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THE WALL STREET JOURNAL

WSJ.com

MARKETS | AUGUST 4, 2011

Big Money Gets Into Landlord Game

By ROBBIE WHELAN

VALLEJO, Calif.—Agustin Gutierrez, a construction worker from this town in the hills northeast of San Francisco Bay, lost his job in 2009, then, 10 months later, he lost ownership of his home.

Now, the husband and father of four rents the same five-bedroom ranch from McKinley Capital Partners, an investment company that's at the forefront of a new breed of big-money landlords.



Getty Images

Hedge funds, private-equity firms, pension funds and university endowments are dipping into the foreclosure market.

McKinley, which has acquired more than 300 foreclosed single-family homes in the Bay Area over the past two years, recently teamed up with [Och-Ziff Capital Management Group LLC](#), a New York hedge fund, with plans to buy at least 500 more foreclosed homes in the next year. Those homes, too, will be rented to people like the Gutierrez family.

Buying foreclosed homes as investment properties has long been dominated by mom-and-pop investors. But now hedge funds, private-equity firms, pension funds and university endowments are dipping into that market. The attraction is double-digit returns at a time when most bonds and other income investments yield very little.

The most popular strategy is for a big investor to team up with a local company that scouts out houses and finds the renters. The hope is to flip the homes in the future when prices recover.

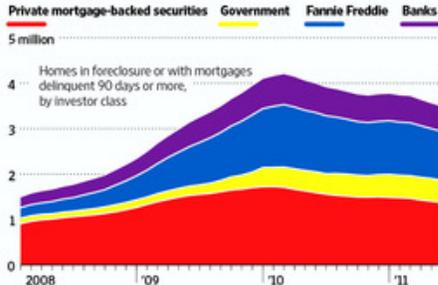
"It's kind of the Wall Street meets Main Street phenomenon," says John Burns, an Irvine, Calif.-based real-estate consultant who has discussed investing in single-family rentals with hedge funds. "The Main Street guys need the capital, and Wall Street needs the expertise."

At the end of May, 3.5 million loans were at least 90 days delinquent or in foreclosure, according to investment bank Barclays Capital. At the same time, the country's home ownership rate has fallen, to 65.9% in the second quarter of 2011 from its peak of 69.2% in 2004, according to figures released by the U.S. Census Bureau last month. That drop has produced millions of new renters and helped push the vacancy rate for rental housing down by about two percentage points, to 9.2%.

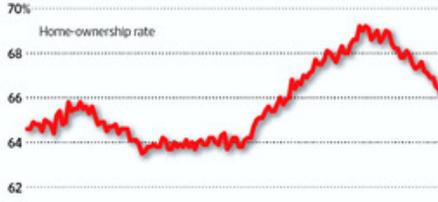
"The single-family rental market is actually quite large," said Dennis McGill, director of research at Zelman & Associates, a research firm that follows the housing market. "The average American says, 'If I've got two kids and a dog, I can't live in a one-bedroom apartment.'"

Fueling the Rental Market

A spike in foreclosures...



...and a big drop in home ownership...



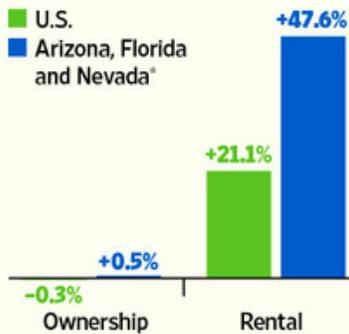
...have pushed down vacancy rates, producing a more favorable environment for landlords.



Sources: Barclays Capital (foreclosures); Census Bureau (ownership, vacancy rates)

Renting a Dream Home

Change in single-family home ownership and rental, 2005-10



*States hit hardest by the foreclosure crisis
Source: Zelman & Associates analysis of Census Bureau data

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Zelman recently issued a report saying that in Arizona, Florida and Nevada, states hard-hit by the foreclosure crisis, the number of families renting a single-family home increased 48% from 2005 to 2010.

Large institutional investors could eventually help stabilize the market by soaking up the huge overhang of foreclosures, which could allow housing to begin healing. However, the number of single-family homes being bought by institutional investors is still small compared to the millions of distressed properties. The biggest players in the market are deploying hundreds of millions of dollars, not the billions necessary to make a major dent.

The federal government has a large role as well. The Obama administration is currently considering ways of selling foreclosed homes to investors who agree to rent them out. Fannie Mae and Freddie Mac and the Federal Housing Administration own more than half of all unsold foreclosed homes.

