

MAJOR MIDWEST MSA MARKET CONDITIONS AND FORECASTS

A TALE OF SIX CITIES

MIDWEST LENDERS CONFERENCE, CHICAGO
ECONOMIC OUTLOOK PANEL
TUESDAY, JUNE 18, 2013

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AGENDA

▶ ADDRESS A FEW BIG QUESTIONS THAT I WILL POSE TO MYSELF

- WHAT IS THE MOST PROBABLE U.S. ECONOMIC OUTCOME?
- WHERE ARE WE IN THE REAL ESTATE CYCLE?
- DOES SUPPLY POSE A SIGNIFICANT THREAT TO PERFORMANCE?
- HAS RENT GROWTH PEAKED?

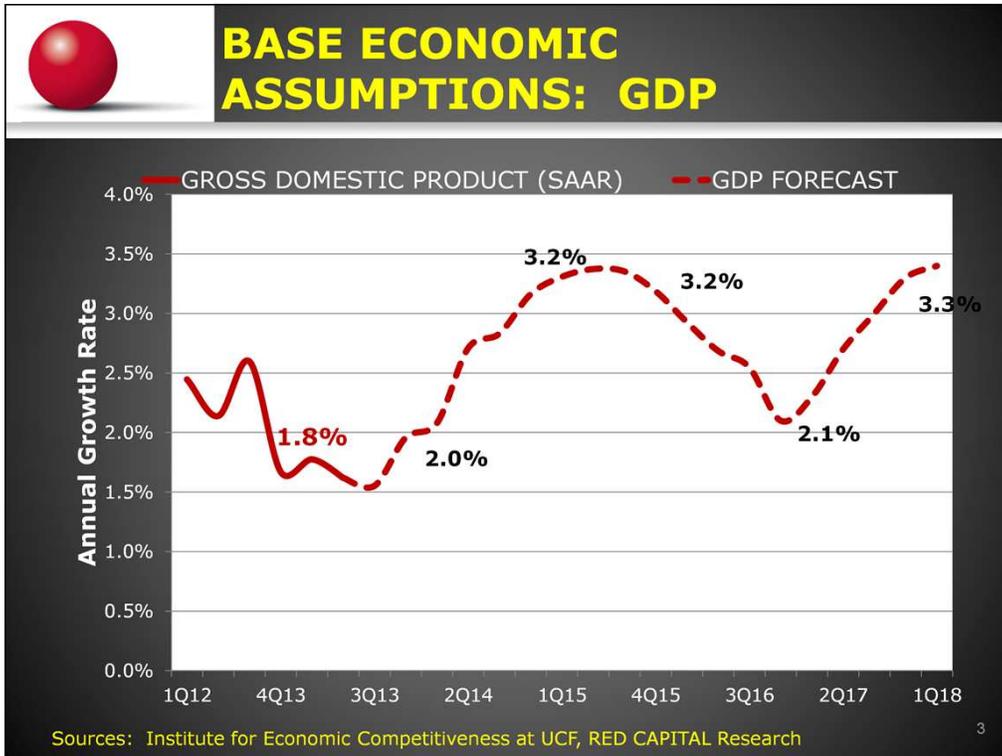
▶ MARKET SURVEY

- PAYROLL JOB OUTLOOK
- RENT AND OCCUPANCY FORECAST
- VALUE AND EXPECTED TOTAL RETURN CONSIDERATIONS
- HUB MARKETS
 - CHICAGO
 - COLUMBUS
 - DETROIT
 - INDIANAPOLIS
 - KANSAS CITY
 - MINNEAPOLIS / SAINT PAUL

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Thank you Ron for the kind words and I would like to thank the MLA for giving me the opportunity to address your group again this year. It's always a great pleasure to join you here at this annual gathering.

Now that Kim has addressed some of micro aspects of market analysis, I will use my time allotment to take a swing at the big picture. I'm going to divide my comments into two sections. In the first section, I'll ask myself a few rhetorical questions on the economy and apartment markets and share with you the light our econometric models are shedding on the questions. The second half of the presentation will deal with current and model forecasted apartment market conditions in the six Midwest HUB markets: Chicago, Columbus, Detroit, Indianapolis, Kansas City and Minneapolis/Saint Paul. As a new wrinkle, I will present probability distributions for most of the forecasted outcomes to give you a sense not only of the point estimates of probable market outcomes but the probability of particularly good or bad outcomes as well.



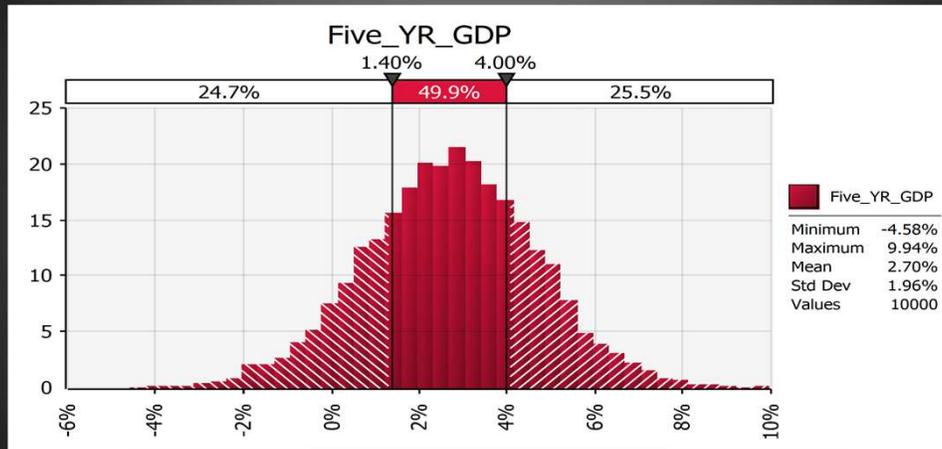
Okay. This first slide depicts our base case forecast for U.S. GDP. The first three years mimic an excellent, well-balanced and consistently reliable forecast from Dr. Sean Snaith of the Institute for Economic Competitiveness of the University of Central Florida. We use it as the foundation of our forecasts. The final two years of the five-year forecast are produced using our own models.

Anyway, as you can see, the forecast is relatively optimistic. Snaith expects GDP growth expressed on a real year-on-year basis to accelerate beginning in the second half of 2013 through the end of 2015, peaking at about 3.2%.

Afterward, growth should slow down a bit, back into the low-2% area but not fall into recession. Rather, the residual pent up demand for consumer goods and housing and low capacity utilization of plant and available labor should permit the economy to rebound in years four and five of the forecast.



FIVE-YEAR ANNUAL GDP GROWTH DISTRIBUTION



25% Probability of 5-year average growth +/- 1.3% from the mean of 2.7%

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Here's our first probability distribution slide. This slide shows a probability density function produced by a 10,000-iteration Monte Carlo simulation of probable GDP paths produced under the assumption that the base forecast is the most probable outcome but varying each quarterly node by an error constant, which constants are normally distributed randomly around the base case assumption in a sample whose standard deviation is equal to the standard error of the model.

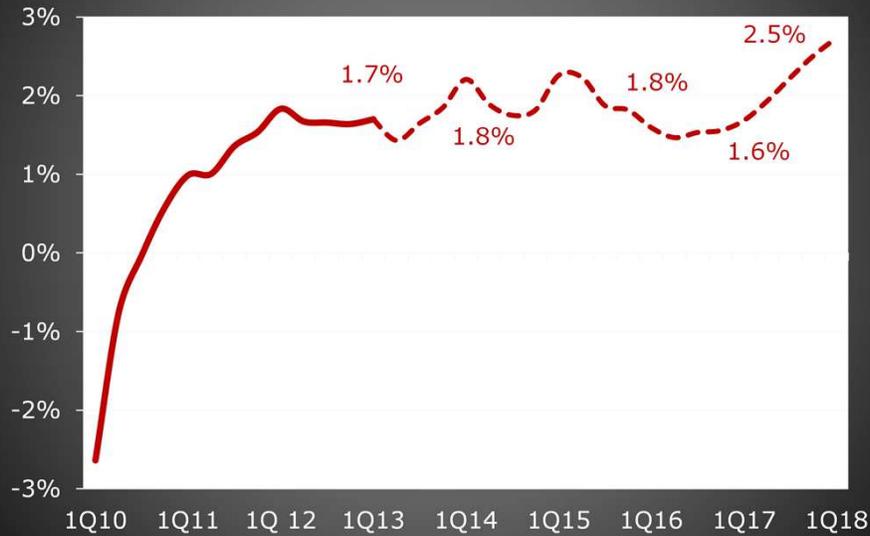
The statistic shown is the annual average rate of GDP growth estimated between 4Q2012 and 4Q2017. The distribution tells us that the mean growth rate is 2.7%, which is consistent with the compound average recorded during the Post World War II period.

The probability of good and bad outcomes is fairly even, as the simulation indicates there are even 25% probabilities that actual GDP will be less than 1.4% or more than 4.0% for the period.

Unfortunately, the probability of GDP growth below 0% is not too small to ignore. According to this model there is a 9.2% probability of negative average GDP growth between December 2012 and December 2017, roughly the same as achieving 5.2% annual growth. There has never been a five-year period of negative GDP growth in the post-war period while five percent or greater growth was observed in 20 quarters over the past 70 years in the 1950s and 1960s.



BASE ASSUMPTION: PAYROLL EMPLOYMENT GROWTH

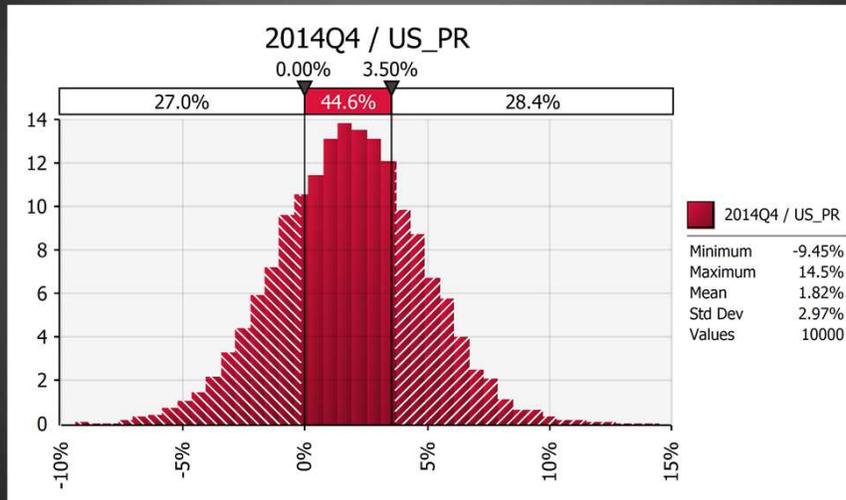


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So what about payroll employment growth. Here's the most probable outcome. Nothing too exciting here as Snaith expects payroll job growth to proceed in a way very consistent with what we've observed over the past two years. Payroll job creation is expected to proceed at 1.6% to 1.8% annual rates until late in the forecast period, when our models project an acceleration of both GDP and job growth. Basically, this pace of job creation translates to month payroll job adds of between 175,000 and 200,000 jobs: not bad but not enough to move the needle on the unemployment rate gauge very quickly. If this forecast is accurate, we should continue to see unemployment rates above 6.5% for the next couple of years.



2014 PAYROLL JOB DISTRIBUTION



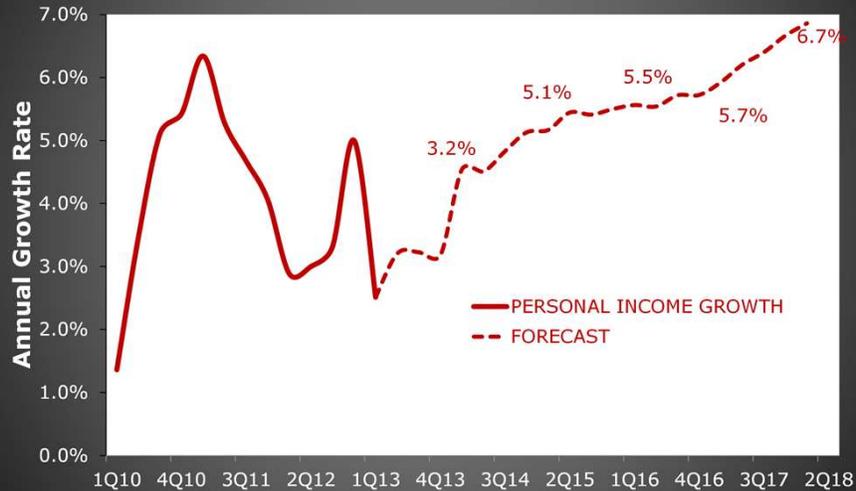
19% Probability of negative Y-o-Y growth in 4Q13.
27% Probability of negative Y-o-Y growth in 4Q14.

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In terms of upside and downside risks, the model generates 19% and 27% probabilities that year-over-year employment growth will be negative during the fourth quarters of 2013 and 2014. These are figures that are pretty typical for mid-recovery periods and should not be considered as a signal that we are approaching a technical recession.



BASE ASSUMPTION: PERSONAL INCOME GROWTH



Sources: Institute for Economic Competitiveness at UCF, RED CAPITAL Research

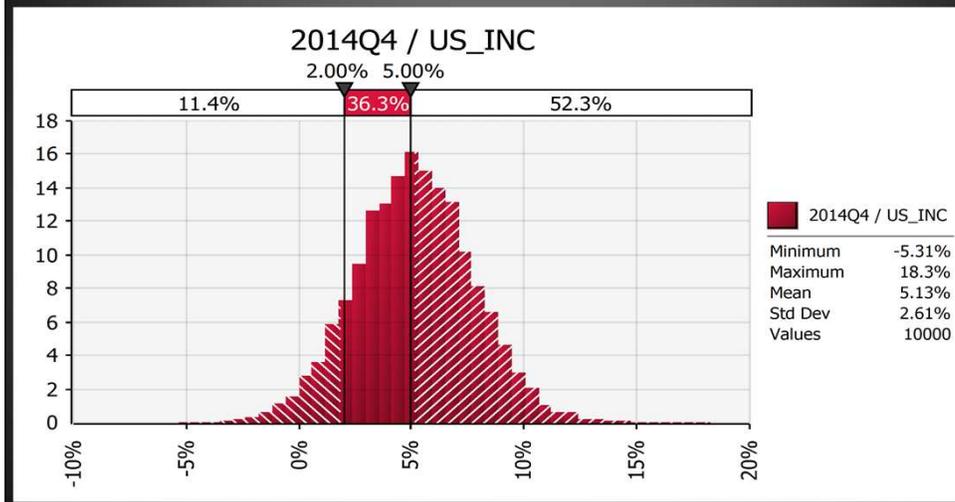
7

This slide depicts the most probable outcome for personal income. This is an important statistic in so much as we have discovered in our modeling exercises that P.I. at the national and metro levels is the single most important factor driving apartment rents.

As you can see, the trajectory of this forecast is considerably different than the last one for payroll jobs. Indeed, we expect P.I. to accelerate throughout the forecast period topping more than 5% in 2015. All other things equal, this level of national P.I. growth is consistent with average effective rent growth in the top U.S. markets over the next five years in the mid-3% range, a very constructive outcome.



2014 P.I. DISTRIBUTION



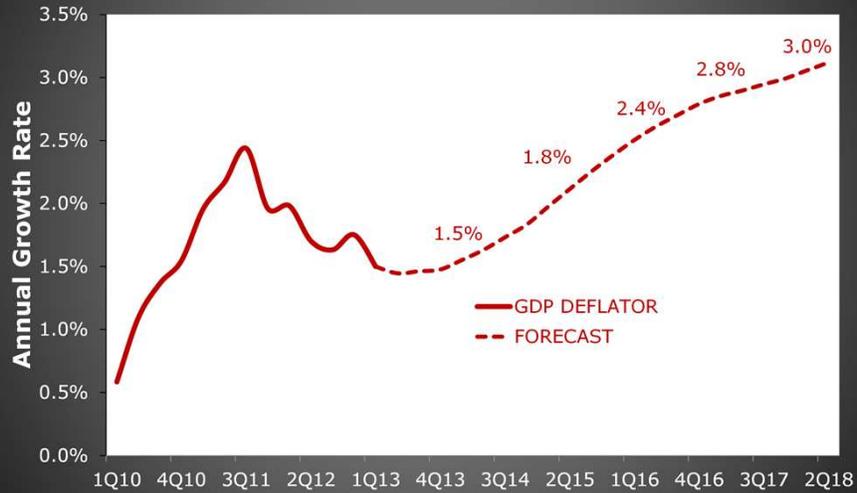
52% Probability of $\geq 5.0\%$ Y-o-Y Growth in 4Q14, a constructive indicator for rents, spending.

