RMBS Research

With Few Bulk Buying Opportunities, Rental Home Buyers Shift Focus to Southeast

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Morningstar Perspective

Fewer distressed buying opportunities for institutional investors in single-family rental houses has led to a shift of securitized properties from the southwest United States to the southeast, and the composition of future issuance will depend on market-driven property acquisition and disposition strategies. After peaking in 2014, fewer single-borrower, single-family rental properties have been securitized, and the geographic makeup of recent securitized pools is concentrated in the broader southeast, including Florida, and Texas rather than in California, Nevada, and Arizona. This shift is likely due to lower acquisition costs and more attractive yields in the southeast. Future pools will depend on issuers' ability to add assets based on these factors but will also hinge on their ability or willingness to refinance existing pools of collateral and to pare assets to realize house price gains.

Morningstar Credit Ratings, LLC has rated all 31 single-borrower, single-family rental transactions brought to market since 2013, seven multiborrower transactions, and one deal backed by residential rental mortgages. This report relies on our database of nearly 120,000 properties from the single-borrower, single-family rental deals.

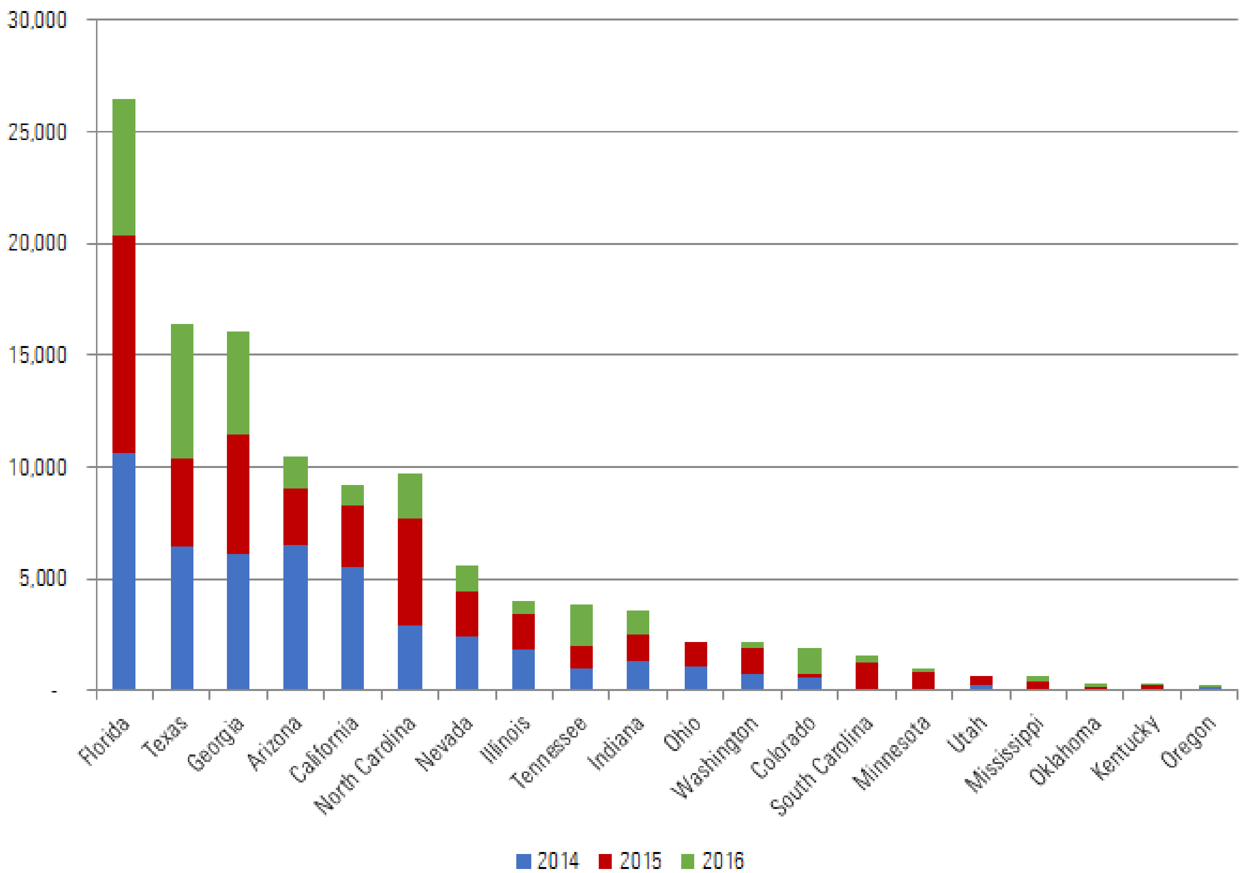
Table 1 summarizes single-borrower issuance, while Chart 1 shows the number of properties from the top 20 states for the 2014 through 2016 vintages.

