CoStar™

With Billions Invested, Build-To-Rent Brings Changes to Apartment Industry

Fast-Growing Property Type Causes Professionals To Adapt Operations

Urbana at Midnight Ranch, a build-to-rent development in Austin, Texas, was contracted by Legacy MCS, a company that has been focused on this property type over the past few years. (CoStar)

By Jon Leckie
CoStar News

March 3, 2024 | 8:20 P.M.

Developers, construction companies — and even lenders — are discovering that built-to-rent single-family housing is an emerging asset class that brings a unique set of characteristics, prompting many to change the way they operate.

It's happening as the property type, typically clusters of single-family houses leased to individual tenants, is drawing billions of dollars of investment at a time when high mortgage rates and limited inventory push traditional home prices higher.

One firm, Legacy MCS, a third-generation multifamily contractor in Austin, Texas, said it has become focused almost exclusively on build-to-rent, with its accelerated timelines and promise of attractive returns, in less than five years.

“Our work is about to be 100%” build-to-rent, Andy Brewer, chief operating officer at Legacy, told CoStar News. Legacy’s Texas projects now total 916 single-family units and include nearly 570 across two developments in Hutto, outside Austin; a 164-unit project in Leander, another Austin suburb; and an additional 183-unit community in New Braunfels, near San Antonio.

The company is handling construction for developers, including Urban Moment, Kaplan Communities, Empire Group of Companies and Bain Capital. Brewer said the company recently won a contract for a fifth build-to-rent project and is working to secure four more, all with second-quarter starts, as it looks to expand beyond central Texas into areas such as Dallas and Houston.

While build-to-rent is still a small portion of U.S. single-family housing, accounting for just 1.7% or 340,000 rental units, according to brokerage CBRE, its numbers are growing. National Rental Home Council data said build-to-rent completions have ballooned 270% since 2019. In 2023, nearly 25,000 build-to-rent homes were completed, a 62% increase over 2022. At roughly $300,000 a door, that represents $7.5 billion in investment, according to CoStar analysis.

Legacy MCS's Texas construction projects include The Village at Hutto Station. (Legacy MCS)

Driving much of that growth have been players such as Blackstone, whose namesake real estate investment trust started 2024 with a deal to purchase Tricon Residential, a Canadian developer with 38,000 build-to-rent houses in the United States, for $3.5 billion. Along with the acquisition, Blackstone said it intends to invest another $1 billion in new build-to-rent developments.

Similarly, Invitation Homes, already the largest single-family rental landlord in the United States, said it would look to increase its 80,000-unit portfolio of single-family homes with an additional $1 billion going toward new home purchases in 2024 on top of the $1 billion it spent on more than 3,200 homes in 2023.

Not to be outdone, Pretium, a New York-based alternative asset investment firm, said this month it had invested $2.5 billion in build-to-rent houses. That same week, developer Middleburg Communities opened its first build-to-rent project in Alabama and signed a financing deal for 260 units in Virginia that brought the company's total investment in build-to-rent up to $500 million.

Middleburg said that although build-to-rent houses tend to be smaller, it can be the next best thing for renters looking for their own four walls, patio space and a private yard.

"Even if the units are almost the same size as an apartment, you can just walk out your back door and walk your dog. You can go out on your front porch and it's like living in a single-family neighborhood," Aaron Tishkoff, assistant vice president of investments at Middleburg, told CoStar News. "That's definitely part of our thesis."

Learning Curve

Legacy broke ground on its first build-to-rent project in 2019.

“It was one of the first projects of that kind in Austin,” Cass Brewer, Andy Brewer's brother and Legacy’s CEO and president, said in an interview. “We’ve been chasing that kind of work. … At first it started out on the smaller side and now these [developers] are doing 200-plus, 300 units.”

Legacy adapted to the industry, overcoming a learning curve along with peers in the construction industry who didn’t quite understand the projects at first, assuming it was work on traditional houses. They've now come to understand build-to-rent as its own asset class, he said.

Brewer said the knowledge transition was largely driven by the unique advantages offered by build-to-rent, including fast construction times, the option for early tenant move-ins before work ends, and a premium on rents compared to similar-sized apartments.

“A key part of the build-for-rent strategy is the vertical construction is faster than conventional multifamily,” Tishkoff said.

Assuming no delays in municipal permitting and other prep work, Legacy said its teams can complete 40 units a month and go from breaking ground to move-ins in a little as eight months, far shorter than the two years typical of traditional multifamily development.

