Single-Family Rental Investment Trends Report

Q3 2024

Topics

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

SFR Construction Hits Another All-Time High as Structured Capital Markets Rebound

Key Findings

- SFR/BTR construction starts surged to another new record high.
- SFR CMBS activity in 2024 is on pace to triple last year's total.
- Cap rates rose to their highest point in more than six years as rent growth remained healthy.

State of the Market

As the single-family rental (SFR) sector expands, its structural strengths continue to counterbalance the challenges of a high-interest rate environment. In construction starts and other fundamental areas, clear signals have emerged that it is well-positioned for another growth spurt.

In recent quarters, institutional investors have focused on ground-up, purpose-built development rather than acquisitions of existing properties, resulting in a build-to-rent (BTR) construction surge.

The SFR sector, including single-family homes for rent, scattered site portfolios, and BTR communities, has a robust set of underlying demand fundamentals right now as access to affordable homeownership remains challenging amid high interest rates, limited available supply, and elevated home prices. According to data from the Federal Reserve Bank of Atlanta, buying a house is about 38% less affordable today than in 2020.

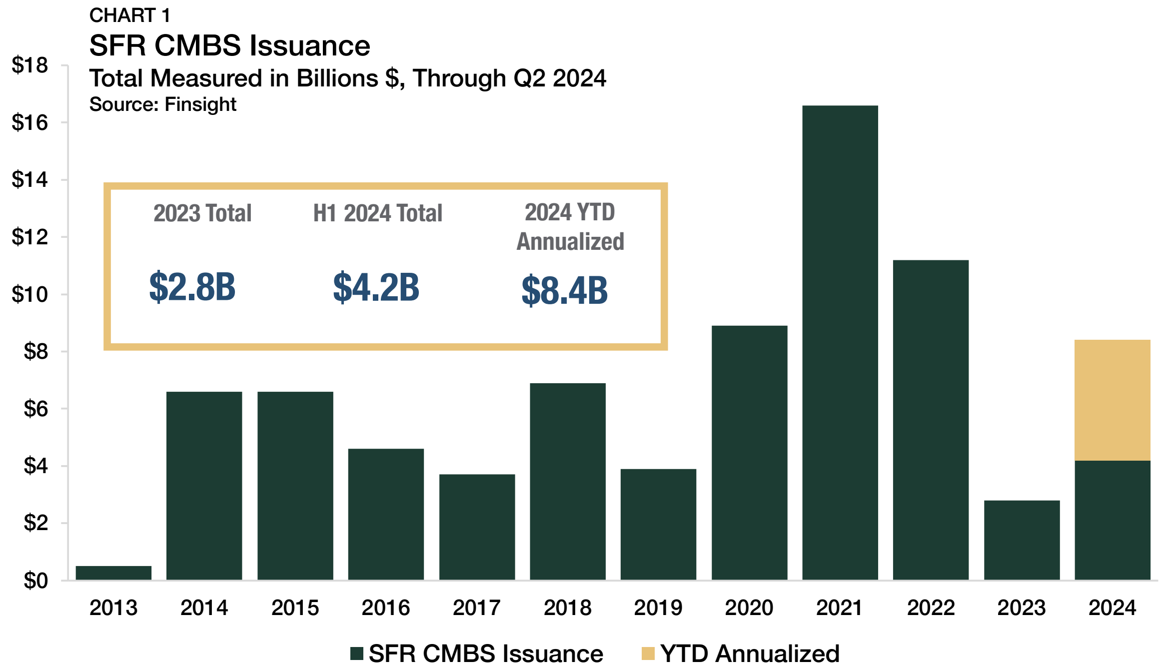
While the challenging conditions associated with high interest rates continue to impact cap rates and debt yields, most other gauges of SFR performance have either stabilized or improved. Structured SFR capital markets saw a burst in activity through 2024's first half, and distress remained minimal within the sector and throughout the broader housing market. Even as inflation pushes the cost of living higher, occupancy rates are stable, rent growth remains healthy, and construction momentum is gaining steam.

As we move through the second half of the year, SFR's structural strengths give it a solid foundation to grow as economic conditions continue normalizing.

Performance Metrics

CMBS Issuance

Structured SFR capital markets have seen distinct signs of improvement so far this year, Finsight data shows. SFR CMBS issuance has totaled [$4.2 billion]() through the first half of 2024 — 143% more than the output from the second half of 2023 ($1.7 billion) *(Chart 1)*.



If issuance in 2024's second half matches or exceeds the first six months of the year, total production would at least triple 2023's mark. While issuance levels have been below the historical highs registered during 2021 and 2022, this year's pace of activity, if sustained, would be roughly in line with 2020's tally and more than double 2019's level, another encouraging sign of a normalization underway.

