red capital group

WASHINGTON, DC

MARKET OVERVIEW & MULTIFAMILY HOUSING UPDATE

RED Capital Group | 2Q17 | October 2017

PAYROLL JOB SUMMARY

Average Payrolls	2,681.0m
Annual Change 2Q17	38.1m (1.4%)
RCR 2017 Forecast	49.3m (1.9%)
RCR 2018 Forecast	44.8m (1.7%)
RCR 2019 Forecast	26.1m (1.0%)
RCR 2020 Forecast	22.1m (0.8%)
RCR 2021 Forecast	15.4m (0.6%)
Unemployment (NSA)	3.9% (8/17)

2Q17 PAYROLL TRENDS AND FORECAST

Payroll growth in the Washington metropolitan area trundled along at the low end of the 1.4% - 1.8% range in which it was stuck for the past year, adding 38,100 (1.4%) jobs year-on-year in 2Q17. But economic growth appeared to break out of its lethargic pattern over the summer as job creation accelerated to a 2.4% annual growth rate in July and August, strongest growth in three years.

The skilled service industries were the principal catalysts. Financial, professional, technical, education and healthcare services added to payrolls at a 30,650-job, 3.7% annual rate in the summer months, up from 2Q's 16,900-job performance. Consumer sectors also found traction as construction, retail trade and personal services accelerated to a 10,400 (2.0%) job y-o-y pace, up from 2Q's halting 3,500-job, 0.7% advance.

Seasonally-adjusted data also displayed strong summer month expansion. This series indicates the Capital area created a net of 20,800 jobs in July and August, the largest 2-month gain since 2010.

Prospective job growth is likely to moderate, in line with forecast national trends. **RED Research**'s metro payroll model uses the rate of change of US job growth (a rare negative coefficient), DC job$^{\wedge 2}$ (+) and US personal consumption expenditure$_{(t-3)}$ (+) growth and S&P 500 returns (+) as independent variables to achieve a 93.7% adjusted-R$^{\wedge 2}$ (SE=0.3%). The model foresees above normal 1.9% - 2.1% annual growth for the next four quarters, followed by gradual deceleration to 1% or slower through the balance of the five-year forecast. The rate of compound annual job growth for the 2017-2021 period is projected to be 1.2%, or 0.1% faster than the US average.

OCCUPANCY RATE SUMMARY

Occupancy Rate (Reis)	94.3%
RED 51 Rank	48th
Annual Chg. (Reis)	-0.9%
RCR YE17 Forecast	93.9%
RCR YE18 Forecast	93.5%
RCR YE19 Forecast	93.7%
RCR YE20 Forecast	94.1%
RCR YE21 Forecast	94.3%

2Q17 ABSORPTION AND OCCUPANCY RATE TRENDS

Tenant space demand improved in the seasonally stronger second quarter. Reis report that renters occupied a net of 942 vacant units in the District, up from 553 in the previous quarter. Developers completed considerably more (1,481 units), however, causing metro occupancy to decline for the fifth consecutive period, in this case by –50 basis points to 94.3%. The Capitol Hill submarket bore the brunt of supply. Reis report that occupancy fell -380 bps sequentially as new units were only 74% occupied upon completion.

Surveys of 249 stabilized, same store properties by Axiometrics reported stronger conditions. This sample was 95.1% leased, up 40bps from 1Q17, and only –30bps lower year-on-year. Occupancy increased to 95.5% in August, down –10bps y-o-y. Class-A 2Q17 occupancy was on 95.2% in spite of heavy supply, topping class-B's 94.7% level. Among submarkets, DuPont/Adams Morgan (96.3%), was highest followed by Mt. Pleasant. Northwest and Woodley Park trailed on about 94.5%. New unit absorption was solid. Renters absorbed an average of 15 units per month per new property in August, up from an average of 13 units/mo. in the second quarter.

RCR's analysis finds that the rate of change of inventory growth (+), lagged rent (-) and job growth (+) and occupancy (-) are the primary drivers of demand. Each will be favorable, leading our 90.9% ARS demand model to project record absorption of 5.733 units over the next four quarters. But supply of 6,909 units will be offsetting, causing occupancy to decline about -70bps by 2018.

