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Blackstone-Fueled Single-Family Home Boom Lifts Chicago

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The tan, three-bedroom house on Chicago's North Side sits half a block from a Family Dollar store and a pawn shop -- an unlikely patch of gold to mine for Blackstone Group LP (BX) in the single-family rental market.

The world's largest alternative-asset manager is among investors buying distressed properties in the Chicago area after private-equity and hedge-fund firms helped send property values surging in hard-hit markets such as Phoenix and Atlanta. That demand, along with low mortgage rates and a growing economy, is now fueling a recovery in the third-biggest U.S. city as it joins the housing resurgence that already has bolstered much of the country.

Chicago home prices climbed 11 percent in November from a year earlier, the biggest jump in almost a quarter century, according to S&P/Case-Shiller data. While gains are slowing across the country, the Windy City was one of nine areas in the group's 20-city index to show a year-over-year increase in housing values.

"They flocked in the early recovery to places such as Phoenix and Las Vegas and parts of California, and Chicago and some other markets lagged behind a little bit," said Lance Ramella, a senior vice president at John Burns Real Estate Consulting in Naperville, Illinois. "Chicago just wasn't providing that yet and now it is."

National Purchases

Institutional investors, led by companies such as Blackstone's Invitation Homes and American Homes 4 Rent (AMH), have bought as many as 200,000 U.S. properties in the last two years, taking advantage of real estate prices that fell as much as a third from the 2006 peak, and rising demand for rentals among Americans who lost their houses in the foreclosure crisis. Their reach has stretched from the hard-hit regions of California to small Ohio towns to the sprawling suburbs of Atlanta.

Chicago trailed some other markets for attracting investor interest because Illinois is a judicial foreclosure state, meaning home repossessions require approval by a court, slowing down the process, and there were fewer opportunities to buy distressed real estate in bulk, Ramella said. Prices in other cities fell further than in Chicago, making them more appealing.

Now that values in other areas have bounced back so much, buying there isn't as attractive and investors have turned to other areas, such as Chicago, for better pricing, Ramella said.

"They're looking for distressed property and a lot of runway for appreciation," Ramella said. "We've got a lot more room to appreciate here."

Investor Purchases

In Chicago, investors accounted for about 20 percent of purchases in the first half of last year, according to Geoff Smith, executive director of the Institute for Housing Studies at DePaul University in Chicago.

Like the portfolios of other investors, Invitation Homes' Chicago-area holdings are mostly filled with properties in suburbs such as Barrington and Oak Park. The smattering of houses they own in the city itself is evidence that the rebound is starting to broaden. Even in some neighborhoods where prices fell more than the rest of Chicago during the foreclosure crisis, values are climbing.

"Those hard-hit areas are seeing some improvement recently," Smith said. "But they have a ways to go and they're in a really big hole."

Invitation has a reddish-brick, four-bedroom, 1,147-square-foot home for rent on tree-lined Moody Avenue for rent for $1,850 per month. The house is about 10 blocks west of Chicago Midway International Airport and about 15 miles from the Chicago home of President Barack Obama.

Chicago Trailing

Chicago has trailed the rebound of the majority of metropolitan areas in the S&P/Case-Shiller index, including Phoenix, Las Vegas, Atlanta, Los Angeles, San Francisco, Minneapolis, Miami, and even Detroit, which is mired in the largest municipal bankruptcy in U.S. history. Its 11 percent gain in November prices, while the city's biggest since December 1988, was still less than the national average of 13.8 percent.

High unemployment and an overhang of foreclosed homes have helped contribute to Chicago lagging behind the housing recovery, said Brad Hunter, the chief economist at housing-research firm Metrostudy. The area's jobless rate was 8.3 percent in December, the latest available figures, and reached as high as 11.9 percent in January 2010. The U.S. rate was 6.6 percent in January, according to the Labor Department.

