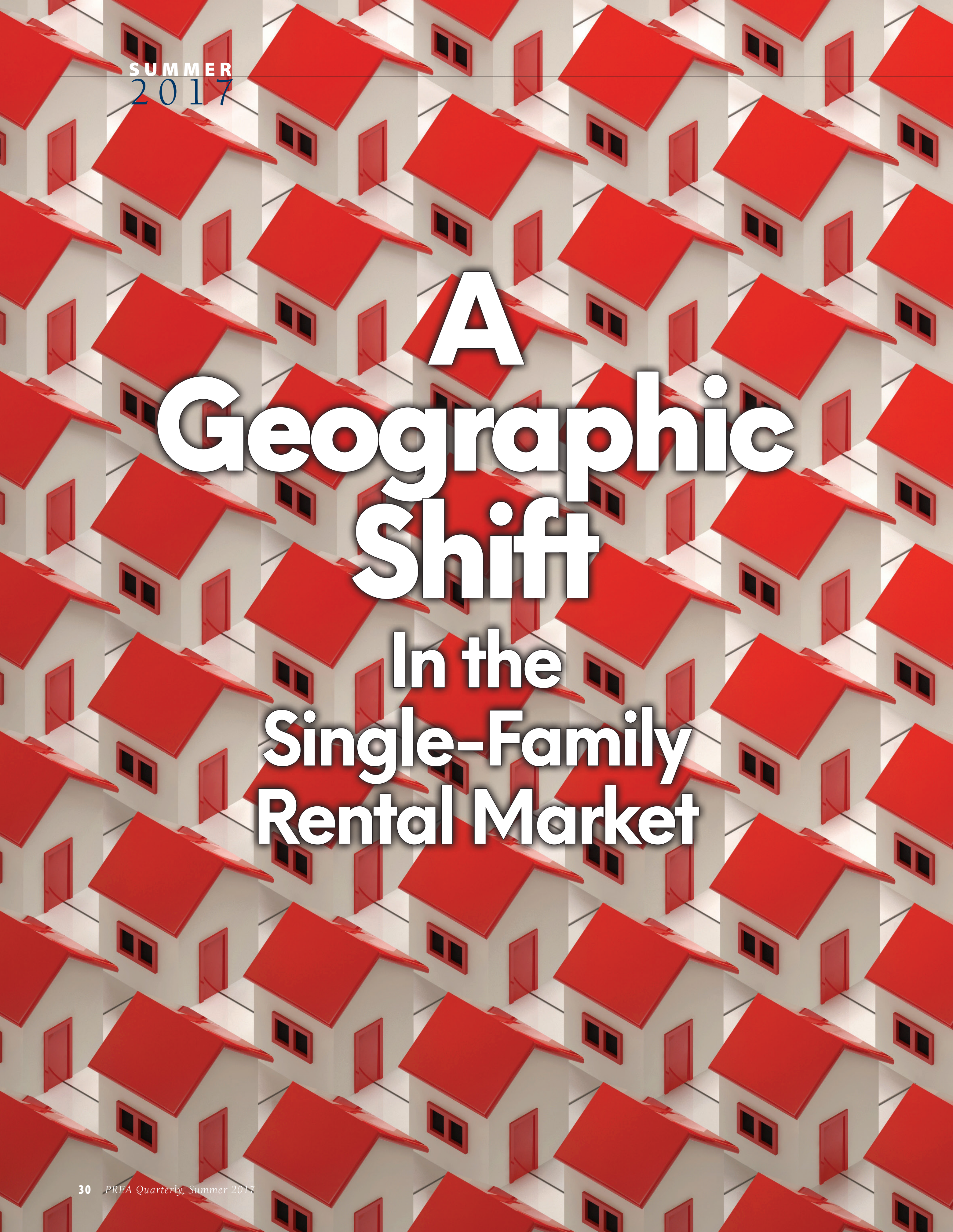

A Geographic Shift

In the Single-Family Rental Market

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An improving housing market, including sustained house price appreciation, has resulted in fewer distressed-buying opportunities for institutional investors and fewer single-family rental securitizations. Just one deal, a $336.2 million offering from Home Partners of America, has come to market this year. As institutional investors become more selective in their purchases, the geographical concentration of securitized properties has shifted from the southwestern US to the broader Southeast, including Florida and Texas. While California properties have experienced some of the highest rental increases among securitized collateral, the gains have been outpaced by increases in property values to such a degree that the state may no longer be a viable option for acquisitions by institutional investors. The purchasing shift is likely because of lower acquisition costs and more attractive yields in the Southeast. Future pools will depend on issuers' ability to buy assets and their ability or willingness to refinance existing pools of collateral or to pare assets to realize house price gains.

Exhibit 1: Single-Borrower, Single-Family Rental Securitization Issuance

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

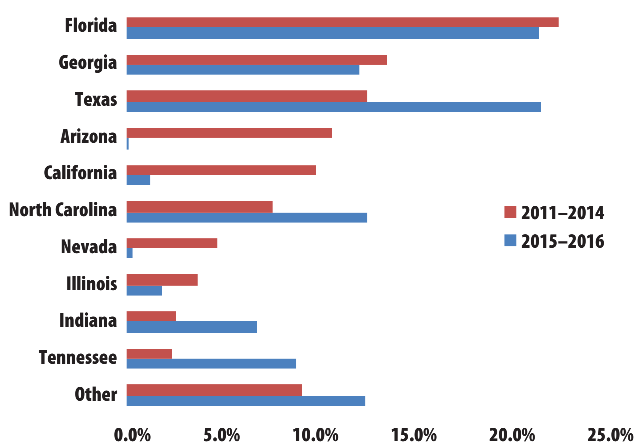
Source: Morningstar Credit Ratings, LLC

Exhibit 2: Top States by Acquisition Year

