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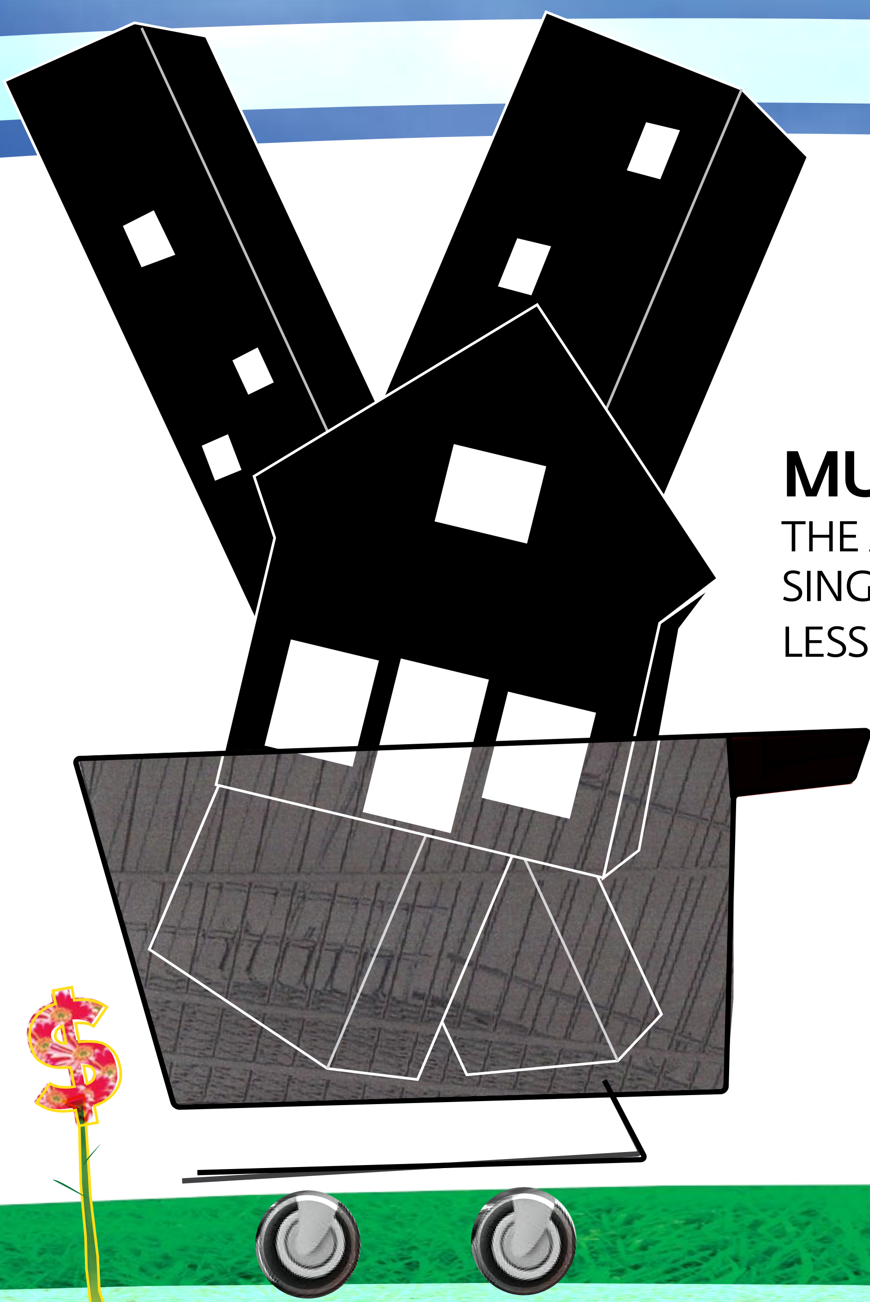
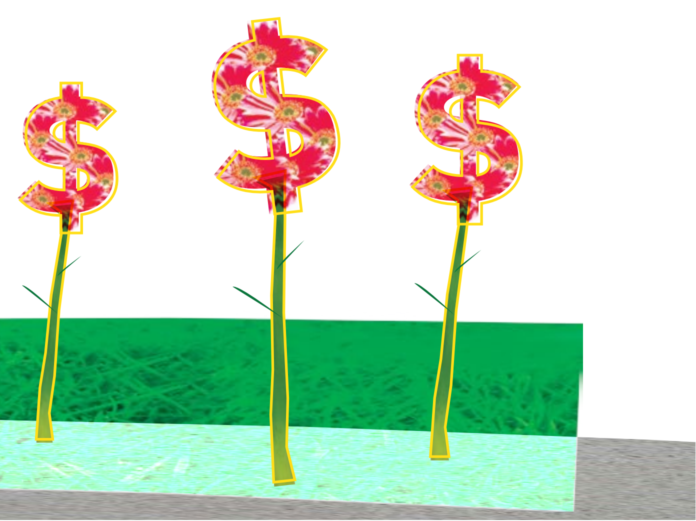
SPECIAL REPORTS

Q1 2014

The Residential Opportunity



and expert insights from:
STARWOOD WAYPOINT · PRAEDIUM
REIS · CARROLL ORGANIZATION



Videos in This Report

On Camera

Colin Wiel, Starwood Waypoint

This special report includes the following new video programs. Watch them at PrivcapRE.com

Florida Multifamily Firing On All Cylinders
Patrick Carroll of Carroll Organization remains bullish on the multifamily housing sector, particularly in recovery markets like Florida.

Multifamily Fundamentals Peak, But No Implosion
Ryan Severino of Reis says multifamily fundamentals have peaked, with vacancy rates set to rise in the next few years. But rents and capital market demand will continue to grow.

Multifamily Growth Returns to Sustainable Levels
Praedium Group's Russ Appel on why multifamily housing hasn't peaked, more sustainable growth rates for the sector, and the supply outlook.

Building a Single-Family Portfolio
Starwood Waypoint's Colin Wiel talks about building a portfolio of more than 10,000 rental homes across the U.S., technology's importance in portfolio management, and his preferred source for deals.

The Rebirth of Fannie and Freddie
Reis's Ryan Severino and Carroll Organization's Patrick Carroll consider the rebirth of Fannie Mae and Freddie Mac, and the implications for multifamily investors.

COMING SOON on PrivcapRE

Institutionalizing Single-Family Homes
Starwood Waypoint's Colin Wiel says the opportunity for institutionalizing ownership of single-family homes is huge.

Deal Story: Phillips Edison's Kenwood Collection
Jeff Edison of Phillips Edison, talks about the firm's acquisition of the stalled 500,000-square-foot, mixed-use development Kenwood Towne Place in Cincinnati.

UPCOMING REPORTS

Q2

Debt Investing

Performance & Benchmarking

Industrial & Logistics

Q3

Value Creation & Active Asset Management

In Case You Missed It...

Must-see thought leadership from **PrivcapRE.com**

For Property Fund Managers, It's Survival of the Fittest

Only the best-performing real estate fund managers will continue to attract investors, says Greenhill Real Estate Capital Advisory Group's Pamela Wright.

A Data-Driven Global RE Tour

Real Capital Analytics' Bob White's outlook for global property in 2014.

Inside Metropolitan's Sale to Carlyle

Metropolitan Real Estate's David Sherman talks about the firm's acquisition by The Carlyle Group.

Explosion of Chinese Capital

Chinese capital is already making its mark on global real estate markets. And it's about to explode, say Joseph Kelly and Simon Mallinson of Real Capital Analytics.

GP Due Diligence: Get Managers Off-Script

Roy Schneiderman of Bard Consulting, whose work involves detailed due diligence "dives" on behalf of some of the world's largest institutional investors, offers advice to all investors.