Table 1 – Single-Borrower, Single-Family Rental Securitization Issuance

Vintage	Property Count	Original Balance ($)	Deal Count
2013	3,207	479,137,000	1
2014	47,546	6,736,973,800	12
2015	40,678	5,902,683,000	10
2016	28,274	4,361,959,843	8
Total	119,705	17,480,753,643	31

Source: Morningstar Credit Ratings, LLC

Chart 1 – Top 20 State Composition by Vintage

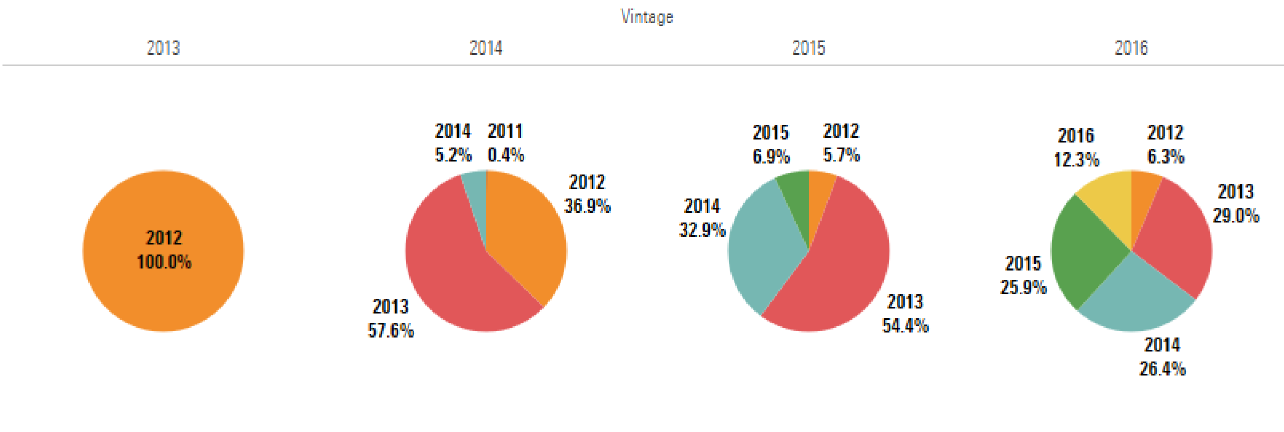


Source: Morningstar Credit Ratings, LLC

Property Buyers Shift Focus to Texas, North Carolina From Western States

Because institutional investors accumulated their properties over time, early-vintage single-family rental securitizations are largely backed by houses purchased from 2012 through 2014. Meanwhile, 2016 securitizations included the refinancings of previous single-family rental issuance, so they contain a mix of older and newer purchased homes. This is illustrated in Chart 2, which shows the acquisition year makeup in each vintage.

Chart 2 – Acquisition Year Makeup by Vintage



Sources: Morningstar Credit Ratings, LLC and Tableau Software

Note: Percentages may not add up to 100% because of rounding.

It is beneficial to use the properties' acquisition years to track geographic changes over time. Table 2 displays the number of properties acquired each year for the top states in single-family rental deals, with refinanced properties removed to avoid double counting. Table 2 illustrates the higher volume of purchases from 2012 through 2014, as institutional investors ramped up their portfolios and took advantage of distressed buying opportunities. Securitized acquisitions dropped 65.6% in 2016 compared with 2015. Table 2 also shows the geographic shift. Property purchases in California, Arizona, and Nevada were more prevalent in 2012-13, while Texas, North Carolina, Tennessee, and even Indiana had more institutional acquisitions from 2014 to 2015. Florida has been among the top states for acquisitions annually since 2012.

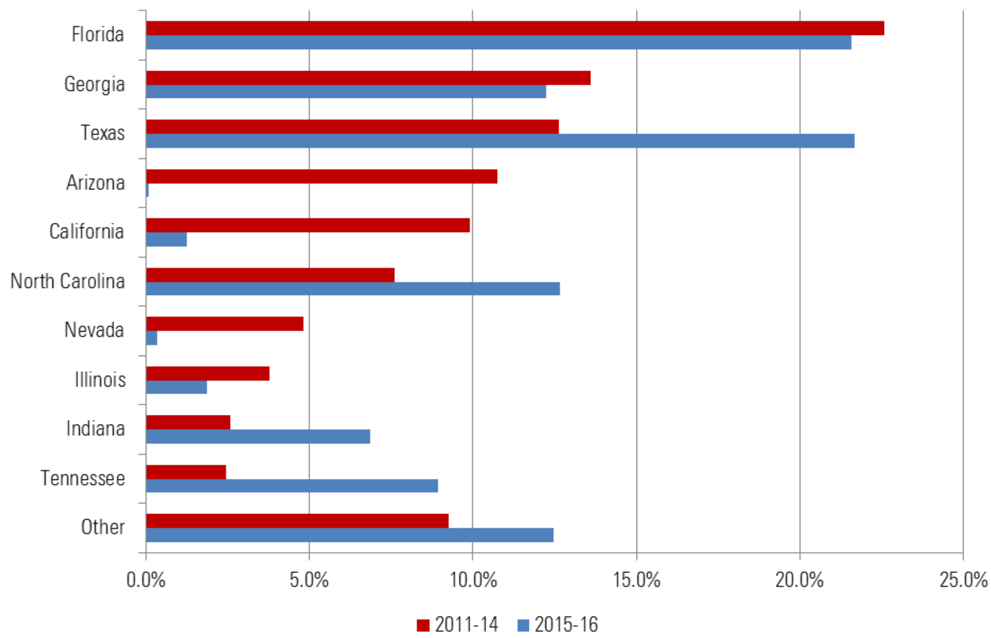
Table 2 – Top States by Acquisition Year

State	2011	2012	2013	2014	2015	2016	Total
Florida	0	4,346	13,857	4,518	2,162	776	25,659
Texas	0	2,700	5,339	4,650	2,396	553	15,638
Georgia	0	3,282	7,945	2,462	989	677	15,355
Arizona	101	5,686	4,385	628	11	0	10,811
California	0	4,804	4,512	646	101	69	10,132
North Carolina	0	712	4,124	2,825	1,376	346	9,383
Nevada	74	938	2,857	972	42	7	4,890
Illinois	0	785	2,480	537	191	64	4,057
Tennessee	0	259	1,204	1,000	995	220	3,678
Indiana	0	288	1,290	1,034	695	239	3,546
Other	0	736	5,879	2,691	1,168	530	11,004
Total	175	24,536	53,872	21,963	10,126	3,481	114,153

