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# U.S. Rented Residential Sector

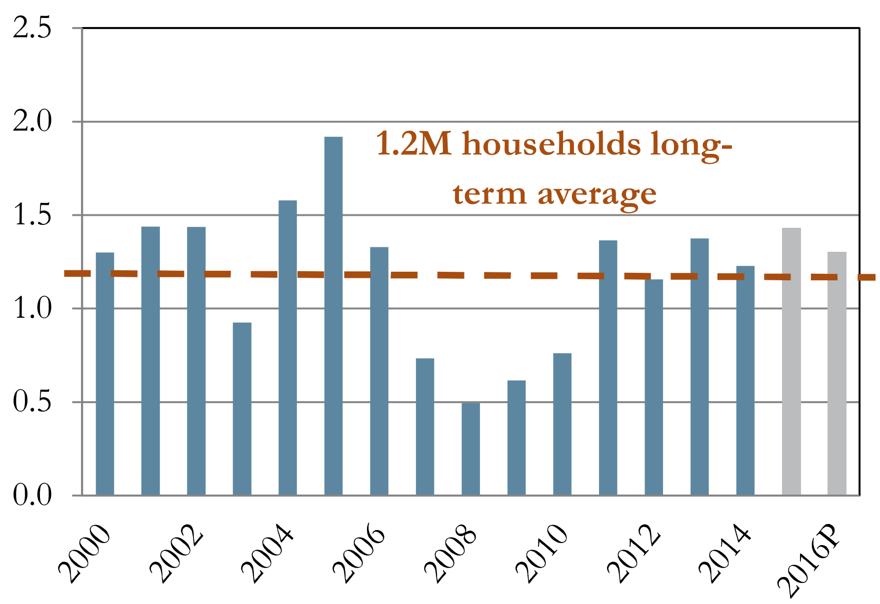
## *Single-Family vs. Multi-Family ?*

GTIS PARTNERS

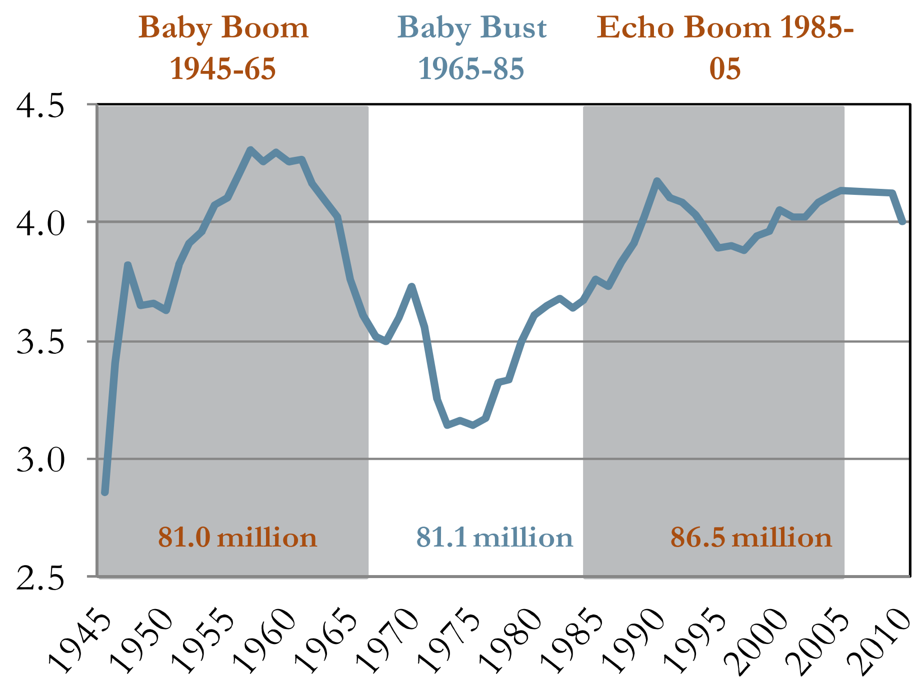
**Dietrich Heidtmann, Managing Director**

# Demand: U.S. Household Formations Are Returning to Normalized Levels and the Entry of Millenials Continues to Boost Demand

