MULTI-HOUSING NEWS

Seizing SFR Opportunities From the East Coast to the Sun Belt

November 1, 2023

Shoreham Capital's Doug Faron explains why he remains confident in the sector's long-term fundamentals, despite short-term headwinds.

Shoreham aims to fill the gap for needed housing in areas that have recently experienced rapid growth, according to Doug Faron. *Image courtesy of Shoreham Capital*

An increasing number of investors looking to diversify their portfolios in the ever-changing multifamily landscape are expanding in or entering the SFR sector.

A year ago, three partners joined forces to launch **Shoreham Capital**, a real estate firm targeting high-growth markets across the East Coast and Sun Belt, two regions where SFR demand is particularly high.

Today, Shoreham has 600 SFR units under construction and is in contract on an additional 1,500. Despite the current uncertainty plaguing investment markets, Founder & Managing Partner Doug Faron is confident that SFR/BTR long-term fundamentals will remain solid. In the interview below, he touches on the challenges caused by economic volatility and points out how his company is seizing SFR investment opportunities across two of the country's most sought-after regions.

What type of SFR properties are you targeting? Tell us more about some of the SFR projects you have underway.

Faron: Within the SFR realm, Shoreham is particularly interested in build-to-rent communities that offer on-site management, amenities that are a staple in large apartment complexes—such as fitness centers, dog parks and swimming pools—and features typical of single-family homes, including garages and fenced backyards. We also consider the site's location within a community, ensuring there is reasonable access to employment opportunities, grocery stores, shopping malls, and beyond.

One of the factors contributing to the popularity of this sector lies in the demands of the Millennial generation, which is transitioning from apartment living to larger spaces as they grow their families. We think providing these services and amenities will attract the broad and expanding scope of the population that is looking to rent rather than own larger townhomes and single-family homes.

In Orlando, we are currently building a 175-unit BTR project that will offer three- and four-bedroom detached homes with garages and fenced yards as well as common-area amenities. Additionally, we are in contract on a large three-phase project in the Tampa area that will produce over 700 homes and townhomes with best-in-class amenities.

Several months ago, you mentioned that 2022 was "a year of dichotomy for the SFR/BTR sector" in our SFR market outlook article. Considering all the economic shifts of late, how would you describe 2023? How have market fundamentals evolved?

Faron: The SFR/BTR sector entered 2022 with an incredible demand, but as interest rates rose and construction costs remained high, developing enough housing to meet the need proved difficult. Our 'year of dichotomy' forecast holds true for 2023, as demand for this asset class has held firm—particularly in our target areas of the East Coast and Sun Belt regions—but evolving capital markets have created short-term headwinds.

So far this year, we've witnessed bank collapses, commercial real estate distress and 11 consecutive interest rate hikes, which have ultimately caused the market and its major players to be plagued by uncertainty. Despite these challenges, we are confident that the long-term fundamentals of the SFR/BTR market remain incredibly strong.

In fact, the segment is one of the best-positioned sectors for this environment as it is one of the few asset classes with an embedded hedge. This means that as rates rise and the cost of construction becomes higher for developers, the cost to own also increases for homeowners, which ultimately drives more individuals into the rental segment—specifically to SFR and BTR properties. In addition, the post-pandemic trend toward larger spaces as well as the uptick in remote work has only further increased the demand for the product we are developing.

With more than 50 years of collective experience in real estate, Managing Partners Nick Zoumas, Steve Figari and Doug Faron founded Shoreham Capital in 2022. *Image courtesy of Shoreham Capital*

In what way has your company felt the effects of rising interest rates, high inflation and potential recession?

Faron: The real estate industry in its entirety, including the SFR/BTR space, has undoubtedly been affected by rising interest rates, inflation and the potential recession. In our experience, it has been harder to get deals done with the changing cost of capital, but not impossible. When interest rates were much lower a few years ago, there were maybe 10 land sites that could work for any given development.

In comparison, now there may only be one site—it exists, you just have to look that much further. Despite higher rates and growing development costs, we remain bullish on the SFR market and believe it will be a growing sector over the next five to 10 years.

What would you say is the most difficult aspect of managing SFR properties today?

Faron: As the economy softens, we will see several impacts on single-family rentals, including slowing rent growth, eroding margins, increases in bad debt and lagging collections. In times like these, we think great management is critical to finding creative ways to attract tenants. We ensure that our properties offer differentiated services that draw potential residents to our community versus another, and we manage our expenses strategically to navigate through the challenging economic times.

What strategies do you use to future-proof your investments and developments in the sector, considering the overall economic uncertainty?

Faron: What's critical to us is developing a best-in-class product. In our Florida developments, for example, where wood-frame houses are acceptable in certain geographies, we have chosen to build only concrete block construction to date as a precaution for potential storm risk. Concrete block may become the norm in these areas should storms affect the Southeast, but by building with this material now, we are future-proofing our investments and developments.

Across the board, our primary focus is location, as we venture to find the best infill sites possible for BTR and SFR developments. We evaluate the area's school districts, retail centers and employment options, as these elements are critical to having projects be successful in the long term as the markets grow and expand.

Can you expand on your data-driven approach to investing and developing SFR assets and targeting assets based on cash flow dynamics?

Faron: We work with several research products, including some proprietary approaches we have developed internally, to screen for the best locations for the assets we are developing and buying. That means finding that intersection between population growth, employment growth, good proximate amenities, and great schools to support the families that tend to favor this product.

Regarding cash flow dynamics, we target projects and existing assets that offer robust, untended yields on costs in areas with strong growth dynamics. Due to our data-driven approach, we are confident that our investments will be successful even without large growth in the area, but with growth, we can produce outsized returns for our investors.

What are some factors that you consider when looking at new investments/projects? Are there any particular metros you're targeting?

Faron: Our investment strategy is supported by our strategic decision to operate in best-in-class locations and high-growth markets with positive supply-demand dynamics within the Sun Belt and East Coast regions. More specifically, this means building rental communities in markets like southwest Florida, where there is strong rent growth as well as a limited supply because of growing migration and employment trends.

When distilled down, at Shoreham we aim to fill the gap for needed housing in areas that have recently experienced rapid growth, all while ensuring that its projects enhance the communities they are built in.

How are rising construction costs affecting your SFR pipeline? How are you dealing with this challenge?

Faron: Despite rising construction costs, development in high-growth markets like the Southeast has remained robust. That said, we do anticipate construction starts to moderate over the next six to 12 months, which will subsequently decrease construction costs. As it relates to Shoreham's pipeline, we see a continued ability to develop projects throughout this high-cost period due to our focus on best-in-class infill locations that are experiencing an undersupply of housing.

What will Shoreham Capital be focusing on going forward?

Faron: We are very focused on growing our portfolio, especially in what we view as a more economically challenged environment, as we believe these are exactly the right times to invest. With that in mind, we still need to consider the current cost of capital and near-term growth challenges, which means finding those projects that are that much more compelling and will pay off when the economy normalizes.

We continue to focus on growing markets including Tampa, Orlando, Fla.; Atlanta; Nashville, Tenn.; Raleigh-Durham, Charlotte, N.C.; and Northern Virginia where we see great dynamics in the long term. We also remain focused on our conservative and strategic approach, utilizing low-leverage and best-in-class locations with long-term growth potential. By doing so, we believe we will emerge with an irreplaceable and defensible portfolio as the economy recovers, which should produce great risk-adjusted returns for our investors.