SYLVAN ROAD

April 21, 2013

SRC Housing Perspectives 2013

Oliver Chang
Sylvan Road Capital
research@sylvanroad.com

TABLE OF CONTENTS

Introduction

Confirming the Macro Data

Distressed vs. Non-Distressed Sales

Categorizing Institutional Investors

Who's Leading Whom?

Impact on Sales

Impact on Prices

The Macro Example

Moving Markets

Where Do We Go From Here?

Moving Homes or Moving Markets?

Macro housing data is increasingly positive, but is the recovery really being driven by the entrance of institutional investors into the market? In this report, we take a deep look at the impact that investors are having on the local market in Atlanta and come to some surprising conclusions:

- **The housing recovery appears to be broad-based and here to stay, although not because of the entrance of institutional investors into the space.**
- **Owner-occupied buyers are driving the market recovery in both sales and prices. Not investors – institutional or otherwise – a conclusion we did not expect to find.**
- **Owner-occupied buyers are paying the highest prices for non-distressed properties, by a wide margin, over the highest investor prices even after taking renovation costs into account.**
- **Institutional investors have a larger impact on distressed sales where macro investors in particular are crowding out smaller investors and owner-occupied buyers. However, they represent a miniscule portion of the total housing market and remain behind the owner-occupied bid for similar non-distressed properties.**
- **For institutional investors, the data suggests that the single family investment opportunity is alive and well. However, spread compression is increasingly a risk, especially for those investors paying higher prices overall such as macro investors.**
- **For the housing market, the data suggests that this recovery has legs, but is substantially dependent on mortgage rates and high levels of affordability to support continued demand from owner-occupied buyers.**

Moving Homes or Moving Markets?

Introduction

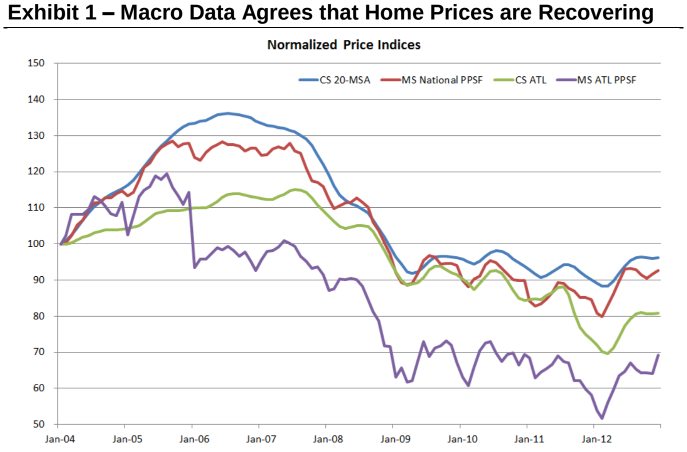
Reading the headlines these days, it seems like the US housing market is not only on the rebound, but that the recovery is both fast and wide spread. Cities that were some of the hardest hit in the downturn, including Phoenix, Las Vegas, Miami and Atlanta, are leading the charge with prices and sales growing at rates unseen since before the bubble burst. There is a growing consensus that the leading cause of the market recovery is the increasing presence of large institutional investors who are buying single family rental properties. The immediate reaction has been to question whether the resulting recovery is sustainable, and what might happen if these investors stopped buying, or worse, started selling their holdings.

But is this consensus justified? To be honest, when we decided to take a look at the impact that institutional investors are having on local housing markets using Atlanta as an example, we expected to find supporting evidence that these investors were paying up to buy properties, squeezing out owner-occupied buyers and generally causing havoc in market pricing and sales. To our surprise, however, we found instead that actual market dynamics are quite the opposite, and it's possible that investors are less in the driver's seat, and more along for the ride.

Confirming the Macro Data

Before we delve into the investor impact on the housing market, we start by re-stating and confirming some of the macro data on pricing and sales to make sure we concur that the macro numbers are in agreement that there is a growing recovery underway.

