A COTTAGE INDUSTRY GOES BIG:

Institutional Investors Flock to Single-Family Homes

The depressed housing market has offered buyers an opportunity: attractive deals. Large investors have responded, buying houses that they intend to place on the rental market. How might their decisions affect the housing sector overall?

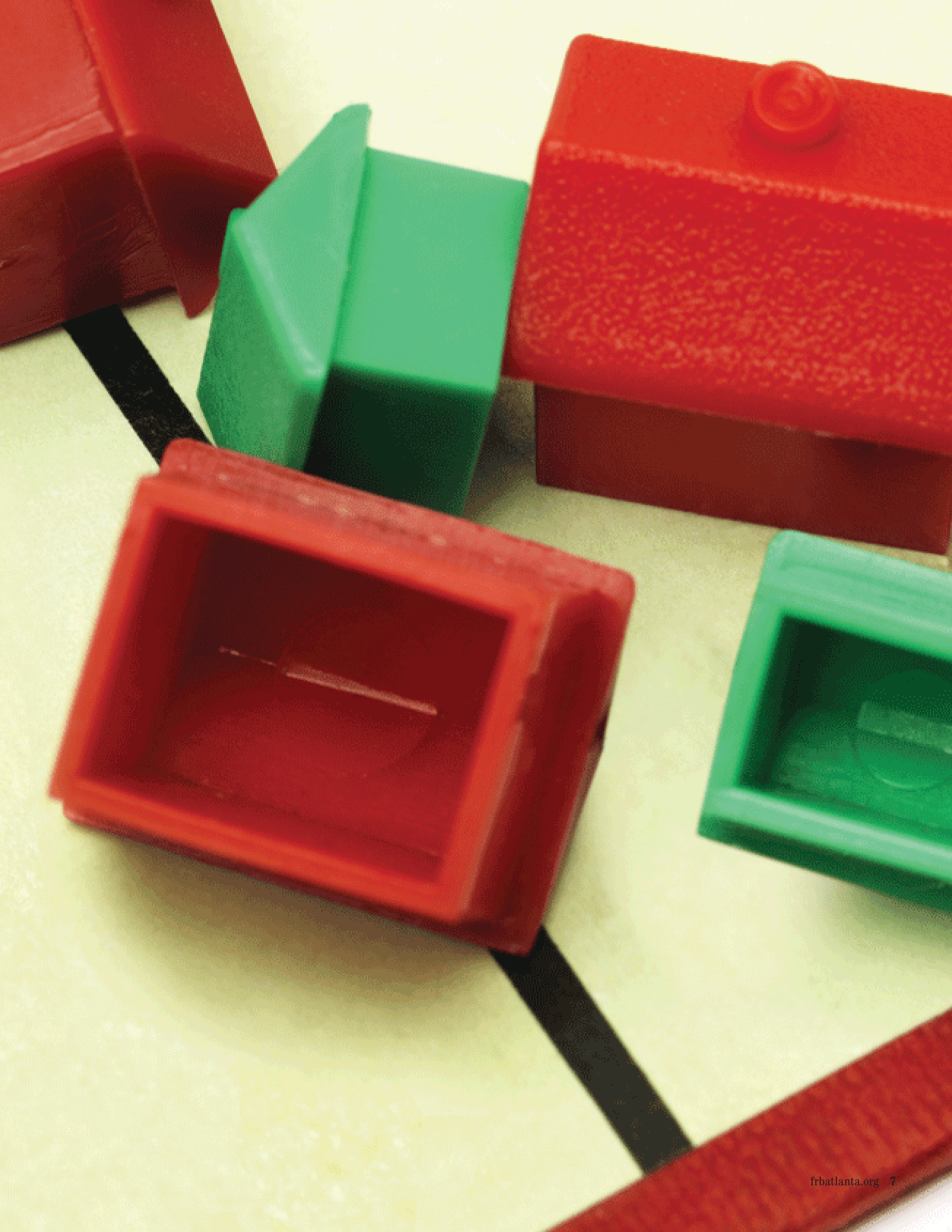
Some of the country's richest, savviest financiers have created a multibillion-dollar industry over the past year and a half. And the Southeast is smack in the middle of it.

