ARBOR

Q3 2021

Single-Family Rental Investment Trends Report

Topics

- State of the Market
- Performance Metrics
- Supply & Demand Conditions
- Outlook

Cap Rates Reach New Lows as Rents Continue to Soar

Key Findings

- Cap rates dipped to 5.5% in third-quarter 2021, hitting a new all-time low
- Vacant-to-occupied (V2O) rent growth reached a record high of 17.1% in July
- Occupancy rates edged down to 95.0% in the third quarter, just 30 basis points off their generational high

State of the Market

The single-family rental (SFR) sector performed well through the third quarter of 2021, with most indicators reflecting a healthy inflow of investment capital and tenant demand.

Heading into the pandemic, the sector was already rapidly professionalizing, leading to a more efficient management process and allowing institutional managers to scale operations. Further, the SFR product type continues to satisfy a significant market need. Would-be first-time homebuyers are often attracted to single-family rentals, as they offer access to suburban single-family homes without the need to make a sizable down payment. According to a Realtor.com analysis, the available supply of U.S. starter homes is less than half of what it was five years ago.

Today, the SFR market is firing on all cylinders. More than $30 billion of institutional capital has been allocated for SFR (including development) since the beginning of 2020, as record-setting rent growth continues to attract new investors to the sector. Many signs point to continued growth for the SFR market going forward.

Performance Metrics

Originations

According to a Chandan Economics analysis of [Fannie Mae]() data, refinancing rather than acquiring has accounted for the majority of recent originations to single-family investors. In 2020, refinancing activity accounted for 71.0% of tracked originations. Through the second quarter of 2021, the refinancing share was even higher, reaching up to 75.9% *(Chart 1)*.

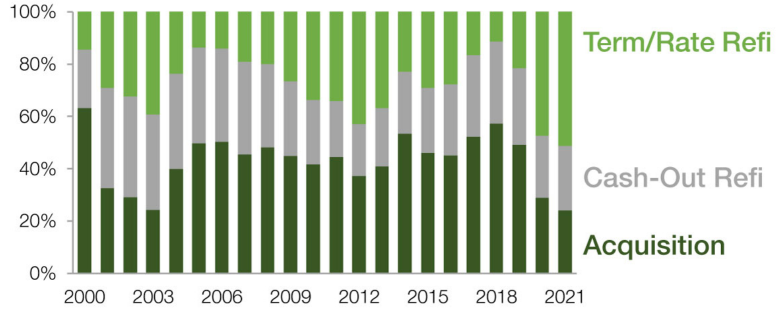
CHART 1

Investment Single-Family Originations by Purpose

Measured as a % Share of Original Loan Balance

Through Q2 2021

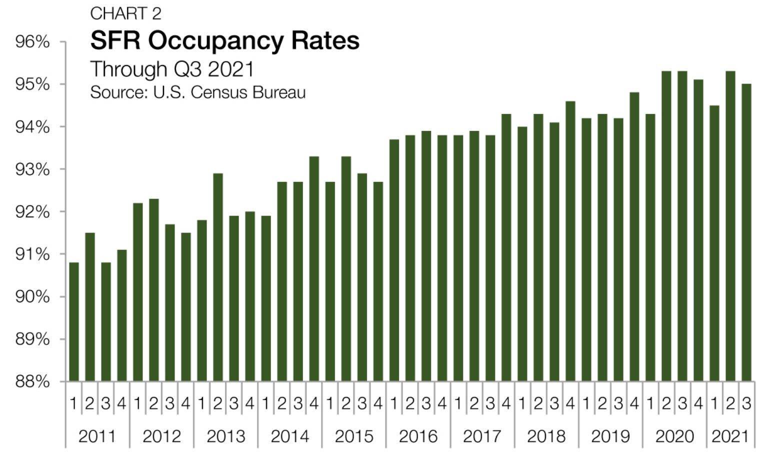
Source: Fannie Mae; Chandan Economics



As recently as 2018, originations for the purpose of acquisitions still accounted for most lending activity. However, with borrowing rates falling to new all-time lows in recent years and through the pandemic, investors have seized the opportunity to lock in lower financing rates. More than two-thirds of recent refinancing originations were rate-and-term refinancings.