Source: Morningstar Credit Ratings, LLC

Chart 3 summarizes the data from Table 2 by showing the percentage by count from each state grouped by acquisition years. The red bar shows the high acquisition period from 2011 through 2014, when institutional investors were growing their portfolios, while the blue bar depicts 2015 and 2016 purchases, a period of more selective institutional investment in single-family rental properties. Florida properties accounted for greater than 20% of acquisitions in both time frames, and Georgia was consistently above 10%. However, Texas, North Carolina, Tennessee, and Indiana acquisitions picked up in more recent years, while those in Arizona, California, and Nevada dropped off.

Chart 3 – Percentage by Count From Top States Grouped by Acquisition Years



Source: Morningstar Credit Ratings, LLC

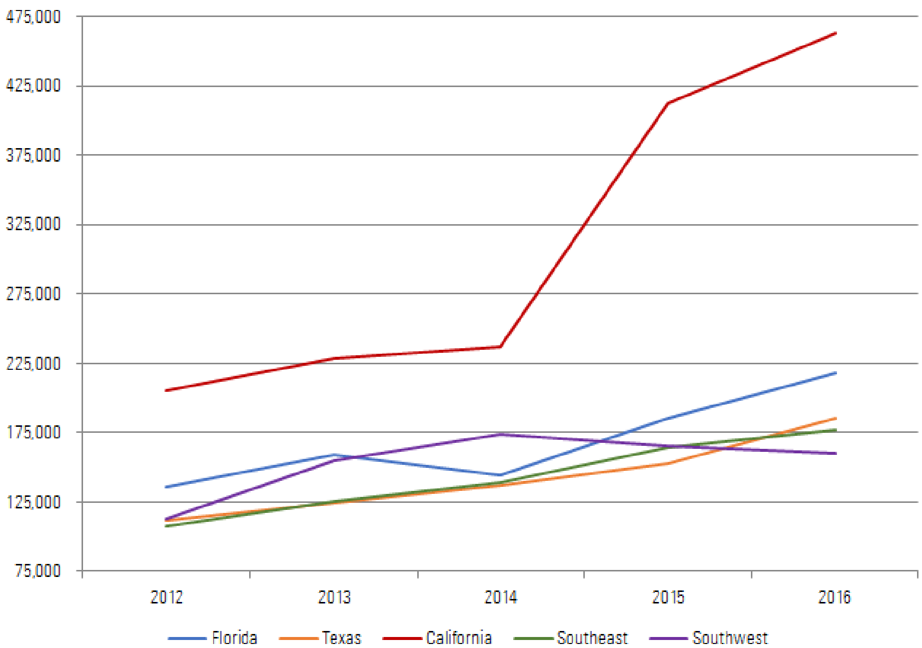
Various Costs, Potential Appreciation, Other Factors Affect Purchasing Decision

Institutional issuers of single-family rental securitizations consider several factors when purchasing properties, including the acquisition channel, the costs associated with the purchase, initial rehabilitation and ongoing maintenance, gross and net yields, and potential home price appreciation. Single-family rental issuers also consider economic factors like regional employment, income, and demographic factors such as school-district rankings. Changes in these considerations will affect the geographic makeup of securitized pools.

Acquisition Channel, Purchase Price, Rehabilitation Costs, and Total Cost Basis

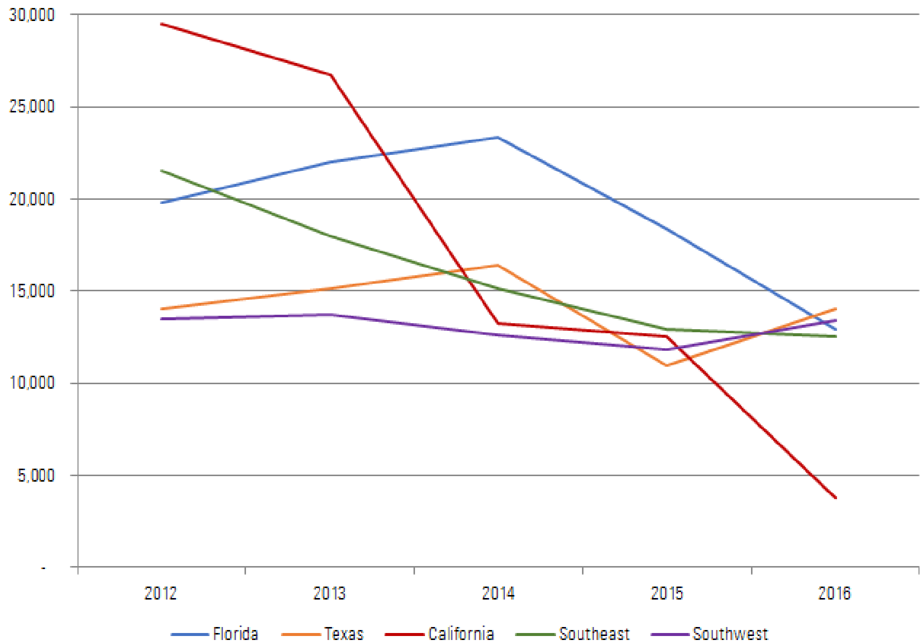
In the infancy of securitized single-family rentals, institutional investors could acquire distressed properties at discounts through bulk purchases and auctions. However, a generally improved housing market, including sustained house price appreciation, has resulted in fewer of these buying opportunities. Thus, institutional investors must add assets selectively, likely through multiple listing service purchases. While purchase prices are higher today, this more opportunistic buying allows issuers to target properties that require less up-front renovation, as evidenced by declining rehabilitation costs. Lower initial rehabilitation costs may also be partly explained by institutional investors improving their operational efficiencies. Despite lower rehabilitation costs, the total cost to purchase homes is higher for more recently acquired properties. Charts 4a, 4b, and 4c summarize purchase price, rehabilitation cost, and total cost basis by acquisition year, in average dollars, for some of the states most typically seen in single-borrower, single-family rental deals and for properties in the southeast and southwest U.S. The southeast includes Alabama, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia properties, while the southwest includes Arizona and Nevada properties.

