Mind the rent gap: Blackstone, housing investment and the reordering of urban rent surfaces

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Abstract

Recent years have seen a burst of new writing on the opening and closing of urban rent gaps. Such studies generally consider individual cases. Rarely does the opportunity arise to readily compare and contrast rent gaps across multiple cities and territories, least of all within the context of a single developer or investor portfolio. Such an opportunity has arisen in the past decade, however, as the US investment firm Blackstone has pursued a multi-territory housing-investment strategy specifically of identifying and closing rent gaps, which it styles ‘buy it, fix it, sell it’. This article examines that strategy and the varying nature of its implementation in Danish, German, Swedish and US cities. It argues that the rent gap is a paradoxical phenomenon: vast gaps, promising vast profits, frequently open up and frequently remain open for long periods before being closed – if they are closed at all. A primary reason is that successful and profitable closure requires not just favourable local political-economic conditions but a singularly well-funded, determined and aggressive investor – an investor, that is, such as Blackstone.

Keywords

built environment, development, economic processes, finance, financialisation, housing

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Introduction

In the period since the global financial crisis of 2007–2009, the Wall Street investment firm Blackstone has built one of the world’s largest and most international portfolios of residential property. In at least 10 different countries, it has acquired housing, let it, and sometimes sold it. In the process, housing has delivered vast profits to Blackstone, its executives, and the investors such as pension funds whose capital it is that Blackstone – which operates as an asset manager – puts to work. The firm’s key executives have spoken widely about the investment ideas and strategies that have guided its housing investment venture, and among these, one crops up perhaps more frequently than any other: ‘buy it, fix it, sell it’ (see, e.g. Grant, 2020).

Blackstone’s widely-discussed investment in US ‘single-family homes’ – that is, standalone homes, as opposed to units in ‘multi-family’ blocks – represents a striking example. Having begun purchasing single-family dwellings in 2011–2012, Blackstone had by the end of 2016 bought in the region of 50,000 such homes, concentrated in cities such as Los Angeles, Phoenix, Tampa, Orlando, Atlanta, Chicago, Charlotte, Las Vegas and Seattle. It did so through a portfolio company established in 2012 and owned by its investment funds – Invitation Homes. In 2017, Blackstone floated around 30% of the shares in Invitation Homes on the stock market. It then proceeded to run down its remaining holdings over the following months and years, selling its final batch of shares in November 2019.

By its own telling, Blackstone–Invitation Homes invested principally in regional housing markets displaying two key features. The first was distress: it targeted foreclosure hotspots where the subprime crisis had hit hardest, prices were cheap – the average price it paid for homes up to May 2013 was $153,000, versus an estimated average 2006 value for those c. 25,000 homes of $303,000 (Blackstone, 2013a: 12) – and years of disinvestment had left the built environment in what was often a sorry state. Foreclosed homes, Blackstone (2013b) said, ‘are usually abandoned and a blight on the neighborhood, contributing to a downward spiral of...
home prices’. Around the time it finally cashed out of Invitation Homes, Blackstone claimed that the company had spent an average of $22,000 per acquired home on renovations and improvements (Lane, 2019) – the ‘fix it’ part of the abovementioned investment strategy. ‘Once we fixed up the houses and leased them out to families’, the firm’s chief executive, Stephen Schwarzman (2019: 276), wrote, ‘we saw these neighborhoods come back to life, their social fabric restored’.

The second key feature was demand for rental housing: it had to be buoyant. As stated in its listing prospectus, Invitation Homes (2017: 1, 70) invested in markets with ‘stronger job and household formation growth … relative to the broader U.S. housing and rental market’. Specifically, it targeted ‘neighborhoods in in-fill locations with multiple demand generators, such as proximity to major employment centers, desirable schools and transportation corridors’. These ‘demand fundamentals’ were said to be especially favourable in the western United States and Florida, which, at the time of the flotation, delivered around 70% of Invitation Homes revenues: local employment growth and household formation rates exceeded national averages, and were responsible, the firm believed, for ‘strong rental rate growth and home price appreciation’.

If we were to put Blackstone’s ‘buy it, fix it, sell it’ housing-investment approach, as exemplified by Invitation Homes, into the conceptual language of urban studies, we would say that the business model fundamentally was – and remains – identifying and closing rent gaps. Originated by Smith (1979), the ‘rent gap’ represents the differential between ‘capitalised’ and ‘potential’ ground rent. The former refers to the return that could be captured under the site’s ‘highest and best use’. Smith argued that years of disinvestment in core areas of major Western cities in the postwar era had opened up significant such gaps, and that capital invested in redevelopment where and when the gap was wide enough to justify the cost of bridging it: in other words, where real estate could be bought (at a land price equating to capitalised rent), fixed up (to highest and best use) and then either let or sold (the two different ways of realising potential rents) at a net overall profit. This is exactly what Invitation Homes – and, as we shall see, various other Blackstone housing investment vehicles – did. Market distress exacerbated by the financial crisis ensured depressed capitalised rents; buoyant demand for rentals ensured elevated potential rents. The figure $22,000 was an indication (but, for reasons that will soon become apparent, only that) of the average rent gap as Invitation Homes calculated it, or rather of the minimum average present value per home of closing the gap and jumping from capitalised to potential rents: the uplift had to justify the rehabilitative investment.

The premise of this article is that insofar as its ‘buy it, fix it, sell it’ approach constitutes a quintessential rent-gap strategy, Blackstone’s program of post-financial-crisis housing investment offers an unusually rich opportunity to examine the conditions under which both (a) rent gaps arise in today’s urban landscape, and (b) such gaps are successfully closed. Where has Blackstone found gaps that it has deemed amenable to profitable closure? And where has it been able to put this approach successfully into practice?

