Avanti Properties Group Investing in land where America grows | Winter 2022 | Issue No.27

newsletter

Keeping Cool as Rates Rise: Our Year-End Outlook in 3½ Minutes

"Nothing gives one person so great advantage over another," Thomas Jefferson once advised, "as to remain always cool and unruffled under all circumstances." At the time, Jefferson was writing to his teenage grandson, who coincidentally later moved to a village called Orlando in the new state of Florida, less than three miles from where Avanti's office now sits. As we consider America's continued growth and the current state of the market, Jefferson's grandfatherly wisdom is just as relevant now.

The housing market is ruffling a lot of people these days. Mortgage rates have reached 7%, inflation is driving up development costs, and both trends are hurting a market that had already reached the limits of affordability. As we wrote last spring, this is the kind of news that can lead to a housing slowdown.

Well, it has. The market has stalled. Across the country, builder activity is slowing, notably in markets where prices had escalated the most. As buyer cancellation rates have climbed, the pace of sales in many communities is half or less of what it was in the spring. Builder appetite for new land is down, as are their stock prices. While all this may make builders anxious, none of it should be surprising. A doubling of mortgage payments in less than six months was sure to hurt housing over the short term.

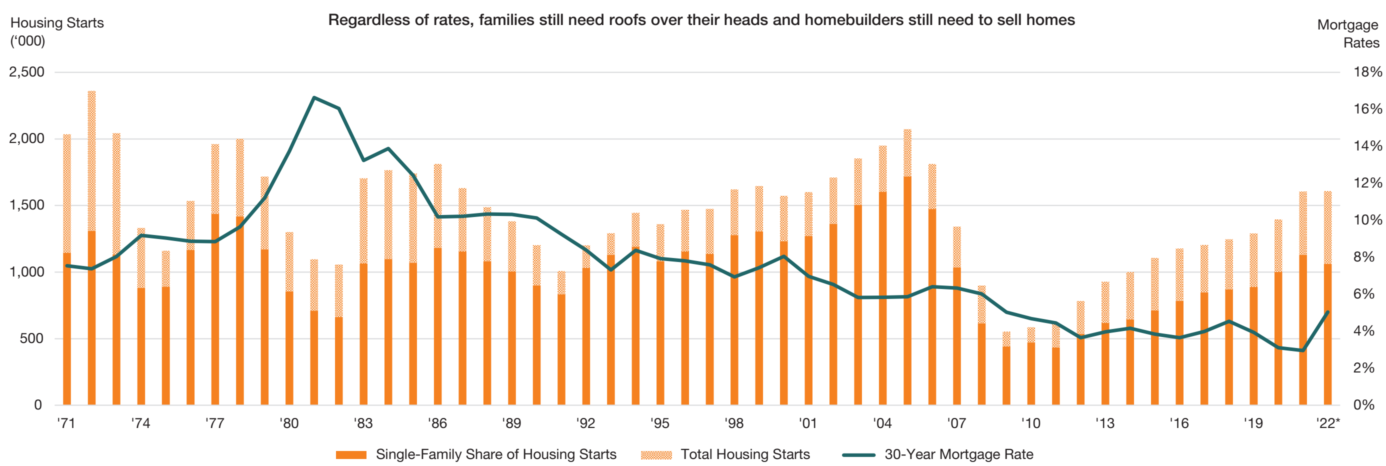
But for those who remain cool and unruffled, market anxiety can lead to advantageous investment. For instance, despite current news, not even the gloomiest analyst can seriously argue that America is overbuilt. In fact, we have been materially underbuilt for years and with vacancy rates near historic lows. And Millennials will again be forming households of their own as they had been, even if the current lack of affordability delays them for now. As markets stabilize over time, those first-time homeowners should buy faster than the increased supply resulting from Baby Boomers exiting the scene – at least for the balance of this decade.

Indeed, until recent rate spikes, demand was already outpacing low supply. This phenomenon was most acutely felt in the shortage of Sunbelt housing for working families. Spurred by a historically low-rate environment, demand has not been fueled by rampant speculation or exotic financing à la 2005, but by a significant buildup from years of underbuilding and added Millennial demand.