Originations by Purpose

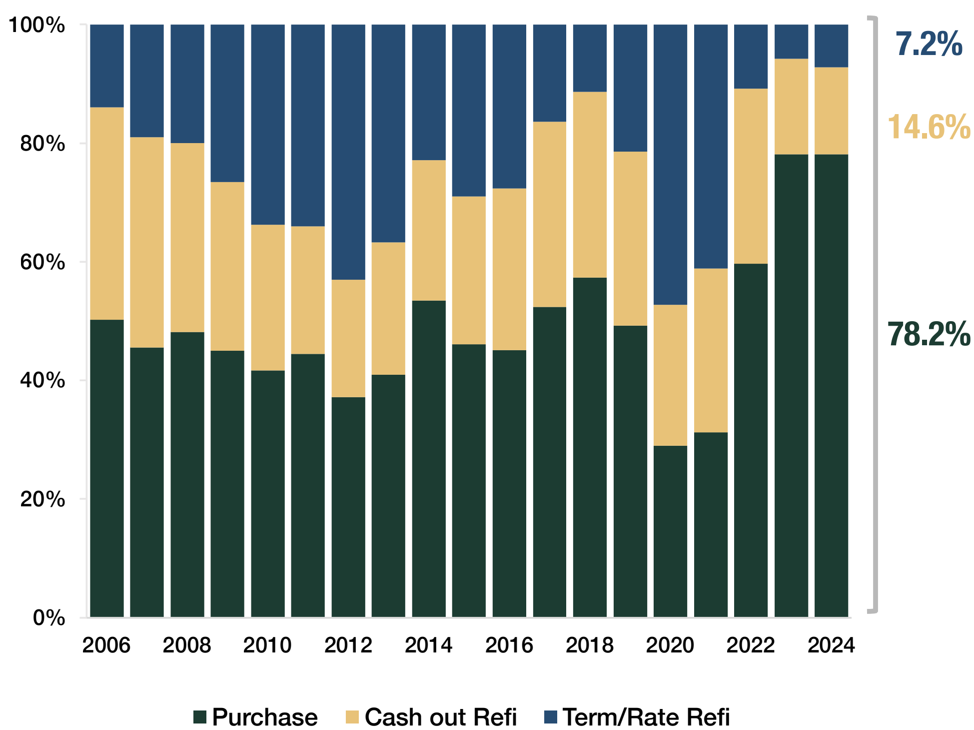
New acquisition loans have accounted for the lion's share of SFR originations since 2022 as the interest rate environment has reduced the incentive for refinancings. According to Fannie Mae, new loans intended for purchasing have accounted for 78.2% of SFR lending activity in 2024, the highest share on record going back to 1999 *(Chart 2)*. By contrast, rate-and-term refinancing loans, which accounted for 47.3% of originations just four years ago, accounted for 7.2% of 2024's lending activity through the first quarter.

CHART 2

Single-Family Originations to Investor Borrowers by Purpose

Measured as a % Share of Original Loan Balance, Through Q1 2024

Sources: Fannie Mae; Chandan Economics



The rolling four-quarter dollar volume of rate-and-term refinancings fell by 45.0%, compared to one year ago, an analysis of Fannie Mae data shows *(Chart 3)*. Cash-out refinancings also dropped significantly, declining by 57.7%. However, investor single-family purchases declined less rapidly, sliding by 28.6%. The dip in SFR purchasing activity was in line with the owner-occupant segment of the market, where single-family home purchases by first-time and non-first-time homebuyers retreated at a pace of 24.9% and 23.8%, respectively.

CHART 3

Fannie Mae Single-Family Originations by Purpose: Annual Percentage Change

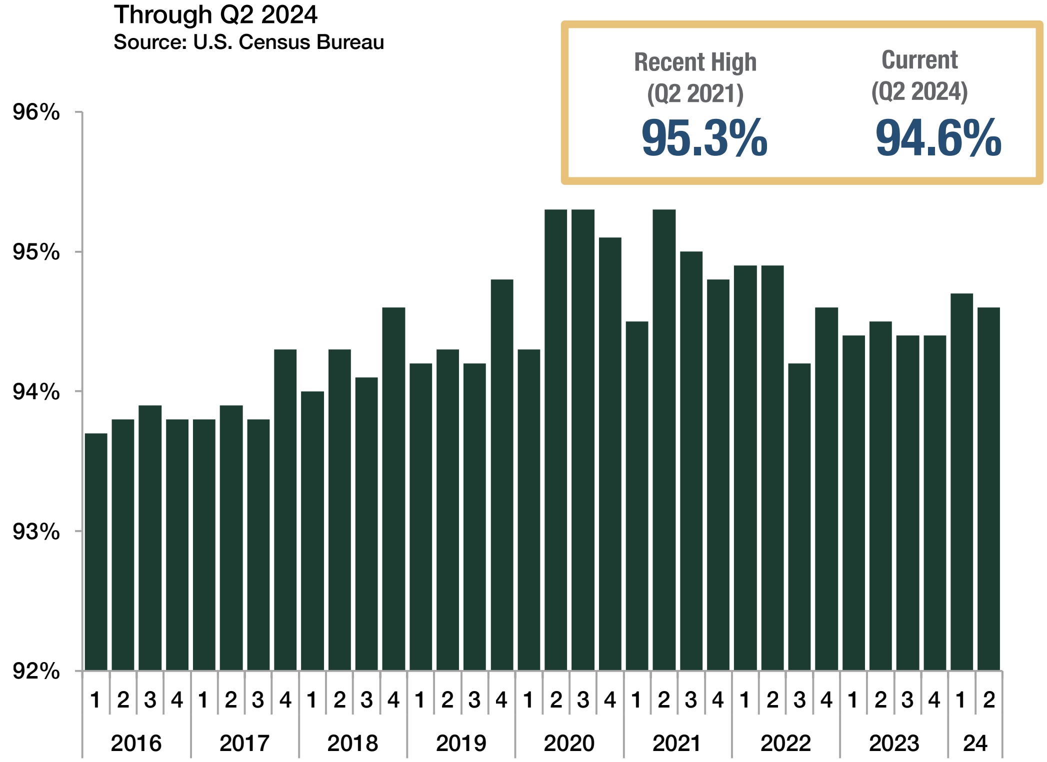
Measured as a Rolling 4-Quarter Sum, Through Q1 2024

