

## **Invitation Homes (NYSE - INVH: \$22)**

With this week's announcement of the merger between Invitations Homes and Colony Starwood, Invitation Homes becomes the penultimate vehicle to invest in the U.S. housing market. With a best in class management and an all-star board combined with size and scale advantages, Invitation Homes offers investors a path to 12% to 15% returns for the next three to five years with little downside due to very favorable macro tailwinds.

### **Merger Creates a Behemoth with Substantive Scale Advantages**

Invitation Homes is merging with Colony Starwood, which itself was a merger of Colony American Homes and Starwood Waypoint. The combined entities will own approximately 82,000 homes. The closest competitor is American Homes 4 Rent, which owns 49,000 homes.

More important than just the pure overall total of homes is that 95% of the revenue of the combined company will come from markets in which they own 2,000 or more homes. On average the company will have 4,800 homes per market. Size and scale are very important in the single-family rental space. Rental houses are scattered around a city and are not like apartments which are primarily all in one location. Grouping homes close together to market and service them more effectively becomes important for long-term profitability.

Invitation Homes has already shown the importance of scale with a 63% Net Operating Income (NOI) margin and occupancy rate of approximately 96%.

With the merger, Invitation believes that the company can wring out \$50 million of expenses due to consolidation and becoming more efficient. The cuts to expenses comes from eliminating duplicative corporate overhead and optimization of the portfolio from adding homes in the same neighborhoods.

### **Portfolio Is in Fast Growing Geographies**

This is a merger of equals and most of the portfolio will be in high growth markets with the fastest price appreciation and highest job growth rates in the country. Over 30% of the portfolio is in Florida (Tampa, Orlando, and Miami). Another 19% is in California, 13% is in Atlanta, 6% is in Charlotte, NC, 6% is in Phoenix, 5% is in Seattle, followed by smaller percentages in Las Vegas, Dallas and other markets.

In the company's combined markets, job growth is 2.1% compared the country at 1.5%. This job growth leads to strong new rental rate growth of 5.4% and turnover of less than 40%. In addition, this leads to strong price appreciation of the homes that Invitation owns. Consider that Seattle's home prices are up a staggering 13.3%, Denver 7.9%, Tampa 6.8%, Charlotte 6.1%, Atlanta 5.5%, and Miami is up 5.3%. Invitation's portfolio is right in the heart of the shortage of housing.

## **Fantastic Macro Backdrop**

The U.S. is not producing enough housing and inventories are at 20 year lows. Making the matter worse, there are labor shortages in the construction industry due to a tight labor market, a shortage of skilled labor and an increasingly tight immigration environment. Add in increased environmental and regulatory costs and housing prices are on the march because builders are struggling to increase the output of homes.

And where the population and job growth is the strongest, is where you see the tightest inventory levels. For example, listed homes available are down over 20% year over year in both Charlotte, NC and Las Vegas. In Denver at some lower price points, listed inventory of homes which is considered normal at 6 months is measured in days.

The situation is extreme for new home buyers at the entry level price points. In 2003, the average price of a new home built was \$152k. Last year, it was \$306k and it keeps going up. The entry level house, which is what Colony Starwood and Invitation own is in ever increasingly short supply as home builders cannot build those homes profitably anymore. This makes owning a diversified basket even more attractive in the long run.

## **Best in Class Management and All-Star Board**

The management team bench is deep as the company is led by CEO Fred Tuomi, who has years of experience when he started at Colony American Homes before the merger to Starwood Waypoint. Prior to that he was an executive at Equity Residential (NYSE: EQR). Other notables include the CFO who has been in the industry from Waypoint, before the company merged with Starwood, which then merged with Colony. Dallas Tanner is the company's CIO and was a founder of Invitation Homes.

The board will include famed real estate investor Barry Sternlicht and Blackstone's Jonathan Gray. This company has the skill, financial acumen and operational experience that is every investor's dream and institutions will flock to this as an investment.

## **Becomes a Go-To Investment Vehicle and is now a top 20 REIT**

The stock market is increasingly driven by flows, index investing and ETF driven investment dollars. Size matters and the larger you are, the more investment dollars are allocated to buy stock. With this merger, the company will now be the 19<sup>th</sup> largest REIT with an enterprise value of \$20 billion.

With its excellent management team, size and liquidity, I believe that investors will choose to invest in Invitation Homes as a proxy for the housing market and this could lead the company to trade at a premium to other REITs in the market. With 82,000 homes, the company is essentially a proxy for the U.S. Housing market.

## **Future Returns**

I estimate that the combined company's NAV is around \$22 per share. I assume the company's portfolio increases in value by 5% a year. I believe this is conservative because the markets they are in are growing faster than that and the assets they own are on the lower end where the inventory of homes is the lowest. With the company levered 50%, the net asset value should increase by 10% a year for the foreseeable future. Assuming the dividend is 2% and rises slowly, I believe Invitation Homes is a relatively easy opportunity to compound money at 12% a year with minimal downside. Assuming the stock gets an institutional premium or that the asset value increases at 8% a year, I believe that investors can earn more than 15% a year, essentially doubling their money in five years.

## **Summary**

Invitation Homes is a blue chip, safe way to invest in the shortage of housing stock, in which investors buy great assets, a fantastic management and board and a stock that will increasingly be the investment destination for institutional investors.