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7 June 2016

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RMBS - US

Declining First-Time Home Ownership in the US is Credit Positive for SFR Securitizations

Executive Summary

Housing affordability in the US, particularly for first-time home buyers, has been falling since 2000, giving a boost to single-family rental (SFR) securitizations. Reduced affordability for first-time home owners, a result of declining personal income and rising home prices, has hit the Generation Y cohort[1] especially hard, as individuals in their 20s and 30s seek to form households and purchase homes. A dearth of "for-sale" inventory of mid-to-lower price homes, combined with ongoing tight credit conditions, forces many to remain in rentals. In addition, many potential first-time home buyers are burdened with high student loans that further constrain their buying capabilities.

As a consequence, demand for rentals is remaining very strong for the limited number of available rental properties. Nationwide rental vacancy is presently 7%, down from 11% in 2009, according to the US Census Bureau. We believe this drop in vacancy bodes well for the SFRs that we rate, especially regarding anticipated future enhanced rental revenue as Gen Y renters are a large component of SFR renters. This also portends higher liquidation proceeds on potential sales of SFR properties.

Stagnant inflation-adjusted household incomes and high non-mortgage debt burdens hamper first-time home buyers

Home ownership rates in the US continue to decline from pre-crisis highs to very low levels for households headed by younger Generation Y individuals. For individuals aged 35 and younger, the home ownership rate declined from 40.4% in fourth quarter 2009 to 34.2% in first quarter 2016, even as the US economy stabilized after the financial crisis. For those in the Generation X cohort (aged 36 to 51), the decline over the same period is from 65.7% to 58.9%. For more established households, those headed by individuals aged 45-54, the rate of decline has been moving likewise, falling from 74% to 69.2%, while still well above the national average of 63.5%.[2]

According to the National Association of Realtors (NAR), overall US home buyer affordability remains high owing mainly to low mortgage rates. The First Time Homebuyer Buyer Index however, continues a negative trend, falling to a value of 113[3] in first quarter 2016 from a value of 116 in 2013,[4] up from 109.2 at 2015 year end. This drop is the result of ever more expensive homes and lagging income growth; low interest rates have not had the expected

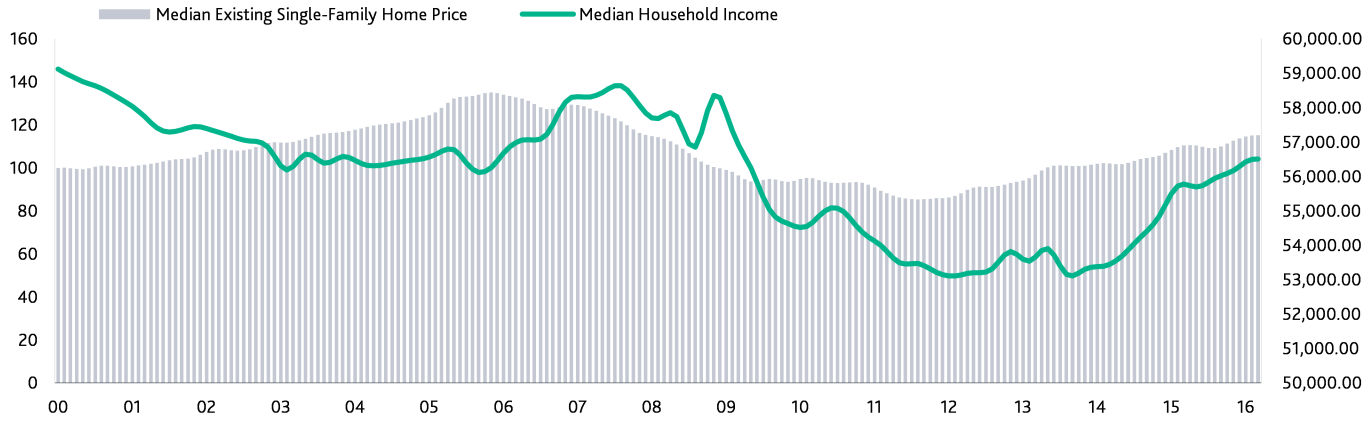
positive impact on the Gen Y cohort, which nonetheless represented 67% of first-time home ownership in 2015.[5]

The Composite Index that includes all potential home buyers in the US remains far more robust, at 171.4 in the first quarter of 2016, albeit down from 176.9 in 2013. Older, well-established homebuyers tend to be the main beneficiaries of low mortgage rates. The low first-time homeowner index value is in relation to a starter home price of $185,000 with a 10% down-payment—a price that is not realistic in many of the preferred metropolitan statistical areas (MSAs) in California and major northeast cities, which are among the least affordable in the nation. A study conducted by the NAR indicates that Gen Y/millennial buyers aged 18-35, mainly married, were the largest segment of 2015 home buyers, at 35% of the market, following a historical household formation trend. In 2015, millennials purchased homes that averaged $187,400 (similar to the first-time homeowner affordability price assumption of $185,000), but had an average income of $77,400 in 2015, which is well above the national median income of $56,000 and the $44,480 income that the NAR uses for its first quarter 2016 first-time homeowner index.[6]

