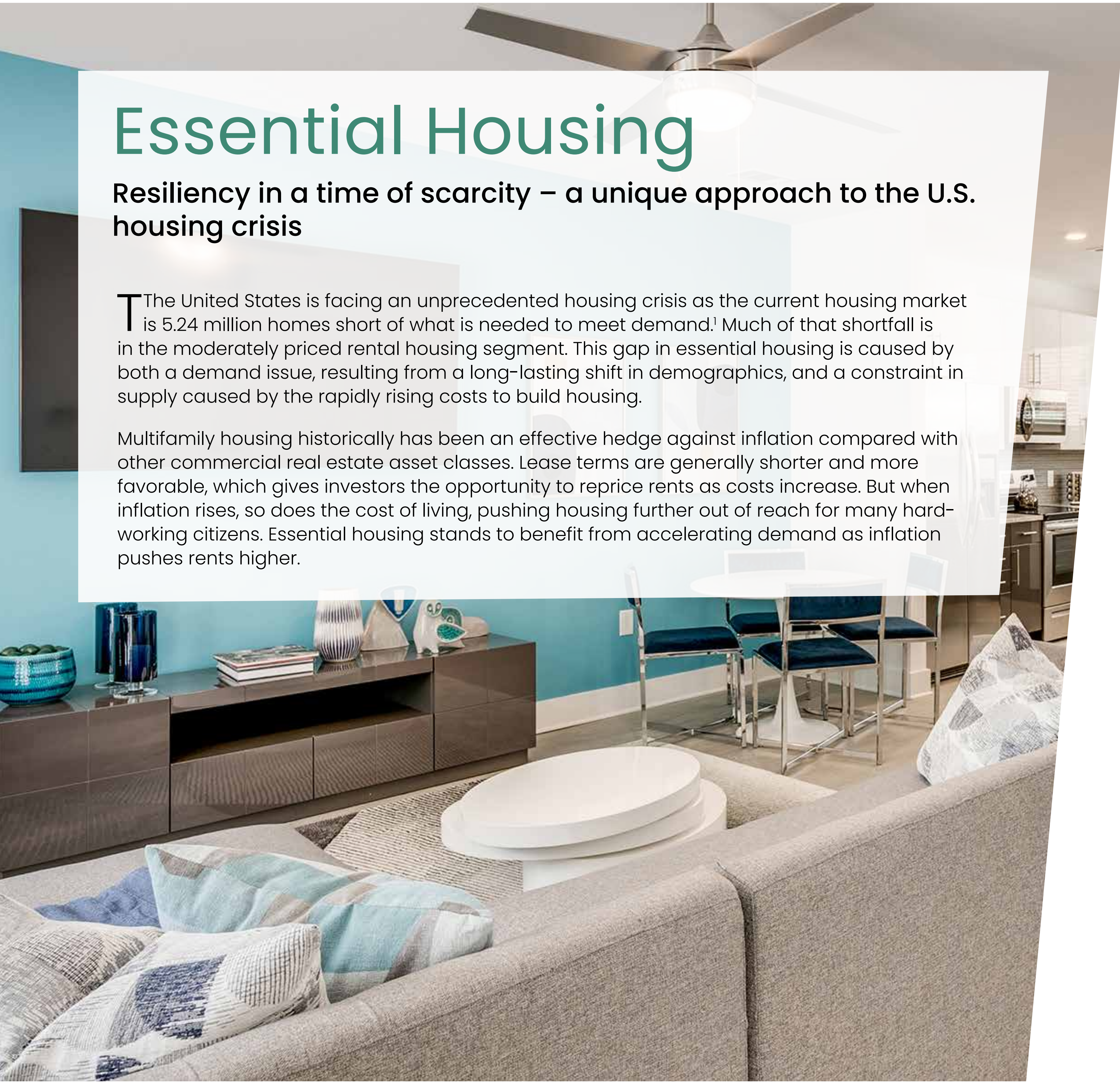
GRUBB PROPERTIES
Perspective drives performance.

Essential Housing

Resiliency in a time of scarcity – a unique approach to the U.S. housing crisis

The United States is facing an unprecedented housing crisis as the current housing market is 5.24 million homes short of what is needed to meet demand.[1] Much of that shortfall is in the moderately priced rental housing segment. This gap in essential housing is caused by both a demand issue, resulting from a long-lasting shift in demographics, and a constraint in supply caused by the rapidly rising costs to build housing.

