

PAYROLL JOB SUMMARY

Average Payrolls	3,009.7m
Annual Change 1Q17	22.5m (0.8%)
RCR 2017 Forecast	47.7m (1.6%)
RCR 2018 Forecast	78.1m (2.6%)
RCR 2019 Forecast	51.8m (1.7%)
RCR 2020 Forecast	21.0m (0.7%)
RCR 2021 Forecast	17.4m (0.5%)
Unemployment (NSA)	5.3% (4/17)

1Q17 PAYROLL TRENDS AND FORECAST

After grinding to a halt in the second half 2016, the Houston labor market gained momentum in 2017. Payroll employment increased at a 22,500-job, 0.8% year-on-year rate during 1Q17, and accelerated to a 43,300-job pace in April and May. Greater stability in oil and gas was most responsible as job losses in extraction and related manufacturing declined from 4Q16's devastating 20,100-job, -14.1% rate to 12,400- and 6,100-job paces in the winter and spring, respectively. Conditions also improved in the business service sector where employers recorded net growth in 1Q17 (2,200 jobs) after five consecutive quarterly declines, as well as a considerably faster advance (11,100 jobs/2.4%) during April and May. And, unemployment fell to 5.3% in April after hitting a 4-year high 5.9% in February.

The seasonally-adjusted job series also provided reasons for optimism. Net payroll gains totaled 19,500 jobs in 1Q17, the best quarter in two years. Jobs added in April and May tallied 17,700, the best comparable period gain since 2014.

RED Research's HOU payroll model employs the rate of change of US payroll growth, Houston personal income^(t-4), industrial production^(t-4), and West Texas Intermediate crude oil^(t-1) price growth as independent variables to reach an adjusted R² of 97.0% (SE=0.33%). As our models project a rebound in WTI prices (\$52-\$56), and faster US job growth in 2H17, the payroll model projects constructive job creation through 2018. Weaker conditions nationally and range bound WTI (\$60-\$70) yield a subsequent slowdown.

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	93.5%
RED 51 Rank	51 st
Annual Chg. (Reis)	-0.7%
RCR YE17 Forecast	91.4%
RCR YE18 Forecast	92.0%
RCR YE19 Forecast	92.8%
RCR YE20 Forecast	93.1%
RCR YE21 Forecast	92.6%

1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Space demand was constructive for the seasonally softer winter quarter as 1,740 tenants occupied formerly vacant units, up from -25 net movie-outs recorded in the comparable period of 2016 (Reis). But supply (3,125) was stronger still, a theme that dominated 2016, and is likely to remain the principal factor determining Houston occupancy through the end of the year. Metro occupancy fell -20 basis points sequentially and -70bps year-on-year to 93.5%, the lowest metric observed in four years.

posted highest May occupancy versus 91.4% and 88.7% for classes-A and -C. Affordable Sharpstown was the only submarket to top 94% in 1Q17. Infill North/Northeast (93.6%) and Braeswood (92.1%) posted better than average numbers, while Imperial Valley (73.2%/-18.4%) and highest average rent Montrose/River Oaks (90.4%/-1.4%) struggled.

An avalanche of supply (22,318 units) will send occupancy still lower by year-end. But supply levels will recede in 2018, and the market should stabilize and begin a tentative recovery. Our demand model suggests that Houston occupancy should bottom in the low-91% range before clawing back above the 93% level by the end of the decade.