Sources: Fannie Mae; Chandan Economics

Occupancy

Occupancy rates across all SFR property types averaged 94.6% in the second quarter of 2024, according to U.S. Census Bureau data *(Chart 4)*. The second quarter's SFR occupancy rate was slightly lower (-10 bps) than the prior quarter's rate, though it was up 10 bps from the same time last year. DBRS Morningstar, which tracks the performance of 133,664 SFR units within its rated CMBS transactions, reported a similar SFR occupancy rate of 92.4% through May 2024.

CHART 4
SFR Occupancy Rates
Through Q2 2024
Source: U.S. Census Bureau



Rent Growth: National

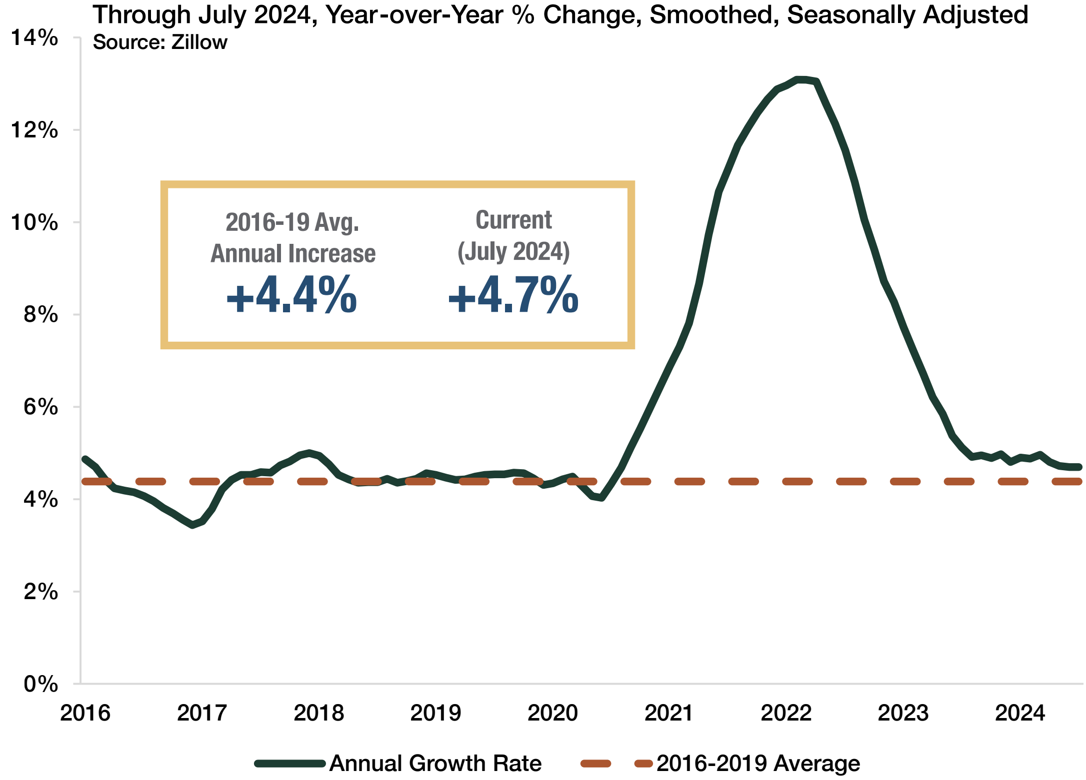
National SFR rent growth continued to increase at a healthy pace. According to Zillow's Observed Rent Index for single-family rental properties, rents in the sector were up 4.7% from a year earlier through July 2024 *(Chart 5)*. While rent growth retreated from the double-digit growth rates of 2021 and 2022, the current pace of increase remains robust by historical standards. Even though SFR rent growth slid in the past four consecutive months, the current annual growth rate was slightly above the pre-pandemic (2016-2019) average of 4.4%.

CHART 5

Zillow Observed Rent Index for SFR Properties: National

Through July 2024, Year-over-Year % Change, Smoothed, Seasonally Adjusted

Source: Zillow



DBRS Morningstar's latest SFR report shows the resumption of seasonal patterns for rent growth, lease renewals, and tenant turnover. Vacant-to-occupied (V2O) rent growth sat at 3.5% through April 2024 — up from 0.7% six months earlier. Renewal rent growth, which generally accounts for 80-85% of the sector's units, stood higher at 6.0% over the same period. Notably, renewal rent price momentum has re-accelerated over the past four months of data, with the annual growth rate rising by 1.7 percentage points in that time frame.

