COMMERCIAL REAL ESTATE

Debt + Equity • Investment Sales • Loan Servicing • Fund Management

Single-Family Build-to-Rent

Strategies Evolve With Rates Elevated and Supply Growth Accelerating

SPECIAL REPORT

December 2023

INTRODUCTION

Supply and Demand Growth on the Rise

While the number of projects in the supply pipeline has attracted the most attention, 2023 has been a strong year for renter demand.

After a few years of rapid growth, the single-family build-to-rent market (SF BTR) is facing its first period of uncertainty. At this stage in the cycle, renter demand for units has remained strong, gaining momentum at the national level and across most major BTR markets. The rise in absorption has been outpaced by an accelerating rate of new construction, with more units set to deliver in the coming quarters with the development pipeline at an all-time high.

There are two primary forces that are influencing the near-term outlook: the competitive impact of new construction on operational performance, and a more restrictive and increasingly expensive capital environment. Fortunately, these factors should ultimately bring the market back closer to equilibrium—greater caution in the capital markets will restrict new development going forward, and ultimately limit supply-side pressures.

While the number of projects in the supply pipeline has attracted the most attention, 2023 has been a strong year for renter demand. Nationally, net absorption in 2023 was up 35 percent year over year.

Absorption is being fueled by an economy that is far stronger than originally forecast and mortgage rates that are making it more costly to transition from renting to owning. Renters find themselves in a position where unemployment is low, jobs are being added at an above-average pace, and wages are rising. In prior cycles, these conditions would prompt home sales, but with mortgage rates twice as high as two years ago and for-sale inventories limited, many current renters are choosing to upgrade their rental housing rather than purchase a first home.

There are two primary forces that are influencing the near-term outlook: the competitive impact of new construction on operational performance, and a more restrictive and increasingly expensive capital environment.

Even with renter demand on the rise, developers are delivering more single-family units than renters can occupy, pushing vacancy rates higher and restricting rent growth. These operational challenges could intensify in the near term, particularly if the economy cools in 2024.

Capital providers are acting more cautiously in this environment. Lenders are still doing deals, but rates are higher and loan-to-value totals are lower. More lenders are requiring recourse on new loans, and transitioning from construction loans to takeout financing is proving to be more challenging. Equity investors are more selective and fewer opportunities now meet higher return requirements.

While the current climate presents some clear challenges, there are conditions that spark some optimism. Inflation is trending lower, and the Federal Reserve has likely completed its cycle of rate hikes. Despite some stresses, the single-family build-to-rent sector is establishing itself as a core component of the residential housing market.

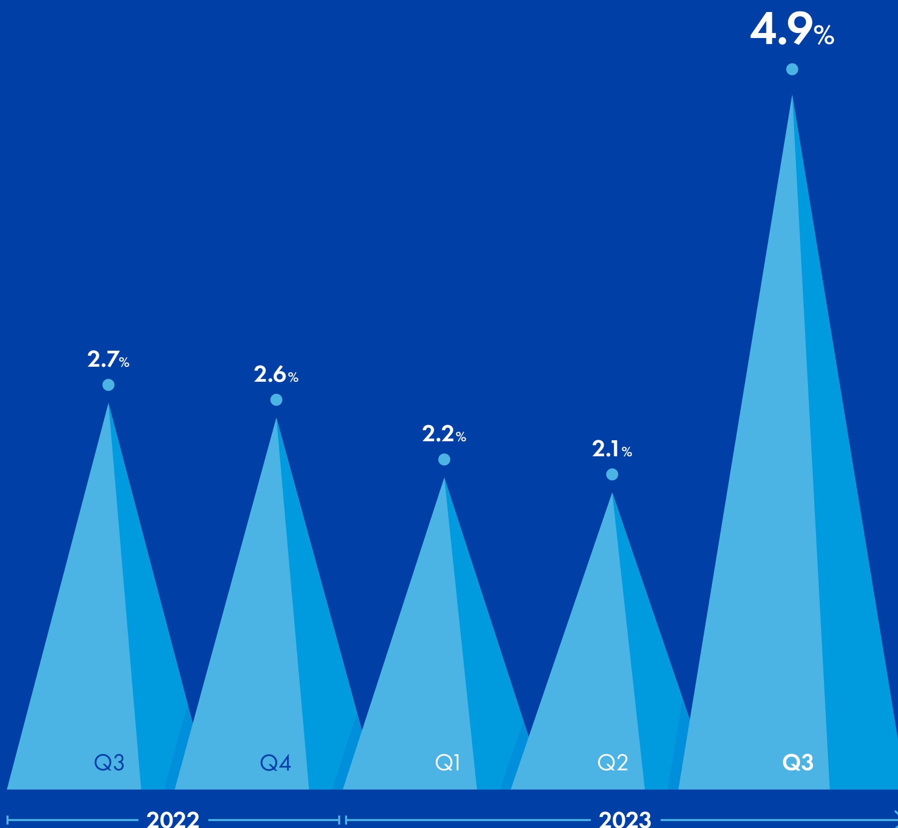
ECONOMIC OUTLOOK

Economy Surging Despite Elevated Interest Rates

Employment gains have been far more robust than preliminary expectations and recent GDP growth has been stronger than anticipated.

The economy outpaced expectations in 2023, supporting demand for housing, but also prolonging the period of higher interest rates. Employment gains have been far more robust than preliminary expectations and recent GDP growth has been stronger than anticipated.

During the first half of the year, quarterly increases in GDP dipped into the low-2 percent range, predictably slower than the pace of growth recorded in the second half of 2022 as the cumulative impact of higher costs of capital worked their way through the economy. During the third quarter, the combined forces of a still-active consumer, increased government spending, and inventory build-ups propelled growth to approximately 5 percent, a figure that surpassed all forecasts.



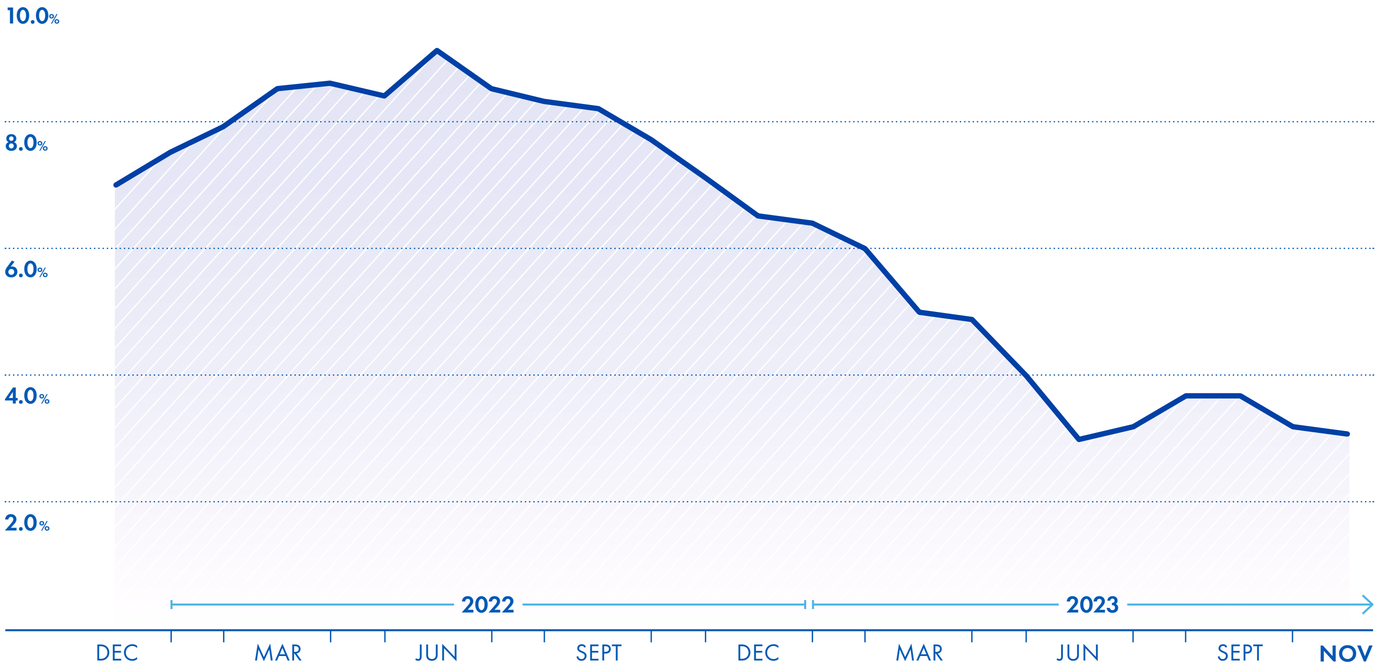
Economic Growth Outpacing Expectations

Quarterly GDP Growth

Sources: Northmarq, Bureau of Economic Analysis

Inflation Down From Peak, Above Target

CPI 12-Month Percent Change



Sources: Northmarq, Bureau of Labor Statistics

The CPI, which peaked at above 9 percent in June 2022, retreated to below 4 percent throughout the second half, and dipped to a low of just 3.1 percent in November.

The better-than-expected economic growth comes at a time when inflation has cooled, but remains above the Federal Reserve's target rate. The CPI, which peaked at above 9 percent in June 2022, retreated to below 4 percent throughout the second half, and dipped to a low of just 3.1 percent in November.

While inflation is largely in check, interest rates remain elevated. One of the clearest impacts of high borrowing costs is in the residential mortgage markets, where existing owners are hesitant to sell because they are unable to replicate their current mortgage rate, and would-be buyers are either less enthusiastic or priced out of the market by rates that have just recently come down from their highest levels in a generation.

Still, growth is strong, and it is this momentum in the economy that is supporting the labor market and fueling new household formation.

LABOR MARKET

Unemployment Low, Even as the Pace of Job Growth Slows

Growth in the national labor market outpaced all expectations during the past year. At the beginning of 2023, most forecasts called for either minimal gains or net job losses as recession fears, inflation, and rising interest rates were expected to drag on the private sector.

