The Pinkard Fund

Investor Update October 2014

Market Update For Q3 2014

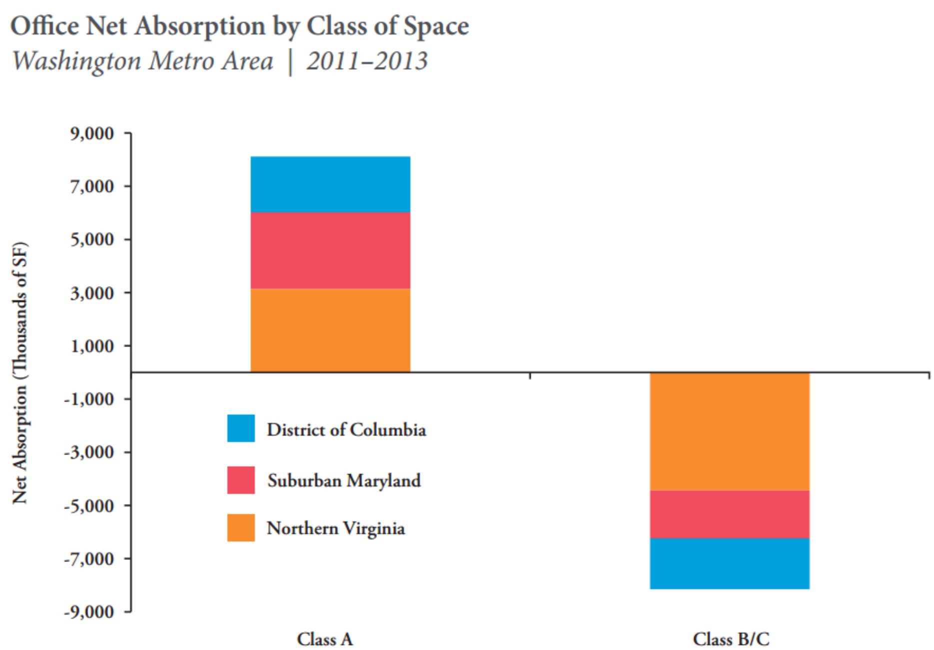
If you read these quarterly reports, you know that we look for anomalies in the market and try to figure out how we can invest to take advantage of them. Often these opportunities come when the experts are predicting a direction for the market that differs from what we are seeing on the ground. The trick is to recognize whether what we are seeing on a day to day basis is anecdotal or a broader trend, and to remain humble in our views without giving up the early mover advantage. Of course, I am preaching to myself here.

There are a couple such anomalies that we are currently pondering. You may have read recently that the growth rate of the Washington DC regional economy has been trailing the nation over the last two years. This is in large measure due to the reduction of both federal and government contractor jobs in the wake of Sequestration. Job growth has continued to be positive, but almost all of the growth has been in lower paying jobs, restaurant workers, hospitality, and healthcare to name a few. Regional economists tell us that we need the higher paying jobs to compete as a region. Here is what doesn't make sense. The region still has a shortage of skilled workers. Talk to employers and they will tell you that they can't find qualified workers with the right educational backgrounds. Websites of technology companies in the region have multiple job openings that they can't fill. In the aggregate we are not growing the number of Professional and Business Services jobs, but if you happen to be in that class you have a lot of choices.

The second oddity in today's market is the robust absorption of apartment units over the past 12 months, over 13,000 according to Delta Associates. An average year would see 6000 units absorbed. At the same time housing prices continue to rise, and migration to the region is robust. We are not increasing our high end employment base, but people are flocking to the region, renting expensive apartments and forcing housing prices up. It doesn't add up.

One view is that the local economy sustained some big hits from 2012-2014, and the worst is behind us. Talented workers from around the world continue to see the region as a great place to find challenging work and an exciting place to live. When the federal footprint finds its appropriate size, look for accelerating growth.

One of the asset classes that we are pursuing is suburban office, one of the most embattled segments of the market. This is a market sector that is still reeling from the reduced government footprint. As we peel back the layers of the onion, we see that 70% of the suburban office inventory is 20 years old or older, and that absorption of space has taken place in the newer "A" buildings at the expense of the older inventory.



Source: Delta Associates; January 2014.

A flight to quality is taking place. This generally happens in soft markets as tenants in "B" space move to the better buildings which they could not afford in a more robust market. We are focusing on those buildings that can effectively compete in a soft market. These are buildings that have column free space, high ceilings, and modern HVAC systems, and which can be purchased at a steep discount to replacement cost.

We also are looking to create value around rebounding urban neighborhoods. Much of the opportunity centers on creating the appropriate mix of uses in concert with multiple transportation options. We view this as more of a market neutral strategy, to borrow a hedge fund term, in that it is less connected to the overall growth of the economy. The transformation of many of these very exciting areas of our region is part of a long term trend that reflects the changing patterns in the way people live, work and play.