

PAYROLL JOB SUMMARY

Average Payrolls	1,946.2m
Annual Change 1Q17	33.6m (1.8%)
RCR 2017 Forecast	32.5m (1.7%)
RCR 2018 Forecast	23.1m (1.2%)
RCR 2019 Forecast	10.8m (0.5%)
RCR 2020 Forecast	6.6m (0.3%)
RCR 2021 Forecast	10.0m (0.5%)
Unemployment (NSA)	3.2% (5/17)

1Q17 PAYROLL TRENDS AND FORECAST

The Minneapolis labor market recorded faster growth during the first quarter. Total payrolls increased at a 33,600 -job, 1.8% year-on-year rate, up from 4Q16's 27,500 (1.4%) job performance, slowest in six years. The rebound was powered by stronger growth among construction, retail and personal service concerns, supported by steady gains in the skilled services industries, particularly finance and health care. Pockets of weakness were evident, however; most notably in the leisure services sector, where accommodations and food service employment declined for the second consecutive quarter, in this case 3,700 (-2.6%) jobs y-o-y, reversing most of the gains made in 2015 and 2016.

Most April and May data were constructive, suggesting the

1Q17 bounce has legs. Annual comparisons overall advanced at a 1.8% rate, with particular strength exhibited in healthcare. Seasonally-adjusted data were choppy, however, as a May loss (-600) followed April's 7,500-job add.

RED Research's forecast is optimistic in the near term but cautious after 2018. Our MSP model uses the rate of change of US job growth, US home price appreciation_(t-4) and the 10-year Treasury yield_(t-3) to achieve a 97.1% adjusted-R² (SE=0.31%). The model foresees payroll job growth above the 28-year 1.2% historical average annual rate through MY2018, but slower growth after. The model indicates that weaker US job creation, and home price increases will give rise to metro sluggishness by 2019.

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	97.0%
RED 51 Rank	4 th
Annual Chg. (Reis)	+0.5%
RCR YE17 Forecast	95.9%
RCR YE18 Forecast	95.8%
RCR YE19 Forecast	95.9%
RCR YE20 Forecast	96.0%
RCR YE21 Forecast	96.2%

1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Space demand was moderately weaker in the first quarter as tenants occupied a net of 307 vacant units (Reis), down from 530 and 721 units in the prior and year-earlier quarters, respectively. Absorptions were fewest in a first quarter since 2010. Reduced supply was both mitigating and in part responsible. Developers completed 325 units, representing one of the smallest quarterly vintages since 2012. Occupancy held on 97% for the third consecutive quarter.

Stabilized, same-store data from Axiometrics was consistent. A sample of 250 properties was 96.1% and 96.8% occupied in 1Q17 and June, respectively, representing 160 and 30 basis point year-on-year increases. Class-A prop-

erties (94.4%) were a drag on the 1Q17 average, but recorded a solid bounce back to 95.6% in June. The small class-C sample was strongest, posing 98.4% and 99.1% comparable metrics. The larger class-B sample chalked down rates near the total sample means: 96.3% and 96.9%.

After something of an hiatus in 2016, supply pressures are expected to return in 2017 and 2018. After falling to a readily digestible 1,978 units last year, MSP inventory is forecast to rise by more than twice that number this year and next. RCR's 94.0% ARS demand model suggests that net absorption will fall about 2,350 units short of supply, causing occupancy to decline -120bps by year-end 2018.

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	\$1,161
Annual Change	3.1%
RED 51 Rent Change Rank	34 th
RCR YE17 Forecast	2.8%
RCR YE18 Forecast	2.7%
RCR YE19 Forecast	2.5%
RCR YE20 Forecast	2.5%
RCR YE21 Forecast	2.8%

1Q17 EFFECTIVE RENT TRENDS

Rent trends decelerated materially over the winter. Average metro effective rent increased \$3 (0.3%) sequentially (Reis) in 1Q17, representing the smallest comparable gain since 2Q10. Rising concessions were primarily responsible as the mean discount increased from -3.0% of asking rent in 4Q16 to -3.4%. The year-on-year comparison declined slightly from 3.4% in 4Q16 to 3.1%; the metric was the slowest annual pace of rent growth observed since 1Q11.