Today, though demand has slowed, it has not vanished forever. People need places to live even when rates increase. And Millennials will eventually leave their parents and roommates when the affordability gap closes. But in the meantime, when mortgage underwriting remains disciplined in a higher-rate environment, the consumer math becomes simple: already-high home prices become too high, and sales slow for the time being. That's to be expected. But over time, demographic growth will prevail, as it did during the double-digit days of the 1970s and '80s, when builders delivered millions of new rooftops despite rate hikes slowing starts in

Annual US Housing Starts Regularly Exceeded 1 Million Units Even Amidst Double-Digit Mortgage Rates

Regardless of rates, families still need roofs over their heads and homebuilders still need to sell homes



Sources: US Census Bureau, US Department of Housing and Urban Development, Freddie Mac
*2022 Figures are through the third quarter

the short term. As the preceding chart shows, even when rates exceeded 18% at their 1981 peak, we still built over one million homes per year.

So, in the near term, what can bridge the affordability gap? A lot. House prices could fall and wages could rise. Slowdowns may cause rates and costs to moderate. Builders could build smaller homes on smaller lots, buy down mortgages, and accept smaller profit margins. Policy-makers can slow rate hikes, provide incentives for affordable housing, and speed up land use permitting and approvals. What *will* happen? Probably a little of each, and the market will probably stabilize – more quickly given the undersupply rather than an oversupply.

In the meantime, anxiety can lead to opportunity, *if* we maintain our investment discipline so we can focus on the only risk we *do* want to take: time. This philosophy not only applies to new investments, but it also fortifies our current portfolio during market slowdowns so we can sell from strength when expansion returns. For us, this discipline includes the following:

- **Buying with a margin of safety:** Pay prices discounted deeply from future values.
- **Avoiding the risk of leverage:** Know that land loans can come due at the wrong time.
- **Refusing to speculate on market or location:** Shop in the best corridors of the cities that deliver the broadest economic growth.
- **Ignoring short-term noise:** Focus on trends that have proven themselves over time.

Investing with these principles will continue to deliver profits and preserve capital in and out of cycles.

Finally, in the next ten years or so, we recognize that America's demographic profile will shift, which will likely begin to decrease absolute demand – also not a surprise. But it would be a mistake to let predictions of trends that necessarily evolve over future decades distract from the opportunities of today. Avanti's low-cost, high-growth Sunbelt markets remain the most economically diverse and vibrant cities in a country that, with all its challenges, remains the envy of the world. As importantly, America's 330 million people, *on their own*, will generate the need for millions of new homes, even if (inconceivably, we believe) we fail to resolve debates over immigration, which would only add to this inherent growth.

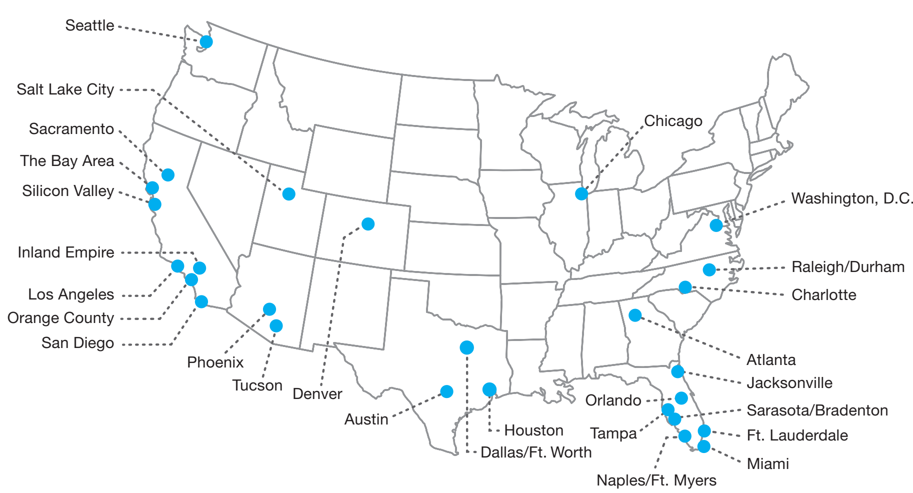
The simple fact is that America will be growing for decades, with or without help from immigration. Today's current market conditions should lead to new investments that will bear fruit as housing supply catches up to years of unmet demand. We therefore declare our independence from the prevailing anxiety, and optimistically look forward to the pursuit of new investments – **always at the right price**.

The Avanti Scholarship in Real Estate

Once again this holiday season, in partnership with the University of Florida's Warrington College of Business graduate school, we are pleased to announce our third annual contribution to the Avanti Scholarship in Real Estate, awarded annually through the Bergstrom Real Estate Center to a student pursuing the degree of Master of Science in Real Estate. The Avanti Scholarship promotes diversity, equity, and inclusion in the real estate industry, and this year is providing essential support for another deserving candidate.

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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Best Wishes

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