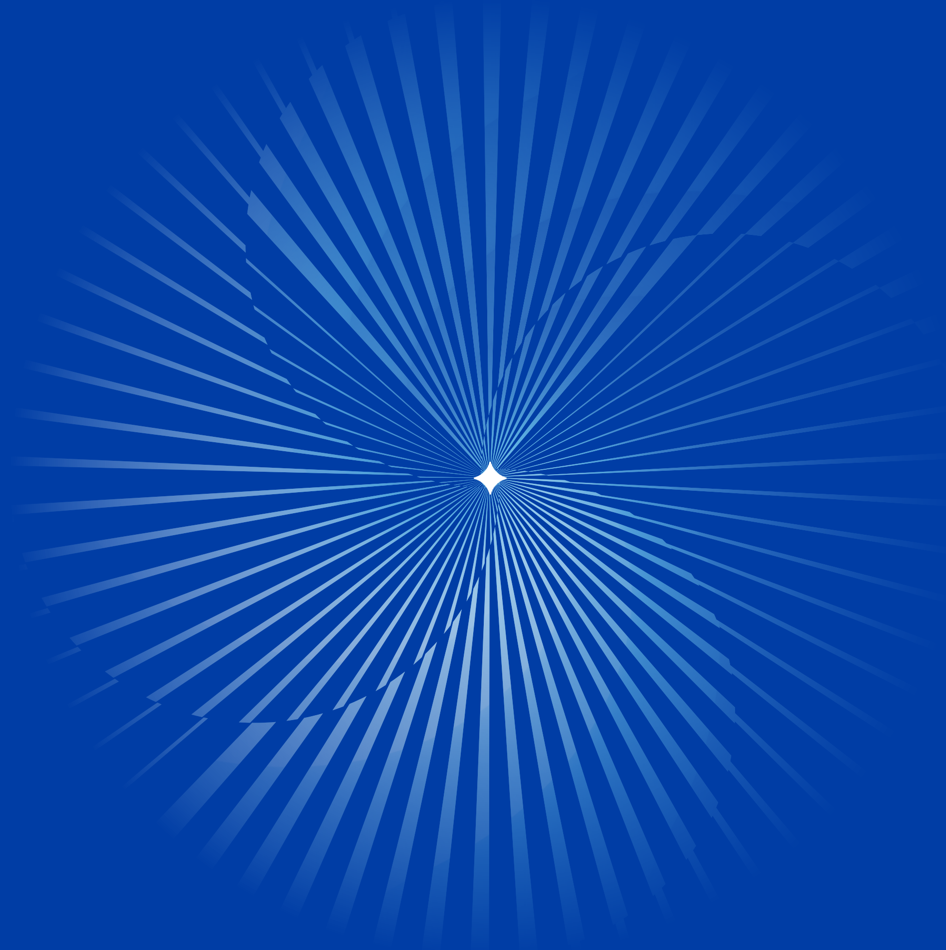
Northmarq

SPECIAL REPORT
OCTOBER 2024

Single-Family Build-to-Rent Properties

RAPID SUPPLY GROWTH PRESENTING BOTH CHALLENGES AND OPPORTUNITIES



Investment trends in the SF BTR product type have been less volatile than in traditional apartment properties in 2024.

Despite Softening, Developers and Investors Maintain Growth Strategies.

INTRODUCTION

Trends in the single-family build-to-rent market (SF BTR) are mirroring some of the larger themes in the national economy. Renter demand for communities of single-family rentals has been elevated in recent years, as the costs associated with for-sale housing have continued to rise. Demand is being fueled by demographics that are supporting new household formation and incomes that have risen at a fast enough pace to support the costs of premium rental units as an alternative to for-sale housing.

In addition to driving demand, these favorable conditions have been supporting a rapid acceleration of new single-family build-to-rent communities entering the development pipeline across a growing number of markets in recent years. While demand has been elevated, it has not kept pace with this rapid supply growth, and the most likely outcome in the near term is that developers will continue to add inventory faster than operators will be able to lease new units.

While these supply-demand forces are applying some short-term stresses on market fundamentals, it is important to note that this is a natural continuation of the real estate cycle, and the trends being posted in single-family build-to-rent properties are emerging in other sectors of real estate as well. The current period of modest softening was forecasted and is a sign of a market performing as it often does.

Some of the largest operators in the space are beginning to implement new strategies to grow their inventories.

The surge in new supply has increased competition across the sector and resulted in higher vacancies, while also creating continued investment opportunities across dozens of the country's fastest-growing markets. Investment groups that raised billions of dollars to allocate to the sector in recent years are deploying that capital as new projects work through the development pipeline.

Investment trends in the SF BTR product type have been less volatile than in traditional apartment properties in 2024. Transaction counts are closely tracking levels from last year, and cap rates are only slightly higher than they were at the end of 2023. Per-unit prices have dipped from earlier highs, reflecting the less frenzied investment conditions and the larger number of properties available for acquisition.

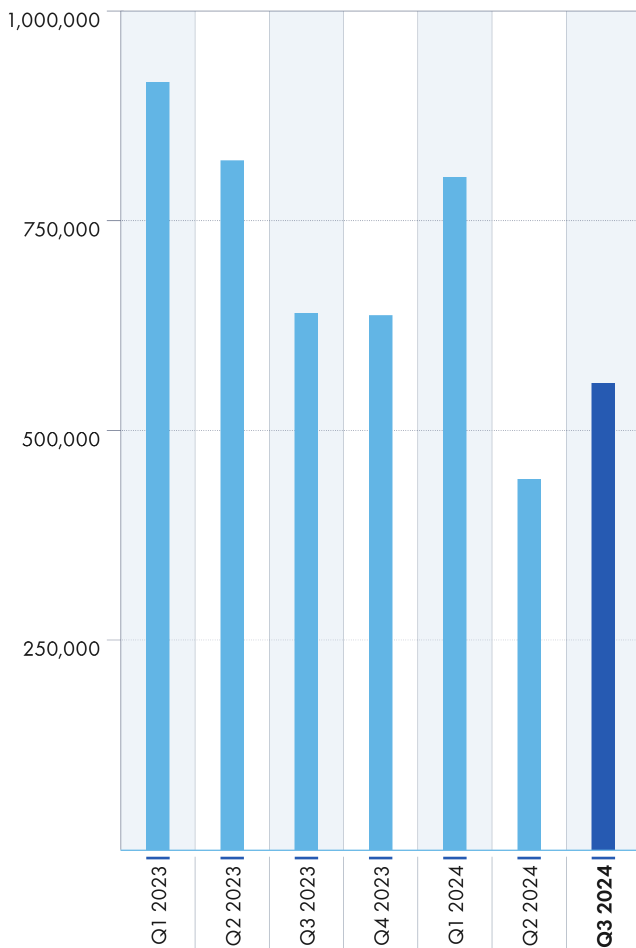
As this year began, most forecasts called for a period of slower economic growth and several rounds of interest rate cuts to stimulate financial and real estate markets. To this point, growth has outperformed expectations and the first rate cuts did not occur until September. Economic growth is cooling modestly, but softness has been limited mostly to a slowing pace of hiring across a handful of employment sectors, rather than widespread losses.

These conditions create some added short-term uncertainty for the single-family build-to-rent property sector but will also present opportunities. Some of the largest operators in the space are beginning to implement new strategies to grow their inventories, while the ways equity capital is being deployed continue to evolve.

ECONOMIC OUTLOOK

Outlook Continues to Call for a Soft Landing.

QUARTERLY JOB GROWTH SLOWING



SOURCE: *Northmarq, Bureau of Labor Statistics*

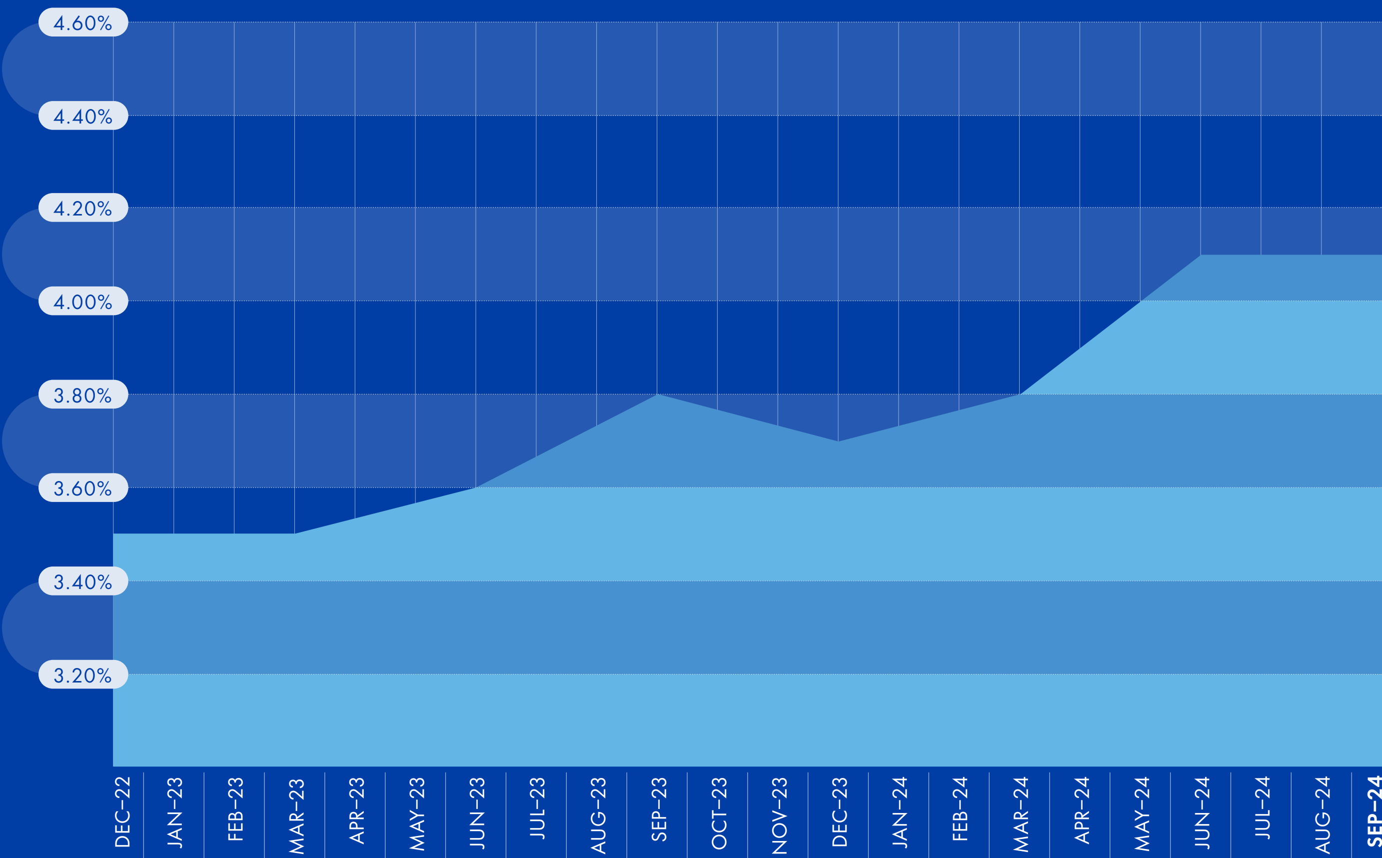
Hiring has remained positive, although the pace has lagged 2023 levels, and gains are being spread across fewer industries.

