FFCM

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How Hard Can It Be?
Single-Family Portfolio Acquisitions

Investors looking to benefit from single-family tailwinds should be well aware of the complexities.

"The details are not the details. They make the design."
- Charles Eames

On November 3, 2021, Zillow reported a staggering single-quarter loss of $420 million and declared an immediate withdrawal from their home-flipping venture. Opendoor and Redfin experienced similar losses, and their stock prices subsequently collapsed by over 90%. But these well-publicized failures weren't mere blips confined to a few companies in 2021 and 2022. Currently, a wide range of single-family investors face significant challenges with their portfolios. Some have entered receivership and began the process of shutting down, while others are burdened by significant unrealized losses, disappointing returns, and uncertain futures.

We think single-family homes can be great investments that offer some of the best risk-adjusted returns available in real estate *writ large*. However, it's crucial for investors to understand the complexity and active involvement required to effectively build and manage profitable single-family home portfolios. To us, it seems that many investors have instead adopted a "how hard can it be?" attitude towards single-family investment resulting in disappointing (or even disastrous) returns.

We are releasing a series of memos to help guide investors and managers assemble high-quality and high-performing single-family rental portfolios. Smaller investors should appreciate that single-family investment is *not the passive enterprise* promised by course-selling gurus. Larger investors should consider the significant operational challenges inherent in implementing these considerations at scale. This first memo discusses the first stage in assembling a high-performing single-family rental portfolio: **home acquisition**.

Single-Family Rental Acquisitions

A well-thought-out acquisition strategy is one of the most critical components in an investor's single-family investment process. An effective strategy defines the *type* of home the investor wants exposure to, the prices they are willing to pay, and tactics that maximize good purchases while avoiding disastrous ones. The discipline imposed by a detailed acquisition strategy helps investors sidestep common pitfalls – such as emotional buying or speculative investments – and guards against overpaying for properties which reduces the potential to benefit from appreciation.

Professional single-family investment funds excel at developing detailed acquisition strategies, as they are foundational for raising capital. Professional investors can precisely outline their markets, sub-markets, property characteristics, and the rationale behind their choices. However, these funds often overlook the complexity of executing these strategies. Often, they fail to recognize the single-family market's low volume while underestimating the challenge of bypassing established stakeholders. Instead, they delegate acquisitions to inexperienced associates – overlooking the very real potential of adverse selection bias. In practice, these funds tend to view properties with excessive optimism, focusing on potential gains while downplaying the risks of significant losses.

By contrast, small and individual investors usually have no defined acquisitions strategy. They hear stories of "passive income" and "wealth generation" from their private networks or social media and jump into the market with little planning. Instead of a predefined strategy, their investment decisions are often informed by local real estate agents who typically lack true investment expertise. While they are unlikely to overpay by as much as institutional funds, individual investors often invest in properties that fall short of financial expectations because they overestimate rental income, underestimate renovation costs, fail to fully account for expenses and vacancies, employ value destructive financing arraignments, and/or select homes that make poor rentals.

Defining the Buy-Box

The first step in developing an acquisition strategy is to define a "buy box" that precisely identifies the types of homes the investor wants to purchase. A detailed buy box specifies the investment's target location (e.g., markets, census tracts, and school districts), property details (e.g., bedroom/bathroom count, year built, and condition of home), and financial criteria (e.g., purchase price, discounts, and rental yield). The buy-box not only streamlines the search for suitable properties – the process of crafting it is equally as important as it forces investors to answer the critical questions and write out their key assumptions up front.

Example Buy-Box

The following buy-box illustrates the question that should be addressed before entering the acquisition stage. This buy-box focuses on institutional grade homes in Midwestern markets.