Instead, the economy proved to be resilient, led by tight labor conditions and consumers that continued to spend on goods, travel, and experiences. Unemployment ended the year at just 3.7 percent, and the rate has remained below 4 percent for nearly two years. This marks the longest sustained period of these low levels of unemployment in more than 50 years.

Employers added approximately 2.7 million net new jobs in 2023, and additions to payrolls continue to outpace expectations on a monthly basis. The pace of growth did slow during the course of the year, and the fourth quarter gain of nearly 500,000 jobs added was the lowest total since the recovery began. The recent slowing trend should carry over into 2024, with fewer jobs likely to be added in the coming year.

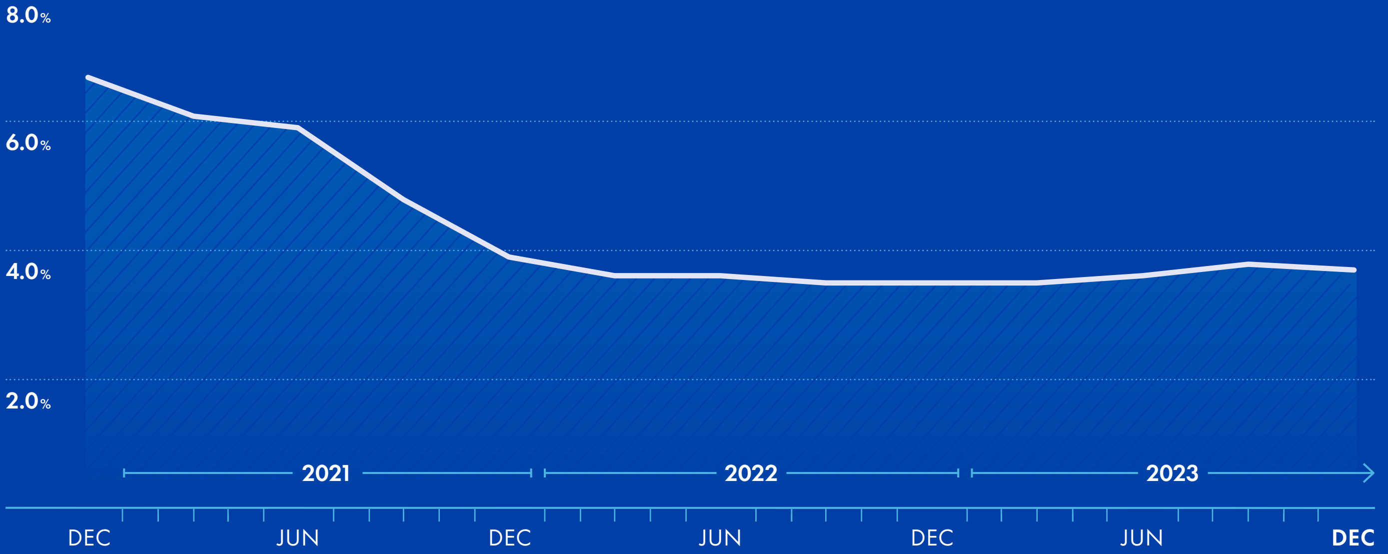
While the labor market is expanding, additions have been more concentrated in recent periods, and some industries that were leading sources of growth in recent years—particularly those that have greater sensitivity to interest rates—are lagging. More than 900,000 jobs were added across the healthcare and social assistance sector in 2023, accounting for nearly 35 percent of all of the nation's net new jobs. This sector, which is fueled by population growth and demographic trends, is expected to remain a leading source of jobs across most major markets over the next several years. Further, healthcare is essentially recession-proof, and the sector tends to expand even as the economy cools.

Employers added approximately 2.7 million net new jobs in 2023, and additions to payrolls continue to outpace expectations on a monthly basis.

Leisure and hospitality is another industry where employers have been adding workers at a heightened pace in recent years, although the recent rate of expansion is likely to prove to be unsustainable going forward. The sector has been in recovery mode since deep cuts in 2020, but is now within 1 percent of all-time highs. With much of the pent-up travel demand likely already released, leisure and hospitality employment should level off in 2024.

Unemployment Remaining Tight for Nearly Two Years

National Unemployment Rate



Sources: Northmarq, Bureau of Labor Statistics

Quarterly Job Growth Strong, but Slowing

Sources: Northmarq, Bureau of Labor Statistics

There are some soft spots in the economy that have dragged on growth. Many white-collar industries that had been leading the way in prior years are now posting only modest gains. Fewer than 50,000 jobs in the financial activities sector were added in the past year, down more than 70 percent from the rate of growth in 2022. A more dramatic decline emerged in the professional and business services sector, which grew by only 132,000 jobs in 2023 after expanding by nearly 750,000 positions in 2022.

While current conditions in the national labor market are healthy, growth is slower and occurring across fewer industries. In earlier periods when every sector was expanding, competition for workers was fierce, and wages were on a steep upward trajectory. More recent readings on wage growth show levels are more consistent with inflation, signaling a healthy—but not overheated—labor market.

FOR-SALE HOUSING

Mortgage Rates Elevated, but Limited Inventory Keeps Pricing High

Persistently high mortgage rates are stifling the transition from renting to owning and supporting demand for single-family rental housing.

Trends in for-sale housing are continuing to impact the single-family build-to-rent market. Persistently high mortgage rates are stifling the transition from renting to owning and supporting demand for single-family rental housing.

Existing home sales account for the bulk of the transaction volume in the for-sale housing market and volume levels have been on a steady downward trajectory since early 2022. In September, the annualized pace of existing home sales dropped below 4 million, reaching its lowest level since 2010. Volume was down in subsequent monthly readings, putting the market on pace for its lowest annual levels of activity since 1992.

While low inventory levels continue to give would-be buyers few options among existing homes, elevated mortgage rates are another factor suppressing activity in the for-sale housing market. Average residential mortgage rates first topped 7 percent in August and approached 8 percent by late-October. While mortgage rates have dropped about 100 basis points since peaking in October, a similar pattern emerged in 2022, before rates reached new heights.

The surge in mortgage rates has weakened housing affordability, dragged on sentiment, and widened the spread between the costs of owning and renting. When rates first began to trend higher, many buyers purchased homes in anticipation of ultimately refinancing when mortgage rates returned to lows that prevailed throughout much of 2022. Now, after more than a year of rates above 6 percent, would-be buyers are increasingly cautious and can not count on refinancing at a lower rate in the near term.

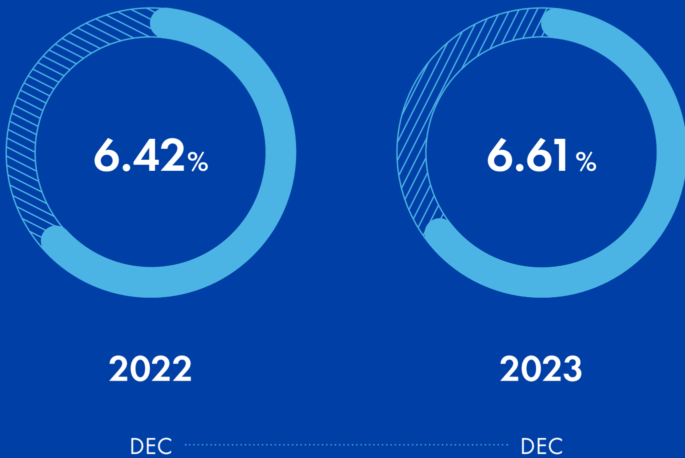
Prices for existing homes have inched lower, but not nearly far enough to offset the rise in mortgage rates. The median price in existing home sales in November was $387,600, down just 5.5 percent from the all-time high in June.

Mortgage Rates Above 6 Percent Throughout 2023

Average 30-Year Fixed-Rate Mortgage

Sources: Northmarq, Freddie Mac

Average 30-Year Fixed-Rate *Residential Mortgage*



The surge in mortgage rates has weakened housing affordability, dragged on sentiment, and widened the spread between the costs of owning and renting.

FOR-SALE HOUSING

Continued

Homebuilders have a greater ability to pay down mortgage rates for buyers than sellers of existing homes, and this is resulting in new home sales accounting for a greater share of total single-family sales activity. In September, new home sales reached a 19-month high. The volume of new home sales in September was up more than 33 percent year over year.

