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REAL ESTATE

Rent-to-Own Homes Make a Comeback

Investment firms bank on giving renters an option to buy

By **LAURA KUSISTO**

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Wall Street firms have found a new way to profit from consumers with blemished credit who can't qualify for a mortgage: let them rent a home first with the option to buy it later.

Rent-to-own programs, once run mainly by small operators, were popular with cash-strapped consumers during the 1990s. They faded a decade later when easy lending made it possible for almost anyone to buy a home with no money down, but with lenders setting a higher bar, they are making a comeback.

For investors, it is a chance to profit off the recovering housing market. Consumers get a chance to lock in a home before they have the money together for a down payment. But the price may be higher rent in the interim and a higher purchase price the longer they wait to move from renting to owning.

One of the fastest-growing rent-to-own companies is Home Partners of America, which was co-founded three years ago by former Goldman Sachs executive William Young. Mortgage securities veteran Lewis Ranieri was an early investor in the company, and real-estate mogul Sam Zell has acted as an adviser to Mr. Young. Late last year, Home Partners received a $500 million equity investment from a group led by money manager BlackRock Inc.'s alternative investments arm.

Mr. Young, who formerly co-headed Goldman Sachs's European mortgage department, said he saw an untapped market helping people who are being shut out of the housing market.

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"What really frustrates me personally is that a lot of people I grew up with, extended family members, would have trouble getting access to mortgage credit today," said Mr. Young. He says his company spent $100 million to buy about 320 homes in June, up from $15 million, or 66 homes, in June of last year.

Brian Stern, a managing director at BlackRock, said he sees Home Partners as a long-term, sustainable business. Mr. Ranieri said the program is both viable and needed given tightness of mortgage credit and the lack of readily available solutions. Mr. Zell declined to comment.

Here's how Home Partners' program works. A consumer teams up with a real-estate agent to select a home in one of Home Partners' approved communities, which tend to be suburban locations with strong school systems and with homes priced between $100,000 and about $725,000. Home Partners buys the home and leases it to the consumer, who has the right to purchase the home from Home Partners within five years in most places. During the renting years, the consumer is expected to repair his or her credit and save for a down payment, but the longer they rent the more they will pay to acquire the house.

For example, a house shown on Home Partners website has a list price of $449,975 in Chula Vista, Calif. The family that agrees to rent that house from Home Partners has the right to purchase the home for $472,035 after one year and would have to pay $573,762 if it waited five years before purchasing, a markup of 28% from the initial list price.

The monthly rent on the property would start at $2,810 a month and escalate to $3,256 in the fifth year.

For consumers, that likely means that they are paying a premium over renting or buying a typical home. Monthly payments on a 30-year conventional mortgage on the same house would be around $1,800. The average rent for a single-family home in San Diego is $2,270 a month, according to Moody's Analytics—although typical single-family rentals are likely smaller and in less desirable areas.

Home Partners officials say that the increases are in line with the rapid rise in home prices in markets such as California and rents are typically within 5% to 10% of comparable properties in the market. The S&P/Case-Shiller Home Price Index, covering the entire nation, rose 4.4% in the 12 months ended in May, slightly greater than a 4.3% increase in April. Home prices in San Diego climbed 4.8% year-over-year in May 2015, according to the index.

Home Partners also notes that the consumer can decide not to purchase if the home is more expensive than comparable properties in the area. If price growth slows and the consumer thinks buying a home is a bad deal, they can walk away with no penalty and Home Partners would re-rent the home. The company says that they expect about half of their renters to ultimately purchase.

Tiffany Morgan, who works in marketing in Sugarland, Texas, turned to Home Partners 2013 after a divorce destroyed her credit. When she first heard about the program, she thought it was a scam. "I thought no way…it's some scheme that I'm going to fall into," said Ms. Morgan, who is in her mid-30s with a 7-year-old son.

Home Partners purchased the home for around $205,000 and she rented it for about a year for $1,730 a month. That same year she improved her credit and bought the house for $215,000. She thought, "What's the worst case? I'll lease it for a while and then if I fall in love with it I'll do what I need to do to make it happen."

For consumers, the advantage is that the homes tend to be in nicer neighborhoods with better school districts than most single-family rental properties. It also guarantees that if house prices escalate faster than that, the price is guaranteed when they go to purchase the home.

Sarah Edelman, a senior policy analyst at the Center for American Progress, a Washington-based nonpartisan policy institute, said that it is early to tell if Home Partners' rent and home price bumps will prove to be in line with the market.

"All things equal this could be a really great opportunity for consumers," she said, referring to the cost of Home Partners program versus the rest of the market. "But all things need to be equal."

So far, Home Partners operates only in 30 metropolitan areas in 15 states, including California, Florida and Texas. It currently doesn't operate in the Northeast. But Home

Partners is teaming up with Berkshire Hathaway Home Services and Realogy Holdings Corp., which operates several real-estate brokerage franchises including Century 21 and Coldwell Banker, which will give it national reach.

