WOP RESEARCH TEAM: *THE INFLATION SERIES*

THE ECONOMIC RESILIENCY OF CLASS A

January 2023

- *The outsized inflation that occurred in the 1970s and early 1980s can inform us on the potential risks and outcomes today associated with job skills and housing market conditions.*
- *Multifamily rents increased 7%-12% each year from 1974 to 1985[1] – today's housing and economic conditions resemble those of the 1970s and 1980s.*
- *Demand for Class A multifamily housing is supported by renters with a high degree of economic resiliency during inflationary periods.*
- *The Class A renter demographic is primarily comprised of renters-by-choice, and the low inventory of single-family homes and increasing mortgage rates are keeping many potential buyers renting today.*

The demographic-driven need for housing supports ongoing investment in multifamily, and the strong risk-adjusted returns of these investments can be attributed to the economic resiliency of the Class A resident. There is a great deal of uncertainty in the economy today, given the high level of inflation, capital markets disruption stemming from the Federal Reserve's efforts to combat inflation, and geopolitical tensions. History suggests superior performance during inflationary periods can be found in goods and services catering to the high-income, higher-skilled demographic. Class A multifamily housing serves the renter-by-choice demographic that typically has a deeper, more valuable skillset than the renter-by-necessity group of Class B and Class C renters. Demand for Class A multifamily is supported by the high cost of home purchases today due to low inventory and increasing mortgage rates. This edition of WOP Insights will dive into historical data to better understand the benefits of investing in Class A multifamily communities during inflationary periods.

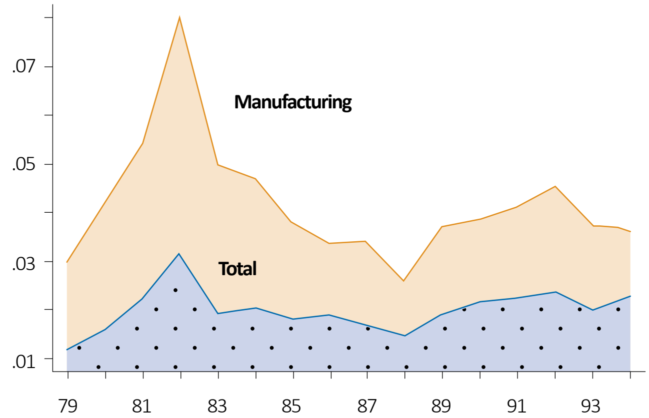
RESILIENT INCOMES OF SKILLED WORKERS

Throughout the last period of outsized inflation in the 1970s and early 1980s, white-collar, higher-skilled workers were less economically impacted than blue-collar, lower-skilled workers. In fact, unemployment levels of blue-collar workers in the early 1980s were 3x higher than white-collar workers.[2] This same discrepancy in skill-related job loss was also experienced during the pandemic, as many of the higher-skilled employees could work from home, while the lower-skilled made up a significant portion of the 13% unemployment rate in 2021.[3] The key differences between the higher-skilled and lower-skilled workforces are detailed in the table below.

During historical periods of high inflation, industries employing higher-skilled workers could withstand economic turbulence and retain employees more than those employing lower-skilled workers. High inflation in the 1970s rose throughout the decade and exceeded 14% in 1980.[4] Consequently, all occupations experienced job loss as the national unemployment rate hit 10.8% in 1982.[5] However, white-collar unemployment only reached 5.4%, while unemployment among blue-collar workers peaked at 16.1%.[6] This stark difference in the impact of high inflation on various skill levels illustrates the resiliency of income for different demographics.

The following graphics provide additional perspectives on the economic resiliency of different demographics.

