

Multifamily Market Trends and Outlook

Summer 2016

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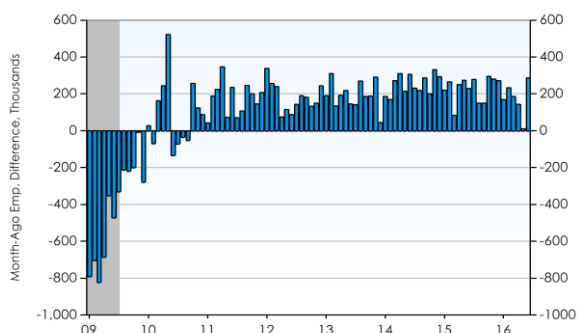
EXECUTIVE SUMMARY

- Maximus Advisors and The Praedium Group have jointly produced this report, which focuses on the US apartment market. We argue **the apartment market will continue to be driven by a solid level of demand, though there is some short-term vulnerability due to increased building activity.**
- **The labor market remains supportive of US economic growth despite multiple headwinds, as consumer spending remains strong amid some recent choppiness in headline employment figures.** Payrolls continue to expand, adding over 171,000 jobs per month through the first half of 2016, while unemployment has fallen below 5% recently. Wage growth is starting to accelerate, while lower energy prices have also supported consumer spending.
- **US apartment demand is strong,** continuing its upward trend over the past few years. **According to Reis data, rising supply additions have started to produce an uptick in vacancies, but availability remains at a very low overall level. Rent growth is still robust,** making strong year-over-year gains and effective rents are now at an all-time high per Reis.
- **The US multifamily market is supported by many long-term trends driving demand.** Though mortgage rates remain very low, student debt continues to soar, keeping people renting. The US housing market is on solid ground, but low inventory of single-family homes is driving home prices higher, raising concerns of affordability and crowding out many first-time buyers, abetting apartment demand.
- **Low homeownership rates continue to feed rental demand,** which is set to rise as the 20-34 age group grows over the next decade. Secular trends including later marriage ages and a high rate of single adult households are also building rental demand, while household formation should continue to expand the renter pool. In addition, young adults staying at home have created pent-up demand that should hit the market in the coming years as their economic conditions improve.
- While **millennials will largely shape the future of residential demand and continue driving rental demand in the coming years,** homeownership rates have declined across US age cohorts over the past decade, substantially increasing apartment demand. The sizeable baby boomers cohort is also seeing a notable shift from homeownership to rentals, embracing the convenience of urban and rental lifestyles especially in the aftermath of the housing crisis.

US Economic Backdrop

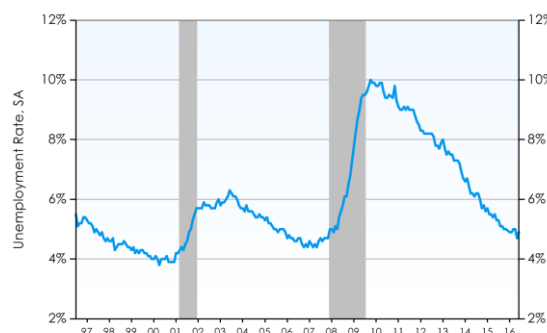
Despite multiple headwinds and some recent softening in payroll gains, the labor market remains supportive of US economic growth. Headline employment figures have been choppy in recent months, but payrolls nonetheless continue to expand and wages continue to rise, as the labor market has still added an average of over 171,000 jobs per month through the first half of 2016. Additionally, unemployment has remained extremely low at 4.9%, a 40 bps decline over the last year. The U-6 measure, which captures underemployment as well, has declined 90 bps from a year ago to 9.6% in June, illustrating that while there is additional slack in the form of the underemployed, it continues to tighten. The decelerating headline GDP figures also masked a much stronger contribution to growth by the consumer.

Job Gains Remain Supportive of Economic Growth Despite Recent Choppiness



Sources: Bureau of Labor Statistics, Ten-X Maximus Research

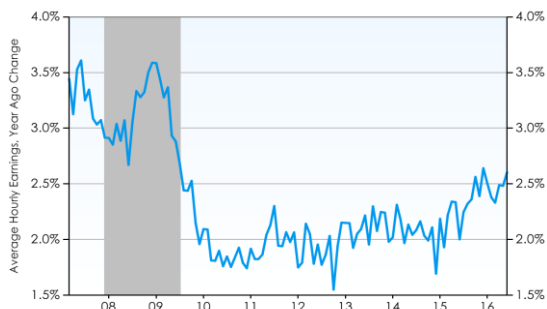
Unemployment Has Fallen Below 5%



Sources: Bureau of Labor Statistics, Ten-X Maximus Research

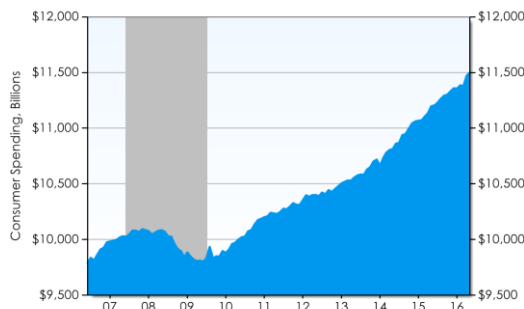
Wage growth is beginning to show signs of life again, resuming its progress after a slow start to 2016. Average hourly earnings growth ticked up to 2.6% from a year ago recently and is still above the range occupied for much of this cycle, while the Atlanta Fed wage gauge posted its strongest increase yet of this cycle last month, increasing an annual 3.5%. Wage growth is the vital statistic for the expansion going forward, as it is needed to improve housing and rental affordability and drive spending. There may be some hiccups as the labor force expands, but we expect a generally positive trend for wage growth in the future. The consumer remains in a robust position, as the labor market is strong, wages are rising and energy prices remain low. This has put the consumer on solid footing to continue driving growth, as consumer spending recently eclipsed \$11.5 trillion.