EFFECTIVE RENT SUMMARY

Mean Rent (Reis)	$1,694
Annual Change	1.5%
RED 51 Rent Change Rank	47th
RCR YE17 Forecast	2.6%
RCR YE18 Forecast	2.8%
RCR YE19 Forecast	1.9%
RCR YE20 Forecast	1.9%
RCR YE21 Forecast	1.9%

2Q17 EFFECTIVE RENT TRENDS

Following a chilly winter quarter when metro effective rents declined $12 (-0.7%) sequentially, trends rebounded robustly in the spring. Reis report that average rent increased $28 (1.8%) in the quarter to $1,694, the fastest quarterly gain since 3Q15. Expressed on a year-on-year basis, rents increased 1.5%, topping the 7-year low 1.1% advance in the prior quarter. Rent decreases were recorded in several Northwest submarkets north of Adams/Morgan, but other neighborhoods posted constructive advances.

Rent trends among the Axiometrics same-store sample were weaker. Sample rents increased only 0.9% sequentially and 0.1% y-o-y in 2Q17. Rent trends in August continued to decelerate, falling to –0.1% y-o-y. Class-A rents declined –0.8% y-o-y in 2Q17, while classes-C (1.5%) and –B (0.6%) were marginally stronger. Rents declined in the Downtown/Logan (-1.4%), Foggy Bottom (-1.1%) and Woodley Park (-0.9%) submarkets, but rebounded in Brookland (2.8%) and Capitol Hill (1.5%). Trends among 2015-2016 vintage assets were moderately stronger, gaining (1.8%).

RCR's DC rent model uses District payroll growth (+), occupancy$_{(t-1)}$ (+), and the Baa/10-yr UST spread (-) as independent variables to reach a 91.2% ARS (SE=0.8%). Although job growth is projected to be constructive through 2Q18, none of the variables is expected to be helpful longer-term. Therefore, the rent forecast calls for faster growth through MY18, followed by weaker trends afterward. Compound annual growth of 2.2% is forecast through 2Q22.

TRADE & RETURN SUMMARY

1H17 $5mm+/60 unit+ Sales	9
Estimated Proceeds	$173.7mm
Average Cap Rate (FNM)	4.7%
Average Price / Unit	$104,479
Expected Total Return	5.6%
RED 49 ETR Rank	47th
Risk-adjusted Index	3.32
RED 49 RAI Rank	36th