The existing literature on rent gaps is arguably richer on the conditions of their opening than their closure. Notable here is the work of Ernesto López-Morales, which has emphasised the role of the state in this regard, for instance via the liberalisation of building regulations (López-Morales, 2011),
land upzoning and investment in public infrastructure (López-Morales et al., 2019). Wachsmuth and Weisler (2018), in their analysis of Airbnb, highlight the role of technology in opening rent gaps, whereby the ‘highest and best use’ of residential property is shifted in such a way as to raise potential rents. Teresa (2019), with a focus on the impact of deregulation, similarly explores situations where rent gaps open as a result of rising potential rents more than falling capitalised rents. To the extent that the few attempts to empirically ‘test’ rent-gap theory in turn consider the conditions of opening and closure, they too have focused more on the former than the latter such conditions, as in the work, for example, of Clark (1988) and Hammel (1999).

The present article builds on these studies by comparing and contrasting across the spectrum of Blackstone’s multi-territory ‘buy it, fix it, sell it’ housing investment ventures, arguing that the emergence of significant rent gaps depends upon the intersection in time and space of a range of relatively propitious political-economic circumstances relating primarily to demand for housing, historical patterns of (dis)investment and last but not least, the strategies of incumbent owners. The importance of this last factor lies in the fact that where and when rent gaps do materialise, it is not always straightforward for them to be closed: again, a set of favourable conditions is necessary; and even if such conditions prevail, incumbents may not be inclined, or best placed, to exploit them. In a sense, of course, this particular finding stands to reason. If it were straightforward to close rent gaps, they would not widen and then persist in the relatively durable forms in which Smith and other urban scholars have depicted them; rather, they would be closed without ado. That the rent gap typically exists for some time prior to any redevelopment is one of Clark’s (1995) main claims about this signature urban-economic phenomenon, which, according to Slater (2017), has now proliferated to the extent of achieving planetary proportions. In short, for actors such as Blackstone to close existing rent gaps, they must overcome those constraints that have militated against the prior closing of the gaps in question.

The article is based on an extensive program of research into Blackstone’s international housing investment program over the past decade, comprising analysis principally of annual reports, financial statements, other securities filings and quarterly earnings release transcripts. It has two sections. The first describes and analyses the nature of the principal assets – including US single-family housing – to which Blackstone has substantially applied its ‘buy it, fix it, sell it’ approach to housing investment. The second describes and analyses the outcomes of Blackstone’s investment in each such case. In both sections, the article uses the Blackstone experience to generalise, as far as is possible and reasonable, about the conditions of possibility previously referred to: firstly, that is, for rent gaps to open up, and secondly for those gaps to be successfully closed. It should be emphasised that the article is not an analysis of Blackstone’s post-financial crisis housing-investment program in toto. As various studies (e.g. Yrigoy, 2021) have shown, in some countries and cities, rehabilitation of acquired stock has not been a significant part of Blackstone’s strategy, and has not been necessary to enable rent increases. The present article examines the most substantive examples of Blackstone’s application specifically (and only) of the ‘buy it, fix it, sell it’ approach, of which it identifies four: Invitation Homes in the US, alongside investments in multi-family rental housing in Germany, Sweden and Denmark.

Throughout, the article uses actual revenue rents as a proxy for ground (i.e. site)
rents. To be sure, it is an imperfect proxy: the rent paid on a Blackstone home is always a composite of ground rent and building rent. But if these two components can be distinguished conceptually, it is a different matter to disentangle them in practice (see Clark, 1988). In reality, higher post-redevelopment revenue rents typically reflect increases in both building and ground rents: the former increase because the building has been improved, and the latter increase for the same reason – transitioning to a ‘higher and better use’ enables ground rent to be capitalised at a higher level. If the direction of change in the two components is consistent, changes in revenue rents can be used as a ‘good enough’ proxy for changes in ground rents. The article assumes that this is by and large the case.

Opening rent gaps

In 2017, Blackstone launched a new investment fund called Blackstone Property Partners Europe (BPPE). BPPE would invest in European real estate in three key sub-sectors: offices, logistics and residential. The geographical focus of its residential investment, initially at least, would be in Germany, and Berlin in particular.1 By the end of 2018, BPPE had acquired seven German residential-property portfolios in total, and owned 176 residential buildings containing 4591 units valued at €1.1 billion. By volume of units, around 80% of BPPE’s German residential portfolio was in Berlin; by gross asset value, over 90% was (Blackstone, 2019).

There had been two especially large deals. First, in February 2018, BPPE secured the purchase of the Taliesin Property Fund. Formed in 2006, Taliesin was a property company that owned 62 buildings in Germany, the bulk of which were multifamily residential buildings. It owned 1362 apartment units in total, around 92% of which were in Berlin, with the remainder in Dresden and Potsdam. Total annual revenue in 2017 was €13.6 million, made up of rents (€10.7 million) and service charges (Taliesin, 2018). Blackstone paid a reported €260 million to take it over. Then, three months later, BPPE paid a reported €425 million to buy a portfolio of around 2500 German residential units from a joint venture that included KauriCAB Management and Apeiron/Aylon (Blackstone, 2018). This time all the acquired homes were in the capital city, the majority concentrated in prime inner-city districts.

Why Berlin? It ticked both of the necessary boxes. On the one hand, there were large amounts of relatively cheap property in need of substantially more than a lick of paint. Although German reunification had inspired expectations that Berlin ‘would become another nodal point, like London or Paris, in the European or global economy’, things, as Fields and Uffer (2016: 1491) have noted, did not work out like that: ‘growth expectations were overestimated, and Berlin suffered a mid-1990s economic decline and population loss, creating a fiscal crisis’. Privatisation of significant chunks of the city’s state-owned housing stock followed over the next decade, designed both ‘to improve Berlin’s budgetary situation and stimulate private investment in housing rehabilitation’ – private investors were expected to ‘modernise’ the housing stock (Fields and Uffer, 2016: 1491). But they generally did not. Demand for rental housing remained low in the first decade of the new millennium, and vacancy rates high: economic incentives to renovate were lacking.

