a 12,750 (4.1%) person increase in the population reporting some sort of employment to the BLS.

The RED Research's CSP payroll model suggests that the good times are likely to persist through 2019. The model reaches a 96.4% adjusted-R^2 (SE=0.5%) using the rate of change of U.S. payroll growth, and Denver job, metro home price$_{(t-3)}$ and nominal GDP growth as independent variables. The model forecasts 2%+ annual growth for the next two years. But weaker national output and job growth expected in the forecast out-years will exert centripetal force on CSP, causing hiring to slow to about the 1% level.

OCCUPANCY RATE SUMMARY	
Occupancy Rate (Reis)	96.6%
RED 51 Rank	10th
Annual Chg. (Reis)	+0.2%
RCR YE17 Forecast	96.6%
RCR YE18 Forecast	96.2%
RCR YE19 Forecast	96.1%
RCR YE20 Forecast	96.1%
RCR YE21 Forecast	96.3%

1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Reis report that no new supply was added to the metro inventory for the second consecutive quarter. This may explain why tenants vacated a net of 133 occupied units, representing only the third quarter of negative absorption in the last eight years. Occupancy declined –40 basis points sequentially but remained 20bps above the year-before level. Preliminary data released by Reis indicate that market occupancy increased 10bps in 2Q17 to 96.7%.

Surveys of stabilized, same-store professionally managed properties by Axiometrics found lower occupancy conditions. The 87-property sample was 95.5% and 94.3% occupied in 1Q and 2Q17, respectively. These metrics represented –30bps year-on-year declines in each case. Class-B (94.6%) recorded highest 2Q occupancy, followed by class -A (94.2%). Occupancy fell in each class y-o-y, but class-C experienced the largest decrease, falling -380bps to 93.1%.

After something of a lull, supply is expected to regain strength over the next two years, expanding market inventory nearly 4% in the process. Our CSP demand model suggests that only about 80% will be concurrently absorbed, causing market occupancy to dip -30 to -40bps by YE18. The longer-term outlook is favorable, however, as supply is expected to diminish after 2018, and demand should be boosted by favorable job and home price trends.

EFFECTIVE RENT SUMMARY	
Mean Rent (Reis)	$865
Annual Change	7.1%
RED 51 Rent Change Rank	1st
RCR YE17 Forecast	5.6%
RCR YE18 Forecast	3.7%
RCR YE19 Forecast	2.8%
RCR YE20 Forecast	2.5%
RCR YE21 Forecast	2.3%

1Q17 EFFECTIVE RENT TRENDS

First quarter rent growth accelerated moderately, rising at a $10 (1.2%) sequential rate, up from $7 (0.8%) in 4Q16 (Reis). The class-A segment provided most of the momentum as luxury asking rents increased 1.3%, while B&C rents gained only 0.1%. Year-on-year comparisons were off slightly, slowing to 7.1% from 7.3% in 4Q16. Still, CSP advanced from #5 to #1 among the RED 51 peer group in the process, reclaiming this distinction for first time since 2010. Preliminary 2Q17 data were constructive as *asking* rents increased 1.9% sequentially, up from 1.0% in 1Q17.

Rent trends were stronger among the Axiometrics same-store sample. Sample rents increased 8.2% and 8.0% y-o-y in 1Q and 2Q17, respectively. The "B" segment (8.4%) was the 2Q class leader, but only class-A accelerated quarter-on-quarter, advancing at a 7.4% rate in 2Q, up from 6.3%. By contrast, growth among class-C properties declined from 11.4% to 6.9% in 2Q, falling from class #1 to last.

Modeling mercurial CSP rents is a challenge. Our best equation uses two lags of metro rent growth, Denver rent growth and metro occupancy change$_{(t-2)}$ as variables. The 95.9% ARS (SE=0.7%) model projects further powerful rent increases through 2018, but moderating trends for the balance of the forecast interval. Rents are expected to rise at a 3.2% compound annual rate, RED 49 19th fastest.