**Annual Household Formation (Millions)**




**Annual Births in the U.S. 1945-2010 (Millions)**

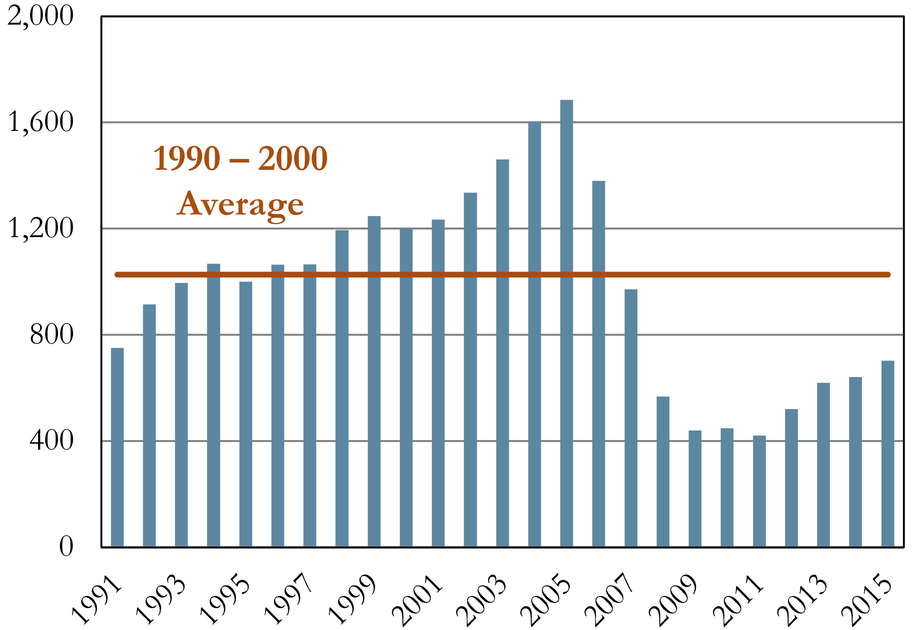



- Steep decline in household formation during the recession as people doubled-up, delayed marriage or returned to parents' homes.
- Only 510k households were formed annually vs. a long-term average of 1.3M, implying 1.4M missing households
- Gen Y (largest cohort on record with 87m people) is expected to boost housing demand especially in the major metropolitan areas. The young adult population is projected to increase by 2 million total between 2013 and 2016