On the other hand, in the years following the global financial crisis, demand for rental housing in Berlin rapidly picked up. The city’s population grew apace (from under 3.4 million in 2008 to more than 3.7 million a decade later), driven by immigration both from overseas and other parts of Germany;
and sluggish new construction meant that rental markets substantially tightened: having remained as high as 5% through 2014–2015, citywide vacancy rates plummeted to just 1% by 2017 (Taliesin, 2018).

In short, what Blackstone found in Berlin was a rent gap. To be sure, some property owners had responded swiftly to booming post-crisis demand by modernising their stock, and lifting rents. But many had not, and in those cases a gulf had opened up between capitalised and potential rents. This was what Blackstone bought into. Indeed, it highlighted the existence of – and the profit potential inherent in – this rent gap when describing BPPE’s Berlin portfolio to investors in the fund’s annual report for 2018. ‘Our portfolio is reversionary’, Blackstone (2019: 22) explained, ‘with in-place rents considerably below market levels’.2 The logic of the Berlin acquisitions was quintessential ‘buy it, fix it, sell it’.

The same logic had seen Blackstone invest in Swedish housing in 2016. In December of that year, it acquired a 46% ownership share, and 65% voting share, in D. Carnegie & Co., the owner of over 16,000 apartments, of which around 10,000 were located in Greater Stockholm, mostly in the suburbs. By the end of 2018, by which time Carnegie had been renamed Hembla and owned more than 21,000 apartments, Blackstone had lifted its ownership share to 61%.

The Carnegie assets also embodied a rent gap, but its form, and the reasons for its opening, were somewhat different from in Berlin. Its roots dated to the famous ‘Million Program’ of 1965–1974, when, in the face of post-war housing shortages exacerbated by labour immigration, the country constructed over a million new residential units, with the outer areas of big cities such as Stockholm seeing much of the new build in the form principally of low-rise multi-family apartment buildings.

As in Berlin, the decade since the global financial crisis has been one of buoyant demand for rental housing in Sweden’s big cities, including in the suburban areas of Stockholm where much of the Carnegie stock, almost all of which dates to the Million Program era, was concentrated. Indeed, the long waiting times required of those in the queues for first-hand rental contracts operated by Stockholm’s ‘housing exchanges’ (bostadsförmedlingar) are notorious: Christophers (2013: 904) reported that for the primary Stockholm exchange (Bostad Stockholm), queuing times ranged from a minimum of 2.2 years to a maximum of 21.2 years. This huge pent-up demand was a vitally important part of Blackstone’s rationale for acquiring Carnegie.

One might imagine that given such demand, Stockholm’s old Million Program stock, including that owned by Carnegie, had been widely improved over the years since its original construction. And yet it had not been: in Carnegie’s case, the proportion of apartments that had been renovated stood at only 4.6% at the end of 2015 (Carnegie, 2016: 45). To understand why, it is necessary to rewind to the latter part of the Million Program period. The economic crisis of the early 1970s saw a curtailment of immigration to Sweden and a surge in vacancies in precisely the areas where Blackstone would later invest – vacancy rates in suburban Stockholm were ‘extraordinarily high’ (Clark and Gullberg, 1991: 502). They remained high through the 1980s and 1990s, reducing the incentive for owners to improve their stock: suburban rent gaps, as Clark and Gullberg (1991) observed, were ‘nonexistent’. Only in the new millennium, as a result of a combination of population growth, rural-to-urban migration, and a sharp fall in levels of new construction, did vacancy levels in those suburban areas of Stockholm begin to fall. And, as in Berlin,
the response from owners in terms of reinvestment was generally lethargic.

A good measure of the rent gap that now characterised unimproved housing in the areas of Stockholm where Blackstone would invest is available from Carnegie’s accounts for 2016. During that year, Carnegie renovated 1253 of its 16,358 apartments. The annualised rent on these renovated properties was lifted from a pre-upgrade average of 1028 kroner (SEK) per square metre (capitalised rent) to 1465 SEK/m² (realised potential rent) – a hike of 43% (Carnegie, 2017: 13, 54). The annualised value of the rent gap, in other words, was 437 SEK per square metre. When Blackstone bought Carnegie, the latter’s apartment portfolio comprised 1.27 million square metres of lettable area. 12.3% had been renovated, meaning 87.7% had not. If an annualised uplift of 437 SEK could be achieved on each of the 1.1 million square metres of property still to be renovated, then the prize from comprehensive renovation would be nearly 500 million SEK (or around US$50 million) per annum in increased rents.3 It is hard to imagine a more striking manifestation of the rent-gap investment calculus.

Meanwhile, a year after investing in Carnegie, Blackstone also started buying housing in Sweden’s Nordic neighbour, Denmark, where again, as in Sweden and Germany, a rent gap had opened up; and again, this gap was most evident in the capital city, namely Copenhagen; and again, the nature of the gap and the explanation for its materialisation had a distinct local flavour. By late 2018, Blackstone reportedly had acquired more than 140 residential assets in Copenhagen – mostly multi-unit properties – worth in the region of 10 billion Danish kronor (Jensen, 2018). A year later, reports indicated that its Copenhagen portfolio had swelled to 160 properties containing 2300 residences (Sommer, 2019).

As in Berlin and Stockholm, Blackstone’s acquisitions were principally of old, often dilapidated stock. The popular image of Copenhagen is of a thoroughly modern city but the reality, especially in the private-rented housing sector, has never entirely conformed to the stereotype. Noteworthy evidence of this came from a survey of private landlords owning some 600 properties containing 10,000 dwellings carried out in the 1990s by Andersen (1998), which found that ‘private rented housing in Denmark is often badly maintained and lacking in modern facilities’. Remarkably (to this author, at any rate), 12% of the surveyed dwellings had no central heating and 23% no bathroom. ‘Only 10 percent required no work’ (Andersen, 1998: 189).

