THE REAL DEAL
REAL ESTATE NEWS

Developers bet big on build-for-rent in these uncertain times

Firms are pouring billions of dollars into new single-family rental communities in the thick of the pandemic

September 08, 2020 07:00 AM
By Katherine Kallergis

From left: David Singelyn of Homes 4 Rent, Jacque Petroulakis of NexMetro, and Adam Adler of Global City (Photos via Nexmetro, Global City, Singelyn via Cal Poly Pomona)

Since moving from an apartment building in Allen, Texas to a two-bedroom house in nearby McKinney in April, Joy Fleming has been on the receiving end of developers stopping by and asking her whether she likes where she lives.

Fleming — a resident living in a community of 180 Avilla Homes built by NexMetro Communities — can now park in front of her house. She has a backyard for her dog to run around in, the trash gets picked up off of her front porch, and she has plenty of natural light. She's also been working remotely over the past few months, making her second bedroom all the more useful.

Fleming, who's in her 60s, is one of tens of thousands of residents flocking to newly built single-family rental communities around the country. A growing number of individuals

and families who have struggled with social distancing in large apartment buildings are opting for more indoor and outdoor space in the suburbs once their leases are up.

But rather than buy a home, take on a 15- to 30-year mortgage and deal with the expenses of owning property and managing everything from utilities to maintenance, they're looking to keep renting. Empty nesters like Fleming, who considers herself a renter by choice, also see an upside in leasing a new home.

Due to Covid-19, the owners and managers of a lot of other properties she looked at "wouldn't show you the space you would be renting," she said. "It just didn't make a whole lot of sense."

Phoenix-based NexMetro, meanwhile, is one of a growing number of firms doubling down on the build-for-rent sector with plans to develop and manage high-end rental home communities in close proximity to large cities. The market is getting a big boost from the pandemic and economic fallout, as many would-be first-time homebuyers rethink their plans due to a growing sense of unease about the future.

And it didn't take long for Wall Street and other institutional investors to catch on. Major players like Brookfield Asset Management and Starwood Capital Group are betting on renters staying renters as many face record unemployment levels and mounting debts, and the build-for-rent space is attracting big money during the pandemic.

JPMorgan Chase and American Homes 4 Rent, for example, launched a $625 million joint venture in May to develop 2,500 single-family rentals in Western and Southeastern states. David Singelyn, co-founder and CEO of Homes 4 Rent, said that while his company, which began building new communities about five years ago, has teamed up with institutional investors before, this marks the first time a partner wanted to be named.

The California-based real estate investment trust owns more than 50,000 homes in 35 cities and is building new home rental communities in 15 of them. And, according to Singelyn, Homes 4 Rent's portfolio is more than 90 percent occupied.

Mike Kelly, head of Real Estate Americas at JPMorgan Asset Management, told *The Real Deal* by email that the joint venture is confident there's enough demand, despite the impact the pandemic has had on the U.S. economy.

"There is a gap in the market between apartments and homeownership, particularly for young families," Kelly noted, "so the single-family build-to-rent model really works for them."

The rental curve

The bulk of new single-family rental developments are in the "smile states" that run from California down through the south and up along the East Coast and upper Midwest — cities and towns with projected economic and population growth and affordable land.

“Every homebuilder in those markets, they’re on fire. They’re having banner years.”

Adam Adler, Global City Development

Miami-based Global City Development, backed by the Brazilian investment management firm Leste, recently broke ground on more than 320 acres in Raleigh, North Carolina, and is aiming to build even larger homes than its competitors.

The companies are planning to develop 700 single-family homes and townhouses, ranging from 1,800 to 2,200 square feet with up to four bedrooms, before the end of 2021 as part of a $2.5 billion plan plan to build tens of thousands of houses in 30 communities over the next five to seven years.

Since purchasing the land in Raleigh in October, the developers closed on 120 acres in Nashville between October and February, and they plan to close on a site in Charlotte by the end of November. The jobs are there to back it up, said Adam Adler, president of Global City’s master-planned communities division. Raleigh is the second largest tech city in the U.S. behind Silicon Valley. And near the Nashville site, Amazon is planning a 3.6 million-square-foot distribution center.

“Every homebuilder in those markets, they’re on fire,” Adler said. “Organically there is a housing shortage.”

Global City and Leste announced their ambitious plan, which also includes parts of Florida, Texas and Arizona, in late 2019. And since the pandemic hit earlier this year, the development team has pushed forward with construction and land closings.

The new communities will include walking trails, fiber-optic internet, business centers and multiple pools and gyms, and the developers’ target household income ranges from $75,000 to $150,000 — similar to many first-time homebuyers. Adler maintained that there’s a growing pool of renters, including a large number of millennials, who can afford to buy but prefer to rent and are seeking the “amenities of the urban core in a suburban environment.”

Single-family rentals aren’t a new phenomenon, of course. The Blackstone Group spent billions of dollars buying distressed homes during the last recession and built up the largest portfolio of single-family rentals before selling its remaining stake in the properties last year.

But many investors are now looking to build luxury communities from scratch and new projects are “popping up everywhere,” said J.C. de Ona of Conway, Arkansas-based Centennial Bank. In some cases, for-sale homebuilders like Lennar, D.R. Horton and Toll Brothers are also getting into build-for-rent, according to industry sources.

Don Walker, chief financial officer of John Burns Real Estate Consulting, which covers the single-family rental market, said there are at least 240 active build-for-rent

communities with about 29,000 homes across the U.S. As of now, there are primarily two kinds of developments in the burgeoning market: houses built on single-family lots and attached homes with fewer rooms and smaller yards.