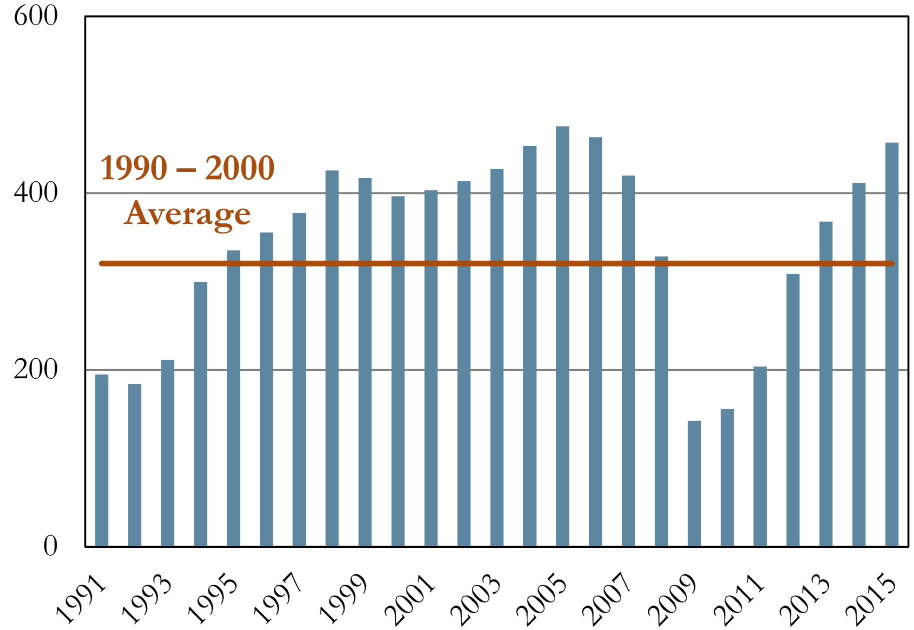
Sources: U.S. Census Bureau, BLS, JBREC

# Supply: Overall Undersupply, But Balance Skewed to Strong MFR Supply and a Shortage of SFR housing

**Single-Family Permits (000s)**




**Multifamily Permits (000s)**



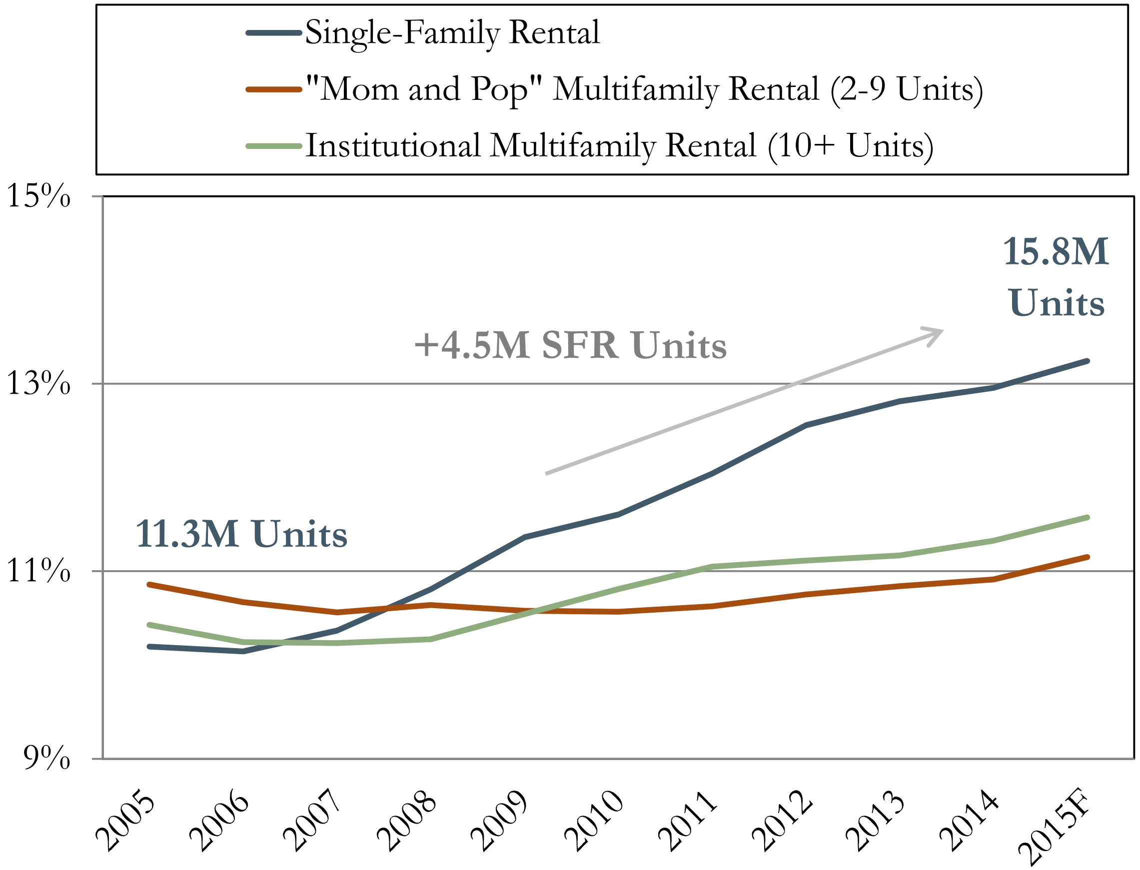

- Overall residential housing permits have slowly recovered (+10% year-over-year and over 2x above trough), but in aggregate still trail demand.
- Currently over 2.2 jobs created for every permit issued compared to long-term average of 1.2
- New supply has been predominantly led by multifamily.
- **New single-family permit issuance is close to the 60-year low** and well below normal levels of 1.0 million annually, while multifamily permits have recovered to recent pre-recession peak and well above normalized levels



Source: John Burns Real Estate Consulting (JBREC)

# SFR Is the Largest And Fastest Growing Residential Rental Asset Class in the US, Adding 4.5 Million Units Since the Recession

## Growth of Rental Housing Stock by Type



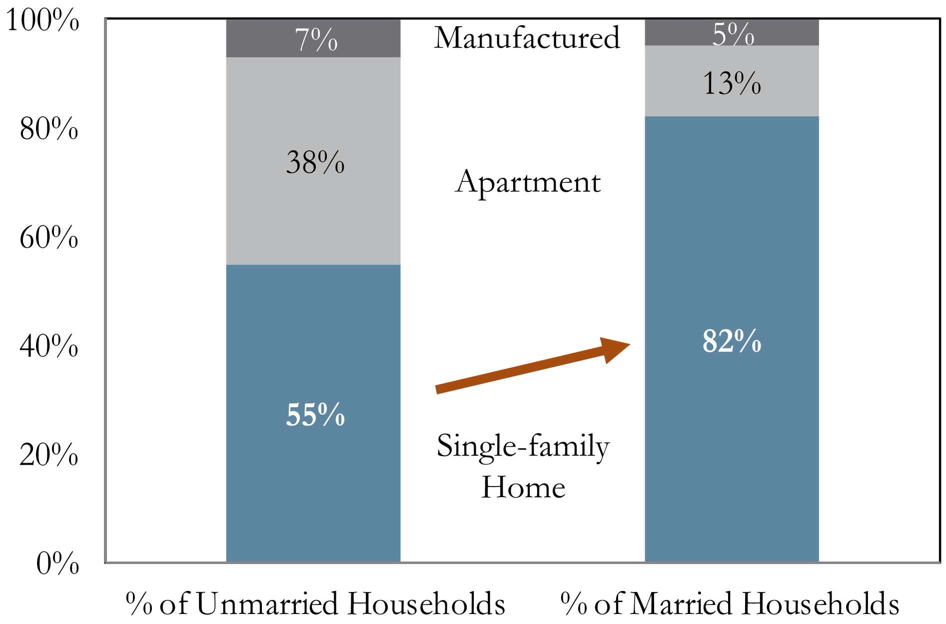

## Size of SFR Sector

- **76%** of the US population lives in single family homes
- **SFR** has grown to nearly **16 million units** nationally, comprising 13% of the total housing stock and **35%** of all rentals
- Overall, more people live in single family rentals than in institutional apartment buildings
- SFR growth is driven by both demographic demand combined with challenging income and credit conditions for traditional home ownership

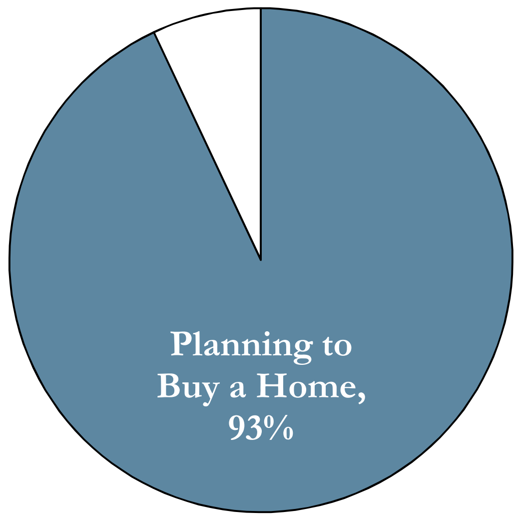
Sources: U.S. Census Bureau, GTIS Partners

