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Build-for-rent is a bet on the 'new normal' housing market

Demand for BFR rentals is growing as home purchases dip, but success in the space is all about location, location, location

By Bill Conroy January 9, 2023

One slice of the single-family home market that has gained traction over the past year in a topsy-turvy housing landscape is the build-for-rent sector — or BFR.

Construction starts in the BFR market are being propelled by the ongoing demand for single-family rental units as high mortgage rates and limited for-sale inventory push home-purchase prospects further out of reach of many would-be homebuyers.

Still, even the single-family rental (SFR) market, including the BFR sector, faces an uncertain future in the year ahead, given the ongoing volatility in interest rates and inflation. Both pose threats to access to capital, the cost of materials and labor, and future housing values.

Through much of 2022, however, build-for-rent housing remained a hot ticket, with supply continuing to increase, "even with the economy showing signs of volatility and capital costs increasing," according to a November special report from Minneapolis-based **Northmarq**.

"Developers are forecast to start 74,000 [BFR] units in 2022, up from 59,000 units in 2021," states the report by Northmarq, a capital markets leader with some $33 billion in annual transaction volume and a loan-servicing portfolio of more than $76 billion. "... The number of units delivered this year is on pace to rise 21 percent, to 64,000 units [compared with 53,000 units in 2021].

"With many homebuilders feeling the impact of rising mortgage rates on new-home sales, delivering units for rent is expected to continue to become a larger segment of the overall single-family housing market."

The Northmarq report points out that the BFR sector currently accounts for only a small slice of overall home starts, at about 6%. A recent report by **MetLife Investment Management** estimates that there are about 14 million SFR homes nationally, including the BFR sector.

“The softer for-sale housing market, particularly for new homes, is expected to allow single-family rental operators to acquire blocks of new homes, finished lots and larger land parcels from homebuilders,” Northmarq’s market report adds.

The **National Association of Home Builders** (NAHB) also recognizes the potential of the build-for-rent (BFR) sector. It’s “Eye on Housing” report published in mid-November indicates that there were 68,000 BFR construction starts over the four quarters ending in Q3 of 2022, up 42% compared with 48,000 such starts during the prior four-quarter period.

“While the market share of [single-family] BFR homes is small, it has clearly been trending higher,” the NAHB report continues. “As more households seek lower-density neighborhoods and single-family residences, a growing number will do so from the perspective of renting.

“This will be particularly true as mortgage interest rates remain elevated and increase. Thus, the [single-family] BFR market will expand in the quarters ahead.”

Riding a cresting wave

Single family rental market leaders that unveiled BFR initiatives in 2022 include **Tricon Residentia**l and **Progress Residential**. The two SFR companies, among the largest operators in the space, announced this past summer that they have thousands of build-for-rent homes planned for development or already in the construction pipeline — some 12,000 on a combined basis. In addition, **JP Morgan Chase & Co**. and partner **Haven Realty Capital** in November announced a $1 billion joint venture to buy and develop SFR properties.

On another front, even multifamily-focused players are getting into the BFR market. **TruAmerica Multifamily** this past summer launched its own BFR division to develop townhome and SFR communities.

Single-family homebuilders, too, are looking to capitalize on the build-for-rent market, with Lennar Corp., one of the nation’s largest homebuilders, recently offering to sell some 5,000 homes to investors in the SFR market, according to a Bloomberg report. Lennar in 2021, with partners **Allianz Real Estate** and **Centerbridge Partners**, launched a subsidiary to acquire and operate SFR and multifamily properties, according to the Bloomberg report.

The surge in build-for-rent single-family housing is coming at a time when there has been a sharp decline in overall in single-family home construction. NAHB attributes that decline to “stubbornly high construction costs (due to inflation), elevated interest rates and flagging demand," which combined are "harming housing affordability." Housing starts as of November 2022 were "down 32% since February, when mortgage rates began to rise," NAHB reports.