Areas such as Phoenix and Las Vegas were among the first markets to come back after the housing bust as private-equity funds and other buyers sought bargain prices. In the Chicago region, investors weren't a big part of the buying market in 2012 and the early part of 2013, Smith said.

Invitation Homes

Invitation Homes entered the market in September 2012, according to Andrew Gallina, a spokesman for the Dallas-based company. Its house near the Family Dollar (FDO) on North Central Park Avenue on the North Side is in the Albany Park neighborhood. It sold for $384,000 last year, according to a warranty deed filed with the Cook County Recorder of Deeds in November. Invitation Homes' website earlier this year listed the monthly rent as $2,800.

For competitive reasons, Invitation Homes doesn't disclose specific data such as number of homes owned or occupancy rates, said Gallina, a spokesman for the company.

"We enjoy healthy occupancy in Chicago, as we do in all of our markets," Gallina said.

Highest Incomes

American Homes 4 Rent, the largest single-family rental company after Blackstone, owned 1,443 homes in the Chicago region, valued at $211 million, in the third quarter. The average annual rental income from the properties is $19,171, the highest of the Agoura Hills, California-based company's markets.

The publicly-traded company, founded by B. Wayne Hughes, has acquired more than 21,000 rental homes across at least 22 states in the U.S. The shares have returned 5.1 percent since the July initial public offering, including reinvested dividends.

The Chicago area's real estate swings have been less severe than in other locales. Phoenix home prices fell 56 percent from their peak in June 2006 to their trough in September 2011, according to S&P/Case-Shiller indexes. Since that bottom, prices rose 45 percent. In Las Vegas, which peaked in August 2006, prices dropped 62 percent until bottoming in March 2012. They've since climbed 42 percent.

By comparison, Chicago home prices declined 39 percent from the peak to their trough in March 2012. Since then, they've risen 23 percent.

Demand Rebounding

Sales demand is rebounding as buyers take advantage of low mortgage rates before expected increases as the Federal Reserve unwinds its stimulus program aimed at reducing borrowing costs. The average rate for a 30-year fixed mortgage was 4.23 percent last week, up from a near-record low of 3.35

percent in May, while still below the historical average of more than 6 percent over the past 20 years, according to Freddie Mac.

Home sales rose 8 percent to 8,126 in December from a year earlier in the Chicago metropolitan area, the Illinois Association of Realtors said Jan. 23. The median sales price jumped 18 percent to $177,000. Across the U.S., the annual pace of transactions declined from a year earlier.

In the city itself, sales climbed 12.5 percent from a year earlier, and prices rose 13.5 percent to $210,000, according to the Realtors group.

Investor purchases play "a real role" in boosting the market, said Jim McClelland Jr., a partner and chief operating officer at MACK Cos., which owns about 1,100 rental units in the Chicago area, mainly in the south suburbs, 95 percent of which are single-family homes.

Business Backbone

McClelland said MACK buys about 30 houses a month and that plenty of supply remains for the company to expand. Single-family home rental is the "backbone of our business," he said.

Home prices are still down 25 percent from their peak in September 2006, according to S&P/Case-Shiller data. Foreclosures and short sales accounted for 31 percent of home sales in December in the Chicago area, compared with a national average of 14 percent, according to Lanny Baker, chief executive officer of ZipRealty Inc., based in Emeryville, California.

The relatively high number of foreclosures remain a scourge for the market, said Dory Rand, president of the Woodstock Institute, a Chicago-based nonprofit research group that studies foreclosures and housing.

"Too often, people read the headlines and hear the news about the economic recovery, the housing recovery," she said. And "they think it's happening everywhere, when in reality it's not."

For all the interest from investors, they might not be enough to maintain the recovery if prices rise too much, said Smith of DePaul. In that case, the question becomes if there will be enough owner-occupiers to fill the gap.

"That's kind of the big question in terms of how sustainable the recent price gains in the housing market are," he said. For investors, "they see opportunity, but if prices go up then the math so to speak might not work as well for them."

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