Average Hourly Earnings Showing Lift with 2.6% Year-Over-Year Growth



Sources: Bureau of Labor Statistics, Ten-X Maximus Research

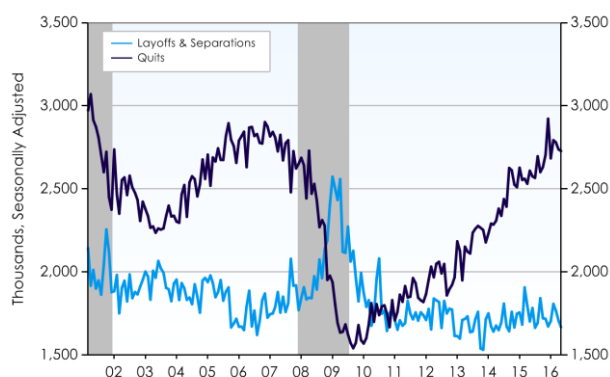
Consumers Continue Driving Economic Growth, Despite Weak GDP Figures



Sources: Bureau of Economic Analysis, Ten-X Maximus Research

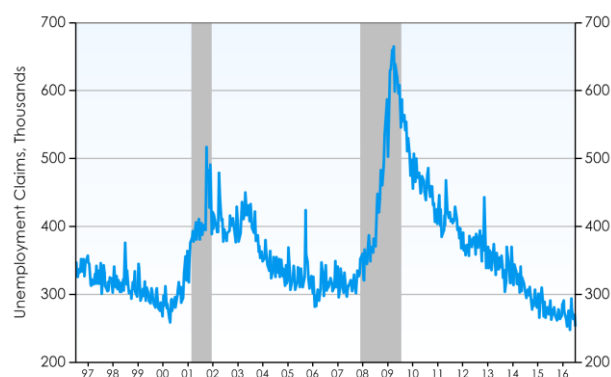
The rising number of voluntary quits further illustrates the solid state of the labor market. Monthly quits broke out of their plateau in late 2015 and most recently measured 2.7 million, 4.6% higher than their year-ago level despite some choppiness in 2016. Quitting implies workers have located a better job and/or have confidence in the labor market that one can be acquired. Layoffs remain muted as well, and have been range-bound between 1.5 and 2 million for nearly six years. Quits started to decline a full year before the prior recession, so this remains a strong leading indicator of economic conditions. Weekly unemployment claims have also remained under the 300,000 mark for over a year now, falling below 250,000 in April at their lowest point. The updraft in January did prove to be statistical noise, as weekly claims have largely hovered between 250,000 and 280,000 for the majority of 2016.

Voluntary Job Quits Still High, Layoffs Remain Muted At A Low Level



Sources: Bureau of Labor Statistics, Ten-X Maximus Research

Unemployment Claims Remain Low, Have Settled Down after Some Early 2016 Transient Upward Movement



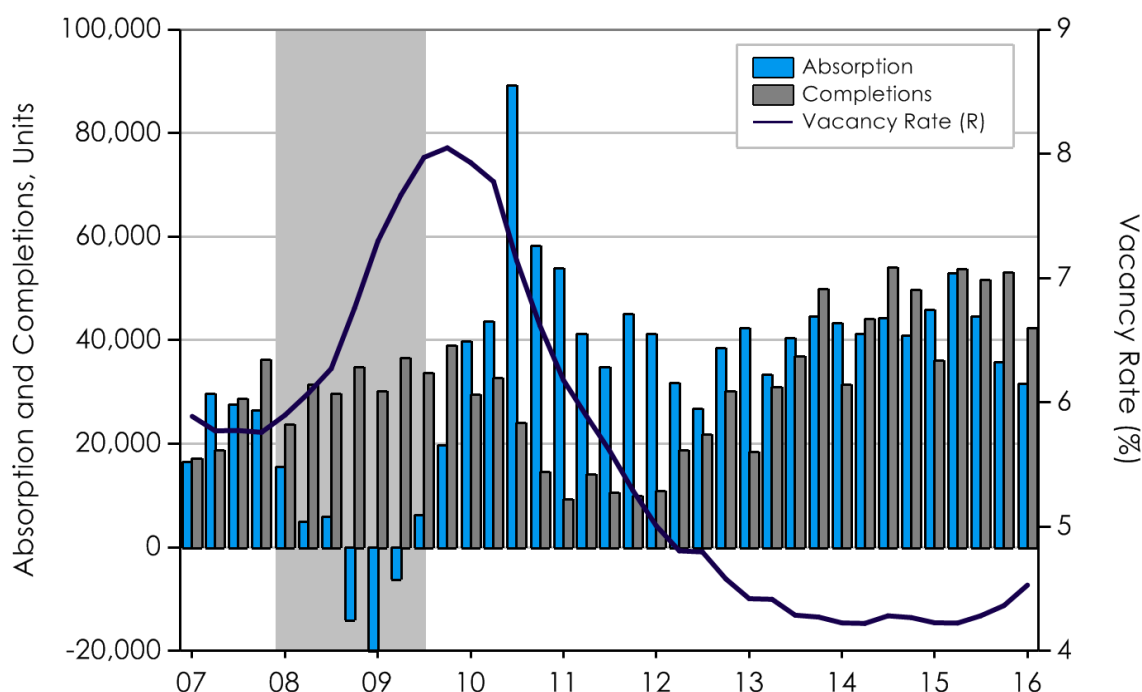
Sources: Bureau of Labor Statistics, Ten-X Maximus Research

While headwinds and trip-wires abound, including fallout from Brexit, the US economy has continued its steady, if unspectacular growth. China's economy continues to flounder and grapple with its transition from manufacturing based to consumer driven. Japan's economy remains moribund despite unprecedented and creative monetary policy. Europe has followed Japan into the negative interest rate pool, though it is yet to yield sustained and robust growth. While oil prices have rallied somewhat, approaching \$50 a barrel, this remains low and the financial carnage is already rattling through the industry. We expect this trend to continue, as the labor market remains steady and fuels the most important part of the US economy, US households. Indeed, the consistent labor market and healthy consumer confidence should support multifamily demand, driving household formations, particularly generating movement for the key millennial cohort, that up to now have remained home in record numbers and present a massive potential demand source for apartments.

Current Multifamily Market

Demand for apartments remains strong. According to Reis data which tracks market rate rental complexes consisting of 40 or more units in metros across the country, US multifamily absorption totaled 178,868 units in 2015, continuing the upward trend in demand over the past few years. However, supply picked up as we have expected, increasing to nearly 195,000 completed units in 2015 per Reis, up more than 15,000 from the year before and marking the highest yearly increase since 1999. The slight mismatch between supply and demand is starting to produce an uptick in vacancies, which had hovered in the low-4% range since 2013, as completions have now outpaced absorption in 7 of the last 8 quarters. After a weak start to 2016, demand has now slowed for three consecutive quarters, spurring the rise in vacancies. Availability measured a seasonally adjusted 4.5% in the first quarter of 2016, up 30 bps from a year ago. Though the recent slowdown in absorption should be monitored, the consistency of the labor market should keep demand healthy, so while increased development activity has lifted vacancies, they remain tight.

