NEXPOINT

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SINGLE FAMILY RENTAL: HERE TO STAY

Exploring the evolution of the Single Family Rental (SFR) investor base, the subsector fundamentals, and an outlook on the industry.

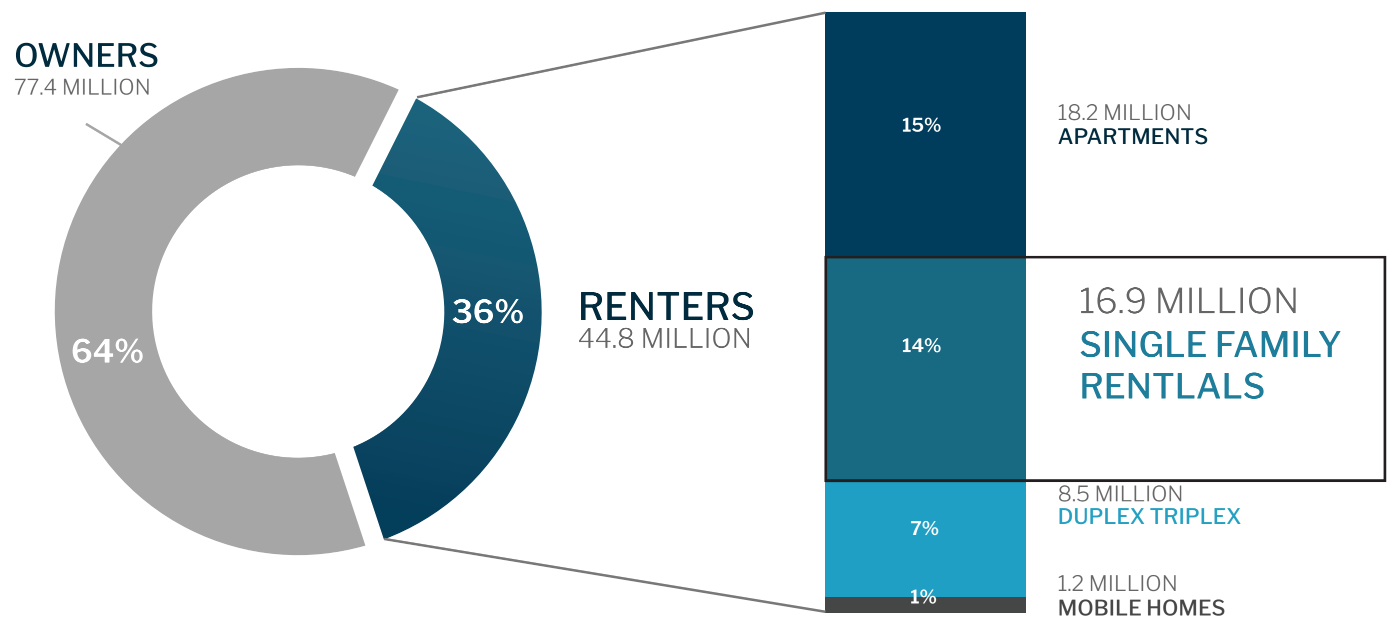
Finding Opportunity in Economic Downturn

Between 2006 and 2009, the US economy experienced its most dramatic recession since the Great Depression. The residential housing market was hit severely, as house prices fell 31% nationwide. Homeownership rates also declined[1]. The impact of the Great Recession is fresh in many Americans' minds. A little more than a decade later, the world economy is once more in turmoil.

TODAY, SFR REPRESENTS 14% OF RENTERS, OR 16.9 MILLION HOMES[2].

While some investors are still haunted by the effects the Great Recession had on the real estate market, others are seeing this an opportunity. Through it all, one thing remains constant: people need a place to live, making the residential real estate subsector an enticing option for investors. Out of the 121 million households in the U.S., 37% of those

US HOUSING MARKET - 121 MILLION UNITS



households are renters. Traditionally, today's renters would become tomorrow's first-time homebuyers. However, within the last decades and if the current lending environment stays in place, today's multifamily renters will become tomorrow's single-family renters. The single-family rental ("SFR") market has evolved materially in the past fifteen years. Today, SFR represents 14% of renters, or 16.9 million homes[2].