# Households Prefer Single Family Housing By a Large Margin After Marriage – 82% of Families Live in Single Family Homes

**Married Couples Move to Single-Family Homes**




**Survey of 18-34 Year-Old Renters**

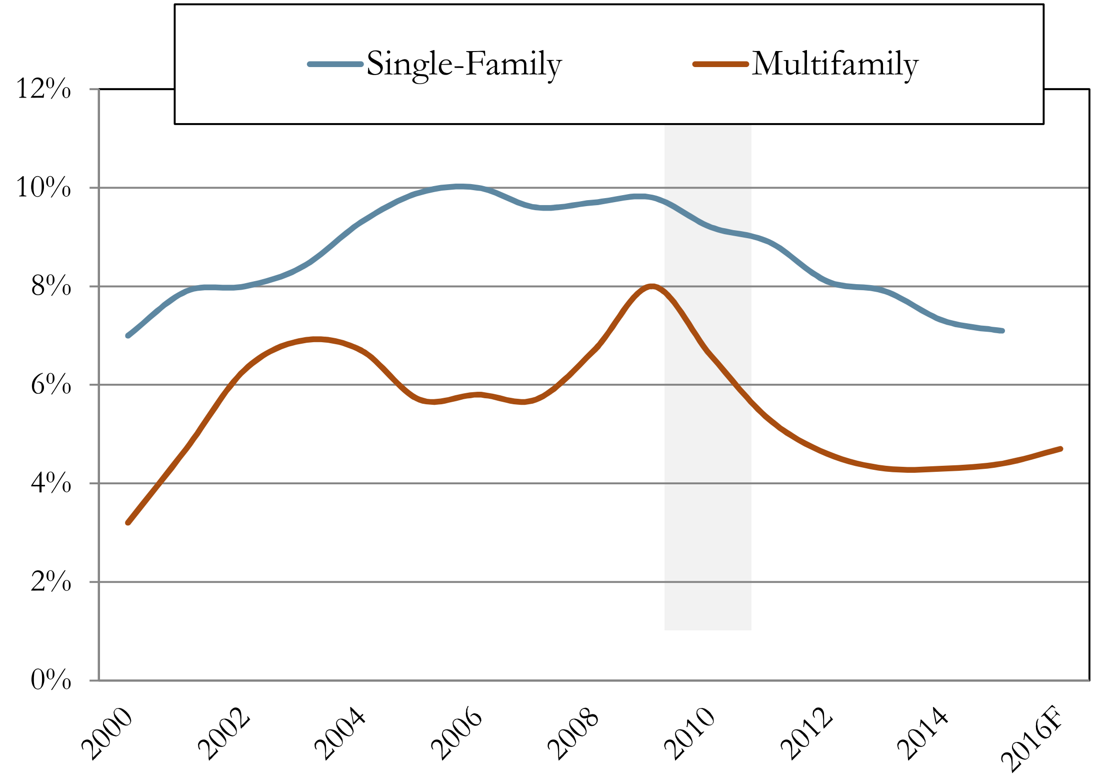



- Family circumstances such as marriage determine the preference for type of shelter (i.e. single-family house), while the choice to rent or own is a separate financial decision driven by income and mortgage availability
- The aspiration to own a single-family house (the American Dream) has not changed, only the ability to afford it
- As the millennial generation matures from their early 20's to early 30's, they are starting to form families and moving to a suburban environment with more space, better public schools and a family oriented community

Sources: US Census Bureau, Conference Board, Goldman Sachs

# Vacancy: Rental Vacancy Has Decreased in Both Multi and Single Family Since the Recession, With SFR Showing Less Volatility

