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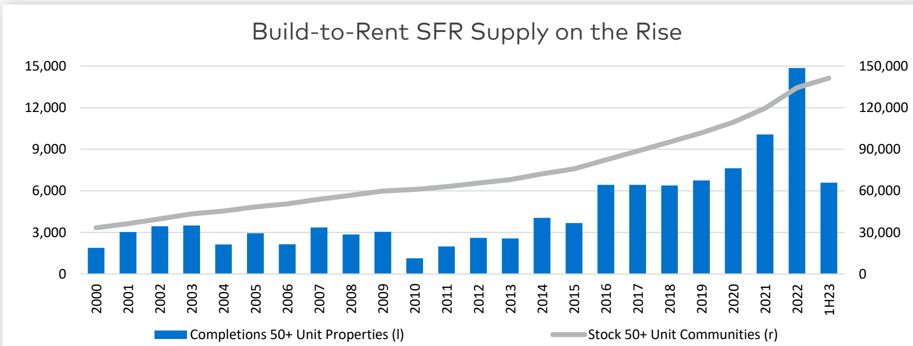
Despite Temporary Stall, Institutional SFR Growth A Good Long-Term Bet

After a period of rapid expansion fueled by low mortgage rates and fast-paced home price appreciation, the institutional single-family rental industry has retrenched into a moderate growth mode with a focus on improving operational efficiency. The new phase is less exciting than rapid expansion and outsize returns, but it puts the industry in position to thrive over the long term.

Institutional SFRs were affected by COVID-19, like all housing segments. Low interest rates and rising home prices spurred sales, while robust household formation fueled demand. Institutions took advantage of historically high multifamily prices and investors looking for higher yields by raising capital to buy single-family homes. The result was rapid growth, although institutions still own a small share of single-family homes. Institutions currently own roughly 600,000 SFR units, about 3% of the 17 million single-family rental homes and a small fraction of the 82 million occupied single-family homes in the U.S.

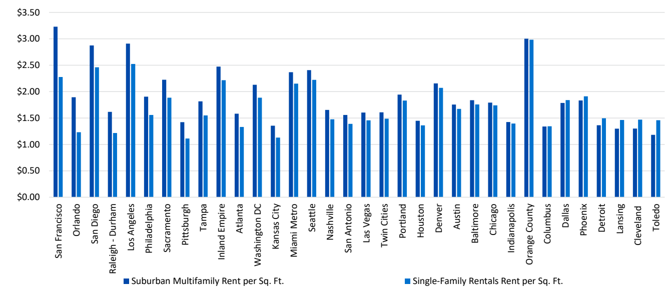
Institutional SFR portfolios comprise scattered site properties (homes acquired individually) and SFR communities, most of which were built as rentals. Yardi Matrix tracks communities with 50 or more SFR units. Our database encompasses more than a quarter-million single-family rental units, comprising 141,000 operating properties and 121,000 units in the build-to-rent (BTR) pipeline, which include 50,000 that are under construction.



Source: Yardi Matrix

Institutional purchases of scattered homes have cooled in 2023 as home sales have plunged nationwide, so the sector's growth in the near term will be concentrated in BTR communities. New construction is a slower growth path than acquisitions. Consequently, sector growth is likely to move in fits and starts in coming years, dependent upon interest rates, the direction of home prices and investor demand for commercial property niche products.

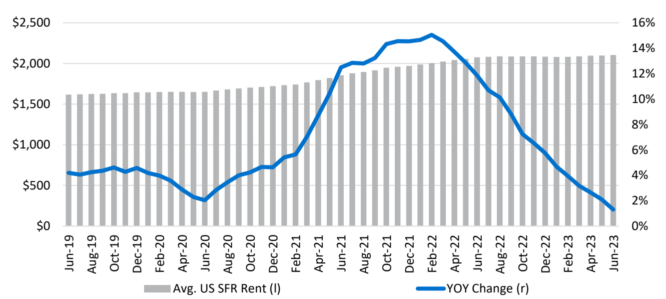
Suburban Multifamily vs. SFR Rent PSF, June 2023



Source: Yardi Matrix

Whatever happens in the capital markets, demand for single-family rentals is almost certain to remain firm. The pandemic provided a boost to household formation and SFR demand that is likely to prove durable. Renters cooped up in small city apartments wanted space for children and pets. People who began to work from home wanted more space for home offices. The percentage of people who work from home full time rose from about 2% to about 8%, while more than a quarter of workers have a hybrid arrangement. Surveys of employers and employees confirm that work-from-home will be a lasting phenomenon.