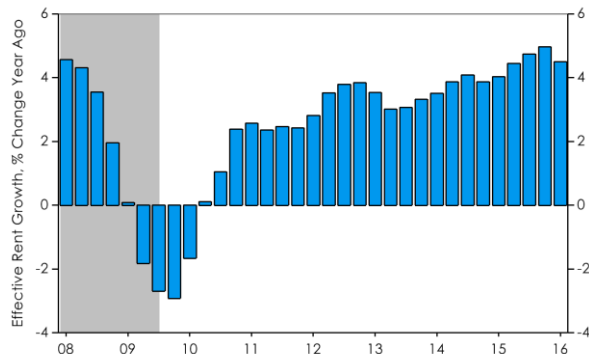
Apartment Vacancies Are Edging Up Owing to Increased Development Activity



Sources: Reis, Ten-X Maximus Research

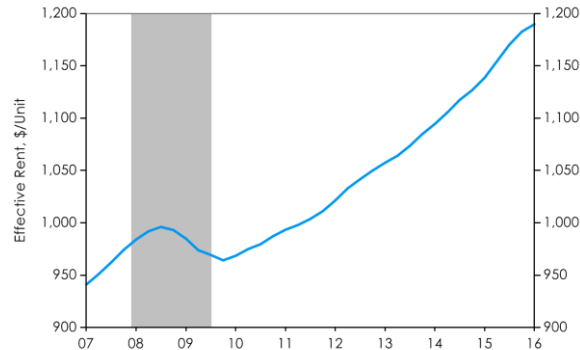
The uptick in apartment vacancies has not put a damper on rent growth, which accelerated throughout 2015. According to Reis, effective rents increased 5% in 2015, the strongest annual gain yet in this expansion and the highest since 2000. Though rent growth cooled somewhat in the first quarter, effective rents now rest at an all-time peak of \$1,190 per unit, 19.4% above their 2008 pre-recession peak and 4.5% higher than a year ago. The overall tightness in availability continues to drive strong rent growth, even as robust demand grapples with the supply pipeline.

US Apartment Rent Growth "Cooled" to 4.5% Annual Rate in the First Quarter



Sources: Reis, Ten-X Maximus Research

Effective Rents Are Rapidly Approaching the \$1,200 per Unit Mark



Sources: Reis, Ten-X Maximus Research

While much attention has been paid to the rising appeal of Downtown and CBD locations for renters, the popularity has also made these urban areas into a construction target. The trend has captivated builders in recent years, to the point where suburban vacancies have trended below those of CBD submarkets. The shift began in the first quarter of 2013 when CBD matched suburban vacancies at 4.4% according to Reis and NREI. CBD vacancies have since risen nearly 200 bps to 6.3% in the fourth quarter of 2015, while suburban fell some 20 bps to 4.2% over the same time period. Though urban absorption has been strong, the amount of construction relative to inventory has risen far more in CBD submarkets than suburban. For instance, 42,000 downtown completions in 2014 represented a 3.6% increase in submarket inventory that year, while 126,000 new suburban units only accounted for a 1.4% overall gain. Additionally, CBD inventory rose 12.5% between 2010 and the first quarter of 2015, compared to just 4.8% in suburban inventory.

Suburban Apartment Vacancies Have Trended Below CBD Levels Since 2013



Source: Reis, National Real Estate Investor

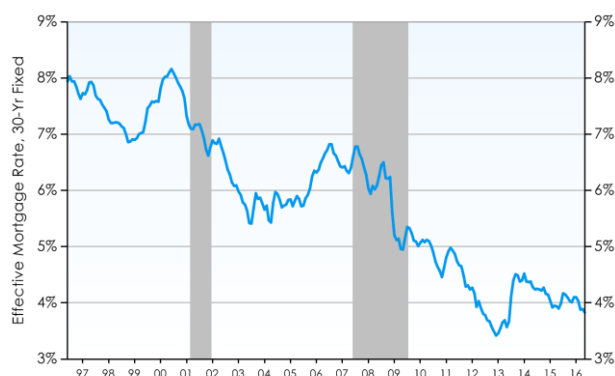
This CBD vs. suburban trend also becomes a consideration in the long term as millennials start to age. The popularity of renting in denser urban areas may be the preference at the moment, but some demand may start to shift with age as affordability, larger living spaces, and public school systems play a growing role in millennial decision-making. Even if suburban life becomes a larger draw, some of the financial hardships facing this generation may force them to continue renting as they are not necessarily in a position to buy.

Long-Term Multifamily Market Trends

The US multifamily market is supported by many long-term trends driving a solid level of demand. The homeownership rate has fallen for more than a decade, first initiated by the recession but continued as a result of several factors. Though mortgage rates are very low, stricter lending standards, mounting student debt, and rising home prices have pushed more Americans away from home buying, keeping them in a rising pool of renter households.

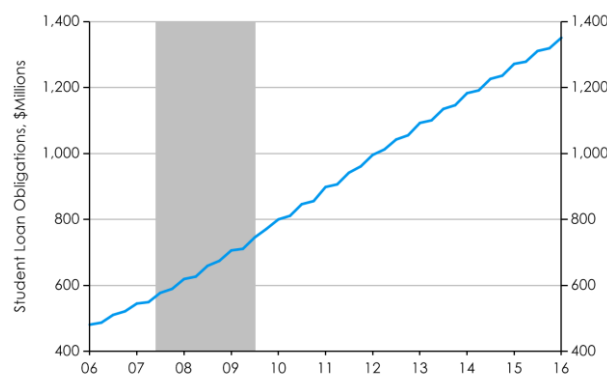
While the US housing market is on solid ground, the obstacles limiting the expansion of homeownership are creating additional demand for apartment rentals. Student debt eclipsed \$1.35 billion in the first quarter of 2016, a staggering 180% increase over the past decade, while the average balance for each borrower has ballooned 56% over the past ten years. This debt overhang has also diminished the impact of progress reported in wage growth with respect to homeownership, as wage increases have not proven strong enough to offset or slow down the skyrocketing student debt. Despite remarkably low mortgage rates enticing potential buyers, the debt burden many face still precludes them from owning a home. After a generation was scarred by witnessing the losses and dislocation from the housing crisis, people are more aware of the risks associated with homeownership and are less inclined to purchase without more financial security, and even those who are willing to buy are limited by stricter regulatory guidelines when it comes to lending. Though traditional mortgages and the broader financial system may be more stable as a result of increased regulation, homeownership is certainly stunted in comparison to prior cycles, in turn generating historically high levels of apartment demand.