In theory, as Andersen (1998) noted, Danish rent control – about which we will have more to say in due course – should have encouraged maintenance and improvement inasmuch as, when making improvements, the landlord could increase rents to the extent necessary to cover capital expenses incurred (1998: 179). But as Andersen (1998) also noted, in practice, the system did not work so well in this regard. The process of improving run-down dwellings had progressed ‘very slowly’. The survey suggested several reasons. One was that only a minority of landlords appeared to be guided by long-term investment considerations. Another was that, especially in Copenhagen, where demand for affordable rental housing exceeded supply, ‘bad maintenance does not reduce very much the opportunities for letting out’ (Andersen, 1998: 193). In any event, Andersen found that not only had not much renovation been done, but little was planned, either: ‘In 65 percent of dwellings requiring improvements there were no plans to do
anything about them’. Furthermore, where rehabilitation had been carried out or was planned, ‘it is not always the landlords with the poorest housing who do [so] but rather the other way round’ (Andersen, 1998: 191).

When Blackstone arrived in Copenhagen in 2017, it found the situation not enormously changed. There were large quantities of stock still requiring major works, and it was these that it targeted. An expert report for the government published in 2019 quantified the size of the remaining opportunity that Blackstone had identified (Transport- og Boligministeriet, 2019). The report disclosed that, across Denmark, approximately 57,000 privately-rented dwellings had already been substantially renovated, and that the average rent uplift associated with these renovations, which is to say the differential between capitalised and potential rents, had been 81% – higher even than Carnegie had achieved in Sweden. But some 74,600 rental homes were still awaiting improvement. Of these, around 60% were located in one of the large urban municipalities of Copenhagen, Frederiksberg, Odense, Aarhus and Aalborg.

Last but not least among the major ‘buy it, fix it, sell it’ housing-investment opportunities identified by Blackstone was, of course, US single-family homes, which was the context in which it first pursued the strategy at scale. As we have seen, between 2011 and 2016 Blackstone, through Invitation Homes, bought up around 50,000 such homes with a view to renovating and letting them. It was able to buy these homes efficiently and in bulk because it did so predominantly through foreclosure auctions, at which, during the foreclosure crisis that wracked the US in the wake of the subprime debacle, large numbers of homes were often up for sale (Mills et al., 2019: 409).

The financial crisis not only created the opportunity for Blackstone to buy these homes, and cheaply. It also played a significant role in fomenting the subsequent demand for rental housing that made single-family housing such an attractive investment proposition. The pressures that the crisis and ensuing recession imposed on household finances – and not only among those households that actually lost their homes to foreclosure – saw the US become more and more a renter rather than homeowner nation. Before the crisis, only about 31% of US households rented; by 2016, nearly 37% did – a huge shift over the course of just one decade (Joint Center for Housing Studies of Harvard University, 2020: 8). Having subdued capitalised rents, and thus purchase prices, in the short term, the financial crisis served to inflate potential rents in the longer term. This was the nature of the rent gap that Blackstone identified and targeted in the US.4

What do the examples of Berlin, Stockholm, Copenhagen and US single-family housing allow us to say about the conditions of opening of contemporary urban rent gaps? The common themes appear to be, firstly, relatively sharp upticks in local demand for rental housing, superimposed on landscapes characterised by what have often been relatively long histories of disinvestment; and, secondly, a relatively slow response from capital to the opportunity to close gaps as and when they open up. Indeed, this slow response is definitive: gaps can only open to the extent that they had done in Germany, Sweden, Denmark and the US if capital fails promptly to grasp the nettle.

In this regard (and this is perhaps the main observation we can make), rent gaps are a somewhat paradoxical phenomenon. Consider, in particular, the Swedish and Danish cases. If premiums of potential rents over capitalised rents of as much as 43% and 81% respectively were available, one is minded to ask: why had capital not hungrily and comprehensively closed the gap before

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"Christophers"
Blackstone pitched up? It is true that in the Danish case, significant numbers of homes had indeed already seen the gap closed; but a much larger number of homes had not. And in Stockholm, the vast majority had not. Why not?

It would only be possible to answer this question by undertaking much more extensive research into the housing histories of the relevant localities. The barriers to rapid and comprehensive closing of recently-opened rent gaps can, in theory, take numerous forms: a widespread failure to perceive that such gaps have indeed opened; a dearth of readily available investment capital on the necessary scale to carry out largescale stock rehabilitation; operational inertia on the part of incumbent landlord-owners; obstacles to the acquisition of rent-gap property by speculative, financially-driven investors; logistical difficulties in undertaking extensive and disruptive capital works; prohibitive rehabilitation costs; regulatory or political difficulties in transitioning from capitalised to potential rents, and so forth. All we can say for sure is, firstly, that where Blackstone has pursued its ‘buy it, fix it, sell it’ approach, substantive barriers of one form or another must previously have obtained; and, secondly, that Blackstone must have been confident either that such barriers had diminished, or that they could be overcome. We now consider how successful it has been in doing so.

Closing rent gaps

Blackstone’s investment in US single-family housing via Invitation Homes was enormously successful: spending an average of around $22,000 per acquired home on improvements, Invitation Homes experienced little apparent difficulty in closing the rent gap. When, in 2019, Blackstone finally cashed out by selling its last Invitation Homes shares, one commentator, Ryan Dezember at the *Wall Street Journal*, undertook the work of trying to calculate how much money Blackstone had made from the venture. Including receipts from share sales and dividends earned before and after the 2017 flotation, Dezember estimated that Blackstone had received payments of about $7 billion in all. This, he said, was more than double the amount of money it had put in. In other words, Blackstone’s profit from Invitation Homes was more than $3.5 billion (Dezember, 2019).

Partly, to be sure, Blackstone’s profit was unrelated to the active closing of a rent gap. When Invitation Homes began buying homes, prices were cheap not only because of disinvestment; they were cheap because the market had collapsed. In turn, part of the reason that the Invitation Homes housing portfolio increased strongly in value during subsequent years was simply a matter of the market recovering. In other words, if Blackstone exploited the gap between capitalised and potential rents, it clearly also exploited the gap between market trough and a higher plateau.

