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Banking Trends

The Rise of the Single-Family REIT

A new investment vehicle spread rapidly after the Great Financial Crisis. Should we be concerned?

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The views expressed in this article are not necessarily those of the Federal Reserve.

Single-family real estate investment trusts (SF REITs) have emerged as significant players in the housing market. To put this growth into perspective, the holdings of the three currently largest SF REITs were close to zero in 2010. Fast forward to 2020, and these three SF REITs held a large portfolio of single-family homes (Figure 1). Just one SF REIT, Invitation Homes, held about 80,000 single-family homes at the end of 2020. Although this only represents about 0.2 percent of the total single-family housing stock, SF REITs like Invitation Homes have concentrated their holdings in certain locations, so in some neighborhoods SF REITs own close to 5 percent of the housing stock, making them significant actors in those areas.

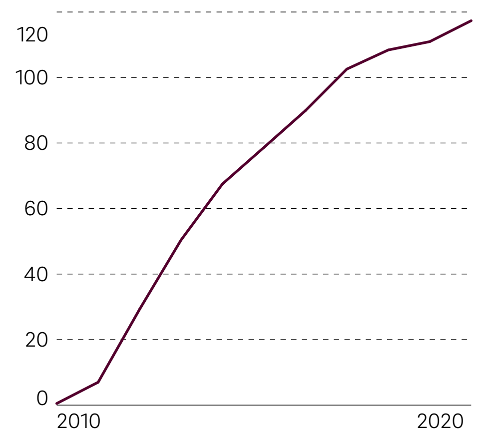
In this article, I take a closer look at SF REITs and their impact on the single-family housing market. I first define "REIT" and

FIGURE 1

SF REITs Ballooned After 2010

Just the three largest SF REITs owned 120,000 single-family homes by 2020.

Top three SF REIT holdings, thousands of units, 2010–2020



Source: CoreLogic.

Note: Data only from Arizona, California, Florida, Georgia, North Carolina, Nevada, South Carolina, and Texas.

"SF REIT" and explain some of their tax advantages. I then highlight the distinct characteristics and investment strategies of SF REITs.

Next, I explore the implications of SF REITs' presence in the single-family housing market. One major concern is that SF REITs, which typically acquire single-family homes with cash, may out-compete individual buyers who rely on mortgage financing. This could make it more difficult for individuals to become homeowners, particularly in markets where SF REITs are acquiring properties. Additionally, the influx of SF REITs may drive up home prices, making housing less affordable for prospective homebuyers.

However, SF REITs may stabilize the housing market by increasing the supply of rental properties and improving property management practices. They may also offer diversified investment opportunities for individuals who wish to participate in the real estate market indirectly. I conclude this article by discussing these potential benefits.

Defining the REIT

A REIT is a corporation that invests in a portfolio of real estate properties or related mortgage investments. These portfolios typically comprise residential and commercial properties. REITs function as large-scale landlords, acquiring properties and collecting rent from tenants.

REITs attract a wide range of investors, ranging from individual households to institutional investors such as pension funds, endowments, foundations, insurance companies, and banks. One key advantage of REITs is that many of them are publicly traded. This means that investors can easily buy and sell shares of REITs on stock exchanges, just like regular stocks. Thus, a REIT provides a level of liquidity and flexibility that traditional real estate ownership often lacks.

REITs offer tax advantages that set them apart from traditional corporations. First, they avoid double taxation. Unlike most corporations, REITs typically do not pay corporate taxes on their earnings. Instead, they distribute their untaxed income to shareholders, who are then taxed at the individual level. This allows for a more favorable tax treatment because the income is taxed only once. Another relatively new tax advantage of REITs is their ability to pass through deductions under the Tax Cuts and Jobs Act of 2017. REIT dividends may qualify for a deduction of up to 20 percent of the pass-through income.

To qualify for this advantageous tax treatment, a REIT must adhere to requirements set forth by the 1960 REIT Act.

First, no REIT may generate income through property flipping.[1] To enforce this prohibition, the Securities and Exchange Commission (SEC) requires each REIT to meet an annual income test.[2] Although the tax code is complicated and there are many ways to meet this test, REITs typically satisfy the income test by keeping rental-income-producing properties for at least two years, and by not selling more than seven properties in a year.[3] REITs that fail this test may pay a corporate tax and, potentially, a penalty tax of up to 100 percent on any "trading" income from properties sold too soon.[4]

Second, REITs must invest primarily in real estate. To enforce this rule, the SEC requires each REIT to invest at least 75 percent of its total assets in real estate. The REIT must also derive at least 75 percent of its gross income from real estate-related sources, such as rental income and proceeds from sales of real property.

