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CHARTING THE COURSE

A Dozen Ways the U.S. As We Know It May Change

By Mitch Siegler, Senior Managing Director

While we are still coming to grips with life during Coronavirus, we're all wondering what life will be like after the pandemic ends – after we have adequate testing, a vaccine and possible herd immunity.

The supply chain for essential goods – like toilet paper and hand sanitizer – will catch up. Handshakes, a cultural staple for thousands of years – will go the way of the Dodo bird. Ditto salad bars, buffets and salt/pepper shakers on restaurant tables. There will be far fewer restaurants, with fewer seats, longer waits and higher prices. Food halls should continue to benefit. Gyms and yoga studios will suffer greatly. Peleton bikes and home-based yoga classes will boom. Cruising will never be the same.

On the "green shoots" front, auto trips, miles driven, gasoline consumption, domestic travel, restaurant dining and hotel lodging are increasing – albeit from very low levels – suggesting that the trough may have already occurred. Looking ahead, maybe the lessons learned from Covid-19 will help us finally get serious about addressing homelessness and cleaning up our air and water.

Below are a dozen economic, social and political predictions:

ECONOMIC

The stock market is hoping for a snapback/V-shaped recovery (we don't see it) – Consumer spending has long been the engine of our service industry economy. Today, nearly 40 million Americans are out of work. Health concerns, low consumer confidence, uncertainty about the re-opening of businesses and schools and a reluctance to travel suggest that a protracted recovery (U-shaped or Nike swoosh-shaped) are more likely scenarios. The non-partisan Congressional Budget Office (CBO) projects that the U.S. economy should rebound strongly in the third quarter but will not fully recover until 2021. CBO does not expect U.S. Gross Domestic Product (GDP) to return to the early 2020 peak before 2022. All of this seems to be disconnected with the equity markets, which are near pre-Covid levels.

Interest rates will remain low for a while, which helps jump-start business activity – We are at the end of a long-term debt cycle where monetary policy doesn't have the same impact it previously did. As the U.S. heads toward zero (or negative) interest rates, lowering rates further doesn't have the same effect in stimulating the economy. In the same way that quantitative easing following the Great Financial Crisis had a lesser impact with each successive round, the Fed's ability to move markets is lessened and only larger and more dramatic moves have an impact. Negative interest rates – as we've seen in other countries – may be coming here as well but regardless, low rates seem like a given for the next few years. Good for borrowers, capital goods spending and investment; not so good for savers and those on fixed incomes. Good for the budget deficit since it keeps the cost of deficit spending lower in the near-term.

Budget deficits are exploding; taxes will rise – Covid-19 is a once in a lifetime event, analogous to the pre- and post-WWII periods from 1930-1945. In 1945, Federal budget deficits exceeded 100% of GDP. The U.S. budget deficit is now $24.9 trillion compared with GDP of $20.5 trillion so this debt/GDP ratio is already 125%. With trillions in additional stimulus likely in the months ahead, the deficit and the debt/GDP ratio are poised to rise further. With skyrocketing budget deficits and an economic downturn likely to be felt for years, federal income taxes will rise significantly. States and cities, also reeling from extra spending relating to Covid-19, are simultaneously seeing their income, sales and hotel tax collections falling dramatically. We'll see higher state and local taxes as well. The pendulum always swings back.

Higher inflation is coming – Maybe not today and maybe not tomorrow but higher inflation is likely around the bend. While people object to higher taxes (something being taken away), fewer notice the impact of printing money to finance more government spending. Health care spending will be increased. Pensions/social security will remain intact. We'll likely invest more in infrastructure to put people back to work. There's no free lunch and, ultimately, we'll see higher inflation, which is likely to propel asset values, including real estate, higher. The key will be nudging inflation higher without it running away – no easy feat.

SOCIAL

The disparity between "Have's" and "Have-Not's" will increase – We've witnessed much of society turned upside down already. Covid-19 has exposed some harsh realities – like which workers are essential and which are not. Far more "have's" are able to work from home than "have-not's". Many "have's" live in single-family homes while many "have-not's" live in apartments with neighbors in close proximity. Those on the edge have seen their limited savings take a hit and many who have lost jobs will be digging out for a while. The stimulus checks have helped ease the pain but, unless extended, they'll end next month.

