How Wall Street Has Turned Housing Into a Dangerous Get-Rich-Quick Scheme — Again

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Global Research, December 02, 2013
TomDispatch 26 November 2013
Region: USA
Theme: Global Economy

You can hardly turn on the television or open a newspaper without hearing about the nation's impressive, much celebrated housing recovery. Home prices are rising! New construction has started! The crisis is over! Yet beneath the fanfare, a whole new get-rich-quick scheme is brewing.

Over the last year and a half, Wall Street hedge funds and private equity firms have quietly amassed an unprecedented rental empire, snapping up Queen Anne Victorians in Atlanta, brick-faced bungalows in Chicago, Spanish revivals in Phoenix. In total, these deep-pocketed investors have bought more than 200,000 cheap, mostly foreclosed houses in cities hardest hit by the economic meltdown.

Wall Street's foreclosure crisis, which began in late 2007 and forced more than 10 million people from their homes, has created a paradoxical problem. Millions of evicted Americans need a safe place to live, even as millions of vacant, bank-owned houses are blighting neighborhoods and spurring a rise in crime. Lucky for us, Wall Street has devised a solution: It's going to rent these foreclosed houses back to us. In the process, it's devised a new form of securitization that could cause this whole plan to blow up — again.

Since the buying frenzy began, no company has picked up more houses than the Blackstone Group, the largest private equity firm in the world. Using a subsidiary company, Invitation Homes, Blackstone has grabbed houses at foreclosure auctions, through local brokers, and in bulk purchases directly from banks the same way a regular person might stock up on toilet paper from Costco.

In one move, it bought 1,400 houses in Atlanta in a single day. As of November, Blackstone had spent $7.5 billion to buy 40,000 mostly foreclosed houses across the country. That's a spending rate of $100 million a week since October 2012. It recently announced plans to take the business international, beginning in foreclosure-ravaged Spain.

Few outside the finance industry have heard of Blackstone. Yet today, it's the largest owner of single-family rental homes in the nation — and of a whole lot of other things, too. It owns part or all of the Hilton Hotel chain, Southern Cross Healthcare, Houghton Mifflin publishing house, the Weather Channel, Sea World, the arts and crafts chain Michael's, Orangina, and dozens of other companies.

Blackstone manages more than $210 billion in assets, according to its 2012 Securities and Exchange Commission annual filing. It's also a public company with a list of institutional owners that reads like a who's who of companies recently implicated in lawsuits over the mortgage crisis, including Morgan Stanley, Citigroup, Deutsche Bank, UBS, Bank of America, Goldman Sachs, and of course JP Morgan Chase, which just settled a lawsuit with the Department of Justice over its risky and often illegal mortgage practices, agreeing to pay an unprecedented $13 billion fine.

In other words, if Blackstone makes money by capitalizing on the housing crisis, all these other Wall Street banks — generally regarded as the main culprits in creating the conditions that led to the foreclosure crisis in the first place — make money too.

An All-Cash Goliath

In neighborhoods across the country, many residents didn't have to know what Blackstone was to realize that things were going seriously wrong.

Last year, Mark Alston, a real estate broker in Los Angeles, began noticing something strange happening. Home prices were rising. And they were rising fast — up 20% between October 2012 and the same month this year. In a normal market, rising home prices would mean increased demand from homebuyers. But here was the unnerving thing: the homeownership rate was dropping, the first sign for Alston that the market was somehow out of whack.

The second sign was the buyers themselves.

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About 5% of Blackstone's properties, approximately 2,000 houses, are located in the Charlotte metro area. Of those, just under 1,000 (pictured above) are in Mecklenberg County, the city's center. (Map by Anthony Giancatarino, research by Symone New.)

"I went two years without selling to a black family, and that wasn't for lack of trying," says Alston, whose business is concentrated in inner-city neighborhoods where the majority of residents are African American and Hispanic. Instead, all his buyers — every last one of them — were besuited businessmen. And weirder yet, they were all paying in cash.

Between 2005 and 2009, the mortgage crisis, fueled by racially discriminatorylending practices, destroyed 53% of African American wealth and 66% of Hispanic wealth, figures that stagger the imagination. As a result, it's safe to say that few blacks or Hispanics today are buying homes outright, in cash. Blackstone, on the other hand, doesn't have a problem fronting the money, given its $3.6 billion credit line arranged by Deutsche Bank. This money has allowed it to outbid families who have to secure traditional financing. It's also paved the way for the company to purchase a lot of homes very quickly, shocking local markets and driving prices up in a way that pushes even more families out of the game.

