

The Pinkard Fund

Investor Update

October 2015

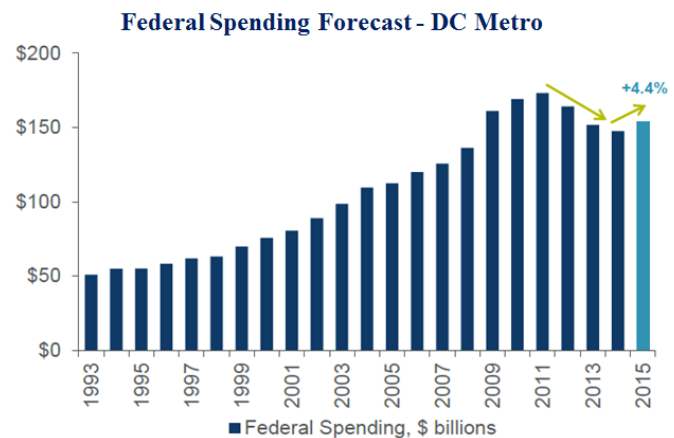
Market Update

For Q3 2015

Earlier this month I attended the Urban Land Institute meeting in San Francisco, and was awed by the economic vitality, dare I say irrational exuberance, of the real estate market there. Apartment rents have risen by double digit percentages for three years in a row, downtown land prices have nearly doubled in the last two years. Tech workers (millennials for the most part) have embraced the urban lifestyle which we have seen in Washington, but the names are completely different. Zoosk, a dating site, NerdWallet, an individual finance app and Zendesk, a customer service support app are some of the tenants who have recently taken large blocks of space. These may be fine businesses, but many of these and other companies like them are betting on the IPO or Google/Apple buyout monetization plan. What happens when that market becomes less frothy? If we were operating in that market, I wonder where we would find assets that presented real value creation possibilities.

Fortunately, the Washington market is in a different part of the cycle. We have discussed in previous reports whether the office market in the Washington region has bottomed. The answer is generally yes, but specific submarkets and building types are experiencing the recovery differently. Across the board concessions to tenants in the form of tenant improvement allowances and free rent have remained elevated, but rental rates in certain tightening submarkets have begun to rise. For example the building that we purchased in the Reston/Herndon sub-market about a year ago is achieving rents that are higher than we projected. This is not San Francisco, but we like being on the front end of the recovery.

The employment picture in the region has also been a cause for optimism. First of all, federal employment which fell for several years in a row has turned positive over the last twelve months, and you can see the reason why in the chart to the right. But federal employment growth is not the only story. Strong growth in the private sector, led by the education and health sectors



combined with the growth in federal jobs has created the most year over year jobs for any period since the Great Recession.

However, as the unemployment rate falls, the nation and the region will face a growing shortage of technically skilled workers. At the ULI meeting, Berkeley economist Ken Rosen pointed out that the number of unfilled jobs nationally has risen dramatically over the last year. He posited that the inability to find skilled workers will be a major factor in dampening GDP growth going forward. Regions will once again be competing for skilled younger workers.

Fortunately, the Washington region has the highest percentage of millennials of any city in the country and is a region that has always attracted educated immigrants. Not only do these two groups help to drive economic growth in the region, but their preferences are also shaping the real estate landscape from the apartments in which they live to the way in which they use office space as well as their food and entertainment choices.