When will single-family rentals reach institutional scale? | PERE

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Although recent headlines may suggest otherwise, single-family rentals are currently a long way from becoming an institutionalized asset class.

In 2021, at least $45 billion was committed to the SFR space by institutional investors, managers, REITs and investment banks, according to John Burns Real Estate Consulting, a leading service provider and data tracker for the industry, up from $3 billion throughout 2020. In January alone, another $5 billion of investments were announced.

Despite this flurry of investment during the past two years, large landlords still account for a tiny share of the single-family rental market. The industry group National Rental Home Council pegs the share at less than 2 percent.

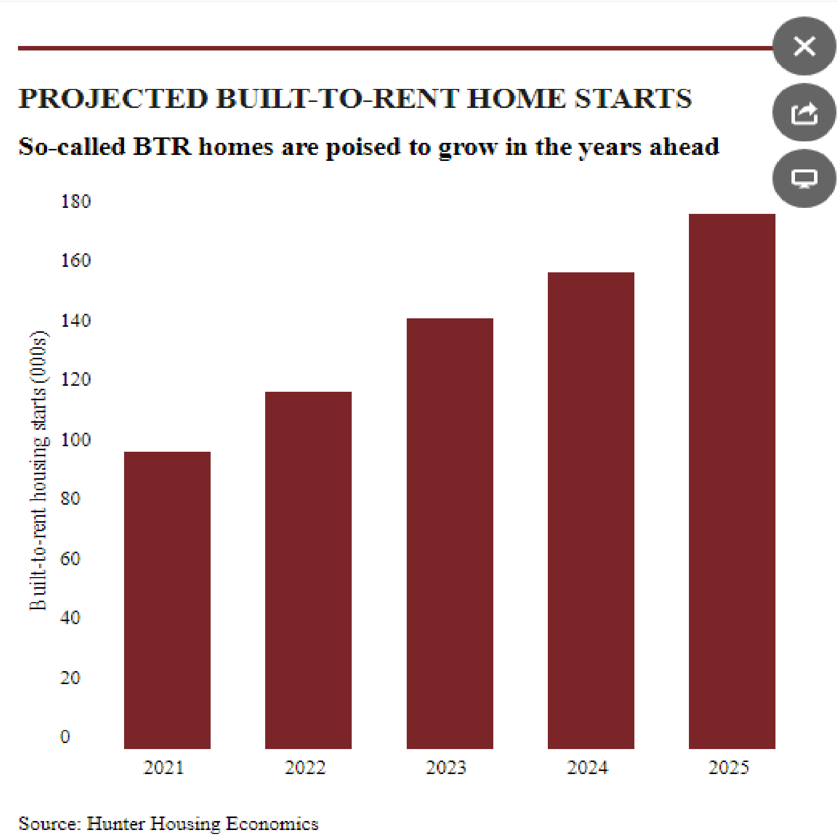
That small exposure is used as both a shield against accusations of market manipulation and an indication for how much runway lies ahead. It is also poised to change as SFR strategies become a staple of institutional portfolios. But just how quickly that transition can happen is up for debate.

"By the end of the 2020s, institutions will account for a majority of the growth in single-family rentals, which is a pretty quick change from where we are today," William Pattison, head of real estate research and strategy at MetLife IM, tells *PERE.*

Daniel Jacobs, a managing partner at the New York investment firm Asia Capital Real Estate, has an even more aggressive outlook, based on the belief that the sheer demand for rental homes will propel them into broad institutional ownership. Pointing to efforts to securitize debt for SFR investments, he says he is confident institutions will near a 50 percent market share within the next five years.

Others, however, see institutional dominance taking much longer to manifest given the sheer volume of rental homes in the country and the financial realities of shifting the balance of power.

"I just don't buy the math," Ben Maslan, managing director of the consultancy RCLCO, says. "You have to have incredible amounts of capital moving into SFR, a rapid ramp up, to get to the point where, in a decade, [institutions are] half or close to half of the market."



All grown up, nowhere to go

Much of single-family rental demand is being driven by millennials, the oldest of whom are turning 40. As members of the cohort get older, marry and have children, they desire more space, Jacobs says. This tendency was supercharged by covid-19, which made the prospect of living – and working – from a city center apartment less appealing.

The shift to suburban living has butted up against a nationwide shortage of housing, especially those priced for first-time buyers, Jacobs says, adding that the dynamic is unlikely to change anytime soon.

“There’s no supply in every major suburb of every major city, so when you have that crazy contrast of supply-demand, it’s going to take a while to adjust,” he says. “It’s here to stay.”

To meet this demand, homebuilders – with the backing of institutional capital – are shifting their development efforts toward purpose-built rental communities instead of for-sale subdivisions.

Brad Hunter, a Florida-based economist and real estate consultant, estimates that starts on built-to-rent properties will increase steadily from roughly 100,000 in 2021 to 180,000 by 2025, growing from 8 percent of the market to nearly 15 percent. But even that rate of construction will not be enough to satisfy the market.

