



Newly constructed homes priced in the lower to middle range are being funded by The American Home, an investment trust, specifically to become rental properties. Photo by Nell Redmond

REITs: Industry insiders are wondering where the phenomenon will lead

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mand for rental homes, as more former homeowners and more likely first-time buyers are either forced or are choosing to lead more liquid lifestyles.

But then there's the other side of the same mad coin.

Are potential first-time homeowners and smaller investors being pushed out of the market by the influx of cash-paying investors?

Could the Charlotte housing gold rush result in another bubble? These are some of the same guys whose greed helped fuel the largely mortgage-driven financial crisis. They want to buy low, sell high, and get as much in rents as the market will allow in the meantime.

What happens if the market underperforms and the investors suddenly dump their holdings? If houses are being bought like so many stocks and bonds, couldn't there possibly be a 1929-style crash?

That's a whole lot of questions, and there simply aren't a whole lot of answers.

Even the likes of Yale University Professor Robert Shiller, who has made a name for himself tracking residential real estate trends, isn't sure. In the October edition of the Atlantic magazine, Shiller is quoted as saying, "There are ambiguities in this."

REITs buying in Charlotte, Atlanta

Here are some facts, to the degree that they can be ascertained. Institutional investors — private equity funds, hedge funds, real estate investment trusts — have bought up an estimated 100,000 homes in target markets across the country, first in high-foreclosure states like Arizona, California and Nevada and now in high-growth-potential markets like Atlanta and Charlotte.

A hundred thousand is not that many if you listen to people like Ron Kuykendall, spokesman for the National Association of Real Estate Investment Trusts, or to Peter Rose, Blackstone's senior managing director for global public affairs.

"There are more than 10 million

rental homes in the country, but only 100,000 are owned by institutional investors, and the rest are in the hands of individuals or small partnerships," Kuykendall said. That equals 1 percent.

But that minimizes the actual impact of the investor's rush into the rental home market, says Daren Blomquist, the RealtyTrac vice president who helped author the recent report.

First of all, he says, national figures are deceiving because the institutional investors are targeting certain markets; Blackstone's Invitation Homes, for instance, is in only 13 cities chosen for demographics and available homes. So those 100,000 homes actually have a far more reaching impact on the local level.

Also, noted Calvin Schnure, vice president of research and industry information for the National Association of REITs, the number of homes owned by large investors has gone from zero to six figures in a matter of two to three years, intensifying the effect.

"One-hundred thousand might not

sound like a lot, but in the communities hit by the recession, 100,000 means an awful lot," Schnure said.

Finally, Blomquist said, that 100,000 estimate might be low because "institutional investor-owned homes can be difficult to track because they form and operate behind a number of LLCs each."

Indeed, according to the RealtyTrac study, American Homes 4 Rent either bought 240 homes in Charlotte in May-June-July through four LLCs, or maybe it's 263 through six. Blackstone's Invitation Homes' numbers are a little more clear; the company appears to have nabbed 375 homes through two LLCs.

But Rose has an answer to that, too, saying that the 2,200 homes Blackstone has bought in Charlotte since the recession ended represents only 1.8 percent of the homes sold in the market during the same period.

And, Rose goes on to say, those 2,200 homes are only 0.3 percent of the total households in the Charlotte market.

Yet Blomquist said he believes "the

heavy participation of institutional investors is impacting the numbers” that show Charlotte’s residential real estate market is rebounding. “They are helping to prop up the numbers.”

That, however, does not mean they are necessarily skewing the numbers, said Eric Locher, who as president of the Charlotte Regional Realtor Association has a pretty wide-ranging view.

“It’s a relatively small number of homes, so it’s not a market-maker, but a portion of the market,” Locher said. “But I think in general that it is true” that the sales to big investors have contributed to Charlotte’s overall rebounding sales figures.

“Remember, somebody had to be willing to sell at that price or under those terms,” Locher said. “It takes the house off the market, reduces inventory at that price point. They’re looking to buy at a decent return, make enough money on rent, and sell at a higher price, all of which is good for the marketplace. The fact that they are investing in this market says that Charlotte has a healthy real estate market.”