Investment Transparency

EY's Mark Grinis discusses the greater demand from investors for transparency and communication from their GPs, and how to achieve it.

About PrivcapRE Special Reports

PrivcapRE Special Reports are exclusively for subscribers to PrivcapRE, the definitive channel for thought leadership in private real estate investment. Each month, PrivcapRE focuses on a critical investment theme and produces a package of thought-leadership content in multiple formats—a digital report, video interviews and panel discussions, and audio programs. The market intelligence of leading authorities forms the core of each package. PrivcapRE Special Reports help market participants better understand opportunities and practices in private real estate, and gain deep insights into potential investment partners.

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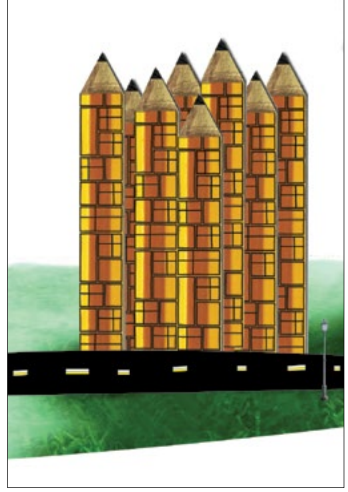

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SPECIAL REPORTS**

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Interviews in this report have been edited for length and clarity.

The Single-Family Exit Game: Stocks or Bonds?

The **single-family rental business** has turned institutional residential real estate strategy on its head, with the six largest players quickly investing more than $16 billion in the once "mom-and-pop" business. How will they cash out?

Market Analysis by Editor **Zoe Hughes**

When it comes to exiting single-family rental investments, the answer appears clear: Securitize rental revenues through a rental bond.

When The Blackstone Group and its single-family rental subsidiary, Invitation Homes, securitized the rental revenues of roughly 10 percent of its more than 35,500 homes in November 2013, it opened a new path to capital for the fledgling sector.

Widely praised for its CMBS-style qualities, investors clamored to get a slice of the first new real estate asset class in a decade. The $479.1 million bond offering was more than five times oversubscribed, with the top tranches pricing at an aggressive 115 basis points over LIBOR.

For Blackstone's rivals, it set in place exit strategies for their own aggregated portfolios of foreclosed, short-sale, and for-sale housing.

Silver Bay Realty Trust, American Residential Properties (ARPI), and American Homes 4 Rent (AMH), the second-largest manager in the space, had earlier taken the IPO route, only to see their platforms price at the low end of expectations. Colony Capital postponed IPO plans in June for its subsidiary, Colony American Homes, citing market conditions.

Today, however, Colony, ARPI, and AMH are all working on securitizations. On a Q4 2013 earnings call, ARPI confirmed it had hired Blackstone's banker, Deutsche Bank, to help it structure a $300 million securitization that would "emulate" the Invitation Homes deal. Colony and AMH, which has hired Goldman Sachs, are also expected to launch securitizations within the next 60 days.

Yet exiting the single-family REO-to-rental business isn't a choice between bonds and REITs. Given the size and scope of the investments—more than $16 billion of equity in 100,000 homes in just two years—it will take both vehicles to successfully liquidate them.

Sizing the bond opportunity

Blackstone's Invitation Homes 2013-SFR1 deal was the only such securitization in 2013, but the market is set to take off. Harris Trifon, a CMBS analyst at Deutsche Bank, expects the rental bond market to grow to $5 billion in 2014. "There's more than enough investor appetite to absorb that amount of supply," he tells PrivcapRE. "It represents the first new asset class that we've seen in about a decade. By that metric, it's exciting and interesting."

Investor concerns about the long-term viability of the sector, however, could temper future demand, no matter the success of the Blackstone securitization.

When the rating agencies Moody's, Kroll, and Morningstar awarded triple-A ratings to the biggest tranche of the Invitation Homes 2013-SFR1 deal, eyebrows were raised. The top ratings helped sell the rental bond to institutional investors,

> INVESTOR CONCERNS ABOUT THE LONG-TERM VIABILITY OF THE SECTOR, HOWEVER, COULD TEMPER FUTURE DEMAND, NO MATTER THE SUCCESS OF THE BLACKSTONE SECURITIZATION.
>
> -ZOE HUGHES

but it was "terribly mispriced" for the risk, a senior sales manager said at a recent mortgage conference.

Questions center on occupancy (78 percent of Invitation Homes' rental bond portfolio had remaining leases of less than 12 months, as of November 2013), the geographic concentration of properties within rental bonds (34 percent of IH 2013-SFR1 was in Phoenix), and the demands of operating such a portfolio. New issuers will undoubtedly need to offer juicier yields than Blackstone to entice the same level of investor interest.

But rental bonds offer only part of the single-family exit landscape. The Blackstone deal represented a small fraction of its portfolio. And given current CMBS underwriting standards, it likely represented some of the more desirable homes. The very nature of single-family rental investing centers on buying foreclosed short-sale homes in need of renovation and turnaround. Looking at the occupancy levels of some of the largest players in the space, the average total portfolio occupancy is 80 percent. Rental bonds can be only one part of the exit strategy.

REIT routes

Despite the poor performance of early single-family rental IPOs, REITs can be expected to provide a long-term exit route for managers. Indeed, Starwood Capital and Waypoint Real Estate launched their REIT, Starwood Waypoint Residential Trust (SWAY), on Feb. 3 to manage and grow a portfolio of more than 7,000 homes and nonperforming loans. For cofounder Colin Wiel, [watch his interview on single-family rental asset management on p. 7], the REIT structure provides the best means to exit single-family rentals.

But that's not to say a SWAY securitization isn't on the way as well.

To get the best returns for investors, both rental bonds and REITs must be a part of any exit discussion./

Click to watch this video at privcapre.com

Waypoint's Single-Family Focus

Colin Wiel of **Starwood Waypoint** says managing the firm's large stable of single-family homes wouldn't be possible without **technology** and **in-house expertise**

Colin Wiel, Starwood Waypoint

PrivcapRE
I want to get an idea of what it takes to manage more than 8,000 single-family rentals across the U.S. How did you build the asset-management capabilities of Waypoint from the start in 2009 to today?

Wiel
It's an intensive, complex business. Every unit's unique, so the renovations, the property management, the leasing—it's all complex. It wouldn't be possible without the aggressive use of technology, and that's something we began doing in 2009. When the company started in January 2009, we began by buying houses, initially with our own capital, and then we raised a series of high-net-worth funds. We steadily scaled up and, almost from the beginning, had a vertically integrated approach. We were doing property management ourselves—leasing, construction management, everything. We grew about as fast as we possibly could have, from when we were buying three to four houses in January of 2009 to 20 houses in December of 2009, and a year after that it was 40 or 50 houses a month. We built out the technology, the business processes, and the team, all in lockstep. Now, five years in, we have 600 employees nationally and do almost every function in-house.

PrivcapRE
When you get them on your portfolio, what's the average state of a house?

Wiel
We'll typically do a $20,000 renovation on every house, which we outsource a fair amount of, and we get a lot done for that amount. They can be in pretty rough shape. We do the construction management, but it's third-party crews doing the construction.

PrivcapRE
I'd love to get an idea of where you source the deals, but also how you align interests with the buying team.

Wiel
We're sourcing houses on the MLS [Multiple Listing Service] and looking at every house in the markets where we're listed. Similarly, for the foreclosure auctions, we're looking at every house. We have a structured process

organized by our technology platform that we call the Waypoint Compass. That's how we manage our queues of what needs to be done and automated valuations and algorithms, but we also have a human component to it. Our acquisition associates are then compensated, not only by how many houses they bought or how much capital they deployed, but based on the performance of every asset they buy.

