LANDLORD LAND

A real estate dance party is being led by a new breed of rental property investors

But some local markets may soon be left without a dance partner

Housing Boom 2.0

The housing market is in full boom.

Nationwide, single family homes and condos in the third quarter of 2016 sold for a median price of $223,500, just 1.5 percent below the pre-recession high of $227,000 in Q3 2005, according to ATTOM Data Solutions. After bottoming out at $143,500 in Q1 2012, median home prices have increased over the last 18 consecutive quarters and are now 56 percent above that Q1 2012 bottom.

Price per square foot growth has continued to increase since the housing crash, according to a Clear Capital analysis, but continues to remain far below the housing boom highs. National price per square foot has steadily increased over the last 21 quarters beginning in Q3 2011. However, as of Q3 2016, the price per square foot of single family homes and condos nationwide had climbed to around $93 a square foot –still more than 22 percent below the pre-recession high of $120.

Home sales volume numbers are also below previous highs — still 19 percent below the pre-recession peak in Q3 2016, according to ATTOM Data — indicating some combination of weaker demand and constrained supply that was not present in the previous housing boom. In spite of this lowered housing turnover, demand is still outpacing supply, as evidenced by the continued strong growth in median sales prices over the past four and half years.

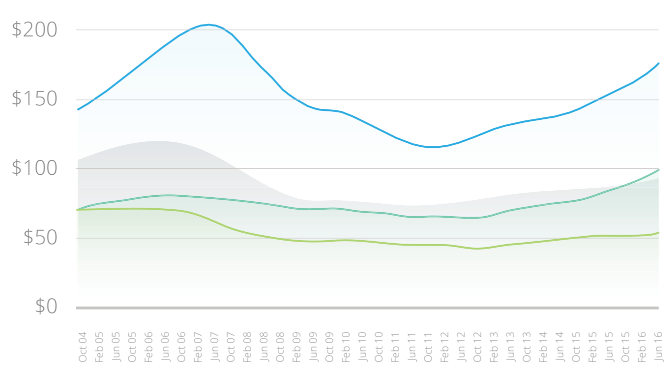
But — given the nearly 50-year low in homeownership rates — the question as to what segment of the market is driving this recovery remains.

ATTOM Data Solutions and Clear Capital set out to answer that question in this analysis. The overarching theme addressed in this analysis is dissecting current and historical price performance against the 'Who' of the buyer profile.

Much has been written about various buyer groups, including cash investors, first time homebuyers, and international buyers, but this analysis is designed to pair overall price trends against the overall trend of buyer profiles. Given the continued decline in the homeownership rate, this analysis helps fill the gap in understanding who is leaving and how that exodus affects different markets, focusing on three high-performing markets: Dallas, Nashville, and Seattle.

Home Prices Per Square Foot Historically

National PPSF | Nashville PPSF | Dallas PPSF | Seattle PPSF



> *"Though prices in several markets are nearing pre-bust levels, the composition of both the supply and demand of today's real estate market is starkly different than a decade ago. As such, it's imperative for all market participants to understand the nuances of the New Normal Real Estate Market."*
>
> **Alex Villacorta**, Vice President at Clear Capital, Research and Analytics

Institutional **Investor Influx**

Given the stubbornly low rate of homeownership nationwide, particularly among the younger buyers of the millennial and Gen-X generations, the housing recovery has been driven disproportionately by investors, primarily those with large stores of cash or perhaps just better access to credit— particularly in traditionally lower-priced markets such as Dallas and Nashville. Leading the way were institutional investors — entities that purchase at least 10 properties in a calendar year — who picked the low-hanging fruit of distressed properties available at a discount between
2009 and 2013.

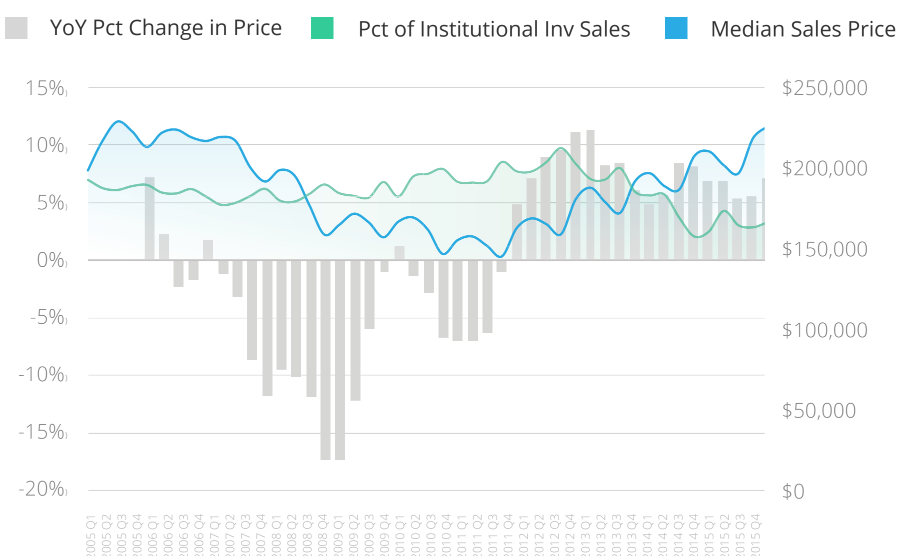
These institutional investors began ramping up on acquisitions in 2009 and 2010, breaking through the 7.0 percent mark of all home sales in Q3 2010, later ramping up to as high as 9.5 percent of all home sales in Q1 2013. (see chart below) These investors often bought foreclosure properties at a sizeable discount and held them as rental properties.

About two years into the institutional investor buying spree — in Q1 2012 — home prices bottomed out and began to climb, providing these investors with the icing on the cake of rising home equity along with the rental returns that were the primary investment objective.

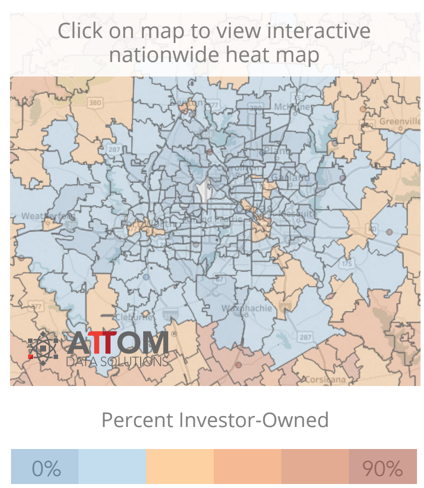
However, the overall health of the housing market began to improve and new foreclosure rates softened as prices crept upward once again, and as a result the industry's share of distressed sales began to significantly shrink after the market trough of 2011 to 2013. As a result, large institutional investors began pulling back in their purchases in 2014, today representing around just 2 percent of home sales nationwide.

