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State of the Market 34: What is an industry?

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And why aren't we one?

Last month's *State of the Market 33, There is a Tide*, focused on the sea change now taking place in not only the American economy broadly but also the affordable housing ecosystem. With the severe recession showing no signs of fading away, and with several million homes in default or foreclosure, the nation is focused on housing affordability as it has not been for more than four decades.

This ought to be a time of great energy and initiative in affordable housing, a time when the affordable housing *industry* is seen as a critical delivery system for an essential component of national infrastructure – and the industry's proposals are greeted with acclaim and enacted.

What proposals? Where the heck is the affordable housing industry?

In our ecosystem, how can competitors collaborate?

An industry is more than just a club in which like-situated entities get together for war stories and gripe sessions – instead it is a national ecosystem of entities that interact in network fashion in an extended value chain. Key to the ecosystem's vitality is when the industry understands the collaboration paradox – that those who compete on individual transactions must also collaborate at a larger scale, to strengthen the ecosystem as a whole.

Our ecosystem has eight types of organization, each performing a specific function:

Pulling together – a novel concept in affordable housing advocacy

- **Developers** (large and small, for-profit and non-profit) convert vision into proposals, and resources into new affordable properties. It's the most entrepreneurial activity in the value chain, and hence the riskiest.
- **Allocators** through-put government subsidies both income and capital-based, both equity and debt. The species is dominated by the state housing agencies, but also includes local and national resource providers.
- **Lenders** originate new loans that they then resell to Fannie, Freddie, FHA or into the secondary markets.
- **Equity syndicators** convert promises of LIHTC tomorrow into development cash today.
- **Investors**, whether motivated by CRA, yield, or a combination of the two, buy equity positions in LIHTC properties and funds in pursuit of stable long-term after-tax yields.
- **Owners** (both those that inherit the function because they are attached to a developer, and those who acquire the real estate or controlling interest) take the ongoing risk and responsibility over properties when they are completed and occupied.

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- **Property managers** provide the complex technical expertise to operate the real estate day to day, without bearing the ownership risk. They are integral actors because this asset class is complex and requires a service performed by specialists that combine scaled platforms and infrastructure with highly customized local knowledge.
- **Specialized consultants** interface among the other participants to enable participants to enter new fields of business, and allow outside money to enter. Like property managers, they are integral actors because the business's complexity requires expert guidance.

Specialization, caused by scaling and competition, is a sign that a business sector is maturing. For its success it requires increased collaboration across roles and information dissemination throughout the ecosystem. To some degree we see these now in affordable housing, as there is plenty of information dissemination – but those effects by themselves do not make a business sector into a functioning industry.

What is an industry?

To be an industry requires something more than just gathering together at association seminars – it represents a conscious cohesion that the participants adopt in recognition of their mutual symbiosis. More significantly than mere differentiation by function, an industry embraces the value of complementarity and interdependence, and actively protects the health of the entire value chain and ecosystem. This includes these elements:

- Dependence on common resources (in affordable housing, government subsidy and financing programs of myriad types).
- Commitment to grow the resource and activity ecosystem *as a whole*, not merely increasing one's own market share.
- Recognition of common interests in a healthy market, even while providing divergent functions or competing with similar providers.
- Collaboration across competitive sectors in the face of ecosystemic threats, not squabbling, blaming others, or actively undermining them.
- Certification, admission, and expulsion to assure quality via self-policing, rather than relying on or even resenting external quality-assurance forces like regulators.

We see these behaviors in the legal or accounting professions, in conventional banking, and even in conventional apartments. Each of these groups has recognizable codes of ethics, certifications and certifying agencies, and enforcement protocols.

Most importantly, *an industry has message coherence and message discipline*. You know what the Home Builders or the Realtors stand for, and when the time comes for their voices to be heard in Congress, it is a chorus, not a cacophony. In affordable housing, I feel like Will Rogers, who more than seventy-five years ago said, "I don't belong to an organized political party. I'm a Democrat."

Why do we need to become an industry?

Affordable housing depends on government resources for the cost-value gap closure that makes individual properties feasible – so in a core sense, our whole ecosystem is collectively a government counterparty. To be an *effective* counterparty, we must unify into an industry, via some bedrock principles on which we publicly agree, regardless of our organization's role in the value chain, regardless of our individual competitive position – and declining short-term subgroup patches in favor of long-term viability for the whole ecosystem.

