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Builder

THE RISE OF THE SINGLE-FAMILY RENTAL

The single-family rental market is booming, and the builders and developers tapping into the segment’s opportunities are thriving. Here's why.

By Lauren Shanesy


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The rental market is hot. Since the start of the Great Recession, the number of Americans living in rental properties has soared to nearly 37%, the largest amount since 1965. Over the same period, households lived in by owners are at an all-time low, according to Census Bureau data.

One sector of rental housing has enjoyed a particularly dramatic rise. Single-family for rent is the fastest-growing segment of the U.S. housing market, according to an analysis by the Urban Institute, which reports that growth in single-family rentals has outpaced the growth of both single-family for sale and multifamily housing in recent years—and it is predicted to keep growing in the years ahead.

The demand for single-family rentals is undeniable, and it presents myriad opportunities for builders across the country. The growth in this segment has paved the way for builders to increase sales by selling to rental operators on a wholesale basis, and prompted a number of developers to tap into the market with a new product: cohesive single-family rental communities filled by niche renters with lifestyle needs that are unlike those of apartment renters.

Economic Factors

Industry experts say the current economic climate has created a perfect storm for the single-family rental market's success. Student debt, a tight job market, and the inability to save for a down payment have kept a number of potential home buyers out of the market.

"Credit markets are still extremely tight, and a lot of people don't have the right credit score. With stricter lending terms than ever, some consumers are not even potential participants in the market," says Dennis Cisterna, CEO of Investability Solutions, a real estate investment firm in the single-family rental space. "[These factors] are eliminating people from homeownership. Without more alternative solutions to getting people into homeownership, whether that is a low–down payment mortgage or assistance programs, there will be a ramp up in rentership, which presents a great opportunity for builders to be able to grow with single-family rentals."

From 2005 to 2015, 56% of the gains in the rental housing stock were due to single-family homes - Source: NAHB

While many middle-class renters don't have enough money for a down payment, they do make enough to spend extra on a rental home. Matt Blank, principal at Scottsdale, Ariz.–based build-to-rent developer BB Living, says the average customer at one of the builder's communities is a couple in their late 30s with two children and an annual income from $80,000 to $110,000. With that, they have the cash flow to pay the monthly rent on a single-family home, which is around $1,600 at one of BB Living's properties—probably a higher monthly payment in the Phoenix area than what a typical homeowner would spend on a mortgage.

Even so, economics isn't all that drives consumers to rent instead of buy. Some simply aren't interested in owning a home.

“I think you also have to realize that the dream of owning a home isn’t as high of a priority on people’s list going forward,” says Mark Wolf, CEO and founder of Irvine, Calif.–based AHV Communities, a developer that builds single-family rental communities in Texas. “Part of that is residual from the downturn, and part of that is that we’re just a much more experience-driven society nowadays and are more portable. People don’t live in their house for 30 years anymore, and they move much more for jobs, so this shift in the way people live their lives means having the portability of a lease while still being able to enjoy the luxury of a home is a perfect combination.”

Christopher Todd Communities Sees Demand for 'Horizontal Living'

BB Living Finds Opportunity with Single-Family Rentals

AHV Communities Bets on Single-Family Rentals

Lifestyle changes, like having children and therefore needing more space, combined with soaring new-home costs in some markets have left some households at a crossroads—a one- or two-bedroom apartment no longer provides the space they need for their growing family, but they may not have the financial means to purchase a home, notes Robert Dietz, NAHB’s chief economist and senior vice president for economics and housing policy.

“Single-family rentals are driven by this demographic wave that’s the new part of housing demand, which is the millennials moving from their 20s to their 30s,” he says. “You have to think about the kind of household that’s going to be moving from a multifamily unit and wants to move based on structure type, but may not have the means to complete a sale.”

Downsizing baby boomers also are attracted to single-family rentals because they can live in a home similar to what they’re used to without sinking retirement cash into a down payment. “Boomers may have lost their home in the downturn or don’t want to purchase a new home, but also don’t want to rent in a high-rise building with stairs or street noise,” says Todd Wood, CEO of Scottsdale, Ariz.–based Christopher Todd Communities, which has a number single-family rental communities underway. “Some of them may also want a transient lifestyle, where they can live somewhere for six to nine months and then travel to visit their children for the rest of the year.”

