# Profit from Housing Shortage:
# Buy Coastal Apartment REITs Aimco and BRE for 50%+ Upside

Jonathan Litt
Craig Melcher
www.LandandBuildings.com

October 2012

# Aimco and BRE Properties: 50%+ Upside



- **Aimco (NYSE: AIV): $40 stock trading at $25**
  - 61% upside: private market value a 6.2% cap rate vs. forward implied cap rate of 7.9%
  - 15% annual AFFO growth 2013 - 2016
  - Focus on coastal markets boosting monthly average rent to $1,400 from $800 at year-end 2005
  - Market underappreciating nearly complete strategic repositioning: selling weaker assets, deleveraging and driving rent growth

- **BRE Properties (NYSE: BRE): $70 stock trading at $46**
  - 54% upside: private market value a 4.5% cap rate vs. forward implied cap rate of 6.4%
  - 12% annual AFFO growth 2013 - 2016
  - High quality coastal California and Seattle portfolio in high cost of home ownership markets should drive net operating income growth of 6% - 8% annually over next several years

- **AIV and BRE: M&A candidates if discounted valuations persist given abundant capital available to both public and private buyers**

 *Source: LANDandBUILDINGS estimates, Company reports*

# Capitalizing on America's Housing Shortage

LANDandBUILDINGS

- AIV & BRE are key beneficiaries of pent-up housing demand and current pace of underbuilding
- Apartment REITs as well as homebuilders have historically seen strong positive returns in prior housing recoveries
- Coastal apartment REITs historically generate 4 - 7 years of 6% - 8% average NOI growth in recoveries
  - Years of runway ahead in current cycle: only in the $2^{nd}$ year of NOI recovery
- Coastal apartments best positioned
  - High cost of home ownership creates captive pool of renters by necessity
  - Stronger household income growth supporting superior rent growth
  - Limited new construction due to high barriers to entry



*Source: LANDandBUILDINGS estimates , Company reports*

# Housing Shortage of 1 Million Homes Annually

LANDandBUILDINGS

- Harvard estimates demand for 1.6 - 1.9 million homes annually between 2010-2020[1]
- Shortfall of 1 million homes annually at current pace of 750,000 housing starts
- Apartment shortfall: multifamily starts at ~200,000 annually are 60% below necessary 500,000[2] units

| Harvard University Study of Components of New Home Demand 2010 - 2020 | | |
|---|---|---|
| *Thousands ('000)* | **Low Immigration Projection** | **High Immigration Projection** |
| **Projected Household Growth** | 11,802 | 13,828 |
| **Increase in Structural Vacancy** | 1,361 | 1,595 |
| **Projected Total Estimated Net Removals** *(Total Units * .025% / Year)* | 3,279 | 3,279 |
| **Projected Total Demand for New Units** | **16,442** | **18,702** |
| **Average Annual New Home Demand** | **1,644** | **1,870** |
| Current Pace of Annual New Home Construction[3] | 750 | 750 |
| **Current Pace of Annual Underbuilding[4]** | **(894)** | **(1,120)** |



*Source: LANDandBUILDINGS estimates, U.S. Census Bureau, Joint Center for Housing Studies at Harvard University*
*(1) Joint Center for Housing Studies of Harvard University (2) Based on historical ratio of 28% of multifamily starts relative to total housing starts from 1961 through 2011 (3) US Census figure as of August 2012 (4) LANDandBUILDINGS estimate combining Harvard projections and US Census figures*

