Single-Family Rentals, Unison Equity Sharing Agreements, & the Case For a Diversified Portfolio

October 2023

Authors:

Lauren Rosales-Shepard
Content Writer, Consumer Product

Peter Wynn
Investment Strategy Analyst

unison
Investment Management

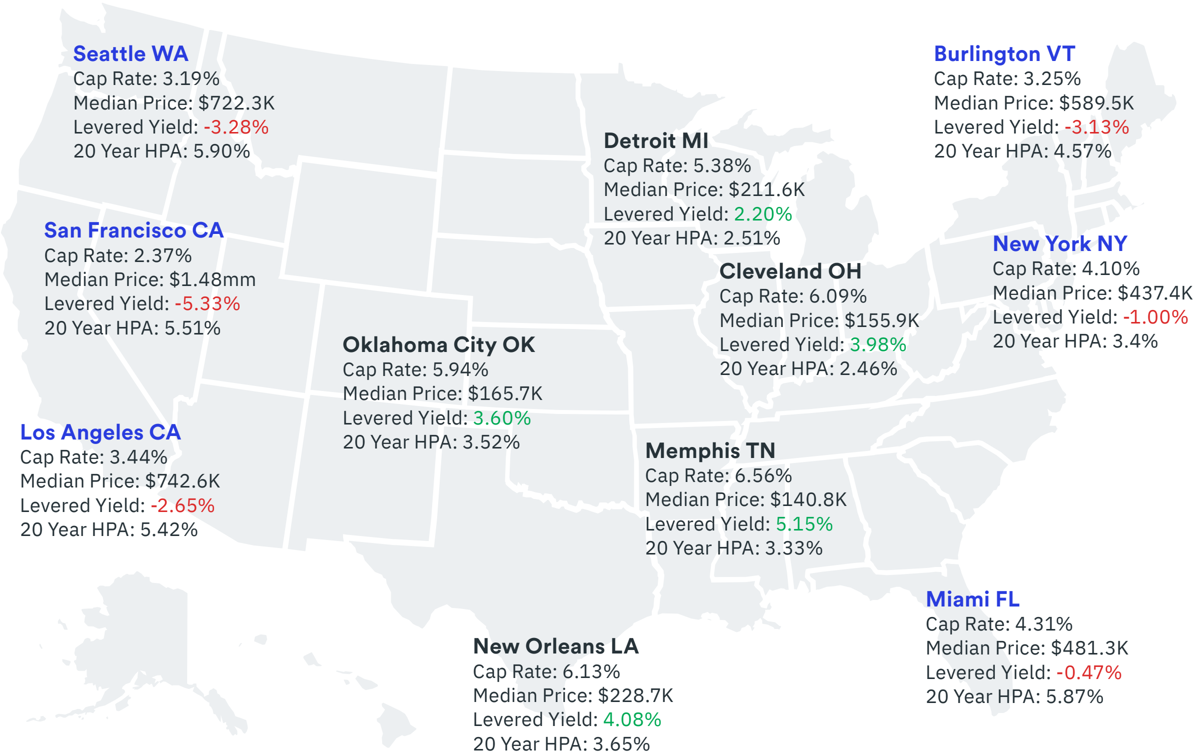
Introduction

At the peak of the COVID pandemic, investor purchases of single-family homes skyrocketed–particularly those of lower-cost, or that were located in the so-called Sunbelt markets. At this time, interest rates were historically low, and rents surged upwards. The vast majority of these homes were, and continue to be, rented out by tenants, rather than re-sold. By 2021, single-family rental (SFR) households comprised roughly one-third of all renters. The popularity of this investment has not dwindled; CoreLogic reports that investors purchased 27% of single-family homes in the first quarter of 2023.

It's an attractive investment option. The recent volatility in the stock market has increased faith in more *tangible* investments, while rising mortgage rates during inflationary periods have led to escalating demand in the rental market and, in tandem, higher rent prices.