Exhibit 1 – Macro Data Agrees that Home Prices are Recovering



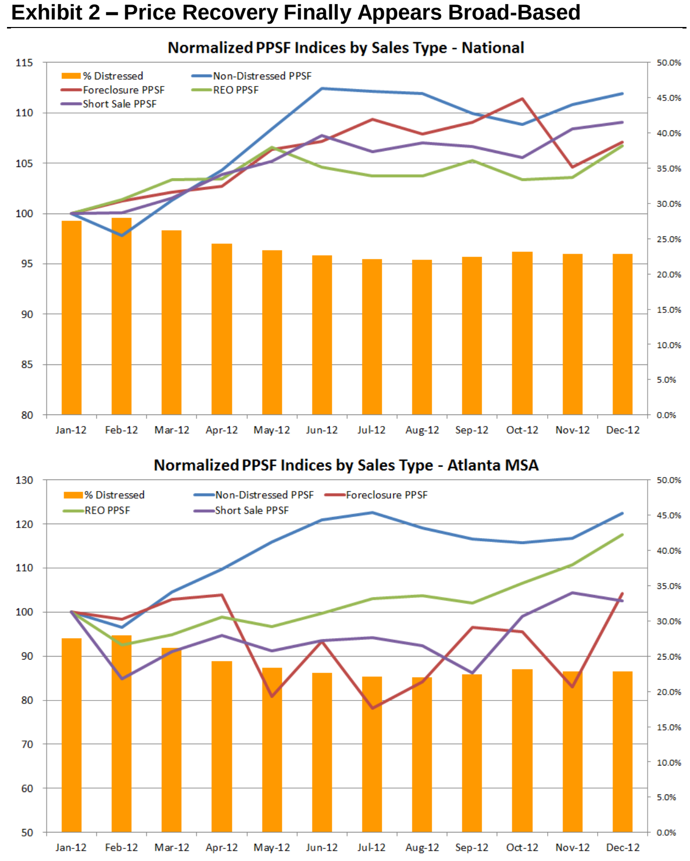
Source: Case-Shiller, Morgan Stanley

In Exhibit 1, we show normalized price indices for the Case-Shiller 20-MSA and Atlanta home price indices and the Morgan Stanley national and Atlanta median price per square foot (PPSF) data. As we can see, 2012 experienced fairly even improvement that exceeds the usual seasonal trends, and prices on a year over year (YoY) basis have improved. It looks a bit like a bounce off the bottom than the beginning of a stable recovery, as we saw a similar pattern following the price declines in the 90s, but we need to look at more data before drawing conclusions.

Distressed vs. Non-Distressed Sales

Sound familiar? The first breakout of data that we want to look at is the distressed vs. non-distressed sales and prices. This is our first analysis to see if there are fairly obvious drivers for the increases that we're seeing in the macro data, for example a large shift in mix away from distressed sales.

Exhibit 2 – Price Recovery Finally Appears Broad-Based



Source: Morgan Stanley

In Exhibit 2, we show median PPSF by sale type and percent of sales that were distressed at the national and Atlanta MSA levels. While there is a clear shift away from distressed sales, non-distressed price changes are now in-line with, or out-performing, distressed prices and price trends, with all prices showing moderate to significant improvement on a YoY basis - bucking a trend that we've seen for several years.

Most interesting in this data, however, is just how much non-distressed prices are increasing in the Atlanta MSA. The median PPSF for non-distressed sales is up roughly 20% on a YoY basis. REO prices are up a significant amount as well. The latter looks like the influence of investors. What about the former? Are there other shifts-in-mix occurring, such as between price points? neighborhoods? property types? What exactly is happening in this market? To answer those questions, we take another step into the data and focus on the institutional investor impact on the market.

Categorizing Institutional Investors

To get started, we clarify that our analysis of the investor impact on the housing market looks at three groups of institutional investors.

First, we look at the "Macro" investors, which we define as those investors whose purchases match the profile that we laid out for macro investors in our last report (*see "SRC Housing Perspectives: All the Difference in the World", November 29, 2012 – available at www.sylvanroad.com*). As a refresher, these investors tend to buy the same types of houses in the hopes of home price appreciation and have less of a focus on renovations, internalized operations or rental income. Typically, these investors buy houses that were built after 1990, have at least 3 bedrooms, 2 bathrooms, are located in suburban neighborhoods and require little renovation work, usually less than 15% of the cost of the house.

Second, we look at the "Value" investors, also as we laid out in our last report. Again, these are investors that focus on both financially and physically distressed houses that tend to be older and in need of more repairs and renovations. These investors try to buy at large discounts to market values, generally focus more on rental income for returns and are less reliant on home price appreciation.

Interestingly, in the process of identifying and classifying these investors, we noticed that there are some institutional investors that show a mix of investment strategies in which some aspects of their behavior look more like macro investors, while others look more like value investors. For example, they may buy newer vintage properties in suburban neighborhoods (macro), but stick to lower prices and PPSF ranges (value). Since they don't fit well into the other categories, we consider them to be a third group, and label them as "Hybrid" investors.

Who's Leading Whom?

To better understand how we attempt to quantify the impact that investors are having on the market, we need a methodology that allows us to make fair comparisons for our analysis.

<u>Apples to Apples</u>

We talk about shift-in-mix a lot, and for good reason: the housing market is not made up of a homogeneous product type that the indices might lead you to believe. Differences across geographies, price points, square footage, vintage, physical states, etc. all have an impact on prices and price trends. For the purposes of our analysis, we try to minimize these impacts when making price comparisons over time by bucketing like-properties together such that the characteristics of each bucket remain relatively consistent over time. It's a balancing act between creating too broad a definition for each bucket and not having enough data to avoid excessive volatility.