Axiometrics surveys of 1,252 stabilized same store properties recorded weaker results. This sample was 91.0% occupied in 1Q17, and 91.4% occupied in May. Class-B (91.8%)

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	\$927
Annual Change	1.3%
RED 51 Rent Change Rank	47 th
RCR YE17 Forecast	2.5%
RCR YE18 Forecast	2.9%
RCR YE19 Forecast	2.8%
RCR YE20 Forecast	1.8%
RCR YE21 Forecast	1.5%

1Q17 EFFECTIVE RENT TRENDS

Houston rents increased \$4 (0.4%) sequentially, according to Reis, representing a significant bounce-back from 4Q16's \$2 (-0.2%) retreat. Annual rent trends continued to decelerate, however, slipping to a 1.3% year-on-year rate from 1.8% during the prior quarter. Average concession levels rose, reaching \$64 (6.5% of asking rent), representing a 26% increase over three years. Trends were notably weak in mostly class-A/B+ Braeswood and Montrose, where rents declined -1.6% and -4.2% y-o-y, respectively.

generating a -2.1% y-o-y loss in 1Q17. Trends appeared to deteriorate further in the spring as the same-store sample posted a -4.6% y-o-y decline in May as many Montrose/River Oaks, West University and Galleria Uptown properties recorded double digit y-o-y rent decreases.

RCR's rent models uses six lags of the dependent variable, and Houston payroll^(t-1) and nominal GDP growth^(t-4) as variables to achieve ARS of 94.7% (SE=0.42%). The model projects accelerating trends through next summer on stronger metro and US growth. But weaker intermediate term economic conditions will curtail local rent growth afterward, holding annual trends below 2% in the out-

Surveys of stabilized, same-store properties by Axiometrics found weaker conditions. Rents in this sample declined sequentially for the sixth consecutive quarter,

TRADE & RETURN SUMMARY

\$5mm+ / 80-unit+ Sales	23
Approximate Proceeds	\$485mm
Average Cap Rate (FNM)	5.6%
Average Price / Unit	\$96,365
Expected Total Return	6.0%
RED 49 ETR Rank	44 th
Risk-adjusted Index	3.82
RED 49 RAI Rank	23 rd

