Northmarq

COMMERCIAL REAL ESTATE
INVESTMENT SALES
DEBT + EQUITY
LOAN SERVICING
FUND MANAGEMENT

SPECIAL REPORT
JUNE 2023

# Single-Family Build-to-Rent

## Uncertainty in the Near Term, Extended Outlook Still Favorable

INTRODUCTION

# **Single-family rentals:** slowing but not stalled

*The single-family build-to-rent market (SF BTR) currently faces some mixed conditions after building significant momentum during the past few years.*



THE SINGLE-FAMILY build-to-rent market (SF BTR) currently faces some mixed conditions after building significant momentum during the past few years. In the near term, the sector is forecast to expand again, with developers on pace to deliver an increasing volume of new units to a growing number of major markets through the remainder of this year and into 2024, a trend that highlights the generally positive sentiment that surrounds the sector.

While new projects are in the construction pipeline, there is greater uncertainty in the capital markets for the next wave of new development. These tighter conditions are being driven by higher costs of capital and a more restrictive environment for both debt and equity. This year will likely result in a significant decline in starts of new SF BTR communities.

Operationally, most new and existing properties continue to perform, although not at the same elevated levels that were being recorded one year ago. While single-family rentals continue to attract a rent premium over traditional apartments, competition has increased, lease-up rates have trailed off and vacancies have pushed higher.

Investment in the sector has not matched the unprecedented heights achieved in 2021 and at the beginning of last year. These cooling transaction conditions are not unique to single-family rentals; similar trends are occurring across nearly all forms of both residential and commercial real estate.

Despite the short-term uncertainty, the expectation is that communities of single-family rentals will continue to capture a larger share of the overall housing market in the coming years. The long-term demographic trends that have fueled demand for this alternative form of housing will remain in place regardless of the highs and lows of any particular business cycle.

Additionally, there are some elements of the current economic conditions that should allow single-family rental properties to outperform in 2023. The barriers to entry in the for-sale housing market remain elevated, with inventories low, prices stubbornly high, and mortgage rates elevated. These factors should drag on transitions into home ownership, keeping more households in the rental pool longer.

While developers and operators should not expect the year ahead to be a continuation of the robust performance recorded in the SF BTR sector since 2020, it should serve as a period for the industry to prove its performance in a slower-growth economic climate.



*The long-term demographic trends that have fueled demand for this alternative form of housing will remain in place regardless of the highs and lows of any particular business cycle.*

JUNE 2023

ECONOMIC OUTLOOK

# **Several headwinds,** but job market continues to expand

*To this point in 2023, the economic signals have been mixed, while the drivers of demand for single-family build-to-rent housing have been fairly favorable.*

**AT THE BEGINNING** of the year, most economic forecasts were calling for either a mild recession or very soft economic growth. While the economy recorded healthy expansion in 2022, the headwinds of persistent inflation, restrictive policy steps being undertaken by the Federal Reserve, higher capital costs, and a softening housing market were expected to drag on growth in 2023.

To this point in 2023, the economic signals have been mixed, while the drivers of demand for single-family build-to-rent housing have been fairly favorable. The primary factor that influences demand for housing is the labor market, and businesses have continued to add workers. Employers added 885,000 net new jobs in the first quarter, and after a strong April reading, year-to-date gains have closely tracked the pace of growth recorded during much of 2022.

In addition to a strong labor market, the conditions in the for-sale housing market continue to restrict current renters from transitioning to home ownership. Home mortgage rates have come down slightly after peaking at more than 7 percent late last year, but are still high enough to restrict home sales.

The higher mortgage rates are discouraging home sales, particularly among renters who aspire to own their own residences. According to survey data from the National Association of Realtors, first-time buyers accounted for only 26 percent of buyers in 2022, down from 34 percent one year earlier, and about half of the total from the peak in 2010.

Inflation has been one of the largest drags on the economy during the past year, as the sharp increase in consumer prices has negatively influenced sentiment, impacted saving and consumption patterns, and has been the driving force behind the Fed's aggressive rate hikes. There was a bit of good news in the April CPI data, with the year-over-year change retreating to 4.9 percent, the lowest reading in two years.

While the current pace of inflation remains roughly double the Fed's target rate, the pace of price increases is clearly slowing, which is supporting some expectations that the central bank may have only one or two more interest rate hikes ahead of them. While forecasts calling for rate cuts are likely premature, there are no expectations for a continuation of the repeated increases that began to take shape in the second quarter of last year.

*Home mortgage rates have come down slightly after peaking at more than 7 percent late last year, but are still high enough to discourage home sales.*

**INFLATION ELEVATED, BUT THE PACE OF PRICE GAINS EASING**

CPI 12-MONTH CHANGE


*Sources: Northmarq, Bureau of Labor Statistics*

EMPLOYMENT OVERVIEW

# The labor market continues to outpace expectations

During a first quarter of mixed economic results, the national labor markets produced some of the strongest readings. Employers added 885,000 jobs in the first quarter, a slightly faster pace of growth than was recorded during the final three months of last year.

The gains in the labor market were stronger than originally anticipated. In fact, most forecasts called for net job losses in 2023. Those that called for gains expected less than 1 million net new jobs for the full year. Through the first four months of 2023, growth has already eclipsed this number, suggesting that the national labor market is well on pace to outperform even the most optimistic forecasts.

While jobs are being added, growth has been uneven across the various segments of the economy. The largest additions to payrolls have occurred in the leisure and hospitality sector and across education and health services fields. The additions in leisure and hospitality represent an ongoing recovery across the sector. Even after adding back workers over the past two years, total employment in the sector is still down more than 2 percent from the pre-COVID peak. With travel volumes likely to remain elevated at least throughout the summer, employment at hotels, restaurants, and bars should continue to expand.

*The largest additions to payrolls have occurred in the leisure and hospitality sector and across education and health services fields.*

## QUARTERLY JOB GROWTH REMAINS FAIRLY STEADY

NET JOB GROWTH

*Sources: Northmarq, Bureau of Labor Statistics*


*The continued perception that jobs are easy to get buoys consumers who are currently working and those who are about to enter the workforce.*

The trends in education and health services reflect the continued gains in this "recession-proof" industry. The sector has expanded at an average pace of about 1.7 percent per year over the past decade, and further additions are likely through the foreseeable future. Expansion in the sector is generally strongest in markets recording the most rapid population growth.

While the labor market as a whole is performing well, there are a few signs of potential weakness. The financial activities and information sectors both recorded minimal net job losses during the first quarter, and these industries are where some of the prominent layoff announcements have been concentrated. Additionally, gains in the manufacturing and retail sectors have lagged expectations.

Still, a strong labor market is supporting consumer sentiment. The national unemployment rate ended April at just 3.4 percent, the 15th consecutive month where the rate remained below 4 percent. The continued perception that jobs are easy to get buoys consumers who are currently working and those who are about to enter the workforce.

JUNE 2023

FOR-SALE HOUSING

# **Elevated mortgage rates restricting** activity among buyers and builders

*Single-family build-to-rent communities compete with for-sale housing as much as they do with traditional apartments.*

**SINGLE-FAMILY** build-to-rent communities compete with for-sale housing as much as they do with traditional apartments. As such, trends in the single-family, for-sale market impact the demand for single-family rentals and have some influence on rental rates. Existing home sales posted monthly declines for 12 consecutive months before accelerating in February 2023. The momentum achieved in February proved to be short-lived, with sales volume declining in March and April; the latest sales figures are down more than 27 percent year over year.

Mortgage rates are restricting the for-sale market in a handful of different ways. The first has been the impact on affordability. After topping 7 percent late last year, 30-year mortgage rates have come down closer to 6.25 percent to 6.5 percent in recent months, but remain twice as high as late-2021 levels. This has caused some would-be buyers to be priced out of the market, while others remain on the sidelines hoping rates will retreat further before deciding to buy a home.

Further, the rise in mortgage rates has restricted the inventory of available homes, as existing owners who locked in low mortgage rates are reluctant to list residences, knowing that they can not replace the low mortgage rates they already have in place. Despite a low volume of transactions, the inventory of homes available for purchase was just 2.9 months at the latest reading.

## MORTGAGE RATES REMAIN ELEVATED

AVERAGE 30-YEAR FIXED RATE


*Sources: Northmarq, Freddie Mac*

**AVERAGE 30-YEAR FIXED RATE** RESIDENTIAL MORTGAGE


*After topping 7 percent late last year, 30-year mortgage rates have come down closer to 6.25 percent to 6.5 percent in recent months, but remain twice as high as late-2021 levels.*

## FOR-SALE HOUSING

For new home sales, similar trends have emerged. New home sales peaked in the second half of 2020 and then trended lower. Before inching higher at the beginning of 2023, the pace of new home sales had declined by 44 percent from peak to trough, causing homebuilders to scale back operations. Homebuilders now have more than 7 months of supply, after inventory levels peaked last summer.

