Allianz Real Estate

Research

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U.S. multi-family in the investor spotlight

U.S. multi-family: increasing appetite for investment

The U.S. residential rental sector will attract increasing international capital buying into trends accelerated by the pandemic. These include U.S. domestic migration to the Sun Belt and suburbanization within cities. The sector has also retained its inherent strengths: markets are large and liquid, and residential improves institutional portfolios' resilience to volatility and risk-adjusted returns. The latest development in the market is the inclusion of single-family rental portfolios. Residential still requires expertise to navigate; the collapse of Zillow's home buying division shows algorithmic approaches are not yet viable.[1]

We expect foreign investment to grow, given the strong trends supporting the sector and the weight of capital looking to enter real estate. Investment in the U.S. multi-family sector in the first half of 2021 was up 64% from the same time last year. Historically, foreign investment into the sector makes up about 10% of total volumes, having grown from USD 866 million in 2009 to USD 12.6 billion in the last 12 months. By comparison, historic foreign investment into the U.S. office sector has been around 20%. Currently, foreign investment into institutional residential has fallen to about 5% this year due to Covid-19.[2]

Rising interest rates are not yet a concern for residential markets. The Federal Reserve has announced recently that it will start tapering its USD 120 billion asset purchase program. The Fed has not yet announced benchmark interest rate rises; however, the central banks of Australia and Canada have. The Bank of England has signaled it will raise interest rates in the "coming months" in response to high inflation but has not yet committed to an increase. These announcements are significant, but they have been well-signaled, and so markets have reacted calmly. Residential markets remain relatively attractive due to a substantial yield spread over real government bonds. This spread is sufficiently wide to absorb increases in real bond yields triggered by the Fed's tapering. Multi-family rental investments may benefit if mortgage rates rise and buying a home becomes less affordable. Annual rent resets in the U.S. multi-family sector help to protect against an inflationary environment, which usually represents the background for interest rate hikes.

[1] https://www.ft.com/content/c4338149-59b3-4a4b-ae19-f9e45ff1a3d2

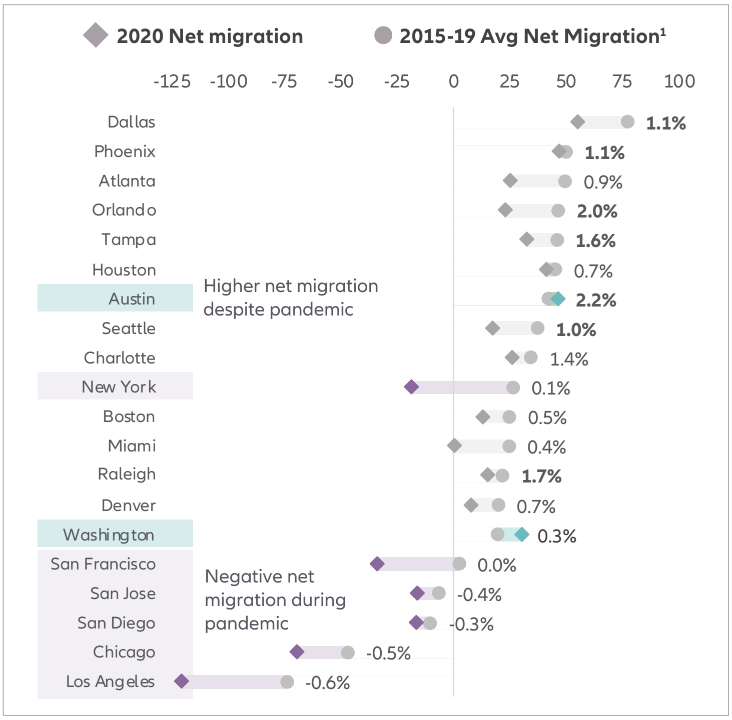
[2] All information on transaction volumes and foreign investment share is based on RCA data

Demand in U.S. Sun Belt and tech cities

U.S. internal migration into the Sun Belt has been a trend since 2015, but this has been accelerated by the pandemic (figure 1). Most companies relied upon extensive home working and are now committing to hybrid working models for the future. Consequently, workers have been able to prioritize the better weather, lower living costs and greater space available in the Sun Belt. Firms are incentivized to follow this talent and the favorable tax environment in these locations. This trend is reflected in investment: Dallas, Atlanta, Phoenix and Austin are amongst the most active markets due to burgeoning multi-family sectors.

