THE CASE FOR US SINGLE-FAMILY RENTALS IN AN INSTITUTIONAL REAL ESTATE PORTFOLIO

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EXECUTIVE SUMMARY

Single-family rentals comprise the largest real estate sector in the US in terms of market value at over $3 trillion. However, surprisingly to us, large, institutional capital represents a relatively low proportion of the sector today. We believe that the asset class should be more widely considered by institutional investors, as we believe it is attractively valued from both an absolute and relative value perspective. Additionally, we feel the current market backdrop is favorably positioned, such that the assets have the potential to generate stable income and capital gains, while providing institutional investors further diversification within their real estate portfolios.

WHY SINGLE-FAMILY RENTALS?

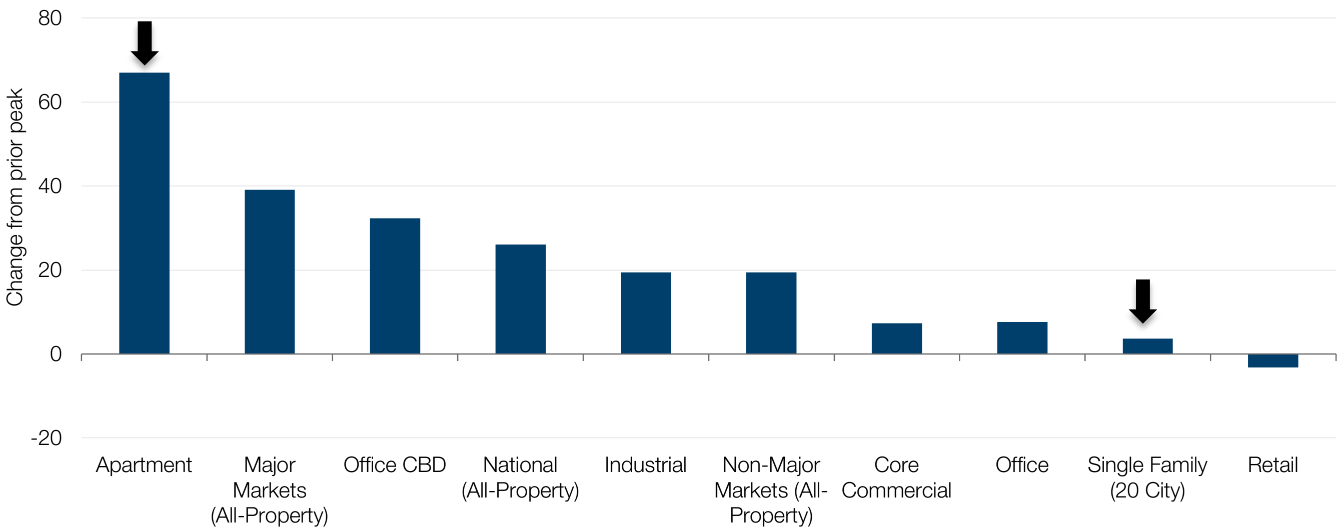
- The largest US real estate sector with low institutional participation[1]
- Attractive relative and absolute value in our view
- Offers potential for stable current income, inflation protection, and capital gains
- May offer diversification benefits
- More liquid than other private market asset classes

WHY WE BELIEVE US SINGLE-FAMILY RENTALS IS AN ATTRACTIVE PLACE TO INVEST

Ten years after the burst of the housing bubble, it might feel to some as if it never happened. Certain real estate assets once again appear fully priced, with average capital values for residential multi-family properties (apartment buildings) now roughly 67% above 2007 highs across the US.[2] That's not to say, though, that US real estate is merely re-treading old ground. As the $11.2bn merger between Blackstone and Starwood's residential single-family rental businesses demonstrated,[3] residential real estate investment in the US is undergoing a period of dramatic change in our view. We believe the "institutionalization" of the single-family housing market is a major long-term trend which has only just begun, and presents a compelling potential opportunity for early movers in the space.

Since the Financial Crisis, the recovery in the single-family residential market (detached stand-alone houses) has significantly lagged the multi-family apartment sector, as shown in Figure 1. This reflects a fundamental difference between the two markets and we believe highlights the current attractive relative value of single-family residential as a sector. This dynamic is similarly expressed in Figure 2 where the widening valuation gap between single-family and multi-family is clearer, and we believe that the former is relatively affordable and presents attractive fundamental value to investors.