However, increased efficiency has come to the market and financing has gotten more expensive. In addition to which it has become increasingly apparent that not all markets are created equal, so to speak. On the one hand, in areas where cap rate has expanded, rental growth has outpaced home prices, and thus been the primary driver of SFR returns. These areas typically have lower property values and are more accessible to institutional SFR. Alternatively, other areas have seen stronger home appreciation than rent growth, tightening cap rates. These features typically signify more expensive cash flow and less efficiency for expense-bearing SFR portfolios. Indeed, after a strong period for the housing market, higher property values combined with rising rates have made some markets unfeasible for SFR altogether.

Rising interest rates are especially impactful in markets with lower cap rates, as homes are more expensive. These markets generally have had and will continue to have stronger home price appreciation due to more diversified economies and wage growth.



Think of it like this: using 3-bedroom median cap rates and rents, mortgage rates with a 25bps premium to approximate SFR warehouse financing, and a 40% expense ratio, we can see market-by-market levered yield. Let's consider this the rent's return on equity.

As you can see, the combination of low cap rates and high interest rates make new SFR investments impractical in markets that have and are likely to continue to experience growing home prices. Bearing these facts in mind, the time is ripe to develop an alternative residential real estate strategy and diversify the residential real estate investment portfolio.

Enter Unison and the equity sharing agreement. Unison complements SFR in the portfolio, and can help mitigate risks inherently taken on by purely SFR strategies. The two, together, enable investors to get a holistic, robust, and diversified exposure to the entire residential real estate market.

Fundamentally concentrated in large urban metropolitan areas with large and diverse economies, Unison Agreements provide institutional exposure to appreciating residential real estate in a scalable way. Meanwhile, SFR strategies purchase and operate portfolios of properties historically located in mid-size metros that produce stronger yields. Both share housing market exposure, but tend to have a substantially different geographic distribution. (Additionally, SFR has additional risks from financing costs, property expenses, and vacancies). Unison and SFR returns naturally fit together; Unison provides efficient exposure to increasing residential property values while SFR provides access to rents. Together, they provide investable access to the strongest real estate and rental markets nationwide.

The addition of owner-occupied residential real estate leads to a better real estate portfolio. Low correlations between investable REITs and the National Case Shiller index contribute to increased diversity–and the asset class also provides strong returns.

Case Shiller vs Other Real Estate Correlations[1]

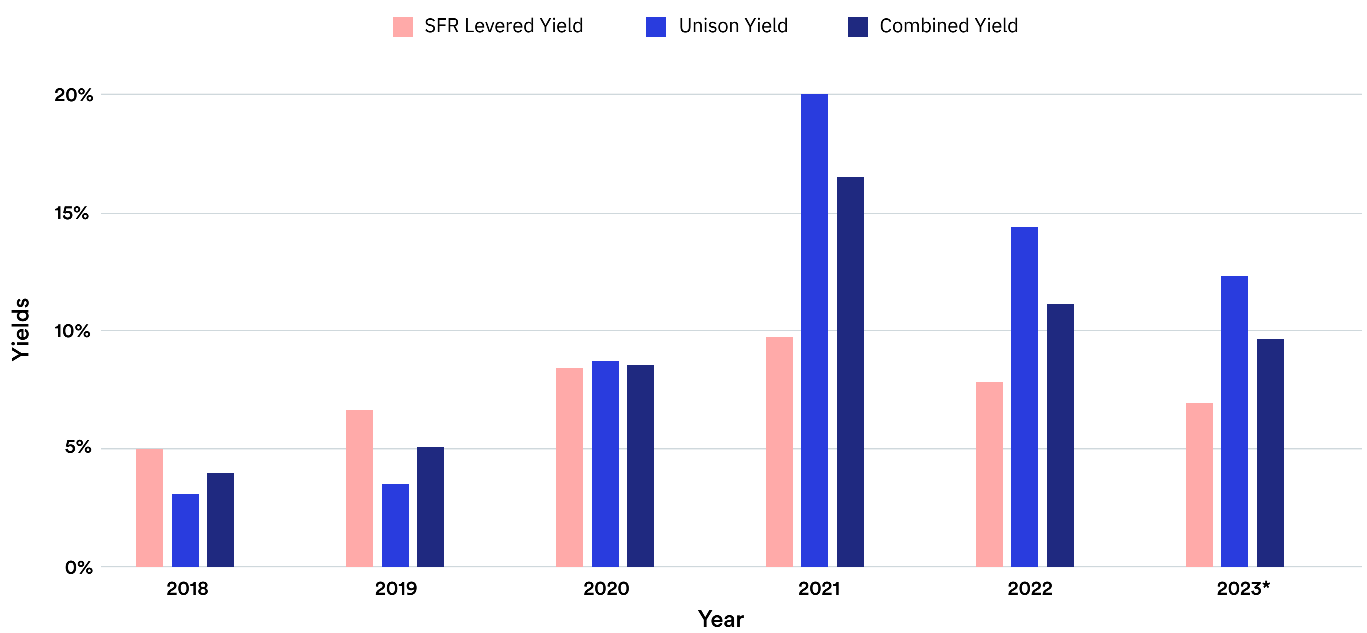
	Case Shiller	Single Family Rental REIT	Commercial REIT	Multi-Family REIT
Case Shiller	1	.20	.10	.15
Single Family Rental REIT		1	.84	.76
Commercial REIT			1	.90
Multi-Family REIT				1