Wealth inequality/vilification of property owners – Following the Roaring '20s and the stock market crash of 1929, the U.S. underwent a credit crisis from 1929-1933. Wealth inequality resulted, which we've been experiencing again the past several decades. Today, the conversation is increasingly antagonistic; as in our political discourse, many don't hear the other side. #Rentstrike, which villainizes property owners (many of whom are pension funds – acting on behalf of retirees – university endowments and life insurance companies), is just one example.

Most schools will re-open for fall – but things will look different – Schools are developing re-opening plans. Some districts, like the California State system, have already announced they will not have physical classes in the fall. The University of Colorado, Boulder has announced reopening plans that combine classroom and online instruction and a truncated schedule, with the fall term ending before Thanksgiving. Some colleges have expressed optimism about reopening with others postponing the opening date and many moving some classes online. We'll surely re-open schools

in some fashion but it's likely to be through a classroom/online hybrid, a one week on/one week off schedule or multiple creative solutions. Sadly, many old-line, liberal arts colleges without huge endowments may not survive if their enrollments or revenue per student fall because of a shift to online learning.

POLITICAL

Governments are increasingly determining capital allocations – With nominal unemployment rates at 16% and effective unemployment rates at 20%, we are unlikely to return to the form of capitalism we knew before anytime soon. In the past several months, Congress and the Federal Reserve have each pumped several trillion dollars into the economy. It's hard to know how all of this will play out in the long-term but certainly this election year, economics will affect politics and politics will materially affect virtually every aspect of our economy and society.

The U.S. will benefit from the dollar but not all countries will be so fortunate – Other major central banks – the European Central Bank, Bank of Japan and Bank of China – are also advantaged by their relatively strong economies which they can support through monetary policy. The developing world doesn't have a reserve currency and will be disadvantaged, which may have many implications – from the price of oil to which countries get vaccines first.

De-globalization – We are hearing a great deal of jawboning about China being the source of the virus and lacking transparency. The U.S. and other countries have become dependent on China as the sole source of critical medical supplies and equipment, pharmaceuticals and even aspirin. This comes on the heels of tariffs on Chinese goods and much jawboning about Chinese theft of intellectual property – which is well documented. Countries will strive to become self-sufficient in the production of these essential goods, though changing supply chains will take time. Rising tensions between the U.S., the established power, and China, the rising power, are inevitable.

Heightened regulatory/political risk – We expect some "emergency" regulations implemented during Covid-19 to be removed only slowly (or not at all). New York City rent control was enacted as an emergency measure after WWII (to protect returning GI's) – and has not been removed to this day. We have recently seen legislation in many states/municipalities to defer evictions for months, sometimes until 2021. Last month, a bill was debated in a committee of the California Assembly which would provide for 25% rent reductions – not just for those showing Covid-19 impact but for anyone requesting them. While this bill has not yet been voted upon and may not pass, it is one more sign of moral hazard – and higher regulatory risk.

Increased geopolitical risks – Among the most significant challenges are the rising tensions between the U.S., the established power, and China, the rising power. "Destined for War," a best-selling book by political scientist Graham Allison, discusses 16 instances during the past 500 years when a rising power challenges the established power's position. In 12 of those situations, war broke out. Think about England/the Netherlands in 1780, Germany/Britain in 1916 and Japan/the U.S. in 1941. War is not inevitable but has frequently been the outcome. Here's hoping that modern diplomacy, technology and a globalized economy will allow cooler heads to prevail.

Chaos can bring opportunity. America is a resilient nation with tremendous creativity and innovation – especially in the medical/pharmaceutical and biotechnology industries, which could prove extremely important. The dollar remains the world's primary reserve currency, which is an important advantage. A low interest rate environment with a little inflation down the road could set the stage for a powerful economic recovery. Reopening the economy and re-opening schools in the fall would give consumer confidence a shot in the arm.

There are risks everywhere but also opportunities. Here's to your health, sanity and good spirits and to a glass that is half-full.

