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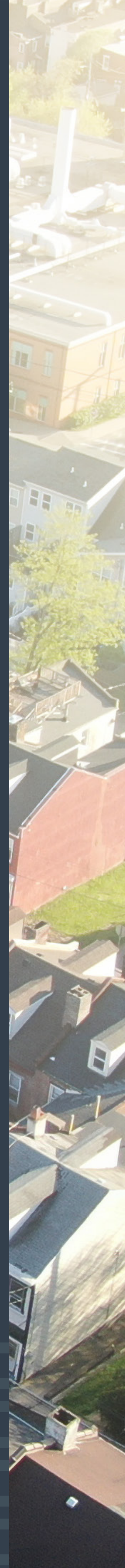
Here Comes The Neighborhood

The Economic and Social Impacts of Private, Residential Real Estate Developers

upright



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Introduction

Since I founded the business that is now Upright, and even before, I have been beating the drum for the entrepreneurial residential real estate developer.

I have long been convinced that local, private real estate developers play a vital role not just in our economy, but in the life of our nation, and its neighborhoods.

That is what we set out to show with this research: That the work of individual developers not only has a positive economic impact, but social benefits, too.

I am delighted that this research bears that out.

Investing in real estate creates wealth, but more importantly it creates homes.

We should be doing all we can to make it as easy as possible for this nation's army of real estate entrepreneurs to build more homes, better homes, accessible homes.

Residential real estate is not just a smart alternative to the stock market, but an investment that adds to the life and vibrancy of communities across the country. And that's something we can all feel good about.

Matt Rodak
CEO, Upright

The housing shortage: A perfect storm

The United States has a well-documented housing shortage. The most recent data from Freddie Mac[1] indicates there is a deficit of 3.8 million homes. But other recent estimates from the National Association of Realtors[2] suggest the figure could be between 5.5 and 6.8 million units.

Whatever the real number, there is a consensus that the gap between supply and demand is growing every year.

The causes of this are a perfect storm of demographic, economic, social, and political factors:

- Rates of homebuilding **plummeted after the Great Recession,** and have never fully rebounded (see fig. 1).
- New household formations[3] are increasing at a higher rate than new homes are being built.
- The issuing of new home permits is not keeping pace with the number of new jobs being created; according to the National Association of Realtors' Housing Shortage Tracker, one permit is issued for every two jobs created, on average, and in **certain metropolitan areas this ratio is as low as one permit per 20 new jobs.**
- There is a construction labor shortage, effectively limiting developers' capacity; according to the U.S. Bureau of Labor Statistics, **in 2022 there were 5.5 job openings for every 100 construction workers,** a figure higher than even in 2020[4].
- The Covid-19 pandemic placed a great strain on the global supply chain, **causing material shortages and increased prices,** with an impact on the number of houses being built, and higher sale/list prices for those that are built[5].
- In recent years, institutional buyers have been buying up residential properties *en masse*, taking them off the market and making them available as rental properties instead. Some analysis suggests that **large institutions own around 5% of the nation's 14 million single family rentals**[6], and MetLife Investment Management estimates this may rise to as much as 30% of single family rentals by 2030, further exacerbating the shortage of homes for sale.

[1] *Freddie Mac: Housing Supply: A Growing Deficit*
[2] *National Association of Realtors: Housing Shortage Tracker*
[3] *FRED: Household formations*
[4] *Buildertrend: Construction labor shortage*
[5] *The Counselors of Real Estate*
[6] *YardiMatrix*