The Axiometrics same-store sample recorded stronger results. Sample rents were up 4.7% y-o-y in 1Q17, down marginally from 4.8% in the prior quarter. Momentum appears to have carried forward into the spring as June

rents were up 4.3% y-o-y. Class-B properties did most of the heavy lifting, rising 5.5% in 1Q17 and 4.9% in June. Classes-A and -C were considerably weaker, advancing at 2.3% and 2.6% rates in 1Q. Three suburban submarkets posted 5% or faster increases in June, while infill Minneapolis and St. Paul were at the back of the pack on 1.8%.

RCR's 96.8% ARS (SE=0.4%) MSP rent model uses metro personal income growth_(t-1), occupancy_(t-1) and occupancy change_(t-1) as independent variables. Projected occupancy losses will hinder rent growth in 2017 and 2018. Occupancy is likely to recover later, but personal income growth is not expected to be fast enough to ignite stronger trends.

TRADE & RETURN SUMMARY

\$5mm+/80+-unit Sales	6
Estimated Proceeds	\$264.1mm
Average Cap Rate (FNM)	5.8%
Average Price / Unit	\$150,972
Expected Total Return	6.6%
RED 49 ETR Rank	34 th
Risk-adjusted Index (ETR/σ _{ETR})	4.46
RED 49 RAI Rank	13 th