Declines in transaction volume are proving to be a drag on pricing, but prices have not dropped enough to spur activity or dramatically impact rent vs. own calculations. In recent months, the median existing home sales price has lagged year-earlier levels, the first year-over-year price drops in more than 10 years. At $388,800, the median sales price in existing homes is down 2 percent from one year ago, while prices for new homes are down 8 percent at $420,800.

These prevailing forces are resulting in a housing market that features low transaction volume, mortgage rates that are 300 basis points higher than one year ago, prices that have slowly begun to inch lower, and limited inventory of available homes. These factors are restricting transitioning from renting to owning, and supporting demand for single-family rentals.

*Before inching higher at the beginning of 2023, the pace of new home sales had declined by 44 percent from peak to trough, causing homebuilders to scale back operations.*

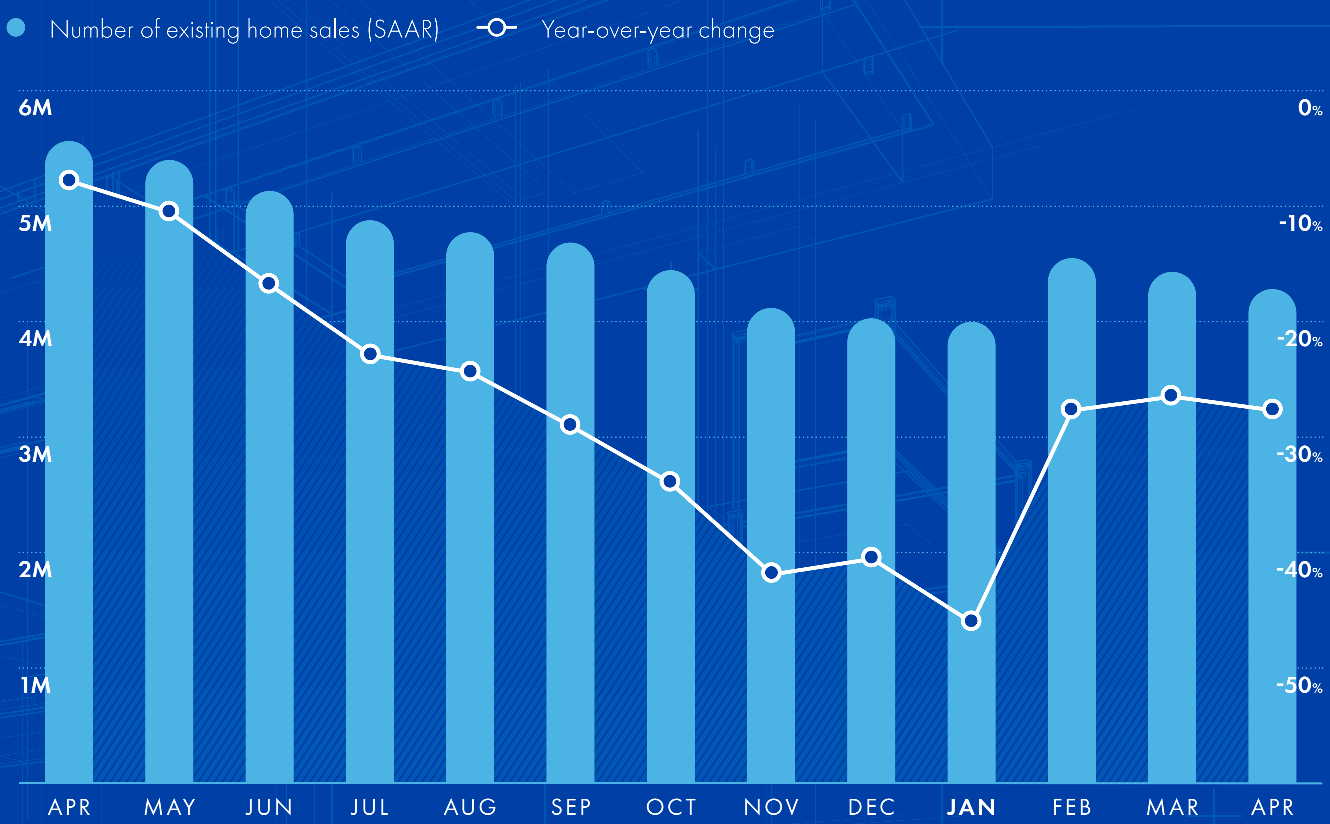
**$388,800**
**MEDIAN SALES PRICE**
EXISTING SINGLE-FAMILY HOMES
*National Association of Realtors*

**+$1,176**
**MONTHLY DIFFERENCE**
BETWEEN RENTING & OWNING
*NMHC*

**-27%**
**ANNUAL CHANGE**
EXISTING SINGLE-FAMILY HOME SALES
*National Association of Realtors*

## EXISTING HOME SALES DOWN MORE THAN 20%

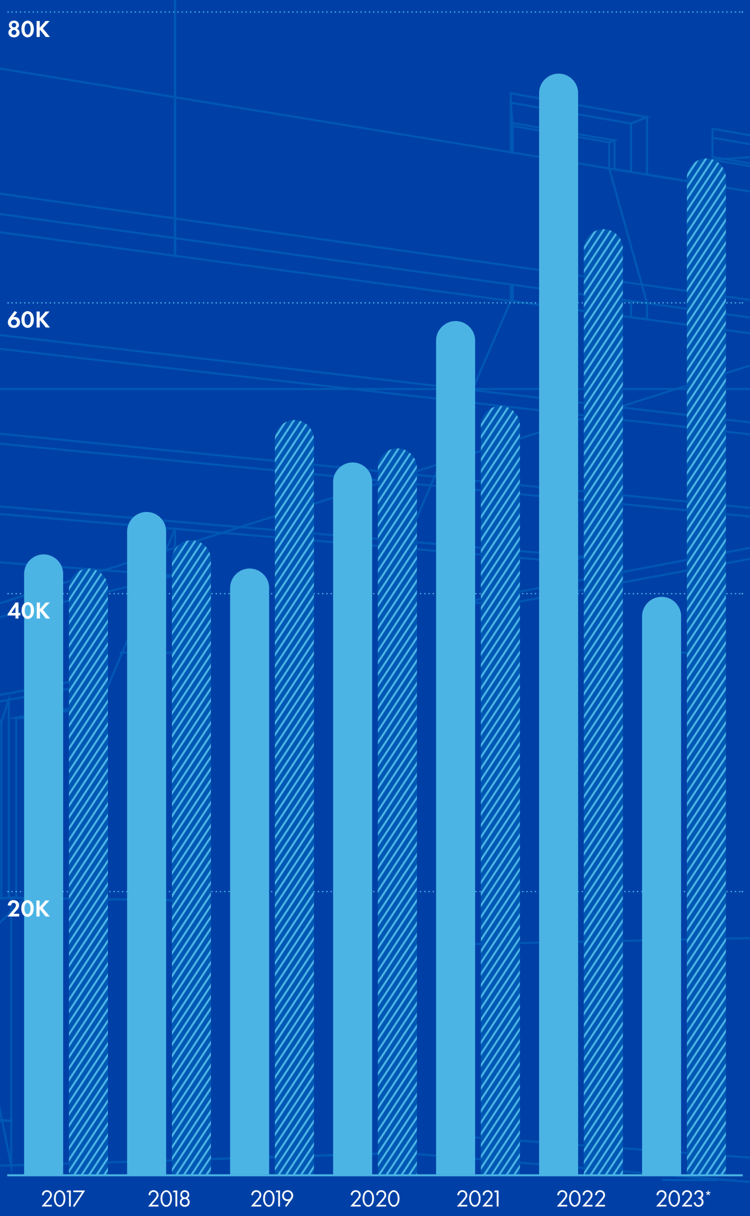
EXISTING HOME SALES + ANNUAL CHANGE
2022-2023




*Sources: Northmarq, National Association of Realtors*

DEVELOPMENT TRENDS: U.S.

# Deliveries accelerating, starts to slow




**AN EXPANDING CONSTRUCTION** pipeline is one of the primary areas of concentration when evaluating the future health of rental housing. Construction of new rental units is ramping up at a time when economic growth—and consequently new household formation—is showing signs of cooling. The increase in new construction is evident in the activity levels for single-family rentals.