Mortgage Rates Remain Very Low



Sources: Federal Home Loan Bank of Boston, Ten-X Maximus Research

But Student Debt Continues to Soar



Sources: Federal Reserve Board, Ten-X Maximus Research

Some single-family housing fundamentals are creating a more competitive landscape for buying single-family homes, limiting the options for potential homeowners and leading to a higher rental population. A tight inventory of homes has been a popular headline restricting stronger home sales growth, with the inventory of existing homes for sale hovering below 2 million on seasonally-adjusted basis since 2013. This is nearly half the inventory level of the pre-recession period. Apart from a couple of exceptions driven by external factors in recent months, home sales have largely hovered at a high level, but have yet to see substantial growth despite low interest rates, steady employment and wage growth pointing to more demand. This demand coupled with limited inventory has pushed strong growth in home prices, which have recently seen 51 consecutive months of year-over-year gains per the National Association of Realtors. Though higher home prices tend to prompt additional listings, we have yet to see a significant movement in inventory, further promoting price increases as competition amongst buyers intensifies. This rising competition for single-family homes is pushing prices upward and keeping a higher number of people renting rather than entering homeownership.

Inventory of Single-Family Homes Remains at a Tight Overall Level



Sources: National Association of Realtors, Ten-X Maximus Research

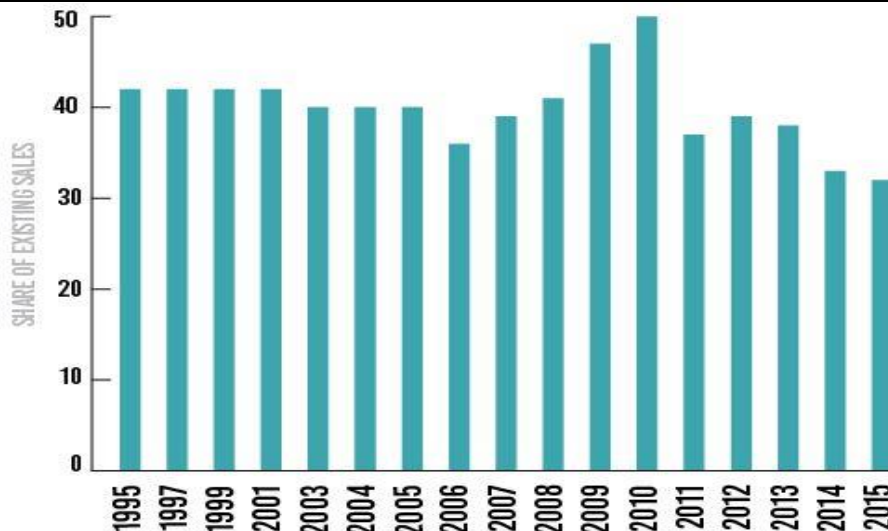
Home Prices Are Recording Strong Gains In A Solid Housing Market



Sources: Moody's Analytics, ECA, Federal Reserve Board, Bureau of Labor Statistics, S&P Dow Jones Indices LLC, CoreLogic, Inc, Federal Housing Finance Agency, Freddie Mac, Fannie Mae

While higher home prices are the result of a solid housing market, these trends have meant trouble for entry-level buyers. The combination of higher prices, debt burdens, and a low inventory of starter homes has raised affordability concerns, effectively pricing out a significant portion of potential first-time buyers, thereby boosting rental demand. According to the National Association of Realtors, the share of first-time buyers has fallen substantially since peaking in 2010, hovering in the low-30% range of late and most recently falling to 30% in May. In addition, home prices are facing additional upward pressure from increased competition. Recent reports suggest that that Chinese investors have increased home purchases in the US, overtaking Canada as the leading foreign purchasers of US homes in 2015, partially as a means to distance and protect their wealth from the devalued yuan and uncertainty in China. While Chinese buyers tend to directly affect higher priced homes in expensive markets, additional reports of increased home-flipping activity are also contributing to the squeeze felt by first-time buyers. With conditions unlikely to reverse in the immediate term, this environment is likely to keep a sizeable portion of potential buyers on the sidelines of the single-family market and instead support further rental demand.

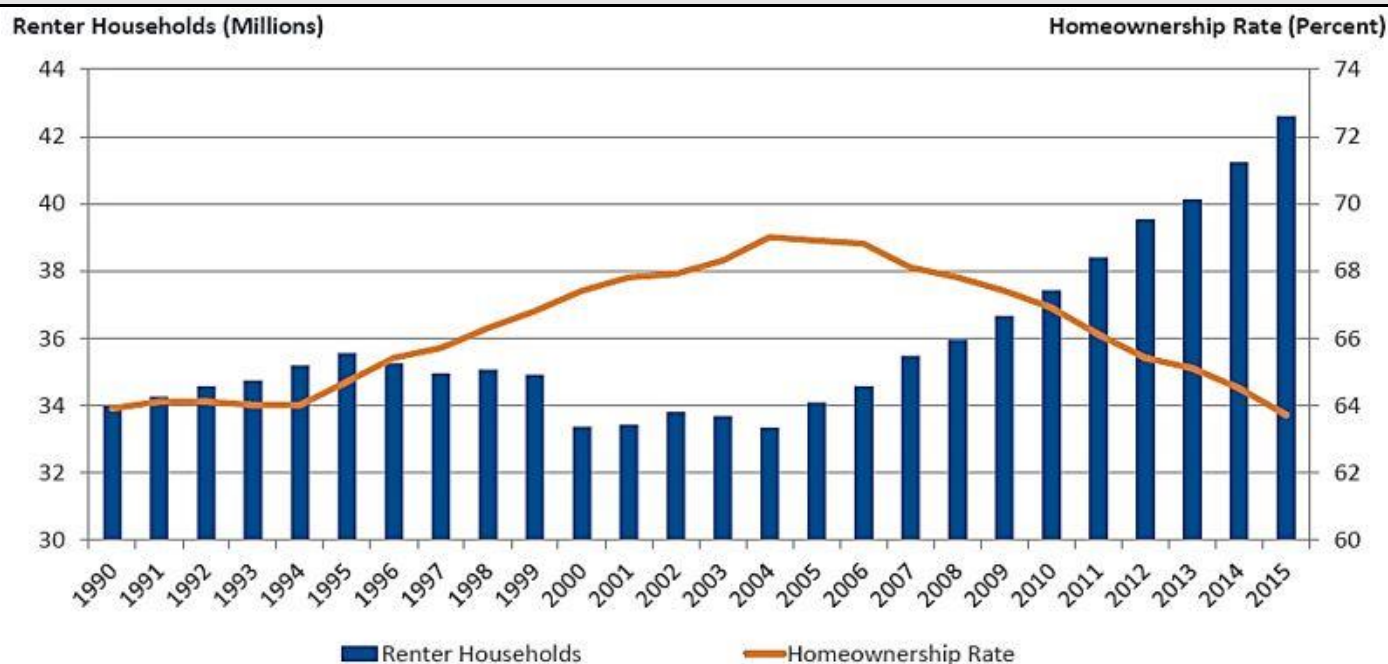
Low Inventory and Strong Home Price Growth Have Boxed Out Many First-Time Buyers Which Supports Rental Demand