1Q17 PROPERTY MARKETS AND TOTAL RETURNS

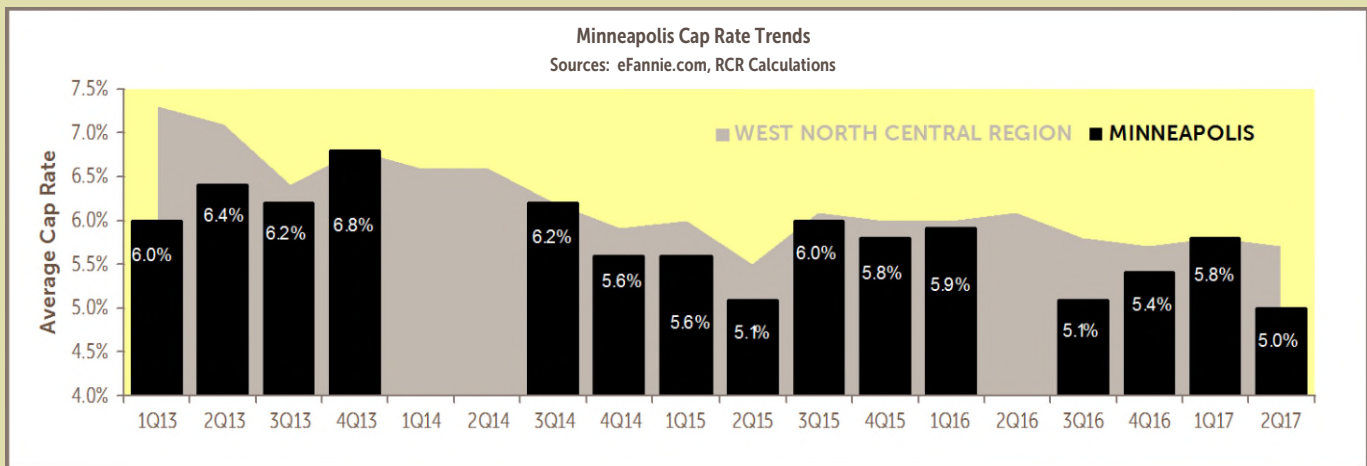
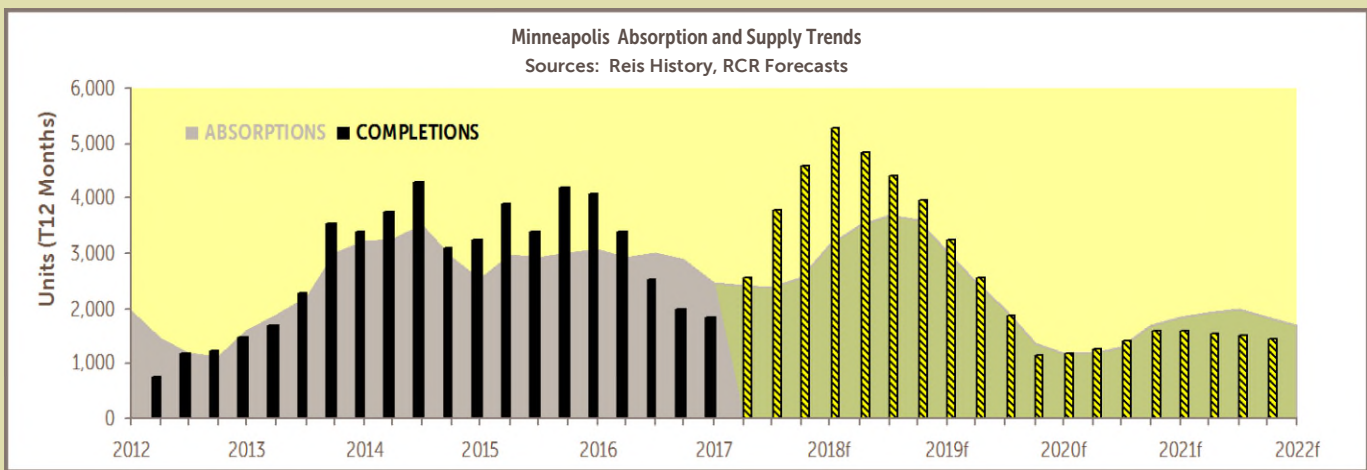
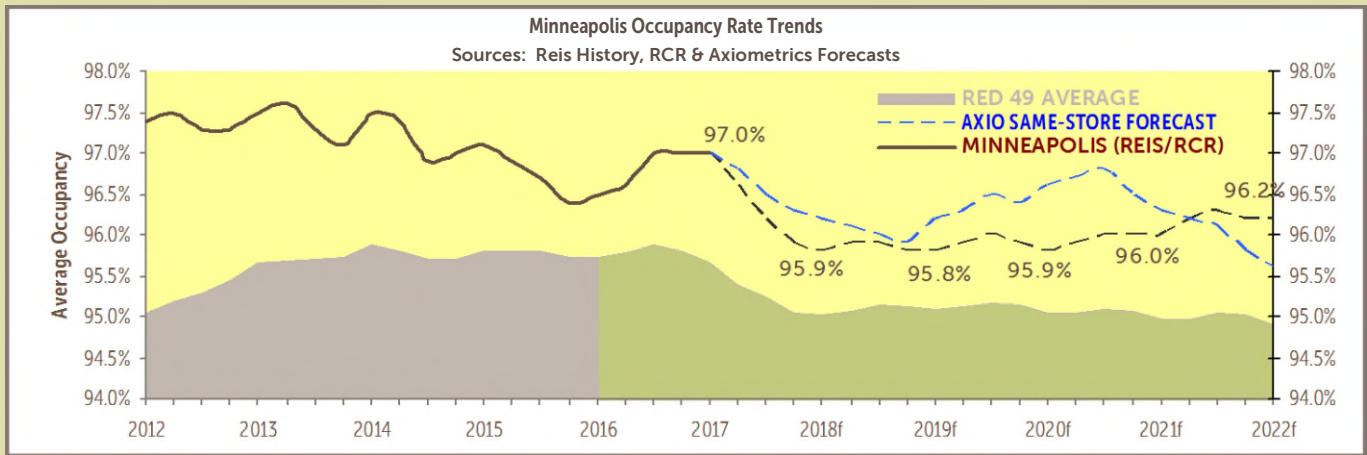
First quarter sales velocity was slower as only six properties valued at \$5 million or more exchanged hands, down from 12 in each of the prior and year-earlier quarters. Volume reached \$264.1 million, according to CoStar, down only -10% from 4Q16, boosted by a quarterly record average transaction size of \$44.0mm. The average price of the 1,749 traded units was up as well, rising to \$150,972, 10% and 3% increases from 4Q16 and 1Q16, respectively.