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FINDING YOUR PATH

The Glass Half Full

By Lorne Polger, Senior Managing Director

Over my life, I've been more of an optimist than a pessimist. More of a glass-half-full guy, than a glass-half-empty one. Working from home over the past three months has provided me the time and opportunity to think about the optimistic and pessimistic elements of if, how, when and why the U.S. (and the world) can heal from the various impacts of the COVID-19 crisis.

The optimist in me says that we seem to be turning the corner on the pandemic. The daily coronavirus-related deaths in the U.S. appear to have peaked over the past couple of weeks (not the rate of new cases, but the mortality rates; it appears as testing has increased, the rate of new cases has generally stayed about the same). The daily numbers that I have followed on the worldometer website and in the local media show a downward trajectory.

The pessimist in me says that even if the health situation is improving, the economic situation is not. Many people are still at home, all over the world. Even as social distancing measures have begun to be relaxed, normal economic life hasn't yet resumed, and I don't believe it will for quite some time. And as social distancing is relaxed and reopening continues, a second wave could occur.

The optimist in me thinks that the world has never worked together on biomedical research, treatments and vaccines in the ways that are being precipitated by the current crisis. And that with such cooperation and immense talent and resources, they will find a vaccine and treatment options in the near future that will blunt the spread and strength of the virus.

The pessimist in me acknowledges that vaccines often take years to develop, and even with relaxed regulatory oversight, it is unlikely that we will see any real headway until 2021 at the earliest.

The optimist in me sees the beginning of the end of stay-at-home orders around the country, and the reopening of businesses. I see more cars on the road, more people on the streets, and increasing social interactions, which drive both positive emotional health and commerce.

The pessimist in me sees astronomical unemployment and industries that will simply not return to their old normal. Some recent estimates I've seen suggest that over 40% of restaurants and 20% of retail businesses will not reopen.

The optimist in me looks at historical data demonstrating rapid recovery from the last two major recessions. The unemployment rate climbed to 10% during the Great Financial Crisis (a rate that had not been seen since the Great Depression), but over the course of the next ten years, the unemployment rate had fallen below 4%, a historic low. Similarly, the recession in 1990 was short-lived and relatively mild. Unemployment ticked up by 2% and settled at slightly above 4% by the end of the recovery a year later.

The pessimist in me says that the recovery from the Great Financial Crisis (GFC) wasn't equal across the population. While the median U.S. household income increased by 15% from 1991 to 2000, it only increased 11% from 2009 to 2018, and women and minority-led households lagged significantly behind. This, while housing costs rose significantly.

The optimist in me says that while the White House was initially caught flat-footed by the pandemic, and Congress remains completely polarized, the government still managed to pass emergency fiscal measures that, to date, have likely saved millions of Americans from complete economic despair. It's unclear whether it was the $1,200 stimulus checks, dramatic increases in unemployment benefits, or forgivable PPP loans, or the combination of the three. Even though the stimulus packages weren't perfect, they were a much-needed step in the right direction.

The pessimist in me says that printing and giving away trillions of dollars will pose significant long-term problems. I've heard several stories recently of employees not going back to work because they made more money from their unemployment income. And I'm really worried about inflation over the long term. It's the greatest expansion of the money supply in our history. When you dump all that money into a supply-constrained economy, you usually get inflation.

The optimist in me says we have been very fortunate in the multifamily world. For the most part, tenants are paying their rent and need a place to live – homes/apartments now also function as offices for many. The state and federal unemployment checks have, to date, allowed most Americans to continue to pay their rent on time. Other sectors of the real estate economy such as industrial and data centers have also fared very well. Unlike prior recessions, we did not overbuild housing, industrial or office this cycle, and we weren't overleveraged before this crisis (that was corrected after the GFC). So, we are in much better shape than we were then.

The pessimist in me is concerned about the hard-hit hospitality and retail sectors. I don't think we will see a rapid return to travel, conferences or fine dining. I think about conventions, convention hotels, airline travel, restaurants, malls, music and theatre venues. These sectors will have a very significant percentage of customers who won't return until a vaccine is in place. Even when lockdowns are fully lifted, consumer behavior will change for an extended period, especially for those who are most susceptible from a health standpoint.