Economic conditions have shifted during the past several quarters. Earlier threats were caused by the perception that the economy was becoming overheated by a combination of economic stimulus, a release of pent-up consumer demand, a tight labor market, and potential pricing bubbles across the equity and housing markets.

As 2024 approaches a close, those concerns have eased and the economy has entered into a period of steady growth. Hiring has remained positive, although the pace has lagged 2023 levels, and job gains are being spread across fewer industries after widespread expansion earlier in the cycle.

In recent years, inflation was a primary consideration and prompted the Federal Reserve to hike rates. While the current rate of inflation remains above the Fed's target, prices are showing signs of stabilizing. The annual rate of inflation as measured by CPI slowed to just 2.4 percent in September, the lowest figure in more than three years. It is this continuing decline in the rate of inflation that is allowing the Fed to enter into an extended period of rate cuts that should continue well into 2025.

UNEMPLOYMENT RATE REMAINING TIGHT FOR NEARLY TWO YEARS
(NATIONAL UNEMPLOYMENT RATE)



SOURCE: *Northmarq, Bureau of Labor Statistics*

Unemployment Low, but the Pace of Hiring Slows.

Monthly gains were soft throughout much of the spring and summer, before a surge in the hiring reported in September.

LABOR MARKET

Hiring trends have been mixed in 2024, outperforming earlier forecasts, while still lagging expansion levels from the prior year. Gains in the employment market are key drivers of new household formation, so a slowdown in hiring could ultimately cool demand for rental housing. At the beginning of this year, employers were forecast to expand payrolls by about 1 percent with the addition of approximately 1.5 million net new jobs, a figure that had already been surpassed by the end of the third quarter.

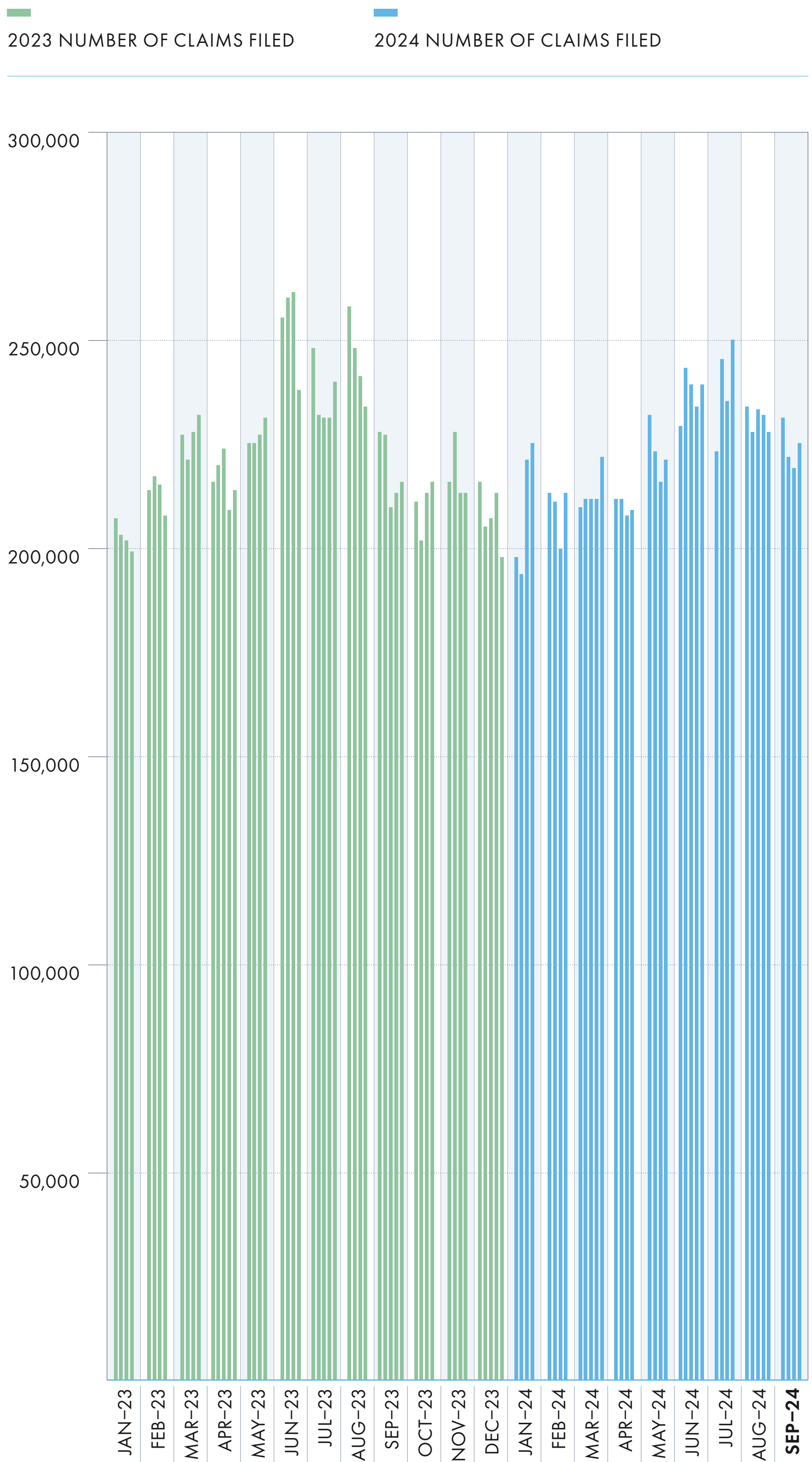
While recent gains are putting the national labor market on pace to add approximately 2 million jobs in 2024, there are signs that conditions are weaker than the current data points reflect. Monthly gains were soft throughout much of the spring and summer, before a surge in the hiring reported for September.

Additionally, in August, the Bureau of Labor Statistics announced that its annual revisions to employment totals would be more significant than in the past several years. The downward revisions, which will be finalized in February of 2025, are expected to reflect 818,000 fewer jobs added from early 2023 through the first quarter of this year. The hardest-hit sectors will include professional and business services and leisure and hospitality.

While the pace of hiring has slowed, unemployment has remained low. The rate ended September at 4.1 percent, only 30 basis points higher than one year ago. Initial jobless claims are another indicator of the health in the labor market. Jobless claims in September of this year averaged about 224,000 per week, only 2.6 percent higher than one year earlier.

The recent trends in the labor market have the potential to be favorable—or at least neutral—for both employers and workers. Businesses are benefitting from a less frenzied hiring market, and the upward pressure on wages has cooled. While the pace of hiring has slowed, current workers have the stability of minimal layoffs, which was a potential concern earlier in the year.