Trade gained momentum in 2Q17. The transaction count rose to 11, and volume was on par with the fourth quarter.

Most recent trade involved class-B suburban garden prod-

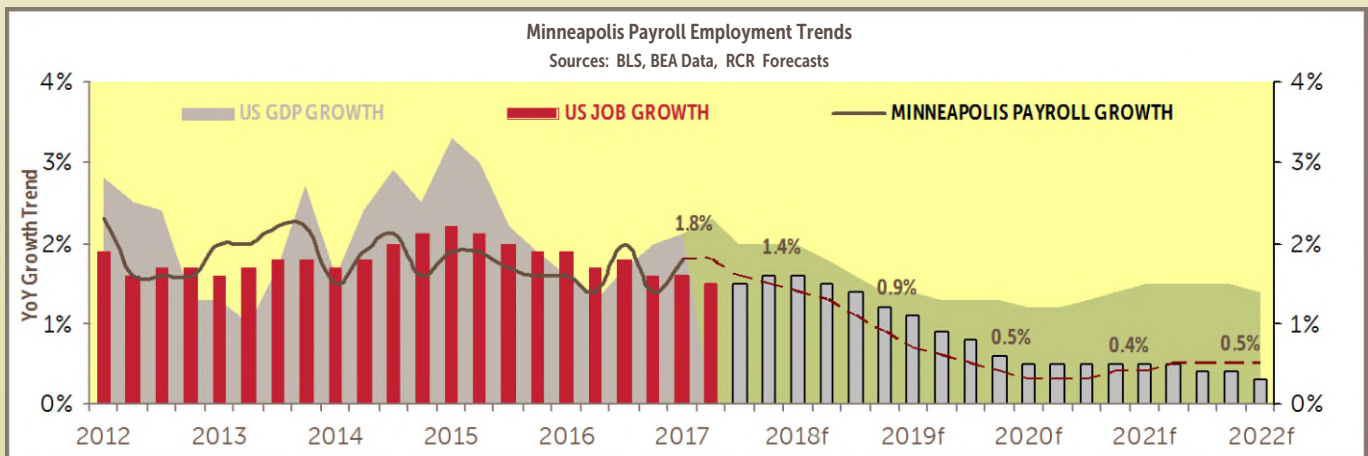
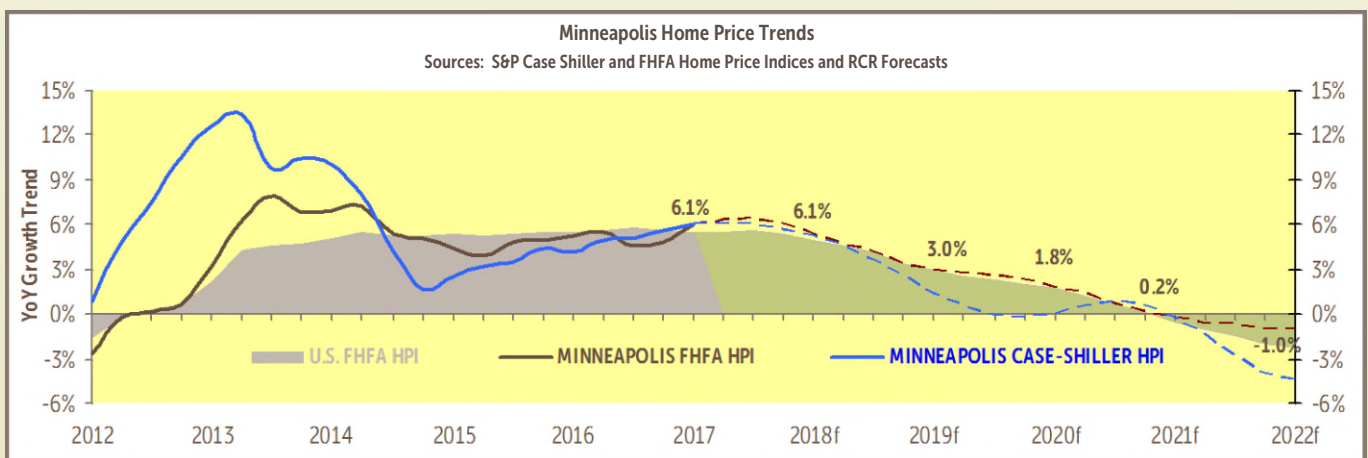
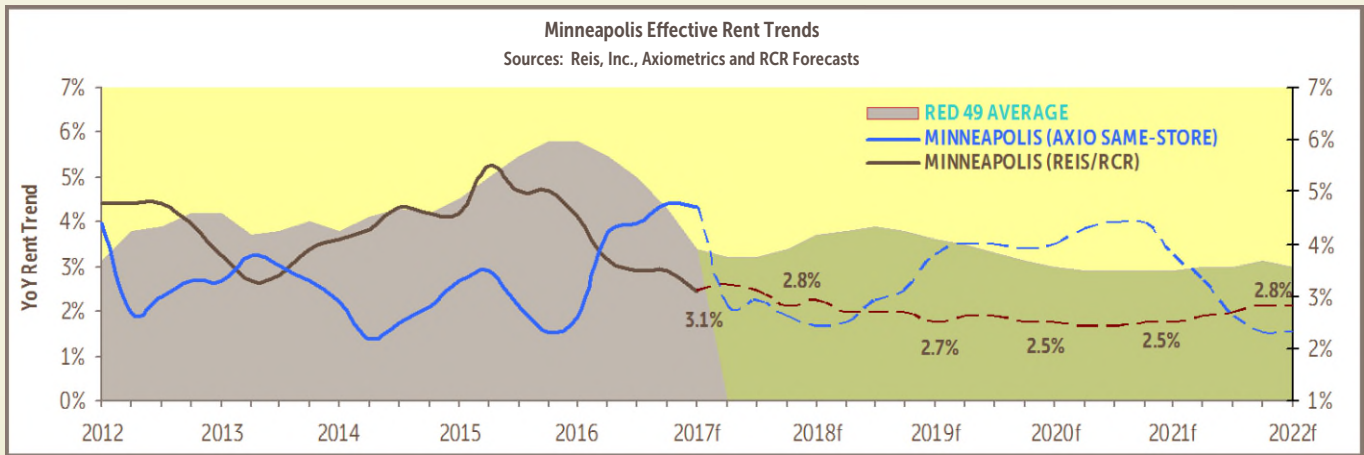
uct. Most cap rates fell in the mid-5% region. Class-A infill assets commanded mid- to high-4% levels, while class-B+ gardens traded around the 5% mark; value-adds about 6%.

