



Q1 2019 SINGLE-FAMILY RENTAL INVESTMENT TRENDS REPORT



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CHATTER
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INSTITUTIONAL CAPITAL SOURCES ARE JUMPING OFF THE SIDELINES AND INTO THE SUBURBS

OVERVIEW

The market for single-family rentals (SFRs)¹ in the United States has seen transformational change in recent years. Multifamily properties have traditionally been a more accessible risk-adjusted return for real estate investors looking to build a portfolio of income-producing assets.

Higher per-unit acquisition costs and difficulties associated with managing and maintaining dispersed properties have limited both institutional penetration into the SFR sector and any semblance of market scale.

Underpriced single-family assets following the financial crisis, technological advancements boosting operating efficiencies and a budding investor pipeline are all contributing to increased interest in SFR investment. Institutional capital sources are beginning to jump off the sidelines and into the suburbs.

In the aftermath of the housing crisis, the supply and demand balance for single-family homes tilted off center. An abundance of vacant homes sat on bank balance sheets as potential would-be homeowners lost the credit standing needed to qualify for mortgages.

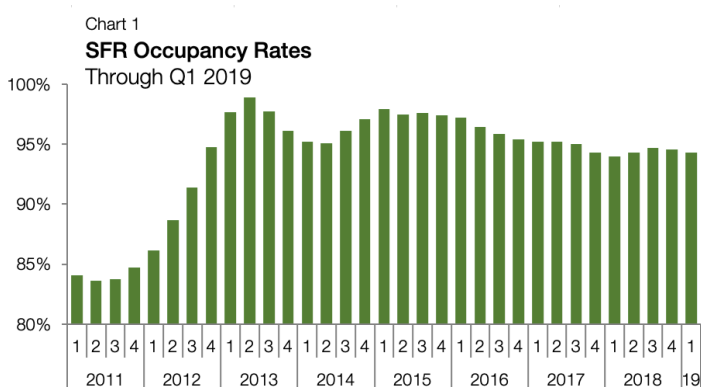
Investors with foresight and capital backing took advantage of this buying opportunity and began to amass large portfolios of distressed single-family properties. After this period of rapid buying activity and before home prices rebounded to the point where they could be re-sold at a profit, investors turned to a rental strategy to generate property income while weathering the storm. In hindsight, this was the emergence of SFR as a true investment asset class.

PERFORMANCE METRICS

Occupancy

Based on Chandan Economics' model estimates, occupancy rates on transacted SFRs have pushed up from the low-mid-80s in the recovery's early days, to a stable range in the mid-90s in the years since. This secular rise in part reflects the housing market's recovery. As single-family homes found pricing equilibrium, a lower number of vacant properties sold at discounts.

The runup in occupancy may also be a result of new listing services meant entirely for SFRs. These new platforms circumvent the necessity to sell vacant homes through traditional multiple listing services geared toward owner-occupants. Occupancy rates on transacted SFRs averaged 94.3% in the first quarter of 2019, down 20 basis points (bps) from the previous quarter (*Chart 1*).



Cap Rates

Within multifamily, asset prices are a function of the surrounding cap rate environment. For SFRs, the reverse seems to be true. SFRs exist in the context of a broader market for owner-occupied single-family homes. According to the FHFA's All Transaction Home Price Index, property prices are continuing to rise, but they are starting to do so at a slowing rate.

¹We define SFR for the purpose of performance metrics as properties containing less than five units. For the purpose of SFR construction starts, we consider only one-unit properties.

Cap rates on SFRs peaked at 11.1%, as home prices bottomed out in 2012. In the years since, cap rates have settled between 6.2% and 7.6%, with a marked lack of volatility. Through the first quarter of 2019, SFR cap rates stood at 6.4%, down 26 bps from the previous quarter and down 105 bps from a year earlier (*Chart 2*).