Even after the pullback of institutional investments, home prices have continued to rise over the last several years. Who else is driving the demand that continues to put upward pressure on home prices? We'll address that question on Page 6 after taking a deeper dive into institutional investor trends in the three local markets: Dallas, Nashville and Seattle.

U.S. Home Prices and Institutional Sales



Investor-Owned Homes Heat Map



Dallas Institutional Investor Trends

Institutional investors did not dramatically increase property acquisitions in Dallas in the wake of the Great Recession — in fact they were already relatively active in the Dallas market before, during, and after the recession. Unlike some other markets hit hard by the housing crisis, Dallas did not experience a massive wave of foreclosures being sold for deep discounts on the courthouse steps, which greatly limited the ability of the institutional investors to buy discounted properties in large quantities.

However, the overall health of the Dallas economy — combined with relatively low home prices compared to other markets across the country — still provided institutional investors with strong rental returns, even on properties priced at full market value. Given these financial advantages, it's not surprising to see that institutional investors represented an average of 10.5 percent of all home sales in the Dallas area between Q1 2005 and Q1 2013.

But by Q2 2013, the share of institutional investor purchases had dropped precipitously, down to 7.0 percent, and has continued to drop since then, falling to 2.7 percent in Q3 2016.

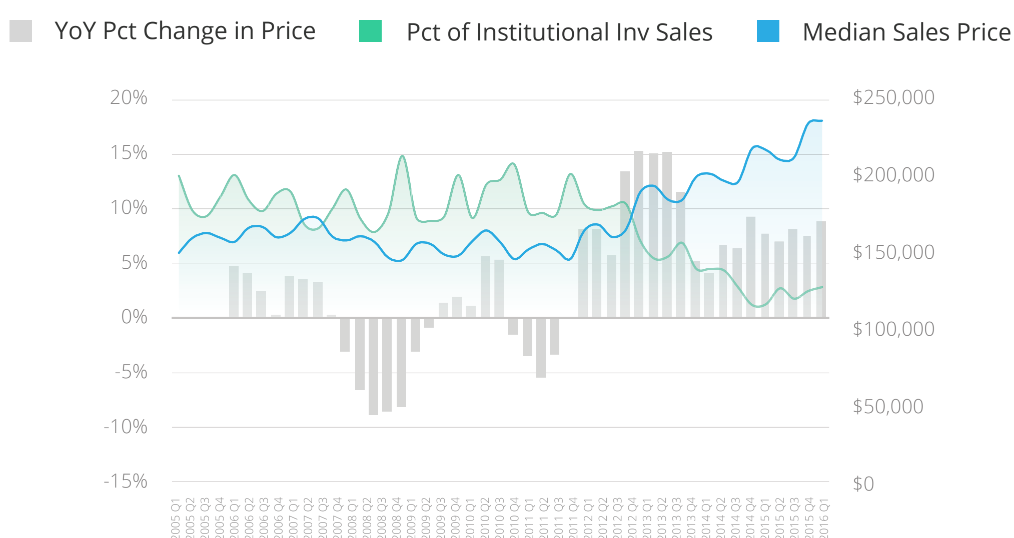
There are two major contributing factors for the declining share of institutional investors. Median home prices in the Dallas metro area had reached a major milestone with a new post-recession high of $189,525 — up a whopping 10 percent from the previous high of $172,235 in Q3 2007. At the same time, the distressed share of the market was continuing to decline, providing a smaller share of discounted inventory for institutional investors to choose from.

To achieve desired rental returns, the home price "sweet spot" for many institutional investors was between the $150,000 and $200,000 price points. Beginning in Q2 2013, the Dallas market started becoming too expensive for an increasing number of investors as prices continued to rise during the recovery. The median home price in Dallas reached a new all-time high of $236,208 in Q3 2016 — 63 percent above the post-recession bottom of $145,103 in Q1 2009 and 37 percent above the pre-recession high in Q3 2007.

Similar to the nationwide trends, home prices continue to post strong year-over-year increases in Dallas, indicating that other groups of buyers apart from institutional investors are helping to drive demand there.

> *"Beginning in Q2 2013, the Dallas market started becoming too expensive for an increasing number of investors as prices continued to rise during the recovery."*

Dallas Home Prices and Institutional Sales



Nashville Institutional Investor Trends

Although Nashville was not one of primary markets of opportunity such as Atlanta or Phoenix for institutional investors as the Great Recession receded, the relatively low home prices of the area did ultimately attract these types of investors. While the increase in institutional investor activity nationwide started circa Q3 2010, the increase in Nashville began a couple quarters later in Q1 2011 — when the share of purchases going to institutional investors jumped to 6.9 percent.

Positive home price appreciation kicked in a little over a year later in Q2 2012, when home prices rose 6 percent year-over-year in Nashville following a nearly four-year trend in declining home prices.

Similar to Dallas, however, the institutional investing strategy became a victim of its own success. Institutional investors accounted for an average of 6.0 percent of all home sales between Q1 2011 and Q1 2015 — as high as 7.5 percent in some quarters — but the share of institutional investor purchases dropped significantly from 6.5 percent in Q1 2015 to 2.4 percent in Q2 2015. Home prices spiked in Q3 2015 to a new post-recession high of $189,900 — nearly the exactly same price point that coincided with the plummeting institutional investor activity in Dallas.

Meanwhile the share of distressed saturation in the market dropped below 12 percent in the Nashville market in Q1 2015 for the first time since 2009, falling to less than half the peak distressed saturation of 27 percent in Q2 2012. This ultimately translated to a smaller inventory of discounted and distressed homes for institutional investors to choose from.

Institutional investor activity in Nashville has continued to decline to 3.9 percent in Q3 2016 as median home prices reached a new all-time high of $212,000, a 12 percent year-over-year increase.

In Nashville, home prices have continued to strongly appreciate despite the pullback of institutional investor demand. We'll look at who is filling that demand void on Page 8.

