ALTA

REAL ESTATE

2024

INVESTMENT OUTLOOK

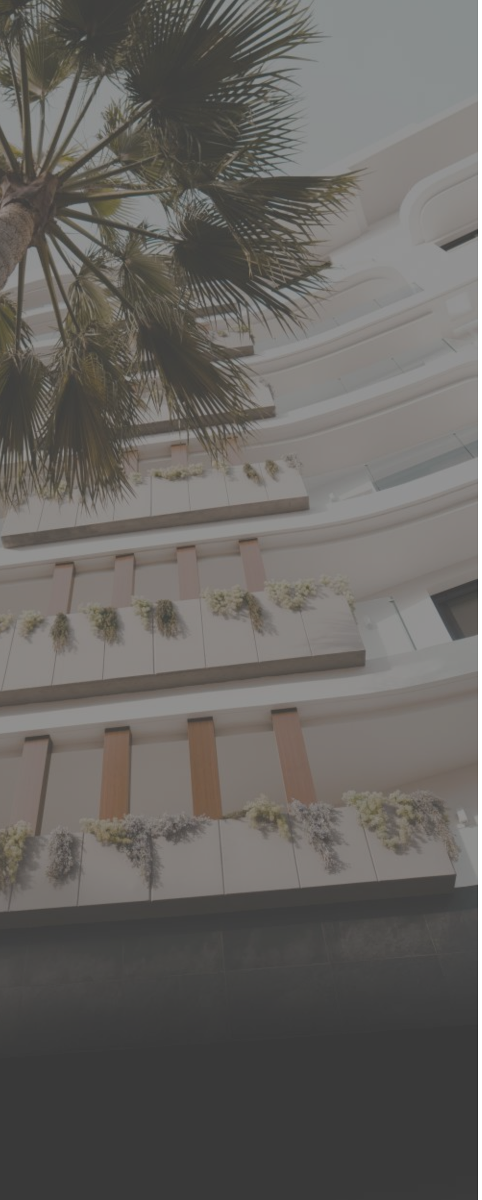
Absorption Changing the Market

2024 Opportunities

01 Lease-Up Properties

02 90s to 2010s B to A/A- Upgrades

03 80s and Older Significant Repositionings



Tectonic Shifts in the Multifamily Market – Absorption Is Not Just New Construction's Problem

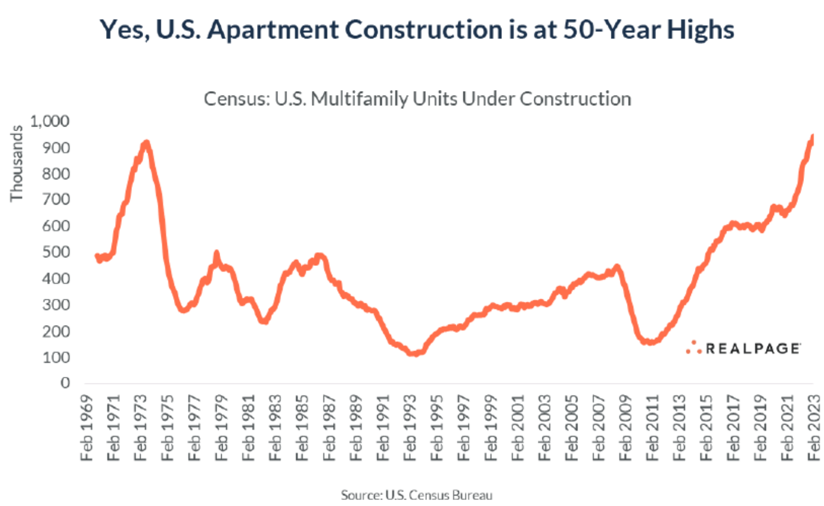
Recently a broker offered to sell us a new development at its construction loan amount. Despite our initial excitement, we were deterred by unfavorable factors such as location, leases, concessions, comparables, and high construction costs. Eventually, we priced the deal 30% below the loan amount and around 50% below construction costs.