## Rental Vacancy Rate by Type of Unit



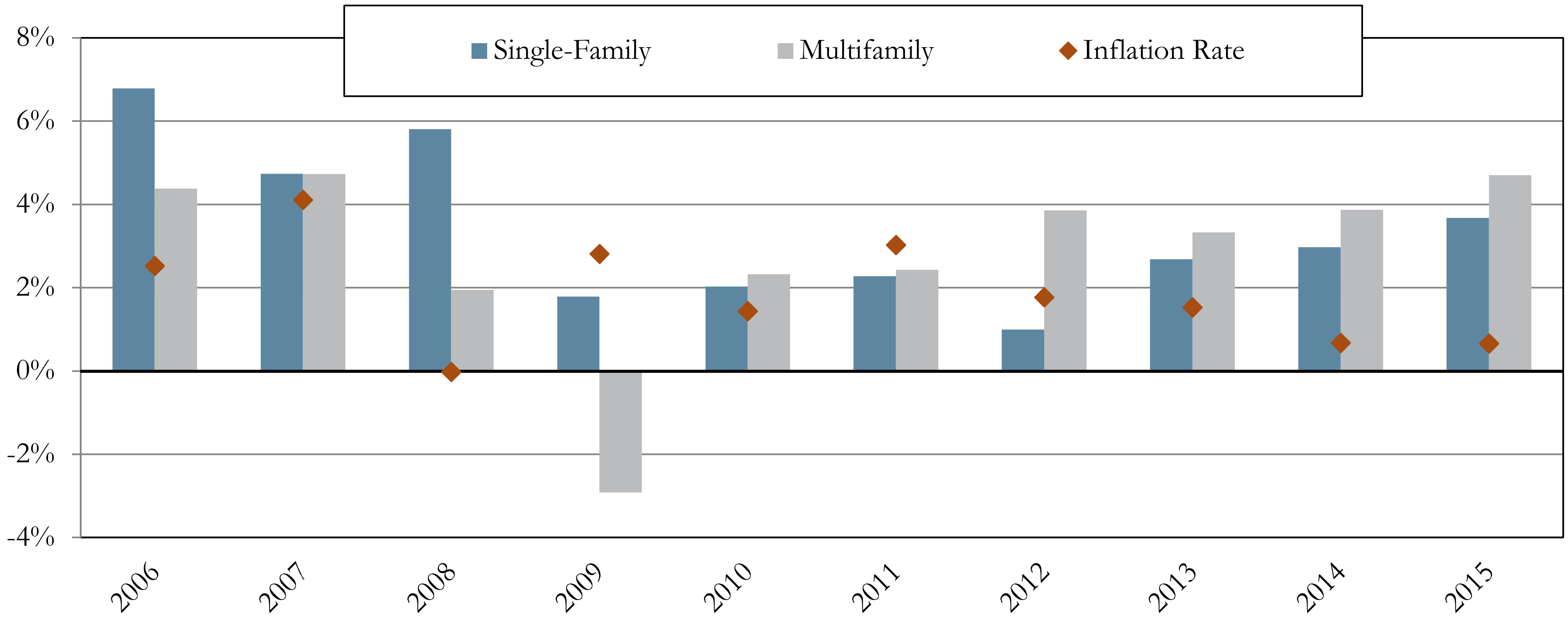

## SFR Outperformance

- Rental housing vacancy has generally remained within a narrow band of 5-7% (multi) and 7-10% (SFR) over the past three decades
- Post crisis, both single-family and multifamily benefitted from the sluggish economic recovery that drove increased rental demand. However, compared to multifamily, SFR has exhibited less volatility and has captured greater market share
- During a downturn, SFR provides better performance and less volatility due to structural demand from displaced homeowners seeking similar type of shelter but unable to buy

Sources: U.S. Census Bureau, REIS, GTIS Partners, Company Filings

# Rents: SFR Rents Have Grown Roughly in Line with MFR Rents but Have Performed More Defensively in Down Years

Annual Rent Growth by Housing Type

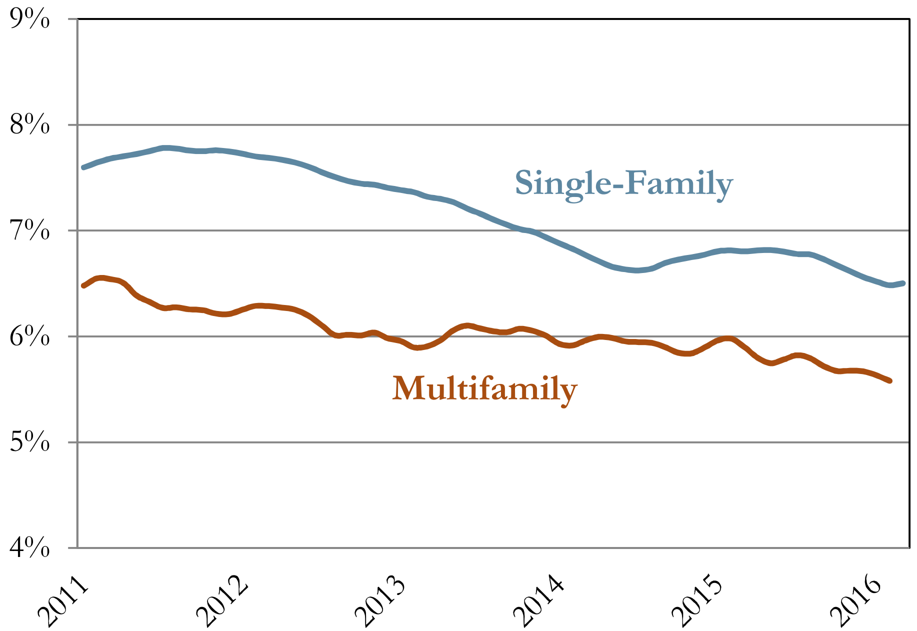



- Rental housing in general is stable and defensive – nation-wide, there have been virtually no down years in terms of rent growth since the Great Depression (local markets vary)
- In a strong economy, rentals provide good inflation protection, with rental growth generally exceeding the inflation rate
- SFR asset class specifically has generally matched multifamily rent growth in good years, while performing defensively in a recession (positive performance even in the depths of the 2009 recession)

