MReport

NEWS AND STRATEGIES FOR THE EVOLVING MORTGAGE MARKET

THEMREPORT.COM

AUGUST 2017

SPECIAL ISSUE

FEATURING THE NATION'S TOP

OUTSOURCING COMPANIES

IN A WHIRLWIND OF INDUSTRY CHANGES, THESE COMPANIES REMAIN STEADFAST.

Also in this Issue:

Ahead of the Curve

Preparing Today for Tomorrow's Uniform Closing Dataset Mandate

Duty Calls

Freddie Mac has a duty to serve the American homebuyer, and with a series of action plans that's just what the GSE plans to do.

Information Overload

Why Lenders Should Automate LO Compensation

Buying Into Renting

The single-family rental market has been booming in recent years. How can traditional mortgage lenders and service providers leverage this growing sector while other revenue streams are waning?

Opportunity Knocks

As homeownership rates dwindle and the single-family rental market continues to grow, what options exist for traditional mortgage lenders and servicers? And what does the future look like as renting becomes more and more common?

By **Aly J. Yale**

As housing prices continue to climb, it's no surprise the homeownership rate is dwindling. In fact, the U.S. rate of homeownership is nearing its lowest point since 1965, with just 63 percent of the population owning their own home.

For many, it's hard to fathom. Homeownership has long been a part of the American Dream, but with rising prices and overwhelming student loan debt keeping many potential buyers out of the market, it seems renting has become the new normal in much of the U.S.

According to the U.S. Census Bureau, out of the 805,000 new households formed in 2016, a whopping 434,000 were renter households. And since 2009? More than 7 million renters have hit the scene.

And that number is only going to grow.

According to independent real estate research firm Green Street Advisors, another 3.9 million renter households will likely join the market by 2020—37 percent of whom will choose single-family rentals over multifamily options like apartment buildings or duplexes.

While this burgeoning single-family rental space might be worrisome to longstanding mortgage lenders and service providers, hope isn't lost for the industry. In looking closely, the nation's trend toward renting may actually open up new doors.

Investigating the Investing Uptick

It's easy to attribute the recent growth in the single-family rental sector to rising home prices, but there's much more to it than that, according to experts. While appreciating values—and subsequently, higher yields—have certainly made investing in single-family rental homes more attractive, there are dozens of other factors at work.

Strapped inventory is one influencer, according to **Jeff Ball,** CEO and President of Visio Lending, a mortgage company that specializes in long-term loans for landlords and investors. Ball says when inventory is low, investors can get a good deal on properties—largely because they pose less of a risk to sellers than traditional buyers do.

"In an environment where inventory is tight, rental investors actually pay slightly less than an owner-occupier, because they bring higher certainty to the transaction," he said. "Most sellers will take an investor's cash offer for a modest discount versus an owner-occupier who's got to go get a conforming mortgage."

According to **Jeffrey Tesch,** Managing Director at RCN Capital, a private investment lender, lagging construction starts are also playing into those low inventory levels and helping the single-family rental market even further.

"It's amazing," Tesch said. "The appreciation is tremendous because there's very little new construction. If the single-family new construction market continues to be as constrained as it is, you will see more and more investors continuing to add to their portfolios because of the nice returns."

Construction on single-family homes has taken a downturn in recent months, with the latest Census New Residential Construction Report showing single-family starts down nearly 4 percent since April.

According to **Bill Green,** CEO at LendingOne—a lender focused on investor, fix-and-flip, and rental loans—when new construction wanes like it has, there's only one place for Americans to go.

"Housing starts are down. So where are these people going?" Green postulated. "They're renting. Until new housing starts get back to normal levels, I think we're going to see renting continuing to grow."

And Green's right. According to the recent Housing Market Index from the National Association of Home Builders, confidence among builders in the single-family market is down—particularly in the South and Midwest. That means many home builders don't see an uptick on the horizon anytime soon.

In his recent 2017 National Single-Family Rental Research Report, HomeUnion's Director of Research **Stephen Hovland** predicted as much. For the remainder of the 2017, "Housing starts will remain well below peak levels," he wrote. "Builders are limiting activity due to low margins for entry-level homes and high land costs."

This continued low construction only means one thing: the

While this burgeoning single-family rental space might be worrisome to longstanding mortgage lenders and service providers, hope isn't lost for the industry. In looking closely, the nation's trend toward renting may actually open up new doors.

SFR market is poised for even more growth in the days ahead.

A Fragmented Market

If you talk to most experts, the single-family rental market is a diverse one, with dozens of niches, specialties, and verticals, and for someone just getting into the space—or simply pivoting from a more consumer-based model—this means lots of opportunity to expand and grow.

"On its surface, it looks like a massive market," Ball said. "Then when you climb underneath it, you find out that no, it's really pretty fragmented."

