

### PAYROLL JOB SUMMARY

Average Payrolls	1,025.0m
Annual Change 1Q17	23.6m (2.4%)
RCR 2017 Forecast	24.5m (2.4%)
RCR 2018 Forecast	28.4m (2.7%)
RCR 2019 Forecast	25.1m (2.3%)
RCR 2020 Forecast	21.3m (1.9%)
RCR 2021 Forecast	19.3m (1.7%)
Unemployment (NSA)	3.6% (5/17)

### 1Q17 PAYROLL TRENDS AND FORECAST

Year-to-date, San Antonio job growth was slower than the full throttle speed observed during the previous two years. Still, it continued to progress at a steady, sustainable pace. Payrolls increased at a 23,600-job, 2.4% annual rate in 1Q17, and accelerated to a 2.5% pace in April and May.

But signs of sector rotation were evident, and not in an entirely benign way. Goods producing industries and health care assumed the lead, adding workers at 4.5% and 6.2% year-on-year rates in 1Q and April and May, respectively, up from 3.1% in 4Q16. But SAN's primary economic drivers—financial, business and leisure services — sagged, expanding only at a 1.4% annual rate in April and May, down from 4.4% and 3.7% y-o-y in 3Q16 and 4Q16.

Trends in the seasonally-adjusted payroll series also were disconcerting. Metro establishments created only 2,300 jobs in 1Q17, down from 8,200 in the prior-year period, and the sequential add in May was slightly negative.

RED Research's SAN payroll model continues to be optimistic but recent outcomes have fallen short of forecast here and elsewhere in Texas, suggesting a slowing trend may be underway. The model uses the rate of change of US growth and lagged GDP growth and SP500 returns as variables to achieve a 94.6% adjusted-R<sup>2</sup> (SE=0.3%). The model foresees a moderate reacceleration in 2018, followed by gradually slower job growth through the end of the five-year forecast interval.

### OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	94.7%
RED 51 Rank45	45 <sup>th</sup>
Annual Chg. (Reis)	+1.5%
RCR YE17 Forecast	95.1%
RCR YE18 Forecast	94.9%
RCR YE19 Forecast	95.5%
RCR YE20 Forecast	94.0%
RCR YE21 Forecast	93.0%

### 1Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Apartment demand abruptly softened during 1Q17. After 32 consecutive quarters of positive net absorption, a period during which occupied stock increased by an average of 1,066 units per quarter (Reis), tenants vacated a net of -156 units, despite completion of 611 new apartments. Metro occupancy declined -40 base points sequentially to 94.7%, trimming progress made since 1Q16 to +150bps. Plunging class-A demand was largely at fault.

Surveys by Axiometrics of 503 stabilized same-store properties found occupancy averaging 92.3% and 92.9% during 1Q17 and May, respectively, each down -50bps year-on-year. Class-C (91.7%) recorded the lowest 1Q17 rate and

largest y-o-y decline (-1.3%). Class-A (92.5%/-50bps) and class-B (92.3/-20bps) segments recorded better results. Far Northeast (94.8%) and Northwest (94.2%) submarkets posted the highest levels, while East, Southeast and Southwest languished below the 90% threshold.

Supply is projected by Reis to decline about -10% in 2017, and -43% in 2018. Unfortunately, RCR's occupied stock model expects demand to decrease at a faster rate, producing a moderate downward bias for occupancy. San Antonio occupancy should hover near 95% through the forecast interval unless inventory growth reaccelerates to the 1.9% historic series average in the interval out-years.

### EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	\$835
Annual Change	2.2%
RED 51 Rent Change Rank	42 <sup>nd</sup>
RCR YE17 Forecast	2.2%
RCR YE18 Forecast	2.9%
RCR YE19 Forecast	3.5%
RCR YE20 Forecast	4.1%
RCR YE21 Forecast	1.6%

### 1Q17 EFFECTIVE RENT TRENDS

San Antonio rent trends continued to descend in 1Q17. Rents declined sequentially (\$3/-0.3%), representing the first quarterly retreat in seven years. Likewise, year-on-year trends declined sharply, falling -100bps from 4Q16, to 2.2%, the steepest one-quarter decrease since the depths of the Great Recession. Asking rents fell -0.3% sequentially in both classes-A and -B&C, but deterioration from 4Q16 was greater in the lower price segment.

