Avid Analytics

AVID ANALYTICS 12-27-23

"Oh, the summer night, has a smile of light, and she sits on a sapphire throne."

— Bryan Procter, Poet

With 2024 now more than half over (wow!), we thought it would be helpful to check in on some of the macroeconomic data, inflation data, jobs data, and take a status check on our 2024 multifamily apartment predictions. We continue to think now is a great time to buy multifamily assets at lower prices, and we are excited about some of our near-term opportunities at hand.

Inflation Status Check: The Battle is Won, Job Market Normalizing

Inflation battle has been won, with many categories now experiencing deflation. Inflation data continues to trend positive and we believe this battle has largely been won. Per below, we are now seeing ***deflation*** in many major spending categories. Headline and Core CPI are both low over the past four months, and are both around 3% over the past six months (which we think will continue to improve). PPI has run a bit hotter this year up 6.1% year-to-date (annualized), however that follows 0% growth in PPI in 2023 and a string of deflationary readings in late 2023 that normalized in early 2024. Overall, both PPI and CPI are improving in a two-steps forward one-step backward fashion. Energy prices (except Crude) has fallen year-to-date. Other commodity prices (steel, lumber, chemicals) have largely fallen this year. Farm goods and wholesale food prices have fallen somewhat meaningfully so far this year. Auto prices are up 1% this year (annualized). Indeed, we really only see elevated inflation levels in Wages (3.8% - 4.9% annualized wage growth YTD), Rents (+4.0% annualized growth YTD), and Crude oil. All in, we think this clears the way for a first Fed rate cut at the September board meeting on September 17-18, though inflationary data between now and then could shift a first cut out to December 17th, after the Presidential election.

Figure 1. Various Inflation Metrics: Mostly Normal Readings with Wages and Rents Still High

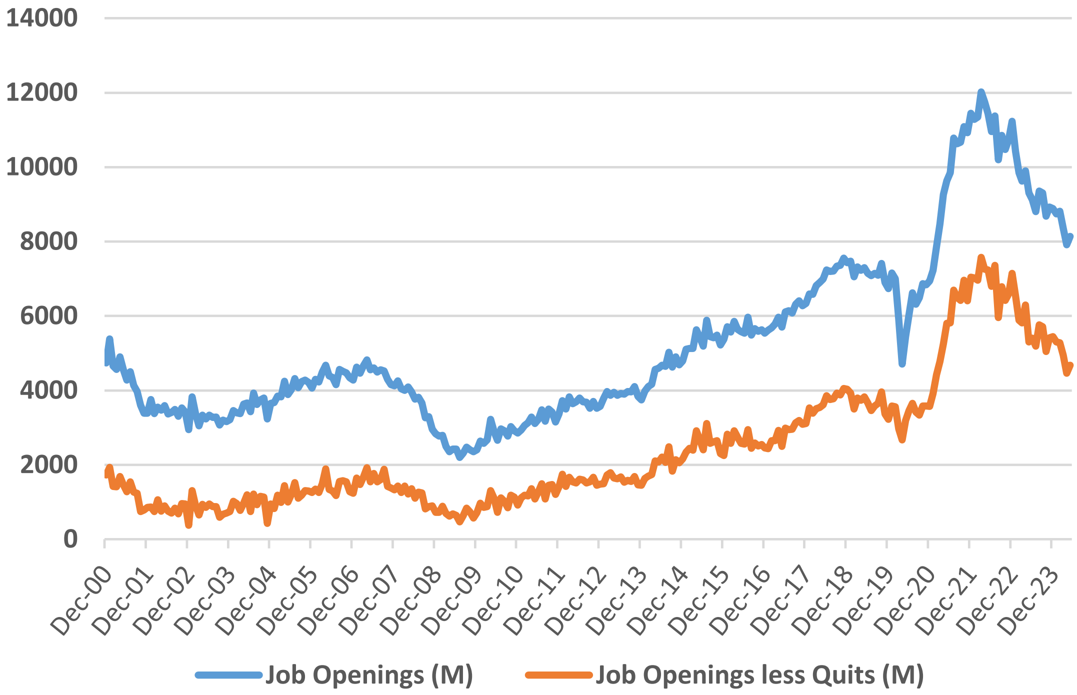
	2019	2020	2021	2022	2023	2024 YTD	Last 4 Months Annualized	Last 3 Months Annualized	Pricing Vs Peak Levels
Headline PPI	1.7%	-0.8%	12.3%	8.9%	0.1%	6.1%	1.4%	-1.2%	-1.8%
Headline CPI	2.3%	1.3%	7.2%	6.4%	3.3%	2.8%	1.9%	1.0%	-0.1%
CPI Less Food & Energy	2.3%	1.6%	5.5%	5.7%	3.9%	3.3%	2.6%	2.1%	Peak
CPI - Urban Wage Earners	2.3%	1.4%	7.8%	6.3%	3.3%	4.9%	3.7%	2.0%	0.0%
Avg Hourly Earnings - Manufacturing	3.1%	2.8%	4.4%	3.7%	5.7%	4.2%	6.1%	5.4%	Peak
Avg Hourly Earnings - Total Private Jobs	3.0%	5.4%	5.0%	4.9%	4.3%	3.8%	3.8%	3.6%	Peak
Rents (Primary Residence)	3.7%	2.3%	3.3%	8.3%	6.5%	4.0%	3.7%	3.5%	Peak
Gasoline (SA)	13.6%	-18.7%	69.4%	-4.5%	-4.0%	-18.2%	-34.5%	-35.0%	-41.8%
Crude Petro (NSA)	19.1%	-24.7%	60.8%	6.5%	-8.0%	24.4%	6.0%	1.1%	-33.6%
No. 2 Diesel (SA)	-0.2%	-2.9%	54.3%	21.0%	-18.5%	-24.0%	-68.6%	-96.8%	-54.0%
Steel Scrap (NSA)	-27.4%	41.6%	37.0%	-30.2%	21.0%	-34.4%	-48.9%	-32.0%	-39.8%
Steel Mill Products (NSA)	-16.0%	5.2%	128.0%	-29.8%	-3.3%	-7.4%	-34.9%	-15.4%	-34.7%
Lumber (SA)	-0.7%	39.1%	18.9%	-23.8%	-7.6%	2.0%	11.9%	13.7%	-43.8%
Industrial Chemicals (NSA)	-5.9%	-2.8%	39.8%	-1.0%	-9.0%	-2.3%	2.4%	0.8%	-21.3%
Pharma Chemicals (SA)	1.8%	1.8%	1.3%	1.9%	2.8%	0.4%	1.3%	1.5%	Peak
Meats (SA)	5.9%	-1.6%	21.0%	-0.8%	12.2%	-7.3%	-6.6%	-10.8%	-3.6%
Dairy - Whole Milk	11.7%	10.9%	5.9%	12.5%	-4.8%	-2.6%	1.2%	6.5%	-6.2%
Farm Products - Grains (NSA)	1.3%	14.6%	43.7%	9.7%	-29.6%	-8.2%	14.8%	17.2%	-43.4%
Animal Feeds (NSA)	0.2%	8.6%	10.5%	14.3%	-6.3%	-9.0%	-4.0%	-1.1%	-11.7%
Motor Vehicles (SA)	-0.1%	0.8%	2.6%	4.7%	0.6%	1.2%	0.4%	-0.9%	-0.2%
Average of Averages	1.1%	4.3%	26.9%	1.2%	-1.4%	-2.8%	-6.8%	-6.8%	-22.4%

