The Pinkard Fund

Investor Update January 2014

For Q4 2013

Market Update

As 2013 gave way to 2014, the financial markets were hard pressed to find a financial crisis that could derail the recovery and create a new wall of worry. Problems like the Fed backing off of quantitative easing seem like good problems to have given where we were just a year ago. Even members of Congress appear to be playing somewhat nicely together in the sandbox. So what should we be concerned about? If you are a natural worrier, you might say a lot, but from the perspective of a Washington real estate person, a lot of bad news has been absorbed (BRAC, consolidations, Sequestration etc.) and priced into the market. After having led the country in job growth at the beginning of the recession, the Washington region lagged the rest of the country in 2013 for the above reasons. We probably will see much of the same sluggishness in early 2014, but look for accelerating growth later in 2014 and beyond.

When this unwieldy aircraft carrier that we call the federal government moves, we don't always feel the full impact right away. When Ronald Reagan came into office in 1980, you may remember the almost immediate ramp up in defense spending. Those of us in the real estate business didn't feel the impact for 18-24 months. This is how our government works: First the legislation is passed, and then months later the money is appropriated by Congress. Once the agencies know they have the money, they begin the competitive contracting process. Contracts are awarded, and then contractors look for employees and office space. This whole process takes a while. The same cycle takes place on the downside, and we are in the midst of feeling the pain of cutbacks that began two years ago. However, with the end of the Sequester and an increase in federal spending, 18-24 months from now we should see an expansion of the government side of the regional economy.

The other point to note is that while the federal government has cut jobs and contractors have as well, Washington does have a healthy private sector. Job growth has continued to be net positive as private sector gains exceed the federal government cutbacks. Healthcare and education jobs, leisure, hospitality and construction all posted positive job gains in 2013. Overall these jobs don't pay as much as the government contractor and federal jobs pay, but they do reflect the breadth of this regional economy.

With the headwinds that we have seen it is encouraging to see capital from all over the world looking to invest here. Although Washington has dropped in the list of favorite places to invest, we have seen no letup in the appetite to buy. Prices for the best properties continue to rise and core cap rates have compressed over the last six months. This capital has not shown the same interest in the more challenged B properties or distressed sectors creating an opportunity for those with the ability to improve the quality and performance of these properties to sell into the institutional market.

On a final note (we have written about this before) we continue to be amazed at the number of Gen Y folks who continue to move to the region and how they are changing the way in which we eat, live, shop and play. They challenge us to rethink the role of real estate in their lives, and the impact on the urban landscape is everywhere, bike share, zip cars, food trucks, micro units, urban grocers, emerging neighborhoods etc. It is a generation that the wise investor would do well to better understand.