# Apartment REITs and Homebuilders Both Benefit from Housing Shortage

LANDandBUILDINGS

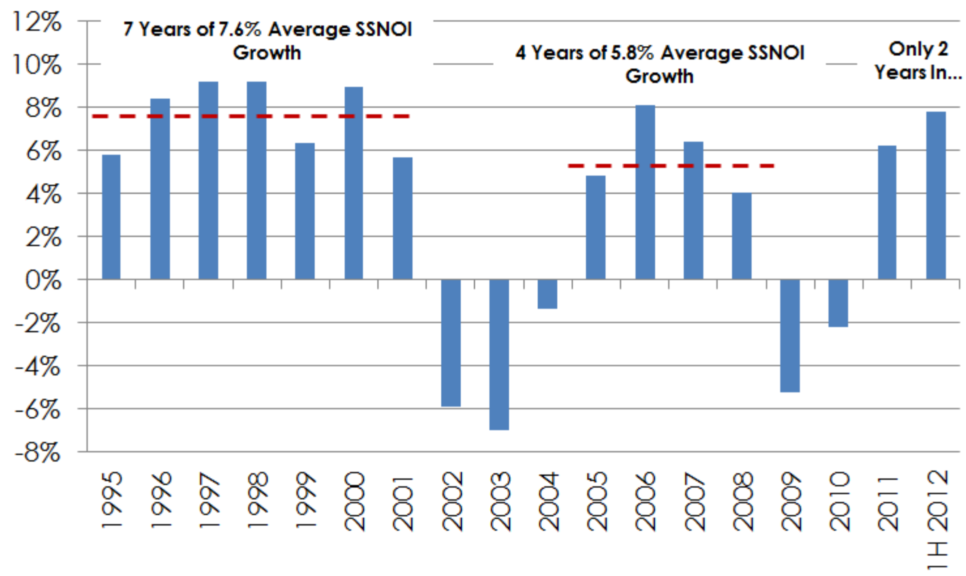
## Housing shortage a boon for apartment owners and single-family developers

- Apartment REITs and homebuilder stocks have strong positive correlation

## For 2013-2016: 5% - 8% annual NOI growth likely for coastal apartments REITs

- ***Mid/late 1990's economic recovery***: Coastal apartment same-store NOI averaged 7.6% over a 7 year period
- ***Mid 2000's economic recovery:*** Coastal apartment same-store NOI averaged 5.8% over a 4 year period
- ***National homeownership rate is 65.5%,*** still above the long-run average of 64.5% prior to the housing boom and continues to decline[1]
  - Year to date, the homeownership rate has declined 50 bps, supporting apartment demand and further declines are forecasted

**Still Early in Coastal Apartment SSNOI Growth Cycle**






Source: Company reports, Wall street research, U.S. Census Bureau
Note: 1995 SSNOI data from Green Street Advisors
(1) Average from 1966 - 1999

# Best Rent Growth Prospects in Aimco's and BRE's Markets

LANDandBUILDINGS

- **Aimco and BRE concentrated in high rent growth coastal markets**
  - BRE is in the top 9 and Aimco is in 12 of top 15 markets with strongest Axiometrics rent growth projections
  - Axiometics estimates likely conservative as portfolios have superior locations, are better managed and will be at the center of the coming housing shortage
- **Fundamentals support robust coastal growth**
  - Superior job growth supporting household formations and income growth
  - Limited new supply due to high barriers to new construction
  - Cost of owning prohibitive making renting the only option for many
  - Room for upside in apartment rent to income ratios

**Top Projected Rent Growth Markets**

| Rank | MSA | 2013 - 2016 Cumulative Growth | AIV Markets | BRE Markets |
|---|---|---|---|---|
| 1 | Los Angeles, CA | 20.8% | ✓ | ✓ |
| 2 | San Francisco, CA | 20.0% | ✓ | ✓ |
| 3 | Phoenix, AZ | 19.6% | ✓ | ✓ |
| 4 | Oakland, CA | 19.4% | ✓ | ✓ |
| 5 | Santa Ana-Irvine, CA | 19.3% | ✓ | ✓ |
| 6 | San Jose-Santa Clara, CA | 18.7% | ✓ | ✓ |
| 7 | Riverside, CA | 18.3% | | ✓ |
| 8 | Denver, CO | 18.2% | ✓ | ✓ |
| 9 | San Diego, CA | 18.0% | ✓ | ✓ |
| 10 | Oxnard-Ventura, CA | 17.9% | | |
| 11 | Newark, NJ-PA | 17.7% | ✓ | |
| 12 | Nassau-Suffolk, NY | 17.2% | | |
| 13 | Washington, DC | 17.1% | ✓ | |
| 14 | Boston, MA | 17.0% | ✓ | |
| 15 | Atlanta, GA | 16.6% | ✓ | |


*Source: Company reports, Axiometrics*

# Best Supply/Demand Dynamics in Aimco's and BRE's Markets

LANDandBUILDINGS

- **Expected annual job growth of 2.2% 2013 - 2016 will drive strong household formations and income growth in the coastal markets**
  - Job growth will unlock pent-up demand from doubled-up households
  - Income growth in key coastal markets already surging, supporting apartment pricing power
    - Annual personal income growth of 9.5% annually last 2 years in San Jose, 4.9% in Los Angeles[1]

