HOUSING

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INDUSTRY BRIEF

2021 Housing Outlook Summary - The Single Family Super Cycle is Here

Summary: The Super-Cycle is here. Entering 2021, we are increasingly convinced that the past year has catalyzed events with enduring momentum. Even post-vaccine, we believe America's housing landscape will feel the repercussions of 2020 for years to come. The combination of social, technological, and demographic shifts in the wake of Covid-19, in our view, has unlocked **a potential "single-family super cycle"** with a multi-year runway for dramatic increases in new home production. *This piece is a brief summary of our larger 2021 Housing Outlook slide deck, which highlights the data behind our thesis in much greater detail.*

Well that was something...now what? As we eagerly try to turn the page on 2020, it's still worth a moment to reflect on a year as consequential as any we've seen in our lifetimes. The collective impact on our society of the pandemic, election-year politics, and myriad policy responses will undoubtedly leave lasting impressions for many years ahead. In one respect, our focus on the housing market affords us a certain perspective. And while we ended the year in a familiar position, the wild ride between here and there was one we hardly could have imagined. Around this time last year, we were upgrading our stance on homebuilders and reiterating our constructive thesis on the single-family rental REITs. Demand had already shifted into gear by 4Q19 at an unseasonably strong clip. Home prices began accelerating amid rapidly declining re-sale inventory, jump-started by mortgage rates that had dropped below 4% for 30-year fixed rate loans. Demographic trends were clearly indicating a shift of millennial demand into entry-level homes, after nearly a decade of depressed household formation rates. Homebuilders started to report their strongest levels of y/y order growth in many years, with the spring selling season getting off to a roaring start as early as mid-January.

Pandemic lockdowns drove a "suburban tsunami". Sometime in February came the trickle of headlines about a "coronavirus", which most first treated as a mild curiosity. By mid-March, however, an all-out national panic ensued at the prospect of widespread stay-at-home orders, school closures, and lockdowns. Grocery store shelves were left barren. Bottles of hand sanitizer sold for small fortunes online. Toilet paper sales were rationed. And amid the panic, the housing market completely froze, as everyone tried to anticipate the inevitable fallout from millions of jobs suddenly lost. For a few weeks, some builders faced new home sales that went net negative from the fallout of contract cancellations. But by mid-April something remarkable began to unfold. With quick adjustments from tech-saavy homebuilders, customers began flocking to virtual tours and online sale interactions. Home showings shifted to "appointment only", and the resurgence of demand from homebound online shoppers was undeniable. Despite the stock market crash, a raging pandemic, and massive economic uncertainty - a determined pool of buyers was more determined than ever to complete a home purchase. That early momentum was merely a precursor for what was to come during the remainder of 2020, namely a "suburban tsunami" of households seeking shelter, affordability, and safety in single-family homes. Single-family housing and new home construction have since established themselves as key pillars of strength in the post-pandemic economic recovery. As we describe in greater length in our full-length 2021 housing outlook, with the new social dynamics unleashed by the pandemic, we believe this momentum will continue for many years ahead.

Housing stocks roared over the summer, but flat in 4Q. Despite the wild swings in the economy, the market quickly recognized the demand shift homebuilders were seeing. Trading at just 1.2x book value in mid-March, the group went on to outperform the S&P 500 by 51% through the end of September. But despite a continued bullish flow of positive data points, starting in October (and similar to last year), the market began to rotate away from housing in favor of other cyclical sectors. Homebuilders in particular have underperformed the S&P by 21% in just the past quarter amid a broad rally to close out the year. Within the residential REIT subsectors, dramatic performance differentials were seen between Coastal multifamily REITs and Sun Belt multifamily REITs, with the former underperforming the RMZ index by -15% on average while the latter outperformed the RMZ by +4%. Bigger winners in 2020, not surprisingly, were the single-family rental REITs (AMH and INVH), which both outperformed the RMZ considerably over the course of 2020 (+25% and +8%, respectively).

- **Overweight Homebuilders -- Top Picks: PHM, KBH, MDC.** Entering 2021, we are increasingly convinced that the past year has catalyzed events with enduring momentum. Even post-vaccine, we believe America's housing landscape will feel the repercussions of 2020 for years to come. The combination of social, technological, and demographic shifts in the wake of Covid-19, in our view, has unlocked **a potential "single-family super cycle"** with a multi-year runway for dramatic increases in new home production. We believe there are now at least five factors driving this secular shift into single-family homes: **1) The lasting consequences of the work-from-home (WFH) social experiment.**

Please read domestic and foreign disclosure/risk information beginning on page 8 and Analyst Certification on page 8.