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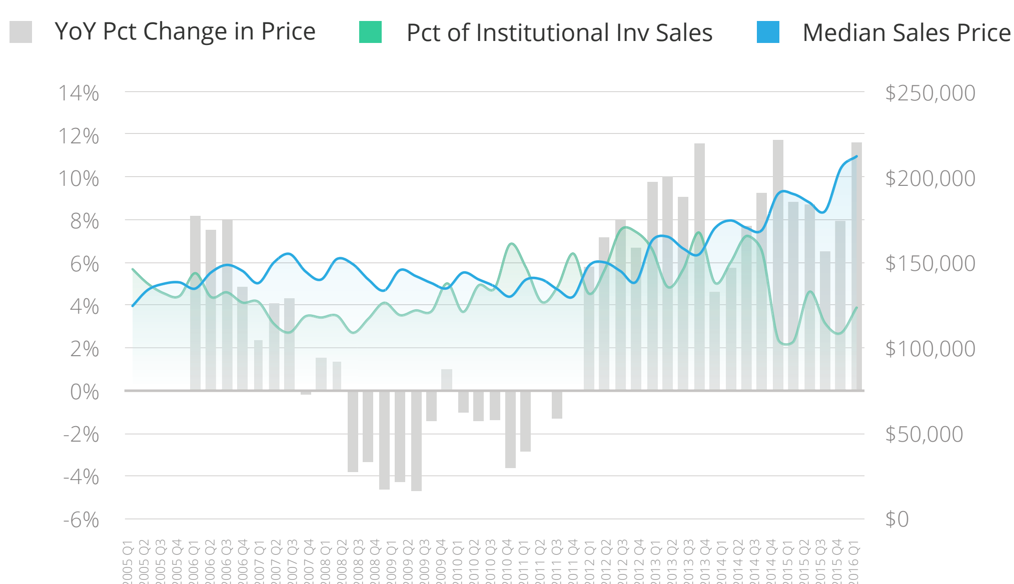
Nashville Home Prices and Institutional Sales



Seattle Institutional Investor Trends

Unlike both Dallas and Nashville, the price point in the Seattle market was disadvantageous for the buy-to-rent investing strategy employed by institutional investors. Even at the bottom of the market in Q1 2012, the Seattle median home price of $225,000 was well above the buy-to-rent sweet spot of $150,000 to $200,000.

Institutional investors did dabble in the Seattle market, however, with a mini-surge in activity between Q1 2013 and Q1 2014. During that time period, institutional investors accounted for an average of 6.6 percent of all home sales in Seattle.

As the housing market recovery continued, median home prices surged past the $300,000 milestone to $320,000 in Q2 2014, and the market share of institutional investors dropped from 6.1 percent in Q1 2014 to 4.8 percent in Q2 2014. Even in Seattle, with its infamously sky-high rents, this rising price point was too rich for many institutional investors, whose share continued to drop to just 1.8 percent in Q3 2016.

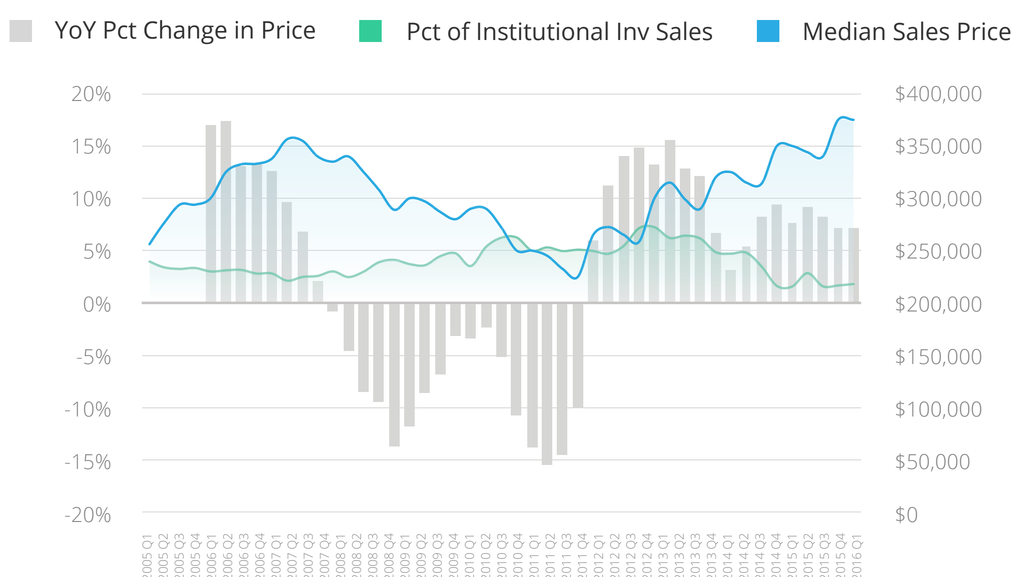
Seattle's distressed saturation has actually been consistently higher than that of Dallas and Nashville throughout the housing recovery, reaching a peak of 38 percent in Q4 2011 and still in double-digits as recently as Q2 2016. Despite a large inventory of distressed properties, the relatively high price of homes in Seattle still prevented significant market activity on the part of institutional investors.

Even without as much lift from institutional investors as in Dallas and Nashville, Seattle home prices have still risen meteorically during this housing boom. Median home prices in Q3 2016 reached a new-all time peak of $375,000, a staggering 67 percent above the low of $225,000 in Q1 2012. Seattle's recovery has been stronger than either Dallas or Nashville, both of which have reported a median home price increase of 63 percent since bottoming out.

> *"There are a few hard money lenders here, and they bring people who are not fulltime investors and people who are end users … to the (foreclosure) auction and are outbidding anyone who is a traditional investor."*

Chris Richter, CEO at Audantic Real Estate Analytics in Seattle

Seattle Home Prices and Institutional Sales



Filling the **Institutional Investor Void**

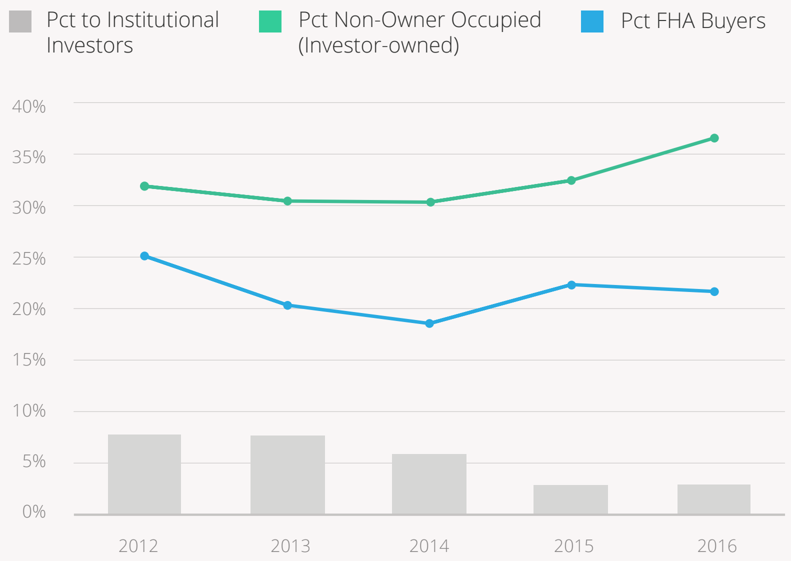
As the larger institutional investors pulled back on home purchases due to the decreasing distressed share of the market, a different type of investor began to fill the void left by the bigger players; smaller investors, willing to purchase in a wider variety of market landscapes and operate on thinner margins, began ramping up activity in the wake of the Great Recession. The nationwide share of non-owner occupied homes purchased in 2011 had risen to 32.0 percent, up from 30 percent in 2010 and 28 percent in 2009.