TRADE & RETURN SUMMARY	
$3mm+/60-unit+ Sales	2
Estimated Proceeds	$22.4mm
Average Cap Rate (FNM)	5.4%
Average Price / Unit	$99,556
Expected Total Return	7.4%
RED 49 ETR Rank	9th
Risk-adjusted Index	2.41
RED 49 RAI Rank	45th

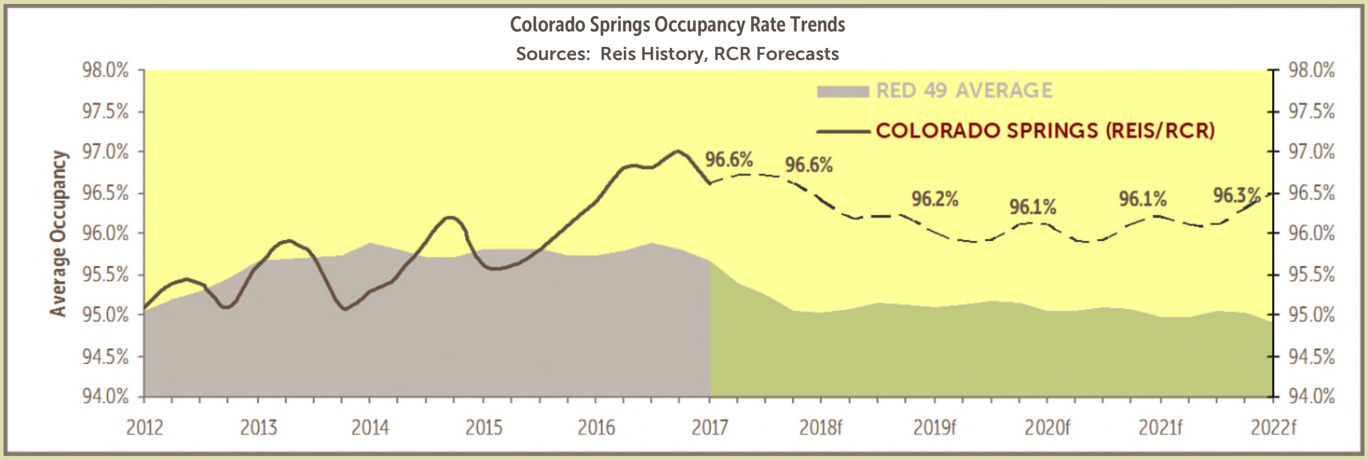
1Q17 PROPERTY MARKETS AND TOTAL RETURNS

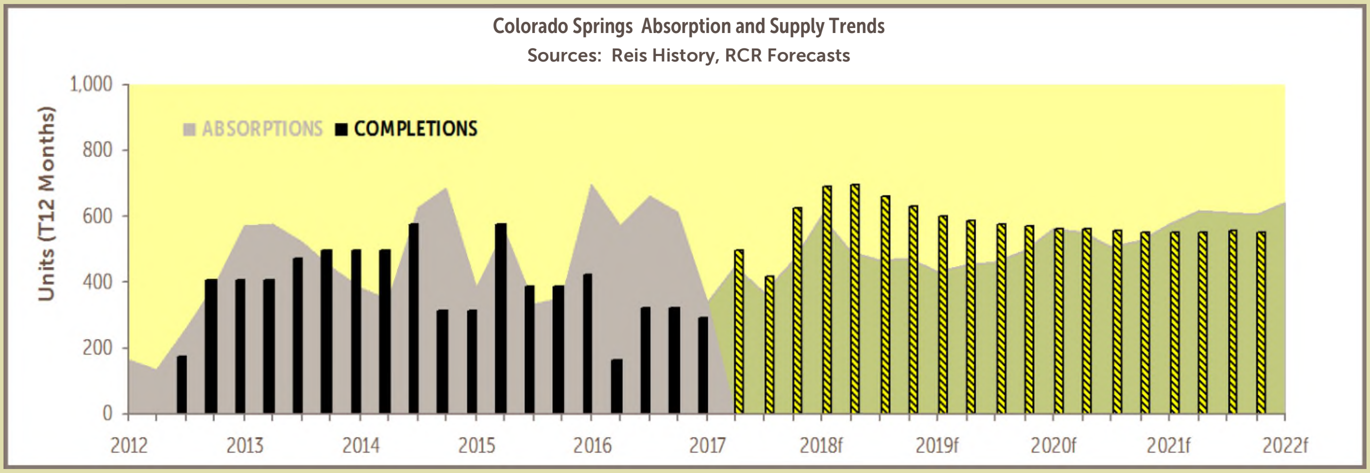
After 2016's record breaking sales the Colorado Springs property market went on hiatus in the first half 2017. Only three investment sales closed January through June for gross proceeds of $51 million. This compares to 14 and 8 transactions for $404mm and $134mm in 2H16 and 1H16, respectively. On $133,858, the average unit price approached 2H16's $142,355 series record, representing the second highest semi-annual metric recorded to date.