Nevertheless, investment in rehabilitation, by Blackstone’s own telling, evidently did enable Invitation Homes to capture potential rents. It is impossible to put a number to the uplift occasioned by renovation, although, as noted earlier, the $22,000 figure is a reasonable guide: if improvements did not on average generate at least that amount of gain in terms of the present value per property of future rent increments, Invitation Homes would not have been nearly as successful and valuable an entity as it was. (Revenues for the nine months ended 30 September 2016 were $688 million, generating earnings before interest of $145 million.) The Invitation Homes flotation prospectus did contain one useful data point in this regard: average monthly rents per home had increased from $1424 in 2014 to $1623 for the three months ended 30 September 2016 (Invitation Homes, 2017: 6, 17). But by
2014, a vast amount of renovations had already been carried out and had, inevitably, already been monetised.

One thing of significance we do know is that in 2018, the year before Blackstone exited from Invitation Homes, the latter dodged a bullet in terms of its ability to continue to smoothly bridge the gap between capitalised and potential rents. It did so in California, its most important regional market. There were two separate attempts that year to revoke 1995’s Costa-Hawkins Rental Housing Act, which substantially constrains the ability of Californian municipalities to regulate rents; had either attempt succeeded, municipalities’ powers to control rents would have been significantly enhanced, with potentially deleterious implications for Invitation Homes. But both attempts failed.

The first attempt took place in the state legislature, where the Santa Monica Democrat Richard Bloom authored a bill to repeal the act. In January 2018, the legislative committee held a hearing on Bloom’s bill, but it fell one vote short of passage. The second attempt took place at the ballot box, in November’s state elections. One proposal on the slate – Proposition 10 – was to repeal Costa-Hawkins. But it, too, failed, and by a larger margin: only around 5 million people voted in favour, with 7.25 million (nearly 60%) voting against. Notably, Blackstone, together with Invitation Homes, was one of the biggest donors to the ‘No on Prop 10’ campaign that preceded the vote – together, the two companies contributed a reported $6.8 million, around 10% of the total raised (Sirota and Perez, 2018).

The other location in which Blackstone’s ‘buy it, fix it, sell it’ rent-gap strategy achieved resounding success, at least from the firm’s own perspective, was Sweden. As we have seen, Blackstone took control of Carnegie and its c. 16,000 Million Program-era apartments, of which around 90% had not yet been rehabilitated, at the end of 2016. There followed two extremely busy years, with Carnegie now newly bolstered by Blackstone’s financial firepower. On the one hand, it aggressively expanded its portfolio: some buildings were sold, but many more were acquired, and thus 16,358 apartments at the end of 2016 had mushroomed to 21,411 two years later, by which time Blackstone had renamed Carnegie as Hembla. On the other hand, Carnegie–Hembla accelerated the renovation program that it had begun before Blackstone invested: c. 3300 apartments were renovated during the course of 2017–2018, at a capital cost of nearly 3 billion SEK (Hembla, 2019: 7).

Carnegie–Hembla, and behind it Blackstone, appears to have encountered almost no difficulty in closing the rent gap that had attracted it to Sweden’s Million Program housing stock. Sweden had long since abandoned its historic system of ‘hard’ rent controls, in favour of a system of ‘soft’ rent control that is more accommodating to sharp rent hikes – if the market will tolerate them. Rents, negotiated between landlords and tenants’ unions, are based on the perceived ‘utility’ value (bruksvärdet) of a property, which means that upgrades to the physical condition and quality of an apartment are a legitimate ground for rent increases. Carnegie–Hembla lifted the annualised rent on the 1626 apartments that it renovated in 2018, for example, from an initial average of 1021 SEK/m² to an average of 1512 SEK/m² (Hembla, 2019: 59). That was an increase of just short of 50%, higher than Carnegie was achieving before Blackstone invested. Equally importantly, the increase had no discernible negative impact on occupancy levels. Thanks to continuing robust demand for rental housing in those regions where Carnegie–Hembla owned assets (such demand being the other key factor, alongside large volumes of unrenovated stock, that had attracted Blackstone to the company), its properties remained
fully tenanted *despite* the rent increases. In other words, there were people prepared and able, if not exactly willing, to pay the higher prices. Hembla’s annual report for 2018, published in early 2019, reported ‘almost no vacancies’ (Hembla, 2019: 58).

It was, if there is such a thing, a textbook case of closing rent gaps. It was with good reason that Neil Smith referred to the higher rents promised by stock rehabilitation as ‘potential’ rents: they are never guaranteed; demand may appear to be strong, and other pertinent conditions also obliging, but it is only in attempting to close rent gaps that capital learns whether they are indeed closeable. Can the potential be *realised*? In Stockholm, it could be, and was.

In fact, Sweden, much more than Invitation Homes in the US, represents the archetypal implementation of Blackstone’s ‘buy it, fix it, sell it’ strategy. In the US, after all, Blackstone–Invitation Homes benefitted from the dialectic of market distress and market recovery as much as it did from rent gaps; Carnegie–Hembla, by contrast, was for Blackstone *just* about rent gaps – any housing-market distress in Sweden resulting from the financial crisis had long since dissipated by the time Blackstone arrived. Meanwhile, as in the US, Blackstone did indeed sell: in September 2019, less than three years after it had taken control, Blackstone offloaded its majority stake in Hembla to Germany’s Vonovia for 12.2 billion SEK, the equivalent of around €1.14 billion, earning itself a reported profit of around 6 billion SEK in the process (Thór, 2019).

Partly, of course, what Vonovia was buying was a business – Hembla – that was now generating more income than when Blackstone had invested: it had more residential units, and each unit was generating a larger average rent – total annual rental income had therefore increased from 1.28 billion SEK in 2016 to 1.79 billion SEK in 2018. But Vonovia was also buying the future, enticed by the very same calculus that had lured Blackstone – the rent-gap calculus. Yes, Blackstone had successfully closed the rent gap on those apartments it had renovated. But the majority of Hembla apartments – some 74% – still remained to be upgraded at the end of 2018. Vonovia had evidently been watching Blackstone in action and seen its success. What it bought into in 2019 was the potential rents on unrenovated apartments, as much as the capitalised rents on renovated ones. The wheel continued to spin.

