The Pinkard Fund I

Investor Update — January 2018

Market Update — For Q4 2017

Last quarter we wrote about the strength of the local economy despite the lack of growth from the Federal sector. We also wrote that surprises to the upside could come from the passing of a federal budget or a return to a more normal legislative climate, both of which generate spending and jobs in the DC Region. In light of the short-lived Government shutdown, our upside surprises may still be a long way off, or maybe Congressional leaders are beginning to come to their senses. Many people have a sense, or perhaps it is a hope, that we must return to a more normalized legislative environment, a reversion to the mean. At the same time there is concern or fear that this is the new normal; the world around us is changing in unpredictable ways; American superiority is not a given; our society is declining and opioid addiction is the canary in the coal mine; our institutions are failing us; and that we are not as safe as we once were. In reading a variety of year-end investment reports a consistent theme begins to emerge. While the consensus predicts that 2018 will be a continuation of the strong economic performance of 2017 with few evident signs of recession, anxiety about geopolitical risk is rising. We are doing well, but not feeling good. Is a black swan event around the corner? With our current economic expansion on course to be the longest since World War II and the Dow rising 4 fold since 2009, it is little wonder that the bears are beginning to come out of hibernation.

Like the general investment climate, real estate values continue to hold up. An abundance of capital and a global search for yield seem to be the drivers of the real estate capital markets. At the more granular product level, 2017 saw the highest net absorption of office space since 2010 at 2.2 million square feet in the Washington Region. As the market-wide move towards office densification runs its course, and the area continues to produce strong growth in Professional and Business Services jobs, net positive absorption of office space should continue to grow. At the same time the growth of new supply has been significant and vacancy rates could rise over the next couple of years, particularly in DC. Significant supply of new apartments in the region has finally outstripped demand with rents in the District of Columbia falling by 3.9% in 2017. Going forward, this should reduce the amount of new construction in the apartment sector.

Notwithstanding the government shutdown and geopolitical concerns, the business climate in the region remains positive. Nestlé will be moving their new corporate headquarters to

Arlington in February, and although Discovery Communications just announced its move to New York in 2020, the Region has three of the final twenty locations for Amazon HQ2 and its 50,000 jobs. If businesses can solve the labor shortage for qualified knowledge workers, then the renewed interest in a strong national defense, the prospect of regulatory easing, and the new Tax Cuts and Jobs Act (discussed below) will pave the way for robust business expansion.