2) The millennial majority reaching age-30 milestones. 3) Baby boomers closing the backdoor of housing inventory (i.e. aging in place). 4) The supply shortage from a decade of single-family under-production. And 5) the "K-shaped" economic recovery post-pandemic, which portends an extended run of low interest rates due to elevated unemployment while personal savings rates among the employed have ballooned to record levels. Moreover, we find sector valuations still trading below historical "early cycle" multiples, and we also believe homebuilders could see significant valuation re-ratings, in the context of much improved capital efficiency achieved over the past four years.

- **Market-weight Multifamily REITs – Top Picks: MAA, NXRT.** As the weather warms and Covid vaccines become more widely available, we fully anticipate a "back-to-work" rebalancing that could help normalize multifamily demand in many urban-core submarkets. That said, our optimism for any short-term lift is tempered by the realization that it still could be years before 2020's effective pricing reductions are fully recouped. **Further, we see any pricing recovery this year still facing a significant new supply headwind, with many new urban-core projects still scheduled to deliver throughout 2021 in key coastal markets.** Accordingly, we still believe multifamily performance will be bifurcated between submarkets, property types, and tenant groups. Given accelerating population migration trends, we continue to believe lower costs of living, lower taxes, and lower density will bolster demand for suburban Sun Belt apartments, particularly those that offer safe, clean, and affordable "workforce housing".
- **Overweight Single-Family Rental REITs – Top Picks: AMH, INVH.** Even after dramatically outperforming the RMZ index in 2020, we remain constructive on the SFR sector in light of the meaningful pricing momentum carrying into 2021 with portfolios now operating at structurally full capacity (97%+ occupancy). With the historic inventory scarcity of affordable re-sale homes, we think the consumer value and flexibility offered by professionally managed SFR homes offers an extended runway for further pricing gains. Rising replacement costs of new construction, demographic growth of maturing millennials, and structural challenges of attaining homeownership all continue to work in favor of the sector's long term potential. Further, the secular trends of 1) de-densification, 2) de-urbanization, and 3) Sun Belt migration are all driving households into the security and flexibility of single-family rentals. Lastly, we are increasingly optimistic about the potential for built-for-rent SFR homes, given the dramatic production deficit of single-family homes in general. We note, early consumer acceptance of these purpose-built homes has been extraordinary, with "off the chart" demand widely reported.

