

RMBS Research

Increasing Rents on Single-Family Properties Suggest Robust Tenant Demand

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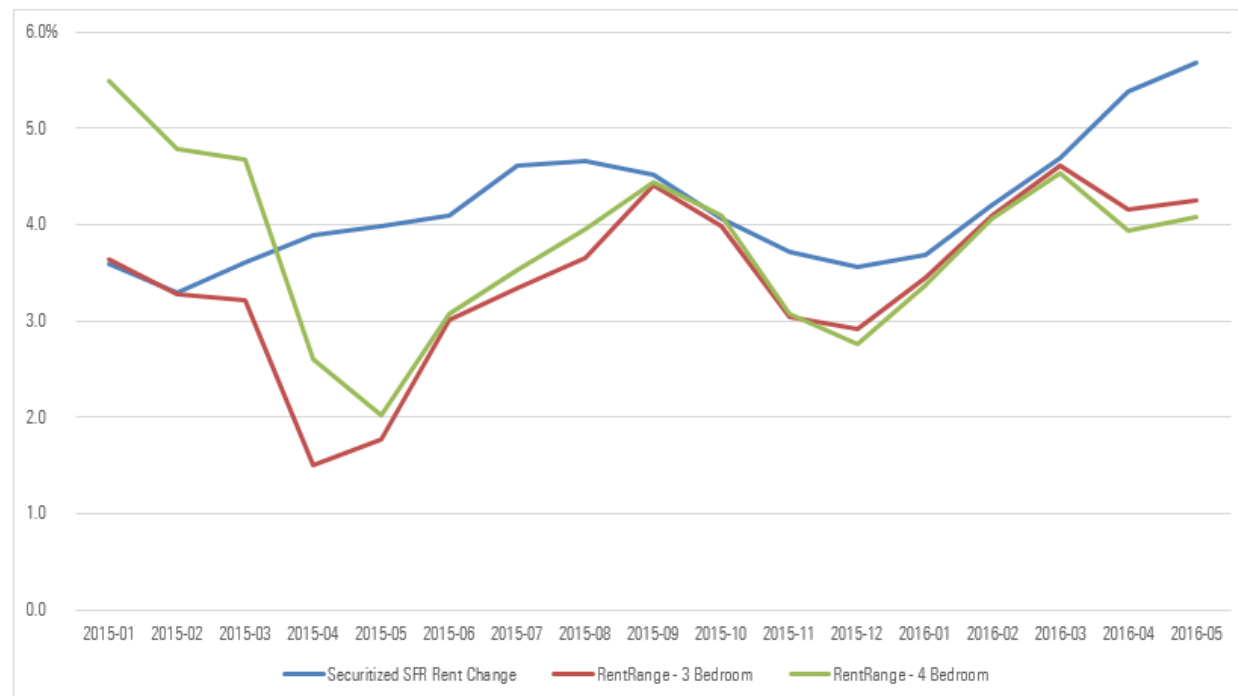
Morningstar Perspective

Tenant demand for single-family rental properties remains strong, with rent increases in securitized properties approaching 6%. Over the past 18 months, rents rose for most properties in 23 single-borrower, single-family rental securitizations, according to an examination of roughly 90,000 single-family rental properties in nearly 100 metropolitan statistical areas. These rent boosts outpaced the year-over-year increases of three- and four-bedroom RentRange, LLC median rents for properties in similar MSAs. These rental trends have met the expectations of Morningstar Credit Ratings, LLC. Rent increases from new tenants showed more seasonality than rental growth from renewals, leading to higher rent changes in summer. Rent increases generally were higher for institutional owners, because they tend to push rental rates more aggressively than smaller landlords. This is due in part to the institutions having more data, resources, and analytical tools. Institutions may have different economic incentives than smaller landlords.

Rental Step-Ups Nearing 6%

As seen in Chart 1, the single-family rental gains peaked at 5.7% as of May. Over the past year, the rent gains in securitized single-family rental properties exceeded the growth in three- and four-bedroom median rents estimated from RentRange data. The seasonality of rental changes can also be seen in Chart 1, with larger upticks occurring in the summer.

