# The Pinkard Fund

## Investor Update April 2018

### Market Update For Q1 2018

Over the past few years we have written fairly consistently about the urbanization trend in the Washington area and the movement of millennials to high density and highly amenitized areas of the region. This is a trend that is not unique to Washington, as city after city across the country has experienced the growing urban vibe together with an accompanying apartment, restaurant and downtown entertainment boom. What is somewhat unique about the dynamic in Washington is the sheer size of the metro area. At over 6 million people it is the seventh largest metropolitan area in the country. As one looks to the future, the next step in the region's growth could be described as New Yorkification. That term definitely won't survive spell check, and it is not meant to be a comparison with the Big Apple in a qualitative sense. There are certain points in a city's growth that lead to inevitable shifts in the way its citizens work, where they live and their mobility, and it affects the real estate that serves their needs. The Washington region is at such an inflection point.

The region has two major Metro rail lines under construction, the Silver Line in Virginia and the Purple Line in Maryland. Completion of these two lines will add 23 stations to the current 91. Each line is affecting the major urban center in its jurisdiction, Tysons Corner in Virginia and Bethesda in Maryland.

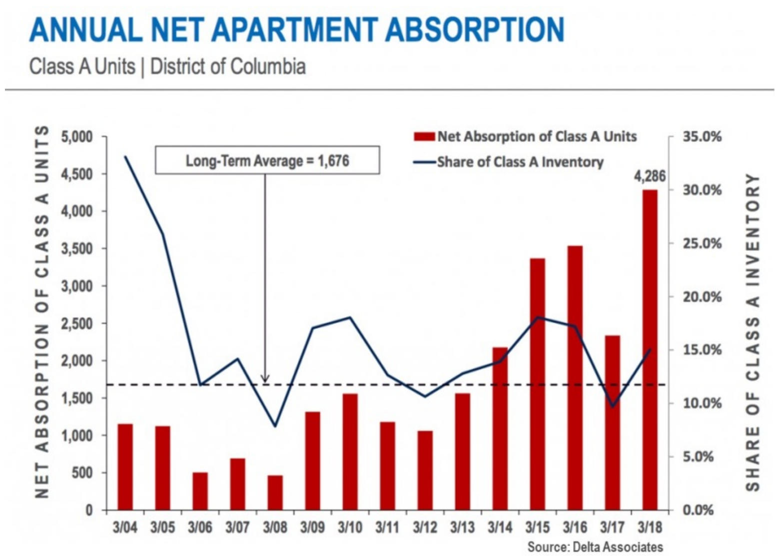
The first phase of the Silver Line opened in Tysons in 2014. The second phase which will connect Tysons Corner to Dulles Airport and areas beyond is scheduled to open in 2020. With the advent of Metro the most sought after properties are now those closest to Metro Stations. At 470 feet the tallest suburban building in the region and the second tallest in the state of Virginia, the Capital One headquarters, is just being completed in Tysons. With rampant apartment development (projects currently under construction will increase the apartment stock by 43%) and the attendant new retail, Tysons is striving to become more of a walkable urban community.

Bethesda has approved a 300 foot tower and a number of projects about to break ground that are just short of that, all of which project above the current skyline and more than 90 feet higher than the tallest buildings in downtown Washington. Bethesda's apartment inventory will increase by 23% with the projects currently under construction. Five years from now the Bethesda skyline will be completely changed. In addition to its connection to Downtown via the

Red Line, Bethesda will be connected to Silver Spring and other development nodes to the East when the Purple Line begins service in 2022. With 1.5 million sf of office and 3,600 apartment units under construction both Bethesda and Tysons Corner qualify as growing mid-tier cities.

The second outgrowth of New Yorkification is the change in residential patterns. The two major suburban jurisdictions in the region, Fairfax County (population 1.14 million) and Montgomery County (1.04 million), are virtually built out. There is little land left for large single family development, resulting in those projects being pushed further out. As those exurban communities develop, most people living there are unwilling to commute into the city, and Reston, Tysons and Bethesda are becoming their downtowns.

The other outgrowth of this lack of land is upward pressure on the price of housing that is located inside the Beltway. With little new supply this is easily understandable. Thus the apartment boom continues and the overall mix of housing has changed with more multifamily, more townhouses and less single family. Industry experts have been opining that the apartment sector is overbuilt, but the units keep getting leased as evidenced by the 2017 record-breaking Class "A" absorption in Downtown DC of 4,286 units. The reason is that the region is not building enough total housing to meet the demand.




One final piece of the housing equation is affordability. High-rise urban projects with parking garages beneath the building are expensive to build and have been attracting more affluent residents. This is particularly true throughout DC, and this gentrification trend is displacing longtime residents. The result has been continued pressure from the Mayor and City Council to find ways to push developers to build more affordable units with particular emphasis on the lower end (30% AMI – area median income). While this is a noble goal, the 30% AMI rents barely cover expenses, resulting in very few such projects getting built. This has been and will continue to be a challenging issue and one that is exacerbated by the continuing prosperity of the region.