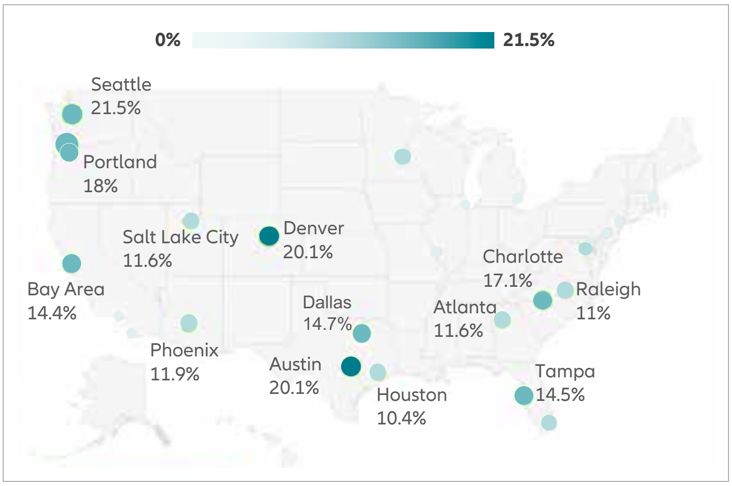
All these trends are particularly strong in the tech sector, which remains a key driver of future growth. As a result, new tech hubs such as Austin have exploded in popularity. These cities are now drawing in many young and talented workers (figure 2).

Figure 1. **Net migration (thousands)**



Source: Oxford Economics, Allianz Real Estate Research (September 2021)

Figure 2. **Millennial population change in large tech talent markets[2] (2015–2019)**



Source: Allianz Real Estate Research based on CBRE: Scoring Tech Talent (2021)

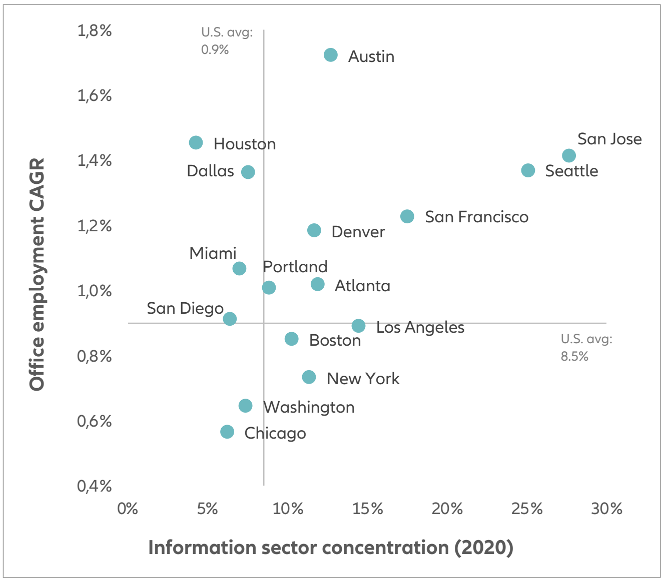
[1] Net migration on the chart in thousands. Percentage values next to grey markers refer to 2015-2019 average migration as a share of metro population.

[2] Large tech talent market per CBRE definition refers to markets with >50k tech labour pool. Millennials aged 23-38. Metro names and values for millennial population growth of more than 10%

The cities with the highest tech sector employment concentration (figure 3) are San Jose (27.6%), Seattle (25.1%) and San Francisco (17.5%). As more mobile and wealthy millennials move to these cities, they will generate demand for high-quality residential properties.

Big coastal cities like Los Angeles, San Jose and New York have seen outward migration, but these cities still have fundamental advantages. The Oxford Economics city strength index shows this clearly (figure 4). San Jose scores highest of all U.S. 400 metros ranked. Its only non-top score is quality of life, which is held back by high cost of living. Los Angeles ranks first among all metros for quality of life, scoring highly with regard to cultural and natural amenities. Big coastal cities' strengths will allow them to refill as the economy normalizes, revitalizing residential demand.

Figure 3. **Office employment growth (2022–2031)**



Source: Oxford Economics, Allianz Real Estate Research (September 2021)

Figure 4. **Oxford Economics City Strength Index**

Rank (out of 30 major metros)	City	City Strength	Economics	Human Capital	Quality of Life
		Rank (out of 382 metros)			
1	**San Jose**	1	1	1	79
2	**San Francisco**	2	3	2	3
3	**Seattle**	3	4	5	41
4	**Los Angeles**	4	19	21	1
5	New York	6	12	11	4
6	**Austin**	7	6	4	159
7	Boston	8	17	8	13
8	Washington	10	15	3	111
9	**San Diego**	11	20	16	15
10	Raleigh	14	8	9	198
11	**Denver**	15	14	14	61
12	Houston	18	16	7	182
13	Orlando	19	51	30	7
14	**Dallas**	21	13	12	207
15	**Phoenix**	22	26	37	32
16	**Portland**	23	25	28	50
17	Charlotte	38	30	22	146
18	Miami	39	71	20	66
19	Atlanta	43	28	18	273
20	Baltimore	53	45	43	124
21	Philadelphia	61	63	71	76
22	Tampa	66	66	84	69
23	Minneapolis	68	59	25	244
24	Chicago	71	98	67	90
25	Columbus	86	86	39	253
26	Cincinnati	111	132	115	110
27	Pittsburgh	113	147	213	28
28	Kansas City	142	100	93	318
29	Detroit	189	185	123	276
30	St. Louis	193	192	176	221