Scottsdale, Ariz.–based Christopher Todd Communities broke ground on five rental communities in 2017, the first of which opened in December in Surprise, Ariz. Read more about Christopher Todd Communities here.

Multifamily Move-Up

Single-family rental community developers say they don't see themselves as a threat to single-family or multifamily builders, but rather as an alternative that provides a housing product type for renters with a specific set of needs.

"We think we have a really symbiotic relationship with multifamily. We think people are going to grow out of multifamily—there is a whole cohort of people who want to be renters, but they can't live in a one- to two-bedroom multifamily unit because they need more space, and there are very few three-bedroom units out there," says Blank. "That's where our communities come in. The millennial generation is growing up and having kids, and as they move out of multifamily, we have product for them to move into—bigger units."

Family is the focus for BB Living's community locations, which hinge first and foremost on the school district.

"School districts rule. We concentrate very heavily on building within the best school districts because we think people are going to want to rent one of our houses in order to get their kids into the right school," says Blank. "We also benefit from a lot of corporate relocations, so when people start researching where to live for a job, they'll search in the best school district for their family and find our rental homes."

BB Living builds its rental homes in master-planned communities that also contain for-sale properties, and many of the company's renters end up liking the community enough to stay—and the community's other builders reap the benefits.

BB Living has built six communities in the Phoenix metro area and is close to reaching the 1,000-unit benchmark. Read more about BB Living here.

“Our product brings a lot of activity into the community, and our renters will end up being future home buyers in that community,” Blank says. “In our Vistancia community in Peoria, Ariz., 30% of our move outs have bought a house in the same community. They may want to try out the community for a while, or want to get their child into the school district while they save up to buy a house, but our community is in the area that they want to be in.”

Investment Opportunity

Thirty-five percent of U.S. renters rent a single-family home, according to the U.S. Census Bureau, and almost all of these 15 million units are individually owned by mom and pop landlords, which means they’re geographically scattered and often don’t offer any amenities. But approximately 200,000 of these, or about 2% of the market, are owned by institutional investment firms—including companies like American Homes 4 Rent, Starwood, and Blackstone—that bought units one by one to create a portfolio. Compare that with the multifamily rental market, where institutional investors own more than 55% of the country’s units.

These institutional firms have gained attention in recent years for bringing big money to the single-family rental scene as they quickly bought up distressed properties and priced many single-family landlords out of the market, but they still encounter problems with managing homes that aren’t located together. That’s where build-to-rent developers like AHV Communities, BB Living, and Christopher Todd Communities benefit by offering neighborhoods that are newly built and managed exclusively for rental purposes.

“We saw that the institutional investment groups were buying up foreclosed homes as rentals in 2011, and we looked at that model and really believed in the rental income side of that equation,” Wolf explains. “But, we thought there was a better, more efficient way to operate and manage rental homes at the property level. We’re a unique subset of the single-family rental world in the sense that we build continuous communities and neighborhoods.”

AHV's communities of detached homes for rent are like a hybrid between a single-family and multifamily development—they’re fully amenitized, managed, maintained, and operated by a property manager. Read more about AHV Communities here.

As land prices have surged, many institutional investors are looking to new construction to enhance their single-family rental business. In a search for inventory, these firms have begun to partner with builders to acquire portions of new communities to manage as rentals.

“A lot of single-family operators that have scale across the country are tracking down single-family home builders to try to capture some of that new inventory,” says Rick Palacios, director of research at Irvine, Calif.–based John Burns Real Estate Consulting. “They’ll offer to take down 10% to 15% of the community right away, maybe at the end of the community or in an area where the builder already has some spec inventory built. The investor can take down 50 homes in one fell swoop, and the builder can move on.”

In this scenario, investors are able to acquire homes in bulk that are located together for easy management, and can reap the benefits of newly built homes. Cisterna says his investment company is looking to acquire communities for rent from builders in this way.