For all of the analysis in the rest of this report, we use average calculations, whether for prices, PPSF, vintage or bedrooms, etc. for apples to apples buckets based on data that we have aggregated in our single family property database, managed by RentalSTAT. For full disclosure, RentalSTAT is a housing software and data company owned by Sylvan Road Capital. The data, like all property-level data, is based on aggregating publically-available transaction records from local sources, which we clean extensively to improve the quality as housing data is notorious for its inaccuracies.

<u>Identifying Institutional Investors and Others</u>

Before we can analyze the data, we need to identify who the institutional investors are so we can track their activities over time. To do this, we looked at sales data from Q4 2012, a time during which all major institutional investors in Atlanta were already active. To be considered an institutional investor, whether Macro, Value or Hybrid, each buying entity must have purchased over 50 houses during that period. All other investors, which encompass smaller and some individual investors, are categorized as Other. Non-investor buyers (as far as we can determine), or owner-occupied buyers, are classified as Owner-Occ. We limit the data set for all of our investor analysis to only houses that sold for under $300K. We do this to remove unnecessary data volatility caused by including very expensive houses, and also because by far the majority of investor purchases occurred below this price point. Exhibit 3 shows two breakouts of investor purchases by price tier for Q4 2012. The highlighted data in the second table shows the strong distinction between purchase prices for the three institutional investor groups.

Exhibit 3 – Institutional Investors Purchases by Price Tier

Price Range	Macro	Hybrid	Value	Other	Owner-Occ	Total
< 50K	0.7%	2.5%	5.8%	34.3%	56.8%	100.0%
50K-100K	7.9%	6.7%	0.5%	24.3%	60.6%	100.0%
100K-150K	13.1%	2.6%	0.1%	8.1%	76.2%	100.0%
150K-200K	7.3%	0.5%	0.0%	5.8%	86.4%	100.0%
200K-250K	2.7%	0.2%	0.0%	4.8%	92.3%	100.0%
250K-300K	0.4%	0.2%	0.0%	3.9%	95.5%	100.0%
>300K	0.0%	0.0%	0.0%	6.4%	93.6%	100.0%

Price Range	Macro	Hybrid	Value	Other	Owner-Occ
< 50K	2.1%	15.1%	86.3%	37.2%	13.8%
50K-100K	39.0%	66.1%	12.4%	42.0%	23.3%
100K-150K	41.0%	16.1%	1.3%	8.8%	18.6%
150K-200K	14.0%	1.8%	0.0%	3.9%	12.9%
200K-250K	3.5%	0.5%	0.0%	2.2%	9.3%
250K-300K	0.4%	0.4%	0.0%	1.2%	6.5%
>300K	0.0%	0.0%	0.0%	4.7%	15.6%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: RentalSTAT

For each investor, we then calculate the average characteristics of the houses they bought from Q4 2011 to present, to determine whether they are macro, hybrid or value investors. These characteristics include purchase prices, square footage, vintage built, bedrooms, bathrooms, geographical locations, etc. To separate the various investor groups, we use the average characteristics to make an assessment.

Exhibit 4 – Institutional Investors Summary

Investor Type	Macro	Hybrid	Value	Other	Owner-Occ
Total Purchases Q4 2011 - Present	2,603	1,017	1,009	14,806	67,195
Foreclosures	48.8%	47.7%	47.7%	15.5%	1.0%
Short Sales	5.1%	4.6%	14.9%	7.9%	7.4%
REO	15.3%	8.5%	15.3%	38.8%	41.2%
Non-Distressed	30.8%	39.2%	22.2%	37.8%	50.4%
Average Price	$ 113,129	$ 79,828	$ 32,821	$ 65,238	$ 117,250
Average Square Footage	2,159	1,818	1,598	1,727	2,036
Average PPSF	54.86	44.87	23.06	37.81	58.97
Average Bedrooms	3.6	3.4	3.2	3.3	3.4
Average Bathrooms	2.5	2.3	2.1	2.3	2.4
Average Vintage	1995	1989	1979	1986	1989

Source: RentalSTAT

While this assessment is ultimately subjective, the differences between average characteristics are stark enough that we think most reasonable analysts would agree with our breakout. Finally, we look at these characteristics over time to ensure that they are relatively consistent to minimize any shift-in-mix effects. Exhibit 4 summarizes our findings and provides average characteristics for each group.

As we can see in the table, the characteristics for the various investor groups differ significantly. As expected, the largest differences can be found between the Macro and Value investors, with Macro investors tending to buy newer-built, less distressed, and larger houses. Due to these differences, the geographical concentrations also differ for these investors. Exhibit 5 shows a breakout by county and the percentage of each investor group's total purchases for those counties.