Returns by Asset Class[2]

	Case Shiller	Single Family Rental REIT	Commercial REIT	Multi-Family REIT
1 Year	4.5%	-31.8%	-24.4%	-32.0%
3 Year	11.5%	-1.9%	-0.1%	-2.0%
5 Year	8.5%	7.3%	3.7%	4.3%
10 Year	6.6%	-	5.7%	6.4%

1. Correlations are Pearson-Moment Correlations using monthly figures for maximum available timeframes through June 30, 2023. Case-Shiller Index is the S&P/Case-Shiller U.S. National Home Price Index. Single Family Rental is the FTSE Nareit US Single-Family REITs Total Return Index. Commercial is the FTSE Nareit US All Equity REITs Total Return Index. Multi Family REIT is the FTSE Nareit Multifamily REITs Total Return Index. Case Shiller value for June 2023 is the Case-Shiller Index is the S&P/Case-Shiller U.S. National Home Price Index Forecast.

2. Case Shiller Index is the S&P/Case-Shiller U.S. National Home Price Index. Single Family Rental is the FTSE Nareit US Single-Family REITs Total Return Index. Commercial is the FTSE Nareit US All Equity REITs Total Return Index. Multi Family REIT is the FTSE Nareit Multifamily REITs Total Return Index. Case Shiller value for June 2023 is the Case-Shiller Index is the S&P/Case-Shiller U.S. National Home Price Index Forecast. Data range is from June 30, 2013 to June 30, 2023.



Rental data from CoreLogic Real Estate Analytics as of April 2023 and represents median national cap rate for all single family rental properties. Unison yields are represented by the annual net investor proceeds from contract terminations by year. Levered SFR yields are calculated using a 40% expense ratio estimate on national average median rent across all SFR property types and a 60% LTV estimate for properties relative to a purchase price. December 2017 calculated using the national median cap rates and rents. Financing cost uses national average 30 year mortgage rates. Estimates for 2023 use data as of April 2023 projected for entire year.

Taken together, Unison and SFR provide complementary cash yields. For example, consider this graph which uses 2017 Unison investments and a hypothetical SFR Portfolio purchased in December of 2017, constructed using national median data. As you will see, Unison cash flows closely reflect national real estate transactions and possess a high upside due to their construction. Levered SFR yields are more stable through time with a lower ceiling due to property carry costs, interest and other expenses.

While Unison Agreements are originated and later terminated with no intermediate payments, they can mature to be quite large and follow national real estate transaction trends. Conversely, when it comes to SFR, historically cheap cash flows have been affected by rising interest rates and a national cap rate compression of 1.3% over 10 years. A combined Unison and SFR portfolio can yield higher maximum cash flows while maintaining stability from rents and liquidity afforded by home ownership.