“The big unknown in the business of acquiring existing single-family homes is what your repair and maintenance costs are going to be,” he adds. “Those costs are going to be reduced dramatically with new-home construction, because the lifespan of the components of the house are going to last longer.”

If the investor becomes involved in the process before the homes break ground, the company often can design the homes to their specifications. “You have the opportunity to change the spec level of the homes to be more consistent to what a renter might want verses a homeowner, which is typically a moderate change where the spec level is going to be a little bit more basic,” Cisterna says. “So, you might lean more toward granite countertops instead of marble, or carpet instead of hardwood. Overall, you’re looking for more durable, long-lasting materials in the house.”

On the other side of the deal, builders benefit by selling a share of their community to investors, eliminating the stress of waiting for buyers to trickle in. It helps builders get through the process faster than with traditional one-off sales.

“Ultimately we want to partner as an investor with the builder and eliminate the traditional marketing channel of the builder selling to the retail market,” Cisterna says. “We’re going to buy the houses typically at a much faster clip than the builder can sell them.”

For example, Cisterna says that in a typical 80-unit subdivision a builder might sell at a rate of two to three homes per month, meaning that it can be anywhere from two to three years from the first sale before that builder exits the community. With a build-to-rent model, investors can typically buy and rent somewhere between six to 12 homes per month.

In the third quarter of 2017, Houston-area home builder LGI Homes, No. 15 on the most recent Builder 100 list of the country’s top builders, sold 96 homes to single-family operators. CEO Eric Lipar and Sean O’Neal, division president of LGI Living, say the partnership is a win-win situation for both parties.

“We’re in the business of selling homes, and so the biggest benefit here is increased absorption,” Lipar explains. “The operators want supply, and we have an entry-level product that works well for them. We aren’t selling any homes through the wholesale division that negatively affect our retail operations, so if we have excess lot inventory and the ability to deliver houses for these operators, then we believe it’s accretive to our closings and earnings to have these additional closings.”

While purchasing costs on the homes through a wholesale channel may be lower than what a consumer will pay, the net profits from the sales remain the same when other expenses, such as marketing, are eliminated.

“The operators may be buying the homes at a reduced cost, but we make sure to achieve at least the same pre-tax net operating income that we would with the retail business,” says O’Neal. “There are efficiencies because we don’t incur as much of the marketing expense or the commission costs, which means that we can transact these homes below our retail price and still achieve that same pre-tax net operating income overall.”

LGI has also seen stronger sales since selling to rental operators, despite the perception that communities may be negatively impacted by the presence of rental customers.

“In theory, some may think that there is a concern with putting rentals in for-sale neighborhoods, but that hasn’t been our experience,” Lipar says. “Our sales have been at least as strong or stronger since we started putting rental customers in our communities. It’s beneficial to have more volume in the community and get the subdivision built out, and it certainly hasn’t been negative for sales or home values.”

The build-to-rent model also helps builders stay more resilient in volatile times, notes John Burns’ Palacios. Building and retaining rental properties allows builders to utilize a cash flow asset as a way to survive during the market’s low points. “With traditional single-family sales, you’re essentially a victim of the cycle. On the way up it works great, but on the way down you have trouble,” Palacios explains. “I think we’ll start to see savvy home builders begin to look at the build-to-rent model as an opportunity to hedge during the next downturn and minimize the volatility on the downward part of the cycle.”

Blank says this concept keeps BB Living “in the business of building affordable housing products in the entry-level asset class,” no matter what the market calls for. The company has the flexibility of selling homes if the homeownership rate goes up, but for now, the build-to-rent product works in the current climate.

“What we love about [the build-to-rent] business strategy is that we have multiple exit options—we can win in either a rising or falling homeownership rate environment, or we can sell at a cap rate to an institutional investor if that’s what the best exit option is,” Blank says. “Whether we sell the homes individually, or never sell and continue to own the properties like we’ve chosen to do now, the multiple exit options available with this business model are something that’s really appealing to us.”

About the Author

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