Third, the primary beneficiaries of a REIT must be its shareholders. To enforce this requirement, the SEC mandates that each REIT distribute at least 90 percent of its taxable income to shareholders annually in the form of dividends.

These requirements incentivize REITs to focus on long-term real estate investments and the distribution of income to shareholders. To meet these requirements (and thus maintain their advantageous tax status), REITs typically hold onto their real estate properties—unlike "home flippers," who engage in short-term buying and selling.

Defining the SF REIT

Single-family REITs, or SF REITs, are a specialized type of REIT. Unlike traditional REITs—which primarily invest in multifamily residential properties, retail commercial properties, offices, and other industrial or commercial properties—SF REITs specifically target single-family homes.

Like other REITs, an SF REIT collects rent from tenants and distributes this rental income to its investors. In essence, it functions as a large-scale landlord for single-family homes. SF REITs arose after the 2007–2008 Great Financial Crisis (GFC). There is no consensus on why REITs did not target single-family homes before then. However, several factors contributed to the emergence of SF REITs in the postcrisis period.

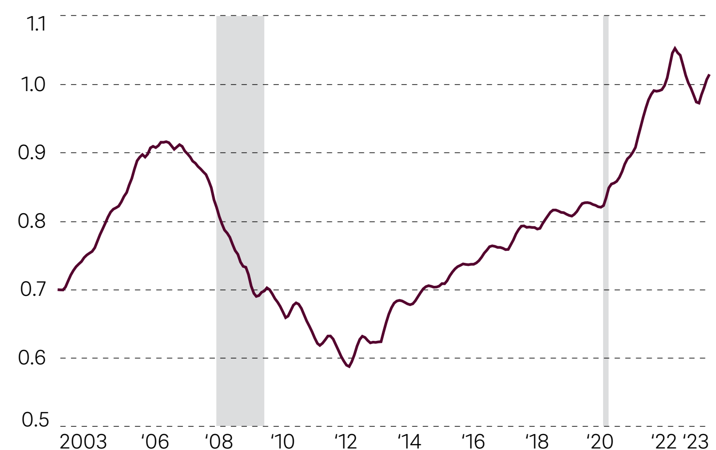
The housing crisis during the GFC led to lower prices for houses. Residential house prices dropped 27 percent from peak to trough, and it wasn't until 2021 that real house prices adjusted

FIGURE 2

Housing Prices Cratered After the Great Financial Crisis

The glut of foreclosed homes allowed SF REITs to purchase properties at lower prices.

S&P/Case-Shiller U.S. National Home Price Index divided by Consumer Price Index for all urban consumers



Sources: Federal Reserve Bank of St. Louis, S&P Dow Jones Indices LLC, and U.S. Bureau of Labor Statistics, retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/CSUSHPINSA and https://fred.stlouisfed.org/series/CPIAUCSL.

Note: CPI is city average of all items less food and energy in U.S.; shaded areas indicate U.S. recessions.

for inflation recovered and reached their precrisis level in real terms (Figure 2). The availability of foreclosed homes for sale after the crisis allowed institutional investors, including SF REITs, to purchase these properties at lower prices. The lower purchase prices increased the potential rental yields for single-family homes, making them an attractive option for REITs seeking to generate rental income.

At the same time, the Federal Reserve implemented measures–such as pushing short-term interest rates to zero and engaging in quantitative easing–that lowered the cost of financing the purchase of real estate properties (Figure 3).[5] This made it financially feasible for more investors, including REITs, to acquire single-family homes as rental properties.[6]

Furthermore, the GFC resulted in an increased demand for single-family rentals. Many households had lost their homes through foreclosure or a short sale during the housing bust and did not have any wealth to purchase a new home. In addition, credit standards were tightened in the aftermath of the GFC, and many households were wary of taking on additional debt to purchase a new home. These factors all contributed to the lower homeownership rate and the higher demand for rental housing (Figure 4).

Information technology has also played a role in the rise of SF REITs. Because single-family homes are more diverse and dispersed, it can be more difficult to price and manage a portfolio of single-family homes. However, advancements in technology, such as the availability of housing information through platforms like Zillow, have made it easier for SF REITs to more accurately price single-family homes, especially those with similar characteristics. This, in turn, has made it easier for SF REITs to expand and manage their portfolios of single-family homes.[7]

SF REITs have been part of a broader trend toward institutional ownership of single-family homes as opposed to owner-occupied homes and traditional "mom and pop" investors.[8] What makes SF REIT ownership special is its fast-increasing scale, concentration among certain neighborhoods, and long-term ownership structure. These all contribute to concerns about their effect, particularly in the areas they target.