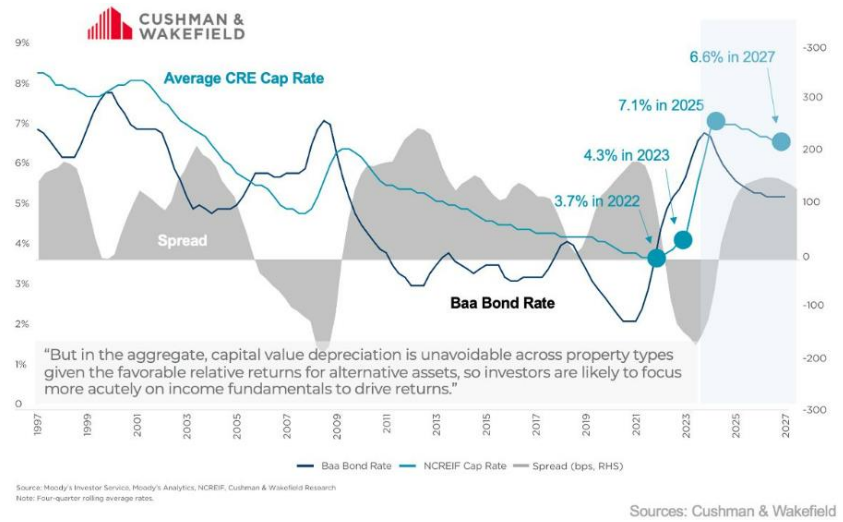
The developer wanted to realize the loan amount to avoid a $12 million personal guarantee, as he didn't want to be responsible for the shortfall if the lender sold the property below the loan amount.

Developments, which require extreme rent growth, extraordinary absorption, and continued low cap rates to be successful have happened over the years. Construction starts are now slowing, but **completed properties may face challenges in a tough apartment absorption market, resulting in significant concessions and rent reductions.**

Multifamily operations are currently grappling with absorption challenges in new developments. Their challenges are cascading down to lower-tier properties. **As renters upgrade to newer, nicer units (A product) with lower rents, it leads to stalled rents, increased concessions, and further rent declines in lower-grade properties (B+/A-).** This downward trend continues, causing vacancies to surge in the lowest-tier apartments (C-/C), potentially leading to the need for demolition due to high operating costs.

Construction Highs | Cap Rate Expansion





The market anticipates a substantial decrease in construction starts in the coming years due to financing and outlook. The need for new absorption will reduce rent growth. We expect future opportunities for rent growth (2026 or 2027) as new units are absorbed and deliveries slow down.

Higher bond rates compared to cap rates has created challenges in underwriting and deal transactions. We expect cap rate expansion, especially in B and C product categories, resulting in a more favorable spread between bond rates and cap rates.

Current Issues Facing Apartment Sector

Revenue Impact

New construction in luxury development and the inability for home developers to sell their homes will decrease revenue for the next 18 months.

Expense Impact

Expenses will outpace revenue growth, with a notable increase in insurance costs, particularly in coastal markets.

Cap Rates

Expect continued expansion of Cap Rates. The chart comparing CW cap rates to interest rates indicates the equity premium's return after a two-year absence. Anticipate declining NOIs unless unit upgrades are implemented.

Bankruptcies

The inability to refinance and lender stagnation is stalling the market. We expect several lenders, including CLOs, debt funds, pref equity, and banks, being forced into bankruptcy. This will cause a delay in the market and result in many deals hitting the market simultaneously in fire sales, further driving up cap rates.

80s and Older Product

Around two-thirds of the collateral for ~3,800 CLO loans (indicative of debt funds) we've reviewed were constructed in the 80s and earlier, with heavy concentrations in the 70s and 80s (refer to the development graph). Large institutions are no longer inclined to pursue this product extensively. Agency lenders now demand 90% occupancy for agency financing eligibility, and with many sponsors being eliminated, the buyer pool will thin, leading to cap rate expansion. Surviving CLOs and Debt Funds are costly, with debt running at approximately 9% and pref reaching 18%.

Lease-Up Properties

Issues

Housing developers face challenges due to a surplus of apartments and homes under development, increased construction costs, and higher financing expenses. The above-mentioned factors are hurting revenue with slower stabilization timeframes, lower rents, and increased concessions. Elevated development costs and higher interest rates are depleting developer reserves rapidly. The reduced NOI makes refinancing these projects without additional cash injection improbable.