Chart 4a – Average Purchase Price ($)



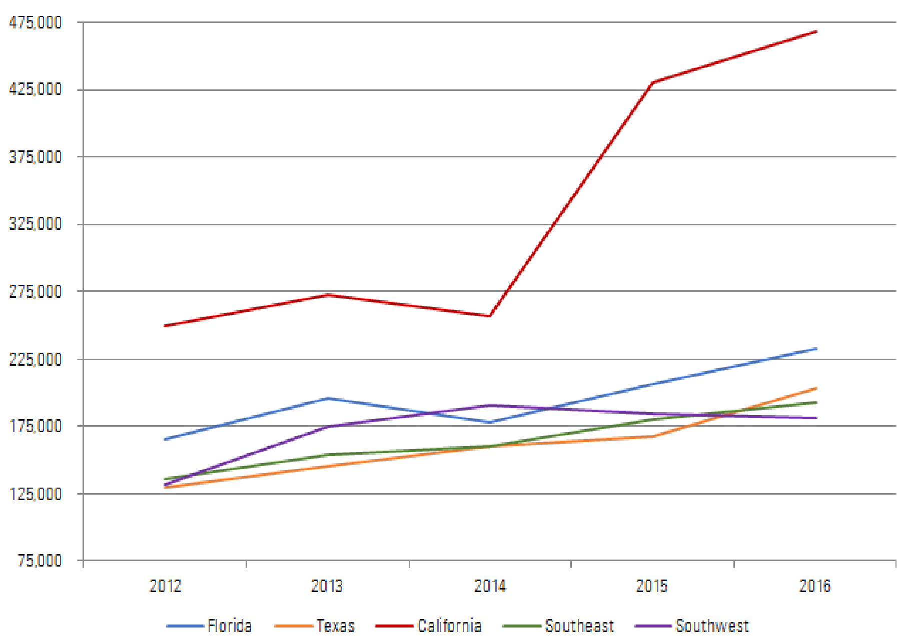
Source: Morningstar Credit Ratings, LLC

Chart 4b – Average Initial Rehabilitation Cost ($)



Source: Morningstar Credit Ratings, LLC

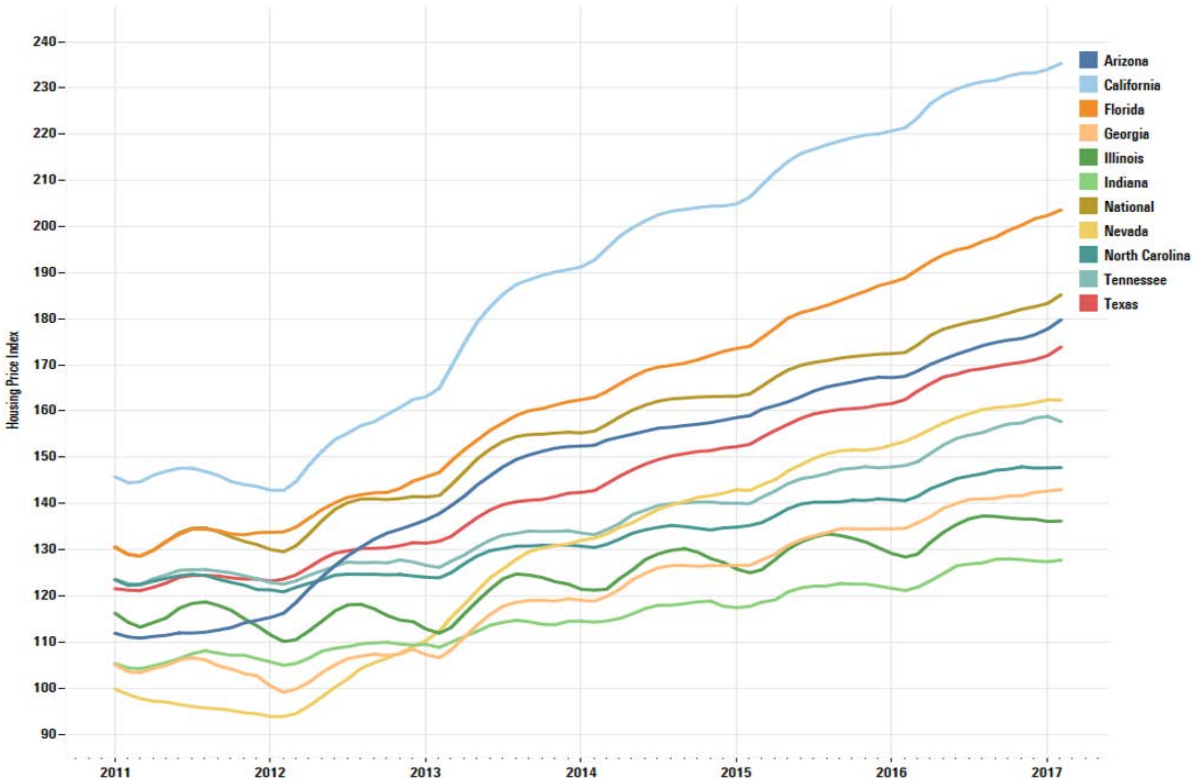
Chart 4c – Average Total Cost Basis ($)