Sources: National Association of Realtors, ChicagoAgent

The homeownership rate is a key measure of the dynamic between single-family and apartment demand. As the rate declines, this means more residential demand is shifting towards rentals. Homeownership has recently fallen below 64% for the first time since 1993, measuring a seasonally-adjusted 63.6% in the first quarter this year, down from its prior peak of 69.4% in 2004. At the same time, renter households have risen to nearly 43 million, an increase of almost 10 million households in the past 11 years. These are remarkable trends, and though recent data suggests that the homeownership rate may be bottoming out in the near future, it is unlikely to recover anytime soon. As more people enter their prime renting age, this low homeownership rate will maintain a solid pipeline of apartment demand in the coming years, even if homeownership stabilizes.

Low Homeownership Continues to Boost Renter Households

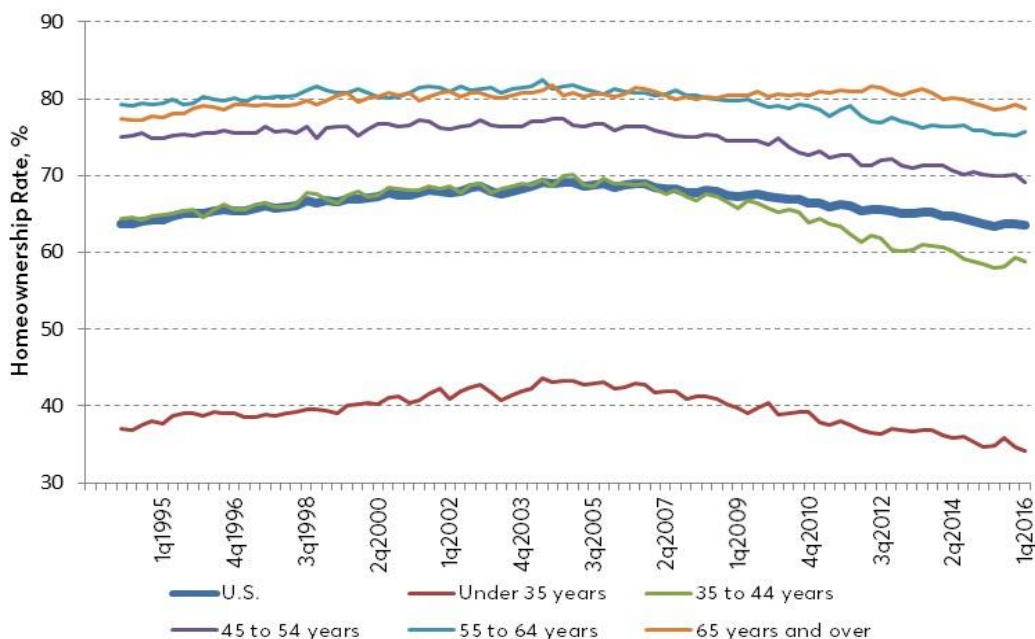


Notes: Annual data for 2015 are from the third quarter of that year. Beginning in 2000, renter household data are the revised, consistent-vintage counts. 2000-09 counts are 2010 vintage, 2010-15 are 2014 vintage.

Sources: US Census Bureau, Housing Vacancy Surveys

As the US homeownership rate has deteriorated over the past decade, a breakdown of the rate by age cohort shows that homeownership has been falling across all groups, including both baby boomers and millennials. Baby boomers represent a large generation that has long been associated with homeownership, but they have actually been forming more rental households recently in part due to the aftermath of the housing bust, but also due to evolving preferences. As more baby boomers have empty nests, they are able to change their living arrangements more freely. Renting proves easier for some as they age, embracing the convenience of renting a smaller space where more responsibility falls on landlords, rather than maintaining a larger property. While this trend among baby boomers has added another layer to growing rental demand, millennials will still determine much of future residential demand trends as the largest US age cohort.

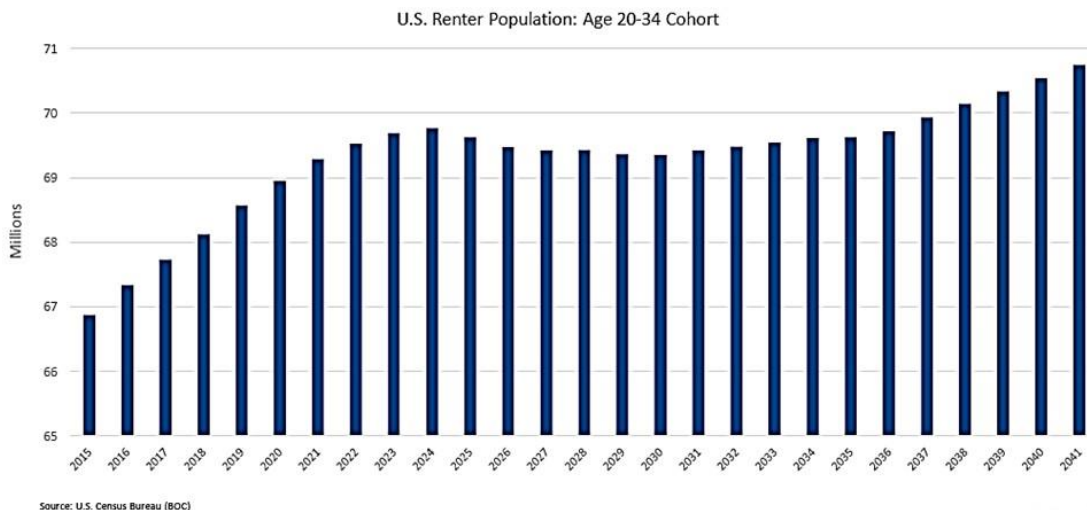
Homeownership Is Falling Across Multiple Age Groups, Including Baby Boomers and Millennials



Sources: US Census Bureau, Ten-X Maximus Research

In addition to the challenges keeping potential homeowners in the rental market, demographic trends also suggest a continued influx of demand for renting. The millennial generation will shape much of the residential outlook in the coming years, and given the challenges facing first-time buyers, this should continue to represent a significant influx of renter demand. The 20 to 34-year-old age group, currently measuring near 67 million, is going to rise for the next 9 years to nearly 70 million people. This age group represents the prime renting age within the US, which will continue pushing the renter households in the US even if the homeownership rate settles.