Rent Growth: Metros

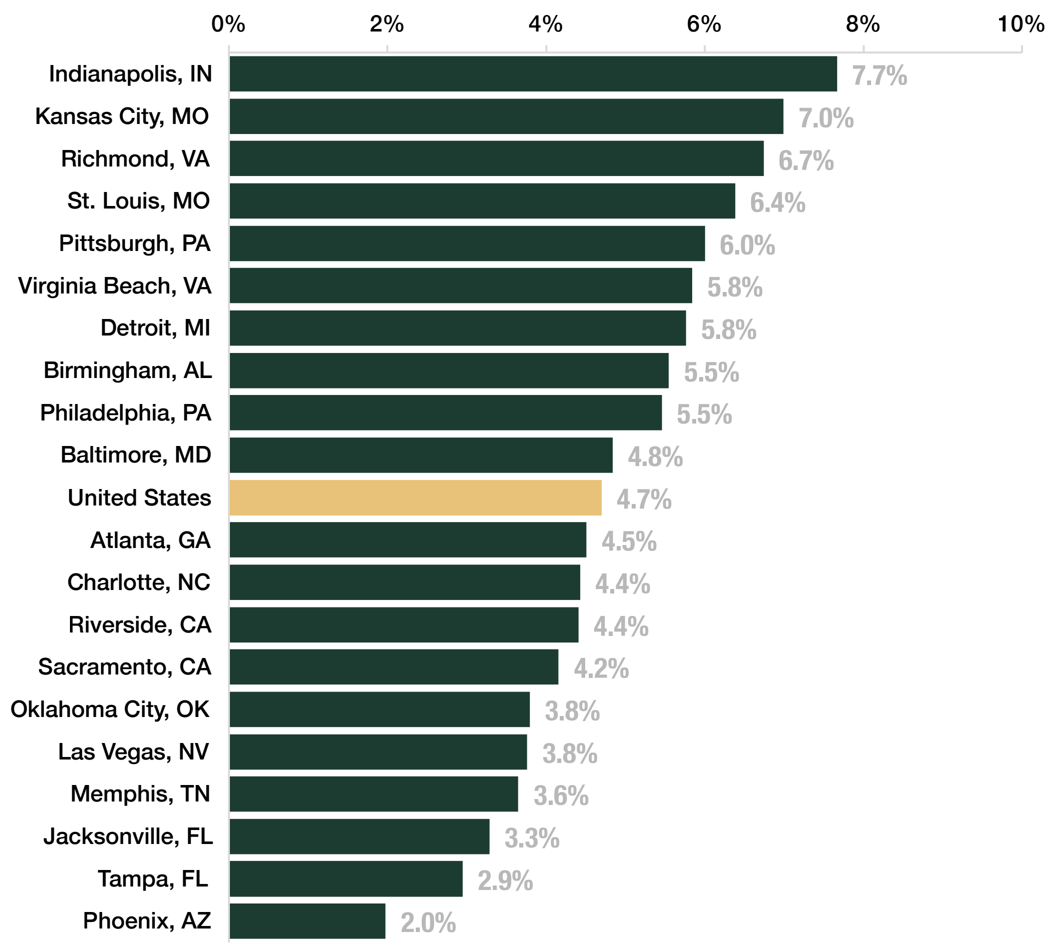
Among the top 20 SFR hotspot markets (defined here as markets with the highest SFR share of rentals across the top 50 metros by population), Indianapolis has been seeing the most robust levels of SFR annual rent growth, with prices rising 7.7% from a year earlier through July 2024 *(Chart 6)*. Closely behind was Kansas City, KS (+7.0%), and Richmond, VA (+6.7%). At the other end of the spectrum are several Sun Belt markets that accelerated most quickly during the post-pandemic boom and cooled afterward, including Phoenix, AZ (+2.0%), Tampa, FL (+2.9%), and Jacksonville, FL (+3.3%).