Where SF REITs Invest, and What They Invest In

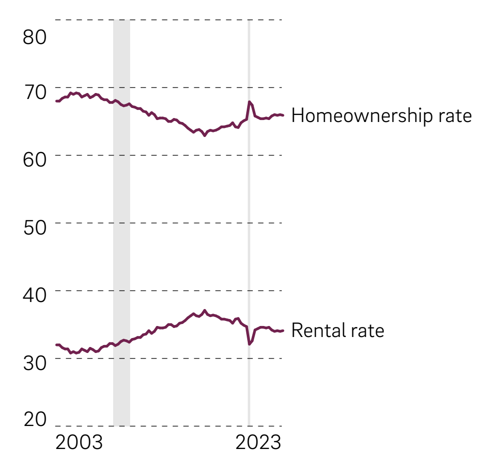
Because SF REITs are investing for rental income, they tend to invest in single-family houses with a higher rental yield. As a result, they tend to avoid investing in the most expensive cities, such as New York, which offer faster price appreciation but a lower rental yield. Instead, SF REITs target Sunbelt cities such as Atlanta and Dallas, where rental yields are higher. Sunbelt states also have a larger housing supply and fewer rental market restrictions, making them attractive for SF REITs seeking to acquire rental properties.[9]

The Sunbelt's more homogeneous

FIGURE 4

The Rate of Homeownership Declined as the Demand for Single-Family Rentals Increased During the Great Financial Crisis

Proportion of homes that are occupied by their owners, 2003–2023



Source: Federal Reserve Bank of St. Louis and Board of Governors of the Federal Reserve System (U.S.), retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/RHORUSQ156N.

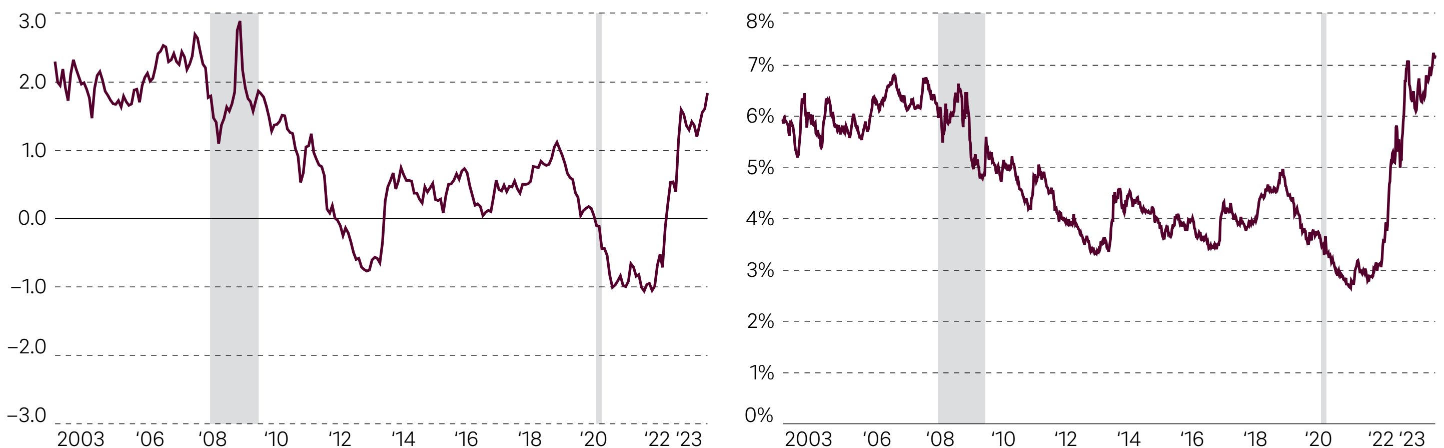
Note: Shaded areas indicate U.S. recessions.

FIGURE 3

The Fed's Response to the Great Financial Crisis Lowered Financing Costs

Low short-term interest rates enabled SF REITs to acquire and rent houses.