PrivcapRE
How do you assess a neighborhood and decide it's an area you want to be in?

Wiel
We have a proprietary system where the country is divided into about 400,000 neighborhoods. These are cohorts of homes of similar age and movement. Then we assign a score to every neighborhood on a zero-to-100 scale, based on median income, school quality, crime level, but also our own proprietary livability score. We have our leasing agents and acquisitions associates visiting these neighborhoods and looking at the physical attractiveness, perception of safety, and the noise level, then coming up with a livability score, which then feeds into the neighborhood score. Based on all of that, we assign a target yield to that neighborhood and underwrite our houses such that they have to generate that yield in order for us to purchase them.

PrivcapRE
You've been doing this since 2009—longer than anybody else. What are some surprises that you came across in building such a large portfolio?

Wiel
There are a lot of small lessons in there, or just kind of learning what the reality is. We have a good sense of what ongoing capex is, with five years of track record. When we were on our pre-spin road show a few weeks back, we were telling people what our repairs and maintenance and capex are expected to be. People told us that "it's higher than some of your competitors are saying." Our answer was: This is reality. We have the track record. We know, unfortunately, that this is the reality of what it's going to be. But the good news is that we know what it's going to be.

PrivcapRE
The main concern investors have when looking at single-family rentals is how you manage thousands of homes in different areas with different specifications. What are the main messages that you give investors who are worried about the operational capabilities?

Wiel
The operational complexity of this business, compared to any other real estate asset class, is higher for a couple of reasons. Primarily, because the size of each investment is so small. But also, it's people's homes; it's their lives. It's more complicated in that regard than renting out an office building. This industry would not have been possible 10 years ago because of cloud computing and, generally, the cost of developing.

PrivcapRE
How do you underwrite the renters?

Wiel
This is one of the most important things that we do, and we do it carefully. We have our own proprietary algorithm that's an important part of our secret sauce. We're looking at income levels and FICO scores as primary components, and there are regions on the FICO spectrum where we definitely don't want to be below a certain level.

PrivcapRE
Is there a greater turnover for single-family versus multifamily?

Wiel
There's far greater turnover for multifamily. Multifamily is in the 50-to-60-percent-per-year rate of turnover. Our rate is about 30 percent. So it's slightly over half the rate, which makes all the difference in the world. Multifamily has a big advantage in terms of operation efficiency, and there's only one roof that needs to be replaced. Capital expenditures are more of a challenge in single-family. The key to this business is to keep people in their homes for three, four, five years.

PrivcapRE
I know Starwood Waypoint has introduced a rewards system. Talk to me about the rewards points and what you're offering renters.

Wiel
Our program is called Lease Plus Rewards, and people are earning points which can be exchanged for cash back or a discount on their future renewal, a cruise, or an improvement to their house—the same things homeowners seek to save money for. What we found early on was that renters felt ambivalent about renting—they feel like they're throwing their money away, not saving. It's a way for people to get that little bit of self-discipline to save some money./

BIO

Colin Wiel is chief investment officer and founder of Starwood Waypoint Residential Trust, where he oversees acquisitions and technology strategies. He previously founded and sold an e-commerce software engineering firm and founded the San Francisco chapter of angel investing group Keiretsu Forum. He received a B.S. in mechanical engineering from the University of California, Berkeley.

Inside the Blackstone Bond

The Blackstone Group and its single-family rental unit, Invitation Homes, securitized rental revenues of about 10 percent of its homes in November 2013, bringing a new capital source to the sector. Here's a look at that bond portfolio.

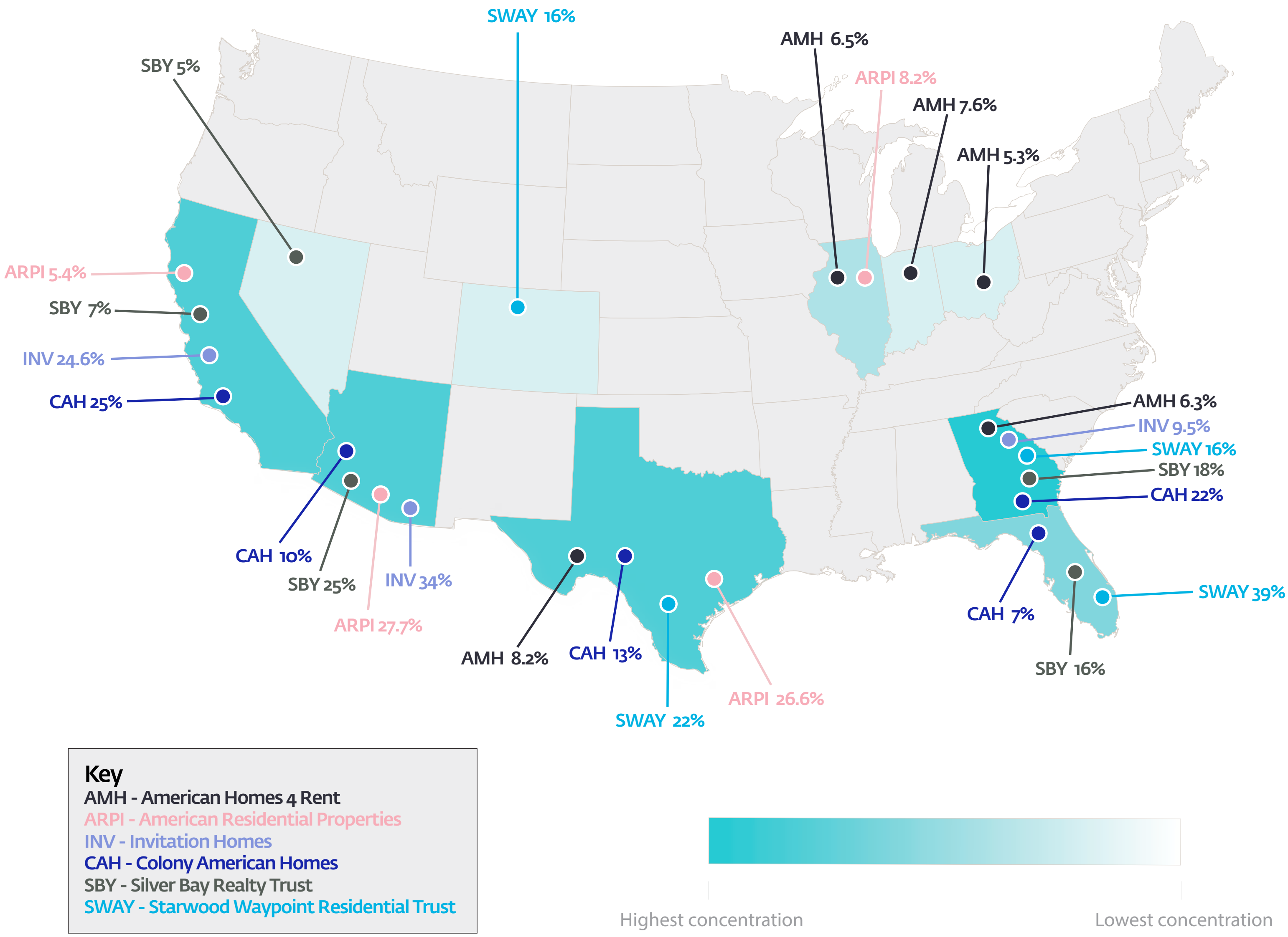
Invitation Homes total portfolio	35,500 homes representing $7.5B of equity investment.
Invitation Homes 2013-SFR1 bond portfolio*	3,207 homes representing $542.8M of equity investment, including cap-ex.
Average monthly rent*	$1,448
Geography*	Five states. Phoenix, 34.0%; Riverside, CA, 17.0%, Los Angeles, 12%; Atlanta, 9.5%; Sacramento, CA, 7.6%
Debt service coverage*	Issuer - 2.12x Kroll - 1.68x (at current LIBOR)
Debt yield*	Issuer - 6.37% Kroll - 5.04%

