"Never let a good crisis go to waste"

Those were the words of David Smith, Chairman and Founder of Recap Real Estate Advisors, ironically quoting Rahm Emanuel, as he led an informal discussion with POAH leadership and staff at the POAH offices in Boston, September 27, 2010. David had a lot to say about the future of affordable housing financing in the United States in light of the recent economic crisis and wryly pointed out some of the inherent contradictions in some of the structures. Some of his observations - at times poignant, at times humorous:

- "We are in a time of structural change in the affordable housing ecosystem. The past model has been driven for the past 15 years on a benign finance environment, so we tolerated a lot of inefficiencies and blockages because you could still make the deal work – whatever price you put in your application, the actual raise was better. When the world goes in reverse, and LIHTC pricing falls, you can't do all that. It reveals fissures in the value chain and it calls the whole system's structure into question."

- Affordable housing nonprofits – are they agents or principals? "Once you become the owner, you have many of the operational control features of a principal but the economics of an agent."

- There are two kinds of finance in affordable housing – enterprise finance (of the business) and project or asset finance (of the individual property). Many intermediate nonprofits have their portfolios financed on a project basis, and "as a result, you have a curious effect: the amount of labor you have to do to extract a dollar of cash from a project is massive but once you do, you can do anything you want with it."

- "There is a relationship between which level of the entity you finance and which you regulate - whichever level gets more regulated is more encumbered and has less 'optionality'. Everything before the closing is negotiable … but after closing, everything not mandated is forbidden and everything not forbidden is mandatory."

- Smith suggested that dual role of agent/principal leads to less efficiency and less impetus to accumulate capital. "If you're doing a new deal, you have to say No five times a day just to accumulate a smidgeon of capital."

- The affordable housing industry was formed by the for-profit sector in the 1960s and early 1970s; non-profits were an afterthought. When non-profits got into the industry, they were treated as for-profits with a twist. This led to asset financing and regulation. "This anti-scaling and anti-experience function flows naturally from the fact that you're financing the asset and not the entity, and that the entity is not regulated, the project is." In the United Kingdom by contrast, all affordable housing developers are non-profits and are required to be licensed. Is there a message here?

- TARP money – how does it fit in? "Imagine social TARP – capital with profit-limiting or executive-compensation-limiting strings. Social TARP could be the lubricant by which the non profit sector turns into an industry and becomes the industry that over

time doubles or triples its share of the ownership of affordable housing nationwide. A model of merchant building – one entity creates the property, then sells it at completion to another, larger non-profit owner – would allow for-profits to develop housing and sell them to long term mission-entrepreneurial entities (read non-profits). With social TARP, registered social landlords (RSLs) could sign up to get enterprise level financing on a favorable basis provided they pledged to re-plow all their equity back into mission and subjecting themselves to regulation and transparency at the enterprise level, plus they would have to accept the concept of licensing and the possibility of being shut down and out of business."

- How could this work? If there was something that looked like a nonprofit affordable housing industry that wanted this, with capable members who could provide affordable housing in virtually every region of the country, Smith is convinced the administration could see its way to funnel "some $10 billion through a system that could distribute it out on a capillary basis." Why? "Because, for example, there are 1,300,000 public housing units that are physically obsolete and need mission owners, and another two million homes nationwide owned by banks or FDIC that need to be turned into something."

- When the government decides it wants to spend money, it does so in a hurry, so the big box providers are set up for it and the money flows to them but if you're organized as a network with a plan, you can get it too. "You have to shortcut the plebiscite process. Have the Treasury say 'We're prepared to put the $10 billion out, but for every dollar we put out, we want you to have four cents liquid cash forever.'" Under this scenario working as an "industry", the members would have to make some non-economic deals to rescue things for the strength of the associative brand.

- Smith says this proposal would require takeup by someone at the highest levels of the administration - "someone who can look above the silos and balance both the banking and housing sides – someone who can see the connection between clearing out the cholesterol in bank portfolios and reversing the disinvestment imperiling communities."

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