Is the Long Upswing Still on Track?

Philip Martin
Head of Research
Waterton

2016 NMHC Research Forum
April 6-7, 2016
Apartment Sector Demand and Growth Catalysts Shifting

• DECLINING homeownership rates and accessibility, apartment vacancies and capitalization rates GIVING WAY to a greater reliance on:
  • The resumption of job and income growth

  • The resumption of household formation growth

  • Relative housing value

  • Changing attitudes towards housing and lifestyle, across a greater number of age-cohorts

  • The execution of value-add investment and capital allocation strategies by experienced owners/managers
We Anticipate Aggregate Housing Demand to Outpace Supply...

- Incremental housing demand forecasted to outpace supply
  - Household formation growth to total housing completion ratio 1.15x vs. 0.83x LTA

Source: Waterton, U.S. Census, Zellman and Associates
...With Apartments Continuing to Benefit Across Many Metro Markets

- Forecasted apartment demand outpacing national and LTA’s in many large metropolitan markets

![Total Forecasted Job Growth to Apartment Completions (5 Year)](chart)

Source: Axiometrics, FRED
Apartment DEMAND Factors Include an Improving Economic Backdrop, Especially Among the 25-34 Age-Cohort...

<table>
<thead>
<tr>
<th>Employment and Economic</th>
<th>Current</th>
<th>Long Term Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States Job Growth (5-year forecast)</td>
<td>1.70%</td>
<td>1.10%</td>
</tr>
<tr>
<td>Aggregate Employment to Population</td>
<td>59.80%</td>
<td>61.70%</td>
</tr>
<tr>
<td>Employed Full Time - 25-34 Age-Cohort</td>
<td>77.00%</td>
<td>78.00%</td>
</tr>
<tr>
<td>Aggregate Job Openings</td>
<td>5,600,000</td>
<td>3,800,000</td>
</tr>
<tr>
<td>Professional Services Job Openings</td>
<td>1,000,000</td>
<td>700</td>
</tr>
<tr>
<td>Initial Jobless Claims (4 week moving average)</td>
<td>270,250</td>
<td>362,500</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>5.00%</td>
<td>6.10%</td>
</tr>
<tr>
<td>Under-Employment Rate</td>
<td>9.80%</td>
<td>10.30%</td>
</tr>
<tr>
<td>Unemployment Rate - 25-34 Age-Cohort</td>
<td>5.20%</td>
<td>6.10%</td>
</tr>
</tbody>
</table>

Percentage of 25-34 Age-Cohort Employed "Full Time"

Pre 2008 Historical Average = 78%

Source: FRED
...and Improving “Real” Wage Growth...

Annualized “Real” Household Income Growth

Source: FRED
...and the Favorable Relative Housing Affordability of Apartments Across Many Metros In Terms of “Rent to Income”...

Median Rent to Income Ratio - "A" v "B" Apartment Communities

Long term average = 26%

Source: Axiometrics

Rent to Income Ratio ("A")  Rent to Income Ratio ("B")
...and as Compared to Homeownership

- Renting vs. homeownership in many large metro markets continues to favor apartments

Median Aggregate Rent to Homeownership Cost Ratio

Homeownership requires a $30,000-$60,000 down-payment among the major metropolitan markets (10%-20% LTV for "median" home)

"Renting" more affordable than "homeownership"

National Average: 92%

Source: Axiometrics, REIS, ESRI
### Aggregate Housing Supply

<table>
<thead>
<tr>
<th>Metric</th>
<th>Current</th>
<th>Long Term Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Institutional Quality Apartment Unit Growth (5-year forecast, % change)</td>
<td>1.60%</td>
<td>1.70%</td>
</tr>
<tr>
<td>Annualized Apartment Unit Growth (5-year forecast)</td>
<td>350,000</td>
<td>250,000-275,000</td>
</tr>
<tr>
<td>Annualized Single Family/Condo Unit Growth (5-year forecast)</td>
<td>1,100,000</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Homeownership Rate - Quarterly</td>
<td>63.50%</td>
<td>65.70%</td>
</tr>
<tr>
<td>Month's Supply of Existing Single Family Homes</td>
<td>5.0-5.5</td>
<td>6.5</td>
</tr>
</tbody>
</table>

### Single Family Housing Supply Below Long Term Averages

**Source:** FRED

- **Single Family Housing Permits**
- **New Single Family Homes For Sale**
- **Existing "For Sale" Single Family Housing Inventory**
- **Months Supply of Single Family Homes (right axis)**
Risks to Consider

• Increasing aggregate housing supply
  • pent-up single family housing demand?
  • Apartment rental rate spreads – new vs. existing

• Potentially improving and more competitive global investment landscape
  • reluctant existing investors have incrementally greater investment choices?
  • reduced incremental investor interest?

• Lack of employment and/or income growth momentum

• Interest rate volatility

• Housing affordability

• GSE reform

• Global economic uncertainty
Is the Long Upswing Still on Track?

Jim Clayton
Head of Investment Strategy & Analytics
Cornerstone Real Estate Advisers

2016 NMHC Research Forum
April 6-7, 2016
SEARCHING FOR CLARITY...IMPLICATIONS FOR APARTMENTS?

CRE: Time to Wave the Caution Flag?

First Quarter 2016

PwC Real Estate Investor Survey™

CRE Valuations are Flat-Lining as Market Cycle Enters Ninth Inning
PRICE AND RENT RECOVERIES BY PROPERTY SECTOR

Moody’s/RCA CPPI Recovery 4Q15
Level as a % of 2007 Peak Pricing

Average Annual Rent Growth (%)
CBRE-EA Rent Index Inflation

Sources: Cornerstone, Moody’s/RCA, CBRE-EA (4Q 2015).

CPPI = Commercial Property Price Index
OCCUPANCY TRENDS ACROSS SECTORS & MARKETS

Office

Current Occupancy Rate (4Q 2015)

2 year forecast

Industrial

Current Occupancy Rate (4Q 2015)

2 year forecast

Retail

Current Occupancy Rate (4Q 2015)

2 year forecast

Apartments

Current Occupancy Rate (4Q 2015)

2 year forecast

Source: Cornerstone, CBRE-EA (4Q 2015)
Investment Themes

- **Economy + demographic and societal shifts** => continued opportunity, but evolving

- **Portfolio tilt away from “beta” toward “alpha”** BUT balance with downside protection

- Submarket and asset selection are key today

- Supply risks are concentrated and may be “different this time”
  - Urban core revitalization and densifying outer nodes
  - Obsolescence of stock
25-29 Year Olds Are “Different” Today

- % Living with Parents
- % Ever Been Married


by Lynn Fisher and Jamie Woodwell, Mortgage Bankers Association, July 2015.