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# Phoenix’s Developer Turned Landlord

Biding its time for the market to rebound, The Empire Group is focusing on converting single-family homes to rentals.

By: Claire Easley
March 16, 2012

By the time the federal government announced its plan last month to begin selling REOs owned by Fannie Mae to investors to be converted into rentals, Phoenix-based The Empire Group of Cos. was already way ahead of them. For a few years, the residential and commercial developer has been biding its time for the development market to come back by acquiring single-family homes around the Phoenix area and turning them into rental properties.

"It started out of necessity in mid-2009," says Geoffrey Jacobs, one of Empire’s principals. "We were overbuilt, and we weren’t going to do a development for a number of years. But we had local knowledge and infrastructure, and the price corrections were unbelievable. In the market segment we focus on, the price drops were 70% peak to trough. It was an artificially low number, and the opportunity was so compelling."

Since then, Empire has amassed more than a thousand properties, and the company is pre-qualified to bid on properties offered in the upcoming round of sales of REOs held by Fannie Mae. (Freddie Mac may later participate in the FHA-led initiative to get investors involved in converting REOs to single-family rentals, but it has not yet announced plans to do so.)

This first batch of sales is something of a test run to see what interest is like. It will offer a total of about 2,390 properties across eight hard-hit markets, including Atlanta, Chicago, Las Vegas, Los Angeles, Phoenix, and parts of Florida, with the possibility of other markets being added in later batches. Most of those properties already have renters in them, however, potential buyers must be approved by Fannie before being allowed access to information on what properties are available in their area. (Empire has already received pre-qualification approval and is now working on the more formal final approval process.)

Thus far, Empire has been focusing on first-time buyer and first-time move-up segments. An average property is about eight and a half years old, 2,100 square feet, has four bedrooms, and is in a Homeowners Association–covered community, "so they’re well maintained," Jacobs says. "They’re your typical stucco and tile roof house. It’s housing stock that, in our market, has done well for decades, and it’s the type of house that will compete well with new homes."

For builders, that might seem like unwanted competition, but Jacobs feels this over-ripe market of inexpensive, fairly new housing stock can be a great opportunity for new-home builders, depending on the market they’re in and their goals.

"Builders know their local market, and they have infrastructure in place," he says. "They can self-manage and handle renovations. There are builders that have a lot of cash. If they're in a market where there won't be any meaningful single-family homes for some years," investing for when the market turns could be a great move, he says.

However, as with all things housing related, it depends on the local market. "Doing this in a place like Phoenix, you've got strong rental rates, low vacancies, and a market that is already showing signs of getting better. If someone wanted to be in this for three to six years, there are going to be very good opportunities. The exit strategy in other markets may be much, much longer though. You have to look at your goals." That being said, Jacobs believes that "across the board, this asset class is undervalued everywhere by Manhattan, beachfront properties, and the San Francisco Bay Area, "which is the nuttiest market I've ever seen," he quips.

Also, maintaining a fleet like Empire's takes a fairly extensive staff, although many builders will likely have many people already in place with job descriptions well-suited for what property management requires. Empire's team includes people overseeing acquisitions, legal issues, renovations, accounting, and managing tenants. "This is very much a hands-on business," Jacobs says. "You can generate very good yields, but if you don't manage it hands-on, you can easily erode your net profit."

At Empire, the plan is to hold the properties for five to seven years as rentals, then sell them when the market improves and return to development. But until then, business in converting rentals couldn't be better, he says. Empire estimates that its occupancy rate is in the mid-90% range, and the rental agency Empire uses receives nearly 4,500 requests from prospective renters per month. Rentals are getting 55 cents per square foot, and Jacobs estimates prices could go up to 60 cents a square foot next year.

Much of the demand, Jacobs says, is driven by the fact that markets are being flooded with renters who have lost their homes. "Apartment renters and house renters are really different," he says, noting that most families can't cram a house-full of people and possessions into a typical apartment. On top of that, Jacobs predicts that these are renters that will stay customers for a few years. "Most of these tenants aren't looking far enough ahead to think about buying yet. They have lost their house. They want to get their life back together again, so they're more stable tenants and in the house for multiple years. We have more than a 65% re-up rate," he says. "It's not a want. It's a need."

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