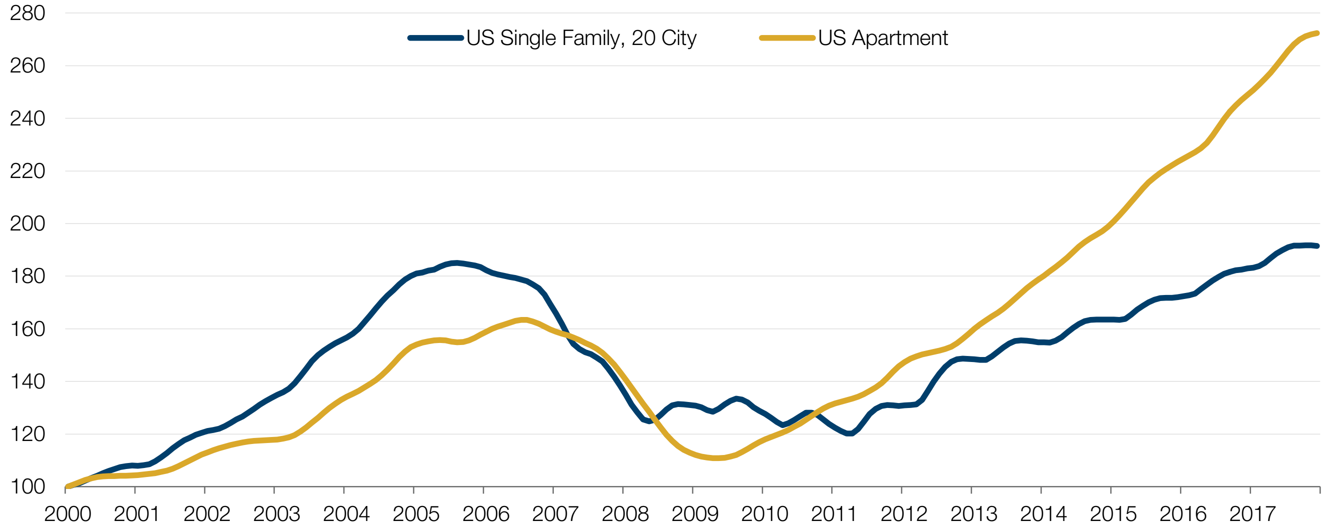
Figure 1. US real estate current capital values relative to peak values in last cycle



Source: Morgan Stanley Research, January 2019.

1. Source: Morgan Stanley Research, February 2018 and John Burns, August 2018.
2. Morgan Stanley Research, January 2019.
3. Source: Widely reported across media outlets in August 2017. Example: Bloomberg, 10 August 2017 – article here.

Figure 2. US residential versus multi-family apartment capital values



Source: Bloomberg, November 2018

We believe the scale of the US single-family market and the composition of the existing investor base are other important factors to consider in framing the potential opportunity. The United States has nearly 16 million[4] single-family homes which are rented to tenants rather than owner-occupied. The total capital value of these rental properties is in excess of $3 trillion, a number that dwarfs the US office market at $1.9 trillion or the US multi-family market at $2.1 trillion.[5] The US housing market also has a high volume of transactions, with 5 million existing single-family home sales in 2018.[6] This scale is increasingly drawing the attention of institutional investors seeking to diversify away from other real estate sectors.

While office and apartment buildings have long been considered an institutional asset class, less than 2% of the 16 million single-family rental properties in the US are currently owned by institutional investors.[7] Several decades ago, the multi-family rental market was similarly dominated by private landlords. As this market became more institutionalized, values became increasingly driven by investor capital flows, the search for incremental yield, and a desire to diversify away from publicly traded securities or other real estate sectors. Institutional investment managers entered the multi-family space, which allowed large ticket capital allocations and the post-crash recovery to take place more quickly. As the single-family rental sector continues to institutionalize, we believe the drivers that supported richer valuations for multi-family real estate during the recovery may similarly come into effect. Furthermore, we believe that once the market has fully recovered, US single-family properties may trade at a significantly lower cap rate (i.e. higher valuation multiple) than multi-family properties – where cap rates typically range between 4-6%[8] – in line with other owner occupier-dominated residential markets, both in the US and internationally.

