Diversifying With Picket Fences

Single-Family Rental Investments

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We believe investors should give greater consideration to including a single-family rental allocation in their portfolios for four reasons. Firstly, long-term macro and demographic factors leading to record high demand and low supply stand to benefit SFR over the coming years, with returns driven by both home price appreciation and rental income growth. Secondly, SFR provides an uncorrelated return stream not only when compared with other real estate sectors, but also when compared to other asset classes including stocks and bonds. Thirdly, SFR provides the opportunity to invest with experienced institutional investors that can build broadly diversified portfolios of rental homes across multiple US geographies. And last but not least, SFR rents and home prices have grown quicker than inflation over the past 30 years and may therefore provide a degree of protection during inflationary times.

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Investors' questions generally focus on similar themes: will this investment make good risk-adjusted returns and how does it fit into my portfolio? This article seeks to answer the latter question, explaining how single-family rental housing ('SFR') fits into a portfolio.

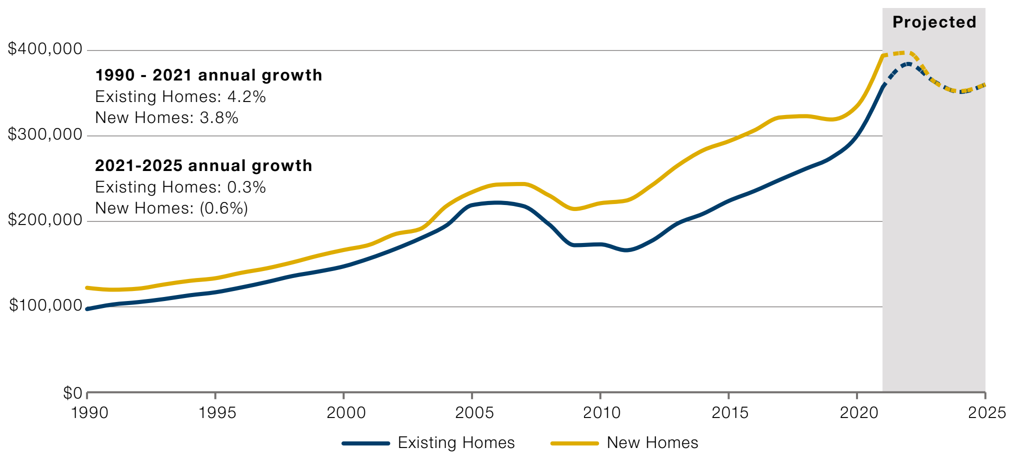
In a nutshell, we believe investors should give greater consideration to including an SFR allocation in their portfolios for four reasons. Firstly, long-term macro and demographic factors leading to record high demand and low supply stand to benefit SFR over the coming years, with returns driven by both home price appreciation and rental income growth. Secondly, SFR provides an uncorrelated return stream not only when compared with other real estate sectors, but also when compared to other asset classes including stocks and bonds. Thirdly, SFR provides the opportunity to invest with experienced institutional investors that can build broadly diversified portfolios of rental homes across multiple US geographies, targeting the most attractive locations. Last but not least, SFR rents and home prices have grown quicker than inflation over the past 30 years and may therefore provide a degree of protection during inflationary times.

Macro Factors Driving SFR returns

Secular shifts that have been underway for almost a decade have accelerated during the coronavirus pandemic and are expected to continue for the foreseeable future. With the enforcement of regulation to curb the spread of the virus, physical retail was forced to give further ground to online. Similarly, demand for office space and urban apartments in multi-family buildings softened, as populations adapted to the ongoing change.

In the midst of all this change, SFR has been a bright spot. Americans continued to leave the urban core for the greater space offered by SFR in the suburbs. A key component of long-term returns for the asset class – home price appreciation and rental income growth – has continued to climb, and indeed accelerated throughout the pandemic (Figure 1).

Figure 1. US Median Sales Price



Source: National Association of Realtors as of March 2022, US Census Bureau as of March 2022, John Burns Real Estate Consulting; as of July 2022.

It is worth stating that the coronavirus is not the only reason for this appreciation: long before the pandemic, the growing cohort of millennials provided a **demographic tailwind to the asset class**. Some 68.8 million Americans are between 20-34 years old, an age group which are likely to buy or rent SFR as they look to get married and have children.

> A compelling reason to add SFR to a portfolio is the diversification benefits it provides.

Correlation to Other Real Estate Sectors

While performance has been positive, a potentially even more compelling reason to add SFR to a portfolio is the diversification benefits it provides.

