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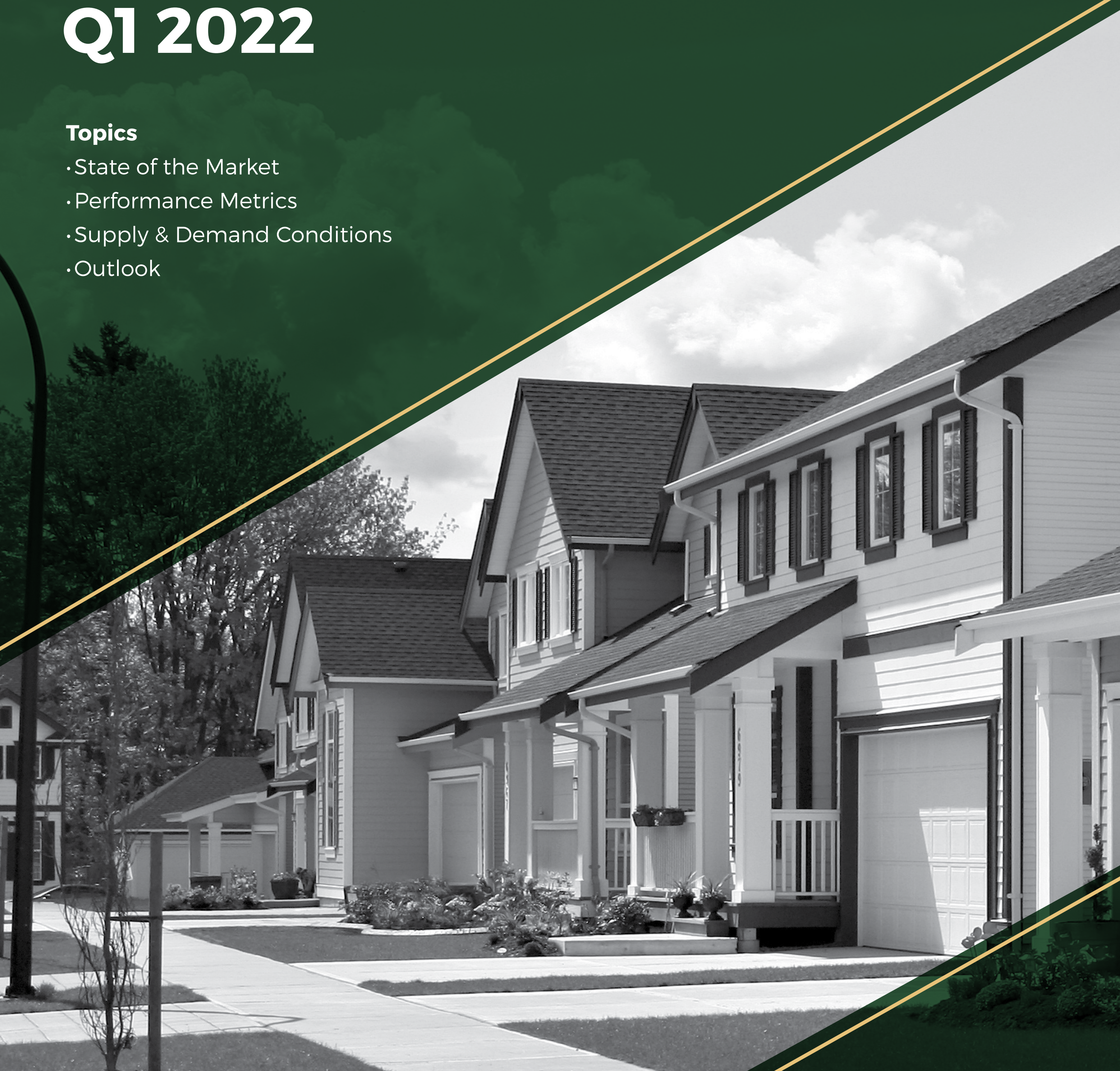
Single-Family Rental Investment Trends Report

Q1 2022

Topics

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



Rent Growth Continues to Surge, Pressing Up Cap Rates

Key Findings

- Annual rent growth for lease renewals reaches 7.8% — a new all-time high.
- Cap rates rise to 5.6% as cashflows strengthen.
- First-quarter SFR securitizations are up more than double from last year.