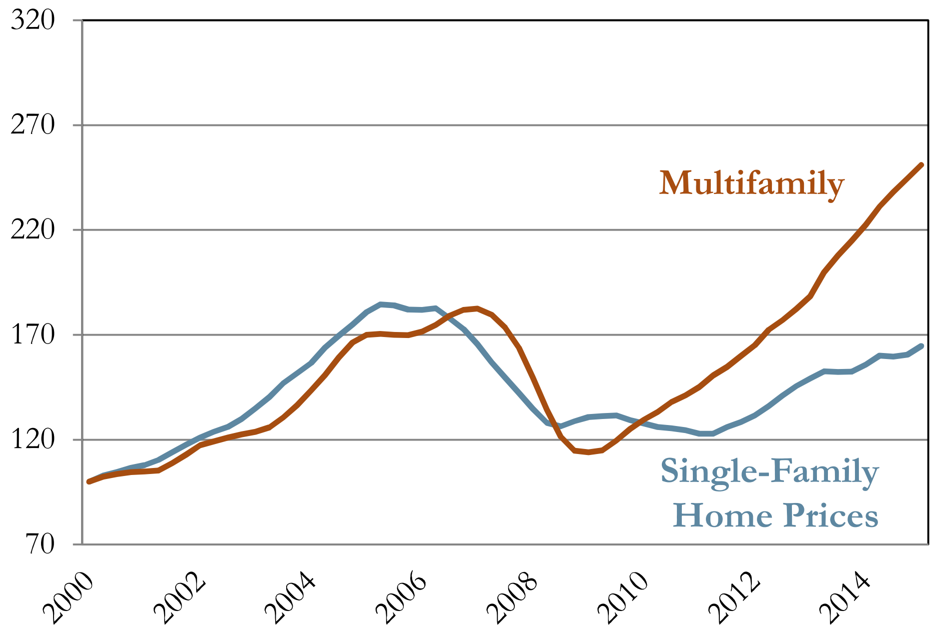
Sources: U.S. Census Bureau, REIS, GTIS Partners

# Valuation: Single Family Valuation Appears Attractive Compared to Multifamily

**Single-Family vs. Multifamily Cap Rates**




**Single-Family vs. Multifamily Value Recovery**



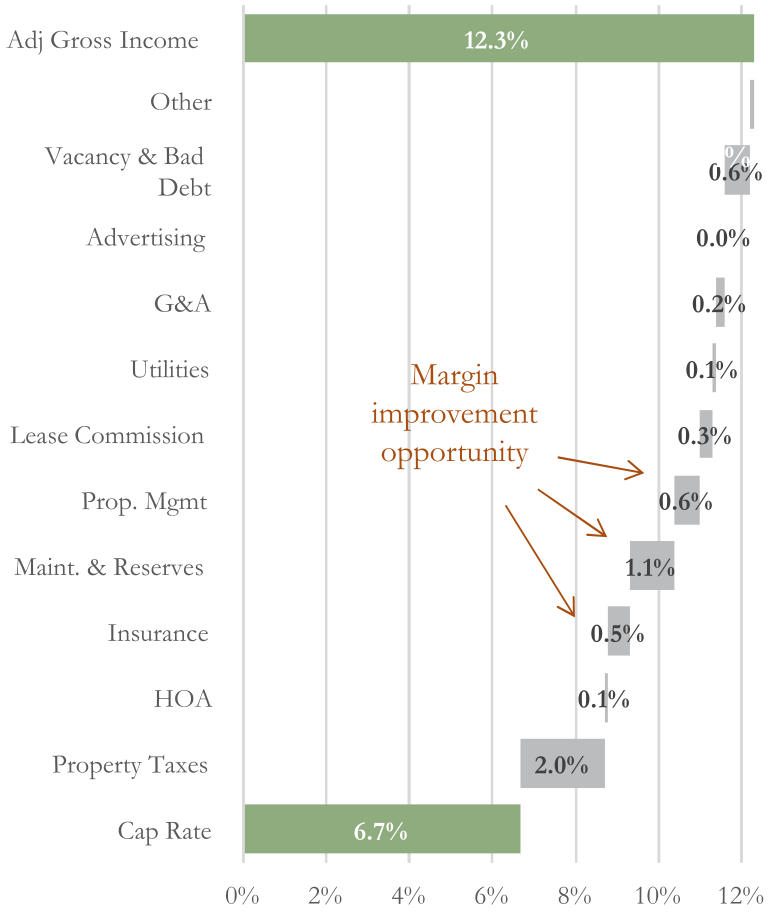

- Single-family rental cap rates appear attractive at 6.5%, or 8-150 bps spread over multifamily
- Multifamily assets surpassed peak valuations in 2013 due to strong rent growth and cap rate compression, but single-family home prices are only 75% back to normal. JBREC forecasts an additional 10.4% home price appreciation through 2018
- Opportunity to invest in a growing and supply-constrained market (SFR) vs. reliance on cap rate compression or high leverage (multifamily)

Sources: Moody's, S&P Case-Shiller, Costar, Zillow, GTIS Partners

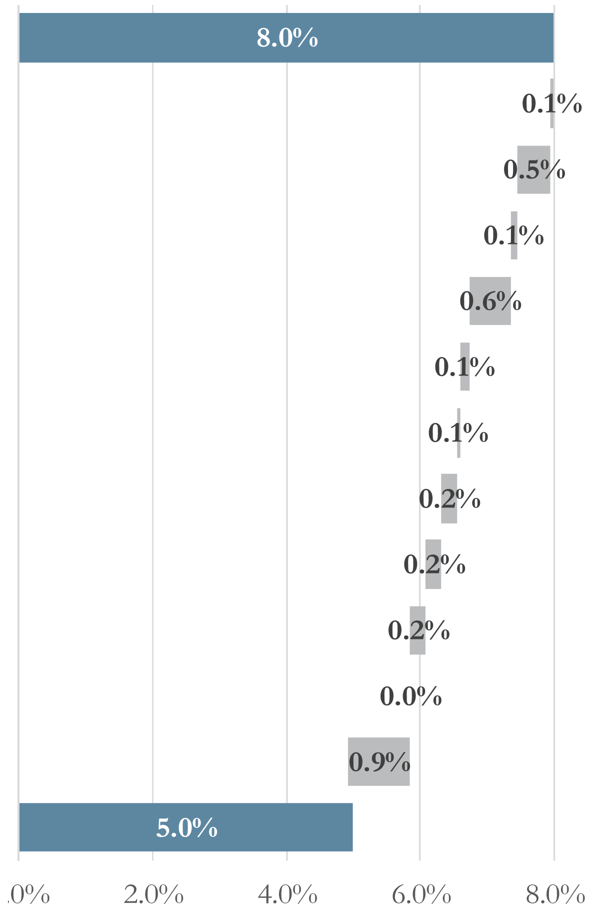
# Operating Margins: SFR Offers Attractive Yield Compared to MFR, With Opportunities For Margin Improvement