Construction starts in the single-family build-to-rent segment totaled approximately 76,000 units during 2022, up more than 25 percent from the prior year. Activity levels were strongest in the middle of the year before slowing modestly during the fourth quarter.

**SINGLE-FAMILY BUILD-TO-RENT**
DEVELOPMENT PIPELINE

SF BTR starts
SF BTR completions

** Forecast*

*Sources: Northmarq, U.S. Census Bureau*

Construction trends in the build-for-rent space did not mirror activity in for-sale housing. Starts of homes being built to be sold declined dramatically in the second half of 2022, totaling fewer than 300,000 units, about 33 percent lower than the total in the first half of the year. The steep upward rise in residential mortgage rates has caused many home builders to pull back, and developers of single-family rental homes initially stepped in to fill the void.

Developers delivered single-family rental units at a consistent pace throughout 2022. Completions totaled approximately 65,000 units in 2022, with deliveries split evenly between the first half and the second half of the year. The number of completed units in 2022 was up more than 20 percent from the prior year total.

Looking ahead, the rapid rate of increase in starts recorded in 2022 should yield an increase in deliveries in 2023. Projects totaling approximately 70,000 units are expected to come online this year. This will likely mark a cyclical high for single-family rental unit completions.

This year, construction starts of single-family homes built specifically intended as rentals are on pace to slow dramatically. While developers are generally bullish on the long-term prospects of the single-family build-to-rent sector, there will be less capital available for new construction projects throughout much of this year. Starts in the first quarter were down 36 percent from the 2022 peak.



*Starts of homes being built to be sold declined dramatically in the second half of 2022, totaling fewer than 300,000 units, about 33 percent lower than the total in the first half of the year.*

## REGIONAL
### DEVELOPMENT TRENDS

In recent years, developers have found the single-family build-to-rent concept is popular with renters and performs well for operators, prompting construction across a greater number of markets. The past year was a particularly active one for new SF BTR starts across all regions. Deliveries have been more uneven, in part because of delays and supply-chain disruptions that dragged on the system in 2020 and 2021.

New development is occurring in markets and regions of the country that are recording in-migration and job growth, and where land sites can be entitled within a reasonable time frame. Many of these markets are in the Sunbelt, but certain Midwest markets are emerging as excellent targets for this alternative to traditional apartment living.

*Deliveries have been more uneven, in part because of delays and supply-chain disruptions that dragged on the system in 2020 and 2021.*

## CONSTRUCTION STARTS
### SF BTR

In 2022, the South region accounted for more than 55 percent of the total starts throughout the U.S., after that figure topped 60 percent in the prior year. Construction starts in the South region rose by 19 percent last year, totaling approximately 43,000 units.

While several markets were active throughout the South region, Dallas-Fort Worth, Tampa, Orlando, and Jacksonville led the way for new projects under construction. These markets have been some of the hottest spots for population in-migration, corporate relocations, and rising housing costs.

The pace of new home starts posted the fastest acceleration in the Midwest region. Starts of new single-family rental housing doubled from 2021 to 2022, reaching 14,000 units. While for-sale homes in the Midwest are generally affordable relative to other regions of the country, prices in the region have risen 15 percent since 2020 and these markets are also impacted by the steep upward climb in mortgage rates. The bulk of the new activity in the Midwest has been in Indianapolis, Columbus, Minneapolis, and Kansas City.

## CONSTRUCTION COMPLETIONS

SF BTR

While the pace of new construction starts accelerated across every region in 2022, deliveries were mixed. The South region recorded a significant spike in new units coming online, with projects totaling more than 40,000 units added to inventory. This represented a 56 percent increase from 2021 levels.

In the West region, where communities of single-family rental units first began to gain popularity as an alternative to traditional apartments, delivery totals rose 30 percent in 2022, reaching approximately 13,000 units. This marked the fifth consecutive year where deliveries in the West region topped 10,000 units.

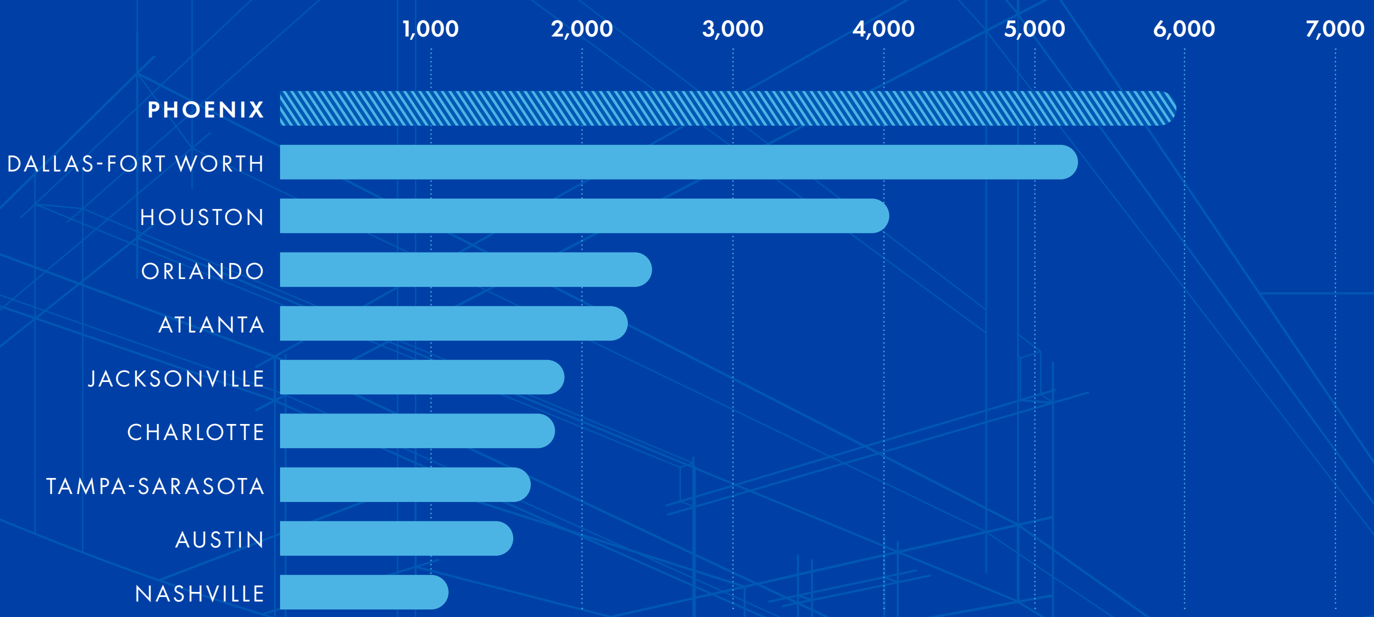
In the Midwest, deliveries declined by nearly 20 percent in 2022, dipping to approximately 9,000 units. The steep rise in starts in the Midwest is expected to result in an acceleration of new units delivered in the next few years.

*The South region recorded a significant spike in new units coming online, with projects totaling more than 40,000 units added to inventory.*