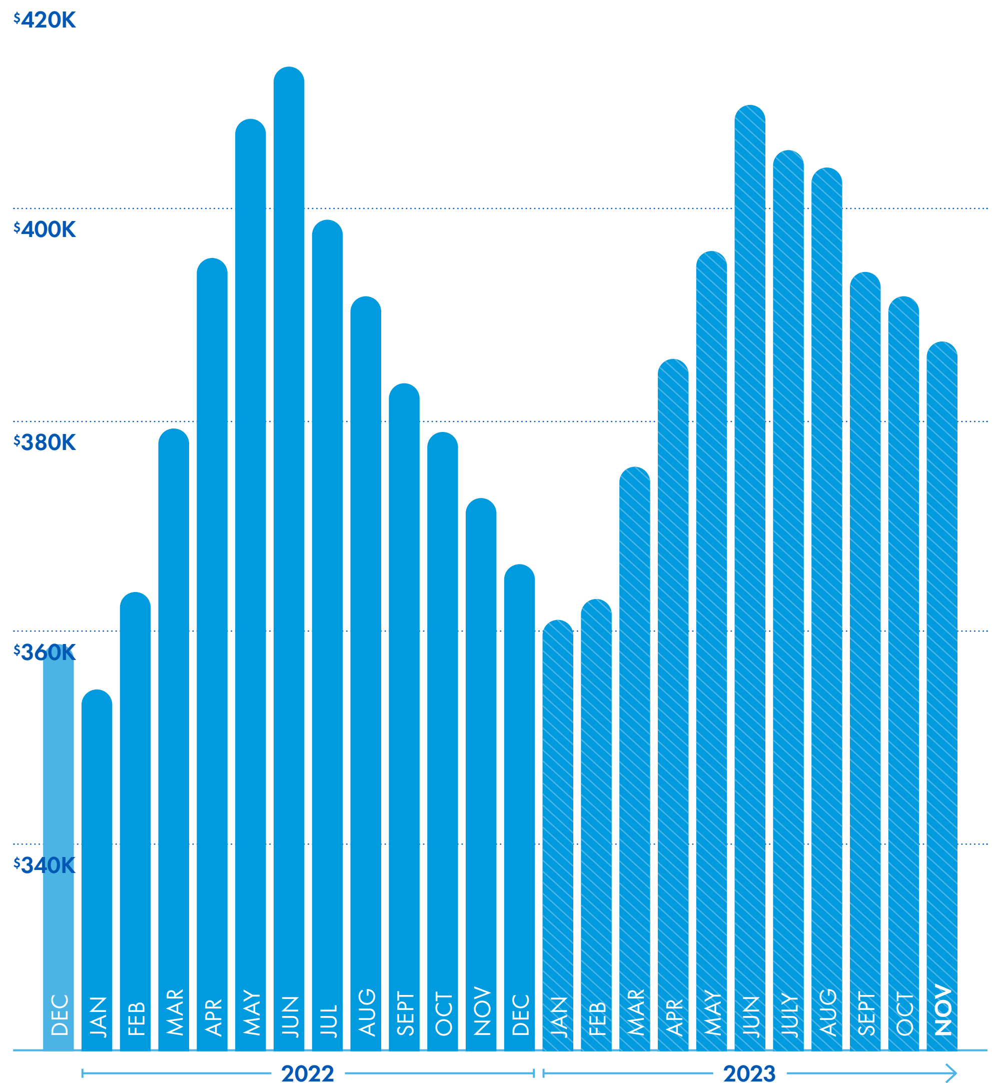
New homes are selling in the same markets where single-family rental homes are being constructed. Year to date, the South region has accounted for 61 percent of the total count of new homes sold, while 23 percent of sales have occurred in the West region.

In September, the annualized pace of existing home sales dropped below 4 million and reached its lowest level since 2010.

Housing Prices Below Peak, but Still Elevated

Median Sales Price U.S. Existing Home Sales

Sources: Northmarq, National Association of Realtors



$387,600

MEDIAN SALES PRICE

EXISTING SINGLE-FAMILY HOMES

National Association of Realtors

$828

MONTHLY DIFFERENCE

MORTGAGE PAYMENT & SF BTR RENT

Northmarq, CoStar, & National Association of Realtors

-7%

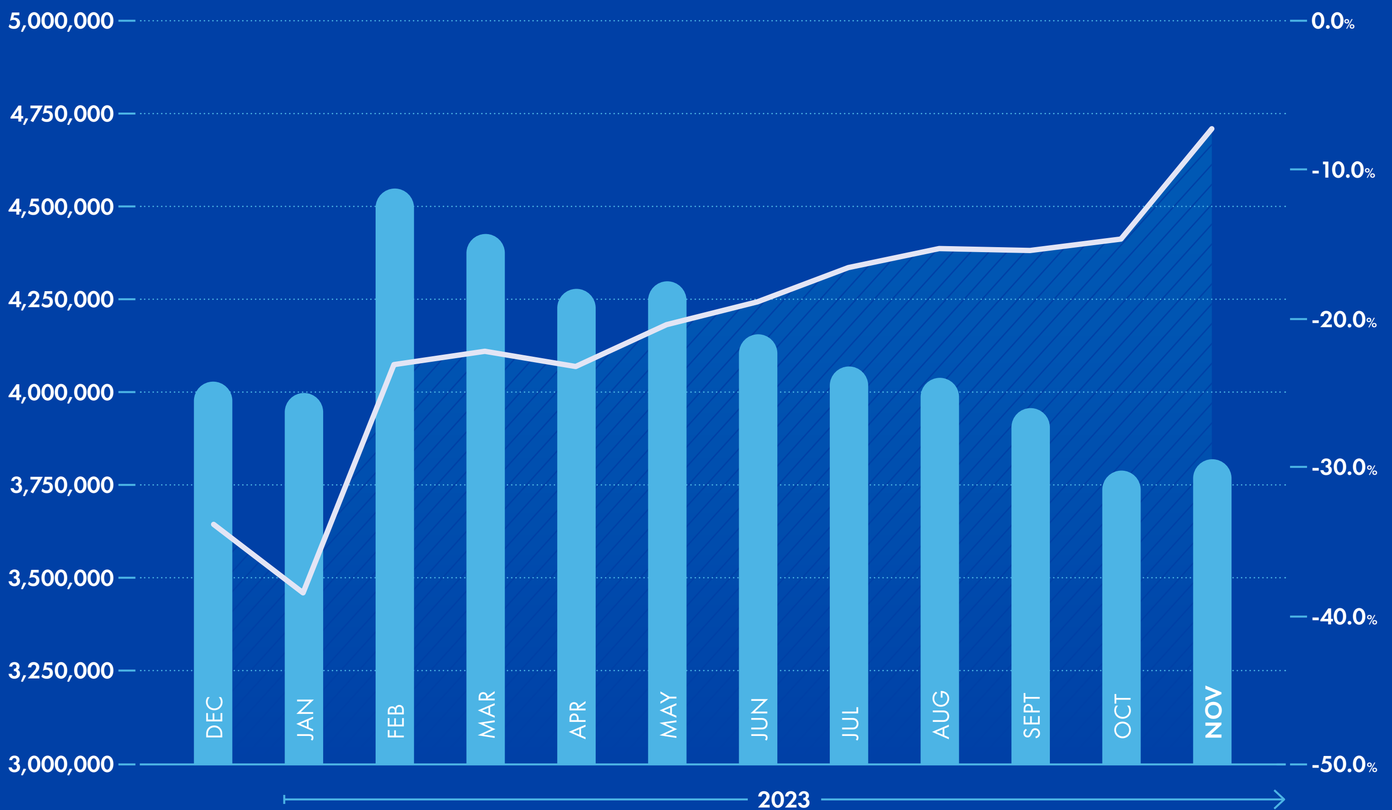
ANNUAL CHANGE

EXISTING SINGLE-FAMILY HOME SALES

National Association of Realtors

Existing Home Sales Continue to Slow

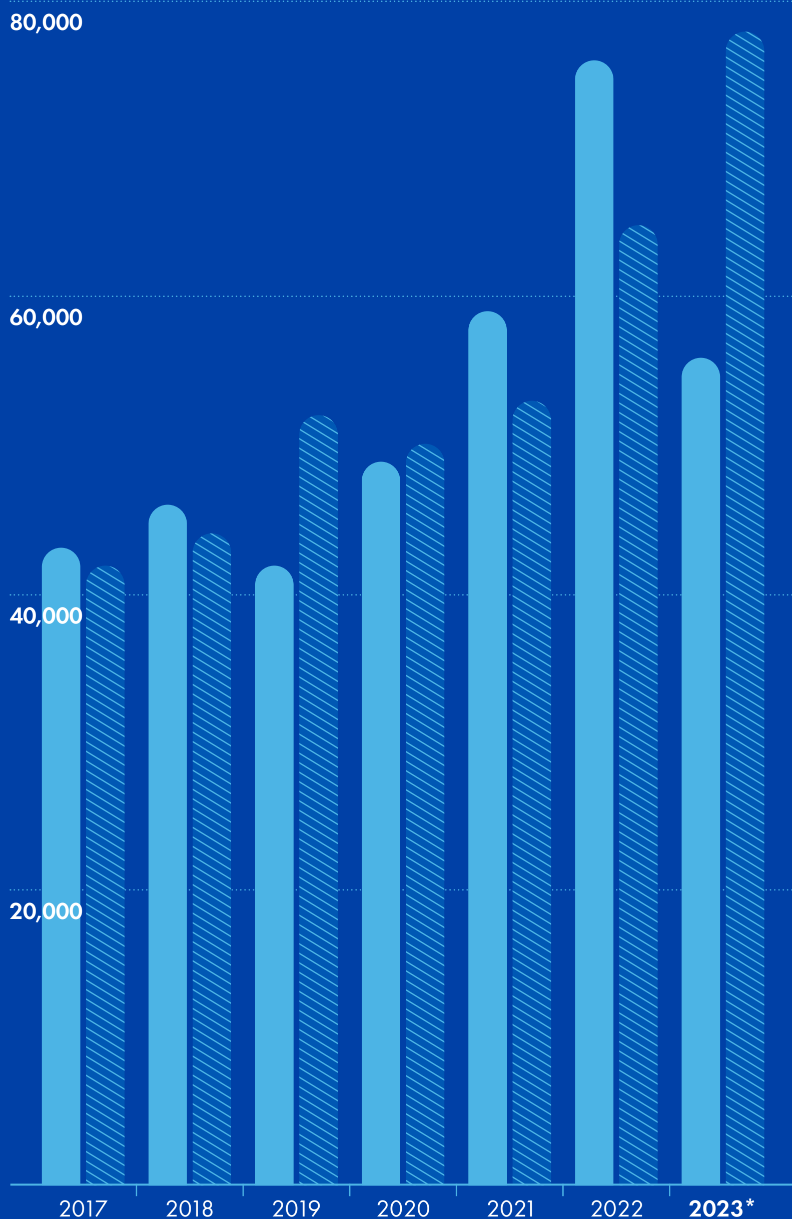
Existing Home Sales + Annual Change



Sources: Northmarq, National Association of Realtors

DEVELOPMENT TRENDS

Heightened Delivery Totals Resulting in Supply-Side Pressures



Supply trends in the single-family build-to-rent market have been volatile in recent years as the sector has gone from a regional experiment to one of the emerging next evolutions of rental housing. The sector recorded steep accelerations of construction starts from 2020 through 2022. Increases in starts averaged 22 percent per year in the past few years, spiking by nearly 30 percent in 2022 to 76,000 units.