Unison and Single Family Rental both derive value from home price appreciation, or cap rate compression, as one might consider it. After that, however, they appreciate differently. While Unison returns are derived primarily from exposure to a home prices, SFR garnishes returns via rental yields, rent growth, and the appreciation of properties within the portfolio.

Another compelling reason to diversify: every area has a different profile of rent and home price growth. By looking at the relative performance of three-bedroom single family properties over the past five years, we see significant disparities in the return profile of metropolitan statistical areas (MSAs).

Stronger Rental Growth

MSA	5 Year Price Growth	5 Year Rent Growth	5 Year Cap Rate Growth
Pittsburgh, PA	2.74%	9.47%	+1.95%
Columbus, OH	7.74%	12.24%	+1.11%
Buffalo, NY	6.76%	11.48%	+0.98%
Tulsa, OK	6.44%	9.14%	+0.77%
Fort Myers, FL	10.31%	12.36%	+0.45%

Stronger Home Price Growth

MSA	5 Year Price Growth	5 Year Rent Growth	5 Year Cap Rate Growth
Seattle, WA	8.08%	5.62%	-0.39%
Salt Lake City, UT	12.50%	6.48%	-1.08%
Durham, NC	11.48%	8.95%	-0.58%
Denver, CO	8.46%	4.75%	-0.79%
San Diego, CA	8.64%	7.02%	-0.27%

All included figures are estimates calculated using CoreLogic Real Estate Analytics as of April 2023. Price growth for SFR properties is computed using median cap rates for 3-bedroom SFR properties in a given MSA. Rental and cap rate growth is computed using provided medians 3-bedroom SFR properties.

In areas where cap rate has expanded, rental growth has outpaced home prices, and thus been the primary driver of SFR returns. These areas typically have lower property values and are more accessible to institutional SFR (left table). Other areas have seen stronger home appreciation than rent growth, tightening cap rates. These features typically signify more expensive cash flow and less efficiency for expense-bearing SFR portfolios (right table). Significantly, institutional SFR has historically remained concentrated in lower price tier areas that produce higher yields. Unison provides both a complementary and alternative strategy that allows for exposure to a different geographic profile.

Single Family Rental vs. Unison Equity Sharing Agreements

Qualitative differences between investment solutions

unison

Unison Equity Sharing Agreements

Returns solely from **exposure to home price appreciation**

Unison **owns a portion of a home's equity**, the original owner retains full occupancy rights and responsibilities

Low overhead throughput lifetime of investment, homeowner remains responsible for all property related expenses

Can be originated on most US residential properties, voluntary termination at homeowners discretion

FOR RENT

Single Family Rental

Returns are due to both **rental income** and **home price appreciation**

Investor is **sole owner of the property**, with cash flows subject to rental payments and **vacancy risk**

Significant **carry costs** involved from interest expense to property taxes to repairs and upkeep