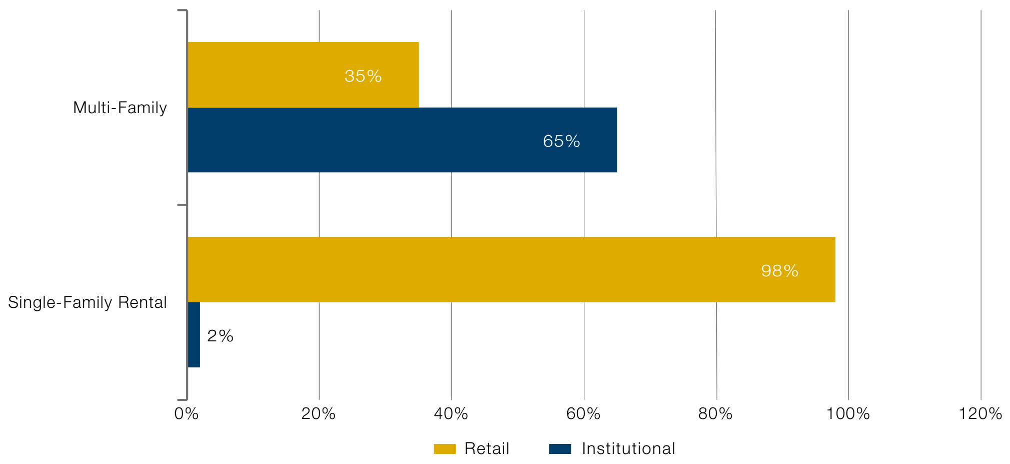
SFR is the only real estate sector that is not correlated to the other core real estate sectors (Figure 2). This is driven in part by the fragmented ownership of SFR: just 2% of SFR is owned by institutional investors, with the remainder owned by retail investors – usually a small landlord with no more than one or two properties (Figure 3). This has a tendency to benefit SFR, as the absence of large flows of institutional money leads to a differentiated return stream compared to other real estate assets: SFR prices are driven by the availability of credit to homeowners and smaller landlords, as well as demand from families looking to live in such homes.

Figure 2. Correlation Matrix – SFR Versus Other Real Estate

	Single-Family Rental	Multi-Family	Commercial Real Estate	Office	Retail	Industrial
Single-Family Rental	1.00	0.48	0.51	0.44	0.50	0.51
Multi-Family		1.00	0.93	0.83	0.79	0.82
Commercial Real Estate			1.00	0.91	0.90	0.88
Office				1.00	0.81	0.77
Retail					1.00	0.78
Industrial						1.00

Source: Bloomberg; between January 2001 and March 2022.

Figure 3. SFR Rents and Prices Versus Inflation



Source: National Association of Realtors, as of March 2022; US FOMC and Federal Reserve Bank of St Louis, as of June 2022; John Burns Real Estate Consulting, as of July 2022.

Geographic Diversification

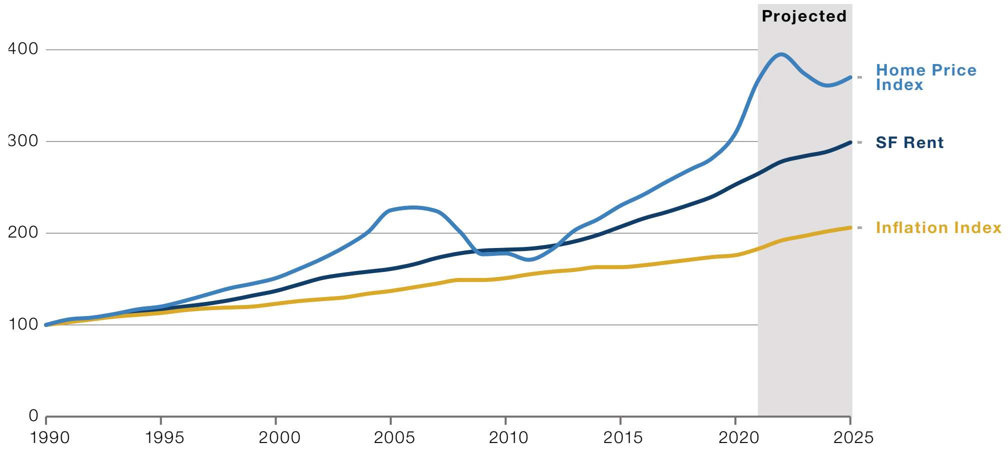
Importantly, at around USD30 trillion, the depth of the US housing market allows investors to pick and choose their locations, providing the additional protection of a geographically diverse portfolio. Not all US housing markets are alike: growing cities in the South and West, such as Atlanta, Charlotte, Houston and Las Vegas, have very different dynamics to more established areas, such as New York or Chicago. Being able to invest in a large number of growing or established markets allows experienced institutional SFR investors to diversify their portfolio against regional downturns, selecting those cities with both growing housing demand and attractive pricing.

SFR has historically provided a degree of protection during inflationary times.

Diversification Into a New Inflation Regime

Finally, it is worth noting that SFR has historically provided a degree of protection during inflationary times. The existing supply and demand imbalance detailed above has already led to a situation where home prices and rents have risen quicker than general inflation over the last 30 years (Figure 4), with forecasts that this trend is set to continue.

Figure 4. SFR Rents and Prices Versus Inflation



Source: National Association of Realtors, as of March 2022; US FOMC and Federal Reserve Bank of St Louis, as of June 2022; John Burns Real Estate Consulting, as of July 2022.

Conclusion

We believe investors should give greater consideration to including an SFR allocation in their portfolios for four reasons. Firstly, long-term macro and demographic factors leading to record high demand and low supply stand to benefit SFR over the coming years, with returns driven by both home price appreciation and rental income growth. Secondly, SFR provides an uncorrelated return stream not only when compared with other real estate sectors, but also when compared to other asset classes including stocks and bonds. Thirdly, SFR provides the opportunity to invest with experienced institutional investors that can build broadly diversified portfolios of rental homes across multiple US geographies, targeting the most attractive locations. Last but not least, SFR rents and home prices have grown quicker than inflation over the past 30 years and may therefore provide a degree of protection during inflationary times.

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