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

Source: Morningstar Credit Ratings, LLC

Exhibit 3: Percentage by Count from Top States, Grouped by Acquisition Years



Source: Morningstar Credit Ratings, LLC

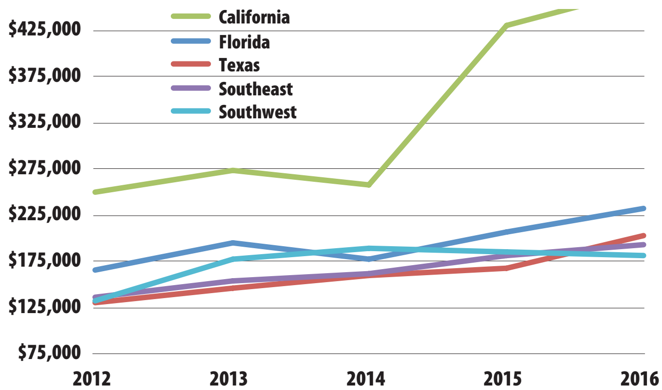
Issuance of single-borrower, single-family rental securitizations, which tops $17 billion, peaked in 2014. These transactions are considered a hybrid of commercial mortgage-backed securities, specifically those backed by multifamily collateral, and residential mortgage-backed securities. The rental streams from these properties support the monthly payments to bondholders, while the value of a property is expected to cover the ultimate principal balance. Exhibit 1 summarizes single-borrower issuance since the first securitization, a $479.1 million deal from Dallas-based Invitation Homes, came to market nearly four years ago.

Exhibit 2 illustrates the higher volume of purchases from 2012 through 2014 by displaying the number of properties acquired each year for the top states in single-family rental securitizations, with refinanced properties removed to avoid double counting. Securitized acquisitions dropped 65.6% in 2016 compared with 2015. Exhibit 2 also shows the geographic shift, where property purchases in California, Arizona, and Nevada were more prevalent in 2012–2013, while Texas, North Carolina, Tennessee, and even Indiana had more institutional acquisitions from 2014 to 2015. Florida has been among the top states for acquisitions since 2012.