Raymond James Housing Projections: 2020-2022

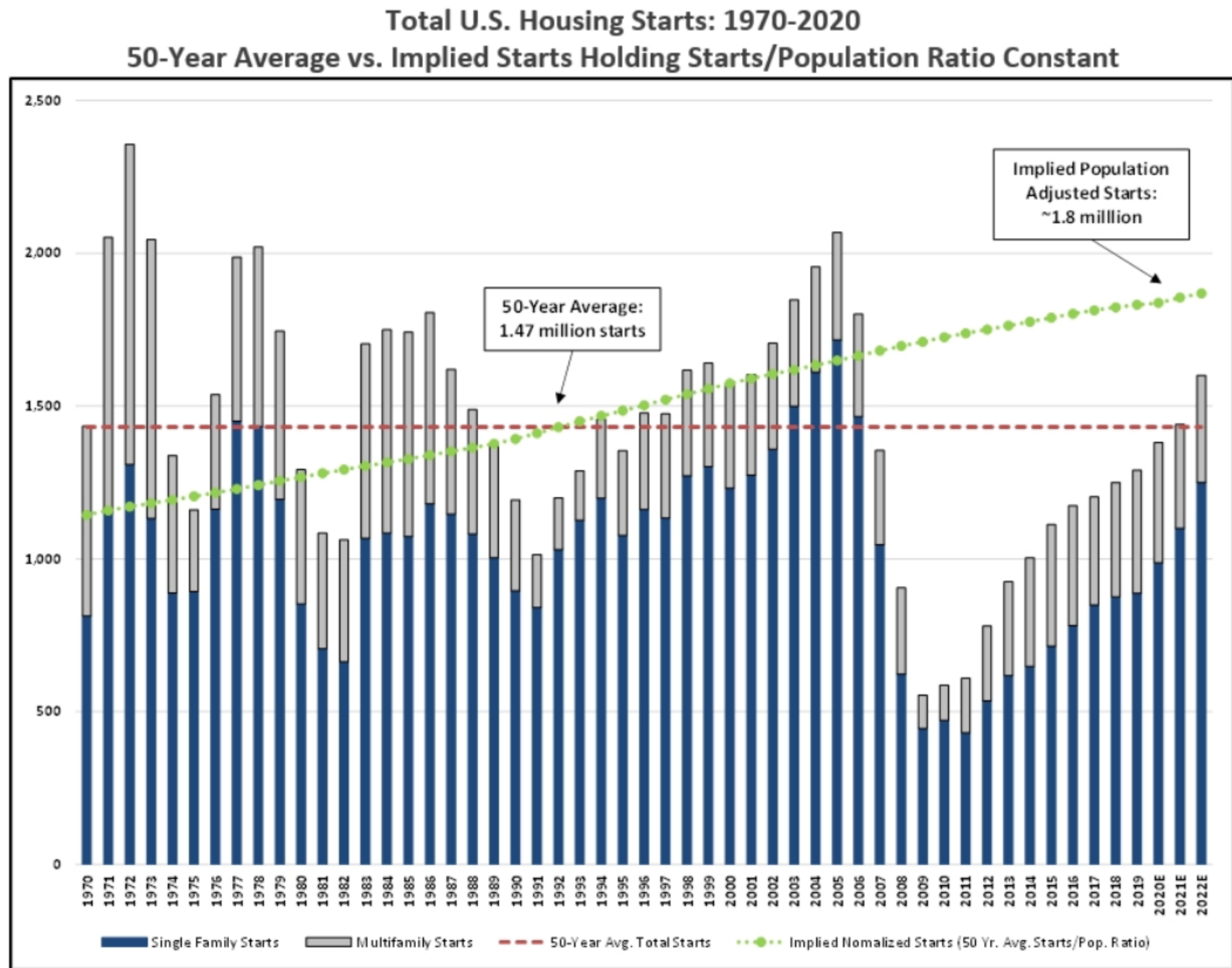
		RJ Estimates			MBA			NAHB			NAR			Fannie Mae		
	2019A	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2020E	2020E	2021E	2020E
Housing Starts - Single Family (000s)	888	987	1,100	1,250	972	1,134	1,165	989	1,034	1,068	941	1,100	1,150	981	1,107	1,187
Housing Starts - Multi Family (000s)	402	393	340	350	395	348	325	393	349	365	390	400	410	394	338	364
Housing Starts - Total	**1,290**	**1,380**	**1,440**	**1,600**	**1,367**	**1,482**	**1,489**	**1,382**	**1,383**	**1,433**	**1,334**	**1,500**	**1,560**	**1,375**	**1,444**	**1,551**
New Home Sales	**683**	**810**	**915**	**1,020**	**842**	**989**	**1,013**	**865**	**884**	**883**	**820**	**1,010**	**1,050**	**844**	**872**	**880**
New Home Price - Median ($000s)	$321.5	$330.0	$340.0	$350.0	$331.2	$332.4	$335.2	NA	NA	NA	$327.2	$345.8	$355.0	$332.0	$346.0	$349.0
Existing Home Sales	**5,340**	**5,600**	**5,800**	**5,900**	**5,659**	**6,270**	**6,295**	**4,968**	**5,455**	**5,533**	**5,523**	**6,050**	**6,200**	**5,639**	**5,792**	**5,600**
Existing Home Price - Median ($000s)	$271.9	$295.0	$310.0	$320.0	$293.7	$297.4	$291.6	NA	NA	NA	$293.0	$306.3	$311.0	$290.0	$302.0	$305.0
30-Year Fixed Mortgage Rates:	3.9%	3.0%	3.0%	3.3%	2.8%	3.2%	3.6%	3.1%	2.9%	3.1%	3.1%	3.1%	3.3%	3.1%	2.7%	2.9%
Y/Y % Chg.																
Housing Starts - Single Family	*1%*	*11%*	*11%*	*14%*	*9%*	*17%*	*3%*	*11%*	*5%*	*3%*	*6%*	*17%*	*5%*	*10%*	*13%*	*7%*
Housing Starts - Multi Family	*7%*	*(2%)*	*(13%)*	*3%*	*(2%)*	*(12%)*	*(7%)*	*(2%)*	*(11%)*	*5%*	*(3%)*	*3%*	*2%*	*(2%)*	*(14%)*	*8%*
Housing Starts - Total	***3%***	***7%***	***4%***	***11%***	***6%***	***8%***	***0%***	***7%***	***0%***	***4%***	***3%***	***12%***	***4%***	***7%***	***5%***	***7%***
New Home Sales	***11%***	***19%***	***13%***	***11%***	***23%***	***17%***	***2%***	***26%***	***2%***	***(0%)***	***20%***	***23%***	***4%***	***24%***	***3%***	***1%***
New Home Price - Median	*(2%)*	*3%*	*3%*	*3%*	*2%*	*0%*	*1%*	*NA*	*NA*	*NA*	*2%*	*6%*	*3%*	*3%*	*4%*	*1%*
Existing Home Sales	***0%***	***5%***	***4%***	***2%***	***6%***	***11%***	***0%***	***5%***	***10%***	***1%***	***3%***	***10%***	***2%***	***6%***	***3%***	***(3%)***
Existing Home Price - Median	*5%*	*8%*	*5%*	*3%*	*7%*	*1%*	*(2%)*	*NA*	*NA*	*NA*	*8%*	*5%*	*2%*	*7%*	*4%*	*1%*
30-Year Fixed Mortgage Rates:	*(11%)*	*(22%)*	*(2%)*	*11%*	*(20%)*	*14%*	*13%*	*(21%)*	*(7%)*	*8%*	*(21%)*	*0%*	*6%*	*(21%)*	*(13%)*	*7%*