Exhibit 5 – Institutional Investors by Preferred Counties

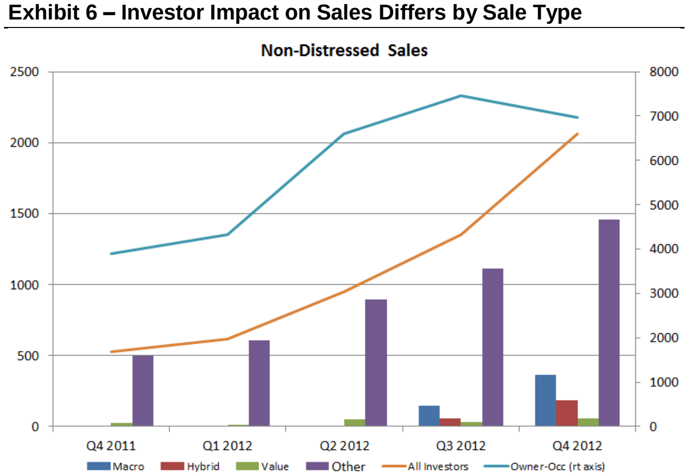
Investor Type	Macro		Hybrid		Value		Other		Owner-Occ	
Top County, Percent	Gwinnett	27.4%	Gwinnett	28.3%	DeKalb	37.5%	DeKalb	23.5%	Gwinnett	18.4%
2nd County, Percent	Cobb	16.6%	DeKalb	21.3%	Fulton	24.9%	Fulton	19.3%	Fulton	17.1%
3rd County, Percent	Fulton	10.5%	Cobb	12.8%	Clayton	20.5%	Gwinnett	12.7%	DeKalb	13.6%

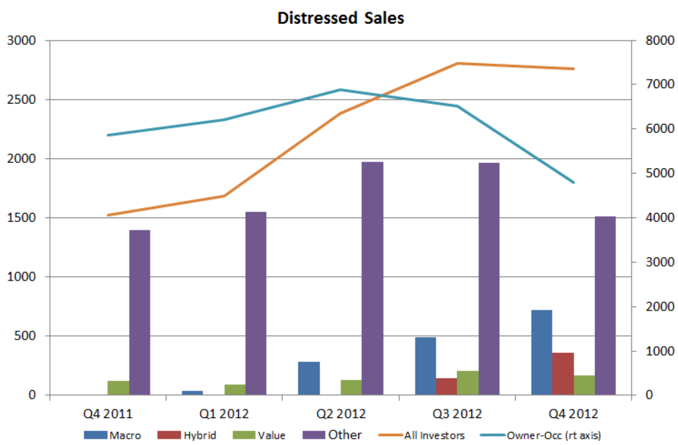
Source: RentalSTAT

Impact on Sales

The first and easiest impact to identify is on the number of sales. We know that individual and small investors have been buying distressed properties in Atlanta for a few years, so what we're really trying to find are changes in numbers or patterns of sales due to institutional investors.

Exhibit 6 – Investor Impact on Sales Differs by Sale Type





Source: RentalSTAT

The two charts in Exhibit 6 show the number of sales that occurred in Atlanta between Q4 2011 and Q4 2012, broken out by non-distressed and distressed transactions. For both sales types, we note that institutional investors as a whole still make up only a small share of the total investor base, and a miniscule share of the total market, although their share is continuing to increase.

Non-Distressed Sales

We can see that smaller investors make up a majority of the investor sales in any quarter. We also see that the institutional investors, led by the Macro group, really only started to make an impact on non-distressed sales toward the end of 2012, contributing to the increasing upward share of the market by all investors. This part of the market remains highly seasonal, so we don't believe the small drop in owner-occupied purchases in Q4 2012 is indicative of a crowding-out effect, but will confirm when looking at pricing. However, institutional investors remain far surpassed by owner-occupied buyers and small and individual investors. What is most surprising is the sheer size of the increase in owner-occupied sales, rising from just under 4000 in Q4 2011 to 7000 a year later, as well as the increase in small investor sales from 500 to 1500. In the same period, total institutional investor sales only increased from about 30 to 600, a much higher percentage change, but a small fraction of the non-distressed market. What this tells us is that while institutional investors may be adding to the total sales volume, they are not really behind the recovery in non-distressed sales and prices that we saw in Exhibit 2. Instead, the recovery is being driven by owner-occupied buyers and small investors.

Distressed Sales

From the distressed chart, we see a different picture. The distressed sale market, which historically does not exhibit much seasonality, seemed to be recovering by itself before the entrance of institutional investors. However, as they entered the market, they took share away from both owner-occupied buyers as well as small and individual investors. The share of distressed sales for all investors is much higher than for non-distressed sales and has been increasing since Q4 2011. Based solely on the sales data, there seems to be some support for the case that institutional investors are crowding out owner-occupied buyers and leading the recovery in this part of the market, but we need to take a closer look at prices and a deeper dive into the data.

Impact on Prices

To quantify the impact on prices, we look not only at the changes in prices, but also at the differences between the prices paid by institutional investors and those paid by other investors and owner-occupied buyers. Exhibit 7 shows a time series comparison of average PPSF for various sale types as well as by buyer type.

