COVID-19 Speeds Up Home Buying Decisions

Health Pandemic Serves as Catalyst to Purchase Home / Relocate

Bottom Line:

The COVID-19 outbreak is a once-in-a-generation event. It shut down global economies, limited social gatherings, and made people think about cleanliness in a new way. It forced people to step back, look at the big picture, and evaluate their future plans. COVID-19 makes urban living a vulnerability (e.g. crowded public transit, dense living). The uncertainty moves up the timeline for leaving the city and finding a higher quality of life for one's family.

Over the next few years, the U.S. is likely to experience a migration. The size of the shift remains unknown, but surveys and Google searches indicate individuals are already considering a lifestyle change. With interest rates at historic lows, COVID-19 could be the catalyst to release pent up millennial home demand. Home builders, mortgage insurers, and rental homes / apartments in second tier cities could all benefit from a COVID-19 migration.

Main Points:

► **COVID-19 Outbreak Changes Life Priorities**

- 1/3 of Harris Poll respondents aged 18-49 are open to moving from a densely populated area to a more rural area.
- Google searches for "mortgage lender" and "land for sale" are spiking.

► **Pent Up Millennial Demand & Low Mortgage Rates**

- Millennials are delaying home purchases, resulting in pent up demand.
- Historically low mortgage rates make home ownership more affordable, especially for first time homebuyers.

► **Entry Level Home Builders, Mortgage Insurers, & Rental Homes Benefit**

- Home builders (entry level focus), mortgage insurers (>20% down payments), and rental homes (inability to purchase home) could see increased demand.

► **Surging Unemployment & Tight Lending Standards Represent Key Risks**

- Rising unemployment and concerns about future job prospects tend to cause housing sales to drop.
- First time homebuyers disproportionately impacted by tighter lending standards.

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Audio Link
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Trade Details

Trade Type
U.S. Equities / Homebuilding Stocks

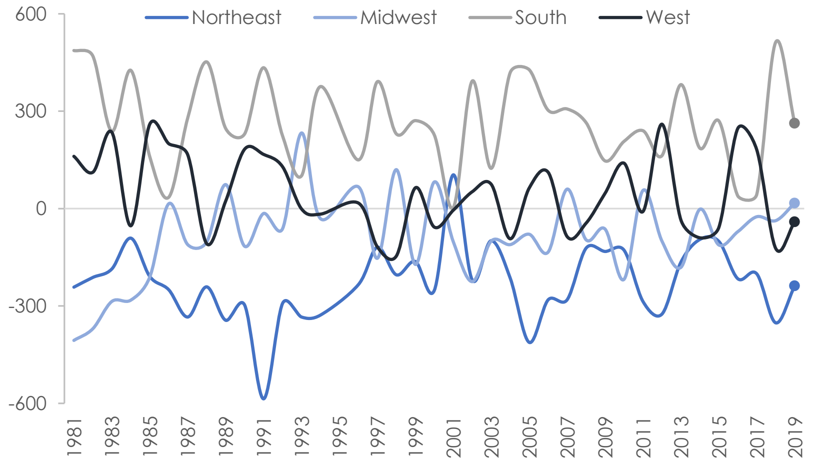
Trade ID
USEQ.2020-05

Ticker(s)
CCS, DHI, FOR, KBH, LEN, LGIH, MHO, MTH, NVR, PHM, MTG, NMIH, RDN, CPT, INVH, MAA, UDR, ESNT, AMH

Benchmark
Blended: Cons Discretionary (50%), Financials (25%), Real Estate (25%)

COVID-19 Changes Life Priorities

Figure 1: Net U.S. Migration by Region (1981-2019)