JOBLESS CLAIMS, LAYOFFS MINIMAL
(U.S. WEEKLY INITIAL CLAIMS AS OF SEPTEMBER 28, 2024)

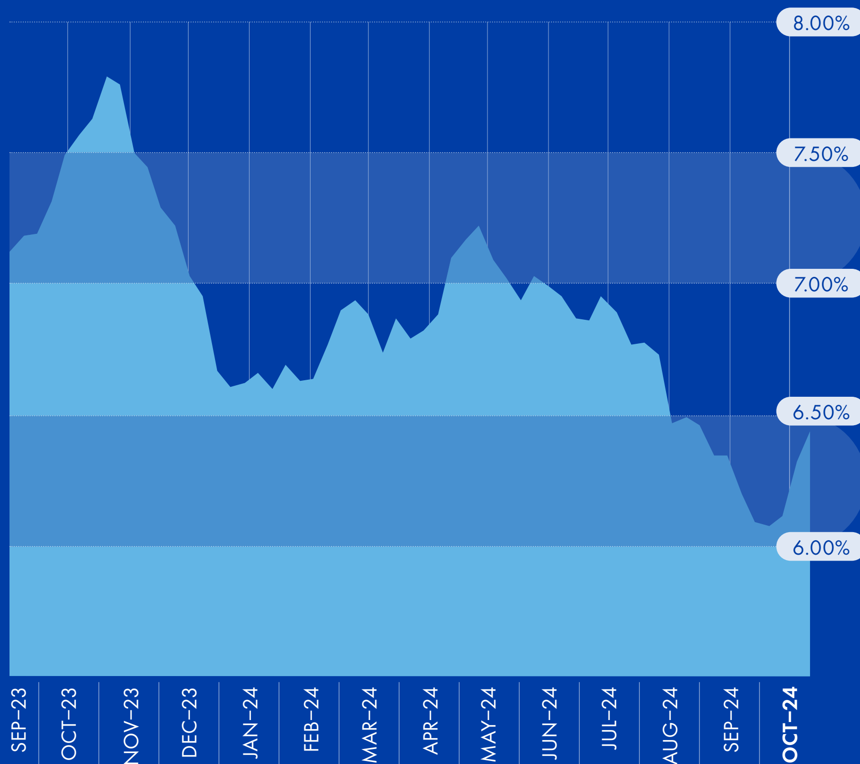


SOURCE: *Northmarq, U.S. Department of Labor*

Mortgage Rates Trending Lower, May Support Moves From Renting to Owning.

The declining mortgage rates could support increased home buying activity in the final few months of this year and into 2025.

MORTGAGE RATES DOWN 130BPS FROM PEAK LEVELS (AVERAGE 30-YEAR FIXED-RATE MORTGAGE)



SOURCE: *Northmarq, Freddie Mac*

FOR-SALE HOUSING

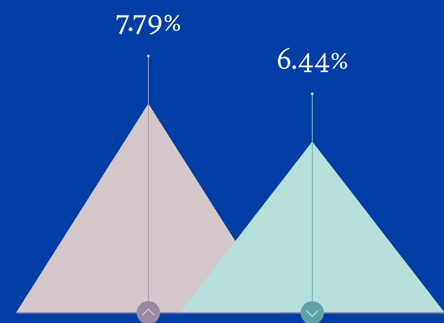
For the past several years, the single-family build-to-rent market has benefitted from a for-sale residential market that was increasingly expensive, featured a low inventory of homes available for purchase, and elevated mortgage rates that dragged down purchasing power.

Some of these trends persist, while others appear to be showing signs of changing course. Throughout much of this year, existing home sales volumes have lagged 2023 levels by approximately 5 percent. Recent volumes are about 45 percent lower than peak transaction levels recorded in the second half of 2020 and much of 2021.

Residential mortgage rates remained above 6.5 percent through the first seven months of 2024, but began to creep lower in August as the prospect and timing of Fed rate cuts became increasingly certain. Recent moves higher, however, illustrate the volatility in the market. Would-be home buyers expecting mortgage rates to decline in a straight line over the coming months may be disappointed.

WHAT IS THE CURRENT MORTGAGE RATE COMPARED TO LAST YEAR?

OCTOBER 2023 OCTOBER 2024



SOURCE: *Freddie Mac*

$416,700

MEDIAN SALES PRICE FOR AN EXISTING SINGLE-FAMILY HOME

SOURCE: *National Association of Realtors*

+4.2%

ANNUAL CHANGE FOR EXISTING SINGLE-FAMILY HOME SALE PRICE

SOURCE: *National Association of Realtors*

+$878

MORTGAGE PAYMENT COMPARED TO AVERAGE SF BTR RENT

SOURCE: *Northmarq*

Still, mortgage rates are lower today than they were one year ago, and further declines are likely. In each weekly reading during the first half of 2024, the average residential mortgage rate was higher than the corresponding week in 2023. That trend reversed beginning in July, and by October, mortgage rates were down approximately 125 basis points year over year and nearly 150 basis points below the peak recorded in the fourth quarter 2023.

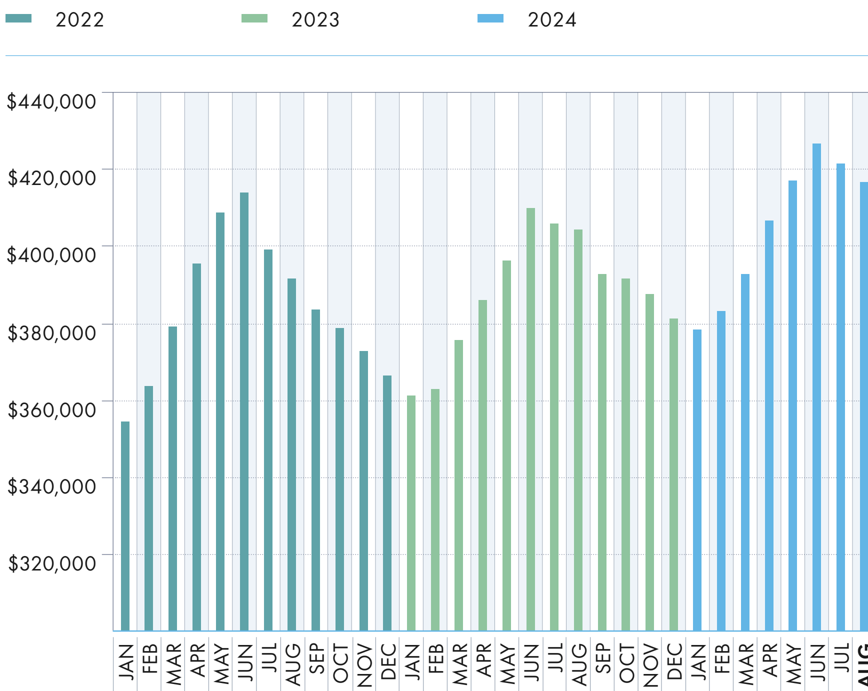
The annual declines in mortgage rates are expected to buoy sentiment among current renters looking to move into home ownership. Many would-be home buyers have remained on the sidelines in anticipation of more favorable mortgage rates, and the expectations of lower rates may spur some renters to take another look at purchasing homes. This movement from renting to owning is a natural progression in the housing market and rental operators have been adjusting to these conditions for generations, but it could have an outsized impact on the single-family build-to-rent market.

While mortgage rates have declined and existing home sales volumes are light, prices remain elevated. The median existing home sales price in August 2024 was $416,700, a figure that was up more than 4 percent from one year earlier. For-sale home prices have continued to inch higher in response to a limited inventory of homes available for purchase and a still-strong economic environment that has supported pricing. There was some thought that prices could trend lower when mortgage rates were elevated, but declines did not materialize and affordability remains a challenge for first-time home buyers.

New home sales are taking up some of the slack in the market, but inventories are growing. The latest data on new home sales reflect a nearly 10 percent year-over-year increase in transaction volumes, but home builders have averaged more than 8 months of supply in 2024, up from levels during the second half of last year. New homes sell at higher prices than existing homes and are less likely to capture renters transitioning to home ownership.

While mortgage rates have declined and existing home sales volumes are light, prices remain elevated.

HOUSING PRICES ON A GRADUAL UPWARD TRAJECTORY
(MEDIAN SALES PRICE: U.S. EXISTING HOME SALES)



SOURCE: *Northmarq, National Association of Realtors*

Developers are bringing new projects online at a time when renter demand for high-quality housing is elevated and the for-sale market remains stuck in neutral.

Supply Growth to Remain Elevated in the Coming Years.

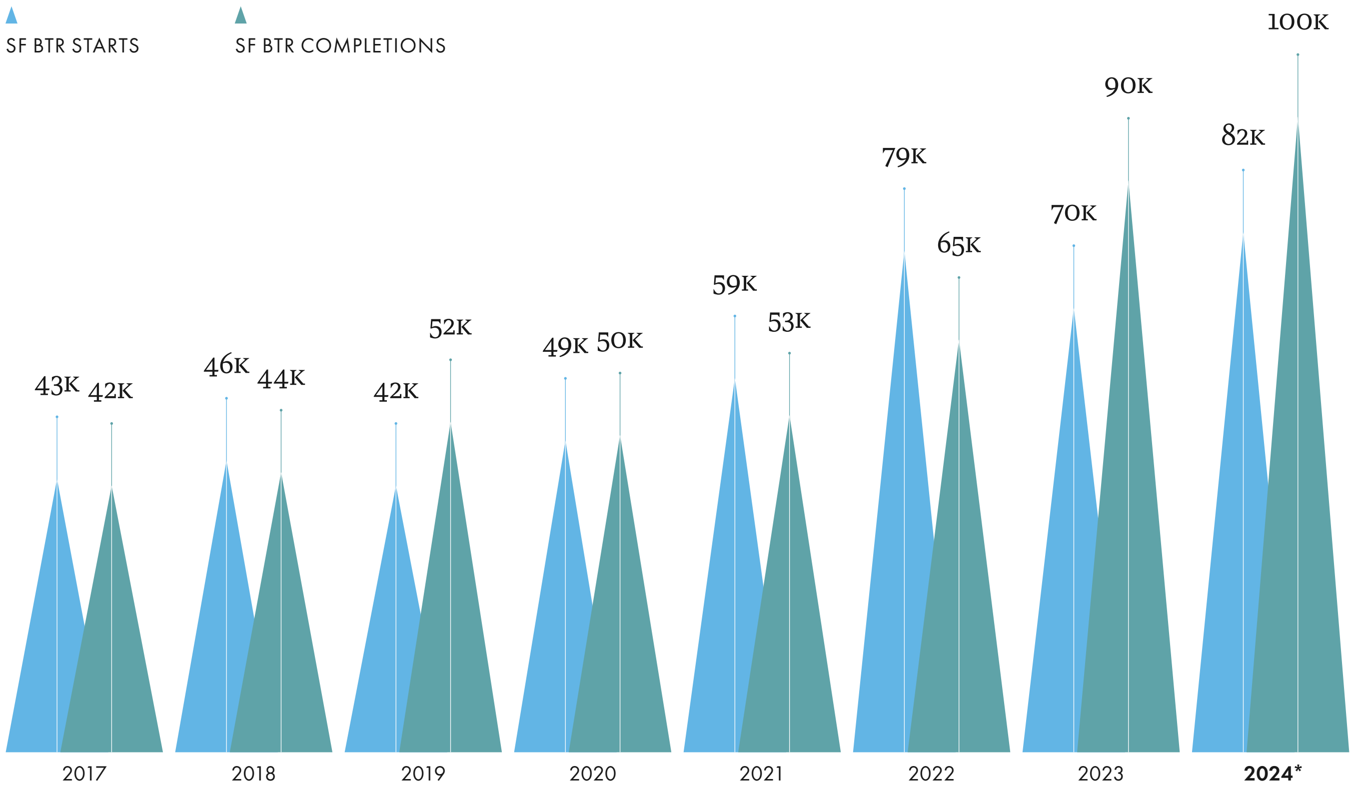
The single-family build-to-rent market is in a period of accelerating supply growth. Developers are bringing new projects online at a time when renter demand for high-quality housing is elevated and the for-sale market remains stuck in neutral. Homebuilders are leading the charge, building communities of single-family rental homes on existing land parcels.