Source: Morningstar Credit Ratings, LLC

Rising house prices affect the markets from which institutional investors add properties, as they must strike a balance between acquisition costs and rents, as well as future rent growth and price appreciation expectations. As illustrated in Chart 5, house price appreciation has been substantial in many of the states where institutional investors have acquired properties. For example, since 2013, both California, at 44.3%, and Florida, at 39.7%, bested the national housing price index's increase of 31.0%.

Chart 5 – House Prices Have Increased Across Single-Family Rental Markets



Sources: Morningstar Credit Ratings, LLC, CoreLogic, and Tableau Software

As securitizations reach their maturity dates, issuers may decide to refinance existing properties into new deals to borrow against these gains. Thus, previously acquired California, Arizona, and Nevada properties may still play a part in future issuance. However, these house price increases can also drive institutional investors to sell properties to monetize these gains. Properties sold in higher-cost areas would likely not be replaced by properties in the same region because yield expectations changed over time.

Decreasing Gross and Net Yields

Institutional investors also consider yield when acquiring properties. Table 3 reflects the institutional investor's yield expectation at the time of acquisition as measured by the annual gross potential rent at cutoff over the total cost basis at cutoff. Gross yields have fallen across the top 20 metropolitan statistical areas in single-borrower, single-family rental deals. However, double-digit, or near-double-digit, yields are still available in the MSAs that have seen more representation in recent securitized pools: Texas, Tennessee, Indiana, and North Carolina. Atlanta and most Florida MSAs have sustained higher gross yields, though Fort Lauderdale and Orlando have dipped below 9.0%. In contrast, the gross yields in California MSAs are among the lowest. As mentioned, issuers consider rental growth and price appreciation expectations when acquiring properties, and the last column in Table 3 identifies the MSAs where higher gross yields may be attainable in the current housing market that features less distressed buying opportunities. It measures gross yield as the current annual gross potential rent, or GPR, over the home-price-index adjusted broker's price opinion, or BPO, value. These gross yields based on current market conditions imply that the gains in rents and home values have been more balanced in Texas and the broader southeast, thereby making them candidates for future investment opportunities. On the other hand, while California properties have experienced some of the highest rental increases among securitized single-family rental properties, the rental gains have been outpaced by the increases in property values to such a degree that the state may no longer be a viable option for acquisitions.

Table 3 – Gross Yield Percentage for Top 20 MSAs

MSA	2011	2012	2013	2014	2015	2016	Current GPR/ HPI adjusted BPO
Atlanta, GA		11.6	10.3	11.0	9.7	9.5	8.8
Charlotte, NC		12.7	10.4	10.0	9.6	9.6	8.8
Chicago, IL		12.6	10.8	11.8	10.2	9.3	9.6
Dallas-Plano-Irving, TX		13.2	12.0	11.2	10.7	10.1	9.3
Fort Lauderdale, FL		11.8	9.5	9.9	9.0	8.6	8.2
Fort Worth-Arlington, TX		13.3	12.1	11.6	11.2	10.8	9.6
Houston, TX		13.9	12.7	12.0	11.7	11.1	10.3
Indianapolis, IN		12.2	11.0	11.1	11.2	10.7	10.3
Jacksonville, FL		11.1	9.7	10.6	9.5	9.1	7.9
Las Vegas, NV	11.0	10.4	8.4	7.9	8.2	8.7	6.8
Los Angeles, CA		7.8	7.7	8.7	7.9	6.0	5.9
Memphis, TN		14.6	11.9	11.3	10.7	11.4	10.0
Nashville, TN		9.4	10.8	9.7	10.0	9.3	8.6
Orlando, FL		10.5	9.8	9.8	9.5	8.7	7.8
Phoenix, AZ	11.1	9.5	8.3	8.5	9.3		6.7
Raleigh-Cary, NC		8.8	9.3	9.2	9.1	8.9	8.4
Riverside-San Bernardino, CA		8.9	8.0	8.3	8.0	6.5	6.3
Sacramento, CA		9.1	8.2	8.4	7.5	6.0	6.1
Sarasota-Bradenton-Venice, FL		10.5	9.5	10.2	9.3	9.1	7.5
Tampa, FL		10.8	9.8	10.9	10.3	9.8	8.2
Total – All MSAs	11.1	10.6	9.8	10.5	10.2	9.5	8.4

Source: Morningstar Credit Ratings, LLC

Net yield must also be considered, as taxes and other expenses vary by location. Table 4 measures net yield as the annual gross revenue at cutoff minus issuer underwritten vacancy, expense, and capital expenditure assumptions, divided by the total cost basis at cutoff. A similar trend is seen based on net yield, where MSAs in Tennessee, Texas, North Carolina, and Indiana are typically higher. Appendix I compares gross and net yields at the state level by acquisition year.