One reason for the declining home ownership and affordability is stagnant household incomes. US inflation-adjusted median household incomes have declined to just over $56,000, [7] from approximately $59,000 in 2000. As Exhibit 1 shows, incomes have not yet returned to pre-crisis levels, having dropped sharply from a peak in mid-2007 to lows in the third quarter of 2013. This said, from 2000 to 2016 median existing single-family home prices[8] climbed 15% on an inflation-adjusted basis, despite sharp drops during the financial crisis. The index has risen sharply by approximately 36% on an inflation-adjusted basis from post-crisis lows in 2012. The Federal Housing Finance Authority (FHFA) purchase only and Case Schiller indices show similar patterns, with even higher growth, as Exhibit 1 also shows. This macroeconomic dynamic limits the ability of potential home buyers 1) to qualify for mortgages under relatively strict, though marginally looser, lending criteria than those established immediately following the financial crisis, or 2) to save the necessary down-payment for ever more expensive properties. In turn, many potential homeowners are forced to opt for rental housing.

Exhibit 1

Inflation-Adjusted Median Existing Single-Family Home Price Compared with Median Household Income



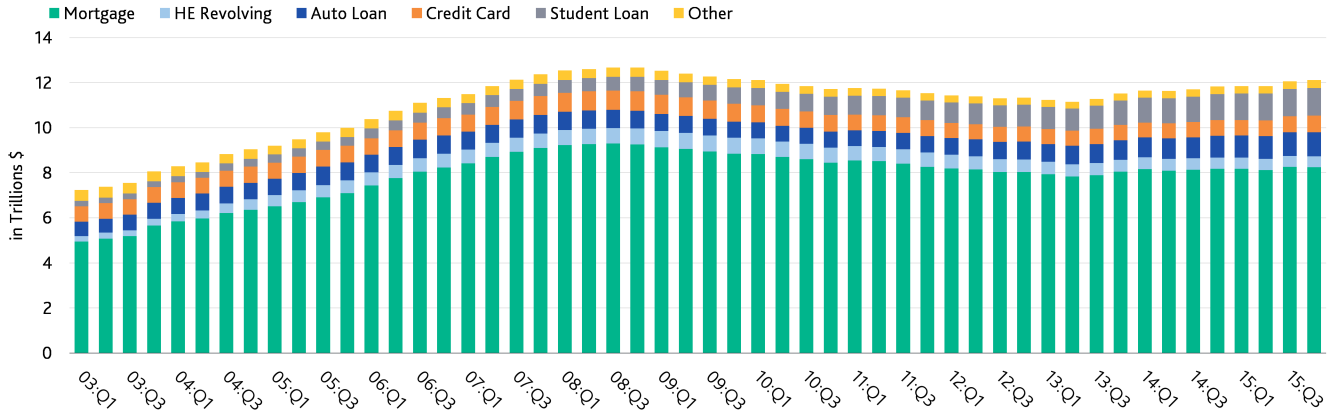
Source: NAR, BOC, Moody's Analytics

On top of stagnant income, high non-mortgage debt also increases the burden of US households. As Exhibit 2 shows, even though absolute household debt has declined marginally from 2008 highs, student loan and auto indebtedness has grown considerably to 10% and 9% respectively of total debt held by consumers at third quarter 2015. In terms of household debt service payments as a percentage of disposable income as compiled by the Federal Reserve, total debt service has fallen from 12.78% in third quarter 2008 to 10.07% in third quarter 2015. Mortgage payment and consumer payment ratios have declined from 6.93% and 5.85% to 4.56% and 5.51% respectively over that period, mainly owing to lower levels of debt.[9] For the younger demographic, a rental obligation typically takes the place of a mortgage payment.

Many younger potential home buyers are saddled with high student loan and auto loan indebtedness on top of high rent and therefore have limited additional debt capacity. Anticipated higher interest and mortgage rates will also move prospective mortgage qualification and home ownership even further away.

