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Are Mega-Investors to Blame for an Overheating Housing Market?

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The American housing market is currently experiencing a perfect storm of high demand and low supply. Prospective homeowners all over the country find themselves at the mercy of an exceptionally low stock of homes, forced into endless biddings wars over the few properties remaining on the market. The question that is immediately raised regarding this crisis is who or what is causing such high prices? Many blame large-scale real estate investors such as Tricon Residential, American Homes 4 Rent, or Invitation Homes, rental home providers that own a combined 165,552 single- and multi-family properties across North America. It is not difficult to see why they would be viewed as the primary culprits behind the booming housing market as it is disadvantageous for average consumers to compete with investors over properties. Thus, mega investors' re-entrance into the single-family housing market would logically constrict the number of available homes. However, their true effect upon the housing market is overstated as commercial interest's market share within the US is only about 15%. While increased mega-investor activity may exacerbate existing housing market issues, decreased property construction and increased material prices are the root causes of the housing crisis.

The reason real-estate investors don't significantly affect national housing prices is because they are generally interested in homes that meet a relatively specific set of criteria. For example, Invitation Homes states that they, "operate in markets with strong demand drivers, high barriers to entry, and high rent growth potential." Investors are looking for undervalued homes accessible to the middle- and working-classes in cities that are likely to experience population and job growth in the next 3-5 years. While this practice may not drive-up housing prices throughout the entire US housing market, it certainly makes it difficult for the middle-class to find affordable homes; investors can easily borrow money with interest rates often 0.6-2.6% cheaper than those faced by consumers (generally about 2-4%), allowing them to increase their asking prices above what would normally be charged. Investors also primarily offer cash for homes, making their offers extremely attractive in a competitive market. Consumers should worry less that large-scale investors are crowding out the market as a whole and worry more that investors' ability to systematically purchase affordable homes that will appreciate (demonstrated by investor portfolio price-rent ratios of 8-1 versus consumer-sought price-rent ratios of 15-1) effectively obstructs the middle class from accumulating wealth through homeownership.

However, if skyrocketing house prices cannot be attributed to mega-investors, then what is causing the US housing market to overheat? The answer can be found in two additional long-term trends. Firstly, single-family housing starts dropped significantly from their peak in 2006 (1,823,000 homes) and ultimately reached a low in 2009 (353,000 homes). Housing starts still haven't fully returned to their previous rate 15 years later (1,160,000 homes). The disappearance of single-family housing construction is largely responsible for the supply shortage consumers currently face because homeowners across the country adamantly oppose local construction in the interest of protecting the value of their properties. In addition to legislative setbacks, construction has been made more difficult by high material costs. For example, lumber increased 114% over the previous year. Lumber's price increase was caused by dramatically reduced national sawmill capacity and increased interest in home renovation due to the COVID-19 pandemic. Lumber is not the only material jumping in cost: steel mill products increased in price by 70% in early 2021. As stated by Robert Dietz, NAHB's chief economist, “Builders are contending with shortages of building materials, buildable lots and skilled labor as well as a challenging regulatory environment. This is putting upward pressure on home prices and sidelining many prospective home buyers even as demand remains strong in a low-inventory environment.” Essentially, a combination of high material costs and a shortage of housing caused by a long-term drop in single-family home construction has resulted in a stressed housing market.

So, what recourse do we have in addressing the current situation? The most important goal is the construction of new single-family homes to alleviate market pressure. Increasing the number of sawmills would lower lumber prices, aiding construction costs. Consumer tendencies are also important to consider. Current homeowners are likely to maintain a scarcity mindset and will seek to oppose local construction, and prospective homeowners are likely to continue to avoid personal home-construction due to the expense of materials like lumber and steel. Conversely, increasing the number of renters may aid the crisis; they are likely to support large-scale housing construction as it will drive their rental costs down. A renter’s economy may be achieved naturally long-term as high price-rent ratios will encourage new families to rent instead of buy, thereby increasing the number of families who support housing construction. In the short term, rent subsidies could be used to entice consumers sooner rather than later. Regardless of the method determined to be most effective, if the US desires a calmer housing market, then it is imperative to focus on increasing the supply of new homes instead of merely blaming large-scale real-estate investors.

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