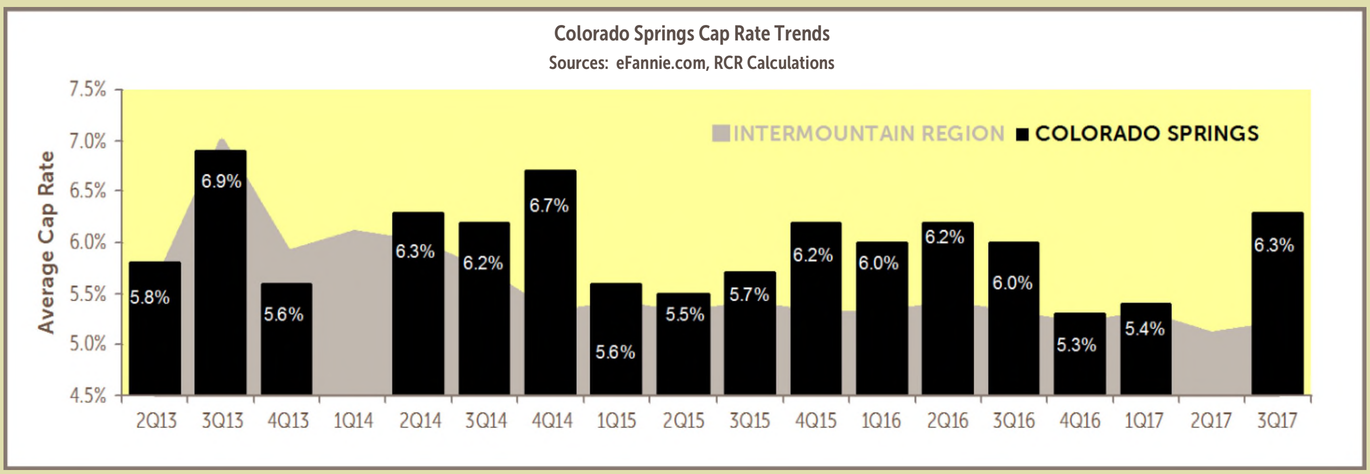
REIT and institutional buyers were active in the market over the past 12 months, collectively accounting for 35% of total sales volume. This compares to a 13% market share observed over the prior ten-year period.

Cap rates varied widely. Investors bid aggressively on established valued-adds, pushing cap rates on older gardens into the high-4% to low-5% region. Class-B+/A- GLRs traded in the same range. Older properties without perceived value-add potential sold to 6%+ going-in yields.

RCR cut the cap rate proxy to 5.25%, the mid-point of the B+/A range. With a terminal cap of 5.9% and model generated rent and occupancy point estimates, we calculate that a 1Q17 investor would expect to earn a 7.4% unlevered annual total return on a 5-year carry. This is ninth highest among the RED 49 peer group. High rent volatility and model standard error hinder risk-adjusted returns. Colorado Spring's risk-adjusted index ranks 45th in the peer group.