CHART 6

Zillow Observed Rent Index for SFR Properties: Metros

Through July 2024, Year-over-Year % Change, Smoothed, Seasonally Adjusted

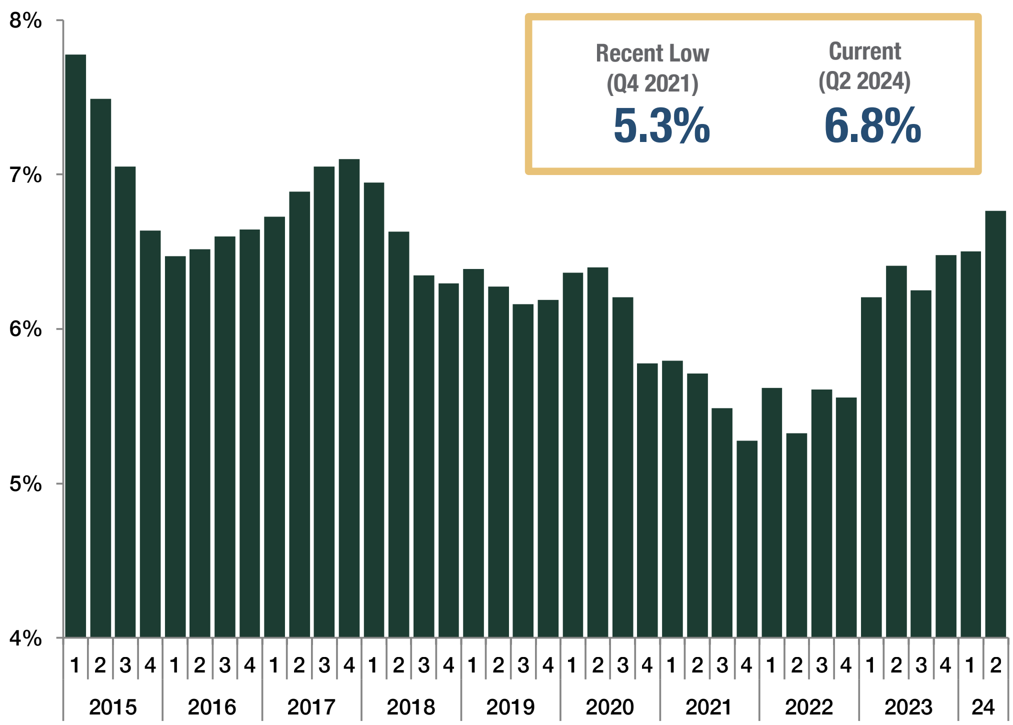
Source: Zillow



Cap Rates

Average cap rates across the SFR sector moved higher again in the second quarter of 2024, rising 26 bps to 6.8%[1] *(Chart 7)*. Cap rates rose in seven of the past 10 quarters, increasing by 149 bps, and have hit their highest point since the first quarter of 2018. With interest rates elevated, investors have been broadly revising their yield requirements. The continued upward movement of cap rates comes as transaction-based measures of home prices slid again in the second quarter of 2024 and property-level incomes rose.

CHART 7
SFR Cap Rates
Through Q2 2024
Source: Chandan Economics



[1] Unless otherwise noted, the Chandan Economics data covering single-family rental cap rates 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.

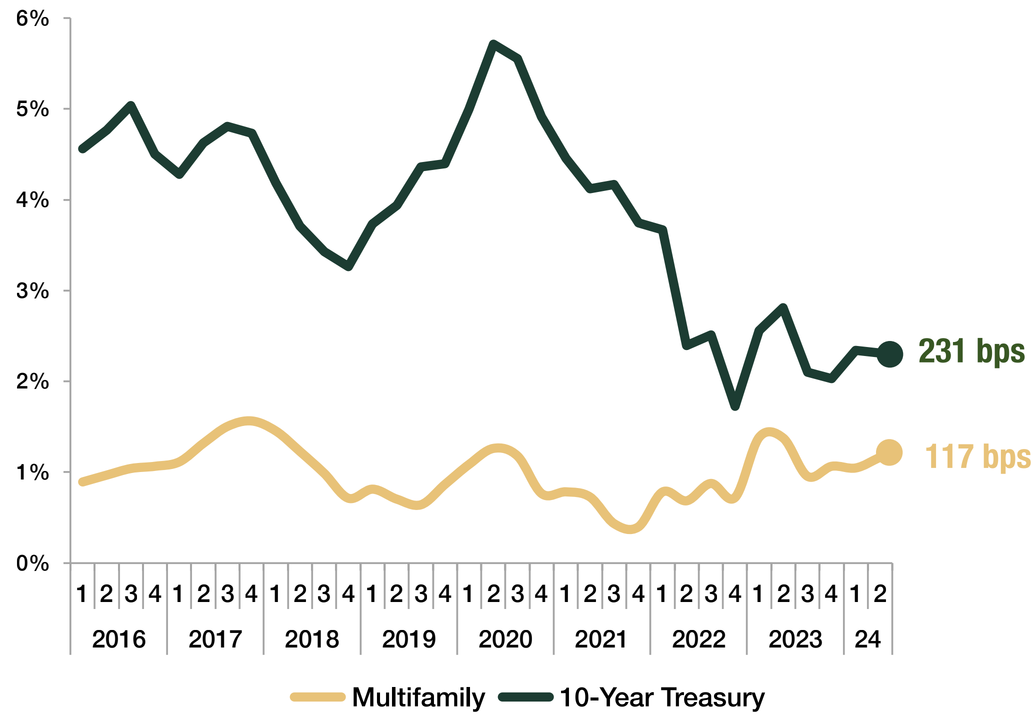
The spread between SFR cap rates and 10-year Treasury yields approximates the SFR risk premium. In the second quarter of 2024, 10-year Treasury notes carried an average yield of 4.5%, jumping from 4.2% in the first quarter. With average Treasury yields and SFR cap rates rising, the SFR risk premium held relatively flat, falling by a negligible three bps to settle at 231 bps in the second quarter *(Chart 8)*. Meanwhile, the spread between SFR and multifamily properties widened slightly by 12 bps, averaging 117 bps.

CHART 8

SFR Risk Premium

SFR Cap Rate Spread Between Multifamily Cap Rates & 10-Year Treasury, Through Q2 2024