State of the Market

With wind in its sails, the single-family rental (SFR) sector continued to gain positive momentum in the first quarter of 2022. With the costs of homeownership rising alongside [mortgage rates](), SFR's growing role as the new U.S. starter home continues to cement.

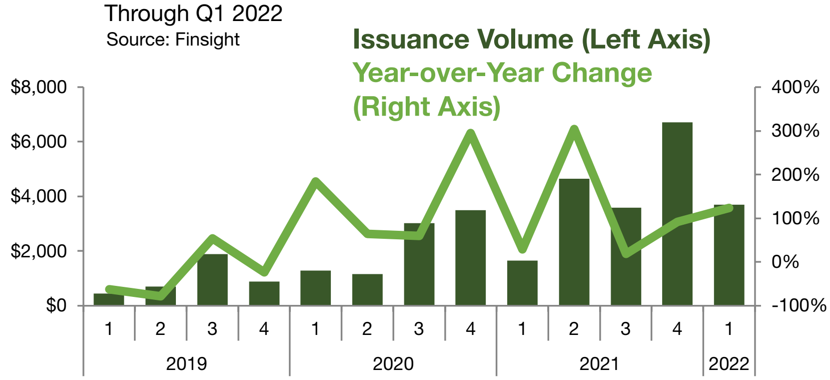
CHART 1

SFR CMBS Issuance

Totals Measured in Millions $,
Year-over-Year Percent Change

Through Q1 2022

Source: Finsight



The sector's [decade-long trend of institutionalization]() has accelerated over the past year. According to [John Burns Real Estate Consulting](), more than $50 billion of institutional capital is currently moving through the SFR sector. In the CMBS market, SFR issuance reached a record $16.6 billion in 2021 — nearly doubling 2020's total of $8.9 billion, according to [Finsight](). In the first quarter of 2022, SFR CMBS issuance reached $3.7 billion, rising 124% above the total observed in the first quarter of 2021 *(Chart 1)*.

The demand for single-family housing in the U.S. increased throughout the pandemic, while access to homeownership did not. With conventional 30-year mortgage rates reaching above 5% in April, the monthly debt servicing costs on new home loans are nearly twice what they were in early 2020 Further, according to the Mortgage Bankers Association, lending standards are about 30% tighter today than they were in early 2020. Additionally, the Federal Reserve's ongoing tightening cycle, which is expected to cool many parts of the economy, will increase mortgage borrowing costs — a development that will push some would-be buyers into the rental market. On balance, the SFR sector is well-positioned to see continued growth in 2022 as cyclical forces play in its favor, and underlying demand for single-family housing remains strong.

Performance Metrics

Originations

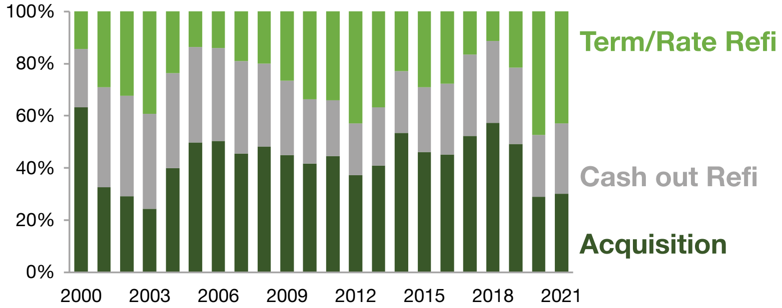
CHART 2

Investment Single-Family Originations by Purpose

Measured as a % Share of Original Loan Balance

Through Q4 2021

Sources: Fannie Mae; Chandan Economics



According to a Chandan Economics analysis of Fannie Mae data, a lending source for mostly non-institutional borrowers, refinancing, instead of acquiring, has accounted for the significant majority of recent originations to single-family investors. In 2020, refinancing activity accounted for 71.0% of tracked originations *(Chart 2)*. In 2021, the refinancing share dropped slightly to 69.9%. While the change from 2020 to 2021 was marginal, on a quarter-to-quarter basis, the shifts were anything but. The refinancing share of lending activity declined every quarter throughout the year, reaching a high of 77.7% in the first quarter and sinking all the way to 60.1% in the fourth. Notably, term/rate refinancings declined by 4.4 percentage points in 2021, and 26.8 percentage points between the first and fourth quarters — a sign that investors were locking into low-interest rates early last year ahead of the Federal Reserve's monetary tightening.