During the peak activity of institutional investing, the market share of FHA buyers, who are typically first-time homebuyers with a low down payment, waned during the early housing recovery from 2012 to 2014. However, in January 2015, FHA lowered its insurance premium 50 basis points, and there was a modest resurgence in FHA buyers — a trend perhaps indicative of loosening credit requirements or of a desire to re-enter the housing market for those displaced during the crash. The FHA resurgence was short lived, however, as the share of FHA buyers essentially flat-lined in 2016 — at 21.7 percent compared to 22.3 percent in 2015.

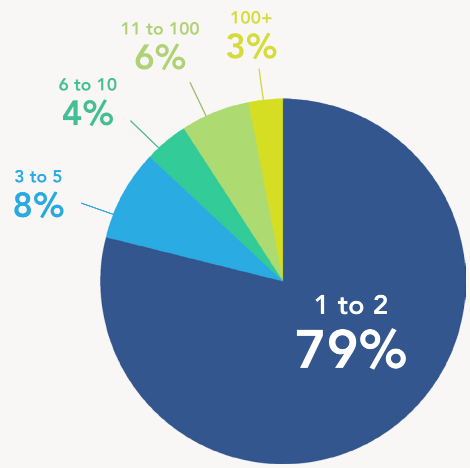
As demand from FHA low-down payment buyers lessened, the demand from smaller investors actually increased. Nationwide, the overall share of non-owner occupied homes purchased in 2015 was 32 percent and one year later jumped to nearly 37 percent — a 21-year high going back as far as ATTOM data is available.

> *"Early on it was the mid-size investors all the way up to the large institutions (that) had the most urgent need for capital. … We see a lot more opportunities from the smaller, mid-sized operators, and so that is where we are focusing our efforts: the broad base of the pyramid."*
>
> **Ryan McBride**, COO at Colony American Finance, a lender to real estate investors

Who is Filling the Void Left by Institutional Investors Nationwide?



U.S. Landlords by Number of Properties Owned



Filling the Demand Void in Dallas

Because the share of FHA buyers has not significantly increased since 2013, it's evident that first-time homebuyers — at least those using FHA loans — are not filling the demand void left by the pullback in institutional investor purchases in Dallas.

The share of FHA buyers in Dallas dropped dramatically during the early years of the housing recovering, falling from 29.0 percent of all sales in 2012 down to 19.6 percent of all sales in 2014. However, the nationwide uptick in FHA buyer share in 2015 was reflected in the Dallas market, where FHA buyers accounted for 21.3 percent of all sales in 2015, but that share dropped back down to 20.4 percent in 2016.

Conversely, smaller rental property investors are clamoring to the Dallas market, with the share of non-owner occupied homes rising from around 21 percent purchased in 2012 and 2013 to 24 percent in 2014, 26 percent in 2015 and a new 21-year high of 32 percent in 2016.

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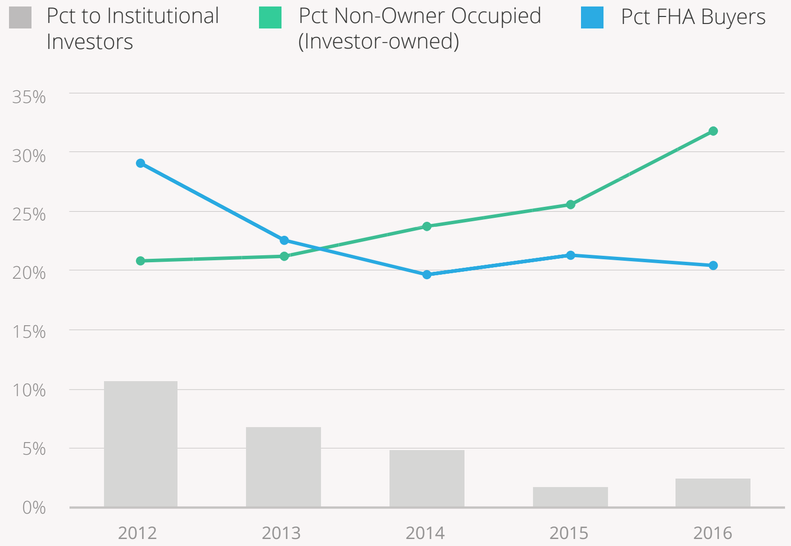
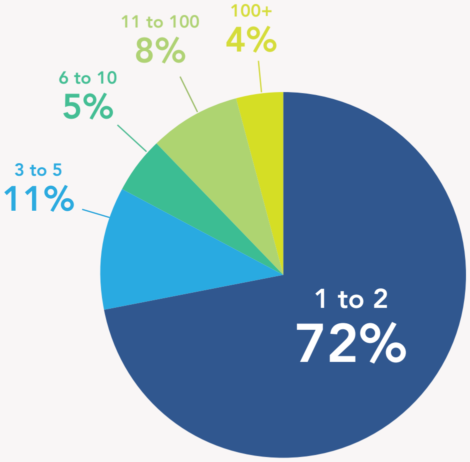
Who is Filling the Void Left by Institutional Investors in Dallas?



Dallas Landlords by Number of Properties Owned



Filling the Demand Void in Nashville

Demand from first-time homebuyers and others using FHA loans did increase more dramatically in Nashville than in Dallas or other parts of the nation — increasing more than 4 percentage points from 20.1 percent of all sales in 2014 to 24.5 percent of all sales in 2015, before dropping back to 23.4 percent of all sales in 2016.