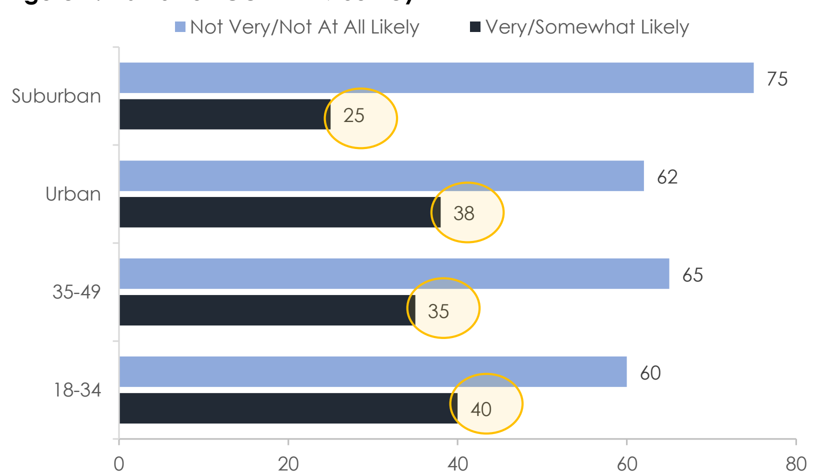
Source: MarketDesk Research, U.S. Census Bureau

U.S. Migration Data Highlights Regional Divergence…

- Figure 1 charts annual U.S. internal migration trends (e.g. excluding immigration) since 1981. It shows a clear migration divergence forming over the past 40 years before the COVID-19 outbreak.

- The Northeast (high cost) and Midwest (manufacturing job loss) regions both experienced net out-migration, while the South and West regions both experienced net in-migration. COVID-19 could strengthen the regional migration trend out of the densely populated Northeast to the South and West.

Figure 2: Harris Poll COVID-19 Survey



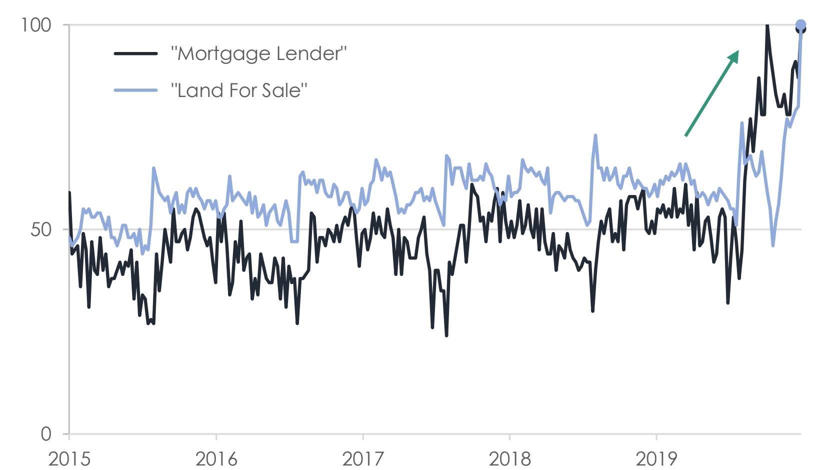
Source: MarketDesk Research, The Harris Poll

COVID-19 Outbreak Allows Individuals to Re-Evaluate Big Life Decisions…

- Figure 2 graphs the results of a Harris Poll survey that asked: How likely are you to move out of densely populated areas and toward rural areas once the pandemic ends? The top two bar sets correspond to where respondents live (e.g. urban vs suburban). The bottom two bar sets correspond to the 18-34 and 35-49 age groups.

- Big events, such as the COVID-19 outbreak, force individuals to step back and look at their lives. The survey results indicate an openness to moving out of densely populated areas.

Figure 3: Google Trends Key Words Related to Moving



Source: MarketDesk Research, Google Trends

Google Trends Demonstrate Moving Intent Amid COVID-19 Outbreak…

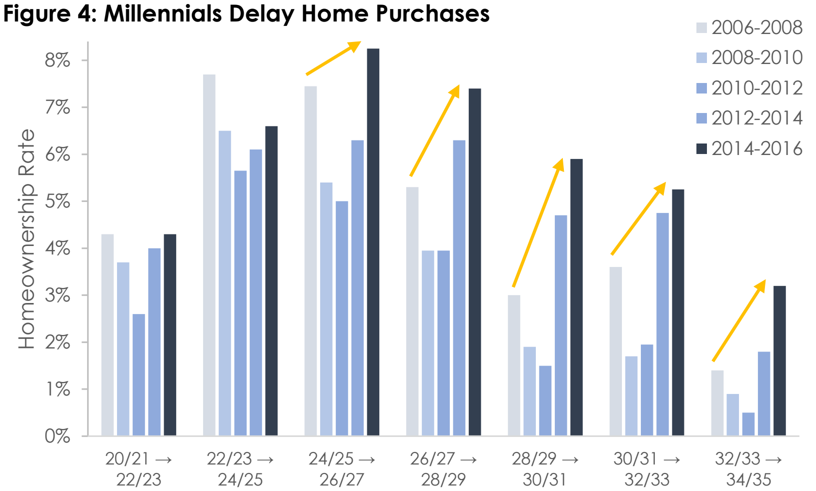
- Figure 3 charts Google Trends data for two key phrases related to moving: "mortgage lender" and "land for sale". The numbers represent search interest over time relative to the highest point, with a value of 100 indicating peak search popularity for the term.