Occupancy

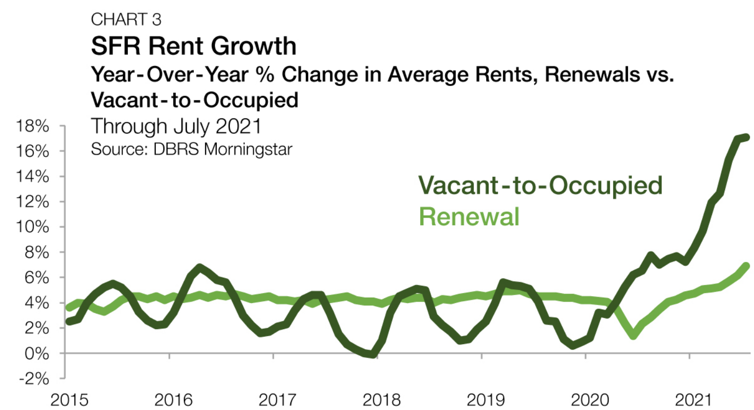
As measured by the U.S. Census Bureau, occupancy rates across all SFRs averaged 95.0% in the third quarter of 2021, dipping by 30 basis points (bps) from the second quarter *(Chart 2)*. The third-quarter reading brings the SFR occupancy rate just off its generational high, but the sector is still operating at or near full occupancy.



Rent Growth

Annualized rent growth on vacant-to-occupied (V2O) SFR properties continues to reach new highs.[1] According to DBRS Morningstar, V2O annual rent growth was up to 17.1% through July 2021. Moreover, V2O rent growth hit a new all-time high in each of the last seven months of data available *(Chart 3)*. V2O rent growth has been surging since second-quarter 2020, as suburban migration has coincided with a tight housing market, placing upward pressure on rents.

For lease renewals, rent growth reached a record 6.9% annualized rate in July, the latest month of available data. Between 2015 and the onset of the pandemic in 2020, SFR renewal rent growth consistently ranged between 3.3% and 5.0%. Since February of this year, SFR renewal rent growth topped the 5.0% mark in six consecutive months of observations.



At the metro level, the Sun Belt has dominated SFR rent growth over the past year. According to CoreLogic's Single Family Rent Index (SFRI), annual rent growth across the top 20 U.S. metros through August was highest in Miami, Phoenix and Las Vegas, climbing by 21.4%, 19.2% and 15.4%, respectively. These metros also have seen strong performance in their multifamily sectors. On the other end of the SFR rent growth spectrum are Chicago, Boston and Philadelphia, which saw annual rent growth rates over the same period totaling just 1.4%, 1.5%, and 3.4%, respectively.

[1] Vacant-to-occupied (V2O) units are single-family properties that were previously vacant and were recently leased by a new renter household. These units tend to adjust more quickly to seasonal and economic factors as they are not contractually tied to a base year rent and are free to adjust to prevailing market rents.

Cap Rates

Property-level yields for SFR assets continued to compress in the third quarter of 2021, reflecting an abundance of capital entering the sector, staunch investor demand and solid asset price growth. As a result, through the third quarter of 2021, SFR cap rates averaged 5.5%, down 23 bps from the previous quarter and 77 bps from the same time last year *(Chart 4)*. The third-quarter reading marks the lowest observed cap rates since Chandan Economics began tracking the sector in 2011.[2]

The yield spread between SFR cap rates and the 10-year Treasury offers an estimate of the SFR risk premium. In the third quarter, this spread inched up by 4 bps to 4.2%, as Treasurys dipped slightly more than SFR yields. While the risk premium grew to 5.8% amid the financial disruption of last year's second-quarter shutdown, it has now come back in line with pre-pandemic conditions observed throughout 2019.

The cap rate spread between SFR assets and multifamily properties fell to another all-time low in the third quarter of 2021, declining by 32 bps to settle at just 0.5%. In the past year, the spread has declined by 79 bps. Moreover, it is still less than 10 years ago when SFR cap rates were more than 500 bps higher than multifamily.