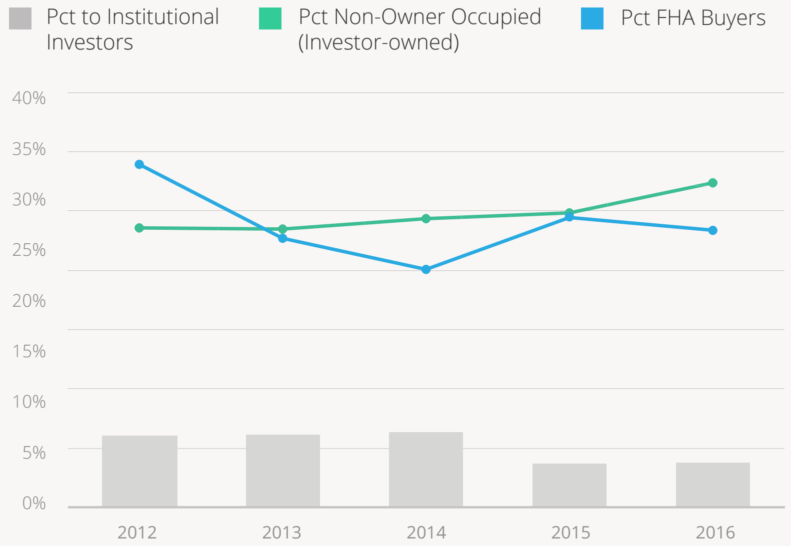
This increase in FHA loan activity is likely due to less competition from investors than seen in Dallas or other markets and an attractive median home price that is slightly below the Dallas or national average. Even with the jump in FHA buyer share in 2015, FHA loan activity continued to track below the share of non-owner occupied home purchases.

While the share of non-owner occupied purchases in Nashville is not as high as in Dallas, it does follow a similar pattern of trending upward throughout the housing recovery, starting at about 24 percent of all home sales in 2012 and 2013 and rising to 25 percent of all sales in 2015 and 27 percent of all sales in 2016 — also a 21-year high.

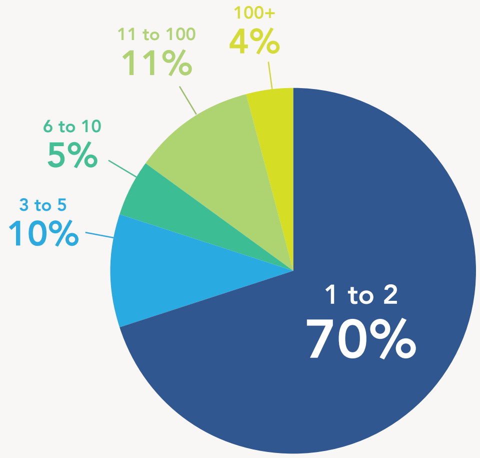
> *"A lot of demand is people in the Bay Area and New York City looking to buy in the Southeast. … We have one Google engineer who just bought his sixth house. He said 'this is fantastic, real estate is so expensive here and I don't want to be tied just to Bay Area real estate."*

Gary Beasley, CEO and founder at Roofstock, an online marketplace for single family rentals

Who is Filling the Void Left by Institutional Investors in Nashville?



Nashville Landlords by Number of Properties Owned



Filling the Demand Void in Seattle

Similar to Nashville, Seattle saw a more than 4 percentage point rise in FHA buyer share in 2015 compared to 2014 — indicating stronger demand from first time homebuyers and others using FHA loans. But as with the other two markets, that share of FHA buyers drifted lower in 2016, reflecting once again the short-lived surge evident in the nationwide numbers.

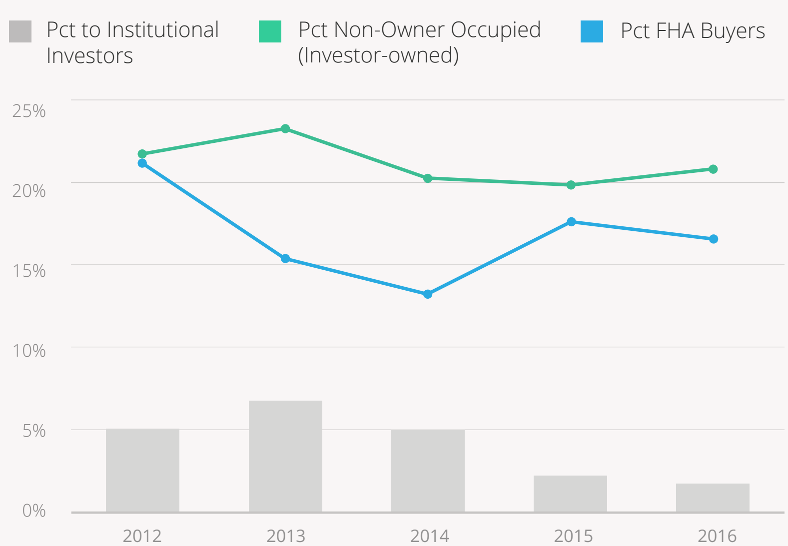
Unlike the Dallas and Nashville markets, however, there has not been a steady increase in the share of overall investor purchases in Seattle during the recovery. To the contrary, the share of non-owner occupied home purchases has trended lower, starting at 22 percent in 2012 and ending at 21 percent in 2016. Of the three markets, Seattle had the lowest share of overall investor purchases in 2016 and was significantly below the national average.

Both ends of the buying spectrum — low down payment borrowers and cash-flush real estate investors — are exhibiting signs of weakening demand in Seattle, but home sales and prices are continuing to trend higher. These trends would indicate that some other pool of buyers is helping to drive demand, likely those somewhere in the middle of the buyer spectrum between first-time homebuyers and investors. This may include move-up buyers, first time homebuyers getting down payment assistance from family, and international owner-occupant buyers purchasing with cash or large down payments.

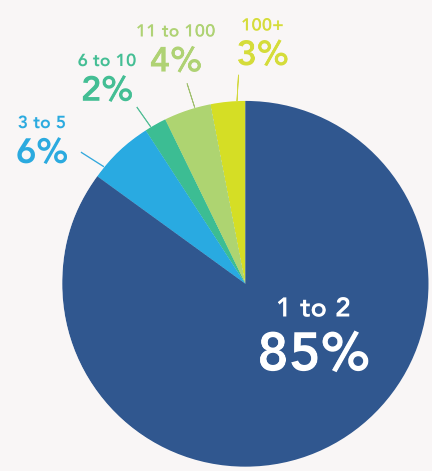
> *In the last year I've noticed more millennials or their parents calling me and saying … 'my son wants to buy a house and we're willing to help with the down payment. He's been living with several other friends in an apartment … and they want to continue to live together.'"*

Edward Krigsman, Managing Broker,
Windermere Real Estate, Seattle

Who is Filling the Void Left by Institutional Investors in Seattle?