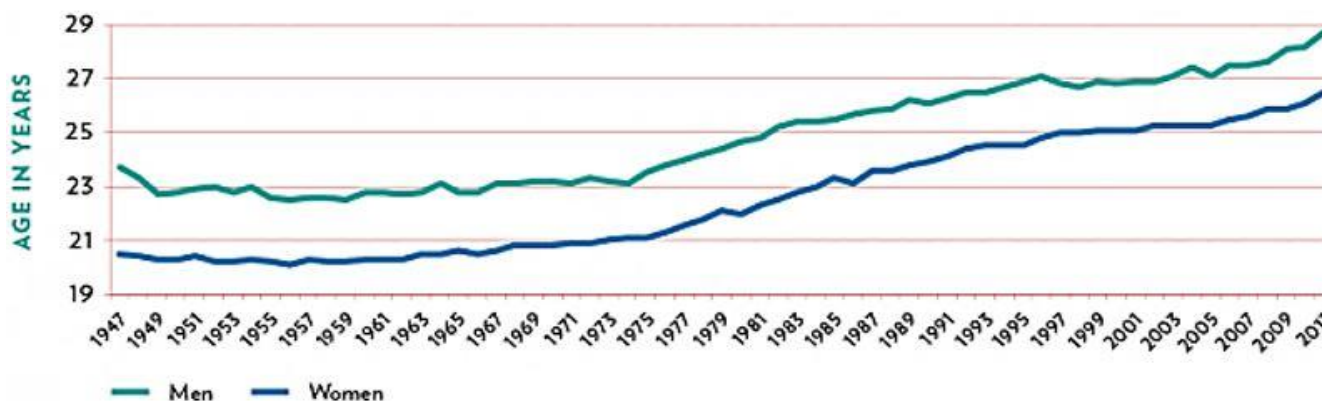
US Population Ages 20-34 Set to Increase for 9 More Years



Sources: US Census Bureau

Behavioral trends closely associated with millennials are contributing to greater renter populations as well. Younger people are waiting longer to get married than ever before, a trend that is still continuing upward. Considering that married couples are more likely to buy homes, this delay is keeping more single people in the renter pool for longer. Also taking into consideration that the population of 20 to 34-year-olds is already set to grow in the coming years, the rising share of single people in this age group is set to bring healthy demand to the multifamily market.

Rising Median Age at First Marriage is Contributing to a Deeper Pool of Renters



Sources: US Census Bureau, Current Population Survey

In addition to delayed marriage ages sustaining more renters, living habits are also generating more rental demand. The percentage of households with one adult has gradually risen over the years, surpassing 25% over the past twenty years. Such households, gradually growing in prominence, are also more likely to rent than own, and boost the demand for overall rental units. This rate has shown some vulnerability to downturn scenarios, as evidenced by the slight dip during the last recession, but even so, the share of single adult households has maintained a high level for many years, a trend that is unlikely to see a significant reversal.

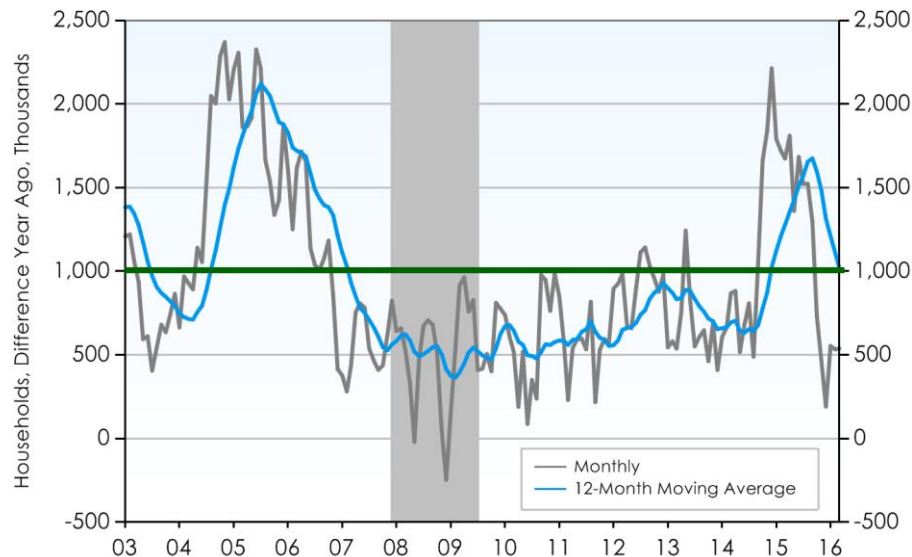
The Percent of Households with One Person Has Held Above 25% For The Past Two Decades, Boosting Rental Demand



Sources: US Census Bureau, Families and Living Arrangements

Household formation is a key indicator of apartment demand growth, which has gradually risen since the recession. There was a spike in number of households formed in late 2014, and although the rate slowed by late 2015, it remains safely in expansion. Given current labor market conditions, household formation should continue to see growth despite some potential noise. While household formation supports all residential demand, many of these new households initially favor the rental market.