CHART 4
SFR Cap Rates
Through Q3 2021
Source: Chandan Economics

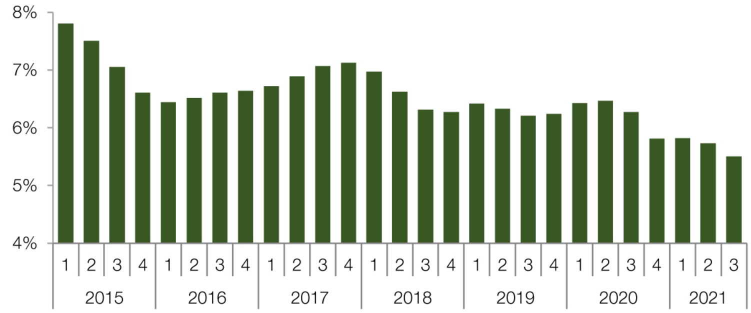
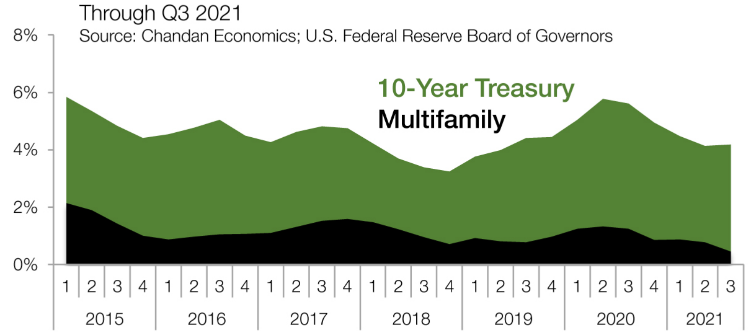


CHART 5
SFR Return Premium
SFR Cap Rate Spread Between Multifamily Cap Rates & 10-Year Treasury
Through Q3 2021
Source: Chandan Economics; U.S. Federal Reserve Board of Governors



The spread has narrowed dramatically over the past decade as asset values have climbed, SFRs have taken on a growing role of providing affordable rental housing, and operations have professionalized, even among smaller operators.

[2] Unless otherwise noted, the Chandan Economics data covering single-family rental cap rates, loan-to-value ratios and debt yields are based on model estimates and a sample pool of loans. Data are meant to represent conditions at the point of origination.

Pricing

According to a Chandan Economics analysis of Fannie Mae securitized mortgages, there are material differences between the average assessed property values on mortgages originated to single-family owner-occupants versus to single-family investors. Through the first half of 2021, the average underwritten value of a single-family investment property was $371,456 compared to $410,196 for owner-occupied units *(Chart 6)*.

Several likely factors contributed to this valuation gap. Many investors are targeting value-add assets rather than paying top dollar for value that already exists. Additionally, investor-owned SFR properties have vacancy, turnover and management-related expenses that owner-occupied units do not have to account for, which could also contribute to lower values for the rental units. Nevertheless, the gap has narrowed dramatically over the past decade.

Between 2004 and 2011, the valuation gap sat in a consistent range of 27.2% to 32.5% *(Chart 7)*. As more investors and capital entered the SFR space, discounted investment units became harder to find and competition for inventory ramped up. The valuation gap fell to an all-time low of 5.4% in 2017, before moderating in the years since. Through the second quarter of 2021, the average valuation gap this year has sat at 9.4%.

CHART 6

Single-Family Housing Unit Valuations: Investor & Owner-Occupied

In Thousands $

Through Q2 2021

Source: Fannie Mae; Chandan Economics

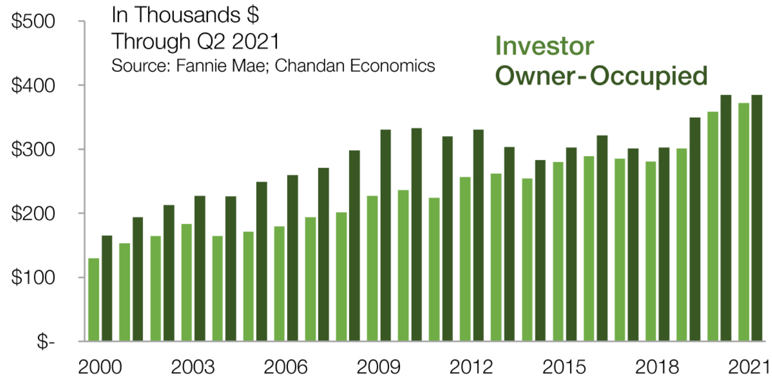
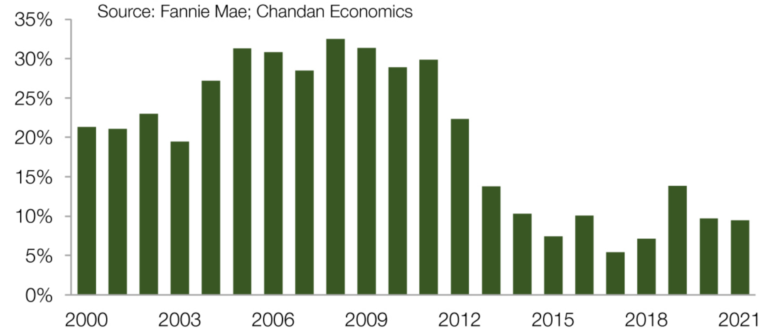


