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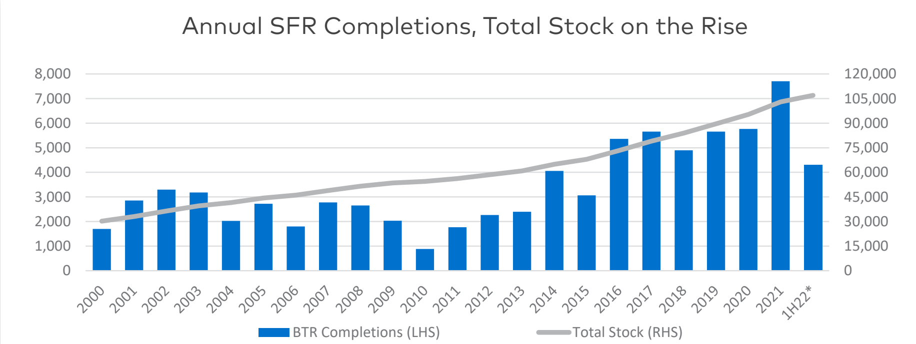
Build-to-Rent Fuels Growth In Institutional Single-Family Rental Market

With home sales cooling as rising mortgage rates bump up against soaring property values, institutional single-family rental property companies are adjusting growth strategies and facing the prospect of lower total returns.

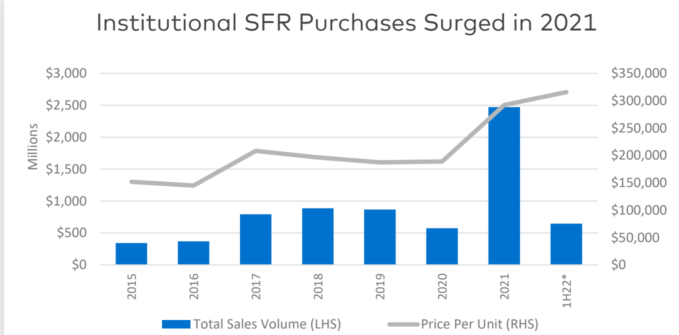
Institutions' growth is currently focused on build-to-rent projects or acquiring portfolios from smaller owners. BTRs are on track to deliver far more units in 2022 than in any previous year. According to Yardi Matrix's SFR database of projects with 50 or more units, more than 25,000 units are under construction. Nearly 4,300 were delivered in the first half of 2022, and the industry will easily surpass 2021's record-high 7,705 deliveries.

Institutional ownership of SFRs is growing rapidly as investors seek property segments with outsize growth prospects as long-term demand for single-family rentals solidifies. Institutions have committed more than $60 billion to buying single-family homes over the past year, according to various corporate announcements and news articles. MetLife Investment Management estimated in a recent research paper that institutions own some 700,000 single-family rentals in 2022, about 5% of the 14 million SFRs nationally. MIM forecasts that by 2030, institutions will increase SFR holdings to 7.6 million homes, more than 40% of all SFRs.



Source: Yardi Matrix, communities of 50 or more units

John Burns Real Estate Consulting wrote that the market value of SFR homes has doubled over the past decade to $4.7 trillion in 2022. JBREC estimates that nationally 3% of single-family rentals are owned by institutions that hold 1,000 or more units, and another 3% are owned by institutions with 100 to 999 units.



Source: Yardi Matrix, communities of 50 or more units

Institutional acquisitions of SFRs in communities of 50 or more units soared in 2021 to $2.5 billion, according to Yardi Matrix. Rising home and mortgage costs in the second quarter of 2022 increased the cost of capital for institutional buyers, so the segment's growth is likely to slow and returns will moderate. Even so, the industry benefits from strong long-term demand drivers and the explosive growth in institutional capital.

Demand Driving Rents

Single-family home prices have soared in recent years due to strong demand, while inventory remains depressed from the drop in housing completions in the wake of the housing bubble that sparked the global financial crisis in 2008. The Case-Shiller 20-city home price index rose 21% year-over-year through April 2022 and was up roughly 40% since the start of the pandemic in March 2020.

