

Essential Housing

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

The COVID-19 pandemic has upended nearly every aspect of modern life. As with the previous Dot.com bubble of the early 2000s and the Global Financial Crisis of 2007-2010, this event will continue to impact our economy and society for years to come.

But, as pointed out by John F. Kennedy, a crisis presents a choice: it can be a danger or an opportunity, depending on how innovative and optimistic we're willing to be. At Grubb Properties (Grubb), we believe that the coronavirus crisis has turned cracks into craters, forcing us to collectively confront the critical necessity of essential housing for urban working professionals.

We are in the middle of one of the biggest housing crises that the United States has ever seen, and 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.

Providing essential housing is not just a smart policy and a good investment strategy – it's also a moral imperative.

What is essential housing?

At Grubb, we define **essential housing** as product for households earning more than 60% of an area's median income (AMI), putting them 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.



< 60% AMI –
Affordable



60% – 140% AMI –
Essential



> 140% AMI –
Luxury

Building this essential housing product is necessary to address the current housing shortage in America. According to recent statistics from Freddie Mac, the U.S. housing market is 3.8 million homes short of what is needed to meet the country's demand.² Freddie Mac estimates there has been a 52% rise in the nation's home shortage since 2018 – the result of underbuilding for 10 years.

Essential housing is not to be confused with workforce housing, which largely serves middle-income working families through existing rental product that 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 don't 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.

Over the last five years, roughly 75% of the new housing product built in the multifamily market was luxury housing.

One issue driving the shortage in essential housing is the growing demographic demand from the large 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 14 years old in 2021), 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 among this population: in February 2020, largely before the COVID-19 pandemic came to the United States, 47% of 18-29-year-olds were living with at least one parent, according to the Pew Research Center³. 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%. This suggests that land costs played a key role in the recent runup in home prices, which climbed nearly 29% over the same period⁴.

- Rising construction costs. Another significant challenge is the unprecedented inflation in construction costs, something that has affected the entire housing industry. The Turner Construct 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 http://www.freddie.com/perspectives/sam_khater/20210415_single_family_shortage.page

3 <https://www.cnn.com/2020/09/04/us/children-living-with-parents-pandemic-pew/index.html>

4 <https://www.jchs.harvard.edu/blog/increasing-land-prices-make-housing-less-affordable>

- Pandemic ripple effects. The pandemic caused supply chain problems, which exacerbated the cost and availability of construction inputs such as lumber, concrete, and steel. For example, lumber, which normally fluctuates between \$200-\$500 per 1,000 board feet, recently reached a record high price of \$1,700 per 1,000 board feet. This rise in lumber prices caused the price of an average new single-family home to increase by nearly \$36,000, according to the National Association of Home Builders⁵.

Housing costs have outpaced wage and inflation growth for some time. With the coronavirus pandemic and related economic contractions, it's 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 don't 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 93 major U.S. metro areas studied. 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.⁶

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.



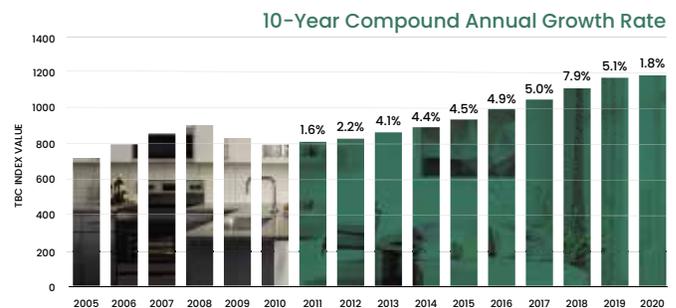
We now find ourselves in a period with tremendous demand for new housing but with little production, something that just feels downright un-American. Today's housing problem is estimated to eclipse \$1 trillion, yet our government keeps trying to tackle the problem with the same agencies and policies that...have resulted in today's problem.”