- **Limited new supply of single and multifamily homes at 0.8% of inventory annually between 2013 - 2016**

| | 2013E - 2016E | | | | |
|---|---|---|---|---|---|
| | Average Annual Job Growth | Average Annual Housing Starts as a % of Stock | Average Annual Multifamily Starts as a % of Stock | AIV Markets | BRE Markets |
| **Major Coastal Metros** | **2.2%** | **0.8%** | **0.8%** | | |
| Baltimore, MD | 2.2% | 0.9% | 0.9% | ✓ | |
| Boston, MA | 2.0% | 0.7% | 0.7% | ✓ | |
| Miami, FL | 2.1% | 1.0% | 1.0% | ✓ | |
| New York / New Jersey | 2.1% | 0.7% | 0.7% | ✓ | |
| San Francisco, CA | 2.6% | 0.6% | 0.6% | ✓ | ✓ |
| San Jose, CA | 2.5% | 0.6% | 0.6% | ✓ | ✓ |
| Seattle, WA | 2.6% | 1.3% | 1.3% | ✓ | ✓ |
| Washington D.C. | 1.9% | 1.6% | 1.6% | ✓ | |
| Los Angeles, CA | 2.3% | 0.5% | 0.5% | ✓ | ✓ |

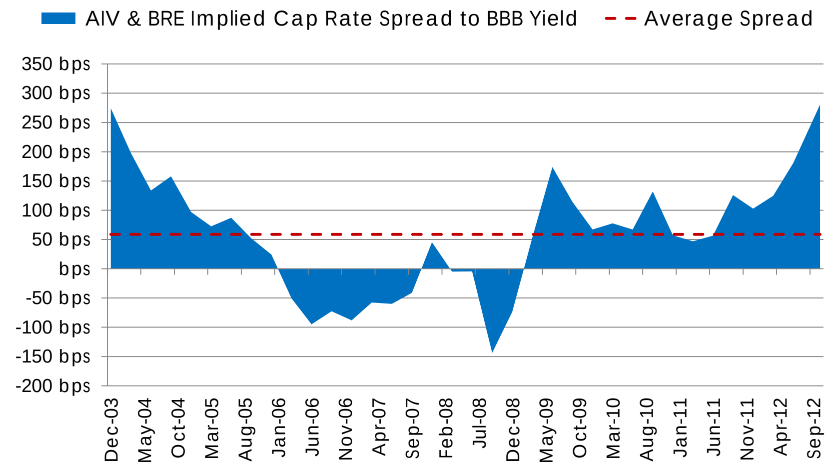


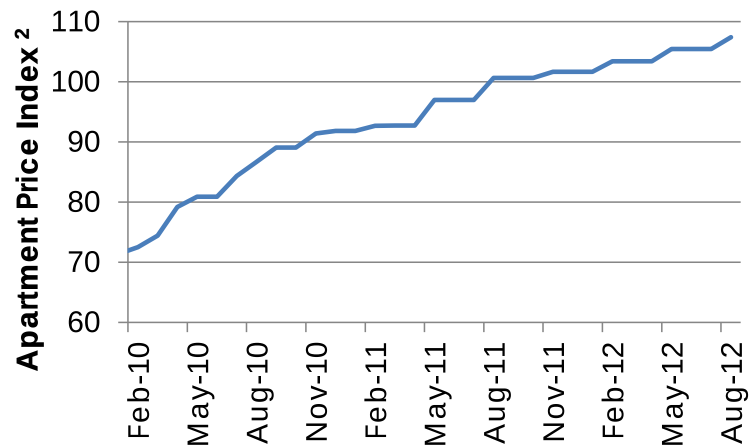
*Source: Company reports, Wall street research, Moody's Economy.com*
*(1) Essex Property Trust Fall 2012 management presentation*

# Aimco and BRE: Cheapest Since 2003

LANDandBUILDINGS

- **Aimco and BRE implied cap rates relative to BBB bond yields are the widest since 2003**
- The average of Aimco and BRE implied cap rates on current NOI is **281bps above BBB bond yields vs. historical average spread of 59bps**
- **Prices in private market continuing to rise**
  - Valuations have been stable to higher in 2012
  - NOI growth continues to be robust, further driving up apartment values
  - CBRE, the leading US commercial real estate broker, expects valuations to rise further[1]






*Source: LANDandBUILDINGs estimates , Wall street research, Company reports, CBRE Group*
*Note: Graph depicts average implied cap rate of AIV and BRE less BBB Yield*
*(1) Based on market by market broker commentary in "CBRE Cap Rate Survey, August 2012" (2) Green Street Advisors Commercial Property Price Index (Apartments)*

# Aimco: $40 Stock Trading at $25

| Fair Value | $40.00 |
|---|---|
| **Upside** | **61%** |
| Current Price | $25.50 |
| Market Cap | $3.7B |
| Implied Forward Cap Rate | 7.9% |
| AFFO CAGR '13 – '16 | 15% |
| Dividend Yield | 3.1% |

**Aimco (AIV):** National owner and operator of 344 apartment properties increasingly focused on high-barrier-to-entry coastal markets with large exposures to the Northeast US, Washington DC and California.