Occupancy

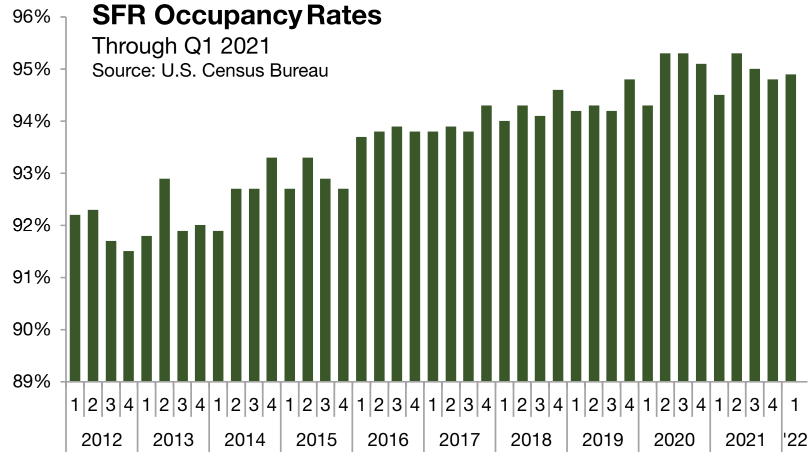
As measured by the U.S. Census Bureau, occupancy rates across all SFRs averaged 94.9% in the first quarter of 2022, rising by 10 basis points (bps) from the fourth quarter of 2021 (*Chart 3*). The first-quarter reading brings the SFR occupancy rate within 40 bps of its generational high — indicating that the sector is operating at or near full potential occupancy.

CHART 3

SFR Occupancy Rates

Through Q1 2021

Source: U.S. Census Bureau



Rent Growth

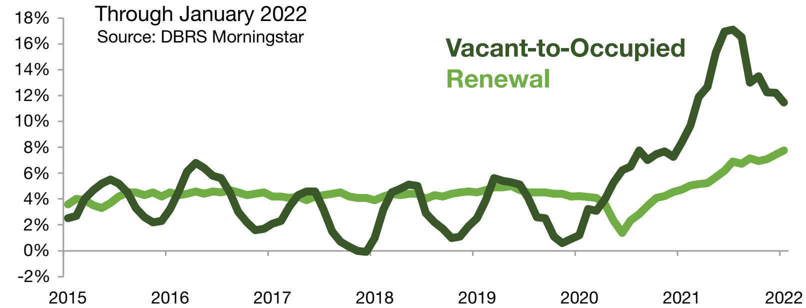
CHART 4

SFR Rent Growth

Year-Over-Year % Change in Average Rents, Renewals vs. Vacant-to-Occupied

Through January 2022

Source: DBRS Morningstar



Single-family rent growth remained robust entering 2022, even as the pace of increase on newly signed leases has started to slow. According to DBRS Morningstar, vacant-to-occupied (V2O) annual rent growth accelerated to an unprecedented high of 17.1% in July 2021 in what can be best described as a recalibration of market pricing *(Chart 4)*. Since then, V2O rent growth slowed in five of six months, reaching 11.5% in the latest reading. Even as momentum has slowed, the current pace of rent increases remains well above the pre-pandemic pattern. Between 2015 and 2019, V2O rent growth averaged 3.3% — a baseline that the January 2022 data point outperforms by a weighty 816 bps.

For lease renewals, annual rent growth hit another all-time high in January 2022, reaching 7.8%. Between 2015 and 2019, SFR renewal rent growth consistently ranged between 3.3% and 5.0%. Since February 2021, SFR renewal rent growth has topped the 5.0% mark in 12 consecutive months of observations.

Surging lease renewal rent growth is best categorized as a market response to the growth in V2O prices. When setting rents for existing tenants, many landlords will consider three primary, interconnected criteria:

- What the unit could rent for on the open market
- Probability of tenant renewal
- Anticipated length of vacancy if a tenant does not renew

When a landlord identifies a unit to be underpriced and perceives that it will be rented again quickly in the event of a vacancy, they are more likely to pursue a sizable rent increase on the next lease. With V2O rent growth topping renewal rent growth for 22 consecutive months, lease-over-lease rents should be expected to accelerate over the short term as prices re-establish an equilibrium.