**SFR gross yields in the 11-13% range equate to asset-level cap rates in the 6-7% range. Comparative multifamily transactions have gross yields in the 7-9% range translating to cap rates in the 4-6% range**

## GTIS Single Family Gross to Cap Rate Spread




## Typical Multi Gross to Net Spread

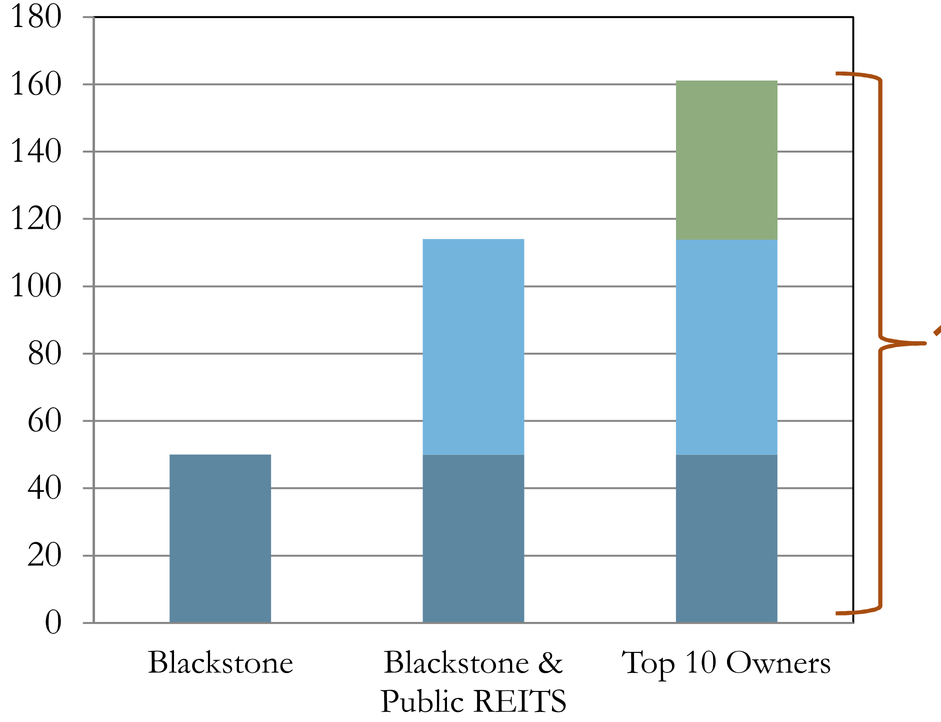


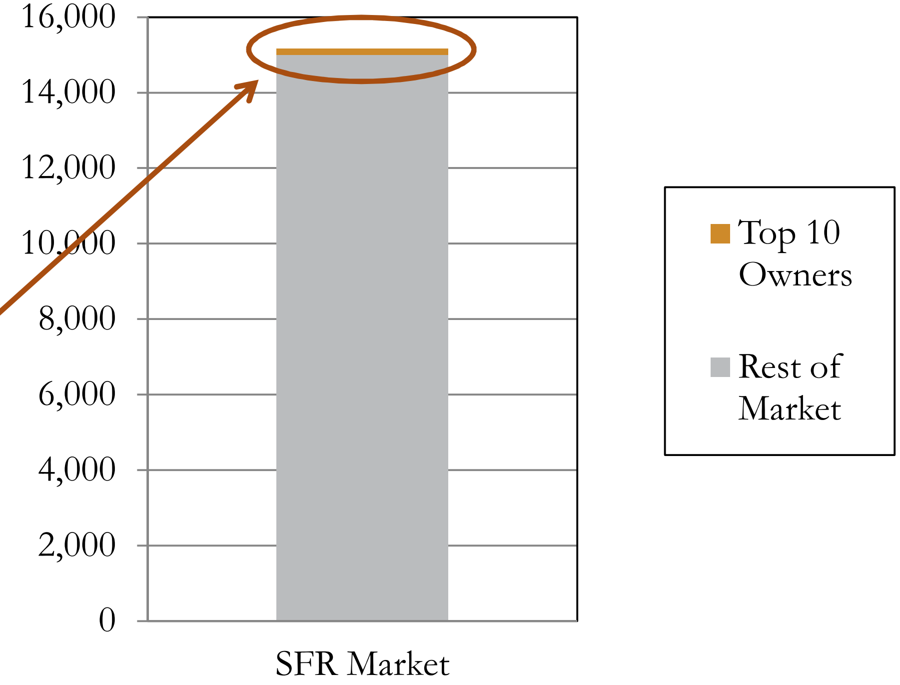

## Note

- Conservatively assuming higher vacancy and bad debt charges for SFR, although experience so far suggests the opposite
- Multifamily G&A typically includes onsite staff
- Most SFR leasing currently done through agents rather than online
- Property management of SFR is more costly due to spread-out nature of the asset
- SFR requires larger maintenance reserves as operations are not stabilized
- MF properties do not have HOAs
- Single family properties pay higher taxes than MF in many jurisdictions

