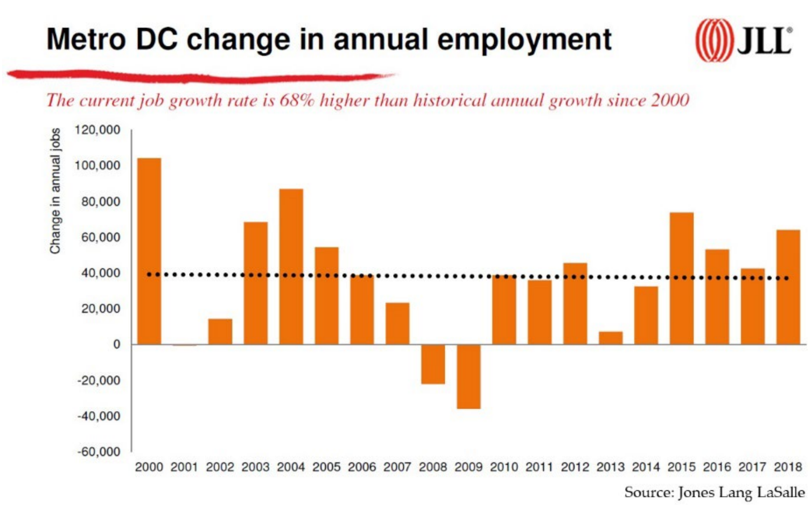
The Pinkard Fund

Investor Update — October 2018

Market Update — For Q3 2018

At a recent Washington Economic Club event, Amazon CEO Jeff Bezos was interviewed by private equity mogul turned media interviewer David Rubenstein. After Bezos explained that his decision to purchase the Washington Post was made by following his gut, Rubenstein wondered aloud what his gut was telling him about locating HQ2 in the Washington area. Of course, he was not going to answer the question, but we did learn the decision will be announced by the end of the year. There is no doubt that the DC region is being seriously considered. While HQ2 may be the big plum, there is expanding tech interest in the area. Amazon's cloud computing business, Amazon Web Services, leased 400,000 sf at One Dulles at Woodland Park in the Dulles Technology corridor in 2016 and is looking for an additional 150,000 sf. Facebook leased 80,000 sf in Tysons Corner earlier this year and Google is currently in the market for 100,000 sf, also along the Toll Road. What is going on here? Is it the educated tech workforce that the area possesses, a recognition from these massive internet businesses that they need to have a presence in this region, a combination of the two, or perhaps other reasons? One thing we do know is they want to be here. After Russian manipulation of the Facebook platform and the Congressional spotlight on Facebook and other tech giants, it is not a question of whether there will be more regulation. It's a question of how much. Silicon Valley and Washington, DC will have a lot more interaction going forward, and having a presence close to your regulator may be a wise move.



As the region waits for the Amazon decision, job growth continues to be strong. The accompanying chart from JLL shows job growth over the last few years. What is most interesting is that this job growth is taking place despite the continued reduction in federal jobs. The war on the federal workforce which began even before the sequester in 2013 has led to a shift in the regional economy. From 2010 to 2017 the Federal share of the local economy fell from 39.8% to 31.2% and is expected to fall further to 27.2% by 2022. This area is slowly reducing its dependence on “Uncle Sugar” and becoming a more diversified economy driven by its growing reputation as a tech hub. The resilience of the region has been shown in the continued job growth during this period of substantial shift in the local economy.

Given the headwinds of higher interest rates and rising construction costs, the diverse demand that we are seeing is welcome. New construction projects are becoming more difficult to finance with ever increasing costs due to tariffs, oil price increases and low unemployment among other factors. We are just beginning to see stress in this part of the business and it is certain that new development will be moderated. If you are an owner of assets, it should be a good time because the delta between your basis and new development is widening. If you are looking to acquire or develop, it is challenging, but sometimes distress follows stress and provides attractive acquisition opportunities for those who are patient.