- Combined with the Harris Poll survey, the Google Trends search data demonstrate an intent to consider moving as a result of the COVID-19 outbreak.

- Most of the respondents and searchers may never act on their views, but even a 25% follow through would represent a seismic population shift.

Pent Up Millennial Demand & Low Mortgage Rates

Figure 4: Millennials Delay Home Purchases



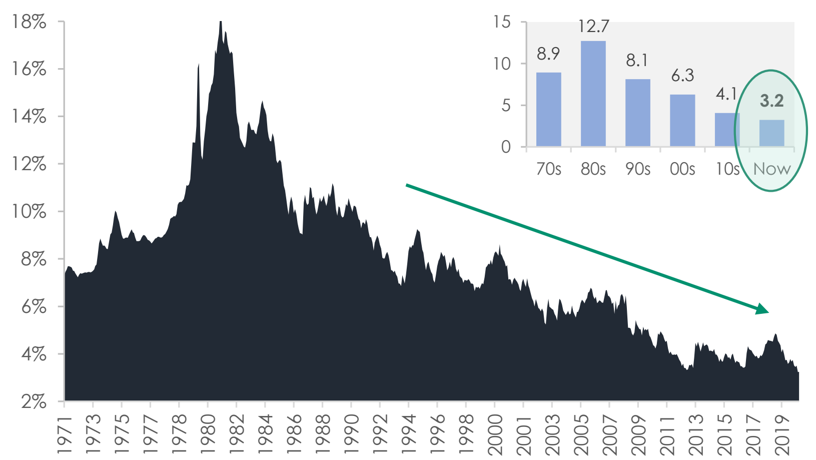
Source: MarketDesk Research, U.S. Census Bureau, American Community Survey

Millennials Represent Pent Up Home Buying Demand…

- Figure 4 graphs the incremental growth in home ownership rate by age group across different points in time. Instead of comparing each age group's total home ownership, it tracks the increase in home ownership as individuals transition into new age groups.

- More recent data (e.g. 2012-2016) peaks later than historical data (e.g. 2006-2012). In other words, today's generation is delaying home purchases to later stages in life. This represents a significant amount of pent up demand.

Figure 5: 30-Year Fixed Mortgage Rate at Generational Low



Source: MarketDesk Research, Macrotrends

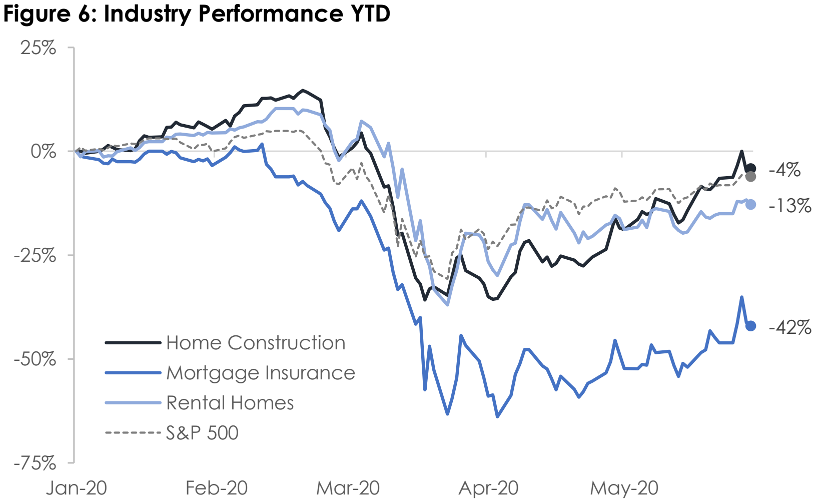
Record Low Mortgage Rates Make Home Ownership More Affordable…

- Figure 5 charts the 30-year fixed mortgage rate over the past 50 years. It now sits at a multi-decade low after peaking in the second half of 1981.

