MARKET REPORT

MID-FIRST QUARTER 2023

Dear Investors, Friends and Colleagues,

We hope this letter finds you well and enjoying the longer, early days of spring.

As we mentioned in our last mid-quarter update, our new acquisition pipeline has been muted while we digest the various macro-economic factors that impact our multifamily investing universe. We have used this down time to further expand and strengthen our company's foundation so that we are ready to take advantage of buying opportunities as they present themselves. We've added a new team member, are building and expanding our relationships to maximize our pipeline, are growing our investor base, have built a 5-year strategic plan, rolled out an employee growth initiative and are revisiting and improving upon all of our systems and processes. Metaphorically speaking, we are giving the engine a full tune up so it is ready for whatever opportunities we may find in the coming months and years. It has been a fun process, and we are grateful for the downtime that has given us an opportunity to further strengthen our systems and set us up for our next phase of growth, which we expect to be a multiple of our growth since inception.

Turning to our current properties, we are pleased to report our portfolio turned out a strong performance in the fourth quarter 2022, with our properties yielding an average of 8.3% annualized (9.3% when including some amortizing loan paydown). At our class A assets, we are starting to see some softness in rents, averaging 3% trade outs on new leases, and 5.5% on renewals, but at our class B/C assets, rent growth remains strong, with new leases average 14% trade outs and renewals at 4%. Occupancy and collections remain strong across the portfolio, at 93% and 95% respectively. Looking ahead, our marketing strategy involves closely monitoring any changes in market supply and demand to minimize turnover, and adjusting rate to maintain stable occupancy while achieving modest rent growth where possible.

To that end, we've implemented the newest revenue management platform, RealPage AI RM, on most of our properties in the portfolio. This platform offers robust, real-time reporting to ensure we have the most comprehensive information available to navigate fluctuations and maximize performance for both new leases and renewals.

MEET RYAN ATKIN, FOUR MILE CAPITAL'S NEW CHIEF INVESTMENT OFFICER

A key component of the foundation strengthening mentioned above is the addition of long-time friend of the firm, Ryan Atkin, in January 2023 as our new CIO. Ryan joined Four Mile to help position the company for potential buying opportunities that we hope to see later this year and next, as well as to lead and execute on our current and future growth strategies. Ryan has jumped right in, helping us refine our process to quickly vet new deals, build out our financial model to provide even more accurate forecasting and to broaden our network of brokers and sellers to ensure we see more and more compelling deal flow.

Before joining Four Mile, Ryan was the Founder of Drive Capital Group, a start-up real estate investment company focused on value-add residential and commercial real estate in select secondary and tertiary markets nationally. Prior to Drive, Ryan was Vice President of Acquisitions and Partner at Real Capital Solutions in Louisville, CO, where he spent nearly 12 years acquiring and capitalizing over $2.0 billion of commercial and residential real estate investments across the United States.

We are super excited to watch Ryan supercharge our pipeline and acquisition activity as we head into the future. While there is still a 15-30% gap between seller pricing expectations and what we are willing to pay for an asset, with Ryan's support we have once again begun underwriting opportunities to get a feel for the market, strengthen existing and foster new broker relationships, and to be ready to jump on any opportunities that are out there. Right now, Ryan's stated goal is to underwrite every deal that is out there in our target markets, and so far we think he is achieving that objective!

If you would like to connect with Ryan, please don't hesitate to reach out to him directly to schedule a call or meeting.

DATA FROM NMHC

Over half of the Four Mile Capital team (Eric, Chris, Ryan, Erin and Jetta) attended the National Multi-Housing Council's (NMHC) Annual Conference in Las Vegas at the end of January. Over 3 days, we had 40+ meetings and attended continuing education classes, listened to notable industry speakers and built and strengthened relationships through sharing meals and attending networking functions. Thanks to those of you who made time to connect with us at the conference!

Throughout the conference we shared dozens of conversations with lenders, brokers, investors, other sponsors and property managers. Here are some of the key takeaways and themes that we learned from our peers that we will account for as we navigate the current investment landscape.

1) There are currently far more apartment buyers than sellers. Nearly every broker that we spoke with has been issuing dozens of BOVs (broker opinion of values) at increased cap rates and lower values to property owners in their markets. But this process, normally the first step in selling a property, is resulting in far fewer listings than in recent years. It seems that if you are property owner with a performing asset and a fixed rate loan, you are not selling in this current environment- you can almost 'wait out' the current cycle. Meanwhile, buyers are also seemingly content to wait, for now, for better pricing to offset the higher cost of debt in today's market.

