

newsletter

The Song Remains the Same

This spring, if you happen to overhear any teenager's playlist, you might be surprised to hear some older songs blasting from the smart-phone. Whether it's Prince's "Purple Rain," Hall & Oates's "Rich Girl," or even Fleetwood Mac's B-side "Silver Springs," young people today are streaming the classics on TikTok as much as they are today's hits, even though these tunes have already been around forever.

For nearly a decade, Avanti's been doing the same thing. Again and again in this newsletter, we've been singing the same old song about how undersupply and Millennial-driven population growth continue to serve as the foundation for the strength of America's housing market. Given that this supply and demand imbalance continues even today, expect to hear Avanti's ballad on repeat for years to come. (Okay, our lyrics don't compare to Prince's songwriting, but we do what we can with the material we've got!)

Ever since the end of the Great Recession, America's housing expansion has been remarkable. Across Avanti's large and fast-growing markets of the South and West, population and employment gains have fueled the con-

Avanti's Residential Communities Continue to Grow



Avanti acquired the Dallas-area Devonshire community in 2018, partly developed with approximately 600 homes in place. Six years later, 3,300 additional homes have been built, with another 1,500 expected at full build-out. Homebuilders featured in the community include Meritage, Pulte, Ashton Woods, Beazer, Lennar, History Maker, Perry, Bloomfield and Highland.

struction of millions of new homes. And against a backdrop of persistent annual underbuilding, coupled with an accumulated nationwide supply deficit, this growth has been resilient, even in the face of a pandemic, interest-rate hikes, and other ever-present macroeconomic risks. Indeed, higher rates have exacerbated this shortage because current homeowners have remained locked in to sub-4% mortgages, keeping inventory levels and vacancies at historic lows.

The numbers are straightforward: today, America has a nationwide deficit

of at least 1.7 million housing units, accumulated largely over the past decade. And with builders on pace to construct only 1.4 million homes in response to the *current* demand of 1.6 million generated by household formation, obsolescence, and second home purchases, that leads to an additional gap of 200,000 units this year alone. When combined with a lack of residential land, these annual and aggregate shortfalls are keys to why Avanti is so bullish about what the next decade will bring.

Continued population growth is lead-

ing to further strength in demand. Today, nearly 90 million Americans born between 1980 and 2000 are in, or near, their prime homebuying years. Moreover, Avanti's markets grow faster than the nation, which itself grew by as many as 3 or 3½ million people last year – one of the largest increases in history. If the US sustains normal levels of immigration in the years ahead, these new households will add further demand beyond organic growth. Even as fertility rates decline and death rates rise over the very long term, we expect this growth to lead to the construction of an additional 15 to 18 million new homes over the next decade or so.

Yet this supply and demand imbalance creates risks to affordability. In many of our markets, housing is too expensive – prices exceed long-established relationships to household incomes. Continued supply deficits in the face of additional demand could exacerbate this trend and lead to even higher prices in the short term, followed perhaps by flattening or declining prices. Likewise, if further interest rate hikes

increase mortgage payments, similar slowdowns could follow, even as tight inventory should ultimately support a floor under the market.

The good news is that builders can address the affordability gap. Builders are hungry and well-capitalized, and they don't face competition from the resale market. With profit margins significantly exceeding 20%, they can afford to provide homebuying incentives to counteract the effect of higher rates. These days, builders can buy down 30-year mortgages on entry-level homes from 7% into the 5% region and still make strong profits on the home sale. So it's not surprising that in spite of today's higher prices and mortgage rates, construction activity is robust, builder profit margins are very respectable, and, as a result, Avanti's land and lot sales are strong.

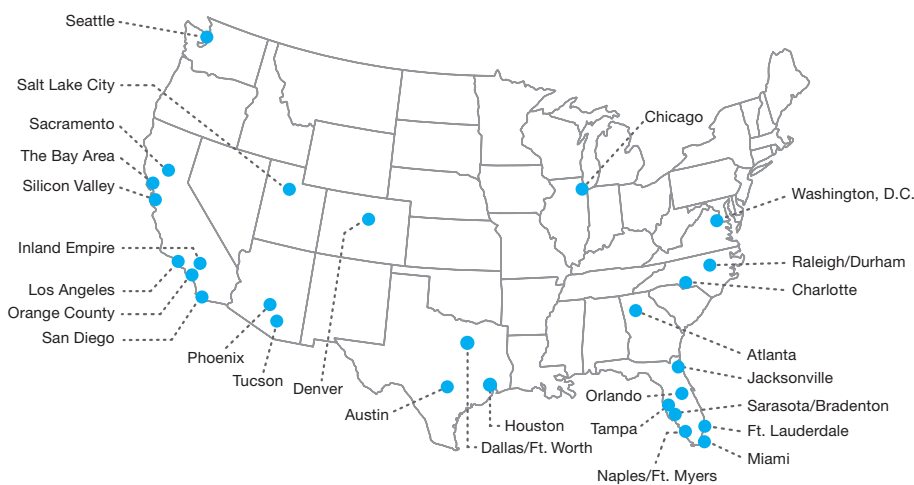
This *increased* competition to buy Avanti's lots is, ironically, also leading to *decreased* competition for new Avanti acquisitions. To offset margin and balance sheet pressure from rate buydowns, builders have become

even less willing to buy land ahead of near-term homebuyer demand. And when builders avoid land, Avanti's pipeline of *new* investment opportunities increases – as in recent months, when our new business has increased substantially with pending acquisitions in Arizona, Colorado, DC, and Texas.

As Prince used to sing, "It's time we all reach out for something new." We agree! So reach out and bring us new deals – at the right price – in any of our target markets. We're focused on those land and development opportunities that can be bought at deep values without the risk of leverage, and are discounted to reflect a strong margin of safety between our acquisition price and what builders will ultimately pay. We love today's market fundamentals, even though we also know that over the short term, prices, volumes, and interest rates can go up or down on any given day. That's why Avanti's patient equity capital exists – to capitalize on these long-term market fundamentals, while offering shelter from the fleeting rain.

Sourcing Network and Markets

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-term projects requiring \$5–\$50 million.



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