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

With housing prices generally appreciating since 2012, institutional investors must strike a balance between acquisition costs and rents, as well as future rent growth and price appreciation expectations. With higher prices, issuers have pivoted to more-targeted property acquisition strategies. As purchase prices have recovered, these newer targeted purchases have required less up-front renovation, evidenced by declining rehabilitation costs. Lower initial rehabilitation costs may also be partly explained by institutional investors' improving their operational efficiencies. Despite lower rehabilitation costs, the total cost to purchase homes is higher for more-recently acquired properties, as shown in Exhibit 4. The Southeast includes Alabama, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia properties; the Southwest includes Arizona and Nevada properties.

Exhibit 4: Average Total Cost Basis



Source: Morningstar Credit Ratings, LLC

In addition to acquisition costs, institutional investors consider yield when acquiring properties. Exhibit 5 reflects an institutional investor's yield expectation at the time of acquisition as measured by the underwritten rent at cutoff over the total cost basis at cutoff. Gross yields have fallen across the top 20 metropolitan statistical areas (MSAs) in single-borrower, single-family rental deals. However, double-digit or near-double-digit yields are still available in the MSAs that have seen more representation in recent securitized pools: Texas, Tennessee, Indiana, and North Carolina. Atlanta and most Florida MSAs have sustained higher gross yields, though Fort Lauderdale and Orlando have dipped below 9%. In contrast, the gross yields in California MSAs are among the lowest. Issuers consider rental growth and price appreciation expectations when acquiring properties, and the last column in Exhibit 5 identifies the MSAs where higher gross yields may be attainable. It measures gross yield

Exhibit 5: Gross Yield Percentage for Top 20 MSAs

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

Source: Morningstar Credit Ratings, LLC

Exhibit 6: Net Yield Percentage for Top 20 MSAs

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

Source: Morningstar Credit Ratings, LLC

as the current rent over a broker's price opinion (BPO) values adjusted by the CoreLogic HPI. These gross yields based on current market conditions imply that the gains in rents and home values have been more balanced in Texas and the broader Southeast, thereby making them candidates for future investment opportunities. Meanwhile, the housing value gains for California properties have outpaced their rental increases to the point where gross yields in the Los Angeles, Riverside–San Bernardino, and Sacramento MSAs are the lowest among the top 20 MSAs tracked in Exhibit 5. As a result, California is likely not an attractive option for future acquisitions.

In weighing investment properties to purchase, institutional investors also consider net yield, as taxes and other expenses vary by location. Exhibit 6 measures net yield as the annual gross revenue at cutoff minus issuer-underwritten vacancy, expense, and capital expenditure assumptions, divided by the total cost basis at cutoff. A similar trend is seen based on net yield, where MSAs in Tennessee, Texas, North Carolina, and Indiana are typically higher.

Morningstar has rated all 32 single-borrower, single-family rental transactions brought to market since 2013, seven multi-borrower transactions, and one deal backed by residential rental mortgages. Of the 32 single-borrower transactions, seven, including Invitation Homes's inaugural deal, have either been paid off or been refinanced into new securitizations. Every deal has performed within Morningstar's expectations. The average vacancy rate among single-borrower deals stood at 4.3% in May; delinquency rates are hovering near or below 1%, and the average retention rate rose for the fourth straight month in March, the latest period available, holding near 80%. Because of sustained house price appreciation, when issuers refinance existing properties into new deals, they can borrow against these gains. Thus, previously acquired California, Arizona, and Nevada properties may play a part in future issuance. However, these house price increases can also drive institutional investors to sell properties to monetize these gains. Properties sold in higher-cost areas will likely not be replaced by properties in the same region because yield expectations changed over time.

In the absence of large-scale distressed-buying opportunities, the future geographic makeup of single-family rental transactions will depend on how successfully issuers can selectively add properties in markets. Institutional investors may choose to leave regions where the economics are no longer optimal or where they choose to sell properties to book profits. ■

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