

Date of Hearing: April 21, 2016

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 2282 (Calderon) – As Amended April 12, 2016

SUBJECT: Rental housing: large-scale buy-to-rent investors: data collection

SUMMARY: Restricts the activities, and requires registration of large-scale buy-to-rent investors, as defined. Specifically, **this bill:**

- 1) Requires the Department of Business Oversight (DBO) in conjunction with assistance that may be offered by county recorders to design and implement a registration program for the purpose of registering and monitoring large-scale buy-to-rent investors.
- 2) Prohibits a large-scale buy-to-rent investor from placing a bid on a normal sale of a single-family home for a period of not less than 90 days.
- 3) Requires DBO to consider methods to require buy-to-rent investors to renew registration of their rental property on an annual basis, including new and current single-family home rentals that they own or in which they have invested.
- 4) Mandates that DBO, on or before January 1, 2018 submit to the Governor and the Legislature a report that includes the following:
 - a) Information regarding how many large-scale buy-to-rent investors own property in the state for the purpose of renting the property and which regions of the state their investment activity is occurring;
 - b) The number of single-family homes each large-scale buy-to-rent investor owns;
 - c) An analysis of the potential impacts their investments are having on the local real estate market, including the price of homes, the ability of individual home buyers, specifically those who need financing, to compete against the large-scale buy-to-rent investors;
 - d) The length of time large-scale buy-to-rent investors are holding their property as a rental; and,
 - e) How many homes large-scale buy-to-rent investors are selling each year.
- 5) Codifies that it is the intent of the Legislature in enacting this provision to monitor the investment activities of large-scale buy-to-rent investors in the State of California that have, since October 2013, designed a mortgage-based security supported by the revenue from single-family rental properties.
- 6) Makes the following legislative findings:
 - a) The emergence of this type of security is likely to grow and scale institutionally owned single-family rental homes to a level that is, at this time, unknown. However, with home prices currently approaching record highs, yet with homeownership at historic lows, it is

important to understand the size and scope of investor activity of single-family homes and the impacts it has on the real estate market in California.

- b) It is in the best interest of the State of California to limit the amount of single-family homes that large-scale buy-to-rent investors can own in our neighborhoods and communities. Furthermore, we must protect against the potential displacement of persons residing in single-family home rentals that is harmful not only to the persons displaced by these practices but also to the entire community in which those persons reside. Large-scale buy-to-rent investors own more single-family homes than any other population in the United States, a market once dominated by local, private owners.
- c) Limiting the activity of large-scale buy-to-rent investors can have a positive impact on the housing market by providing a greater supply of homes to individual buyers, protect the real estate market from large fluctuations in home prices, create a stronger sense of community in our neighborhoods, and defend the American dream of becoming a homeowner

EXISTING LAW: States legislative findings and declarations that the preservation and enhancement of opportunities for homeownership are beneficial to the well-being and prosperity of the people of the state (Health & Safety Code, Section 50001).

FISCAL EFFECT: Unknown

COMMENTS:

Need for the bill.

According to the author's office:

In the aftermath of the financial crisis and Great Recession, the supply of vacant homes far exceeded the demand for owner-occupied homes. This severe imbalance created a unique opportunity for a small number of well-funded investors to purchase large number of single-family homes. For example, in 2013, a subsidiary of the private equity firm Blackstone took \$479 million loan from Deutsche Bank that was secured by a pool of more than 3,000 homes. By creating a bond securitized by revenue from rental properties suggests these investors plan on keeping their properties as permanent rental units, or at the very least, long-term rentals. In fact, according to a recent Federal Reserve Board report, only 7 percent of properties purchased by these investors in 2012 were resold within 24 months. This is what sets the buy-to-rent investors business model apart from the traditional investor, is their stated intention to hold the property as a rental unit for a number of years, possibly even permanently, rather than re-sell in the owner-occupied market.