Source: U.S. Census Bureau, National Association of Realtors, Mortgage Bankers Association, National Association of Home Builders, Fannie Mae, and Raymond James research. Data as of December 2020.

- **Top of the 2nd inning in the "SuperCycle".** Our updated 2021 housing forecasts incorporate our thesis on a potential single-family super-cycle, including 1) an above-consensus view on single-family new home sales and starts into 2022; 2) a below-consensus view on new multifamily construction; and 3) a benign mortgage rate environment which should promote above-trend growth in median home prices.
- **Momentum to carry into 2022 and beyond.** Given our increasingly bullish view on single-family homes, we are increasing our 2021 starts forecast to 1.44 million (from 1.33 million) and introducing an above-consensus 2022 starts estimate of 1.6 million total.
- **Benign mortgage rate outlook.** Part of our call is predicated on our view for an extended period of low mortgage rates. This economic recovery has a unique K-shape and elevated unemployment challenges among the most vulnerable population. Accordingly, we believe the

Fed will maintain a very accommodative policy on long-term rates for the foreseeable future, providing ample fuel for a new housing cycle.

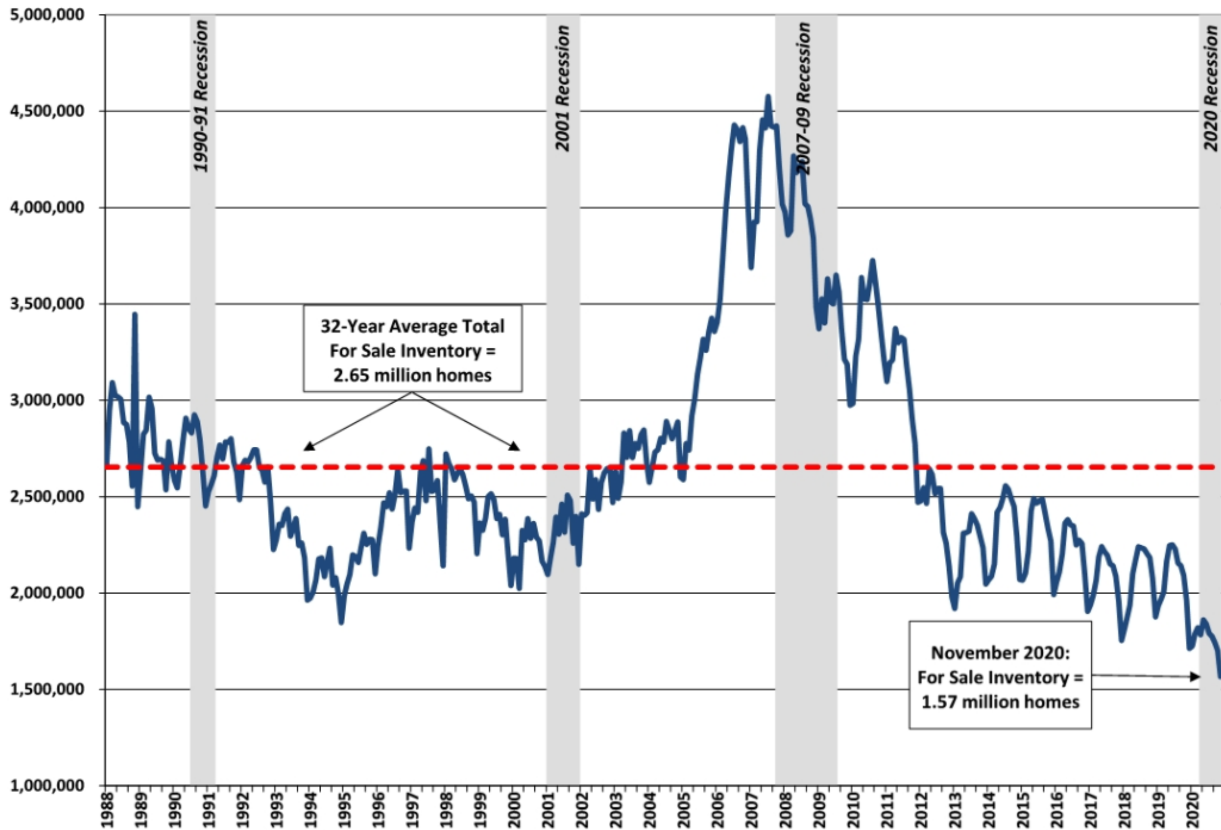
- **Urban-core multifamily projects likely paused.** We believe many multifamily projects previously slated for urban-core locations with highly-amenitized class-A properties will find the economics and risks of starting construction too great in the near-term. As these deals are likely paused, we see more development capital flowing to suburban locations in higher growth markets – but not enough to prevent a few years of below trend apartment production.



