
FOR RENT

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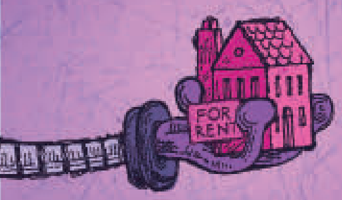
THE RENTAL-HOME MARKET HAS A BIG FOOTPRINT



Single-family for-lease properties could be part of the affordable-housing solution

Many people are shocked to learn that the single-family rental market represents the majority of rental-housing stock in the U.S. Structures of four or fewer units comprise 53 percent of all rental housing, according to the 2016 American Community Survey conducted by the U.S. Census Bureau.

Institutional investors, however, have largely overlooked this sector of the housing market. As a result, single-family rentals represent an opportunity for commercial mortgage brokers to work with these investors, especially as Fannie Mae and Freddie Mac expand their financing in this space. »

Illustration by Dennis Wunsch

> "The larger aggregators of SFR portfolios … are finding the best returns in properties valued below $200,000."

<< **Rentals** continued from Page 31

Although the multifamily mortgage market tops $1.2 trillion in outstanding debt, the total of securitized single-family rental loans held by institutional investors barely tops $20 billion. Owners of single-family rental (SFR) properties have been forced to resort to high-cost hard money loans, full-recourse personal loans or pure equity to acquire and manage their assets.

Institutional lenders in the SFR space started to emerge in 2014, following the wave of well-established, opportunistic investors purchasing portfolios of foreclosed homes and financing them with Wall Street capital. These major players — including Invitation Homes, American Homes 4 Rent, Progress Residential and others — amassed enormous portfolios of homes but still only account for about 1 percent of the total SFR market.

The other 99 percent of investors are not being afforded the same access to capital. So, a multi-borrower SFR market has emerged that is composed primarily of small and midsize owners of residential rental properties, a market opportunity estimated to be as large as $6 trillion.

Boosting affordability

Single-family rental properties provide an excellent housing opportunity for working-class families. They offer safe neighborhoods and access to good schools, as well as more living space and outdoor space than apartments. More often than not, they also are affordable. The traditional mom-and-pop owners of SFR properties are highly focused on maintaining occupancy and tend to keep rents low to avoid turnover. And the larger aggregators of SFR portfolios, which can range from 10 to 1,000 units or more, are finding the best returns in properties valued below $200,000.

These are the target borrowers for private lenders that focus on providing mortgage capital to the SFR space. Some 78 percent of the properties included in a 2016 SFR securitization, for example, were deemed affordable for residents earning 80 percent of their area's median income, or AMI. In addition to being large and underserved, the small-balance SFR market is predominantly affordable.

It's no surprise, therefore, that the SFR market has caught the attention of Fannie Mae and Freddie Mac. The two government-sponsored enterprises (GSEs) have a stated goal of increasing the availability of affordable housing across the country. Historically, this has been accomplished through the purchase of residential mortgages as a way to lower the cost of capital for homeowners. More recently, both Fannie and Freddie became active purchasers of multifamily mortgages, expanding their influence into the rental-housing sector.

Now, as the single-family rental market has matured, the Federal Housing Finance Agency (FHFA), which oversees both Fannie and Freddie, has paved the way for the GSEs to be more active in SFR financing. Both agencies have recently sponsored securitizations of single-family rental loans, and Freddie has launched a pilot program to purchase SFR loans from approved sellers and servicers.

GSE involvement

A 1998 study by the U.S. Department of Housing and Urban Development reported that 83 percent of single-family rental units qualified for the GSEs' low- to moderate-income housing goals, compared to 35 percent of single-family owner-occupied properties. The same study said SFR mortgage purchases by the two GSEs totaled $11.6 billion, or about 3 percent to 4 percent of their overall mortgage volume.

Those figures have certainly increased in the two decades since, given the estimated $6 trillion market for small and midsize owners. Becoming more involved in the SFR market is a logical strategy for the GSEs to meet their affordability goals. Given the fragmented nature of both ownership and financing of SFRs, however, their tactics to expand market penetration are varied.

In April 2017, Fannie Mae completed the first GSE securitization of SFR properties by guaranteeing 95 percent of a $1 billion loan made by Wells Fargo to Invitation Homes. The transaction was groundbreaking for the SFR industry and allowed Fannie Mae to partner on a low-risk basis with a best-in-class rental operator backed by the Blackstone Group. The transaction drew criticism, however, because of the perception that Fannie Mae was using taxpayer dollars to enhance the returns of an already successful private-equity behemoth. Further, only 67 percent of the assets owned by Invitation Homes are classified as affordable

Continued on Page 34 >>

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<< Rentals continued from Page 32

for tenants earning less than 100 percent of AMI — less than the 81 percent share for Fannie's multifamily acquisitions in 2017.