Opportunity

The foregoing issues are hitting lenders all at once, depleting their debt reserves and impacting profitability and solvency. Consequently, lenders are inclined to remove these loans from their balance sheets and are less likely to be flexible with development loans.

We see this as a significant opportunity to acquire these assets at discounts ranging from 30% to 60% below peak pricing.

ALTA has the expertise to complete the lease ups of underperforming properties without being burdened by developers' legacy costs. With debt costs ranging from 8% to 9% for lease-ups, we recommend financing the properties with minimal or no debt. Holding top-tier assets will secure their position for at least 5 years, as there will be minimal new apartment deliveries from the second half of 2025 through the first half of 2028.

Traditional Value-Adds | 90s to mid 2010s Assets

Issues

Large institutional shops prioritize 90s and newer products in the value-add space. Due to heightened competition, acquiring this sought-after product type is limited unless sponsors possess strategic advantages. Additionally, rising construction costs, especially in labor, challenge the effective execution of value-add business plans and hinder achieving strong ROIs.

Opportunity

Numerous value-add deals were acquired over the last few years on variable rate debt. Factoring in the capex funds that lenders provided, the LTVs for these projects at times, could reach 100% or more. Operators will struggle covering debt service, leading to the availability of distressed value-add deals at a discount.

We see a significant opportunity to acquire value-add assets at discounts ranging from 40% to 70% below peak pricing.

ALTA has formed relationships with a number of lenders and is actively seeking distressed value-add deals. While older vintage value-add deals are starting to go into special servicing, we foresee an increase in 90s to 2010s assets becoming distressed throughout 2024. ALTA also provides in-house construction management to reduce the rising construction costs. Through sub-contractor relationships, we are able to significantly reduce capex costs by 30% - 50%.

Repositioning Class C Assets

Issues

As previously mentioned, the absorption issues facing new builds will trickle down to the lowest end of the spectrum - Class C assets. Due to the older vintage of these assets, higher operational costs will add to occupancy and bad debt issues. Unless a sponsor can substantially enhance the asset and operations, this asset class will be severely affected. The strategy to safeguard class C assets is to reposition them into B+ / A- assets.

Opportunity

We expect Class C cap rates to expand the most out of all asset classes due to lower demand for this product type. Repositioning these assets will significantly increase revenue ($200 to $600 premiums). Additionally, these enhancements will also safeguard the assets against high vacancy, bad debt, and increased expenses.

In order to substantially reposition the assets, heavy value-add work needs to be completed: replacing any aluminum wiring (expensive to insure), heavy pipe work / re-piping, new windows and siding, significant repairs / replacements of HVACs, aesthetic improvements, and concrete/parking lot improvements.

We see a significant opportunity to acquire and reposition Class C assets at discounts ranging from 50% to 90% below peak pricing.

Given the heavy amount of capex investment, attractive returns can only be achieved through acquiring at a very low cost basis. Furthermore, due to the high cost of debt for this type of investment, we think that low to no debt should be used on these properties until they are fully stabilized and then agency debt should be used.

Disproportionate Asset Value Declines

Multifamily Valuation Declines (from peak pricing):

Class A: 30% - 60%
Class B: 40% - 70%
Class C: 50% - 90%

The main reason for the declines is the **increase in interest rates**, which have caused the **expansion of cap rates.** Below are several other reasons for the changes:

- Economic Outlook
- Poor Management
- Lower Revenue:
  - Higher Vacancy
  - Concessions
  - Lower Rents
  - Increased Bad Debt
- Increased Costs
  - Wages
  - Taxes
  - Materials
  - Insurance

These factors are not the only factors and are not spread evenly across properties and operators, but we see the biggest value decline in the C space, resulting in the majority of class C apartments being underwater.