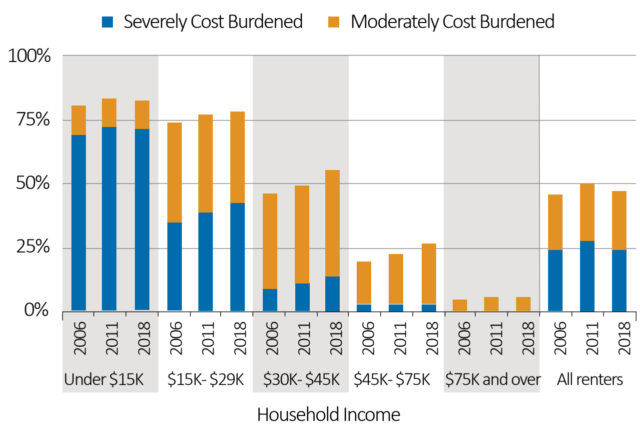
HIGHER-SKILLED / WHITE-COLLAR WORKERS	LOWER-SKILLED / BLUE-COLLAR WORKERS
Renter-by-choice	Renter-by-necessity
Stable employment in high paying, recession resistant industries	Cyclical employment in less resilient, lower paying industries
Requires special training/higher educational attainment	Requires fewer specialized skills/lower educational attainment
Harder to replace labor due to higher skill set	Labor can be easily replaced due to lower skill set
Lower unemployment levels and job displacement	Higher levels of unemployment and job displacement
Employed in service-producing industries e.g., finance, medical, legal, education, business, and technology	Employed in goods-producing industries e.g., mining, construction, manufacturing, machinery, textile, and automotive
Jobs are more resilient to automation and offshoring	Jobs are often subjected to automation and offshoring
COVID prompted a shift to remote work with minimal disruption	COVID led to mass job losses due to the “in-person” nature of many jobs
Tend to have higher rates of household formation	Tend to have lower rates of household formation
Not as likely to be cost-burdened renters	More likely to be cost-burdened renters



MANUFACTURING VS. TOTAL JOB DISPLACEMENT RATES FROM 1979-1994

Increased global trade and high inflation of the late 1970s and early 1980s led to the offshoring of many blue-collar jobs – the closing of manufacturing plants resulted in disproportionately higher rates of displaced manufacturing workers compared to all displaced workers.

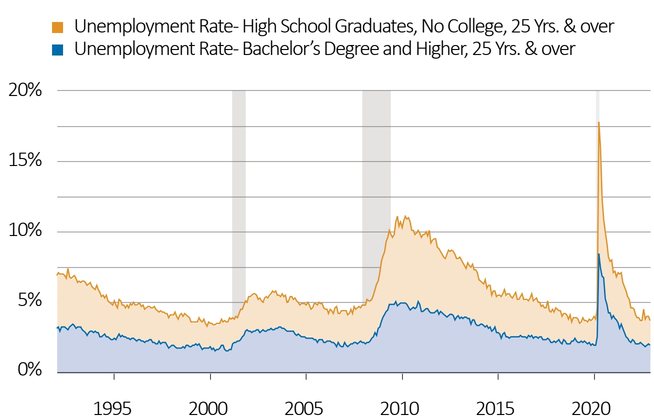
Source: Author's calculations from the 1984-86 Displaced Worker Surveys.



HISTORICAL COST BURDENS BY INCOMES FOR RENTER HOUSEHOLDS

Class A renters tend to have higher incomes and are, therefore, less likely to be cost-burdened, allowing them to absorb higher rents. White Oak Partners' Class A properties have a median household income of more than $75,000.

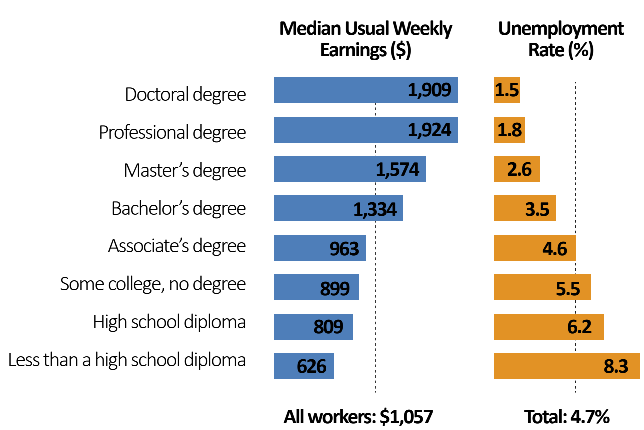
Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates.



HISTORICAL UNEMPLOYMENT RATES BY EDUCATIONAL ATTAINMENT

The unemployment levels of those with a "Bachelor's Degree and Higher" are consistently lower than the "High School Graduates, No College" demographic, indicating those with higher levels of educational attainment are more economically resilient as they are able to maintain employment.