Additionally, some of the largest single-family rental operators are increasing their inventories by either partnering with homebuilders or buying newly built communities. Previously, companies such as Invitation Homes and American Homes 4 Rent built their supplies of rental homes by acquiring individual homes, but both companies are demonstrating a preference for purpose-built single-family rental housing communities.

These factors have driven increased levels of both starts and completions of single-family for-rent units to this point in 2024. Inventory growth is occurring across the Sunbelt, with some of the largest markets—highlighted by Phoenix, Dallas-Fort Worth, Atlanta, and Houston—leading the way for new inventory growth.

During the first half of this year, more than 40,000 single-family build-to-rent units were started, up 24 percent from levels recorded during the same period in 2023. Construction starts in the first half of this year were also about 5 percent ahead of the prior peak in 2022. Data for the third quarter will not be released for another month or so, but recent development trends are likely to continue.

SINGLE-FAMILY BUILD-TO-RENT DEVELOPMENT PIPELINE (NUMBER OF UNITS)



SOURCE: *Northmarq, U.S Census Bureau*

** Data for 2024 forecasts both construction starts and completions*

During the first half of this year, more than 40,000 single-family build-to-rent units were started, up 24 percent from levels recorded during the same period in 2023.

The units that were started a few years ago are coming online. During the first half, completions totaled more than 50,000 units, a 25 percent spike from levels recorded in the first half of last year. Quarterly delivery totals had been fairly consistent throughout much of 2023 and in the first few months of this year before surging in the second quarter.

REGIONAL DEVELOPMENT TRENDS

Development of single-family build-to-rent homes has been expanding to a greater number of markets in recent years, but construction is still largely concentrated in the South region. Developers are bringing new projects online in regions of the country where land costs are less prohibitive and population growth is strongest.

With a few exceptions, these trends are likely to continue. While there have been a handful of examples of new build-to-rent communities being developed in more expensive markets such as California, or in slower-growth regions including the Midwest, the bulk of the projects that will move through the construction pipeline will be in the Sunbelt.

SF BTR CONSTRUCTION STARTS

During the first half, construction starts in the South region totaled approximately 27,000 units, up 17 percent from the same period in 2023 and representing more than 60 percent of the national total.

Development of single-family build-to-rent homes has been expanding to a greater number of markets in recent years, but construction is still largely concentrated in the South region.

Construction trends in the South region had an outsized influence on the national performance. Outside of the South, construction start trends were mixed.

In the West region, starts totaled approximately 8,000 units in the first half. This doubled the volume from the same period last year, when the prevailing climate in the West was more cautious, and concerns about overbuilding—particularly in the large Phoenix market—limited development. Construction in the West regained momentum in the second half of 2023 and carried over into 2024.

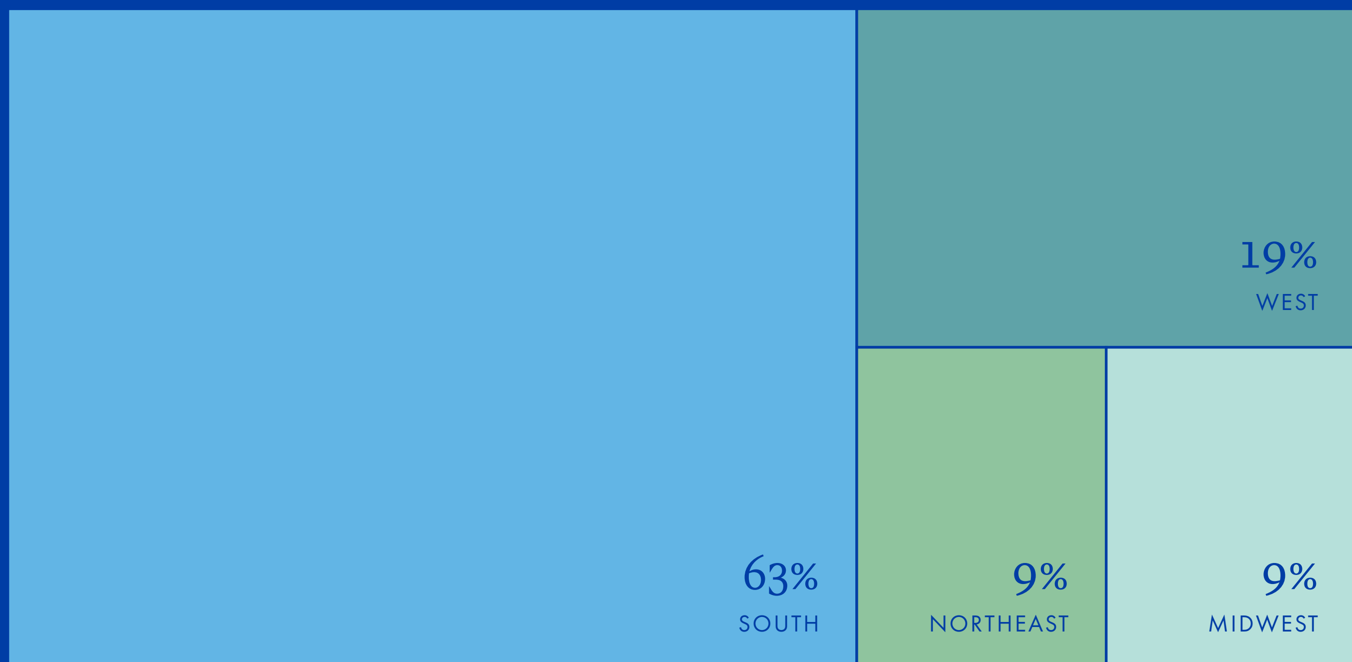
There was an increase in starts in the Midwest region in 2023, a trend that has reversed course lately. Starts in the Midwest totaled only about 4,000 units year to date, or an annual decline of approximately 40 percent. Columbus and Kansas City are top markets for construction starts.

SF BTR DELIVERIES

The South region posted deliveries of more than 33,000 units during the first half, up more than 50 percent from the total in the first six months of 2023. The South region is posting the greatest activity levels as well as the most rapid acceleration in new deliveries of any region in the country. These trends are likely to continue in the years ahead.

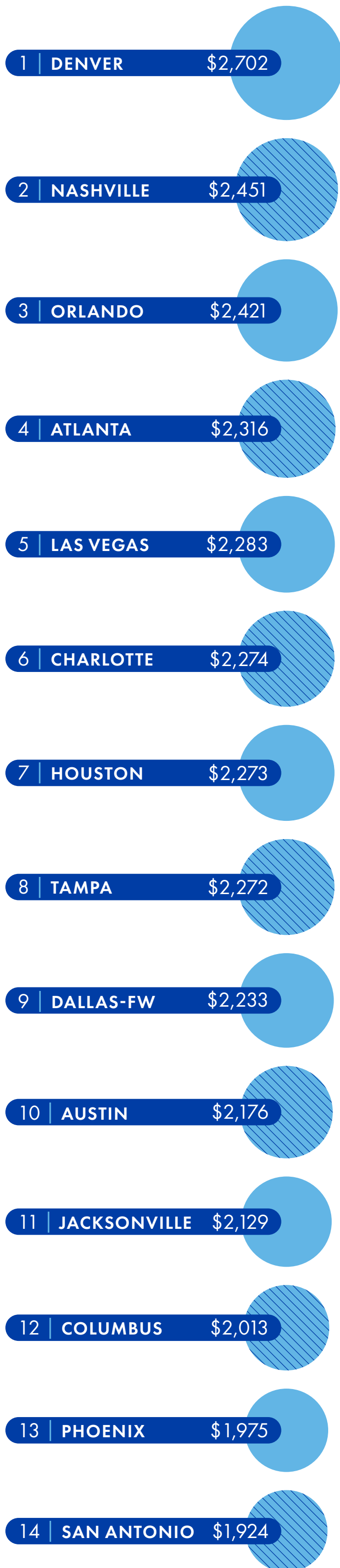
Recent deliveries are occurring in traditionally steadier markets. Completions in the Midwest are ahead of the 2023 pace, while deliveries in the West were down nearly 50 percent year over year. The recent increase in starts in the Western states should result in resumed inventory growth in the region beginning in 2025.

