BNY MELLON | Dreyfus

A Foundation for Growth?

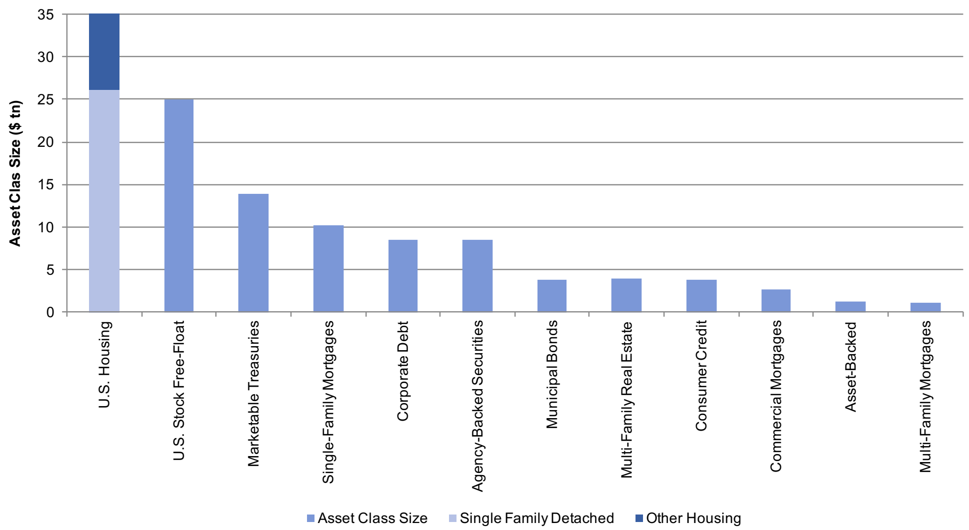
AUGUST 2017

Amherst CAPITAL MANAGEMENT

The U.S. housing market offers significant opportunity if you know where to find it.

If you were asked to identify one of the world's single largest asset classes, U.S. housing probably wouldn't be at the top of your list. But, at US$35 trillion, the U.S. housing market easily outstrips the combined value of the U.S. S&P Index (~US$20tn) plus the market for U.S. Treasuries (US$13tn) (see Figure 1). It has close to 135 million housing units all told, of which 15.4 million are single-family households. Here, according to Sandeep Bordia, managing director of Amherst Capital Management, is the often-underestimated investment opportunity. "We have a key message," he says, "U.S. housing is a really big market. Its size and depth makes for a potentially very rewarding place to invest if you know where to look."

Figure 1: U.S. Housing Is the World's Largest Asset Class

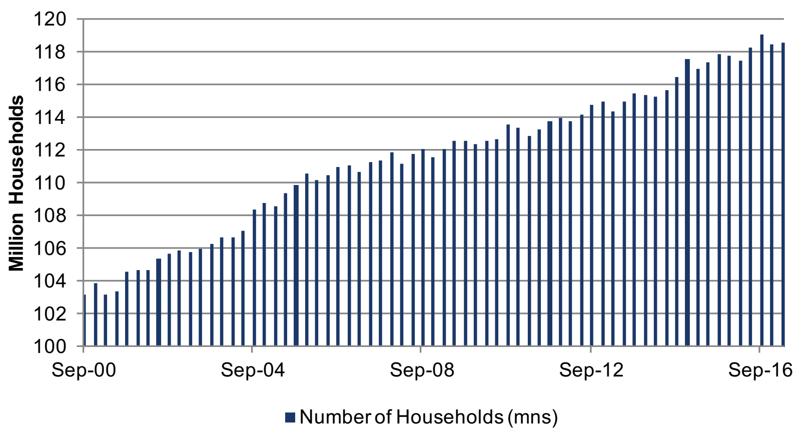


Source: Estimated by Amherst Capital based on Federal Reserve Z.1 release as of June 9 2016; MSCI, SIFMA data; and data from the National Multi-Family Housing Council.

