Finding Opportunities in U.S. Multi-Family
Achieving Returns in a Maturing Market

While there are many facts and statistics available to support the view that the current US economic growth cycle is exceptional and will continue at its current pace for the foreseeable future, all cycles eventually mature, leading to a moderation in growth. Attempting to “time the market” is not an advisable investment strategy as it involves more luck than skill and investors cannot afford to sit on the sidelines with uninvested capital. So how can investors in a mature market earn attractive returns while protecting themselves from the risk of a possible downturn? Below examines how Starlight Investments achieves both objectives in the U.S. Multifamily sector by narrowing our investment focus and maintaining an innovative and rigorous asset management program.

Where Are We in the Cycle?

Ten Consecutive Years of Economic Expansion

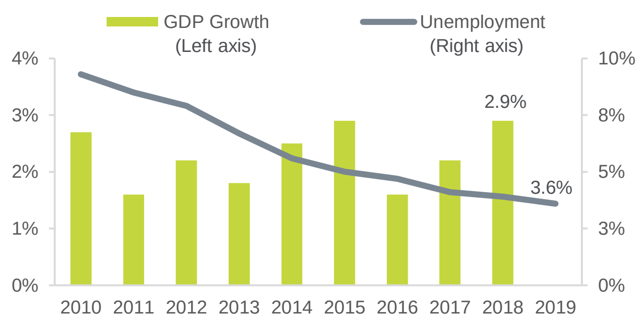
Before explaining where to go next, it is helpful to review where we are now and how we got here. Since the Global Financial Crisis of 2009 (“GFC”), the United States (“US”) has undergone a significant transformation, deleveraging balance sheets to reduce risk, investing capital to expand productivity, and reducing taxes to enhance competitiveness. These and many other initiatives have created the longest period of consecutive growth in US history, which now exceeds ten years. The second longest period of economic expansion was after the 1990 recession and lasted for a total of ten years.

This remarkable economic expansion has led to the creation of more than 15 million new jobs, record low unemployment levels and growing inflation, which in turn have led businesses and individuals to relocate from high-cost, high-barrier-to-entry gateway cities to attractive second-tier cities, primarily in the southern and western United States. Many second-tier cities now have lower unemployment and faster labour-force growth than gateway cities such as New York City.

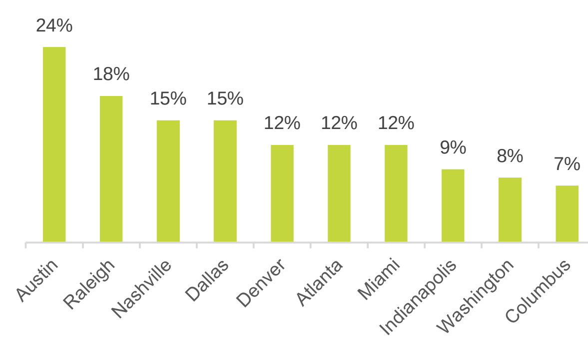
> ***“Moving our Headquarters to Nashville allows us to offer advantages to our employees that we simply couldn’t in the NY metro area.”,***
> ***Seth Bernstein, President/CEO, Alliance Bernstein***

This economic run has also led to increased demand for multi-family assets, raising pricing levels and attracting both new development and institutional capital. Capitalization rates for multi-family assets across the US have fallen by 80 basis points compared to pre-GFC levels, while total inventory has increased by 1.5 million units or 15% during the same time period[1] .

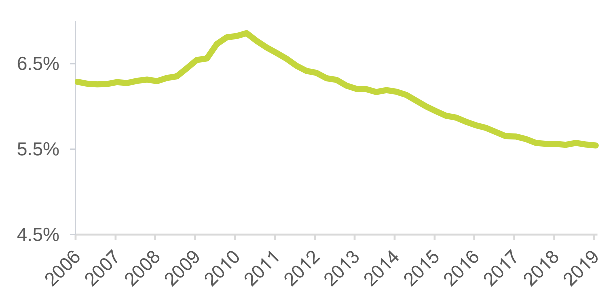
Continuous Gross Domestic Product Growth and Unemployment Rate at a 17-Year Low



Tier-2 Cities Dominate Labour Growth (‘10-’18)