Our squabbling over ARRA shows how far we have to go. As a result of our inability to unify, all we got was the TCAP loan patch and the Exchange proposal, and those poorly vetted and (as a result) long in delivery.

While the Exchange may have saved some properties in the pipeline, it retarded the re-establishment of LIHTC pricing support, and hence slowed down most of the 2009 and 2010 production by distracting developers, allocators, and lenders. Now we've gone all through 2010 with many of us investing energy, political and otherwise, in a one-year renewal of the Exchange, only to come up with nothing. We would have done better to have no Exchange and watch the LIHTC market come back.

Can we learn from that experience? The several million homes in foreclosure could be turned into affordable housing, workforce housing, non-profit co-operatives, or other new tenure and income forms. They ought to be the raw material for all of us to be busy beyond imagining. For that to happen, the properties need resources, and we'd want them to flow through our hands – but we can't just ask for a big check with the claim we can 'do it.' Do what? How? We need to define a collaborative solution that takes advantage of this opportunity.

What would make us an industry?

An industry always finds ways to increase its aggregate market. For affordable housing, this means constantly boosting efficiency and using those efficiency gains to earn larger aggregate subsidy resources (applied to an expanding universe of property types). What things could we do to increase our aggregate market?

1. **Standardize a chart of accounts consistent with the REIT model**. Cottage industries have parochial formats, no two of which are compatible with each other. That keeps outsiders from validly criticizing your performance … which also keeps them entering your market. And it keeps your market small, by keeping it opaque and unable to attract more resources.
2. **Pool real operating data and make it transparently available at no cost**. Standardized reports are just the first step toward full portfolio-level transparency. When that happens, efficiency rises sharply, and cost of capital drops equally sharply. Look at the explosion of services that have arisen from GPS data, whether Google Maps or Zillow home price comparisons. It is fundamentally absurd, and embarrassing, that in two minutes I can learn more about the home an HFA executive director lives in than I can learn about the operating expenses of any FOIA-reporting property in that HFA's portfolio.
3. **Collaborate to drive down soft costs**. Over time, efficient businesses commoditize and scale information, and use that leverage to minimize intermediary and soft costs. It happened in the securities brokerage and money management businesses; it is now happening in the real estate brokerage business. The LIHTC business stubbornly refuses – and it's not because we're all such geniuses that mortals cannot comprehend us. Rather, the high soft costs are a function of the overly specified LIHTC statute, the over-engineered LIHTC value chain, and the parochialism of small funders each of whom wants to imprint their own requirements on an already over-regulated property. Efficient businesses get soft costs down, and redeploy the brainpower thus liberated into more productive and no less challenging goals, like

growing the aggregate supply and demand.

4. **Via transparency, discover broad areas of industry-wide agreement**. Sure, we'll always squabble about details, but we should agree on big principles. By making claims checkable, transparency and efficiency help us visualize our points of agreement and places our technical disagreements into context.

5. **Expand aggregate investment demand and diversify demand sources**. During the equity-boom heyday, we all got lazy and allowed a dangerous, and in hindsight foolish, overconcentration of demand. Now many of our colleagues are relieved that demand is back – but at what price, and over what part of the country? An industry always has enough excess demand so that the withdrawal of any one major actor, or even of a whole cohort of actors, means a smooth change in pricing and not a discontinuous collapse or market freeze. What are we doing to assure reliable, evergreen, national-level demand?

6. **Have no more than three national policy priorities, and constantly advance them**. Quick – what are the three most important positive goals for the affordable housing industry to achieve? You can't name them? If you did, others would vehemently disagree with you? An industry, as opposed to a motley crew of like-minded actors, makes its case consistently, professionally, broadly, and clearly. We don't.

Will economic pressure forge us into an industry?

For fifteen straight years the LIHTC business had nothing but success – ever higher prices, ever greater demand, ever deeper targeting, even legislative wins like indexing – with few losses and minimal downside. We all read and touted the statistics saying the program's failure rate was ten times better than conventional apartments. Believing our own press clippings, we saw no need to unite on messaging or on ecosystemic protection.

Now we do need action. The financial system is being remade about our ears, and with it the external environment that will determine LIHTC's viability. In 2011 a divided and already fractious Congress will grapple with huge reforms that will shape our next universe. The GSEs will have a new form and mandate. CRA will be revamped.

What is affordable housing's position on these issues?

Any industry that doesn't know what it wants is certain not to get it.

Affordable housing had better become an industry soon, or fundamental reform will have occurred and we'll be wondering why, once again, we were left out.