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



Pricing

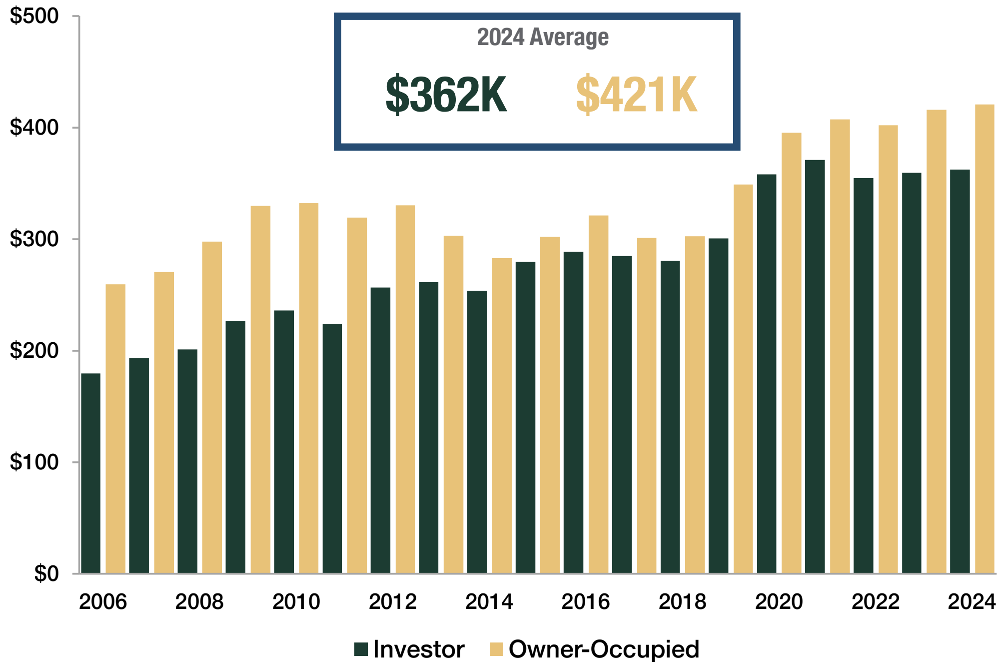
The average valuation of a single-family rental that received a Fannie Mae mortgage in the first quarter of 2024 was $362,343 — up 0.8% from the 2023 average *(Chart 9)*. During the same time frame, average valuations for owner-occupied units are up by a comparable 1.1%, reaching $420,790.

CHART 9

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

In Thousands $, Through Q1 2024

Sources: Fannie Mae; Chandan Economics



Historically, the average assessed property values on mortgages originated to single-family owner-occupants and single-family investors have been consistently different. Underwriters consider factors in rental properties (such as vacancies, turnover, and management-related expenses) that are not present in owner-occupied units, contributing to generally lower assessed values for rentals. Average property values are also lower because investors are incentivized to target value-add assets rather than paying higher prices for existing value.

While underwritten valuation gains have been marginal, trends this year have been encouraging. After valuations declined for both renter-occupied and owner-occupied single-family homes in 2022, each segment bounced higher in 2023 and has continued to do so thus far in the 2024 data. Notably, these trends contrast with transaction-based price indices, such as the Federal Reserve Bank of St. Louis' Median Home Sales Price Index, which continued to decline. This divergence reflects current market conditions in which lower-priced homes have a wider pool of buyers and sellers.

Debt Yields

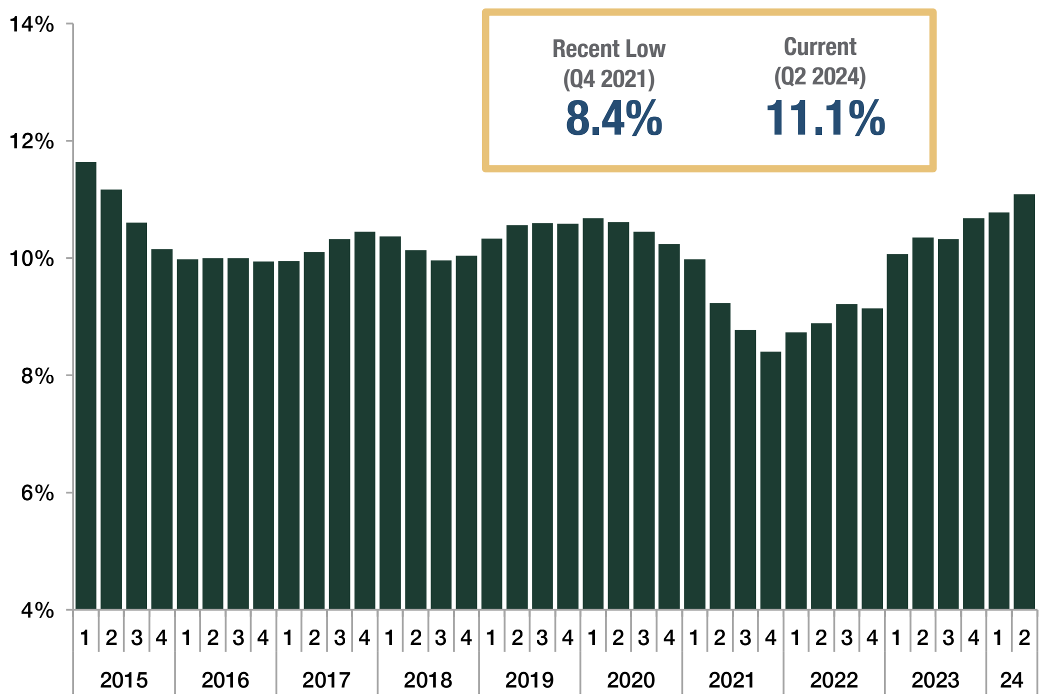
Debt yields, a key measure of credit risk, jumped again during the second quarter of 2024, rising by 31 bps to finish at 11.1% *(Chart 10)*. The increase marked the eighth time debt yields have risen in the past 10 quarters, indicating that lenders have remained cautious in an unsettled investment climate. The rise in debt yields in recent quarters translates to SFR investors securing less debt capital for every $1.00 of property-level net operating income (NOI). Through the second quarter of 2024, SFR debt declined to $9.02 for every $1.00 of NOI, a decrease of $0.26 from the previous quarter and a drop of $0.64 from the same time last year.