Chart 1 –Single-Family Rental Rent Change Versus RentRange Year-Over-Year Rent Change

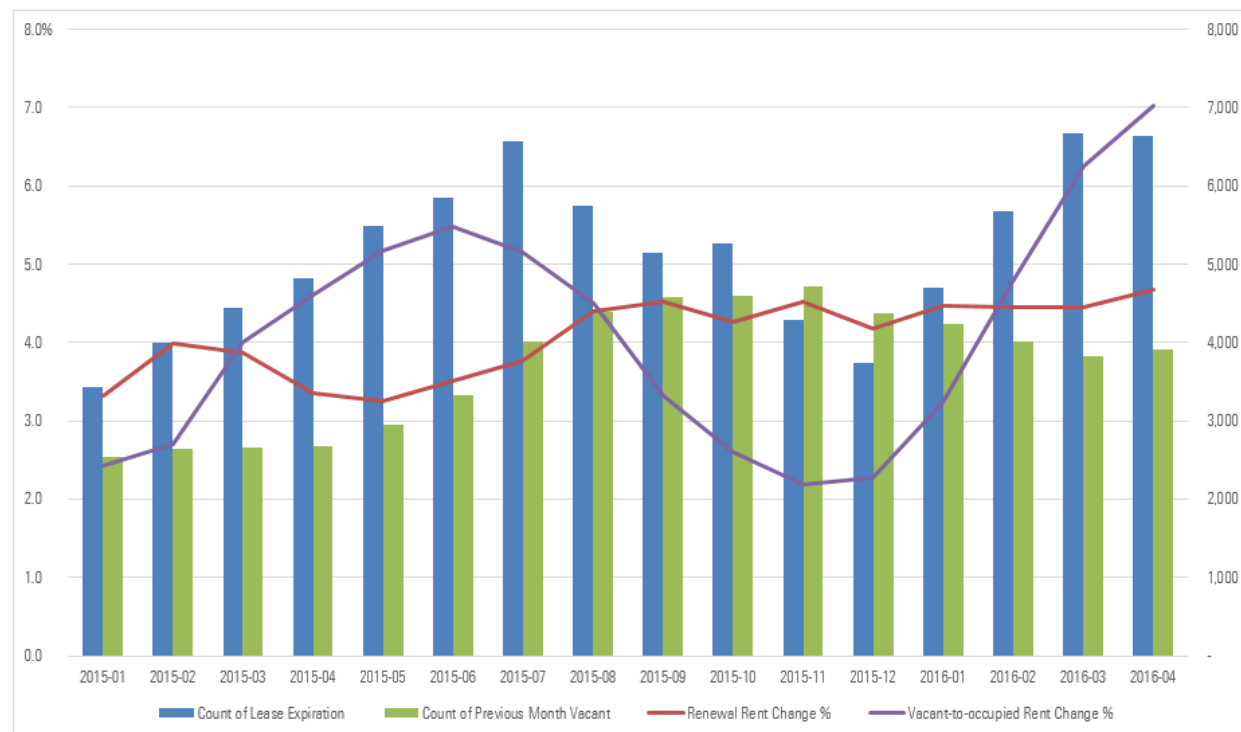


Sources: Morningstar Credit Ratings, LLC; RentRange

Vacant-to-Occupied Properties Exhibit Greater Rental Change Seasonality

To examine the reasons for rent increases, Morningstar reviewed rent changes for both renewal properties and vacant houses later occupied by tenants. In Chart 2, both renewal properties and vacant-to-occupied properties showed accretion. However, the rental increases from renewals tended to be in the 3.5% to 4.5% range. Vacant-to-occupied properties showed more seasonality, with much larger gains in the 2015 summer months. It is our interpretation that these summer rent spikes appear to be the driver of the seasonality in Chart 1. This follows a common sentiment in the single-family rental market. Anecdotal evidence suggests tenants prefer to move in the summer, in part because of milder weather. In addition, property managers stress that tenants place importance on their preferred school districts. Chart 2 suggests that new tenants are willing to accept higher rental rates in the summer, possibly to move in time for the new school year, and renewing tenants will pay higher rental rates in the fall, possibly because of their desire to stay in a school district.