Table 4 – Net Yield Percentage for Top 20 MSAs

MSA	2011	2012	2013	2014	2015	2016
Atlanta, GA		6.5	5.6	6.3	5.5	5.4
Charlotte, NC		7.5	6.1	6.0	5.6	5.5
Chicago, IL		6.2	5.6	5.6	4.5	4.6
Dallas-Plano-Irving, TX		7.4	6.4	5.8	5.5	5.2
Fort Lauderdale, FL		6.2	4.9	5.7	4.9	4.5
Fort Worth-Arlington, TX		7.0	6.3	6.0	5.5	5.5
Houston, TX		6.8	6.2	6.0	5.6	5.8
Indianapolis, IN		7.0	6.4	6.6	6.2	6.3
Jacksonville, FL		6.0	5.0	5.8	4.9	4.8
Las Vegas, NV	7.0	6.2	4.8	4.6	5.0	5.3
Los Angeles, CA		4.5	4.2	5.0	4.9	3.7
Memphis, TN		8.4	7.3	6.9	6.1	6.9
Nashville, TN		6.6	7.1	6.4	6.1	5.8
Orlando, FL		5.5	4.8	4.8	4.8	4.8
Phoenix, AZ	7.1	5.4	4.7	4.3	4.2	
Raleigh-Cary, NC		5.8	5.8	5.7	5.4	5.3
Riverside-San Bernardino, CA		5.0	4.3	4.7	4.3	3.8
Sacramento, CA		5.3	4.6	4.1	4.0	3.9
Sarasota-Bradenton-Venice, FL		5.5	4.8	5.3	5.0	4.9
Tampa, FL		5.3	4.8	5.6	5.2	5.1
Total – All MSAs	7.1	5.9	5.3	5.8	5.5	5.4

Source: Morningstar Credit Ratings, LLC

Occupancy, Rental Growth Strong in Western States

Performance has been strong for properties in single-borrower, single-family rental securitizations; however, the geographic shift has introduced variability across regions. The Phoenix, Las Vegas, and the California MSAs have some of the lowest average vacancies and highest year-over-year rent increases in single-family rentals, reflecting strong tenant demand. On the other hand, the Florida, Indiana, Tennessee, and Texas MSAs have had higher-than-average vacancies, though they are within expectations. Table 5 summarizes the monthly vacancy percentages for the top 20 MSAs over the past six months.

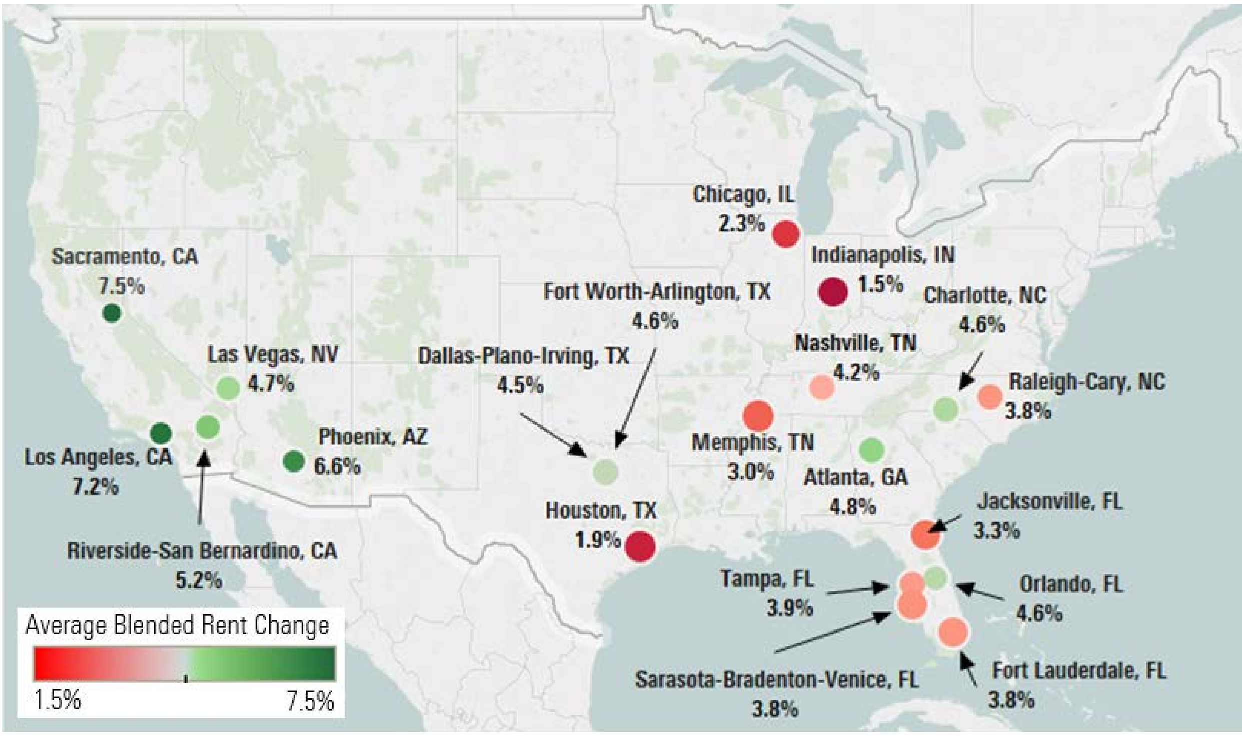
Table 5 – Month-End Vacancy (by Percentage) for Top 20 MSAs

