MFE

MULTIFAMILY EXECUTIVE

Multifamily operators battle front-line turnover

INSIDE
Supply chain issues continue to hinder the industry.

NOVEMBER/DECEMBER 2021 • VOLUME 26, ISSUE 8 • MULTIFAMILYEXECUTIVE.COM

development

Is Single-Family Build-to-Rent a True Missing Middle Solution?

The model quickly delivers the right kind of housing, but some professionals worry it's not enough. By Mary Salmonsen

Courtesy //3877

Above: The living area at Residence 628, a condo building by architecture and design firm //3877 in Washington, D.C.

Far Right: The Springs brand by Continental Properties serves the "missing middle" renter demographic.

Bottom: A rendering of Clay Street Commons by The Bradley Development Group, a mixed-use multifamily development in Nashville, Tennessee. The firm has historically turned down single-family build-to-rent projects.

THE MISSING MIDDLE—DEFINED HERE AS HOUSEHOLDS WHO EARN between 80% and 120% of the area median income—occupies a difficult position in the housing market. In many areas, households at this level do not qualify for subsidized housing, cannot afford the housing options in a given market, and have very little in the way of smaller-scale housing options from which to choose. Steve PonTell, CEO and president of nonprofit National Community Renaissance, defines the housing that would be affordable to this group as housing that "the market is not providing and subsidy does not provide."

This stems from a perfect storm of causes, among them high land prices, building material prices, and regulatory considerations that drive builders toward larger and more elaborate homes in order to justify the cost of a purchase.

"There is a scarcity of land zoned for development of moderate housing," says James H. Schloemer, CEO of developer Continental Properties. The company operates two townhouse-style residence brands, Authentix and Spring, designed to serve missing middle-income levels across 19 states. "As with all scarcities, this leads to dramatically inflated prices for sites that can be entitled for missing middle housing. Additional labor costs are required in the construction of new housing to satisfy regulatory mandates by federal, state, and local agencies. ... While some of these requirements are appropriate for health and safety measures, many are burdensome without providing sufficient value to residents or the community. Labor and material suppliers do not have a specific objective of expanding the supply of missing middle housing. Government agencies should, and sadly only in limited cases do, have the objective of expanding the stock of housing for middle-income Americans."

"People want more space than ever, but with market instability, unemployment rates still high, and growing purchase prices in both urban and suburban areas, purchasing a home is not feasible for many people."
—TOM PFLUEGER

As for-sale single-family housing remains out of reach for many households in the 80% to 120% AMI bracket, single-family build-to-rent has emerged as an asset class that delivers precisely what this group wants. Scalable build-to-rent models provide what developers are rarely incentivized to build—small-scale housing, attached or detached, with lower barriers to access than the single-family for-sale market.

"People want more space than ever, but with market instability, unemployment rates still high, and growing purchase prices in both urban and suburban areas,

purchasing a home is not feasible for many people," says Tom Pflueger, senior associate at MBH Architects. "Single-family rentals are likely to continue to grow in popularity especially among young families that want the convenience of close proximity to jobs and urban amenities."

The appeal of these communities bears out in the data. According to the single-family build-to-rent portion of Yardi Matrix's September 2021 Multifamily National Report, rents at those properties have risen 14.3% over the past year, with markets such as Atlanta, Miami, Phoenix, and Tampa, Florida, nearing or exceeding 30% year-over-year rent growth. Houston has led the nation in occupancy growth, up over 8% in the past year, closely followed by San Antonio at over 4%.

However, a number of professionals warn that this model does not solve the core missing middle issue that drives demand for single-family build-to-rent housing. Namely, single-family for-sale housing remains out of reach for the households that might otherwise turn to it—and builders do not have a financial incentive to create options for them.

"I don't believe that the build-to-rent model is the answer," says David Shove-Brown, co-founder and principal of Washington, D.C.–based architecture and design firm //3877. "This is like putting a Band-Aid on a broken arm. We need to be providing incentives for people to move to and stay in a community. At the end of the day, if someone is going to be spending all of their money on rent, then why not have a mortgage and do it the right way? What is the incentive for renters to stay in this community?"

As the model currently exists, its growth is driven by financial gain. If single-family build-to-rent were to suddenly become unprofitable, it would no longer be built and its operating structures may change. It is also still subject to the same constraints on land, labor, material prices, and regulatory cost.

Jared Bradley, owner of The Bradley Development Group and The Bradley Projects, echoes this sentiment. His firms have turned away from single-family build-to-rent opportunities to date for just this reason. "Overall, this model capitalizes on the middle class by not allowing them to buy their own home at an affordable rate but instead renting it," Bradley says. "We believe that it is our obligation and purpose to serve and help strengthen the middle class. Until there is a solution on how to get people on the track toward eventually owning their own homes, townhomes, or condos, there will be no long-term solution for the missing middle."

Under current circumstances, some locations are more appealing from a ROI perspective than others. Out of the top 30 markets for single-family build-to-rent growth as defined by Yardi Matrix, only one—Pittsburgh—is in the Northeast. Locations not deemed financially advantageous will not receive this type of housing.

"[In urban areas] land is valued at a certain price based on how it has been defined from a zoning perspective," says Ken Colao, founding principal and president of CNY Group, a New York–based development services firm. "For example, a property zoned where an 80-story structure can be constructed is going to be worth more than a site with a height cap that is restrictive. ... Consequently, the land itself becomes too expensive to be developed into missing middle housing without an overarching shift in planning and zoning practices."

Single-family build-to-rent is also a relatively new asset class, and its strong early returns are driving a high level of investment activity—with little clear picture of what the landscape will hold in the years to come. The housing model's long-term success will depend on the outcomes of these communities, the financial situations of its target renters, and the options available in for-sale markets. "New development of single-family rentals [in contrast to the rental of existing housing stock] is still in its infancy," says Schloemer. "It is too early to tell if this model can be developed at costs that will significantly serve the needs of missing middle households."

In Schloemer's view, the best way to create provisions for missing middle housing is through "accommodation by governmental bodies." These could include zoning, fee, and entitlement relief for developments that propose housing that will be affordable to households earning between 80% and 120% of the AMI. MFE

Top: Matt Dahlman;. Bottom: Courtesy The Bradley Projects