Chart 2 – Rental Changes for Renewals Versus Vacant to Occupied

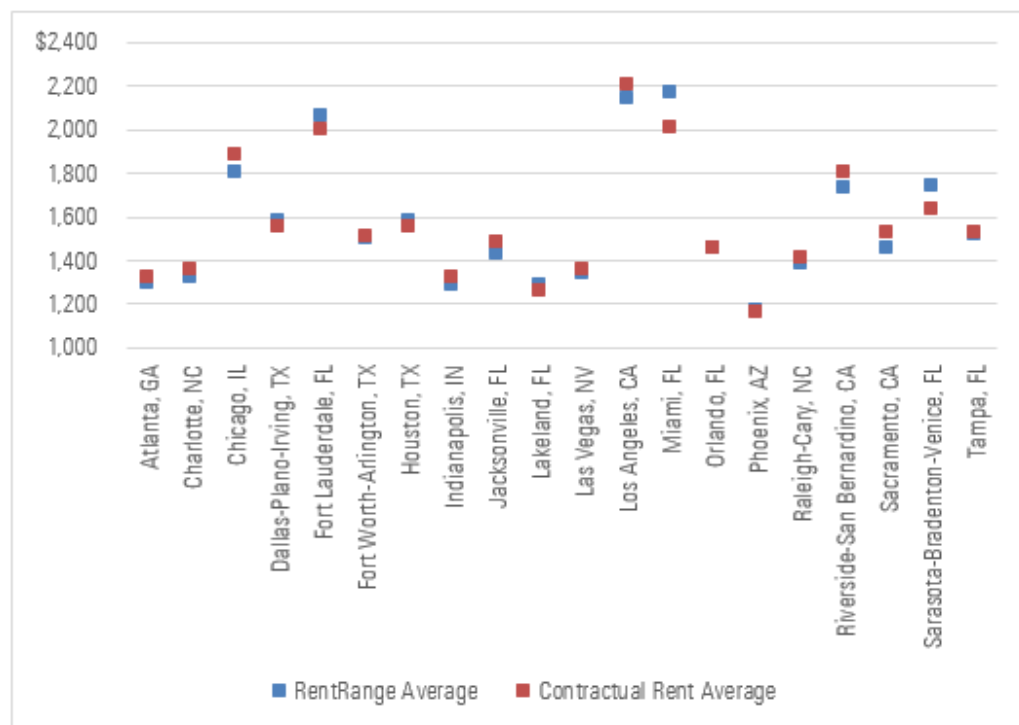


Source: Morningstar Credit Ratings, LLC

Contractual Rents Strong in Major Single-Family Rental Markets

Chart 3, which shows some of the MSAs most frequently found in single-family rental securitizations, takes a snapshot of the May contractual rents in the Morningstar single-family rental database and compares these rents with their property-specific rent estimates from RentRange. Generally, the contractual rents are in-line with the RentRange property-level rent estimates. Exceptions can be seen in some of the Florida MSAs, where single-family property rents in Fort Lauderdale, Lakeland, Miami, and Sarasota-Bradenton-Venice are below their RentRange estimates.

Chart 3 – May 2016 Average Contractual Rent Versus Property-Level RentRange Estimate by MSA



Sources: Morningstar Credit Ratings, LLC; RentRange

While deals backed by single-family rental properties have existed for less than three years, their performance has met our expectations. In recent months, rent increases across single-borrower, single-family rental deals approached 6%, and as of May, contractual rents were generally in line with property-level RentRange estimates in large single-family rental markets. Our Single-Family Rental Performance Summary, published each month, examines various performance metrics of these properties, including vacancy, delinquency, and lease renewal trends. While it is not known if the rent gains seen over the past 18 months will be sustained, Morningstar will incorporate rental trends in its Performance Summary.

Appendix I outlines our approach and Appendix II shows the top single-family rental MSA average contractual rents and compares the rents to the three- and four-bedroom median rents from RentRange.