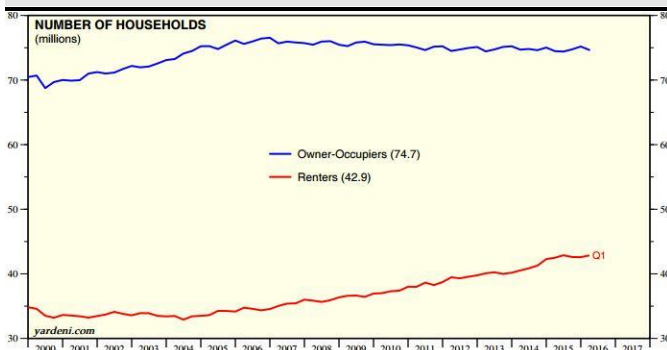
Household Formation, a Key Driver of Apartment Demand, Remains in Expansion Despite a Sluggish Fourth Quarter



Sources: US Census Bureau, Ten-X Maximus Research

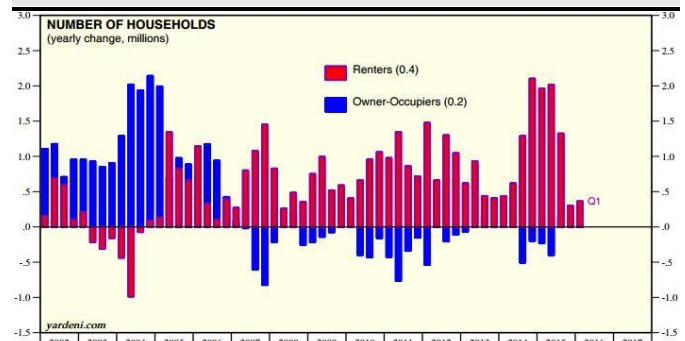
The increase in household formations contains an interesting renter/owner dynamic. While the number of owner-occupant households substantially outweighs renter households, 74.7 million vs. 42.9 million respectively, recent trends paint a very different picture. It is unsurprising that renter households made more progress than owner households immediately following the housing crisis, but this trend has now continued for more than a decade. Renter household gains have dominated an otherwise sluggish household formation rate for owner-occupants for several years, showing that most of the recent household formation progress has benefited rental demand, while owner households have been fairly stagnant. Given the long-term nature of this movement, household formation looks to continue heavily favoring rental demand.

Though Owner-Occupants Outweigh Renter Households, Renters Have Risen Significantly



Sources: US Census Bureau, Haver Analytics, Yardeni Research

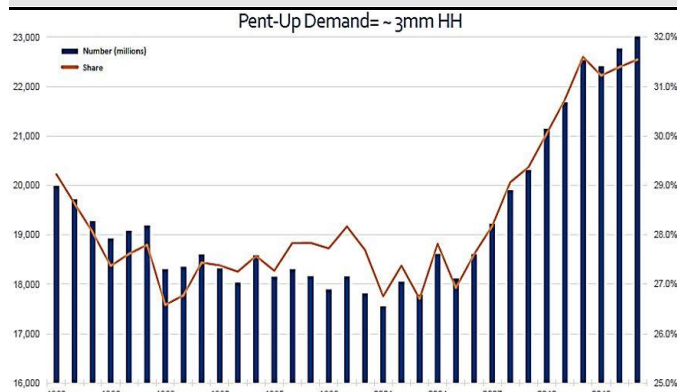
Renter Household Additions Have Dominated Owner-Occupier Household Gains



Sources: US Census Bureau, Haver Analytics, Yardeni Research

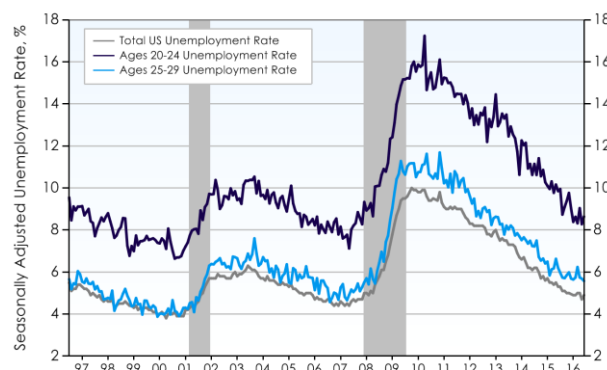
The number of young adults living at home surged during the recession, increasing by over 5 million since 2001 as their percentage jumped from 27% to more than 31% in less than a decade. As economic conditions improve for millennials, household formations, particularly renters, should see further expansion as young adults begin to move out of their parents' homes, where they currently reside in record numbers. This demographic has created a significant level of pent-up demand that is waiting to boost household formations, a trend that is starting to play out as the share of young adults staying at home has shown signs of stabilizing.

Young Adults Staying at Home Has Created Pent-Up Rental Demand



Sources: US Census Bureau

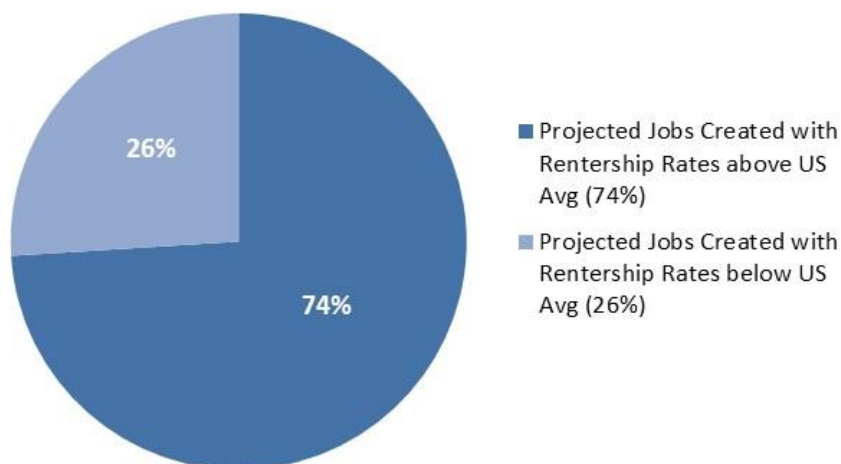
Young Adults Will Boost Household Formations as Their Economic Condition Improves



Sources: US Census Bureau, Ten-X Maximus Research

The economic recovery from the last recession has also created an interesting dynamic for residential demand, as the nature of the recovery has generated jobs that tend to have lower wages. While this has been an unfortunate social development and a limiting factor for the US economic recovery, such jobs are conducive to renting rather than buying, shifting more demand towards apartments. This trend is expected to continue, with the expectation for the majority of jobs created to generate more rental demand than homeownership demand.