Exhibit 7 – Investor Impact on Prices Varies Substantially

	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q4 YoY Chg
Non-Distressed						
Macro	$ -	$ -	$ 50.97	$ 75.09	$ 57.59	NA
Hybrid	$ -	$ -	$ -	$ 46.45	$ 50.84	NA
Value	$ 27.93	$ 23.91	$ 28.60	$ 25.52	$ 26.17	-6.3%
Other	$ 44.98	$ 41.98	$ 43.34	$ 41.18	$ 44.65	-0.7%
Owner-Occ	$ 68.22	$ 69.17	$ 73.25	$ 72.92	$ 73.05	7.1%
Foreclosures						
Macro	$ -	$ 46.84	$ 47.33	$ 51.46	$ 53.32	NA
Hybrid	$ -	$ -	$ -	$ 37.18	$ 39.10	NA
Value	$ 14.99	$ 14.68	$ 16.66	$ 18.58	$ 23.37	55.9%
Other	$ 37.25	$ 36.58	$ 32.11	$ 41.50	$ 41.54	11.5%
Owner-Occ	$ 40.84	$ 37.15	$ 39.00	$ 42.76	$ 40.73	-0.3%
REO						
Macro	$ -	$ -	$ 39.68	$ 51.82	$ 53.96	NA
Hybrid	$ -	$ -	$ -	$ 41.22	$ 51.19	NA
Value	$ -	$ 14.19	$ 21.30	$ 22.39	$ 21.99	NA
Other	$ 26.95	$ 28.84	$ 30.37	$ 32.04	$ 34.59	28.3%
Owner-Occ	$ 41.36	$ 41.55	$ 43.52	$ 44.63	$ 46.68	12.9%
Short Sales						
Macro	$ -	$ -	$ 51.58	$ 56.75	$ 50.62	NA
Hybrid	$ -	$ -	$ -	$ 42.41	$ 43.94	NA
Value	$ 26.87	$ 23.05	$ 27.26	$ 31.85	$ 26.05	-3.1%
Other	$ 34.56	$ 36.05	$ 33.59	$ 39.64	$ 39.06	13.0%
Owner-Occ	$ 53.15	$ 51.80	$ 52.21	$ 53.27	$ 53.95	1.5%

Source: RentalSTAT

There are some very interesting observations that can be made from the data in Exhibit 7. First, we see that for non-distressed sales, owner-occupied buyers consistently pay the highest PPSF versus any investor type, and not by a small margin. Some of this might be due to differences in the mix of transactions, but from Exhibits 4 and 5, we saw that owner-occupied buyers tend to buy product that looks very similar to Hybrid investors. Compared to Hybrid investors, owner-occupied buyers paid 44% more for non-distressed houses. Taking into account the fact that the Hybrid investors probably added 20% of the purchase price in renovations, the premium would still be about 20%. Still, owner-occupied buyers paid only 7% more for non-distressed houses in Q4 2012 versus a year earlier, a smaller increase than the macro data showed in Exhibit 2, and likely due to the removal of all transactions above $300K, which have higher PPSF levels.

Second, prices for foreclosures and REOs have skyrocketed over the past year among investors, particularly as the institutional investors entered the market, but not among owner-occupied buyers. A year ago, these prices averaged about $15/SQFT for Value investors and $27-$37 for small investors. By Q4 2012, while both Value and small investors were paying higher prices, Macro investors pushed prices to over $53 for the types of houses that they buy, up 14% in less than a year. They also paid the highest prices among all investors for any type of sale, distressed or non-distressed, in some cases exceeding owner-occupied prices, while in some cases being below those comparable levels. In all cases, however, even adding 15% renovation estimates to their purchase prices, they always remain below the price that owner-occupied buyers are paying for non-distressed properties, suggesting that while institutional investors (particularly Macro investors) may be pushing pricing within the distressed market, they are not the ones leading the way in the larger non-distressed market.

Since some of these differences could also be due to a variance in the mix of the types of homes purchased by investors versus other buyers, we take a closer look at an apples-to-apples comparison of housing product to reach our conclusions.

The Macro Example

So far, the high level data seems to show that owner-occupied buyers, not investors (whether institutional or otherwise) are truly driving the market recovery, mostly because they are driving increases in both sales and prices of non-distressed homes while also paying higher prices for those homes than any investor for any type of sale even after accounting for renovation costs. If this is truly the case, it would have significant implications for both investors in the market as well as owner-occupied buyers. As a final check to ensure that we're not being biased by differences in property mix between investor groups and owner-occupied buyers, we take yet another step into the data and make as close to an apples-to-apples comparison as we can. We focus on the Macro investors because of their higher prices paid relative to other investors and their larger share of the market.

To perform this analysis, we first define the parameters of the property type bucket that we will use for comparison based on the characteristics that Macro investors prefer from Exhibits 3, 4 and 5. Exhibit 8 shows these characteristics for our analysis.