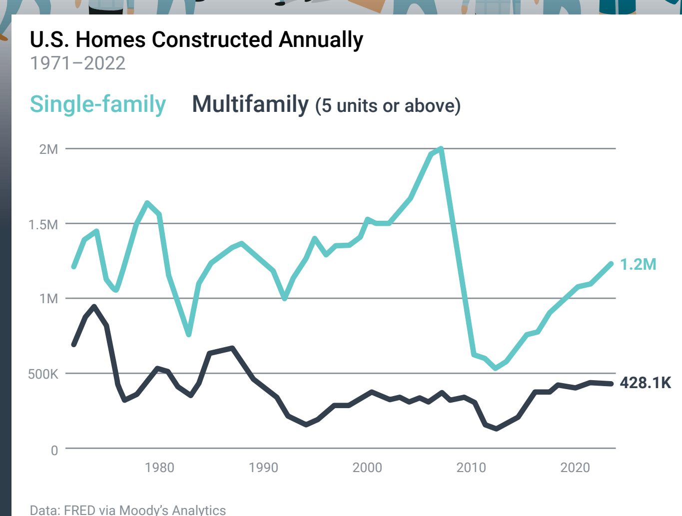


Fig 1: U.S. homes constructed annually

- Freddie Mac also points to other factors, including land-use regulations, zoning restrictions that prevent supply from picking up in areas that have the most demand, and "NIMBYism" (the opposition by individuals to new development near them, a term derived from the acronym, "Not In My Back Yard").

The housing shortage is particularly acute when it comes to entry-level homes. This is a long-term trend (see fig. 2) but is exacerbated as Millennials, now the largest generational cohort, seek to establish their own households.

The net effect is that millions of people, particularly younger people, are effectively priced out of the housing market, whether they aspire to buy or rent.

Rates of homebuilding plummeted after the Great Recession, and have never fully rebounded.

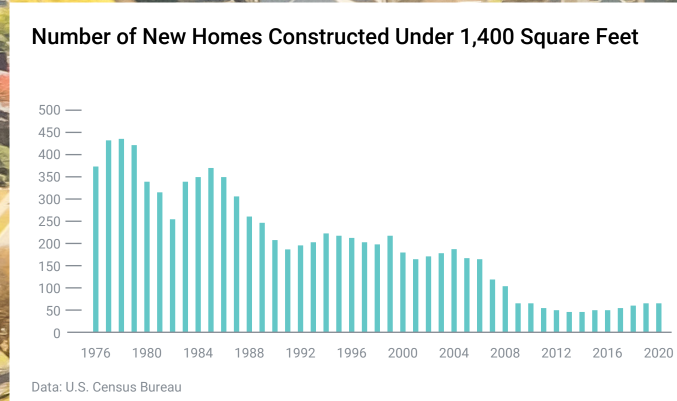


Fig 2. The number of new homes constructed under 1,400 sq. ft.

The vital role of redevelopers and builders

Much house building in the U.S. is undertaken by a small number of publicly traded companies. In 2022 the top 10 builders accounted for 43.2% of new single-family home closings, with the two largest responsible for 23.7% between them[7].

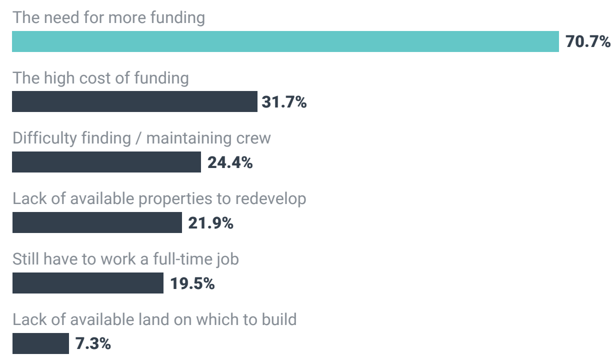
But these large companies are by no means the only ones seeking to meet the growing demand for new homes.

There are **more than 50,000 private real estate developers in the U.S.**[8]. These entrepreneurial individuals play a vital part in bridging the gap between housing demand and supply:

- 50,000+ private real estate developers in the U.S.
- They **build approximately 400,000 new properties a year**, around 30% of the 1.3M new homes added to the market[9].
- They redevelop and make habitable a combined total of **an additional 407,000 existing homes** each year[10].
- The average sales price of new construction, single-family homes in the U.S. is $513,000[11].
- They invest around $34B of their own money in their projects (average $42.5K per project).
- **Building an average single-family home creates 2.9 year-long jobs**, and there were 12M privately owned single-family home starts in 2022[12].
- Their housing projects vary between homes intended to meet the massive demand for low-income renters, to the transformation of individual derelict properties into aspirational single-family homes, to multiple new homes on brownfield sites.

Research[13] shows that most of these developers would undertake more housing development projects each year, if they could. (Indeed, all of those surveyed said that they would like to take on more projects.)