National SFR Rent Growth Decelerates From Peak



Source: Yardi Matrix

SFRs also meet the demands of many families who desire the amenities provided by a house without the responsibility of ownership. Some SFR tenants prefer not to own homes to have flexibility to move or avoid the burden of property maintenance. Others would prefer to own the house in which they live but cannot afford it or have credit issues. Some SFR operators have programs that provide a pathway for these types of renters to buy their house after renting for a period, but those constitute a minority of SFR rentals.

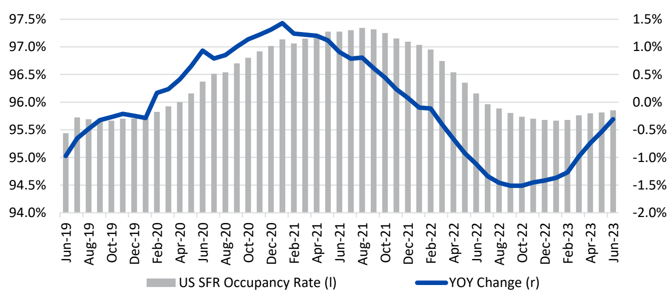
Given the occupier demand for the product and the strong returns produced by the sector to date, SFR has solidified its presence as a niche segment of the overall commercial real estate market. The extent of growth, however, will depend on how much SFR owners and investors can find consistent means of financing acquisitions and develop efficient property management strategies.

Healthy Fundamental Drivers

Single-family rents participated in the run-up of housing costs during the post-pandemic period. As of mid-year 2023, the average SFR rent in the U.S. was up 27.9% since January 2020 and 39.8% since Matrix began tracking the sector in January 2018. *(All SFR performance data cited in this report is from Yardi Matrix's database of SFR communities with 50 or more units.)* Rents increased by $350, or 20.2%, in 2021 and 2022 combined, with year-over-year growth peaking at 15.0% in the first quarter of 2022.

Rent increases have slowed in 2023, up $23 in the first half of the year, while year-over-year growth has decelerated to 1.3%. Rents were bound to slow, as the average rate is bumping up against limits of affordability. That rents continue to rise is a sign of the strong demand. Metros with the strongest year-over-year growth as of mid-year 2023 include Nashville (21.3%), Baltimore (13.3%), Chicago (11.1%), Pittsburgh (10.7%) and Philadelphia (8.3%). Rent growth was weakest in Orlando (-20.9%), Miami (-8.6%) and the Inland Empire (-4.0%).

National SFR Occupancy Remains High



Source: Yardi Matrix

SFRs are less dense than multifamily, but they often produce higher rents per square foot than suburban multifamily units. In 27 of the 34 largest institutional SFR markets, SFR units achieved higher rents per square foot than suburban multifamily properties (we only compared suburban multifamily, since SFRs are almost entirely located in the suburbs). The differential was largest in San Francisco ($0.95/sf), Orlando ($0.66), San Diego ($0.41) and Raleigh–Durham ($0.40). In only six of the top 34 metros did SFRs produce less revenue per square foot than suburban multifamily, including Toledo (-$0.28/sf), Cleveland (-$0.17), Lansing, Mich. (-$0.16) and Detroit (-$0.13).

Another sign of strong demand is the extremely high occupancy rates. Since January 2018, the national SFR occupancy rate had ranged between 95.7% and 97.2%. The occupancy rate stood at 95.8% in July 2023. Although that is down 30 basis points year-over-year, it is a robust number and is likely to remain that way.