Exhibit 8 – Property Parameters for Comparison Analysis

Parameter	Values
Counties	Cherokee, Cobb, Gwinnett, Paulding
Price	Below $300,000
Square Footage	1500-2500
Vintage	1985-2005

Source: RentalSTAT

Non-Distressed Sales

After defining the parameters, we look at each type of sale separately to again avoid mix differences. Exhibit 9 shows the resulting average prices, sales and other data for non-distressed sales by quarter since Q4 2011 and by buyer type.

Exhibit 9 – Non-Distressed Comparison

Date	Investor Type	Sales	PPSF	Price	SQFT	Vintage	Beds	Baths
Q4 2011	Other	14	$38.03	$76,213	1,984	1997	3.3	2.5
	Owner-Occ	333	$61.31	$123,683	2,015	1996	3.5	2.4
Q1 2012	Other	32	$53.02	$103,830	1,962	1994	3.3	2.5
	Owner-Occ	348	$64.98	$128,701	1,980	1996	3.4	2.5
Q2 2012	Macro	1	$66.22	$124,500	1,880	1999	3.0	2.5
	Value	2	$64.51	$101,485	1,551	1993	3.0	2.5
	Other	40	$55.58	$109,691	1,957	1996	3.4	2.6
	Owner-Occ	642	$73.86	$149,484	2,023	1996	3.4	2.5
Q3 2012	Macro	27	$61.60	$123,033	2,001	1998	3.7	2.4
	Hybrid	5	$50.49	$93,900	1,851	1989	4.0	2.8
	Other	60	$48.42	$91,598	1,897	1995	3.6	2.5
	Owner-Occ	697	$70.23	$141,538	2,014	1996	3.4	2.5
Q4 2012	Macro	64	$63.00	$119,990	1,914	1998	3.5	2.4
	Hybrid	33	$50.02	$95,082	1,917	1994	3.6	2.5
	Other	70	$48.94	$95,526	1,972	1995	3.6	2.4
	Owner-Occ	755	$70.29	$140,442	1,992	1996	3.4	2.5

Source: RentalSTAT

Now that we're looking at more detailed data, some of the trends become more noticeable. First, we see that for these parameters, owner-occupied buyers really do pay the highest prices, both in terms of PPSF and actual purchase price, with Macro investors behind them and all other investors even further back – notice that Value investors barely show up in these product parameters. The characteristics of the houses are also very similar to those bought by Macro investors from the square footage to the vintage, bedrooms and bathrooms. This cannot necessarily be said for other investor types such as Hybrid investors. Even after adding 15% for renovation costs to the purchase prices by Macro investors, owner-occupied buyers are still paying more, although the difference is lower than what we previously saw in Exhibit 7. Finally, they are paying more than they did a year ago – in fact, Macro investors in Q4 2012 paid only slightly more than owner-occupied buyers did in Q4 2011. This suggests that owner-occupied buyers are the ones driving the increases in prices in the non-distressed market.

Distressed Sales

Next we look at distressed sales, breaking them out further between foreclosures and REOs due to the much larger owner-occupied participation rate in the latter versus the former. We ignore short sales due to the lack of significant institutional investor activity among those sales for the given parameters. We start with foreclosure sales, the data for which can be found in Exhibit 10.

Exhibit 10 – Foreclosure Comparison

Date	Investor Type	Sales	PPSF	Price	SQFT	Vintage	Beds	Baths
Q4 2011	Value	1	$13.78	$30,000	2,177	1995	4.0	3.0
	Other	52	$36.27	$69,492	1,916	1997	3.5	2.4
	Owner-Occ	11	$41.26	$75,733	1,913	1992	3.3	2.6
Q1 2012	Macro	12	$42.17	$89,216	2,119	1998	3.5	2.4
	Value	1	$14.33	$26,401	1,842	1992	5.0	3.0
	Other	50	$39.09	$80,001	2,029	1996	3.4	2.5
	Owner-Occ	14	$40.50	$72,600	1,761	1996	3.0	2.3
Q2 2012	Macro	92	$47.29	$94,490	2,011	1998	3.4	2.5
	Other	44	$34.81	$68,799	1,941	1996	3.5	2.4
	Owner-Occ	7	$43.73	$75,222	1,795	1995	3.3	2.3
Q3 2012	Macro	106	$54.94	$111,901	2,058	1997	3.4	2.5
	Hybrid	12	$43.44	$75,058	1,741	1996	3.4	2.3
	Other	31	$49.08	$100,194	2,062	1996	3.6	2.6
	Owner-Occ	6	$42.23	$73,049	1,752	1997	3.5	2.4
Q4 2012	Macro	110	$57.52	$114,105	1,995	1997	3.5	2.4
	Hybrid	24	$45.64	$83,592	1,848	1994	3.4	2.3
	Value	1	$23.19	$35,626	1,536	1988	3.0	2.5
	Other	22	$57.29	$101,288	1,756	2000	3.1	2.6
	Owner-Occ	2	$44.21	$97,501	2,115	2003	3.5	2.5

Source: RentalSTAT

Again, we see a very different story. For foreclosure sales, Macro investors seem to have crowded out some of the other investors both by volume and by price. As there are not, and have never been, many owner-occupied buyers who buy at foreclosure auctions (due to the all-cash requirement), they are not exactly being crowded out. In this case, however, Macro investors are generally paying the highest prices for these houses on a PPSF basis, and certainly higher than any other institutional investor, while buying the largest and newest properties.