Through the first three quarters of 2023, the pace of new construction starts slowed, with further declines likely. Capital has been more difficult to obtain for new developments, although projects that had secured funding coming into the year have broken ground and will ultimately come online. Year to date through the third quarter, projects totaling approximately 49,000 units broke ground, down 11 percent year over year.

Single-Family Build-to-Rent Development Pipeline

Number of Units

SF BTR Starts

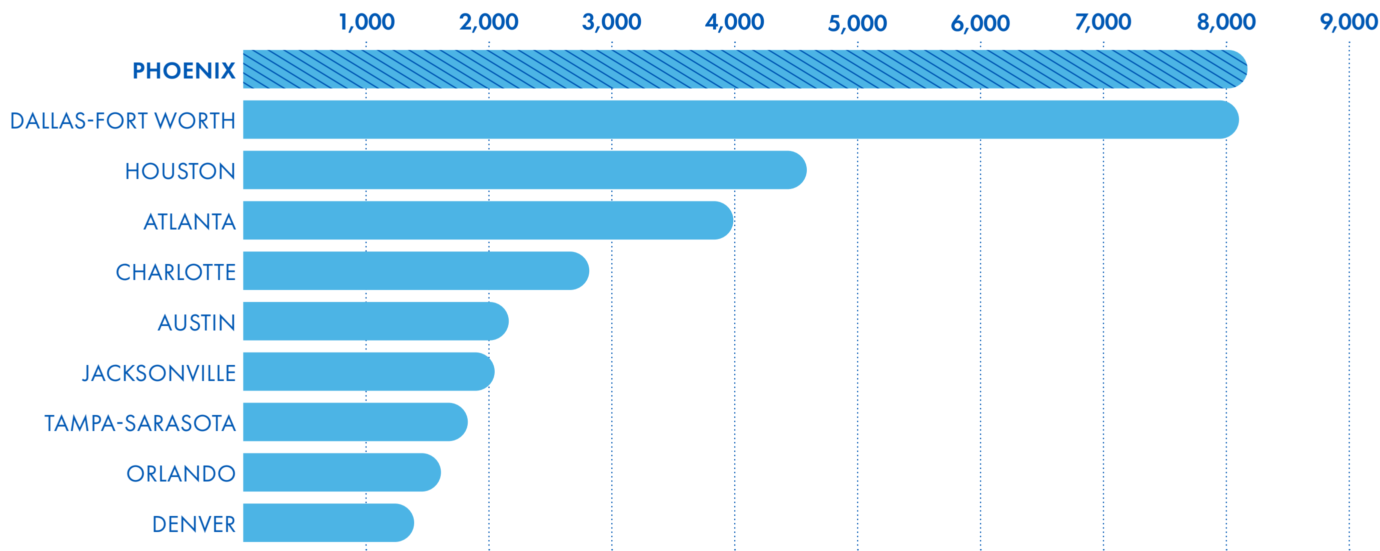
SF BTR Completions

** Forecast*

Sources: Northmarq, U.S. Census Bureau

Top Markets for New SF BTR Development

BTR Units Under Construction



Sources: Northmarq, CoStar, Yardi

With mortgage rates trending higher, some homebuilders are transitioning a share of their lots that were originally intended to be for-sale homes into for-rent communities.

In comparison, housing starts in the for-sale segment of the market began to drop in the second half of last year. Starts of single-family, for-sale homes are down 14 percent year over year, although levels have picked up in recent quarters as the inventory of existing homes available for purchase has declined. Additionally, some homebuilders have responded to rising mortgage rates by transitioning a share of their lots that were originally intended to be for-sale homes into for-rent communities.

The lag between starts and deliveries is resulting in mixed construction trends for single-family rental homes in 2023. Through the first three quarters of the year, approximately 70,000 single-family rental homes were delivered, up 35 percent from the same period in 2022.

While final year-end totals will not be available until early 2024, construction trends are on pace to diverge further. Deliveries of single-family rentals were forecast to reach approximately 78,000 units in 2023, up 20 percent from the 2022 total. Starts, on the other hand, will show a steep slowing in the second half. For the full year, the volume of construction starts for new single-family rental homes is slated to drop 27 percent from 2022 levels.

Development of single-family build-to-rent homes has been regionally concentrated since the product type first began to gain traction. After some broadening out to a greater number of markets in recent years, current construction trends appear to be returning to earlier patterns.

Much of this transition is in response to increased caution among capital providers. As more projects are delivered across a wider range of markets, there are some concerns about the competitive impact of inventory growth, as well as uncertainties regarding the pace of economic expansion. A less robust economy would likely lead to slowing household formation, which could stifle lease-up.

DEVELOPMENT TRENDS

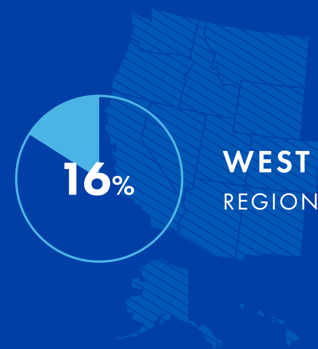
Continued

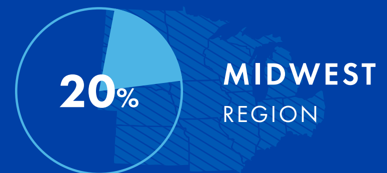
SF BTR CONSTRUCTION STARTS

Construction starts have been concentrated in the fast-growing Sunbelt regions for the past several years, a trend that has intensified to this point in 2023. Year to date, about 60 percent of the nation's build-to-rent starts have occurred in the South region, slightly lower than the region's total in 2022.

The region of the country that has accounted for a smaller share of new projects in 2023 than in past years is the West, which fell from 20 percent of starts in 2022 to just 16 percent year to date. The West region, which is led by Phoenix, Denver, and Las Vegas, has recorded a 25 percent year-over-year decline in construction starts.

The Midwest has been one part of the country where single-family build-to-rent construction is on an upswing, with starts up about 40 percent from 2022 levels. Many Midwest markets were not experiencing the job growth or population gains that most developers of single-family rental projects were seeking in the prior cycle. There are some markets—including Indianapolis, Minneapolis-St. Paul, and Columbus—where growth is strong enough and wages are sufficient to spark development of new projects.

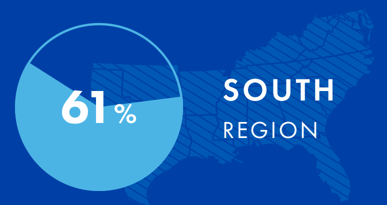




SF BTR Construction Starts by Region

Through Q3 2023

Sources: Northmarq, U.S. Census Bureau



Deliveries in the South region have totaled approximately 35,000 units year to date, or about half of the national total.

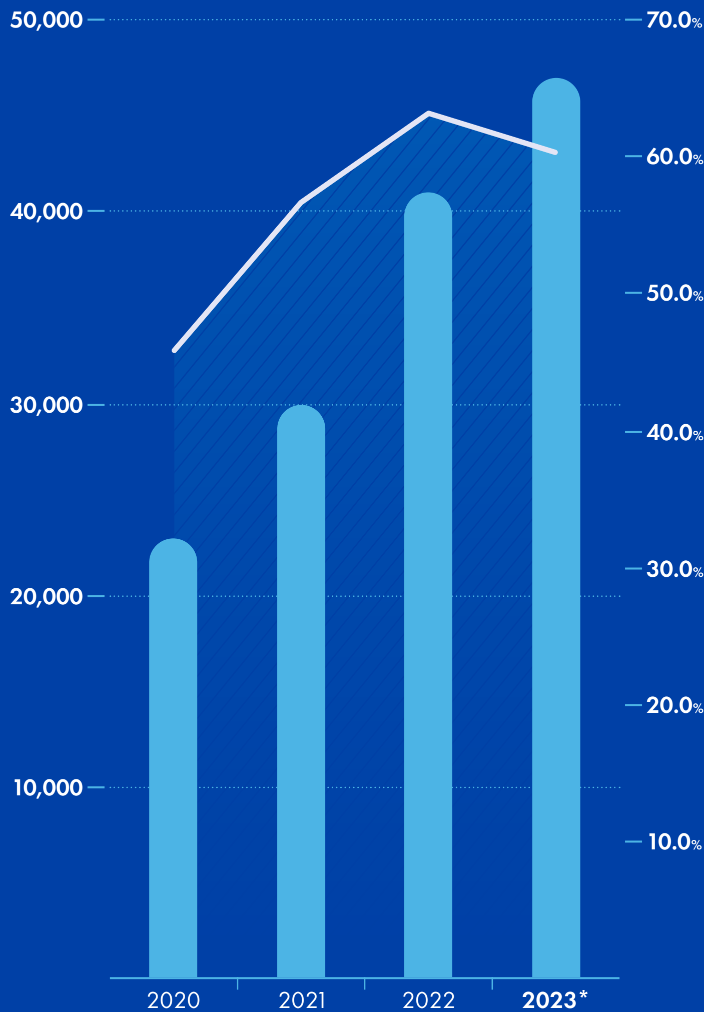
SF BTR CONSTRUCTION DELIVERIES

Through the first nine months of the year, completions of single-family build-to-rent communities are 35 percent ahead of the pace established in 2022, which was then a record year for deliveries. This trend is forecast to continue into 2024, as developers work through a crowded construction pipeline.

Deliveries in the South region have totaled approximately 35,000 units year to date, or about half of the national total. Year over year, the pace of completions in the South is up just 12 percent, following a 36 percent spike in 2022.

Outside of the South, the other regions in the country recorded significant increases in completions in 2023. Approximately 17,000 units have been delivered in the West region year to date, rising more than 50 percent from the levels of completions during the same period in 2022.

The Midwest and the Northeast regions have both posted completion totals that have already eclipsed figures from all of 2022. In the Midwest, nearly 15,000 units have been delivered through the first three quarters of 2023, while deliveries in the Northeast are approximately 4,000 units.