Being a landlord can be a costly hassle for large investors. Unlike apartment complexes, which concentrate hundreds of rental units in one place, investors must buy hundreds of single-family houses that are miles apart, each with separate maintenance problems. Tenants can be troublesome.

"You could have a bad tenant who doesn't want to pay their rent, or maintain the pool," says Guy Johnson, an investor who buys foreclosed properties in Nevada, Arizona and California and rents some of them out. "A hedge fund manager doesn't want to have to be their own plumber or electrician."

Buying foreclosed properties isn't easy either. Investors sometimes have to pay thousands of dollars in "cash for keys" payments to the previous homeowners in order to entice them to leave the property, and foreclosed homeowners often damage their homes before they are evicted.

Private-equity giant Carlyle Group LLC tried its luck with the single-family home market two years ago but abandoned the strategy late last year after concluding that the returns weren't large enough. Carlyle's strategy was different. The company formed partnerships with local asset managers in California that bought and flipped homes, rather than renting them.

For now, more investors are plunging into the single-family rental market. McKinley, the Oakland, Calif., company that owns Mr. Gutierrez's house, has already begun to use Och-Ziff money to purchase houses. Its model is to buy homes at an average price of about \$100,000 apiece, put between \$10,000 and \$25,000 in renovations into them, and set the rental rate of the house so that it produces a return of 8% to 12% annually. This often works out to a rent of roughly \$1,200 per month.

McKinley and Och-Ziff could see additional returns from selling the houses at a higher price after a few years, once the market has improved. "Two years ago no one thought you could scale

this business or that it could be institutionalized," said Gregor Watson, a principal with McKinley. "Now, you can get very good yields. It's a very good long-term strategy." He declined to comment on the Och-Ziff investment. Och-Ziff also declined to comment.

Other large investors have formed rental-housing partnerships.

G8 Capital, a private-equity fund based in Ladera Ranch, Calif., has bought 3,000 homes across the country since 2008, mostly to flip them. It decided last year to begin pursuing a hold-and-rent strategy. It has since bought 250 foreclosed homes as rentals. Carrington Property Services LLC, a Santa Ana, Calif.-based property investment company that manages about 4,500 homes nationally, is in talks with investors to raise funds for a real-estate investment trust, to be called Residential National Trust, which would acquire foreclosed homes for rental. The company plans to buy as many as 5,000 more rental homes in markets including Chicago, Miami, Phoenix and Las Vegas.

Waypoint Real Estate Group, an Oakland, Calif.-based company, has bought 700 homes in the past two years as rental properties. Doug Brien, a former place kicker for the New York Jets who is now managing director of Waypoint, says that his company has approached pension funds, university endowments and large private investment groups about investing in his fund. In July, he says he closed on a financing deal from an Ivy League university endowment, but declined to name the university.

"At some point, there will be a shortage of housing," Mr. Brien said. "Everyone is realizing that single-family buy-and-hold is the way to go."

In November, hedge fund manager William Ackman's Pershing Square Capital Management LP released a report arguing that single-family rental properties are an "under-owned asset class" that would make "an intelligent investment for institutional investors." Pershing Square predicted that investing in single-family homes and holding them as rentals for 10 years could produce double-digit investment returns, even if U.S. home prices only improved marginally.

All the activity is fueling a renewed debate over whether investors are good or bad for the housing market. In the early days of the housing bust, some community groups discouraged banks from selling foreclosed homes to investors for fear they wouldn't take proper care of the properties. Some communities riddled with foreclosed homes became slums.

Alan Mallach, a senior fellow with the Brookings Institution in Washington, argues that instead of running from investors, local governments should provide subsidies to investors who buy, rent out and are good landlords for foreclosed properties. "If a neighborhood has a high rate of home ownership, that's obviously better," he said. "But in some markets, there was so much inventory coming on the market that the sheer number of properties was destabilizing those markets."

Mr. Gutierrez, the Vallejo construction worker, now pays \$1,800 a month in rent, compared to the \$2,500 per month he was paying to cover the cost of his mortgage when he owned the house. He says it bothers him that he no longer owns his home, but is happy to pay less and says his new landlords are good property managers.

He bought the house in 2003 for \$340,000 using a \$322,700 loan. He refinanced the home five times, driving up the total amount of debt on the house to \$400,000. He lost the house to foreclosure in 2009. McKinley paid about \$155,000 for the house that year.

"It's confusing, because sometimes I think it's my house, but I have to remind myself that it's not," said Mr. Gutierrez, who says he doesn't plan to try to repurchase the house. "It's sad, but it's what happened to a lot of people."

—Nick Timiraos contributed to this article.

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