Seattle Landlords by Number of Properties Owned

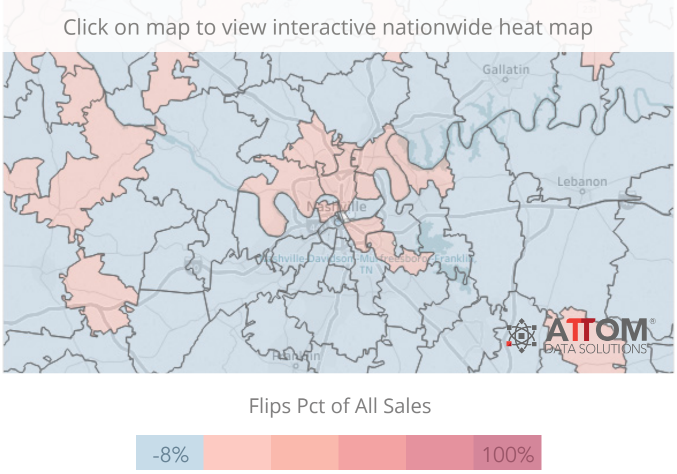


Feeding the **Flipping Frenzy**

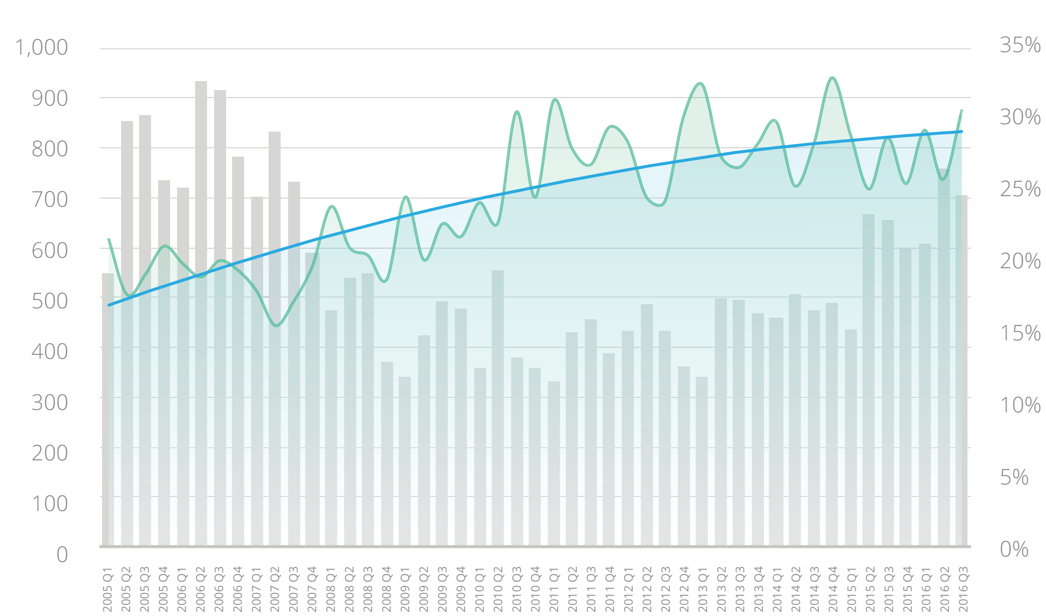
The national trend of investor-driven demand for homes was led by cities like Nashville and Dallas, areas typically more attractive to investors because of relatively low-priced homes that can provide better potential for strong cash flow on rental properties. The strong demand from buy-and-hold rental investors in these markets has also helped to fuel the markets for flippers who rehab older, outdated housing inventory into turn-key rentals for the passive buy-and-hold investors to purchase for their portfolios.

In Nashville, 30.6 percent of all homes flipped in Q3 2016 were sold to all-cash buyers — likely other investors planning to buy and hold the property while collecting rents. That share has trended higher throughout the housing recovery, averaging 33 percent since Q1 2012 compared to an 18.7 percent average during the house flipping surge 10 years ago between Q2 2005 and Q3 2007. While the home flipping boom 10 years ago in Nashville — and many markets nationwide — was driven by demand from owner-occupant buyers with easy access to no-document loans, the flipping boom this time around is much more heavily driven by other investors tapping into the hot rental market grounded in ongoing low homeownership rates.

2016 Home Flipping Heat Map



What is Fueling Flipping Comeback in Nashville?



Seattle Flipping Bucks the Trend

Bucking the national trend to a large degree was Seattle, where the housing recovery has been less dependent on investors and driven largely by traditional buyers. In Seattle, relatively high home prices combined with a low share of distressed properties available on the market deterred many investors from taking the plunge, but strong wage growth has been able to help fuel a rise in home prices without the additional demand of a large investment sector.

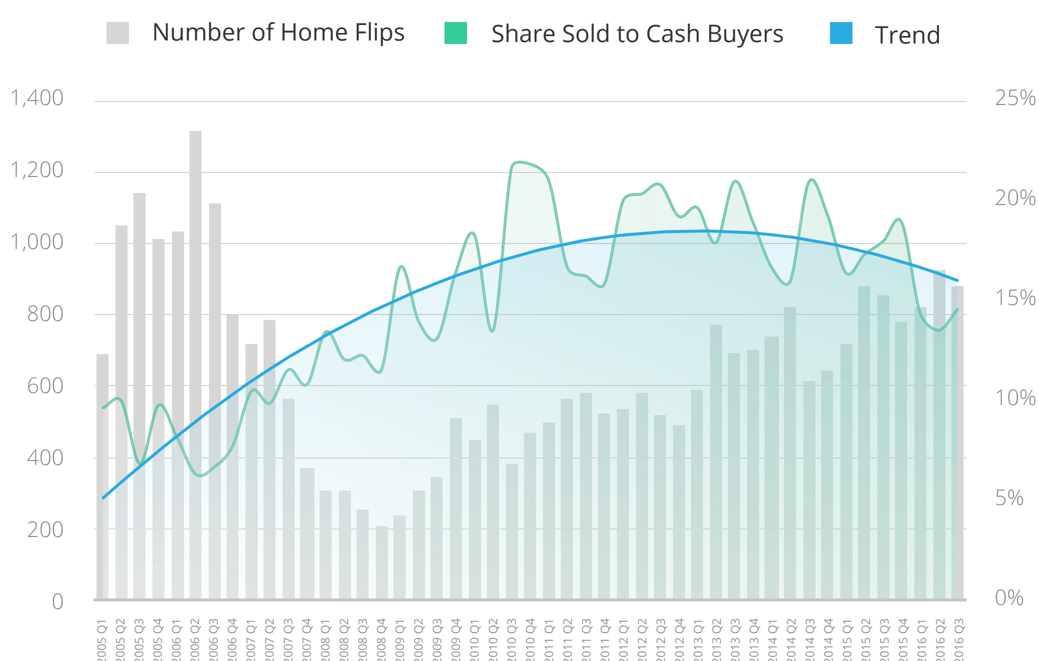
So while home flipping is on the rise in Seattle — where the number of homes flipped reaching a 10-year high in Q2 2016 — homes flipped are much less likely to be sold to cash buying investors than in Nashville. Moreover this trend is declining, indicating that even fewer investors are purchasing from flippers. Instead an increasing share of flipped properties is likely going to traditional, owner-occupant buyers.