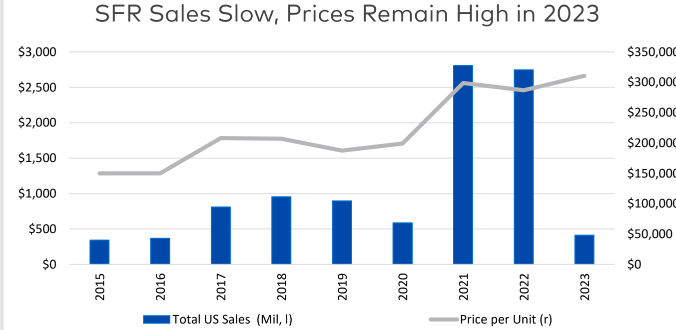
Acquisition Growth Slows

Institutional SFR acquisitions have slowed in 2023 after two years of record volume in the sector. Through two quarters in 2023, only $412 million of transactions were completed, far behind the pace that saw $2.7 billion of transactions in 2022 and $2.8 billion in 2021. To be clear, the data tracks sales of properties with 50 or more units, not all acquisitions by institutional SFRs. Despite that caveat, the trendline is consistent with slower individual property acquisition activity.

Sales in 2021 and 2022 were boosted by cheap financing, the amount of single-family inventory for sale, and the amount of investment capital flowing to the industry. Low mortgage rates of 3-4% enabled institutional SFRs to go on buying sprees, as low debt-service costs enabled SFR investors to underwrite high returns, even as home prices rose.

Mortgage rates, however, have shot up as the Federal Reserve has increased short-term interest rates by 525 basis points since the spring of 2022. Higher capital costs make it harder for SFR firms to meet return targets at current home prices and rent levels. At the same time, single-family inventory for sale is extremely low because the millions of homeowners with low-rate mortgages are reluctant to give up low monthly payments. Fresh investment capital is pulling back from the sector, making significant growth unlikely if interest rates

SFR Sales Slow, Prices Remain High in 2023



Source: Yardi Matrix

remain at current levels. The Federal Reserve has been adamant that it will not cut rates until it feels inflation is safely at or near its target 2.0% level, which means rates will remain at current levels into next year and possibly longer.

Although home sales nationwide are cooling, the average price per unit of institutional SFR communities sold has increased so far in 2023, according to Yardi Matrix's database. The average sales price per SFR unit in the first half of 2023 rose to $310,000, up 8.0% over the average price of $286,000 in 2022, and 55.8% more than the $199,000 average price in 2020. The average unit price peaked in 2021 at $298,000.

Top Owners of SFR Communities With 50+ Units

Owner	Units in Communities of 50+
Redwood Living	17,107
NexMetro Communities	5,903
American Homes 4 Rent	5,720
D.R. Horton	3,782
Empire Group, The	3,536
Lewis Group of Companies	3,169
Inland Real Estate Group	2,931
Hunt Companies	2,794
Taylor Morrison	2,792
W3	2,208
Mill Creek Residential Trust	2,021
Wan Bridge	1,950
Abrams Company, The	1,932
Camillo Properties	1,816
Corvias Group	1,700

Source: Yardi Matrix

Despite the rapid growth, the ranks of institutional SFR investors remain thin. The Urban Institute estimated in a paper published in April 2023 that more than three-quarters of institutional SFR units are controlled by 32 "mega" investors that own 1,000 or more properties, with small percentages owned by a range of others referred to as small, local investors, trust funds, flippers, servicers, builders and government agencies. There are two SFR public REITs that had an equity market capitalization of $28.7 billion as of year-end 2022 with a strong five-year annual return of 7.4%, which beats the 3.9% annual total return of all REITs, according to NAREIT.

BTR Deliveries Accelerate

The number of properties in institutional SFR communities with 50 or more units tracked by Matrix was 141,000 as of mid-year 2023 and is growing rapidly. The amount of SFR stock has increased 40% since the beginning of 2019 and has doubled since 2014. Some growth is the result of acquisitions, but most represents the expansion of the BTR sector. Investors increasingly recognize that banking growth on individual property acquisitions can be risky and that they have more control over quality and costs if they build properties themselves.