## TOP MARKETS FOR NEW SF BTR DEVELOPMENT

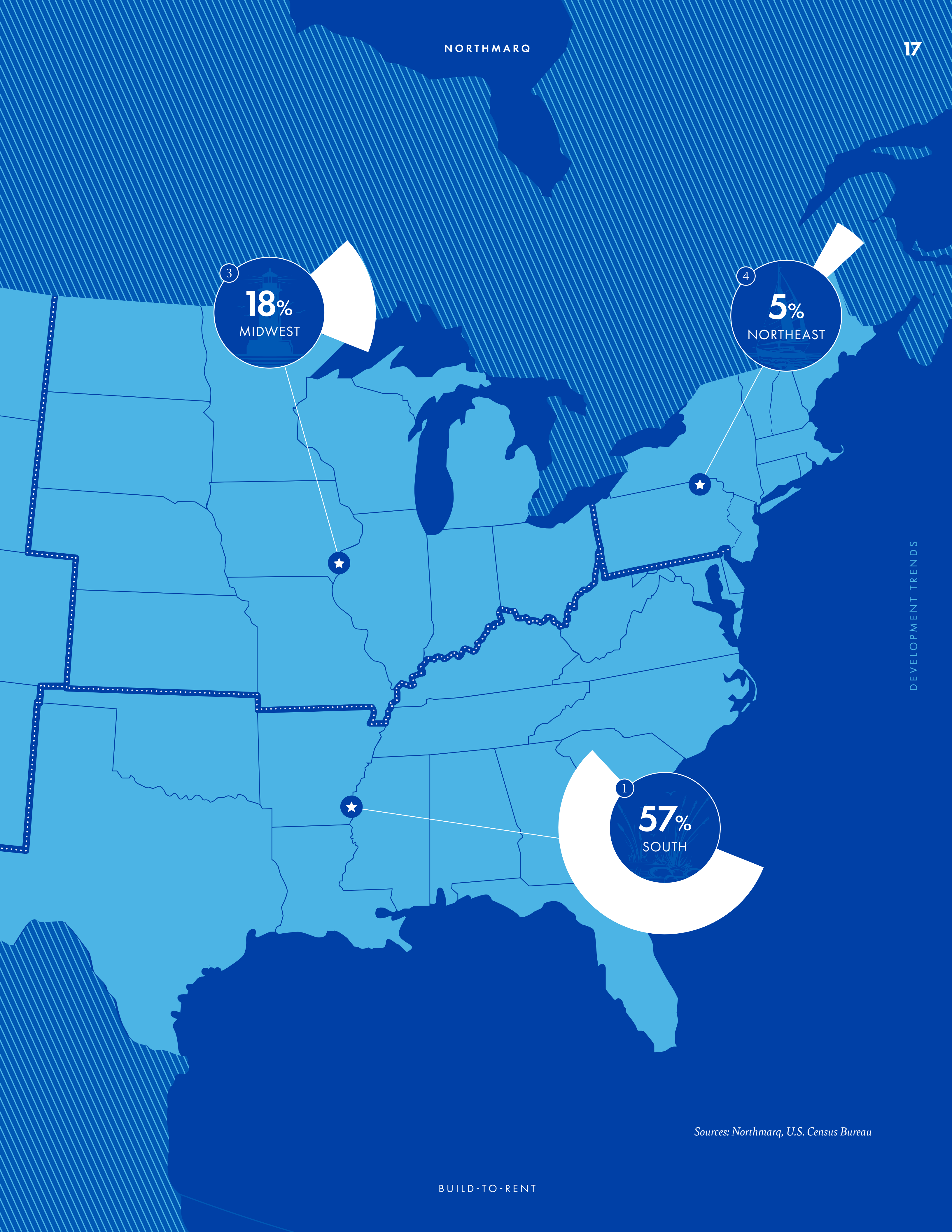
UNITS UNDER CONSTRUCTION




*Sources: Northmarq, CoStar, Yardi*


# **Construction starts** by region—2022

*While several markets were active throughout the South region, Dallas-Fort Worth, Tampa, Orlando, and Jacksonville led the way for new projects under construction.*




Sources: Northmarq, U.S. Census Bureau

OPERATIONAL PERFORMANCE TRENDS

# **Completions outpacing absorption,** pushing vacancies higher

AFTER SEVERAL STRONG years of demand for single-family rentals, conditions have begun to soften somewhat in recent quarters. Vacancies have generally trended higher, with the national rate reaching 8 percent in the first quarter, up 220 basis points year over year. There are both supply- and demand-related drivers pushing the vacancy rate higher.

On the supply side, deliveries accelerated across the country since 2022, with several markets doubling or tripling their inventories of communities of single-family build-to-rent units.

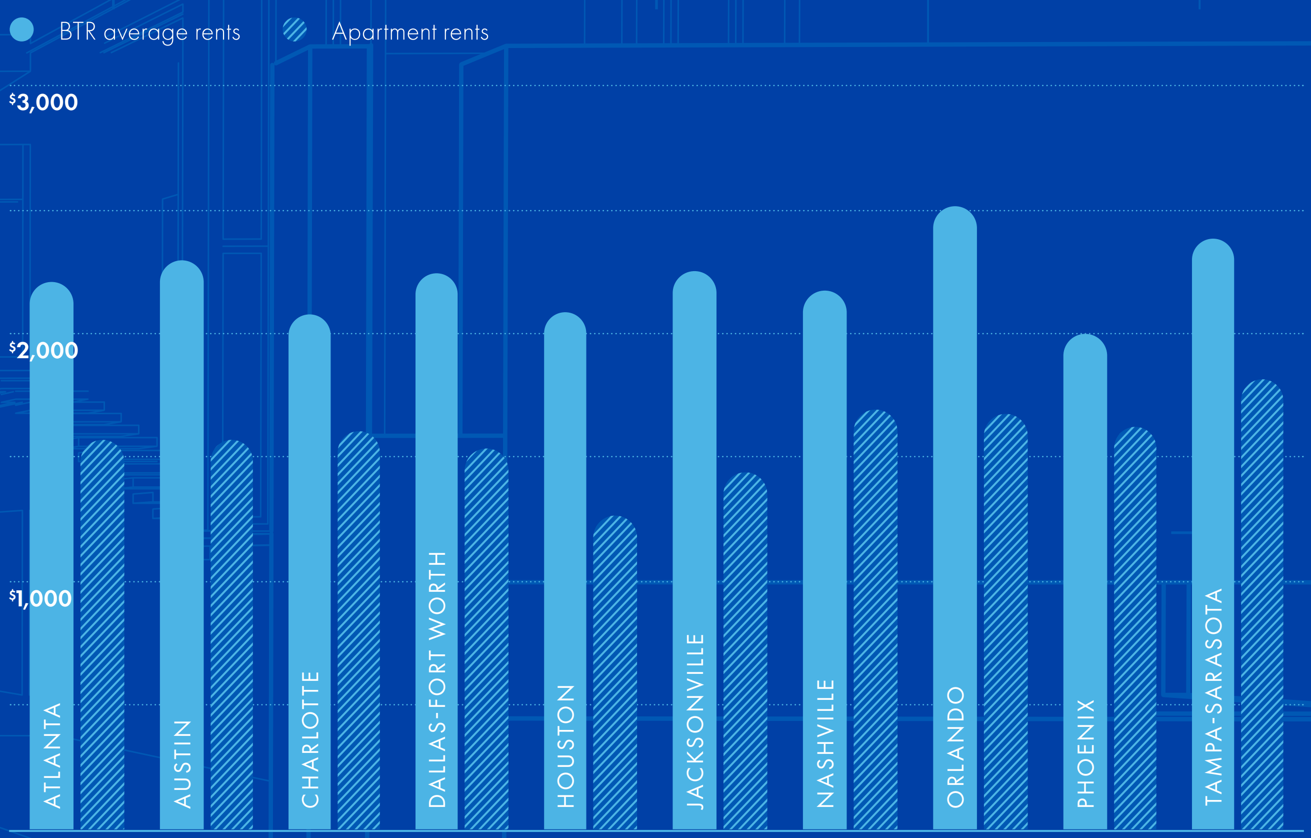
Demand has been positive, but absorption has not kept pace with supply growth. In prior years, lease-up time had been minimal, but leasing momentum has slowed across all forms of rental housing during the past 12 months. Among top markets, net absorption in 2022 accounted for approximately 60 percent of total deliveries during the year, a slightly higher percentage than in the apartment market.

Additionally, SF BTR communities are facing increased competition from new supply in many parts of the country. As recently as one year ago, developers of single-family rental communities across several markets had a first-mover advantage. The first few communities in any given market were able to capture the pent-up demand for this new form of rental housing. Now, as the product type has become more widespread, operators are competing with a greater number of similar communities.

Rents have generally ticked higher, advancing about 1 percent year over year. Some of the strongest gains have been recorded in the Southeast, with Tampa, Orlando, and Charlotte posting annual gains exceeding 3.5 percent.

*Vacancies have generally trended higher, with the national rate reaching 8 percent in the first quarter, up 220 basis points year over year.*

**SF BTR RENTS ABOUT $600 PER MONTH**
HIGHER THAN APARTMENTS




*Sources: Northmarq, U.S. Census Bureau*

*Some of the strongest gains have been recorded in the Southeast, with Tampa, Orlando, and Charlotte posting annual gains exceeding 3.5 percent.*

Operators continue to be able to command a rent premium for single-family rentals. The average monthly rent for SF BTR units is about 35 percent higher than monthly apartment rents across most major markets. Some of this premium is associated with the larger unit sizes and private yards that come with many SF BTR housing units.

Looking ahead, the single-family rental market is expected to become increasingly competitive as new inventory is delivered. Still, absorption trends in single-family rentals have been closely tracking the traditional apartment market. Renter demand is expected to remain fairly consistent throughout this year, although it will likely lag levels achieved from 2020 through early 2022.

MARKET SPOTLIGHT

# **Huntsville,** Alabama

**AN AFFORDABLE COST OF LIVING,** a thriving aerospace sector, and a mix of public- and private-sector employers looking to expand has pushed Huntsville to the top of several "Best Places to Live" lists in recent years. The result has been a population that has expanded by nearly 20 percent—or 70,000 residents—in the past decade.