Source: U.S. Census Bureau; Raymond James Research

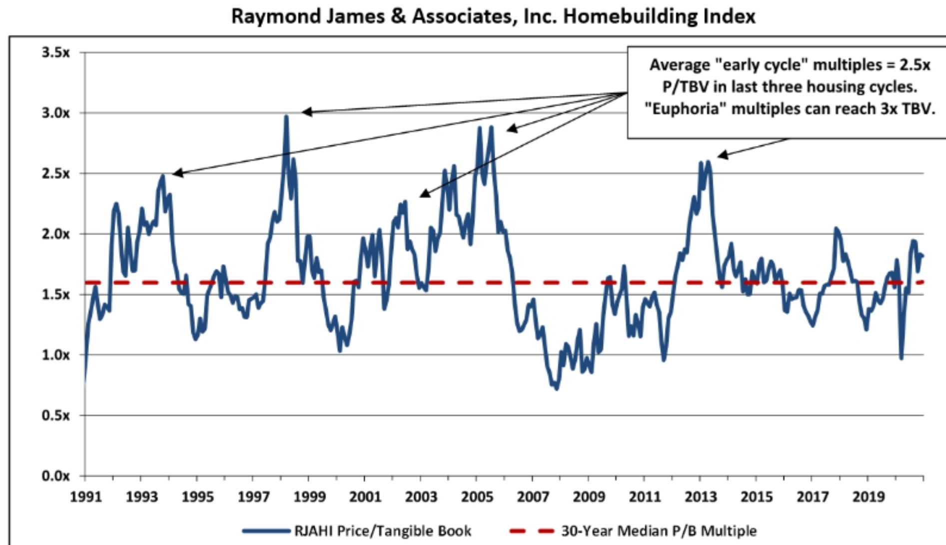
- **A decade of housing underproduction.** Since the end of the Great Recession/Financial Crisis, the recovery in U.S. housing has been painfully slow – particularly in single family construction. The overhang of excess construction during the 2002-2006 period needed to be absorbed. But also, the financial overhang of damaged credit through foreclosures and workout programs significantly reduced the potential buyer pool, given the structural changes made to mortgage underwriting through the 2010 Dodd-Frank Act.

- **Many more homes needed.** Multifamily construction rebounded first given the demand for rental housing solutions. But by any objective measure, the cumulative housing underproduction since 2008 has left an enormous production deficit, especially in single-family homes.