Source: Avid Realty Partners

Oil still a risk to go-forward inflation. President Biden's decision to drain the Strategic Petroleum Reserve throughout much of 2022 (from ~650 million barrels of oil to ~350 million barrels of oil today), and the administration's desire to aggressively cutover to 'clean and sustainable energy' are risks to energy-driven inflation measures. Higher (or potentially much higher) energy prices remains a primary inflation risk going forward. We think the President's short-sighted actions made the USA less secure, and hindered our ability to confront our energy adversaries (whom we have placated in recent years anyways). This strategic blunder (pun intended) has been heightened by the administration's decision to cancel a slew of Alaska oil drilling permits. This puts the USA's energy independence in a tenuous position, and increases the risks that gas prices could increase in coming quarters as Crude prices have so far in 2024.

Jobs market has cooled meaningfully, with the Fed's higher interest rates soon putting the economy's 'soft-landing' at risk. Inflation readings on Labor and Wages have cooled a bit over the past few months, a plus, but they are still running hotter than most categories given the delayed impact of annual raises and a finally-normalizing labor market. The jobs market has weakened noticeably since peaking in early 2022 with Job Openings down 32% from peak levels, a plus for the cooling of the economy and the fight against inflation (where good news is bad news and bad news is good news). Furthermore, average hourly wages are still up 4.5% year-over-year in June, but that is down from average reading of 5.7% year-over-year wage growth over the past 30 months. So, the rate of wage increases is falling. Net, we believe this gives the Fed further ammunition to cut interest rates in September or December, or else risk too much weakness, thus putting the US economy's 'soft-landing' at risk.

Figure 2. Labor Market Still Supports Soft Landing Scenario, but Higher for Longer Could Jeopardize It



Source: Avid Realty Partners and fred.stlouisfed.org

2024 Economic and Multifamily Outlook: Our Top 10 List

2024 to be an exciting year of politics, economic progress, and tremendous real estate buying opportunities. We think that 2024 is shaping up to be an exciting year with Presidential and Congressional politics taking up a lot of peoples' attention, with a broad economic recovery advancing in a lower interest rate environment, and with these dynamics creating a very compelling buying opportunity in Real Estate. **Here is Avid Realty Partners' Top 10 List of the forces that will shape the 2024 overall environment:**

1. **Presidential and Congressional politics will remain highly partisan and nasty, and will suck up much of the oxygen in the room this year.** Unfortunately, we expect that the 2024 Presidential and Congressional campaign cycle will remain highly partisan and nasty. We think it's time that America's leaders get back to a more dignified and civil tone, putting the country's needs first. With a Biden-Trump rematch likely (unfortunately), and a highly contested Senate hanging in the balance, we expect this will be the most expensive and ugly political cycle ever, taking up a lot of peoples' attention and sucking the oxygen right out of the room. Despite this nastiness, we still think America's political system works, and its checks and balances will even things out over time; **Update: This is more true now than ever, particularly in the wake of the abhorrent assassination attempt against Donald Trump, and the terrible debate performance from Joe Biden (and the subsequent fallout). While a new Democratic candidate is certainly possible, it seems like Republicans are poised to win back the Presidency and pick up seats in both the House and the Senate as the pendulum swings away from extreme Progressive ideology and unlimited immigration.**
2. **#TheFed will cut rates by 100-125 bps to aid in a 'soft-landing' scenario, with the 10-Year Treasury exiting 2024 at 2.75%-3.25%.** We think #TheFed will cut rates by a total of 100-125 bps in 2024 to aid in the economy's 'soft-landing', and to stay 'neutral' in the upcoming Presidential election. While the Fed telegraphed three likely cuts in 2024, we think some of those cuts will be 50bps. In general, we think the 10-Year Treasury trades in a 'normal' range of 1.7%-3.0%, as it did from 2011-2019, a time period that is BC (before Covid), but after the Great Financial Crisis. Furthermore, we believe that Uncle Sam is effectively broke with total federal debt to GDP now at 124% versus only 30% in 1980, a QUADRUPLING of the USA's relative debt over the past 43 years! Given this, we do not think Uncle Sam can afford to pay 5% treasury rates anymore, or even 4% treasury rates, and will 'coordinate' with other high interest paying countries (Canada, Australia, UK, France) to lower global AAA-rated paper towards 2.5% over the coming quarters. In short, we expect lower interest rates from #TheFed to filter down to market interest rates, some of which is already reflected in now-lower Treasury Rates; **Update: We think the Fed is poised to cut rates in September and we could see 50bps-75bps of Federal Funds rate cuts this calendar year, though clearly this action is back-end loaded. If this is the case, we could see the 10-year treasury trade at 3.25%-3.50% in the next couple of quarters.**
3. **Inflation will mostly be beaten back, but pressures will remain in wages, energy, farm products, and possibly rents.** We think that the inflation battle has mostly been won already, and will be won more fully in coming months and quarters, with victory declared by 2H'24 (ahead of the Presidential

