

## newsletter

### If you think we're in late innings, you're watching a different game

In recent months, it's been hard to think of a conversation that hasn't included a variant of this question: "Isn't it too late in the cycle to be investing in real estate?" Of course, this popular topic is nothing new. We addressed it in both our December 2017 and December 2018 newsletters, and now, halfway through 2019, we're doing so again. The bottom line is this: those who fear that the end of the cycle is near are focused on the wrong cycle.

While cap rates and other metrics signal that much of American real estate may be expensive, Avanti is nevertheless finding deep value across the country in medium-term land. There is simply no meaningful organized investment competition for acquiring well-located land from motivated sellers in our large and growing target markets. More notably, this lack of competition comes at a time of great opportunity. For land that is planned for single-family entry-level housing, we're **not even close** to the end of the so-called cycle. To the contrary, we are in the early stages of a multi-year residential expansion.

To understand why, consider these compelling numbers: this year alone, housing *demand*, driven primarily by household formation, will be 1.65 million units. Housing *supply* in response? Maybe 1.30 million. The difference between this supply and demand yields a current housing deficit of 350,000 units. Put another way, if we merely want to meet existing household demand in

2019 alone, we need to build 350,000 more new homes this year than we would if we continue at present rates. On top of this current deficit, the accumulated nationwide backlog is even greater. According to Freddie Mac, the backlog totals 2.5 million unbuilt homes since the end of the recession.

The math is not complicated. First, simply to keep up with today's demand, the country needs to build more. Second, to erase the backlog of unbuilt inventory, the country needs to build even more than that. To do both over the next decade, we'll need to build another 19 million new homes, or 6 million beyond the 13 million we are on pace to build today. Third, consider one last point: these numbers do not fully contemplate the inevitable demand for shelter from 20-30 million Millennial households, the largest number of which are still five years away from buying their first homes.

And where does the bulk of this pent-up demand exist? In Avanti's large and growing markets, demand is where Henry Ford sold cars and Sam Walton sold merchandise: at prices that people can afford. The heart of American housing has always been at the entry-level end of the market, where buyers can afford to buy and be financed at a reasonable multiple of their household incomes.

Now, we're not the only ones who see these trends, even if we are the only folks who focus on medium-term land.

#### Supply Gap Persists



Housing demand in 2019:

1.65 million units

New homes built in 2019:

1.30 million units

Supply gap in 2019:

350,000 units

Cumulative housing deficit since the end of the recession

2.5 million units

Despite the general "late cycle" chatter, others understand the need to deliver entry-level housing too - namely, our homebuilder customers. Led by D.R. Horton, which launched its Express Homes division in 2015 to satisfy the need for affordable homes, large publicly traded builders are making concerted efforts to do the same. NVR offers Simply Ryan, Lennar offers Everything Included, and Meritage offers LiveNow. And others are following suit, with privately held Ashton Woods offering Starlight Homes and Berkshire Hathaway's Clayton Homes recently having acquired eight growth-market builders targeting workforce housing. Contrary to the prevailing narrative, the builders' investment in affordability illustrates the reality of this pent-up demand.

Moreover, Avanti sees powerful anecdotal evidence of this expansion in our own portfolio. In communities where

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we own land that can serve entry-level housing, we can't keep the finished lots on the shelves. And in our new investments, we have builders expressing serious interest in buying from us even before we close.

While constructing homes to service this unmet demand, builders will profit from higher construction volumes, while continuing their practice of not buying land ahead of their near-term needs, even if home prices do not rise. As a result, Avanti can participate in this expansion at even deeper values than the builders - by investing, without meaningful competition, in the land on which these affordable homes will be built. That translates into an uncrowded, less risky path to profits for both our investment and our land developer partners.

So let others wring their hands over the question of whether we are late in the cycle. To us, the five keys to today's op-



## To Avanti, the five keys to today's opportunity are obvious:

- 1 **A current housing deficit, on top of**
- 2 **Years of underbuilding, in the face of**
- 3 **Powerful Millennial demographics, in**
- 4 **A capital-constrained market, with**
- 5 **Proven customer demand upon exit.**

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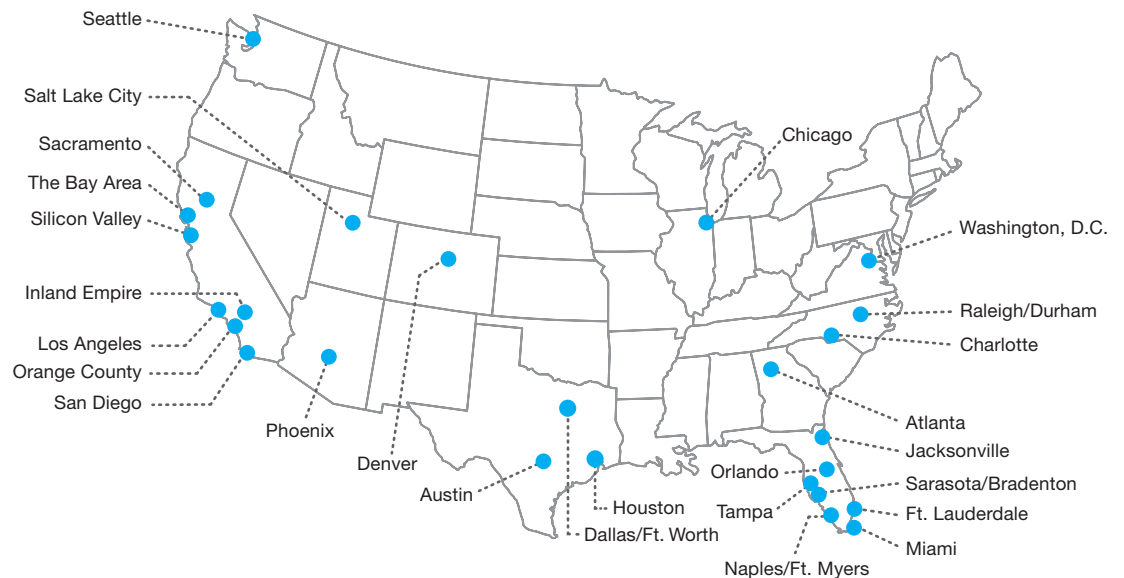
1. A current housing deficit, on top of
2. Years of underbuilding, in the face of
3. Powerful Millennial demographics, in
4. A capital-constrained market, with
5. Proven customer demand upon exit.

At the right price, we couldn't be more excited to invest in land to feed the

fundamental need for shelter across our vibrant, growing, and underserved cities. When it comes to deep value investing in medium-term land, by no means are we late in the cycle. Instead, pick whatever metaphor you'd like: Whether we're in the early innings, rising above the ground floor, or cleared for takeoff, we've got miles to go before we sleep.

For more than 30 years, Avanti has dedicated itself to land investment, focusing on well-located sites in fast-growing metropolitan areas. Today, Avanti owns land that can accommodate nearly 45,000 homes in its residential holdings alone. Avanti looks forward to working with experienced local land developers who benefit from having a strong equity partner for medium- to longer-term projects requiring \$5-\$50 million.

## Sourcing Network and Markets



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