Trends in US home ownership: rent vs. buy

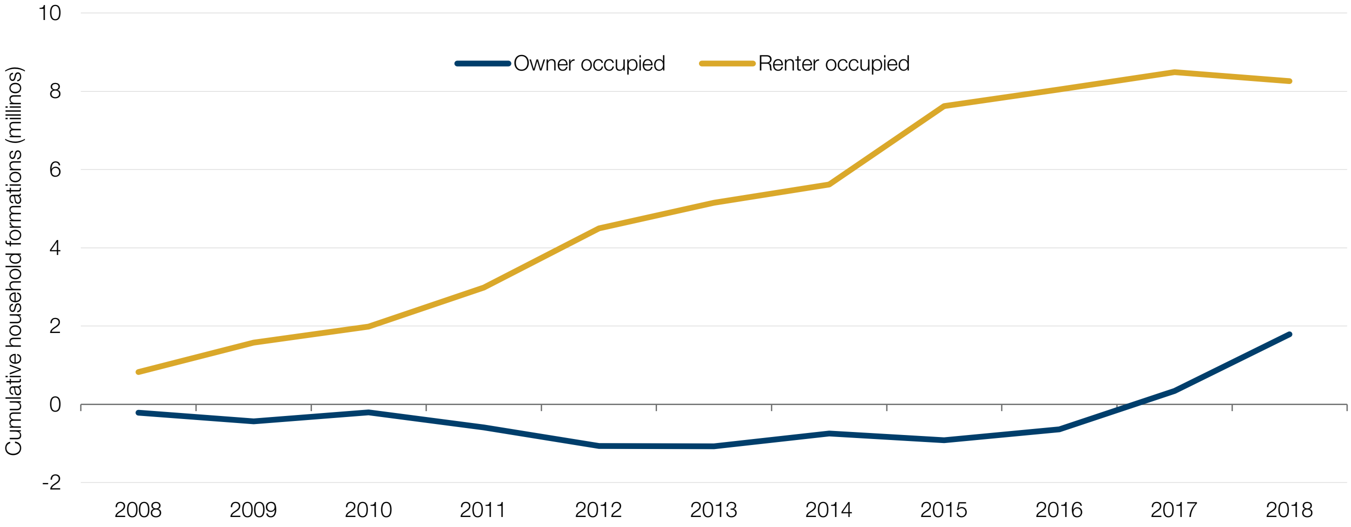
When looking at the dynamics of the single-family housing market, we also consider the potentially shifting trends of home ownership in the US in the wake of the financial crisis. At around 64%, home ownership in the US is amongst the highest in the developed world.[9] While owning your own property has historically been associated with economic prosperity and the “American dream,” renting needn’t only be the preserve of those economically locked out of home ownership. For example, within our current rental portfolios, the average tenant’s household income is approximately $100,000 per annum and compares favorably to average monthly rent of $1,600 (or $19,200 per annum).[10]

Many US Millennials (born since 1980) have a different view of home ownership to their parents’ generation. Millennials witnessed the price falls of the financial crisis, and may therefore be more comfortable with the idea of renting and the optionality it offers. Throughout the financial crisis and the recovery to date, the number of owner-occupied households has remained largely stable, while rental households have increased by 8 million (Figure 3).

All of this is not to say that there isn’t still a strong bid for property assets from individuals. Unlike the pre-financial crisis housing market, the residential market has been on an upward trajectory because of supply and demand dynamics, rather than credit. It’s a matter of market fundamentals as opposed to speculation in our view.

4. Source: John Burns, August 2018. **5.** Source: Morgan Stanley Research, February 2018. **6.** Source: National Association of Realtors, December 2018.
7. Source: John Burns, August 2018. **8.** CBRE Cap Rate Survey, January 2019. **9.** US Census Bureau, October 2018. **10.** As of December 31, 2018

Figure 3. Change in household formations from 2007



Source: US Census Bureau, October 2018.

Attractive Supply/Demand Dynamics

Last year there were 1.3 million total 'household formations' in the US – 25% above the long-term average.[11] In a recent research note, Morgan Stanley said that they expect this trend to continue for at least the next 5 years driven by long-term demographic trends.[12] Household debt-to-GDP has fallen significantly since the Financial Crisis, with consumers reducing both secured and unsecured debt. US economic indicators are robust, housing affordability metrics are more favorable to the consumer than they have been for some time and demand for housing currently outstrips supply, which as depicted in Figure 4, is at depressed levels.

Figure 4. Inventories of homes for sale are at 16-year lows

Source: Existing home sales inventories, National Association of Realtors, December 2018.