Multifamily housing historically has been an effective hedge against inflation compared with other commercial real estate asset classes. Lease terms are generally shorter and more favorable, which gives investors the opportunity to reprice rents as costs increase. But when inflation rises, so does the cost of living, pushing housing further out of reach for many hard-working citizens. Essential housing stands to benefit from accelerating demand as inflation pushes rents higher.



1 REALTOR Magazine - Report: America Is Short 5.24M Homes

< 60% AMI – Affordable

60% - 140% AMI – Essential

> 140% AMI – Luxury

What is essential housing?

At Grubb Properties, we define **essential housing** as product for households earning more than 60% of an area's median income (AMI), putting these households above the cutoff for a public housing subsidy, but less than 140% of that AMI, putting them below the threshold to afford luxury housing. Essential housing should serve about 41 million households in the United States, offering working professionals an affordable, quality housing option in urban markets.

Essential housing is not to be confused with workforce housing, which largely serves middle-income working families through existing rental product. Workforce housing often has a greater number of configurations with 2-4 bedrooms and is typically located in suburban areas close to schools. While this is a critically important component of the U.S. housing stock, these unit configurations and locations largely do not fit the needs of young people entering the workforce today. Essential housing is also not luxury housing, which targets those earning above 140% of the AMI, and which is currently saturating the market in most cities. The Wall Street Journal found that 80% of the 371,000 new rental apartments expected to be built in 2020 were luxury properties.[2]

An issue primarily driving the shortage in essential housing is the growing demographic demand from the sizable Millennial and Gen Z generations who are already in or about to enter the workforce. Given that peak births occurred in 2007 (making that population 15 years old in 2022), this demographic force is expected to last at least another decade. In addition to this overall demand, there is also pent-up demand for housing from these populations: in February 2020, largely before the COVID-19 pandemic came to the United States, 47% of 18- to 29-year-olds were living with at least one parent, according to the Pew Research Center.[3] In 2020, the impact of the pandemic only created more pent-up demand and pushed more than 52% of this age group to be living at home.

Despite this demand, housing supply has remained at historic lows because of the cost challenges in building new housing. Several factors contributing to the rise in cost are:

- Rising land costs. Between 2012 and 2017, the value of land used for single-family housing in the United States rose almost four times faster than inflation. As a result, the median price per acre of land under existing single-family homes rose 27%.[4] In 2019, the median land value of a quarter-acre lot occupied by an existing single-family home was a staggering 60% higher than it was in 2012.[5] This land trend suggests that land costs play a key role in the growth of home prices, with no relief in sight.

- Rising construction costs. Another significant challenge is the unprecedented inflation in construction costs, something that has affected the entire housing industry. The Turner Building Cost Index found the 10-year average compound annual growth for construction costs is 3.95% - approximately 25% higher than the average wage growth over the same time period.

2 The Wall Street Journal - Aiming at Wealthy Renters, Developers Build More Luxury Apartments Than They Have in Decades
3 CNN - 52% of young adults in the US are living with their parents. That's the highest share since the Great Depression
4 JCHS - Increasing Land Prices Make Housing Less Affordable
5 The State of the Nation's Housing 2021

– Pandemic ripple effects. Supply chain problems are interfering with the cost and availability of construction inputs such as lumber, concrete, steel, and many fixtures needed to complete new builds. For example, lumber, which normally fluctuates between $200-$500 per 1,000 board feet, reached a record high price of $1,700 per 1,000 board feet in April 2021 and has continued to vary significantly. This rise in lumber prices caused the price of an average new single-family home to increase by nearly $18,600 as of January 2022, according to the National Association of Home Builders.[6] Housing costs have outpaced wage and inflation growth for some time. With the coronavirus pandemic and related economic contractions, it is expected this trend will accelerate precipitously, putting housing out of reach for an even larger swath of younger, employed Americans.

This economic pressure will expand the "missing middle" renters who do not qualify for subsidized housing but cannot afford the luxury housing that is the majority of new construction. For example, Trulia recently found that teachers could afford less than 20% of the homes for sale in 11 of 55 major U.S. metro areas studied.[7] The essential housing gap leaves the "missing middle" without a tangible path to homeownership and, ultimately, to economic stability and mobility. The Financial Times recently found that in 2020, many Millennials, now in their 30s, own just 3% of all household wealth. Comparatively, Baby Boomers had 21% of household wealth when they reached their late 30s in the 1990s.[8]

This "missing middle" population needs quality housing that they can afford in locations that work for them – making essential housing even more essential at this exact moment in time.