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Here's the P.I. distribution for 2014, showing a 5.1% expected rate of growth with a 52% probability of growth of 5% or faster and less than a 12% probability of growth slower than 2%. Good stuff.



BASE ASSUMPTION: GDP DEFLATOR



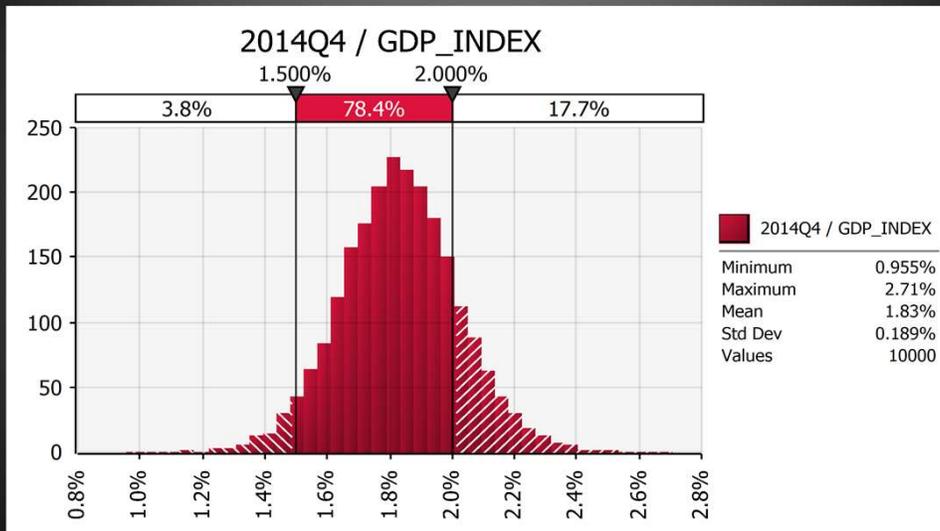
Sources: Institute for Economic Competitiveness at UCF, RED CAPITAL Research

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Here's the inflation outlook. We use the GDP deflator series as the proxy for price inflation in our model. As you can see, the model expects inflation to accelerate as the economy strengthens, which is as we would expect to see as labor and commodity prices rise, producing cost push pressures on prices. In this case, we see price inflation creeping up from its current mid-1% level to about 3% in 2018. I think this may exaggerate the risk somewhat as the models are specified using a nearly 70-year data series wherein prices were considerably more sensitive to economic activity than they have been over the past couple of years. It wouldn't surprise me were inflation to be meaningfully lower than this in the base case economic environment.



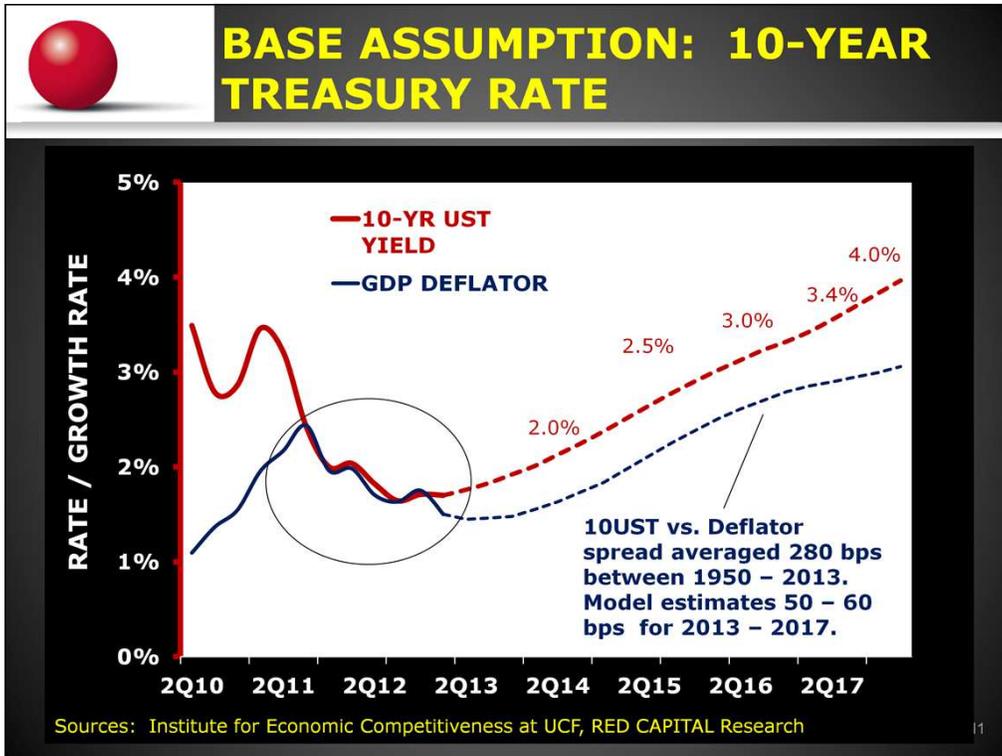
2014 GDP DEFLATOR DISTRIBUTION



17.7% Probability of \Rightarrow 2.0% Inflation in 4Q14.

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Even in this forecast environment, the inflation outlook is pretty benign. Our model projects that there is less than a 20% probability of the deflator rising by 2% or more next year.



So where may interest rates head? Neither I nor our models can provide much insight into when the Fed will pull the plug on the quantitative easing program or what on earth its exit strategy is but we can forecast how the 10-year may behave if monetary policy intervention is removed from the recipe and rates are determined largely by the demand for credit and underlying inflationary pressures..

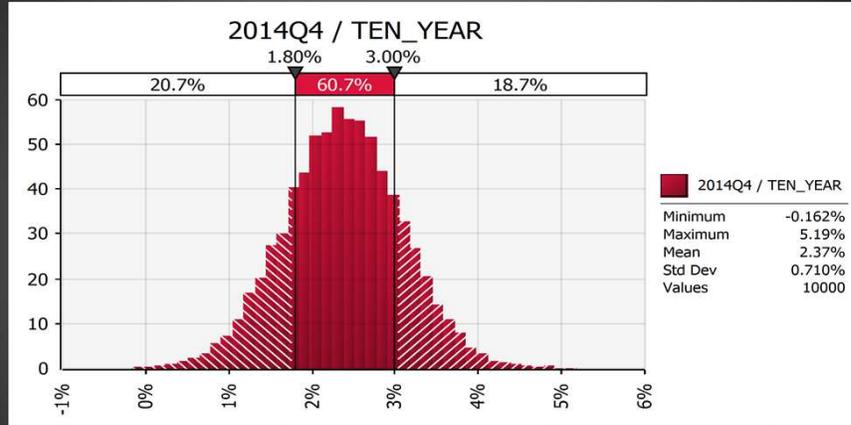
This slide depicts the relationship between the 10-year Treasury yield and the GDP deflator. The circled area illustrates the situation over the past 18 months or so. Note that the 10-year yield was right on top of the deflator during that period.

In the first quarter we saw a small move in the direction toward the normal relationship between inflation and term interest rates, with the spread going from essentially zero to +20 bps. That compares to a 63-year average of 280 basis points.

Looking forward, we see the spread hanging in more or less at the deflator + 40 or 50 bps range. In this scenario we find that the 10-year yield remains below 3% through 2015.



2014 10-YR UST YIELD DISTRIBUTION



$\mu = 2.4\%$.

Probability of 10-yr yield $\leq 1.8\%$ is 20.7%.

Probability of 10-yr yield $\geq 3.0\%$ is 18.7%

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In terms of probability, the mean level for 4Q14 is 2.4%. The distribution of year-end 2014 results is pretty normally distributed around the mean as there is a 21% chance of the 10-year being 60 bps below the mean and a 19% probability of the 10-year being 60 bps above the mean.



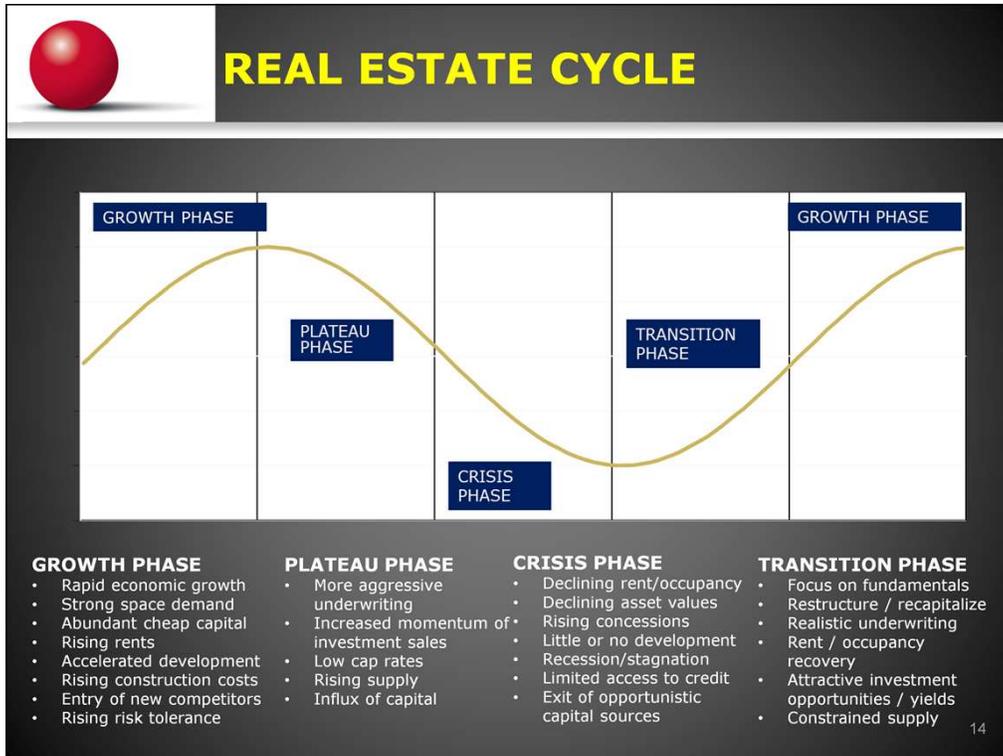
ECONOMIC SUMMARY

- ▶ **ECONOMIC FUNDAMENTALS ARE RELATIVELY HEALTHY**
- ▶ **MODERATE ECONOMIC GROWTH IS THE MOST PROBABLE OUTCOME**
 - 2.7% ANNUAL GDP GROWTH
 - 5% ANNUAL PERSONAL INCOME GROWTH
 - 1.8% - 2.0% PAYROLL JOB GROWTH
 - INFLATION LESS THAN 2%
 - 10-YR YIELD < 3% THROUGH 2014
- ▶ **CONSISTENT WITH 1.3% 1.5% AVERAGE APARTMENT DEMAND AND 3%+ EFFECTIVE RENT GROWTH**
- ▶ **BUT DOWNSIDE GROWTH AND ECONOMIC POLICY RISKS ARE CONSIDERABLE**

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So to summarize: economic fundamentals look surprisingly favorable for the multifamily rental industry. We expect moderate economic growth and job creation rates that will provide fuel for decent household formation but not so much wealth and income among rental households that we are likely to see a major shift in tenancy preference away from rental back toward ownership.

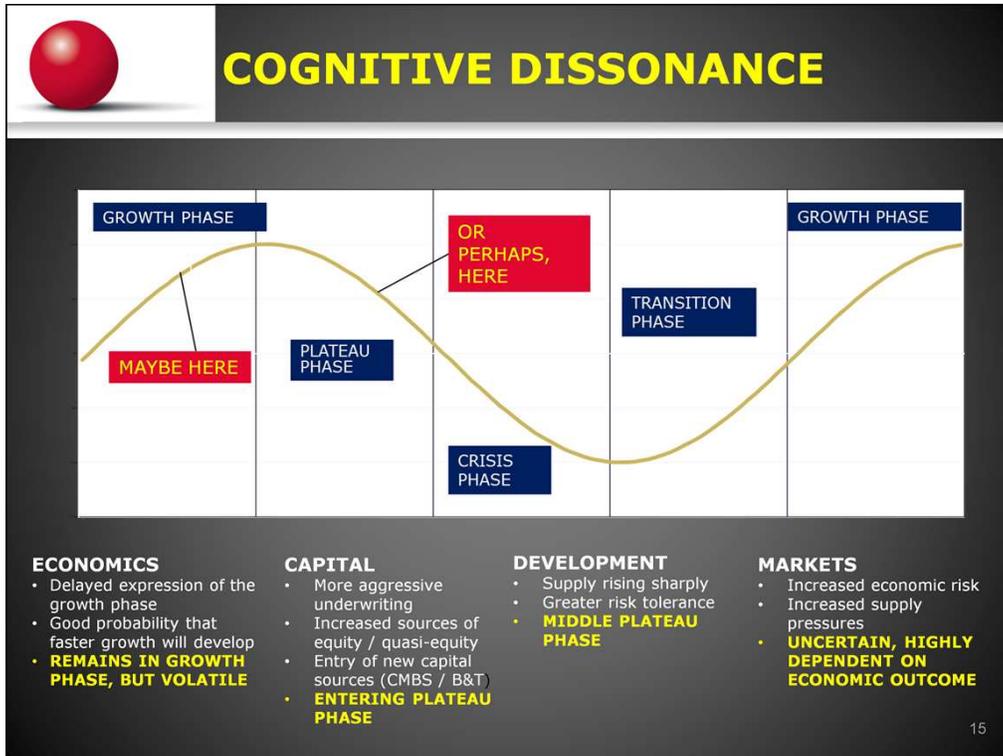
Indeed, the outlook is consistent with absorption rates in the low- to mid-1% range and effective rent growth of around 3.5%, well above the rate of inflation. That connotes NOI growth in the neighborhood of 5% per year, which is a nice neighborhood to live in.



So, where are we in the real estate cycle? Briefly, cycle theory posits that real estate markets follow a consistent sine wave trajectory paralleling the broader business cycle. The first phase is called the growth phase, characterized by rapid economic growth, strong space demand, rising rents and accelerated development. The Plateau Phase follows as the growth phase supply is delivered, characterized by an influx of capital, declining cap rates, aggressive underwriting assumptions and topping occupancies.

Plateau is followed by Crisis, a period in which the market is plagued by falling and occupancies and rents, rising concessions, limited access to capital and the exit of opportunistic capital players.

Finally, when the excess are cleansed from the market, a new growth phase may begin.



So where are we in the current cycle? I would describe the current situation as cognitive dissonance, which in psychology is the state of holding two diametrically opposed thoughts simultaneously.

Adapting this metaphor, it's not clear exactly where we are. In respect to economics, we appear to be in the middle growth phase, with the prospects of faster output and employment growth over the next couple of years, quite the opposite of what one typically would anticipate in year four of an economic recovery.

On the other hand, the supply and capital market conditions resemble a mid-Plateau point.

So following this logic, we're either roughly two years from the beginning of a down-cycle or four years out, depending on the actual economic outcome. Our economic forecast suggests that we're in pretty good shape for the next four or five years, but there is a great deal of uncertainty in the global economy and capital markets and in the property market itself due to supply concerns, so we need to be extra vigilant about spotting impending growth, inflation or interest rate shifts over the coming months and years.



DOES A SUPPLY CRISIS LOOM IN OUR FUTURE?