Although growing single-family BFR demand is an overall plus for the homebuilding industry, there are economic forces working to dampen enthusiasm for the SFR market as well. Those headwinds also are being fueled by the double-edged sword of high interest rates and stubborn inflation and include declining home values; the prospects of a recession later this year (and with it, rising unemployment); a pattern of moderating rents; and continuing liquidity and fundraising challenges posed by capital-markets volatility.

The **Mortgage Bankers Association** projects unemployment could reach 5.5% by the end of this year, up from 3.7% as of November 2022. Home prices are already declining and are projected to drop further over the coming year by anywhere from a modest 1.5% on an annualized basis, according to **Fannie Mae**, to as much as 20%, according to some market forecasts.

"For housing markets, the combined forces of rising interest rates and slower economic growth are weighing on demand and pricing," Northmarq reports. "New and existing-home sales prices have begun to inch lower, and rental rates in most markets have leveled off."

Knowing where to build

Ben Hunsaker is a portfolio manager focused on securitized credit for Santa Monica, California-based **Beach Point Capital Management**, an alternative-credit investment firm with about $16 billion in assets under management as of Sept. 30, 2022. He said in addition to SFR operators starting to see rental growth rates slow, or even decline in some areas, as leases turn over, they also have "seen property taxes and cost structures increase materially."

"So, the operating metrics that it takes to earn an acceptable return on capital have increased, and so [their] top-line revenue growth needs to be increased, but the actual top-line revenue growth is probably stagnating," he said. "There's an argument to be made that there's a sort of evaluation reset that has to happen for these operating entities in the SFR space, which you see generally reflected to some extent in the public stock prices."

National real estate brokerage platform **Redfin** reports that investor home purchases dropped more than 30% year over year in the third-quarter of 2022, which is "the largest decline since the Great Recession, aside from the second quarter of 2020," at the height of the pandemic. Redfin defines investors as any institution or business that acquires residential real estate. Its report is based on an analysis of county records across 40 of the largest U.S. metro areas.

"Investor purchases slumped 26.1% on a quarter-over-quarter basis, the largest quarterly decline on record with the exception of the start of the pandemic," the Redfin report notes. "That compares with a 17.4% quarterly drop in overall home purchases."

NAHB also reported that the BFR home-start mark for the third quarter of 2022 (some 16,000 new homes) is down 6% compared with third-quarter 2021.

Signs of sputtering in the BFR market surfaced as early as August of last year, when SFR company **Home Partners of America**, controlled by private-equity firm **Blackstone Group**, announced it was pausing home purchases in a total of 38 markets as of Oct. 1, 2022, according to a **CoStar News** report**. Bloomberg** reported in October that another major player in the SFR market, **Invitation Homes**, was in search of a partner for a $1 billion joint venture. The report added that seeking external capital was preferable to raising money through an equity offering, given at that point the company's stock price "was down roughly 28%" since the start of the year — and it has continued to drop further since then.

"Headwinds have been gathering with rising financing costs, uncharted inflation, elevated geopolitical risks, and increasing concerns about a general economic recession," states a September 2022 report on the SFR securitization market by **Kroll Bond Rating Agency**. "Should these factors lead to meaningful declines in home prices, rental rates and/or operating margins, the [SFR] sector will be subject to stress it has not previously encountered."

That stress is already present in the homebuilding market, according to Stuart Miller, executive chairman of **Lennar Corp.,** who was among the executives presenting at the homebuilder's recent third-quarter earnings call.

"Our current view is that production of single-family and multifamily dwellings nationally will be down between a quarter to a third in 2023, exacerbating the national housing-supply shortage," Miller said during the Dec. 15, 2022, earnings call. "Numerically, that means that approximately 1.5 million homes produced over the past couple of years per year will drop to around a million homes produced."

"… While our [home-sale contract] cancellation rate of 26% is decidedly higher than the 12% last year, it has been falling from the peak of 28% reached in October, and we expect it to normalize below 20% in the near future," he added.

Hunsaker pointed out that if you're a builder in the current market, your options include "shelving the land that you've banked or that you've optioned to build up, or building it up … and selling it to one of these build-for-rent aggregators as an SFR."