South Region: BTR Deliveries by Year

**2023 Forecast*

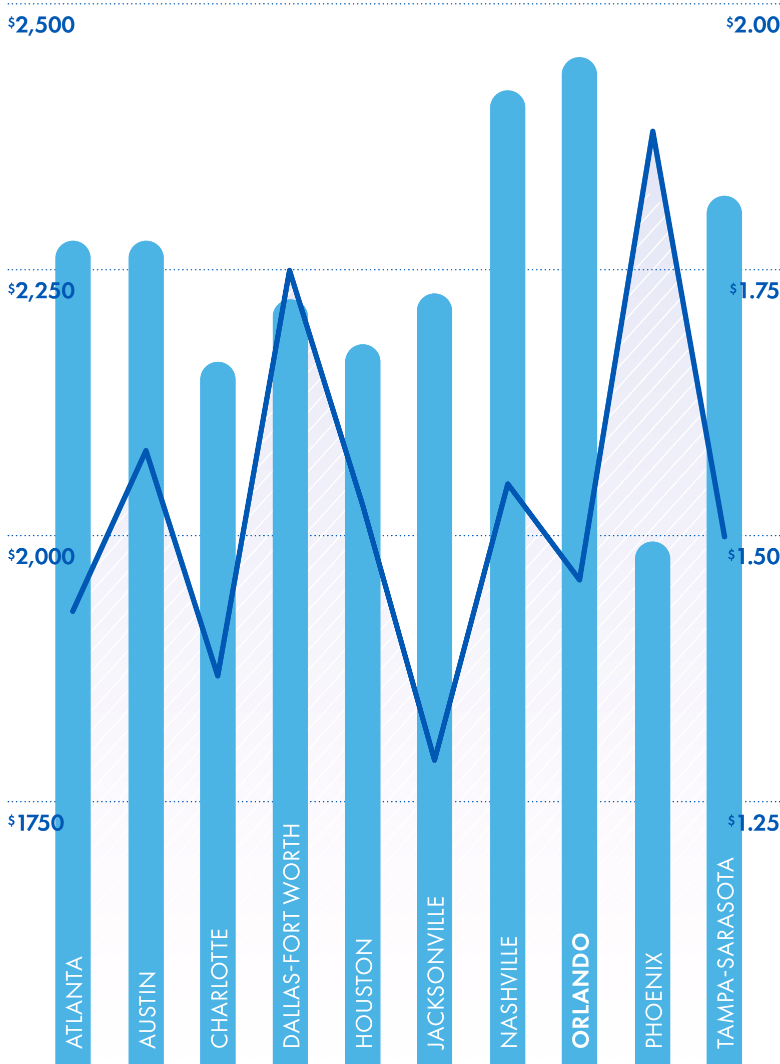
Deliveries in the South Region

Share of U.S. Total

Sources: Northmarq, U.S. Census Bureau

OPERATIONAL PERFORMANCE TRENDS

With Construction on an Upswing, Vacancies Rise and Rents Plateau



Many of the markets with the largest numbers of SF BTR communities have vacancy rates that closely track national averages. In Phoenix, vacancies ended the third quarter at 7.7 percent—about 70 basis points higher than the market's apartment vacancy rate—and up 160 basis points year over year.

In Dallas-Fort Worth, vacancy rates ended the third quarter at 7.4 percent, nearly identical to the national rate. Rapid in-migration and continued employment growth are supporting demand in the Metroplex, even as new units come online at an elevated pace.

In parts of the country with some of the largest inventories of single-family rental homes, the Southeast generally has the tightest operating conditions. Vacancy rates in Atlanta, Charlotte, and Tampa all range between 4.5 percent and 6 percent.

New supply growth is outpacing new demand, but single-family homes remain popular with renters. Net absorption of SF BTR units was up 35 percent compared to levels in 2022. This builds on a gain of 46 percent from 2021 to 2022.

Net absorption has been particularly strong in the Texas markets, led by demand growth in Dallas-Fort Worth, Houston, and Austin, which have combined for net absorption totaling more than 5,000 units year to date.

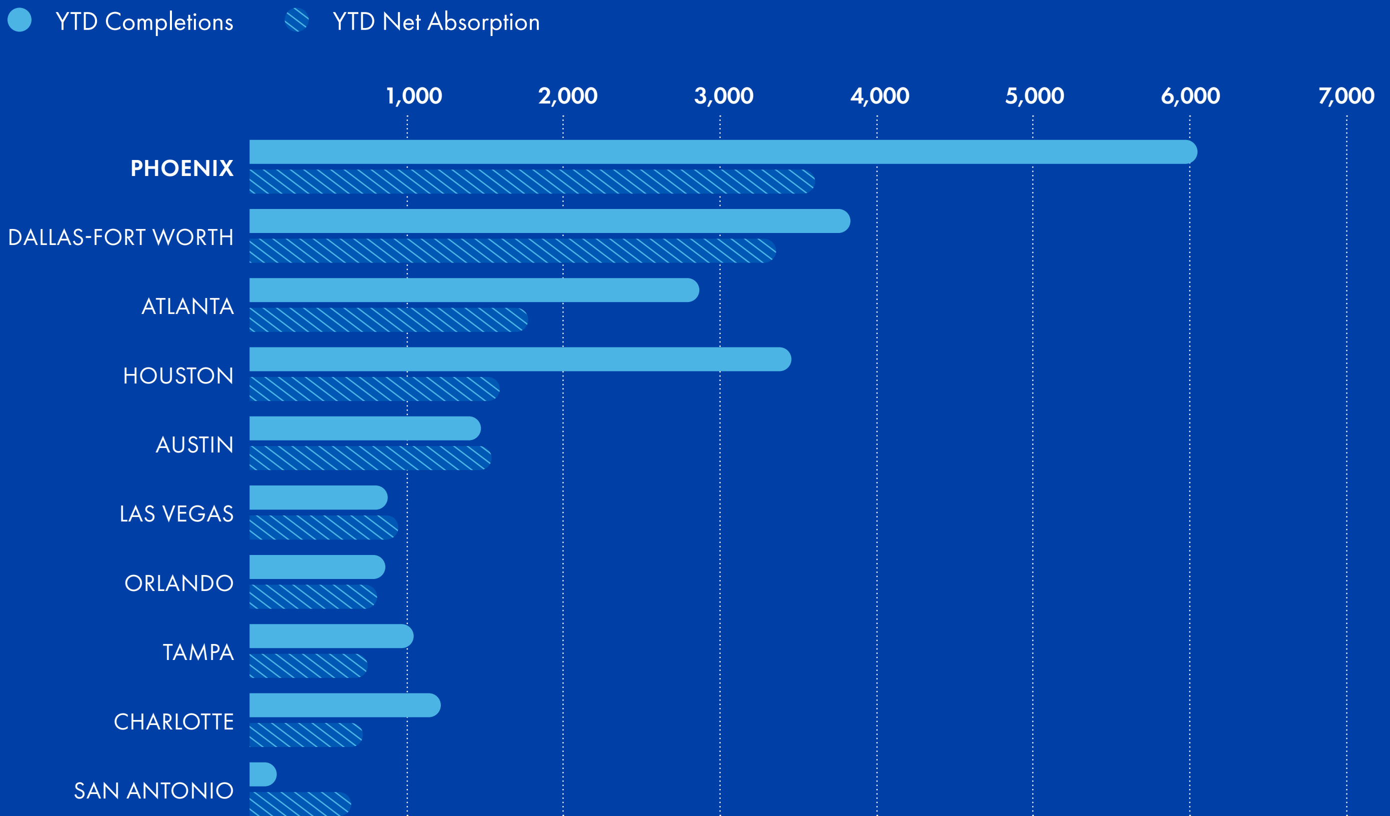
SF BTR Rents Typically Average Between $2,000-$2,500 per Month

As of 3Q 2023

BTR Average Rent

Average Rent/SF

Sources: Northmarq, CoStar, Yardi



Sources: Northmarq, CoStar, Yardi

Vacancy has trended a bit higher over the past few quarters, but there are clear differences when making market-by-market comparisons.

Phoenix has historically been a top market for single-family rental demand, and absorption spiked to more than 3,600 units in 2023, doubling the annual average from the preceding five-year period. While demand was elevated, deliveries topped 6,000 units in the past year, up from approximately 3,300 units in 2022. High-growth markets Atlanta and Houston recorded similar supply-demand ratios.

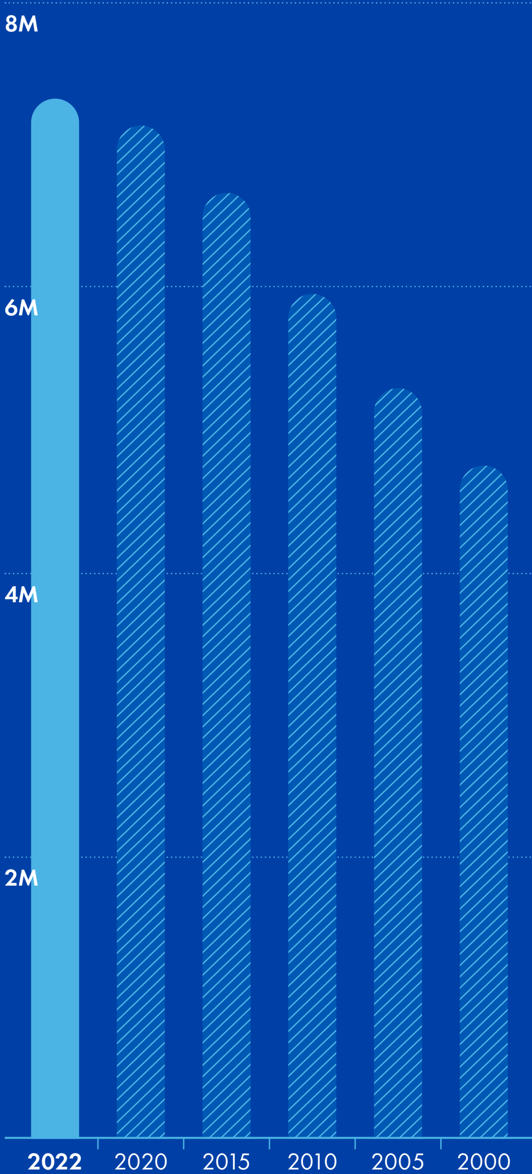
At the national level, rents are nearly identical to levels from one year ago. Most major markets are recording either slight increases or minimal declines. San Antonio and Charlotte are among the top markets for rent growth, with annual gains between 2.5 percent and 4 percent.