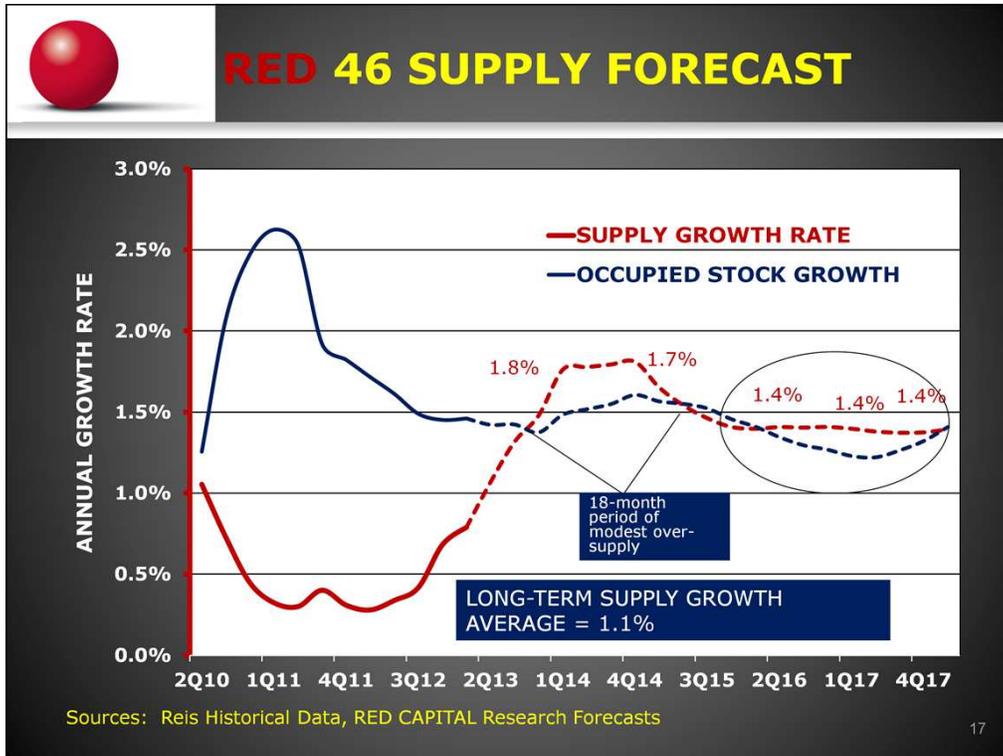


Sources: Census Bureau

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Which brings us to the question of supply? As we know too well, apartment supply has been building since we emerged from the Great Recession in late 2009. We're now back near the historic run rate with respect to 5+ building permits in the area of 250,000 to 300,000 units per year., which are depicted here, and around 210,000 to 225,000 unit starts.

So are we facing the sort of damaging period of over-supply that typically characterizes a late-Plateau / Crisis period?



Well, we don't believe so; at least not in the near term. This slide depicts the recent historical and forecasted growth rates for occupied stock and supply in the 46 large markets that we model and forecast, what we call the RED 46.

As you can see to the left of the graph, stock growth, the blue line, has grown at a much faster rate than supply during the economic recovery period, producing steadily higher occupancy rates. But the lines have begun to converge and we expect them to cross later on this year.

But we don't anticipate a wild imbalance of supply and demand, even in the short run. Rather, the rate of average inventory growth will reach only the 1.7% to 1.8% level and hold steady there through the end of 2014. This will exceed demand by roughly 20 bps per year, having a commensurate negative effect on average occupancy.

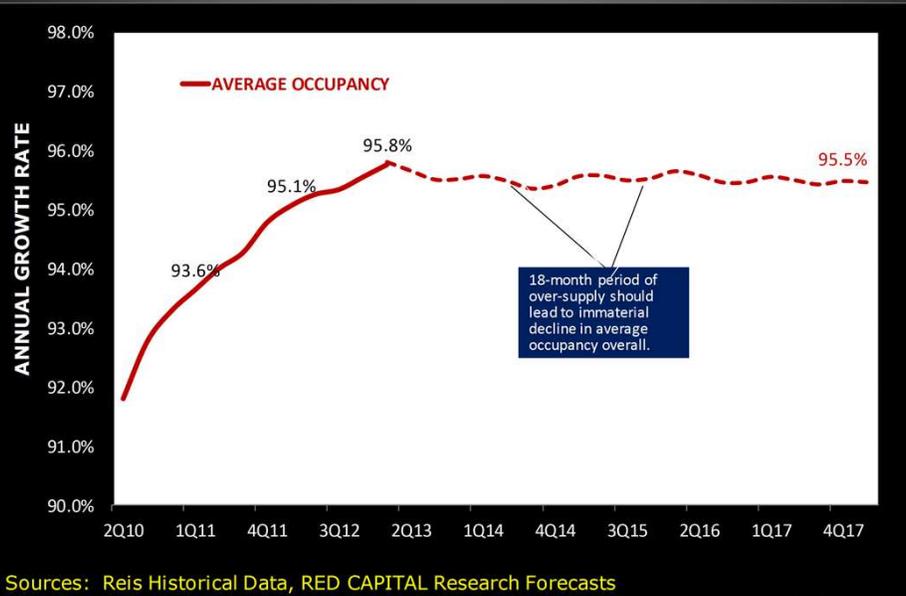
By 2015, we should begin to see market forces bend the supply curve down. After a period of intensive construction, construction and land costs begin to rise and the rate of rent growth tends to moderate, factors that inhibit new construction. As a result, we should see the pace of supply decelerate to about 1.4% by 2015, which is only slightly faster than the 1.1% long-term average growth rate. Demand probably won't be quite that strong, but the supply / demand gap will be very modest, allowing average occupancy to remain above 95% or so throughout the forecast period.

So, in spite of the fact the permitting activity suggests that developers are teeing up a

major supply overshoot, and there may be spotty excess supply levels in a few growth metros like Houston and Atlanta, we expect the market to remain in equilibrium for the foreseeable future, and as we shall see, in our region as well, with the possible exception of Indianapolis.



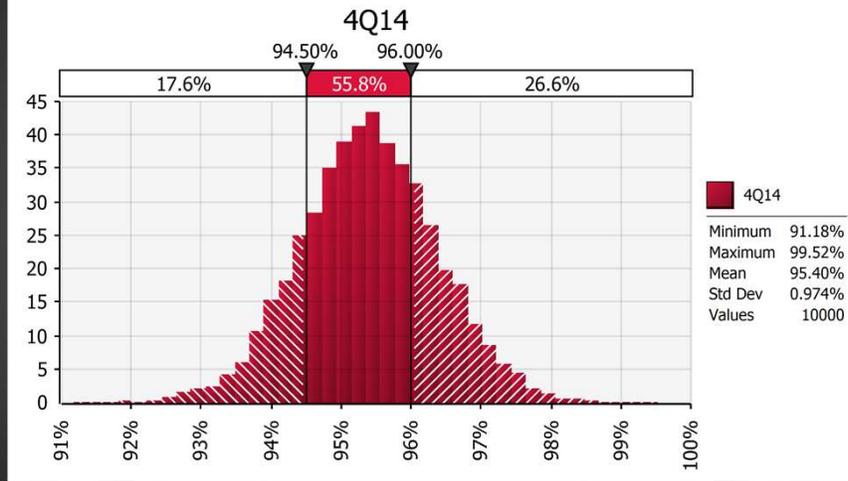
RED 46 OCCUPANCY FORECAST



Here's the RED 46 occupancy forecast, showing peer group average occupancy falling about 20 to 30 bps over the course of the forecast.



2014 RED 46 AVERAGE OCCUPANCY DISTRIBUTION



Probability of Occupancy => 94.5% is 82.4%.
Probability of Occupancy => 96.0% is 26.6%

19

As for distribution of 4Q2014 occupancy rates, there is an 82% probability that the RED 46 rate will be 94.5% or higher; again comforting stuff.



RED 46 EFFECTIVE RENT FORECAST



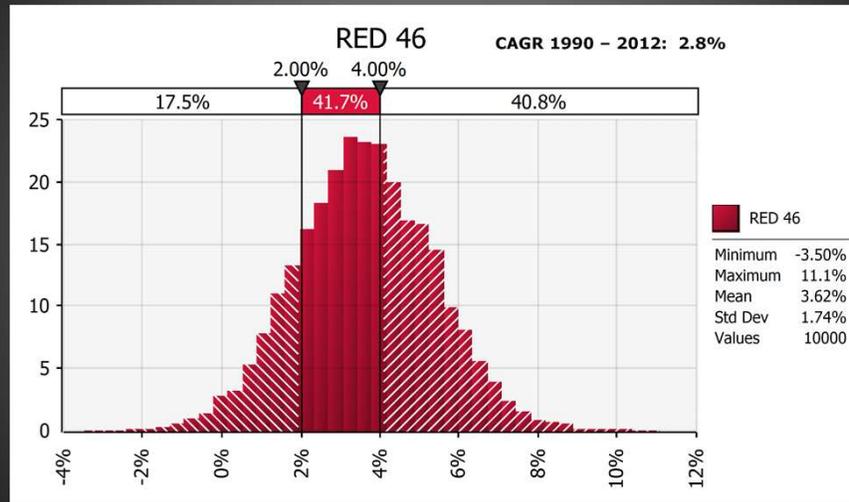
Sources: Reis Historical Data, RED CAPITAL Research Forecasts

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.... And average rent growth rates in the mid-3% range.



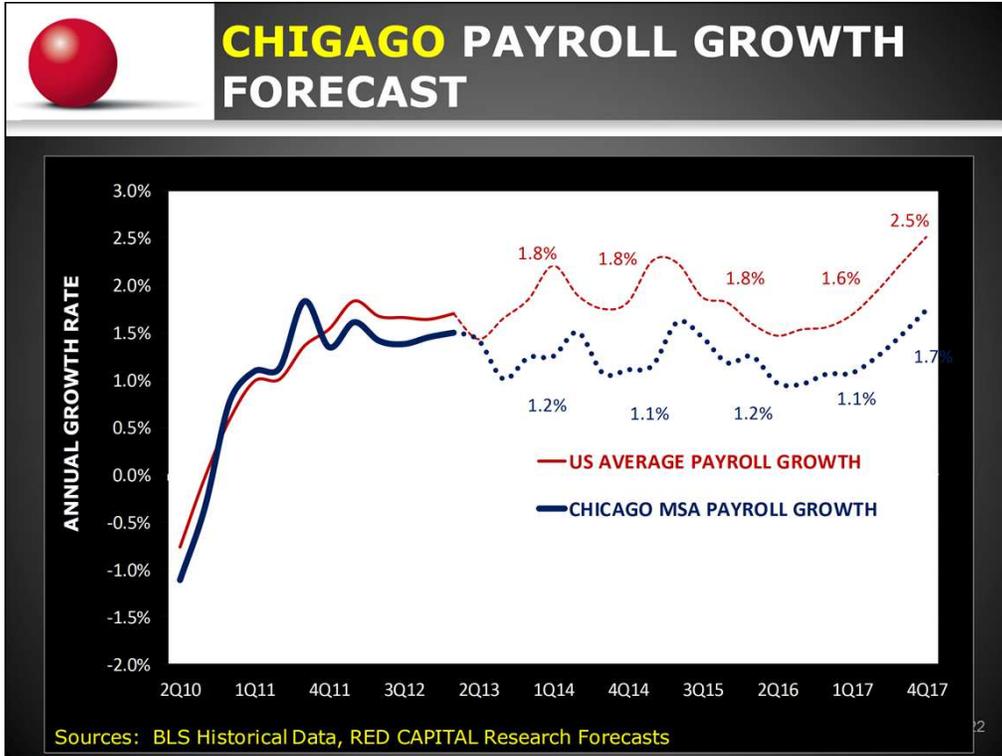
RED 46 5YR COMPOUND ANNUAL RENT GROWTH DISTRIBUTION



Probability of CAGR Rent \Rightarrow 2% is 82.5%.
Probability of CAGR Rent \Rightarrow 4% is 40.8%

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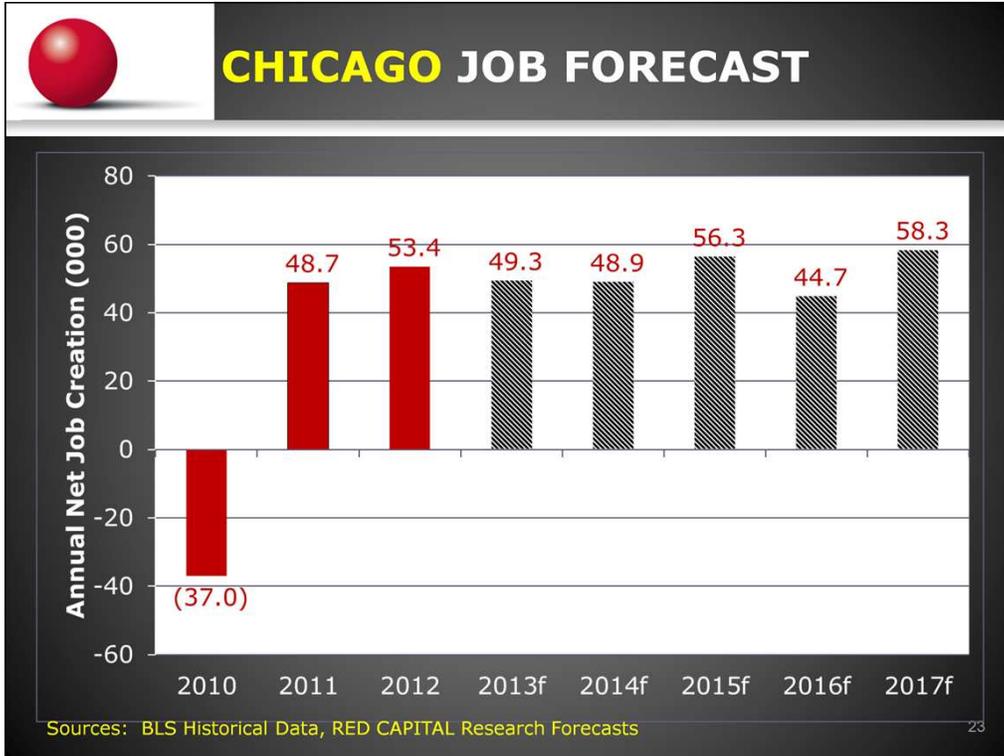
... and an 82.5% probability of chalking down compound annual growth of 2% or higher (i.e. real effective rent growth).



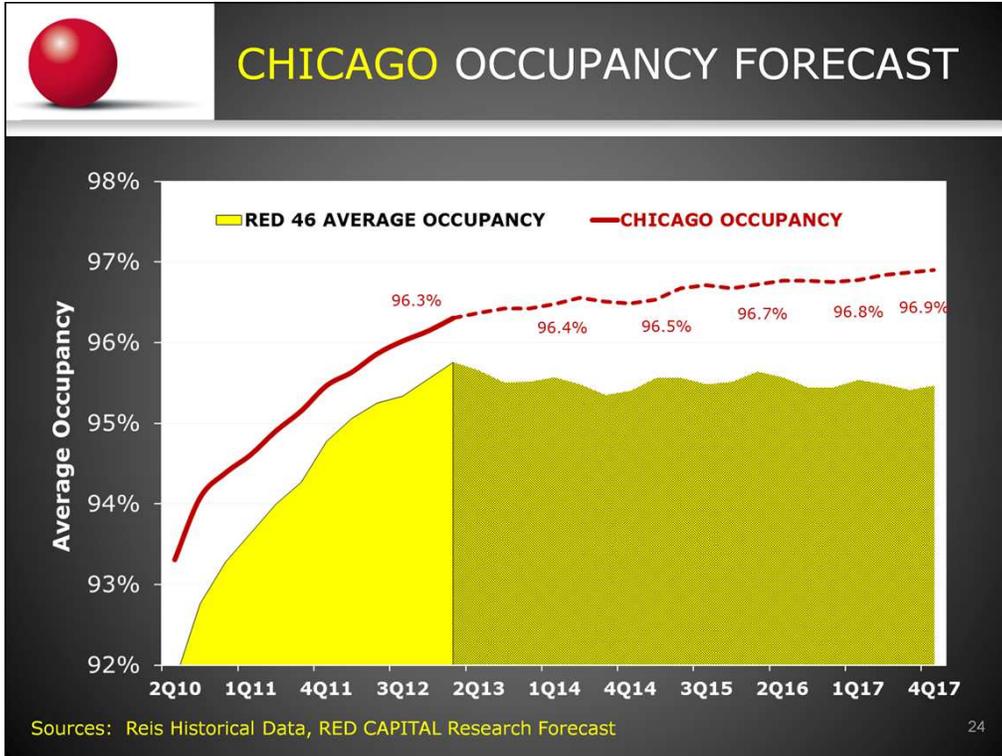
So what about our Midwest region. Let's start with our host city Chicago and move along alphabetically.

Until last March, government data suggested that Chicagoland job growth during the recovery was sluggish, significantly lagging the U.S. average. But with the release of the BLS's annual re-benchmark revisions, we find that the Windy City actually performed very well during the past two years, keeping pace with the U.S. average payroll growth rate and generating roughly 50,000 per year in 2011 and 2012.

Our forecast for Chicago forecasts a bit slower growth in over the next three or four years, averaging about 1.3% per year. Translating to the number of jobs produces this:



Steady as you go in the 50,000 –jobs per year range with some volatility in 2016 and 2017.