Multi-Family Capitalization Rates at All-Time Lows



Source: US Bureau of Economic Analysis; US Bureau of Labor Statistics; Real Capital Analytics

[1] Source: Real Capital Analytics and REIS

Navigating a Maturing Economic Cycle

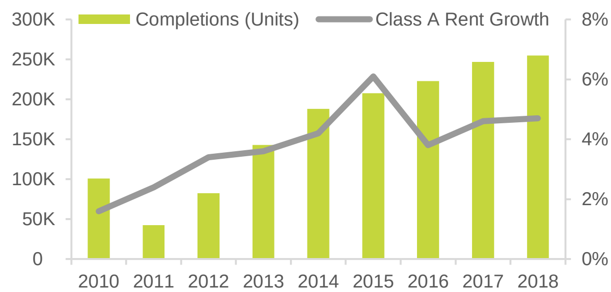
Multi-family is more resilient compared to other real estate asset classes[1] and the sector has become a favourite of institutional investors due to its defensive qualities. However, achieving superior returns in a maturing market, requires a rigorous, multi-faceted approach that leverages your core competencies and includes creative investment and asset management solutions with a clear view and strategy on risk mitigation. At Starlight, our approach begins with our investment thesis and a thoughtful perspective on market selection.

> ***"Skate to where the puck is going not where its been", Wayne Gretzky, Former Professional Hockey Player***

We focus on identifying changing market dynamics and getting ahead of opportunities as they present themselves. As demand drivers remain uniformly strong across markets in the Southern and Western United States, the variable that is most affecting rental growth is new supply. In many markets however, the volume of development activity has led to a dramatic increase in construction costs, making development returns relatively unattractive. As future projects are delayed or cancelled, rents in these markets will naturally rise. Therefore, to find value at this stage of the cycle, ***Starlight is focusing on markets where we can buy properties at (or close to) replacement cost[2]***

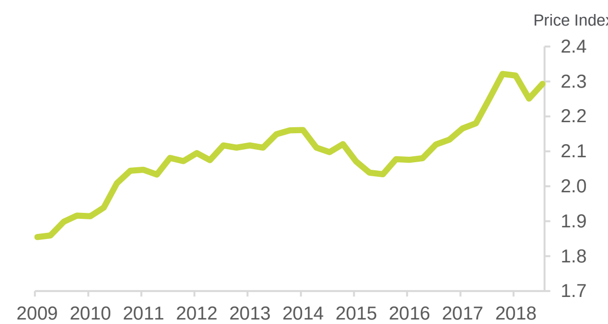
After identifying market opportunities, the next step is to identify assets that consistently outperform their competitors. Starlight seeks well-located and constructed, high-quality assets that are differentiated from their competitors by features including: walkability, proximity to retail and employment, unique amenities, high visibility, healthy demographics and strong barriers to entry with clear potential for rent growth. However, competition for these assets later in the economic cycle often remains exceptionally high and to avoid the "winners curse" of overpaying, investors must find new ways to access opportunities based on their own expertise.

New Development Moderating Rent Growth



Source: REIS

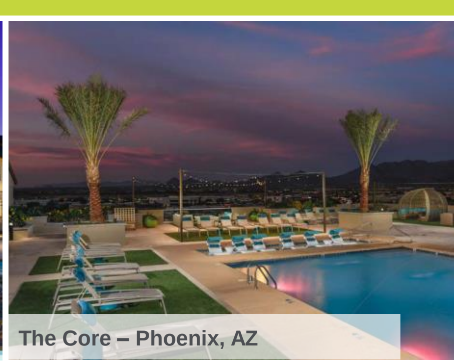
Rising Multi-Family Construction Costs

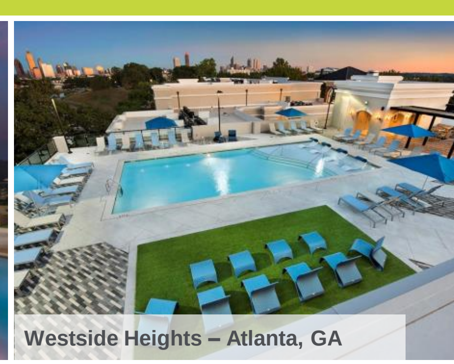


Source: Producer Price Index for Inputs to Residential Construction; US Bureau of Labor Statistics

Given Starlight's strong track record of underwriting and executing lease-up opportunities, one approach that has been utilized is to acquire newly-constructed, but pre-stabilized, properties directly from merchant developers. This has provided Starlight with more control over asset selection, while providing an efficient exit for the developers. Controlling lease-up of these properties also provides Starlight with the ability to qualify tenants and manage lease expiry profiles, reducing future leasing risk.