	Year 2016				Year 2017	
MSA	Sep	Oct	Nov	Dec	Jan	Feb
Atlanta, GA	4.5	4.8	4.8	4.6	5.1	4.5
Charlotte, NC	5.1	5.5	6.0	5.6	5.2	4.7
Chicago, IL	6.1	6.4	5.5	5.4	4.7	4.6
Dallas-Plano-Irving, TX	4.4	5.4	5.3	4.4	4.2	3.9
Fort Lauderdale, FL	7.2	6.9	6.6	6.0	6.6	6.7
Fort Worth-Arlington, TX	3.4	4.0	4.6	5.0	5.1	4.5
Houston, TX	7.8	8.0	7.7	7.1	6.2	6.2
Indianapolis, IN	6.9	8.7	8.1	6.8	6.2	5.2
Jacksonville, FL	6.4	6.9	7.3	7.6	6.6	5.1
Las Vegas, NV	3.7	4.1	3.7	4.3	3.4	3.4
Los Angeles, CA	3.9	3.2	3.0	2.9	2.4	2.7
Memphis, TN	6.6	8.3	8.7	8.8	8.1	7.8
Nashville, TN	3.5	4.8	5.8	5.5	5.5	5.9
Orlando, FL	4.7	4.7	5.0	4.5	4.0	3.9
Phoenix, AZ	4.3	4.4	4.6	4.2	3.6	3.0
Raleigh-Cary, NC	5.2	4.6	4.8	5.0	5.1	5.8
Riverside-San Bernardino, CA	4.0	3.8	4.0	3.6	4.0	4.7
Sacramento, CA	2.9	3.0	2.4	2.3	2.5	3.0
Sarasota-Bradenton-Venice, FL	6.8	7.2	7.2	6.6	7.4	6.1
Tampa, FL	4.8	5.1	5.0	5.2	5.3	4.5
Total – All MSAs	5.0	5.2	5.3	5.1	4.9	4.6

Source: Morningstar Credit Ratings, LLC

Despite these vacancies, tenant demand in the southeast typically has been strong enough for issuers to raise rents, though the increases have been smaller than those in California, Arizona, and Nevada. Chart 6 depicts average vacancy over the past year, where the bigger the circle, the higher the average vacancy, while the color of the circle represents the average rent change, where green is higher and red is lower.

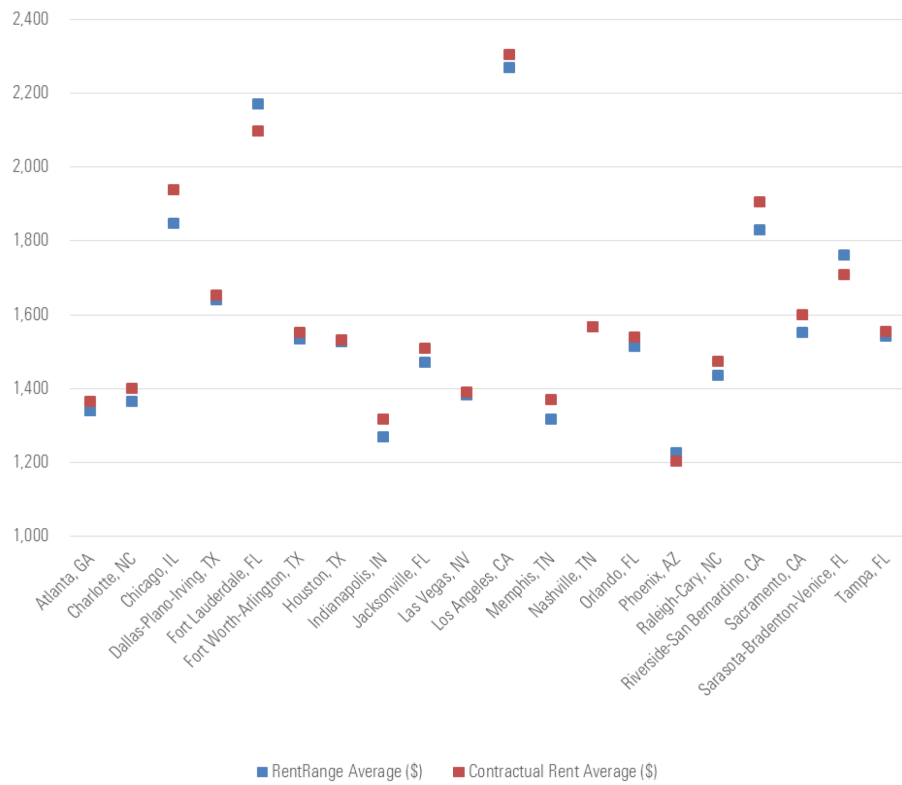
Chart 6 – Vacancy Versus Rent Change*



Sources: Morningstar Credit Ratings, LLC and Tableau Software
*The size of the circles represents the average vacancy percentage (by count) of properties in each MSA over the past year, ranging from 2.8% to 7.3%. Because of their proximity, the Fort Worth-Arlington, Texas, MSA is hidden behind Dallas-Plano-Irving.

Chart 7 compares the contractual monthly rent in each MSA, as of the latest data available, to the property-level RentRange rent estimate. Typically, the institutional investors can obtain higher rents than their property-level RentRange estimates; the most notable exceptions are the Florida MSAs of Sarasota-Bradenton-Venice and Fort Lauderdale. Contractual rents that are higher than their property-level RentRange estimates in markets such as Houston, Indianapolis, and Memphis indicate that issuers may be willing to accept a higher-than-average level of vacancy in exchange for higher rents.