Institutional capital began to trickle into the single-family rental market after the Great Recession and has increased exponentially in the years following, creating increased efficiencies benefiting investors and residents alike. The growth potential of this subsector is creating what experts believe will be one of the fastest growing segments of the US housing market, thanks to solid fundamentals that have been in place for over a decade and have only been accelerated by the current recession. There's no doubt this recession will have lasting effects on the economy, demonstrating the resiliency of the asset class.

The Institutionalization of an Emerging Asset Class

The SFR subsector represents a massive opportunity for investors. While 55% of multifamily rental units are owned by large institutions[3], only 2% of single-family rentals are owned by institutions[4A], making this asset class ripe for consolidation. Nearly 90% of SFR investors own fewer than 10 units[3]. Today, there are three publicly-traded, SFR-focused REITs and approximately 50 private SFR operators.

As stated previously, the Great Recession in the mid 2000's is what originally drew many of the current institutional players to SFR ownership. As foreclosures appeared in masse, homeownership rates decreased significantly, from a peak of 69.2% in 2004, declining to a low of 62.9% in the following years[4B]. While a shift in several percentage points may not seem significant, it is important to note that each percentage point represents approximately 1 million households. As the appetite for rentership increased, institutions dipped their toes into the SFR pool, bringing much needed capital and liquidity to markets in turmoil from bank-originated foreclosures nationwide. It is estimated that over half of the increase in real house appreciation rates between 2006 and 2014 were attributed to institutional investors entering the SFR space[1].

Only 2% of single-family rentals are owned by institutions, as opposed to 55% of multifamily units

Institutional ownership allows for increased efficiencies and the ability to quickly scale when entering new markets. The other 98% of SFR operators are "mom and pop" owners who do not benefit from large regional or national platforms or have access to a network of industry experts. Large institutions also often have a stronger balance sheet, allowing for access to a diverse group of reputable lenders, while "mom and pops"

Largest Single Family Rental Operators

#	Company	Public/Private	Inception	Asset Type	# of Homes	# of Markets/ States
1	Invitation Homes	Public	2012	A	80,330	5
2	American Homes 4 Rent	Public	2010	A	53,984	8
2	Ares/Pretium	Private	2021	-	41,861	Nationwide
4	Progress Residential	Private	2012	A	40,000	16
5	Cerberus/First Key	Private	1992	B/B+	24,500	12
6	Tricon American Homes	Public/Subsidiary	2012	B	23,502	10
7	Amherst Residential	Private	2013		20,000	Nationwide
8	Home Partners	Private	2012	A	19,000	16
9	Vinebrook	Private	2007	B/C	14,025	19
10	Residential Capital Management	Private	2012	A	13,000	Nationwide
11	Conrex/Brookfield	Private	2011	-	10,000	5
12	McKinley Partners	Private	2006	Distressed	5,249	4
13	Man Group	Public	1784	-	4,000	17
14	Street Lane Homes (GTIS Partners)	Private	2016	B,B-, C+	4,000	8
15	Haven Realty Capital LLC	Private	2010	Distressed	3,600	4
16	The Prager Group	Private	2008	-	3,009	6
17	Gorelick Real Estate Advisors	Private	2005	B	2,440	1
18	Camillo Properties	Private	2011	-	2,261	3
19	Focus Partners	Private	-	-	2,000	1

often only have access to smaller, regional banks. Institutions are often able to obtain capital in advance of purchase from a variety of sources not available to small owner-operators, such as private equity or large bank lines of credit[5]. Stricter lending standards brought on by the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 contracted mortgage supplies, making access to mortgages more difficult or costly for individuals[1].