The optimist in me says the power to heal is immense. I went through four significant orthopedic surgeries over a seven-year period, wondering each time whether I would be able to get to the other side and resume a healthy, pain-free life. I did, each time. New York City bounced back after the horrific events of 9/11. Our society lived through the battle-scarred years of the Vietnam War, and came together. The world lost 70 to 85 million people during the World War II years (an unfathomable number), but managed to survive, and subsequently, thrive. We've been through conflicts, plagues, despots and dictators. Hurricanes, riots and earthquakes. All caused rampant destruction. And all passed.

The pessimist in me says this time could be different. We are a very divided nation today. While the pandemic has brought on illness, death and economic destruction, the reactions to the different methods of dealing with it have sown scorn, distrust and ridicule.

A few weeks after my wife passed away in 2016, I took some clothes into the dry cleaner. My late wife was always very fond of the woman who worked behind the counter. She saw me walk in, and knowing of my recent loss, she said to me, "don't worry dear, time is medicine." Indeed.

The optimist in me says time is medicine. Time can heal many of the health, economic and societal wounds that have been inflicted.

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ZEITGEIST – SIGN OF THE TIMES

Virtual Apartment Touring Takes Off

Accelerated by the recent social distancing and stay-at-home orders enacted due to the ongoing pandemic, virtual tours have rapidly become a prerequisite to leasing apartments. Although virtual touring technology has been around for years, it has been somewhat sparsely adopted and generally only used by larger, more sophisticated multifamily owners; this changed very quickly this year.

According to recent *Zillow* data, creation of three-dimensional (3D) apartment tours increased over 2,000% in March as owners realized adoption of this technology has become necessary to lease apartments and stay competitive in the marketplace. *Apartments.com* recently reported that properties with 3D tours now generate 42% more leads than those without and renters have viewed 300% more 3D tours since the beginning of March.

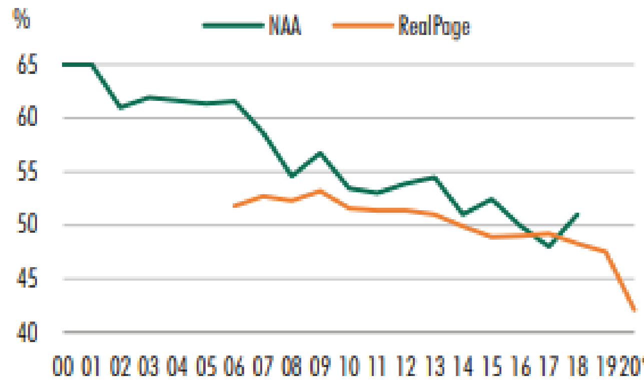
The immediate benefit of this technology is clear as many renters prefer virtual leasing over in-person leasing due to concerns related to Covid-19. Beyond the pandemic, virtual leasing will likely continue to thrive as the technology becomes more widely adopted and provides a practical solution for renters moving to different cities or states or who are too busy to visit all available properties in their area.

(Editor's Note: Pathfinder has expanded its virtual tour platform in recent weeks to include virtually staged apartments and common area amenity tours. We believe the technology is here to stay.)

Renters are Staying Put

In 2019, the U.S.'s average apartment turnover rate – which measures the proportion of residents who move out of their apartment each year – was 47.5%. In a typical 100-unit apartment complex, 48 residents would have moved out in 2019 and it costs $1,500/unit ($72,000) to prepare those apartments for re-renting, $250/unit ($12,000) marketing the apartments and additional funds on staffing costs to coordinate the process. Turnover is expensive and most landlords want to reduce it.

Figure 1: Historical Multifamily Turnover - U.S.



Source: CBRE Research, National Apartment Association (NAA), RealPage, April 2020. *2020 = April. Other years are annual averages.

According to a recent report by *CBRE*, turnover in April 2020 was 42.1%, an 11% decrease from the 2019 average and the lowest level in over 20 years. The report notes that the decline can be attributed to the Covid-19 pandemic and that turnover is expected to stay relatively low for the remainder of the year. Apartment turnover rates have been steadily falling since the 2000 peak of 65%. The rate started rising again in the mid-2000's following the national construction boom but fell sharply following the 2008 recession and has continued to trend downward ever since. With no end in sight for the U.S.'s ongoing housing shortage and the Covid-19 pandemic keeping many Americans in place for the near term, we should expect apartment turnover to stay low for the foreseeable future.