A motivating factor for home buyers to use a rent-to-own program is the combination of government policies and banks' increased cautiousness have made mortgages much more difficult to get, even for middle-class Americans. Buyers typically must have higher credit scores than were needed even in the early 2000s, before the subprime boom. The homeownership rate for middle-income Americans has fallen to 63% from 69% in 2000, according to Zillow.

Home Partners isn't alone in seeing a profitable niche in the rent-to-own space. New York City-based HomeLPC, started by a former Lehman Brothers banker, launched about a year ago and has expanded to three states, where it has bought two dozen homes. It plans to expand into five more states by the first quarter of 2016. Premium Point Investments, a New York-based asset manager, is in the midst of testing a rent-to-own business focused on the South and Southeast.

Whether rent-to-own will prove to be profitable remains to be seen. A number of companies that rent out single-family homes have found that few renters have become buyers, either because they haven't been able to restore their credit or haven't been able to save enough for a down payment. But Home Partners said its credit screening targets middle-class and affluent clients who have steady jobs and an overall financial history that makes it likely they will be able to repair their credit and save money for a down payment within a few years.

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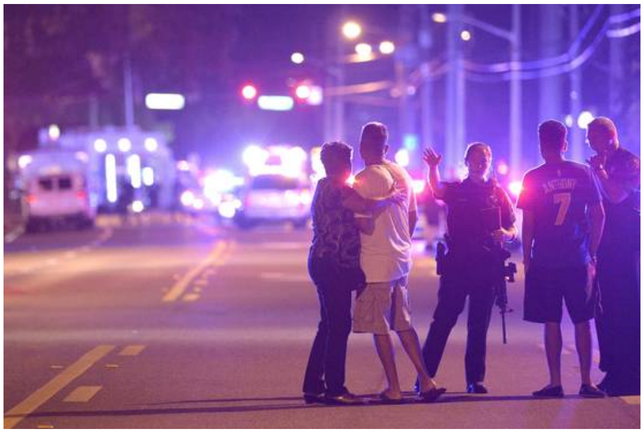

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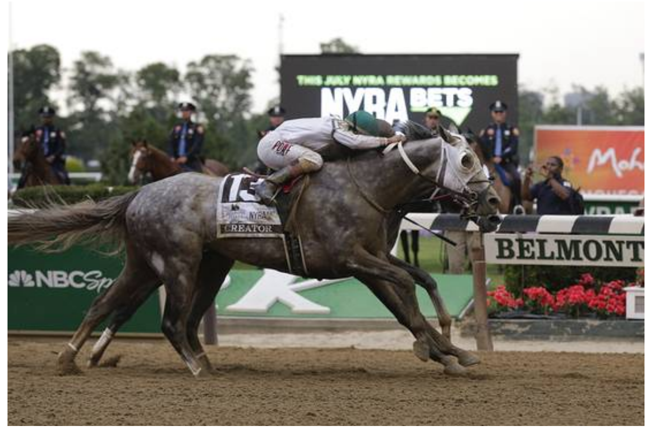

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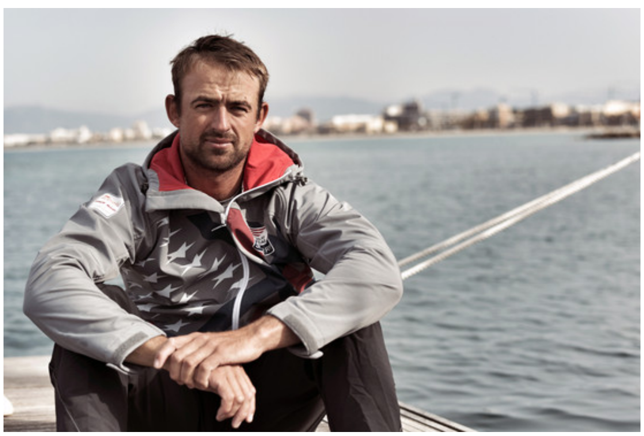

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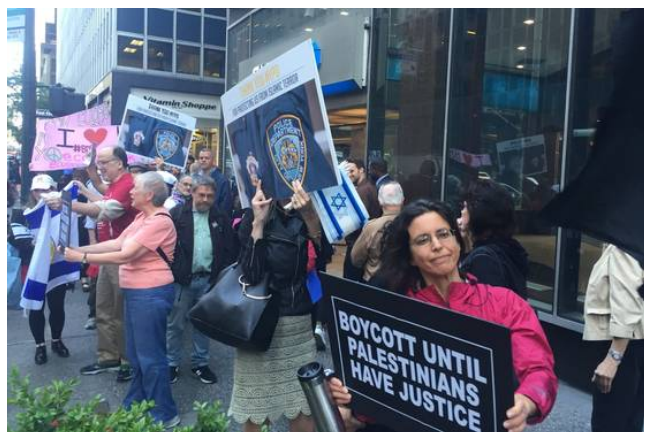

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