ARTICLE | From Scotsman Guide Commercial Edition | November 2019

Take Another Stroll Down Opportunity Street

The market for single-family rental properties is alive and well

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One of the worst moments in the U.S. housing market also spurred a big opportunity for investors in single-family rental properties. Investment companies bought thousands of homes at bargain prices in the aftermath of the Great Recession. Many of these properties were casualties of the foreclosure crisis.

As the economy and home prices recovered, however, you may have heard that the window of opportunity has closed on this market — that it's too late to find suitable homes to convert to rentals, that these homes cost too much or there's no inventory. Don't believe it. There's still ample opportunity to broker deals in the single-family rental space. There are more financing options than ever before. And there are several other reasons why this market should remain strong.

The 2007 financial crisis and its aftermath brought about a historic change in U.S. real estate. Homes foreclosed at an unforeseen pace, banks failed and real estate values dropped to new lows. The housing collapse was a painful chapter, but it also created an unprecedented opportunity for investors to buy homes in certain markets at prices well below the cost to rebuild them. Although many investors still shied away from the market, a few major investors made a play for distressed properties.

Companies like Colony Capital, Blackstone and American Homes 4 Rent spotted the opportunity, built a business model and gobbled up single-family homes with the intention of converting them to rentals. Fast forward eight years and this initial vision has proven highly successful. As of this past May, single-family home values were up 56% nationwide since the market bottomed out in 2012, according to the S&P CoreLogic Case-Shiller Indices. In major cities like Las Vegas, San Francisco and Denver, values have risen significantly more during the same time span.

Today's market is much different than when investors began buying single-family properties eight years ago. The strong economy has spurred heavy buyer demand and caused a run-up in home prices. These conditions naturally raise the question of whether single-family rentals remain a good investment. The answer is yes for a number of reasons.

> "The fractured nature of a single-family rental portfolio allows investors to purchase homes with various locations and rent levels."

Solid yields

First, alternative investments have varying degrees of problems. It's been nothing short of a heroic quest to find investment yield over the past several years. Bond rates have been next to nothing, while the stock market remains volatile and uncertain. Meanwhile, low interest rates have pushed a significant amount of money into commercial real estate, specifically the multifamily-housing market where investors have been squeezed by high

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asset prices and historically low capitalization rates.

Multifamily cap rates in numerous cities remain low, making the apartment sector a tricky place to find solid investment returns. The average cap rate for multifamily infill assets, across all market tiers, was 5.3% in the second half of 2018 — the lowest cap rate among all commercial real estate sectors, according to CBRE. At 4%, the lowest cap rates were found in San Francisco and San Jose, roughly 2 percentage points above risk-free Treasury yields. Meanwhile, other asset classes currently carry additional risks and uncertain long-term yields. Traditional retail has been under pressure from Amazon and other online retailers, while hotels face challenges from Airbnb and other online lodging platforms that allow apartment owners to rent out their rooms to overnight guests.

By contrast, yields for single-family rental assets remain strong. In most markets, 10 single-family rentals will yield a higher return than a 10-unit apartment building. This is the result of a few factors. First, you can still find single-family homes to buy at reasonable costs. In many metropolitan areas, there's still a backlog of foreclosed properties that investors can acquire below retail price via auction. A savvy investor also can often score discounted prices from motivated sellers in off-market transactions.

Second, the fractured nature of a single-family rental portfolio allows investors to purchase homes with various locations and rent levels. This works as a sort of a hedge, where an investor can purchase a few lower-value homes with higher returns but also acquire some higher-value homes. The investor can dip into various cap-rate environments while not being overexposed to any particular neighborhood. Finally,

single-family homes generally have stickier tenants who stay longer than those living in apartments. Longer leases also result in fewer frictional turnover costs, which in turn drives up yield.

Changing consumer tastes also have boosted demand for single-family rentals. A greater percentage of people prefer renting to homeownership than a decade ago. In 2006, 31% of the population rented and 69% owned homes, according to U.S. Census data. As of second-quarter 2019, those numbers have shifted to 36% and 64%, respectively. This trend is expected to continue into 2020 and beyond as many millennials are trading in the ideal of the American dream of homeownership for the flexibility and less-anchored status of renting. This, coupled with the sluggish pace of new-home construction, creates a solid platform for the rental market under which the single-family investor can expect consistent, long-lasting income.

> “ **Technology continues to play a huge role for investors of all sizes in executing their single-family rental strategies.** ”

Using technology

For investors, it may naturally seem overwhelming to find, purchase and manage multiple scattered-site investment properties. How do you find the right opportunities? How do you better understand the market economics in each area? How will you be able to manage numerous homes that are not in the same location? One answer is technology.

Technology continues to play a huge role for investors of all sizes in their single-

family rental strategies. Roofstock and SFRhub, among others, list an inventory of rental properties and portfolios in multiple markets, many of which have been rehabilitated and may already have a paying tenant in place. This allows investors to go outside of their local market, identify opportunities and purchase homes without knowing the asset's return beforehand.

Redi Match and other tracking companies provide intricate market data throughout the country, enabling an investor to study and identify new markets of interest. Redi Match provides historical data and forecasts on specific neighborhoods to help investors better understand the opportunities. Investors can build out a profile that can be used to match properties to that investor's criteria. Most markets also have experienced single-family property managers who use online payment and operating systems. Given all these technologies, the idea of owning multiple rentals in different markets suddenly becomes attainable.

Financing options

The increased appetite for rental properties is accompanied by the need to find capital to purchase, renovate and maintain these rentals. Fannie Mae and Freddie Mac cap the number of loans available to investors through its programs. In the single-family rental business, however, scale is important. In order to build a profitable portfolio of rentals, one must have access to capital. The good news is that as more investors have looked to buy single-family rentals, there also has been an increase in lenders willing to finance such transactions.

Although most banks have failed to aggressively pursue these types of loans, private lenders have entered the space and created customizable, aggressive, nationwide lending options that enable investors to grow their business. With competitively priced debt in place, investors have been able to accelerate their returns and build long-term, profitable businesses. The bottom line is that the single-family rental market has been a strong investment since 2013, but you will still hear the same sentiments among skeptics that the window has passed. Other investors, however, will continue to recognize the opportunity and reap the benefits of owning single-family rentals.

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This is not a new asset class. Single-family rentals have long been part of the housing inventory in the U.S. The financial crisis opened the door, but there is still tremendous opportunity for commercial mortgage brokers and investors of all shapes and sizes who are willing to explore this world.

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