Appendix I – Analysis

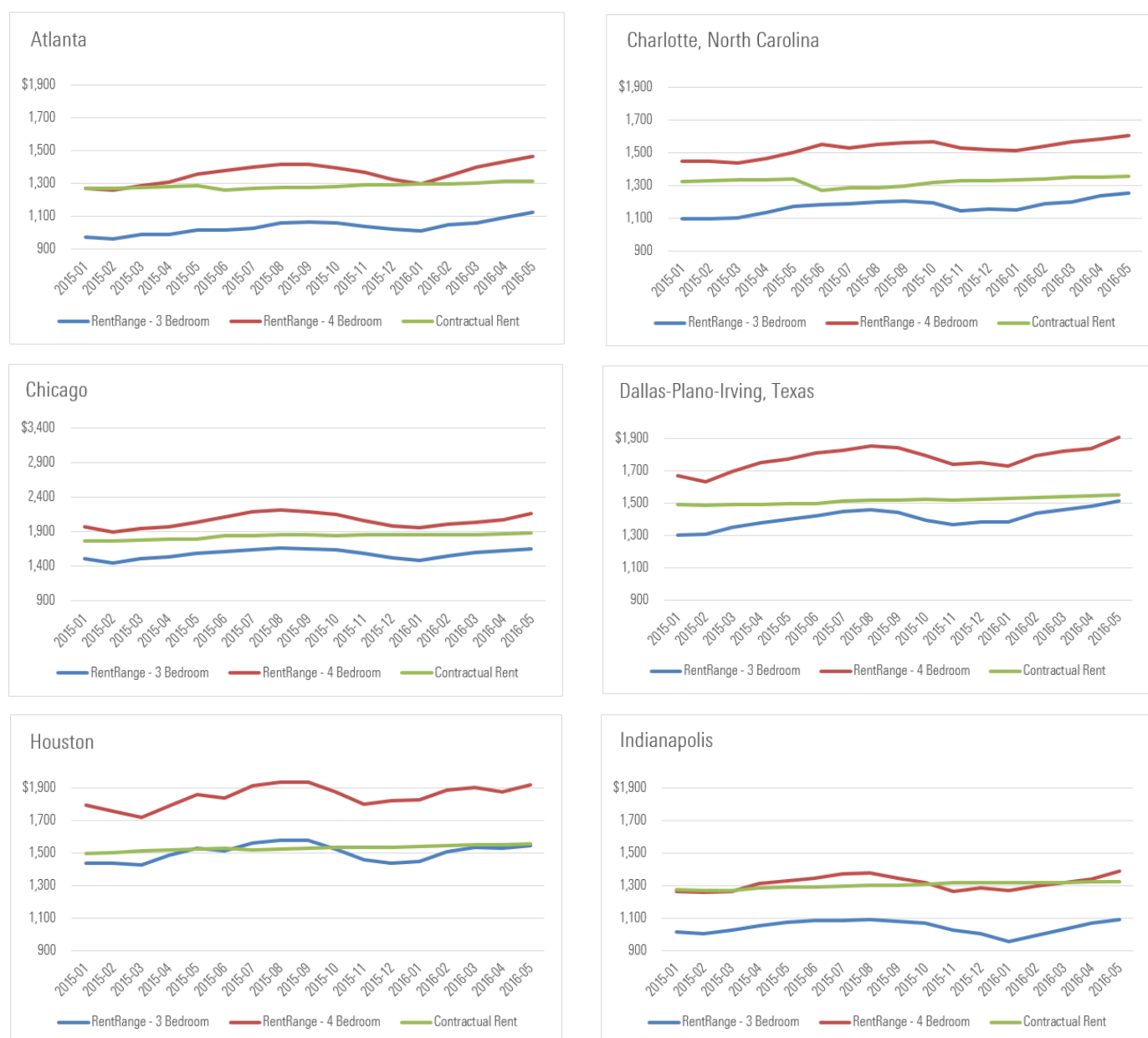
In our analysis, Morningstar reviewed issuers' rental reporting and took steps to standardize the data. For example, tenants on month-to-month leases are often subject to a fee and sometimes pay a monthly rent that is higher than the contractual rent paid during the lease term. As a result, a comparison of MTM rents to their previous contractual rents can show atypical rental jumps. To control for this, Morningstar removed MTM rents from the analysis. Morningstar also considered rent changes in multiyear leases. Certain multiyear leases have annual rental increases built into the contract. In this analysis, Morningstar compared the rent to the incremental rent increase within the scheduled lease term, because comparing the current rent to the initial rent of a multiyear lease can lead to unusually large gains. Lastly, Morningstar normalized the timing of rent changes. In some instances, issuers reported the rental change of a renewal as soon as they knew it, rather than reporting the change when it took effect. For leases renewed before the scheduled lease expiration, a timing mismatch could occur. To address this, Morningstar's analysis aligns the rent change with the lease expiration date.