Exhibit 11 – REO Comparison

Date	Investor Type	Sales	PPSF	Price	SQFT	Vintage	Beds	Baths
Q4 2011	Other	64	$31.21	$60,873	1,973	1995	3.4	2.4
	Owner-Occ	495	$44.29	$87,490	1,963	1996	3.5	2.5
Q1 2012	Other	65	$34.55	$66,416	1,929	1995	3.5	2.5
	Owner-Occ	521	$44.86	$88,146	1,957	1996	3.4	2.5
Q2 2012	Macro	13	$50.22	$106,169	2,106	2001	3.5	2.5
	Value	1	$24.53	$42,100	1,716	1990	3.0	2.0
	Other	105	$37.43	$70,973	1,898	1994	3.4	2.5
	Owner-Occ	635	$48.68	$95,336	1,955	1996	3.4	2.5
Q3 2012	Macro	45	$56.88	$114,879	2,033	1999	3.5	2.5
	Hybrid	3	$38.06	$83,300	2,216	1988	3.7	2.3
	Value	1	$19.37	$43,600	2,251	1986	4.0	2.5
	Other	102	$37.90	$71,050	1,874	1994	3.5	2.4
	Owner-Occ	554	$48.49	$95,247	1,954	1996	3.4	2.5
Q4 2012	Macro	32	$58.25	$119,764	2,078	1998	3.5	2.4
	Hybrid	13	$47.68	$94,192	1,984	1997	3.8	2.5
	Value	1	$25.44	$56,900	2,237	1986	4.0	2.0
	Other	68	$40.81	$77,529	1,905	1993	3.4	2.4
	Owner-Occ	411	$52.98	$104,274	1,966	1997	3.4	2.5

Source: RentalSTAT

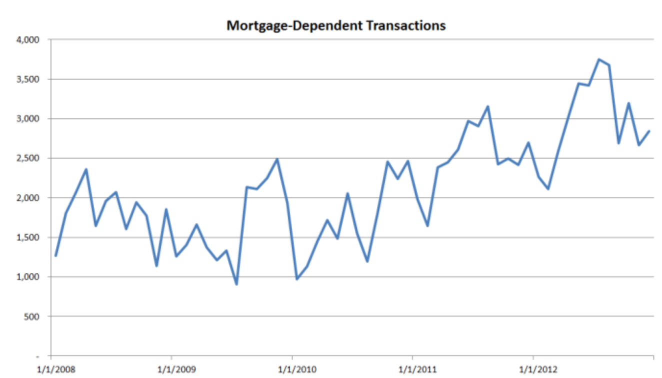
Looking at REO sales, the data for which is shown in Exhibit 11, we see the same pattern that we saw in foreclosure sales. Macro investors have started to crowd out smaller investors by price and volume. The biggest difference is that owner-occupied buyers represent the largest share of REO purchases, however they also seem to be crowded out by the Macro investors by price and volume. Macro investors already pay the highest prices and PPSF for remarkably similar property, and this does not include the 15% estimate for renovation costs. In turn, we believe that Macro investors are driving the recovery in the REO market (and the distressed market in general) – in fact, the prices that they paid in Q4 2012 for these property parameters were 31.5% higher than what owner-occupied buyers were paying a year ago, 87% higher than what smaller investors were paying a year ago, and still 43% higher than what smaller investors paid in the same period.

But are they overpaying? After adding 15% of purchase price to account for renovations, the Macro average PPSF in Q4 2012 was $66.99, which remains below the $70.29 that owner-occupied buyers were willing to pay for non-distressed houses during the same period. Based on those numbers, the Macro investors remain behind the fundamental owner-occupied bid for these property parameters. Interestingly, smaller and hybrid investors, who arguably have to put in a higher amount of renovation costs (closer to 20% of purchase price in our estimate), would be at a considerable discount to the Macro investors, and even more of a discount to the owner-occupied bid, but their purchase prices have risen as well. All of this data suggests that cap rate or spread compression for investors is in effect, however, purchase prices have not exceeded the owner-occupied bid on average.