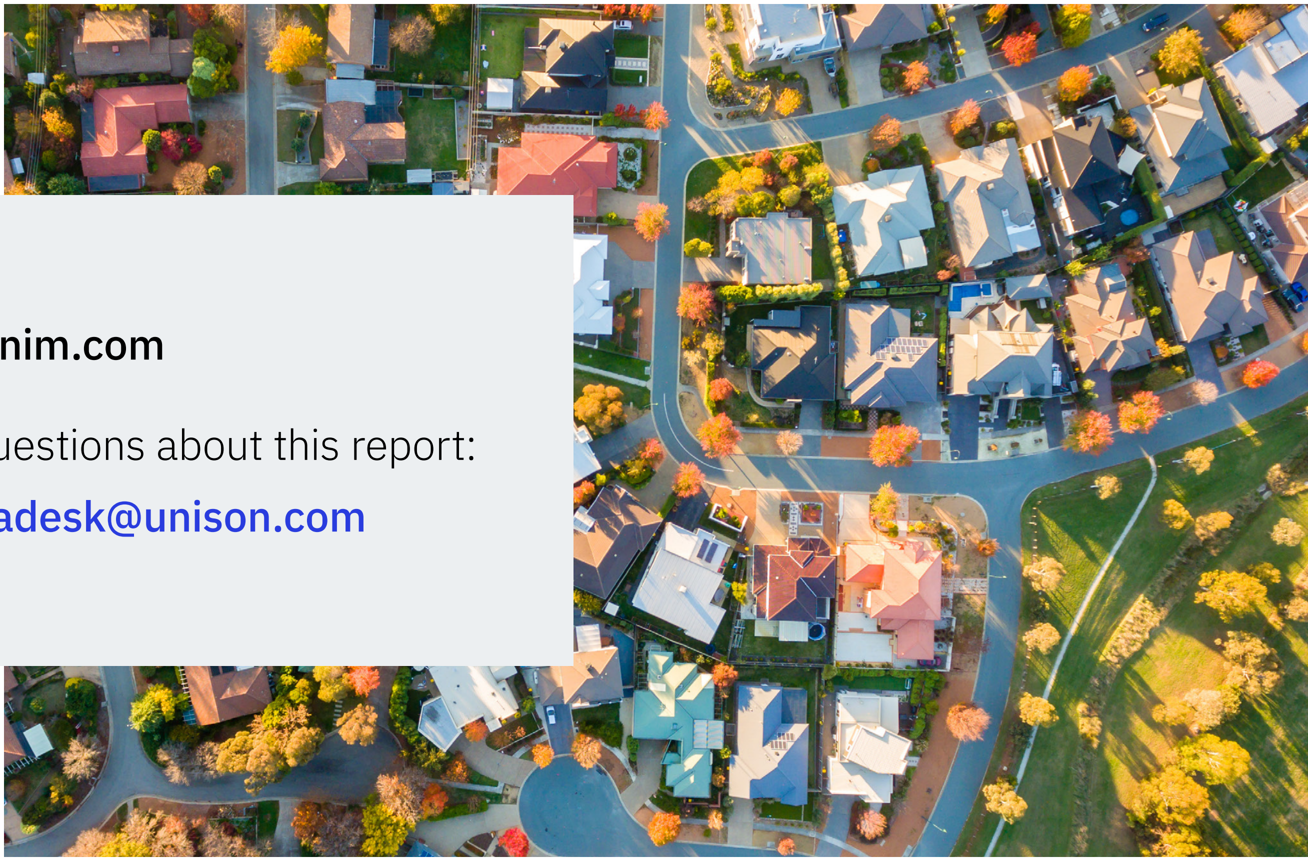
Acquisitions through on and off-market listings, build-to-rent, and other typically high-priced transactions

Summary

To conclude, Unison allows institutional access to levered cap rate compression, or the appreciation of residential real estate, without the added overhead and expenses incurred by SFR investors. Cap rates have tightened just as interest rates have risen, making SFR transactions increasingly expensive. Unison can combine optimally with SFR investments in a portfolio, targeting high appreciation areas while SFR targets high yield areas, resulting in ideal exposure to both strong cash flows and price appreciation. It's truly the best of both worlds.

About Unison

Unison is a Delaware corporation based in San Francisco and Omaha that is pioneering a smarter, better way to own your home. Until now, the only way to finance a home was by taking on debt. Through Unison residential equity agreements, we help homeowners access their equity flexibly with no monthly payments or interest. We enhance home affordability, reduce debt, and deliver a less risky way for homeowners, investors, and society to think about that important asset - the home. Unison Investment Management, LLC is a Delaware limited liability company that serves as investment manager to Unison's investment funds and separately managed accounts. It powers efficient capital deployment and active management at scale. Our investment philosophy is ingrained in the models, systems, and processes we build to make investments. We are committed to providing institutional investors unrivaled transparency and innovative product offerings for this new asset class. For additional information, visit www.unison.com and www.unisonim.com.



unisonim.com

For questions about this report:

mediadesk@unison.com

Investment Management