The same factors that are attracting new residents to the area are also supporting the development of new single-family rentals. During the past few years, developers have delivered SF BTR projects totaling approximately 1,200 units to the Huntsville area.

More units are slated to come online in the next 18 months. Projects totaling an additional 1,100 units are currently under construction, with the bulk of the new developments located either in the city of Huntsville or in Madison, a suburb southwest of the city. In addition to the units that are currently under way, developers have projects totaling an additional 970 units in the planning stages.

One of the largest economic drivers in the region is the NASA Marshall Space Flight Center, which is also in the southwest segment of the market. The facility is NASA's largest, employs about 6,000 people, and is also home to U.S. Space Camp. The Space Flight Center is located within the larger Redstone Arsenal U.S. Army post, with about 38,000 employees.

*The result has been a population that has expanded by nearly 20 percent—or 70,000 residents—in the past decade.*

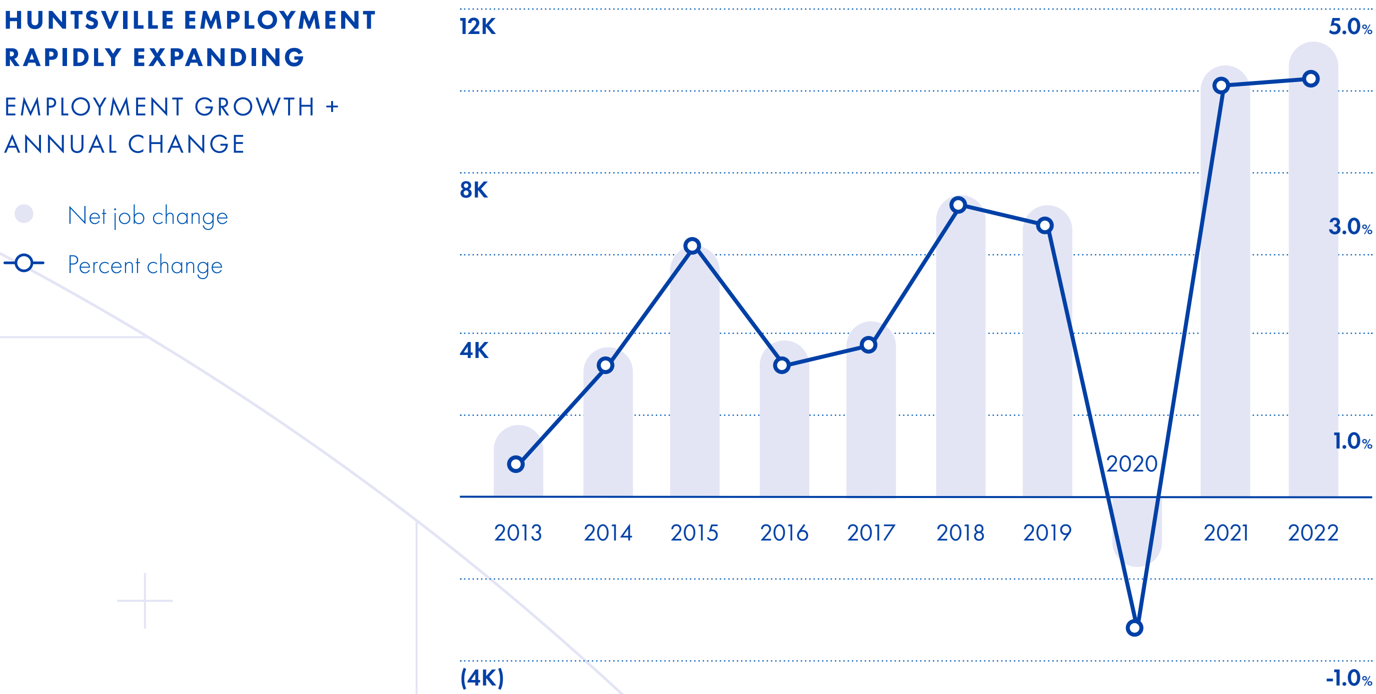
**LOCAL LONG-TERM POPULATION GROWTH FUELING DEMAND**

TOTAL POPULATION HUNTSVILLE MSA


*Sources: Northmarq, U.S. Census Bureau*

**HUNTSVILLE EMPLOYMENT RAPIDLY EXPANDING**

EMPLOYMENT GROWTH + ANNUAL CHANGE




*Sources: Northmarq, Bureau of Labor Statistics*

The labor market in Huntsville is growing rapidly, but is also largely insulated from significant downside risk due to the large presence of NASA and the Army. Last year, the local economy added more than 11,000 jobs, a 4.3 percent rate of growth. This topped the 10,600 additions to payrolls recorded in 2021. The Huntsville economy outperformed even in volatile times; in 2020, total employment retreated by less than 1 percent, with net job losses totaling fewer than 2,000 positions.

The pace of growth has ratcheted up in recent years. With the exception of 2020, job gains have averaged more than 9,000 per year, compared to about 3,000 jobs added annually from 2010 to 2017.

Huntsville is home to dozens of military contractors. Boeing, Northrop Grumman, Dynetics, and SAIC are among the largest employers in the region, with a combined local workforce of more than 10,000 employees.

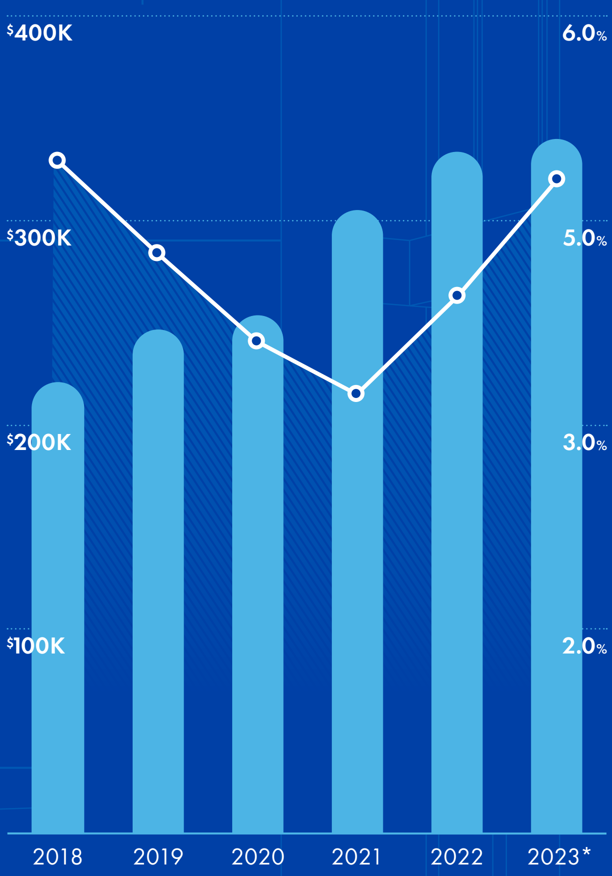
White-collar professional and business services is the largest employment sector in the region, covering nearly 70,000 workers, up 40 percent in the past decade.

*The labor market in Huntsville is growing rapidly, but is also largely insulated from significant downside risk.*

Huntsville features a thriving manufacturing sector, headlined by Toyota's 1.3 million-square-foot facility. The automaker, which opened its Huntsville plant in 2003, has expanded six times, including in 2021 with a $288 million investment that resulted in 450 new jobs at the Huntsville plant. The next expansion is currently under way; in 2022, Toyota announced a plan to invest an additional $222 million in the Huntsville facility. In total, employment in the manufacturing sector has expanded by approximately 7,300 workers in the past five years, a 29 percent spike.

INVESTMENT SALES OVERVIEW

# Transactions may gain momentum by year end




**TRANSACTION ACTIVITY** in the single-family build-to-rent space has been mixed in recent years. Activity levels peaked in 2021, as the number of properties available for acquisition swelled and institutional investors allocated billions of dollars to move into the sector.

Some of this momentum carried over into the beginning of 2022, but transactions slowed considerably in the middle part of last year, as buyers and sellers adjusted to the rises in interest rates. The market recorded a change of direction in the fourth quarter of last year, when activity picked back up; sales in the fourth quarter nearly matched the combined levels of transactions in the second and third quarters.

That rebound in transaction activity proved to be short lived, and single-family build-to-rent communities during the first quarter of 2023 traded at a sluggish pace. The number of single-family rental properties that sold during the first quarter was down 74 percent year over year; this figure was nearly identical to the declines recorded across the traditional multifamily sector.