election, of course). We do expect ongoing pressures in wages, with peoples' raises delayed relative to the immediate repricing of goods throughout the rest of the economy. We expect there could be ongoing inflation pressures in the energy sector as many political leaders attempt a more aggressive cutover to 'clean and sustainable' non-carbon-based energy sources. We expect the takeover of the family farm by private equity shops and other institutional investors will continue to drive some inflationary pressures in farm products. Finally, we think that substantial cost increases in housing-related insurance, maintenance expenses, labor, property taxes, and others will cause rents to continue to climb, though this factor will be somewhat offset in the near-term by substantial deliveries of new multifamily apartments supply. Net, net, we think the overall inflation battle has been won, and that The Fed's efforts to shrink its balance sheet via QT will have the intended consequences of keeping inflation low for the foreseeable future. **Update: We are now seeing deflation in many categories and think that the inflation battle has largely been won. We think prices overall are rising around 2% now. Wages and Rent are the two areas that are still seeing new all time highs and continuing price growth, particularly wages as peoples' salaries catch up to this higher cost of living.**

4. **The stock market will grind higher, though many of the gains are already behind us.** As noted, the US stock market indices are already well off their recent lows of September 2022, with the S&P 500 up 36% off its bottom and the NASDAQ up a whopping 46% off its bottom. But, with #TheFed announcing that it will be cutting rates multiple times in 2024, with a 'soft-landing' economic scenario increasingly likely, and with inflation mostly beat back at this point, we think the stock market is poised to run higher in a two-steps forward and one-step backwards fashion. **Update: The stock market's run has been nothing short of incredible, though much of the gains are concentrated in the seven largest technology stocks, with substantially less broader market participation. Nevertheless, with the NASDAQ up 24% year-to-date and the S&P 500 up 18% year-to-date, we have to wonder how much longer these impressive gains can continue.**

5. **Institutional Investors will slowly get off the sidelines and re-enter the investment markets.** With interest rates lower (already), the stock market rallying meaningfully, and a 'soft-landing' economic scenario increasingly likely, we think that broadbased investor redemptions will wane and more institutional investors will slowly get off the sidelines. We do think transaction volumes will increase given that there is less uncertainty into the economy and interest rates than there was just one year ago, and that the world will return to a more normal working environment. With so many institutional investors 'on the beach' in 2023, transaction volumes were low, prices were low, and there was limited demand for new investments. We expect these factors to transition to a more normal capital markets environment in 2024. **Update: More real estate investors are coming off the sidelines, and transaction volumes have picked up from 2023 levels. That said, the pace of gains feels slower than it should, and we continue to think now represents a phenomenal multifamily investment opportunity when outsized gains can be generated.**

6. **Many investors purchased over-priced multifamily in 2021 and 2022, and those with limited balance sheets and deals with bridge debt will feel the pain.** Yes, many multifamily buyers purchased over-priced multifamily deals in 2H'20 – 1H'22 when cheap money was as plentiful as air. In fact, nearly anyone that purchased a deal in 2021 or early 2022 overpaid for the deal! Those firms with limited

balance sheets, who were overly aggressive in purchasing deals, and those with a plethora of highly-leveraged bridge debt deals will feel significant pain (if they aren't already) as interest rate caps expire and 'cash-in' refinances become the norm. Some of these buyers may use Pref Equity to kick the can down the road (Pretend and Extend) until multifamily prices are at higher levels, but many smaller firms will not make it that far. In short, there is financing distress, bridge debt-related distress, interest rate cap-related distress, and many of these issues will come to a head in 2024, resulting in a large supply of lower quality deals available at cheaper prices. **Update: This is playing out as predicted, and will continue to play out as predicted. We note that most 'distressed' multifamily deals are in 1970s-1980s built deals in B or C locations. Further, higher quality deals tend not to be distressed, and while they are priced meaningfully lower than in 2021-2022, they are still not 'cheap' and continue to trade thin on a going-in cap rate basis around 4.5% - 5.3% (and sometimes lower).**

7. **Distressed debt deals and Pref Equity will see the most activity in 2024, but plain vanilla investment opportunities will make a comeback too.** We sort of reference this in the prior point, but most institutional investors want 'distressed deals' at very VERY attractive prices, or they want to put Pref Equity to work where they have very little or no risk with their investment dollars. We have seen this already in 2023, and expect to see a continuation of this trend in 2024. Afterall, if one has cash on hand today then now is the time to press one's advantage. Despite these dynamics, we think 'plain vanilla' deals that are high quality in nature will be increasingly en vogue as normal institutional investors get back to the business of buying quality assets at attractive prices, even if they are not 'distressed' deals. **Update: This is playing out, with many Pref Equity providers providing rescue capital, and with high quality institutional deals still in demand and not 'cheap' (though cheaper than they were two years ago).**

8. **Multifamily supply will continue to deliver at a meaningful rate, especially in 1H'24, creating a unique opportunity to buy attractively-priced new construction core-plus multifamily deals.** There has been a LOT of multifamily supply that has delivered in 2023, and we expect a LOT more to deliver in 2024, particularly in 1H'24. Projects that are mid-construction will by and large deliver as expected, particularly in the multifamily apartment sector. In fact, multifamily supply deliveries are at 50-year highs, levels not seen since the early 1970s! We believe this is creating one of the most unique and attractive opportunities to purchase brand new construction core-plus multifamily deals at or below cost, and that acquisitions at today's prices will look very smart three to five years from now in hindsight. Indeed, this is one of Avid Realty Partners' core focus areas for 2024. **Update: This is true and playing out as predicted, however, quality new construction product is NOT being dumped below cost as much as we might have hoped.**