Institutional investors, led by private-equity giants Blackstone LLC and Colony Financial Inc., have fire-hosed money into the traditionally mom-and-pop business of buying discounted single-family houses, renovating them, and then renting them out. In the past year, deep-pocketed investors have scooped up tens of thousands of distressed properties, including thousands in Georgia and Florida, before prices rise too much. Just to name a couple of the biggest players, Blackstone has spent more than $4 billion on about 25,000 houses and is still shopping, while Colony has invested more than $1 billion in more than 8,200 properties and, as of March, still had $1 billion set aside to buy another 1,000 homes a month. In May, Colony's single-family rental subsidiary, Colony American Homes, filed for an initial public offering.

Individual firms' strategies differ, of course, but the idea behind this new asset class of single-family rentals is straightforward. Investors are targeting markets with two broad traits: places that suffered abundant foreclosures and the recession-driven decline in home prices, but ones that also offer sound long-term economic prospects. Along with several cities in the West and Southwest, Atlanta and Florida's metropolitan areas—including Miami, Orlando, and Tampa—fit that bill, in the view of these investors. Investors are acquiring houses through numerous channels, including foreclosure auctions (see the sidebar)—the source of roughly half of Blackstone's portfolio—and normal individual purchases, as well as acquiring homes from government-sponsored mortgage enterprises, financial institutions, and other investors.

It's the old mantra, with a twist: buy low, fix up, rent, and then perhaps sell high.

"We looked at this asset class and said, 'Gosh, we can buy homes that sold for $300,000-plus for $150,000,'" Jonathan Gray, global head of real estate for Blackstone, said at the Credit Suisse Financial Services Forum held in February 2013 in Miami. Gray's firm last year formed a company called Invitation Homes to execute Blackstone's rental strategy. Blackstone calculates that, given the dearth of new homes built since the housing bust,



its venture should work with even modest economic and population growth.

Colony Financial, a publicly traded real estate investment trust established by the private equity firm Colony Capital, is equally enthused about this "new institutional real estate asset class," said its CEO, Richard Saltzman, during a March earnings conference call.

The institutionalization of house rentals parallels what happened to the apartment business about 20 years ago. Around the early 1990s, the multifamily real estate business evolved from one dominated by individual landlords with a handful of units to one ruled by institutional players with sprawling apartment complexes all over the country, noted several real estate experts, including Marcus Ridgway, the chief operating officer of Invitation Homes (see the Q&A on page 12).

Long-range implications are unclear

This emerging rental industry is sufficiently new that its implications for the broader housing market are not clear. Most observers believe investor purchasing has pushed up home values, which have risen nationwide in the past year but remain below prerecession levels in most markets hit by the housing bust. At the same time, by forcing prices up and the supply of available homes down, the entrance of deep-pocketed buyers has shrunk the supply of homes available to lower-end buyers as well as small-scale landlords, who traditionally have bought foreclosed houses.

Then there are questions about what this trend could mean for communities. Some real estate agents and neighborhood activists worry that bulk home buying will flood neighborhoods with renters and thus make communities less stable. In addition, the large investors figure to eventually sell their houses for a profit. On top of the rental income, home price appreciation is part of the typical institutional investment strategy, spelled out in the initial public offering documents of a couple of firms. When will they sell, and how will that affect local housing markets?

Many of these medium- and long-term effects probably won't be apparent for several years. But some things are clear, notably the startling speed at which this new business is coalescing.

Blackstone, widely billed as the country's biggest private-sector real estate owner, bought 1,500 houses in metro Atlanta in a single April transaction for Invitation Homes, bringing to roughly 25,000 the number of houses Invitation Homes has acquired nationally since early 2012. Another firm, Arizona-based American Residential Properties Inc., bought or put under contract 785 houses in the first two weeks of April, including 91 in Florida and Georgia. Meanwhile, Silver Bay Realty Trust of Minneapolis aims to acquire 300 to 400 homes a month across the country this year. At the end of 2012, 45 percent of Silver Bay's inventory of 3,400 homes was in the Southeast. Colony American Homes plans to expand its holdings this year from 8,200-plus

On the Courthouse Steps

Buying dozens or even hundreds of houses at a time has typically not been the practice of purchasers at foreclosure auctions. Before the institutions showed up, individuals who rented out a dozen or couple dozen houses were generally the only buyers on courthouse steps, said Frank Norton, CEO of the 85-year-old real estate and insurance brokerage the Norton Agency, which is based in Atlanta and has offices in three states.

The institutions have changed that. Recent monthly foreclosure auctions in metro Atlanta have drawn four times the usual crowds, said Norton, who closely follows Atlanta-area housing conditions. In suburban Gwinnett County, the April auction drew 250 people, Norton estimated. Before the housing bust, Gwinnett's monthly auctions attracted 50 or 60 people.

