What is the state of the rental housing market? Multifamily issues are in the news. Blackstone announced a $3.5BN Single-Family Rental (SFR) acquisition. Rental growth is falling, contributing to disinflation.

Our View: While there is short-term stress in multifamily, we are bullish on rental housing fundamentals in the medium term.

The current headline issues in rental housing have been concentrated in multifamily. We believe these are cyclical, driven primarily by material new supply following decades-high construction starts in 2021-22. This has put pressure on rents and occupancies, adding to stress arising from operating expense inflation and borrowers' widespread use of floating rate debt. Stress in multifamily may persist as new supply delivers through 2024 and 2025 as borrowers struggle to refinance ZIRP-era debt against a backdrop of weaker performance.

We believe the current multifamily stress is primarily cyclical. A medium-term correction to supply is already visible via the material drop in new starts since 2022. We expect this will lead to a paucity of new deliveries after 2025. This is further buttressed by a recovery in household formation rates following a pandemic era boom-and-bust. Once current supply is absorbed, we anticipate a more robust market emerging in late 2025-early 2026.

The SFR market has retained a better balance of supply versus demand. Most new supply has been built for sale not rent and homebuilders have offered mortgage rate buydowns to incentivize retail takeout. The balance of supply and demand has kept rent growth positive, returning to pre-pandemic norms of 2% to 4% rent increases per annum after surging in 2021-22. Institutional SFR acquisition volumes have fallen in line with other income-producing property classes. However, Blackstone's recent take-private acquisition of SFR owner-operator Tricon, at a 30% premium to public market pricing, appears to reflect the bull case against the backdrop of resilient fundamental performance.

We believe several factors will prove constructive for rental housing over the medium term. First, a 3+ million unit national housing shortage and material barriers to new supply, especially at moderate home price points. Second, renter household formation growth driven by better affordability versus owning (especially for entry-level housing) and generational demographic trends. Finally, housing demand is relatively insulated from technological disintermediation (workers may WFH and consumers shop online, but people cannot live in the metaverse).

Naturally there will be risks to navigate. Notably, equity valuations may re-price lower due to higher-for-longer mortgage and cap rates as well as operating margin pressure (elevated insurance, sticky labor costs). However, we expect fundamentals to prove robust over time and supportive of orderly re-pricing in the medium term.

How LibreMax is Positioning:

We see relatively attractive private market opportunities in rental housing where the expected loan tenors and liquidity profiles align with our medium-term thesis.

In multifamily we are focused on new construction mezzanine positions, generally the 50-70% Loan-to-Cost portion behind a senior and priced at 13% to 16% yields. We believe current short-term multifamily stress makes market terms more lender friendly, reflecting the adage that "the best of loans are made at the worst of times". We expect deliveries to dovetail with a cleaner supply-demand equilibrium in 2026 and are selective around markets with favorable migration and employment dynamics. We expect borrowers to refinance into cheaper debt (typically Fannie or Freddie) or to sell the property at stabilized occupancy post-construction, and we generally seek to hedge the associated interest rate risk.

In SFR we are focused on mezzanine positions in financing facilities for large SFR owner-operators, generally the 70-85% LTV portion behind a senior and priced at 12% to 16% yields. The borrowers under such facilities regularly seek to optimize the facility holdings by selling/buying new collateral. Additionally, selling individual homes into strong retail demand is a viable option to manage facility debt loads. We expect exits to include private refinancings, public securitizations, and a mix of bulk, mini-bulk and individual asset sales.

February 26, 2024

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