1Q17 PROPERTY MARKETS AND TOTAL RETURNS

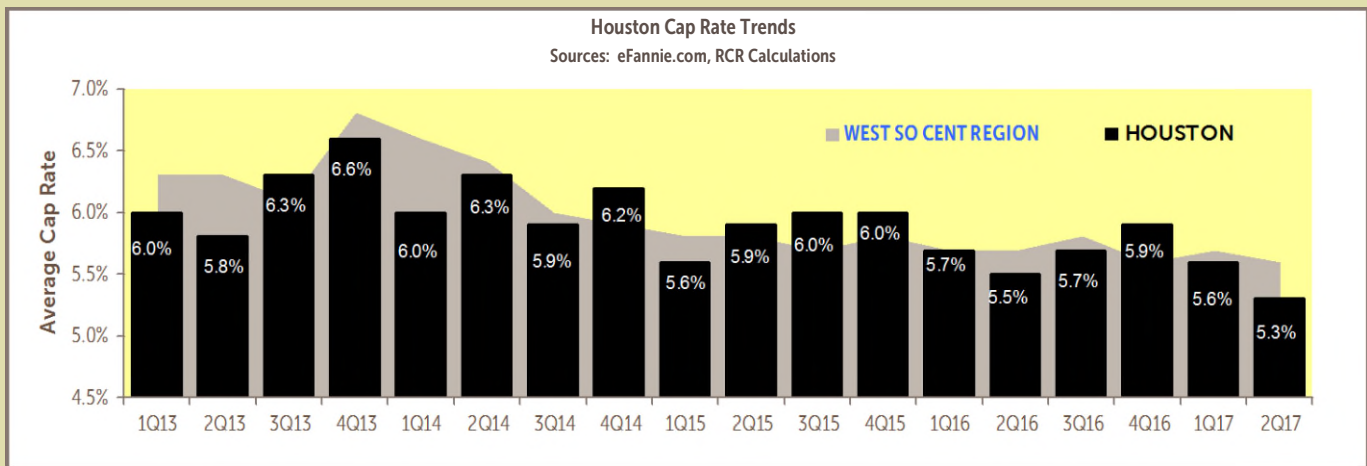
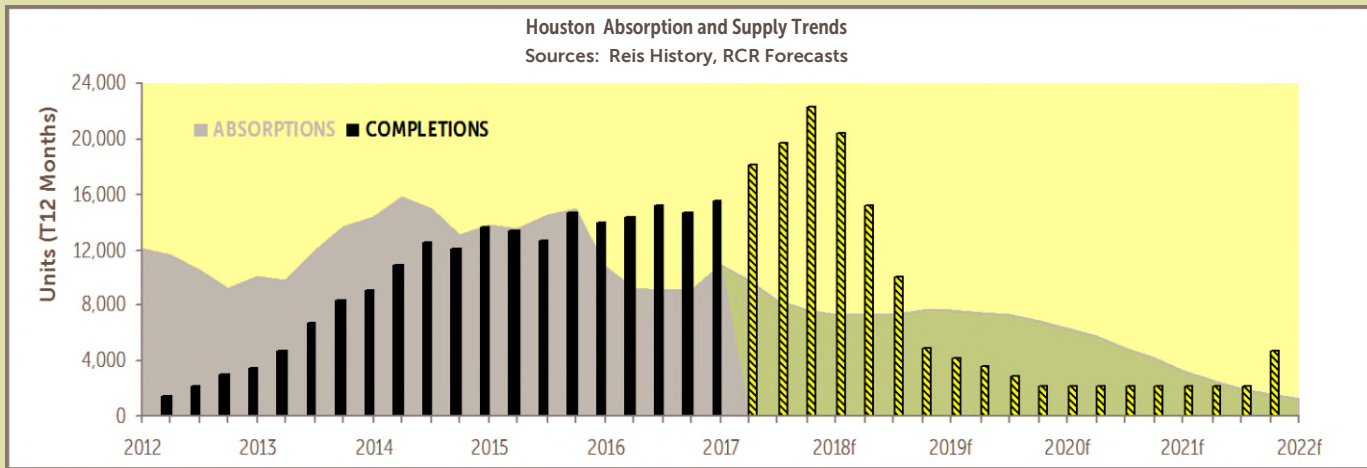
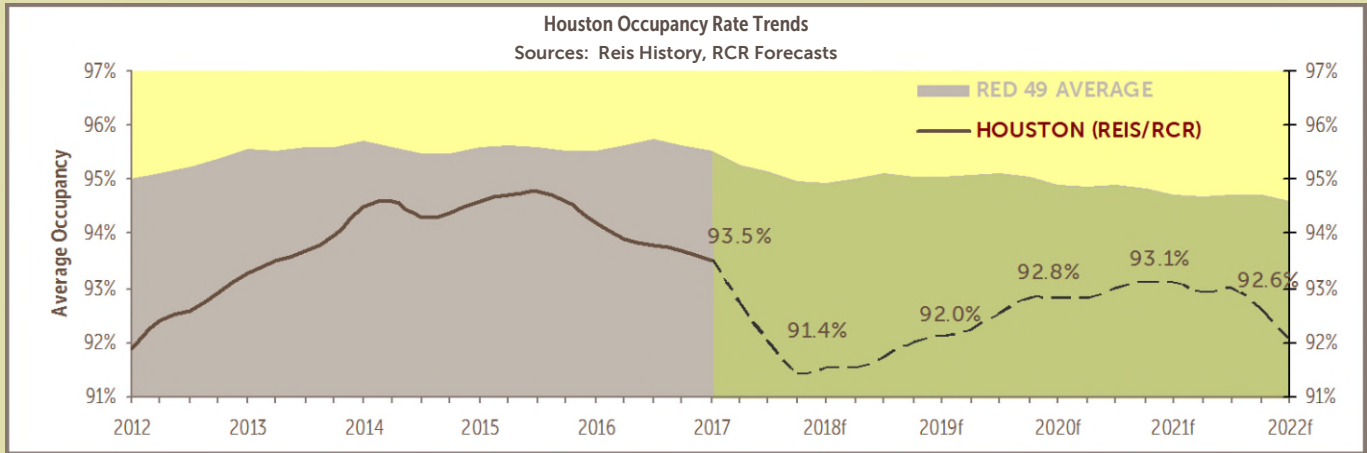
Sales activity diminished in 1Q17, as investors paused to reassess Houston prospects. Sales volume declined about -68% sequentially and -59% year-on-year to about \$480 million, according to CoStar data. A reported 5,390 units exchanged hands at an average price of \$96,365, moderately lower than the \$107,426 and \$100,828 metrics observed in 4Q16 and 1Q16, respectively.