# <u>Ownership</u>: SFR Remains Very Fragmented, and Ripe for Consolidation, Similar to Multifamily REITs in the 1990's

## SFR Market Share (000's of Units)




- **Institutional investors still comprise less than 2% of the SFR market** and the sector continues to be very fragmented, providing massive consolidation opportunity
- In recent quarters, institutional investors have slowed down purchases in order to concentrate on leasing and stabilizing their portfolios acquired over the last 2-3 years
- There is significant opportunity for well capitalized ventures to expand rapidly into fully functioning operating platforms

Source: Public company filings, Keefe, Bruyette & Woods, US Census Bureau, GTIS Partners

# Comparison of Single Family and Multifamily Investment Drivers

## Comparison of Single and Multifamily Sector

- **Demand Drivers and Relative Size**
  - SFR is both the largest and the fastest growing segment of the rental market – SFR has grown by 5 million units (from 11 to nearly 16 million) over the last decade, while institutional multifamily increased by 1.7 million
  - Demographic trends are in favor of SFR as the large millennial generation (87 million people) matures from their early 20's (typically apartment renters) to early 30's (typically home owners, but unable to qualify for mortgage in the current environment)
  - Share of households living in a house vs. apartment rises from 55% to 82% once they start a family
- **Fundamentals – Vacancy and Rents**
  - As the rental market has tightened and vacancy decreased over 3 percentage points since 2007, SFR rents have been pushed up by over 3% annually
  - SFR rent growth has generally matched multifamily rent growth in strong years, while being more defensive in downturns – even in 2009 when multifamily rent growth was negative, SFR rents rose 1.8%
- **Operating Margins**
  - SFR is more expensive to operate than multifamily rentals, with a 5-6% spread between the gross rental yield and net cap rate, compared to 3-4% spread for multifamily – this is due mostly to higher property management and maintenance costs, higher real estate taxes, and generally more dispersed nature of the SFR assets
  - However, due to high initial gross yield (11-12%), SFR net cap rate after all expenses still significantly exceeds typical multifamily cap rate (6-7% vs. 4-5%)
  - SFR offers significant opportunities for margin expansion due to potential economies of scale in operating a larger portfolio, bulk contracting and more sophisticated, technology driven yield management that has already been implemented in multifamily management
  - Opportunity to apply multifamily management know-how to the SFR management process
  - SFR has lower turnover - 25-30% of tenants leave compared to 50-60% in multifamily – leading to potentially lower turnover and leasing costs

# Comparison of Single Family and Multifamily Investment Drivers (Continued)

## Comparison of Single and Multifamily Sector

- **New Supply**
  - Supply of new multifamily product is a concern in a number of markets – new permits in 2015 (460k units) are back to pre-crisis peak and significantly above the long-run average of 320k
  - Meanwhile, single family housing continues to be undersupplied in the aftermath of the worst housing recession - permit issuance of ~700k units is close to 60-year low (all the way to the Great Depression), and well below normalized level of 1.0 million
- **Valuation**
  - Valuation of multifamily assets has increased dramatically following strong recent performance - multifamily surpassed prior peak valuations in 2013 mostly due to cap rate compression, and is now 38% above peak
  - Single family home prices are only 75% back to normal with analysts forecasting an additional 10-15% price appreciation through 2018. SFR cap rates remain attractive at 6-7%, which is a 80-150 bps spread to multifamily
- **Optionality on Exit**
  - Unlike multifamily, SFR offers great optionality on exit – if the economy is weak, strong yields will likely attract institutional buyers looking for income in a low interest rate environment; if the economy is strong, households will return to buying homes and assets can be sold individually at a premium that home buyers typically pay
  - Homes are relatively liquid, whereas Class B and C apartment assets that have comparable yields suffer in terms of liquidity during a recession, as institutional buyers retreat from secondary markets
  - Low correlation with interest rates - housing values are not correlated with interest rates (15% correlation) as the main driver is job growth, while multifamily REITs move with interest rates (~50% correlation) and are more likely to suffer in a rising rate environment
- **Competitive Landscape and Entity Value Creation**
  - Multifamily apartments have largely been institutionalized starting in the early 1990's and the landscape is very competitive
  - SFR only now emerging as an institutional asset class – the landscape is very fragmented with institutions owning <2% of total SFR stock
  - Opportunity to invest in a market leading SFR platform and take advantage of future consolidation and growth, creating entity value that is hard to attain in multifamily

# Thank You For Your Attention !

**Dietrich Heidtmann**

Managing Director -

Head of International Capital Markets

**GTIS Partners**

10, Place Vendôme

75001 Paris, France

Office: +33 1 7037 5880

Cell: +33 6 1582 3050

dheidtmann@gtispartners.com

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