A few markets are recording modest drops, including Tampa and Phoenix, where rents posted steep spikes in recent years. Annual rent declines in these markets are ranging from -1.5 percent to -3 percent as of the third quarter.

Rents generally range from about $2,000 per month to $2,500 per month, although product mixes and average unit sizes vary across markets and regions. As of the third quarter, rents across most of the largest markets averaged between $1.50 per square foot, per month and $1.75 per square foot, per month.

HOUSTON

Developers Concentrating Efforts on Large, Traditional Homes



MARKET SPOTLIGHT

Houston is proving to be an active spot for build-to-rent communities, with builders demonstrating a clear preference for the traditional single-family home product type. The Houston area has a market inventory of more than 8,200 units of single-family build-to-rent communities, 5,700 of which have been delivered since 2021.

Houston has nearly all of the fundamentals that attract developers in the SF BTR space. A strong local economy, rapid and continued population growth, and a healthy concentration of high-wage industries and workers are supporting the single-family rental market in Houston.

Harris County, with a population of more than 4.7 million residents is routinely one of the top-5 counties in the country for annual population growth. During the past decade, the population in Harris County has surged by more than 600,000 residents, and the county ranked second in the country for net population growth in 2022, with a gain of more than 45,000 residents.

Rapid employment growth has propelled Houston for the past two decades. The energy sector is still a driving force in the economy, but the local job market has become more diverse, with healthcare, aerospace, manufacturing, and trade supplementing the oil and gas industry.

Long-Term Population Trends Supporting Demand

Houston MSA Population

Sources: Northmarq, CoStar, Yardi

Since 2010, the local economy has expanded by more than 800,000 net new jobs, with growth averaging more than 2 percent per year. Gains have been particularly strong in recent periods; since the local labor market returned to its pre-Covid peak, nearly 180,000 jobs have been added, an expansion of 5.6 percent.

About 80 percent of units in the local build-to-rent inventory are traditional homes, where unit sizes are larger and density is lower than in townhomes and horizontal apartments. This trend should continue going forward, with traditional homes accounting for about 75 percent of the nearly 4,500 build-to-rent units currently under construction.

The product mix of larger units results in rental rates that are considerably higher than traditional apartments. The average rental rate in SF BTR units in Houston is nearly $2,200 per month, about $650 per month higher than the average Class A apartment rent in the market.

While Harris County has the most residents, Montgomery County in the northern section of the Houston metro area is one of the top locations for new single-family rental properties. Nearly a dozen communities totaling approximately 3,000 units have been delivered in Montgomery County in recent years.

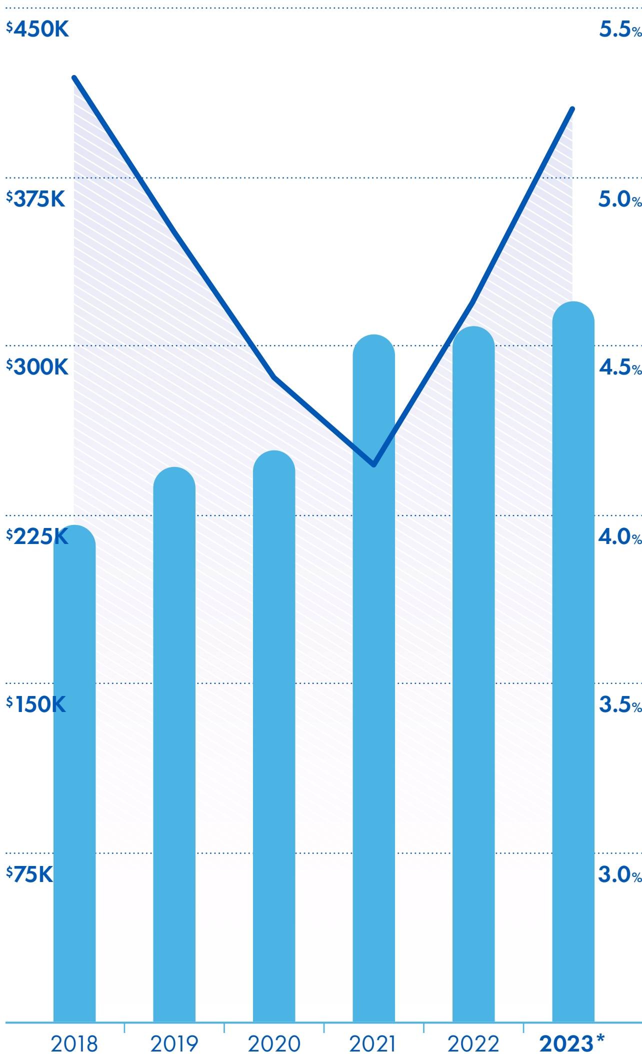
Looking ahead, projects totaling approximately 2,800 units are on pace to be completed throughout the Houston region in 2024, increasing the total inventory in the region by nearly 30 percent. The development pipeline thins after 2024, allowing new units to lease-up ahead of the next phase of SF BTR development.

Net absorption for single-family rental communities in Houston spiked in 2023, highlighting the growing popularity of the product type with renters. Absorption totaled more than 1,500 units, up from an average of about 500 units per year since 2020.

Since 2010, the local economy has expanded by more than 800,000 net new jobs, with growth averaging more than 2 percent per year.

INVESTMENT SALES OVERVIEW

Sales Velocity Down, but Homebuilders Still Active



Investment sales activity slowed across the commercial real estate landscape in 2023, but the decline in transactions involving communities of single-family rentals has been less severe than across most other property sectors. Through the first three quarters of the year, sales velocity was down 18 percent compared to one year earlier and about 35 percent below levels recorded in the same period in 2021.

Transactions are occurring in the single-family build-to-rent segment for a number of reasons. The first is that projects are delivering and being sold by developers either at or prior to stabilization. Even if pricing is lower than originally anticipated, some developers are selling assets to deploy capital into new projects.

Further, while the competitive impact of new supply has been a significant concern across the multifamily industry, there are several secondary and tertiary markets where transactions are closing that have only a few single-family rental communities. In these instances, operators are still achieving significant rent premiums over traditional apartments.

Finally, a sizable share of recent transactions include properties that homebuilders originally planned as for-sale communities and then were developed as single-family rentals in response to strong rental demand and cooling conditions in the for-sale market. D.R. Horton has been the most active homebuilder to deliver and sell single-family rental homes in 2023.

SF BTR Investment Trends

**Year-to-Date*

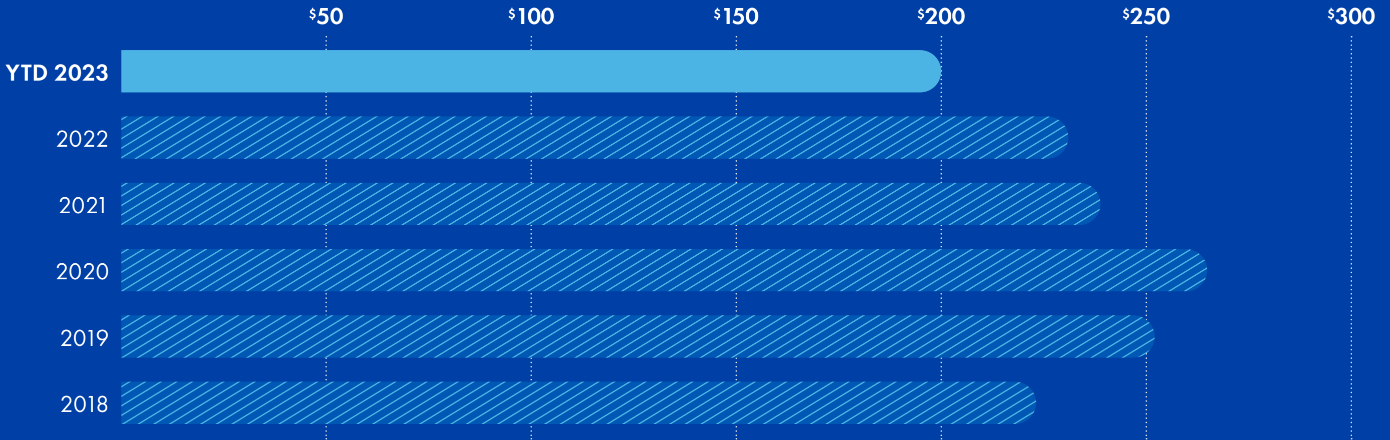
Median Price per Unit

Average Cap Rate

Sources: Northmarq, CoStar, Real Capital Analytics

Median Price per Square Foot

U.S. SF BTR



Sources: Northmarq, CoStar, Real Capital Analytics

Pricing trends have been mixed to this point in 2023. The median price in deals that have closed year to date has inched higher, reaching $320,000 per unit, up about 4 percent from the median price recorded in 2022. This increase in the median price is more a reflection of specific sales with larger unit types, rather than an increase in values due to cap rate compression or rent growth.

The average unit size in properties that have sold thus far in 2023 is 20 percent larger than the average unit size in transactions that closed one year ago. The result has been a decline in price per square foot, even as the price per unit has trended higher. The median price in 2023 is approximately $200 per square foot, about 14 percent lower than in 2022.

Cap rates have trended higher, a function of the higher costs of capital and the decline in the number of buyers actively pursuing acquisitions. Cap rates averaged approximately 5.2 percent through the first three quarters of 2023, and trended up towards the mid-5 percent range during the second half of the year.