On the heels of the Invitation Homes deal, Freddie Mac planned a comparable transaction but, in this case, had an increased focus on affordability. In December 2017, Freddie Mac guaranteed 80 percent of a $200 million multi-borrower securitization, with 94 percent of the properties classified as affordable for tenants earning less than 100 percent of AMI. Through this transaction, Freddie Mac was able to jumpstart its $1 billion commitment to the SFR sector and did it in a manner that was consistent with its overall housing goals.

Concurrent with that securitization, Freddie also launched a pilot program to purchase SFR loans of $5 million or more that are predominantly collateralized by affordable housing. It has named nine designated lenders to source this product and closed its first loan this past January. The collateral supporting the $11 million loan was 100 percent affordable for tenants earning up to 100 percent of AMI. Fannie Mae also has received FHFA approval for its own pilot program. Based on their increasing involvement, the GSEs appear to officially be active participants in the SFR financing market.

Market ramifications

What will GSE involvement do for the SFR industry? A glance back at the owner-occupied single-family and multifamily mortgage markets may provide a clue. Both of those financing sectors have seen steady growth with the backstop of taxpayer-supported purchases and guarantees.

With Freddie Mac (and Fannie Mae likely soon to join them) buying more qualified SFR mortgages, there should be enhanced liquidity for these properties. This should attract more investors to the market and more lenders to finance them. Ultimately, this may lead to consolidation of a fragmented market with larger, more sophisticated operators amassing diversified portfolios of properties.

An active SFR market should benefit the mortgage brokerage community as well. Enhanced liquidity for rental properties facilitates investor participation, boosting sales and property values. Historically, nonowner-occupied residential properties had limited options for financing, especially on a nonrecourse basis. The market for permanent financing of SFR-property portfolios is now well-established and growing. This also creates opportunities for the mortgage banking community, which had not previously considered SFR loans to be part of the commercial mortgage spectrum. With SFR loan portfolios now encompassing assets worth many millions of dollars, the revenue opportunities for commercial mortgage brokers are much more obvious.

Another potential benefit of institutionalizing the SFR industry could be the standardization of leases, financial statements and loan documentation. Freddie Mac, for example, has developed loan documents that take the best from existing precedents, and these will be the prototypes for new entrants into the market. The Mortgage Bankers Association and CRE Finance Council are now including SFR financing in their programming and advocacy efforts, and this should help create new market standards. Already, SFR securitizations are conforming to the CRE Finance Council's investor-reporting package.

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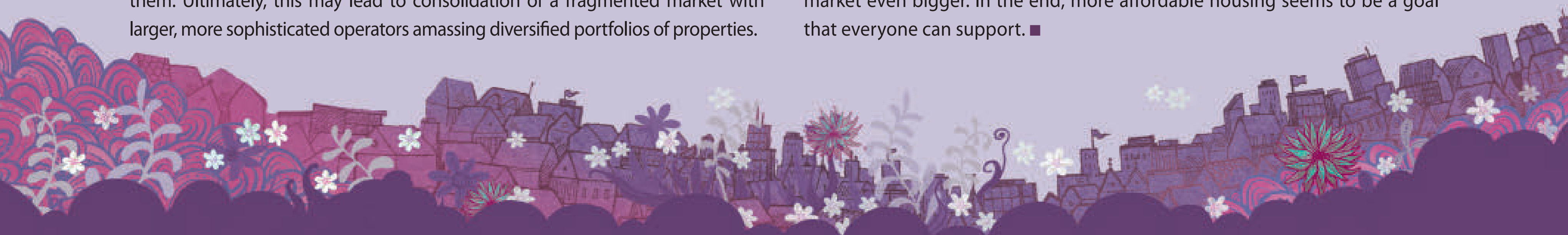
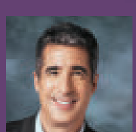
Ultimately, the beneficiaries of GSE involvement in the SFR market will be tenants themselves. An active secondary mortgage market, GSE guarantees and increased competition among lenders should lower the cost of debt for property owners. Consequently, cheaper financing should put less upward pressure on rents.

Additionally, abundant debt capital also may result in an increase in the rental-housing stock across the U.S., which could make an already-large SFR market even bigger. In the end, more affordable housing seems to be a goal that everyone can support. ■





Christopher Hoeffel is the chief financial officer of CoreVest Finance, the leading lender to residential real estate investors nationwide. He has more than 30 years of experience representing top financial institutions. Previously, Hoeffel was managing director and head of real estate debt investments at Investcorp. He received a bachelor's degree in business administration from Georgetown University and an MBA from the Wharton School at the University of Pennsylvania. Reach Hoeffel at chris@cvest.com.