SINGLE-FAMILY BUILD-TO-RENT CONSTRUCTION STARTS BY REGION (THROUGH 2Q)



SOURCE: *Northmarq, U.S Census Bureau*

AVERAGE SF BTR RENTS BY MARKET



SOURCE: *Northmarq, CoStar, Yardi*

OPERATIONAL PERFORMANCE TRENDS

Supply-Side Pressures Driving Vacancies Higher.

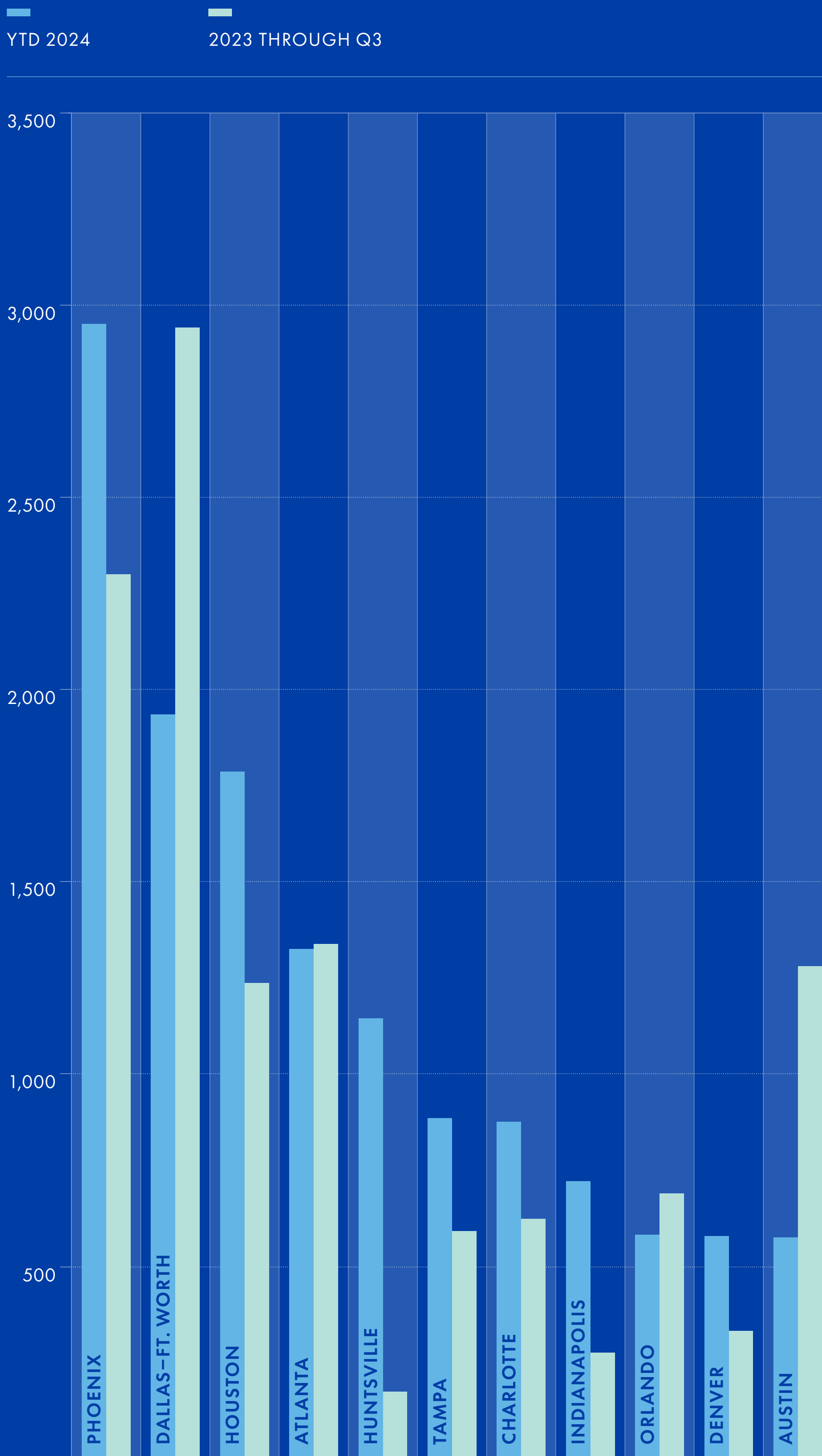
The wave of new inventory is impacting the national single-family build-to-rent market. Vacancy rates, which dipped to as low as 4 percent in 2021 and early 2022, have more than doubled during the past several quarters. While vacancies have pushed higher, rents have been mostly flat, as the newer inventory entering the market is generally at the high end of the pricing scale.

The national vacancy rate ended the third quarter at 8.6 percent, up from 7.5 percent one year earlier. Vacancy rates differ significantly across some of the sector's largest markets. Some of the better-performing markets include Las Vegas, Denver, and Orlando. Vacancy rates in these markets range between 4.5 percent and 6.5 percent.

Several high-growth markets have vacancy rates between 10 percent and 12 percent. These markets generally had vacancy rates between 6.5 percent and 8 percent one year ago. While these year-over-year vacancy increases are noteworthy, they are also a function of rapid supply growth. Many markets have posted inventory SF BTR increases topping 10 percent during the past year, reflecting the rapid growth in a fairly new property sector.

Asking rents averaged $2,269 per month in the single-family build-to-rent sector as of the third quarter, down 1 percent from levels one year ago. Rent trends have been fairly consistent across the country's largest build-to-rent markets. More than half of the largest markets have posted annual rent declines, including some markets such as Tampa and Austin, that were among the market leaders for rent growth in recent years.

The national average rent in single-family build-to-rent communities ended the third quarter at $1.56 per square foot, per month, essentially unchanged from one year earlier. Rents vary based on overall housing costs as well as the product mix across various markets. Some markets with a higher percentage of horizontal apartments feature some of the highest rents per square foot. Phoenix is a leading example of this trend, with monthly per-square-foot rents 18 percent higher than the national average.



SOURCE: *Northmarq, CoStar, Yardi*

Absorption is positive across much of the country, but it is concentrated in markets where inventories are largest, and construction has been most active.

While the supply pipeline has attracted much of the attention when discussing rental housing markets, demand has been particularly strong and somewhat overlooked. This is especially true in the SF BTR market. After a slower start to the year, net absorption totals at the national level reached a record high during the second quarter, and that total was then surpassed in the third quarter. Year to date, net absorption is up approximately 7 percent compared to one year earlier.

The accelerating demand patterns strengthen the outlook for the remainder of this year. Absorption is positive across much of the country, but it is concentrated in markets where inventories are largest, and construction has been most active. Phoenix, Dallas-Fort Worth, Houston, and Atlanta have led the way for net absorption to this point in 2024, with some of these markets posting year-over-year absorption increases of 30 percent or more.

MARKET SPOTLIGHT
PHOENIX, ARIZONA

Robust Absorption Offsetting Some Supply-side Pressures.

Several submarkets have been active areas for new development, led by East Mesa, South Mountain, Goodyear, and Peoria.

Phoenix has been the largest and most active single-family build-to-rent market in the country for the past several years. The region was an early adopter of single-family rental communities, with the first few properties coming online in 2016 and 2017 before the pace of deliveries began to ramp up significantly in the following years.

This timing coincided with a surge in demand for all forms of housing in the Greater Phoenix region, when vacancies tightened and rents—along with for-sale housing prices—spiked. These favorable conditions sparked an accelerating pace of new construction, where developers delivered an average of more than 2,000 units of SF BTR inventory per year from 2020 through 2022.

Development has continued to increase throughout the Greater Phoenix area, with dozens of new communities, totaling more than 7,200 units opening since the beginning of 2023. Several submarkets have been active areas for new development, led by East Mesa, South Mountain, Goodyear, and Peoria. Future inventory growth is on the way, with projects totaling nearly 6,000 units currently under construction.

While the Phoenix area has been one of the top two markets in the country for new supply growth during the past year, local vacancy rates have remained fairly steady. The stabilized vacancy rate in SF BTR properties in Phoenix ended the third quarter at 8.2 percent, 40 basis points lower than the figure from one year earlier. Vacancies in local build-to-rent communities reached as low as the mid-3 percent range as recently as 2021, but the rate started to push higher beginning in 2022.

Phoenix has been a leading market for investment sales activity throughout the short history of the single-family build-to-rent sector.