On a gray and unseasonably chilly morning in May, some 200 people crowded the steps of the Fulton County Courthouse in downtown Atlanta. To a novice, the event might appear chaotic. Three people simultaneously read legal notices and conducted auctions. Potential bidders clustered around each auctioneer and leaned in to hear, many of the bidders swiping through listings on tablet computers or perusing pages on clipboards. Several people circulated through the crowd wearing caps bearing the logo of bidcast.tv, an online service that provides live streaming video of auctions around the country.

Buyers for institutional investors have in recent months attended these auctions "in armies," carrying folders stuffed with cashier's checks, Norton said. "They leave the auctions disappointed they weren't able to buy more."

Their purchasing has raised home prices, though it is hard to gauge how much price appreciation is a result of investors. Rising investor demand, which has supported house prices, could "continue to provide a floor for them," Federal Reserve Governor Elizabeth Duke said in a March 2013 speech. She added that some investors will likely sell their accumulated homes as prices rise. She also said, though, that she suspects "the development of large-scale rental of single-family homes as an asset class has gained enough traction with investors to continue in some form." ∎

A Sampling of Institutional Investors' Single-Family Holdings in the Southeast			
Silver Bay Realty Trust	**Properties**	**Average cost/ property**	**Average age (years)**
Tampa	897	$125,000	23
Atlanta	785	116,000	17
Orlando	134	139,000	23
Miami-Dade, Broward, Palm Beach counties	115	158,000	33
Jacksonville	51	89,000	36
American Residential Properties			
Atlanta	169	70,554	20
Fort Myers, Florida	138	45,996	9
Colony American Homes			
Georgia	1,848	110,000	23
Florida	603	161,000	22
Invitation Homes			
Florida	5,800	DND	DND
Atlanta	3,800	DND	DND

Notes: Data are current as of March 31, except data for Invitation Homes are current as of May 9. Average cost per property includes renovation costs. DND indicates "did not disclose."
Sources: U.S. Securities and Exchange Commission filings, Invitation Homes

houses as of March—including more than 1,000 in Georgia—to about 20,000, according to the company (see the table).

Exact volume of investor-owned homes hard to quantify

It is difficult to calculate the precise number of houses institutional investors have acquired, but their overall share of the total housing market is small. For instance, among the 13 million to 13.5 million single-family rental houses in the United States, institutional investors own no more than 100,000 to 300,000, Ridgway said.

Still, a year and a half ago, they owned far fewer. In metro Atlanta and Florida during 2012 and early 2013, the top half-dozen institutional investors appear to have amassed at least 15,000 homes based on interviews, data from securities filings, news reports, listings on rental company websites, and CoreLogic, a data and analytics company. Four Southeast markets—Miami, Orlando, Atlanta, and Tampa—were among the seven markets nationally where institutional investors were most active in 2012, according to CoreLogic (see the chart).

In Miami, 30 percent of 2012 home sales were to institutional investors, which CoreLogic defines as groups that buy five or more properties a year using the same name, or as investors that used an incorporated entity to finance their purchases. Yet Miami is an outlier in the single-family home market, as the majority of home sales in Miami-Dade County—60 percent—are condominiums, said Ron Shuffield, president of Miami-based EWM Realty International, one of south Florida's leading residential real estate firms.

In recent months, Atlanta Fed surveys of builders and real estate agents found that investors accounted for about a quarter of all home sales in the Southeast. But that portion rises to more than half of sales in some markets in central and south Florida.

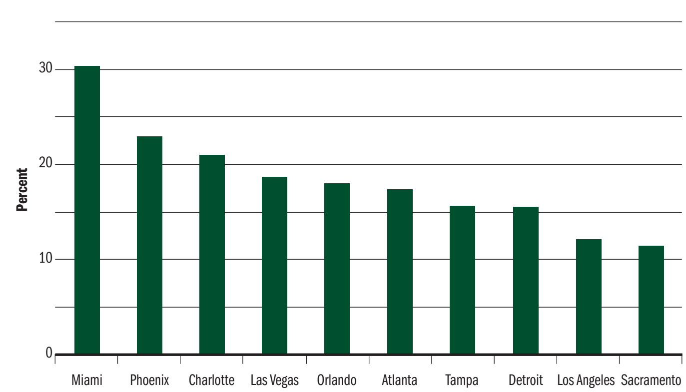
Is the window closing?