Illustrative Properties With Unique Characteristics





[1] CBRE research from February 2019 found that U.S. multifamily property rents declined less than those of office and industrial properties during the 2001 economic recession (+70-1100 bps) and their growth rate was significantly higher post-recession (+430-570 bps)

[2] "Replacement cost" is defined as the current cost to develop a comparable property, including the fair market value of land.

Maximizing Returns Through a Rigorous Asset Management Approach

The second component of achieving attractive returns in a maturing market is a rigorous asset management program focused on maximizing value and strengthening the quality of cash flows.

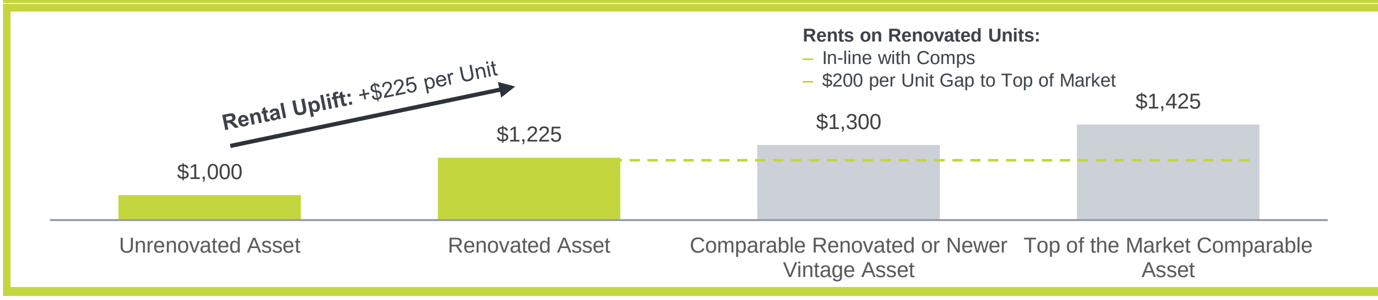
Generating Additional Ancillary Income

While newer properties already feature a rich array of amenities, there is often significant unmet demand for additional services amongst tenants. Starlight's asset management program aims to provide a full-service experience for tenants. The implementation of customized services, results in a higher lease renewal rate, strong rent growth and additional ancillary income.

Maximizing Rents by Upgrading the Asset

Older vintage properties in strong locations offer even greater upside potential with a high degree of visibility. For these assets, Starlight seeks to upgrade the quality of the property by renovating common areas and amenities, as well as interior units, resulting in significant rental increases while maintaining a meaningful discount to new construction rents in the submarket, providing downside risk protection.

Illustrative Example of Value Creation



Attracting and retaining high-quality, long-term tenants is also important at this stage of the cycle. Not only are these tenant less likely to leave in the event of a downturn, but they require far fewer concessions and lease units at higher average rates, compared to new tenants. Maintaining high occupancy and retention levels has become a key focus for Starlight's asset management group.

In summary, while opportunities may be more be difficult to identify and risks may be heightened in a maturing market, skilled investors and operators can continue to generate attractive returns, without moving significantly up the risk spectrum.

About Starlight Investments

Starlight Investments is a privately held Toronto-based, full service, multi-family and commercial real estate investment and asset management company driven by an experienced team of over 200 professionals. The company currently manages over $11.0 billion of direct real estate as well as real estate investment securities. Investment vehicles include institutional joint ventures, True North Commercial REIT, Starlight U.S. Multi-Family Funds and Starlight Capital Funds. Starlight Investment's portfolio consists of approximately 36,000 multi-residential units across Canada and the U.S. and over 6.2 million square feet of commercial properties. Please visit us at www.starlightinvest.com and connect with us on LinkedIn at www.linkedin.com/company/starlight-investments-ltd-

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