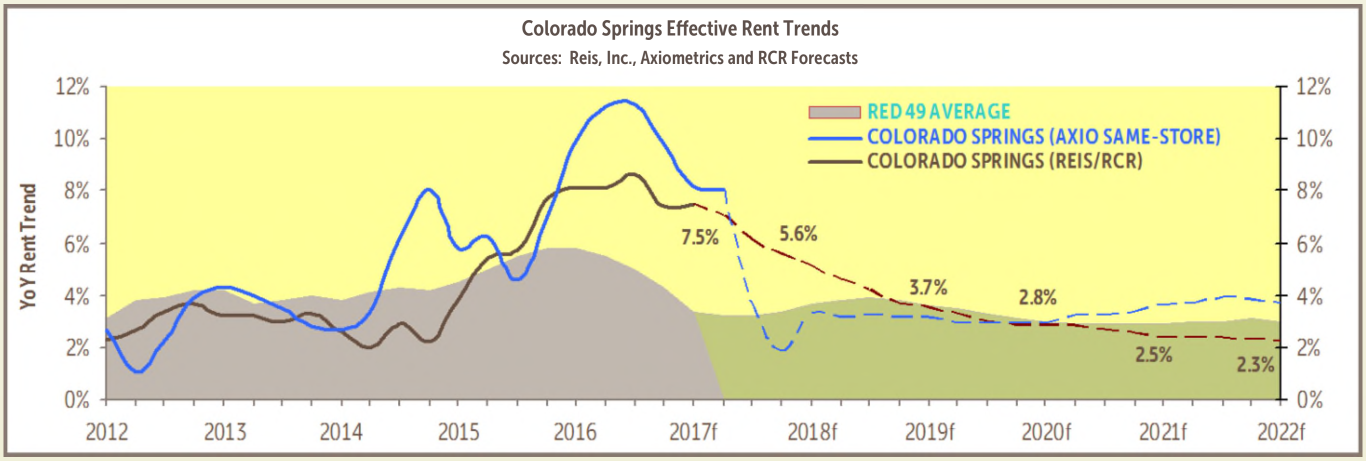


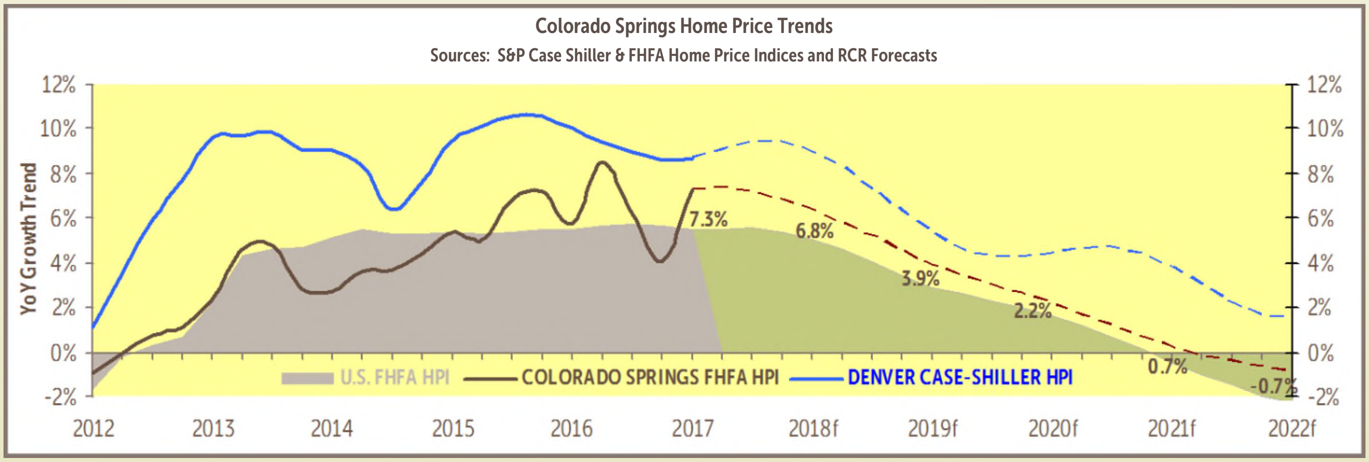


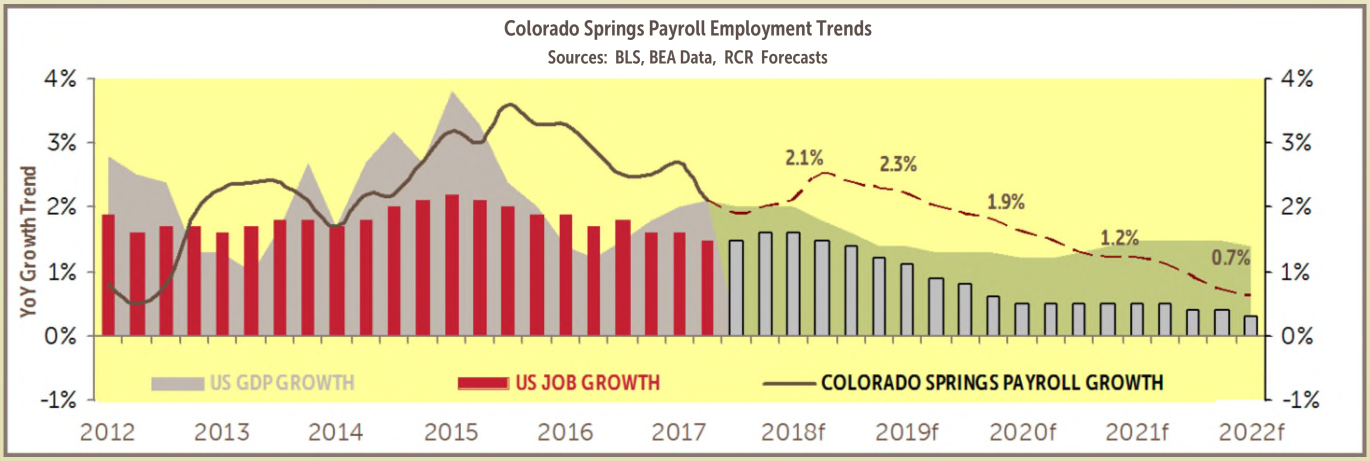


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
Grand River Canyon (Far Northeast / Briargate)	B+ / WF GLR (1999)	30-Nov-2016	$73.3	$166,477	5.2%
Vineyards of Colorado Springs (Far NE / Briargate)	A- / WF GLR (2001)	30-Nov-2016	$55.3	$184,267	5.56% (UW)
First and Main (Far Northeast / F&M Town Center)	A- / WF GLR (2014)	9-Dec-2016	$67.3	$213,651	4.8%
Aviator Apts. (Far Northeast / East Colorado Springs)	B / WF GLR (1971/94)	9-Dec-2016	$14.0	$96,238	6.4%
Regal Estates (East / Knob Hill / S. Academy Blvd.)	C+ / MB LR (1972)	9-Dec-2016	$13.1	$87,000	4.9% (UW)/5.6% T-3
Bonterra Apts. (Southeast / Quail Lake)	B- / WF GLR (1973/99)	23-Jun-2017	$28.6	$183,333	5.8%