In Copenhagen, however, things did not prove so straightforward. It will be remembered that in 2017–2019, Blackstone bought some 160 residential properties, containing around 2300 units, in Denmark’s capital city, concentrating, as in Stockholm, on older stock in need of renovation. Its investment strategy was, as far as can be discerned, precisely as in neighbouring Sweden: buy it, fix it, and sell it. In Denmark, its ability to lift rents upon carrying out renovations derived from the provisions of section 5, subsection 2 of the country’s Housing Regulations Act (1996). This clause enabled landlords to significantly increase rents on units (except those in buildings containing six or fewer homes) when previous tenants vacated them, if they spent a minimum of approximately 250,000 kroner per unit on renovations. It did so by allowing a transition from regulated, cost-based rents (i.e. capitalised rents) to deregulated market rents (potential rents), the latter of which, as we have seen, in Denmark are typically substantially higher than the former.

This, then, is what Blackstone did. Aided by local partner 360 North, which it subsumed during 2019, Blackstone set about renovating its Copenhagen stock at an even more dramatic pace than in Sweden. By January 2020, it was being reported that, already, around half of the apartments
Blackstone had acquired in Copenhagen had become vacant, had been renovated and had then been re-let at substantially higher rents (Hecklen and Nielsen, 2020).

But all was not settled. In Sweden, Blackstone’s activities certainly attracted robust criticism: an August 2019 opinion piece in *Expressen* by Marie Linder of the tenants’ union, titled ‘Profit-maximizing companies are destroying our homes’, was typical – Blackstone, she claimed, carried out only cosmetic (but nonetheless highly disruptive) renovations, it overlooked capital works that actually needed to be done, it skimmed on maintenance, and it hiked rents as high as it could, with the result that poorer residents were rapidly being displaced (Linder, 2019). This was as nothing compared to the storm that Blackstone provoked in Denmark, however. Criticism reached the very highest level of the government: In pledging stricter legislation to control housing costs in the capital, Denmark’s new left-wing government singled out Blackstone in October 2019 for what it described as ‘unsustainable’ practices. ‘An American private-equity fund is purchasing our houses’, exclaimed Prime Minister Mette Frederiksen (cited in Buttler, 2019). ‘Does greed know no boundaries? Apparently not’. Indeed, the fact that Sweden’s politicians, by contrast, had remained quiet, evidently supine, in the face of Blackstone’s works, was precisely one of Marie Linder’s complaints.

So intimately and quickly in Denmark did Blackstone become associated with the ‘buy it, fix it, sell it’ approach and its seemingly negative ramifications that the aforementioned statutory clause enabling renovation-based rent increases, namely *boligreguleringslovens* § 5, stk. 2, soon became known by another name: ‘Blackstone-paragraffen’ – the ‘Blackstone clause’. Moreover, numerous Blackstone tenants lodged complaints about rent levels with the Rent Board; of the 23 cases decisioned by October 2019, Blackstone lost no fewer than 20 (Sommer, 2019). And observers were minded to ask, too, how it was that Blackstone had been able to renovate so much of its acquired stock in such short order – were natural tenant turnover levels really that high? Allegedly not: In late 2018, the national daily newspaper *Berlingske* reported that 360 North was putting pressure on tenants to vacate properties in order that renovations could be undertaken and rents lifted: ‘In LLO Hovedstaden [a local tenants’ organisation representing about 33,000 households], we know of several tenants who have been offered “very large” sums of several hundred thousand kroner by 360 North to move’ (Jensen, 2018). So lucrative, seemingly, was the profit to be made from closing the rent gap.

Stung by all the criticism, Blackstone changed 360 North’s name to Kereby, just as in Sweden it had turned Carnegie into Hembla – indigenous names suggested a friendlier face. Moreover, unlike in Sweden, Blackstone in Denmark also made a much more significant change. It reviewed rents at the c. 1000 renovated units on which rents had been lifted and it determined that the rent should be lowered on around 300 of them. ‘The purpose of the rent reductions’, Kereby’s operations director told reporters in January 2020, ‘is satisfied customers and a better image’ (cited in Hecklen and Nielsen, 2020).

It is possible that this concession was in part an attempt to stave off the new housing regulations threatened by Denmark’s new government. If so, the attempt failed. Later that same month, the Danish parliament reached an agreement on new legislation. Passed in June 2020, and entering into force in July, the law – the so-called ‘Blackstone-indgreb’, or ‘Blackstone intervention’ – aims to preclude future opportunistic ‘buy it, fix it, sell it’ investments. It prohibits landlords from offering tenants money to vacate.
More importantly, it states that after buying and renovating properties, five years must elapse before rents can be lifted in accordance with the abovementioned ‘Blackstone clause’. There is, however, a ‘green’ exclusion: the five-year waiting period does not apply if a property’s energy class is raised by at least three levels or energy improvements of at least 3,000 kroner per square metre are implemented.

In sum, having initially enjoyed considerable success, Blackstone’s rent-gap-closure strategy has latterly encountered significant difficulties in Denmark. Closure did not fully hold in respect of 30 percent of the units that it had renovated. And, unless it can make profitable use of the aforementioned green exclusion, the firm’s ability to close the rent gap on property not yet renovated now appears to be constrained. It is certainly noteworthy, at any rate, that Blackstone remains invested. If the strategy was indeed ‘buy it, fix it, sell it’, the ‘sell it’ part is yet to be successfully executed.

Blackstone has not exited in Berlin, either, where, as we saw earlier, it used its Blackstone Property Partners Europe (BPPE) fund to purchase around 3700 residential units in 2017–2018; and where, as we also saw, ‘buy it, fix it, sell it’ – thus closing the gap between in-place, capitalised rents and market-level, potential rents – was again the stated strategy. ‘We are focused on upgrading and maintaining the units in our portfolio to a high standard’, Blackstone (2019: 22) said in BPPE’s annual report for 2018.