ies vintage value-adds trade to going in yields from 6.5% to 7.5%. Recently rehabbed older properties traded between 6% and 6.5%. By contrast, institutional quality mid-rises continued to command prices equating to high-4% yields.

Trade appeared to regain momentum in the second quarter. Through June 23, 32 \$5mm+ property sales were recorded for estimated proceeds of more than \$900mm.

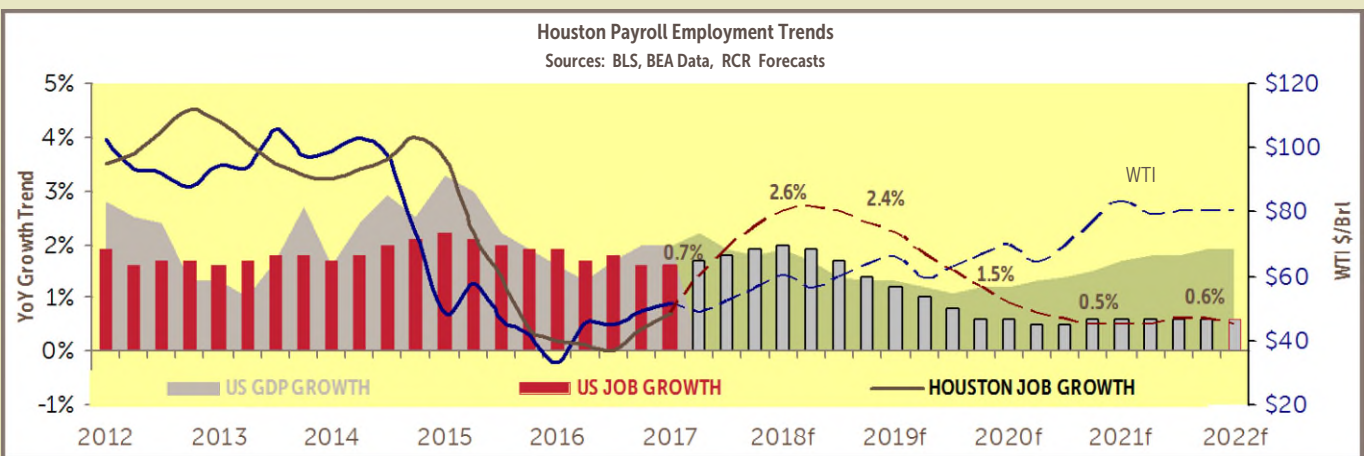
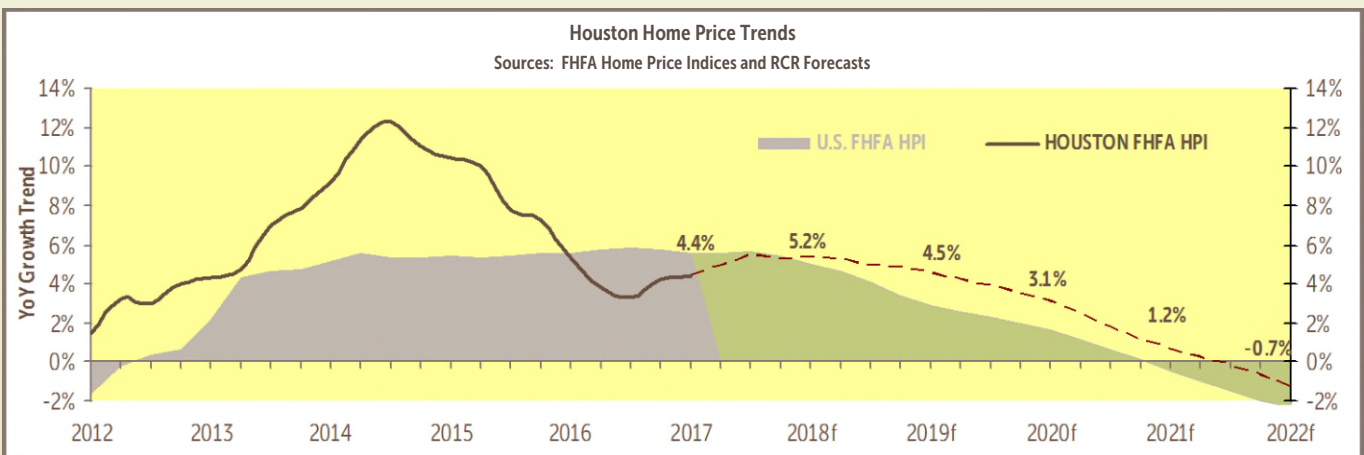