9. **Increased multifamily supply will continue to pressure Occupancy, Rental Rates, and overall financials, while insurance and inflation-driven expenses will compress the bottom line, thus leading to overall asset price rationalization.** The above-referenced supply-boom has pressured occupancy rates, rental rates, and concessions in 2023, and this will continue to be the case in 2024 as this supply is absorbed and digested. Beyond this, very large cost increases in insurance, property taxes, payroll, maintenance expenses, and everything else – thanks to inflation and heightened weather events – is squeezing multifamily investors from both the top line and bottom lines and shrinking overall

property-level net operating incomes. **Update: This is true and playing out as predicted. In many supply-exposed markets, rents are falling or have fallen significantly (think Austin, Phoenix, Nashville, Vegas, Dallas, others). While in other supply-limited markets rent and revenue performance is just fine (and in some cases making new all-time highs). On the expense side, insurance, property taxes, and other expenses are squeezing profits in addition to the pressures seen on the revenue side. So, in growth markets in particular, Net Income has been squeezed meaningfully and that is one reason why most deals are not trading at a 6.0% cap rate or higher. We think these pressures normalize in coming quarters, and that 2025 will see a return to broadbased revenue growth.**

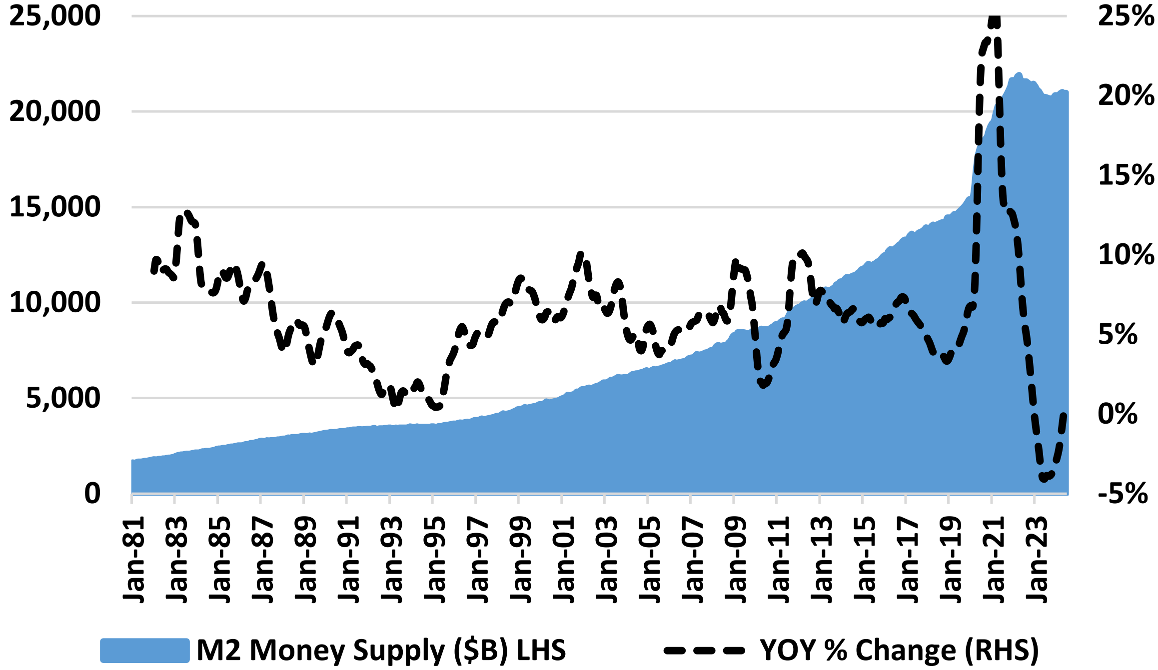
10. **Multifamily prices will find a bottom, with higher transaction volumes versus 2023, creating a compelling buying opportunity ahead of growth in 2025-2027.** As referenced above, the compression in net operating income metrics from both revenues and expenses is very meaningfully contributing to a reset in property prices. The lack of institutional equity (limited demand to purchase multifamily properties) is also contributing to a reset in property prices. We believe this reset in prices is substantially behind us at this point, but more property owners/sellers may come to terms with lower market pricing in 2024 and become market sellers (sometimes due to death, divorce, disease, etc). Indeed, we expect these factors to contribute towards higher transaction volumes. **Overall, we expect multifamily prices are now bottoming, inflation has peaked, interest rates have peaked, institutional investors are re-entering the investment market, and NOW is a tremendous and unique opportunity to purchase high quality apartment deals at very attractive prices.** **Update: This is true and playing out as predicted, now is a phenomenal buying opportunity in multifamily apartments.**

Revisiting the Root Causes of Inflation

<u>Excessive Quantitative Easing and too much Government Stimulus (vote buying) money.</u> We believe that 70%-80% of the root cause in inflation was due to the Federal Reserve's out-of-control Frankenstein experiment known as Quantitative Easing (QE). As shown below, #TheFed egregiously grew the US' M2 Money Supply by 43% from the onset of Covid in February 2020 through early 2022. That is 43% growth in US M2 Money Supply in 23 months!! Well, it is no wonder we have had 43% inflation over the past few years!! Other causes of inflation include repeated Federal & State Government stimulus programs, including many that were not needed, and to more affluent people that did not need the funds (some twisted form of politician-driven voter appeasement or vote buying). We think that supply chain bottlenecks accounted for less than 10% of the overall cause of inflation, and the Russia/Ukraine war less than 2% of the overall cause of inflation.