Some institutional investors believe that the window for bulk buying could be closing as the inventory of distressed homes dwindles and home prices climb. In Phoenix, Arizona, for example—thanks mainly to institutional investors—the price of foreclosed houses shot up 37 percent in the fourth quarter of 2012 compared with the same period in 2011, according to data from CoreLogic. News reports in late 2012 said institutional buyers had shifted their attention from Phoenix and toward markets such as Atlanta and Tampa, where prices of foreclosures—or real-estate-owned property (REO)—had not risen as much (14.5 percent and 12.5 percent, respectively) and REO properties were more plentiful.

As of April, builders and real estate agents in Georgia and Florida apparently did not think the window for investors had closed. The Atlanta Fed conducted a survey in April, and 96 percent of respondents in Florida and 56 percent in Georgia expected home sales to investors to remain steady or increase in the second quarter of 2013 over the first quarter.

Meanwhile, public statements from corporate landlords indicate they expect buying will remain active. For instance, the CEO of Silver Bay, David Miller, said on a March conference call with analysts that his company sees plenty of bargains left. While conditions differ from market to market, Miller said that Florida has a backlog of foreclosures because the process there involves the judicial system and therefore takes longer than in

Institutional Investor Share of Home Sales, 2012



Source: CoreLogic

some other states. "In Florida, we see supply for a number of years," Miller said. "Our team is at auction every day; they're writing offers every day."

A boon to homeowners?

Support for home prices is good news for homeowners looking to build, or rebuild, equity. Fed researchers have estimated that house price increases of 10 percent or less, from levels in April, would allow about 40 percent of underwater homeowners to regain positive equity, noted Federal Reserve Governor Sarah Bloom Raskin in an April speech.

Yet there is another side to the equation. The investor purchases are forcing up prices of lower-end homes, according to numerous reports, which damages the prospects of homeownership for some potential buyers, some real estate agents say. CoreLogic notes that in markets where institutional investor activity rose last year, lower-end home prices rose 15 percent, compared with only 6 percent in other markets.

In the \$100,000–\$250,000 price range in relatively new subdivisions, "it's definitely having an effect," said Brad Monroe, a past president of the Greater Tampa Association of Realtors. "It's a popular conversation … any time you get a group of Realtors together, bemoaning the fact they can't get offers accepted because [the sellers] have multiple all-cash offers from investors."

Higher prices at auctions are also pricing out the smaller single-family landlords, said Frank Norton, CEO of the Norton Agency, an Atlanta-based real estate and insurance brokerage. And rising values are fueling the notion that prices for distressed properties will eventually reach a level that will undermine the business model of institutional single-family home landlords.

