

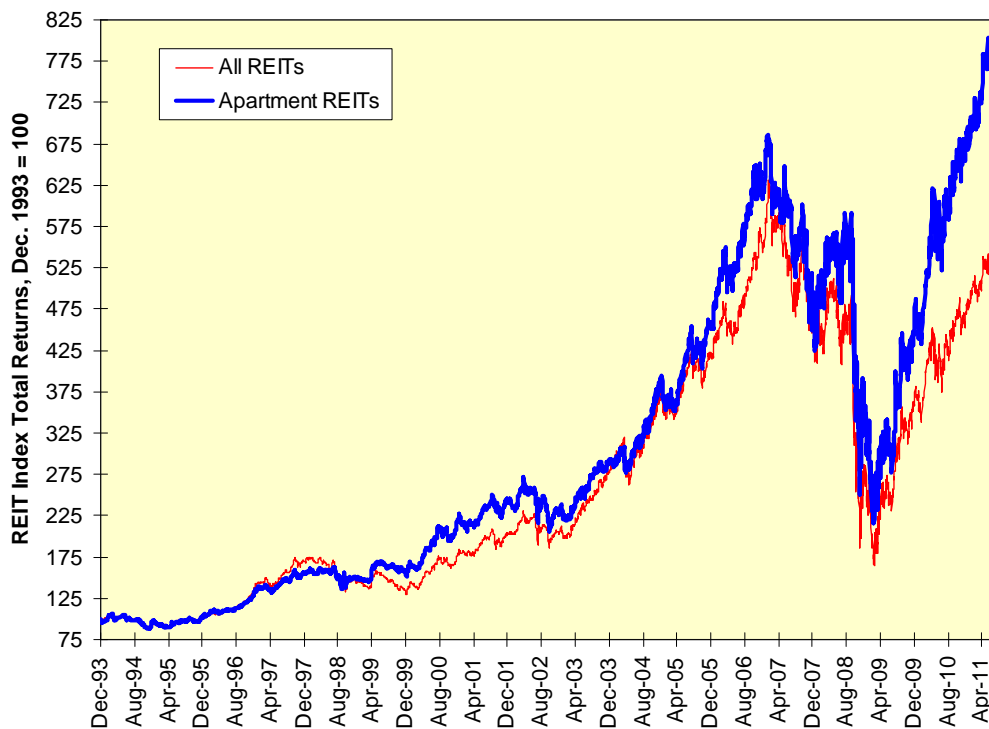
Slouching Toward Tenancy

One of the problems of being an aging Baby Boomer is keeping track of all of those lazy, no-good generations coming up behind us who share not in our profound glory...even though they have forgotten more about really cool videogames than we ever knew.

Whether it applies to some generation, be it X, Y, Z or in the grand fashion of Microsoft Excel, Generations AA and AB (sound like blood-types, do they not?), the reality is they have become scared of residential real estate and for very understandable reasons. They have seen too many foreclosures, homes underwater and people so burdened by an albatross of a place they cannot move or trade-up. Other psychological factors, such as the fear of imminent unemployment and their watching too many people of their parents' age getting tossed into the dumpster by supposedly solid corporations, surely cannot help.