The key to understanding the market, according to Bordia, is to consider the rising mismatch between supply and demand in single-family housing units. He notes how, over the past decade, U.S. household formation continued apace but the number of people who own their houses declined even as the number of people renting increased dramatically. "We've added seven million new households in the past 10 years," he says. "But nearly all of that growth has been going to rental houses. This is partly because of tighter lending in the residential mortgage market, which means it has become almost impossible for most people to get meaningful access to credit." Federal housing data underlines the point: The median credit score needed to gain mortgage approvals has risen from just over 700 in 2006 to well over 750 now.[1] "For the 80% of buyers who require a mortgage to own a home this presents a huge challenge," says Bordia.

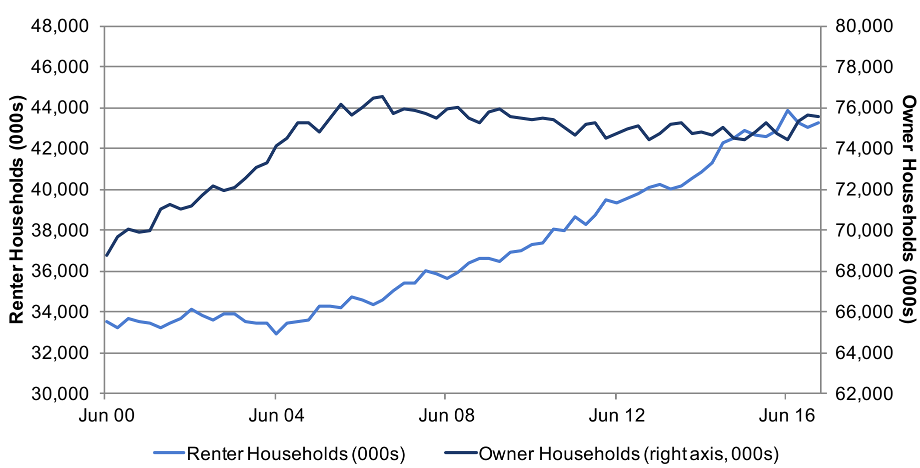
Exacerbating the trend has been the rise of student debt, which has increased nearly fourfold over the past 13 years (see Figure 4). The requirement to service monthly payments on this debt makes for a demographic cohort less likely or able to take on the additional burden of regular mortgage outgoings even as they begin to think about settling down and starting a family.

Figure 2: Number of Households Continues to Rise



Source: U.S. Census Bureau as of 2017 Q1.

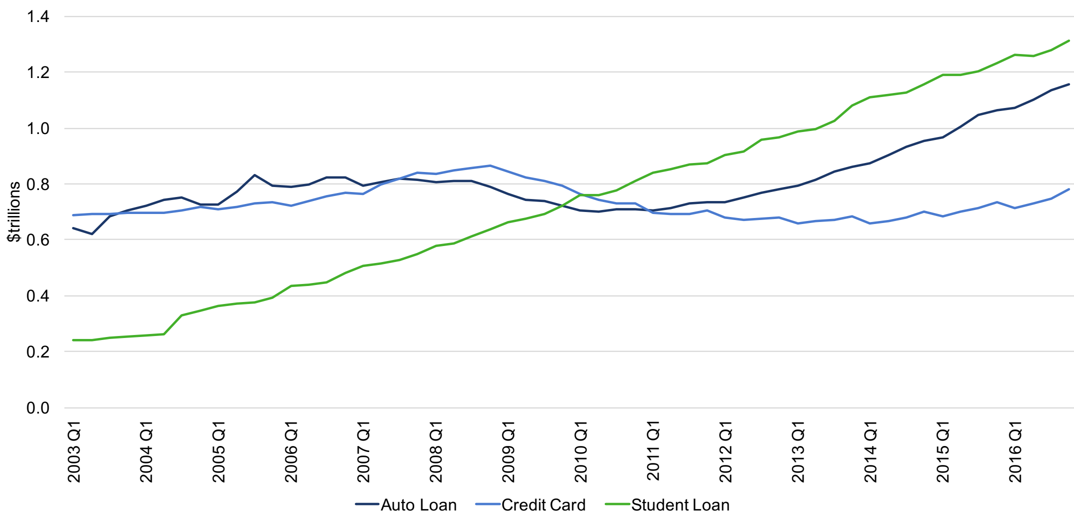
Figure 3: But Fewer People Are Buying While More People Are Renting



Source: U.S. Census Bureau as of 2017 Q1.