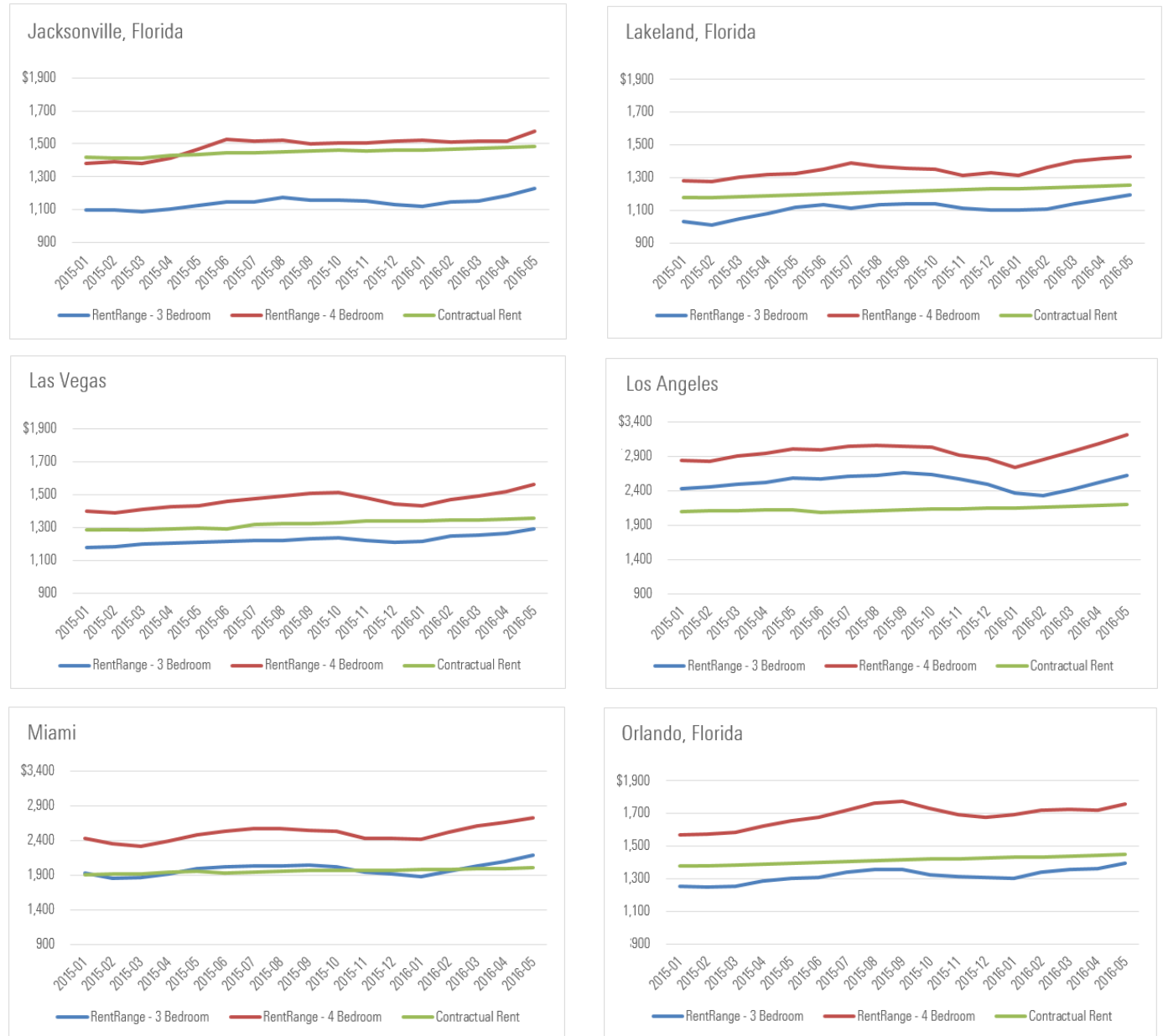
To calculate the rent change across 23 single-family rental transactions in Chart 1, Morningstar isolated the leases starting in a given period and compared the contractual rent in that period to the prior occupied contractual rent. Morningstar then compared this rent change with the year-over-year change in three- and four-bedroom median rents from RentRange. Morningstar weighted the RentRange median rents by geography to match the MSA concentration of the Morningstar single-family rental database.