While SFR has been a successful investment for many “mom and pop” owners, they often don’t have the financial means or expertise to purchase, customize and routinely update the most advanced cloud-based property management technology. Many institutional players have established dedicated technology departments and additional capital to keep abreast of the latest and greatest property management software options and often develop their own proprietary products. Cloud-based software allows operators to streamline virtually all aspects of the business and increase efficiency. Common usage of these systems includes: creating algorithms for acquisition processes, improving communication and transparency related to tracking maintenance requests, and expanding the company’s reach through marketing. Leveraging their scale, institutional owners are able to provide the best possible service to tenants, a win-win for both parties.

Today, there are three publicly traded single family rental REITs representing a market cap of $25.1 million, compared to 15 publicly traded multifamily REITs representing an implied market cap of $109.4 million[6]. Even manufactured homes currently represent more market cap than SFR, with $26.0 across three publicly traded manufactured home REITs. There are also approximately 50 private SFR companies. With only 16% of the publicly traded REIT total market cap, SFR is clearly an asset class with immense opportunity to grow.

Why are Renters Choosing Single Family?

Occupancy rates in SFR are currently higher than they have been in over 20 years at 94.4% and are above the historical average[4C], signifying a growing trend in single family rentership. However, as demand grows, supply remains the same, creating a substantial supply/demand imbalance. Since 2009, 4.9 million single family homes have become rental properties, vs 6.3 million newly created apartment units[4D].

What is the catalyst in this shift? Renting is becoming more attractive to all age groups as the interest in homeownership wanes[4E]. Many people choose to rent simply for the flexibility – a large portion of their net worth isn't tied to one asset or location. Lack of homeownership also allows the flexibility to pursue employment or educational opportunities. Renters are also often forced into the situation by life events, such as death, job loss or divorce. Convenience also plays a big factor in the decision to rent vs. own, as having a landlord eliminates many of the headaches and costs related to maintenance and upkeep.

Another obvious factor adding to the increase in popularity in renting is the high barriers to homeownership[7]. In a survey, 49% of renters cited "not enough money for a down payment and closing costs" as a major obstacle on the quest to purchase a house. Other major obstacles were not earning enough money to meet a monthly mortgage payment (41%) and mortgage payments higher than rent/current mortgage payment (40%). At the current mortgage rate of 3.18%, 69% of households can afford a $200,000 mortgage and only 24% can afford a $600,000 mortgage[8A]. However, even at the entry-level price point, new homes are hard to find. Builder sales below $200,000 make up the smallest share of total new home sales, at 10%[8B]. Saving for a down payment and closing costs can be more difficult with debt burdens, such as student loans.

82% of renters view renting as more affordable than homeownership, up 15 points from February 2018

The average student loan payment is now $343/month, an increase of 64% from a decade ago[8C]. Also, 51% potential homeowners had insufficient credit scores, making them unable to qualify for a mortgage. Even if someone is able to find an entry-level priced home, the majority of the supply is older, which could require additional costs for renovation, maintenance, and upkeep. While renters may not be able to afford to purchase a home of their own, SFR becomes the obvious choice compared to multifamily for many families.

Household formations outpace the rate of housing starts, with 1.7 million households formed annually between 2017 and 2019, 34% above the rate of housing starts[9]. The term "household formation" is mainly associated with starting families, but also refers to roommate living arrangements, a trend increasingly common with millennials who are delaying starting families. With larger households comes a necessity for more space. Only 11% of apartments contain three bedrooms, compared to 65% of single-family rentals[8D]. In addition to larger square footage, many renters seek amenities not available in multifamily properties, such as a yard, increased storage and the lack of a shared wall; increasing privacy and decreasing noise. Renters seeking single-family options also perceive SFR as a "step up" compared to a multifamily rental. In one survey, one respondent stated they "felt more like adults, the fact that we're in a house, with a driveway and a garage[10]."