- Home prices trended higher the past few years as the economic recovery strengthened and inventory shortages created bidding wars.

- If COVID-19 serves as a catalyst for first time homebuyers and city dwellers to move, low mortgage rates could make it achievable.

Figure 6: Industry Performance YTD



Source: MarketDesk Research

COVID-19 Migration Stock Baskets Underperform to Start 2020…

- Figure 6 tracks the YTD performance for three impacted groups: home construction, mortgage insurance, and rental homes against the S&P 500.

- The opportunity is to invest in COVID-19 migration related names. In our view, the COVID-19 outbreak will release pent up first time homebuyer demand. Interest rates will make home ownership more affordable and enable first time homebuyers to purchase.

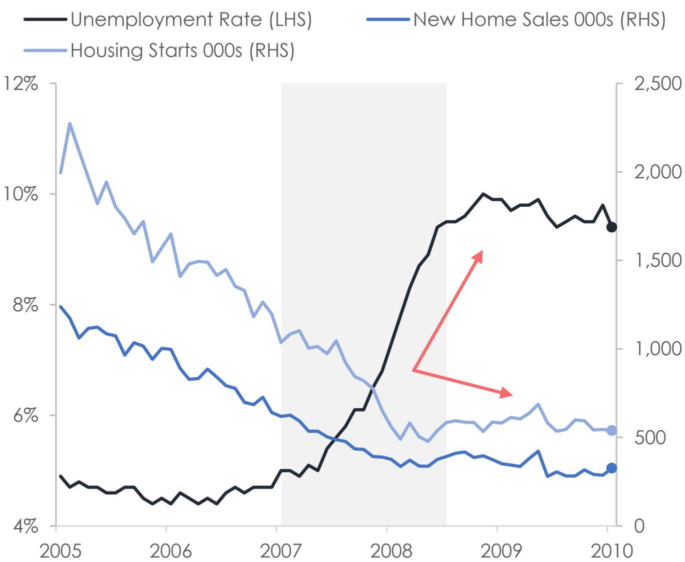
- Refer to the "*Trade Implementation*" discussion on page 4 for the impacted industries.

Key Risks: Housing Market Tied to Economic Recovery

There are two risks to the COVID-19 migration investment thesis. The U.S. housing market is heavily influenced by employment levels, mortgage rates, and loan underwriting standards.

#1 Surging Unemployment: More than 38 million individuals filed for unemployment benefits since March due to the COVID-19 outbreak. The U.S. unemployment rate currently sits at 14.7% as of April 2020, but it is likely headed higher in the coming months. There is a high probability all of the lost jobs will not return, which could cause unemployment to remain elevated for more than a year.

Figure 7: Unemployment vs Housing Sales (2005-2010)



Source: MarketDesk Research, U.S. Bureau of Labor Statistics, National Association of Realtors

Purchasing a home represents one of the biggest life decisions and expenses individuals can make. Figure 7 shows the connection between unemployment and home sales from 2006-2010. Surging unemployment and weak economic growth make individuals more hesitant to purchase homes. It becomes more difficult for buyers to make mortgage payments and renters to make rent payments. The end result is lower housing demand and fewer individuals with the financial ability to make a down payment.

#2 Tightening Lending Standards: First time homebuyers tend to be the riskiest borrowers. They are earlier in their careers, which means less savings for a down payment, and more likely to have lower credit scores. They also tend to be recent graduates with college student debt. Some work non-traditional jobs as freelancers, which makes it more difficult to show proof of stable income.

Banks are tightening lending standards during the COVID-19 outbreak in an effort to lower loan risk. First time homebuyers, which are most likely to live in densely populated areas and consider moving, will likely be disproportionately impacted by tightened lending standards. As a result, entry level homebuilders could experience falling demand.

Trade Implementation: Targeted First Time Homebuyer Exposure

The COVID-19 migration investment theme impacts three industries: home construction, mortgage insurance, and rental homes / apartments. There are three home builder focused ETFs: XHB, ITB, and PKB. Each of the ETFs captures home builders with varying exposure, but they also capture home ecosystem stocks (e.g. building products, specialty chemicals, furnishing stores). As a result, we prefer to implement the investment via single name stocks. Refer to page 5 for a full list of tickers within each category.