The Axiometrics same-store sample also experienced a sequential quarter decline (-0.5%) and a steep deceleration of y-o-y trends, dropping from 2.8% in 4Q16 to 2.1%. Rent trends appeared to stabilize during the spring, how-

ever, as rents in May also represented a 2.1% advance over 2016. Class-B (2.2%) enjoyed the strongest spring growth, but class-C exhibited the greatest rent rebound, rising 3.2% y-o-y in May. Lower rent Southwest (4.6%) and Far Northeast (4.2%) submarkets exhibited strength but highest cost Central (4.7%) posted the fastest 1Q17 annual gain.

SAN rent trends are meandering and somewhat volatile. RCR's best model uses lagged inventory (-) and payroll (+) growth as independent variables to reach an ARS of 89.6% (SE=0.7%). This comparatively weak model foresees moderately accelerating rent trends as supply pressures recede while job creation continues at a fairly robust pace.

### TRADE & RETURN SUMMARY

\$3mm+ / 80-unit+ Sales	13
Estimated Proceeds	\$275mm
Average Cap Rate (FNM)	5.7%
Average Price / Unit	\$105,840
Expected Total Return	7.0%
RED 49 ETR Rank	22 <sup>nd</sup>
Risk-adjusted Index	3.85
RED 49 RAI Rank	24 <sup>th</sup>

