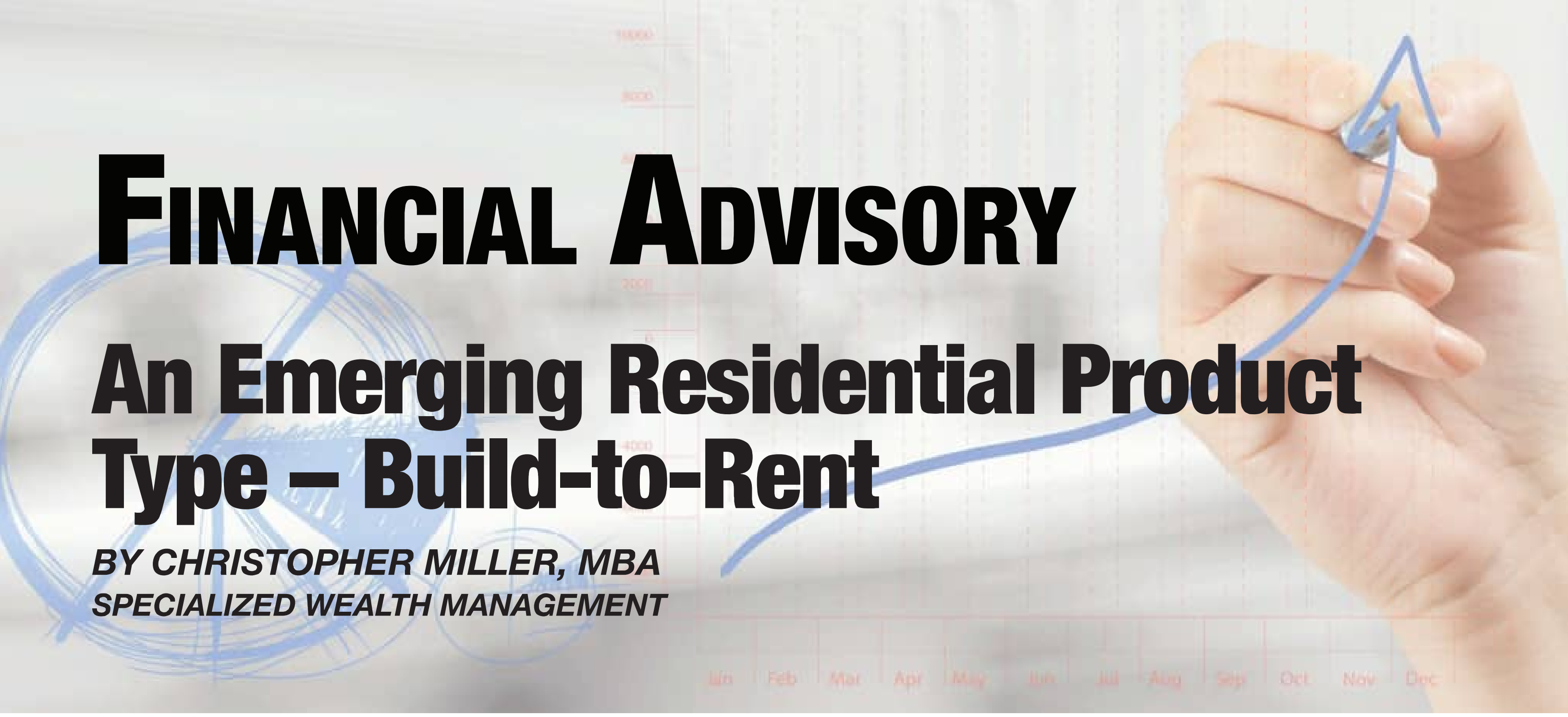

FINANCIAL ADVISORY

An Emerging Residential Product Type – Build-to-Rent

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I have seen many offerings from a relatively new type of multifamily investment property called "Build to Rent." This month, we will explore this new asset class to learn more about it.

WHAT IS "BUILD-TO-RENT?"

To create a Build-o-Rent property, a construction company – often a large homebuilder - will produce a neighborhood of condominiums or of single-family residences, complete with driveways, garages, and back yards. (These features are uncommon in traditional multifamily properties.) Then, rather than selling the homes off individually, the contractor will hire a management company to lease the units to tenants. When the property has reached " stabilized occupancy," (90- 95 %), the entire development will then be sold to an investor. The investor buys a stream of income and growth potential, and the construction company uses the proceeds to build another community.