Lenders in the SFR space target all sorts of niche audiences. Take Visio Lending, for example, which works mostly with landlords—those smaller-time investors who rent out their properties themselves.

There's a need for lenders like these, according to Tesch, whose RCN Capital also targets smaller investors—ones who rent their properties out or fix and flip them. Most traditional institutions, he says, just won't finance these types of buyers more than a handful of times.

"Time and time again, we hear that our investors are capped out by traditional banks at five, six, or seven properties," Tesch said. "After that, the banks don't want to have anything to do with it."

According to Hovland, there's also a need for lenders that can handle larger-size investors, too.

"Buying 300 homes is a really challenging thing to do," Hovland said. "Overcoming that hurdle and the lending piece to that is probably the biggest revolution we're going to see in the SFR market over the next three years."

But investor size isn't the only way an organization can differentiate itself in the SFR space. Other companies specialize in types of property—occupied or vacant—or focus on investors within specific demographics or geographic areas.

Still, while many in the space choose a highly targeted, drilled-down niche, other brands opt for a broader approach, like Altisource, which not only offers a sales platform via its Investability brand, but also property management, renovation services, and leasing brokerage. This one-stop shop model aims to "reduce as many friction points as possible" for the investor, according to the company's CRO **Dennis Cisterna.**

Whether the approach is super-targeted or more comprehensive, one thing's for certain: Regardless of how an organization decides to frame its services in the single-family rental market, the options are there—and they're endless.

> "On its surface, it looks like a massive market. Then when you climb underneath it, you find out that no, it's really pretty fragmented."
>
> —**Jeff Ball,** CEO and President of Visio Lending

Lending to Landlords

For those looking to pivot from a more consumer-based lending model to one aimed at investors and landlords, it's important to switch strategies, too.

According to seasoned SFR veterans, there's an inherent difference between traditional lending and lending to investors and landlords—particularly because of the nature of the customer relationship. Unlike in traditional homebuyer transactions, an investor isn't looking for a one-and-done lender. They want a partner—someone they can rely on in the long term, month after month and year after year.

"It's a repeat clientele, and it's repeat transactions," Cisterna said. "With real estate investors, we're not looking to serve one customer once every seven years. We're looking to serve a customer 200 times in a year."

But getting those investors to come back time and time again? That's not as easy as simply giving them the financing they need. In the investor space, it all comes down to service.

"It's all about customer service," Tesch said. "It's all about having that relationship between the company and the customer. In the financial world, people lose track of who's paying the bills. I don't quite know why that is."

Service is where lenders can truly differentiate themselves from others in the industry—and it's often an area where traditional lenders lag behind, according to Green.

"There's a gazillion places to get a mortgage," Green said. "The customer experience you're going to get there is not necessarily something that will leave you saying, 'Wow, I just love my mortgage company.'"

According to **Charlie Fitzgerald,** CEO of Affinity Venture Partners, in the investor world, great customer service requires hands-on, one-on-one work. Lenders need to find out each investor's unique needs and goals and come up with creative solutions to help them see success.

"I just think the relationship side of business in general—and certainly in an industry where some big dollars are being talked about—is really important to maintain," Fitzgerald said. "Companies and service providers need a fundamental belief that it's really about relationships. It's about finding out as much as I can about my client and what their needs are."

Following in Multifamily's Footsteps

Lenders and servicers don't have to completely rewrite history to get into the single-family rental space. In fact, since Fannie Mae struck a deal with SFR megalith Blackstone Group in February, financing real estate investors may soon be easier than ever.

According to **Greg Rand,** CEO of OwnAmerica, the deal was a signal that a more SFR-friendly market is on its way.

"Lenders who originate service loans that are, essentially, Fannie, Freddie, and FHA products, I think they could expand those products," Rand said. "So you don't have to be an initial lender with SFR, like with a custom-made SFR product. You can actually just be a mortgage banker. You get to penetrate this side of the market because those government entities and GSEs, I think, are going to open up the doors to it."

And they just may well. Hovland says he expects Fannie Mae to introduce a new SFR-specific product in the near future.

"I wouldn't be surprised, from the people I've had conversations with, if Fannie Mae unveiled a new lending program in the next 18 months that opens up that 11-to 100-unit SFR lending arm," Hovland said.

But the Fannie Mae deal did more than just open up potential new lending opportunities; it was also a sign—a sign that, like many in the industry had postured, the single-family rental market is following in the footsteps of multifamily, becoming more institutionalized and more important every year.

"The Fannie Mae deal said 'You know what? This is a real business, and this is business isn't going away anytime soon.' That's really what it comes down to," Tesch said. "It legitimized a business that has, quite frankly, been there forever."

But despite the entry of the bigger guys, individual investors will continue to dominate—institutions will just be there to provide more capital, Cisterna said.