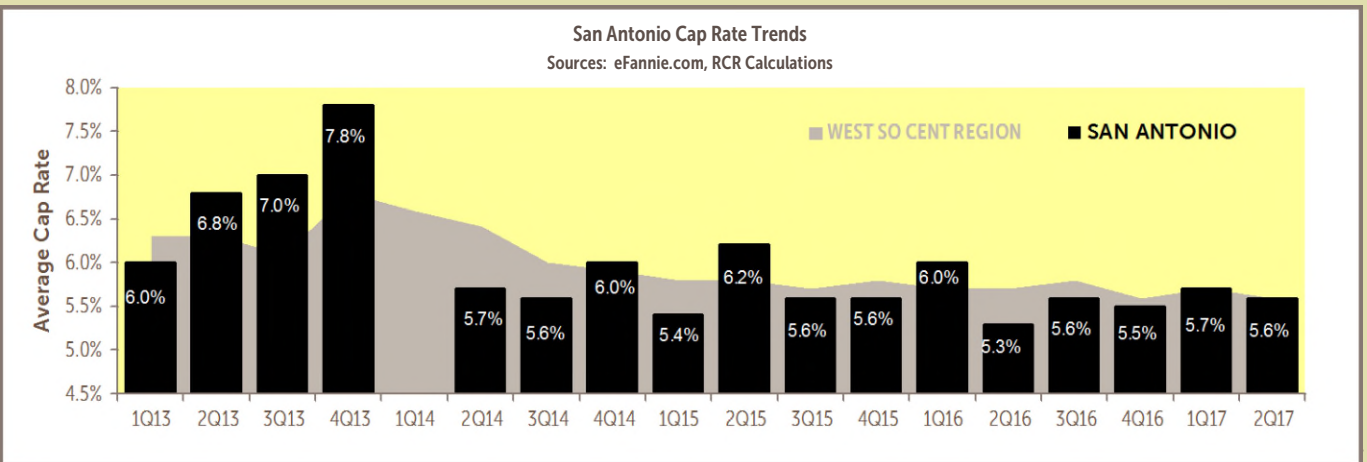
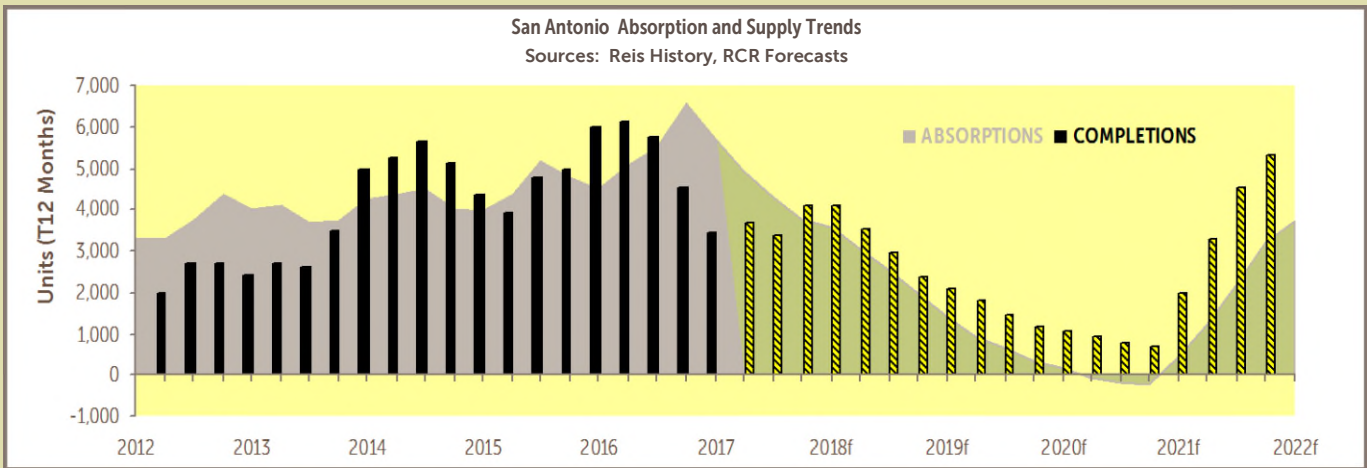
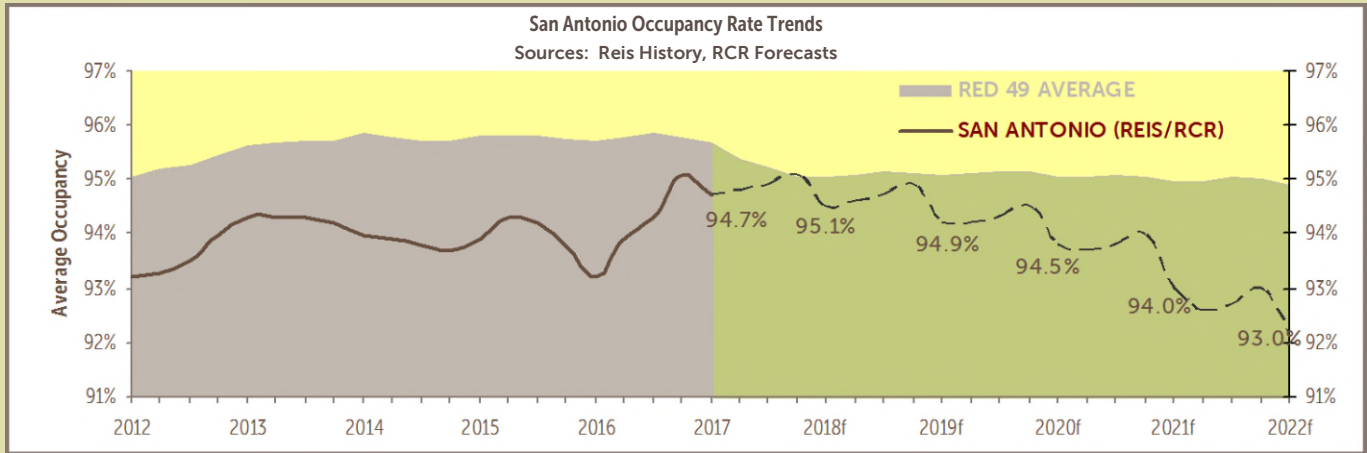
### 1Q17 PROPERTY MARKETS AND TOTAL RETURNS

Sales of 25 apartment properties of 80 units or more closed during the fourth quarter (CoStar), a series record. Proceeds are likely to have exceeded \$550 million. First quarter activity returned to seasonal norms as 13 properties exchanged hands for total proceeds of approximately \$275mm. This compares to 13 asset exchanges valued at about \$300mm closed during the same period of 2016.

