

Resmark Apartment Living

You can't be a little bit disciplined

A Special Forces officer's insights on risk in an evolving real estate cycle



Ziv Cohen is the president of Resmark Apartment Living, the multifamily division of The Resmark Companies, and is responsible for

the operations and strategy for the platform. He has more than 20 years of real estate experience and has been involved in the origination, financing and development of over 15,000 residential units in the United States and Israel. Under his direction since 2011, Resmark's multifamily division has developed approximately 5,000 units through joint venture and direct investments. Prior to joining Resmark, Cohen was a member of Fieldstone Communities' management team. Before arriving in the United States, he served as an operations manager for Peled Residential Construction in Israel and as a major in the Israeli Defense Forces.

CORPORATE OVERVIEW

Founded in 1995, Resmark is a fully integrated real estate investment group. The Resmark Companies' divisions — Resmark Land and Housing, Resmark Apartment Living, and Resmark Impact Ventures — finance, acquire, develop and manage real estate in California, the Western United States, the D.C./Mid-Atlantic region, Texas and other select major metropolitan markets nationwide. To date, Resmark has participated in more than 200 investments encompassing approximately 30,000 single-family and multifamily residential units, and has committed in excess of \$3 billion of capital. Headquartered in Los Angeles, Resmark also maintains offices in San Diego and Irvine, California, and McLean, Virginia.

"We must all hang together, or most assuredly we shall all hang separately." It's a battlefield axiom attributed to Benjamin Franklin that parallels a Hebrew turn of phrase that was one of my mantras when I served as a company commander in the Israeli Defense Forces. For six years, I led elite infantry men in war zones embroiled in constant uncertainty, risk and potential crisis. Living in this type of environment conditions you and your team to maintain extreme discipline, yet be nimble, adaptive, creative and resourceful — as a group and as individuals.

Three decades later, I continue to utilize the tools of my training when assessing developing market conditions and changing risk characteristics. This is most pertinent in today's environment when ensuring the defensive elements of our investment strategy are in place for a potential market turn.

Multifamily development in the United States has proven to be an extremely rewarding sector for the past six years. The fallout of the Great Recession, coupled with sizable demographic shifts favoring rental living, has resulted in significant rent growth, strong occupancy gains and record property values. It has prompted the entire industry to deliberate about its duration or, quite possibly, a new permanence.

While demand fundamentals are expected to remain strong for the foreseeable future, recent headwinds have been observed consisting of (i) moderating rent and occupancy growth, (ii) overbuilding in select gateway markets,

(iii) thinner institutional demand for stabilized Class A multifamily assets, (iv) increasing construction costs, (v) overheated land pricing expectations, (vi) rising interest rates and (vii) economic policy uncertainty under the new administration.

Operating within these unpredictable market conditions, one must be very selective and disciplined in underwriting multifamily development investments and insist on:

- A "development spread" of +/- 150 bps between the spot cap rate and the untrended development yield
- An "exit cap spread" 75 to 100 bps between the spot cap rate and the projected exit cap rate upon stabilization and sale
- Modest rent growth assumptions
- Prudent hard cost escalation projection
- Prudent interest rate assumptions and projected rate increases for construction loans and permanent financing

I recall the legendary Sergeant Major Isaac Tayto of Bahad 1, the Israeli equivalent of West Point, who instilled in us that "Discipline is indivisible and absolute." You can't choose to be a little disciplined. It starts with small things like proper bed assembly, shoe shining, morning shave, clean uniform and routine gear inspection for readiness, and translates into maximum productivity at minimal time and cost. There are no shortcuts, and it requires intense discipline. With discipline, hard

training leads to easy battles — that’s a conviction in every military training facility I have ever stepped foot in.

When conservatively and prudently underwritten, multifamily development opportunities still provide for superior risk-adjusted returns within the multifamily space, when measured against core, core-plus and value-add alternatives, as well as in comparison with other commercial real estate categories. While we maintain a positive outlook for multifamily development and, as such, remain very active in this space, I instill in my team at Resmark to always expect the unexpected. On patrol or on a mission, my military team never turned a corner uncovered and never contemplated only one exit strategy. We maintained maximum flexibility to address what might await at “the other side of the hill.” This is the same approach we take to investing on behalf of our institutional partners.

Since early 2016, commercial banks have made credit less readily available for multifamily development. Credit contraction is observed through lower loan-to-cost (LTC) sizing, higher rate pricing and more stringent sponsorship requirements, which favor existing clients. Commercial banks’ conservatism is applauded. Will it continue in 2017? If so, it will extend the multifamily development cycle and help it reach a new equilibrium with limited undesired erraticism.

We anticipate the following scenario continuing to play out in the near term:

- Limited availability of construction debt will lead to consummation of fewer development projects
 - > Leading to fewer multifamily starts and, ultimately, resulting in

healthy reductions of multifamily supply in select gateway markets

- Land values will likely adjust downward, and construction labor costs are likely to moderate or at least flatten

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- Equity investors are likely to fill the debt void with additional equity while seeking higher return requirements
 - > Leading to a repricing of development opportunities and driving market conditions towards a new equilibrium

As a combat operative, I participated in regular briefings in which risk-reward relationship, cost-benefit analysis and opportunity cost were incorporated into planning and execution. Not unlike the anticipated scenario outlined above, these briefings would occur in real time, up until minutes from departure from our home base into the unknown. The Resmark team applies similar real-time analysis to every investment we evaluate, from underwriting through to execution.

Looking to the second half of 2017 and beyond, the pipeline of attractive development opportunities has already become more robust and will increase

as developers, investors and land owners continue to adjust to a more conservative lending environment and the changing market dynamics. Investment success in the years ahead will rise and fall based on the talent that an

organization recruits, and the cumulative quality of the team to truly “all hang together” to be equipped to handle a crisis management situation. I attribute Resmark’s continued access to quality pipeline to the reputation that we have earned over the past 22 years. It’s a company-wide understanding that discipline truly is indivisible — and it’s a belief that empowers our team in the face of uncertainty and risk as we advance to the other side of the hill.

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