Analyzing rent growth at the market level, unsurprisingly, the Sun Belt has maintained its dominance. According to CoreLogic's Single-Family Rent Index (SFRI), annual rent growth across the top 20 U.S. metros through February was highest in Miami, Orlando, and Phoenix, climbing by 39.5%, 22.2%, and 18.9%, respectively. All of the tracked Sun Belt metros saw rent growth totals above 10.1% in the year ending February 2022.

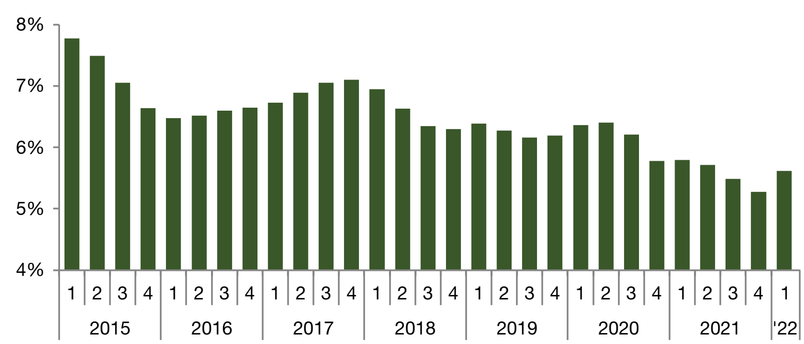
Cap Rates

Property-level yields for SFR assets ticked up in the first quarter of 2022, rising by 34 basis points to settle at 5.6% *(Chart 5)*.[1] The first-quarter observation marks the first time that SFR cap rates have risen since the onset of the COVID-19 recession.

While growing cap rates may concern operators, the reason why yields are rising carries much greater importance. The first-quarter rise is attributable to strengthening net operating incomes achieved through higher rents — not a devaluation of assets. Historically, single-family rent growth has lagged inflation by several months. Rent rolls, which take a full year to reset, are currently still adjusting to the bull-run of home prices experienced in 2021. This lagged adjustment is creating an anticipated catch-up period where property incomes are rising more quickly than valuations, causing upward pressure on cap rates.

The yield spread between SFR cap rates and the 10-year Treasury estimates the SFR risk premium. Despite growing SFR yields in the first quarter of 2022, this risk spread narrowed as the yield on Treasurys rose by a more significant 42 bps. In total, the risk premium sank 8 bps from the previous quarter to land at 3.7% — the lowest level since late 2018. Moreover, the risk premium

CHART 5
SFR Cap Rates
Through Q1 2022
Source: Chandan Economics



[1] 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.

is down by a weighty 70 bps from one year ago *(Chart 6)*.

The cap rate spread between SFR assets and multifamily properties widened by 35 bps in the first quarter of 2022, settling at 84 bps — within one basis point of where they were this time last year. Over the past decade, SFR-multifamily cap rate spreads have narrowed from a high of 496 bps in 2012 to the sub-100 bps levels observed today. Increased liquidity and tech adoption have allowed the SFR sector to operate more efficiently over the past decade, generating a bid-down of its risk premium. Over the long term, some positive yield differential between SFR and multifamily assets remains likely — accounting for the co-location efficiencies and shared physical inputs.

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 single-family investors. The average underwritten value of a single-family investment property in 2021 averaged $367,926 compared to $405,844 for owner-occupied units *(Chart 7)*.

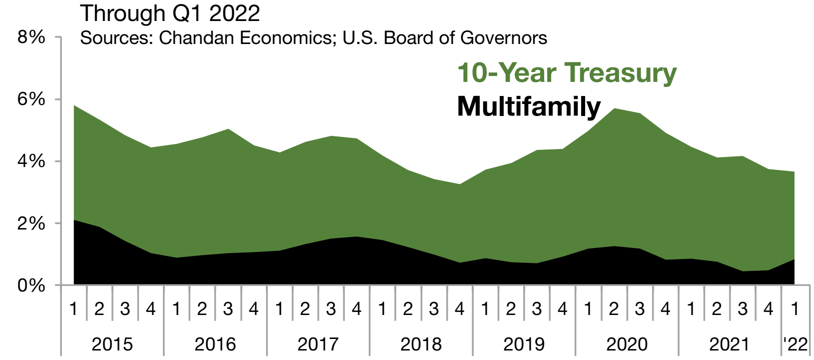
CHART 6

SFR Return Premium

SFR Cap Rate Spread Between Multifamily Cap Rates & 10-Year Treasury

Through Q1 2022

Sources: Chandan Economics; U.S. Board of Governors



Several likely factors contribute to this valuation gap, one being that 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, contributing to lower values for the rental units. Nevertheless, the gap has narrowed dramatically over the past decade.