Second quarter volume was steady. Preliminary reports indicate that 12 trades were consummated in 2Q for total volume of at least \$325mm. The average price of units traded for which pricing data were publicly available was \$150,666, eclipsing the previous metro high by nearly 9%.

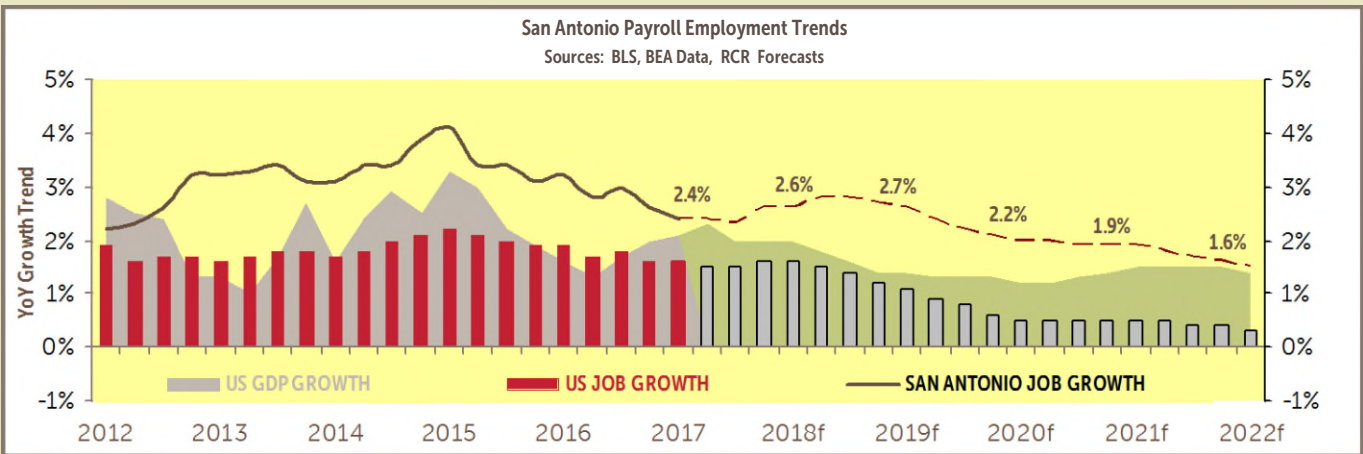
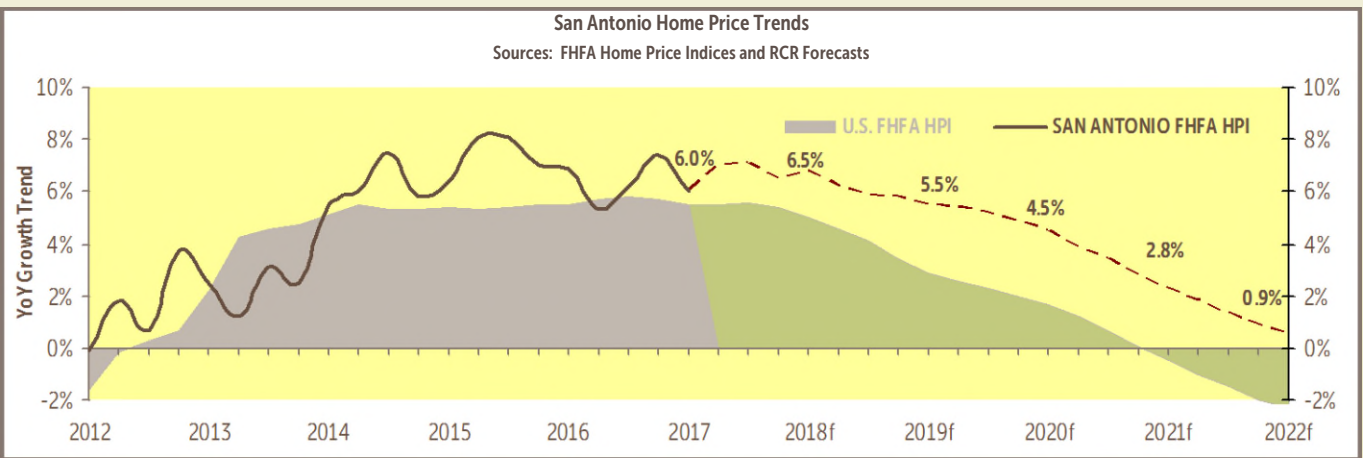
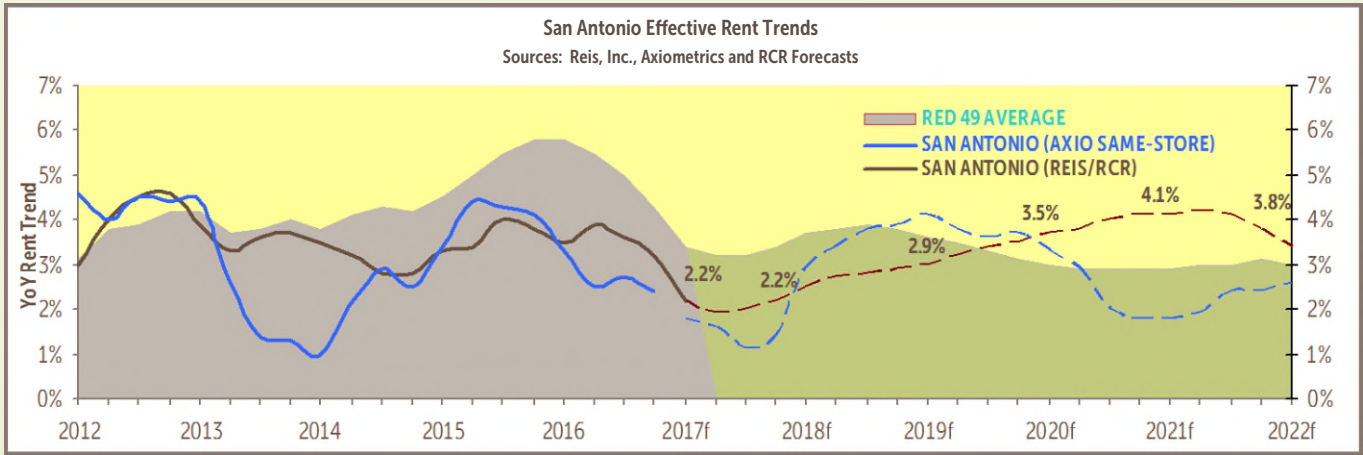
Cap rates were mostly in the 5% to 6% range. Class-A/B+ gardens were priced to low- to mid-5% yields, depending on location. Class-B assets and value-adds traded to high-5% to low-6% cap rates; class-C properties up to 7%.

With high-quality assets trading to near 5% yields RCR chose to reduce the purchase cap rate proxy to 5.35%. At this level, a 5.9% terminal cap rate and model generated rent and occupancy point estimates we calculate that an investor would expect to earn a 7.0% unlevered total return on a 5-year hold. This ranks #22 among the RED 49 large metro peer group. Performance volatility is about average, producing a similar #24 risk-adjusted return ranking.