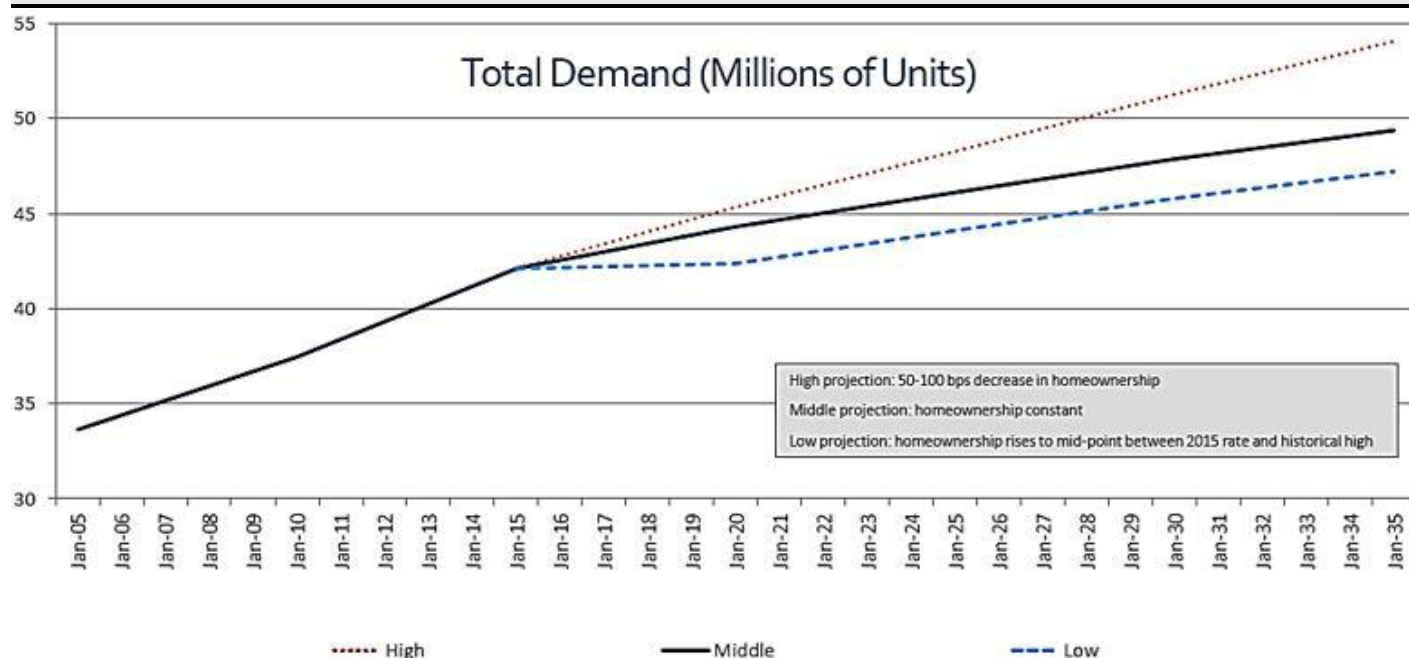
Projected Job Growth Favors Potential Renters with Lower Wages



Sources: Freddie Mac, Bureau of Labor Statistics Employment Projections, US Census Bureau, American Community Survey Public Use Microdata Sample (2013 1-year estimate), Ten-X Maximus Research

The overall level of multifamily demand is going to be dependent on the homeownership rate in the coming years, but almost every realistic outcome points to increased demand in part due to the many demographic and secular trends supporting the sector. With homeownership already at record lows and starting to hover in recent quarters, and considering the potential for growth in single-family demand given the current economic climate, our expectation is for the homeownership rate to stabilize over the next few years, pointing to the middle road in the demand projections below. That being said, it is certainly plausible for the rate to continue declining given all of the trends we have described. On the other end of the spectrum, an uptick in the homeownership rate seems less likely, but even if that occurs, apartment demand would rise in the long term. Given the pressures that potential homeowners still face in this environment, however, we still find a rise in homeownership to be an unlikely scenario over the next few years.

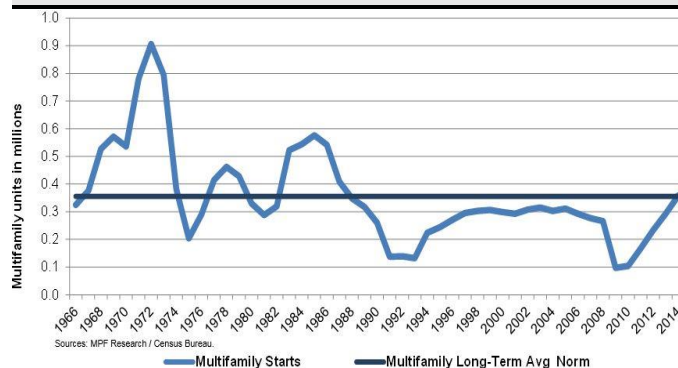
Total Multifamily Demand Projected to Rise Substantially



Sources: Axiometrics, Yardi Matrix

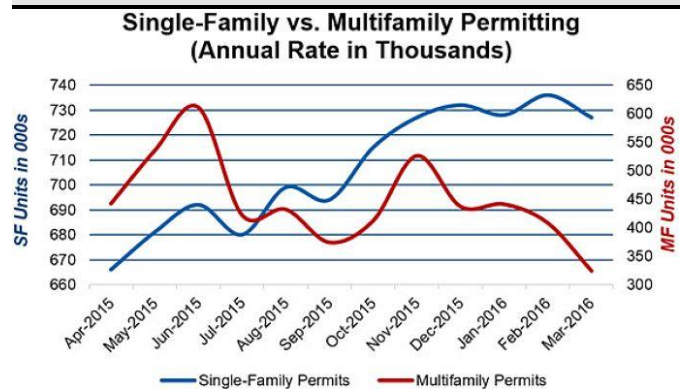
In response to an obvious rise in apartment demand, construction activity has ramped up, steadily rising each year from a low of 42,000 completions in 2011 to nearly 195,000 in 2015 per Reis data, which tracks market rate rental complexes consisting of 40 or more units in metros across the US. This trend is also reflected in the number of multifamily starts per MPF research using Census data, which differs from Reis as the Census counts properties with 2 or more units including condos and co-ops, but ultimately follows a pattern similar to Reis. While this building activity is well documented, the amount of permit activity seems to indicate that the flurry of multifamily construction should start to wane after seeing a large number of completions hit the market in 2016 and 2017. Over the past year, multifamily permitting has fallen choppy while single-family has been on the rise, likely a reaction to low single-family inventory and rising multifamily construction. It can typically take a couple of years for permit trends to be reflected in completions, so this follows our expectations for the new supply pipeline to cool following 2017.

Multifamily Starts Have Picked Up, But Have Yet to Notably Offset Increased Demand



Sources: MPF Research, US Census Bureau

Multifamily Permit Activity Has Declined Recently



Sources: Axiometrics, US Census Bureau

Notes



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