"… So, I think there's joint incentive structures there that make [BFR] a hard art asset class to wrap your hands around."

With that said, Hunsaker said the BFR market is becoming much more a game of geographic chess, adding that "there are great places for build-for-rent and there are awful places for build-for-rent." He points to Florida, a long-time hot SFR market (along with the southern Sunbelt states generally), as an area where there are now many not-so-good places to pursue BFR communities.

"You're not land-constrained" in terms of building opportunities in many Florida communities, he said, and there already has been a lot of SFR development and activity — plus, he added, "you have this really hard-to-measure impact for insurance … post-hurricane."

The Northmarq report indicates that year to date through October of 2022, BFR construction starts in the South generally have accounted for "63 percent of the national total, up from 61 percent in 2021."

"It [BFR] has become very regional, community by community, city by city," Hunsaker added. He said it takes a high level of sophistication to capitalize on the market now, pointing to JP Morgan Chase, a relatively new BFR sector entrant via its recent joint venture with New Haven, as an example of a player that likely has the market intelligence to make good bets.

In the build-for-rent zone

Doug Faron, one of three founding partners at Florida-based Shoreham Capital, a BFR and multifamily residential developer focused on markets in the Southeast, agrees with Hunsaker's take on the direction of the market. But he and his partners — all longtime industry veterans — also believe plenty of opportunities still exist in even crowded SFR markets like Florida.

Among the projects the company is developing is a 175-unit build-for-rent community called The Preserve at Poinciana, which is south of Orlando and slated to start construction in the second quarter of 2023. Shoreham also is developing a more

traditional 412-unit multifamily community, called Siesta Lakes, in Cape Coral, Florida, which is set to start construction in the first quarter of this year.

Faron launched Shoreham early last year along with fellow Shoreham founding partners Nick Zoumas and Steven Figari. Zoumas also is the founder and president of JNS Homes, a West Palm Beach, Florida-based homebuilder with some $1.25 billion in completed construction projects.

“We are partnered with institutional and family office or pension-backed capital to develop these [BFR] assets and hold them in certain instances,” Faron explained in discussing Shoreham’s BFR strategy. “And we are also selling to what is likely the institutional market on the backend, given the scale these communities [is of a] a size that fits within that market.”

Faron and Figari, in a recent interview with HousingWire, stressed that Shoreham is focused on developing build-for-rent communities that are more like multifamily projects — and developing them in the right areas. Faron explained that Shoreham’s single-family build-for-rent projects offer many of the same perks that are a staple in large, more upscale apartment complexes — including onsite management and amenities such as gyms and swimming pools.

“Those are the amenities that people have become accustomed to, especially millennials [now young adults] who are used to living in apartments,” he said.

Figari added that “over time, people will start to see and look at this strategy of what we’re building as being very similar to multifamily, but at the same time you get the benefits of that single-family home.”

Faron said Shoreham is looking at investments across the Southeast, including in Florida, because they are “bullish about the growth there.”

“We certainly have to take into account rising insurance costs [in Florida],” he added, but Faron said there are plenty of unique geographic pockets in a state like Florida, and the Southeast at large, with strong population growth and related strong rent-growth prospects. As an indicator of the growth in West Palm Beach, where

Shoreham is headquartered, Faron said traditional office space has doubled over the past three years.

"People need housing, they need a place to live, and we're trying to hit an approachable price point with a better product," Faron said. "… The millennial population is moving toward household formation, and that is requiring them to want yards and garages, and so we think the trend is [toward] larger living units.

"We are really focused on making sure that we're building the right product [in the right place] for people that can afford to be in there," he added.

The Northmarq report points out that while the economic picture for build-for-rent projects dimmed as 2022 progressed, "the short- and medium-term outlooks for single-family build-to-rent properties have remained attractive."

"Renter demand for these homes is being fueled by demographic trends as millennials age and their housing needs change," the Northmarq report concludes. "… Residents are expected to continue to demand new, single-family rentals, particularly as the affordability of for-sale housing grows further out of reach."