Source: Oxford Economics (September 2021)

High ranking — Low ranking

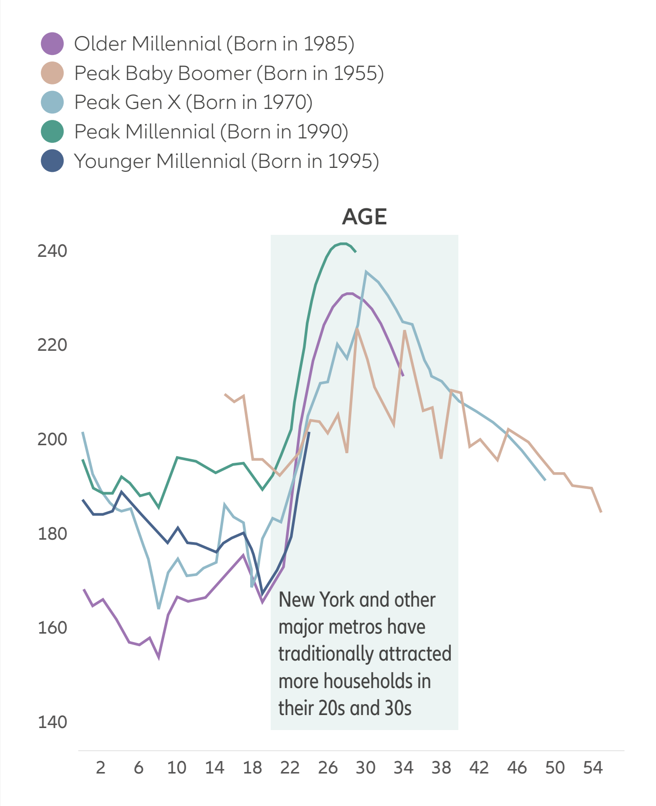
Suburbanization

Within cities, workers moving out to the suburbs is another trend that has accelerated during the pandemic. This shares many of the drivers behind Sun Belt migration. Easy access to offices is now less important, whereas the greater space and lower costs of suburbs are more attractive than ever. The other major driver is demographics: the pandemic came just as the bulk of the affluent millennial cohort has reached prime family formation age.[1] These new families need more space that may only be available further out in cities (figure 5).

These factors are generating increased demand for single-family rental houses, which are mostly found in suburban locations. Recent deals within the single-family rental space include Blackstone's acquisition of Home Partners of America for USD 6 billion. Home Partners owns over 17,000 houses that it rents out to tenants who are given an option to buy them eventually. Goldman Sachs has also invested GBP 200 million into buying new market rent homes from Urban & Civic, a U.K. developer. This follows a similar GBP 150 million acquisition earlier this year of 918 units from Gatehouse Bank.

Allianz Real Estate has expanded its presence in the sector with a USD 300 million investment into one of the world's largest private single-family rental vehicles, the Upward America Venture. Alongside several large institutional co-investors, this venture is positioned to acquire more than USD 4 billion of new single-family homes in strategic locations across the U.S.

Figure 5. **New York metro population by age cohorts (thousands)**



Source: CBRE: Covid-19 Impact on Resident Migration Patterns (2021)