Factors holding developers back from taking on more projects



The most notable factor setting these entrepreneurial developers apart from corporate house builders is the vested interest they have in the neighborhoods in which they build.

Research indicates that most private developers begin their careers with projects in their own, or neighboring communities.

And even as many broaden their horizons to encompass different cities, counties, and states, they remain invested in the neighborhoods in which they began, often walking or driving past those early developments every day.

CASE STUDY

Paul Smetona

Paul Smetona of Smetona Homes LLC is a small business owner and real estate developer. He lives in Cleveland and works in the surrounding areas. Paul mostly deals in fix-and-flips, but has interest in multi-unit projects in the future.

Paul's background is in electrical engineering, and the transition to real estate investing came from a desire for more freedom with his time and finances.

Paul has fully repaid two loans with Upright, and has 10 active projects currently on the platform.

[7] National Association of Home Builders
[8] IBISWorld
[9] U.S. Census Bureau and U.S. Department of Housing and Urban Development
[10] ATTOM
[11] U.S. Census Bureau and U.S. Department of Housing and Urban Development
[12] National Association of Home Builders
[13] Upright research, August 2023

Adding character, adding value

Many developers express a degree of personal pride in their ability to improve the visual appeal or character of the neighborhoods in which they work, filling in 'gap tooth' streets with attractive properties, as well as the fact that they are creating new homes where they would not otherwise exist.

But there are also very real economic benefits that accrue to a neighborhood when a dilapidated property is redeveloped, or new homes are added:

- Academic research[14] has shown that properties neighboring redevelopments enjoy "significant increases" in value, even before the redevelopment in question has been completed.
- The same research suggests that this economic benefit varies with proximity between the properties and the redeveloped site: **"Properties which have the closest proximity with the redevelopment [were] found to have experienced greater increase in price after redevelopment."**
- This research is borne out by Upright data, which shows that when neighboring properties are redeveloped there are higher trading comparables nearby, leading to higher real estate values throughout the neighborhood. An analysis of ZIP codes that have seen a lot of residential development shows that in most cases, the value of homes neighboring newly built or redeveloped properties increases at a rate that outpaces local market growth. **While residential property values increased by between 3.7%–8.0% in those states analyzed (July 2022–July 2023), in the ZIP codes that experienced development, residential property values increased by between 4.8%–13.0% over the same period.**
- Conversely, according to the Appraisal Institute, **a rundown property could reduce the value of neighboring properties by up to 10%**[15].
- Similarly, a study by The Center for Responsible Lending conducted during the Great Recession showed that **homeowners who live within 300 feet of a foreclosed residential property experience a drop of 1.3% in the value of their homes**; and those living 300 to 500 feet from a foreclosed home typically see a drop in value of 0.6%[16].

In ZIP codes that experienced development, residential property prices increased between 4.8%–13.0%.

[14] International Journal of Urban Sciences, Vol 14, Issue 3
[15] Appraisal Institute
[16] New York Times

It is not just other property owners who benefit from neighboring developments:

- The National Association of Realtors estimates that **one job is generated for every two home sales.**[17]
- And for every $100K invested in remodeling a property, 0.75 jobs are created.[18]

Simply put, neighborhoods without the blight of derelict or dilapidated properties, or vacant lots, are more likely to prosper economically.

- Anecdotal evidence suggests that small business owners are more inclined to set up shop in streets and neighborhoods where they are not likely to be neighbors with residential properties in need of repair or redevelopment. And new shops, cafes, and other businesses add to the vibrancy of the neighborhood, as well as its economic prosperity.

Neighborhoods without the blight of derelict or dilapidated properties are more likely to prosper economically.

UPRIGHT

Generating economic prosperity through housing development

- In 2022 Upright (formerly Fund That Flip) generated $800M in income from new construction ($500M) and rehab ($300M) projects across all the communities to which the company lent.
- These developments will continue to add $40M in annual income on an ongoing basis.
- These projects also added $486M in salaries, wages, and tax revenue, while creating 8,500 jobs and continually creating 557 jobs on an annual basis.