That’s right, Rose said. Blackstone chose Charlotte because “the economic fundamentals are there. We see not much supply of new homes, and demand is up. Charlotte’s population will grow 2.4 percent per year for the next five years when the national average is 1 percent. Our research shows that households will grow 9 percent in five years when the average is 7. And there is every reason to believe there will continue to be strong employment growth.”

Schnure put his views bluntly: “Your housing market needed help. It needed capital to help it grow when capital was not available from the usual sources.”

Competition for houses increases

Locher’s use of the words “at that price point” is key, said Braun, who has helped broker many a post-foreclosure home.

“The negative impact is that it is getting hard for the first-time homebuyer and small-time investor to compete. They are being squeezed out or forced to improve their offers, which is difficult against a cash-paying competitor.

“This hasn’t jumped into anything over \$200,000. It’s mostly been in the \$120,000-\$200,000 range, some in the \$50,000-\$120,000 range.”

The average value of a Charlotte-area house owned by American Homes 4 Rent is \$173,271, according to corporate records, meaning the company has invested more than \$150 million in the local housing market.

J.C. Underwood is president of both the nonprofit National and Metrolina Real Estate Investors associations, trade groups that represent smaller investors.

He says: “It’s not just foreclosed homes now. There are bidding wars, so now they are coming in a paying full price, say \$80,000 to \$115,000, and they are paying cash. That’s hard on our investor-members. When we put a bid in, the sellers say they have six offers. They send an email to all the (prospective) buyers, saying send us your highest and best offers by 6 p.m. But as long as the playing field is level and nobody is getting robbed, that’s fair.”

While homeowner hopefuls and small investors might be getting squeezed out, Rose said that Invitation Homes is filling in a related need.

IH, he said, and other big investment companies are meeting an increasing demand for rental homes by individuals and families who might have been likely first-time buyers but now do not have the wherewithal for a down-payment or the credit-worthiness to get a mortgage in today’s more stringently regulated home-loan environment.

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Eric Locher, president of the Charlotte Regional Realtor Association

underwriting standards,” Schnure said. “A rental home is a safe landing place for people who were hurt in the recession. They’re able to rent the type of place that fits their needs.”

Another fear being expressed by some local real estate insiders is that absentee landowners – and their renters – will not properly maintain their rental homes.

“When you’ve got renters, they don’t necessarily care about the rules; they can just move out,” Underwood said about single-family homes in subdivisions with homeowners association and rental condominiums as well. “And absentee landlords, they don’t know or particularly care what’s going on.”

Rose answered that Invitation Homes is buying only post-foreclosure homes, many boarded-up and falling down, and is putting up to \$50,000 into them to fix them up.

And, he said, it is in the company’s best interest to keep them that way, ensuring income-producing rental rates – which can range up to \$1,400 a month for a three bedroom model in good shape and as low as around \$750 for a one-bedroom in the same condition, according to RentRange – and a good price if and when it comes time to sell.

The whole point, Rose said, is to make a profit for Blackstone’s and Invitation Homes’ investors, which include many public and private sector retirement and 401(k) funds. He said IH has hired a property management firm and has employees to keep an eye on its investments in Charlotte.

Locher agreed with Rose’s assertions. “It is highly unlikely they will let their holdings deteriorate,” said Locher, a Cottingham Chalk Hayes Realtor. “It’s an investment they know they have to protect, and they will develop processes by which they are going to protect them.”

Schnure summed it up this way: “Deferred maintenance is costly to own-

ers. They will hire property management companies to do repairs and maintenance; and they know they need people on the ground. It is in their long-term interests. They know they can’t just turn their backs on property.”

Wondering where it will lead

The biggest unknown – and the biggest fear being expressed out there – is the end game. What happens in three to five to seven years down the road, when it is time to sell, or to take the private companies like Invitation Homes public?

“This could potentially destabilize the market,” Underwood said, echoing fears about eventual stock market-like volatility expressed by Braun, Blomquist and others.

