



When Wall Street Buys Main Street

The Implications of Single-Family Rental Bonds for Tenants
and Housing Markets

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Introduction and summary

Over the past few years, institutional investors have quietly bought approximately 200,000 single-family homes at bargain prices and converted them into rental homes. In some parts of the country, especially those areas that experienced deep price declines during the 2007–2009 housing bust, these firms—along with smaller cash investors—have bought more than half of all homes for sale.¹

In our previous report, “Cash for Homes: Policy Implications of an Investor-Led Housing Recovery,” we explored the questions raised by the presence of investors in our neighborhoods.² While cash investors have helped stabilize and even increase home prices, and while the large supply of single-family rentals can help meet the needs of many families, we do not know whether these new landlords will be responsive to their tenants, maintain affordable rents, or properly care for their properties. We also do not know to what extent they are crowding out potential owner-occupants or artificially inflating home prices. Finally, we do not know what will happen to neighborhoods with a lot of investor activity if and when these investors withdraw, particularly if they leave the market as quickly as they entered it.

In October 2013, an institutional investor created the first triple-A-rated, mortgage-backed security supported by revenue from single-family rental properties, a development that may offer even lower-cost financing to institutional buyers than has been available thus far through bank credit lines.³ A mortgage-backed security is created by pooling assets together and then selling interests in that pool to investors, who then receive regular payments from the asset pool. This process provides access to a much larger pool of investors than would otherwise be feasible, increasing liquidity and generally providing a less expensive source of funding than traditional borrowing from banks or private investors.

In this instance, a subsidiary of the private equity firm Blackstone took out a \$479.1 million loan from Deutsche Bank that was secured by a pool of more than 3,000 single-family rental homes. The loan was then turned into a security that was purchased by investors, who now receive monthly rental cash payments from the homes. If the loan is not repaid, the trustee—the legal representative of the bondholders—has the right to seize the homes.⁴

The emergence of a new form of mortgage-backed securities tied to single-family rentals is certain to have an impact on the housing market, communities, and tenants. Analysts predict that the funding of single-family rental acquisitions through securitization will likely become a dominant model quickly; American Homes 4 Rent and Colony American Homes, two new single-family rental firms, are reportedly preparing to launch single-family rental bonds in the coming months.⁵ The market for this new asset class is expected to top \$70 billion per year by 2016, on par with the bond financing for apartment buildings, casinos, and commercial real estate for this year.⁶ While institutional investors only represent a fraction of those in the housing market—mid-sized companies and small mom-and-pop investors who own less than 10 properties are currently far more prevalent in most markets—securitization may begin to shift this balance.

Depending on the success of this new asset class, investor appetite for these types of bonds may boost the size and scope of this relatively new and untested industry to a level that may not be sustainable, either because the industry does not have the capacity to manage thousands of new homes or because a significant increase in purchases inflates home prices.

Furthermore, this new financing structure is likely to have little effect on whether these new investors stay in this business after home prices increase and the business becomes more costly. In the Blackstone deal, for instance, the securities will mature in two to five years, after which the firm must find new financing to repay bondholders or sell the properties. While it is typical for mortgage-backed securities that finance apartment buildings to require refinancing after several years, this extremely short time frame suggests that bondholders may not be ready to make a longer-term bet on the single-family rental industry.

Many of the potential challenges presented by this new, large-scale, single-family rental industry could arise regardless of the type of financing used to acquire and rent out homes. Yet securitization may exacerbate some of these challenges, both by supercharging industry growth and by shifting some of the risk away from investment firms and onto the shoulders of a large and diverse group of bondholders.

In this report, we offer a guide to the Blackstone single-family rental securitization deal, the structure of which is likely to serve as a template for the industry. We then explore the questions that will arise if securitization increases the number and percentage of single-family homes owned by large institutional investors, including the risks to tenants and communities. In conclusion, we call for improved regulatory oversight, increased transparency, and strong tenant protections to guard against any potential downsides to these new developments.

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