Up until the end of 2018, everything appeared to be going to plan. Not only had BPPE acquired stock rapidly, and at scale. But it had also begun the job of rehabilitation, albeit not quite with the alacrity demonstrated in Copenhagen. ‘We have refurbished and released 203 units and invested €11 million of capex into our [Berlin] portfolio during 2018’, Blackstone (2019) reported at the outset of 2019. ‘The large majority of our vacancy is driven by ongoing refurbishment works’. It did not say by how much it had been able to lift rents on those refurbished units. But it did indicate that, as in Sweden, it was having no problem in finding tenants for those dearer units. With residential vacancy across Berlin standing at what Blackstone described as ‘frictional levels’, occupancy of BPPE’s own residential units in the city – adjusted for vacancy due to refurbishment – was at 97%.

Blackstone continued with the renovations in 2019: another 324 units were rehabilitated that year, at a cost of €29 million (2020: 24). But it did not continue to acquire stock. In fact, over the course of the year, BPPE’s Berlin portfolio shrunk, though only minimally – from 3717 units at the end of 2018 to 3714 units at the end of 2019. (Unit numbers had increased in south Berlin, but declined by slightly more in the centre of the city.) Having established investment momentum during 2018 and having shown every sign at the end of that year of possessing an appetite to build the portfolio further during the following year, Blackstone had abruptly halted. And, as it told investors in BPPE, this halt was not happenstance. It was policy. ‘While we continue to believe in the long term fundamentals of the Berlin residential market’, Blackstone said in the fund’s 2019 annual report, published in early 2020, ‘we are no longer actively acquiring residential assets in Berlin’ (Blackstone, 2020: 26). Why not?

Because Berlin had introduced rent controls. In January 2019, local politicians from the SPD (Germany’s centre-left Social Democratic Party), which runs the city in a coalition with the Greens and the Left Party, announced a proposal to impose a five-year rent freeze to ease the growing burden on the city’s renters, who had seen rents double in the decade since the financial crisis. Berlin’s leading landlords, led by the
goliath Deutsche Wohnen, raised vociferous opposition to the SPD proposal and lobbied intensively during the course of 2019; but to no avail. Despite hostility to the plan from Chancellor Angela Merkel and her Christian Democrats, the local coalition held firm. The new rent regulation, the *Mietendeckel*, was passed by Berlin’s legislature in January 2020 and came into effect on 23 February 2020. Homes built after 2014 were exempted (as a way to encourage continuing new construction), as was social housing; but, according to Berlin’s Department for Urban Development and Housing, that still left around 1.5 million apartments that fell under the terms of the regulation.

The regulation had several components. First, rents on existing leases were frozen for five years at the level they were at on 18 June 2019; and after those five years, increases would be limited to the rate of inflation. Second, prices on new contracts were capped at a range of monthly maximums depending on building age and topping out at a *Kaltmiete* (‘cold rent’, which is before utilities) per square metre of €9.80 – or €10.80 if renovated. Third, tenants whose existing rent was more than 20% higher than the cap could apply to have theirs lowered.

Little wonder, then, that Blackstone ceased investing. Its stated rationale for halting investment was, in the event, relatively restrained: ‘given the recently approved rental regulations’, there was, it contented itself with saying, ‘considerable uncertainty’ about prospects for Berlin’s rental housing market (Blackstone, 2020: 26).

In contrast to the situation in Denmark, however, events would subsequently swing back in Blackstone’s favour in Berlin. In April 2021, Germany’s highest court ruled that Berlin’s *Mietendeckel* was unconstitutional and hence null and void. A glance at BPPE’s annual report for 2020, published the previous month, indicates just how impactful this striking-down is likely to be. Having lifted weighted-average rents on its Berlin-dominated residential portfolio by 6% year-on-year in 2019 on a like-for-like basis, BPPE had then seen rents decline by fully 12%, on the same basis, in 2020 – ‘primarily’ due to Berlin’s rent controls (Blackstone, 2021: 26). Newly inhibited in Copenhagen, Blackstone’s ‘buy it, fix it, sell it’ approach is, therefore, newly unshackled in Germany.

The cases of Invitation Homes, Stockholm, Copenhagen and Berlin tell us a considerable amount about the conditions under which the rent gaps that periodically open up in contemporary urban environments are subsequently, successfully, closed. The first pertinent observation is simply about scale and ambition. One reason that substantive rent gaps are not closed as soon as they materialise is that it clearly requires determination and financial muscle to effect such closure. For incumbent landlord-owners, the relevant costs are those of stock renovation. For new entrants such as Blackstone, there are the costs of renovation and acquisition. Not many property investors are of a sufficient scale and financial wherewithal to undertake the combination of acquisition and largescale renovation that Blackstone pursued in say Sweden or the US; perhaps no others, meanwhile, would be big enough, not to mention motivated enough, to undertake the strategy in Sweden, the US, Berlin and Copenhagen more-or-less simultaneously.

The point about motivation and ambition is critical, because it speaks to a certain corporate mind-set that Blackstone has shown to be invaluable. It is not just about being motivated; it is arguably necessary to be aggressive, too, as Blackstone clearly was, for instance, in Denmark. And, similarly, it is necessary to be remarkably tolerant of criticism. Blackstone has received widespread rebuke for its practices in every
country where it has applied the ‘buy it, fix it, sell it’ approach to residential housing investment, but only in Denmark, to the best knowledge of this author, has it ever taken so much as a step backwards when in the line of fire. Closing rent gaps is not for the faint-hearted; it is the territory of capitalists red in tooth and claw.