"Inventory constraints and climbing home prices ... limit the profit potential and make these purchases inherently more risky," said Matthew Gardner, chief economist at Windermere Real Estate, covering the Seattle market. "The fact that over half of homes that are bought for flipping are financed rather than cash purchases signifies that prices are getting to levels that are out of reach for flippers."

"Inventory constraints and climbing home prices … limit the (home flipping) profit potential and make these purchases inherently more risky."

Matthew Gardner, Chief economist at Windermere Real Estate

What is Fueling Flipping Comeback in Seattle?



Dance with the **One That Brung Ya**

Data from this analysis supports the theory that the housing boom of the past four and a half years has been driven in large part by non-owner occupant buyers (investors) — first the large institutional investors acting as the tip of the spear and followed by the much broader base of smaller investors chasing a similar strategy.

First-time homebuyers have played a part in driving demand in this housing boom, but in many markets they have played a relatively small role, as evidenced by the stubbornly low homeownership rate nationwide and the flat-lining of FHA buyer share following a short-term surge in 2015.

Because the driving force behind this housing recovery has been real estate investors, home prices have risen higher and more quickly than if the recovery had been driven more heavily by first time homebuyers. Buyers new to the housing industry are more directly constrained by affordability and the availability of credit in a tight market, while investors are constrained by rate of return — typically in the form of rental cap rates. In many markets, this results in investors more willing and able to pay a higher price point than first-time homebuyers.

Ultimately, these trends have left a market in a precarious position, with affordability for average wage earners nationwide inching closer to its long-term norm, according to the ATTOM Affordability Index. Given the current trajectory of home prices and interest rates, affordability will go below the long-term norm of 100 in 2017, locking an increasing number of would-be first time homebuyers out of the housing market.

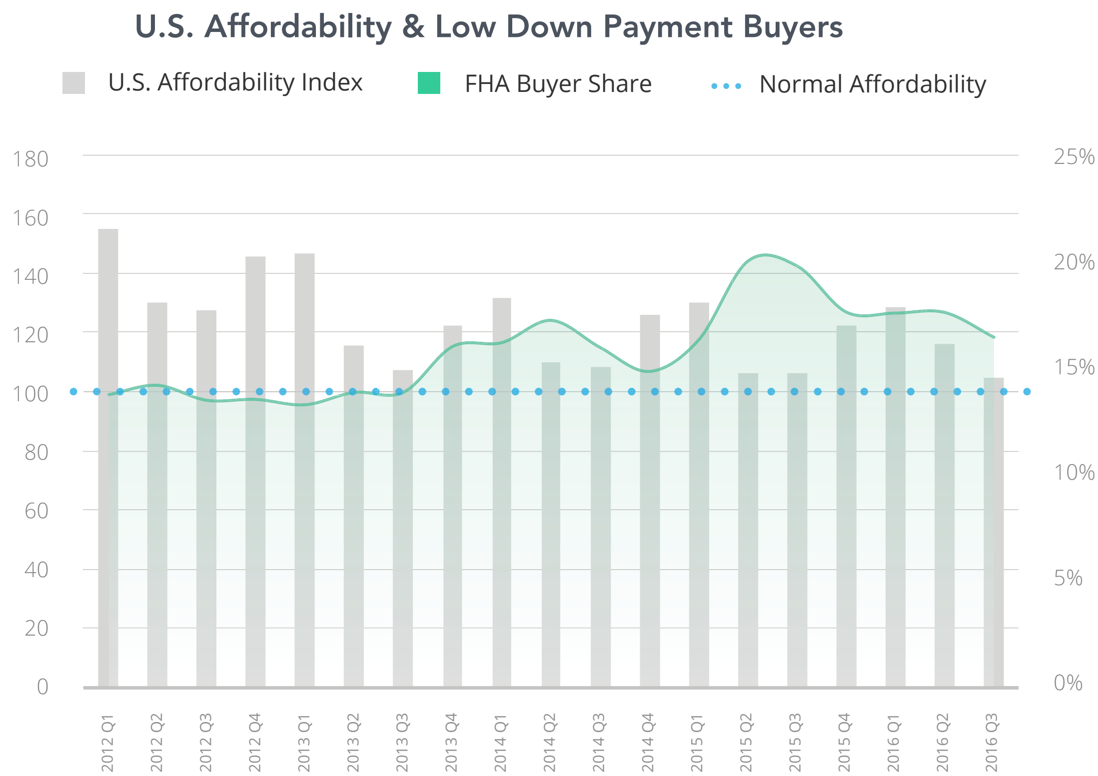
As a result, future growth in the housing market will continue to be largely in the laps of landlords — particularly in markets like Dallas and Nashville that have been more heavily dependent on investors thus far in the recovery. Meanwhile, markets like Seattle are more poised to see growth coming from the traditional buyer segment of the industry.

Even though median home prices are substantially higher in Seattle than in either Dallas or Nashville, the Seattle market is more in line with its own historical affordability standards, allowing for continued growth from average-wage-earning traditional buyers in that market. Contrastingly, both Nashville and Dallas are now significantly less affordable than their high historical affordability norms — putting would-be buyers,who are now renters in those markets between a rock and hard place.

In short, markets will likely be forced to dance with the one who brought them to the housing boom party — and hope their dance partner has strong legs.