CHART 7

Valuation Gap Between Investor & Owner-Occupied Single-Family Housing Units

Through Q2 2021

Source: Fannie Mae; Chandan Economics



Credit Trends

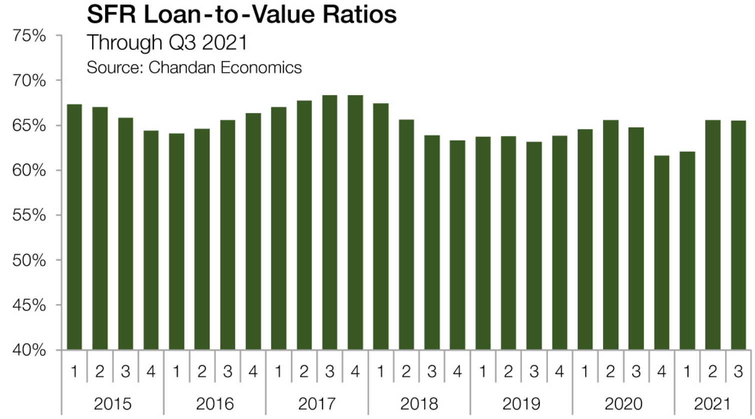
Loan-to-value ratios (LTVs), a measure of credit risk, on SFR mortgages edged down in the third quarter of 2021 by 7 bps, landing at 65.5% *(Chart 8)*. The marginal

CHART 8

SFR Loan-to-Value Ratios

Through Q3 2021

Source: Chandan Economics



decline in the third quarter came after a second-quarter surge of 351 bps — the largest observed one-quarter increase since the Great Financial Crisis. Through the third quarter of 2021, SFR LTVs were 98 bps higher than where they were at the beginning of the pandemic. The return of LTVs to pre-pandemic levels is a welcome signal that credit risk appetites have recovered and remain aligned with the sector's favorable outlook.

CHART 9
SFR Debt Yields
Through Q3 2021
Source: Chandan Economics

Debt yields, another key measure of credit risk, fell by 46 bps between the second and third quarters of 2021, settling at 8.8% — the lowest rate on record *(Chart 9)*. The drop in debt yields translates to SFR investors securing more debt capital for every dollar of property-level net operating income (NOI). Through the third quarter of 2021, SFR debt increased to $11.39 for every dollar of NOI, a $0.57 increase from the prior quarter and a $1.82 increase from this time last year.

Supply & Demand Conditions

Residential Default Rates

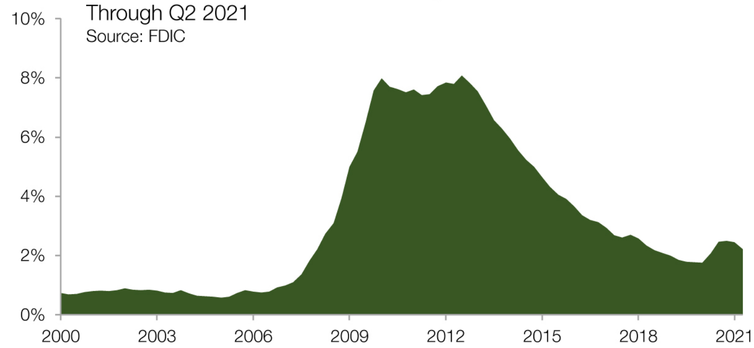
During the 2008 housing crisis, investors with available financing took advantage of the market dislocation, acquiring large portfolios of single-family assets at steep discounts. According to the Federal Deposit Insurance Corporation (FDIC), mortgage default rates peaked at 8.1% in 2012, leading to an abundance of distressed sales and the beginning of the SFR sector as we know it today *(Chart 10)*.