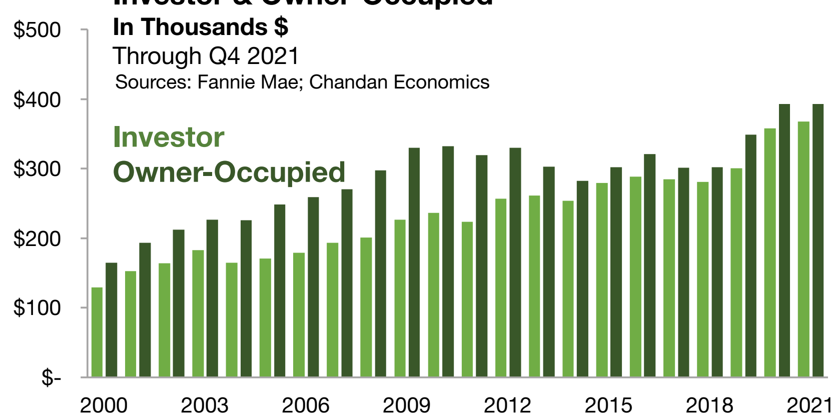
CHART 7

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

In Thousands $

Through Q4 2021

Sources: Fannie Mae; Chandan Economics



Between 2004 and 2011, the valuation gap sat in a consistent range of 27.2% to 32.5% *(Chart 8)*. 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. In 2021, the average valuation gap averaged 9.3% — a marginal 16 bps decrease from the 2020 average.

Credit Trends

Loan-to-value ratios (LTVs), a measure of credit risk on SFR mortgages, kicked off 2022 by rising 56 bps, landing at 66.1% *(Chart 9)*. After sinking by 328 bps during 2020, LTVs quickly recovered back to pre-pandemic levels by mid-2021. The first-quarter 2022 observation marks the highest LTVs have sat in the sector since first-quarter 2018.

Debt yields, another key measure of credit risk, rose by 33 bps during the first quarter of 2022, to settle at 8.7% *(Chart 10)*. The increase marked the end of a streak of debt yield declines that had stretched to seven-consecutive quarters. The slight increase in debt yields translates to SFR investors securing marginally less debt capital for every dollar of property-level net operating income (NOI). Through the first quarter of 2022, SFR debt declined to $11.45 for every dollar of NOI, a $0.45 decrease from the prior quarter, yet still up by $1.43 from this time last year.