> *"A housing recovery that is highly dependent on real estate investors is a bit of a double-edged sword. Rapidly rising home values have been good for homeowner equity, but also have caused an affordability crunch for the first-time homebuyers the housing market typically relies on for sustained, long-term growth."*

Daren Blomquist, SVP at
ATTOM Data Solutions



U.S. Affordability & Low Down Payment Buyers
U.S. Affordability Index
FHA Buyer Share
Normal Affordability
180
160
140
120
100
80
60
40
20
0
25%
20%
15%
10%
5%
0%
2012 Q1
2012 Q2
2012 Q3
2012 Q4
2013 Q1
2013 Q2
2013 Q3
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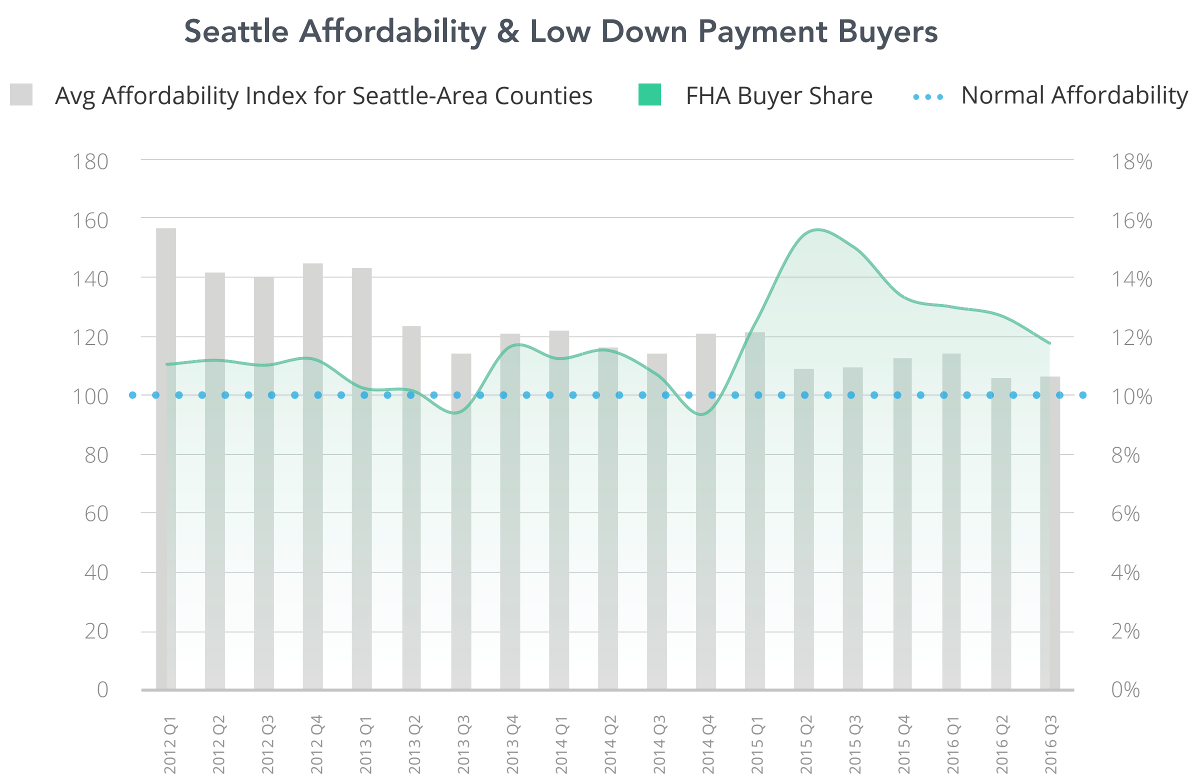
2016 Q1
2016 Q2
2016 Q3



Seattle Affordability & Low Down Payment Buyers
Avg Affordability Index for Seattle-Area Counties
FHA Buyer Share
Normal Affordability
180
160
140
120
100
80
60
40
20
0
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
2012 Q1
2012 Q2
2012 Q3
2012 Q4
2013 Q1
2013 Q2
2013 Q3
2013 Q4
2014 Q1
2014 Q2
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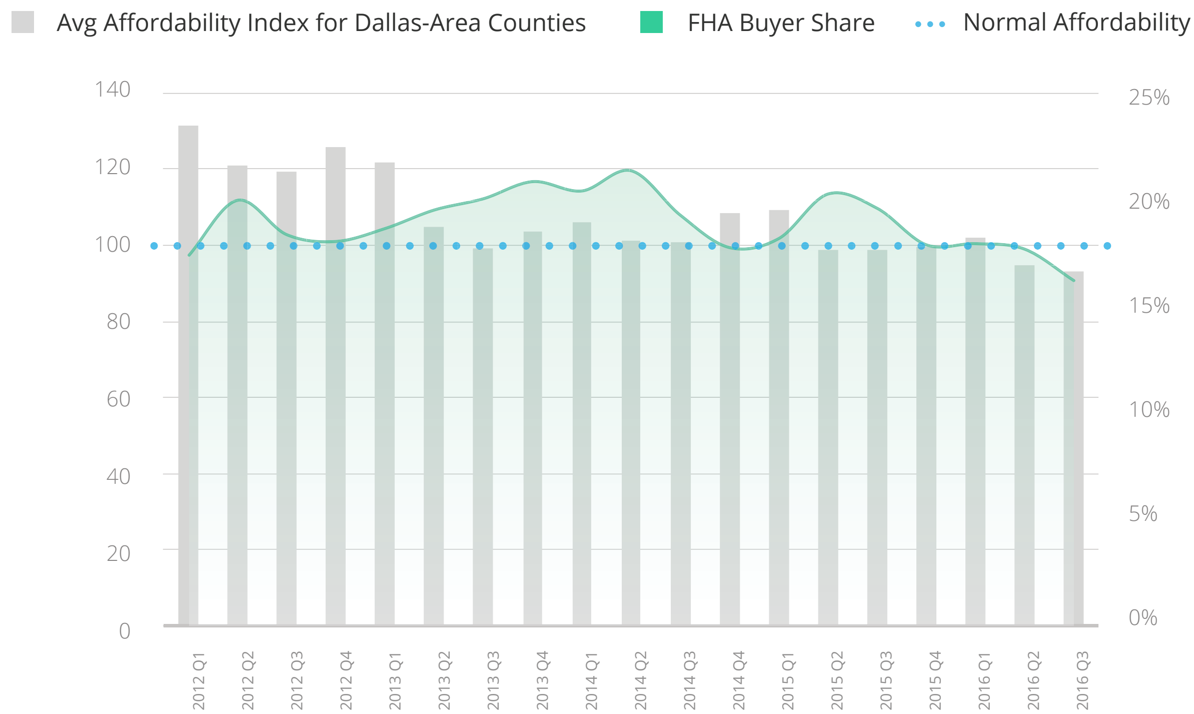
Dallas Affordability & Low Down Payment Buyers



Nashville Affordability & Low Down Payment Buyers