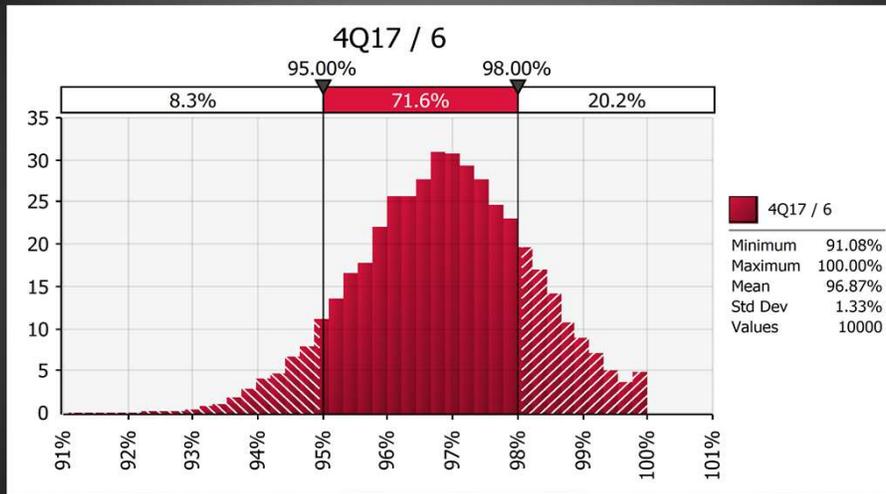


This amount of job growth gives rise to a solid occupancy outlook. Supply promises to be stout in 2014 when we expect about 6,000 units to come on line, most in the Gold Coast, Loop and West Loop submarkets. But demand shouldn't have too much trouble keeping pace as the product being delivered seems to be in keeping with what Chicago households are searching for.

Our forecast projects that occupancy will be steady to higher throughout this period of heavier supply. Occupancy will rise 10 to 30 bps per year over the next several years, approaching a 97% average by the end of 2017, highest level observed since the late 1990s.



4Q17 AVERAGE OCCUPANCY DISTRIBUTION



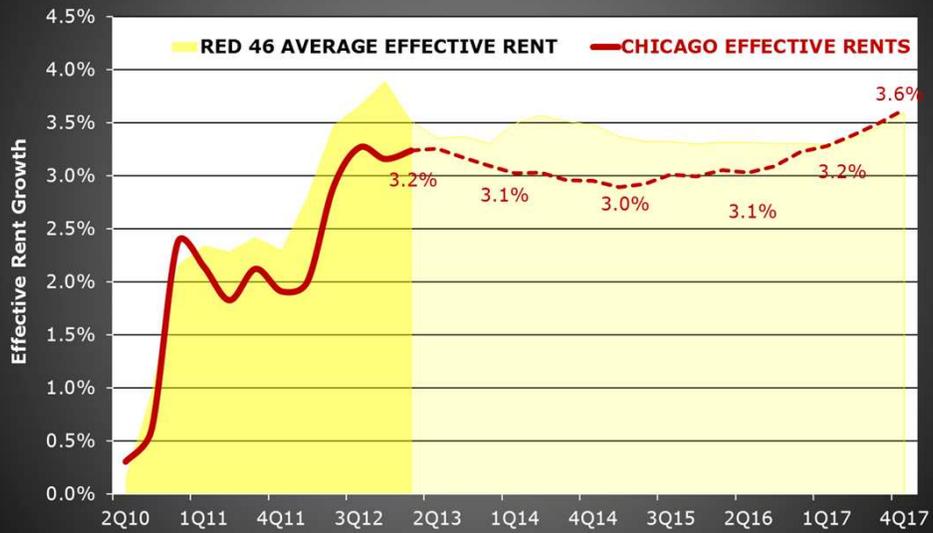
Probability of Occupancy => 95% is 91.7%.
Probability of Occupancy => 98% is 20.2%

25

Downside occupancy risk is almost non-existent. Our models indicate that there is less than a 10% probability that the Reis apartment occupancy series will fall below 95% in 2017.



CHICAGO EFFECTIVE RENTS



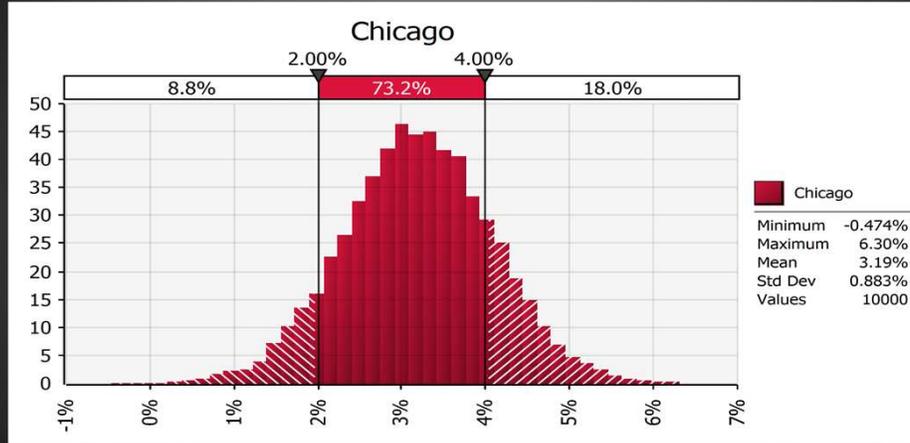
Sources: Reis Historical Data, RED CAPITAL Research Forecast

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With respect to rents, our Chicago effective rent model forecasts slightly slower than average rent growth during the first four years, with stronger results coming near the end of the forecast period.



5YR COMPOUND ANNUAL RENT GROWTH RATE DISTRIBUTION



Probability of CAGR Rent \leq 2% is 8.8%.
Probability of CAGR Rent \geq 4% is 18.0%

27

In respect to five-year compound annual rent growth, the model indicates that rents are likely to grow at a 3.19% annual compound rate from 2012 to 2017. This also ranks first among the six markets that we'll examine today. Moreover, the rent outlook is very stable, with less than a 10% probability that growth will slip below 2%.



CHICAGO EXPECTED 5-YR TOTAL RETURNS AND RETURN DISTRIBUTION

| GENERIC CLASS-B/B+ ASSET ASSUMPTIONS | DATA |
|---|------------|
| Going-in Cap Rate | 5.7% |
| Exit Cap Rate | 6.2% |
| Purchase Price | \$105,673 |
| Sales Price | \$121,496 |
| Expected Total Return | 8.4% (#19) |
| Risk-adjusted Return Index (μ IRR / δ_2 IRR) | 4.76 (#13) |

TOTAL RETURN DISTRIBUTION

| PROBABILITY OF ACHIEVING STATED IRR OR BETTER | 90% | 70% | 50% | 30% | 10% |
|---|------|------|------|------|-------|
| CHICAGO | 5.7% | 7.2% | 8.1% | 9.0% | 10.0% |

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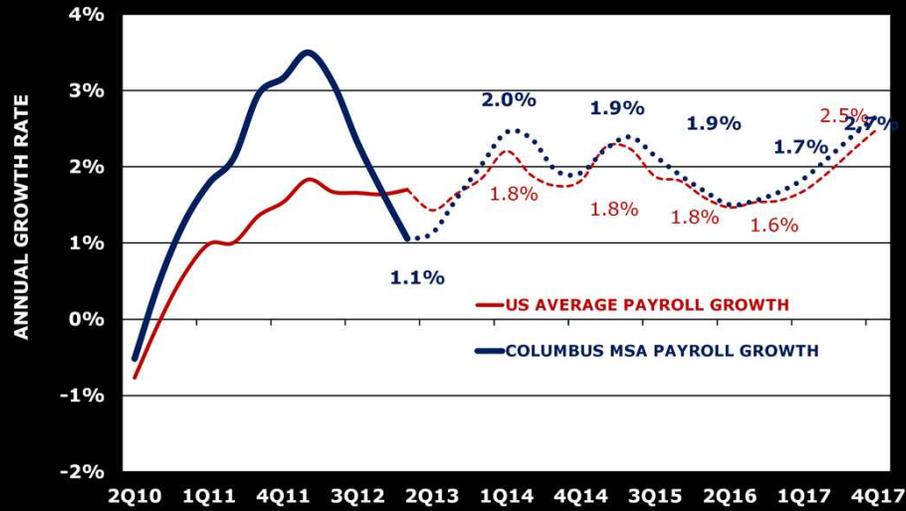
So what kind of returns would an investor expect to generate from a generic Chicago asset? Using a 5.7% estimate for a generic B-B+ institutional quality asset in Chicago and a derived 6.2% exit cap rate, we estimate that an investor would expect to generate a 8.4% annual unlevered return over five years. That ranks 19th highest among the RED 46 markets.

Due to the tight distribution of likely outcomes, the risk adjusted index – that is, the ratio of expected total return to the standard deviation of return generated by a 10,000 iteration Monte Carlo simulation, is 4.76; 13th highest among the group.

Because of the low volatility characteristics of Chicago apartment cash flows, downside risks are small. Indeed, investors are expected to have a 90% probability of achieving at least a 5.7% return, a level more than 100 bps above conventional and FHA mortgage interest rates.



COLUMBUS PAYROLL GROWTH FORECAST



Sources: BLS Historical Data, RED CAPITAL Research Forecasts

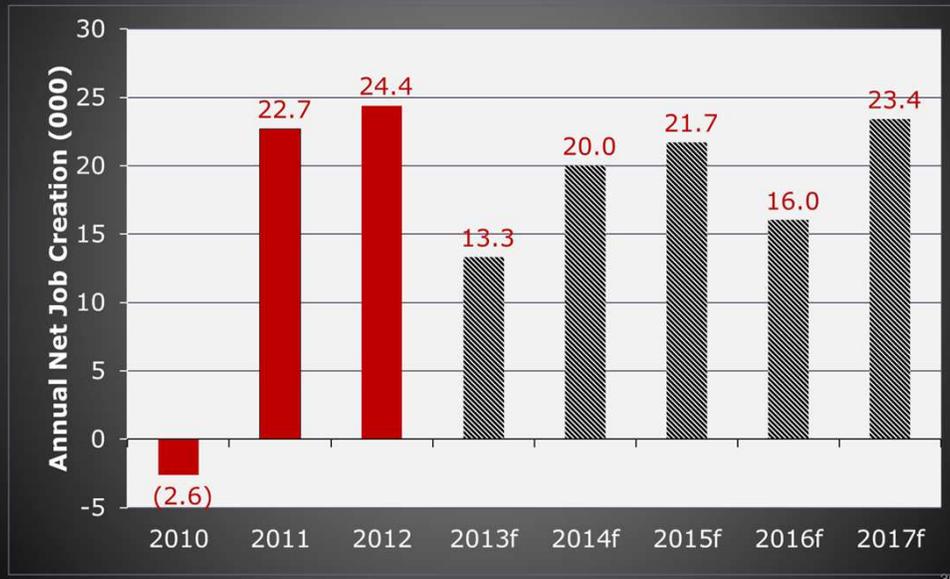
Next to Columbus. In terms of payroll growth, Ohio's capital city was flying high in 2011 into 2012, posting some of the fastest job growth figures in the nation. But the past three quarters were dramatically slower as hiring slumped in a host of industry sectors including trade, transportation and financial and leisure services.

As a result, the 1Q13 print was slower than the U.S. average for the first time in more than three years.

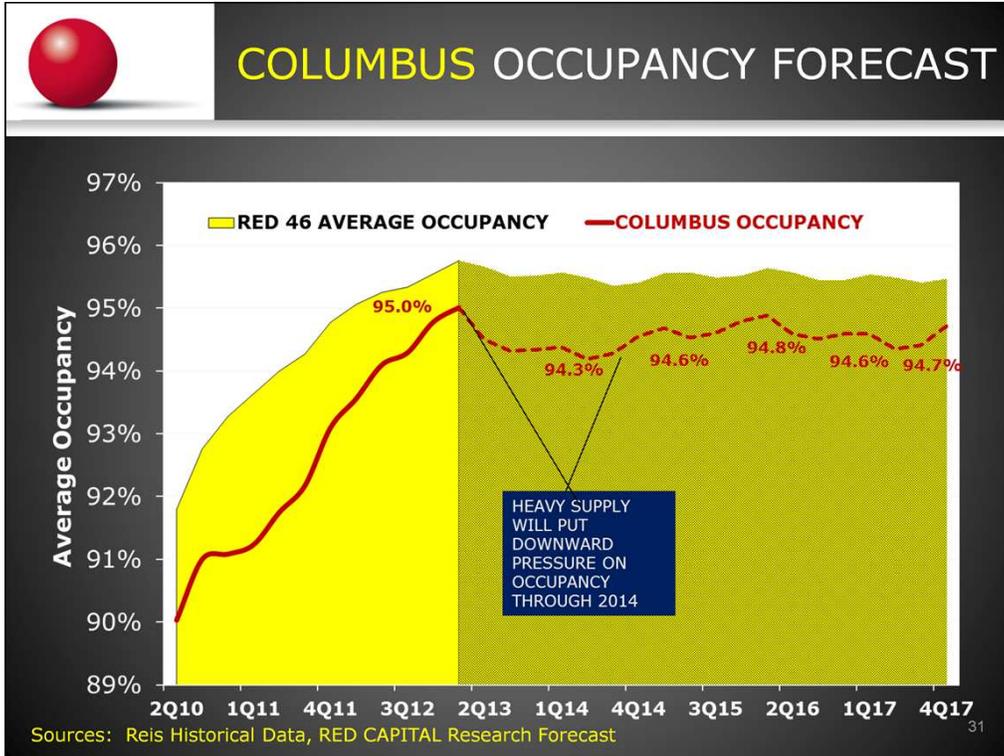
Our model indicates that this pause is temporary and that Columbus should return to its normal pace, slightly faster than the national average later this year. We see job growth proceeding in the 1.7% to 1.9% year-on-year range over the next three or four years.



COLUMBUS JOB FORECAST



That translates to between 13,000 and 23,000 jobs, a bit faster than the long-term 10,000 to 12,000-job average typical of the Columbus.



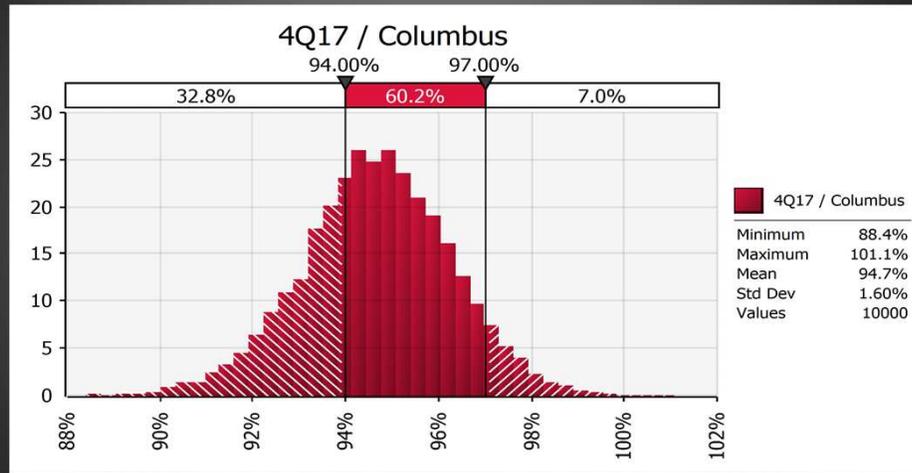
As regards occupancy, we also have a temporary supply problem in Columbus. At present, we have about 4,000 units in the pipeline at one stage or another, which would represent about 3.2% of the existing Reis inventory.

We expect that roughly 2,200 units per year will be added to the inventory through 2016. Tenants are likely to absorb about 5,900 units over that period, raising vacant stock by only about 80 bps of the total inventory at the cycle nadir and about 20 bps over all and thereby reducing average occupancy to 94.2% at the trough.

Consequently, occupancy should remain in the vicinity of 94.5% to 95.0% over the five-year forecast period.



