Newsletter — Institutional Home-buyers are Pulling Out of the Market in Droves—What Do They See That You Don't?

Institutional investors (those who own 1,000 or more homes) have been selling off their inventory in 2023. These big investors have reduced their buying activity by nearly 80% from Q4 of 2022 compared to Q4 of 2021, according to John Burns Research and Consulting.

This change in activity has led to 90% fewer purchased homes in January and February of this year than in the first two months of 2022.

This is a sharp contrast to the pandemic purchasing of houses in the U.S. These were times when it was easy to borrow money and interest rates were at rock bottom coupled with rising rents and soaring home prices making it a perfect storm for institutional homebuyers to add to their portfolios. So, why has the trend reversed?

We'll take a closer look at the trends of institutional homebuyers, the reasons why they are backing out, and what this means for individual investors.

Selling Homes and Shrinking Portfolios

American Homes 4 Rent and Invitation Homes have been net sellers in the first quarter of this year. As of March 31, 2023, American Homes 4 Rent—a leading builder in single-family rental communities—had a portfolio of 58,639 homes, which was reduced by 354 homes compared to 58,993 homes (666 homes sold, while 299 newly constructed and 13 acquired) as of December 31, 2022.

In the first quarter of 2023, Invitation Homes purchased 194 homes and sold 297. As the U.S.'s biggest owner of single-family rentals, its portfolio decreased from 83,113 to 83,010 single-family homes.

What's more, data from Redfin shows that institutional investors are fleeing once sought-after towns such as Las Vegas, Nevada, and Phoenix, Arizona, due to home prices dropping. How much have they dropped? Newly built homes in Phoenix dropped 15% year over year in March, according to Realtor.com.

Rising interest rates

With the Fed increasing rates rapidly, it has caused mortgage rates to creep up. According to Forbes, a 30-year fixed mortgage rate was 3.22% in early 2022 but has since risen to an average of 7.17%. Consequently, the deals aren't as lucrative compared to during the pandemic.

What's in store for the remainder of the year? Experts—including Dave Meyer are predicting more volatility in interest rates and that we may have or will reach a peak during the summer, with rates steadying by year-end.

Housing prices are fluctuating

We're seeing limited inventory as new home listings have reduced by over 20% compared to last year, according to Realtor.com. In an April report from the National Association of Realtors (NAR), data shows that the median existing-home sales price dropped 1.7% from one year ago to $388,800.

Overall, we're seeing limited inventory and a decline in home sales, along with home prices bouncing back in half the country, while the other half is declining from pandemic peaks.

Rent growth has declined

Recently, rent growth in the U.S. has been flat. In April, asking rents in the U.S. increased by only 0.29% annually to $1,967—the smallest year-over-year rent growth in 37 months. New Orleans, Louisiana (-15%) and Austin, Texas (-14%) were the hardest hit. During the pandemic, we witnessed millennials starting families and buying homes, but now households plan to stay put.

Even though rent growth may have slowed, renter demand will likely increase. The issue of housing affordability will make it challenging for Americans to become homeowners.

Are Institutional Investors Scooping Up All the Inventory?

Contrary to popular belief, institutional homebuyers aren't sucking up inventory and pushing prices even higher. In fact, according to NAR, although institutional homebuyer share increased in 84% of the states, they only made up 15% of single-family home purchases in 2021. So, everyday investors shouldn't worry too much about a battle scenario between David versus Goliath.

What This Means For Everyday Investors

These factors mean the return on investment isn't nearly as lucrative during the pandemic. Ultimately, with rising interest rates, overinflated housing prices, and rental growth slowing down, the financial gains aren't what they used to be.

However, you may have noticed higher-than-usual institutional homebuyer activity if you live in certain Sun Belt regions, including Texas, Georgia, Oklahoma, and Alabama. These regions have made up a larger portion of overall homebuying activity. So, it depends on where you live in the U.S. to determine how much of an impact this will have on you.

Another study by Yardi Systems shows that in 2022, institutional investors who owned single-family rentals made up only 5% of the market (700,000 out of 14 million). Furthermore, MetLife Investment Management (MIM) predicts it could grow to 40%, or 7.6 million homes, by 2030.

Is It a Good Time to Buy a Rental Property?

Only time will tell when institutional homebuyers will get up from the sidelines and actively buy more inventory. If mortgage interest rates and home valuations decrease, we may see an uptick in purchasing activity. Sheharyar Bokhari, a senior economist at Redfin, predicts it's "unlikely that investors will return with the same vigor they had in 2021." This is welcome news for mom-and-pop real estate investors who feel they are competing with institutional investors.

What's more, it comes down to crunching the numbers to see if it makes financial sense. With mortgage rates inflated and low inventory, we're seeing Americans holding out as well. But with rising home prices nationwide, there will be growing demand for renters in the long term. You'll need to determine whether any potential rental property will add value to your portfolio based on your individual financial goals.