"You can't compete with a company that's betting on speculative future value when they're playing with cash," says Alston. "It's almost like they planned this."

In hindsight, it's clear that the Great Recession fueled a terrific wealth and asset transfer away from ordinary Americans and to financial institutions. During that crisis, Americans lost trillions of dollars of household wealth when housing prices crashed, while banks seized about five million homes. But what's just beginning to emerge is how, as in the recession years, the recovery itself continues to drive the process of transferring wealth and power from the bottom to the top.

From 2009-2012, the top 1% of Americans captured 95% of income gains. Now, as the housing market rebounds, billions of dollars in recovered housing wealth are flowing straight to Wall Street instead of to families and communities. Since spring 2012, just at the time when Blackstone began buying foreclosed homes in bulk, an estimated $88 billion of housing wealth accumulation has gone straight to banks or institutional investors as a result of their residential property holdings, according to an analysis by TomDispatch. And it's a number that's likely to just keep growing.

"Institutional investors are siphoning the wealth and the ability for wealth accumulation out of underserved communities," says Henry Wade, founder of the Arizona Association of Real Estate Brokers.

But buying homes cheap and then waiting for them to appreciate in value isn't the only way Blackstone is making money on this deal. It wants your rental payment, too.

Securitizing Rentals

Wall Street's rental empire is entirely new. The single-family rental industry used to be the bailiwick of small-time mom-and-pop operations. But what makes this moment unprecedented is the financial alchemy that Blackstone added. In November, after many months of hype, Blackstone released history's first rated bond backed by securitized rental payments. And once investors tripped over themselves in a rush to get it, Blackstone's competitors announced that they, too, would develop similar securities as soon as possible.

Depending on whom you ask, the idea of bundling rental payments and selling them off to investors is either a natural evolution of the finance industry or a fire-breathing chimera.

"This is a new frontier," comments Ted Weinstein, a consultant in the real-estate-owned homes industry for 30 years. "It's something I never really would have dreamt of."

However, to anyone who went through the 2008 mortgage-backed-security crisis, this new territory will sound strangely familiar.

"It's just like a residential mortgage-backed security," said one hedge-fund investor whose company does business with Blackstone. When asked why the public should expect these securities to be safe, given the fact that risky mortgage-backed securities caused the 2008 collapse, he responded, "Trust me."

For Blackstone, at least, the logic is simple. The company wants money upfront to purchase more cheap, foreclosed homes before prices rise. So it's joined forces with JP Morgan, Credit Suisse, and Deutsche Bank to bundle the rental payments of 3,207 single-family houses and sell this bond to investors with mortgages on the underlying houses offered as collateral. This is, of course, just a test case for what could become a whole new industry of rental-backed securities.

Many major Wall Street banks are involved in the deal, according to a copy of the private pitch documents Blackstone sent to potential investors on October 31st, which was reviewed by TomDispatch. Deutsche Bank, JP Morgan, and Credit Suisse are helping market the bond. Wells Fargo is the certificate administrator. Midland Loan Services, a subsidiary of PNC Bank, is the loan servicer. (By the way, Deutsche Bank, JP Morgan Chase, Wells Fargo, and PNC Bank are all members of another clique: the list of banks foreclosing on the most families in 2013.)

According to interviews with economists, industry insiders, and housing activists, people are more or less holding their collective breath, hoping that what looks like a duck, swims like a duck, and quacks like a duck won't crash the economy the same way the last flock of ducks did.

"You kind of just hope they know what they're doing," says Dean Baker, an economist with the Center for Economic and Policy Research. "That they have provisions for turnover and vacancies. But have they done that? Have they taken the appropriate care? I certainly wouldn't count on it." The cash flow analysis in the documents sent to investors assumes that 95% of these homes will be rented at all times, at an average monthly rent of $1,312. It's an occupancy rate that real estate professionals describe as ambitious.

There's one significant way, however, in which this kind of security differs from its mortgage-backed counterpart. When banks repossess mortgaged homes as collateral, there is at least the assumption (often incorrect due to botched or falsified paperwork from the banks) that the homeowner has, indeed, defaulted on her mortgage. In this case, however, if a single home-rental bond blows up, thousands of families could be evicted, whether or not they ever missed a single rental payment.

"We could well end up in that situation where you get a lot of people getting evicted… not because the tenants have fallen behind but because the *landlords*have fallen behind," says Baker.

