

# Ground-Up Development in 2022

3 Reasons Why Now is the Right Time  
to Explore Ground-Up Development

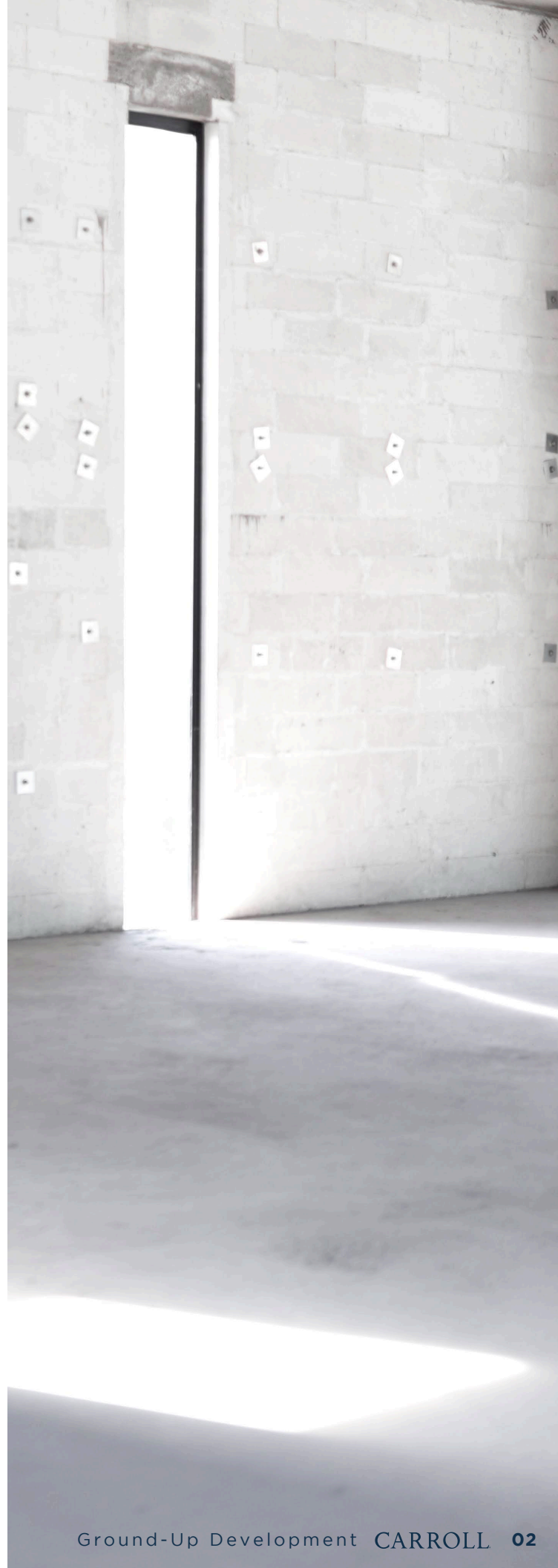


CARROLL<sup>®</sup>

# Introduction

The U.S. is facing a housing shortage. The past two years have seen a rare blend of record-low interest rates, increased demand for space and single-family product, and a supply line that has been decimated by global issues. Housing inventory was at a [25-year low](#) through the beginning of 2022, even with the median home price rising to \$425,000. At this point, many Americans would normally turn to multifamily to ride out a hot market and save for a larger down payment, but vacancy rates at multifamily communities are [trending at lows](#) not seen since the early 1980s – meaning options are limited across the board. All factors considered, is now a good time to explore ground-up development? In short, yes.

With today's housing fundamentals, some real estate companies may have an opportunity to pivot their operations to include ground-up development. CARROLL, for example, as a vertically integrated company, is primed to benefit from its business structure by seizing the opportunity to launch ground-up development as an addition to its investment platform. This expansion will provide CARROLL with complete control over new assets and enhance our ability to meet market-specific demands, while still maintaining access to established MSAs through existing assets.