Demand for single-family homes has multiple drivers. Some households decided during the pandemic lockdowns to move out of urban areas to suburbs to get more space for children and pets, and as a better environment to work from home. Household formation has been robust, as employment growth, stimulus payments and wage growth enabled individuals to form individual household units away from family and housemates. Households in the U.S. collectively increased savings by trillions of dollars over the last two years, and Moody's Analytics pegged that number at $2.7 trillion as of mid-year 2022.

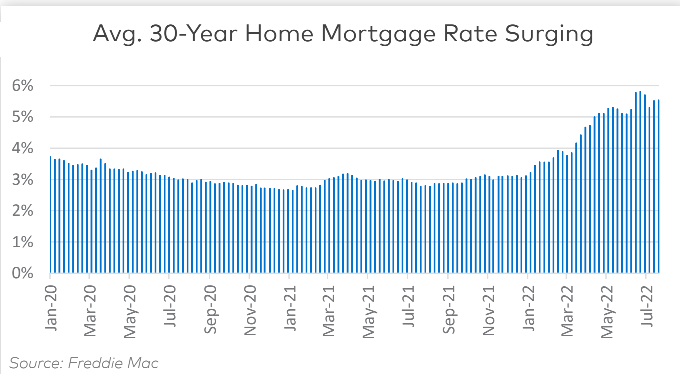
Plus, and maybe most important, homebuying was spurred by historically low mortgage rates that enabled buyers to borrow more with lower monthly payments. The average 30-year mortgage in the U.S. dipped to 2.8% in late 2021, about one-third of the 7.8% 50-year average and half of the 30-year 5.7% average, according to Freddie Mac.

Market conditions, however, reversed sharply in the second quarter of 2022 as the Federal Reserve raised policy rates to stem persistently high inflation, which rose to 9.1% in June. The average 30-year fixed mortgage rate climbed to 5.5% in mid-July. That prompted home sales to drop 20% between January and June, according to the National Association of Realtors. During that time, the NAR's housing affordability index dropped by one-third and housing inventory on the market increased by nearly 50%.

SFR fundamentals remain healthy despite—or maybe because of—the weakening of the single-family for-sale market. The deteriorating conditions slowed homebuying, but demand for single-family housing remained robust. Many first-time homebuyers want the amenities of single-family houses even if they put off purchasing a home because they can't afford the down payment or decide to wait until economic conditions are less volatile before buying.

Declining affordability of homeownership is one factor in SFR demand and supports continued strong rent growth. SFR rents have tracked a similar path to multifamily in recent years. Like multifamily, SFR rents shot up in early 2021, with year-over-year increases in the double digits every month since the second quarter of 2021, topping at 15.0% in February 2022, according to Yardi Matrix. The average SFR unit rent hit an all-time high of $2,071 in June 2022, up from $1,646 in March 2020, at the start of the pandemic.

SFR occupancy rates are even higher than those for multifamily, being at or above 96.9% every month since late 2020. Given the long-term shortage of single-family homes and the high cost of homeownership, SFR occupancy rates are projected to remain high into the future.



Institutional Activity Grows

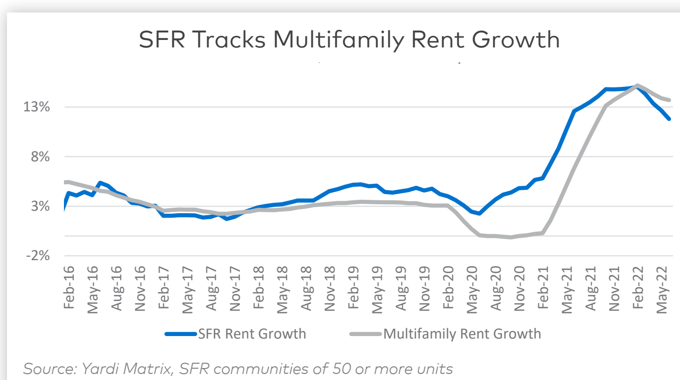
With fundamentals so heathy and prospects for continued growth so strong, institutions looking for high-yield assets in which to park capital are flocking to the sector. Yardi Matrix's database of institutionally owned SFRs in communities of 50 or more units has increased to 1,233 properties with 167,000 units, encompassing 108,000 operating units, 26,000 units under construction and 33,000 units in the planning stages.