Institutional investors have played an important role in many markets that were struggling at the time. They helped raise home price, albeit artificially, and reduce the number of vacant properties in the neighborhoods hit hardest by the Great Recession. At the same time, the sheer scope of investor activity in the single-family home market relative to owner-occupant purchases is unprecedented, as is the size of these large, single-family rental portfolios.

Holding thousands of single-family homes in their portfolio puts California communities at risk. If the market predictions from these hedge fund managers are wrong, and fail to pay

back their investors of the bonds they're creating, then we could see another housing crisis with a huge flood of single-family home hitting the real estate market...again. However, this time, not only will housing prices drop dramatically, thousands of families could be disenfranchised to no fault of their own.

Further, and more importantly, homeownership rates are near historic lows. Nationally, homeownership is the lowest it's been since 1967 at 63.4 percent, however, California's homeownership rate is almost 10 percent lower, at 54.1% in the fourth quarter of 2015, according to recent census data. What's troublesome about the lack of homeownership, are large institutional investors are no longer just buying short-sales or foreclosures, which are typically harder for low and moderate income families to buy, but are now buying natural sales of homes. The CEO of Colony American Homes Inc. recently stated, "The first phase was distressed homes. The second phase is acquiring homes in a more regular way." By having this new type of investor in the single-family home market, families must now not only compete against their more financially secure community members, but multiple, large hedge fund companies who have millions of dollars of cash on hand to outbid them. Furthermore, as state before, these institutional investors have computer algorithms that can calculate whether or not they should bid on a property within eight minutes. So, not only do large-scale buy-to-rent investors have a monetary advantage, but they now have a technological advantage, as well.

The foreclosure crisis created massive inventories of foreclosure properties across the nation. Many of these foreclosed homes are just now finding their way onto the housing market. With the private label mortgage backed securities (MBSs) market on life support, institutional investors needed other investment outlets in the housing market. These investors bought large portfolios of foreclosed homes and securitized the rental income. The structure of various single-family rental (SFR) securitizations are very similar as callable and/or non-callable bonds are issued from a single loan, backed by portfolios of SFRS. The bonds typically have terms of two to three years with options for one-year extensions capped at five years total.

On September 19th, 2014, American Homes 4 Rent issued the first bond of this kind bearing a 10-year fixed interest rate, with coupon payment tranches amounting to a weighted average coupon rate of 4.418%. The majority of the portfolio is located in Texas, Illinois, Indiana, Ohio, and North Carolina; markets that have experienced less volatility than other markets. When rent-backed securities premiered on the market in October 2013, the \$479 million offering from the private equity giant Blackstone Group generated more demand from investors than the private equity firm could accommodate. Since then, Blackstone and several other firms specializing in the rental of single-family homes have sold more than \$3 billion of these bonds. REO-to-rental securitization has been hailed as an exciting new asset class, with financial analysts at Keefe, Bruyette & Woods estimating that it could swell into a nearly \$1 trillion industry over the next six years. SFR industry has expanded tremendously in the past two years. According to Commercial Mortgage Alert, the US CMBS issuance was about \$94 billion and the US SFR issuance was about \$6.8 billion in 2014. As of July 2015, year-to-date US SFR issuance is \$5.42 billion up 53% from \$2.85 billion for the same period in 2014 whereas year-to-date US CMBS issuance is \$55.74 billion up 22% compared to the same period in 2014. The SFR bond market is currently estimated to be a \$12.65 billion market with Blackstone's Invitation Homes unit having a leading market share of 42.1% through its seven offerings totaling \$5.32 billion. American Homes 4 Rent stands second at \$2.08 billion followed by Colony American Homes at \$1.75 billion. The business is so profitable that the founder of Blackstone is worth

more than \$10 billion and for his 60th birthday party was entertained by Rod Stewart which begs the question of what is more egregious, the securitization of rental properties or that Rod Stewart is available for birthday parties?

Impacts?

