

PRIVATE CAPITAL

Residential Credit

Single-Family Rental Loans

After approximately one decade of consistent growth of the institutional single-family rental (SFR) market, investor interest in the sector seems have increased since the onset of the pandemic. Rising rental rates and high occupancy rates resulted in strong performance for SFR over the last two years. Institutional investors have reacted by allocating significant equity dollars to the SFR sector. MetLife Investment Management (MIM) has identified over \$30B¹ in announced institutional equity capital commitments to SFR over the last 18 months. Total equity invested including unannounced commitments is likely much higher.

Despite the growing appetite, institutional equity ownership in SFR today is still estimated at only around 2%². MIM believes that institutional SFR ownership is likely to grow significantly over the next decade. As a point of reference, while individual investors continue to own a significant majority of single-family rentals, only 14% of multifamily units today are owned by individuals.³ MIM expects that single family rentals will trend toward the multifamily ownership model with institutional owners taking an ever growing piece of the SFR market.

Increased equity investment in the sector will also likely drive a need for significant growth of the institutional debt financing market. MIM's analysis indicates that simply moving institutional ownership of SFR from 2% today to 10% in the future will result in a need for over \$200B in incremental debt financing.

| Institutional SFR Market Share | 2% | 5% | 10% |
|-----------------------------------|-----------|-----------|-----------|
| Number of Homes (millions) | 15.6 | 15.6 | 15.6 |
| Average Home Value | \$225,000 | \$225,000 | \$225,000 |
| Estimated Market Value (millions) | \$70,092 | \$175,230 | \$350,460 |
| SFR Debt Market (millions) | \$48,000 | \$120,000 | \$240,000 |

Institutional growth from 2% to 10% will result in almost \$200B of incremental debt financing needs.

Similar to commercial mortgage sectors, we believe debt funding gap will be filled with a mix of bank lending, securitization funding and the growing use of bi-lateral term lending in the SFR market. Direct term loan financing is likely to be a key piece of this overall financing puzzle. Institutional lenders positioned to participate in this market are likely to see opportunities for attractive deal terms as MIM believes competition in the SFR direct lending space remains more limited than many other lending categories. The rise of SFR lending also presents an opportunity for commercial loan investors to diversify into a new lending category that may be less correlated to other commercial mortgage sectors as well. For example, life insurers today hold almost \$600B⁴ of commercial and multi-family mortgages on their balance sheets and MIM estimates less than \$10B in SFR mortgages.⁵

The increased need for debt financing in a relatively nascent market will require investors to understand how direct, bi-lateral SFR term loans are underwritten and what aspects are most important. MIM underwrote our first direct SFR loan in 2016 and we believe is well-positioned to assist investors in understanding the SFR direct loan market. MIM has helped meet the financing needs of 19 different issuers and provided over \$4.0B in financing. This meaningful underwriting history helps MIM provide perspectives into how investors can evaluate risk and opportunity in the sector.

Single Family Rental Debt – Underwriting Fundamentals

MIM believes there are four key aspects of underwriting SFR debt. In the section below, we provide a high-level summary of what MIM considers important in these four areas.

Single-Family Rental Asset Manager

We believe Investors should first understand the asset manager's strategy and experience. At MIM, we focus on developing a deep understanding of how an asset manager acquires and manages properties as well as ultimately if and how they plan to exit the investment. This starts with a review

of the experience and track record of the company's management team. How extensive is the team's experience in SFR or in multifamily more broadly? How long has the team worked together? We seek to evaluate management's historical performance and compare this performance to other managers and strategies in the market. Does management's articulated strategy match the portfolio composition? How is the Property Manager integrated into the business and is this aligned with the broader strategy of the asset manager? Finally, we feel investors need to evaluate the equity strength of the owner and ensure a meaningful financial commitment to the business.

Property Manager

MIM believes understanding the property manager's operations is just as important as understanding the asset management approach. Does the owner utilize external property manager(s) or internal property management teams? What is the property manager's experience and track record in the SFR sector? An in-depth review of the property manager's operations is performed to understand whether staffing is centralized or dispersed, the property manager's scale in the asset manager's target markets, and how operational functions are managed and monitored (i.e., renovation, lease up/marketing, tenant screening, rent collection, repairs & maintenance). A review of the technology used by the property manager is performed to assess where technology is utilized across the operation and how it streamlines different areas of the business to optimize operational efficiency. During COVID, we feel additional attention should be given to understanding the property manager's eviction procedures for delinquent tenants and their processes for ensuring adherence to all local, state, and federal rules and regulation. When possible, on-site reviews of a property manager can generate significant insights into the platform and we believe are invaluable to a deeper underwriting of the property manager.