Last year's $2.5 billion acquisition volume was well above the pandemic-impacted $554 million in 2020 and the previous annual high of $887 million in 2018. Meanwhile, the price of SFRs is soaring. The average acquisition cost for an SFR unit reached $315,000 in the first half of 2022, up 8.2% from the previous annual high achieved in 2021, and more than double the average $152,000 acquisition cost in 2015.

Unlike other commercial property types, there is very little SFR stock in the Northeast and in primary metros, for several reasons. One is that the original institutional involvement was concentrated in areas where there were bulk foreclosure sales. That is easier to accomplish in some states than others, due to how the foreclosure process is operated and the fact that for economic reasons some metros saw a larger concentration of foreclosures during the GFC.

Although mom-and-pop owners still hold the bulk of SFRs, institutions are increasing market share. Institutions purchased 13.2% of residential homes sold in the U.S. in 2021, according to a recent study by the National Association of Realtors. However, the market share varied widely by market, with the highest share in the South and Southwest. Texas (28%) topped the list of states with institutional buyers, followed by Georgia (19%), Oklahoma and Alabama (18%) and Mississippi (17%), per the NAR.

Institutions have abundant capital and are eager to deploy. However, market conditions make acquisitions more difficult. The modern institutional market was formed when investors bulk purchased foreclosed mortgages from banks in the wake of the global financial crisis,



but that avenue has dried up. More recently, one of the main acquisition strategies employed by institutional SFR firms in recent years has been to buy individual homes marketed through multiple listing services (MLS). That strategy produced returns in the upper teens or upwards of 20%, depending on investors' efficiency at managing operating expenses and the rent charged.

Purchasing individual homes one by one is less efficient today. One problem is that home prices rose 30% to 50% (or more in some metros) over the last few years, which means that profit margins are thinner. Another issue is that fewer home sales are likely to be transacted in coming months because sellers are reluctant to accept reduced market prices. Plus, the recent increase in financing costs—such as mortgage debt and credit facilities—has further cut into the profitability of this strategy.

Institutional single-home acquisitions won't dry up completely, but net profit margins are thinning to the teens rather than 20%-plus. Profit margins can be boosted right back up to the previous 20% target if rent growth continues

SFR Units U/C by Market Size

	50+ Community Units U/C
Gateway Markets	626
Other	3,250
Tech Hub Markets	16,823
Tertiary Markets	5,020
National	25,719

Source: Yardi Matrix

Units Under Construction by Metro

Market	50+ Community Units U/C
Phoenix	5,254
Dallas	2,234
Charlotte	1,426
Houston	1,050
Tampa	989
Charleston	926
Atlanta	862
Raleigh	747
SW Florida Coast	720
Nashville	615
Huntsville	603
Jacksonville	591
Sacramento	574
Austin	455
Denver	425

Source: Yardi Matrix

SFR Units U/C by Region

Region	50+ Community Units U/C
Western	6,505
Southeast	5,070
Southwest	4,194
Florida	2,994
Midwest	2,863
South	2,302
Northern California	734
Pacific Northwest	476
Northeast	231
Central California	178
Southern California	172

Source: Yardi Matrix

SFR Units U/C by Builder

Owner	50+ Community Units U/C
American Homes 4 Rent	2,757
NexMetro Communities	1,702
Redwood Living	1,659
D.R. Horton	1,113
Wan Bridge	941
Empire Group, The	725
TerraLane Communities	543
Cavan Companies	514
BB Living	479
Sands Companies	474
W3	474
Zilber Residential Group	467

Source: Yardi Matrix

to shoot up, but most analysts are projecting rent growth to decelerate owing to inflation and recessionary fears.

