BISNOW

October 1, 2023

SFR Investors Test Build-To-Rent Waters As Well Of For-Sale Homes Dries Up

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Wall Street landlords are eyeing the build-to-rent space as a means of padding their bottom lines amid a housing shortage and elevated mortgage rates that are stymying their ability to buy existing homes.

Single-family rental investors have spent the last few years capitalizing on the nation's growing need for housing by scooping up thousands of individual homes and turning them into rentals. But as it becomes more difficult to amass inventory, some are looking to create homes where there weren't ones before.

"Purchasing one-offs from the MLS is really hard right now because there is just no new resale supply," said Danielle Nguyen, vice president of research for John Burns Research and Consulting. "Groups are pivoting to BTR or buying from builders as an opportunity to grow their portfolios."

Earlier this summer, American Homes 4 Rent entered a $625M joint venture aimed at constructing and operating newly built rental homes, 20% of which the firm would own, per GlobeSt. Pretium Partners inked a $1.5B deal to acquire about 4,000 finished and unfinished homes from D.R. Horton in June.

Both agreements came on the heels of a $415M equity JV formed in late 2022 between SFR investor Haven Realty Capital and JPMorgan Chase to acquire and develop more than $1B worth of BTR developments across the Sun Belt.

The shift to BTR comes as mortgage rates rise and a competitive purchase market embroils homes in intense bidding wars.

Those two factors have skewed the profit targets firms are required to meet and dampened the buying power of investors, said Craig Torrance, CEO of MCS, a national provider of residential and commercial property services.

"Even though they have the capital and they could outbid many people buying these homes, it becomes whether they can buy it at the price point that makes sense for their algorithm," he said. "The competitiveness in the market is going to be driven by the appreciation of these assets, and at which point does it just not make sense?"

Build-to-rent gained significant momentum over the last three years as rising prices forced would-be homeowners to remain renters. BTR developments offer the white-picket-fence lifestyle many families crave, but without the high barrier to entry that comes with buying a home.

"For-sale affordability is very challenging right now, with rates at more than 7.5% — that's keeping a lot of renters in place," Nguyen said. "If they want to move to a newer area or a newer house, one way to do that is through build-to-rent."

Challenges for SFR investors come as investor appetite for rentals has never been stronger. The vast majority of rental homes are still owned by mom-and-pop entities, but the share of institutional players increased as historic levels of demand fueled rent growth and strong returns.

But the environment shifted as mortgage rates rose, putting buyers and sellers at a standstill and exacerbating an inventory shortage that has pushed prices to new heights.

Landlords with 1,000 properties or more accounted for 0.4% of U.S. home purchases in the second quarter, a deceleration from a peak of 2.4% in late 2021 and early 2022, per John Burns data.

"High borrowing rates have drastically reduced investor home purchases, with institutions owning more than 1,000 homes nationally almost completely halting buying activity across big markets over the last year," Nguyen said. "Investors are still buying homes, just not at the same level as they have over the past couple of years."

AMH [purchased 780 homes] this year, most of which were built in-house, per The Wall Street Journal. Meanwhile, [Invitation Homes] bought a $645M property fund in July that included 1,870 houses. That added to the 470 homes the company purchased so far in 2023, many of which it acquired from builders.

"We entered the build-to-rent space in 2021 to help bring new supply to the market and meet the increased demand for high quality, modern, single-family homes that come with the ease and flexibility of a lease," Invitation Homes Senior Vice President of Communications and Public Relations Kristi DesJarlais said in an email.

"We'll continue to explore disciplined growth opportunities, including an expansion of our homebuilder pipeline."

Unsplash/Ernie Journeys

The majority of institutional investors in the SFR space are selling more than they are buying. Both Invitation and AMH were net sellers in the first half of 2023, a move that will arm them with the capital they need to pick up more inventory once sales start moving again.

“They’re selling homes in their portfolios and monetizing them just because prices are still elevated and there’s very low supply,” Nguyen said.

U.S. rent growth has normalized of late, up just 1.6% year-over-year in July, which was 30 basis points below June and a 400-basis-point decline year-over-year, according to the latest Yardi Matrix survey of 140 markets.

As a result, investors can now make more money offloading homes than continuing to collect rent, Torrance said.

“We’ve seen massive rent growth over the last couple of years, and then it kind of cooled a bit,” he said. “Now we are at a point where the appreciation of the home could actually make [a company] more money if they sell it.”

Other companies may be selling homes to deploy capital in cities where home prices are still competitive. MCS has noticed increased interest in secondary and tertiary markets like Albuquerque, New Mexico; Memphis, Tennessee; and Colorado Springs, Colorado.

“[Cities] that made sense for them a few years ago may not make sense now just because of the bidding war,” Torrance said. “They’re deploying capital, and they have to get a return on that capital, so they can either wait and see if the market dynamics change or begin to explore other areas.”

Companies that would typically spend millions to buy individual properties off the multiple listing service are now turning to brand-new developments. AMH plans to build more than 2,200 homes in 2023 and has bought land to add 13,000 more, per the WSJ.

Yet shifting into BTR might not be the panacea investors are looking for. The space is highly nuanced and takes not only a high level of expertise but also a deep bench of relationships, said Mark Wolf, founder and CEO of AHV Communities, a BTR developer and operator of 34 communities across 10 markets.

“If you’re not in that business and you’re not ingratiated with the trade base, the supplier base and the vendor base, good luck,” Wolf said. “It’s very difficult to get the trades to pay attention to you, let alone find the people to actually execute the business plan at the local level.”

SFR investors entering the space have yet to pose a competitive threat to companies like AHV, Wolf said. Instead of purchasing dozens of sites in a particular market, AHV tends to focus on quality over quantity, creating a product that rivals some of the inventory investors are picking up, he said.

“They’re usually afterthoughts in the back of a community,” Wolf said of the properties acquired from homebuilders in existing developments. “If they were the best houses they had, they’d sell them to the public market at a higher price.”

The SFR industry has come under severe scrutiny for eating up available inventory and pushing first-time buyers out of the market. Now, as those same companies team up with homebuilders, the problem is being replicated on the new development side.

“Horton and Lennar and all of these other big companies that have traditionally been selling the American dream are now saying, ‘Screw Bobby and Susie, we’re just going to sell to Wall Street because they’ll pay us the most, the fastest,’” Wolf said.

Whether SFR investors continue to acquire newly constructed inventory once challenges in the housing market recede is yet to be seen. But the product has proven to generate healthy returns, so SFR investors will likely continue to dabble in the space for the foreseeable future, Torrance said.

“In times of distress, you start looking for new stuff to do, and you poke on a few things and you get some emeralds — clearly, BTR has some emeralds,” Torrance said. “My view is that it doesn’t go away, but as the market softens, I would expect a little bit of movement back to the bread and butter.”

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