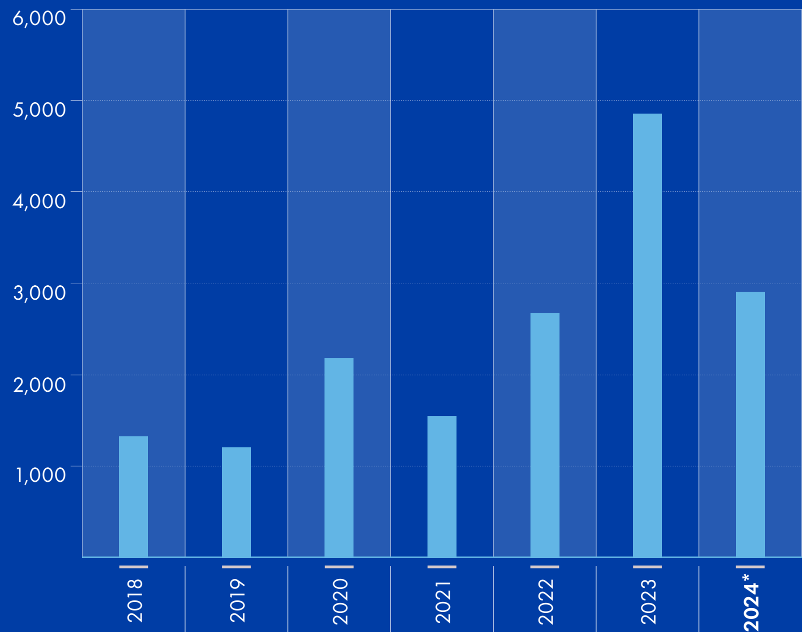
Rents have dipped slightly in recent years after operators of the first wave of communities had significant pricing power. Current rents are $1,975 per month, after first topping $2,000 per month in the middle of 2022. Rents posted double-digit annual gains a few years ago, but have been essentially flat for the past 10 quarters.

Phoenix has been a leading market for investment sales activity throughout the short history of the single-family build-to-rent sector. That trend has continued into 2024. Year to date, sales velocity is nearly identical to levels from the same period in 2023.

While transaction activity levels have remained fairly steady in the Phoenix area, pricing has declined. The median price in SF BTR properties that have sold to this point this year is approximately $337,000 per unit, down from about $400,000 per unit in 2023 and a peak that topped $450,000 per unit in 2022.

While there was a mix of sales involving properties in lease-up and stabilized properties throughout the past few years, transactions in Phoenix this year have consisted primarily of properties that have already been stabilized. Homebuilders are entering into forward-sales transactions, and there should be an increase in this activity going forward.

ANNUAL BTR COMPLETIONS IN THE PHOENIX MSA (NUMBER OF UNITS)



SOURCE: *Northmarq, CoStar, Yardi* — ** Year-to-date*

COMPARISON OF BTR VS. TRADITIONAL APARTMENT RENTS IN THE PHOENIX AREA (AVERAGE MONTHLY RENTS)

SOURCE: *Northmarq, Apartment Insights, CoStar, Yardi* — ** Through 3Q 2024*

Capital is still being allocated into the sector, but buyers are less aggressive and prices have trended lower.

Investment Market Remains Active, Although Prices Have Trended Lower.

INVESTMENT SALES OVERVIEW

Investment activity in the single-family build-to-rent market is reflecting the higher interest rate environment and the more competitive supply-demand dynamics. Capital is still being allocated into the sector, but buyers are less aggressive and prices have trended lower. Investors are adjusting to the current market conditions, and the continued transaction activity is allowing for sufficient price discovery for buyers and sellers to adjust expectations.

Year to date, sales velocity across the sector is down just 5 percent when compared to the same period in 2023. While the number of transactions is similar to the 2023 pace, activity was concentrated during the first few months of the year, and fewer properties have sold in the spring and summer months. More than half of the single-family build-to-rent properties that have traded this year sold during the first quarter.

The mix of sales has also varied somewhat from prior years. Approximately 70 percent of the total SF BTR transactions have involved townhome properties; in 2023, sales were more evenly distributed between townhomes, horizontal apartments, and traditional single-family assets.

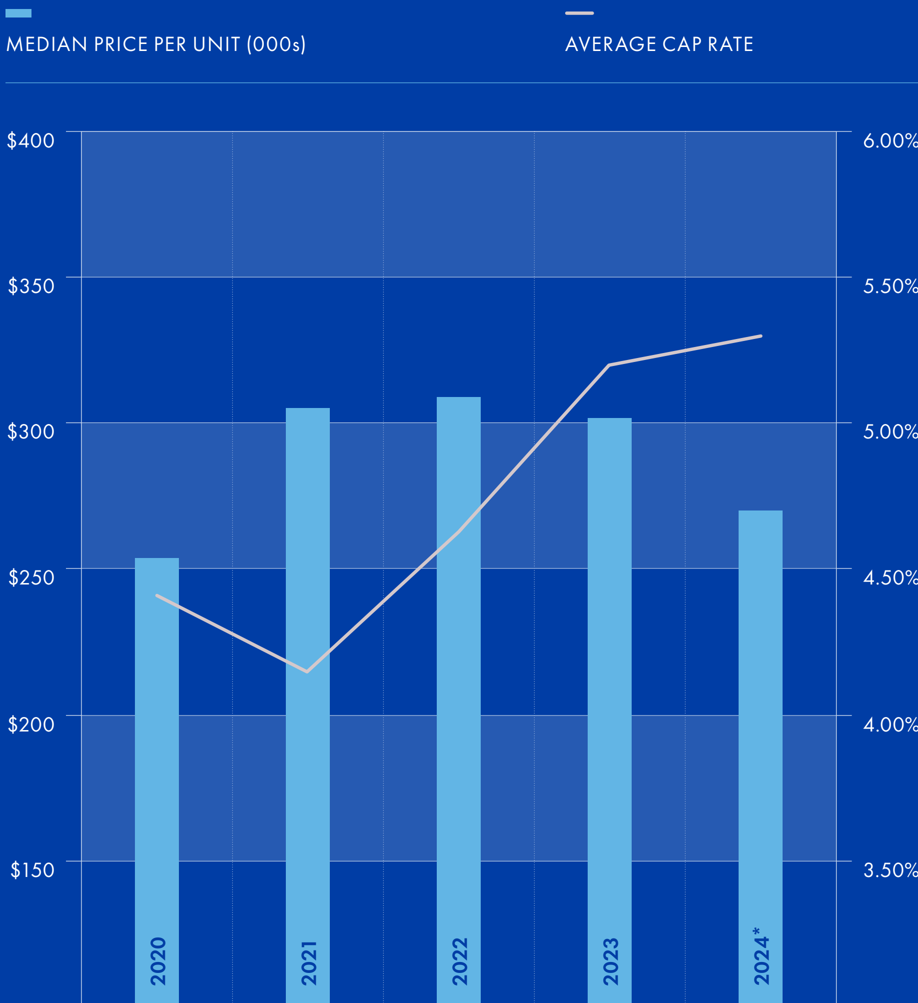
MEDIAN PRICE PER SQUARE FOOT
U.S. SF BTR PROPERTIES (YTD)

SOURCE: *Northmarq, CoStar, Real Capital Analytics*

The national median price has trended lower in 2024, reaching $270,000 per unit year to date. Last year, prices closed at $302,000 per unit. There is a wide range in per-unit pricing across markets and transactions. There have been a handful of assets that have sold at prices topping $400,000 per unit, although the number of deals above this threshold has declined in 2024. With townhome properties accounting for the bulk of the total transactions in the market, their pricing trends are reflected in the overall totals. The median price in townhome property sales year to date is $267,500 per unit. In 2023, prices for townhome communities were closer to $285,000 per unit.

Cap rates have generally ranged between 5 percent and 5.5 percent year to date.

INVESTMENT TRENDS: SF BTR PROPERTIES



SOURCE: *Northmarq, CoStar, Real Capital Analytics*

** Year-to-date*

Cap rates for single-family build-to-rent communities are still at the lower-end of the market scale for investment properties. Cap rates have generally ranged between 5 percent and 5.5 percent year to date, similar to levels recorded during the second half of last year. At the height of the market, cap rates had compressed to the high-3 percent to low-4 percent range in 2021.

Single-family build-to-rent properties have posted steadier investment volumes than traditional apartments or other commercial real estate sectors. The continued additions to supply have fueled the investment market, as properties have been sold during lease-up or at stabilization. Homebuilders are bringing a steady flow of properties to market—combining for sales volume of more than $325 million year to date.

MARKET SPOTLIGHT
COLUMBUS, OHIO

Regional Developers Play a Large Role, as Growth Profile Attracts New Entrants.

Total employment in Columbus has traditionally grown at a pace of about 1.3 percent, with employers adding an average of about 15,000 net new jobs each year.

Columbus, Ohio is generally one of the top performing rental markets in the Midwest. The local economy is supported by one of the largest public universities in the country and being the capital of the seventh-most populous state in the nation. Total population in the Columbus metro area is about 2.2 million, similar in size to Kansas City, Indianapolis, Las Vegas, and Nashville, markets that have had some successes in the SF BTR space.

Total employment in Columbus has traditionally grown at a pace of about 1.3 percent, with employers adding an average of about 15,000 net new jobs each year. In 2023, gains were stronger, with the local economy expanding by 19,400 jobs. The pace of growth has cooled in 2024, and only about 10,000 jobs have been added during the past 12 months.

White-collar industries account for a significant share of the local workforce. Professional and business services is one of the largest employment sectors in Columbus, accounting for about one-in-six jobs in the area, while financial activities totals another 8 percent. Prominent employers in these industries include JP Morgan Chase and Nationwide Insurance, which combine to have more than 30,000 workers throughout the market.

The Ohio State University is a prominent economic force in the region. Enrollment at the Columbus campus totals approximately 60,000 students, with a faculty of approximately 7,800 and more than 40,000 staff and student employees. The university's total annual economic impact on the region approaches $20 billion.

The local single-family build-to-rent landscape is dominated by two Ohio-based developers. Redwood Living has about a dozen projects totaling approximately 2,000 units throughout the Columbus region with a few additional developments slated to come online in the next few years.

Wilcox Communities is the other major operator in the local SF BTR space. The company has several existing properties totaling more than 1,450 units under its Residences brand, including about 600 units that have delivered year to date. Nearly 400 additional units are currently under construction. Wilcox markets its properties to "renters by choice," targeting active adults aged 50 and over.