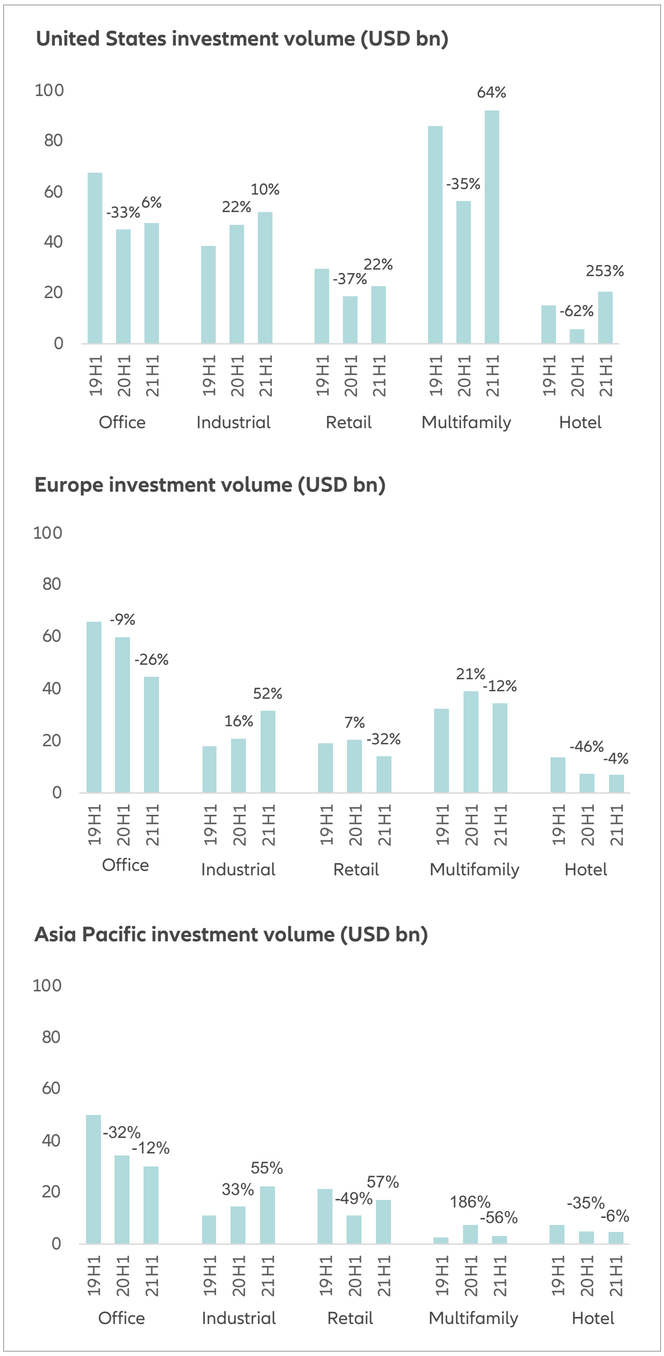
[1] CBRE: Covid-19 Impact on Resident Migration Patterns (2021)

Diversification and risk-adjusted returns

The U.S. multi-family market makes up 73.3% of the global market of institutional grade residential stock. The market has been larger than the U.S. office market since Q2 2017, and the gap has rapidly expanded in 2021. Europe's multi-family sector has grown consistently since 2009, with transaction volumes in YTD 2021 65% higher than 2016. Asia Pacific's market remains relatively small; however, Japan is an exception with the 3rd largest residential market after the U.S. and the U.K. As markets have grown, they have also become more institutionalized, which has further improved liquidity.

The pandemic has clearly demonstrated the diversification benefits of multi-family. People need to live in residential property, such that demand is less susceptible to downturns. Cash flows proved resilient during the pandemic as household incomes benefited from furlough and government support schemes. Key risks are therefore more related to government regulation or politics rather than macroeconomic dynamics. For example, enough inflation may lead to governments imposing rent controls.

Figure 6. **Transaction volumes H1 2021**

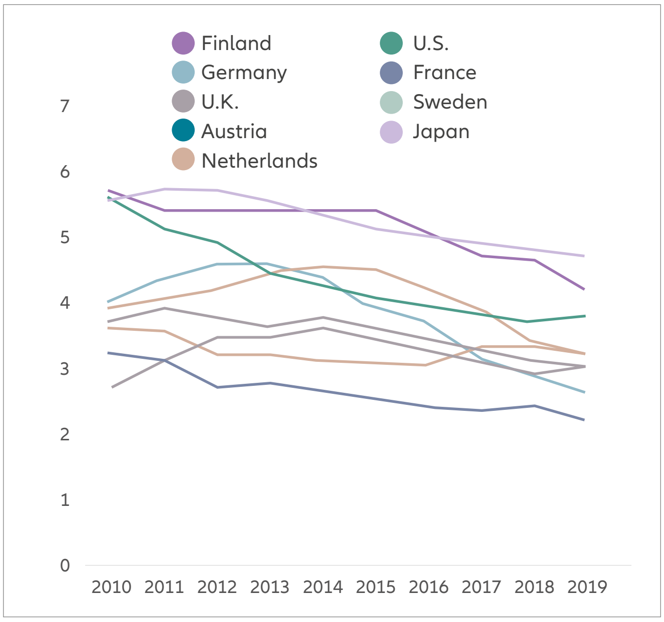


Source: Real Capital Analytics (Q2 2021)