Bugs in Blackstone's Housing Dreams

Whether these new securities are safe may boil down to the simple question of whether Blackstone proves to be a good property manager. Decent management practices will ensure high occupancy rates, predictable turnover, and increased investor confidence. Bad management will create complaints, investigations, and vacancies, all of which will increase the likelihood that Blackstone won't have the cash flow to pay investors back.

If you ask CaDonna Porter, a tenant in one of Blackstone's Invitation Homes properties in a suburb outside Atlanta, property management is exactly the skill that Blackstone lacks. "If I could shorten my lease — I signed a two-year lease — I definitely would," says Porter.

The cockroaches and fat water bugs were the first problem in the Invitation Homes rental that she and her children moved into in September. Porter repeatedly filed online maintenance requests that were canceled without anyone coming to investigate the infestation. She called the company's repairs hotline. No one answered.

The second problem arrived in an email with the subject line marked "URGENT." Invitation Homes had failed to withdraw part of Porter's November payment from her bank account, prompting the company to demand that she deliver the remaining payment in person, via certified funds, by five p.m. the following day or incur "the additional legal fee of $200 and dispossessory," according to email correspondences reviewed by TomDispatch.

Porter took off from work to deliver the money order in person, only to receive an email saying that the payment had been rejected because it didn't include the $200 late fee and an additional $75 insufficient funds fee. What followed were a maddening string of emails that recall the fraught and often fraudulent interactions between homeowners and mortgage-servicing companies. Invitation Homes repeatedly threatened to file for eviction unless Porter paid various penalty fees. She repeatedly asked the company to simply accept her month's payment and leave her alone.

"I felt really harassed. I felt it was very unjust," says Porter. She ultimately wrote that she would seek legal counsel, which caused Invitation Homes to immediately agree to accept the payment as "a one-time courtesy."

Porter is still frustrated by the experience — and by the continued presence of the cockroaches. ("I put in another request today about the bugs, which will probably be canceled again.")

A recent Huffington Post investigation and dozens of online reviews written by Invitation Homes tenants echo Porter's frustrations. Many said maintenance requests went unanswered, while others complained that their spiffed-up houses actually had underlying structural issues.

There's also at least one documented case of Blackstone moving into murkier legal territory. This fall, the Orlando, Florida, branch of Invitation Homes appeared to mail forged eviction notices to a homeowner named Francisco Molina, according to the *Orlando Sentinel*. Delivered in letter-sized manila envelopes, the fake notices claimed that an eviction had been filed against Molina in court, although the city confirmed otherwise. The kicker is that Invitation Homes didn't even have the right to evict Molina, legally or otherwise. Blackstone's purchase of the house had been reversed months earlier, but the company had lost track of that information.

The Great Recession of 2016?

These anecdotal stories about Invitation Homes being quick to evict tenants may prove to be the trend rather than the exception, given Blackstone's underlying business model. Securitizing rental payments creates an intense pressure on the company to ensure that the monthly checks keep flowing. For renters, that may mean you either pay on the first of the month every month, or you're out.

Although Blackstone has issued only one rental-payment security so far, it already seems to be putting this strict protocol into place. In Charlotte, North Carolina, for example, the company has filed eviction proceedings against a full 10% of its renters, according to a report by the *Charlotte Observer.*

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About 9% of Blackstone's properties, approximately 3,600 houses, are located in the Phoenix metro area. Most are in low- to middle-income neighborhoods. (Map by Anthony Giancatarino, research by Jose Taveras.)

Forty thousand homes add up to only a small percentage of the total national housing stock. Yet in the cities Blackstone has targeted most aggressively, the concentration of its properties is staggering. In Phoenix, Arizona, some neighborhoods have at least one, if not two or three, Blackstone-owned homes on just about every block.

This inundation has some concerned that the private equity giant, perhaps in conjunction with other institutional investors, will exercise undue influence over regional markets, pushing up rental prices because of a lack of competition. The biggest concern among many ordinary Americans, however, should be that, not too many years from now, this whole rental empire and its hot new class of securities might fail, sending the economy into an all-too-familiar tailspin.

"You're allowing Wall Street to control a significant sector of single-family housing," said Michael Donley, a resident of Chicago who has been investigating Blackstone's rapidly expanding presence in his neighborhood. "But is it sustainable?" he wondered. "It could all collapse in 2016, and you'll be worse off than in 2008."

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[Note: Special thanks to Symone New and Jose Taveras for conducting the difficult research to locate Blackstone-owned properties. Special thanks also to Anthony Giancatarino for turning this data into beautiful maps.]

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