Loan-to-Value

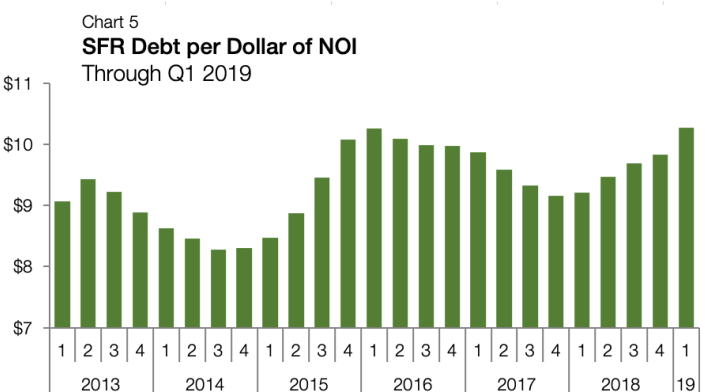
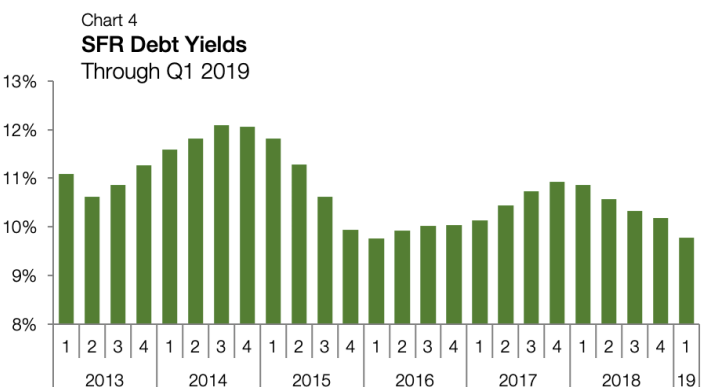
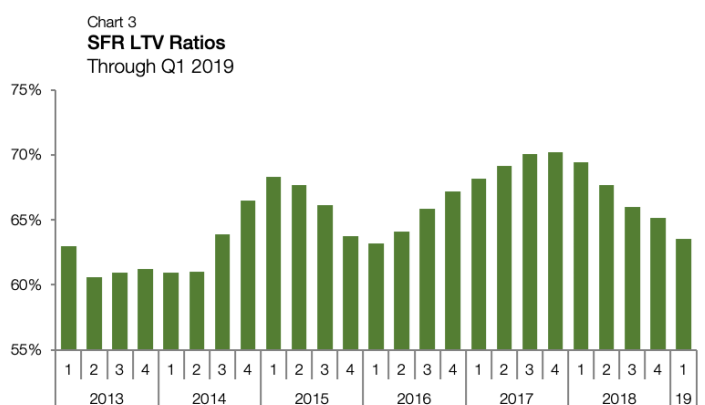
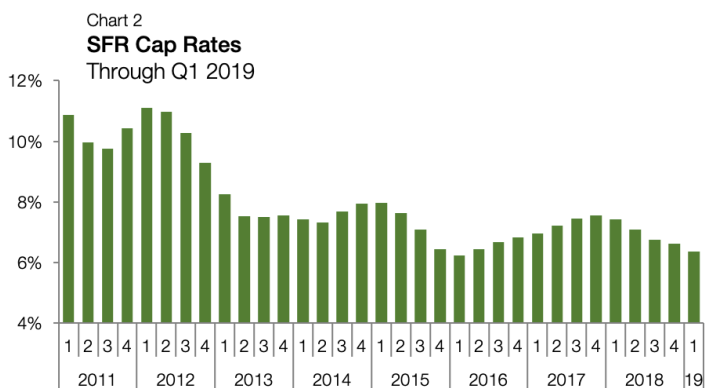
Loan-to-value ratios (LTVs) on SFR mortgages rose from their 2013-low of 60.6%, up to a post-recession high of 70.2% in late-2017. Despite an improvement in the economy's underlying performance, concerns over business cycle timing have re-emerged.

These concerns have translated to conservative underwriting on SFR mortgages. Since early 2018, LTVs have steadily fallen. Through the first quarter of 2019, LTVs on SFR properties averaged 63.6%, down from 69.4% this time last year (*Chart 3*).

Debt Yields

For over a year, caution in underwriting has contrasted with greater investor risk-tolerance. Debt yields have fallen for five consecutive quarters, nestling down to 9.8% through the first three months of 2019, the lowest measure on record as part of Chandan Economics' model estimates (*Chart 4*). The inverse of debt yields, debt encumbrance per dollar of net operating income (NOI), jumped to \$10.27, up \$0.44 from fourth-quarter 2018 (*Chart 5*).

In addition to shifts in investor behavior, these trends are also a likely result of the SFR sector's evolving profile. New technologies, lending products and marketplaces are allowing SFRs to operate more similarly to multifamily, fueling investors' operational confidence.