TRAILBLAZING: CREEKSIDE VILLAGE, VANCOUVER, WA

Crossing the River to More Affordable Living

Vancouver, Washington sits on the north bank of the Columbia River across from Portland, Oregon. Although Vancouver is in Washington, it falls within the Portland metropolitan statistical area (MSA) and is Portland's largest suburb. Vancouver has a small town feel with access to big city amenities, world-class, outdoor recreation and affordable housing options.

Last summer, we discovered Creekside Village – a 132-unit apartment community nestled amongst large trees and adjacent to a meandering stream – the perfect candidate for our eighth investment in the Portland MSA.

Renovated Kitchen

Creekside Village, built in 1992, is situated on 12 acres and includes a mix of two- and three-bedroom apartments averaging 1,300 square feet. Most units (64%) are spacious, 1,450-square-feet townhomes with fireplaces, large patios and direct-access garages – an affordable alternative to a single-family, detached home. The property is just three miles from downtown Vancouver, five miles from the Portland International Airport and 14 miles north of downtown Portland.

Vancouver residents can enjoy an affordable, family-friendly environment with great schools while having access to Portland's robust employment options (employers include Netflix, Oracle, Yahoo, Intel and Nike). Vancouver also offers abundant recreational options with 90 parks and over 20 miles of trails. Additionally, Washington residents pay no income tax and Vancouver residents can shop in nearby Oregon and pay no sales tax. Last year, Vancouver was ranked by *Sunset Magazine* as one of "The West's Most Affordable Towns and Awesome Places to Live".

Our residents have direct access to Burt Bridge Creek Trail, a 15-mile trail along a lazy river offering outstanding walking, jogging and biking in the great outdoors – a valuable amenity during these challenging, social distancing times.

Burnt Bridge Creek Trail

New Resident Package Locker System

Renovated Fitness Room

Renovated Clubhouse

In our first year of ownership, we enhanced the property with new exterior paint and signage, upgraded the landscaping and installed a resident package locker system, dog park and fencing outside all first-floor apartments, creating private patio spaces. We also began renovating units with new stainless-steel appliances, cabinet fronts, countertops, light fixtures, faux wood flooring and upgraded bathrooms. In May, we remodeled the leasing office, clubhouse and fitness center and enhanced the pool area with a new gas barbeque and pool furniture.

Vancouver: Did You Know?

Vancouver's Waterfront Revitalization: Vancouver's downtown waterfront is currently undergoing a $1.5 billion transformation, including a 32-acre, mixed-use project that will provide 3,300 residential units, one million square feet of office and retail space for restaurants, specialty shops and services. Upon its completion, this new urban neighborhood will provide more than 10,000 jobs. The first phase, which consisted of an apartment building with first floor commercial space, two restaurants and a seven-acre park and pier, opened in late 2018. Additional buildings were completed in 2019 and several more are currently under construction or in the planning phases.

Vancouver Waterfront

NOTABLES AND QUOTABLES

Change

"It is not the strongest or the most intelligent who will survive but those who can best manage change."

- Charles Darwin

"Intelligence is the ability to adapt to change."

- Stephen Hawking,
English Physicist

"The art of life is a constant readjustment to our surroundings."

- Kakuzo Okakura,
Japanese Scholar

"The world is changing very fast. Big will not beat small anymore. It will be the fast beating the slow."

- Rupert Murdoch,
Australian-American Businessman

"Adapt what is useful, reject what is useless, and add what is specifically your own."

- Bruce Lee,
Chinese-American Martial Artist

"Bad companies are destroyed by crisis, good companies survive them, great companies are improved by them."

- Andy Grove,
Former CEO of Intel

"In fast moving markets, adaptation is significantly more important than optimization."

- Larry Constantine,
American Computing Pioneer

"Everyone thinks of changing the world, but no one thinks of changing himself."

- Leo Tolstoy,
Russian Author

"Yesterday I was clever, so I wanted to change the world. Today I am wise, so I am changing myself."

- Rumi,
Persian Poet

IMPORTANT DISCLOSURES