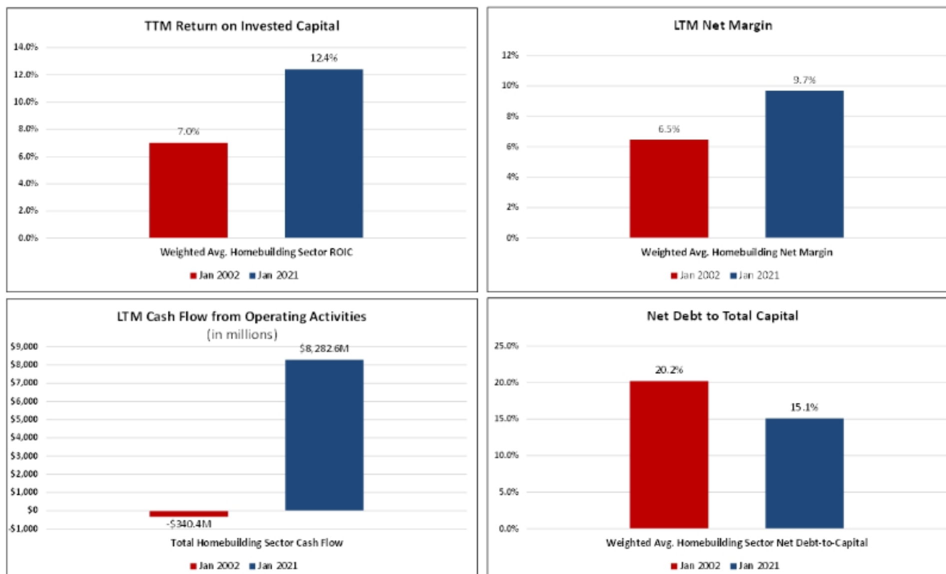
Source: National Association of Realtors, U.S. Census Bureau, and Raymond James research. Data through November 2020.

- **Inventory at record lows for both new and existing homes.** Listed inventory for sale (new and re-sale) is now at lowest levels in over 30 years.



Source: FactSet and Raymond James research. Data through December 2020.

- **Builders can reach 2.5x TBV "early cycle".** Over the past 30 years, we have seen the homebuilding sector reach materially higher valuation levels during either "early cycle" or "euphoric" stages. Currently, the sector is trading new 1.8x tangible book versus the 30-year median of 1.6x TBV. In the context of the sector's much improved ROIC, cash flow, and debt positions versus previous cycles - we believe there remains significant room for sector multiple expansion.

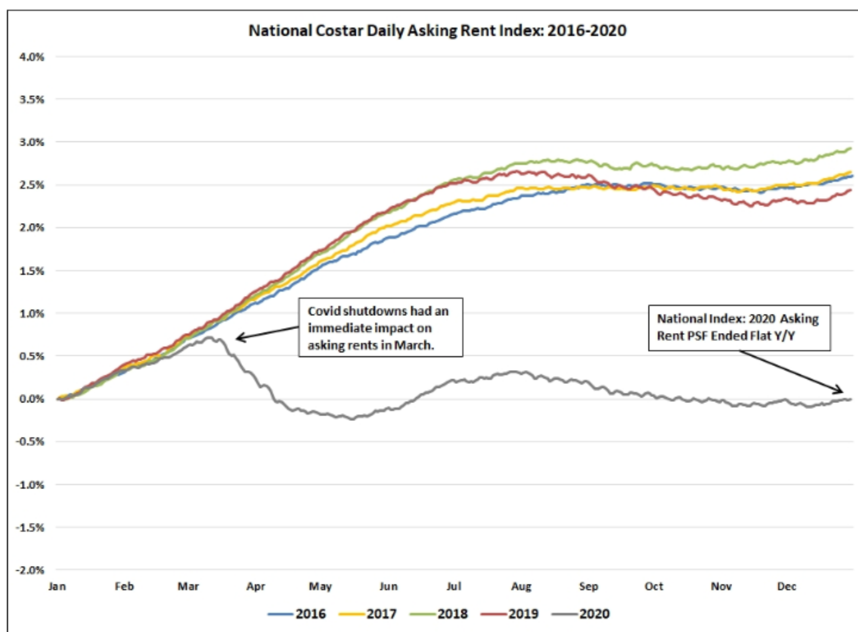


Source: FactSet and Raymond James research. Data through December 2020.

- **We believe the homebuilding sector is potentially due for a significant valuation re-rating.** Historically, investors have traded the

sector between valuations between 1.0x-2.0x book value and high-single digit EPS multiples. We think those "rule of thumb" approaches are outdated, considering the significant progress homebuilders have made improving their balance sheets, cash flows, and ROIC metrics.

- **Builder financials far superior vs 2002.** Relative to the start of the last major housing upcycle (2002), homebuilders' financial metrics are already far superior, despite trading at valuations below those achieved in 2002 (1.8x TBV now vs. 2.1x TBV in 2002).