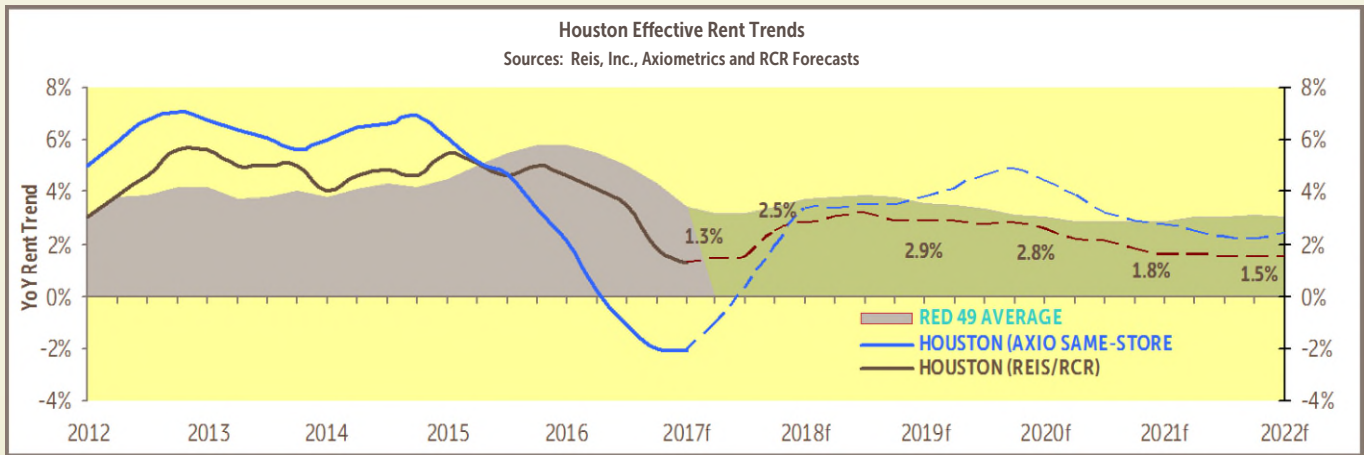
RCR elected to boost the purchase cap rate proxy 25bps to 5.75%. With a terminal cap of 6.33% and model derived performance point estimates we calculate that a purchaser would expect to earn an unlevered annual return of 6.0% over a five-year hold. This ranks #44 among the RED 49 large metro peer group. Low model standard error and rent volatility give risk-adjusted returns some heft. Houston's RAI ranks twenty-third in the R49 on this basis.