The sector completed a record 14,858 BTR units in 2022 and is on track to match that pace this year, with 6,600 units delivered through June. Meanwhile, just shy of 50,000 units are under construction, which is an indication that the growth in BTRs is certain to accelerate. Yardi

SFR Stock by Region

Region	Completed Units
Midwest	33,406
Western	22,024
Southwest	20,246
South	15,598
California	13,690
Southeast	13,145
Northeast	9,763
South	7,920

Source: Yardi Matrix

Matrix's database also tracks 36,000 units that are in the planning stage, which means they have approvals in place but have yet to start construction, and 36,000 units in the prospective stage, which is earlier in the entitlement process and somewhat further from breaking ground.

New supply follows the sector's historical geographic pattern, with properties under construction concentrated in the Southwest (10,678 units), West (9,842), Southeast (7,431), Midwest (6,395) and Florida (5,963). Regions with the most current operating stock are the Midwest (48,726 units), Southwest (46,474) and West (44,455).

Metros expecting a big increase in stock include Orlando, with 1,400 units under construction, a 417% increase in stock; Urban Atlanta, with 512 units under construction, a 280% increase in stock; Jacksonville, with 1,880 units under construction, a 213% increase in stock; and Savannah–Hilton Head, with 644 units under construction, a 211% increase in stock.

Some of the regional concentration stems from the beginnings of institutional involvement in the segment, when vulture investors bought large portfolios of defaulted home mortgages from banks, mostly in the Southeast and Southwest, in the wake of the 2008 global financial crisis. Other regional attractions for institutional SFRs include cheaper housing and availability of land to build new units.

Institutional SFRs with the most units under construction (in communities with 50 or more units) are: American Homes 4 Rent (3,055 units), Redwood Living (2,351), D.R. Horton (2,073), Wan Bridge (1,675) and NexMetro Communities (1,421).

Bigger May Be Better

The institutional SFR sector is in its infancy, having come into being less than 15 years ago. As a result, much about it remains fluid. One unsolved question involves risk and returns: How much should investors get paid for the lower amount of liquidity than multifamily? What are the best debt structures and lenders, and how should debt be priced?

SFR Units U/C by Builder
in Communities 50+ Units

Owner	U/C Units
American Homes 4 Rent	3,055
Redwood Living	2,351
D.R. Horton	2,073
Wan Bridge	1,675
NexMetro Communities	1,421
W3	864
Banyan Residential	655
Quarterra Multifamily	648
Watermark Properties	638
BB Living	635
Family Development	628
Empire Group, The	598
Cavan Companies	558
Embrey Partners	528
Greystar	508

Source: Yardi Matrix

Property management and operations are also developing rapidly. Maintaining and marketing a portfolio of spread-out properties has its challenges, but the largest owners have made rapid strides in improving maintenance costs and customer service. Operations technology and procedures continue to evolve rapidly.

Another challenge faced by the market is a pushback by legislators seeking to limit growth of purchases by institutional SFRs. Legislators in several states and Congress have introduced statutes—the Congressional bill's title is the "Stop Wall Street Landlords Act"—aimed at limiting corporate purchases of single-family homes. Critics claim that institutions drive home prices up and are worse at maintaining properties.

Besides being unnecessary—institutions comprise less than 1% of the single-family housing landscape and do not have enough market share to drive up prices—such legislation would be counterproductive. Not only would the practical effect be to limit new housing supply and ultimately make it more expensive but the premise is also wrong since there is evidence that institutions may be more suitable to manage rentals than mom-and-pops.

Economies of scale give institutions a competitive advantage that allows them to better renovate homes in need of repair. The Urban Institute paper noted that institutions tend to buy newer homes, which "allow for more uniformity and hence better economies of scale in making purchases during the renovation process, including appliances, HVAC (heating, ventilation and air conditioning) systems and components, and windows."

Institutions also have the means to better implement property management functions such as tenant screening, tenant communications, collecting rents, charges for delinquent payment, and eviction notices and filings. The Urban Institute paper concluded: "Institutional investors have economies of scale that allow them to implement policies that can improve the rental experience at a far lower cost than mom-and-pop investors can. This should be the focus of future public policy."

—Paul Fiorilla, Director of Research