CHART 8

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

Through Q4 2021

Sources: Fannie Mae, Chandan Economics

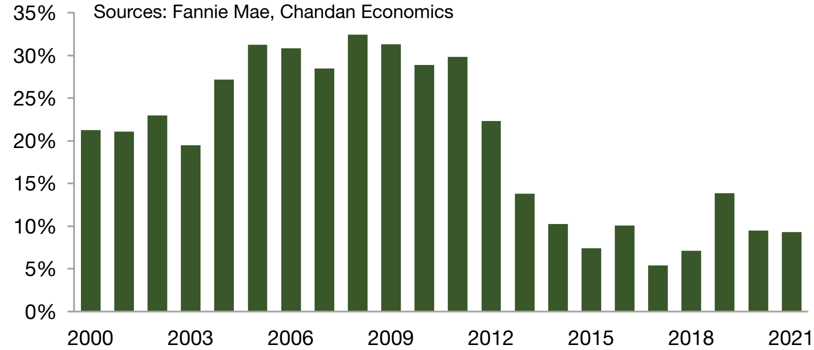


CHART 9

SFR LTV Ratios

Through Q1 2022

Source: Chandan Economics

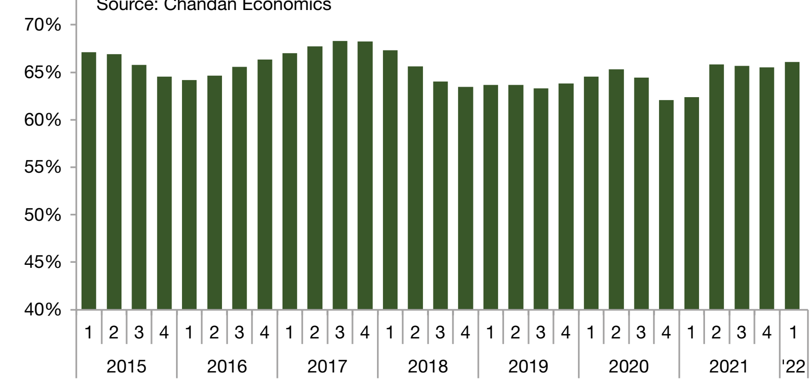
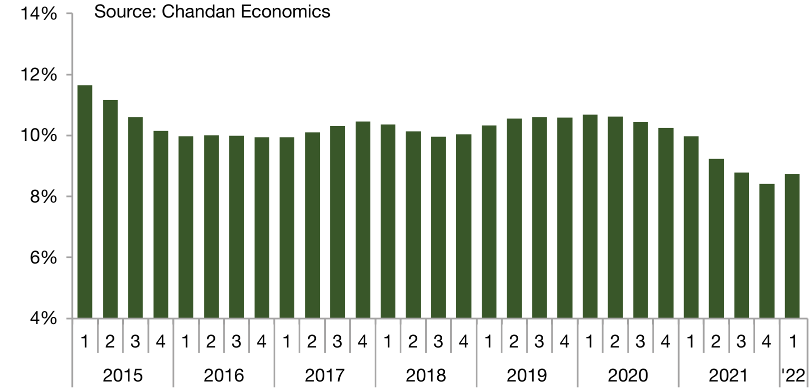


CHART 10

SFR Debt Yields

Through Q1 2022

Source: Chandan Economics



Supply & Demand Conditions

Residential Default Rates

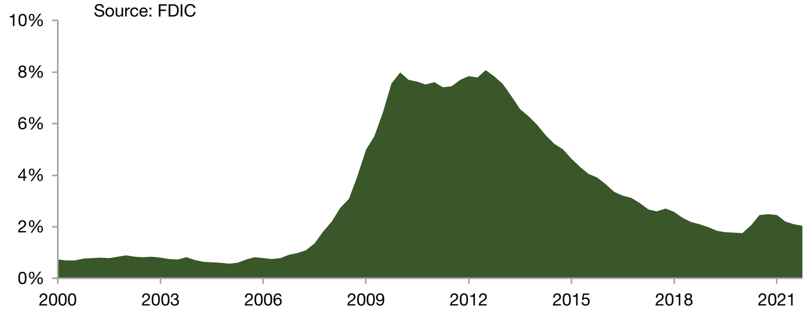
During the 2008 housing crisis, investors with available financing took advantage of the market dislocation, acquiring large portfolios of single-family assets at steep discounts. According to the [Federal Deposit Insurance Corporation](#) (FDIC), mortgage default rates peaked at 8.1% in 2012, leading to an abundance of distressed sales and the beginning of the SFR sector as we know it today *(Chart 11)*.

CHART 11

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

Through Q4 2021

Source: FDIC



The pandemic had a much different impact on the housing market than the Great Recession. Demand for single-family housing increased, causing [prices to rise](#) through the distress. Between growing asset prices and federally directed forbearance, homeowner defaults remained uncommon during the pandemic. Default rates hit a pandemic high of 2.5% in the fourth quarter of 2020 — just 74 bps above its all-time low. As of the fourth quarter of 2021, single-family default rates declined for four consecutive quarters, settling at 2.0%.

Build-to-Rent

Purpose-built SFR properties, known as build-to-rent (BTR) 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, BTRs accounted for a little less than 2.0% of all single-family construction starts *(Chart 12)*. In 2013, BTR's percentage share of construction starts reached an all-time high of 5.8%, and through the fourth quarter of 2021, the share remained elevated at 4.5%. BTR construction starts totaled 51,000 units through the end of 2021, a 15.9% growth rate from a year earlier and a new all-time high. While these construction totals represent significant market growth, they are also like to be understated.

