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Home Builders Bypassing Individual Home Buyers for Deep-Pocketed Investors

Rising mortgage rates could lead to a pullback in demand by traditional buyers

By Will Parker

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Investors who buy and then rent new homes are fast becoming a favorite customer of the home builder industry.

The vast majority of the hundreds of thousands of new homes built last year were sold to individuals and families to live in. But rising mortgage rates are making those purchases much more expensive and could lead to a pullback in demand by those traditional buyers.

However, investors holding billions of dollars are eager to buy these homes in bulk, a boon to home builders who have increased construction in recent months.

More than one in every four houses purchased by a professional rental investor in the fourth quarter last year was a new-construction house, according to a report from John Burns Real Estate Consulting LLC and the National Rental Home Council, a landlord trade group.

Brand new homes were just 3% of what these investors bought during the third quarter in 2019.

Large investors have amassed some $89 billion in capital to spend on building or buying new rental homes and have deployed only about one-quarter of it, according to real-estate research and advisory firm Zelman & Associates.

Home builders often choose to sell in bulk to investors because it allows them to turn a profit on new homes more quickly. Investors have more capital and can close on a large number of homes at once.

As of February, there were 799,000 single-family homes under construction across the U.S., up 28% from a year prior, according to government figures.

Rising mortgage rates, meanwhile, are shallowing the pool of individuals who can afford to buy new homes. The average fixed rate for a 30-year mortgage was 4.72% as of April 7, according to Freddie Mac, up from the 2.97% rate during the same month last year. Mortgage application volume fell 41% below what it was during the same week in 2021, according to the Mortgage Bankers Association.

That makes selling to rental investors even more attractive to builders, especially those who typically sell to entry-level buyers, said Robert Dietz, chief economist at the National Association of Home Builders, a builder trade group.
"Those potential buyers still want more space," he said. "And so single-family rental is likely to continue to show some strength."

Investors say new rentals enable people to live in single-family homes in desirable neighborhoods, where they either can't afford to buy or prefer to rent. Investors offer a reliable sale even if interest rates rise because many already have cash on hand.

"We can offer them something that feels a lot more certain," said Sudha Reddy, founder of investor Haven Realty Capital, which has acquired more than $1.1 billion worth of new construction rental homes from builders since late 2020.

Sales to investors can have strong appeal to builders.
PHOTO: MICHAEL DUERINCKX

Builders like Rich Eneim, Jr., agree that sales to investors have strong appeal. His firm, Keystone Homes in Scottsdale, Ariz., last year decided to refocus almost entirely on rental houses. Keystone has an 800-house construction pipeline, and about half of what it builds now it will sell to investors, Mr. Eneim said. The other half he will hold on to and lease to tenants.

One of Mr. Eneim's latest developments is The Havenly Fountain Hills, a community of stucco-and-tile homes about 30 miles outside of downtown Phoenix. Houses average only about 1,100 square feet, but they rent for more than $2,500 a month. Collecting rent now and selling to an investor later allows the company to ride out any headwinds in the for-sale market, Mr. Eneim said.
"When we do a for-sale community, we have to sell, no matter what the price is, no matter what the market is, if it's good or bad" he said. "For rent, we can be patient."

Many of the new homes investors are now buying were originally conceived as rentals, but a majority are homes that builders later decide to sell to rental companies. When combined, these homes account for as much as 9% of all single-family home starts, according to estimates from the Burns firm, though that percentage has been rising in recent years.

Rental investors also bid up land prices in hot markets, home builders and analysts say. Higher land prices make it difficult to build for entry-level buyers in those areas, analysts say.

Rental builders can often pay more for land because they are backed by larger capital sources, build denser communities with more units and come in with plans to raise rents every year, said Rick Palacios, an analyst at the Burns firm. "It's not a shocker," he said. "In the Southwest, rents are going up double digits, and they have been going up double digits for a while now."