Disproportionate Losses in Class C Multifamily From Peak

Class B+ / A-				Class C			
Date	**Mar-22**	**Jan-24**	**Var (%)**	**Date**	**Mar-22**	**Jan-24**	**Var (%)**
Units	100	100		Units	100	100	
Cap Rate	3.00%	6.50%	350 bps	Cap Rate	3.50%	8.00%	450 bps
Valuation	**48,000,000**	**23,630,769**	***(50.8%)***	**Valuation**	**20,571,429**	**4,950,000**	***(75.9%)***
Price Per Unit	480,000	236,308		Price Per Unit	205,714	49,500	
Revenue	2,400,000	2,640,000	*10.0%*	Revenue	1,440,000	1,224,000	*(15.0%)*
Expenses	960,000	1,104,000	*15.0%*	Expenses	720,000	828,000	*15.0%*
NOI	1,440,000	1,536,000	*6.7%*	NOI	720,000	396,000	*(45.0%)*
Economic Outlook	Strong	Soft		Economic Outlook	Strong	Soft	

Analysis Notes:

- This analysis uses generalized numbers based on properties we have seen that have been marketed but in large part **did not sell**.
- Some properties, particularly coastal properties, have seen larger increases in expenses due to insurance. We have observed multiple properties with negative or near negative NOIs.
- A bid-ask spread exists between buyers and lenders holding property loans (previously, it was between buyers and sellers before seller equity was wiped out). The analysis cap rates reflect what we believe the cap rates would be at true market values.
- The drop in values are reflective of peak values seen in 2021 and 2022.

Lender Takeaways: Analysis | Conversations | Conferences

Debt Fund and CLO leverage = High Risk

It is our observation that the debt funds and CLOs themselves are leveraged up to 80%. Meaning, if a debt Fund lent $10mm, $8mm of that was borrowed from a 3rd party (often banks) through a warehouse or repo line.

The loans on the warehouse and repo lines are not very accretive. It is our observation that the delta between the money lent to real estate investors is only 50 to 150 bps above the interest rate on the warehouse and repo lines.

Given the large amount of leverage, the low accretive spread, aggressive proceeds leant on properties, and a generally low quality of borrower, we think that this will lead to numerous insolvencies and bankruptcies by Debt Funds and CLOs.

It does not take many loans going bad for these groups to become insolvent.

Inaccurate Reporting

Upon closer examination of CLOs, we've found inaccurate reporting on individual loans—an issue we suspect also exists in the CMBS market.

Anecdotal Evidences:

1. We received the financials on a property and it had a negative NOI of $1mm and it matures in February 2024. The CLO issuer/servicer marked this loan as performing and did not impair it on its reporting.

2. A senior asset manager at a major servicer publicly mentioned that losses on impaired loans wouldn't be marked down in 2023, so year-end bonuses could be secured. Mark downs were planned for February or March 2024 after receiving bonuses.

3. One CMBS Trustee at a major servicing company told us that he knows his CMBS Trust is insolvent but that no one wants to be the first to admit that their CMBS Trust is insolvent.

ALTA's Position from Observations (data and anecdotal)

We are of the opinion that the losses in the CLO market will largely surpass those in the junk bond space, causing ripple effects in other areas of the CLO.

Many CMBS tranches will have losses.

Large portfolios owned by debt funds and CLOs will be sold at large discounts. In many cases, these portfolios will be sold as part of a bankruptcy, and the proceeds will be used to repay parts of the warehouse and repo lines and senior tranches of the CLOs.