Example Buy-box: FFUSHF Midwest Yield

LOCATION	
TARGET MARKETS / MSAS	Kansas City, MO and Louisville, KY
CENSUS TRACT	Middle or better census tract
NEIGHBORHOODS AND SUB-MARKETS	Strong school districts (school score of 4) Low crime rates Within 20 minutes from major business districts
OTHER PREFERENCES	Off busy streets (double-yellow lines)
PROPERTY CHARACTERISTICS	
BEDROOM / BATHROOM	3+ bed / 2+ bath
YEAR BUILT	1980 or newer
SIZE	1,200 – 2,500 SF
CONDITION	Move-in ready / minimal or cosmetic repairs
RENOVATION LIMITATIONS	Cosmetic or under $30,000
OTHER	Must have attached 2+ car garage
INVESTMENT CRITERIA	
PURCHASE PRICE	$225,000 - $275,000 or under $140 / SF
DISCOUNT TO MARKET*	5%+
RENTAL YIELD	6.5% or higher @ ~65% op margin. Approx: $\frac{Expected\ Rent * 12 * 65\%}{Total\ Investment}$
APPRECIATION POTENTIAL	Low to Moderate

MLS Acquisitions

In major metro areas, only a few homes each month can be sourced at prices that a buyer can be fairly certain are below market value. We typically estimate that for every 1 million people living in a greater metro area, our team will be able to source about 5 institutional-grade homes per month at a true 5-10% discount to their market value. For example, in Louisville (population of 1.4 million) we'd expect to find about 5-7 discounted homes per month; in Phoenix (population of 5 million) we'd expect to find about 25 such deals. This is a rough estimate – there is a lot of month-to-month variability, and this is somewhat dependent on the size of your sourcing team – that said, it helps set expectations appropriately. We never expect to find large swaths of discounted homes; markets simply don't work that way.

There are a few tactics buyers can use to negotiate below-market purchase prices. While these may seem obvious, we find they are rarely used effectively. First, buyers should have the seller's agent represent both parties and allow seller's agent to retain the full ~5% commission. Many funds try to disintermediate listing agents or squeeze their profitability. This is a mistake. Second, in exchange for a below-market price, buyers should offer terms very favorable to the seller (e.g., post-possession agreements, leasebacks, non-refundable earnest money, 10-day closings, etc.). These terms typically cost investors very little but can be highly valuable to some sellers. Third, buyers should submit solid offers based on the property's marketing photos and include a clause allowing for a prompt property inspection. If the inspection reveals significant differences from the listed condition or major structural or mechanical issues, buyers can justify a renegotiated price at that time.

Off-Market Acquisitions

For more significant discounts, investors need to turn to off-market and wholesale channels. Creating a network of wholesalers takes time. It's easy to get on wholesale mailing lists, but homes advertised broadly through mailing lists tend to have more bids that drive the price higher. It's much better to be the primary buyer for one or two good wholesalers than one of many buyers in an off-market pool. Finding and building strong individual relationships with quality wholesalers allows for more direct and early access to properties before they are widely marketed. This takes time and effort but can significantly enhance your chances of securing significantly discounted homes.

Working with wholesalers also carries its own set of risks. Since these transactions often occur quickly and with minimal publicity, there's less time for thorough due diligence and, in our experience, there are almost always unforeseen problems with the property. Additionally, the quality of wholesalers can vary significantly; some may not provide accurate, honest, or complete information about the properties they're selling. Put together, the *actual* discount when purchasing a wholesale property is almost always less than the initial expectation, as margins quickly evaporate when small things go wrong or cost more than anticipated. Investors should require higher discounts when purchasing through wholesale channels to compensate for these very real risks.

Setting Realistic Acquisition Expectations

Investors tend to grossly overestimate the number of discounted, high-quality rental homes they will be able to acquire. This is very noticeable when large institutions raise billions of dollars and quickly drive up home prices in a given market. Investors should let the availability and value of homes (not the amount of capital) guide their capital deployment timelines. This approach prevents investors from overpaying for properties and helps them to algin their purchases with their underwriting assumptions.