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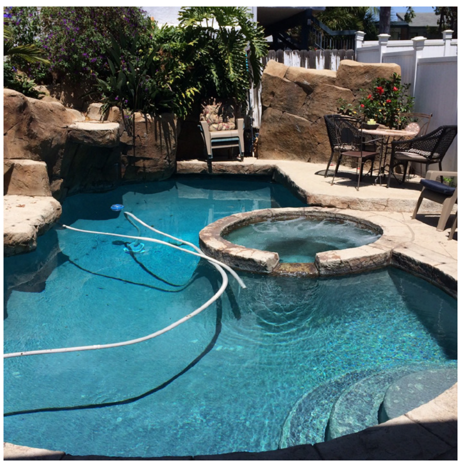

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Irvine, CA 92604

Southern California home prices have been falling. Are the drops over?

Last year, rising mortgage interest rates chilled the previously hot Southern California housing market.

Buyers backed off, sales plunged and, for the first time in a decade, home prices underwent a sustained slide.

By one measure, prices in the six-county region fell 13% from the peak last spring.

That might be as low as they go.

In recent months, there have been growing signs home values may have resumed their climb, potentially dashing the hopes of first-time buyers holding out for cheaper housing in the months or years ahead.

What exactly is happening?

According to several data trackers, home prices ticked up in the last few months.

In April, the median sales price for an existing single-family house in Southern California rose 2% from a month earlier to $785,000, according to the California Assn. of Realtors. That was the third straight month prices climbed from the prior month.

Similar increases can be found in data trackers from mortgage company Black Knight and real estate brokerage Redfin.

But not all sources show prices rising across the board.

According to Zillow, the typical price in the combined six-county Southern California region continued to fall in April, but the decline was the smallest since values turned negative last year.

Why is this happening?

Essentially, buyers have been more willing than sellers to return to the market this spring.

A decline in mortgage rates from above 7% into the 6% range brought some buyers back, real estate agents say, as did a belief among buyers that rates wouldn't fall much more if they continued to hold out.

Some agents said they've seen mostly first-time buyers return.

"Why pay high rent?" Ramon Sanchez, a Whittier-based agent, said. "They would rather see if they can qualify to buy."

Jeff Tucker, an economist with Zillow, said first-time buyers may also be "bursting at the seams in their apartment" as their families grow, another reason "a lot of interested first-time buyers are not in a place where it's easy to wait."

At the same time, many homeowners are waiting, unwilling to list their homes and trade their sub-3% mortgages to borrow at 6%.

Since the start of the year, the total number of homes for sale in Southern California has dropped 21%, according to data from Redfin.

Despite fewer options, sales increased 34%.

"Inventory is just very low," Tucker said. "There are enough folks who can afford prices at this height that they are still bumping into each other getting into a little competition."

If I am looking to buy a home now, what should I know?

Well, there is a little more competition. Compared with a few months ago, open houses should be busier and there's a greater chance you'll need to bid against others.

Tracy Do, a Coldwell Banker agent who specializes in the highly sought-after neighborhoods of northeast L.A., said that once again, some homes are selling for more than $100,000 over asking.

In southeastern Los Angeles County, Sanchez isn't seeing jumps as big, but the last three properties he listed had multiple offers and either sold, or are in escrow, for more than the list price.

"We got more buyers in the market than we have sellers," Sanchez said.

Although the market is more competitive, it's nothing like the pandemic housing boom.

In March 2022, buyers paid more than list price in 76% of home sales in Los Angeles and Orange counties, according to Zillow. Fast-forward to March 2023, that percentage was 42%.

Do said buyers — compared with early 2022 — are also more likely to get away with leaving in contingencies, or convincing the seller to pay for repairs.

Pricing is also lower.

According to the California Realtors, though April's median in the combined six-county Southern California region was up $15,000 from March, it was $52,000, or 6.2%, below April 2022 levels.

In Los Angeles County, the median was 8% less than a year earlier and 17% lower than when prices topped out in the county last September.

In Orange County, April prices were 8% from that county's peak; in the Inland Empire, 5% below the peak; in Ventura County, 7% below the peak; and in San Diego County 5% below the peak.

Will home prices drop further?

What ultimately happens will be influenced by a variety of factors including the direction of mortgage interest rates and whether the economy enters a recession.

But Tucker, the Zillow economist, said the most likely scenario is home prices rise from here on out, because high mortgage rates should keep many homeowners from listing their homes.

Jordan Levine, chief economist with the California Assn. of Realtors, also predicts rising prices, but like Tucker at a more modest level than during the pandemic.

Levine said still-high mortgage rates and a slowing economy are likely to damp demand enough to keep prices from soaring.

Other experts stressed that values could again turn negative.

"Home prices are still well out in front of what underlying incomes today would support at today's interest rate levels," said Andy Walden, vice president of research at Black Knight. "There is still potential price risk out there."

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