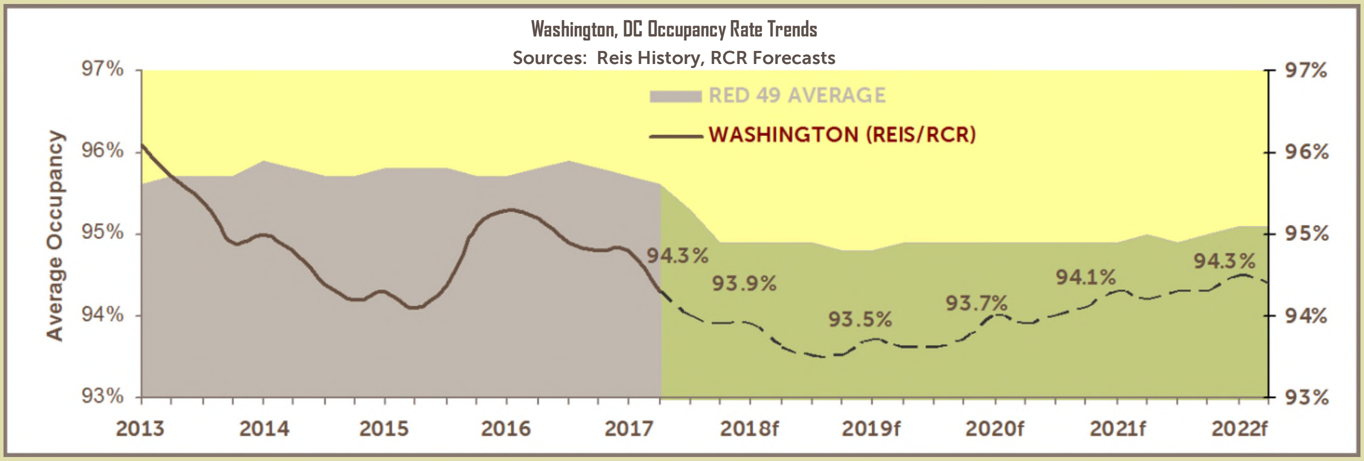
2Q17 PROPERTY MARKETS AND TOTAL RETURNS

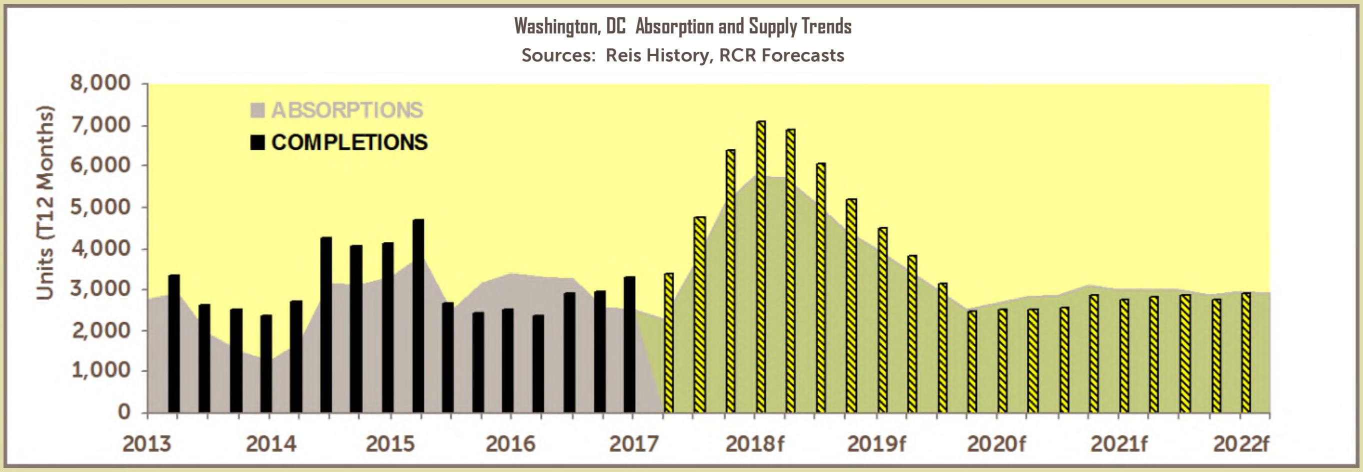
Second quarter trade was thin as only three DC property sales closed for gross proceeds of $78.0 million. This compares to four transactions for $181mm in 2Q16, and six closings for $125.7mm in the previous quarter (CoStar). The average price of 696 units sold in 2Q17 was $68,979, the lowest quarterly metric since 4Q07.

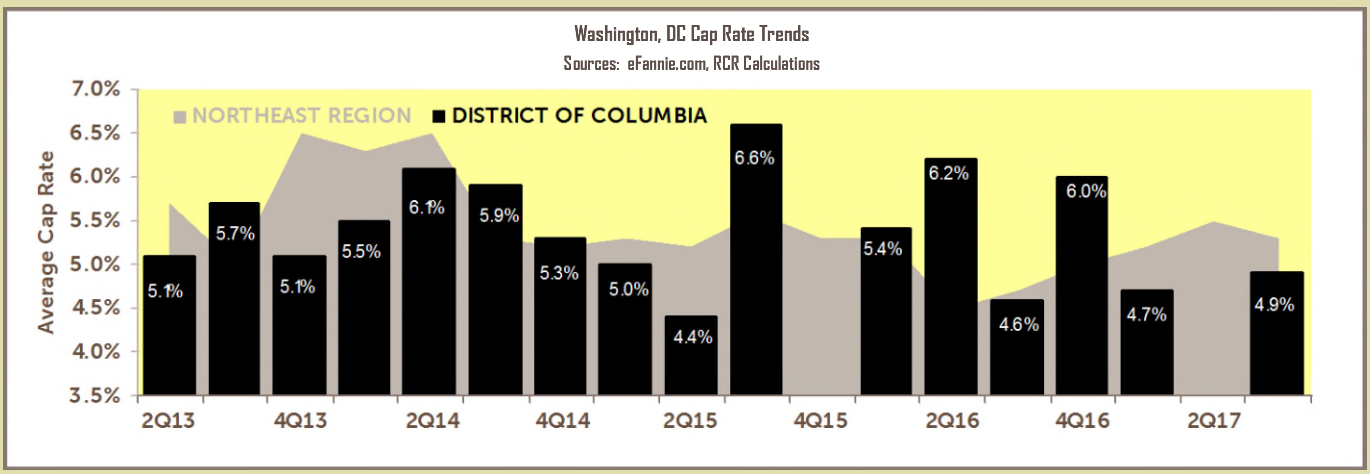
Third quarter property market activity was no stronger. Preliminary results indicate that four DC apartment properties exchanged hands and volume totaled $35.8mm. Barring a late addition this will be the smallest one-quarter volume in nearly ten years.