Maybe the most significant learning from the cases at hand, however, is that closing rent gaps requires accommodating regulatory and political milieux. A turning of the political tide and subsequent regulatory transformation has constrained, if not crushed, Blackstone’s Copenhagen venture. Meanwhile, while local politics and regulation temporarily hobbled its Berlin venture, that venture has been revivified partly due to national politics: the successful legal case to overturn Berlin’s rent controls was brought by landlords backed by politicians from the conservative Christian Democratic Union/Christian Social Union alliance and the pro-business Free Democratic party (Connolly, 2021). Similarly, Blackstone succeeded in closing rent gaps in Sweden and the US because politics and regulations allowed it to do so. The US case highlights, of course, another crucial learning, which is that closing rent gaps is also often about power: one reason Invitation Homes remained able to continue to close the rent gap in California is that in an environment where Blackstone is a powerful lobbyist, legislators and then the general public voted in 2018 against enabling municipalities to enact meaningful rent controls.

Finally, demand is key. Partly this is about demand for rental housing, and specifically, at the inflated rents that the closing of the rent gap by its nature entails. The fact that Neil Smith’s ‘potential rents’ are only ever potential, until realised, cannot be stressed enough: any substantive flagging in Sweden, the US, Berlin or Copenhagen of demand for rental housing, or of the purchasing power required to monetise that demand at higher rent levels, would have been ruinous for Blackstone. It did not happen, or has not yet; but such things cannot be reliably predicted. They require good fortune – as, needless to say, does the other crucial element of demand upon which ‘buy it, fix it, sell it’ depends: demand among other investors to take rehabilitated rental housing off Blackstone’s hands, thus enabling it to crystallise its gains. Stock-market flotation gave Blackstone a profitable exit in the US; sale to Vonovia gave it a profitable exit in Sweden. But such exits are not always available – and may yet not be in Berlin and Copenhagen.

One of the main criticisms of Smith’s rent-gap theory during the 1980s and 1990s was that it was considered overly abstract. The plotting on a diagram of curves for capitalised and potential land rents (Smith, 1979: 544) seemed to suggest that the process for which Smith posited the rent gap as explanation – the inner-city redevelopment associated specifically with gentrification – was almost mechanical in nature; after all, his curves appeared not unlike those used by orthodox economists to trace the movement of market prices in terms of the abstract dynamics of supply and demand.

A key contribution of Wachsmuth and Weisler (2018), López-Morales et al. (2019), Teresa (2019) and other recent analysts of actually-existing rent gaps has been to show that the processes whereby such gaps are opened up are in fact shot through with the messy, overdetermined and geographically-variegated realities of technological change, government regulation and the like. A no less important contribution, however, has been to show that this does not gainsay Smith’s core insights. The opening of rent gaps is a social and political process, to be sure, but it is nonetheless also a market one.
The contribution of the present article has been to show that the same is true of the closing of rent gaps. In fact, very similar contingent factors – ranging from regulatory and political context to landlords’ investment ‘culture’ – have been shown to apply. This is not unexpected. Whereas in Smith’s own work and in early evaluations of rent-gap theory the focus tended to be on the role of falling capitalised rents in opening rent gaps, recent work such as that cited in the previous paragraph has tended to focus more on the effect of rising potential rents. But then, the analysis generally stops, without addressing the question: Are rent gaps successfully closed, and if so, through what mechanisms and under what conditions? The present article complements the existing literature by showing that the factors that explain where and how capitalised rents are indeed lifted to the level of potential rents are comparable to those that explain why potential rents diverge substantively from capitalised rents in the first place.

### Conclusion

There has arguably never previously been a major global investor whose principal avowed strategy in the residential property space is precisely to close urban rent gaps, and that has set about implementing that strategy with the vigour that Blackstone, the Wall Street asset management firm, has demonstrated in recent years. As such, Blackstone’s experience affords an unprecedented opportunity for analysts of urban socio-spatial transformation to learn more about contemporary rent-gap dynamics.

This article has considered the four main countries in which, during the period since the global financial crisis, Blackstone has pursued its ‘buy it, fix it, sell it’ approach to housing investment: Denmark, Germany, Sweden and the US. In all four cases, Blackstone has identified rent gaps, acquired the relevant housing stock, renovated it and lifted rents – from the ‘capitalised rents’ that constitute the lower bound of the rent gap to the ‘potential rents’ that constitute the upper. In Sweden and the US, Blackstone has also successfully sold as well as bought and fixed, thus realising the profits occasioned by rent-gap closure. In Denmark and Germany, however, it has not; things have been less straightforward. The common theme in these latter two countries is that left political parties have forcefully questioned and (albeit only temporarily in the German case) actively curtailed Blackstone’s capacity to bridge the gap between capitalised and potential rents.

If there remains a significant gap in our understanding of rent-gap dynamics, it is not so much in understanding how rent gaps are closed (or indeed how they open up in the first place), but rather why they frequently are not closed when they do open. The paradox, in places such as Denmark and Sweden, is that vast gaps between capitalised and potential rents were not more aggressively and comprehensively exploited long before Blackstone arrived on the scene to do the job. Why were they not? This article has offered tentative suggestions, but no more than that. This, as much as anything else, is where further research is required. If we can understand what is going on when rent gaps are not closed, then perhaps we can also contribute ultimately to making rent gap theory – the theory that, under existing political-economic conditions, such gaps inevitably will sometimes open up and will eventually be closed for private gain – not true (c.f. Clark, 2014).

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Notes

1. Note that Blackstone was not new to the German/Berlin housing market. Most notably, it had acquired c. 15,000 apartments, predominantly in the capital, from the failed property group Level One in 2011–2012. But that had not been a ‘buy it, fix it, sell it’ proposition. Its investments in German/Berlin housing via BPPE and beginning in 2017 were, and these are the exclusive focus in what follows.

2. By ‘reversionary’, Blackstone presumably meant that rents were expected to revert to market prices once the necessary action – here, renovation – was taken.

3. To be clear, this refers to a one-time step change in rental income that is then sustained at that increased level – not additional and incremental increases of the same scale each and every subsequent year.

4. Christophers (2021a) provides a fuller analysis of how and why US single-family housing became an asset class for financial investors such as Blackstone after the financial crisis; Christophers (2021b) examines the role of the state in this.

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