With relatively strong fundamentals in the rental market (generally speaking, apartment assets are performing well) and the uncertainty surrounding how interest rates will move over the next 12-18 months, this **STALEMATE** should result in muted transaction volume and deal flow in the 1H2023, with perhaps an uptick in activity in the 2H2023. At that point, some buyers might be forced to get more aggressive in their underwriting and pricing if they have to place capital (funds, for example, have a specific timeline on which they must invest all of the fund's capital), and/or we could see transaction volume start to increase if the Fed signals a reversal to their interest rate hike strategy because the economy has entered, or is entering, a recession.

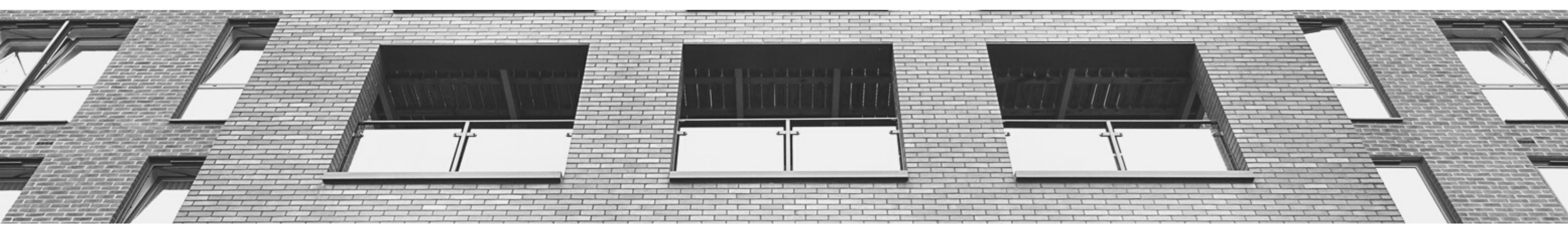
DATA FROM NMHC, continued

2) It seems like there is a mindset that if one waits for **STABILITY** you could miss out on buying opportunities. Our colleagues are trying to guess when the bottom of the market will come in, then jump back in. For us, this is a time to remain patient and disciplined, as we believe the opportunities will present themselves in time. Because we are not a fund, we do not have to place capital when market conditions and pricing don't align, as is the case today.

3) It's common belief that there will be some level of **DISTRESS** among high leverage and/or floating rate business plans executed over the past few years, as well with lease-up deals that are struggling to stabilize before their loan and/or rate cap matures. It remains to be seen whether these opportunities will present themselves in 2023, 2024, or ever, especially considering the proliferation of "rescue capital" funds looking to invest preferred equity or mezzanine financing into distressed deals. There's an argument that this strategy is simply 'kicking the can' down the road and we'll see these for-sale opportunities resurface once again in 2025-2026, but perhaps without the same level of distress or urgency.

Further, with multifamily fundamentals relatively strong, lenders appear to be more motivated to work with their borrowers (much more so than in 2008-09). Anecdotally, we've heard of some lenders who are acting as the rescue capital themselves and/or serving as an intermediary between their borrowers and new capital sources. Over the coming months, we will attempt to position ourselves as a resource for lenders' special servicing groups with the hope to potentially source of some of these 'rescue' deals. Whether and to what extent lenders are willing to work with their borrowers, as well as how much rescue capital is available, will directly influence how much buying opportunity we see in the coming years.

4) In February 2023, month over month **RENT GROWTH** stayed positive for the second consecutive month, after declining monthly since August 2022, however national year over year rent growth decelerated from 3.2% in January 2023 to 2.9% in February 2023. Midwestern markets including Indianapolis, Columbus and Cincinnati were all in the top 5 markets for rent growth, with Sun Belt cities faring the worst overall, particularly in Las Vegas and Phoenix. Leasing traffic is returning to healthier levels coming out of the holiday seasonal slow-down, but a good portion of this activity likely relates to higher turnover.



DATA FROM NMHC, continued

Resident retention rates, which skyrocketed over the past few years (with rents running, it was often cheaper to renew than to relocate), dropped 5.5% year over year in January 2023, to 51.3%, a more historically normal level. This retention rate is expected to drop even further in the coming months as a big wave of new apartment supply (plus cooling rents) incentivizes more turnover among tenants looking for a good deal.