1) Aimco has ~60% upside to private market values: trading at a 7.9% forward implied cap rate vs. 6.2% private value

2) Strong same-store NOI growth of 5% - 7% annually likely over next several years

3) Repositioning strategy close to completion

Source: LANDandBUILDINGS estimates, Company reports

# Aimco: Strategic Turnaround Nearly Complete

LANDandBUILDINGS

## CEO finally gets it: "If you can't beat them, join them." – March 2012

- **Significantly improved portfolio quality**
  - Sold low-quality, low growth properties
    - Aimco has sold ~$7 billion of lower-rent, lower-growth properties since 2006
    - Committed to selling an additional $1 billion of lowest-quality properties (bottom ~10%) that will sell at a 7.0% cap rate or better (current NOI), a richer valuation than the entire company at 7.9% (forward NOI)
  - Sold asset & property management businesses
  - Reduced leverage to 8x debt to EBITDA, more in-line with REIT peers at 7x
- **Average rent per unit following portfolio repositioning: $1,400+[1]**
  - Well above the apartment sector average and up from ~$800 year-end 2005
  - Conventional portfolio will be ~70% coastal following repositioning
- **<u>Repositioning will lead to comparable valuation to its higher-valued REIT peers</u>**


*Source: LANDandBUILDINGS estimates, Company reports*
*(1) Average rent per unit at year-end 2012 following additional $1 billion in accelerated planned dispositions*

# Aimco Upside: 61%

LANDandBUILDINGS

- 61% upside[1] to forward NAV assuming a 6.2% warranted cap rate vs. 7.9% forward implied cap rate
  - A detailed review of Aimco's assets by market reveals significant under valuation
- AIV should post NOI growth of 5% - 7% annually next several years
  - Company's current heavier concentration on the coasts and benefit from improved revenue management system will allow for growth consistent with prior coastal apartment cycles
- Redevelopment to drive both earnings and NAV increases
  - Will spend approximately $150 million annually on major renovations at 200 basis point spread

| Aimco (AIV) NAV Analysis | Forward 12 Months |
|---|---|
| **Fair Value** | **$40** |
| *Current Price* | *$25.50* |
| **Total Return Potential** | **61%** |
| | |
| *Conventional NOI* | *$540,186* |
| *Applied Cap Rate* | *5.89%* |
| **Conventional Asset Value** | **$9,173,193** |
| | |
| Affordable NOI | *$79,615* |
| *Applied Cap Rate* | *8.50%* |
| **Affordable Asset Value** | **$936,646** |
| | |
| Cash | $566,474 |
| Redevelopment Assets/Value Creation | $428,010 |
| Other Assets | $371,834 |
| | |
| **Total Assets** | **$11,476,157** |
| | |
| Pro Rata Debt | ($4,765,136) |
| Other Liabilities | ($237,483) |
| Preferred Stock | ($366,216) |
| | |
| **Total Liabilities** | **($5,368,835)** |
| | |
| **Net Asset Value** | **$6,107,322** |
| Common Shares/OP Units Outstanding | 152,142 |


*Source: LANDandBUILDINGS estimates, Company reports (1) 57% upside to net asset value plus dividend yield of 3.1%*
*Notes: Estimated NOI in 12 months; Balance sheet data as of second quarter 2012; Cash balance includes retained cash flow in excess of dividend; Redevelopment assets/value creation includes book value of 3 vacant redevelopment assets and estimated profit in $450 million of redevelopment projects over 3 years; All numbers in thousands except per share and percentage figures*

