

Investor-Owned Properties and Rental Securities

Investor-Owned Rental Properties

In the wake of the mortgage crisis, large investment companies saw an opportunity to invest in cheap properties and rent them to make a profit. They began buying distressed properties in states like California, Nevada, Florida, Arizona, Texas, Georgia, and others. Using their cash advantage, these large investment companies participated in bulk sales and bought thousands of properties across the country.

There are an estimated **200,000 investor-owned properties across the country worth a total of \$20 billion**. Many of these properties are clustered in cities like Riverside, Phoenix, Sacramento, Tampa, Miami, Orlando, Atlanta, and others.

A New Financial Product – Rental Backed Securities

In October 2013, Blackstone introduced a new financial product – a **single family rental backed security**. This product is similar to a mortgage backed security, but rental payments rather than mortgages are securitized. Bondholders are paid back with interest with the revenue from rental payments. On January 28, 2014, American Homes 4 Rent announced it would partner with Goldman Sachs to issue a similar bond backed by the rents from the properties it owns, and on March 21, Colony Capital announced a planned bond deal worth \$513 million, and backed by 3,000 rental properties.

Blackstone's Bond: Invitation Homes 2013-SFR1

- Blackstone announced that it would sell \$479 million in bonds, backed by the rental income from 3,207 properties in Arizona, California, Florida, Georgia, and Illinois.
- The bonds are sold in tranches, with senior investors getting paid back first and junior investors paid last, but with a higher interest rate. Moody's gave the bonds in the most senior tranche a triple-A rating.
- Fitch and S&P refused to give the bond an AAA rating, because it has a limited track record and there is little historical data on changes in rents, tenant renewals, vacancy rates, and how the business model would hold up during a downturn.

Concerns with Investor Owned Properties and Rental Backed Securities

As a new financial product, little is known about the impact rental backed securities could have on the housing markets and how risky they may prove for investors and tenants.

- **Investment firms don't have experience managing rental properties**
 - Stories are cropping up across the country about sub-par repairs, and it's unclear how they will handle filling vacancies, and adapting to meet local housing requirements.
 - Companies have an incentive to skimp on repairs and maintenance to maximize profits.
- **Impact of an economic downturn**
 - If demand for rentals drops, and vacancy rates rise, the issuer could be forced to sell off properties to pay back bondholders.
 - A massive sell-off would leave thousands without homes and wreak havoc on local markets.
- **Similarities to Mortgage Backed Securities**
 - There is no incentive to ensure that renters can afford their payments, because the large firm is bundling the rental stream and insulating itself from loss.