BUILD-TO-RENT GIVES US MORE OPTIONS AT SALE – FOR POTENTIALLY MORE PROFIT

I have always liked real estate investments that give us more options at sale. For instance, let's imagine that San Diego's Del Mar Fairgrounds are for sale, we could buy it at a price that makes sense, and that it would provide us a good return with income from operating the horse racing track and convention center. This is a 340-acre oceanfront site and homes within a mile of the property are currently for sale at a minimum of $3.5 million up to $35 million.

A large space like this has room for a multi- use development: residential, retail and recreational such as parks and youth sports complexes. A full-size, par 72, 18 hole golf course will fit in 175 acres; so there will be room for that, as well.

These options give the fairgrounds more potential value in the future. At some point, the need for other uses could outweigh the need for a racetrack and it may be redeveloped. As owners, we won't even need to do the redeveloping to benefit from this additional potential. If our property is worth $300 million as it sits, and a developer thinks it will take an extra $400 million of development to make it worth $1 Billion; that developer could afford to pay us above market value – maybe $350 or $375 million. That is around a 20% premium – and still a good deal for both of us.

BUILD-TO-RENT HOMES CAN POTENTIALLY BE SOLD INDIVIDUALLY IN THE FUTURE

As we discussed in my article several months ago; single family homes generate poor cash flow – but for a good reason – because their value is so high. If we could buy 75 three- and four- bedroom homes for $30 million today that generate close to a 5% potential annual cash flow; that is an attractively- priced property in today's market. If we can see 4% annual appreciation from this property, in 10 years it could be worth $45 million. At that time, however, perhaps we can sell off the homes individually and earn $60 million. This additional " exit option" can give us more opportunities to profit.

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WHAT I LIKE TO LOOK FOR IN BUILD-TO-RENT COMMUNITIES

Before I buy, or advise my clients to buy, an investment property, I will perform a thorough due diligence review and evaluate potential rents, expenses and future rent growth potential. With Build-to-Rent properties, I will pay close attention to the following two characteristics:

COMPETITIVE VALUES

When evaluating an investment from this asset class, I pay close attention to the price per unit sales price. I will then compare that figure to home values and recent sales in the property's immediate area. In the above example, those 75 three and four-bedroom homes cost an average of $400,000 each . If three- and four- bedroom homes in the development's immediate area are selling for between $450,000 and $500,000, than this property makes a lot of sense – an investor could potentially buy the property and immediately start selling the units individually at a profit. If surrounding homes are costing an average of $ 400,000, then our "multiple exit" plan could still make sense – if we expect SFR values to grow faster than apartment values. (Which they historically have.) A per- unit price that is significantly higher than surrounding values could mean that the SFR value has a smaller chance of rising above the "as apartments" value.

METRO AREA WITH A GROWING POPULATION COULD EQUAL A GROWING DEMAND FOR HOUSING

With these assets, I will also take a close look at the surrounding market area. Is population in the metro area and in the neighborhood's submarket growing faster than the US national average? If so, there could be potential for housing prices to grow faster than average as well – and therefore our chances of having that second exit option.

POPULAR IN THE PARTIAL INTEREST AND DST MARKETS

I most often see the term "Build-to-Rent" used in the partial-interest and Delaware Statutory Trust (DST) business. Many partial-interest investors buy as part of 1031 Exchanges, so the potential to sell off these properties in 75 portions is not as attractive: An investor who bought $500,000 of equity in the example property above could be receiving sales proceeds in $10,000 chunks if such a plan was followed – it would be tough for him to defer his taxes further with additional exchanges, so therefore this could create a tax liability.

Partial interest investors can, however, still benefit from this additional exit option even if the properties aren't sold one at a time. My hypothetical example above considered a Build-to-Rent offering that was potentially worth $45 million as apartments but could bring as much as $60 million if the units were sold individually. This means an apartment investor would only be willing to pay us $45 million. An investor willing to do the work to sell these properties individually, however, may be willing to pay us $50 million. This would yield a sales price that is 11% over market for the partial interest investors – and selling a property for more than it is worth is always a good result.

Multifamily investments have been one of my favorite asset classes for over two decades now due to the potential income and value growth they provide. This asset class has several "submarkets," such as Student Housing, Independent Senior Living and now Build-to-Rent. Just like the other submarkets, Build-to-Rent can potentially offer attractive benefits – if an investor chooses his property wisely. If you would like to discuss, my office number is (877) 313-1868.

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