4Q17 AVERAGE OCCUPANCY DISTRIBUTION



Probability of Occupancy => 94% is 67.2%.
Probability of Occupancy => 97% is 7.0%

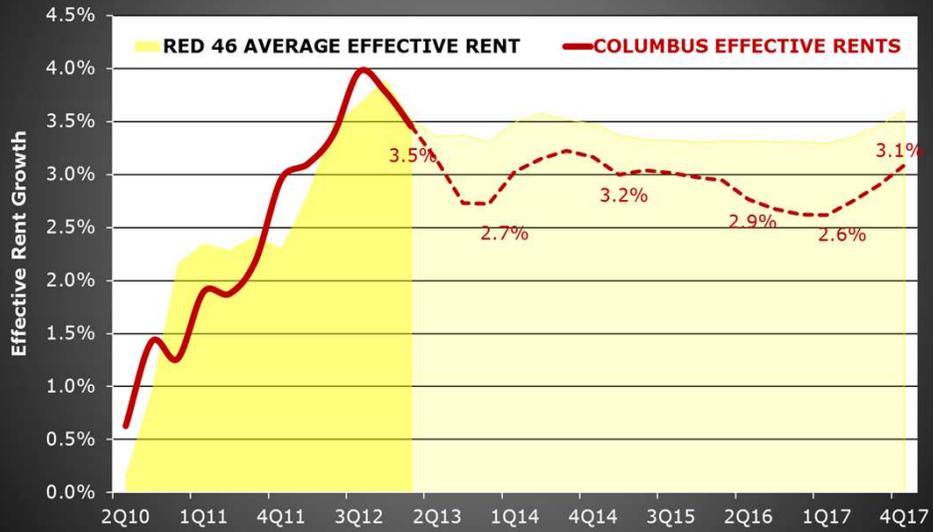
32

By way of probabilities, we estimate that there is a 67% probability that metro average occupancy in the Reis series will be above 67% in 2017.

But upside is limited too. The probability that occupancy will be above 97% is only 7.0%.



COLUMBUS EFFECTIVE RENTS



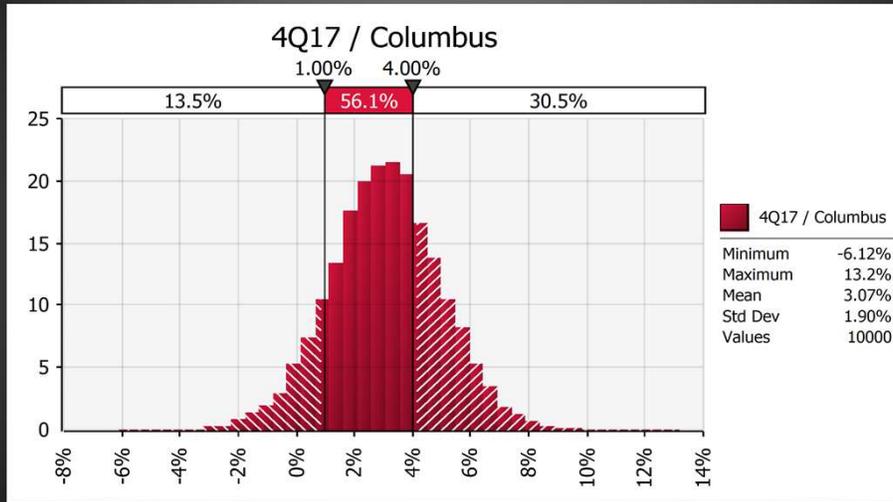
Sources: Reis Historical Data, RED CAPITAL Research Forecast

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On the rent question, we see rents continuing to slow from the 4.0% cycle peak set last summer, falling into a stable 2.6% to 3.2% range for the forecast period. That's slower than Chicago, certainly, but as we'll see in a moment it's pretty attractive relative to where cap rates are in Central Ohio at the moment.



5YR COMPOUND ANNUAL RENT GROWTH DISTRIBUTION

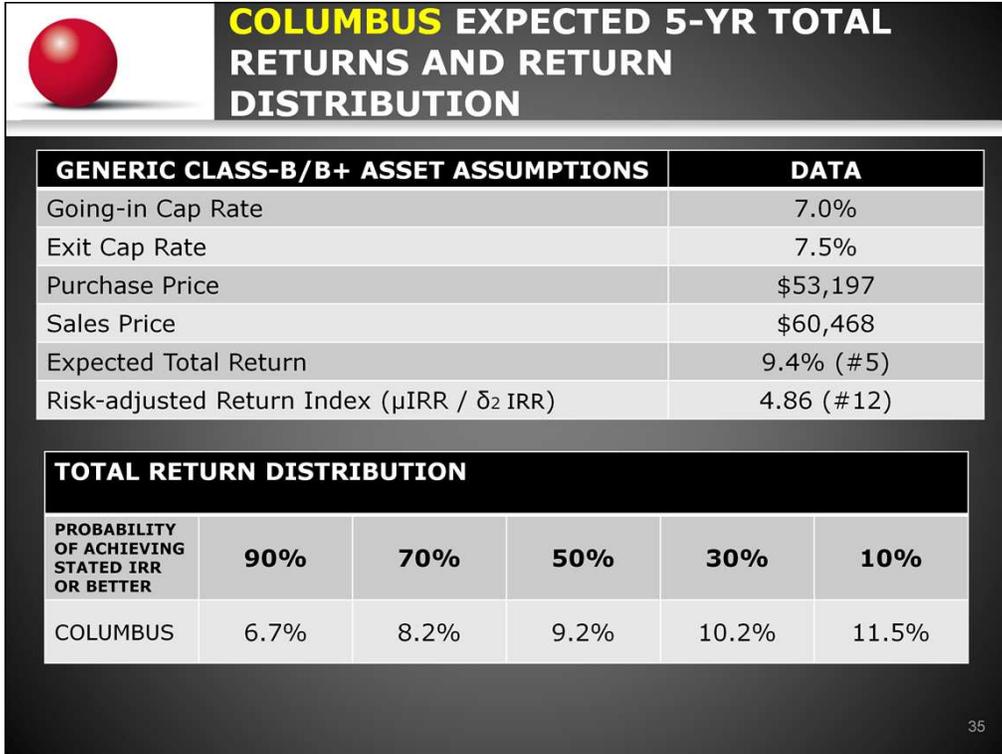


Probability of CAGR Rent \leq 1% is 13.5%.
Probability of CAGR Rent \geq 4% is 30.5%

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Here's the five-year rent CAGR distribution, and as you can tell, the distribution here is pretty tight. We have a nearly 3.1% mean, with 90% probability of notching 1% or greater compound growth.

That's not as strong as Chicago, but the right tail of above average statistics is considerably stronger. In this case we have a 30.5% probability of achieving 4% or faster growth, about 12% greater than Chicago.

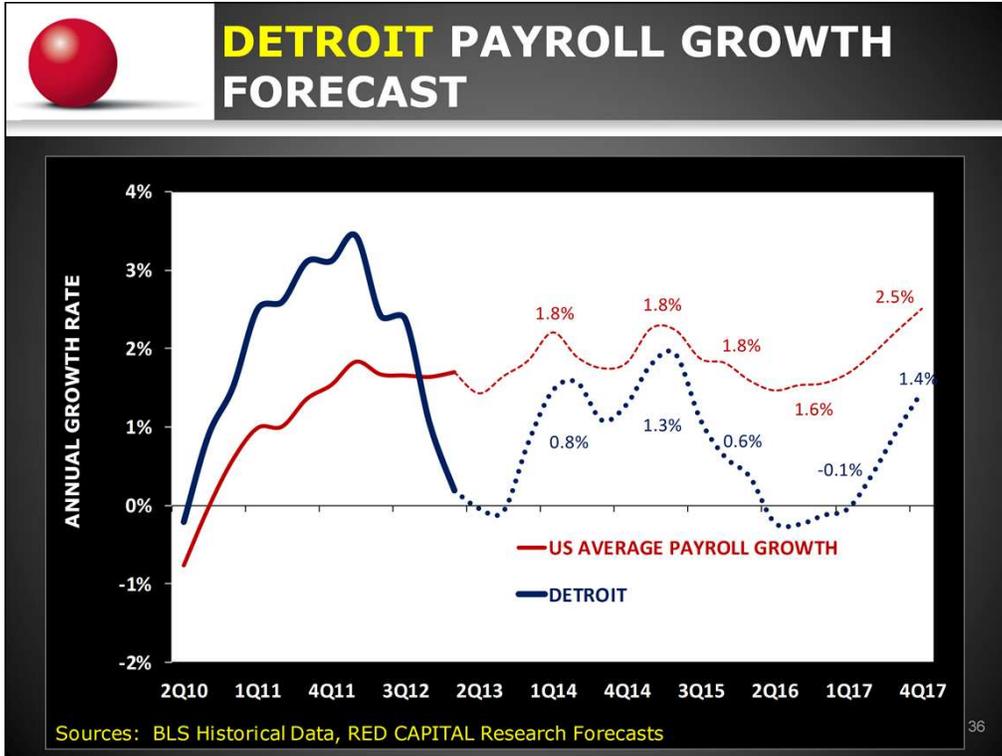


But a peak at cap rates will demonstrate the value proposition in this metro area. Rather than 5.7%, the typical institutional quality B or B+ asset in Columbus can be had at an approximately 7.0% cap rate. With the foregoing occupancy and rent forecasts and a projected 7.5% exit, we think an investor would expect to realize a 9.4% total return over five years.

That's 4th highest among the 46 markets we model.

The wide rent distributions hurts the risk-adjusted returns a bit, but Columbus still checks in at number 12 among the peer group.

In the return distribution, I point your attention to the 10% probability box. Our model projects that an investor would have a 10% probability of achieving an 11.5% return or higher in Columbus. That compares to a 10% statistic for Chicago.



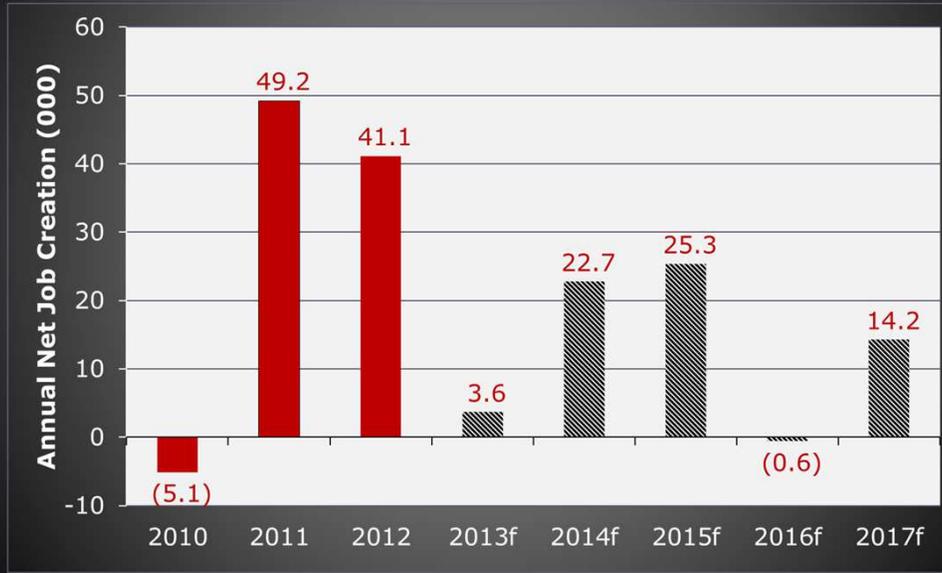
Next, on to the Motor City. In this instance we see another pattern similar to Columbus's only more exaggerated, with employment surging in 2011 into the first half of 2012 and then plunging over the past nine months.

For Detroit, our models suggest they have a little further to go down before they recover. We foresee a couple of negative year-over-year comparisons later in 2013 before job growth recovers back above 1% in 2014.

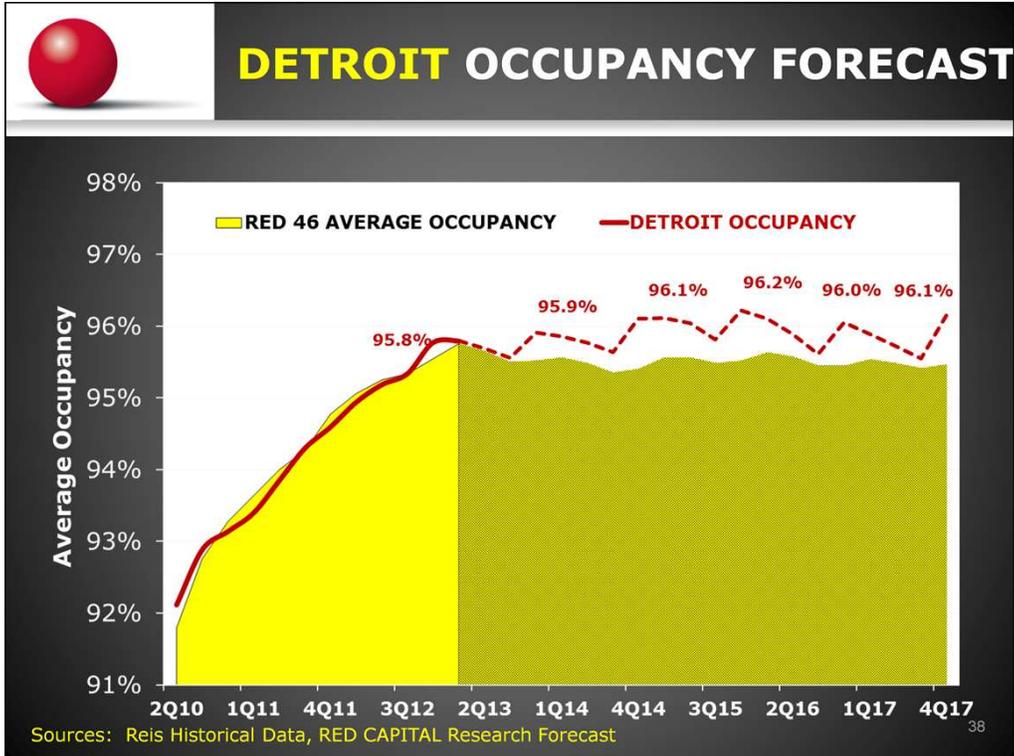
The model sees a mirror image of this pattern in 2015 and 2016, but this could be more of a question of mathematics rather than a meaningful forecast of trend.



DETROIT JOB FORECAST



Anyway, job growth is likely to be a bit volatile over the next few years, tied to the cyclical pattern of vehicle demand. We see about 3,600 jobs added this year, followed by a couple of relatively strong years in the 22,000 to 26,000-job area.

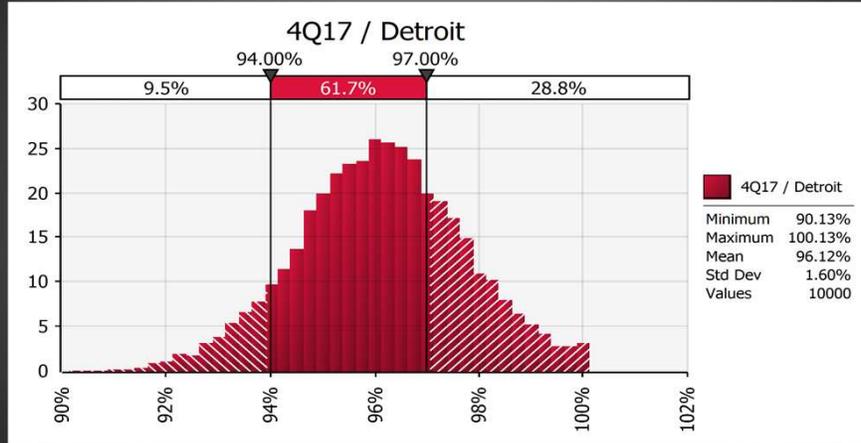


Here's the occupancy forecast. Addressing supply, we do expect deliveries to rise from the very low base that was recorded over the past decade, when total inventory increased by only about 1%. Over the next five years, we should see stock growth picking up to about 1,000-units per year, translating to a 0.5% growth rate

But we expect absorption to keep pace with supply. Consequently, we're likely to see a moderate improvement in occupancy in Detroit, going from the current 95.8% levels to the low 96% range by 2015, holding steady there for the duration of the forecast period.