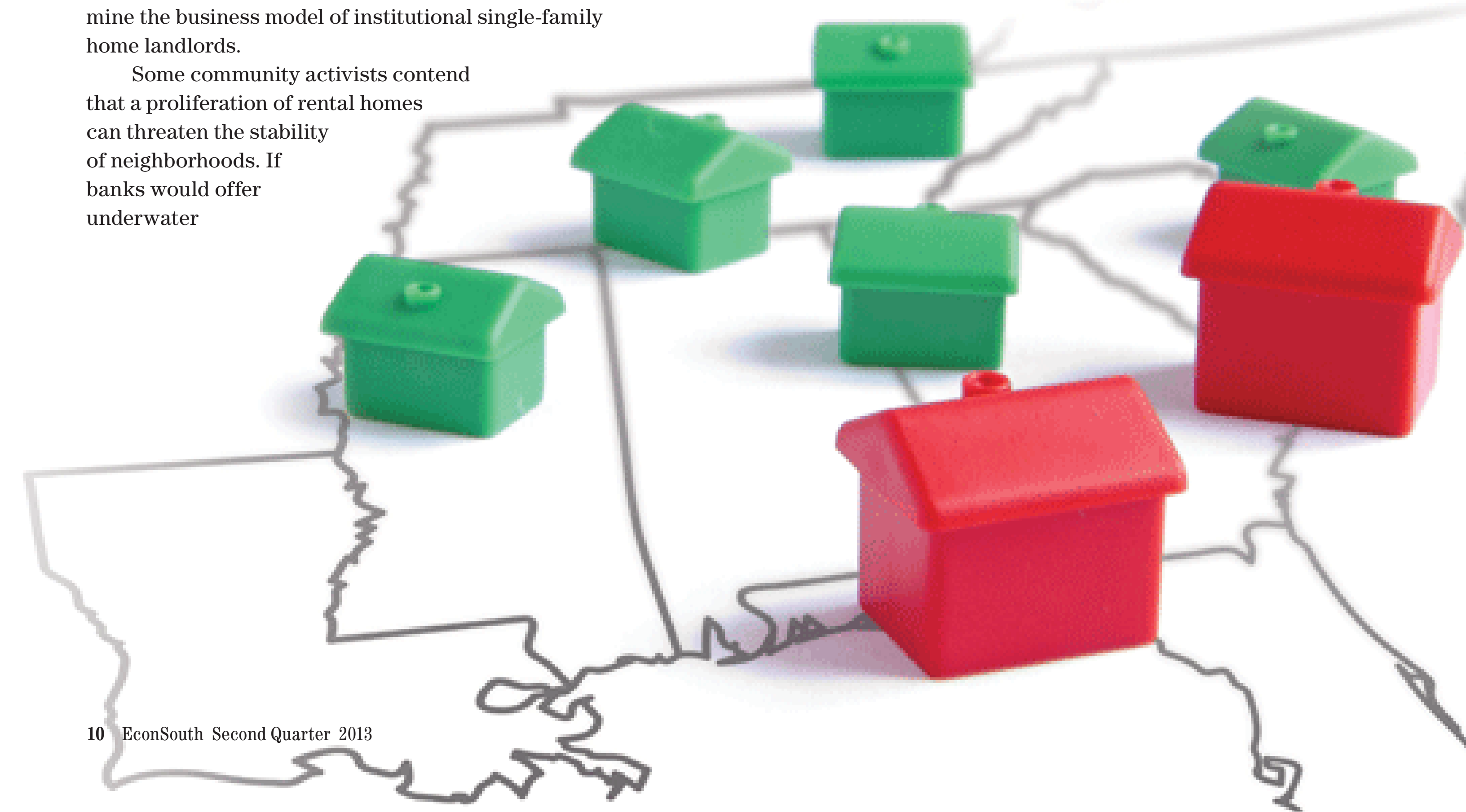
Some community activists contend that a proliferation of rental homes can threaten the stability of neighborhoods. If banks would offer underwater homeowners principal reductions that match the prices they are getting at foreclosure auctions, more homeowners could probably make payments and remain in their homes, rather than seeing them sold to investors, Atlanta neighborhood activist Shabnam Bashiri wrote in a recent column on the *Huffington Post* website.

A compelling business strategy

A confluence of factors makes single-family rental an attractive business strategy for groups that can secure hundreds of millions of dollars to buy houses in bulk.

First, millions of homes in foreclosure or in distress can be had for less than "replacement cost," or what it would take to build them. Second, because of tighter lending standards, many aspiring or former homeowners can't secure financing to purchase a home and are therefore renting. If a homeowner loses a house to foreclosure, for instance, that person is unlikely to qualify for another mortgage for many years.

In metro Atlanta, for example, the homeownership rate fell from 68 percent in 2006 to 63 percent at the end of 2012, according to the U.S. Census Bureau. Nationally, the share of people who own homes was 65 percent in the first quarter of 2013, the lowest level in 18 years and down from a peak of 69 percent in June 2004. Every 1 percent drop in the homeownership rate equates to 1.1 million new prospective renters, said the single-family rental firm American Residential Properties Inc. in a March Securities and Exchange Commission filing for an initial public offering. The firm cited research by John Burns Real Estate Consulting of Irvine, California.



Finally, household formation plummeted during the recession. One reason frequently cited: young people who were unable to land jobs, or who were only able to find lower-paying work, lived at home with their parents. As the economy continues to slowly recover, household formation is expected to rebound and outpace housing starts by more than 2 million households through 2015, according to John Burns Consulting.

Other factors are at work, too. With jobs harder to find, many people want to be mobile so they are more likely to rent a home than own one. As a result of these factors, rental rates in recent years have risen, vacancy rates have fallen, and institutional investors have decided to become single-family landlords.

"There are just not a lot of people building," Ridgway said. "There are not a lot of people lending, and there's a lot of people needing homes."

Who said homes are not an investment?

After home values plummeted in recent years, conventional wisdom held that homeowners should not consider houses an investment. Median U.S. home prices had climbed steadily since the 1940s, according to the U.S. Census Bureau. But after the Great Recession, the notion that home prices would climb forever became debatable.

"Whatever changes homeownership undergoes," said a 2009 *EconSouth* article, "it seems probable that more Americans will regard their home primarily as their domicile rather than an investment that comes with a roof over their heads."

That may well be right for "more Americans." But four years on, houses have become investments again—only on a grander, institutional scale. ▮

This article was written by Charles Davidson, a staff writer for EconSouth.