BUSINESS > REAL ESTATE

Denver startup Flock Homes looking to gather accidental or retiring landlords

Fintech startup is pooling investment properties and offering owners an exit strategy

DENVER, CO – APRIL 07: Owners of a new the start-up company Flock, Matt Litovitz, left, and Ari Rubin out in front of their first property purchase April 07, 2021. Flock Homes is a start up company that acquires rental homes from landlords who are seeking an alternative to selling. (Photo by Andy Cross/The Denver Post)

By **ALDO SVALDI** | asvaldi@denverpost.com | The Denver Post

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When Shirlee Turner lost a long-time tenant in her Denver rental home at the same time her property manager announced he was retiring, it forced a reckoning.

“The incentive for keeping the property in the first place was to have the appreciation and another stream of income. But I got spoiled. I had such a great experience with my renters and didn’t have many of the headaches like people usually have,” Turner said.

Turner, who is the chief medical officer at The Denver Hospice, purchased her home in 2005 and lived there for about six years before moving and converting it to a rental, which her former neighbor helped manage. Holding on proved a smart decision, given the huge home price gains Denver homes have racked up the past decade.

In Turner’s case, the home gained $285,000 in value beyond the original purchase price, per Zillow estimates. But that meant any sale would come with a big capital gains tax bill, not to mention no more monthly rent payments.

Using what is known in the tax code as a 1031 exchange could have avoided taxes, but it requires rolling any proceeds into another real estate investment. Doubling down with her 60s approaching wasn’t an appealing option, Turner said. Nor was keeping the home and rolling the dice when it came to finding a new property manager and tenants.

Looking for options, Turner stumbled across a Facebook ad for a Denver company called Flock Homes, which was recruiting landlords to try a different model for owning real estate.

The Denver startup, founded by Ari Rubin and Matt Litovitz, who met at the Stanford University Graduate Business School, operates similar to a real estate investment trust or REIT. But rather than ponying up cash for shares, landlords contribute their investment properties, in what is called a 721 exchange. In return, they earn a piece of the dividend stream spun off by a much larger pool of homes.

“Millions of Americans own rental properties,” Rubin said. “We are focused on the accidental landlord and the retiring landlord. We seamlessly convert their rental property into a share of a pool of houses.”

The company offers landlords like Turner a way to switch from active to passive ownership, avoid capital gains taxes, maintain income and diversify their real estate holdings, Rubin said. He adds the model is for those who find “owning a hassle, but selling costly.”

Flock Homes has raised money from angel investors and venture capital firms, but it isn't as capital intensive as investment pools that purchase homes outright. The company recently assembled a group of 20 Denver properties in a test run of the concept, with plans to eventually scale up in a variety of markets.

And while 721 exchanges aren't new, the financial technology behind the company's platform, which greatly simplifies the entire process, is. Rubin said Flock Homes wouldn't have been achievable 10 years ago.

The company charges a management fee of 1% fee of assets, which is on the high side for a REIT. But for someone used to paying fees for active management of their equity portfolio, that figure isn't out of line, said Troy Miller, executive director of the Investment Community of the Rockies.

"Yes, that does seem high, but looking at this, you have to consider the active or passive investor," Miller said. "You have someone who has invested more mainstream through their financial institution and only expects a more conservative return."

Miller said Flock Homes is "ideal" for accidental landlords, such as heirs who pick up homes they don't know what to do with through probate. Splitting a monthly dividend payment is easier than fixing up and selling grandma's home and dividing proceeds. Plus, it avoids completely parting ways with a home that might have been in the family for decades and carries sentimental value.

Rubin adds that there is a wider community benefit. Many independent landlords allow their properties to show their age as they show theirs, often losing either the ability or interest in maintaining them. In the initial group of properties that Flock Homes acquired, it had to address multiple issues, Rubin said.

Flock's model is to upgrade the homes it acquires, add more environmentally friendly amenities like native ground cover and solar arrays, and command a higher rent to benefit investors.

The model, however, has the potential of bumping heads with a concept that Denver and other cities are exploring called Naturally Occurring Affordable Housing or NOAH. In exchange for a lower rent, some tenants are willing to live with 1980s decor and outdated floorplans. Often it isn't a matter of choice. Having a wider mix of homes allows for a more diverse mix of households to live alongside each other.

Under a NOAH approach, Denver would implement restrictions designed to preserve older homes with below-market rents as part of the housing stock. That could range from banning buy-and-scrapes in popular neighborhoods to limits on home upgrades, preventing them from commanding the highest rents possible.

There's also the wider issue of metro Denver's inadequate home inventory. If fewer landlords sell, the fewer options that renters who want to become homeowners will have.

Once landlords contribute their properties, they lose the ability to pull them out and do a tax-deferred exchange in the future. It represents an end-of-the-road strategy in that regard.

Another question landlords will need to consider is what joining Flock Homes will cost them in terms of the monthly income they receive. Rubin said that depends on different things, such as the value of the individual property and how the overall portfolio performs. But generally speaking, managing multiple properties provides scale and reduces costs, with those savings passed onto owners. Vacancy risks are also reduced when spread out across a wider pool of homes.

Turner said her desire to keep things stable with her tenant caused her to fall behind the market on the rents she charged. By joining Flock Homes, she will actually make more each month than she was before.

She can also put her Flock interest into a trust for her special needs son, guaranteeing him an income stream when she dies rather than the burden of dealing with a rental home. And as an added bonus, she won't have to handle those late-night calls.

"You aren't worried about that 12 a.m. call that the pipe froze or the water heater stopped working. You sleep better," she said. "I told them I wish I had 15 or 20 houses to give you."

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