While it's hard to pinpoint exactly how much money has been invested in build-for-rent communities, Walker and others say that at an average cost of about $250,000 per home, the total would come out to more than $7.2 billion.

Michael Finch, principal owner of the Phoenix-based brokerage SVN | SFRhub Advisors, said he's now working with investor groups looking to deploy $15 billion to $20 billion of capital into the build-for-rent space.

Finch, who's also the general partner of a $1 billion single-family rental fund that launched earlier this year, said millennials who "already watched their parents struggle in the last recession" are hesitant to buy homes themselves — if they can afford to.

The shift toward remote work could also propel more people to move out of cities and into suburban communities, though it's unclear how long that trend will last.

"You are going to see major changes in the way America lives," said Chuck Brecker, a real estate attorney with Saul Ewing Arnstein & Lehr in Florida who has been studying the issue. Remote working "is not going to end when the pandemic ends," he argued.

Playing the long game

A growing number of developers plan to hold onto their communities after they're completed, while others may sell the houses individually or to institutional buyers in bulk.

"The only negative that has kept a lot of developers out is concern of an exit strategy," said Brecker. "If it turns out that there are no buyers, then you're left with selling them one by one. That will certainly be more difficult when they are used [rather than] brand new homes."

Transcendent Investment Management, one of the build-for-rent sector's newer entrants, plans to construct up to 4,000 new rental homes in the Carolinas, Georgia, Florida and Texas and hold onto the properties once they're built.

"We look at these, in large part, not much differently than a garden-style multifamily, and will amenitize them similarly," said Adam Wolfson, Transcendent's chief investment officer. "As people tend to age out of multifamily, this is a great step for them."

NexMetro, one of the sector's largest and longest running developers, has sold six communities in Phoenix and the Dallas-Fort Worth area since the company was founded in 2012. But it's now weighing the benefits of long-term holds, citing increased demand for the asset class, said Jacque Petroulakis, NexMetro's executive vice president of marketing and investor relations.

The company has built about 4,800 Avilla-branded homes in 32 communities in several states, and has another 1,500 homes across eight communities in the works. NexMetro, which advertises that its residents are "renters by choice" seeking "a new American dream untethered by the responsibilities of home ownership," closed on its first site in Florida this year.

Construction on the 152-unit project in Odessa began in July, with an opening set for early 2021, and NexMetro is planning to expand to Orlando and the Tampa area.

Petroulakis said the company's rent collections have fallen by just 1 to 2 percent, as many of the firm's tenants have high household incomes, while the company's occupancy across its portfolio is hovering at around 96 percent. Showings are also easier to manage remotely, she added. Since March, NexMetro has held 1,300 tours without a leasing agent present by giving prospective tenants access to the homes using a secure code.

"The appeal of more square footage is unmistakable," Petroulakis said, noting that a growing number of apartment dwellers are antsy, as they work in small spaces with kids or children, Petroulakis said. "That notion of sharing an elevator and sharing a hallway is becoming less and less appealing to consumers."

The recession equation

Most investors in the space are targeting millennials and baby boomers looking for the flexibility that high-end rental communities provide.

"If you need flexibility to move, it's much easier to break a lease than try to liquidate a house in a market that may be deteriorating," said Global City's Adler.

Though U.S. interest rates are at a historical low, would-be first-time homebuyers are finding it difficult to close on properties due to recent job losses and economic uncertainty.

"Banks are being careful about underwriting loans" to homebuyers, despite low rates, said Joe Hernandez, a partner at the Florida-based law firm Weiss Serota Helfman Cole & Bierman. "It's just an unprecedented time where a lot of these factors are coming together to make [build-for-rent] attractive."

"These communities are targeting the demographic that would like to buy a home and set up their life but they have been priced out."

Ana Bozovic, Analytics Miami

Lenders are generally comfortable with the build-for-rent sector's absorption and occupancy rates — especially in the Sun Belt region where there's job growth and a shortage of new housing. As with almost any other property type, however, it's more challenging to secure financing for many developers as well now.

"Because it's a hot new asset class, there are a lot of people that want to get into it and that's great. But in a pandemic recession, lending is a lot harder to come by," said Brett Forman, executive managing director of the eastern U.S. division at Trez Capital, a Canadian lender that has provided $250 million in loans for up to 20 single-family or townhome build-for-rent communities.

Centennial's de Ona said the bank is looking for developers to pitch in more equity today than pre-pandemic, and won't go above a loan-to-cost ratio of 65 percent.

Unlike with condo, co-op and single-family home closings, developers can't rely on sales or presales to show demand to their lenders.

"That's one of the big reasons not every developer has the funds to build apartment buildings," said attorney Felix Rodriguez, who works with Lennar, Toll Brothers and other homebuilders. "The only way it works is if you have some kind of permanent financing lined up."

Demand for rental homes will still likely increase, as the country's largest homebuyer pool, millennials, look to move onto the next stage of their lives during one of the biggest downturns since the Great Depression.

But many, in a sense, are trapped into remaining renters for years to come, said Ana Bozovic, founder of the real estate data firm and brokerage Analytics Miami.

Median sale prices are hovering at all-time highs as student debt keeps climbing, she noted, pushing the median age of first-time home buyers to a record high of 33 in late 2019, before the pandemic hit.

"The economic hardships we're under are being felt more strongly by millennials," Bozovic said. "These communities are targeting the demographic that would like to buy a home and set up their life but they have been priced out."