5) **EXPENSE CONTROL** will be incredibly important this year and beyond, both on assets in our existing portfolio as well as in underwriting acquisition targets. Taxes, insurance, payroll, and utilities have already seen huge increases in this inflationary environment and for now we are assuming those trends will continue. We will continue to focus on gaining operating efficiencies across our portfolio, while managing for stable occupancy (in lieu of rent growth), in order to reduce turnover costs wherever possible.

INFLATION UPDATE

The consumer price index (CPI) moderated in February on a year-over-year basis to 6%, down from 6.4% in January, marking the lowest level of inflation since September 2021 and the 8th straight month of easing inflation since the peak of 9.1% in June 2022. The still elevated inflation report, along with strong employment data, will likely keep the Fed on track to continue raising interest rates at their upcoming March meeting. However, nothing is certain; while probably an unlikely outcome, there is some noise that in the aftermath of the SVB collapse last week, the Fed will opt to hold rates at current levels.

Despite some signs of softening, national employment remains incredibly resilient in the face of the Fed's efforts to battle inflation. The February jobs report showed non-farm payrolls increased by a seasonally-adjusted 311k, which was a drop from January's revised 504k gain. The unemployment rate also rose to 3.6% from January's 3.4% (the lowest jobless level since 1969), as more people jumped into the labor force. Average hourly wage growth decelerated from January's 0.3% to 0.2%, another positive data point that could lead the Fed to moderate the pace of future rate increases. Leisure and hospitality industries led the employment gains across all sectors as those segments continue to restabilize to pre-pandemic norms.

INFLATION UPDATE, continued

In comparing these data points to the trends that began during the Great Financial Crisis (GFC), the average U.S. unemployment rate from 2010-2019 was 6.2%, while inflation was at a sub-Fed target of nearly 1.8% for CPI, and 1.6% for PCE. The supply/demand dynamics introduced during the pandemic, and persisting today in some forms, essentially caused a complete reversal of those trends, with 2022 average CPI inflation at ~8.0%, average PCE at 6.2% and the average rate of unemployment at 3.6%. We've pivoted from excess unemployment to excess jobs, however, despite the Fed's aggressive interest rate hike policy, the increasing number of layoffs beyond tech and finance, and simmering inflation, we are unlikely to realize a looser U.S. labor market anytime soon.

We think Berkadia's Macro Commentary sums up these trends nicely: "Even as COVID effects dissipate, a mixture of influences such as demographic obstacles and overall declining participation rates (we do acknowledge participation rates have been moving up, but not meaningfully) will keep the U.S. labor market more constricted in this cycle than many may believe. While we have likely moved beyond the most 'unpleasant' parts of the current labor shortage (as indicated by the softening of wage growth), the effects of the pandemic simply unveiled issues and / or deficiencies in the foundation of the U.S. labor market: a retiring generation (dwindling labor participation rates), deglobalization, reduced immigration, and broader demographic headwinds. These changes are neither easily nor quickly fixed.

This new economic background provides a framework in which the Fed will have to keep a tighter policy stance in an effort to contain inflationary pressures within the labor market. If we have already achieved the "soft landing" where employment is stable and deflationary pressures exist, then there is no need for future rate cuts, and the current trajectory of 5%+ terminal rate will actually become the neutral rate. Unfortunately, it is more likely that this framework will keep core CPI well above the 2% target, and the higher-for-longer monetary policy will ultimately squeeze profit margins such that unemployment is forced to rise to a longer-term average. Currently, we forecast a 5.4% unemployment rate by next year, but we have yet to feel the full effects of the unprecedented rate hikes of 2022, and these projections could easily worsen as the Fed focuses on restoring price stability first and worrying about the labor market second."

Until the economy, and specifically inflation and the labor market, settles, where interest rates will go is still very uncertain. We will continue to watch these developments closely in the weeks and months ahead and have modified our underwriting to stress test the effects of high inflation and higher interest rates as we evaluate new opportunities.

RENT CONTROL/GOVERNMENT INITIATIVES UPDATE

We're closely monitoring several rent-control initiatives proposed in markets across the country and will not invest in these markets if there is a high likelihood of those measures passing. In addition, the Biden-Harris Administration recently announced initiatives focused on the rental housing industry called "The White House Blueprint for a Renters Bill of Rights" and a "Resident-Centered Housing Challenge".

- The Blueprint for a Renters Bill of Rights lays out a set of principles to drive action by federal, state and local governments, along with the private sector, to promote rental affordability and strengthen tenant protections. Several federal agencies, including the Federal Trade Commission (FTC), Consumer Federal Protection Bureau (CFPB), Federal Housing Finance Agency (FHFA), and Department of Housing and Urban Development (HUD), have agreed to collect information on industry practices. In addition, these agencies will be considering rulemaking to implement specific Blueprint goals.
- The Resident-Centered Housing Challenge is intended to encourage housing providers and other stakeholders to voluntarily adopt policies and practices viewed as more favorable to renters.