Although the essential housing gap is a considerable problem, it also presents a significant opportunity for investors to be part of what we believe to be one of the most resilient asset classes, where there is little competition.

How do we tackle the problem?

At Grubb Properties, we believe we have found a solution to the housing gap that serves all stakeholders: investors, potential residents, and our broader community. We enact it through our Link Apartments℠ brand, which is focused on intelligent design and resident amenities to provide a lower cost, urban infill living opportunity.

In developing Link Apartments℠, we focus on two key differentiators: location and price point. We choose urban locations that are near community

6 NAHBNNow - Latest Wave of Rising Lumber Prices Adds More than $18,600 to the Price of a New Home
7 trulia - Making a Housing Wage: Where Teachers, First Responders and Restaurant Workers Can Live Where They Work
8 Financial Times - 'We are drowning in insecurity': young people and life after the pandemic

amenities, transit options, and major counter-cyclical employment anchors such as research universities and medical centers. We also target rents that are affordable to residents earning 60-140% of area median income.

How are we able to achieve those prices in these target locations, where virtually no other multifamily product is being developed at this price segment? We drive value through a variety of proven proprietary methods, such as innovative site acquisition, shared parking, tax incentives, grants, and more. For example, we focus on just six highly efficient floor plan types that we replicate across all our communities. This is unique in the industry, where the standard is often more than 25 unit-types.

We also rely on our 59-year history and deep experience in both multifamily office investment to help with innovative site selection, which helps us reduce costs. For example, in many markets we acquire office buildings in urban infill locations with acres of surface parking. We then develop a Link Apartments℠ community on that land, including a parking garage that is shared between the office tenant and the new residents. This strategy saves on construction costs and provides a steady non-tenant revenue stream, allowing us to pass the savings on to our residents.

We also look at sustainability and ESG (Environment, Social, Governance) principles as investment tools that can drive down the recurring cost of utilities for our residents, further enhancing affordability. Our most recent Link Apartments℠ community earned a National Green Building Standard (NGBS) Silver designation. Our 2021 combined GRESB Sustainability Benchmark improved 19% over our 2020 score, while our 2021 GRESB Sustainability Benchmark Development Score is 81 out of 100, above the global average.

Focusing on the customer delivers both a better resident experience and the returns investors expect through a truly differentiated product that addresses a major market gap.

What is the benefit for investors?

For the investor, essential housing provides a stronger margin of safety than building luxury apartments, because essential housing is driven by demographics rather than by how well the economy is performing at any given moment. The large Millennial and Gen Z populations are already facing a housing shortage, and the cost pressures constraining the supply are only going to intensify over the next few years.

By targeting the missing middle population, essential housing can reach a larger audience that is drastically underserved by most of the product being built today. This provides an opportunity for investors to participate in a resilient, risk-mitigated strategy, with little competing product in urban markets throughout the United States.

Essential housing is desperately needed in both gateway markets and high growth cities and can be an appealing product for investors looking to enter those markets. Gateway markets like Los Angeles, the Bay Area, and New York City have experienced decades of housing challenges, and the problem is worsening.

The pandemic created a unique opportunity for developers to enter these resilient markets at a discount as people temporarily shifted from high-density cities to lower-density ones. This short-term shift in demand for housing created buying opportunities for sites in these dense markets, lowering the cost and availability of one of the most critical inputs: land.

High-growth markets, by definition, have a high demand for housing that is driving construction costs up even further. Cities such as Charlotte and Atlanta are struggling to build enough housing, and the housing they are building is mostly luxury and therefore unaffordable to many of their residents.

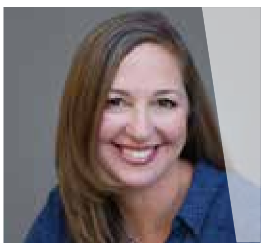
While fast growth makes these markets challenging, Grubb Properties is often able to deploy techniques to drive down our effective cost, such as sourcing land for free through our commercial division or negotiating tax abatements in exchange for moderately priced housing, among other creative methods. This allows for a diversification of markets in an investor's portfolio, and an opportunity to invest in some of the most resilient markets with economies and job centers that perform well even during economic downturns.