CHART 10

SFR Debt Yields

Through Q2 2024

Source: Chandan Economics

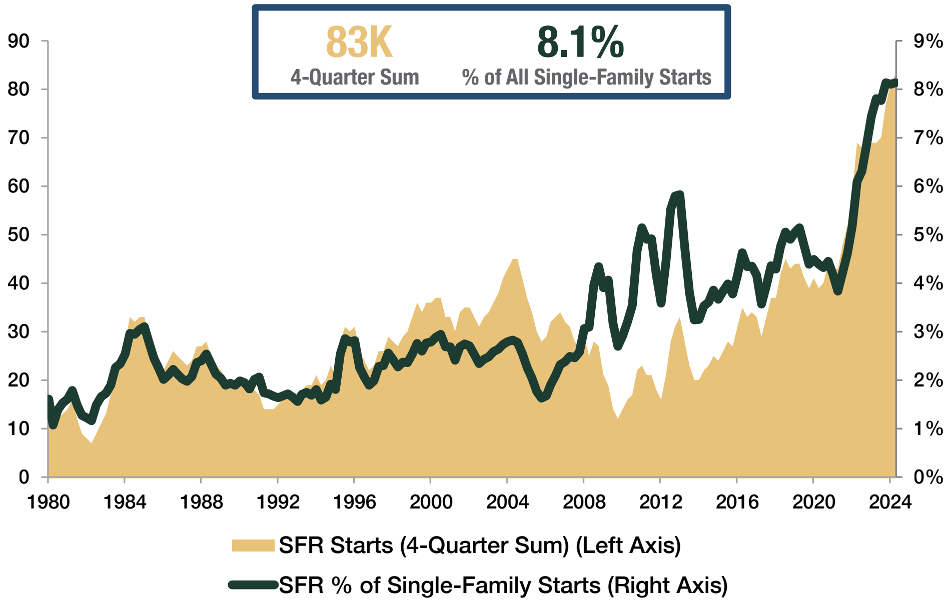


Supply & Demand Conditions

Build-to-Rent (BTR)

BTR communities have become a defining feature of the SFR sector. Through the second quarter of 2024, BTR development remained robust, with aggregate production and single-family market share both pushing up against all-time highs. Over the past 12 months, BTR accounted for 8.1% of all single-family construction starts, reclaiming the record high for the product type *(Chart 11)*.

CHART 11
Single-Family Rental (BTR) Housing Starts
Measured as Rolling 4-Quarter Sum, Total Measured in Thousands, Through Q2 2024
Sources: Chandan Economics; U.S. Census Bureau

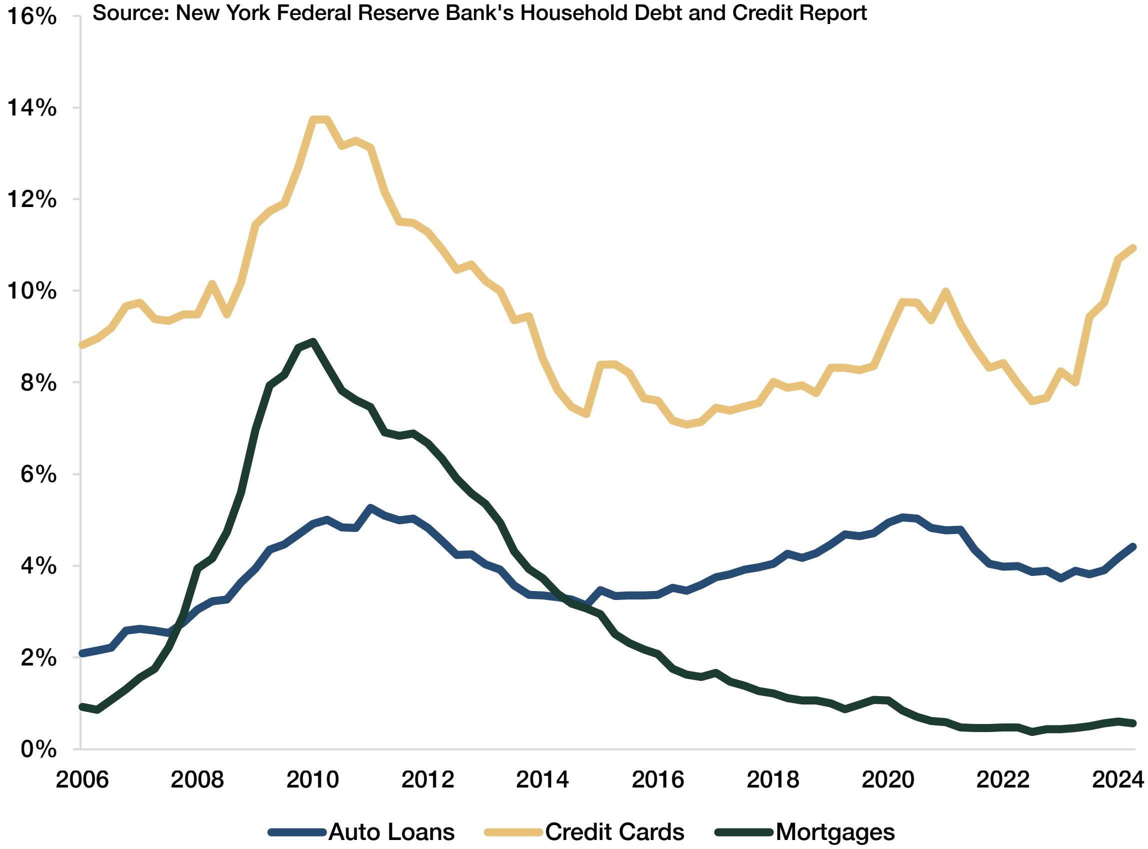


For comparison, before the SFR sector institutionalized in the aftermath of the 2007-09 recession, the BTR share of single-family construction never eclipsed 3.1%. By unit count, 83,000 BTR construction starts were recorded in the 12 months that ended in the second quarter of 2024 — another new record high. Notably, the rolling annual sum is up by 20.3% when compared to a year ago, demonstrating the sustained surge in BTR development.