RCR chose to raise the MSP purchase cap rate proxy 5 basis points to 5.3% to bring it in line with recent GLR trades. Using a terminal cap rate of 5.9%, and model derived rent and occupancy point estimates we calculate that a 1Q17 investor would expect to earn a 6.6% unlevered annual return on a 5-year hold. This currently ranks 34th among the RED 49 peer group. With respect to risk adjusted returns, low historical occupancy and rent volatility elevate the metro to 13th rank in the RED 49 on this basis.



NOTABLE TRANSACTIONS

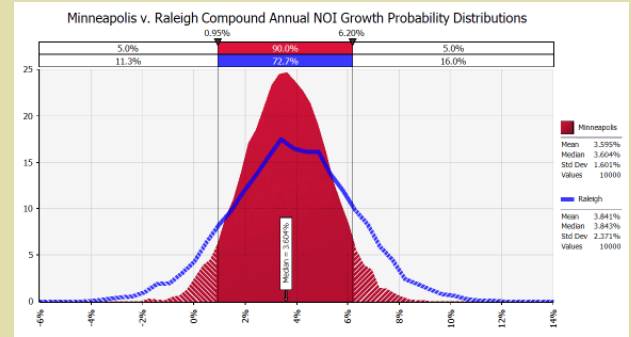
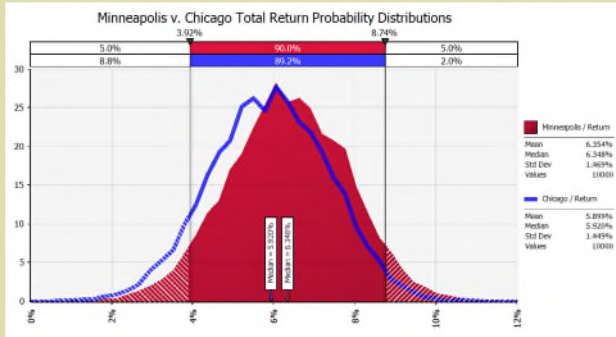
Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
City Walk (Washington County / Woodbury)	B+ / WF MR (2006)	18-Jan-2017	\$43.7	\$209,853	5.1% (RCA)
Twelve 501 (Dakota Co. / Burnsville / Crosstown)	B / MB MR (1986)	20-Jan-2017	\$35.4	\$150,522	5.5%
ARRIVE Eden Prairie (Southwest/Eden Prairie)	B / WF GLR (1986)	10-Feb-2017	\$84.8	\$166,830	5.03% (UW)
Bristol Village (Southwest / Bloomington / West)	B / WF GLR (1987)	16-Mar-2017	\$50.8	\$175,000	5.7%
Oak Grove Towers (Minneapolis / Loring Park)	B / SR HR (1974)	11-May-2017	\$33.2	\$145,614	5.0%
Oxbo (Saint Paul / West Seventh)	A / SR MR (2017)	8-Jun-2017	\$61.5	\$321,989	NA/4.5% pro forma



The information contained in this report was prepared for general information purposes only and is not intended as legal, tax, accounting or financial advice, or recommendations to buy or sell currencies or securities or to engage in any specific transactions. Information has been gathered from third party sources and has not been independently verified or accepted by RED Capital Group. RED makes no representations or warranties as to the accuracy or completeness of the information, assumptions, analyses or conclusions presented in the report. RED cannot be held responsible for any errors or misrepresentations contained in the report or in the information gathered from third party sources. Under no circumstances should any information contained herein be used or considered as an offer or a solicitation of an offer to participate in any particular transaction or strategy. Any reliance upon this information is solely and exclusively at your own risk. Please consult your own counsel, accountant or other advisor regarding your specific situation. Any views expressed herein are subject to change without notice due to market conditions and other factors.

SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent			Physical Vacancy		Basis Point Change
		1Q16	1Q17	Change	1Q16	1Q17	
Dakota County	0.6%	\$1,026	\$1,060	3.4%	2.3%	2.4%	10 bps
Minneapolis	2.4%	\$1,411	\$1,467	4.0%	8.2%	4.7%	-350 bps
Northeast	0.0%	\$924	\$954	3.3%	1.9%	1.6%	-30 bps
Northwest/Anoka County	1.4%	\$895	\$925	3.4%	2.2%	2.2%	0 bps
Southwest	0.2%	\$1,120	\$1,134	1.2%	2.6%	2.2%	-40 bps
Saint Paul	4.9%	\$1,114	\$1,187	6.6%	3.1%	5.0%	190 bps
Washington County	-1.7%	\$1,101	\$1,149	4.3%	1.4%	1.1%	-30 bps
West	-0.3%	\$1,167	\$1,198	2.7%	3.6%	2.6%	-100 bps
Metro	1.1%	\$1,126	\$1,161	3.1%	3.5%	3.0%	-50 bps



FOR MORE INFORMATION ABOUT RED'S RESEARCH CAPABILITIES CONTACT:



Daniel J. Hogan
 Director of Research
 djhogan@redcapitalgroup.com
 +1.614.857.1416 office
 +1.800.837.5100 toll free