The following table illustrates how we estimate the number of reasonably discounted homes we can expect to buy in a moderately sized Midwestern market (population about 1.5 million). The total expected monthly capital outlay is approximately $2.4 million, a surprisingly low number. Many investors – especially institutional ones – assume they will be able to deploy significantly more capital than this. While this may be possible with a relaxed discount threshold, a crucial factor is the percentage of the local home buying market the buyer intends to represent. If a buyer intends to acquire more than 10-20% of the housing inventory, they will significantly drive up demand and prices in the market. They might indeed deploy more capital, but at considerably higher prices.

Example Deployment: FFHSHF Midwest Yield - Market A

EXPECTED DISCOUNT	**0-5%**	**5-10%**	**10-15%**	**15-20%**	**20+%**
HOMES PURCHASABLE (FILTER: BUY-BOX)					
MLS / ON MARKET	100	15-25	5-7	1-4	1-2
OFF MARKET	-	-	2-10	2-4	1-2
DEPLOYMENT					
TOTAL HOMES PURCHASABLE	127-154				
DISCOUNT THRESHOLD	5%				
TARGET HOMES PER MONTH	27-54				
CLOSE RATE / MARKET SHARE	20%				
TARGET ACQUISITIONS	5-11				
AVERAGE PRICE	$300,000				
CAPITAL DEPLOYED / MO	$1.5-3.3 million				

Compliance and Review

Large institutional-sized funds usually have defined compliance processes, smaller funds and individual investors often lack structured review policies. Before purchasing homes, buyers should create a comprehensive checklist that covers some of the most vital aspects of home buying. Ideally, general contractors and legal professionals should review major condition and compliance items to have eyes on areas where investors can incur very significant losses.

Compliance processes may seem mundane, but they are an essential risk management tool. While major tasks such as home inspections are rarely overlooked, the smaller, seemingly trivial details are just as crucial. For instance, investors should check for any outstanding property liens and conduct environmental assessments (particularly in areas vulnerable to natural hazards like flooding). Items like these can affect both the property's value, risk profile, and cost to insure. Tasks like these, though trivial in appearance, are fundamental to protect investors against rare-but-significant financial losses.

Example Compliance Checklist: FFCM SFR COMPLANCE (Partial)

UNDERWRITING	
Buy Box	Does the property meet all buy box criteria?
Fixed Costs	Estimate property taxes, insurance cost, HOA fees, and other fixed costs of ownership.
Inspections	Review third party renovation. Check status of major structures and systems. Do they match expectations.
Estimated Renovation	Contractor review. Determine renovation scope, timeline, and budget.
Financial Analysis	Estimate return profile given underwriting results, discount to market, local rental supply, and prices.
HOA	
Dues and Assessments	Do HOA dues materially impact yield?
Rental Restrictions	Check CC&Rs to confirm no rental restrictions
Other Restrictions	Rental caps, lease approval requirements, additional fees and assessments.
OCCUPANCY	
Lease in place	Security deposit transfer on sale/rental terms and dates/property management contact information, etc.
Lease back terms	(If applicable) If seller leases back property, formal tenant lease agreement with security deposit and credited to buyer as agreed upon.
Post-possession terms	(If applicable) Date post-possession ends. Formal post-possession agreement.
Post-possession escrow funds	(If applicable) Funds held in escrow to ensure seller vacates premises in accordance with post-possession agreement.
LEGAL AND COMPLIANCE	
Flood zone	Check flood zone status. Will lenders require additional flood insurance? If so, underwrite with additional flood insurance premiums
Title commitment review	Outstanding judgements, liens, or encumbrances. Note any special assessments.
Settlement Statement	Ensure title company has credited proper taxes/rent/ security deposits/concessions are credited appropriately.
P&C Insurance	Ensure policy is in place for the day of closing.

In Closing

The success of a single-family rental portfolio is largely determined by adhering to a sound acquisition strategy and process. In this memo, we have outlined some of the key components of a robust acquisition strategy, including the importance of creating a detailed buy-box and some ideas on how to target properties inside of it. While we think the items outlined here are universally applicable, it's important to acknowledge that every market and investment strategy has its unique characteristics. What works in one area may not be applicable in another, and investors should tailor their approach accordingly.

The FFCM Team

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