Alongside diversification benefits, residential investments enhance overall portfolio risk-adjusted returns by reducing the volatility of income streams to the portfolio.[1] Although residential total returns can be volatile as capital values change, income streams nearly always remain stable (figures 7 and 8). Throughout the pandemic, rent collections held at or just below historic norms (U.S. ~93% in Dec '20, German/U.K. PRS ≥95% as per Oct '20), despite growing unemployment levels.[2]

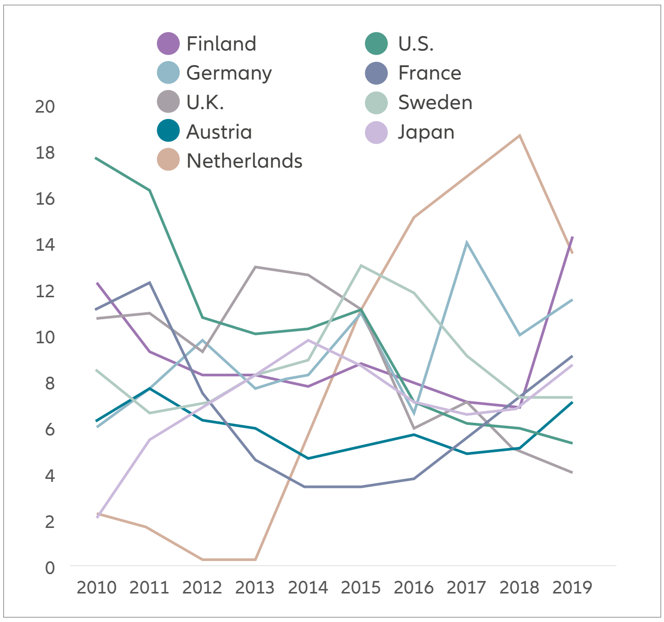
For further exposition on the returns offered by U.S. multi-family compared to other U.S. asset classes, please see our PIMCO colleagues' paper: *Commercial Real Estate Fundamentals After the COVID-19 Outbreak: Surprisingly Attractive*.

Figure 8. **MSCI income returns residential 2010–2019 (%,pa)**



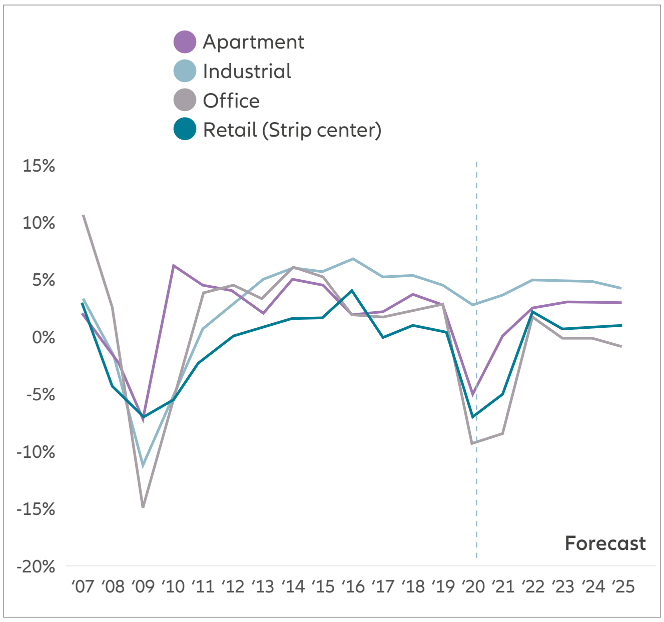
Source: MSCI (direct property indices, February 2021)

Figure 7. **MSCI total returns residential 2010–2019 (%,pa)**



Source: MSCI (direct property indices, February 2021)

Figure 9. **US market rent growth by sector (%,pa)**



Source: Green Street (February 2021)

[1] Risk-adjusted returns are defined as total annual returns divided by volatility of total returns. Figure 8 is based on MSCI direct property index total returns for 2011-2019 for all markets except Singapore (based on JLL prime total returns) and U.S. (Costar all-star definition).

[2] JLL Global Real Estate Perspective (February 2021 p36), GreenStreet (October 2020), Inrev (June 2021).

Conclusion

The demand outlook for the residential sector remains strong; high investor appetites reflect healthy fundamentals. The U.S. residential market should be attractive to international investors due to the current regulatory environment and high transparency. Pent-up demand and the millennial family boom give the market solid foundations. Within the U.S., Sun Belt metros and suburban locations are benefitting from widespread remote working. A supply-demand mismatch further bolsters the positive outlook for single-family rental markets, and urban coastal markets and tech cities will continue to generate growth and higher paying jobs.

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