# Aimco: Massive Discount to Private Market

LANDandBUILDINGS

- **AIV upside clearly illustrated when valued market by market using CBRE private market cap rate transaction and valuation data**

| Markets | Average Monthly Rent | # of Units | Occupancy | % Portfolio | Cap Rate |
|---|---|---|---|---|---|
| Southern CA | $1,813 | 8,144 | 95.8% | 18% | 4.75% |
| Washington DC-NoVA-MD | $1,440 | 7,851 | 96.4% | 14% | 6.00% |
| Florida | $1,169 | 8,971 | 95.6% | 13% | 5.75% |
| Sunbelt | $942 | 8,363 | 94.8% | 9% | 6.50% |
| Boston | $1,318 | 4,129 | 96.1% | 7% | 6.50% |
| Philadelphia | $1,472 | 3,888 | 94.7% | 7% | 6.25% |
| Chicago | $1,358 | 3,993 | 95.7% | 7% | 5.75% |
| Northern CA | $1,780 | 1,845 | 96.1% | 4% | 5.00% |
| Manhattan | $2,685 | 999 | n/a | 3% | 4.75% |
| Suburban NY-NJ | $1,387 | 1,162 | 97.1% | 2% | 6.25% |
| Seattle | $1,653 | 239 | 97.9% | 1% | 4.50% |
| Other | $960 | 11,729 | 94.9% | 14% | 7.00% |
| **Total Conventional** | **$1,290** | **61,313** | **95.5%** | **100.0%** | **5.89%** |
| | | | | | |
| Total Convention | | | | 88.0% | 5.89% |
| Total Affordable | | | | 12.0% | 8.50% |
| **Aimco Applied Average Cap Rate** | | | | **100.0%** | **6.20%** |
| | | | | | |
| *Aimco Implied Forward Cap Rate* | | | | | *7.90%* |

- In first half of 2012, AIV sold 8 non-core properties ($155 million) at a 6.6% cap rate
  - Average rent per unit was under $800, or about 55% of the rent of AIV's repositioned portfolio

LANDandBUILDINGS *Source: LANDandBUILDINGS estimates, Company reports*

*Notes: All figures as of second quarter 2012; Average monthly rent equals average monthly revenue per effective unit*

# BRE Properties: $70 Stock Trading at $46

LANDandBUILDINGS

| Fair Value | $70 |
|---|---|
| Upside | 54% |
| Current Price | $46.50 |
| Market Cap | $3.6B |
| Implied Forward Cap Rate | 6.4% |
| AFFO CAGR '13 – '16 | 12% |
| Dividend Yield | 3.3% |

**BRE Properties (BRE):** Owner, operator and developer of 79 apartment throughout the supply-constrained markets on the west coast, including San Francisco, Los Angeles, Orange County, San Diego and Seattle.

1) BRE has ~50% upside to private market values: trading at a 6.4% forward implied cap rate vs. 4.5% private value

2) West coast markets earlier in the recovery: same-store NOI accelerating and will be 6% – 8% for several years

3) M&A target if discounted valuation persists
   a) High-quality portfolios in high demand and rare in the private markets
   b) Financing plentiful for public and private buyers
   c) Tax-efficient structures available to address Prop 13 and capital gains taxes


*Source: LANDandBUILDINGS estimates, Company reports*

# BRE Properties Upside: 54%

LANDandBUILDINGS

- 54% upside[1] to forward NAV assuming a 4.5% warranted cap rate vs. 6.4% forward implied cap rate
- BRE will likely enjoy NOI growth of 6% – 8% annually over next several years
  - California is in initial 2 years of what has historically been a 4 to 7 year cycle of strong NOI growth
  - Newly implemented revenue management system will provide a boost to growth in the short-term and more robust revenue growth over the long-term
- Development to drive both earnings and NAV increases
  - 4 high-quality assets under construction and strong pipeline of future projects

| BRE Properties (BRE) NAV Analysis | Forward 12 Months |
|---|---|
| **Fair Value** | **$70** |
| *Current Price* | *$46.50* |
| **Total Return Potential** | **54%** |
| | |
| *Property NOI* | *$287,821* |
| *Applied Cap Rate* | *4.54%* |
| **Private Market Value of Properties** | **$6,336,388** |
| | |
| Share of JV Property NOI | *$5,125* |
| *Applied Cap Rate* | *6.00%* |
| **Private Market Value of JVs** | **$85,419** |
| | |
| Cash | $45,006 |
| Construction in Progress/Land | $459,100 |
| Development Value Creation | $205,638 |
| Other Assets | $54,645 |
| | |
| **Total Assets** | **$7,186,195** |
| | |
| Debt | ($1,683,481) |
| Other Liabilities | ($65,715) |
| Perpetual Preferred Stock | ($53,993) |
| | |
| **Total Liabilities** | **($1,803,189)** |
| | |
| **Net Asset Value** | **$5,383,006** |
| Common Shares/OP Units Outstanding | 76,796 |