Moving Markets

While we do not include the data for other parameters of property types in this report, we did check various geographical concentrations, square foot ranges, and vintages, and found that the patterns we identified above generally hold true across the board for properties that institutional investors are actually buying. As a final check, we found that the number of transactions that occurred in Atlanta which required a mortgage, and is a good indicator of owner-occupied demand, has been rising steadily since 2010 and experienced a strong gain in 2012, as shown in Exhibit 12.

Exhibit 12 – Mortgage-Dependent Transactions Rise



Source: Morgan Stanley

Based on the consistency between the breakout data and the higher level data that we used to evaluate general impacts on sales and prices, we are inclined to conclude that it is not investors, whether institutional or not, that are driving the recovery in housing in Atlanta, but rather the recovery is being driven by owner-occupied buyers – a conclusion that we did not expect to find. While institutional investors certainly are driving parts of the market, particularly foreclosure and REO sales and increasing the competition amongst themselves for certain property types – that competition being highest for the property types on which Macro investors have focused their attention – they seem to be more along for the ride, at least from a price perspective. One could even make the argument that the presence of investors is actually helping to prevent prices from rising even faster, as their lower purchase prices, whether for distressed or non-distressed properties, are used for comps when appraising other houses. This conclusion has major implications for the single family rental opportunity and the housing market in general.

Implications for Investors

For institutional investors, and really all investors, our conclusion implies that the investment opportunity remains both strong and widespread. Cap rate, or spread, compression is what investors must mainly contend with at this point. This compression does not affect investors equally, as the pricing levels show. Assuming that all investors renovate their properties to roughly the same standards in a given neighborhood and can therefore achieve market rents, spread compression should affect Macro investors disproportionately versus other investors. What we mean by this is that if cap rates tighten an equal amount on a percentage basis (say by 25%) for all investors, there is a big difference between going from a 12% gross cap rate a year ago to an 8% gross cap rate today, versus going from a 20% gross cap rate a year ago to a 15% gross cap rate today.

Prices for investors, on the other hand, while rising significantly from a year ago, remain below the owner-occupied bid for non-distressed houses, implying that so long as those non-distressed prices keep increasing, the outlook from a capital appreciation perspective remains positive – of course more positive for investors buying at larger discounts, and less positive for those closing in on that market bid. All this is to say that investor strategies still matter when deciding where to put one's money, however, generally, the single family investment opportunity is alive and well.

Implications for Housing

The implications for the housing market, on the other hand, are a mixed bag. On the one hand, price increases led by owner-occupied buyers rather than investors suggests that the recovery is sustainable and not due to technical factors caused by large institutions. On the other hand, the price increases are large enough to warrant asking the question of whether they are actually fundamentally driven, by sources such as income improvement and job creation, or if instead they are credit and/or cost of capital driven, or if it is a result of a shortage of available inventory because there has been little building over the past few years, and many owners remain underwater on their mortgages and unable to sell their homes. While this question would take another entire report to be sufficiently addressed, it is not hard to believe that record low mortgage rates are a big part of the recovery. With credit as hard as it is to qualify for today, it's a good thing that owner-occupied buyers are driving sales and price increases – it means that there is some level of increasing fundamental demand given the other circumstances in the market. But that's a far different conclusion than to say that this recovery is sustainable at its current pace.

Where Do We Go From Here?

Based on our findings in this report and our understanding of the housing and housing finance markets, we believe that at least in Atlanta, and most likely in similar cities, the housing market has turned the corner for good on this latest cycle. However, we expect the pace of price and sales increases to slow over the next few years, and be very sensitive to changes in the mortgage rate environment. We cannot stress this point enough. If it is true that owner-occupied buyers are driving this market recovery, then the recovery will only be that much more dependent on the cost and availability of mortgage credit. As it is, home prices are rising, so if mortgage rates were to return to their pre-bubble levels, affordability would fall considerably – all at a time when income growth remains tepid. The result would likely be augmented by the increased presence of investors in the market. Investors are not emotional buyers, and we would expect them to adjust their capital deployments and strategies over time depending on the trajectory of the owner-occupied buyer. As a result, the market may become more volatile going forward. Of course, we must also consider the other possibility if mortgage rates remain low for a substantial period of time. The last time that home prices went up because of cheap and easy mortgage credit, it led to the largest housing bubble in nearly a century. Mortgage credit is cheap again, albeit for different reasons. But what happens if lending standards start to ease as well?

Important Disclosures

The information contained in this communication reflects the views of Sylvan Road Capital, LLC or its affiliates and sources it believes are reliable as of the date of this publication. Sylvan Road Capital, LLC makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. Sylvan Road Capital, LLC does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate legal, accounting and tax professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for or recommendation of the purchase or sale of any security or financial instrument, product or service sponsored by Sylvan Road Capital, LLC or its affiliates. Investment products described are not FDIC-insured, are not bank-guaranteed and may lose value.

Circular 230 Notice. To ensure compliance with requirements imposed by the IRS, we inform you that any US federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed within.