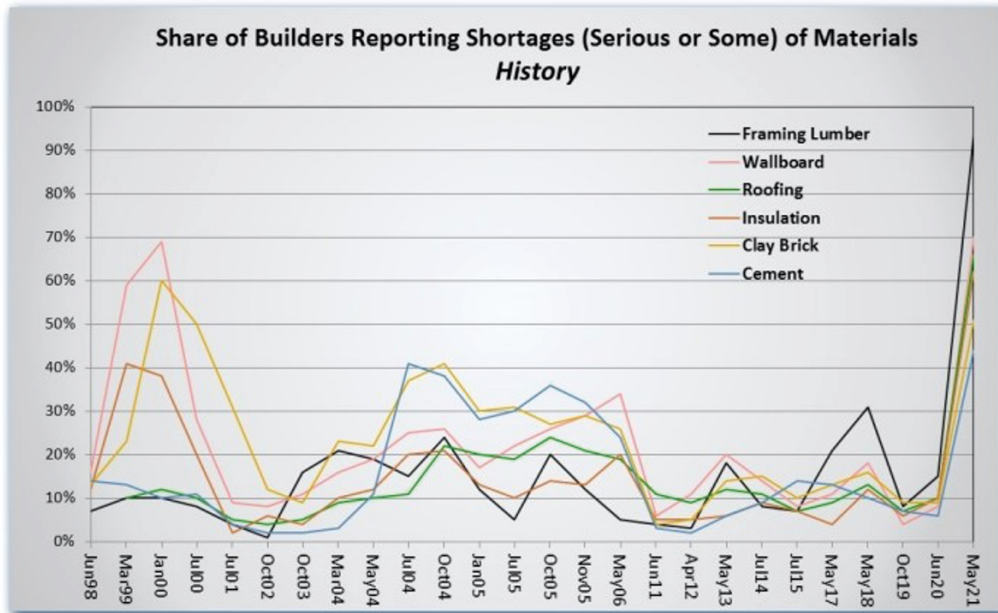
# 01

## Development creates much-needed inventory for a constrained housing supply.

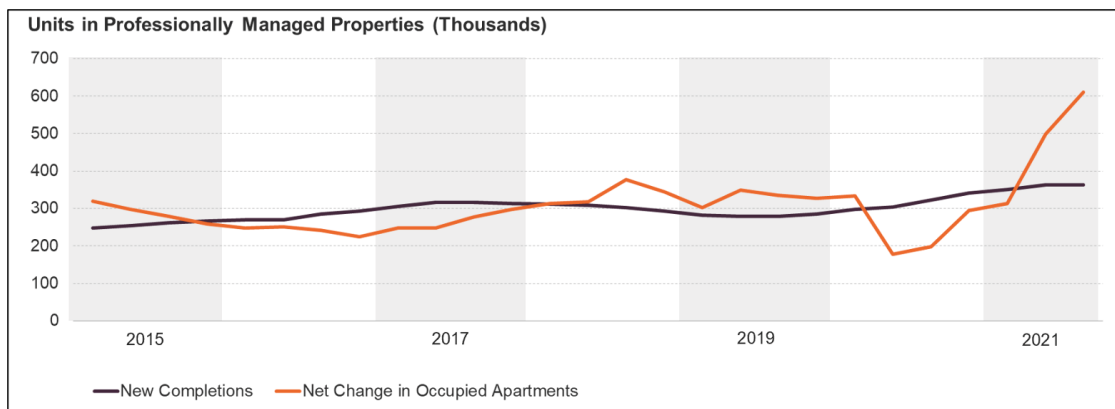
While a strained housing supply is not the sole indicator for timing ground-up development, it is a major KPI when assessing market conditions. The housing shortage in the U.S. has been years in the making, with some experts claiming the market never fully recovered from the collapse of 2008. With that in mind, pointing to the COVID-19 pandemic as the catalyst for recent housing trends might have validity at a high level, but it is the cumulative impact of multiple factors that appears to be the bigger issue.

Prior to the pandemic, the industry was already playing catch up to keep pace with the housing demand in all sectors. Millennials and Gen Z were entering the fold, bringing an array of needs that spanned from multifamily communities in a busy business district to single-family starts in suburban areas. This full-spectrum demand already had developers on the defensive, forcing strategic planning in hopes of predicting the biggest long-term growth. In addition, supply lines were being threatened by diminishing trade relationships and increased pressure from tightening environmental regulations. Then, along came COVID-19. All of those mounting challenges were suddenly amplified with the restrictions and uncertainty related to a global pandemic.

To illustrate COVID-19's extreme impact on just material shortages, the National Association of Home Builders plotted the history of materials crucial for development from 1998 to 2021. As the chart indicates, the shortages seen in May 2021 were unprecedented, but the baseline had been on the rise since 2012.



These supply constraints are not exclusive to single-family homes, either. Tabulation of RealPage data by the Joint Center for Housing Studies of Harvard University (JCHS) demonstrates how rental demand far outpaced new supply growth in 2021.



These ongoing challenges have been well documented by both endemic and non-endemic sources, so is there a way to overcome them? For the right firm, this could actually be the perfect scenario for expansion.



# 02

## Development adds diversity to a company's investment strategy by providing a new and dynamic avenue for growth.

Taking the housing shortage and market conditions into consideration, ground-up development represents an integral opportunity for a company to strategically expand its capabilities. This expansion includes more than product portfolio growth, it includes the ability to offer investors new ways to engage, and can provide a firm with access to fast-growing secondary and tertiary markets through both build and buy channels.

At CARROLL, we have spent years cultivating an investment strategy that has led to acquisitions in high-growth markets. As the success of those markets becomes more obvious to others, there is increased competition for existing assets. The addition of ground-up development affords us the option to stay competitive in our target markets, even as prices increase and supply dwindles for existing inventory.

Beyond basic access to a market, ground-up development provides control and flexibility over the design and construction of an asset. Having more control over the composition and build often translates to better quality and value for both renters and owners when compared to purchasing an existing asset. It creates opportunities for a company to adjust to market demands, which can in turn lead to a more suitable product for the market – representing the potential for broader access to housing.