The growing need for essential housing, combined with Grubb Properties' years of work and deep expertise in building out these creative methods, has us well positioned as we emerge from the current crisis. We believe that providing essential housing is not just a smart policy and a good investment strategy — it is also a moral imperative.

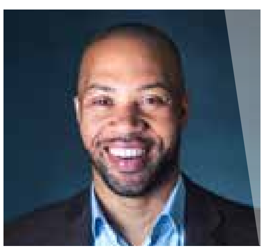
About the Author:

Todd Williams is the Chief Investment Officer at Grubb Properties and is responsible for leading the company's private equity real estate investment programs and institutional joint ventures, including the development, launch and fundraising for discretionary funds that provide equity capital for the company's real estate investments into essential housing. Todd has more than 25 years of industry experience including prior executive and senior-level roles at Grubb Properties in development, acquisitions, underwriting and debt financing. He has overseen fundraising for more than $750 million in equity capital deployed across $1.5 billion in real estate transactions during his career with the company.

About our Contributors:

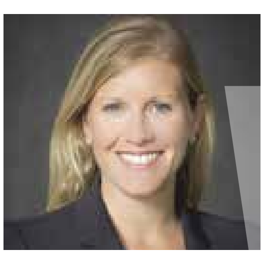


Megan Slocum oversees the company's Link Apartments℠ development, including entitlements, rezoning, pro forma development, design, construction, and stabilization. She first joined Grubb Properties in 1994 and spent five years on site in property management. As Vice President, Construction and Development, she spent four years from 2005 to 2009 overseeing that team. In 2009 she became a senior vice president and ran the operations of the company's residential after division. Megan became Vice President, Residential Operations, overseeing the multifamily and essential housing division for two years until she transitioned to Managing Director of multifamily and essential housing development.



Annanias Rose Vice President, Brand Strategies & Innovation, joined Grubb Properties in 2020 to help roadmap the scalability of the Link Apartments℠ brand. Annanias brings over 20 years of hands-on experience nationally in hospitality, multi-family operations, marketing, design, and development. "Contributing to the housing crisis and making a sustainable impact with a collaborative team is the most exhilarating endeavor I have been part of. Over the next ten years, we will create 28,000 apartment homes for prospective residents throughout the country. We will produce a product that we all can be proud of, knowing essential housing should be attainable to all".

For media inquiries:



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You may find more information about our currently open Grubb Properties essential housing funds below. You can also visit our website to learn more about us.

Fund VII

Our flagship fund focuses on Essential Housing in select resilient and high-growth U.S. markets through our Link Apartments℠ brand, given that the Millennial and Gen-Z workforce is facing severe housing affordability challenges in major metropolitan areas. While development will be the primary execution method, the Fund may also include acquisitions of existing properties that can be upgraded and re-branded. In addition, Grubb Properties will look for opportunities to source land and create parking synergies through the acquisition of commercial properties to drive down capital and operating costs for its Essential Housing strategy.

For more information about Fund VII, visit www.grubbproperties.com/funds/fund-vii or send us an email at fundvii@grubbproperties.com.

Link Apartments Opportunity Zone REIT

Our Qualified Opportunity Fund (QOF) pursues our essential housing strategy in Qualified Opportunity Zones (QOZs) in resilient and high-growth markets across the United States. The QOF program was created by the Tax Cuts and Jobs Act of 2017 to encourage investment and spur development in newly created QOZs. By investing recently realized capital gains into a QOF, an investor is eligible to receive two primary tax benefits:

1. Deferral of capital gains tax on the previous investment until December 31, 2026
2. Complete exclusion from capital gains tax of the appreciation of the fund investment and realization, following a 10-year holding period

We have deep experience and a positive track record with essential housing projects in these areas. By the time the legislation was implemented, we already had four Link Apartments℠ sites in development or in service in QOZs.

With shovel-ready seed investments and our longtime commitment to working with communities, our QOF offers significant advantages to investors, businesses, and neighborhoods.

For more information about our Link Apartments℠ Opportunity Zone REIT, visit www.grubbproperties.com/funds/2022-link-apartments-opportunity-zone-reit or send us an email at LinkOZREIT@grubbproperties.com.

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