Clay Grubb via PERE

The Housing Crisis in America Today



Housing Cost Exceeds Inflation & Wage Growth



Source: Turner Construction Company - Turner Building Cost Index

⁵ <https://www.nahb.org/news-and-economics/industry-news/press-releases/2021/04/skyrocketing-lumber-prices-add-nearly-36000-to-new-home-prices>

⁶ <https://www.ft.com/content/77d586cc-4f3f-4701-a104-d09136c93d44>

How do we tackle the problem?

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

In developing Link ApartmentsSM, we focus on two key differentiators: location and price point. We choose urban locations that are near community 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 59 proven 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 look at sustainability and ESG as an investment tool that can drive down the recurring cost of utilities for our residents – and our most recent Link ApartmentsSM community earned an National Green Building Standard (NGBS) Silver designation.

A testament to the Grubb strategy is the fact that our multifamily communities maintained high occupancy throughout the pandemic (collections exceeded 98% for every single month in 2020 compared to 94.8% for the southeastern United States, as reported by Yardi Matrix) and had rent collections markedly above national averages. We keep a close eye on the 'end user' and what we need to do differently. We look to understand why they are struggling and what our solution needs to be – all while exceeding their expectations for quality and experience.



Our 2020 GRESB Sustainability Benchmark improved over our 2019 pre-assessment score by over **40%**



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?

While addressing this essential housing gap is our mission, we would not be able to execute our strategy without our 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 who is drastically underserved by 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 median

home price in the Bay Area has risen an inflation-adjusted 70% since 2012.⁷

Today, there is a unique opportunity for developers to enter these resilient markets at a discount because of the pandemic. People have temporarily shifted from high-density cities to lower-density ones. This short-term

shift in demand for housing has created buying opportunities for sites in these dense markets, lowering the cost and availability of one of the most critical inputs: land. And, a better resident experience and the returns are enhanced for the investor through a differentiated product without wasted resources on unnecessary components of a community the resident doesn't value.



**First Responder/Dog Dad/
Practical Guy**

Household Income \$72,000

Michael Emerson is a new resident at Link ApartmentsSM Montford. He and his four-legged friend, Scarlett, recently moved to be close to family during the pandemic. He is close to work at Atrium Health Carolinas Medical Center where he is a paramedic.

Finding rent within his budget was a top priority. The efficient size of the apartment reduces his utility bills as well. Because Michael has irregular work hours, a maintenance-free way of life helps. He is a big fan of Park Road Shopping Center, where he spends much of his free time on evenings and weekends.

Spends their time:

- With his family
- Meeting fellow transplant friends
- Exploring his new neighborhood
- Maintaining a budget within his means



**Newly Married Couple/
Teachers/Cyclists**

Household Income \$120,000

Emmet & Addison Banning met while both were visiting a local cycling club in Atlanta, GA. Their first date was cycling the entire Beltline, and they knew it was a match. Emmet is an art instructor at Georgia State University, and Addison teaches at Maynard Holbrook Jackson High School.

They settled in Link ApartmentsSM Grant Park as both their employers are nearby.

Having a cycle center in the building where they can store their bikes and reduce their carbon footprint aligns with their efforts of being responsible stewards. They also spearhead a resident function, wine and paint night, contributing to the spirit of resident engagement.

Spends their time:

- Going to the zoo
- Riding the Beltline
- Painting in Piedmont Park
- Planning to expand their family



**Graduate Student/
First apartment/No Roommates**

Household Income \$Scholarship

Lydia Hernandez is a grad student at UNC-Chapel Hill, concentrating on public health. She moved to Chapel Hill from New York and is the proud renter of her first apartment. She rented a jr. one bedroom that was just within her budget.

Lydia's decision to rent with Link ApartmentsSM Linden happened when she learned about the rich history of the area. She admires the repurposed millwork inside of the leasing office and clubhouse. She has a life outside her unit in the various thoughtful amenities. She has met several neighbors at resident functions and feels a strong sense of community.