**Rental bond portfolio as of Nov 19, 2013, taken from Kroll Bond Ratings Invitation Homes 2013-SFR1 report.*

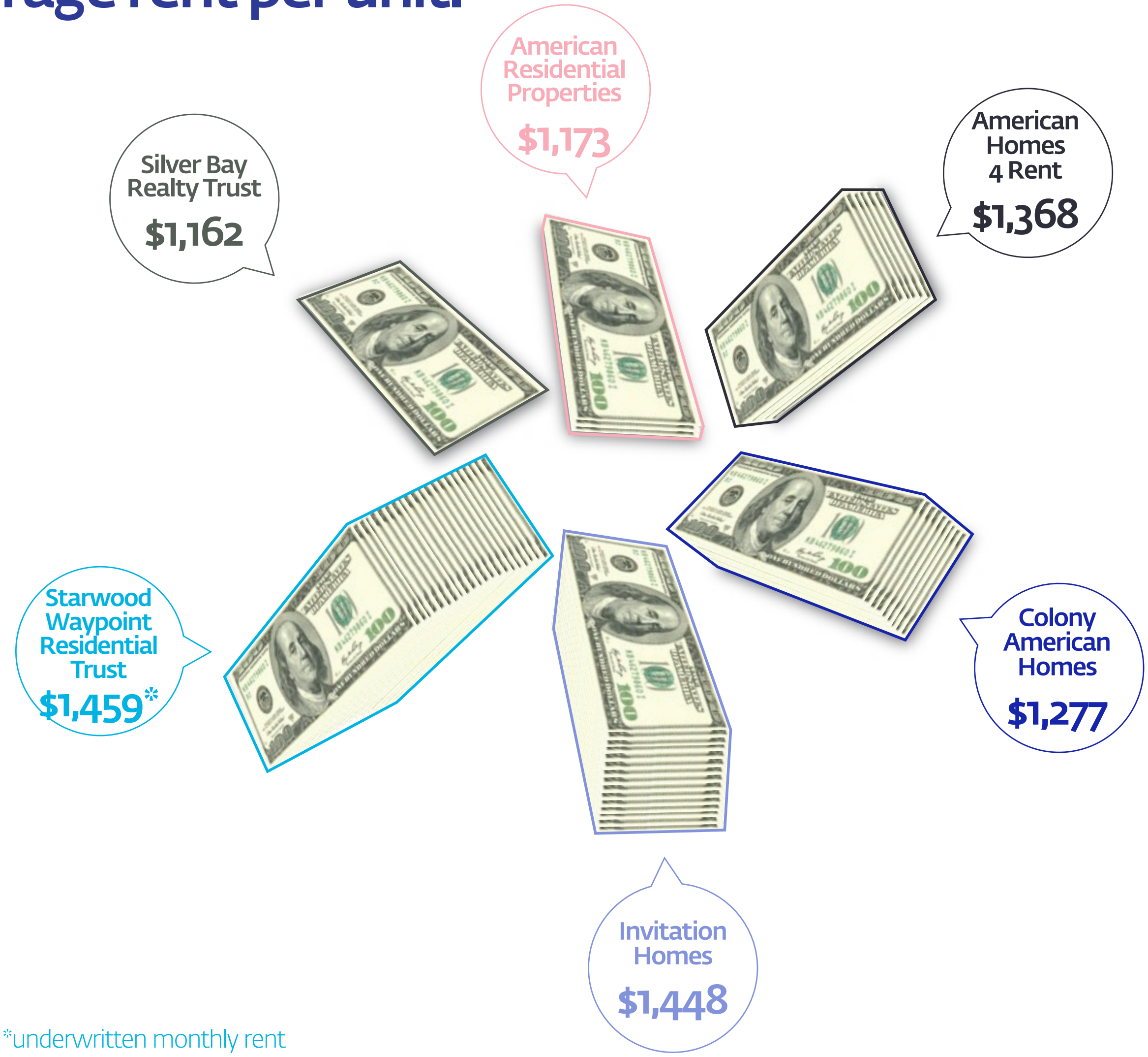
The Single-Family Showdown

Major investors have flooded into several key housing markets. Here is where the **top six investors** have been investing most heavily.

1. Top investment locations, by percentage of portfolio.

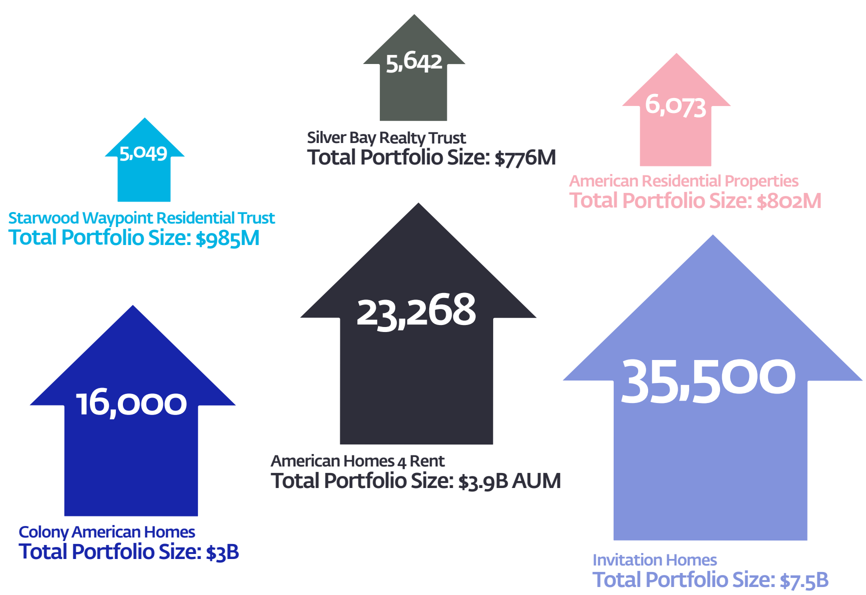


2. Average rent per unit.



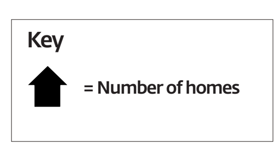
*underwritten monthly rent

3. Total single-family homes in portfolio.



About This Research

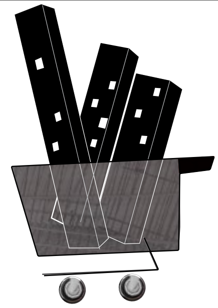
American Homes 4 Rent: as of Dec 31, 2013; Q4 financial results
Colony American Homes : Background information and as of March 31, 2013; taken from pre-IPO financial report
Invitation Homes, owned by Blackstone Real Estate Partners VII: rental bond portfolio as of
Nov 19, 2013; taken from Kroll Bond Ratings Invitation Homes 2013-SFR1 report; Blackstone Q4 media earnings call
Starwood Waypoint Residential Trust (SWAY): as of Dec 31, 2013; taken from Jan 21, 2014, investor presentation
Silver Bay Realty Trust: as of Dec 31, 2013; taken from Q4 earnings presentation
American Residential Properties: as of Dec 31, 2013; taken from Q4 earnings release and earnings call; as of Sept 30, 2013, taken from Raymond James investor presentation



The Multifamily Market

PrivcapRE looks at how market fundamentals are set to influence institutional investment in the U.S. apartment market

A Building Balancing Act



Experts discuss concerns about multifamily housing supply and demand, whether the sector has peaked, and markets to watch

Watch the Video

Ryan Severino
Senior Economist
Reis

Ryan Severino is senior economist in the research and economics department at Reis. He has been associate director of research at Met Life Real Estate Investments and director of investment strategy and market research at Starwood Capital Group. Severino holds degrees from Columbia University and Georgetown University.