Cap rates averaged approximately 5.2 percent through the first three quarters of 2023.

The trends that have dominated the investment landscape in recent quarters will likely persist into 2024. Transactions will continue to close, in part because new developments will continue to work their way through the development pipeline. Cap rates may not push much higher than current levels, particularly if interest rates level off after an extended run of trending higher.

MINNEAPOLIS-ST. PAUL

Area Developers Looking to BTR for Rent Growth

MARKET SPOTLIGHT

The Minneapolis-St. Paul region features the strong employment growth and high-wage earners that developers of build-to-rent communities target. Since 2015, the region has added approximately 115,000 net new jobs, with a thriving healthcare sector accounting for approximately half of the total gains.

In recent years, developers have delivered nearly two dozen SF BTR projects totaling almost 1,600 units. Most of the properties that have come online have been smaller than apartment communities, typically ranging between 50 and 125 units. The first wave of build-to-rent properties to deliver were mostly traditional homes, which account for about 65 percent of the total single-family rental inventory.

Developers are gradually shifting into more dense unit mixes, with townhouse properties accounting for a greater share of new construction. Three significant townhouse properties have been delivered to this point in 2023, totaling approximately 450 units.

More than half of the units that have come online have been concentrated in a handful of areas. The Maple Grove submarket has the most existing projects. There are nearly 500 units in the city located northwest of Minneapolis in Hennepin County.

Woodbury, a city in Washington County immediately east of St. Paul, has the second-largest inventory of build-to-rent properties totaling approximately 300 units. An additional 180 units are currently under construction and expected to deliver in the next 12 months.

The first wave of build-to-rent properties to deliver were mostly traditional homes, which account for about 65 percent of the total single-family rental inventory.

Rents for single-family rental homes are elevated, totaling nearly $3,100 per month.

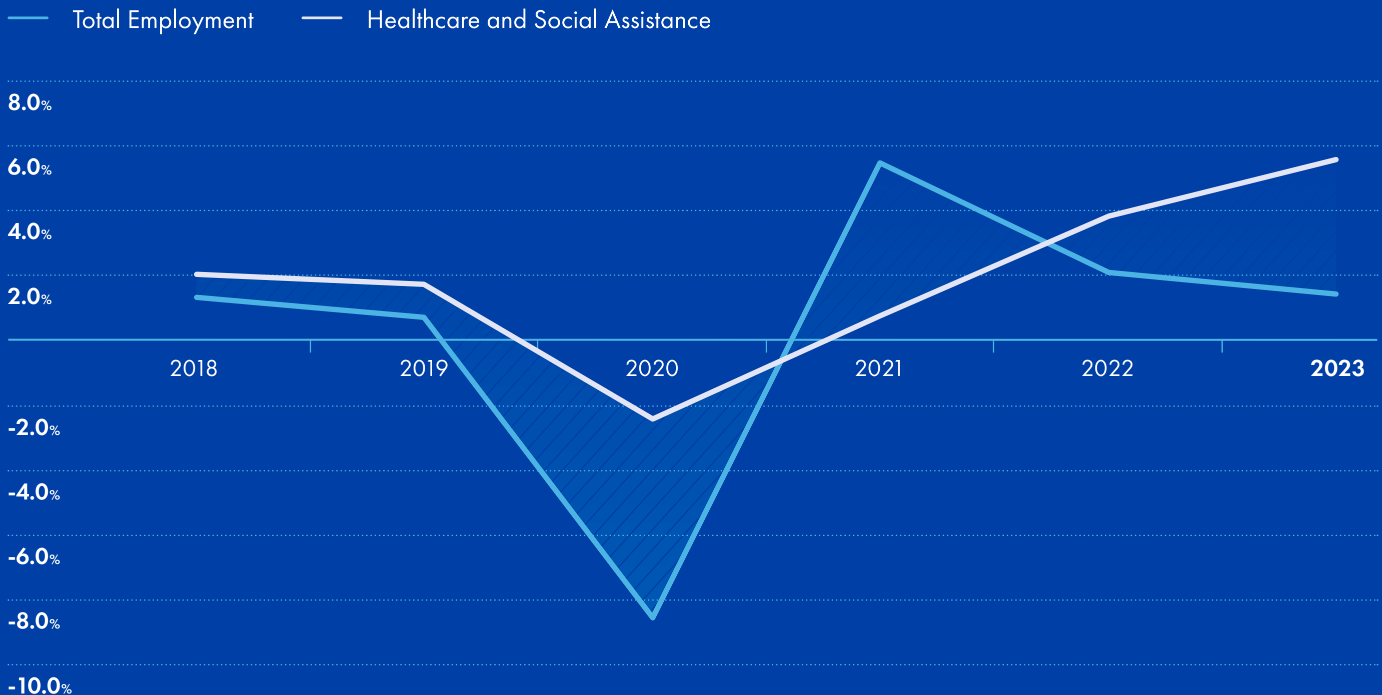
The development of new single-family rentals in the Minneapolis-St. Paul region has been fueled by strong property performance and elevated rental rates. Throughout the past few years, vacancy rates have remained between 4 percent and 6 percent, although that figure has trended higher and topped 8 percent earlier this year.

Rents are elevated, totaling nearly $3,100 per month, or approximately $1.70 per square foot, per month. This compares to $1,859 per month and $1.95 per square foot, per month for the area's Class A apartment units.

Despite a healthy economy bolstered by large financial companies and leading healthcare providers, the Twin Cities rental market has undergone some recent uncertainty, particularly in St. Paul where voters passed one of the strictest rent control measures in the country in 2021. The climate for new development has improved since the original measure passed, with the city council passing exemptions to the policy, including a 20-year exemption for new-construction rental properties.

Rapid Healthcare Gains Supporting Local Economy

Annual Employment Change Through 3Q 2023



Sources: Northmarq, Bureau of Labor Statistics

DEBT & EQUITY

Rate Hikes Likely Concluded, but how High for how Long?

The biggest change in the capital markets for single-family build-to-rent properties has been surrounding equity capital.

High interest rates dragged on the capital markets in 2023. While rates remained elevated throughout much of the year, the movement in bond yields of varying maturities have influenced the economic outlook and the financing climate. Further, recent declines have injected some optimism that rates will be lower in 2024, after the "higher for longer" outlook prevailed for much of 2023.

Increasing rates have impacted the single-family build-to-rent market, but financing remains available, primarily for acquisitions. As cap rates have pushed higher and interest rates have shown signs of trending lower, more transactions may begin to pencil.

Rates Peaked in October, Trended Lower to Close 2023

U.S. Treasury Yield

Sources: Northmarq, U.S. Treasury

ACQUISITIONS

Fannie Mae and Freddie Mac remain the leading sources for build-to-rent acquisitions. As in prior periods, the agencies are underwriting transactions with similar terms to new, Class A multifamily properties.

Agency financing is expected to remain available into 2024. Outside of the agencies, some lenders are showing greater caution when reviewing single-family build-to-rent transactions. Loans are still being funded, but lenders are exercising greater caution, particularly in markets where there are potential supply-side pressures on future operations.

EQUITY

The biggest change in the capital markets for single-family build-to-rent properties has been surrounding equity capital. As recently as 2021 and the first half of 2022, a flood of equity was being raised to move into the SF BTR space, either through acquisitions or new development.

In the current environment, there is still equity available for the acquisition of existing properties, but sources for new development have become more scarce. Equity investors are exercising greater caution and expressing concern about the competitive impact of new supply on future operations.

Additionally, equity investors are responding to the changing capital environment. Build-to-rent projects inherently involve more risk due to longer construction timelines. In the current environment, with a full development pipeline adding competition for new and existing properties, risks have increased for equity investors. The added competition creates a climate where lease-up periods may be extended, and it may be more difficult to achieve the rents required to make projects meet new return requirements.

Further, new projects that meet the current return-on-cost requirements for most equity investors are increasingly difficult to find. As such, the use of preferred equity is on the rise, as a way of insulating equity holders in an increasingly challenging financing and operational climate.

Equity tends to follow returns, and institutions and private equity investors will ultimately move back into the build-to-rent market as returns become more predictable and meet new thresholds in a higher-rate environment. Sensitivity to future supply waves in specific markets could restrict equity for new construction in 2024.

CONSTRUCTION

Debt financing for construction of single-family rentals is still available in some markets, but terms have become increasingly conservative since the beginning of 2023, lowering loan-to-cost ratios. Further, many lenders are being more selective on the loans they quote, particularly in markets where the BTR development pipeline has several projects already under way.

Banks and debt funds are the primary sources of debt for new construction projects. Banks are currently willing to finance between 45 percent to 50 percent of the construction costs, down from 60 percent of costs or more one year ago. Additionally, banks are often preferring or requiring deposits to be made by the borrower into the bank itself, a move that creates greater liquidity for the bank.

The other significant change in bank financing for new construction is the increased requirement of recourse by the borrower on new loans—a provision that was not standard in construction loans as recently as one year ago. The recourse requirements are an added hurdle for securing construction financing and are limiting construction starts.

Looking ahead, the refinancing of construction loans to permanent loans will be a source of volume in the capital markets. With projects under construction across many of the largest markets in the country, demand for permanent financing will increase in 2024. Borrowers will find permanent financing is available, but rates will be elevated. Bridge loans are expected to be a popular alternative option during lease-up, allowing borrowers to remove recourse requirements and freeing up more time for a property to reach stabilization.

For townhome-style product, HUD can be a source for construction financing and takeout financing, assuming the development meets requirements. Specifically, at least half of the buildings need to be attached by four or more units.

OUTLOOK

Some Uneven Short-Term Performance Likely in 2024

As the SF BTR product type proves its place in the overall housing market, its performance can be measured, evaluated, replicated and improved upon.

The single-family build-to-rent property class is expected to remain in growth mode into 2024. While obtaining financing for future development is a challenge, the projects that are already under way will significantly boost inventory levels across dozens of markets. Additionally, the capital stack is evolving, with bridge loans and preferred equity filling some of the voids created as some lenders and JV providers have pulled back.