RECENT FOUR MILE CAPITAL TRANSACTION HIGHLIGHTS

Sale of Laurel Pines. In January 2023, we successfully closed on the sale of the 120-unit Laurel Pines Apartments in Richmond, VA for $21,000,000, or $175k/unit. Laurel Pines, built in 1993, was purchased off-market in March of 2017 as part of a two-property portfolio for $10,558,000, or $88,000 per unit, along with another asset, the 182-unit Frontier Apartments in Roanoke, VA (purchased for $10M, or $55k/unit). We previously sold Frontier in late 2020 for $17.25M, and in the process, returned ~135% of initial investor equity in the portfolio.

RECENT TRANSACTION HIGHLIGHTS, continued

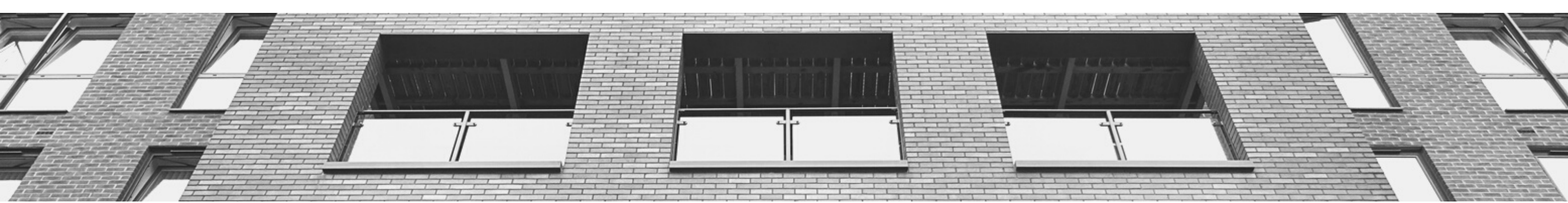
While Laurel Pines was a strong cash yielding asset, returning the equivalent of a ~11% annualized cash return from operations (calculated on initial equity, as all equity was returned in 2020 from the Frontier sale), we felt that we had created the vast majority of the value in our initial business plan, having invested nearly $600k to upgrade the clubhouse, pool and unit interiors, so we opted to create some liquidity for our investors and sell, a process we began in the summer of 2022.

Ultimately, the sale of Laurel Pines resulted in a deal-level 29.57% IRR and 4.02x equity multiple, and at the investor level, a 24.94% IRR and 3.27x equity multiple. In looking at the portfolio-level returns for LPFA Holdings LLC (combined with the cash flow and sale of Frontier in 2020), this sale resulted in a deal-level 33.50% IRR and 3.68x equity multiple, and at the investor level, a 30.32% IRR and 3.22x equity multiple. We were thrilled to deliver this outcome for our investors.

District at 6th Refinance. As mentioned in our last letter, we purchased District at 6th Apartments (D6) in Des Moines, IA in October 2021 with a 2-year, $30.7M floating rate loan with UBS. Given the rapid increase in interest rates, refinancing into a longer-term fixed rate loan to protect investor equity was one of our highest priorities over the past few months. Initially, due to the run-up in interest rates, we could only obtain loan proceeds of $27-$28M—well short of the funds needed to fully refinance our current loan.

Rather than lock in a rate and proceeds that would have required a capital call of several million dollars, we instead went to work with our property management team and lender to take steps to increase our proceeds.

We helped the property management team maximize NOI through targeted expense-cutting, and also by shifting our leasing strategy to a revenue-maximization approach (rather than managing for occupancy as we had done while we finished leasing up D6). We also worked closely with our loan originator, Grandbridge Real Estate Capital, to provide them with all documentation and information needed so we were positioned to almost immediately lock in a lower interest rate (and therefore higher loan proceeds) if/when we saw a dip in treasuries. Grandbridge, in turn, worked incredibly hard to negotiate a competitive 170bps spread over the 7-year Treasury index with our lender, Freddie Mac.