Exhibit 2

US Household Indebtedness

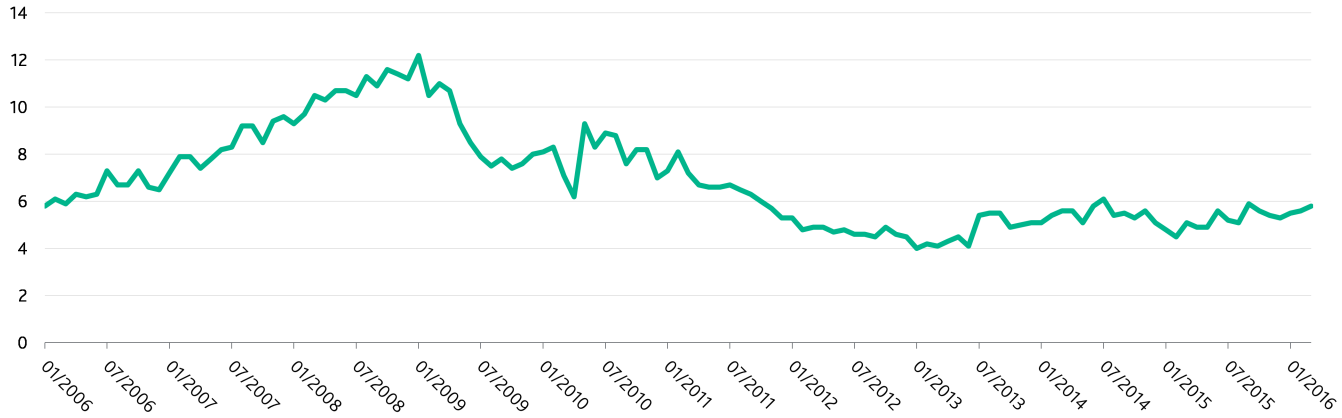


Source: New York Fed Consumer Credit Panel/Equifax

In addition, a low inventory of homes for sale—especially of starter homes at low- to mid-tier home prices—can discourage potential first-time homebuyers, and in many cases the value proposition comes up wanting for those seeking to buy in the relatively more attractive but costlier MSAs. The current monthly supply of homes remains well below the recent peak in availability of late 2008 and marginally below the six-months' supply that economists generally consider a balanced supply, as Exhibit 3 shows.[10]

Exhibit 3

Monthly Supply of Houses in the US



Source: US Bureau of the Census, Federal Reserve Bank of St. Louis

Potential homebuyers also appears to be a reluctant to commit to home ownership given the extreme variability in home prices and homeowner equity before, during and after the financial crisis. The tax benefits of home ownership may also be questioned because general household deductions for many often exceed the benefits of an itemized return that deducts from taxable income mortgage interest and property taxes, as a result of low mortgage rates and the typically lower financed cost of a home for first time homeowners.

Rental rates will continue to rise, benefiting SFR securitizations

The Inflation-Adjusted US Rent of Primary Residence is up 15% since 2000, with year-over-year growth of around 3%. As of March 2016, Zillow Rent Index has reported a growth of 10.6% since the end of 2010. This upward trend is in line with home price appreciation and strong consumer demand for rentals as the rate of home ownership rate declines. Of the 37% of households that rent in the US, 51% of renters are younger than 30 and 74% are younger than 44. This said, rental vacancy rates remain historically low, at 7% in first quarter 2016, down from a peak of more than 11.1% in 2009. Homeowner vacancy rates also remain low at 1.9% at the same juncture, down from a peak of 2.9% in fourth quarter 2008. But median asking rent (unadjusted for inflation) for vacant rent units as reported in the US Census survey continues to rise, averaging $850 nationally in fourth quarter 2015, up from approximately $675 at commencement of the financial crisis. We believe the increasingly unattainable goal of home ownership for many, in tandem with the low national rental vacancy rate, will persist and continue to buoy rental demand and the ensuing higher rents, both of which bode well for SFR cash flows. While some Gen X and millennials prefer a mobile lifestyle and high-cost locales with higher-paying jobs, others, particularly those with families, are opting for single-family homes. In 2015, 35% of renter households were single-family homes.[11]

While many household formations over time include a move from urban to suburban locales, this trend may be slowing down in major city suburbs that are also out of the price range for many potential first-time home buyers and renters. Many affordable MSAs are located in smaller urban areas where jobs are fewer than in large metropolitan MSAs but home prices and rents are lower.

The majority of SFR rental properties in transactions that we rate are located in or near urban centers, but these do not include the largest MSAs in the northeast and the west, where very high home prices and related rents are less economic for SFR securitizations. Exhibit 4 details the largest MSAs that contain properties backing the SFR deals that we rate.