(left) Market yield of U.S. Treasury securities at 10-year constant maturity, quoted on an investment basis, inflation-indexed, 2003–2023
(right) Freddie Mac, 30-year fixed-rate mortgage average in the U.S. [MORTGAGE30US], 2003–2023



Source: Federal Reserve Bank of St. Louis and Board of Governors of the Federal Reserve System (U.S.), retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/DFII10 and https://fred.stlouisfed.org/series/MORTGAGE30US.

Note: Shaded areas indicate U.S. recessions.

housing stock also makes it easier to price and manage its properties. "Cookie-cutter" homes in large developments are much easier to price due to their similarity and their proximity to each other. In contrast, single-family homes in older cities were constructed over a longer period, leading to greater variation in their designs and construction standards.

The SEC filing of Invitation Homes, the largest SF REIT, reveals this concentration of holdings in the Sunbelt. Arizona, California, Florida, Georgia, Nevada, North Carolina, South Carolina, and Texas constituted 86 percent of Invitation Homes' total holdings by the end of 2021. Other major SF REITs exhibit a similar pattern of investment.

In addition, Sunbelt cities have become attractive investment locations due to their favorable rental market conditions. These areas often have a higher proportion of younger residents and faster population growth, providing the potential for increased demand and, thus, increased rental income.[10]

Even within the Sunbelt, SF REITs tend to concentrate their investments in specific areas. For example, the three largest SF REITs own significant shares of single-family homes in certain zip codes (Figure 5). In many of these zip codes, SF REITs own close to 5 percent of the single-family housing stock. Although these SF REITs lose the benefit of a more diversified portfolio, they capitalize on the advantages of an economy of scale. By clustering their investments geographically, SF REITs streamline property management and repair services, leading to increased operational efficiency. For example, a single technician can repair multiple air conditioners on a hot day if the houses are near each other rather than scattered across different cities. In addition, SF REITs work with developers and commit to buy some fraction of homes being developed, providing another potential economy of scale.

FIGURE 5

SF REITs Tend to Concentrate Their Investments in Specific Areas

Although SF REITs lose the benefit of a more diversified portfolio, they capitalize on economies of scale.

Zip codes with highest share of properties owned by the top three SF REITs, 2010 and 2020

Source: CoreLogic.

Another characteristic of SF REITs' investment strategy is their preference for buying entry-level homes. Although not exclusively focused on SF REITs, one article shows that large corporate buyers concentrated their holdings in low-income, historically nonwhite neighborhoods in Atlanta, Miami, and Tampa during the COVID-19 pandemic.[11] Homes in these less-luxurious areas are particularly popular among renters. By investing in entry-level homes, SF REITs can tap into a larger rental market and cater to the needs of a younger demographic. However, this means first-time homebuyers likely compete with SF REITs.

Why Worry About SF REITs?

SF REITs, as institutional investors, compete with individual homebuyers in the housing market. Unlike most individual homebuyers, however, SF REITs can pay cash. Sellers generally prefer cash offers due to the associated benefits, such as a shorter time-to-close and a lack of a mortgage financing contingency clause.[12] Indeed, recent research shows that a cash purchase is linked to a 16 percent reduction in the time required to complete a housing sale, and sellers are willing to accept a price discount of 5 to 7 percent for the faster and more dependable cash offers.[13]

Because SF REITs have such concentrated portfolios, they exacerbate competition in neighborhoods popular among first-time homebuyers. And because

homeownership is how most U.S. households build wealth, the difficulty homebuyers face in purchasing their first home can have long-term financial consequences.[14] With SF REITs targeting these neighborhoods, it becomes even more challenging for individual homebuyers to enter the housing market and build wealth.[15]

Research indicates that institutional investors, including SF REITs, outbid individual homebuyers, further exacerbating market competition.[16] According to this research, the increasing presence of institutional investors in the housing market explains over half of real house price appreciation between 2006 and 2014, and the market entry of institutional investors contributed to the decline in the homeownership rate during that period. However, we need to conduct further research to understand the dynamics and implications of this more-recent period.

But SF REITs Have Their Benefits, Too

However, SF REITs benefit both investors and renters in the real estate market. For investors, SF REITs offer a more convenient way to invest in multiple single-family homes. Investing in real estate can be expensive, making it challenging for individual investors with limited funds to diversify their portfolios. An SF REIT solves this problem by pooling resources from multiple investors and allowing them to benefit from the diversification of investments across various properties.

Investors in SF REITs enjoy benefits like those available to individual homeowners and small real estate investors. For instance, SF REIT investors can deduct interest payments as expenses—much as individual homeowners can deduct the interest they pay on their mortgages. This tax advantage can lower the overall tax liability for SF REIT investors and improve their investment returns.