Watch the Video

Patrick Carroll
CEO
Carroll Organization

Patrick Carroll is founder and CEO of the Carroll Organization, focusing on commercial development and investment. In 2004, he formed P. Carroll Properties, has since acquired three property-management companies, and is a multifamily owner and operator.

Watch the Video

Russ Appel
Founding Principal
Praedium Group

Russ Appel is founding principal at Praedium Group. Previously, Appel worked at CFSB's commercial-mortgage finance business and was managing director, as well as a vice president in the real estate department at Goldman Sachs. He holds a B.S. and M.B.A. from the Wharton School.

SEVERINO ON WHETHER MULTIFAMILY HAS HIT A PEAK.

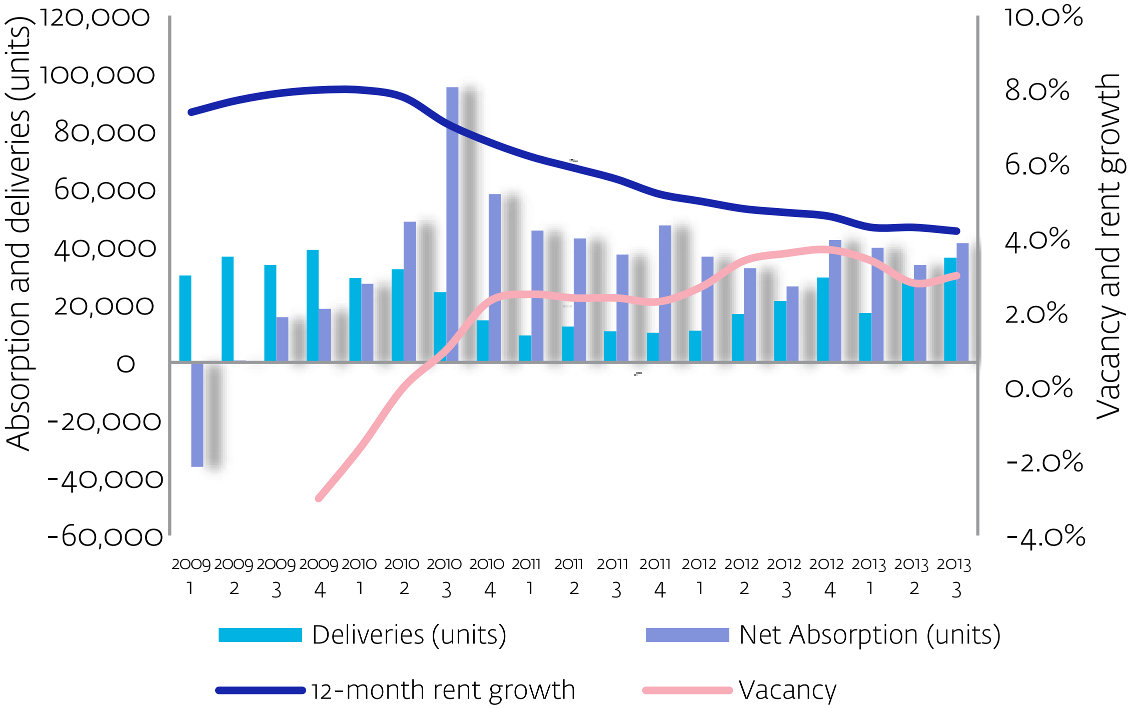
PrivcapRE
Multifamily housing is considered the gold standard of commercial real estate investing. We've seen significant capital flows into the sector in the wake of the crisis, yet many are questioning whether it's hit its peak. How do you assess the market?

Ryan Severino, Reis
Fundamentals, based on data and our outlook, have hit a bit of a peak. We expect vacancy to trend upward for the next four to five years, even though rents will continue to grow. On the capital side, there's still demand for apartments, both in existing inventory and developing new product. We expect to see cap rate compression and a pricing increase in the next four to five years. Capital markets haven't quite peaked yet. There is still pent-up demand for multifamily that will be unleashed in the next few years.

PrivcapRE
The fundamentals are suggesting something different in terms of the value we can get out of multifamily. What are your expectations for net operating income growth, and what's driving that?

Severino
That will be an interesting change for the property type versus what we've seen in the last three, four, five years. Coming out of the recession, landlords were willing to play the occupancy game to generate revenue growth. They weren't as concerned with pushing asking rent so much as generating occupancy increases for revenue and NOI growth. That story played out, and we're starting to see construction ramp up, so vacancy compression won't contribute as

United States Multifamily Performance Indicators



Source: Reis and Jones Lang LaSalle

much to revenue growth. The onus will be on landlords to push rents in order to drive that revenue growth.

PrivcapRE
Are we set for a demand implosion for multifamily?

Severino
I don't think so, because if you look at the underlying drivers, they're all pretty strong. We're talking about Generation Y being a relatively young, large generation. Most market prognosticators define the prime rental cohort for apartments as 20-to-34-year-olds. Most of Gen Y doesn't have a spouse; they don't have children; they're transient. All of those things dissuade them from being owners as opposed to renters.

PrivcapRE
What are your expectations for rent growth in the next three years?

Severino
A little higher—in the 3 to 3½ percent range. It's partly a function of vacancy being tight at about 4 percent. Even if it does drift upward during the next four to five years, sub–5 percent vacancy is still tight enough for landlords to extract rent increases from their tenants. Supply will increase, and some landlords will lose tenants. That's counterbalanced with new properties tending to come online at higher-than-average market rents. Because those two things are in a tug-of-war, somewhere in the 3 to 3½ percent range annually is a reasonable outcome in the next three to five years.

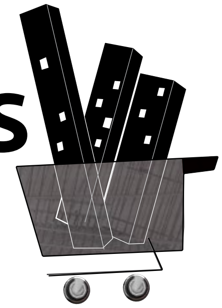
PrivcapRE
Are we expecting a glut of supply in 2014 and 2015?

Severino
Most construction will probably come online in 2014. It's not as if we'll downshift into the levels of the last few years, when people were concerned about fundamentals and the economy. There was less capital available for new construction. I do expect a decrease over time, but not anything like the last few years. There will be more construction and competition in the marketplace than in 2009, 2010, or 2011.

PrivcapRE
In terms of multifamily, is there anything in the next few years that worries you?