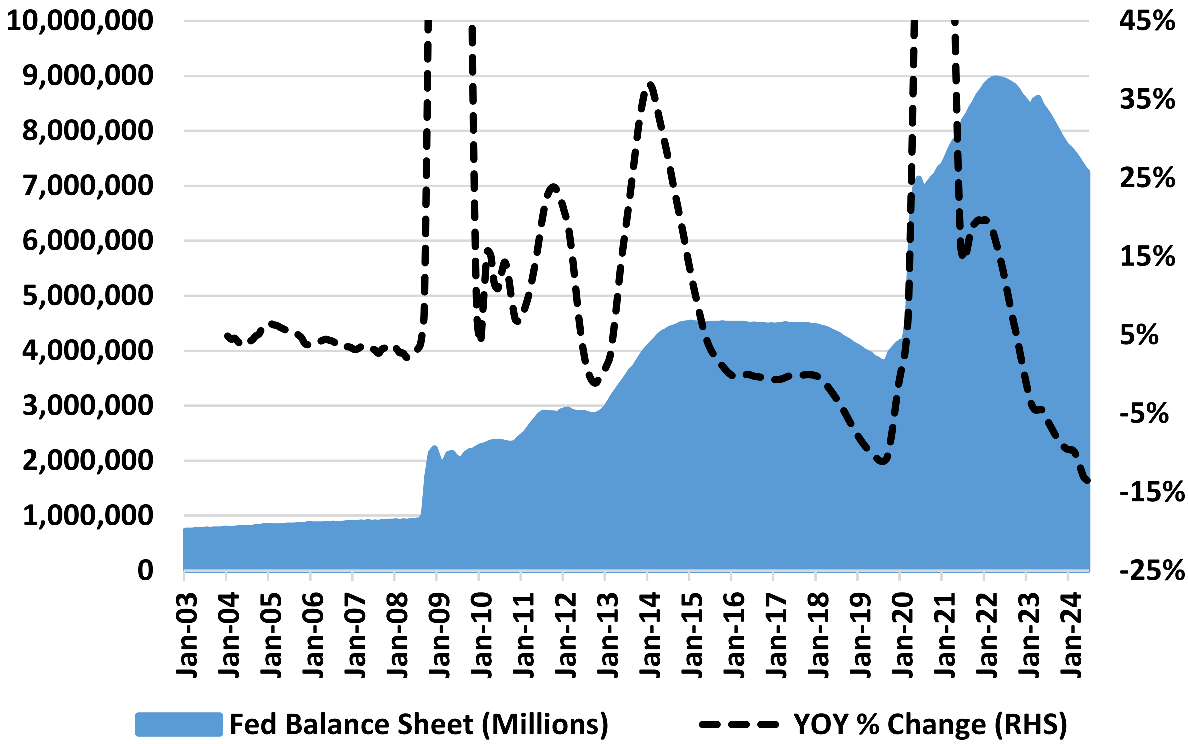
<u>M2 Money Supply and the Federal Reserve's Balance Sheet are the monetary tails wagging the inflation dog.</u> Did you know that the Federal Reserve grew M2 Money Supply by a reckless 7.75% annually for 15 years running from July 2007 – July 2022? ***Wow, those Fed Governors should not only be fired, but prosecuted for Treason!!*** The below graph shows a couple of things: 1) Growth in M2 Money Supply has been out of control and has now fallen below historically normal year-over-year growth levels with Quantitative Tightening as the Fed works to undo some of the damage it has done; 2) #TheFed probably needs to shrink its balance sheet and overall M2 Money Supply aggressively, not just prevent it from growing further if it truly wants to get inflation under 2% target levels; and 3) The last time growth in M2 Money Supply was over 10% was in the early-to-mid 1970s (through 1977), which spurred its own inflation nightmare in the late 1970s and early 1980s. We note that the Fed has shrunk M2 Money Supply by a somewhat-paltry 4.3% since its peak in Apr'22, and that M2 Money Supply is now growing again! And, the Fed has shrunk its overall Fed Balance Sheet by a slightly-better 19.0% since its peak in Apr'22. This is a reduction of $1.70 Trillion in Fed Assets from peak levels, which is a paltry sum considering Congress and the President gave those sums away to affluent voters who did not need it, undocumented immigrants, student loan borrowers, the war effort in Ukraine, and others with the strike of a pen…the Fed needs to do more, and Congress must reign in its over-zealous spending ways!

Figure 3. Growth in M2 Money Supply the Cause of Inflation…QE The Fed's Frankenstein Baby



Source: Avid Realty Partners and fred.stlouisfed.org

Figure 4. The Fed's Balance Sheet Grew Recklessly Fast; Has Fallen 19.0% From Peak of Apr'22