Source: U.S. Bureau of Labor Statistics, FRED.



MEDIAN WEEKLY EARNINGS AND UNEMPLOYMENT RATES BY EDUCATIONAL ATTAINMENT, 2021

During the pandemic, those with higher levels of educational attainment experienced higher median weekly earnings and lower rates of unemployment than those with lower levels of educational attainment. This indicates that higher educational attainment, a trait often found in white-collar employment, provides job security.

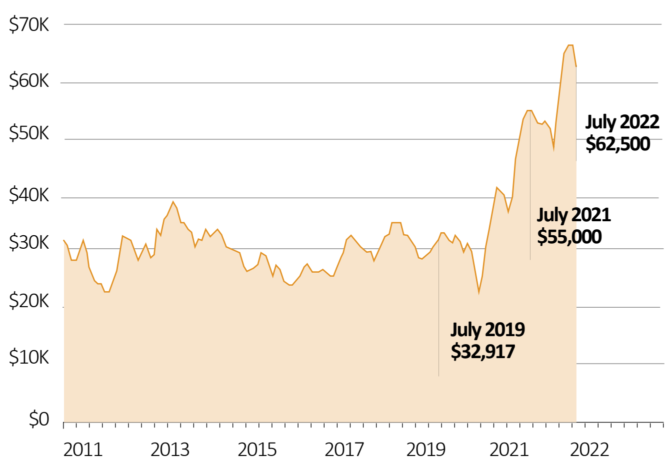
Note: Data are for persons age 25 and over. Earnings are for full-time wage and salary workers.

Source: U.S. Bureau of Labor Statistics, Current Population Survey.

NOT A GREAT TIME TO BUY A HOUSE

The similarities between today and the previous period of outsized inflation can also be seen in the for-sale housing market. The large demographic-driven need for housing, combined with high inflation and the undersupply of single-family homes, fosters an increasing demand for multifamily units. In the 1970s, population growth, baby boomer household formation, and high mortgage rates, resulted in a record number of multifamily units built.[7] Similarly, Millennials today are facing high inflation, high mortgage rates, an undersupply of housing,[8] and an increased down payment requirement that is almost $30,000 higher than the median down payment in 2019.[9] (Figure below) These factors have sidelined many potential homebuyers who, by all other accounts, are renters-by-choice. As prospective homebuyers wait for the housing market to cool, they tend to extend their tenure as renters while taking advantage of the fact that today's average monthly rent payment is more than $1,000 cheaper than the average monthly mortgage payment.[10]

Median Down Payment for U.S. Homebuyers, in Dollars



We can look to the past to understand the impact that higher-than-average inflation has on property performance. Broadly speaking, rental occupancy rates tend to move in parallel with the Consumer Price Index (CPI), indicating that during periods of high inflation, renters remain in place. This feature allows investors to capture a consistent stream of rental income. From 1974 to 1985, rents increased 7%-12% each year.[11] Today's housing and economic conditions echo the 1970s and 1980s, suggesting that the high inflation we are seeing today will be accompanied by strong rental growth.

CONCLUSION

As inflation gives rise to rent growth, investors in Class A multifamily communities can capitalize on the steady inflow of rental income. During times of high inflation and economic turbulence, higher-skilled workers have proven resilient due to their transferable skill sets and educational attainment. These workers make up the low-risk, financially stable Class A renters-by-choice demographic that can absorb rental growth, given they qualify for leases at 5x rent-to-income.[12] As buying a home continues to be a challenge for many, the suburban amenities found at Class A multifamily communities, which includes highly rated schools and low crime rates, will continue to increase in importance. As such, Class A renters appear poised to drive demand for suburban Class A communities in the foreseeable future.

Sources:

1. *RealPage Analytics*
2. *U.S. Bureau of Labor Statistics*
3. *U.S. Bureau of Labor Statistics*
4. *Federal Reserve History*
5. *U.S. Bureau of Labor Statistics*
6. *U.S. Bureau of Labor Statistics*
7. *FRED | St. Louis Fed*
8. *Institutional RE, Inc*
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10. *Marcus & Millichap*
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12. *RealPage Analytics*

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