Cap rates varied in a wide range. Pre-war brick buildings in preferred neighborhoods like Adams Morgan traded in the high-3% to low-4% range. Renovated mid-rise structures in second tier neighborhoods close to Downtown and Capitol Hill were priced to yield in the high-4% area. Properties located at some remove from primary employment centers traded at meaningful discounts.

RCR conclude that an appropriate B/B+ purchase cap rate proxy remains about 4.9%, but thin trade suggests that the true bid/ask spread is fairly wide. Using this level, a terminal cap rate of 5.45% and model derived performance point estimates we calculate that a 2Q17 investor would expect to achieve a 5.6% unlevered annual total return on a 5-year hold. This ranks 47th among the **RED 49**. Expected return volatility is lower than average, however, resulting in a higher ranked (**RED 49** #36) risk-adjusted index.

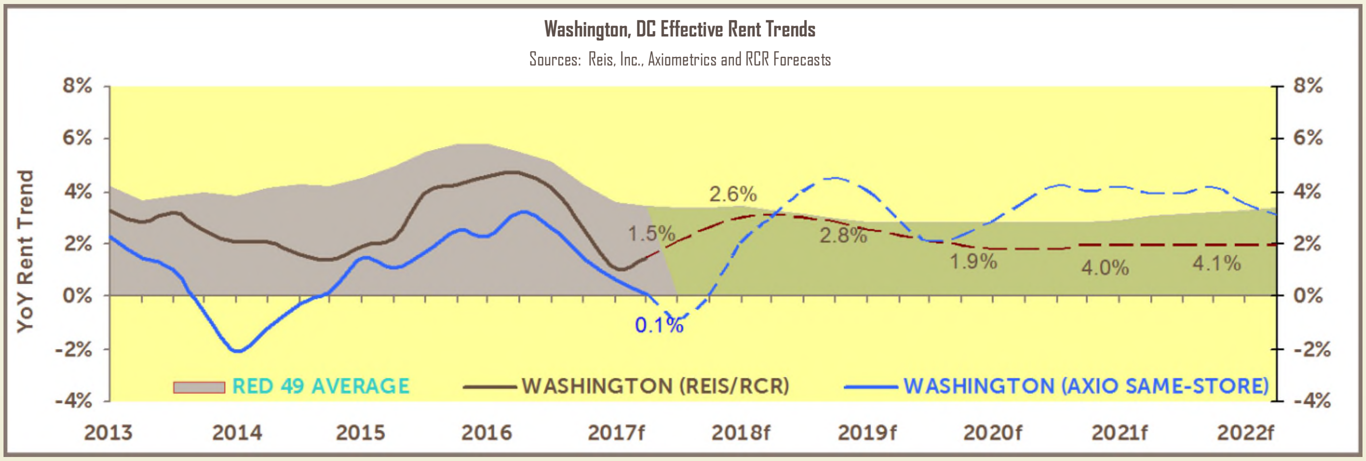


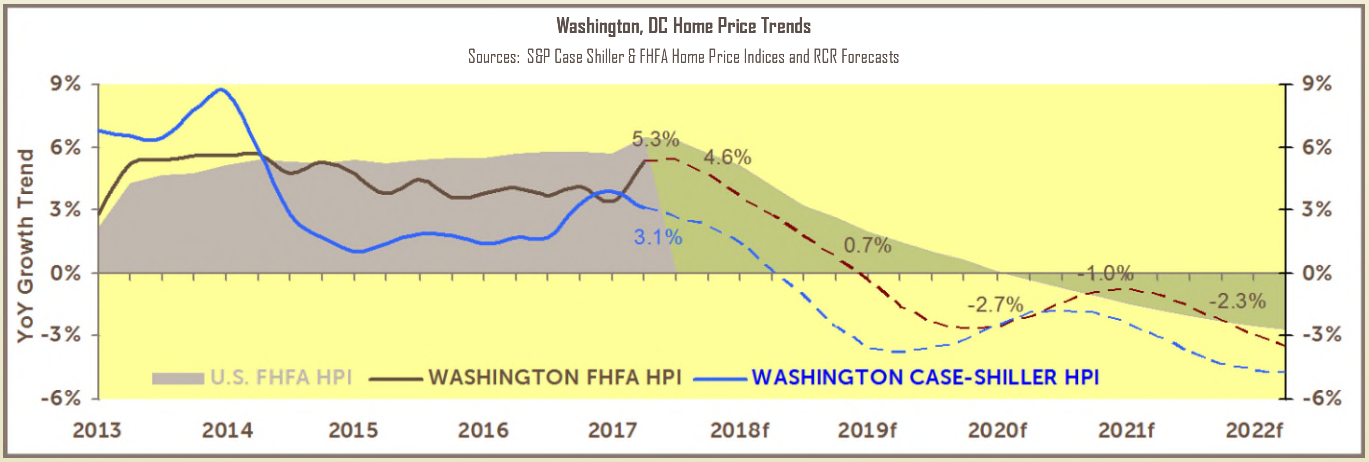


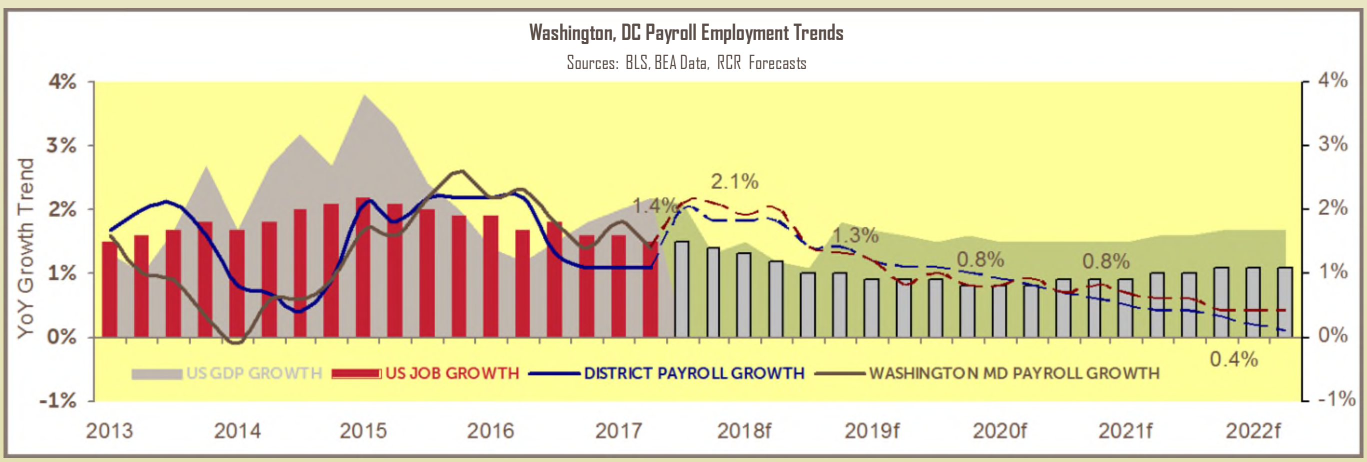


NOTABLE TRANSACTIONS

Property Name (Submarket)	Property Class/ Type (Constr.)	Approx. Date of Transaction	Total Price (in millions)	Price / Per Unit	Estimated Cap Rate
1841 Columbia Road (Adams Morgan)	A- / MB MR (1923)	17-Feb-2017	$59.0	$508,621	4.0%
1600 Penn (Capitol Hill / Hill East)	B+ / RC MR (2015)	17-Feb-2017	$26.2	$344,156	4.8%
The Metropolitan (Brookland / Brentwood)	B+ / MB MR (1936)	28-Jun-2017	$46.2	$285,802	4.9%
M Street Tower (Logan Circle)	B / MR (1965)	14-Jul-2017	$37.8	$304,839	6.0%