The reason why the initial BTR estimate may be understated is that the single-family construction starts data does not include units that have been started and sold to SFR operators (build-for-rent or BFR). In a recent Arbor-Chandan analysis, Chandan Economics estimates that the total number of SFR construction starts over the past year may be as high as 90,000 through the fourth quarter of 2021 *(Chart 13)*.

Tracking Demand

Utilizing Google Trends, the popularity of the search term "homes for rent" can be leveraged as a proxy for hotspots of SFR demand. Savannah, GA, was the most popular area where the term was searched during the first quarter of 2022, dethroning another Georgia metro, Macon, which had seen the highest search frequency in the previous period *(Table 1)*.

CHART 12

SFR Housing Starts

Measured on a Rolling 12-Month Basis,
Total Measured in Thousands

Through Q4 2021

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

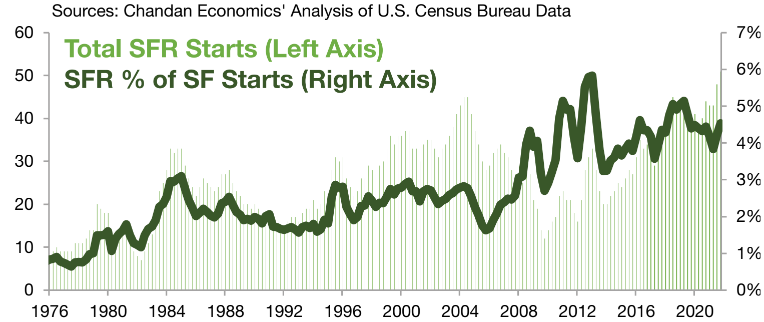


CHART 13

Estimated Single-Family Rental Construction Starts

Measured in Thousands of Units,
Note: 2021 Data are Rolling 4-Quarters Through Q4 2021

Sources: U.S. Census Bureau, American Community Survey, Chandan Economics

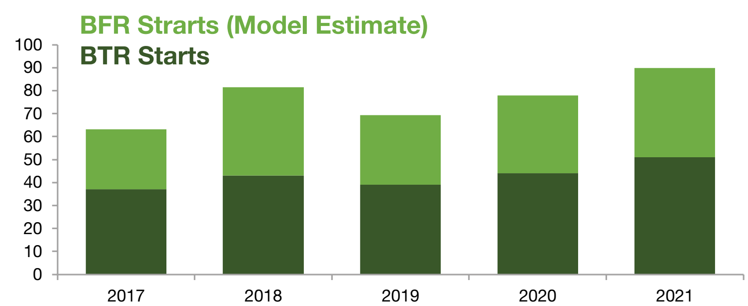


TABLE 1:

Popularity of Search Term "Homes for Rent"
Rank by Metropolitan Area

Measured Over Q1 2022

Source: Google Trends

Rank	Metro Area
1	Savannah, GA
2	Memphis, TN
3	Augusta, GA
4	Columbia, SC
5	Macon, GA
6	Albany, GA
7	Montgomery, AL
8	Greenville-New Bern-Washington, NC
9	Atlanta, GA
10	Dothan, AL

The Sun Belt continues to be the region driving new SFR demand, with the southeast corner of the country standing as a tightly-packed epicenter. All of the metros in the top 10 are located in just five states: Georgia, Tennessee, South Carolina, Alabama, and North Carolina. Among the reasons why the Sun Belt continues to attract new residents and SFR demand, affordability, lower taxes, and warmer weather all top the list.

Outlook

The SFR sector had a marquee year in 2021. Early indications are that it will continue to post impressive growth totals in 2022 — even as some of the pandemic-related tailwinds are exhausted. According to the John Burns Real Estate Consulting Single-Family Rental Market Index, a diffusion index where a reading above 50 indicates improving conditions, momentum has slowed. The index has declined in two-consecutive quarters through the end of 2021, falling from 84.4 to 71.5. Two of the index's sub-components, occupancy, and current leasing conditions, have declined for three consecutive quarters. Still, all sub-components and the overall index remained above 50, signaling improving conditions across the board. All told, the immediate outlook for the SFR sector remains firmly positive. According to the Federal Reserve Bank of New York 2022 SCE Housing Survey, just 42% of renters think they will buy a home in the next three years — down from 52% when surveyed last year. The SFR sector is well-positioned to absorb both lifestyle renters and a growing wave of forming families that are priced out of homeownership, creating a dependable bedrock of demand for the year ahead.

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