This new inventory growth will likely yield mixed results. The supply-side pressures are expected to push vacancy rates higher across many metro areas, a trend that is already occurring in nearly all forms of rental housing, led by traditional apartments. With renters having a greater number of options, the pace of rent growth will level off after steep upward gains in recent years.

Despite these operational challenges, the coming quarters will be important ones as the build-to-rent sector moves from a niche property type to a larger share of the overall rental-housing market. The product type is still new and, in many markets, inventories are limited to a few dozen properties totaling 5,000 units or less. The current cycle is the first one where operators will face significant competition from new and existing properties. In prior years, many operators maintained a first-mover advantage that allowed them to set market rents.

While supply growth will be active across most major non-coastal markets, the demand outlook is more uncertain. Demand was healthy throughout much of 2023—although it has lagged additions to supply by about 25 percent—but growth should slow going forward. Employment expansion and new household formation are linked, and most forecasts call for a slower pace of growth in 2024 following a surprisingly strong past 12 months. Further, some of the high-wage industries that attract renters of single-family build-to-rent units have posted sluggish performance that could linger into 2024.

While the BTR sector faces some obvious headwinds, affordability challenges in the for-sale housing market will continue to support demand for single-family rentals. Average mortgage rates have remained above 6 percent for more than a year and spent much of the second half of 2023 above 7 percent, although rates did retreat a bit after peaking in October. These elevated financing costs make purchasing a home cost prohibitive, and mortgage rates may remain near current levels throughout much of 2024.

The Federal Reserve has paused—and has likely concluded—its rate hiking program, allowing the impact of an extended period of tightening to work its way through the economy. The consensus is that the federal funds rate may not go any higher than its current range of 5.25 percent to 5.5 percent, leading to speculation about the timing and the number of rate cuts.

The current forecast is that the Fed will cut rates in 2024, but at a cautious pace. With inflation still above the central bank's target rate of 2 percent and the labor market remaining healthy, an extended period of cuts prior to the second half of 2024 appears unlikely.

The interest rate environment will impact investment trends and the pricing and availability of capital. For most transactions, current cap rates are lower than lending rates, which will likely continue to restrict acquisition activity. While cap rates may trend a bit higher, investors looking to expand in the SF BTR space will likely have to allocate more equity to transactions than in prior periods. The opportunities will come as more developments work their way through the construction pipeline; many new construction projects will either be acquired or recapitalized in 2024.

Many of the factors outlined above address the short-term outlook for 2024. Over the longer-term, the outlook for single-family rental communities brightens. The product type addresses a clear need for new, single-family homes for high-income households where transitioning to for-sale housing fails to make sense, either from a financial standpoint or for lifestyle reasons.

As the SF BTR product type proves its place in the overall housing market, its performance can be measured, evaluated, replicated and improved upon. The slowdown in starts in 2024 should ease supply-side pressures in 2025 and 2026 and allow the market to return closer to equilibrium. As the capital markets become less restrictive over the next year, the sector should regain momentum.

Despite these operational challenges, the coming quarters will be important ones as the build-to-rent sector moves from a niche property type to a larger share of the overall rental-housing market.

Proven Results

$5 Billion

TRANSACTION VOLUME

140+

TOTAL TRANSACTIONS

30+

ACTIVE BTR ASSIGNMENTS

350+

BTR/SFR EVALUATIONS

The newest investment sales category isn't new to us.

Northmarq has positioned itself as an early industry leader in brokerage and financing single-family build-to-rent communities. Our professionals have assisted in the sale and financing of SF BTR transactions totaling approximately $5 billion.

Regardless of market conditions, we continue to evaluate opportunities with developers and investors. With our coast-to-coast capabilities, we demonstrate how our client-focused, integrated approach is one of the best in the industry.

We are here to advise you throughout the life cycle of every investment and ensure you maximize each opportunity by making informed decisions.

ParcHAUS at Celina Parkway
186 Homes | Celina TX
New Construction BTR Project

Coming Soon

Villas at 79th Ave
149 Homes | Glendale AZ
Under Construction

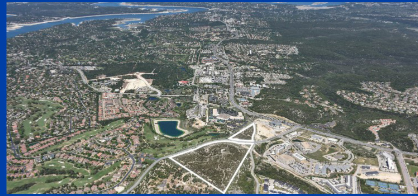
On the Market

Homes @ Susan's Ranch
144 Homes | Buckeye AZ
Under Construction

On the Market

Sunnyview Development Site
±10.03 Acres | Oklahoma City OK
Multifamily/BTR

On the Market



Hillsong Development Site
±26 Acres | Lakeway TX
For Sale or Rent SFR/BTR & Retail

On the Market

The Farm on 10th Street
7 Homes | Phoenix AZ
Multifamily/BTR

On the Market

Vista Via
±1.50 Acres | Vista CA
Under Construction

In Escrow

Empire Portfolio
659 Homes | Atlanta GA
Under Construction

In Escrow

West Wind
95 Homes | Stephens City VA
Multifamily/BTR

In Escrow

Cross Creek & Falls of Columbia
168 Homes | Columbia MO
Townhome/BTR, Attached Garages

In Escrow

Southside Townhomes
188 Homes | Nampa ID
New Construction

In Escrow

Kara Lynn Place
40 Homes | Tyler TX
Attached Garages

Closed

AVERE on the High Line
56 Homes | Denver CO
New Construction, Attached Garages

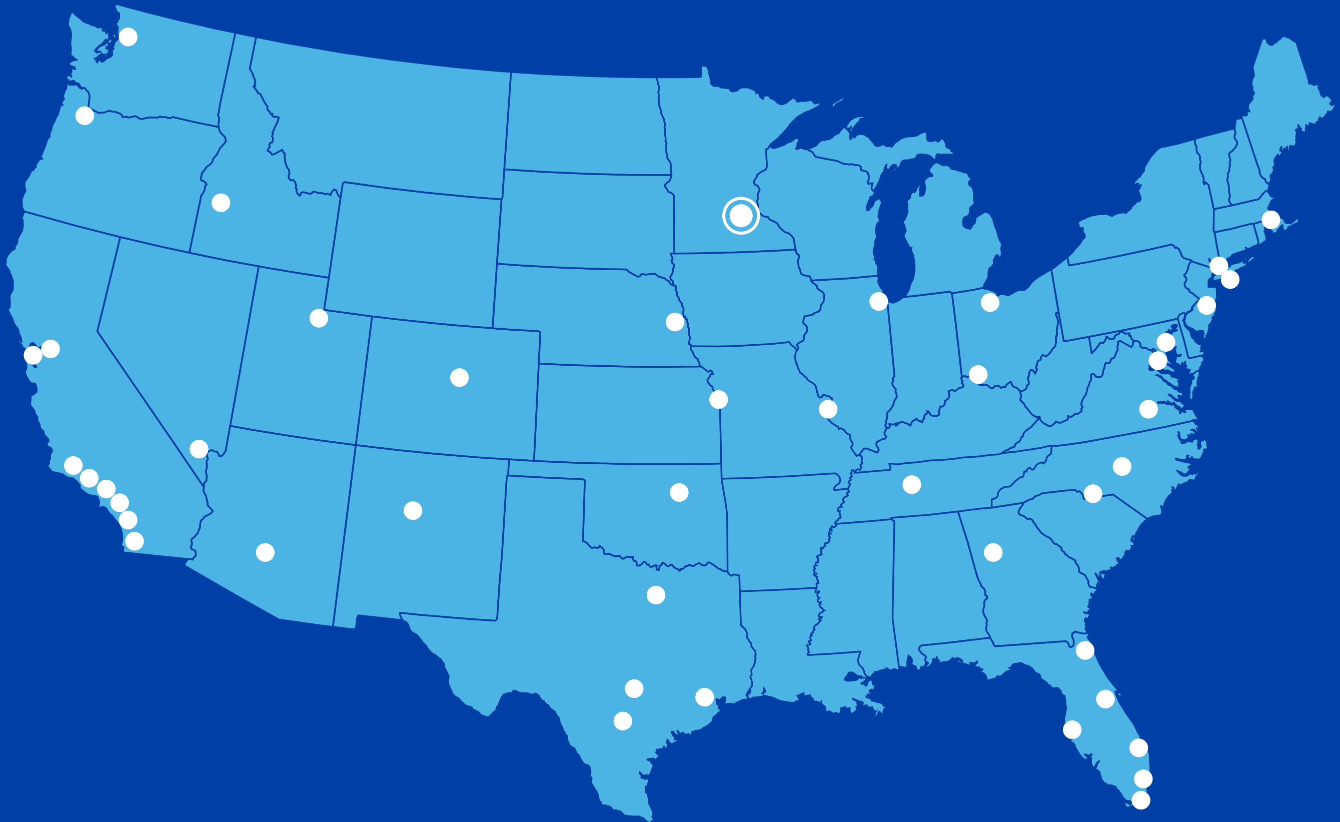
Closed

Village Crossing
36 Homes | Mesa AZ
New Construction, Attached Garages

Closed

Ashford Townes
74 Homes | Fuquay-Varina NC
New Construction, Attached Garages

Closed



Why Northmarq?

INTEGRATED TEAM OF PROFESSIONALS

We've built our reputation on valuing long-term trust over short-term wins, grounded in our commitment to put client interest before our own – offering a customized approach with an integrated team of experts.

COLLABORATION KEEPS THE DEAL SIMPLE

Leave the due diligence, market evaluation, buyer interest, and equity partnerships to us. We'll identify the best positioning for the property and target potential partners early in the process to ensure the transaction is smooth – from start to finish.

NATIONAL PLATFORM PERSONALIZED SERVICE

At Northmarq, we recognize that every investor has unique investment goals. That's why we take the time to understand your needs and customize our approach. Leveraging the power of our national platform, we deliver personalized solutions designed exclusively for you.

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