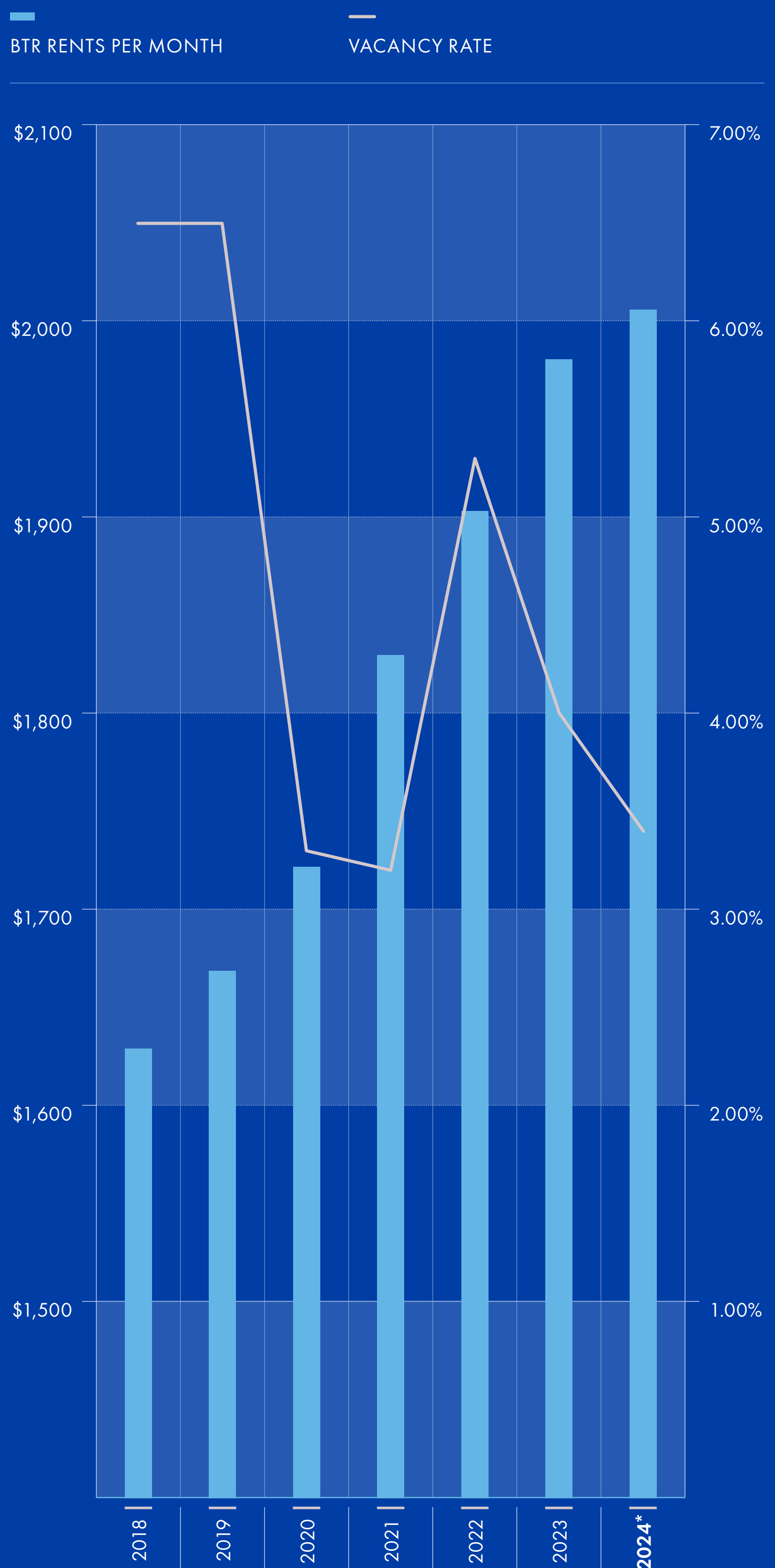
Single-family rental properties in the area perform well, with a vacancy rate that has ranged between 3.5 percent and 4.5 percent since the beginning of 2023. This is one of the lowest vacancy rates in the country for SF BTR communities. The market has benefitted from a fairly steady pace of new construction that has kept up with renter demand but not outpaced it.

Single-family rental properties in the area perform well, with a vacancy rate that has ranged between 3.5 percent and 4.5 percent since the beginning of 2023.

Additionally, new communities have been spread throughout the metro area, with a handful of properties located across Delaware County, Fairfield County, and Franklin County. With the market dominated by just a few local participants, these developers have not overbuilt new communities that would create significant competition for their own existing properties.

With supply and demand conditions closely aligned, operators have been able to command healthy rents. Rents for single-family build-to-rent communities topped $2,000 per month at the beginning of this year. Single-family rental communities are generating a significant rent premium over traditional apartment units in Columbus. Current rents for apartment properties average a bit under $1,400 per month, or $1.47 per square foot per month. Class A apartment rents average nearly $1,700 per month, about 15 percent lower than the average SF BTR rent in the Columbus area.

COLUMBUS BTR RENT AND VACANCY TRENDS



SOURCE: *Northmarq, CoStar, Yardi*

** Through 3Q 2024*

Current Treasury yields are about 80–115 basis points lower than levels from October 2023.

After an Extended Run of Elevated Rates, Cuts are on Deck.

Elevated interest rates have dragged on the capital markets and restricted activity during the past few years, but the outlook is brightening in the final few months of 2024. The Federal Reserve cut the Fed Funds rate by 50 basis points at its September 2024 meeting, the central bank's first interest rate cut since March 2020.

Additional rate cuts are anticipated through the remainder of this year and into 2025. At the beginning of this year, expectations were for the Fed to cut rates five or six times in 2024, with the total likely to reach approximately 150 basis points.

Instead, cuts started later in the year than originally anticipated. The current forecast calls for the Fed to still lower the Fed Funds rate into the mid-3 percent range, but that target may not be reached until the second half of 2025. While the stubbornly high interest rates dragged on lending markets for commercial real estate through much of 2024, additional cuts could provide a boost in the fourth quarter and into 2025.

TREASURY YIELDS DOWN ABOUT 100BPS FROM OCT. '23 PEAKS

While the Federal Reserve has just started its rate cutting program, the Treasury yields that often have the greatest influence on commercial real estate lending rates had been trending lower during the summer months. The yield on the 10-year Treasury dropped below 4 percent in early August and ended the third quarter at approximately 3.8 percent.

Yields on the 2-year Treasury ranged from between 4.8 percent to 5 percent during the second half of April and the beginning of May, but then posted significant declines. The yield on the 2-year Treasury ended the third quarter at about 3.65 percent. The steep declines in the yield on the 2-year note reflected the market expectation for additional declines across shorter-term maturities.

Some surprisingly strong economic data released at the beginning of the fourth quarter caused Treasury yields and mortgage rates to push higher. While the extended outlook still calls for declining yields, rates may remain volatile in the near term. Yields on both the 2-year and 10-year Treasury bonds rose about 50 basis points in early October.

The primary impact of interest rate declines in the commercial real estate sector will be more attractive pricing for borrowers. Current Treasury yields are about 80-115 basis points lower than levels from October 2023. Recent Treasury yields reached lows last recorded in September 2022, which was near the peak in the multifamily and build-to-rent investment market. Investors will likely respond favorably to the lower rates, although there will be a wait-and-see approach where some buyers may postpone taking action in anticipation of lower rates in 2025. Activity in real estate markets should build at a gradual pace.

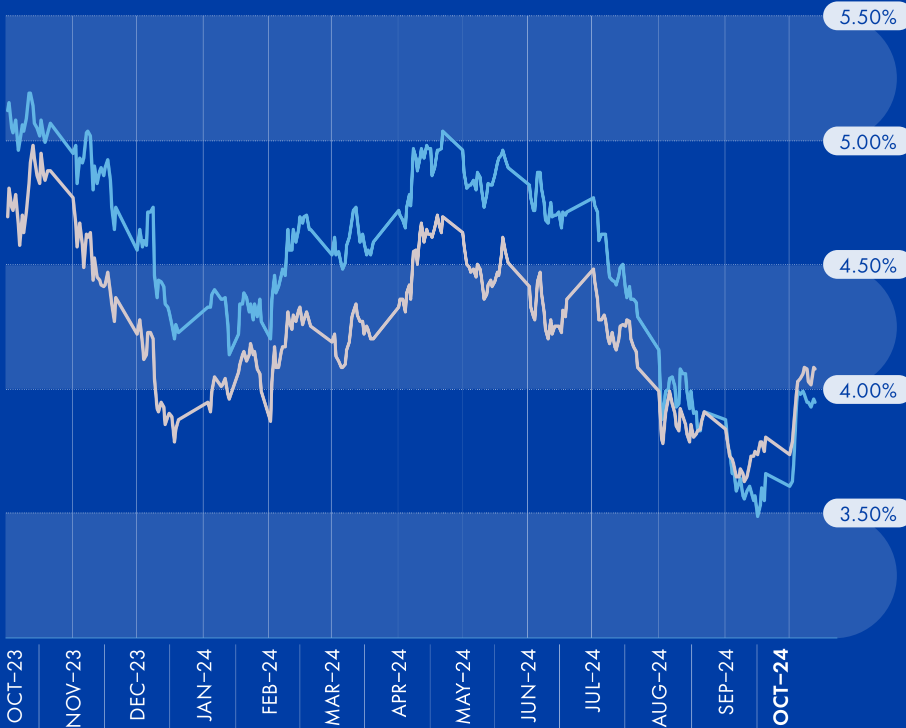
ACQUISITION FINANCING

Debt for acquisitions of single-family build-to-rent properties is fairly consistent. While pricing fluctuates, Fannie Mae and Freddie Mac continue to serve as the leading sources for investors acquiring SF BTR communities. The agencies are underwriting transactions with similar terms to new, Class A multifamily properties.