[17] National Association of Realtors
[18] National Association of Home Builders

Here comes the neighborhood

"There goes the neighborhood" is a typical response to negative developments, be that the shuttering of a local business, the boarding up of vacant buildings, or the building of an unsympathetic or incongruous property nearby.

But the opposite can also be true: The development of attractive new properties, or the 'saving' of derelict or rundown properties through their sensitive redevelopment, can contribute to the creation of a happier, healthier neighborhood — social benefits, as well as economic ones.

This is a real estate version of **'The Mister Rogers Effect'**, named for the beloved children's television presenter who for decades championed neighborliness. In this case, it is the nature of the built environment itself that may be shown to lead to "a beautiful day in the neighborhood":

- Research entitled 'More Than Just an Eyesore' published in the Journal of Urban Health shows a correlation between the incidence of vacant lots and the physical and mental health of local residents: **"Vacant land was described as impacting physical health through injury, the buildup of trash, and attraction of rodents, as well as mental health through anxiety and stigma."[19]**

It may be argued that these social benefits go even further. Cities across the country are keen to minimize the number of vacant lots since, according to research by Community Blight Solutions[20], **a typical foreclosed home imposes costs of at least $170,000.** But this research shows that the negative impact of such properties on their neighbors goes beyond the financial cost:

- Vacant properties lead to **increases in violent crime.**
- The impact of vacancy on crime increases as the property stays vacant for longer periods.
- **Vacant buildings are major fire hazards;** vacant residential buildings account for one of every 14 residential building fires in America.

People in neighborhoods that have benefited from the redevelopment of housing may therefore be assumed to be happier, safer, and able to enjoy better physical and mental health.

[19] Journal of Urban Health
[20] Community Blight Solutions
[21] U.S. Energy Information Administration

The nature of the built environment itself may be shown to lead to "a beautiful day in the neighborhood."

Sustainable neighborhoods

Another side effect of the redevelopment of old properties or the sympathetic addition of new ones to neighborhoods is the increased sustainability of those areas.

As building codes have been updated and become more stringent over time, the requirement for properties to be more energy efficient has increased.

Each new home that is built is more sustainable than those that went before, and each older property that is redeveloped and brought up to code is more sustainable than it was before, and usually more sustainable than its neighbors.

Analysis from the U.S. Energy Information Administration (EIA) shows that homes built in 2000 and later consume only 2% more energy on average than homes built prior to 2000, despite being on average 30% larger. These new homes consume 21% less energy for space heating on average than older homes[21].

Conclusion

Builders and redevelopers have a vital role to play in solving the nation's housing shortage, a shortage that cannot be solved by the major housebuilders, or large corporate investors that may buy up large housing developments as rental properties.

While those larger businesses have scale, they are generally divorced from the communities in which they are building or investing. This can result in the destabilization of a neighborhood ecosystem, for example with the influx of a disproportionate number of transient rental tenants, or the development of unsympathetic properties out of keeping with the existing character of the area.

By contrast, this country's army of residential real estate developers tend to be highly invested in their projects, which are very often in or adjacent to the places they live. They are helping to solve the housing shortage one project at a time, creating homes where they did not previously exist, for people who will live, work, and play alongside them and their families.

As this research shows, each redevelopment or new build is not only one more home, but a net generator of wealth, health, happiness, and much more.

APPENDIX

Methodology

There is a wealth of data available on the residential real estate market, and in this paper we have made every effort to reference the most up-to-date information available.

Key sources include: The Counselors of Real Estate; FRED; Freddie Mac; The National Association of Home Builders; and The National Association of Realtors, as well as various U.S. government agencies, and data subscription sources, including HouseCanary.

Where data for all private real estate developers is unavailable, we have made extrapolations from Upright's data.

In addition, we undertook original research among a representative sample of private residential real estate developers; this group includes, but was not limited to Upright customers.

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About Upright

Upright (formerly Fund That Flip and FlipperForce) is an award-winning fintech platform that provides real estate investors with software tools to help them scale their business, capital to help them grow their portfolio, and passive income opportunities for accredited investors, all under one roof. With offices in New York City and Cleveland, Ohio, Upright helps restore communities across the United States through its network of experienced, dedicated real estate professionals backed by a diverse base of institutional and individual investors.

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