“We’re still chasing demand,” Hunter says. “There’s not enough production, and you can see that wherever you see built around communities opening for lease. They lease up about as fast as they can be developed.”

Institutionalization trends

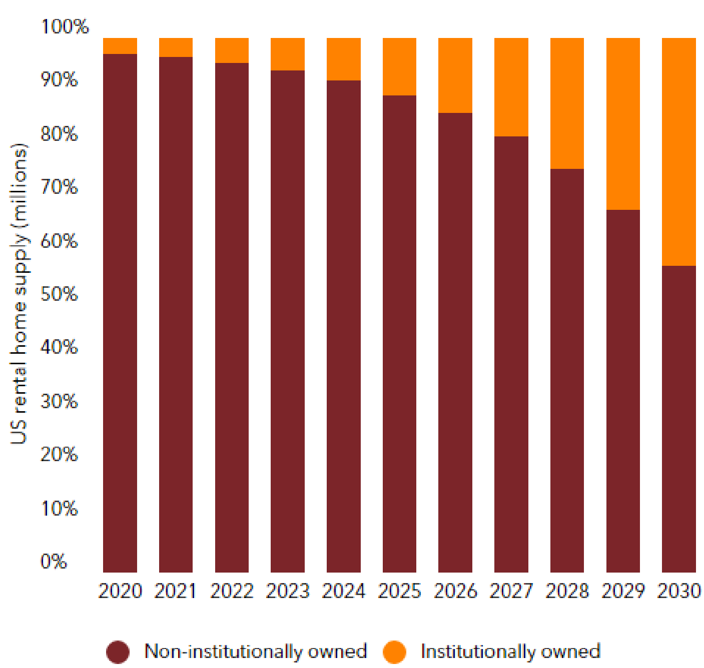
Rental homes have existed in the US for decades, but were not commodified until after the global financial crisis, when millions of homes were foreclosed upon, creating a mass buying event for institutional managers.

In 2020, MetLife IM tallied more than 14 million non-institutional rental homes against 436,000 institutional, pegging the institutional share at roughly 3 percent. The insurance investor projects both categories will grow until 2024, with non-institutional ownership surpassing 14.5 million before steadily declining in the following years. The institutional share, meanwhile, is set to grow by roughly one-third annually, hitting 7.6 million, or a 40 percent market share, by 2030.

“That’s following pretty closely what we saw, in self-storage,” Pattison says. “Self-storage was less than 10% institutionally owned in the early 2000s and it’s now primarily institutionally owned today.”

Multifamily followed a similar trend, Pattison adds. In the early 1990s, apartments made up around 10 percent of the NCREIF Property Index. Today, they account for 26.5 percent. At least 60 percent of the multifamily units in the country are owned by corporations, REITs or investment partnerships, according to the National Multifamily Housing Council, a trade group.

MetLife IM predicts institutional owners will have a 40% share of the US rental home market by 2030



Source: MetLife IM

As the SFR sector continues to deliver stellar performance – total returns for SFR REITS eclipsed 50 percent in each of the last two years, according to industry group Nareit – and become more transparent, the cost of capital will fall, Pattison says. This means institutions will be able to accept a lower rate of return, giving them a competitive advantage over non-institutional buyers.

“As the required rate of return goes down,” he says, “it means that for an average family or household thinking about where they want to live, the rental proposition will look more attractive than the buying proposition.”

Long way to go

The average built-to-rent home in 2020 was 975 square feet and costs between $105 and $115 per square foot between land purchases and improvement, according to John Burns Consulting. On the low end, that prices an institutional rental home at $102,375. If that holds steady – an unlikely outcome given rising costs of land, materials and labor – it would equate to $735 billion of investment between 2020 and 2030. Factoring in the acquisition of more costly existing homes, which figure to be a substantial portion institutional growth in the SFR space in the years ahead, drives the total capital requirement even higher.

Berman: institutions will acquire one million rental homes over next decade

Gary Berman, chief executive of Toronto-based Tricon Residential, expects the stock of institutionally owned rental homes to increase by about one million during the next decade. "The capital that needs to go into funding that million-unit growth is significant," he says.

Not every dollar committed to SFR during the past two years is being used to expand the market. Berman points to the $300 million preferred equity investment Blackstone's Real Estate Income Trust made into his firm in August 2020 as a prime example of this. That was essentially a recapitalization, he tells *PERE*.

Berman estimates that as much as half the institutional investment into this space could be categorized similarly. While that restructuring of ownership does not expand the market, Berman said it is a crucial component to its future proliferation.

"That's what real estate private equity is," he says. "It's the same office building getting traded, the same apartment getting traded, new investors coming in, recapitalizing and putting more money in, and then it repeats. It's a game of musical chairs. That's partly what's happening in single-family, which is very healthy, because that didn't exist before."