## NOTABLE TRANSACTIONS

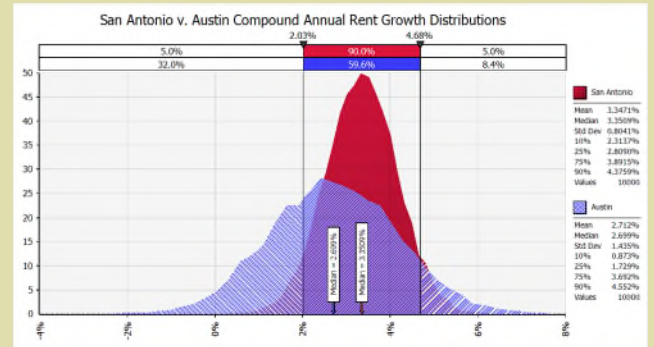
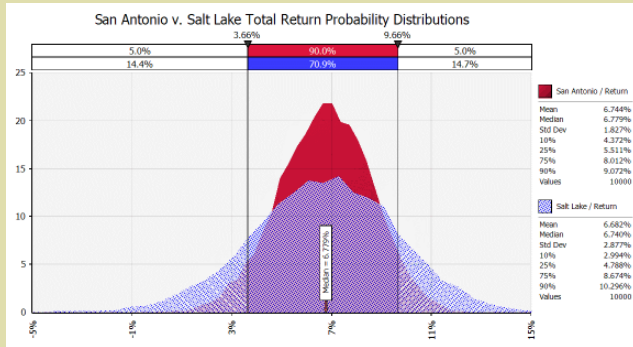
Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
Hidden Meadow (Far Northwest / Leon Valley)	C / WF LR (1976)	3-Feb-2017	\$6.5	\$41,068	6.52% (UW)
Vineyard Springs Apts. (North Bexar Co./The Vineyard)	B+ / WF GLR (2001)	17-Feb-2017	\$40.9	\$112,256	5.29% (UW)
Alcove Alamo Heights (East/Alamo Heights/Terrell Hts.)	A / WF GLR (2015)	17-Mar-2017	\$17.0	\$158,878	5.0% / 5.66% pro forma
Parc 410 Apts. (Far West / Leon Valley)	C+ / WF GLR (1980/00)	14-Apr-2017	\$22.0 (est.)	\$63,885 (est.)	5.85% (UW)
The Richland (Far Northwest / North Leon Valley)	B- / MB GLR (1984)	2-May-2017	\$12.6 (appraisal)	\$56,502 (est.)	6.19% (UW)
Canyon Springs (North Bexar Co. / Wilderness Oak)	A+ / MB MR (2007)	9-Jun-2017	\$55.4 (allocated)	\$165,373	5.2%



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## SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent			Physical Vacancy		Basis Point Change
		1Q16	1Q17	Change	1Q16	1Q17	
Airport/Northeast	4.6%	\$848	\$865	2.0%	5.8%	5.1%	-70 bps
Central San Antonio	3.3%	\$799	\$826	3.4%	7.1%	6.5%	-60 bps
East	0.0%	\$919	\$939	2.2%	7.7%	6.1%	-160 bps
Far North Central	3.2%	\$880	\$895	1.7%	6.9%	4.1%	-280 bps
Far Northeast	2.0%	\$733	\$764	4.2%	5.3%	5.3%	0 bps
Far Northwest	0.4%	\$856	\$863	0.8%	5.4%	4.8%	-60 bps
Far West	4.1%	\$752	\$802	6.6%	8.6%	5.8%	-280 bps
Northwest	-6.1%	\$580	\$591	2.0%	2.5%	3.7%	120 bps
South	22.4%	\$692	\$773	11.6%	12.3%	11.4%	-90 bps
Southeast	8.5%	\$615	\$663	7.7%	10.2%	10.5%	30 bps
Southwest	-1.8%	\$596	\$600	0.6%	6.3%	3.1%	-320 bps
Metro	2.0%	\$817	\$835	2.2%	6.8%	5.3%	-150 bps



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