At the same time, the supply of new single-family households coming onto the market has been anemic at best (see Figure 5). The overall result, says Bordia, is a vast mismatch in supply and demand for single-family homes across the U.S.

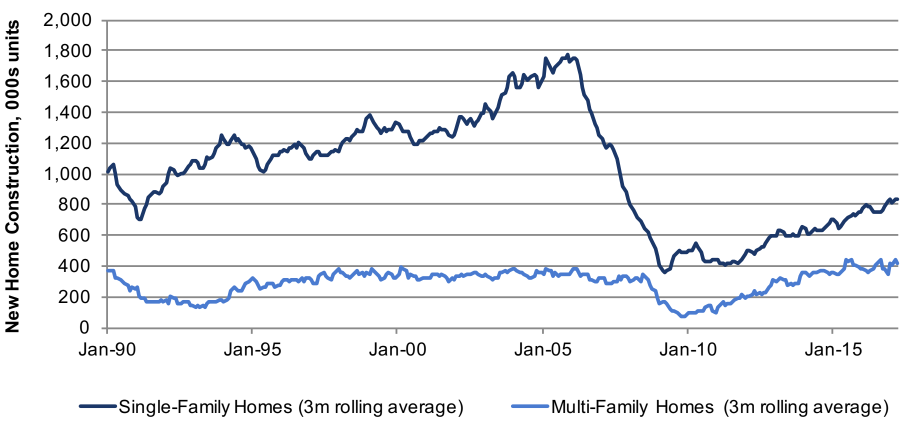
Figure 4: U.S. Debt, Q1 2003–Q3 2016



Source: Federal Reserve Board FRBNY Consumer Credit Panel/Equifax as of 2016 Q4. Student Debt Overview last published in 2012.

For Amherst, this is the opportunity. The company owns and manages geographically dispersed portfolios of single-family houses which it then makes available for single families to rent. By doing so, it services the pent-up demand for single-family houses but it also aims to provide its own investors with an attractive return.

Figure 5: Single- and Multi-Family Home Construction, 1966-2016



Source: U.S. Census Bureau as of 3/31/2017.

Meanwhile, he points to what are believed to be four tailwinds that may benefit this approach to investing in the U.S. housing market:

1) Economies of scale

New technology has made the logistics of underwriting, buying, repairing and managing thousands of geographically dispersed properties on a daily basis possible for institutions.

2) Tighter mortgage credit

Less competition from retail buyers — inability to buy homes or qualify for mortgages.

3) Better financing

Institutions have access to cheaper and more appropriate financing through warehouse lines and securitization. Smaller investors' access to financing is limited to more expensive 30-year loans.

4) Geographical diversification

"Mom-and-pop" retail investors are generally focused on areas near where they live — institutions may allow greater diversification over retail investors.

Bordia concludes: "We can point to a range of factors that underline the potential long-term opportunity in the U.S. single-family rentals markets. On the one hand, tight mortgage credit and higher student borrowing bode well for rental demand. On the other, we think demographics and anemic levels of single-family home construction work further in our favor. We believe the risk/reward profile continues to look favorable — especially for institutions like ours that are able to access technology, economies of scale and cost-effective financing."

---

[1]Sources: (1) FRBNY/Equifax Credit Panel as of 2016 Q1. eMBS, Federal Housing Administration (FHA) and the Urban Institute. As of Q1 2016.