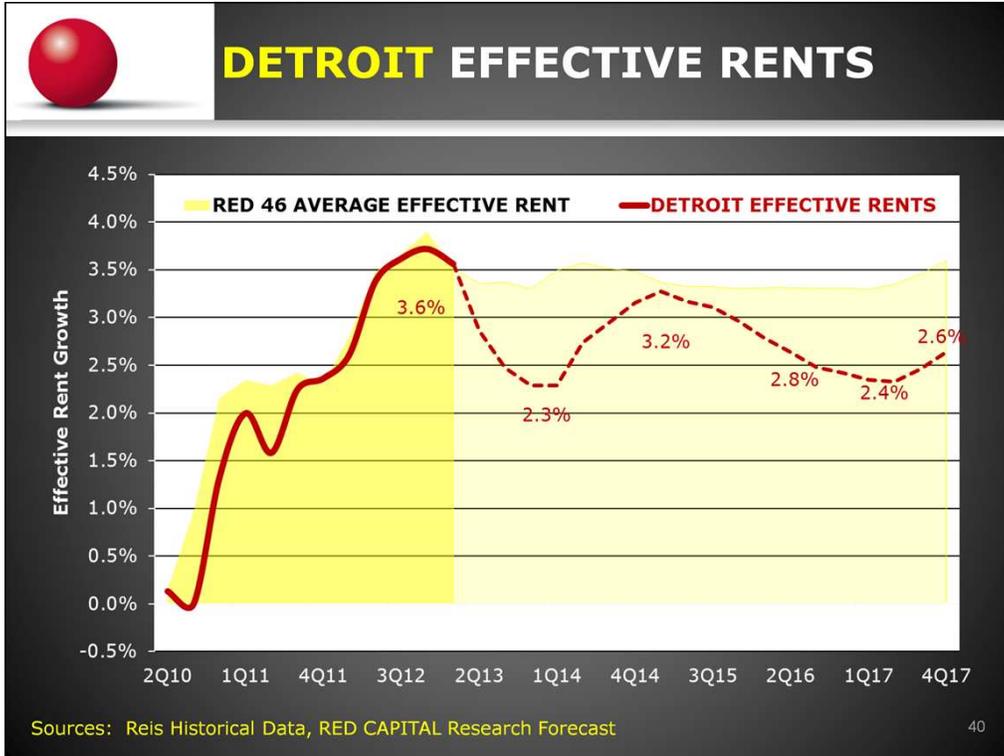
4Q17 AVERAGE OCCUPANCY DISTRIBUTION



Probability of Occupancy => 94% is 91.5%.
Probability of Occupancy => 97% is 28.8%

39

The occupancy distribution is promising, characterized by a 96.1% mean year-end 2017 outcome and 90% confidence that occupancy will be 94% or higher. There also is some upside potential should job growth be on the high side of the range, with a 25% probability of occupancy above 97% in 2017 .

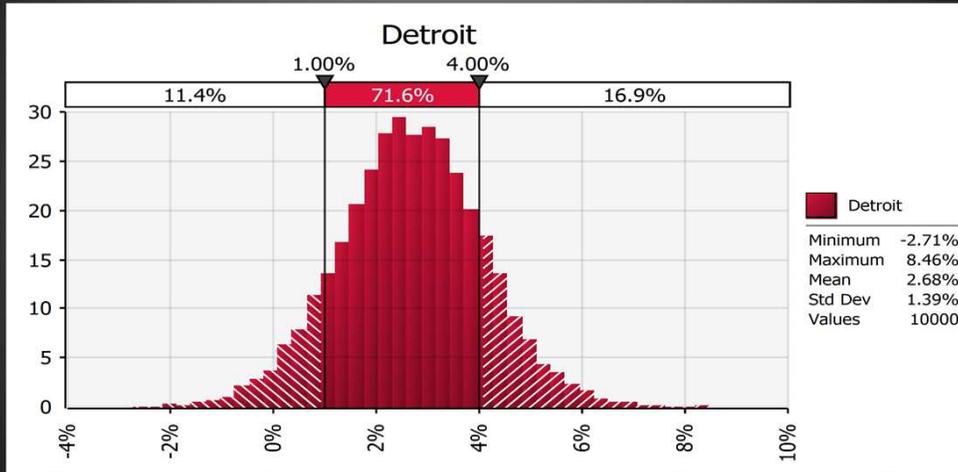


The rent trend and forecast look a lot like Columbus, with the cycle peak reached in the fall 2012, in this case about 3.6%, followed by weakening over the winter. We expect the weakness to persist throughout this year until such time as meaningful job growth returns.

Rent growth will be highly income and employment sensitive, with annual gains ranging from about 2.4% to 3.0% for the forecast period.



5-YR COMPOUND ANNUAL RENT GROWTH DISTRIBUTION



Probability of CAGR Rent $\leq 1\%$ is 11.4%.
Probability of CAGR Rent $\geq 4\%$ is 16.9%

41

Distribution wise, we have a very low volatility situation, with nearly 72% of outcomes in a range between plus or minus 150 bps from the mean. But we do have fairly fat tails with some measurable downside. The model indicates that there is about a 3% probability of negative rent growth, which is the only market among those we will review today with a negative rent incidence about 1% save for Minneapolis.



DETROIT EXPECTED 5-YR TOTAL RETURNS AND RETURN DISTRIBUTION

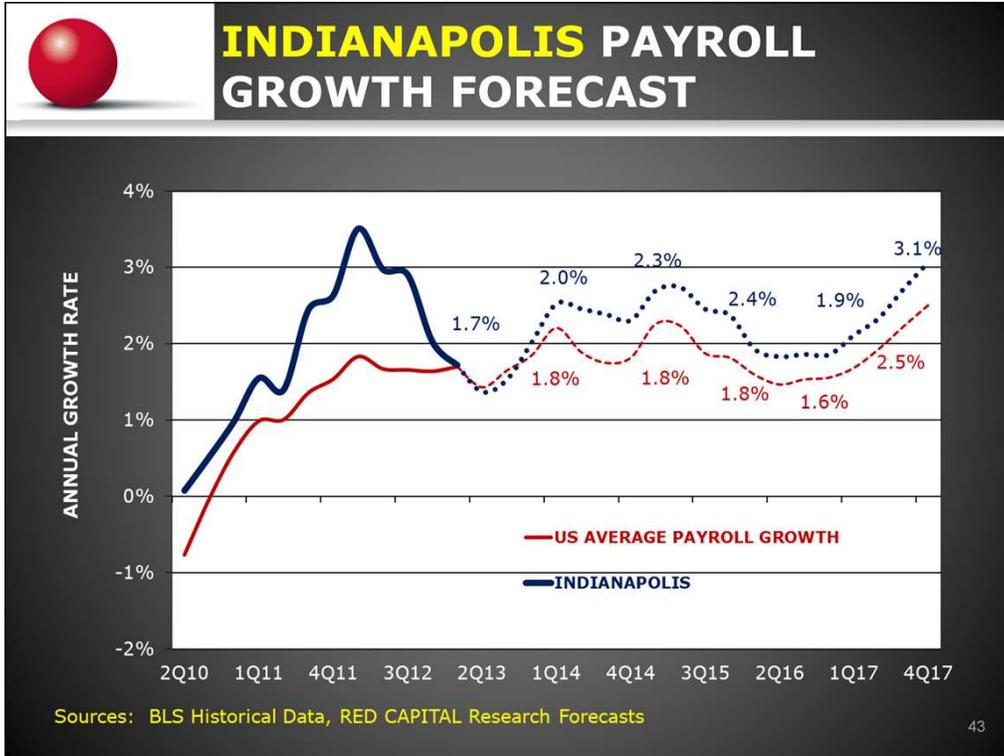
| GENERIC CLASS-B/B+ ASSET ASSUMPTIONS | DATA |
|---|------------|
| Going-in Cap Rate | 7.25% |
| Exit Cap Rate | 7.9% |
| Purchase Price | \$62,999 |
| Sales Price | \$68,997 |
| Expected Total Return | 9.0% (#8) |
| Risk-adjusted Return Index (μ IRR / δ_2 IRR _{1-10,000}) | 4.11 (#22) |

TOTAL RETURN DISTRIBUTION

| PROBABILITY OF ACHIEVING STATED IRR OR BETTER | 90% | 70% | 50% | 30% | 10% |
|---|------|------|------|-------|-------|
| DETROIT | 6.3% | 8.1% | 9.2% | 10.2% | 11.7% |

42

Let's turn to the investment page. As a cap rate, we think 7.25% is a good indication of value. That's tied with Cleveland for the highest level among the 46 markets we model for investment purposes. With an exist cap rate of 7.9%, we estimate an expected total return of 9.0%, eighth highest in the R46 and second highest among our group of six Midwest markets. The fat-tailed rent distribution and downside risks hold the RAI to 22nd rank, which is pretty good but still the second lowest among our Midwest six.



Okay, let's move west to Indianapolis. Indy has been the best economic performer in the region during the past couple of years, with a similar growth pattern to Detroit and Columbus, but hindered by a drop off over the past nine months.

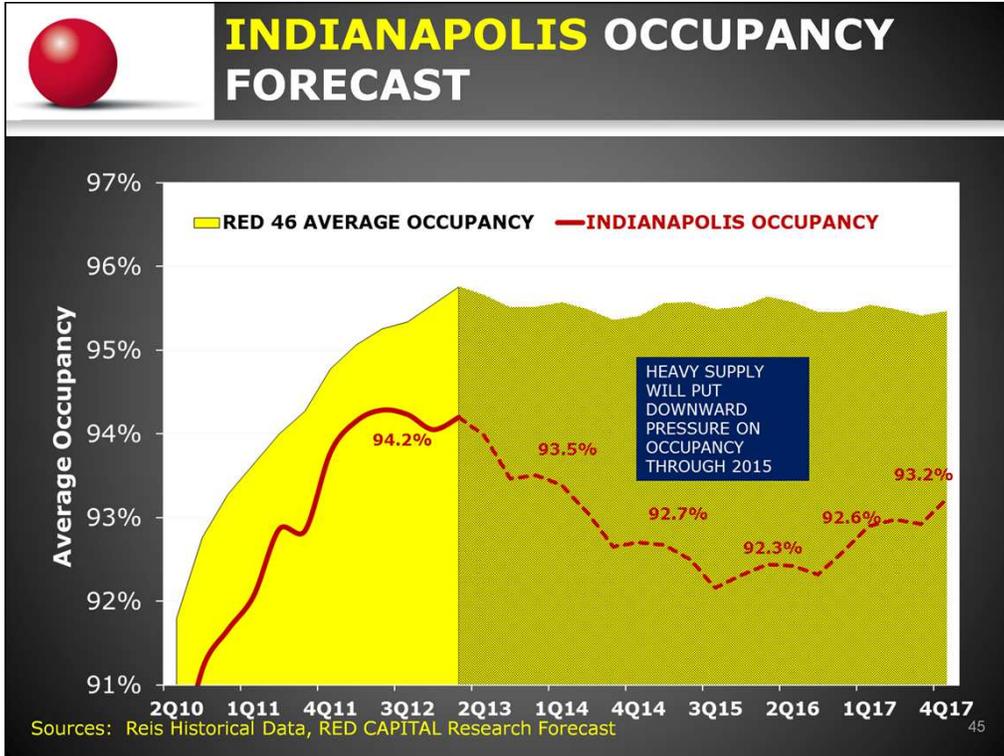
By way of forecast, we again can see a similarity to Columbus, with growth consistently above the national average. Holding in a 1.9% to 2.5% range.



INDIANAPOLIS JOB FORECAST



By way of numbers, we project job gains of about 15,000 this year, followed by larger increases during for the forecast out-years, falling within an 18,000 to 26,000-job range.

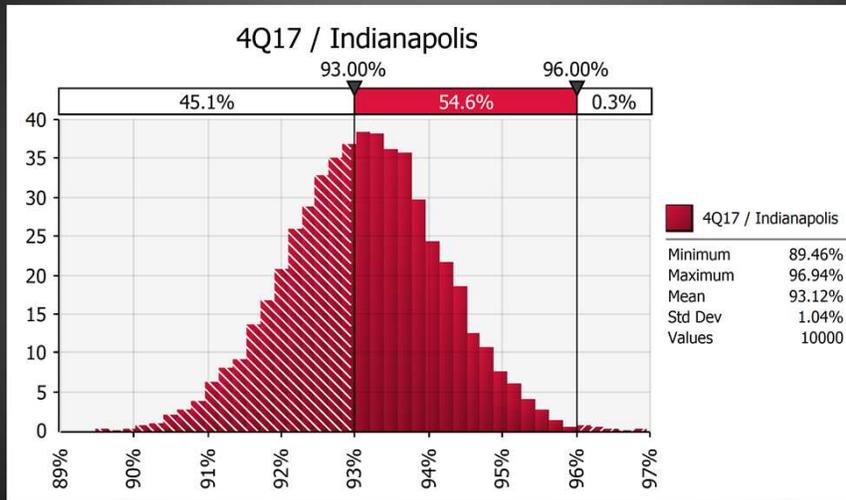


The occupancy forecast isn't quite as rosy, however, as a combination of heavy supply and acute competition from single family housing is expected to result in overall vacancy increases.

The forecast calls for developers to bring nearly 7,000 new units to market over the next three years, while tenants are projected to absorb about 5,000. Consequently, occupancy may fall about 200 bps by the end of 2016 before recovering some lost ground in the out years when supply declines and stronger job growth reignites demand.



4Q17 AVERAGE OCCUPANCY DISTRIBUTION



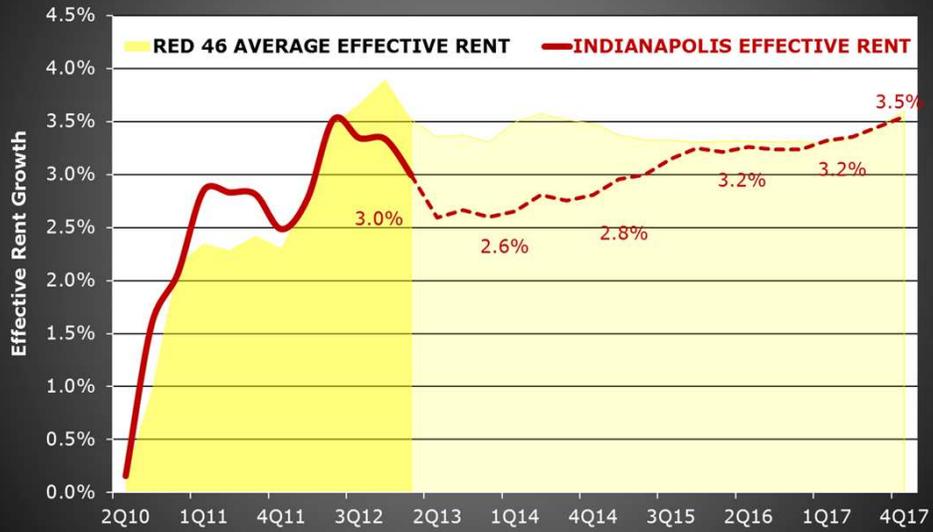
Probability of Occupancy => 93% is 54.9%.
Probability of Occupancy => 96% is 0.3%

46

By way of probability, the mean 4Q17 occupancy rate is 93.1%, with a 45.1% probability of occupancy of 94% or lower and only a 0.3% probability of occupancy above 96%.



INDIANAPOLIS EFFECTIVE RENTS



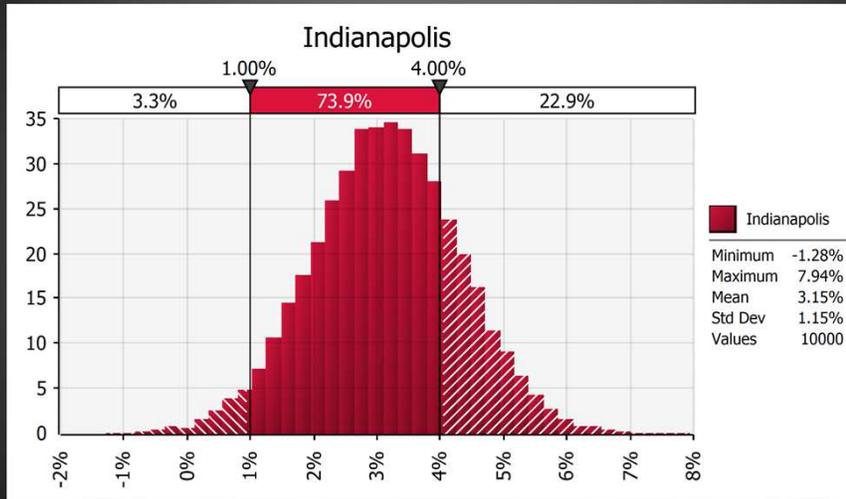
Sources: Reis Historical Data, RED CAPITAL Research Forecast

47

Indy rent growth was not quite as strong as Columbus or Detroit, but it too experienced slow rent trends during the summer and fall of 2012. We expect trends to bottom at about 2.6% this year before climbing steadily throughout the forecast period, boosted by faster income and occupied stock growth.



4Q17 EFFECTIVE RENT GROWTH DISTRIBUTION



Probability of CAGR Rent $\leq 1\%$ is 3.3%.
Probability of CAGR Rent $\geq 4\%$ is 22.9%

48

The mean five-year compound rent growth metric is 3.15%, nearly equal to Chicago for the regional. The downside risk is appealing as the risk of negative rent growth is only 0.3%, and the upside potential isn't bad either, with a 22.9% probability of achieving 4% compound rent growth or greater.