Chart 7 – Average Contractual Rents Versus Property-Level RentRange Estimates



Sources: Morningstar Credit Ratings, LLC and RentRange

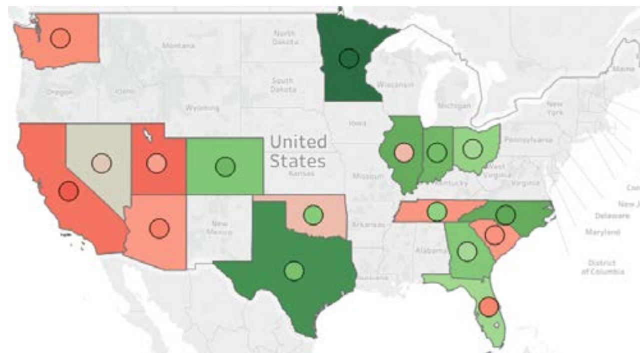
In the absence of large-scale distressed buying opportunities, the future geographic makeup of single-family rental transactions will depend on how successfully issuers can selectively add properties in markets based on their yield and home price appreciation expectations. Additionally, institutional investors may choose to leave regions where the economics are no longer optimal or where they choose to sell properties to monetize the value of house price appreciation. Geographic concentration will also depend on institutional investors' ability and willingness to stay in certain markets by refinancing existing securitizations backed by earlier acquired properties. Property performance has been strongest in California, Arizona, and Nevada, regions from which institutional investors may no longer be able to add assets. Vacancy metrics in securitized pools have benefited from properties in these high-demand regions, and while performance in the broader southeast and Texas has been within Morningstar's expectations, if pools become more concentrated in these locations, overall vacancy may increase.

Appendix I – Comparison of Gross and Net Yield

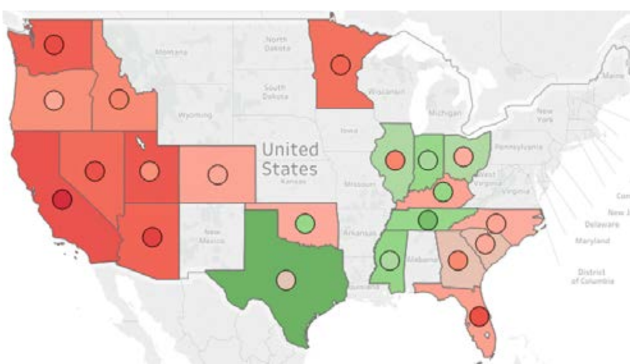
In the maps, the shade of the state represents the state's average gross yield, while the shade of the circle displays the state's average net yield, with green higher and red lower. These maps show the generally decreasing trend of overall yields through time, while highlighting the shift of relatively higher yields from the southwest to the southeast.

Acquisition Year 2011

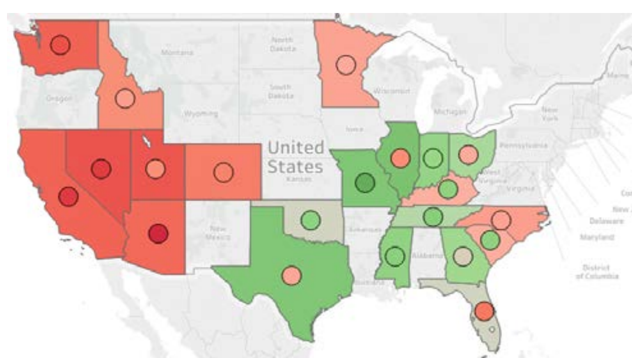
Acquisition Year 2012



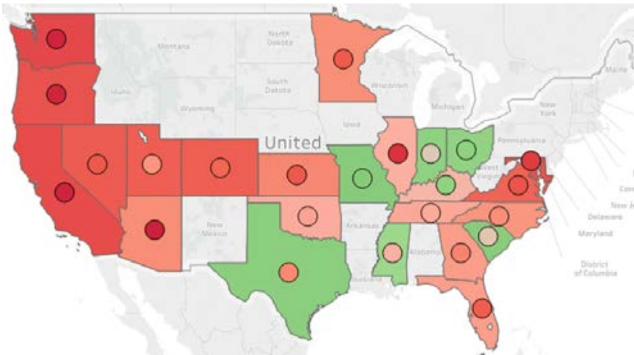
Acquisition Year 2013



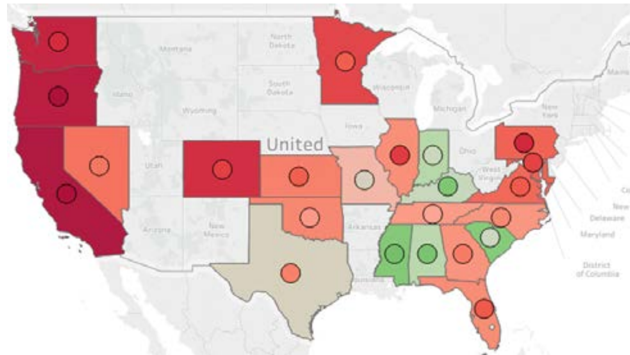
Acquisition Year 2014

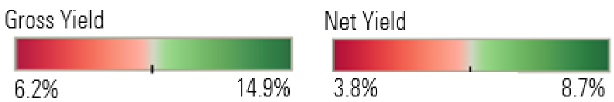


Acquisition Year 2015



Acquisition Year 2016





Sources: Morningstar Credit Ratings, LLC and Tableau Software

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