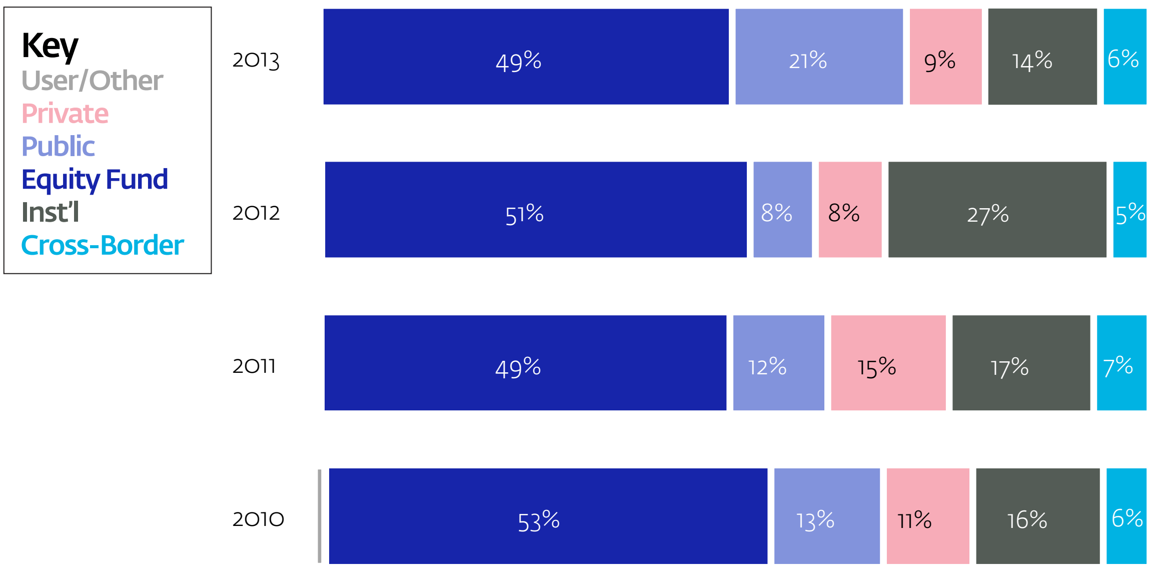
Severino
The big concern is supply. Everybody knows

Multifamily Fundamentals



2013 Top Apartment Buyers

Past Four Years



Source: RCA

2013 Apartment Buyer Composition

Garden

	Buyer	Capital Group	Acq (in $M)	# Props
1	Equity Residential	Public	2,805.2	32
2	AvalonBay Communities	Public	2,629.9	38
3	Essex Property Trust	Public	2,510.9	49
4	Blackstone	Equity Fund	2,496.8	98
5	MAA REIT	Public	2,084.8	113

Mid/high-rise

	Buyer	Capital Group	Acq (in $M)	# Props
1	Equity Residential	Public	6,253.1	49
2	AvalonBay Communities	Public	3,326.3	33
3	Essex Property Trust	Public	2,158.2	30
4	Invesco RE	Institutional	972.7	9
5	Rainbow Estates Group	Private	651.7	97

Source: RCA

real estate is a local phenomenon. Investors and developers are going to have to be cautious about the submarkets and neighborhoods they're in—making sure that if they're going forward with a deal, they really understand the local factors. Three to five years ago, it wasn't as much of a concern, but given where we are in the cycle now, this is an important juncture. We're going to see vacancy rates flat to upward in the next five years.

CARROLL ON HAVING FAITH IN FLORIDA, AND BALANCING SUPPLY AND DEMAND.

PrivcapRE
There's been a lot of capital going into the multifamily sector, which has many asking: Can performance in 2014 be as robust as in the past couple of years?

Patrick Carroll, Carroll Organization
It's submarket specific. We're looking at which markets have been slower to recover, and that's where we want to invest our dollars. Markets that have been strong will continue to perform well, but you won't see outsized returns. We're firm believers in markets like Florida that have been slow to come back. We're seeing that market rebound, and that's where we'll be investing heavily.

PrivcapRE
What are you seeing in terms of occupancy? How is the housing market's recovery impacting your strategy and occupancy gains?

Carroll
Occupancy has been strong, and we're cautious of overbuilding. If there's demand and need, it will more than likely be oversupply. We're focusing on submarkets that haven't seen a lot of supply—suburban markets where it's been hard to get capital to develop—and that's where we're looking to buy. I hope demand keeps up with the new supply.

PrivcapRE
There are concerns about coming supply when you look more widely at multifamily, not only at Florida and Texas. Are there any concerns from your side?

Carroll
Houston, Texas, has been a great market. A market that shows early signs of recovery is the easiest in which to raise capital to develop new properties. They see new supply first, and the story has yet to be told on how those markets digest it. Houston is taking it in stride.

PrivcapRE
What are the expectations for your own portfolio but also general growth in the next couple of years?

Carroll
Again, it's submarket specific. As a whole, in the markets we're most active in—Texas, Florida, Georgia—we project 3 to 4 percent rent growth. That's coming off 7 to 8 percent rent growth in some of these markets. To get those outsized returns, we'll have to improve the property, reduce expenses—do something to create additional NOI for our investors.

PrivcapRE
You see quite a rebound for multifamily in Florida. What are you expecting?

Carroll
I'm looking forward to a continued rebound in Florida, which was devastated by the downturn in housing markets. It was almost a domino effect. The housing market got crushed, it affected the overall employment picture, and that caused everybody to pull back. Now tourism is back, the housing market is coming back, and Florida is going to start firing on all cylinders again.

APPEL ON GROWTH RETURNING TO MORE SUSTAINABLE LEVELS.

PrivcapRE
When you look at capital inflows for the U.S. multifamily market, one question is whether we'll continue to see the same performance as in the last couple of years. What's your perspective on today's market, and what are you expecting in 2014 and 2015?

Russ Appel, Praedium Group
The last couple of years were the first in my 30-year career where investing in real estate could earn almost four times the risk-free rate in current cash flow, with leverage of 60 to 65 percent. We can earn six times the five-year risk-free rate, again, using 60 to 65 percent leverage. It's certainly not maximizing leverage, and earlier in my career I could never have said that. Looking forward, we can get great yields from the sector and continue to see growth.

The Future of Fannie and Freddie

After being bailed out by U.S. taxpayers to the tune of $189 billion, the mortgage agencies Fannie Mae and Freddie Mac have roared back to life, but U.S. politicians aren't cheering. Members of a Senate banking committee introduced a draft bill in mid-March that would replace Fannie and Freddie with a new structure based on private enterprise and government oversight. Our experts weigh in on the implications for multifamily housing.

"...THEY'VE PULLED BACK SLIGHTLY FROM THE MARKET, SO MAYBE IT'S MORE OF A GRADUAL TREND OVER TIME. BUT THE INDICATIONS I GET—AND I TALK TO [THE AGENCIES] FREQUENTLY—IS THAT THEY'RE IN BUSINESS AND THEY'RE LOOKING TO DO MORE BUSINESS."

-Patrick Carroll, Carroll Organization

"I THINK THEY'LL EXIST, BECAUSE THEY'RE TOO VITAL TO THE MARKETPLACE.... I DON'T THINK THEY'LL HAVE THE FREE HAND NECESSARILY, THE WAY THAT THEY DID. I THINK THEY'LL PROBABLY NOT BE ABLE TO TAKE AS MUCH RISK AS THEY WERE ABLE TO TAKE IN THE PAST."

-Ryan Severino, Reis

Giant Portfolios: Fannie and Freddie by the Book

Fannie Mae*	Freddie Mac*
Total book of business: $3,155 billion	Total book of business: $1,915 billion
Multifamily book: $200 billion	Multifamily book: $172 billion
Multifamily income 2013: $10.1 billion	Multifamily earnings 2013: $2.4 billion

**All figures taken from full-year 2013 financial reports*

Watch the Video

PrivcapRE
When you look at your portfolio and rising interest rates, is there enough growth ahead in 2014 and 2015?

Appel
Everybody's concerned because we had two years of high growth in the sector. This property type is forecasted to have the highest growth in the next several years, but because it's less than in the prior two, people are concerned. There should be concern about supply in certain markets, but demand is strong. It's the only property type with a hedge against interest rates. Not a complete hedge, but if interest rates go up, home mortgage rates will likely increase, meaning the cost of home ownership goes up and pushes people back to the rental market.

PrivcapRE
Is there anything that's concerning you in multifamily as you look at the next couple of years and compare it to growth in 2012 and 2013?

Appel
If we get less growth than in 2012 and 2013 but it's still solid, no one's going to complain, because of the cash flow you can get from multifamily. We'll see growth in the sector, albeit not as robust as in 2012 and 2013. We can't keep up that kind of growth—it's not sustainable in an environment where wage growth has been relatively slow.