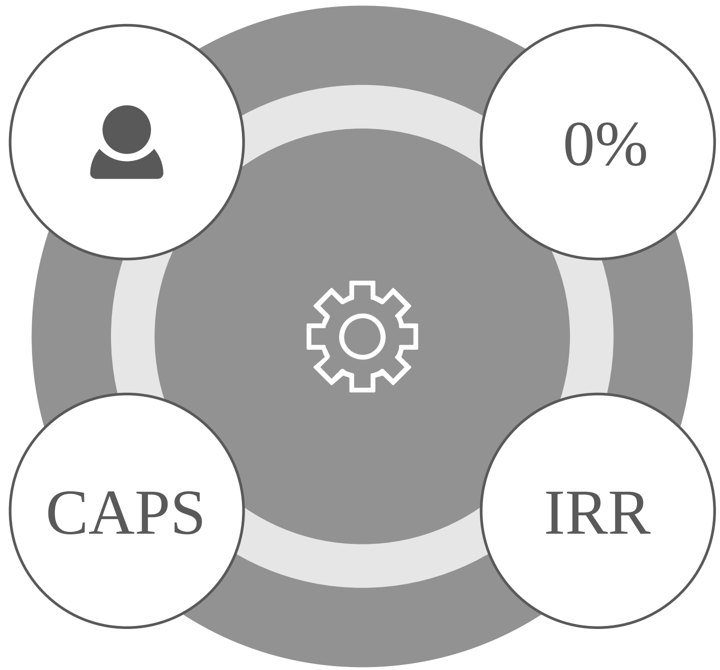
Underwriting Assumptions and Returns

Occupancy | Vacancy

Vacancy will depend on deliveries in a market. Austin and Phoenix will probably have increased vacancy with sub-90 occupancy, while DFW heading to the low 90s. Economic vacancy will be higher in 2024 and 2025.

Exit Caps

We plan on exit caps to range between 5.5% and 7.0% depending on location, asset type, and duration.



Organic Rent Growth

Flat rent growth in 2024 and 2025. In 2026 and beyond, we plan on rent growth to align with MSA growth and attractiveness.

Returns

We seek to price deals north of a 20% gross IRR on a 7-year hold. Depending on the asset type, we seek to have unlevered yields average between 7% and 12%, resulting in levered returns between 9% and 15% on average.

Brennen Jones
Partner | Co-Founder

Prior to ALTA, Brennen was the VP of Investments for Tides Equities, Senior Director of Asset Management for the Irvine Company, and in Asset Management at JRK Property Holdings. Throughout his career, he has overseen operations and improvements on over 23,000 units and has worked on the acquisitions of several thousand units.

Brennen is fluent in Spanish, has a BS in finance from Brigham Young University and an MBA from the University of Southern California.

Jake Murray
Partner | Co-Founder

Prior to ALTA, Jake was the VP of Acquisitions at Peak Capital Partners and an AVP at Zions Bank's National Real Estate Group. Throughout his career Jake has worked on purchasing several thousand units, real estate fund creation, and partnership structuring. During the GFC, Jake spent several years working out hundreds of commercial real estate loans across the country.

Jake is fluent in Portuguese and is working on becoming conversational in Spanish. Jake has a BA in Political Science from the University of Utah and an MBA from Brigham Young University.

Shea Bahr
Principal

Shea oversees Capital Improvements and Operations at Alta. Shea was most recently a General Contractor with Texas Elite Construction as an owner / operator. She has overseen 3,000+ unit renovations and has worked extensively on all types of capital projects including roofing, fencing, exterior and interior renovations, along with general demo and ground-up rebuilds after heavy storms. Shea has also been a controller of several entrepreneurial ventures.

Shea has an accounting degree from Cal State University Northridge.

VERTICALLY INTEGRATED

Multifamily Asset Management:

- Directly oversee property management instead of a Regional Manager
- Ensure the person overseeing the property is focused on investment goals instead of the goals of a third-party manager
- Regular property visits, lease audits, and staffing decisions
- Hire top managers and staff
- Direct oversight with expenses to prevent overspending
- Internal Revenue Management

Capital Expenditures | Renovations:

- Directly oversee all capital projects
- Strong contractor relationships – ability to perform renovations at significant discounts – up to 50% compared to competitors
- In-Unit Renovations: able to complete in 1-3 days, significantly reducing vacancy from 30-45 days to 5-15 days
- Extensive Renovation Experience: over 5,000 units

Accounting | Back Office:

- Partnership with Cornerstone Residential Management
- Accounting and back-office work assisted by Cornerstone

TARGET MARKETS

ARIZONA
TEXAS
UTAH

ALTA focuses on Western Inland Growth States

Target Market Characteristics:

- High Paying Job Creation
- Employer Office Relocations
- Low Tax Structures
- High Quality of Life and Outdoor Recreation
- Low Living Cost Relative to Costal Markets
- Strong Population Growth

ALTA

REAL ESTATE

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Disclaimer

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