RECENT TRANSACTION HIGHLIGHTS, continued

With that preparation in place, when interest rates dropped in early January, we were able to quickly index lock the 7-year treasury at 3.64% (putting our all-in interest rate at 5.34%). This resulted in loan proceeds of $30.4M that, when factoring in the sale of our rate cap and closing costs, allowed us to fully refinance the balance of our current loan, needing less than $200k cash-in to close on February 6, 2023. Because we had halted distributions during the Property's lease-up, we were able to pay the cash-in payment from the property, therefore avoiding a capital call from our investors. All told, we went from application signing and rate lock to closing in 22 business days, an incredible outcome! Most importantly, we were able to protect 100% of investor capital and expect to begin cash flow distributions in Q2 or Q3 of this year.

Old Mill Refinance. Finally, we are in the process of refinancing the loan on one of our Virginia assets, the Old Mill Townhomes in Lynchburg, VA. Though there are several years left on the current loan (with an interest rate of 5.05%), we realized that for a very low prepayment penalty we could refinance the current loan with a new loan at a low 60% loan-to-value. In so doing, we will be able to pay investors 100% of their accrued and unpaid preferred return and return 100% of investor capital, all while locking in a fixed interest rate for 10 years with full-term interest-only payments.

Over the past week, we worked diligently with our loan originator, Newmark, to put ourselves in a position to rate lock quickly given recent market volatility. We are very excited to report that we locked our interest rate on the refinance at 5.16% on March 13. Our timing was very fortunate as the very next day, the same loan would have commanded an interest rate of over 5.40%, so we are exceedingly pleased with this result. Congratulations to all of our investors in Old Mill and thank you for your quick approval of this transaction! Without hearing back from you as quickly as we did, we could not have rate locked on Monday this week.

Following closing of the refinance at the end of April, investors will continue to own the asset and receive distributions of 70% of all go-forward profits and cash flows despite having had their initial investment returned to them tax-free. We expect investors in Old Mill to continue receiving distributions of 6%+ when calculating future cash flows divided by their initial equity investment. We also estimate that as of today there is $8M of equity left in the property that will hopefully grow to a much larger sum between now and when we sell the asset.

ADDITIONAL 2023 PORTFOLIO INITIATIVES

Though the D6 refinance is complete, we still have one other property in our portfolio that is subject to a floating-rate loan—the Meridia Apartments in Tulsa, OK. While the apartments are very stable at 98%, as is the 19,500sf of retail at 92% occupied, the Birdcage Parking Garage (purchased in conjunction with the apartments and retail) continues to lag behind projections. This under-performance is directly impacting our ability to refinance out of our last floating-rate loan in the portfolio, so improving garage operations continues to be a key focus for us going forward.

In the near-term, we are replacing the parking garage manager in an effort to quickly boost revenue above today's levels. In the longer-term, we are exploring making some small but meaningful capital improvements (fencing in the lower levels, adding parking arms, etc.) and/or converting all or a portion of the garage to self-storage. In the end, we will analyze all alternatives to improve performance and select the path that we believe will provide the best outcome for our investors. Once the garage is stabilized, we will proceed to either renegotiate the loan terms with our current lender or refinance into a new loan. We will also consider selling all or a portion of the investment should that make the most economic sense.

In addition to the above initiatives, we've also been busy overseeing capital projects and improvements at our portfolio properties, continuing to look for ways to maximize income and minimize expenses and executing on the business plans we laid out for each asset in the portfolio at acquisition.

The Meridia Apartments and BIrdcage Garage
Tulsa, OK

OF INTEREST

In closing, below are links to a couple of interesting articles regarding economic developments in one of our top markets, Des Moines, IA. Four Mile Capital currently owns 3 assets totaling ~650 units in the market.

- In exciting market news, the city of Des Moines has announced plans to build a 6,300-seat soccer stadium (Des Moines Soccer Stadium) to host their new pro soccer team. This is part of the redevelopment of the Dico industrial remediated Superfund site, located across the river from our District at 6th project and near the minor-league Principal Park.

- The City has also been working on a 40-acre project which is designed to house new businesses, housing and attract locals to visit, located just blocks from District: Market District.

- Top Golf has announced plans to build their first driving range facility in West Des Moines, further validating the growth we expected in Des Moines.

District at 6th Apartments
Des Moines, IA

Aspire Townhomes
Des Moines, IA

Bricks at Waukee East
Waukee, IA

THANK YOU!

If you're still reading, thank you for your interest as well as for the trust and confidence that you continue to place in us. We are grateful for our relationship with each of you, and we look forward to our continued partnership.

We'd love to hear from you, so please don't hesitate to reach out if you'd like to discuss any of the points mentioned above.

Stay well and talk to you soon.

Best regards,

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