As we see wage growth, maybe we can go back to that robust growth. That will depend on household formations and the trade-off between ownership and renting. The question investors are asking is how much supply there is. We have a big hole, because there was such limited construction in the past three years. Now we're going back to average levels of supply and not enough supply for the demand.

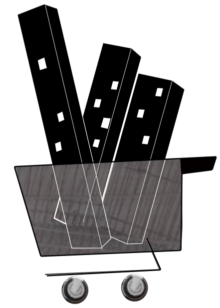
PrivcapRE
We talk about Gen Y and Gen X renters. Will we see a peak in demand, and will it decline in the near future?

Appel
You have the echo boomers coming to an age where they're creating households. More broadly, about two-thirds of the population owns and one-third rents. For people in their early 20s to mid-30s, it's the opposite, so two-thirds rent, one-third own. If you look at the number of people approaching that age, we're going to see more demand. Then it depends on whether they buy or rent over time. No one knows the answer to that, but getting mortgages is harder today.

PrivcapRE
Is multifamily about to hit a peak, or has the sector already hit one?

Appel
I don't think we've hit a peak, and we're not about to hit one, because there's still growth and good yield. There aren't many investments offering that across the investable universe./

Global Market Spotlight



Institutional investment in apartments is big business abroad. PrivcapRE examines two key European markets, London and Berlin.

By **Christopher O'Dea**

MARKET SPOTLIGHT: BERLIN

Berlin is still the cheapest EU capital to live in, and it's the number one investment destination for residential property in the EU. Yet the dynamics of German rental housing can make it uneconomical to build large rental properties, leading to a paradoxical situation where diversified economic growth, population increases, and rising household formation are not overheating the multifamily market.

At the micro level, Berlin consists of 12 districts encompassing the city's 190 postal codes. Each code is a town unto itself, with about 18,000 inhabitants. In the 1950s and 1960s, Germany's federal states and large companies built volumes of basic, affordable housing owned by municipal associations and industrial groups. In keeping with German cultural and engineering practices, this housing was built to last; owner investments maintain a stock of high-quality affordable housing. In some areas, as much as 35 percent of multifamily housing units are in such buildings, says Michael Schlatterer, director and residential-valuation team leader at CBRE Berlin, providing a buffer that allows consistent but modest rent increases. "It's a unique situation," he says, "and the overall market is really functional." Functional and dynamic; the purchasing power of residents in each district differs, resulting in micro-rental markets with varied pricing and standard dwelling sizes.

Germany suffered recession and weak employment in the early 2000s, before labor reforms fired up the German export engine. Between 2002 and 2007, state-owned housing associations sold off older properties, often to Nordic, American, and British private investors. Following the crisis, rents began rising; as Germany's role in the world and the EU grew, Berlin became a hot spot, and its residential real estate sector has developed into a scale industry where large government owners are now moving to create more lower-rent units through acquisitions and new building. At the same time, several large, private, integrated property ownership and management companies, such as LEG Immobilien AG, GAGFAH SA, and Deutsche Annington Immobilien SE, have emerged and listed on stock exchanges; those public shares are now the way that institutional investors are gaining indirect access to the German and Berlin residential sectors, says Schlatterer. Some of the government's multifamily companies have also listed; GSW Immobilien AG, for example, was formerly a limited liability company owned by the municipality of Berlin.

As large players rose, Real Capital Analytics data shows, private equity firms, family offices, and specialty developers sold a number of smaller projects in Berlin. Those developers include U.K.-based Benson Elliot; American firms Lincoln Equities Group and Strategic Value Partners; Swedish NCC AB, a Swedish construction company; and Sanus AG, a Berlin firm specialized in refurbishing pre–World War II buildings.

Large, listed German residential real estate companies such as Deutsche Wohnen AG illustrate that the future for multifamily rental housing in Berlin will belong to a few players with large operating platforms. Deutsche Wohnen is virtually a pure play on Berlin's residential market; following its merger last November with another public real estate company, GSW, Deutsche Wohnen owns nearly 150,000 units, with 72 percent of those in Berlin. Deutsche Wohnen says Berlin is one of the most attractive markets in Germany and projects rental growth of more than 5 percent over the next several years. But that won't come easily. The six municipal housing associations in Berlin agreed with the Senate of Berlin in 2012 to limits rents—and thus rent increases—to 30 percent of net household income. That's made the government the most important player in the Berlin residential market; the associations are buying and upgrading existing housing stock but also starting to build new units with the aim of increasing the supply of housing with "socially acceptable rents"—below 8 euros per square meter—about the average of what CBRE reports for Berlin in 2013.

The "Big Six" own 15 percent of Berlin's 1.9 million housing units, and because 86 percent of Berlin's housing is rental units, their impact is significant. GESOBAU AG, for example, plans to build more than 1,000 new units in current designs by 2018 and as many as 2,000 more units in sustainable designs favored by Berlin's housing policy. GEWOBAG—an association owned by the City of Berlin itself—brought 6,800 existing Berlin units under the rent-control umbrella since 2012 and plans to build another 2,300 units to raise its total inventory to 65,000.

The upshot is that the cost of land and construction in Berlin is higher than the average rental rate for new lettings, so Berlin's multifamily opportunity for private capital lies mainly in higher-end condominiums in the central city; about 80 percent of new construction in Berlin for several years has been condos, says Schlatterer. Berlin supply-demand data tells the story. Household formation in Berlin is expected to top 20,000 per year for several years. Builders can't keep up. Only 4,180 of 7,600 planned rental units were delivered in 2012, and only 2,194 of those were in multifloor residential properties. Most of the 18,000 units on the drawing board for 2014 won't be completed by 2018, says CBRE, and only 14 percent—2,520 units—are in multifamily format.

While Germany's historical market structure imposes clear constraints, large private equity players have found ways to participate. In early 2013, Deutsche Wohnen bought a 6,900-unit Berlin rental property from Blackstone Real Estate Partners Europe III in a cash-and-shares transaction that made Blackstone Funds a 5 percent owner of Deutsche Wohnen. Deutsche Wohnen's CEO says in a press release that the deal was central to its plan to scale its Berlin platform—a strategy boosted by the GSW merger.

MARKET SPOTLIGHT: LONDON

Private investors in London face a very specific problem: building an operating platform. "London faces a chronic housing shortage," says Graham Parry, Grosvenor's head of research for Britain & Ireland. Rapid household formation in London has pushed up prices, leaving many first-time buyers unable to afford home ownership. Banks have tightened lending criteria and required larger down payments, blunting the impact of the "Help-to-Buy" program the U.K. government launched in 2013 to help boost the housing market. With those factors fueling a "sustained shift in preferences toward renting over buying by London's relatively young professional population," Parry says, "the opportunity exists for investors to partner with existing residential developers to deliver a new large-scale private rental development."

Enter the Dutch. Dutch pension fund manager APG Asset Management last December formed a 50-50 equity joint venture with U.K. property developer and management firm Delancey to acquire the Elephant & Castle Shopping Centre in South London. "Affordability of housing in London is an increasing concern," says Delancey CEO Jamie Ritblat; the firm plans to build 600 rental units on the site. The project follows Delancey's conversion of the London Olympics Athletes' Village to more than 1,400 residential rental units, says Chris Lacey, executive director of Central London residential investment at CBRE, which introduced APG to Delancey.

That project gave Delancey expertise in large-scale development and in on-site management and leasing, a rare skill set in London real estate. London's multifamily market is 20 years behind the U.S. and Canada in terms of such integrated development experience, says Lacey. "The joint-venture platform between Delancey and APG is the first of its type to bring an experienced development firm together with a long-term pension fund in London," he says. German banks participated in debt financing with equity from several U.S. and U.K. family offices, says Lacey.

