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State of the Market 33: There is a tide

By David A. Smith

There is a tide in the affairs of men,
Which, taken at the flood, leads on to fortune;

A month after delivering the remarks that formed the kernel of *State of the Market 31: Building stronger sponsors*, I spoke to two separate national gatherings, one of developer-owners, the other of equity syndicators. Each time the audience was hungry for perspective on the subject now generating so much anxiety in the affordable housing industry: *Where is our industry going?* As my answer evolves, it is currently this: *We are not an industry yet*. A cottage industry is not an industry.

And we had best come together into one quickly, because the ecosystem is undergoing profound structural realignment and its tides are turning.

Omitted, all the voyage of their life
Is bound in shallows and in miseries.

Becoming an industry is far from easy, for it requires reshaping one's own business to make the value-chain linkages work better for the ecosystem – no one can survive alone inside a dwindling or dying ecosystem. That involves, I think, at least the following five principles:

1. Translate affordable housing results into bank-speak

Have you ever been merging onto a highway only to be elbowed aside by an intruding bus? Despite having the right of way, you deferred, because he's bigger than you are and in a clash, he'll be ruffled and you'll be totaled. That's affordable vis-à-vis its other industries, such as banking or conventional residential. For all our $6 billion a year of equity, we are tiny in comparison, so we always get short shrift

"Which taken at the flood leads on to fortune"

versus banks, single-family, or even conventional rental.

Moreover, among ourselves we insist on speaking our own dialect – equity cents per LIHTC dollar, AMI percentages – that does not map effectively into standard financial ratios like FFO or same-store sales.

If we want larger sectors to see us as an industry and not a sideshow, *we* have to learn *their* language, because they will not bother to learn ours. Stop fuming about consolidation being unfair or misrepresentative – FASB will not redo its principles for us – and instead figure out how to comply with FIN 46 while also presenting a better perspective on reality (such as with two balance sheets, one fully consolidated, the other presented as supplementary schedules by functional units). Harmonize with REIT reporting and pull into affordable housing financial statements any key performance indicators used in broader real estate segments.

2. Grasp the two-edged sword of transparent data

Pool your data, in an institutional-grade form – standardized classification, rigorous and consistent compilation, and transparently

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accessible – and take the consequences. An effective affordable housing *industry*, with serious financial performance metrics, will mean that some players fail … but more players will fail if the issue is evaded.

Financial markets live and breathe data. Pick a publicly traded stock, and with a few Google clicks you can call up an astonishing breadth, depth, and granularity of reporting data. Try that with affordable housing. Want to know the average operating expenses for LIHTC family properties in Texas? Impossible. Something is wrong with our industry when we can find out more about the typical Facebook user than about a particular LIHTC property.

For over 20 years, the LIHTC universe has avoided data transparency. We've grumbled at the compilation cost. We've cited proprietary advantage. We've whined that ratios cannot capture the diversity of our experience. We've rationalized that our regulated apartments can't be compared with unregulated apartments. We've been unwilling to fund the cost of an accessible platform, either on an open-source or members-only basis. And the financial markets have assumed we refuse to publish because we fear the comparisons – as the world becomes increasingly transparent (see *State of the Market 10: The Bank of Glass*), that approach is unsustainable.

When the broad capital markets cannot quantitatively measure a business, they decline to invest in it. Our stubbornness cost us in 2008 and 2009, when our usual investors disappeared and none new were ready to take their places. Though we are out of those woods now – cross your fingers – who can say when next we'll need the broader marketplace? To have continuous market access, we should be doing the following:

- ***Settle on a standardized chart of accounts,*** consistent with conventional apartments, and report to that on a supplementary schedule.
- ***Agree on a set of accessible key performance indicators,*** like Effective Gross Income per apartment per month, Economic Occupancy (including concessions, bad debt, and collections losses), year-over-year NOI per apartment per year, and current liquid capital per apartment.
- ***Publicly compare our operating performance with REITs.*** I can feel you flinching now, but until we lay our results alongside the unregulated inventory, how can anyone develop cross-sectoral perspective?
- ***Aggregate our data in a central Web-based repository.*** Non-profits' financial statements are on Guidestar; why aren't property operations on (say) RentStar?
- ***Accept that low performers will be exposed.*** Some of us will reveal that we don't add value, and will openly fail. Do you think they won't fail otherwise?

3. As we scale up, define ourselves clearly by what we do not do

The greatest hitters swing at the lowest percentage of pitches. The art of business strategy, as distinct from scavenging, lies in choosing what not to do and then adhering to not doing it, even in the face of economic fasting.