Exhibit 4

SFR Property Concentrations by MSA

MSA Name	Number of Properties	% of Total SFR Properties
Atlanta-Sandy Springs-Marietta, GA	11,494	12.67%
Phoenix-Mesa-Glendale, AZ	9,676	10.67%
Tampa-St. Petersburg-Clearwater, FL	6,437	7.10%
Charlotte-Gastonia-Rock Hill, NC-SC	4,698	5.18%
Dallas-Fort Worth-Arlington, TX	4,660	5.14%
Houston-Sugar Land-Baytown, TX	4,317	4.76%
Las Vegas-Paradise, NV	4,266	4.70%
Miami-Fort Lauderdale-Pompano Beach, FL	4,185	4.61%
Orlando-Kissimmee-Sanford, FL	3,808	4.20%
Chicago-Joliet-Naperville, IL-IN-WI	3,384	3.73%

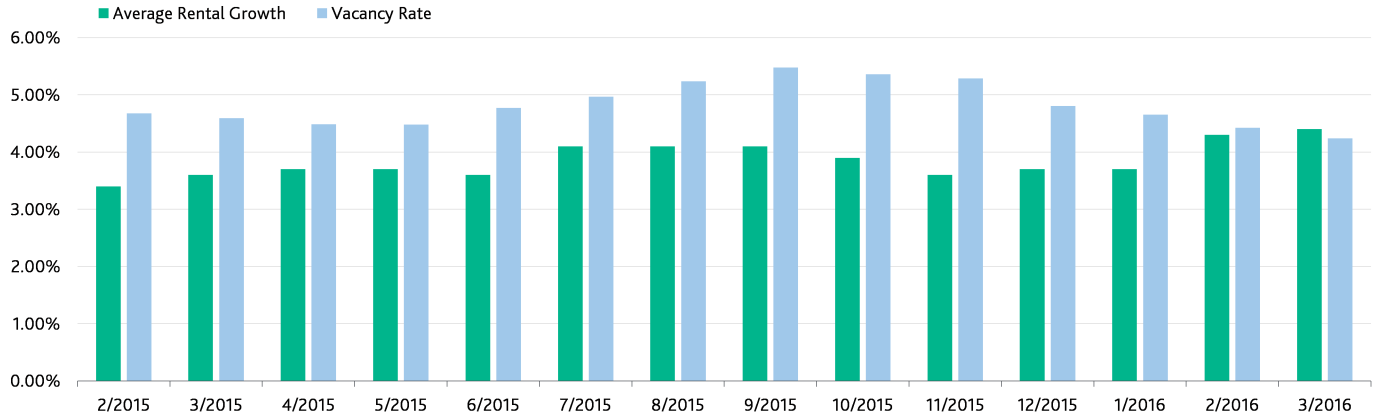
Source: Moody's Investors Service, based on data from servicer

As of March 2016, the vacancy rate of the rental properties backing SFR securitizations was 4.2%, a low rate when compared with national rental vacancy rates of 7%, as Exhibit 5 shows. Moreover, SFR operators have been able to secure monthly rents on new leases and lease renewals that are 3% to 6% higher than on previous leases. The transactions are all generating monthly rental revenues of 3.6x to 6.1x the monthly distributions necessary to service the debt obligations.

In spite of already elevated rents, we expect the revenue growth rate of rentals to continue to outstrip the inflation rate over the next several years because renters will have little choice but to pay higher rates owing to the lack of available rentals and limited home ownership opportunities. Slowing home price appreciation and anticipated higher interest rates should continue to constrain home prices and associated rents.

Exhibit 5

SFR Average Rental Growth and Vacancy Rate



Source: Moody's Investors Service, based on data from servicer

Stronger demand for rental properties will benefit SFR securitizations by enhancing borrower and transaction-specific revenue streams and net cash flows, while also potentially increasing recoveries on foreclosures of underlying properties, should the need arise. The continued financial strength of borrowers and compliance with transaction performance metrics are more likely in this healthy industry environment.

Endnotes

1 While inexact, the phrases "Gen Y" and "millennial" refer to individuals born between 1980 and 1995, and "Generation X" or "Gen X" refers to individuals born between the mid-1960s and 1980.

2 *US Census Bureau News* , 28 April 2016, US Department of Commerce.

3 The NAR Homeowner Affordability Indices measure the relationships among home price, income mortgage cost and related affordability for potential buyers. An index of 100 is defined as the point where a median-income household has exactly enough income to qualify for the purchase of a median-priced single-family home; an index of 113 means the median-income household has 113% of the income necessary to qualify for a mortgage with an LTV of 80%.

4 *First-time Homebuyer Affordability Report* , National Association of Realtors, 9 May 2016.

5 *Home Buyer and Seller Generational Report 2016* , National Association of Realtors, 9 March 2016.

6 *Home Buyer and Seller Generational Trends Report 2016* , National Association of Realtors, 9 March 2016.

7 Measured in 2016 dollars.

8 NAR reports median existing single-family home prices on a quarterly basis.

9 *Quarterly Report on Household Debt and Credit* , Federal Reserve Bank of New York, November 2015.

10 The monthly supply is the ratio of the number of houses for sale to the number sold. The monthly supply indicates how long the current for-sale inventory would last given the current sales rate if no additional new homes were built.

11 *Quick Facts: Resident Demographics*, National Multifamily Housing Council, August 2015 data.

REPORT NUMBER 1027801

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