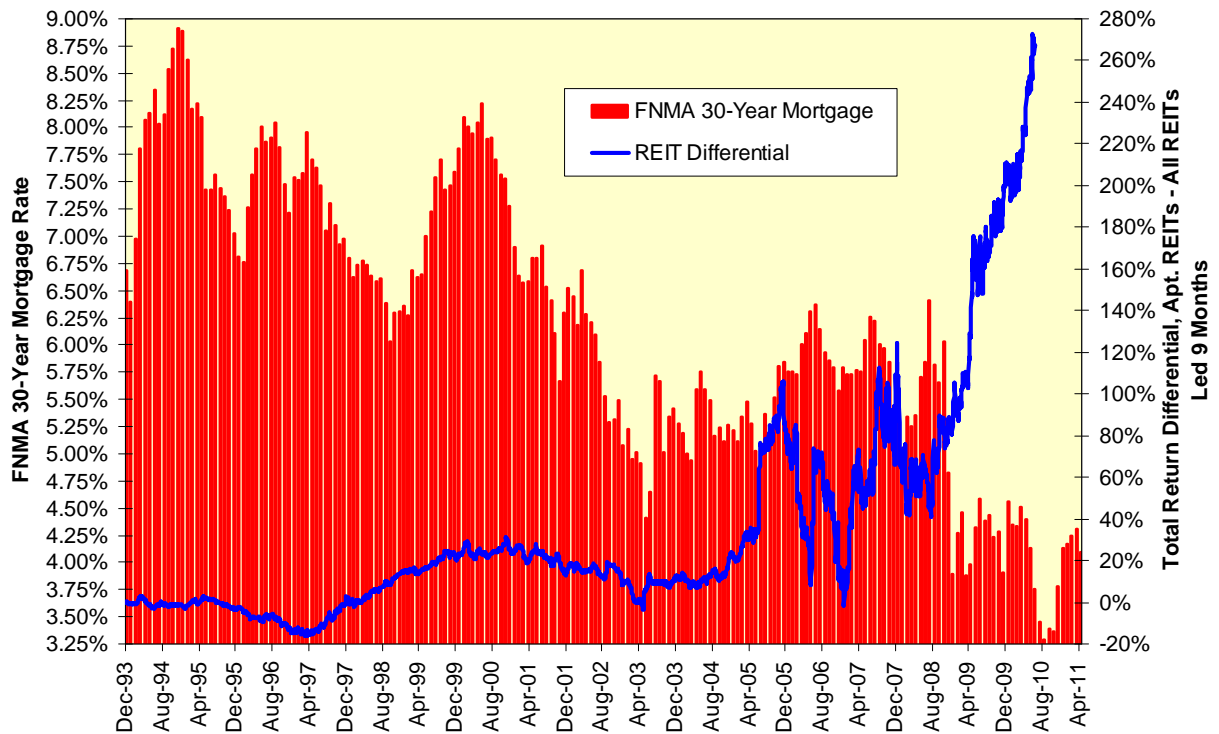
The end result is a rather pronounced shift in preference at the margin between homeownership and tenancy. One way of illustrating this is to compare the total returns for two REIT indices compiled by Bloomberg, one for all REITs and one for apartment REITs. The two matched each other reasonably well until early 2009. While your initial response may be to associate this date with the general market low, I think the real event here was the proliferation of programs to support housing prices over their market-clearing levels. All of those mortgage-backed security purchases, loan modifications and the like signaled to buyers the price was artificially high.

How Do REIT Investors Value Apartments?



We can see this another way by mapping the Fannie Mae-conforming 30-year mortgage against these REIT return differentials led nine months. We have been trying to bribe buyers with a national policy of low mortgage rates, but this was misdirected. Even if the concept is initially unclear to many, subsidies and tax credits tend to be captured not by the buyer but by the seller, with the proportion related to the price elasticity of supply; the more inelastic it is, the more the seller captures. This holds true for things such as first-time homebuyer tax credits, insulation tax credits and that favorite of the addle-brained everywhere, cash-for-clunkers.

Apartment REITs And Mortgage Rates



Restated, the federal government has been trying to move heaven and earth to support homeownership and has contributed to a preference for tenancy by preventing home prices falling to a market-clearing level. To paraphrase Churchill, never before have so few done so much damage to so many. Or, to quote myself, “What a bunch of doofuses.” Milton Friedman was so right when he said, “If you put the federal government in chart of the Sahara Desert, in five years there’d be a shortage of sand.”

Who are some of the apartment REITs who have benefited from this trend, one that will last until home prices finally hit bottom? The top performers year-to-date include Essex Property, Camden Property, Equity Residential and Avalonbay Communities.