CHART 10

Default Rate on Real Estate Loans Secured by 1-to-4 Family Residential Properties

Through Q2 2021

Source: FDIC



When the pandemic reached the U.S. in 2020, there was concern that there might be a wave of household defaults and a housing crisis on the horizon. However, those fears have yet to materialize. Favorable levels of liquidity, aggressive buyer demand and federally directed forbearance all played a part in limiting widespread distress. Through the second quarter of 2021, the latest quarter of FDIC data availability, mortgage default rates already started to recover, declining 25 bps from the previous quarter to land at 2.2%.

Build-to-Rent

Purpose-built SFR properties, known as build-to-rent communities, continue to become a defining feature of the SFR sector, especially within the institutional slice of the market.

Based on an analysis of Census Bureau data, between 1975 and the start of the prior recession in 2007, SFRs accounted for a little less than 2.0% of all single-family construction starts *(Chart 11)*. In 2013, SFR's percentage share of construction starts reached an all-time high of 5.8%. Through the second quarter of 2021, the share remained elevated at 3.7%.

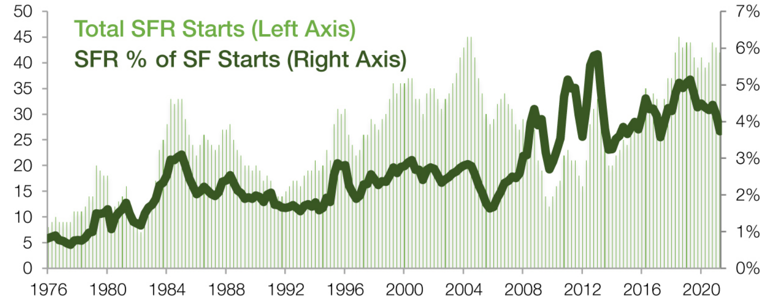
CHART 11

SFR Housing Starts

Rolling 12-Month Basis, Total Measured in Thousands

Through Q2 2021

Source: Chandan Economics' Analysis of U.S. Census Bureau Data



SFR construction starts totaled 42,000 units through the year ending in second-quarter 2021, which is down by 1,000 units from the previous period and down by 3,000 from its most recent high in the third quarter of 2018. It is important to note that these data may understate the full stock of incoming SFR supply as it does not include units that are started and sold to SFR operators, which the National Association of Homebuilders estimates could account for another 2% of single-family housing starts.

Tracking Demand

Utilizing Google Trends, the popularity of the search term "homes for rent" is leveraged as a proxy for hotspots of SFR demand. Columbus, GA, was the most popular area where the term was searched during the second quarter of 2021, dethroning Savannah, GA, which had seen the highest search frequency in the previous period *(Table 1)*.

The Sun Belt continues to be the U.S. epicenter for SFR demand. All the top 10 markets searched for in third-quarter 2021 were in the Sun Belt. Moreover, nine of the 10 were in the Census Bureau's South region, which saw its resident population grow by 10.3% in the decade ending in 2020, more than any other region. Between robust population growth, which fuels rental housing demand, and greater availability of buildable land, the South is a conducive area for builders to develop single-family rental communities.

TABLE 1:

Popularity of Search Term "Homes for Rent"

Rank by Metropolitan Area

Measured Over Q3 2021

Source: Google Trends

Rank	Metro Area
1	Columbus, GA
2	Memphis, TN
3	Columbia, SC
4	Savannah, GA
5	Dothan, AL
6	Macon, GA
7	Florence-Myrtle Beach, SC
8	Jacksonville, FL
9	Fresno-Visalia, CA
10	Atlanta, GA

Outlook

SFR investments appear to be enjoying widespread success heading into the final months of 2021, as demographic and housing market shifts are fueling investor and renter demand. Measures of occupancy, rent growth and valuations are all near their all-time highs, as cap rates continue to compress and market liquidity improves. These results come as the JBREC/NRHC Single-Family Rental Market Index (SFRMI), a measure of overall SFR market activity, continued to expand in the second quarter of 2021. Further, the SFRMI Survey indicated that operators are upbeat on their assessments of current leasing activity and their forecast for leasing activity six months ahead.

All told, single-family rentals are quickly becoming the new starter home, as young households who struggle with residential mortgage affordability still desire suburban housing. SFRs continue to offer attractive housing options to fill a significant needs gap, which should continue to fuel positive renter and investor demand going forward.

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