Tishkoff said these shortened timelines allow developers such as Middleburg to start leasing before the end of construction, bringing revenue in the door sooner, offsetting interest expenses on its construction loans, and reducing overall project costs.

“Our lenders factor in those early move-ins into their interest reserve calculations,” Tishkoff said. “If we couldn’t move people in until the entire project was complete, we would have to add hundreds of thousands, probably a couple million dollars, given the projects of our size. So that’s absolutely part of what makes our build-to-rent strategy work is getting residents in during the middle of construction.”

It's a page borrowed from the playbook of traditional home construction, where new owners can move in before work is completed. At Middleburg, it was an open question whether build-to-rent residents would be willing to live in a construction zone, but Tishkoff said so far that's not the case. Residents have already moved into the company's development in Huntsville, Alabama, even though the recreation-focused clubhouse has yet to be completed.

"We've seen this at our own project and we've seen it in other projects where people are willing to live right in the middle of a massive 30-acre construction site," he said, "because they want to live in this type of unit."

Other potential residents have specific lots in mind, much like potential home buyers who pick their own space because of its proximity to a lake or relative position within the development. At the Huntsville project, Tishkoff said five units that are yet to be completed have been leased by selective residents who researched site plans beforehand.

"In certain apartment communities there is sometimes a manor building or certain units that face the pond or [provide] privacy that is extra desirable," he said. "But I think it's much, much more in the build-to-rent space."

No Shortage of Renters

Despite annual inventory growth in Austin that has reached 9% and pushed vacancy rates up to 14% in traditional multifamily properties, according to CoStar data, Legacy said it hasn’t seen any slowdown in interest from renters.

"The ones we've finished were leased up 100% by the time we walked out of the last unit," Andy Brewer said. He predicts potential tenants at Legacy's Leander project, which is likely to start move-ins in four months, will be "screaming at us for units."

All this despite the premium that rents carry on a build-to-rent home compared to an apartment.

Tishkoff says Middleburg's portfolio of build-to-rent is still young, but early results show a 15% to 20% premium on build-to-rent rates over rents for similar-sized conventional multifamily units. Research from real estate consulting firm John Burns shows similar premiums for build-to-rent at 18% to 19% above the newest nearby garden-style apartments consisting of multiple buildings of four floors or fewer.

"Whereas sometimes the multifamily rents just don't support a certain size construction loan," Tishkoff said. "With the [build-to-rent] differentiator, it helps get the lender and the appraisers comfortable underwriting the [net operating income] that we need to support the loan amount."

Tishkoff says Middleburg has designed its build-to-rent strategy to take advantage of its experience in traditional multifamily, but he expects further operational changes to emerge across the industry as build-to-rent expands. One area he points to is the establishment of entirely new business divisions, such as property management arms devoted to build-to-rent communities that may present different challenges and resident needs than properties within the company's traditional multifamily portfolio.

Pretium this week agreed to purchase BH Management Services, a nationwide property management company, to handle its growing portfolio of build-to-rent communities.

Other companies like Greystar, the nation's largest apartment manager, have launched entirely new brands, such as the company's portfolio of Summerwell communities that's dedicated to build-to-rent.

Andy Brewer said he's seen every big apartment developer getting into build-to-rent over the past two years, and even a few home builders including Lennar and D.R. Horton. "It's out of control right now," he said.

The reason, according to Cass Brewer, comes down to the product's demonstrable financial advantages and high levels of demand.

“Construction costs are so affordable, it’s an asset class that people want to live in, and you’re turning your cash faster," he said. "It really is an attractive asset class and now it’s been proven up.”

RELATED RESULTS

How Accor's Reorganization Has Streamlined Operations, Owner Relations

Hotel Executives Forecast Robust Group Demand

Relationship Pays Off for Peachtree Group and Merrill Hotel

High Rents Keep Many Young Adults Living With Parents, Construction Spending Edges Lower, Mortgage Rates Rise

WeWork's Unsecured Creditors Panel Seeks to Sue Majority Shareholder SoftBank

Ribs With Your Pancakes? Applebee’s and IHOP Placed Under One Roof As Eateries Test Formats

Chicago Area and Texas Extend Record Streaks for Corporate Facility Investments

US Airport Passenger Volume Indicates Continued Recovery in Business Travel

Theater Chains Start 2024 With Lagging Attendance, Key Inflation Metric Trends Lower, Jobless Claims Rise

New York’s Resorts World Plans $5 Billion Expansion in Casino Bid