Collateral

The secured nature of the lending, often in a bankruptcy remote vehicle, means the loan collateral may be the most important aspect of a loan. At MIM, we feel geographical diversity is a primary risk mitigation factor for SFR loans. With greater geographical diversification comes a lower probability of idiosyncratic risk to any one city or neighborhood. We also evaluate average property values, age of the homes, and the size and condition of homes. What renovations occurred at acquisition of the property or are projected to occur in the future? We consider the markets targeted by the asset manager - the projected demographic trends, forecasted home price appreciation, and affordability of living in those areas. Our analysis includes a review of the asset manager's underwritten operations and additional MIM developed stress scenarios to try and determine downside protection for our loan. Finally, we analyze gross yields, net yields and NOI margins under both benign and stress scenarios.

Structure

Loan structures can vary significantly based on a borrower's need and the comfort of the lender with requested term accommodations. The legal structure of SFR loans often consists of an equity pledge of the equity owner's interest in the special purpose vehicle that is the legal borrower. Depending on the borrower and structure, mortgages on the underlying properties may be recorded at the time the loan is originated or may be "springing" mortgages that are required if performance on the assets begins to deteriorate. Generally, borrowers are looking for terms between 2 and 10 years with most loans between 5 and 7 years. Many of the term loans we evaluate are fixed rate but we will consider and have closed floating rate loans as well. Prepayment protection often exists for most of the loan term with the final one or two years of the term open for prepayment without penalty. MIM generally lends between 60% and 75% of the property value based on the collection of underwriting factors that we consider.

Lenders are also asked to consider a range of loan accommodations that often increase the loan spread the borrower is willing to pay. These potential accommodations include:

- Interest only terms
- Delayed draw structures that reduce future borrowing risk and complexity for the borrower
- Substitution options that enable borrowers to manage their portfolio strategy while maintaining DSCR and LTV limits

Loan Pricing

Based on our review of the underwriting factors described above, MIM will assess what we believe the right pricing on the loan should be and work with the borrower to come to terms. MIM believes that SFR loans offer strong relative value in today's market along with an opportunity to diversify both portfolio and commercial mortgage exposures in a new asset sector.

Endnotes

- ¹ John Burns Real Estate Consulting, Investor and Capital Transactions October 2021.
- ² National Rental Home Council.
- ³ *America's Rental Housing, 2020*. Joint Center for Housing Studies of Harvard University.
- ⁴ 1Q21 Fed Flow of Funds data tables L.219, L.220.
- ⁵ Based on MetLife Investment Management's knowledge of the overall market for SFR lending.

Authors



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Scott Waterstredt leads the alternatives, sustainable investment strategies (SIS), Private Structured Credit and residential whole loans teams at MetLife Investment Management (MIM).

Scott joined MetLife in 2009 and previously co-led MIM's structured finance group focusing on trading and residential credit. Prior to MetLife, he held positions at Capital One in product strategy and served as a Captain in the U.S. Army.

Scott graduated cum laude from the University of Notre Dame with a Bachelor of Arts in economics and earned an MBA from The Tuck School of Business at Dartmouth. He is a CFA® charterholder.

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Mike Finn is a Director focused on MIM's Single Family Rental portfolio. Prior to this role, Mike spent 10 years in MIM's private fixed income group, predominantly focused on tax motivated investments. He previously held positions at Citigroup and started his career in public accounting at PricewaterhouseCoopers. Mike holds a Masters of Business Administration degree from Rutgers Business School and graduated from Muhlenberg College with a B.A. in Accounting. Mike also holds a CPA designation.



STEPHEN GRAFAS

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Stephen Grafas is an Associate Director responsible for managing MIM's Single-Family Rental debt portfolio. Previously within MIM, Stephen worked in Structured Finance acting as a lead analyst for the commercial MBS portfolio. Prior to joining MetLife, he held positions at PGIM Real Estate in loan securitization and portfolio management. Stephen graduated Cum Laude from Drew University with a B.A. in Economics.



ALLISON HOCK, CFA

Product Specialist – Private Capital

Allison Hock is a product specialist for Private Capital, including Private Structured Credit, at MetLife Investment Management (MIM).

Previously, Allison was the structured finance assistant portfolio manager and product specialist at MIM. She also served in several other roles at MIM, including as the lead credit analyst for auto, equipment, credit card and timeshare ABS sectors, deputy chief of staff to the chief investment officer, portfolio manager in the US Domestic Portfolio Management Unit and analyst on the High Grade Corporate Trading Desk. Allison previously worked at Aflac as head of the office of the global CIO.

Allison holds an MBA from University of Oklahoma and an Honors Bachelor of Science from the University of Delaware. She is a CFA® charterholder.

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For more information, visit: investments.metlife.com

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² At estimated fair value. Includes MetLife general account and separate account assets and unaffiliated/third party assets.

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