*Source: LANDandBUILDINGS estimates, Company reports (1) 51% upside to net asset value plus dividend yield of 3.3%*
*Notes: Estimated NOI in 12 months; Balance sheet data as of second quarter 2012; Cash balance includes retained cash flow in excess of dividend; Development value creation reflects discounted development profit on active and identified projects; All numbers in thousands except per share and percentage figures*

# BRE Properties: Massive Discount to Private Market

LANDandBUILDINGS

- **BRE upside clearly illustrated when valued market by market using CBRE private market cap rate transaction and valuation data**

| Markets | Average Monthly Rent | # of Units | Occupancy | % Portfolio | Cap Rate |
|---|---|---|---|---|---|
| San Diego | $1,600 | 4,056 | 94.9% | 19% | 4.75% |
| Inland Empire | $1,475 | 1,173 | 94.2% | 5% | 5.25% |
| Orange County | $1,574 | 3,789 | 95.8% | 17% | 4.75% |
| San Francisco Bay Area | $1,933 | 4,197 | 95.3% | 24% | 4.25% |
| Los Angeles | $1,800 | 3,267 | 95.4% | 17% | 4.25% |
| Seattle | $1,356 | 3,456 | 96.0% | 14% | 4.25% |
| Non-core | $1,050 | 1,302 | n/a | 4% | 5.75% |
| **BRE Average/Total** | **$1,599** | **21,240** | **95.4%** | **100.0%** | **4.54%** |
| | | | | | |
| *BRE Implied Forward Cap Rate* | | | | | *6.40%* |


*Source: LANDandBUILDINGS estimates, Company reports*
*Notes: All figures as of second quarter 2012; Average monthly rent equals average monthly revenue per home*

# LANDandBUILDINGS Background

Jonathan Litt is the Founder and CEO of LANDandBUILDINGS, a long/short investment firm that actively invests in securities of global real estate and real estate related companies. Prior to LANDandBUILDINGS, Jonathan Litt was Managing Director and Senior Global Real Estate Strategist at Citigroup where he was responsible for Global Property Investment Strategy from 2000 to March 2008. Jonathan Litt led the #1 Institutional Investor All American Real Estate Research Team for 8 years and was top ranked for 13 years while at Citigroup, PaineWebber and Salomon Brothers. Craig Melcher, Co-Founder and Principal at LANDandBUILDINGS, was a key member of the Citigroup team. Land & Buildings Investment Management is a Registered Investment Adviser with the SEC.

# DISCLOSURES

LAND and BUILDINGS

*This report is for informational purposes only and should not be construed as investment advice. It is not a recommendation of, or an offer to sell or solicitation of an offer to buy, any particular security, strategy or investment product. Our research for this report is based on current public information that we consider reliable, but we do not represent that the research or the report is accurate or complete, and it should not be relied on as such. Land & Buildings Investment Management recognizes that there may be confidential information in the possession of the companies discussed in the presentation that could lead these companies to disagree with Land & Buildings' conclusions. The analyses provided may include certain statements, estimates and projections prepared with respect to, among other things, the historical and anticipated operating performance of the companies, access to capital markets and the values of assets and liabilities. Such statements, estimates, and projections reflect various assumptions by Land & Buildings concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies and have been included solely for illustrative purposes. No representations, express or implied, are made as to the accuracy or completeness of such statements, estimates or projections or with respect to any other materials herein. Actual results may vary materially from the estimates and projected results contained herein. Our views and opinions expressed in this report are current as of the date of this report and are subject to change. Past performance is not indicative of future results. Registration of an Investment Adviser does not imply any certain level of skill or training. Land & Buildings has received no compensation for the production of the research/presentation.*

*Funds managed by Land & Buildings Investment Management and its affiliates have invested in common stock of Aimco (NYSE: AIV) and BRE Properties. (NYSE: BRE). Land & Buildings manages funds that are in the business of trading – buying and selling – securities and financial instruments. It is possible that there will be developments in the future that cause Land & Buildings to change its position regarding Aimco or BRE Properties. Land & Buildings may buy, sell, cover or otherwise change the form of its investment for any reason. Land & Buildings hereby disclaims any duty to provide any updates or changes to the analyses contained here including, without limitation, the manner or type of any Land & Buildings investment.*