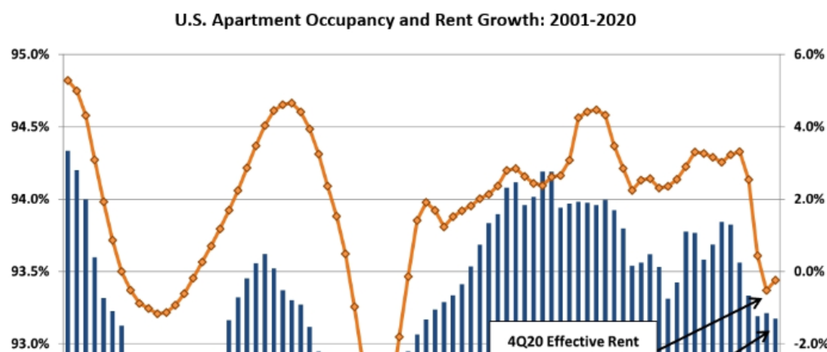


Source: CoStar Group, Raymond James research. Data through December 2020.

- **Apartment asking rents ended 2020 where they started, but that doesn't tell the story.** Nationally, multifamily asking rents bottomed sometime in mid-May, recovered through the summer, and then began a modest seasonal fade ending the year roughly where pricing started 2020. However, that hardly tells the divergent story between geographies and submarkets during 2020. **Coastal gateway markets and downtown urban-core submarkets suffered disproportionately relative to Sun Belt markets and suburban locations**. Asking rents in downtown markets fell nearly 7% (before lease concessions) over the year, while suburban submarkets actually saw rent growth of 1.5% y/y.

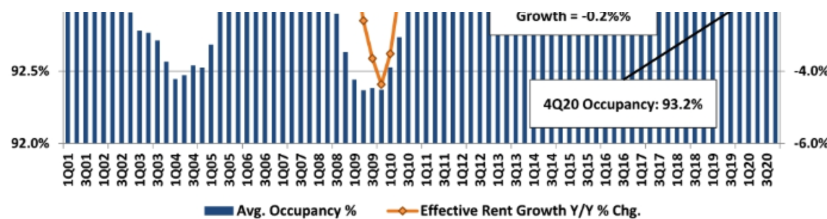
- **Sun Belt markets dramatically outperformed Coastal as population migration accelerated.** In addition to the great suburban vs urban divide, one of the more fascinating trends that unfolded during 2020 was the evidence of **accelerated population migration between markets and across state lines**. We saw these trends pick up significant momentum by May, when it became clear that certain relocation markets were already in price recovery mode while high-cost Coastal markets were seeing accelerating pricing deterioration. Markets like Atlanta, Tampa, Phoenix, Charlotte, and Jacksonville all saw dramatic pricing improvements and positive YTD rent growth. High cost Coastal markets such as San Francisco/Bay Area, Seattle, Boston, New York, and Washington DC all saw steady price deterioration, which has only recently begun to flatten out.