What is the impact of large scale rental investment strategies on the housing market? According to Department of Finance data, California has a little over nine million single family homes. The estimated portfolio of homes turned to rentals owned by Invitation Homes, a subsidiary of Blackstone is around 10,000-12,000 in California. The impact of rental securitizations on home prices is unclear. Some market observers have found that SFR securitization deals have relied on projected occupancy rates that real estate professionals have called unrealistic at best. Blackstone's first offering, for example, assumed a 94% occupancy rate and claimed that 100% of properties were occupied when the deal was launched. Within a few months, 8.3% of these properties were vacant or occupied by delinquent renters, causing rental income to fall by 7.6%. Reported vacancies also rose last year after Blackstone offered a second, \$1 billion bond in May and Colony Capital launched a \$514 million deal in March.

Two issues not addressed in this bill, but that have major impacts on pricing are flipping and foreign cash buyers. RealtyTrac, a real estate foreclosure marketplace, tracks the number of house "flips" and reports they made up 5.5% of last year's real estate sales. Since the housing crash, investors have consistently made up a significant portion of home buyers, but they largely purchased homes to convert to rental property. In the last couple of years, RealtyTrac says the trend has been toward flips. The total number of investors who completed at least one flip in 2015 was at the highest level since 2007, and the number of flips per investor was at the lowest level since 2008. Homes flipped in 2015 were on average purchased at a 26% discount below estimated market value and re-sold by the flipper at a 5% premium above estimated market value. Some real estate experts find that when home flipping numbers go up, it is usually an indication that the housing market is in trouble. He says home flipping tends to artificially inflate home prices. That makes houses less affordable and increases the risk of a bubble. The average flip in California grossed close to \$100,000 in profit and impacts the price of surrounding homes.

Another contributor to expensive housing in certain California markets has been the large influx of foreign cash buyers.

According to data from the National Association of Realtors, during 2014/15 the average price foreign clients paid for a house was \$500,000, compared to the overall U.S. average house price of \$256,000. Approximately \$54.5 billion of sales was attributed to non-resident foreigners, with resident foreigners accounting for \$49.4 billion of sales. The bulk of purchases by international clients were all-cash, accounting for approximately 55% of reported foreign transactions.

Amendments

This bill was previously heard in the Assembly Committee on Housing where the author agreed to accept the following amendments in Banking & Finance:

- 1) Change the prohibition on a large scale buy-to-rent investor from bidding on a property from 90 days to 15 days.

- 2) The bill applies to companies that hold 10 or more properties. The amendments would change that threshold to 100 or more.

Issues going forward

As the author further refines the bill going forward the following issues should be addressed.

- 1) The Legislative findings and declarations provide that limiting the activity of large-scale buy-to-rent investors can protect against large home price fluctuations. Given the numerous housing difficulties in California and the multitude of issues that contribute to our housing costs this provision may need to be reworked so as not to give the indication that this one issue will have a significant impact on home price appreciation.
- 2) The registration program to be administered by DBO lacks detail. It does not give DBO the authority to charge a registration fee nor provide any penalties for entities that do not register. Additionally, DBO is not given authority to confront entities that may report inaccurate information.
- 3) The entities covered would be required to renew their registration but the process is somewhat unclear and confusing.
- 4) The report required of DBO mandates that they provide an "analysis of the potential impacts" these large-scale buy-to-rent investors are having on the housing market. Staff believes that DBO may not have the expertise necessary to provide an "analysis" and may need to hire a third party to comply with this provision. The author may want to consider authorizing DBO to hire an independent third party to conduct this study.
- 5) Prohibits the large-scale buy-to-rent investor from placing a bid on a "normal sale." The term "normal sale" is not a defined term in existing law. The author may wish to define this term.
- 6) The bill exempts short-sales, foreclosure sales, and real estate owned property from the purchase prohibition even though foreclosure sales provided the initial bulk of properties to these investors. While foreclosures have declined significantly, the author may wish to further examine this issue.
- 7) The prohibition on buying a home for 15 days also would impact sellers of property.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

California Apartment Association

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