The Impact of COVID-19 on the Future of SFR

While no one can predict the future, there are many parallels between the last major economic downturn and the economic crisis caused by COVID-19. Stricter lending standards, rising student and consumer debt burdens, and lower household incomes were all product of the Great Recession. These factors are only increasing with this recession. As stated previously, student debt has grown exponentially, while record -breaking unemployment levels are lowering household incomes and causing consumer debt to increase. Another unfortunate trend leading renters to single family homes is the trade down effect.

As Americans experience job loss (or, specific to COVID-19, family death or illness), they may be forced to sell their homes, but may seek a similar living arrangement with the comforts of a home, as opposed to an apartment. The trade down effect also occurs with higher-class multifamily renters choosing a lower-priced single-family rental.

One notable difference between the last downturn and this recession is the housing supply. In the last recession, large amounts of foreclosures flooded the market, driving down housing prices. As a result, new construction lagged during that time, causing a tight supply that has carried into this recession[11]. Due to the tighter supply, rents have remained stable and collections have stayed at or above historical averages. The two largest publicly traded SFR REITS, American Homes for Rent (NYSE: AMH) and Invitation Homes (NYSE:INVH) experience strong rent collection and occupancy. In early August 2020, both AMH and INVH reported that May rent collections through month end represented 97% of historical averages.

Another COVID-19-specific impact is the work from home trend. As workers continue to be just as productive from their homes, many large employers are giving employees the option to work from home in the future. With an office at their fingertips, Americans can live virtually wherever they want. Those who have seen the impacts of COVID-19 in large once-popular urban metros, such as New York and San Francisco, may now seek more space and less density, in addition to the benefit of lower cost of living, and move to suburbs. Those same renters may also begin to crave the added freedom and space of a home after being cramped inside an apartment for months on end, especially families.

As some real estate asset types are in the midst extreme turbulence (such as office and retail), SFR is emerging as a safe haven. In mid-April, US REIT prices declined 25%, compared to the 16% decline in the S&P 500. However, SFR REITs have declined less than multifamily and the MSCI US REIT Index (RMZ). Year to date, the stock prices of the two largest publicly traded SFR REITs, AMH and INVH, increased 7.67% and declined 4.90%, respectively, compared to the 17.32% decline in the RMZ and the 13.12% decline in the Bloomberg Apartment REIT index. Sell-side analysts from reputable firms such as Janney Montgomery Scott and Raymond James have highlighted the subsector in recent reports.

In conclusion, the SFR sector is here to stay. Institutional support will streamline and propel the SFR space to new heights, much like what occurred during the 1990s with the multifamily space. The strong fundamentals in place before the recession have only been amplified by coronavirus, causing more and more demand amongst all age groups. Furthermore, there is plenty of room for institutional players. With only 2% of the market institutionally owned, there is ample opportunity and the increased growth and competition stemming from increased institutional ownership will benefit investors and renters alike.

Risk Disclosures & Notes

Sources

(1) Philadelphia Federal Reserve, Institutional Investors and the US Housing Recovery
(2) Source: Green Street Advisors, US Housing Dynamics, as of June 2020.
(3) Source: National Rental Home Council, Myths and Realities about the Single Family Home Rental Industry, March 2020.
(4) Source: John Burns 1Q20 Report, (A) As of Feb 2020, (B) As of June 2020 pg 89, (C) as of March, 31, 2020 pg. 73, (D) As of March 31, 2020 pg 77, (E) As of Sugust 2019 pg 57
(5) Source: Freddie Mac, Spotlight on Underserved Markets, pg 18
(6) Source: Nareit, June 2020
(7) Source: Freddie Mac, profile of Today's Renter, June 2019
(8) Source: John Burns (A) pg 109, (B) pg 97, (C) pg 91, (D) pg 68
(9) Source: Land and Buidlings, pg 2
(10) Source: The Terner Center, pg 8
(11) Source: HousingCanary May 2020 pg 1

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