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# State of the Market 39: 2016, Housing's imminent future

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Having taken a little time off to visit the future (always a refreshing thing to do during economic troubles), I have returned with nine 'future truths,' technically known as 'predictions' to avoid violating the laws of temporal paradoxes.

(I had ten predictions but budget cutbacks forced me to eliminate one.)

The ecosystem of affordable housing policy is entering the most dynamic period since the invention of LIHTC a quarter-century ago; those who take these predictions to heart will earn their friends' undying gratitude by forwarding this essay to them.

By 2016, five years hence:

## 1. All operating data will be electronic, transparent, consistent, comparable, and upscaled

As an asset class, American multifamily apartments are the world's best, largely because American multifamily capital finance (large pooling capacity of both debt for securitizable pools, and equity via REITs) is the world's most efficient. These capital pools in turn rely on quality electronic data that is reported regularly and consistently. Yet, though American affordable housing is equally world class, our data collection and reporting systems are obsolete and incompatible with each other, much less with conventional multifamily systems.

Within five years, under pressure from the capital markets (including Fannie, Freddie, and FHA), affordable housing will adopt standardized reporting using the REIT metrics. To access scalable capital, get used to same-store sales, FFO, and a host of other terms that though verbally incongruous to us are what Wall Street wants to see.

"The future is hurtling toward us at the speed of time!"

## 2. A quarter of all sponsors will have quietly gone away

Scarcely a prediction, this is an unvoiced fact. The production-oriented business model of so many smaller LIHTC sponsors was predicated on continuously winning the next allocation to cover the cash flow deficits of the last development. No longer is this viable: now, with capitalization and liquidity differentiators between the quick and the dead in new equity placements, many of these weaker sponsors somehow gasped their pipeline property through to equity closing, and then quietly retired from the development arena.

## 3. Public housing authorities will be decontrolled

Under public housing's 75-year-old use covenant schema, properties are condemned by their tenancy and rent-setting policies to negative Net Operating Income.

In theory, the federal government closes the gap with sufficient Operating Subsidy (for expenses) and Modernization Funds (for capital improvements and upgrades). However, a succession of Administrations and Congresses has persistently underfunded both Op Subsidy and Mod

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Funds, resulting in an inventory – an irreplaceable national asset with an aggregate replacement cost well in excess of $150 billion – that is obsolescent and deteriorating.

A recent HUD study pegged the public capital backlog at $26 billion (which has to be regarded as the absolute minimum capital recovery requirement). The rehab required cannot be funded under the current use covenant. Hence decontrol will happen to public housing, simply because HUD will need to distance itself from responsibility for paying the looming cost.

## 4. The GSEs will be run as national public utilities, with multifamily split off from single-family

Conservatorship, though necessary as a stopgap, prolongs uncertainty over the Federal financial obligation (currently $138 billion and counting) and hobbles the GSEs' capacity to innovate, an essential attribute the country needs. Exit, therefore, will clarify the rules and boost the recapitalized GSEs' value.

That exit will be into an explicitly chartered institution with an explicit Federal credit guarantee up to a certain level, but no more.

The recapitalized GSEs will be operated as private companies (private governance and entrepreneurial motivation) that are effectively public utilities (public oversight of business activities, risks and mitigation, and profitability).

Moreover, given the significant differences between single and multifamily housing, why glue them together? Why not have one GSE devoted to each? Their current charters are the result of historical accident and empire building, not sensible design. Multifamily, easier to accomplish, will probably come first.

## 5. A reinvented CRA will apply to all financial institutions and capital providers, including insurers

Reinvention of the Community Reinvestment Act ("CRA 2.0") has been overdue for more than a decade, but no one wanted to mess with perceived success during the Great Illusory Boom of 2002-2007.

Failure is not so forgiving. Financial catastrophe being a common precondition to financial reform, CRA reinvention will be taken up alongside GSE recapitalization. The two involve parallel policy and political challenges: both of them influence the volume and structure of capital flows into housing, community development, and urban renewal.

The new CRA will be a comprehensive refresh: an expanded universe of covered institutions, broader forms of capital recognized, credit for liquidity and the secondary market, and impact targets based on demography, not fixed geography.