Data from Real Capital Analytics shows that most private capital deals in London's apartment sector in the past two years have been small, with most involving no more than 200 units and many fewer than 100. American private equity firms Apollo Global Management and AREA Property Partners have been buyers in London, while Blackstone sold three properties. But the Elephant & Castle project opens a new chapter for London's multifamily sector. Says Lacey: "The sites and opportunities exist, and there are potentially great returns to be had."

The Student-Housing Learning Curve

By **Suzanne Franks**

The **student-accommodation market remains fragmented,** but is rapidly institutionalizing as investors and developers realize the returns aren't **academic**

Student-housing investments used to be considered a "niche" strategy, more of an elective than a core requirement. In the search for yield, so-called niche assets—student housing, senior housing, self-storage, and medical office—have become more central.

The sector's fundamentals have been compelling: U.S. university enrollments are increasing steadily, driven by the millennial generation as well as by an expanding cadre of international students. With rising demand for technical skills in a competitive job market, a college degree is almost required for many entry-level positions. As a result, the student population is increasing by about one percent per year—a rate expected to continue through 2021. Today, 70 percent of all high school graduates continue their education.

At the same time, the existing stock of university housing is increasingly inadequate and outdated, although little capital is available for new facilities. Shrinking budgets have limited new construction at public universities, while private colleges saw their endowments decline during the recent downturn. New campus construction tends to create more classrooms than dormitories, and off-campus housing accommodates almost 70 percent of the college population.

Enter the student-housing managers, both public and private. Offering investment management and development expertise, they have been powered by readily available debt and equity capital. Yet the industry remains highly fragmented; small, local operators—some with only a handful of properties—dominate the market as measured by number of beds. The top 10 firms, including the sector's three public REITs, control just one-and-a-half percent of the total.

The trend, however, is toward greater institutional ownership. Christopher Merrill, co-founder and CEO of Harrison Street believes that greater institutional participation will encourage more transparency, increase liquidity, and reduce overall risk. He points to the growth in aggregate market capitalization of the sector's three REITs: $5 billion at the end of 2013, compared with $1 billion at year-end 2008.

Performance has been strong, with student-housing REIT returns outpacing those of both the NAREIT Apartment Index and the NAREIT Equity Index at year-end 2011. Student-housing investments outperformed all other property sectors during the credit crisis, leading some to label it "recession resistant."

Too Much Capital?

Is too much capital pouring into a relatively small sector, estimated at $300–$400 billion? "No," says Al Rabil, managing partner of the real estate private equity team at Kayne Anderson Capital Advisors (KAREA). "As a whole, this is a healthy industry, and in certain markets new development is justified." New development, estimated at $3 billion to $4 billion annually, adds 10 to 15 percent to the sector each year.

That being said, KAREA has reduced its target locations for student housing from 75 to 25 to 30. KAREA invests in both traditional university towns and nontraditional urban markets like Boston. They prefer large universities with a consistently growing student body in areas where barriers to new development are high. "We are continuing to find new opportunities that meet our investment requirements," says Rabil.

Today's student-housing complexes are built to enhance their residents' quality of life. Privacy and comfort are key, with "bed/bath parity" and amenities like Internet, fitness centers, pools, saunas, basketball courts, and coffee bars standard in most new construction. Such high-frill projects have been designed for the children of the baby boomers and are very different from the barracks-like accommodations that housed their parents.

The best locations are on campus or within walking distance. Rents range from $400 to $600 to as much as $1,200 per bed per month, depending on the university, the amenity package, the location, and the age of the property.

"We continue to identify opportunities for both new development projects and existing property acquisitions in the student-housing space," notes Harrison Street's Merrill. "In any given year, our student-housing investment program is typically 40 to 50 percent development and 50 to 60 percent acquisition."

Student-housing professionals typically look for opportunities at large public four-year universities where undergraduate programs tilt toward technical degrees and specialized training as opposed to liberal arts. Enrollment in these schools—many in the Sun Belt—is growing faster in general than at more traditional universities.

The Risks

So what are the risks to investing in student housing? Besides the usual real estate issues—location, property condition, capital requirements, and competition—deal size in the student-housing sector tends to be small. Managers aren't always able find good opportunities to satisfy available capital, making it hard to assemble a diversified portfolio that will generate target returns. Besides the difficulty of aggregating assets, managers agree that the need for knowledgeable, hands-on management is critical for investment success. Student housing is essentially an operating business, characterized by short-term leases and sometimes challenging tenants. The local manager has to walk the property frequently, maintain it aggressively, and quickly deal with tenant issues.

Certain markets are overbuilt. At some schools, too much capital was invested in new development projects; the resulting oversupply has put downward pressure on rents at those schools. In some areas, multifamily developers, lured by easy capital before the downturn, have moved into the student-housing space, contributing to supply imbalance.

To mitigate the risk of overbuilding, particularly in an urban area like Boston, managers may broaden the potential appeal of their projects. KAREA, for example, has developed high-rise projects suitable for many tenant types. Small, highly functional units with an efficient layout appeal to students and non-students. Apartments carefully tailored to their market can serve undergraduates, graduate students, and young urban professionals in the early stages of their careers, expanding the potential tenant base.

Student housing is a young industry with some operating inefficiencies. There is potential for declining yields due to excess development and competition for good deals. As the sector grows, increased institutionalization should create a more sophisticated and transparent environment. Student housing may well become a requirement for institutional investors./

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What is a triple net lease?
When the tenant is responsible for all costs related to the asset being leased, in addition to paying rent.

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W. P. CAREY

Last year, sale leaseback specialist W. P. Carey struck a deal with RML Automotive to acquire the real estate assets of eight U.S. automotive dealerships. It was the first of an expected series of similar deals in a space that both firms say represents a great opportunity.

For W. P. Carey, many automotive dealerships own great real estate and are great potential tenants. For RML, the deal represented an opportunity to unlock value and put capital to work in better way. According to Frank McLarty, CEO of RML, the Arkansas-based company had been growing strongly through acquisitions, and by 2012, "We wanted to continue to grow, so we looked for the best return on our equity investment. We also looked at the return we get on our operational investments versus the real estate—there's a substantial difference between the two."

Out of a desire to unlock the value of its real estate, RML entered into a sale lease-back transaction with W. P. Carey.

Jason Fox, managing director at the firm, says W. P. Carey carefully considers two elements when weighing a sale lease-back deal, first, the criticality of the real estate to the tenant, and second, the property's underlying, fundamental value. For many automotive dealerships, both of these boxes are checked.

Fox's team has found car dealerships, because they often sell new and used cars, are less impacted by economic cycles. Also, parts and services provide steady cash flow and cover 70 percent of fixed costs for the average dealership. W. P. Carey considers this element of stability attractive. "Few institutional investors are currently targeting this opportunity," says Fox.

According to McLarty, the sale-leaseback transactions bought out some other property owners, allowing RML to consolidate its landlord relationships into one lessor. "To have one institutional landlord whose interest is purely in being a long-term, triple-net lease landlord gives us the clarity and certainty we need to aggressively grow our business, whether it's by improving operations or acquisitions," says McLarty. We can focus our attention and corporate resources on operating the business, not on complicated real estate negotiations."

In August, W. P. Carey completed a follow-on transaction with RML, acquiring a Toyota dealership in Texas for $15 million. The facility will be leased back to RML on a triple-net basis for 16 years.

According to Fox, W. P. Carey remains highly interested in automotive retail deals. "This industry meets many things we look for in a long-term net lease. Given the lack of institutional capital focused on only real estate in the automotive market, there are opportunities to find ways to invest money at good yields."/