This flexibility over the design and construction of a multifamily asset is a notable advantage in today's charge for ESG-friendly practices. [A recent report from Deloitte](#) points out, ESG is here to stay and “will increasingly shape and influence real estate valuation, and therefore real estate investment, as investors wish to allocate their commitments under this banner.”

Multifamily housing is, by its very nature, a more efficient use of space in comparison to single-family homes. Vertical builds utilize less square footage of usable land than houses, and can reduce energy consumption through shared walls, pipes, and infrastructure. Shared utility metering and monitoring also helps to detect inefficiencies, leaks, and other issues that may arise, and provides insight into consumption trends and opportunities for improvement. Constructing more sustainable buildings benefits not just the environment, but it can benefit investors who are increasingly focused on supporting sustainable solutions. By entering the ground-up development space, CARROLL will be able to continue seeking financial returns while expanding its ESG initiatives by mitigating environmental risks.

# 03

## Depending on market conditions, the cost of ground-up development can be lower than purchasing an existing asset.

As the recent rise in interest rates continues to parallel escalating home prices beyond the reach of many would-be purchasers, the flight toward rental products is likely to increase. While some portion of the existing owned-home inventory may be leased by investors or relocators – and additional lifespan might be given to existing rental home inventory through value-add propositions – this only amounts to a minor shuffling and cycling of inventory in comparison to the replacement void that must be filled by new, ground-up development.

From an investor's standpoint, being able to build a new asset for less than buying an existing asset could be a more opportunistic source of capital because the returns on the sale of the property tend to be higher on the risk/reward spectrum. The underwriting on new development below replacement cost, and not in direct competition with the aggressive purchasing of existing assets, allows for more of a cap-rate spread that naturally makes the product worth more at the exit – even if the rent growth were to remain constant between the two.

Metropolitan Statistical Area	Multifamily Permits: Mar-22 (Units #YTD, NSA)
New York-Newark-Jersey City, NY-NJ-PA	13,660
Dallas-Fort Worth-Arlington, TX	7,395
Austin-Round Rock, TX	5,439
Seattle-Tacoma-Bellevue, WA	5,140
Houston-The Woodlands-Sugar Land, TX	5,127
Washington-Arlington-Alexandria, DC-VA-MD-WV	4,387
Minneapolis-St. Paul-Bloomington, MN-WI	3,983
Phoenix-Mesa-Scottsdale, AZ	3,889
Atlanta-Sandy Springs-Roswell, GA	3,787
Denver-Aurora-Lakewood, CO	3,768

While there may not be a way to solve the challenges that come with the inevitable cycles in the economy, making smart investments in products that can best withstand the effects can help reduce the associated risks. CARROLL’s current focus is to pursue conservative, lower basis development opportunities that satisfy a wider range of customers versus highly speculative products that might not be as sustainable if rents or values start to decline. Keeping with our acquisition strategy, we remain bullish on the Sun Belt region for our development approach.

[Data released from NAHB](#) in mid-May 2022 shows the top 10 MSAs that issued the highest number of multifamily permits, and more than half were issued by states in the Sun Belt. Even though cap rates are set by the market (thus susceptible to change as market conditions change), one way for businesses like CARROLL to maintain some control is by being strategic in adding supply where this is clear demand.





# Conclusion

Entering ground-up development may not be feasible for all organizations. Launching a new vertical in an established business strategy will always come with challenges. And correctly identifying timing while facing a volatile market can create a separate layer of issues. As the U.S. housing market continues to ride an ever-changing trend, ensuring access to target markets should be at the core of every investment strategy.

Beyond the access, development provides firms with more control over the property's construction, which can have downstream impacts on the long-term attractiveness of an asset and can be a major driver of measurable ESG initiatives and a positive step toward a more sustainable future.

For CARROLL, the benefits of entering the ground-up development space at this time are significant. This investment, even in the face of supply issues and rising costs, will enable our company to remain competitive in an increasingly crowded industry that continues to show strong fundamentals.

# About CARROLL

CARROLL, a privately held real estate company, was founded in 2004. With headquarters in Atlanta, Ga., and regional offices in Dallas-Fort Worth, Raleigh, Denver, Tampa, and New York CARROLL focuses on multifamily communities, including acquisitions, property and asset management services, ground-up development and fund management. The Firm has raised more than \$4.3 billion of equity through CARROLL-sponsored funds and joint ventures. CARROLL has successfully purchased, developed, or sold more than \$19.6 billion in real estate.

The company manages more than 32,257 multifamily units across nine states representing \$8.3 billion in assets under management and has purchased other multifamily owner/operators throughout the U.S. CARROLL has also developed student housing, single-family residential, and retail communities, and has managed more than \$500 million in construction projects throughout the past 10 years. From due diligence to execution, CARROLL has the internal capabilities and the external relationships to identify, underwrite, and close transactions. For more information, visit [carrollorg.com](http://carrollorg.com).



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