INDIANAPOLIS EXPECTED 5-YR TOTAL RETURNS AND RETURN DISTRIBUTION

| GENERIC CLASS-B/B+ ASSET ASSUMPTIONS | DATA |
|--|------------|
| Going-in Cap Rate | 6.5% |
| Exit Cap Rate | 7.0% |
| Purchase Price | \$52,456 |
| Sales Price | \$59,967 |
| Expected Total Return | 8.9% (#11) |
| Risk-adjusted Return Index (μ IRR / δ_2 IRR) | 5.76 (#9) |

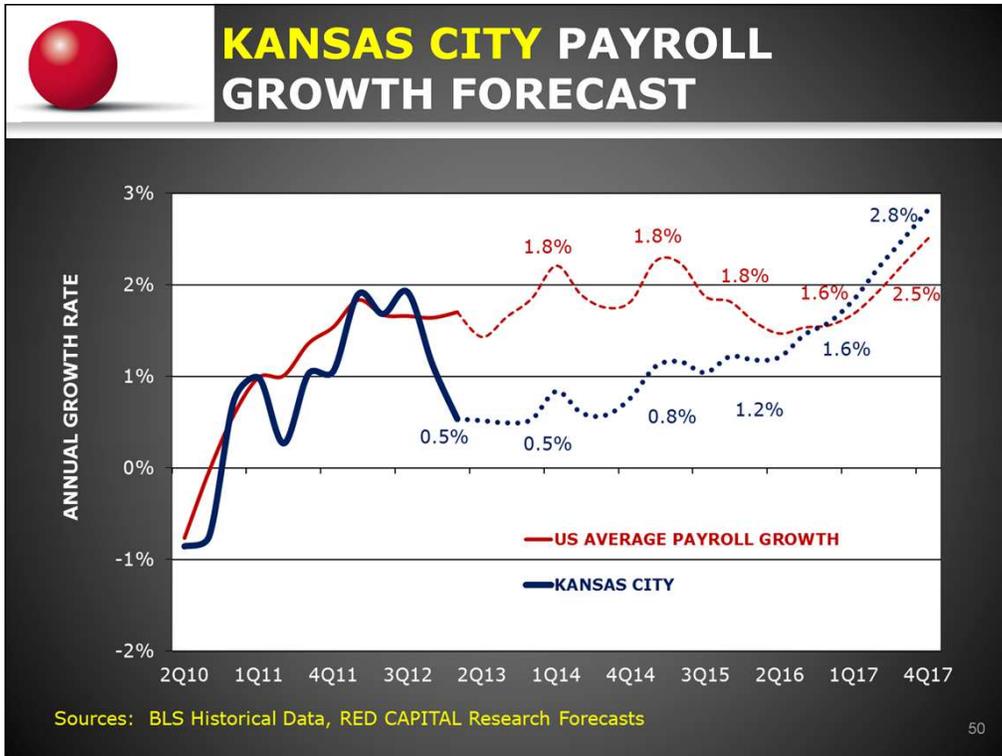
TOTAL RETURN DISTRIBUTION

| PROBABILITY OF ACHIEVING STATED IRR OR BETTER | 90% | 70% | 50% | 30% | 10% |
|---|------|------|------|------|-------|
| INDIANAPOLIS | 6.6% | 7.8% | 8.6% | 9.4% | 10.5% |

49

Unfortunately, cap rates are lower in Indianapolis than Detroit or Columbus. Our observation is that investment quality assets trade at about 6.5%. Using this purchase cap rate and a model derived 7.0% exit, we estimate that investors will achieve a 8.9% total return, ranked 11th among the R46 and third among the Midwest group. The risk-adjusted index is excellent at 5.76, 9th in the R46 and best among the Midwest group, due to the low downside risk on the rent distribution.

This downside protection is manifested in the 90% probability return distribution box which shows a 6.6% downside risk scenario, which compares very well to conventional funding costs in the mid-4% range currently.

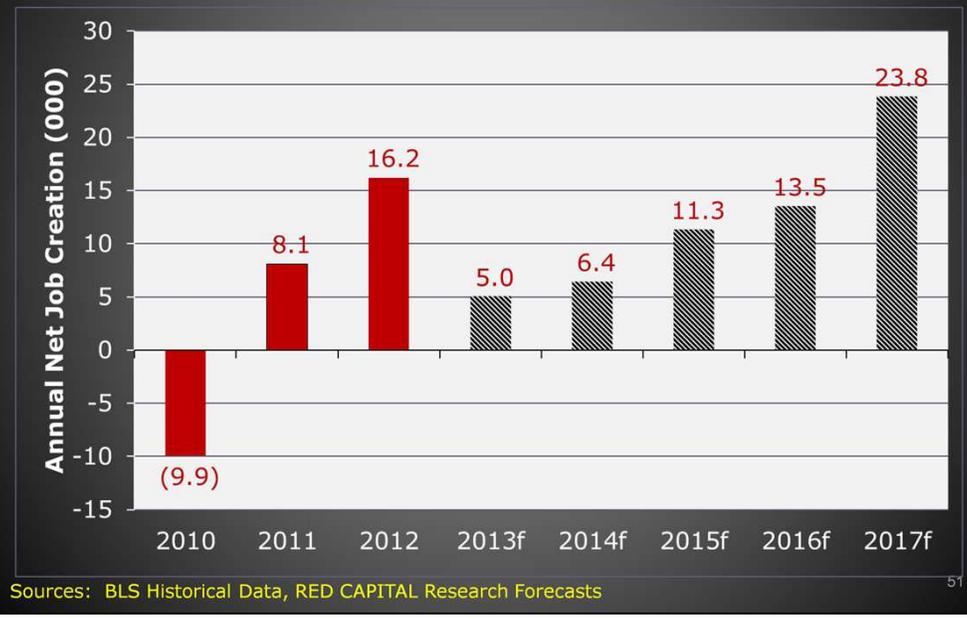


Let's veer to Kansas City now. In the payroll path we see the same downward spike that was apparent in the other secondary markets we've encountered. In this case, unfortunately, it was not preceded by a period of significantly above average growth. Consequently, current employment conditions in the K.C. area are decidedly on the sluggish side, with gains averaging 0.5% during the first quarter.

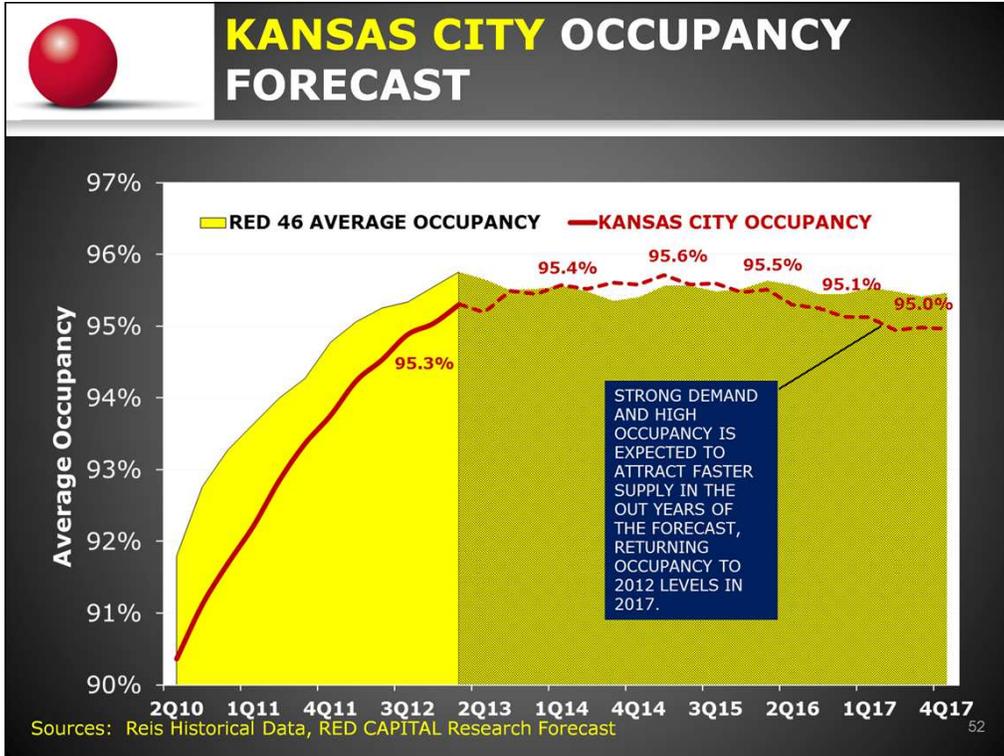
And, as you can see, our forecast anticipates that job trends will remain that way for the next three years before they return to a pace comparable or superior to the national average.



KANSAS CITY JOB FORECAST



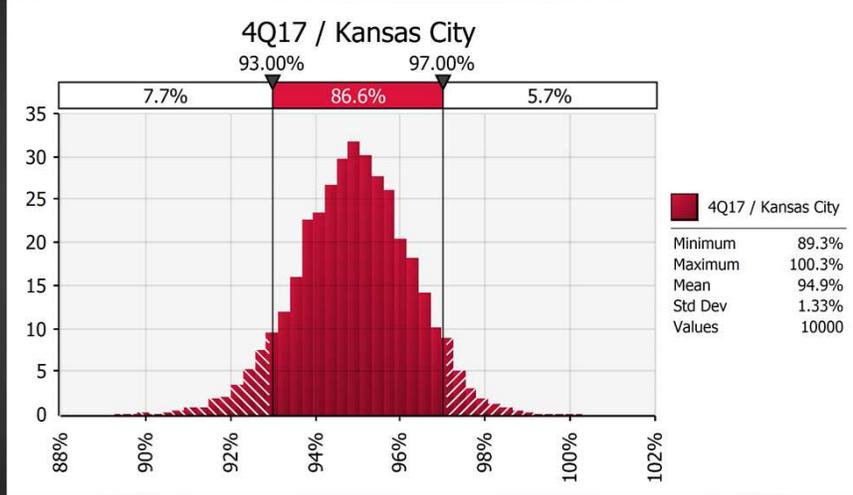
In terms of absolute job growth, gains should range from the 5,000-job to 13,000 job level through 2016 before a possible break out in 2017.



Occupancy average 95.3% in the first quarter and we expect its to hover in that range, plus or minus 20 bps, through 2017. Our model foresees a moderate acceleration of the supply deliveries in the out years of the forecast, however, possibly putting some downward pressure on occupancy at that time.



4Q17 AVERAGE OCCUPANCY DISTRIBUTION



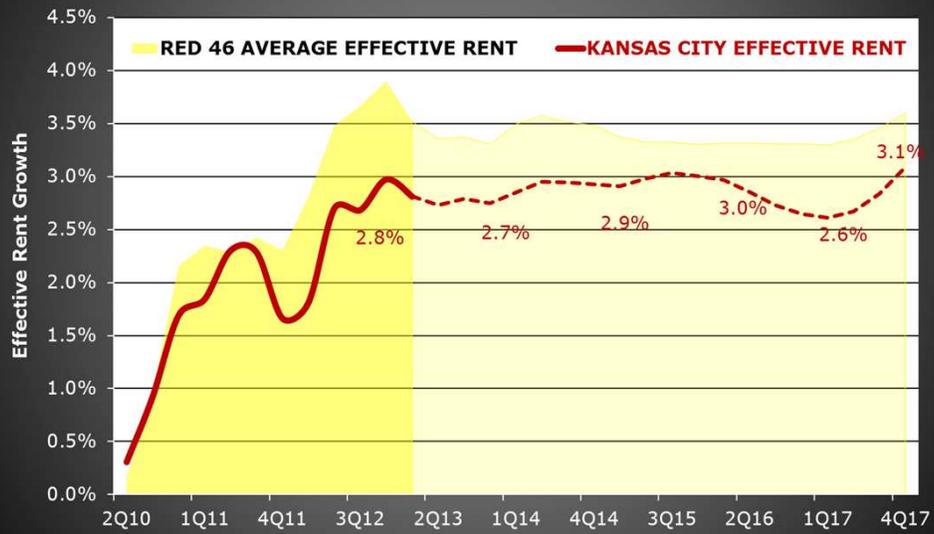
Probability of Occupancy \Rightarrow 93% is 92.3%
Probability of Occupancy \Rightarrow 97% is 5.7%

53

The probability distribution is fairly neutral, with 7 out of 8 iterations producing occupancy levels within a +/- 200 bps range from the 94.9% anticipated 4Q17 mean.



KANSAS CITY EFFECTIVE RENTS



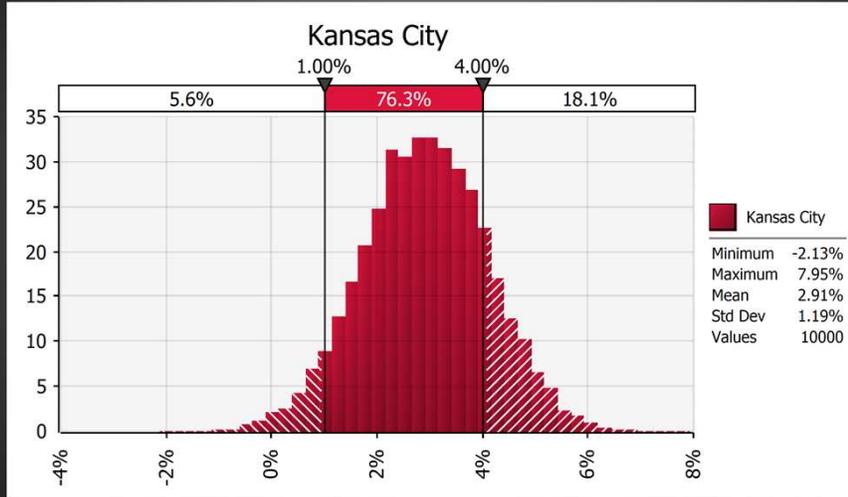
Sources: Reis Historical Data, RED CAPITAL Research Forecast

54

Rents never reached the heights of our other markets last year, holding steady in mid-to high-2% area for the past five quarters. The model expects that pattern to hold for the five years.