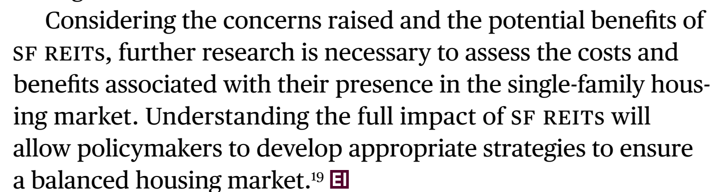
SF REITs also benefit renters, particularly renters in the single-family housing market. SF REITs increase the availability of rental properties in areas where options were previously limited. For example, SF REITs increasingly invest in built-for-rent single-family homes, and their investment encourages new construction of those homes. The increasing number of built-for-rent single-family homes might alleviate the housing supply shortage. By investing in housing development, SF REITs contribute to the expansion of the rental stock in these neighborhoods, addressing the demand for housing. One study found that the share of built-for-rent housing starts (out of all single-family housing starts) increased from almost zero in 1974 to about 4 percent in 2020.[17] This trend aligns with the broader interest of SF REITs in the Sunbelt, as it allows them to focus on areas where the housing stock is more homogeneous, making pricing and management more efficient. This increased supply provides renters with more options and helps alleviate rental market pressures.

SF REITs also make living in desirable suburban neighborhoods more affordable for renters, particularly young households. SF REITs enable individuals and families to reside in desirable locations without the hassle of purchasing a home or the burden of carrying a mortgage. A recent research paper shows that institutional housing investors may improve renter welfare. It finds that concentrated institutional ownership increases housing rents but reduces local crime rates.[18] SF REIT ownership increases the accessibility of housing options and allows renters to enjoy the amenities and benefits associated with these neighborhoods.

Conclusion

The emergence of SF REITs has garnered attention. Although SF REITs are still relatively small in the overall housing market, their rapid growth, particularly in certain locations, has raised concerns regarding their potential impact on individual homeownership. These concerns arise because SF REITs often acquire properties with cash, which makes it challenging for individuals to compete with them in the housing market.

However, SF REITs provide benefits to both investors and renters. Investors can take advantage of the opportunities offered by SF REITs to invest in a diversified portfolio of single-family homes. Renters can benefit because SF REITs increase the availability of rental properties in areas where there was previously a limited supply. This expansion of rental options addresses housing needs and provides individuals with more choices for their living arrangements.



Considering the concerns raised and the potential benefits of SF REITs, further research is necessary to assess the costs and benefits associated with their presence in the single-family housing market. Understanding the full impact of SF REITs will allow policymakers to develop appropriate strategies to ensure a balanced housing market.[19]

Notes

1 This "investment term" rule makes clear that REITs are intended for long-term real estate investments rather than short-term buying and selling. See Schneider et al. (2022).

2 See the 2011 SEC bulletin for an overview.

3 This is called a safe harbor rule.

4 See Lecha (2020) for more details.

5 See Drozd (2018) and Yu (2016) for examples.

6 Although SF REITs do not use mortgages to purchase individual real estate properties, they borrow at the corporation level, and the cost of issuing equity is linked to external financing costs.

7 See Dezember (2018) and Cashdan (2021) for examples.

8 See Lambie-Hanson, Li, and Slonkosky (2018).

9 See Immergluck (2022).

10 See Hermann (2021).

11 Raymond et al. (2022).

12 A mortgage financing contingency clause allows a potential buyer of the house to back out of a real estate transaction if their mortgage application is rejected. The seller would then have to return the initial deposit. This would likely lead to the property being relisted, delaying the sale.

13 Han and Hong (2023).

14 A rent-to-own agreement, which allows a renter to commit to renting a property for a specific period, with the option of buying it before the lease runs out, is rarely used for properties owned by SF REITs.

15 See Turner and Luea (2009), for example. However, this might benefit the homeowners in these neighborhoods due to higher housing prices. See Li and Rui (2006) and U.S. Department of Housing and Urban Development (2023).

16 See Lambie-Hanson, Li, and Slonkosky (2022). They classify a transaction as having an institutional buyer or seller if the property is bought or sold by a company instead of a named individual.

17 Hermann (2021).

18 Gurun et al. (2023).

19 In his 2023 *Economic Insights* article, Philadelphia Fed economist Kyle Mangum explains how housing policy can mitigate the negative impact of housing market investors.

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