The Growth of Single Family Rentals as an Asset Class for Institutional Investors

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The last panel of the day was on the growth of Single Family Rentals as an asset class for institutional investors. Professor Stijn **Van Nieuwerburgh** began the panel with a brief presentation on the macroeconomic factors which lead to the acquisition of these houses by investors. His slides showed the evolution of housing prices over the last decade and how the spike in foreclosures following the 2008 crisis created an environment where institutional money began looking at single family homes as an investment opportunity. Following his introduction, he looked to the panelists to better understand this asset class, which is still in the very early stages of its development. The main question for the panelists was whether the movement of institutional money into this asset class is a structural shift in the American housing market or whether it is simply a short term arbitrage play. The panelists were Steve **Hentschel**, the head of Real Estate Investment Banking at Gleacher & Company, Lani **Porter**, the SVP of Operations for American Residential Properties, which is scheduled to IPO in the coming months, and Richard **Saltzman**, President of Colony Capital which holds over 4,000 homes.

The panel's discussion centered around the fact that this market for rentals is at an extremely early stage. Both Lani **Porter** and Richard **Saltzman** stated their belief that this is something that Americans have a growing appetite for. Porter began the discussion by highlighting the rise of Americans who have taken up a "transient lifestyle". These are people who have become underemployed as a result of the financial crisis and are not in a position to invest in a home while there is uncertainty regarding their future prospects. **Saltzman** echoed these sentiments and added that people have become more comfortable with the option of renting since they have realized that housing isn't as safe an investment as they had thought prior to 2008. Reports have recently shown that U.S. home ownership has fallen back to 65% from a peak of almost 70%. There is a possibility that the home ownership rate may stabilize at this level or fall further if the psychology of Americans has indeed changed to where it is more acceptable to rent as opposed to own.

The panel then moved on to examine whether they thought that there was a long term strategy for these rentals or whether the current participants would quickly exit after achieving short-term returns. **Saltzman** pointed out that there has always been a market for this type of investment; after all there are 12 million single-family rentals in the U.S. But most of the investors are mom & pop shops who typically owned properties for their price appreciation potential. But the shift in sentiment towards owning, the size of the rental market, and the yields that single-family properties generate suggests that there may be a long-term play for institutional investors. While **Saltzman** recognized this structural shift, he at the same time mentioned that his investors might be ready to cash out on short-term appreciation.

Hentschel then offered an insight from a transactional standpoint. He believes that single-family rentals have already proven themselves as a long-term trade because of the sheer volume and the momentum they have received from investors. These institutions have created large portfolios of homes, and **Hentschel** cannot see anyone spending the time to dismantle these portfolios piecemeal. **Saltzman** echoed these sentiments, stating his vision for potential exit strategies for investors; he suggested acquisitions by REITS, developers, and management companies who are looking to grow in the future.

With the panel establishing the appetite for this asset class both by the everyday American as well as by institutional investors, the panelists began to dig into a few of the lingering questions with the business plans. One fear that several critics have posited is that these operators might be flooding the market with several rentals driving the market rent down with excess supply. But neither **Porter** nor **Saltzman** appeared to be too bothered by this possibility because of how small their stock is going to be in comparison to the overall housing markets they are entering.

Instead of concerning themselves with leasing out their units, both **Porter** and **Saltzman** voiced their firms' priority to acquire as many properties as possible in an attempt to achieve economies of scale. **Porter** went on to state that as American Residential has scaled up in each city, they have been able to get properties to cash flow quicker than their competition and are gaining valuable on-the-ground knowledge of the region that they will be able to apply as they move forward. **Saltzman** mentioned that since these operators are in the portfolio ramp-up stage, they are looking to break even at best as they scale up, especially because there are a lot of upfront costs associated with the houses they are acquiring. While they may be running at a loss for now, they expect units to be fairly cash flow stable because of the type of tenant they would attract. These units would be leased out for 4 or 5 years at a time, since families are less likely to vacate a unit because of their ties to the particular community, especially when they have children.

Other important aspects that the panelist discussed at length were the logistics of maintenance & repair of a geographically dispersed portfolio of houses, and the nature of the management of the properties: internal versus external.

After presenting a strong case for Single Family Rentals as an investable asset class, the Q&A session focused on how these institutions are executing their strategies. Notable insights included a brief view into how these firms are acquiring properties. Ms. **Porter** stated that about half of their properties have come from previously arranged portfolios while the other half came from developing relationships with people (brokers etc.) in each region who can identify properties that fit their acquisition criterion. Another interesting detail that came from the Q&A is that Colony has been doing all of its acquisitions with 100% equity stakes, meaning they would have the ability to scale up very quickly if they decided to finance the properties they currently own. The last question of the day was on how banks are going to go about valuing these properties. **Hentschel** once again indicated that this is a very early stage for the asset class and that it is unclear how the uncertainty about property management might factor into the value of the assets. He went on to speculate that valuation would move towards the same methods used for multifamily properties. His thoughts echoed the overarching theme of the panel- single family rentals have become an institutional asset class which are being thought of in a similar light to multifamily rentals, but are still at an early stage where there is uncertainty regarding how best to execute a business strategy with these assets.