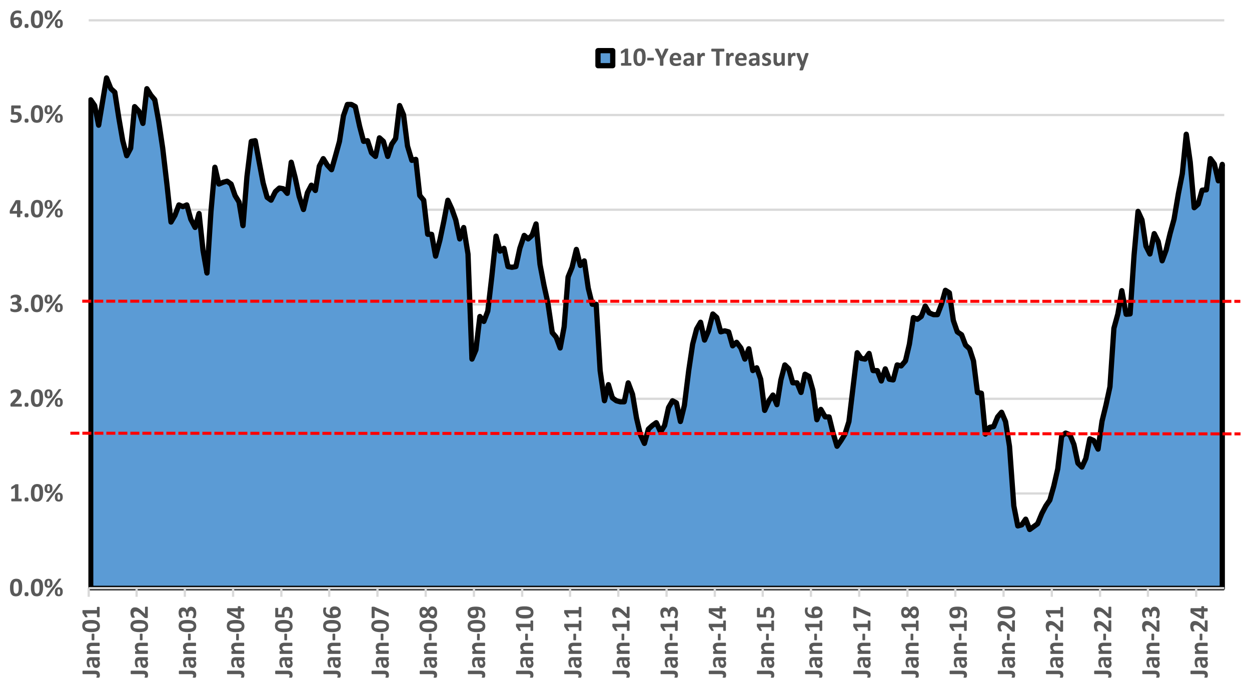


Source: Avid Realty Partners and fred.stlouisfed.org

Interest Rates Likely Going Lower with a 'New Normal' of 1.7% - 3.0% Range

So, where are interest rates going? We think lower. As seen below, 10-year Treasury Bonds have traded between 0.6% and 5.3% over the past 21 years. Yes, we know that Treasury Bonds traded at much higher rates in the 1970s-1990s, however, we believe structural changes to the global fiscal and economic system means that society is not going back to those rates any time soon. During the past 21 years, we believe the years from 2012 to 2019 represent 'the new normal' in Treasury Bond pricing, with normalized yields ranging between 1.7% - 3.0%. We think these rates are what Uncle Sam can afford given the USA's growing annual deficits and mounting fiscal debt from entitlements and general over-spending. While the USA's fiscal and monetary policies and positions are not buttoned up, this country is still one of the best houses on a bad block, leaving global investors few choices of better investment alternatives than low-risk US Treasuries. So, in short, we think 10-year Treasury Bonds are going to trade higher, resulting in yields that trend in this 1.7% - 3.0% in coming years. We believe this range is 'the new normal' that will come into effect once we put this inflation debacle further in the rearview mirror.

Figure 5. Treasury Rates Should Now Trade in a 'New Normal' Range of 1.7% - 3.0%



Source: Avid Realty Partners and fred.stlouisfed.org

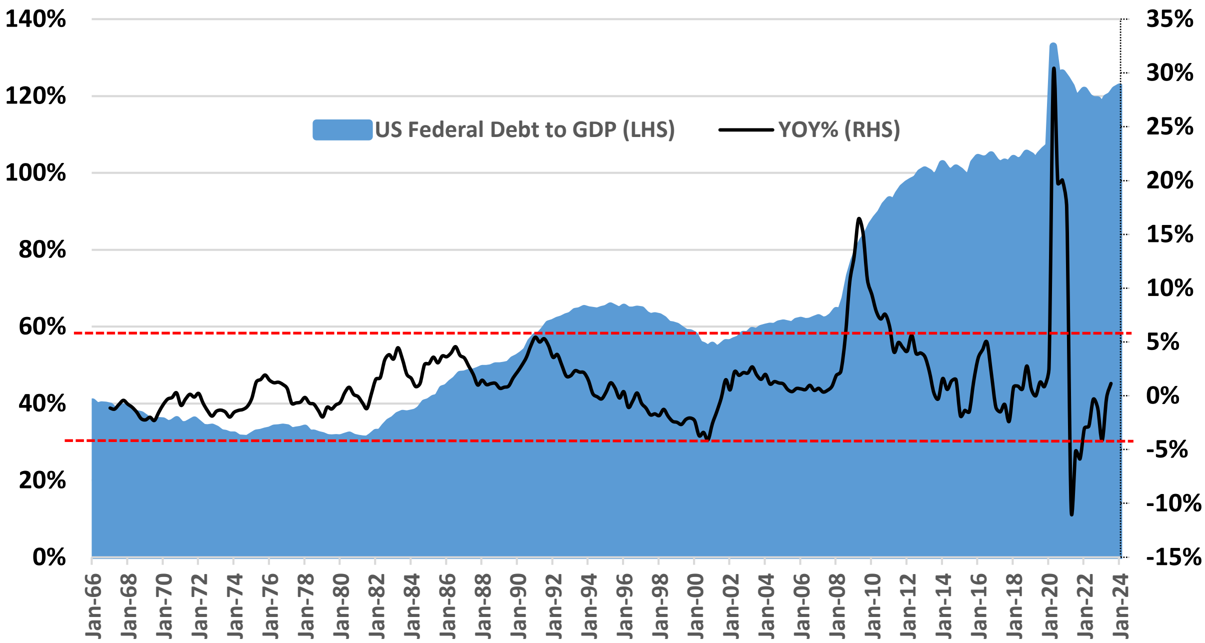
What does this mean for real estate and multifamily trends? Normalized cap-rates will trend flat to down. We believe that Treasury Bond rates set the cost of Fannie Mae and Freddie Mac agency borrowing rates, which in turn help set the cap-rates that multifamily deals trade at. So, we think that Multifamily agency borrowing rates are 150bps-200bps higher than 10-Year Treasury Bond rates, which equates to a normalized borrowing rate of 3.2% - 5.0%, with a likely normalized agency borrowing rate in coming years of around 4.2%, give or take. Generally, we think that institutional quality multifamily deals trade in a cap-rate range of Agency borrowing rates +/- 50 bps. ***This means that institutional quality multifamily deals will trade in a cap-rate range of 4.0% - 4.8% in coming years.*** Too many investors are underwriting a 6.0% exit cap rate, which we think is too high for quality product. If multifamily owners can grow their yield on total cost to 6.5%-7.0% on a five-year hold deal, and then sell near a 4.5% exit cap rate, then we think these deals will be an absolute homerun in retrospect. We continue to think that multifamily prices will go up over the long-term, buoyed by rising construction costs and growing rental rates, and that buying quality deals at a good price during periods of volatility and price contraction (like what we are seeing today), will lead to above average returns over time.