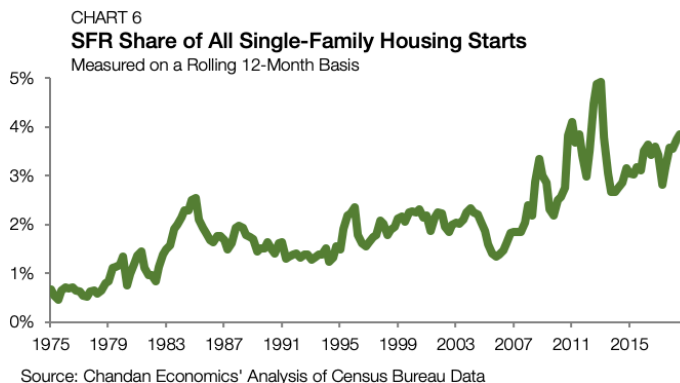
BUILD TO RENT

SFR Share of Single-Family Starts

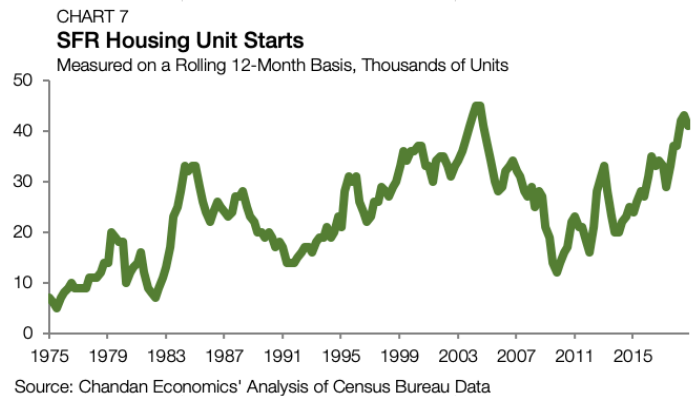
The SFR market's formalization and supportive demographic trends have created a need for a supply pipeline independent of existing property conversions. Build-to-rent SFRs have always existed, but they were far from conventional.

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Based on an analysis of U.S. Census Bureau data, between 1975 and the start of the recession in 2007, SFRs accounted for a little less than 1.6% of all single-family construction. In the years since, the SFR share of single-family starts has soared. In 2013, SFR construction share approached 5%, and today it remains elevated at 3.8% (*Chart 6*).



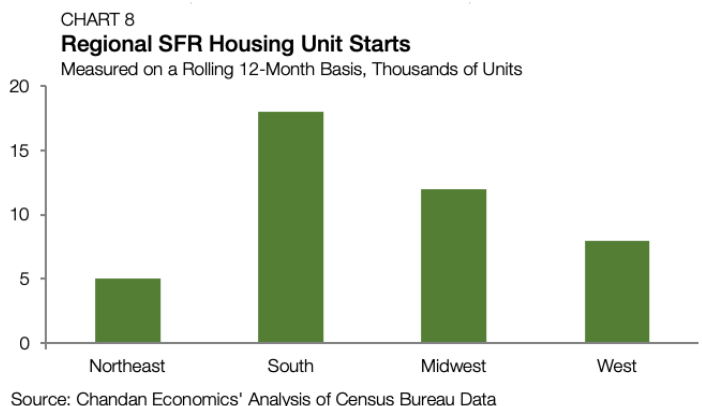
The 12-month rolling total of SFR construction starts through the fourth quarter of 2018 measured 41,000 units, down 2,000 from the post-recession high set in third-quarter 2018 (*Chart 7*). Furthermore, the 12-month total is brushing up to the pre-recession high of 45,000 units.



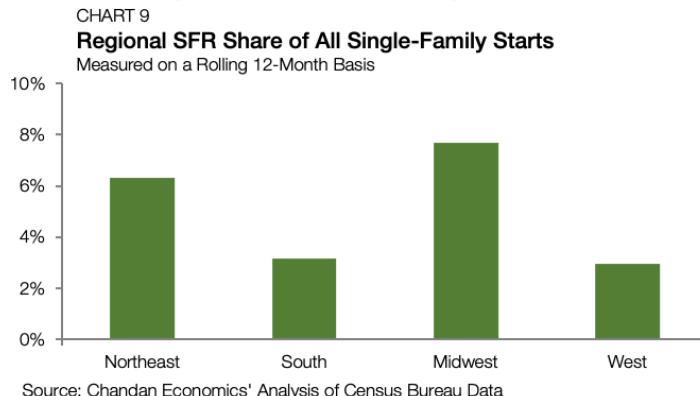
The pace of improvement for SFR construction has far outpaced the broader single-family market. Presently, SFR starts have recovered more than 90% of the ground lost from the housing crisis, while single-family starts less-SFR starts have made up less than 50%.

SFR Starts by Region

Analyzing SFR starts regionally, the South had overwhelmingly seen the highest levels of construction activity in the 12-months ending December 2018. The 18,000 SFR starts in the South accounted for 42% of the national total (*Chart 8*). The next most-active SFR construction region, the Midwest, measured 12,000 starts through 2018, while the West and Northeast totaled 8,000 and 5,000, respectively.



Taking these SFR starts within the context of each region's broader construction activity, however, tells a bit of a different story. While the Northeast had the lowest absolute number of SFR starts, its SFR construction share of all single-family housing starts notched up to 6.3%, second to only the Midwest's 7.7% (*Chart 9*). Both the Southern and Western regions stood considerably lower, at 3.3% and 3.0%, respectively.



OUTLOOK

On balance, the SFR market should continue to leap forward in 2019. The maturation of the Millennial cohort should bolster an increase in overall single-family housing demand. Primary mortgage underwriting standards remain tight by historical standards. The SFR market stands to benefit from absorbing the excess demand of forming families that cannot yet make the jump into ownership.

The introduction of new SFR lending products, and a growing filtering process between bespoke investors and institutional property managers, are improving the commodification and liquidity of the SFR market as a whole.

While attention to growing economic concerns is warranted, and asset price growth would invariably slow down in a recessionary period, operating income would likely strengthen, all else being equal. SFR is an asset class well-positioned to withstand variations in the business cycle and should continue to perform favorably over the medium- to long-term. ■

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