The Pinkard Fund

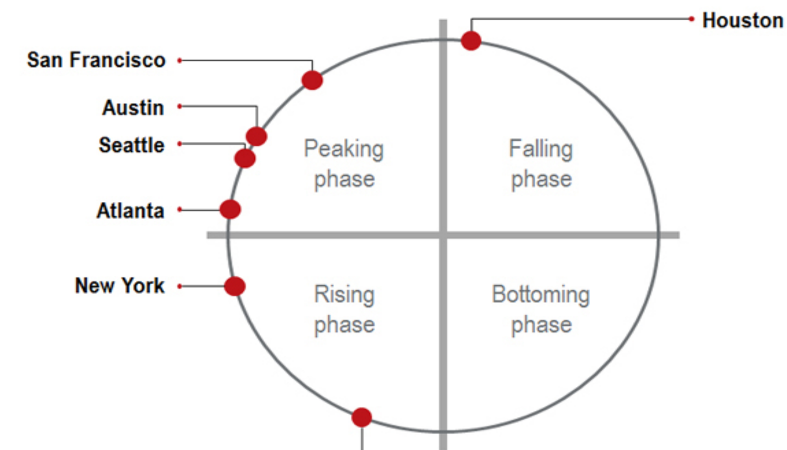
Investor Update — July 2016

Market Update — For Q2 2016

In the midst of this political season of surprises our attention understandably is on the short term as our country is presented with two starkly different candidates with radically different views of our path forward. I recently attended a political event where political savant Charlie Cook of The Cook Political Report was a guest speaker. Charlie has a legendary record of predicting elections, but at this event he suggested, albeit tongue in cheek, that we not listen to him since every projection that he has made about Donald Trump has proven to be wrong. Fortunately, the current real estate investment tea leaves seem easier to read than the political ones. Looking back on past versions of this market update, we continue to make similar comments about trends as they play out over months and years. The direction seems fairly certain, the timing less so.

In this report we will give an update on the office and apartment markets in the Washington region and make some observations about the real estate debt markets which may provide some headwinds to real estate activity going forward.

On the office leasing side of the equation we have been discussing for several quarters that the market has bottomed and is beginning its recovery. In our portfolio we have seen a substantial uptick in tour activity and leases signed in the past 12 months. The chart below from JLL illustrates where they view the region relative to the rest of the country. The last 18 month period has seen robust job growth, particularly in the higher paying office-using Professional Services jobs. Job growth is a leading indicator of office absorption which bodes well for the next few years. In the District of Columbia new construction is starting to pick up to meet the



growing demand with 3.5 million square feet of new space under construction. Look for the vacancy rate in the District to go up in the short term. The Maryland and Northern Virginia suburbs are recovering more slowly despite the strong job growth, particularly in Northern Virginia. The absorption of shadow space (space under lease, but not fully occupied) is one reason for the slower than expected recovery. The other dynamic is that this has proven to be a market of winners and losers – where high quality buildings, proximate to demand drivers and transportation access have outperformed the competition.

The apartment story continues the interplay of record supply and record demand. According to Newmark Grubb Knight Frank, the supply of institutional grade apartments has increased by 28% over the last five years. The market appears balanced at this elevated level with rents rising modestly. While market followers have been predicting over supply for several years, trends in the debt markets may dampen supply going forward, leading to a balanced market.

Basel III regulations were adopted in January 2015 and have directly impacted commercial real estate in numerous ways. Perhaps the biggest impact has been the introduction of higher risk weighting for High Volatility Commercial Real Estate (HVCRE) loans, which apply to certain acquisition, development, or construction loans. These loans are now assigned a risk rating of 150%, whereas previously some of these loans were charged a risk rating of 50% and others 100%. As a result, lenders are required to reserve significantly more capital for riskier loans like construction loans, forcing spreads to widen and banks to place greater emphasis on fee income and deposit relationships. There is also a greater emphasis on the part of the banks towards the origination of less risky term loans on existing properties. These loans have a lower reserve requirement. The larger concern is that the effort to regulate the large banks is presenting liquidity challenges to community banks as well. Depending on your point of view the Fed is either preventing the market from overheating or planting the seeds of recession by reducing liquidity in the debt markets. Perhaps one piece of good news in this bizarre political season is that we have a politically independent Fed which uses data and actually applies rational thought to its actions.