Covid Hitting Apartment Occupancy, Now Lowest Since 2011



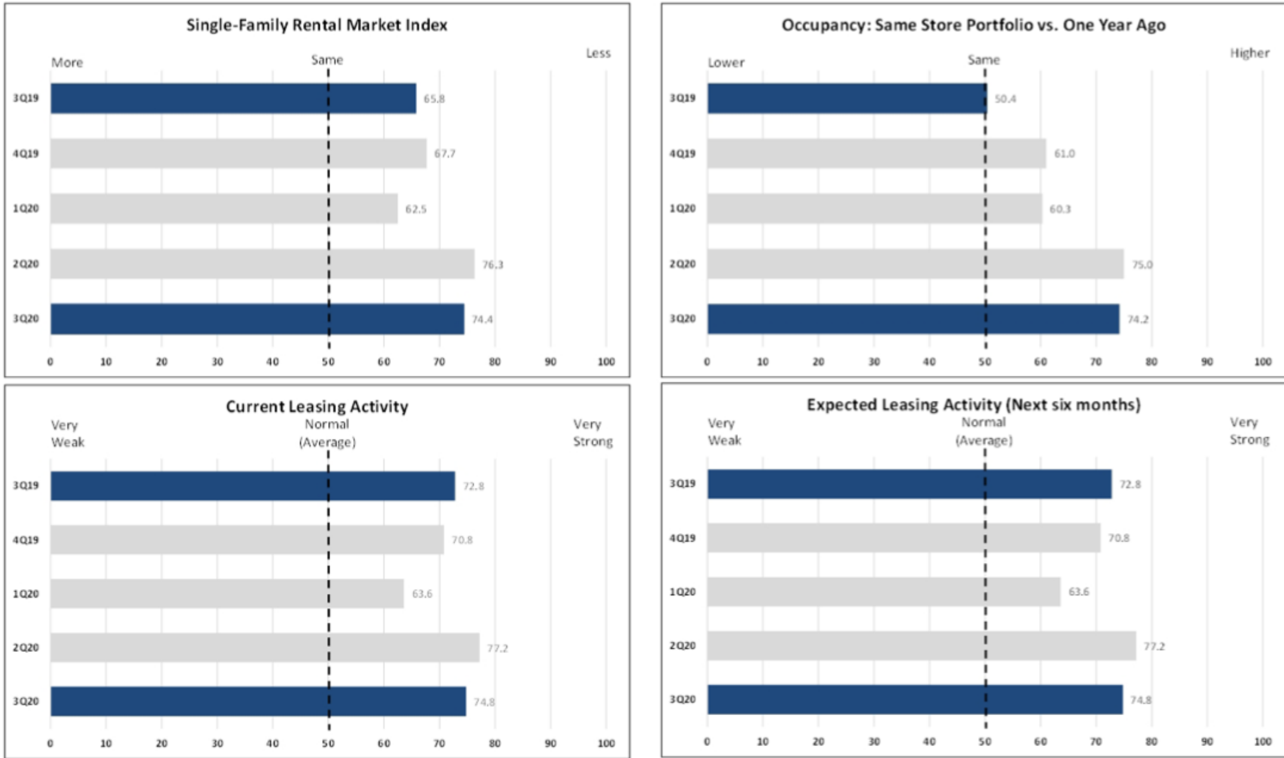
- **Overall effective multifamily rent growth slowed rapidly in the aftermath of Covid shutdowns.** Coastal gateway cities and downtown urban-core submarkets were hit the hardest. Recently, 4Q20 trends have started to stabilize. Nationally, effective rent growth was -0.3% y/y in 4Q20.

- **Apartment occupancy at 93.2%.** Per CoStar's database, national multifamily occupancy reached 93.2% in 4Q20, the industry's lowest occupancy since 2011.



Source: CoStar and Raymond James research. Data as of 1Q 2020.

Occupancy trends, however, now vary widely between downtown submarkets (91%) and suburban locations (94%).



Source: John Burns Real Estate Consulting and Raymond James research. Data as of 3Q 2020

- **SFR index still strong in 3Q20.** John Burns Real Estate Consulting (JBREC) and The National Rental Home Council (NRHC) produce a quarterly Single-Family Rental Market Index (SFRMI) Index, which measures the health and sentiment of the industry by surveying institutional SFR operators across 59 MSAs that collectively manage 182,000 properties.
- **An expanding market.** While the SFRMI index dipped 2 points q/q to 74.4 in 3Q20, it still marks the 2nd highest reading in this index's history with robust indications for current leasing activity, occupancy, and expected leasing over the next six months.
- **Both AMH and INVH reporting record high results**. During recent 3Q20 results, both AMH and INVH reported record-high same-home occupancy (96.9% and 97.8%, respectively), with surging pricing momentum on new leases (+5.9% and +5.5%, respectively).
- **Rental collections steady.** Both AMH and INVH reported that rent collections continue to come in around 97-98% of billed revenue including recoveries from prior periods, relative to a pre-Covid collections rate around 99%.

For more details on all of the trends mentioned above, please see our full length 2021 Housing Outlook slide deck.

Company Citations

Company Name	Ticker	Exchange	Closing Price	RJ Rating	RJ Entity
American Homes 4 Rent	AMH	NYSE	$29.45	SB1	Raymond James & Associates
Invitation Homes Inc.	INVH	NYSE	$29.05	SB1	Raymond James & Associates
KB Home	KBH	NYSE	$33.71	SB1	Raymond James & Associates
M.D.C. Holdings, Inc.	MDC	NYSE	$47.45	SB1	Raymond James & Associates
Mid-America Apartment Communities, Inc.	MAA	NYSE	$124.21	MO2	Raymond James & Associates
NexPoint Residential Trust, Inc.	NXRT	NYSE	$40.77	MO2	Raymond James & Associates
PulteGroup, Inc.	PHM	NYSE	$42.08	SB1	Raymond James & Associates

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