Cap rate ranges were unusually wide. Seventies and Eight-



NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
Broadstone Grand Parkway (Katy / Cinco Ranch)	B+ / MB GLR (2010)	6-Jan-2017	\$40.4	\$118,129	4.5/5.7% pro forma
Hollister Place (Inwood-Near Northwest / Fairbanks)	B / WF GLR (1998)	17-Feb-2017	\$24.5	\$94,231	6.75%
Lakeshore (Clear Lake / UHCL)	B- / WF GLR (1978/05)	20-Mar-2017	\$18.2	\$78,276	6.04%
Stella Shadow Creek (Pearland / Shadow Creek Ranch)	B+ / WF GLR (2010)	24-Mar-2017	\$53.3	\$135,918	5.5%
Campus Vue (Interloop / South Houston / University)	B Std. / WF MR (2015)	5-May-2017	\$42.9 (Appraisal)	\$99,306/bed	5.55%
SYNC at Harmony (Far Northwest / Spring)	B+ / WF MR (2015)	12-May-2017	\$40.3	\$130,701	5.2%/6.0% pro forma



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SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent			Physical Vacancy		Basis Point Change
		1Q16	1Q17	Change	1Q16	1Q17	
Alief / Kirkwood	-0.3%	\$721	\$748	3.7%	3.8%	3.4%	-40 bps
Baytown	0.0%	\$686	\$729	6.2%	7.6%	5.1%	-250 bps
Bear Creek / Katy	1.4%	\$1,011	\$1,031	2.0%	10.4%	8.6%	-180 bps
Braeswood / Bellaire	0.0%	\$1,171	\$1,152	-1.6%	4.8%	7.6%	280 bps
Briar Forest	0.1%	\$935	\$957	2.4%	4.8%	5.6%	80 bps
Briar Grove	0.4%	\$985	\$1,003	1.8%	4.0%	6.4%	240 bps
Champions / FM 1960	0.0%	\$829	\$841	1.4%	7.7%	8.8%	110 bps
Clear Lake / NASA	-0.2%	\$890	\$900	1.1%	3.2%	5.2%	200 bps
Cloverleaf	0.0%	\$688	\$717	4.2%	4.5%	4.3%	-20 bps
Cypress / Fairbanks	0.0%	\$938	\$947	0.9%	5.2%	7.1%	190 bps
Far Northwest/Montgomery	3.8%	\$991	\$1,004	1.3%	12.9%	11.6%	-130 bps
Fondren / Westbury	0.0%	\$649	\$667	2.8%	3.9%	3.7%	-20 bps
Fort Bend County	2.6%	\$1,137	\$1,172	3.1%	10.3%	7.4%	-290 bps
Imperial Valley	0.0%	\$613	\$631	2.9%	8.4%	9.4%	100 bps
Interloop South Houston	0.0%	\$796	\$818	2.7%	3.1%	3.5%	40 bps
Inwood / Near Northwest	-0.9%	\$720	\$731	1.5%	5.3%	6.0%	70 bps
Montrose / River Oak	3.6%	\$1,447	\$1,387	-4.2%	10.9%	8.7%	-220 bps
North Northeast Houston	0.6%	\$797	\$944	18.5%	5.4%	6.9%	150 bps
Northborough	0.0%	\$681	\$696	2.2%	6.4%	6.4%	0 bps
Pasadena / Deer Park	0.0%	\$697	\$723	3.8%	3.6%	3.7%	10 bps
Sharpstown	0.0%	\$695	\$719	3.5%	5.0%	4.5%	-50 bps
Spring Branch	-0.2%	\$779	\$861	10.5%	4.1%	6.0%	190 bps
Spring / Humble	2.8%	\$899	\$912	1.4%	2.8%	5.7%	290 bps
Metro	0.6%	\$915	\$927	1.3%	5.8%	6.5%	70 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