Pricing trends have reflected the changing costs of capital and cap rate requirements. Through the first three quarters of 2022, the median price hovered around $370,000 per unit. During the fourth quarter of last year, the median price cooled, retreating to about $315,000 per unit. For the full year, the median price reached $333,700 per unit.

**INVESTMENT TRENDS** SF BTR PROPERTIES

Median price per unit

Average cap rate

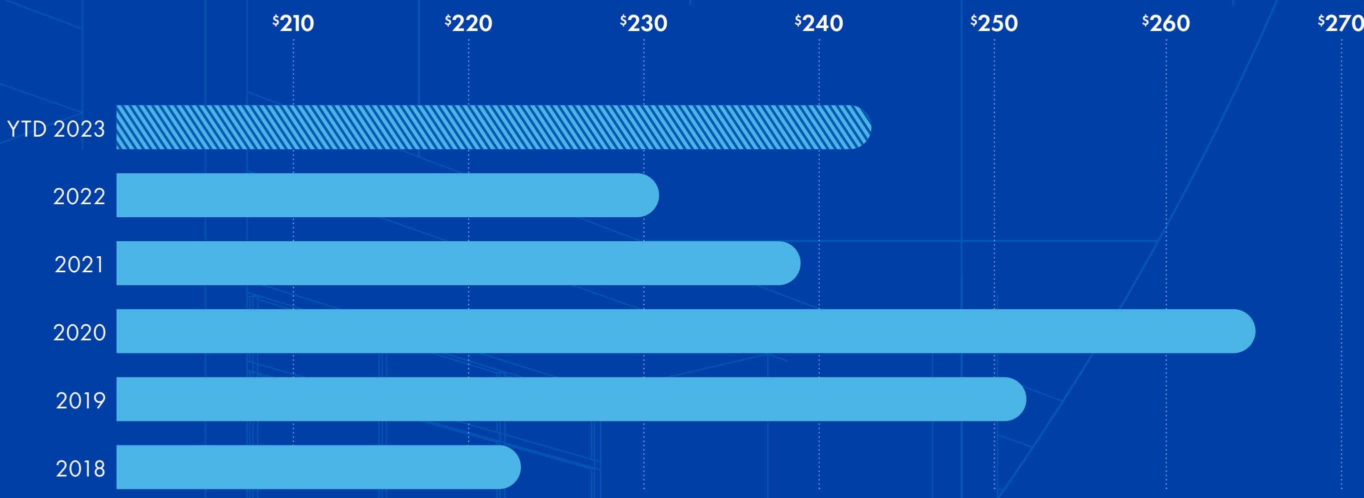
*Year-to-date*

*Sources: Northmarq, CoStar, Real Capital Analytics*

*Activity levels peaked in 2021, as the number of properties available for acquisition swelled and institutional investors allocated billions of dollars to move into the sector.*

## MEDIAN PRICE PER SQUARE FOOT

U.S. SF BTR




*Sources: Northmarq, CoStar, Real Capital Analytics*

The mixed pricing trends that emerged in 2022 have carried over into 2023. The median price in the properties that have sold year to date has reached nearly $340,000 per unit, with pricing reflecting the mix of properties that have changed hands and the markets that have proven popular with investors.

*The median price in the properties that have sold year to date has reached nearly $340,000 per unit.*

Sales prices reached about $243 per square foot in the beginning of this year, up from $231 per square foot in 2022. Pricing trends can vary significantly based on market and product type. In recent periods, true detached single-family homes in top markets and some of the projects with unit sizes averaging under 1,000 square feet have traded for prices at over $400 per square foot. The townhome product has generally been trading at prices closer to $200 per square foot to $250 per square foot.

Cap rates have trended higher as interest rates have risen and underwriting has grown more conservative. Between late 2021 and early 2022, cap rates bottomed, ranging from 3.25 percent to 4 percent on average. In subsequent quarters, cap rates have risen, approaching 4.75 percent by the end of last year, and reaching closer to 5.25 percent year to date.

Investment activity is expected to gain momentum by the end of the year. One driver of the anticipated increase in activity will be the volume of new projects that are delivered and leased-up across some of the highest-growth markets in the country.

Additionally, while there were several forward sales that closed in recent years, the current investor sentiment favors acquiring properties after stabilization. This change in investor preference should result in a greater number of transactions involving leased-up assets in the second half of 2023—properties that might have otherwise already sold prior to the shift in market conditions.

MARKET SPOTLIGHT

# **Indianapolis,** Indiana

*Consistent employment gains and steady population additions have been major drivers for the SF BTR sector in Indianapolis in recent years.*



INDIANAPOLIS IS ONE Midwest market where the single-family build-to-rent sector has grown in recent years. Developers have delivered projects in response to the area's continued economic and employment growth. From 2015-2019, the local labor market grew at a pace of 1.75 percent per year, adding more than 90,000 jobs. The market has fully recovered from pandemic-related losses and current employment totals are 55,000 positions—or 5 percent—higher than the pre-COVID peak.

One factor driving this growth is location. Indianapolis is centrally located within a few hundred miles of many of the Midwest region's largest population centers. The market has excellent infrastructure making it an ideal location for transportation and distribution businesses. The trade, transportation, and utilities sector is the largest industry in the region, with nearly 250,000 workers. One of the region's largest logistics employers, FedEx, recently announced plans to expand its aircraft maintenance operations in Indianapolis, moving operations away from Los Angeles.

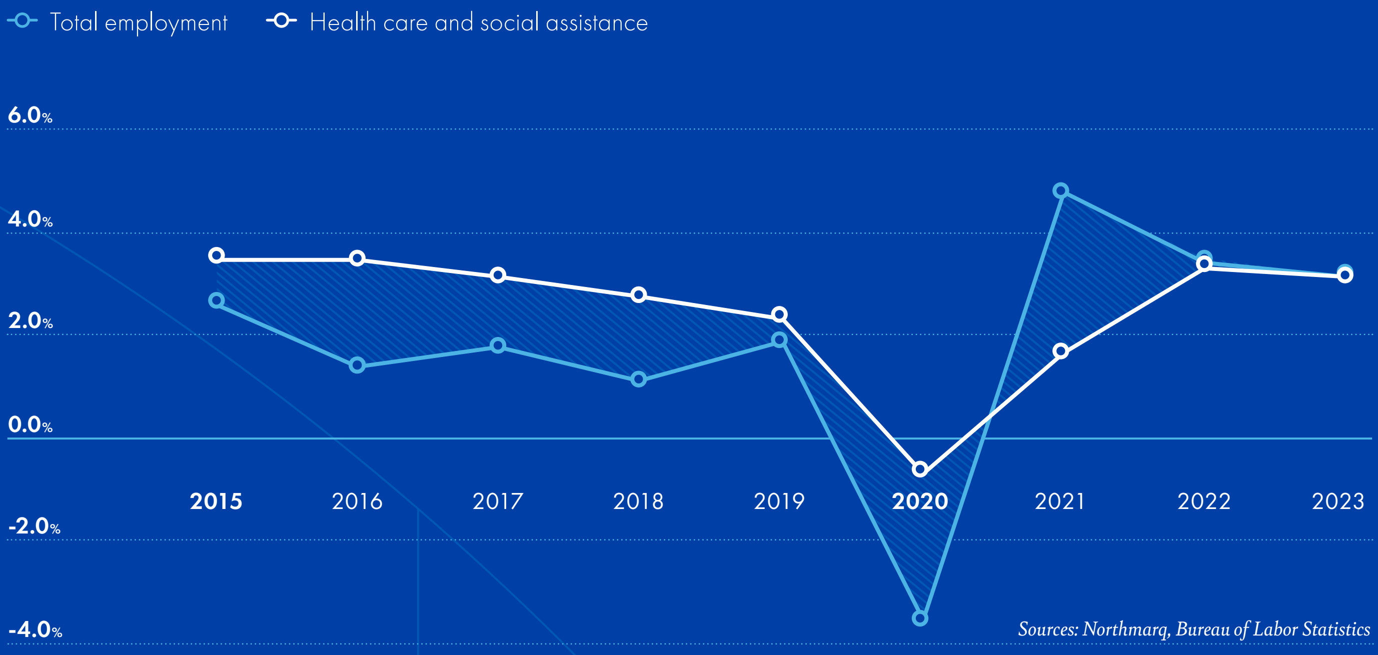
Another major driver of the local economy is its thriving health care sector, specifically life sciences. The state of Indiana leads the nation in life sciences product exports including pharmaceuticals and medical devices. Indianapolis leads the way in the state's life science success with major employers including Eli Lilly, Anthem, Roche Diagnostics, and Corteva. In total, Indianapolis employs more than 150,000 workers in its health care and social assistance industry.