Focus discipline is equally important when one is linked with others in an extended hybrid value chain; as we stray into new businesses, we may wittingly or not compete with our value-chain collaborators. Lenders may want to be investors, or syndicators to be asset managers, even developers.

Each new business we enter opportunistically requires us to learn a new set of skills, and maintain those skills throughout the investment cycle. It grows harder to compete when there are already incumbents with whole portfolios on which they perform the function that we are now trying out for the first time. Eventually we are stretched in too many directions to be truly dominant in a few—and have lost the goodwill of those who were once our partners.

For a maturing organization, the moment of wisdom comes when you clearly define yourself, retreating from spaces occupied by others that either have enduring proprietary advantages or natural symbiotic partnering with your core competencies. At Recap Real Estate Advisors, for instance, we recently refocused what we do. It's the first line of our Web site, only seven words: *real estate advisory services for multifamily housing*. We've clustered our service offerings into broad categories – transactions, due diligence and advisory, asset management, and capital planning through our subsidiary On-Site Insight – that are all recognized terms in the broader real estate industry (see Part 1 above) and readily graspable. Under these, of course, we have particular specialized products and services with high levels of granularity, and with which we customize for client benefit. We reject business that falls outside those seven words.

Take the time to define your company by what you need done but will not do yourself. That in turn will reveal your strategic partners and the sideline businesses that you may cherish but must give up.

4. Protect brand as a pervasive and self-consolidating asset

Brand is who the world perceives you to be, and it knows no boundaries. Your reputation is the agglomeration of all that is seen or reported or read about you, and you cannot directly control it. Time and again we have seen that when one member of a group is tarred – rightly or wrongly, but preferably via a vivid YouTube visual – the whole group gets blackened. In the Twitter age, "Ignore the scoundrels around me, for *I* am an honest person" is not a communications strategy.

You are who do you business with. Give your customers your best and expect the same from others. We provide genuine value to residents in the properties we work so hard to develop, operate, and maintain. But reputational damage can spread up and down the value chain. An equity fund implosion hurts us all, as does the failure of a portfolio owner, or even a rats-roaches-and-bad-plumbing story on cable news. An on-site employee using a racial epithet to a resident holding a cellphone camera is a brand catastrophe right up there with a fire.

Since the risk cannot be prevented, it must be mitigated – by escrowing brand equity through building up a positive reputation, not just for ourselves but for our colleagues and counterparties. This is more than mere everyone-has-won prize-giving at trade association gatherings; it involves rethinking our attitudes toward our partners, counterparties, stakeholders, and most importantly our competitors. Absolutely compete their brains out, but praise the competition. Take a page out of the NFL's playbook and grow the game, not just our own won-loss record.

5. Embrace certification and licensing as the key to evergreen flows

Why have CDFIs, in only fifteen years, risen from nothing to a position of dominance and scale, while affordable housing developers and owners, who predate them and outnumber them, are struggling with overcapacity and undercapitalization? (See *State of the Market 31: Building Stronger Sponsors*.) In a phrase, they benefit from evergreen cash flows coming from government in to the entities themselves. How gained they this wellspring? By being certified and strongly regulated at the enterprise level.

You don't get evergreen concessionary capital without strong governmental oversight – so we have to choose regulation by property or by sponsor. I believe that, twenty-five years ago, we unwittingly chose wrong.

In LIHTC, we hyper-regulate the property but leave the sponsor unfettered. As I've written before, notably in *Tax Credit Advisor*, we could reverse that polarity, accepting the bridle of sponsor-level regulation and supervision in exchange for release of property-level restrictions. We could, in short, REIT-ize affordable housing if only we would limit the

ownership to what in the UK are called 'Registered Social Landlords.'

We could get there – say with a 'social-investment preferred stock' to capitalize *only* those mission entrepreneurial entities willing to accept wholesale data transparency, strong capital regulation, certification licensing and potential decertification and disbarment. Such a trade would attract those entities with a genuine bottom-line orientation, and repel those only in it for the money.

Coalescing from a sector into an industry often takes a galvanizing event, and two loom on our horizon – resolving the GSEs (Fannie Mae and Freddie Mac), and updating the Community Reinvestment Act. Do we have it in ourselves to behave like an industry-in-formation, or will we revert, as we have done in the past, to every-subgroup-for-itself?

On such a full sea are we now afloat;
And we must take the current when it serves,
Or lose our ventures.

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