Residential Distress

Even with elevated mortgage interest rates, there has been little to no distress across the U.S. housing market. The Federal Reserve Bank of New York's [Q2 2024 Quarterly Report on Household Debt and Credit] indicated that only 0.6% of household mortgages were more than 90 days delinquent through the second quarter of 2024, which is half of a percentage point below where default rates were at the start of the pandemic *(Chart 12)*.

CHART 12
Share of Balance Seriously Delinquent (90+ Days) by Loan Type
Through Q2 2024
Source: New York Federal Reserve Bank's Household Debt and Credit Report



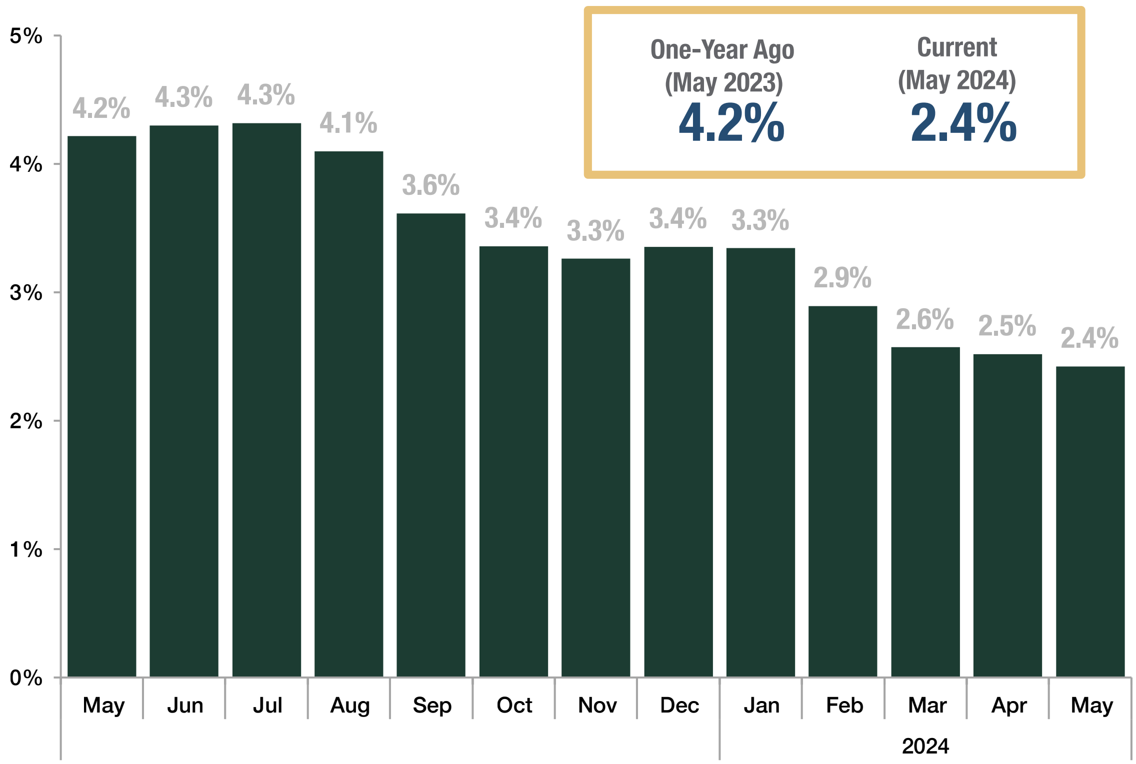
Within the SFR sector, evidence suggests that distress patterns mirror the broader single-family ecosystem, with delinquency rates dropping considerably. According to DBRS Morningstar, within rated SFR CMBS transactions, 2.4% of loans were delinquent in May 2024 — nearly half the 4.2% rate reported one year earlier *(Chart 13)*.

CHART 13

SFR Delinquency Rates

Loans in SFR CMBS Transactions, Through May 2024

Source: DBRS Morningstar



Outlook

Investors [broadly expect] that the Federal Reserve will loosen monetary policy this year, adding momentum to an ongoing normalization of real estate capital markets. Regardless, the SFR sector has not waited to hear the Fed's starting bell.

With structural tailwinds overmatching cyclical headwinds, BTR construction's gains this quarter were clear evidence of a sector on the rise. SFR's short- and long-term prospects continue to be bright due to its long-term demand profile and a strong pipeline, which will limit the need for conversions.

As the math behind rent-versus-buy calculations changes, single-family homes for rent continue to be an attractive option for many would-be buyers priced out of the housing market. On balance, while risks and challenges remain, investments in purpose-built communities and scattered site portfolios are solidly positioned to grow and even outpace its current gains in future quarters.

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