#1 Homebuilders Focused on First Time Buyer: First time homebuyers are the most likely to purchase homes in our view. Younger individuals tend to live in more densely populated areas, which means the COVID-19 outbreak disproportionately impacted them. They are also more likely to have growing families with young children. Affordability issues due to an entry level home shortage prevented first time homebuyers from purchasing. Now, the COVID-19 outbreak may provide the catalyst to purchase a home, and low mortgage rates may make it more affordable.

Home builders with a focus outside of the Northeast in second tier cities, such as Raleigh, Nashville, and Columbus, OH, could see increased demand from first time homebuyers.

#2 Mortgage Insurers: Homebuyers making a down payment of less than 20% of the property value are required to take out private mortgage insurance. If the mix of homebuyers is more heavily weighted to first time buyers, mortgage insurers will write more policies and earn higher premiums.

Mortgage insurers sold off significantly during the COVID-19 outbreak. Rising unemployment and federal programs allowing loan forbearance create the potential for mortgage defaults. However, the sell-off is overdone in our view. While forbearance technically means a borrower is in default, it is not considered a default requiring mortgage insurers to payout. Even though mortgage defaults are likely to rise in the coming months, we do not think they will rise to 2008 levels. Mortgage insurers are better capitalized today and have significantly improved their underwriting standards (e.g. loan to value, credit scores, full vs reduced documentation).

#3 Rental Homes and Apartments with a Second Tier City Focus: For those individuals without the required down payment that are intent on moving, rental homes and apartments are a viable option. Similar to home construction, we prefer to focus outside of the major cities.

Company Tear Sheet

Figure 8: Impacted Companies

Ticker	Company	YTD Return	Notes / Rationale
Home Construction			
CCS	Century Communities	5.9%	Mountain state & Southeast focused; 44% of 1Q20 LTM deliveries below $250,000
DHI	D.R. Horton	6.7%	Broad geographic footprint; 67% of home closed below $300,000
FOR	Forestar Group	-27.5%	Residential lot developer; Early stage housing indicator
KBH	KB Home	-1.0%	Utilizes "build-to-order" model; West Coast & Southwest focused; 57% first time buyers
LEN	Lennar Corporation	8.9%	Largest U.S. homebuilder by revenue; Primarily East & West Coast focused
LGIH	LGI Homes	17.5%	Central & Southeast focused; Low average sales price for homes ($239,000)
MHO	M/I Homes	-15.5%	Midwest & Southeast/Texas focused; 2019 average sales price of $384,000
MTH	Meritage Homes	17.3%	Focused on entry & first move up buyers; West Coast, Texas, & Southeast focused
NVR	NVR	-15.5%	Eastern state & Washington D.C. focused; Does not engage in land development
PHM	PulteGroup	-11.2%	West Coast, Florida, & Southeast focused; 45% of closing above $400,000 price point
Mortgage Insurer			
ESNT	Essent Group	-36.4%	Strong return on equity; 92% of insurance in force with reinsurance protection
MTG	MGIC Investment	-41.2%	Slower revenue growth; ~12% exposure to policies written prior to 2008
NMIH	NMI Holdings	-53.4%	Strong revenue growth, but higher risk level if claims are high
RDN	Radian Group	-38.1%	Slower revenue growth; Lower valuation than NMIH & ESNT
Rental Homes / Apartments			
AMH	American Homes 4 Rent	-5.4%	~52,500 single family homes across 22 states
CPT	Camden Property	-14.1%	Multifamily rentals; Top cities: DC (16.5%), Houston (11.4%), Atlanta (8.6%), LA (8.1%)
INVH	Invitation Homes	-13.0%	80,000 single family homes across 16 states; ~70% of revenue from West and Florida
MAA	Mid-America Apartment	-11.8%	Multifamily rentals focused on Sun Belt; Dallas (13.2%), Atlanta (12.2%), Charlotte (7%)
UDR	UDR	-19.3%	Multifamily rentals; Urban/suburban mix: 40%/60%; West Coast (42%), Northeast (21%)

Source: MarketDesk Research. ***Note*** *a blended benchmark across three sectors will be used for this tactical opportunity. 50% Consumer Discretionary (i.e. Home Construction), 25% Financials (i.e. Mortgage Insurers) and 25% Real Estate (i.e. Rental Homes).*

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