Uncle Sam's Finances are a Mess: Politicians Must Act Decisively and Bravely

The Bond Markets told us something, and our elected political leaders should listen. The Treasury Market's recent climb to 5.0% rates were telling us something, and for the sake of our country and our children's futures, I hope US politicians in Washington DC listen. What is the bond market saying? Well, it's hard to say exactly, but it feels like the message is something like this: "The United States' financial house is in disarray, with increasing risk premiums, and decreasing confidence in the future viability of our nation and its currency". Here are some of the reasons why this is the likely message:

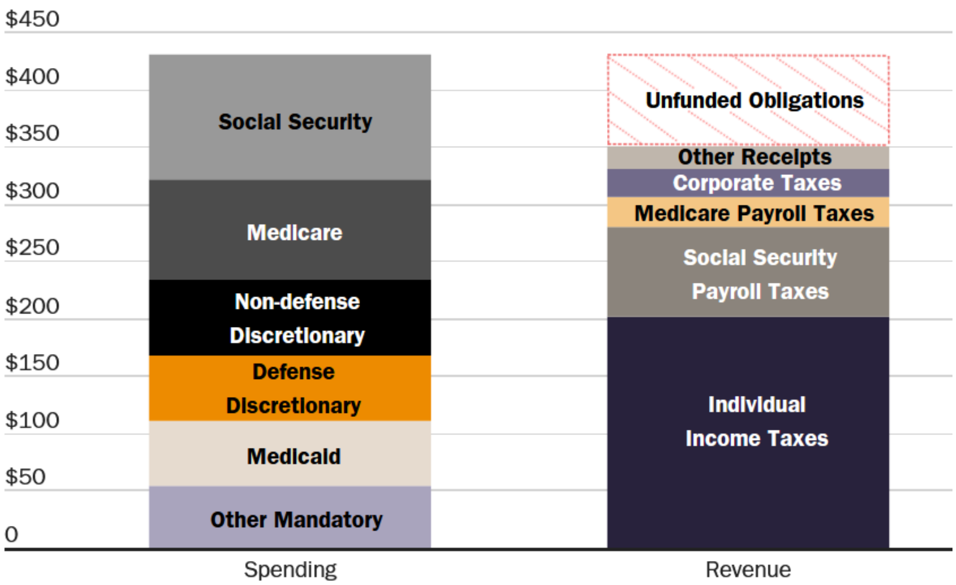
First, US Federal Debt-to-GDP Ratios are insanely high and likely going higher. Yes, the United States' US Federal Debt is sky high, and on a Debt-to-GDP basis is at historically dangerous levels. Currently, the US has about $34.5 Trillion of US Federal Debt (up $3 Trillion in just the past year!), or about $101,500 for every person in the country. This equates to 122% of annual Gross Domestic Product (GDP), down slightly from peak levels seen during Covid, but up from only 30% of GDP just 40 years ago in the early 1980s. As if these figures weren't scary enough, the US has an additional ***$80 Trillion*** in unfunded Social Security and Medicare obligations over the next 75 years in present value dollars! The Financial Report of the US Government forecasts that total US Federal Debt-to-GDP ratios will rise to 200% by 2046 and to 566% by 2097…wow! This same report suggests that by 2050 (just 27 short years from now), the US Federal Government's debt service will total 10% of annual GDP, which is pure insanity. No government in the history of mankind has ever recovered from these mountainous levels of debt. When will our elected 'Leaders' take notice and respond in kind by cutting spending, right-sizing federal program activities, stopping the endless free-money giveaways, balancing our Federal budget, and funding Social Security and Medicare obligations? It could take a financial crisis to get anyone to listen, and by then it could be too late.

Figure 6. US Federal Debt-to-GDP Ratios are Dangerously High



Source: Avid Realty Partners and fred.stlouisfed.org

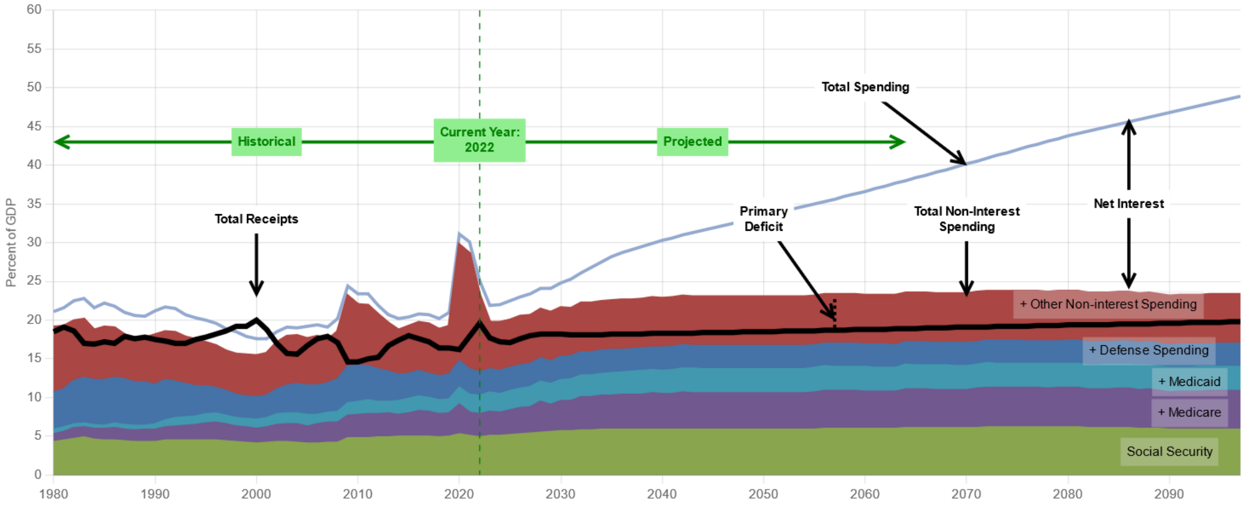
Figure 7. Unfunded US Government Obligations Will Total $80 Trillion Over 75 Years



Note: The graph displays total projected non-interest spending and revenue in 2022 present value terms.

