Toll Brothers, Lennar Bullish on Apartment Rentals

By Kris
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Crews lay bricks for a patio at Lennar's Crest at Park Central apartment complex under construction in Dallas. Photo: Kris Hudson/The Wall Street Journal

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Two of the largest U.S. home builders are redoubling their push into the rental-apartment market, despite concerns the red-hot segment is getting overbuilt.

Upscale builder Toll Brothers Inc. has said it intends to expand its apartment-development division, a three-year-old venture that so far has focused on the Boston-to-Washington, D.C., corridor, to build projects across the U.S. In all, Toll plans to double its equity investment in the division to up to $300 million.

Rival Lennar Corp. in July said it has recruited sovereign-wealth funds and institutional investors to create a $1.1 billion fund for building and holding apartments in up to 25 major U.S. markets. Lennar, which will build the fund's apartments, intends to expand the fund's equity to $2 billion within a year, executives said.

The apartment market has been a boon for developers and investors so far this decade. Vacancies are hovering near 15-year lows at 4.2%, according to market-research firm Reis Inc., as young adults stay in rentals longer than earlier generations did. Meanwhile, apartment asking rents have steadily risen to a 15-year-high of $1,194 a month in 79 U.S. markets in the second quarter, according to Reis.

"Today we see great fundamentals in the business," said Rick Beckwitt, Lennar's president, in an interview. "You have 3 million-plus young adults living at home who want housing, and most of them will rent."

The flow of renters into the market has been robust. Despite a comeback in household formation in recent quarters, the U.S. homeownership rate declined to 63.4% in the second quarter from 64.7% a year earlier. That suggests that most new households, as well as a few former homeowners, now are renters.

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Rick Beckwitt, president of Lennar, says there are "great fundamentals" in the apartment rental business. Photo: Kris Hudson/The Wall Street Journal

Another factor boosting rentership: The percentage of people 18 to 34 years of age who are doubled up, meaning they are living with an adult other than a spouse, increased to 48% this year from 44% in 2007, according to the Pew Research Center. That suggests many are living with parents, other relatives or roommates and might soon opt for their own rental.

Such trends have developers racing to build rental complexes. Charlotte, N.C.-based Crescent Communities LLC has built 5,000 apartment units in the past two years, with another 5,000 in the works for the next two years.

"I think there is going to be much higher demand for rental housing in this cycle," said Alex Barron, president of the Housing Research Center in El Paso, Texas, which tracks home-builder stocks.

But others caution the cycle might be nearing a peak. Ryan Severino, a senior economist at Reis, notes that developers in 79 markets built 173,000 apartment units last year, an anticipated 220,000 this year and 190,000 next, whereas the long-term annual average is 120,000. He added that the average vacancy rate hasn't changed much in the past two years, which he interprets as a sign that it is poised to rise.

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"Everybody's developing, and everybody thinks Generation Y is going to rent forever," Mr. Severino said. "Let's say, for argument's sake, that doesn't come to fruition. There is going to be more supply than demand. Unfortunately, real estate is the type of business that's prone to that kind of overbuilding."

Lennar and Toll say the market isn't peaking. "I think it's too soon to tell if there has been a fundamental shift in homeownership rates," Lennar's Mr. Beckwitt said. "What we do know today is there is demand on both sides," meaning for homeownership and for rentals.

For both companies, apartments are a side business. Lennar delivered roughly 21,000 homes in its last fiscal year. Toll, which specializes in luxury homes, sold nearly 5,400. Both can ease off on apartments when need be.

“We are very conservative,” Toll Chief Executive Douglas Yearley said in an interview. “If we feel a market is overheated…we’ll be even more careful.”

Toll is scouting several markets, including Seattle, San Francisco, Los Angeles, Dallas and Denver, for land where it can build apartments in 25% to 75% joint ventures with its partners. Among those with which it has worked on previous apartment projects: The Pennsylvania State Employee Retirement System, Prudential Real Estate Investors and Brandywine Realty Trust.

Lennar, meanwhile, intends for it new fund to ramp up its pace of apartment development, which already was robust. Since 2011, Lennar and its partners have developed or started development of 28 apartment projects.

Lennar pledges to focus its fund on building in up to 25 major markets, including Los Angeles, San Francisco and the Miami area. It plans to build a range of garden, midrise and high-rise projects mostly in urban settings in those cities. But some will be more suburban, such as Lennar’s 387-unit, three-story Crest at Park Central complex opening this year in Dallas with monthly rents ranging from $925 for one bedroom to $1,890 for two.

Lennar aims to retain a few of its renters as homeowners by offering discounts to those with good payment histories of up to $10,000, or 3% of the home’s price, on upgrades, options and closing costs.

Lennar’s fund, titled Lennar Multifamily Venture, will have an eight-year term. Lennar and its partners will have the option to sell the portfolio, take it public or divest individual properties.

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