Bloomberg

August 10, 2017 | bloomberg.com

Markets

Real Estate Billionaires Form Rental Giant in Shifting Industry

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August 10, 2017

- Landlords consolidate to gain scale in still-new asset class
- Invitation Homes, Starwood Waypoint to own 82,000 U.S. houses

It was a simple phone call between two real estate billionaires that led to the formation of a behemoth in the house-rental industry.

Property investor Barry Sternlicht called Jon Gray, head of real estate for Blackstone Group LP, in the spring proposing a combination of Starwood Waypoint Homes, of which Sternlicht is chairman, and Invitation Homes Inc., majority-owned by Blackstone. The companies announced the $4.3 billion merger Thursday after months sorting out the details, creating a company that will be the largest U.S. single-family landlord, with 82,000 homes across the country.

The move further consolidates the still-young industry for corporate ownership of house rentals, leaving two large public companies. Private equity firms and hedge funds, led by Blackstone, spent hundreds of millions of dollars a month in the aftermath of the housing crisis to buy homes at distressed prices, building businesses that eventually were big enough to go public. Now, with property values soaring and foreclosures slowing to a trickle, landlords are combining to gain scale and hone their operations.

“This merger gives the industry more credibility now that there’s a more than $10 billion company, bigger than some apartment real estate investment trusts,” said Jade Rahmani, an analyst at Keefe, Bruyette & Woods Inc. “It makes it a more investable sector with consistent returns.”

Shares of Starwood Waypoint jumped 5.2 percent Thursday to $35.35 at 3:16 p.m. New York time, while Invitation Homes rose 3.6 percent to $21.74. Blackstone’s 70 percent stake in Invitation Homes will be reduced to 41 percent of the combined company, according to the firm.

Housing Bet

In forming the new real estate asset class, Wall Street was betting on unprecedented demand for rentals from people who lost residences to foreclosure or were unable to get mortgages as banks tightened lending standards. Together, the private equity firms and hedge funds institutionalized a business traditionally run by mom-and-pop investors and gave America a new way to think about rental housing, with standardized renovations, call centers and technology that simplifies processes for tenants.

So far, their bets have paid off. Invitation Homes, already the largest company in the industry, had a $1.8 billion initial public offering in January, and its shares are up more than 8 percent since. American Homes 4 Rent, the second-biggest house-rental landlord, has gained almost 40 percent since its 2013 IPO.

Yet the companies have had to adapt as the housing market stabilizes. In the past couple of years, Invitation Homes has made more targeted acquisitions and sold properties that no longer fit its business model. Starwood has grown by merging with Waypoint Real Estate Group and then Tom Barrack’s Colony American Homes. American Homes 4 Rent has turned its eyes to acquiring land and building new homes strictly to rent.

“The easy money has been made,” said Carl Bell, an early investor in the single-family rental industry and co-head of investments at Washington-based Invictus Capital Partners. “From here it’s about operational and financing efficiency to help drive returns. Scale is key.”

Cost Savings

Invitation Homes and Starwood Waypoint say their transaction is expected to create annual savings of $45 million to $50 million. The new company, which will keep the Invitation Homes name and will be based in Dallas, will have about 5,000 homes in each of its markets and an 83 percent overlap, with a concentration in places such as Southern California, Phoenix and South Florida. That’s necessary when taking into account the costs associated with managing scattered site properties.

Those added expenses have driven some smaller investors, such as Axonic Properties LLC, out of the business. The firm is selling its houses, mostly to first-time homebuyers, and buying apartments in Florida.

“The only way the single-family home business works long term is if operators have massive efficiencies of scale,” said Jonathan Shechtman, managing principal at Axonic. “Otherwise the costs of things like repairs and maintenance on houses, which each have a different floor plan, may have higher expenses when compared to apartments.”

Rates, Buyers

The biggest threat to the single-family landlords is rising interest rates, said Rahmani of Keefe Bruyette. If interest rates surge and rent increases fail to keep up, returns would compress, he said.
Homebuilders are also increasingly targeting entry-level buyers in some of the same markets where these large rental firms operate. D.R. Horton Inc., the largest homebuilder in the U.S., is seeing growth in its Express brand, aimed at people in their 20s and 30s, the biggest generation of buyers. A major loosening of credit could have a larger impact on the firms as more renters than expected turn into buyers.

That doesn’t seem to be playing out yet. Starwood Waypoint Chief Executive Officer Fred Tuomi, who will lead the combined company, said on a conference call Thursday that rental demand is even stronger than it was five years ago, when he first got involved with the landlord.

“We have a tremendous advantage of cost of capital as well as our scale,” he said. “We’re positioned to win for the long term.”