Though it will take the better part of two years to do what (absent lobbying) could be done in two days, when the dust finally settles all stakeholders, including the newly regulated, will realize that the revised system is much less abstract and arbitrary, and much more closely aligned with their logical business imperatives.

## 6. Triple-bottom-line accounting and reporting will be mandatory, quantitative, and omnipresent

In terms of desired outcomes for corporations, in addition to the first bottom line (economics) and the second (social impact) has more recently been added the third (ecology) – but as of today, these last two are merely desires, with no agreed-upon metrics. Certifications like LEED have no teeth and no consequence, so at the moment they are mainly used as propaganda – cited if favorable, ignored if not.

This is in sharp contrast to even the current CRA, where the capital-reinvestment and community-service obligations *are* reported in quantifiable ways, and those ratings have big sharp teeth (denial of bank mergers, for example). Within five years, there will emerge quantifiable and standardized metrics of energy/ green performance, which will also reveal which green/ energy upgrades are cost-effective and which are not.

Social-impact performance metrics will take longer to emerge and standardize, but within five years there will be meaningful studies and the beginning of effective paired comparisons.

The reinvented CRA 2.0 will have a fresh new set of choppers that will bite on both green and social-impact outcomes. So they will result in …

## 7. Social-investment departments will be as big as CRA

Today, CRA-based community development or community lending divisions generate profit, provide an R&D window into lower-income markets, offer a business incubation laboratory, and create leadership development opportunities – all in addition to meeting CRA goals and generating good optics for public consumption. Five years hence, the Social Investment Department (SID) will play a similar role, with similar profitability and mission-criticality for financial institutions.

Already the linkages are visible in outline. Better data drives quantifiable performance metrics, which in turn will be assigned financial consequences via a reinvented CRA, and suddenly there will be a market to be made.

In the mid-1980s, CRA boomed from a combination of stick (bank-merger rating requirements) and carrot (the newly invented LIHTC to qualify as CRA equity investment.) Bank CRA departments will gain new vigor and new resources as they are reinvented upward into Social Investment Departments, where the concept of "risk-adjusted market return" gives way to "triple-impact-adjusted market return."

Professionalizing CRA took the banks three decades. Professionalizing Social Investment will happen much more quickly, because the banks have learned how to do it and because they will need to do it much faster.

## 8. Most of the subprime overhang will have been repurposed into rental

Three years after house prices went into reverse and several million homes went into foreclosure, several million homes are *still* in foreclosure or REO.

These foreclosed homes sit empty, imposing external costs on communities, at the same time, and in the same community, are worthy families seeking affordable housing. These former homeowners will be driven into rental by a combination of credit histories (damaged), tighter lending practices (higher down payments), and disillusion with homeownership as a magic carpet to riskless wealth (mugged by reality).

Cities and states may well decide to satisfy two constituencies with one solution, funding their conversion into new forms of workforce housing.

Retrofitting formerly owned housing to rental will require aggregation, either into neighborhood-level scattered-site developments or by acquiring individual condominiums within larger structures. Both paths will require creating and growing a new kind of mission-oriented landlord that straddles small-property attentiveness with larger-development scalable management systems.

Building the infrastructure – ownership infrastructure of entities, financial infrastructure of resized debt –will take non-recoverable Federal money. Nevertheless, there is no choice. Probably sooner than later, the Administration will realize that the overhanging has to be cleared by funding the buydown of its outstanding debt to levels that can be supported by affordable workforce rental housing, and owned by Mission Entrepreneurial Entities.

Just in time for the coming wave of inflation ….

## 9. High inflation will make owning residential real estate fashionable once again

Inflation is already passing invisibly among us. If CPI were calculated today using the same methodology in place thirty years ago (which unlike today's CPI factored in food and energy), it would be reported at 6-10 percent. However convenient a lower CPI may be for a federal government that links benefit increases to CPI, for those Americans who do have to buy food or energy, inflation is rising and will continue to rise.

Inflation is also reaching residential real estate. Whatever home prices may be doing, apartment rents are rising throughout the country, and have been doing so for five quarters. Multifamily NOI is likewise rising in both nominal and real terms. Though it may be hard to envision today, five years hence people will realize that 2011 and 2012 were great years to buy apartments.

In short, it's feeling like 1978 all over again – with 1980-82 looming in our future.