Source: Cato.org and Dept of Treasury, "The 2022 Financial Report of the U.S. Government," 03-24-23

Figure 8. Fed Govt Hasn't Run a Surplus Since 2001; Debt Service Forecast at 10% of GDP in 2050

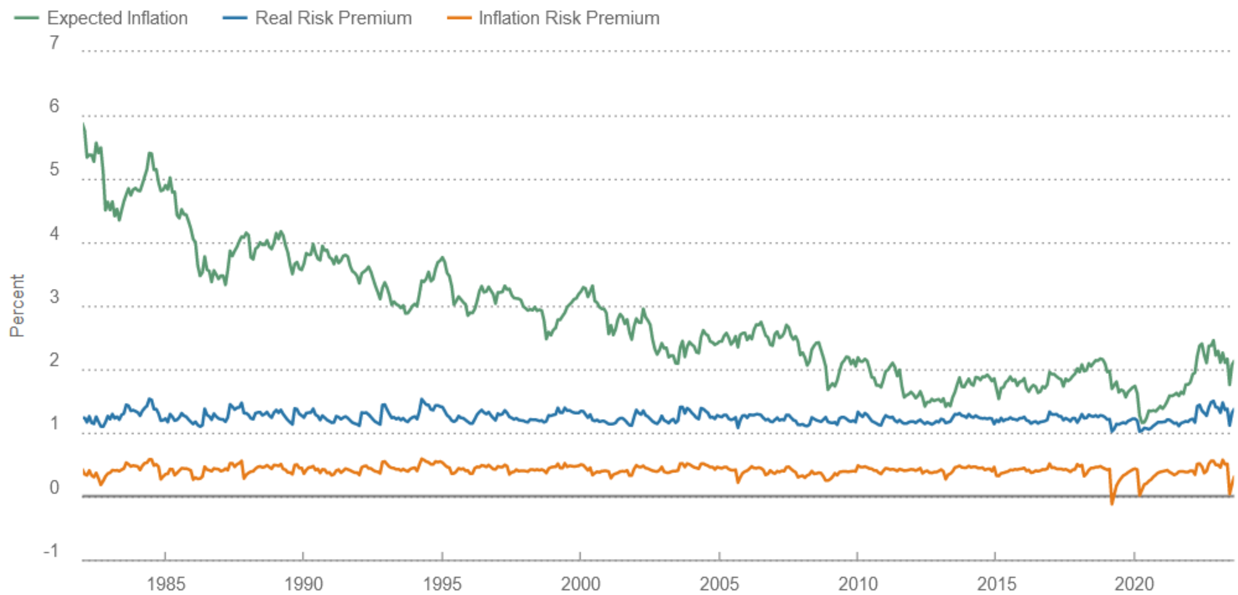


Source: Dept of Treasury, "The 2022 Financial Report of the U.S. Government," 03-24-23

Second, Growth in Money Supply has caused inflation, impaired the value of the US Dollar, and puts the US Dollar's status as World's Reserve Currency at risk. The US enjoys the benefits of having our currency – The US Dollar – serve as the world's reserve currency. We get to trade goods internationally in dollars, we enjoy a lower cost of capital by selling US Treasuries more easily (thereby financing our endless government spending deficits), and we enjoy cheaper imports and slightly more expensive exports. Also, commodities including oil and many others, trade on the international markets in US Dollar denominated transactions. This makes it easier for US businesses to conduct operations. The US Dollar's status as reserve currency is because of the safety, reliability, and dependability of the US financial system, and the overall strength of the system. But, with so much growing Federal Debt, political instability, and with the chaos of each passing Debt Ceiling battle, the safety and reliability of this system gets called into question. These factors serve to substantially increase doubt about the dependability of the US financial ecosystem, and these issues could ultimately risk the US Dollar's status as the world's reserve currency. As the Federal Reserve's growth in MS money supply during Covid, and outside of the Covid pandemic too, caused inflation to spike and made the US Dollar worth much less. The Fed's QE Frankenstein experiment stabilized the economy during the peak of the crisis, but had major negative impacts with inflation, and quite frankly, was reckless. The Fed, along with the actions of our elected leaders, are putting the US Dollar's status as reserve currency at risk, and could drive the next financial crisis to be much worse for every day Americans.

Third, the US Risk Premium is higher because of these issues, and that is pricing into US Treasuries. Yes, due to the aforementioned issues, and the lack of real leadership from The Federal Reserve and from our elected officials, Treasury markets have to offer investors more return to get them to invest into US Treasuries. Simply put, the US Risk Premium is increasing, and while it has bounced meaningfully off of Covid-pandemic lows, it could go even higher still.

Figure 9. US Bond Risk Premiums are Up Off the Lows, But Could Still Go Higher



Source: ClevelandFed.org

So, what does all this mean for the Multifamily Apartment investment market? This is a lot of data to digest! We still feel that the multifamily apartment sector is 'essential' and that people will always need someplace to live. Even if the US Federal Government goes belly up some day in the future, people will still need homes and apartments. A few other thoughts: 1) With its hugely increasing debt load and interest payments, the US Government cannot continue to offer 4.5% - 5.0% interest rates on US Treasuries without breaking the bank, and causing debt service payments to skyrocket. So, we think Treasury rates have to come down to lower levels; 2) With lower relative yields and more political and financial instability here at home, there could be fewer countries willing to buy US Treasury debt. This could force the government to right size its spending and/or cut Social Security and Medicare entitlement benefits; 3) If the Federal Reserve or political leaders try to 'inflate our way out' of the growing fiscal calamity the country is in, those that own hard assets like apartment properties will see the value of those assets rise in lockstep with inflation; 4) We cannot control these things so we continue to buy the best quality and location multifamily assets we can at a fair price, or lesser quality assets at a great price, and with a strong focus on property-level and corporate-level execution. Afterall, everyone needs someplace to live, and we intend to be a part of the housing ecosystem for decades to come.

Thank you for reading, enjoy a wonderful holiday season, and let us know if you have any questions or thoughts.

---- Craig, James, Mary, Jim, Eddy, Jeff, Luis, Omar, Sebastian, Jeanette, Robin, and Jamie

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