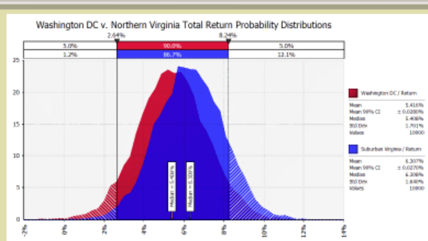

Washington, DC Effective Rent Trends
Sources: Reis, Inc., Axiometrics and RCR Forecasts
YoY Rent Trend
8%
6%
4%
2%
0%
-2%
-4%
2.6%
1.5%
2.8%
1.9%
4.0%
4.1%
0.1%
RED 49 AVERAGE
WASHINGTON (REIS/RCR)
WASHINGTON (AXIO SAME-STORE)
2013
2014
2015
2016
2017f
2018f
2019f
2020f
2021f
2022f

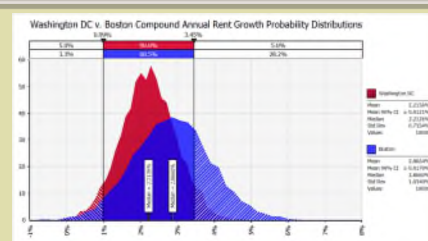

Washington, DC Home Price Trends
Sources: S&P Case Shiller & FHFA Home Price Indices and RCR Forecasts
YoY Growth Trend
9%
6%
3%
0%
-3%
-6%
5.3%
4.6%
3.1%
0.7%
-1.0%
-2.7%
-2.3%
U.S. FHFA HPI
WASHINGTON FHFA HPI
WASHINGTON CASE-SHILLER HPI
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022f

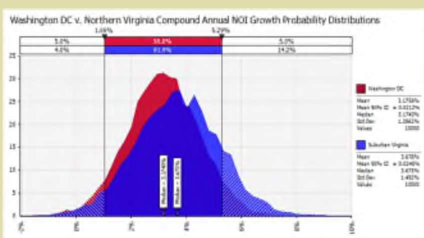

Washington, DC Payroll Employment Trends
Sources: BLS, BEA Data, RCR Forecasts
YoY Growth Trend
4%
3%
2%
1%
0%
-1%
2.1%
1.4%
1.3%
0.8%
0.8%
0.4%
US GDP GROWTH
US JOB GROWTH
DISTRICT PAYROLL GROWTH
WASHINGTON MD PAYROLL GROWTH
2013
2014
2015
2016
2017
2018f
2019f
2020f
2021f
2022f

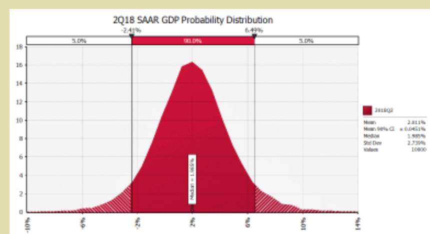
SUBMARKET TRENDS (REIS)

Submarket	Reis Inventory Percent Change	Effective Rent 1Q17	Effective Rent 2Q17	Effective Rent Change	Physical Vacancy 1Q17	Physical Vacancy 2Q17	Physical Vacancy Basis Point Change
Anacostia Northeast	-0.2%	$1,075	$1,122	4.4%	5.4%	5.3%	-10 bps
Brookland / Ft. Totten	0.0%	$1,147	$1,233	7.5%	4.6%	4.1%	-50 bps
Capitol Hill / Southwest	14.7%	$1,666	$1,805	8.3%	8.9%	12.7%	380 bps
Downtown/Logan Circle	-0.2%	$1,895	$1,969	3.9%	3.1%	2.9%	-20 bps
DuPont Circle/Adams Morgan	0.9%	$1,812	$1,837	1.4%	3.9%	4.6%	70 bps
Foggy Bottom	0.0%	$1,959	$2,023	3.2%	1.8%	1.8%	0 bps
Mt. Pleasant	0.3%	$1,909	$1,839	-3.7%	7.0%	7.2%	20 bps
Northwest/Georgetown	0.0%	$1,838	$1,835	-0.2%	3.2%	3.1%	-10 bps
Woodley/Cleveland Parks	0.0%	$2,230	$2,175	-2.4%	7.1%	6.9%	-20 bps
Metro	1.4%	$1,664	$1,694	1.8%	5.2%	5.7%	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

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