“The long-term goal is to do this for three to five years, then go public with their group or dump them back out onto the market, all at once or in groups. They have to make 7 to 8 percent on them; these hedge funds are buying for the state of North Carolina teachers’ retirement funds. They’re manipulating the market to make that expected return. We don’t know exactly what the fallout will be, but we are going to be watching them.”

Rose had a riposte: “I am mystified why buying post-foreclosure homes can be in any sense ‘destabilizing,’” Rose said in an initial email.

Later, in an interview, Rose had a more reasoned reply:

“Our intention with Invitation Homes is to create a company with brand recognition for quality rental homes, which we believe will continue to be in demand, a brand like Toll Brothers has for quality new homes.”

That also appears to be the goal of an effort by a REIT called The American Home.

It is paying Charlotte-based Oakmont Homebuilders to construct dozens of new homes that are now up for rent in lower middle-class neighborhoods like Reid Meadows. Oakmont typically builds three- and four-bedroom homes for an average \$95,000, according to Mecklenburg County building permits, and sells most of them in the low \$100,000’s range, according to the builder’s website.

Officials at The American Home did not respond to calls, and Oakmont owner Judson Stringfellow would not comment, citing the wishes of American Home and another investment firm for which he is building homes.

Building new homes for rent “is a new one on me,” Rose said, reiterating the same thing said by Kuykendall, Schnure and Blomquist. “I’ve never heard of that before.”

Rose said there are several exit strategies for IH and for others, like American Homes 4 Rent and The American Home, including going public, which he said would “obviate what you’re talking about, ‘dumping’ the homes.”

“We will exit as we eventually exit all our investments,” Rose said. “The state and local pension plans invested in our company might well want us to IPO this company. If we exit by selling off the homes, we would do so carefully.

It makes no sense for us to try to sell assets in a declining market. We don’t see that as an option.”

Locher agreed, comparing today’s fears about REITs and other institutional investors to fears in the 1960s that newly created mutual funds would destabilize and dilute the stock market, which did not happen.

Selling their holdings in Charlotte all at once “would be destabilizing themselves,” Locher said. “It is most likely they will let these go over time. It is always in their best interest to sell at the highest price. At the end, when they have 27 houses left, and they can’t afford the infrastructure it takes to maintain them as rental properties, they might get rid of all of them, but 27 houses will not destabilize the market.”

Locher concluded by saying: “As long as the REIT or investment firms stay financially healthy, I don’t think we’ll see a problem with it.”

Signs of concern

But Braun and others note that there are already some troubling signs on the horizon that at least some REITs and investment firms are already experiencing financial difficulties.

Bloomberg.com recently reported that American Homes 4 Rent, a publicly traded company that owns 20,000 homes in communities across the country, fired 15 percent of its workforce after announcing a \$14 million loss. This prompted one housing-market blogger to aver that “the worm is turning for investment real estate.”

Another recent item, reported by Inman News, said that Oaktree Capital Group and partner Carrington Mortgage Services have a portfolio of about 500 leased homes up for sale all at once, “a departure from their initial plans to convert their portfolio into a real estate investment trust.”

The report concludes that the move “appears to offer the latest indication that investors . . . are now beginning to attempt to cash out, as returns on rental revenue from homes begins to slide.”

That’s scary, Braun said, even if it is difficult to ascertain whether Oaktree or Carrington have invested in homes in Charlotte.

“Two major REITs, selling off properties to Wall Street in bulk; that’s what’s going to happen,” Braun said. “And it will dilute the market, selling in bundles to other investors.”

The final word, for now, will go to Tom Pearson, owner of Pearson Land Corp., a former mortgage banker and long-time observer of the Charlotte development and real estate scene.

“We just don’t know the answers,” Pearson said.

“These investors are eating up the foreclosure stuff, which is certainly a good thing in the short run, and might be good in the long run, too. They’ve taken a lot of downward pressure off the market. But they are not going to hold onto these houses forever.

“Time will tell.”

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