Consistent employment gains and steady population additions have been major drivers for the SF BTR sector in Indianapolis in recent years. Typically, the local population in Indianapolis expands between 1 percent and 1.5 percent each year making it the second-fastest growing market in the Midwest region, trailing only Columbus, Ohio.

This consistent, sustained growth and a diversified economy have attracted development in the single-family rental space. There are more than two dozen existing SF BTR communities throughout Indianapolis totaling approximately 3,000 units.

## INDIANAPOLIS LABOR MARKET EXPANDING

ANNUAL EMPLOYMENT CHANGE




*Sources: Northmarq, Bureau of Labor Statistics*

*Indianapolis is an established market for single-family rental communities boasting strong operational property performance.*

Local single-family rental communities are primarily located in outlying suburban neighborhoods, including Inner Hendricks County, Lebanon/Whitestown, and Noblesville/Durbin. Additional development is coming online. Projects totaling more than 600 units are currently under construction.

The most active developer and operator of single-family rentals in Indianapolis is Redwood Living, which has a market share of approximately 50 percent of the total existing inventory and a majority of the projects that are currently in the planning phases. The company focuses on the Midwest and currently maintains a construction pipeline of more than 4,000 units throughout the region.

Indianapolis is an established market for single-family rental communities boasting strong operational property performance. Compared to the traditional apartment market, the vacancy rate in the BTR space is consistently lower while asking rents are significantly higher.

The average vacancy rate in the BTR market in Indianapolis ended the first quarter at just 3.4 percent, about 100 basis points lower than the rate for apartments. Additionally, asking rents for single-family rentals average more than $1,650 per month in Indianapolis, nearly $500 per month higher than rents in the apartment market.

FINANCING CLIMATE

# **Debt & equity** climate

*This pullback has created opportunities for middle-tier banks to enter the space and fill some of the construction financing void.*

**THE CAPITAL ENVIRONMENT** surrounding single-family build-to-rent properties has been inconsistent during the past few years. As recently as late 2021, institutions were allocating billions of dollars of equity to move into the SF BTR space, either through acquisitions of existing properties, joint ventures, or land purchases for ground-up development.

The sentiment has softened since the second half of 2022 and into this year. These trends are consistent with the overall mood surrounding both rental and for-sale housing. Developers are taking a more cautious approach as they evaluate the new costs of capital, the liquidity in the market, and the overall strength of the economy.

**YIELD CURVE HAS BEEN INVERTED** FOR NEARLY A YEAR


*Sources: Northmarq, U.S. Treasury*

## CONSTRUCTION DEBT FUNDING

In the near term, obtaining construction financing for single-family rentals is expected to prove challenging. While the asset class is still favored by lenders, particularly in light of the attractive demographics of the renter pool, the primary source of construction financing had been regional banks.

The volatility recorded among a few regional banks in the first few months of 2023 has created a more cautious lending environment across the board. Concerns about deposit flows and exposure to commercial real estate—particularly among office assets—is restricting activity. Further, the regional banks face greater scrutiny and likely higher costs associated with the potential for additional regulation in the coming years.

While the stresses the regional banks have experienced or may be impacted by going forward are generally not associated with the construction of single-family rentals, it is reasonable to expect that these challenges will lessen the availability of debt for new construction projects.

This pullback has created opportunities for middle-tier banks to enter the space and fill some of the construction financing void. Deals will get financed as the year progresses, but there will likely be fewer lenders competing in the space, and terms are not expected to be as favorable on new construction financing as in years past.

## ACQUISITIONS DEBT FUNDING

The segment of the capital markets that has undergone the least change in recent quarters surrounds debt financing for acquisitions. While origination volumes are down and rates are up from previous periods, Fannie Mae and Freddie Mac remain the leading sources of acquisition financing. The agencies continue to underwrite transactions with similar terms to new, Class A apartment properties.

The agencies are expected to remain competitive in the coming quarters, particularly with activity levels down across the investment market. Projects that can fall under the affordable mission-driven priorities will find particularly attractive terms.

## FINANCING EQUITY FUNDING

The pace of equity moving into single-family build-to-rent properties has slowed in recent quarters, although there continue to be acquisitions of recently completed projects and the record-setting number of units that broke ground in 2022 will provide opportunities for equity capital.

A few different equity strategies have emerged in recent years. One has involved the sales of fully stabilized properties. Recently, assets that have delivered but have not yet fully-leased up were accounting for a greater share of transactions. Equity investors who a year or two ago may have been targeting stabilized assets or land for new development, appear now to be shifting attention to assets that can be acquired at a bit of a discount prior to full stabilization.

Institutions and private equity investors are willing to provide equity capital for new development, but are increasingly favoring projects where the construction financing is in place before committing to a project.

OUTLOOK

# New strategies emerge following rapid growth

AFTER SURGING ahead for the past several years, the near-term outlook for the single-family build-to-rent property class is more uncertain. Last year marked sharp accelerations in both deliveries and construction starts, but current capital conditions will likely slow the pace of growth of SF BTR communities in the coming years.



*After the accelerating pace of starts in recent years, 2023 will be an active period for deliveries.*

This year is on track for uneven performance in the sector. After the accelerating pace of starts in recent years, 2023 will be an active period for deliveries. Looking further out into the future, the development pipeline will likely include fewer projects, as funding for new construction has become much more difficult to obtain. The result is forecast to be a period of peak deliveries in 2023 and into the first half of 2024, followed by a more gradual pace of completions in the following year or two.

The duration of the construction slowdown will likely be directly linked to the economic climate and to liquidity in the capital markets. Economic conditions to this point in 2023 have proven to be stronger than originally forecast. The health of the economy has generally been seen as a positive, although some forecasts suggest that this will result in one or more additional rate hikes that could push the possibility of a recession a few quarters into the future.

While there is a significant amount of uncertainty present in the economy, there is greater reliability regarding the for-sale housing market, where conditions making it difficult to transition into home ownership will persist. Mortgage rates have come down from recent peaks, but are expected to remain above 6 percent, making transitioning into home ownership challenging and expensive. And while prices have dipped modestly, low inventories of for-sale homes have limited downside pressures on prices.

These conditions will continue to make it difficult for existing renter households to buy their first homes. Single-family rentals compete as much with for-sale housing as they do with traditional apartments, and the inaccessibility in the for-sale housing market will drive some would-be buyers into this intermediate step between apartment living and owning a first home. Single-family rentals will continue to fill the void between residents who have moved beyond the traditional apartment lifestyle, but are not able to or interested in purchasing a single-family home of their own.

While an expensive housing market will support rental demand, there are several sources of uncertainty that will spill over into the single-family build-to-rent market and will limit investment activity. Chief among these is the health of the economy and the prospect of recession. Most forecasts still call for the dip into recession by the end of this year or in early 2024.

The Federal Reserve seems far more likely to implement another rate increase or two than to cut rates, and the cumulative impact of continued Fed tightening should ultimately restrict economic growth. Further, the cooling economy and tighter liquidity will likely result in a second half of this year where net payroll growth is limited.

In addition to slowing the pace of the economy, rising interest rates have resulted in higher costs throughout the capital stack. These costs and a more conservative outlook will restrict acquisitions and new development in the coming quarters. Buyers and sellers will ultimately close the expectations gap, which should spark activity, and that process can begin once short- and long-term interest rates stabilize.

While the next 6-18 months will likely result in a modest pace of new investment and development of single-family rental communities, the longer-term trends all point to this type of housing accounting for a greater share of the overall housing market across a growing number of states and regions. Demographic trends highlight the aging of the Millennial generation, and this group is transitioning from traditional apartments to single-family living.

As long as for-sale housing inventories remain limited, prices stay elevated and mortgage rates are twice as high as recent lows, renting will remain the best option for many mid- to high-income earners. Communities of single-family rental units will continue to capture a share of these desirable renters.

Further, single-family rental communities are coming online in the parts of the country that are recording the greatest population growth and employment expansion. These regions face housing shortages, and the bulk of the new inventory coming online is luxury apartment projects. These new developments will compete with each other, and could result in some supply-side pressures in the overall rental market, but single-family rentals will be more of a substitute to these luxury projects, rather than a direct competitor.

*As long as housing remains limited, prices stay elevated and mortgage rates are above 6 percent, renting will remain the best option for many mid- to high-income earners.*

# Proven **results.**

*The newest investment sales category isn't new to us.*

Northmarq has positioned itself as an early industry leader in brokerage and financing single-family build-to-rent communities. Our professionals have assisted in the sale and financing of SF BTR transactions totaling approximately $2 billion.