Build-to-Rent on the Rise

With bulk and one-off home purchases becoming less attractive as options, a growing number of institutions are employing the BTR strategy, which encompasses building homes that are rented rather than sold. Currently, institutions have a record-high 25,000 units under construction in communities of 50 units or more, according to Yardi Matrix. Between 2000 and 2014, roughly 2,500 units in such communities were delivered annually. Average annual deliveries rose to about 5,500 between 2015 and 2020. This year, BTR deliveries are expected to far exceed the annual high number of 7,700 set in 2021.

As with the acquisition market, BTRs are a regional business. Of the 25,000 BTR units under construction in communities of 50-plus units, almost two-thirds are in secondary markets. Only 626 units are in gateway markets, where construction and labor costs are high, available land for large single-family developments is scarce, and the entitlement process is protracted. Development also can be more difficult in urban ring municipalities that require rentals to have more density, i.e., apartment complexes, some with an affordable component.

On a regional basis, BTR units under construction are concentrated in the West (6,500 units), Southeast (5,070) and Southwest (4,200). Only 213 are in the Northeast and 1,100 in California. Phoenix is the leading market for build-to-rents, with 5,200 units under construction, followed by Dallas-Fort Worth (2,200), Charlotte (1,400), Houston (1,100) and Tampa (1,000).

Many of the largest owners of SFRs in 50-plus unit communities also are the largest developers. Redwood Living of Independence,

Top Owners, 50+ Unit Communities

Owner	50+ Unit Community Units
Redwood Living	14,234
American Homes 4 Rent	5,286
NexMetro Communities	4,553
Inland Real Estate Group	2,453
Lewis Group of Companies	2,417
Abrams Company, The	1,932
D.R. Horton	1,822
Wan Bridge	1,416
Empire Group, The	1,147
Middleburg Communities	1,060
Hunt Companies	996
Capstone Communities	961
Taylor Morrison	952
W3	924

Source: Yardi Matrix

Ohio, is the largest owner of SFR communities, with 14,234 homes and nearly 1,700 under construction. Calabasas, Calif.-based American Homes 4 Rent, which owns 5,300 units in SFR communities, has 2,800 under construction, more than any other company. And NexMetro Communities of Phoenix owns 4,600 units, with 1,700 under construction.

Despite Challenges, Outlook Positive

The SFR industry faces challenges. The higher cost of capital and weak sales market will reduce growth. SFR companies must manage capital expenditures efficiently and maintain occupancy rates. And there are growing worries about regulation that would limit investor home purchases, as some advocacy groups are blaming institutions for the increase in home prices. These accusations make little sense given the scale of the industry relative to the housing market and the long-term housing supply shortage that is the main cause of the spike in housing prices. Nevertheless, Congress held hearings on institutional ownership of housing, so the industry must be vigilant.

Stock, Rent Growth by Region

Region	Stock-50+ Unit Communities	YoY Rent Growth - May 2022
Midwest	31,312	11.6%
West	17,219	14.0%
Southwest	14,745	11.4%
Northeast	8,230	11.9%
South	7,784	10.5%
Southern Calif.	6,227	15.4%
Southeast	5,706	11.9%
Florida	5,218	20.4%
Central California	4,148	13.2%
Pacific Northwest	4,036	12.3%
Mid-Atlantic	1,381	-16.8%
Northern Calif.	1,040	12.6%

Source: Yardi Matrix

The upshot, however, is that the industry looks to be fundamentally sound and poised for growth. Homeownership will likely be in for a bumpy ride over the next year or two as home prices reset and mortgage rates remain at recent higher levels, but that should be good news for single-family rentals. Families still aspire to the amenities provided by detached houses, and if they can't afford to purchase, they will rent. What's more, supply of single-family homes is likely to remain weak as supply-chain issues delay materials, development and labor costs skyrocket, and the entitlement process delays deliveries. The annualized number of new housing starts dropped 14% between April and June, moving in the wrong direction as the U.S. faces a long-term shortage of housing units estimated at 2 million to 4 million. While the housing shortage is unfortunate on many levels, it improves the investment prospects of the SFR market.

—Paul Fiorilla, Director of Research