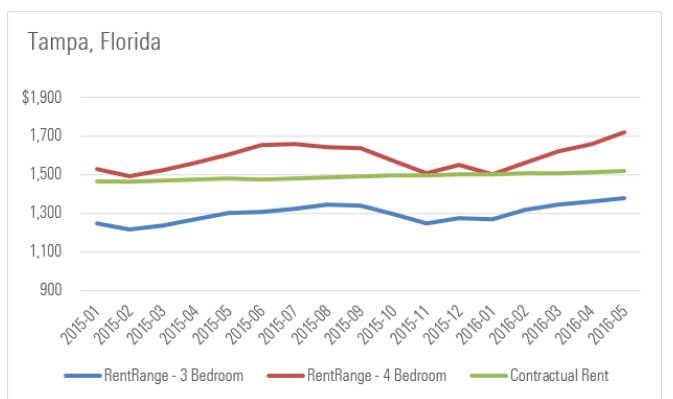
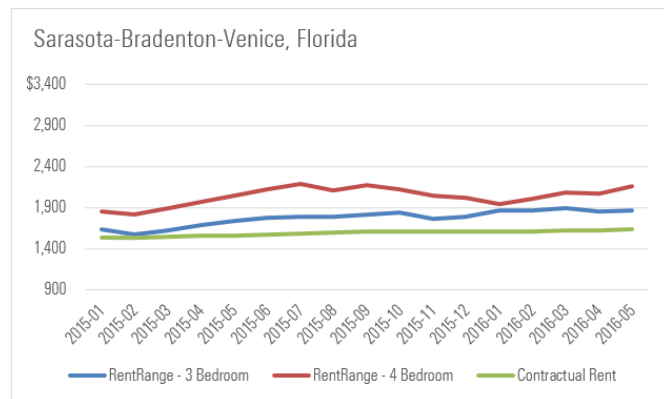
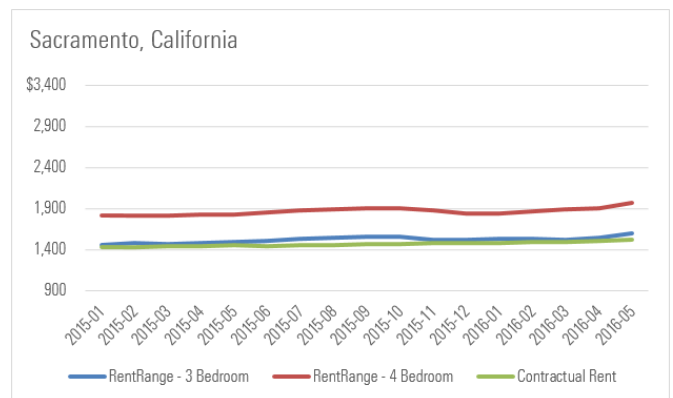
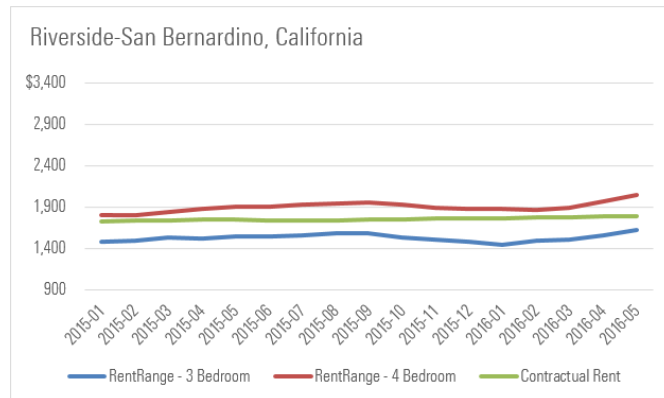
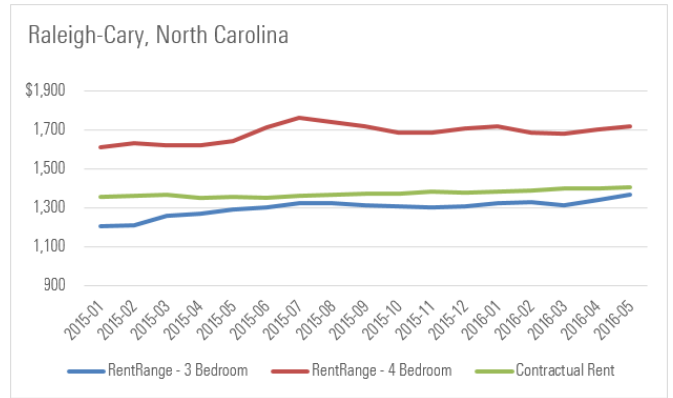
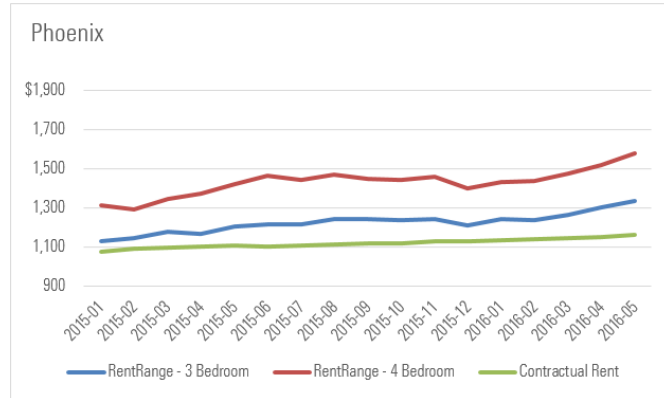
For Chart 2, Morningstar calculated the rent change using the contractual rent for the corresponding period versus the prior occupied contractual rent. For renewals, Morningstar looked three months back to set a lease expiration sample. This provides a sample that is more representative of the current lease expiration schedule than simply relying on the property cutoff data, and captures tenants who renew their leases before their expiration. Because Morningstar looked three months back, there were instances when tenants vacated properties between the time Morningstar determined its sample and the month in which the tenant decided whether to stay in the property. Morningstar excluded these vacated properties from its lease expiration sample. After isolating the applicable lease expiration sample, Morningstar looked at the property tape to determine the renewed properties, and then compared that contractual rent to the prior contractual rent. For vacant properties subsequently occupied by new tenants, Morningstar isolated those properties that were vacant in a given month and then occupied in the next month, and again compared the current contractual rent to the prior contractual rent.

Appendix II – Average Actual Contractual Rent Versus RentRange Three- and Four-Bedroom Estimates (by MSA)

The scales for Chicago; Los Angeles; Miami; Riverside-San Bernardino, California; Sacramento, California; and Sarasota-Bradenton-Venice, Florida, reflect the higher rents associated with these MSAs. The average contractual rents for some MSAs, notably Los Angeles, Phoenix, and Sarasota-Bradenton-Venice are below the median three-bedroom rents from RentRange. This could be the result of ZIP code and property type concentrations within the MSAs. Institutional investors may focus on specific property types in particular ZIP codes that vary from the characteristics of the overall MSA data reported by RentRange.







Sources: Morningstar Credit Ratings, LLC; RentRange

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