Regardless of market conditions, we continue to evaluate opportunities with developers and investors. With our coast-to-coast capabilities, we demonstrate how our client-focused, integrated approach is one of the best in the industry.

We are here to advise you throughout the life cycle of every investment and ensure you maximize each opportunity by making informed decisions.

$2 Billion
**TRANSACTION** VOLUME

75+
**TRANSACTIONS** ACROSS THE U.S.

22
**ACTIVE BTR** ASSIGNMENTS

350
**BTR/SFR** EVALUATIONS

**Golf Estates at Barton Creek**
±15.5 acres | Spicewood TX
Multifamily/BTR

*Coming soon*

**Presidential Glen Townhomes**
±10.24 acres | Manor TX
BTR

*Coming soon*

**Fort Pointe**
±69 acres | Warrenton/Astoria OR
Multifamily/BTR

*On the market*

**AVERE on the High Line**
56 homes | Denver CO
New construction, attached garages

*On the market*

**Empire Portfolio**
659 homes | Atlanta GA
Under construction

*On the market*

**Retreat Townhomes**
104 homes | Fort Worth TX
Individual tax parcels

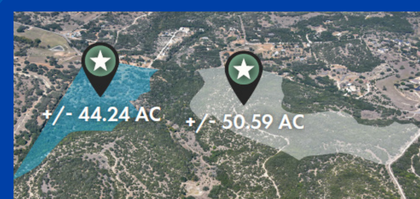
*On the market*

**Hillsong Development Site**
±26 acres | Lakeway TX
For sale or rent SFR/BTR & Retail

*On the market*

**Highway 71 Development Site**
±20.8 acres | Bee Cave TX
Mixed Use/BTR

*On the market*




**Thomas Ranch**
±94.9 acres | Spicewood TX
Multifamily/BTR

*On the market*

**Union Wine**
±89.2 acres | New Braunfels TX
Multifamily/BTR

*On the market*

**Loop 410 at Presa**
±18.9 acres | Mesa AZ
Mixed Use/BTR

*On the market*

**Lockhart Highway 130**
±91 acres | Lockhart TX
Multifamily/BTR

*On the market*

**The Orchards**
38 homes | Phoenix AZ
New construction, individual tax parcels

*In escrow*

**Townhomes at Bluebonnet Trails**
114 homes | Waxahachie TX
New construction

*In escrow*

**Manor Villa Estates**
±14.6 Acres | Manor TX
BTR

*In escrow*

# **Our team** of experts

With demonstrated expertise and with skilled experts operating in the most active build-to-rent markets, Northmarq is the industry leader for brokerage and capital markets activity in the space.

Please contact one of our SF BTR experts for any financing or brokerage needs.

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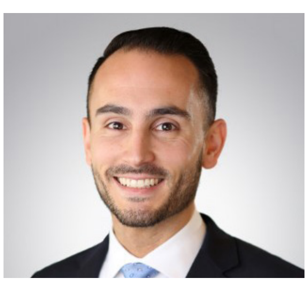

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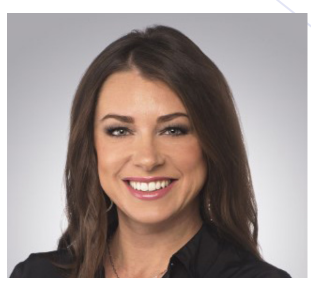

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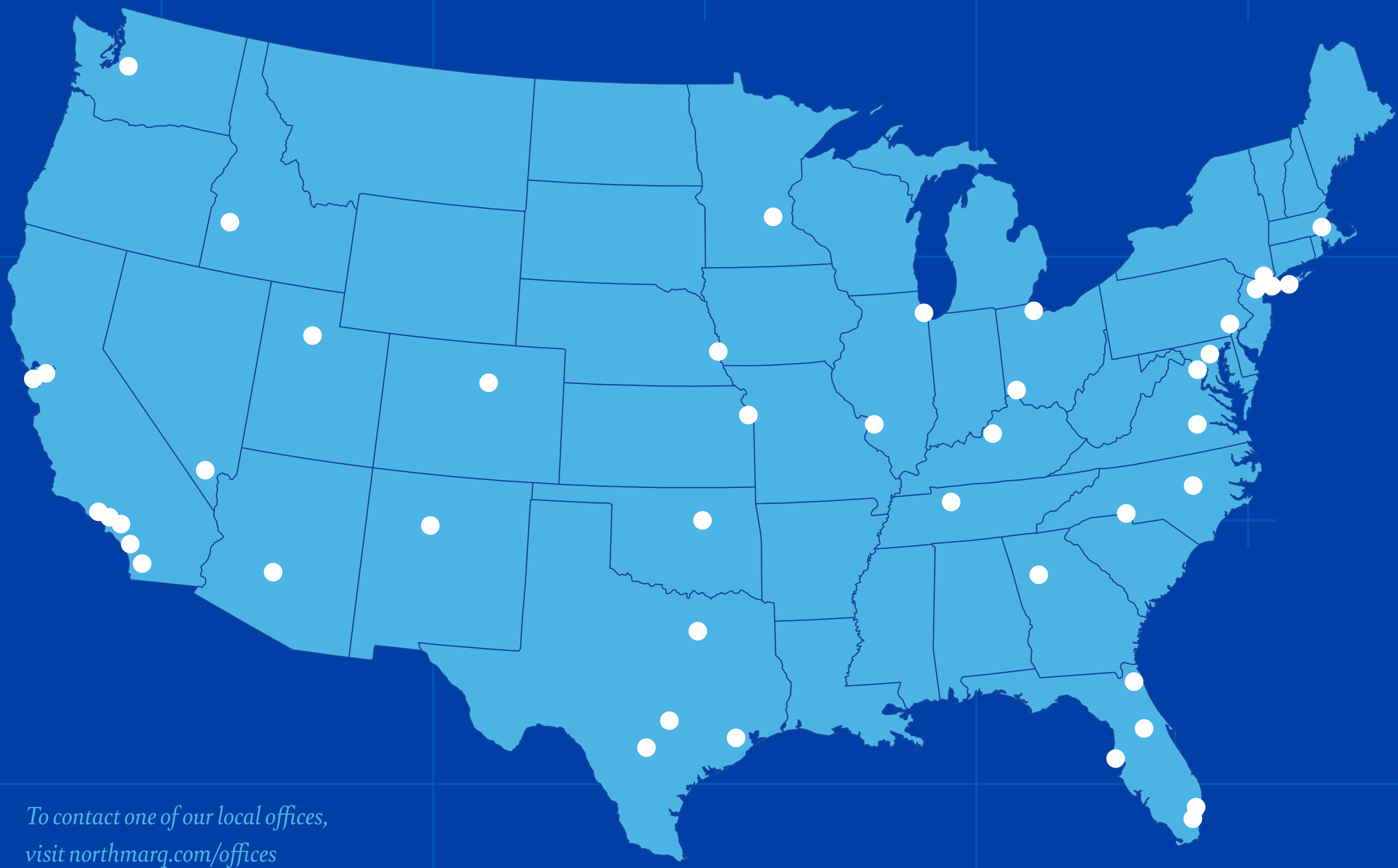

*To contact one of our local offices, visit northmarq.com/offices*

# Why Northmarq?

## INTEGRATED TEAM OF PROFESSIONALS

We've built our reputation on valuing long-term trust over short-term wins, grounded in our commitment to put client interest before our own – offering a customized approach with an integrated team of experts.

## COLLABORATION KEEPS THE DEAL SIMPLE

Leave the due diligence, market evaluation, buyer interest, and equity partnerships to us. We'll identify the best positioning for the property and qualify uniquely motivated investors early in the process to ensure the transaction is smooth – from start to finish.

## NATIONAL PLATFORM BOUTIQUE TOUCH

While Northmarq transacts across the country, we're best known for the customized approach we offer clients. We operate like a boutique firm, where the entire Northmarq team rallies to provide the best outcome and experience for our clients.

## ABOUT **NORTHMARQ**

As a capital markets leader, Northmarq offers commercial real estate investors access to experts in debt, equity, investment sales, and loan servicing to protect and add value to their assets. For capital sources, we offer partnership and financial acumen that support long- and short-term investment goals. Our culture of integrity and innovation is evident in our 60-year history, annual transaction volume of more than $37 billion, loan servicing portfolio of more than $76 billion and the multi-year tenure of our over 1,000 people.

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