WHY WE FEEL A SINGLE-FAMILY RENTAL ALLOCATION MAKES SENSE WITHIN A WIDER REAL ESTATE PORTFOLIO

Institutional investors in real estate have historically allocated to commercial real estate sectors, which include office, industrial, retail, and logistics. The underlying fundamental drivers of these sectors are largely linked to the corporate business cycle, whereas the value and rental yield potential of US single-family homes are driven by the health of US consumers more broadly. This difference in fundamental drivers creates the potential for enhanced portfolio diversification for investors who add US single-family rentals to their real estate portfolios, including those benchmarked to the NCREIF property indices. Single-family homes have exhibited:[13]

- Only moderate correlation to other real estate sectors (43-54%) while other real estate sectors are highly correlated to each other (81-95%)
- Low correlation to stocks
- Negative correlation with bonds

11. US Census Bureau, Current Population Survey. **12.** Source: Morgan Stanley, "Bringing it Back Home", March 2017. **13.** Bloomberg as at 30 April 2018. Return series from Dec 2000 – April 2018. Price Indices: Single Family Residential (Case Shiller all US), CRE all (RCA CPPI Composite Indices National All Property), Multifamily (RCA CPPI Composite Indices Apartment), Office (RCA CPPI Composite Indices Office), Retail (RCA CPPI Composite Indices Retail), Industrial (RCA CPPI Composite Indices Industrial), S&P 500 (price return), Barclays US Agg (total return).

Figure 5. Single-family homes have exhibited relatively low correlation to other real estate sectors

Sector	Single Family	CRE	Multifamily	Office	Retail	Industrial	S&P 500	Barclays US Agg
Single Family	100%	48%	43%	44%	54%	43%	10%	-7%
CRE		100%	94%	95%	93%	88%	10%	-12%
Multifamily			100%	83%	81%	75%	8%	-10%
Office				100%	87%	85%	9%	-13%
Retail					100%	82%	11%	-9%
Industrial						100%	6%	-14%
S&P 500							100%	-11%
Barclays US Agg								100%

An examination of the correlation between single-family and multifamily assets over time (3-year rolling periods) additionally demonstrates that the relationship between these two sectors has diverged, particularly since the Global Financial Crisis.[14]

Figure 6. The relationship between single-family and multifamily assets has not remained constant

Further, single-family homes have exhibited lower volatility than other real estate assets, and traditional asset classes, despite the US experiencing the deepest nationwide housing crisis in history.[15]

The below annualized volatility figures are based on returns from Dec 2000 – April 2018:

Figure 7. Single-family homes have exhibited relatively low volatility

	Single Family	CRE	Multifamily	Office	Retail	Industrial	S&P 500	Barclays US Agg
Annualised Volatility:	2.84%	2.88%	3.00%	3.22%	2.84%	2.94%	14.32%	3.43%

CONCLUSION

As the challenge of delivering returns across asset classes remains at the forefront of institutional investor concerns, we believe that allocating to US single-family rentals could prove an attractive course of action. Institutional investors are yet to broadly embrace the sector within their real estate portfolios and by engaging with the opportunity now, we believe that relatively early-movers will be best positioned to benefit from the favorable outlook for the asset class.

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Mikko Syrjänen is Co-Head of Real Assets at Man GPM and a member of the Man Group Executive Committee. He is a co-founder of Man GPM Aalto (previously Aalto Invest), which was acquired by Man Group in 2017, where he held the role of Chief Executive Officer, with particular responsibility for real estate debt, including loan sourcing, underwriting and portfolio construction. Before co-founding Man GPM Aalto in 2010, Mikko co-headed Cheyne Capital's team responsible for real estate debt investments and illiquid alternative strategies. Prior to this, he was a vice president in Morgan Stanley's Investment Banking Division in London. Mikko holds a Master's Degree in Finance from the Helsinki School of Economics.

14. Source: Bloomberg as at 30 April 2018. Return series from Dec 2000 – April 2018. Price Indices: Single Family Residential (Case Shiller all US), Multifamily (RCA CPPI Composite Indices Apartment), correlation of monthly returns over rolling 3-year periods **15.** Source: Monthly return series from Dec 2000 – April 2018 - volatility is annualised. Indices: Single Family Residential (Case Shiller all US), CRE all (RCA CPPI Composite Indices National All Property), Multifamily (RCA CPPI Composite Indices Apartment), Office (RCA CPPI Composite Indices Office), Retail (RCA CPPI Composite Indices Retail), Industrial (RCA CPPI Composite Indices Industrial), S&P 500, Barclays US agg.

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