These trends are likely to remain in place through the remainder of this year and into 2025. Agency financing is expected to be the primary source of debt for acquisitions. Outside of the agencies, some lenders may choose to exercise continued caution, particularly across some of the faster-growth areas that will be impacted by supply-side pressures in the coming quarters.

The yield on the 10-year Treasury dropped below 4 percent in early August and ended the third quarter at approximately 3.80 percent.

RATES BEGINNING TO TREND LOWER



SOURCE: *Northmarq, U.S. Treasury*

CONSTRUCTION FINANCING

Debt financing for construction is going to continue to present challenges for developers looking for construction debt on new properties. Lenders are taking a conservative stance given the rapid supply growth occurring across a number of markets.

There has been an increase in bridge financing as an interim step as developers move from a project's construction loan before securing permanent financing. Developers are taking advantage of bridge fund options in anticipation of lower rates on permanent financing being available beginning in 2025.

EQUITY

With many equity sponsors perceiving oversupply as the primary threat in SF BTR markets, some new strategies are emerging. Equity investors are exploring options in markets that previously had not attracted as much attention. High-income submarkets within some of the faster-growing Midwest markets are being viewed more favorably than earlier in the cycle, when equity pursuits were concentrated in the Sunbelt.

Additionally, equity providers are favoring joint ventures with established home builders and operators where the deal structure can be replicated across projects in more than one market. This strategy is preferred because it is a way to efficiently allocate capital while not creating too large a position in any one local market.

In the near term, it is fair to assume that the sector will face a supply-demand imbalance across several markets.

A Mixed Outlook Prevails Heading into 2025.

OUTLOOK

The dominant themes in the economy will be some of the driving forces in the single-family build-to-rent property class in the coming quarters. In the latest real estate cycle, the sector has largely withstood the combined forces of inflation's impact on construction costs, rising interest rates, and accelerating supply growth.

Looking ahead, the pace of new development will remain elevated at least through 2025. Projects that have secured financing and have broken ground will continue to come online, increasing inventory levels—sharply in some markets—and creating greater competition for operators as well as more choices for renters.

While the construction pipeline offers a fairly clear picture of the supply-side forces that will impact the market in the coming quarters, aggregate demand is more challenging to forecast. The economy is showing signs of slowing, and while a soft landing is still the most likely economic outcome, recent data releases have highlighted uncertainty and volatility.

A period of declining interest rates should offer some relief to businesses and consumers, but single-family rentals compete with for-sale housing more than traditional apartments do. There is some evidence that a segment of the SF BTR renter pool has remained on the sidelines waiting for mortgage rates to drop from 20-year highs before entering the for-sale market. These current renters of single-family properties may turn into first-time home buyers in 2025, potentially softening the demand for SF BTR units.

While this possibility is noteworthy, all forms of rental housing consistently compete with for-sale options. Operators will adapt strategies to address the trends that will emerge over the next several quarters just as they have for generations.

In the near term, it is fair to assume that the sector will face a supply-demand imbalance across several markets. Vacancies will likely rise and rents are not expected to gain much momentum. Still, a healthy economy will drive new household formation, demographic trends support demand for single-family homes, and operators are becoming increasingly skilled at marketing properties to a large and expanding "renters by choice" subset of the population.

Taking a longer view of the sector, the outlook brightens. The supply-side pressures will likely ease within the next 18-24 months, as fewer projects break ground and move through the development pipeline. A strengthening for-sale market may drive traditional homebuilders to allocate more resources to building for-sale homes, allowing the single-family rental segment to return closer to equilibrium.

Additionally, much of the uncertainty that has dragged on decision making could lift by the end of 2024. For more than a year, the cost and sources of capital have been tougher to predict. The cost of debt has increased, lenders have become more selective, and borrowers have tried to determine how future rates might compare to current terms. Additionally, by the end of this year, another election cycle will have come and gone, and investors will likely have a clearer outlook on tax and regulatory policy stances, even if specifics will be unclear until 2025.

The single-family build-to-rent market will face challenges through the end of this year and into 2025, but the longer-term outlook remains bright. The sector has clearly proven its popularity with renters with elevated incomes. A handful of markets across high-growth regions of the country will encounter over-supply conditions, but this is also true in the traditional apartment market. And in a growing sector, supply-side pressures ultimately resolve themselves, as developers ease back on construction starts, favor projects with lower unit counts, and allow demand to catch up with supply. As these issues across capital markets, property operations, and the economy are worked through, the SF BTR sector will ultimately be positioned for the next phase in its expansion cycle.

Operators are becoming increasingly skilled at marketing properties to a large and expanding "renters by choice" subset of the population.

PROVEN RESULTS. EXCEPTIONAL OUTCOMES.

More Markets. More Transactions. More Experience.

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SF BUILD-TO-RENT TOTAL TRANSACTION VOLUME

+$1.7 Billion
SF BUILD-TO-RENT TOTAL SALES VOLUME

+$1.3 Billion
SF BUILD-TO-RENT TOTAL FINANCING VOLUME

150+
SF BTR TRANSACTIONS ACROSS THE US

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No commercial real estate company can match our experience or breadth of knowledge in the BTR business. During the past six years, we have devoted resources to industry-leading research, custom financial modeling, and cutting-edge marketing tailored specifically to the BTR product type.

These investments have yielded results. We have brokered and financed dozens of BTR transactions across the United States since 2018. Additionally, Northmarq has ranked among the industry's top tier of investment sales and debt and equity providers in each of the past five years.

Hampton Edison
151 Homes | Maricopa AZ
New Construction, Detached Garages

ON THE MARKET

Blackburn Ridge
102 Homes | Seminole OK
New Construction, Attached Garages

ON THE MARKET

Black Ridge Townhomes
142 Homes | Saint George UT
New Construction

ON THE MARKET

The Residences at Old Hawthorne
42 Homes | Columbia MO
Individual Parcels, Attached Garages

IN ESCROW

Townhomes at Bluebonnet Trails
114 Homes | Waxahachie TX
New Construction

IN ESCROW

Yardly Dechman
142 Homes | Grand Prairie TX
New Construction, Detached Garages

IN ESCROW

Yardly McDowell
167 Homes | Phoenix AZ
New Construction, Detached Garages

IN ESCROW

Harmony Landing
200 Homes | Raleigh NC
New Construction, Attached Garages

SALE

Southside Townhomes
188 Homes | Nampa ID
New Construction

SALE

Village of Chandler
109 Homes | Chandler AZ
New Construction, Detached Garages

SALE

Townhome Portfolio
Phoenix MSA
New Construction, Attached Garages

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EVR Spur Cross
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New Construction

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FOUNDED IN 1962

* Transactions from 2022-2023

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Based on strong values and integrity, our culture attracts the best minds in the industry. We empower our teams to put clients first and deliver creative and innovative solutions that drive value.

BUILD-TO-RENT ADVISORY GROUP

TREVOR KOSKOVICH
President
602.952.4040
INVESTMENT SALES

SHANNON HERSKER
Senior Vice President
602.952.4054
DEBT + EQUITY

JEFF ERXLEBEN
President
972.455.1934
DEBT + EQUITY

JESSE HUDSON
Regional Managing Director
602.952.4042
INVESTMENT SALES

TAYLOR SNODDY
Regional Managing Director
972.455.4928
INVESTMENT SALES

FARON THOMPSON
Regional Managing Director
678.954.4674
DEBT + EQUITY

SCOTT LAMONTAGNE
National Director, NDS
512.450.6820
INVESTMENT SALES

LUIS ELORZA
Managing Director
813.223.5207
INVESTMENT SALES

BRANDON HARRINGTON
Managing Director
602.508.2204
DEBT + EQUITY

ARI AZARBARZIN
Senior Vice President
410.296.0709
INVESTMENT SALES

JOHN CURRIN
Senior Vice President
704.595.4276
INVESTMENT SALES

ERIC STOCKLEY
Senior Vice President
972.322.9257
INVESTMENT SALES

PETER CHACON
Vice President
678.954.4662
INVESTMENT SALES

Northmarq

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OCTOBER 2024

FOR MORE INFORMATION, **PLEASE CONTACT**

TREVOR KOSKOVICH
President, Investment Sales
602.952.4040
tkoskovich@northmarq.com

JEFF ERXLEBEN
President, Debt + Equity
972.455.1934
jerxleben@northmarq.com

SHANNON HERSKER
BTR Leadership, Debt + Equity
602.952.4054
shersker@northmarq.com

PETE O'NEIL
Director of Research
602.508.2212
poneil@northmarq.com

REAL ESTATE EXPERTS WITH A NATIONAL REACH.

Northmarq is a full-service capital markets resource for commercial real estate investors, offering seamless collaboration with top experts in debt, equity, investment sales, loan servicing, and fund management. The company combines industry-leading capabilities with a flexible structure, enabling its national team of experienced professionals to create innovative solutions for clients. Northmarq's solid foundation and entrepreneurial approach have built a loan servicing portfolio of more than $76 billion and a two-year transaction volume of $52 billion. Through the 2022 acquisition of Stan Johnson Company, Northmarq established itself as a provider of opportunities across all major asset classes.

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