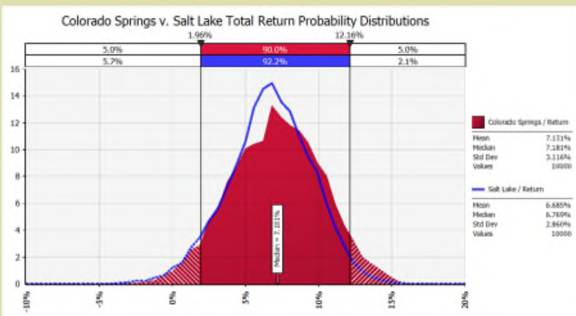

Colorado Springs Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecasts
YoY Rent Trend
RED 49 AVERAGE
COLORADO SPRINGS (AXIO SAME-STORE)
COLORADO SPRINGS (REIS/RCR)
7.5%
5.6%
3.7%
2.8%
2.5%
2.3%
12%
10%
8%
6%
4%
2%
0%
2012
2013
2014
2015
2016
2017f
2018f
2019f
2020f
2021f
2022f

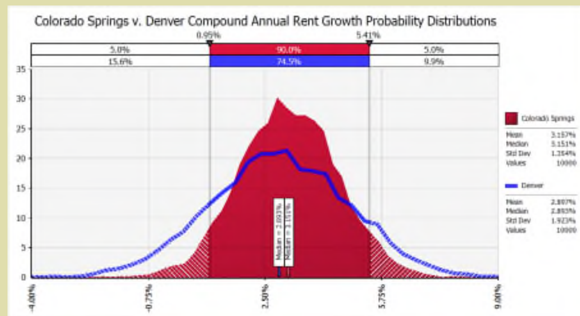

Colorado Springs Home Price Trends
Sources: S&P Case Shiller & FHFA Home Price Indices and RCR Forecasts
YoY Growth Trend
U.S. FHFA HPI
COLORADO SPRINGS FHFA HPI
DENVER CASE-SHILLER HPI
7.3%
6.8%
3.9%
2.2%
0.7%
-0.7%
12%
10%
8%
6%
4%
2%
0%
-2%
2012
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022f

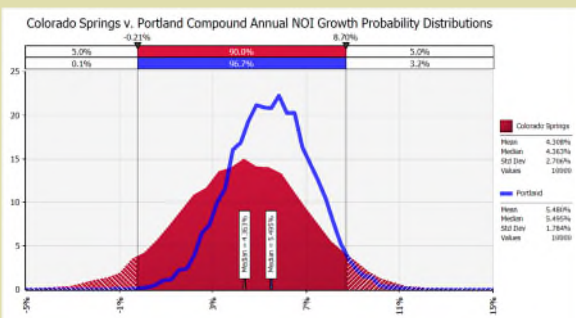

Colorado Springs Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
YoY Growth Trend
US GDP GROWTH
US JOB GROWTH
COLORADO SPRINGS PAYROLL GROWTH
2.1%
2.3%
1.9%
1.2%
0.7%
4%
3%
2%
1%
0%
-1%
2012
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022f

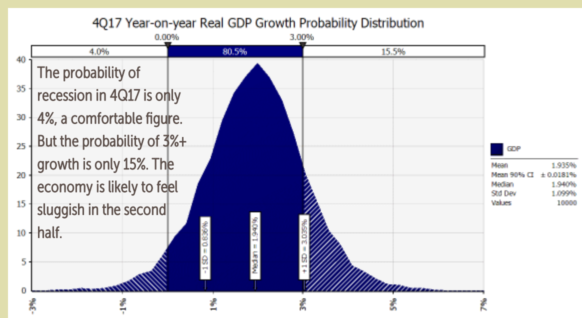
SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent 4Q16	Effective Rent 1Q17	Change	Physical Vacancy 4Q16	Physical Vacancy 1Q17	Basis Point Change
Central	0.0%	$716	$733	2.3%	2.0%	2.6%	60 bps
Northeast	0.0%	$958	$976	1.9%	2.7%	3.2%	50 bps
Northwest	0.0%	$981	$1,002	2.2%	5.0%	4.9%	-10 bps
South	0.0%	$664	$660	-0.5%	3.3%	3.8%	50 bps
Southwest	0.0%	$885	$892	0.8%	2.8%	2.9%	10 bps
Metro	0.0%	$855	$865	1.2%	3.0%	3.4%	40 bps









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