Spends their time:

- Jogging on greenway
- Watching UNC basketball
- Visiting the Botanical Gardens
- Walking to the Chapel Hill Farmers Market

⁷ <https://www.vitalsigns.mtc.ca.gov/home-prices>

High-growth markets, by definition, have a high demand for housing that is driving construction costs up even further. These cities like 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 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 moderate-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 Unique Grubb Structure

Given the depth and severity of the essential housing gap, Grubb has organized our vertically integrated company completely around meeting this need. Our development program is solely focused on bringing Link ApartmentsSM communities to desirable urban infill markets where this type of housing is desperately needed. Although we have experience and success in value-add housing, we are selling that dwindling part of our portfolio to focus on the development and management of essential housing to drive investment returns.

Our current investment strategy is born from our deep experience in both multifamily and office investment. This plays out in methods such as our 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 ApartmentsSM community on that land, with a parking garage that is shared between the office



tenant and the new residents.. This strategy saves us construction costs and provides a steady non-tenant revenue stream, allowing us to pass the savings on to our residents.

Our targeted amenity strategy is also aimed at driving down costs, such as our Cycle Centers, which reduce parking demand at each property. Grubb is the first private developer in North America to work with Copenhagenize, the world leader in designing for alternative forms of transportation. This not only allows for sustainability benefits and appeals to residents, but also improves local communities.

We understand the resident who needs and wants essential housing, and what matters most to them. We work to enable them to stay at our properties and build true communities. Our Long-Term Resident Program caps rents for any resident that lives at any of our properties for at least five years. More than 8% of our residents are currently part of this program.

Recently, we created a Link Innovation Lab to develop and test even more creative approaches and efficiencies that will empower us to deliver more essential housing in the areas that need it most.

The growing need for essential housing, combined with Grubb's years of work and deep expertise in building out these creative methods, has us well positioned as we emerge from the current crisis. There is no company better organized or better prepared to meet this critical moment.

For more information, visit our Link ApartmentsSM website at www.linkapartments.com or our Grubb Properties website at www.grubbproperties.com to see how our investment perspective starts with principle.



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 ApartmentsSM 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. In 2005 as Vice President, Construction and Development, she spent four years 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 for the Link ApartmentsSM 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".

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Some of our available Grubb Properties Essential Housing Funds for 2021. If you are interested, please contact any of our team members for more information.

Fund VII - This fund will continue our Link ApartmentsSM flagship fund strategy, which has evolved over the past decade. Grubb Properties creates real estate environments through the repositioning of office buildings and the development of moderately priced multifamily communities, or essential housing, under its nationally registered Link ApartmentsSM brand. The current investment strategy is born from the firm's experience in both sectors and our focus on deep value-add execution to drive investment returns. We are seeing very interesting opportunities related to price dislocation and distress brought on by the pandemic, and we anticipate this will continue as the new cycle evolves. Our approach to essential housing is defensive and will continue to play well under both current and future economic conditions.



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2021 Qualified Opportunity Fund - A Qualified Opportunity Fund is an investment vehicle created by the Tax Cuts and Jobs Act of 2017 to encourage investment and spur development in newly created Qualified Opportunity Zones (QOZs). By investing recently realized capital gains into a Qualified Opportunity Fund, an investor is eligible to receive three primary tax benefits:

1. Deferral of capital gains tax on the previous investment until Dec. 31, 2026
2. Reduction of the amount of tax owed on the deferred gain of up to 15%, based on the achievement of five- to seven-year holding periods
3. Complete exclusion from capital gains tax of the appreciation of the fund investment at realization, following a 10-year holding period

We have deep experience and a positive track record with these types of essential housing projects. By the time the legislation was implemented, we already had four Link ApartmentsSM sites in QOZs. With shovel-ready seed investments, and our longtime commitment to working with communities, our Qualified Opportunity Fund offers significant advantages to investors, businesses, and neighborhoods.



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