5-YR COMPOUND ANNUAL RENT GROWTH DISTRIBUTION



Probability of CAGR Rent $\leq 1\%$ is 5.6%.
Probability of CARG Rent $\geq 4\%$ is 18.1%

55

The rent distribution is fairly narrow also, as nearly 80% of five-year compound annual rent observations fall between 1% and 4%



KANSAS CITY EXPECTED 5-YR TOTAL RETURNS AND RETURN DISTRIBUTION

| GENERIC CLASS-B/B+ ASSET ASSUMPTIONS | DATA |
|---|------------|
| Going-in Cap Rate | 6.5% |
| Exit Cap Rate | 7.1% |
| Purchase Price | \$65,027 |
| Sales Price | \$71,553 |
| Expected Total Return | 8.3% (#20) |
| Risk-adjusted Return Index (μ IRR / δ_2 IRR _{1-10,000}) | 4.74 (#14) |

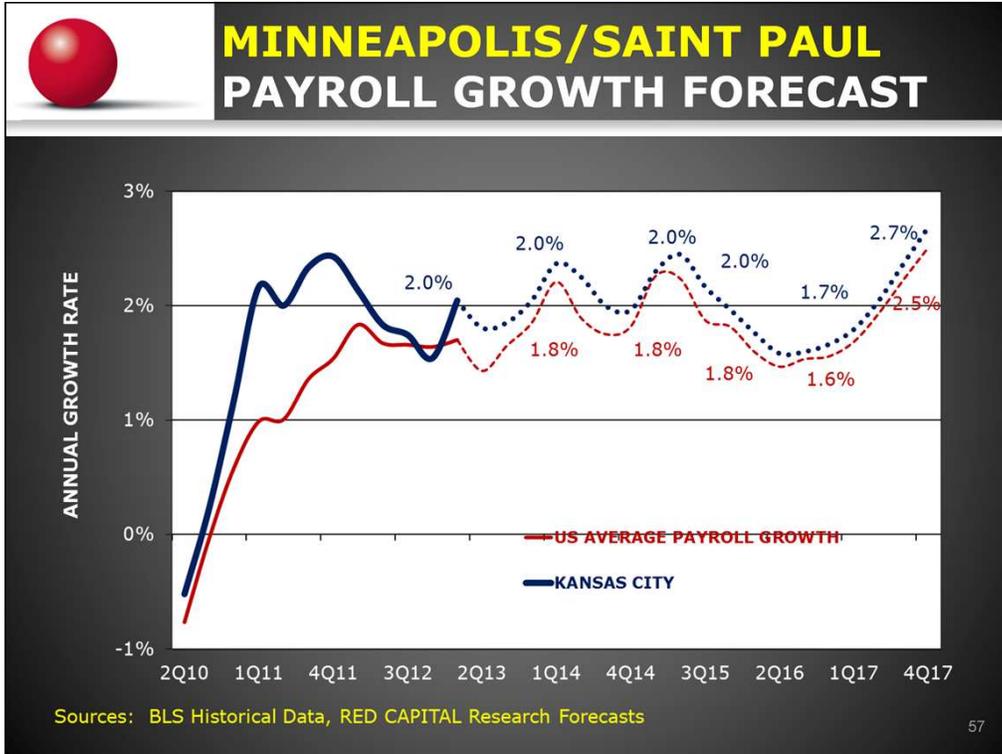
TOTAL RETURN DISTRIBUTION

| PROBABILITY OF ACHIEVING STATED IRR OR BETTER | 90% | 70% | 50% | 30% | 10% |
|---|------|------|------|------|-------|
| KANSAS CITY | 5.9% | 7.3% | 8.3% | 9.2% | 10.4% |

56

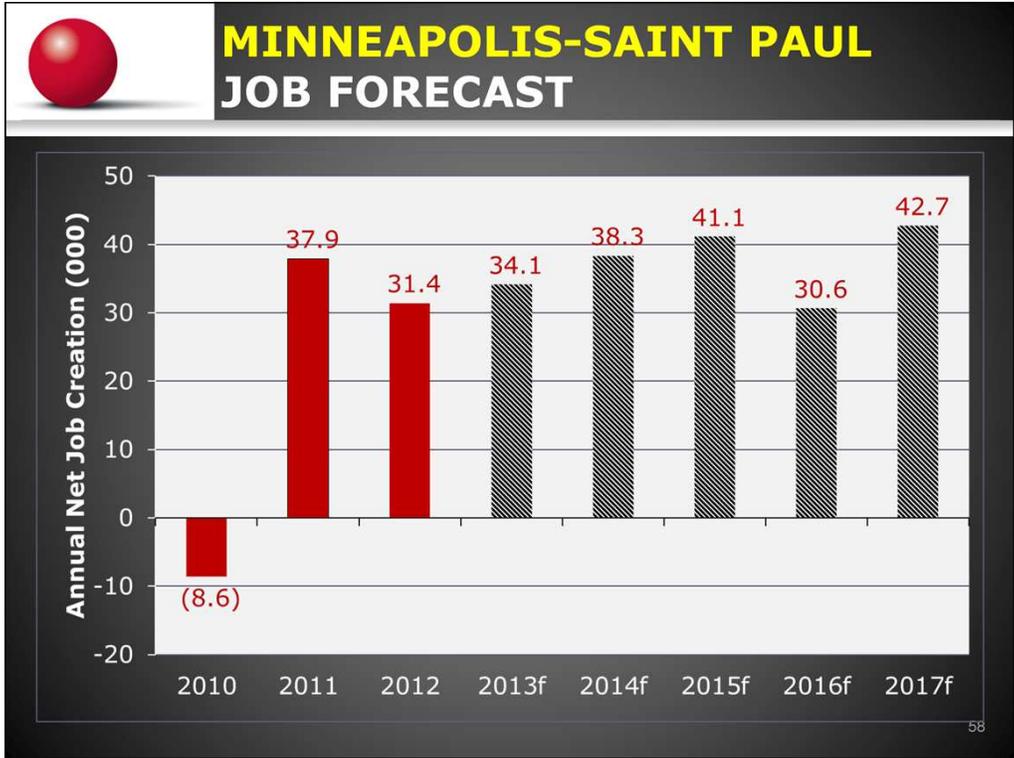
While upside potential in K.C. is a bit weaker than the other secondary markets in this group, cap rates remain fairly low, supported by a strong bid from local and regional investors. We believe that a 6.5% rate also is appropriate in this case.

Using a 7.1% exit cap rate, we estimate that K.C. assets will deliver an expected 8.3% annual return, ranked #20 in the U.S. rankings and #5 among the Midwest group. The narrow rent distribution helps the risk-adjusted return, which ranks 14th overall and 4th among the Midwest group.

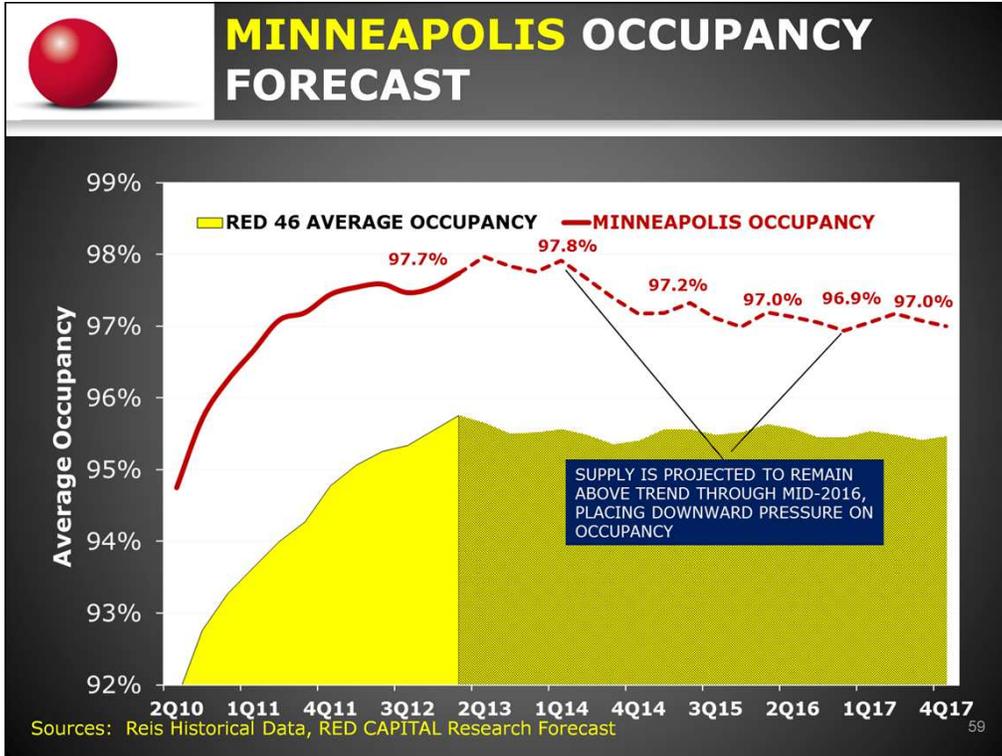


Finally, to Minneapolis / Saint Paul. The Twin Cities are enjoying excellent economic and employment growth trends, trailing only larger Chicago with respect to absolute jobs added and rivaling Indianapolis with regard to the pace of growth. While somewhat slower than before, job growth continued at a 2% annual rate in 1Q13, fastest among the Midwest group.

The forecast looks a lot like our other two Midwest economic dynamos, Columbus and Indianapolis. That is, we continue to expect MSP to outperform the U.S. average by 10 or 20 basis points, with gains ranging from near 2% to about 2.3%.



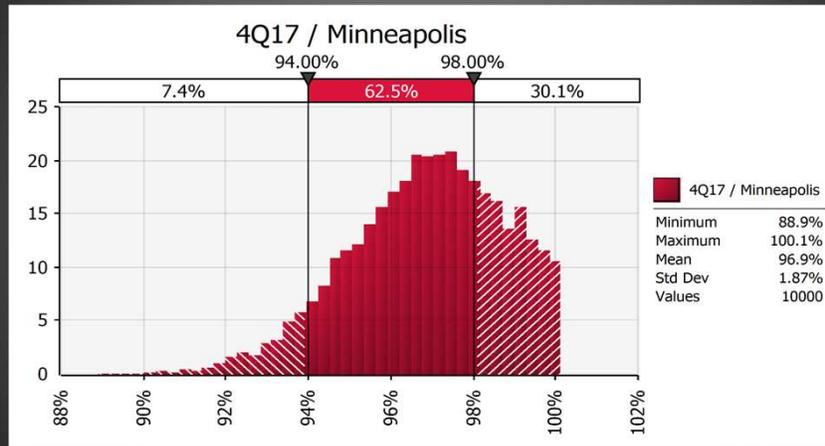
Here is the forecast by absolute number of jobs to be created.



Unfortunately, Minneapolis will experience some significant supply pressures, also along the lines of Columbus and Indianapolis. Absorption won't keep pace, but occupancies will remain the highest in the country. We expect metro occupancy to peak at about 97.8% later this year before gradually declining under supply pressure to about 97% by the end of the forecast period.



4Q17 AVERAGE OCCUPANCY DISTRIBUTION

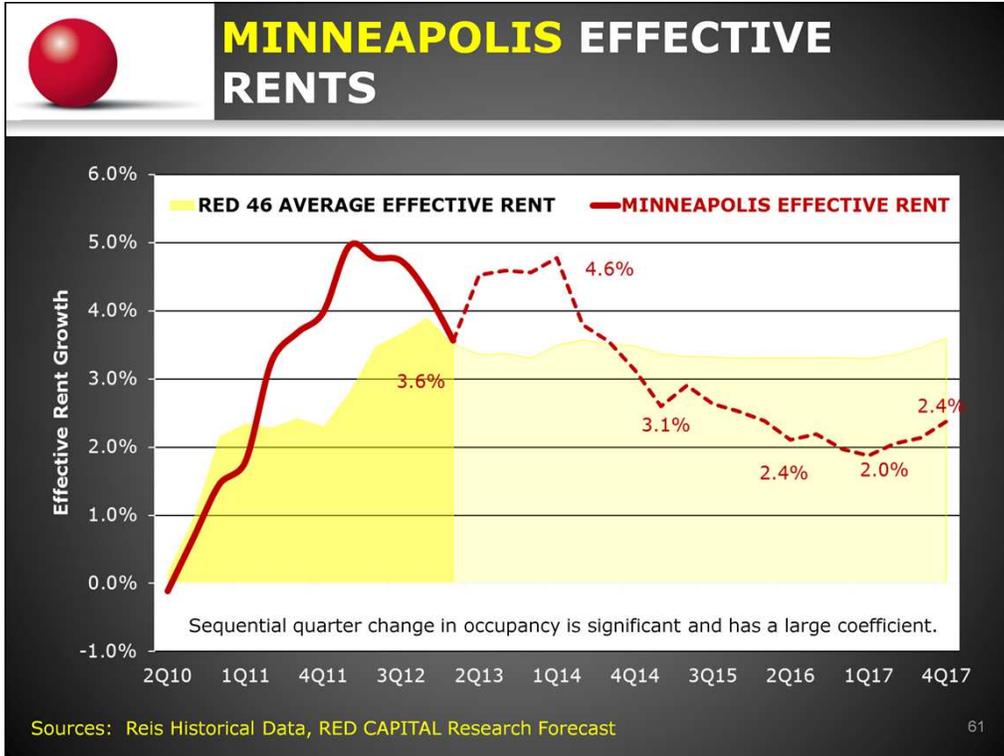


Probability of Occupancy => 94% is 92.6%
Probability of Occupancy => 98% is 30.1%

60

By way of distribution, we see a very left-tailed histogram because of the upside boundary created by 100%. There's actual about a 2% probability of achieving 100% occupancy in 2017, and a 14% probability of hitting 99% or above.

As for downside risk, we believe there is just a 7.4% likelihood that occupancy would fall below 94% in 2017.

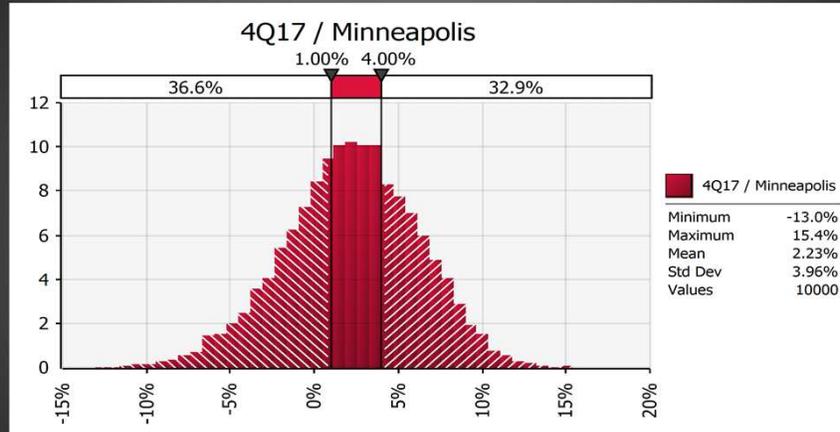


As for rents, Minneapolis saw the strongest gains in the region, indeed in any market in the country, during 2011- 2012, but it too experienced substantial deceleration during the last three or four quarters. The latest print was 3.6% in 1Q13, tying Detroit for the fastest growth in our group.

Our models tell us the recent deceleration was a head fake. The income and payroll growth rates remain very strong and the market is exceptionally tight. Consequently, we expect rent trends to rebound to above 4% for the duration of 2013 before settling down to regional average levels for the remainder of the forecast.



5-YR COMPOUND ANNUAL RENT GROWTH DISTRIBUTION



Mean Compound Annual Growth Rate: 2.23%
Probability of CAGR = <1% is 36.6%.
Probability of CAGR = >4% is 32.9%

62

As for rent distribution we see a comparatively wide bell curve here with fat tails. Indeed, only about one-third of outcomes show a compound average growth rate between 1% and 4%.

The downside scenario should concern investors. Our Monte Carlo run found that 17.7% of paths produced negative rent results over five years. That compares to next riskiest metro we've looked at, Indianapolis, which produced a 3% negative rent probability.



MINNEAPOLIS EXPECTED 5-YR TOTAL RETURNS AND RETURN DISTRIBUTION

| GENERIC CLASS-B/B+ ASSET ASSUMPTIONS | DATA |
|--|------------|
| Going-in Cap Rate | 5.6% |
| Exit Cap Rate | 6.4% |
| Purchase Price | \$93,694 |
| Sales Price | \$98,912 |
| Expected Total Return | 6.7% (#43) |
| Risk-adjusted Return Index ($\mu\text{IRR} / \delta_{2 \text{ IRR}(1-10000)}$) | 1.28 (#45) |

TOTAL RETURN DISTRIBUTION

| PROBABILITY OF ACHIEVING STATED IRR OR BETTER | 90% | 70% | 50% | 30% | 10% |
|---|------|------|------|------|-------|
| MINNEAPOLIS | 0.0% | 4.5% | 7.2% | 9.9% | 13.2% |

63

To make matters worse, cap rates in Minneapolis are the lowest in the group at 5.6%. With a plus +80 bps exit, we estimate a 6.7% total return expectation, 43rd among the R46 and last among our Midwest group.

The high rent volatility doesn't help the risk-adjusted index, as we come in the #45th highest in the R46.

And, we see a 0% return figure in the 90% probability bucket, which is better than only two markets in the RED 46: Raleigh and New York, which fall into negative territory in this bucket.



MIDWEST RETURN SUMMARY

METRO RANKINGS

| METRO | TOTAL RETURN | PROBABILITY DISRIBUTION | | | | |
|--------------|--------------|-------------------------|------|------|-------|-------|
| | | 90% | 70% | 50% | 30% | 10% |
| Columbus | 9.4% | 6.8% | 8.4% | 9.3% | 10.1% | 11.4% |
| Detroit | 9.0% | 6.2% | 8.1% | 9.2% | 10.2% | 11.7% |
| Indianapolis | 8.9% | 6.7% | 7.8% | 8.6% | 9.4% | 10.4% |
| Chicago | 8.4% | 5.8% | 7.2% | 8.1% | 9.0% | 10.3% |
| Kansas City | 8.3% | 5.9% | 7.3% | 8.3% | 9.1% | 10.4% |
| Minneapolis | 6.7% | 0.0% | 4.5% | 7.2% | 9.9% | 13.2% |
| RED 46 Avg. | 7.9% | 4.3% | 6.4% | 7.7% | 8.9% | 10.5% |

So to wrap up, here is the Midwest HUB office League Table. Columbus takes the competition by virtue of high cap rates and consistently good, if less than great, rent growth. Indianapolis edges it out on the basis of risk-adjusted returns by virtue of its constructive and stable rent distribution, while Chicago earns its reputation for the best investment market in the region as its tremendous liquidity and depth compensate for a moderate yield discount to its smaller regional peers.



THANK YOU!

LET'S MOVE ON TO Q&A