"You're still going to see the market dominated by individual investors," Cisterna said. "I can tell you there were hundreds, if not thousands, of participants in the market that we're watching that deal and hoping that was a signal that Fannie is starting to view this state in a similar manner as they do multifamily. With that, that means they'd start underwriting these properties based on the income of the property and not the income of the borrower, which is what has really hamstrung a lot of the smaller investors in this space—not being able to access cheaper, longer-term capital."

And Hovland agrees. The Fannie Mae deal will not only bring a lot more capital into the space, he said, but it will also make rates more affordable.

"Right now, it's much more expensive to get a loan in that area," Hovland said. "When the agencies come in with their current lending rates, which are by far the most attractive in the SFR arena, I think we're going to see a lot more money pumped into SFRs."

There's also another, lesser-known benefit of the institutionalizing of SFR. According to Cisterna, it's improving tech, too.

"Technology and services have improved dramatically over the last four years," Cisterna said. "A lot of those services and technology, they were never invested in the single-family space, because there were never owners large enough to commit to that type of spend. Now there are."

If You Buy it, Renters Will Come

The entrance of Fannie Mae and other big institutions aside, there are other signs that the SFR market is only going to continue to grow. Namely? Renting itself is growing.

The Rental Protection Agency estimates that more than 2,600 people enter the U.S. rental market every day, and according to HomeUnion's report, rental vacancies are set to bottom out later this year.

"Vacancy will reach a cyclical low," the report stated. "SFR vacancy is projected to decrease 30 basis points to 6.4 percent."

There are dozens of reasons for this uptick in renting—and the subsequent downturn of homeownership. For one, Baby Boomers are retiring, and many are selling their homes to pay the bills.

"Americans are just ridiculously underinvested for retirement," Ball said. "So the aging Baby Boomer population, they're going to have to sell their houses to pay for their retirement. They won't be able to afford to go to where people retire. They're going to stay where they are. Some of them will move into apartments. Some of them will move into assisted care living. Some of them, at least for a period of time, will rent houses."

According to Hovland, from 2005 to 2015, 9 million rental households were formed, and 5 million of those were Baby Boomers.

But Boomers aren't the only generation to blame for the recent rise in renting. Millennials, who are starting their families later, traveling more, and are generally slower to purchase homes than their predecessors, are also playing a role.

"Millennials don't want to own anything," Fitzgerald said. "They don't want to keep a yard. They don't want to put their trash cans out. They don't want to paint a house. They don't want to mow a lawn. They want to go to work, make their money, and go play. I think that a large part of why people now rent more than they buy is just a shift in the mentality about what's important."

But it's more than just attitudes or lifestyle choices that are keeping millennials in the renting arena, Cisterna said.

"They've shown that millennials are not as keen to be homeowners as the previous generation," Cisterna said. "But there's also certain things in their factor that limits them from being a homeowner even if they wanted to. Right now, a large percentage of the millennial generation doesn't have the luxury of even choosing to be a homeowner."

One of those limiting factors? Record-high student loan debts.

"The college debt issue is a big crisis in this country," Green said. "Folks are coming out of school burdened with $100,000 to $200,000 in debt and they just have to pay off that college loan before they can get a mortgage."

The homebuyer capacity of millennials has dropped 9 percent since 2016, according to Fitch Ratings, and that's largely due, as Green said, to rising student loan debt. In the first quarter of this year alone, student debt grew by $34 billion. It now tops out at over $1.34 trillion across the nation, according to the New York Federal Reserve.

Millennials are also more transient than other segments of the population. They pick up and move for jobs often, and many of them even work from home, so they're not tied down to particular cities or economies—and that means renting is simply a more fitting option. According to Hovland, technological advances may cause that transient sector of the population to grow even further.

"People will be able to live further away from work," Hovland said. "High-speed internet available in everyone's home today enables people to work at home more. That work component is going to become much smaller of a factor of where people live."

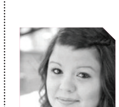
> "Folks are coming out of school burdened with $100,000 to $200,000 in debt and they just have to pay off that college loan before they can get a mortgage."
>
> —**Bill Green,** CEO, LendingOne

Can Anything top SFR?

Ultimately, the question isn't what's driving the single-family rental market on its upward trajectory. It's what will stop it.

"The big thing that I think everyone's trying to figure out is what curbs the demand for the investment property?" Cisterna asked. "There's nothing that really any kind of economist or housing market analyst can point to that is potentially going to curb the demand for rental housing. The only thing that kind of starts to curb that demand that we can, to a certain degree, is building; adding new supply."

But until that happens, the SFR space—and all the opportunities that come with it—will just keep chugging along. **M**



ALY J. YALE *is a freelance writer and editor based in Fort Worth, Texas. She has worked for various newspapers, magazines, and publications across the nation, including the* Dallas Morning News *and* Addison Magazine. *She has also worked with both the Five Star Institute and* REO Red Book, *as well as various other mortgage industry clients.*