

## newsletter

### Affordability Is the Best Amenity

Dog parks. Walking trails. Swimming pools. Fitness centers. Cul de sacs. Playgrounds. Laundry rooms. Energy Star-rated appliances. Ceiling fans. Open-concept kitchens. Hardwood floors. Double kitchen sinks. Community gardens. Patios. Walk-in pantries.

Surveys show that these are the items that buyers most desire when shopping for new homes and moving into new communities. Yet what is far more important than any of these features? AFFORDABILITY. Even though it's a topic that few surveys ever mention, affordability is the threshold question that preempts everything else, except for the most affluent of buyers. If a house is too expensive, forget about its amenities and location. Buyers won't even bother to ask about dog parks or open-concept kitchens. They'll simply move on. If a home is not affordable, its amenities are irrelevant.

What does affordability mean? Opinions vary. Many traditionalists assert that buyers should spend only about 25-30% of their monthly gross income on housing. One consumer finance guru believes that buyers should only purchase a home if it is priced at 90% of the mortgage amount for which they have qualified. Still another view is less formulaic: if a homeowner can pay for housing comfortably and have money left over for living and savings, then that house is one the homeowner can afford.

Whatever the philosophy, each recognizes a simple, common thread: affordable home prices are related to household incomes. And with decades of data demonstrating how American homebuyers actually behave, long-term



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trends have established another measure of affordability. For example, for more than 60 years, the national ratio of housing price to household income has averaged about 3.5 to 1 – meaning the median household pays 3.5 times its annual household income for a new home. Buyers who pay a lower multiple are finding better value relative to their neighbors, while buyers who pay more may be overspending.

While this ratio has consistently held over the long term, there have been two notable exceptions. The first was during the housing boom from 2001 to 2006, when prices escalated well beyond the long-term ratio during a period of historic unaffordability. Indeed, in cities like Orlando, Atlanta, and Phoenix, prices exceeded incomes even more, driven by the prevalence of easy credit that created the illusion that buyers could afford more than their household incomes could sustain. The second exception occurred during the aftermath of this escalation, when prices plummeted to levels well below the 60-year trend line.

In business, one path to profitability starts with delivering the most products that the most people can afford – wheth-

er you're selling hot dogs or houses. In a country where the median annual household income hovers around \$62,000, that could mean starting with a home price of \$225,000. And in the most desirable growth areas of Avanti's large, growing, and economically diverse target markets, where household incomes trend a bit higher, affordable home prices can reach \$250,000, 325,000, or greater in certain higher-income corridors. If land developers and homebuilders can deliver finished lots and houses that meet these prices, they can serve a market with millions of prospective homeowners lining up to buy.

While the affordable segment of the market is always where the bulk of demand is, this is especially true today. As we have noted in previous newsletters, there has been massive underbuilding across the country. Nationwide, Freddie Mac estimates that there is a deficit of 2.5 million homes. In addition to this accumulated deficit, the country will build 400,000 fewer homes this year than demand requires – 1.3 million new houses to meet demand for 1.7 million. And with the largest group of the 80 million Millennials still five or six years away from buying their first homes, further demand for affordable housing will add additional pressure to already historically low inventories.

Although homebuilders complain that less-expensive homes lead to lower profit margins, the resulting higher sales volumes should enable them to make the same amount of money. Moreover, as builders become more efficient in delivering affordable houses, profit margins for these homes should increase in turn.

These compelling supply and demand

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metrics match our own anecdotal experiences across Avanti's portfolio. In communities where we can offer finished lots on which homebuilders can deliver affordable homes, we can barely keep lots on the shelves. Homebuilder hunger for well-priced finished lots is palpable as the large, publicly traded national homebuilders continue to turn their focus away from expensive, infill locations to expand their focus on sensibly appointed, well-located suburban homes.

In spite of this pent-up and increasing demand from builders and buyers, the residential land investment market remains uncrowded. Even in strong growth corridors in Avanti's healthy and growing markets, builders are remaining disciplined about not acquiring land ahead of their immediate need to build vertically. Instead, builders will contort themselves in a variety of ways to avoid carrying that four letter word on their balance sheets: from temporarily contracting for land before quickly off-loading it to lot developers, to working with so-called "off balance sheet" companies



to control land while keeping it at arm's length, or contracting for land and funding the vast majority of its horizontal infrastructure even before taking title to the property.

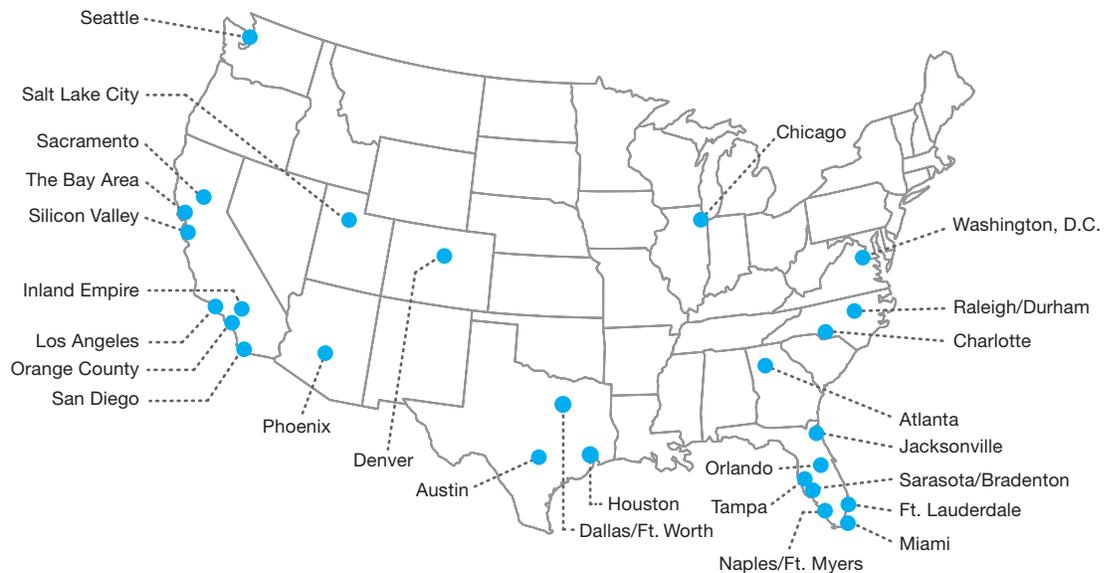
Because builders do gymnastics to avoid buying land until they have buyers for homes, it's a great time to be in the land investment business for Avanti and its partners. This continued homebuilder behavior, combined with a persistent lack of organized competition, has created a nationwide opportunity for deep value investment in the land where America grows. Moreover, in a strengthening residential environment with immediate builder demand for lots, it's

possible to invest with both a strong margin of safety and a clearer view to a shorter exit.

By shopping in an uncrowded market, Avanti can unlock deep value from sellers who don't have the time, patience, or expertise to convert their land into buildable lots – all with an eye to selling to millions of families looking for roofs over their heads without breaking the proverbial bank. And by providing land developers and builders across the country with the strength and safety of equity capital, Avanti can help create the communities that our country so desperately needs and that offer the most important amenity: *affordability*.

For 35 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 more than 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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*Best Wishes*

for the Holiday Season  
and a Happy, Healthy,  
and Prosperous New Year.