

Cretaceous extinction or Cambrian explosion?

18th Annual Conference
San Diego Housing Federation

CAS FINANCIAL ADVISORY SERVICES



David A. Smith dsmith@casfas.com October 15, 2009



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- What we do
- **Manage \$4.0+ billion of multifamily assets**
 - Asset management, capital providers
 - Advisory: state HFAs, sellers and buyers of structured assets
 - Capital planning
 - National HUD public housing ‘portfolio baseline’ survey
 - **Green Capital Needs Assessment**
- Who we are
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 - Founded 1989, now part of the CAS Partners platform
- How we do it
- **“Skate to where we think the puck is going to be”**
 - Thought leadership, industry and government seminars
 - **State of the Market**, monthly, free
 - *Policy Update*, as events warrant
 - To subscribe, email me: dsmith@casfas.com



1. Our world ... and welcome to it

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The 'ecosystem' of housing finance

- Housing finance as an ecosystem
 - “Terrain”: geography, demography, history, culture ...
 - “Nutrients and energy”: money
 - “Plants”: laws, programs, sessile entities (e.g. HFAs)
 - “Animals:” entities that scurry about making change
 - Make a payroll, own a P&L, manage a balance sheet
 - For-profits, non-profits
 - Developers, owners, managers, lenders, service professionals
- Ecosystems are complex and robust
 - Unique and ever-changing; everything influences everything else
 - Species become interdependent, complementary, even symbiotic
- Ecosystems evolve toward greater complexity and higher populations
- Every now and then, something happens ...
 - Global capital markets crunch
 - LIHTC production and delivery value chain 'broke'



The changing marketplace: Macro trends operating for at least half a decade

- Shifting center-of-gravity in affordable housing
 - From HUD
 - Through the states
 - To Wall Street
 - Back to Washington (via TARP)?
- From capital consumers (deals) to capital providers (money)
 - Capital is now national if not global
- Consolidation in the financial sector
 - As the customers get bigger, their service providers get bigger
 - Outsourcing after reduction-in-force (or job-o-suction)
- Maturity and specialization
 - Sophisticated linked value chains and distributed activities
- The rediscovery of risk
 - The rediscovery of a premium for the best talent
- Crisis comes from a triggering event ...



Every so often, the ecosystem undergoes structural change ...



“Whew! For a minute there I thought we were in trouble!”

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Structural changes in the US affordable housing ecosystem

1934	Creation of FHA	Public housing Mortgage insurance
1965	Creation of HUD	Public-private rental Resident income subsidy Equity syndication
1986	Enactment of LIHTC	Passive-loss rules "Soft equity"
2009	Global credit crunch Repricing of risk	GSE conservatorship Workforce housing Mission Entrepreneurial Entities Green improvements

Each structural change arose during great financial stress ... each involved invention of brand-new entities and value chains



2. The system “broke” ... and yet we still need it

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The capital markets and banking system today ... and yet, there's an enormous need



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LIHTC has unique features not replicable in appropriated programs

1. Risk transfer

- Government pays funds only after the property is built (not before)
- Private sector bears entire non-completion risk
- In appropriations, government writes a check up front

2. Collectible recapture

- Recapture takes money not from the property but from a 'bystander' (the investor)
 - Ergo, instantly and fully collectible (and no flinching!)
- Appropriated programs take money from the property
 - Tenants become economic 'human shields' against enforcement
- Appropriated programs take money from the sponsor
 - Non-profits become political 'human shields' against enforcement

3. Outsourcing administration via 'outcome-based' compliance

- Pay for results, charge penalties, minimal administration
 - Ergo, property pays its own costs of monitoring (accountants)
 - In appropriated programs, process-oriented (did you follow rules?)



Two public-policy outcomes require two essential roles: allocator and investor

- **Policy = Allocator**

- **Goal: quality public policy outcomes**

- Choose the most socially deserving properties
- Assure long-term housing quality, affordability
- Make maximum use of scarce federal resources

- **Core activity: compliance**

- What they don't do – take over troubled or busted properties

- **Economics = Investor**

- **Goal: receive LIHTC returns as projected**

- Choose the safest (least risky) properties
- Assure long-term housing viability
- Maximize cash flow, residual value

- **Core activity: asset management**

- What they don't do – second-guess policy choices

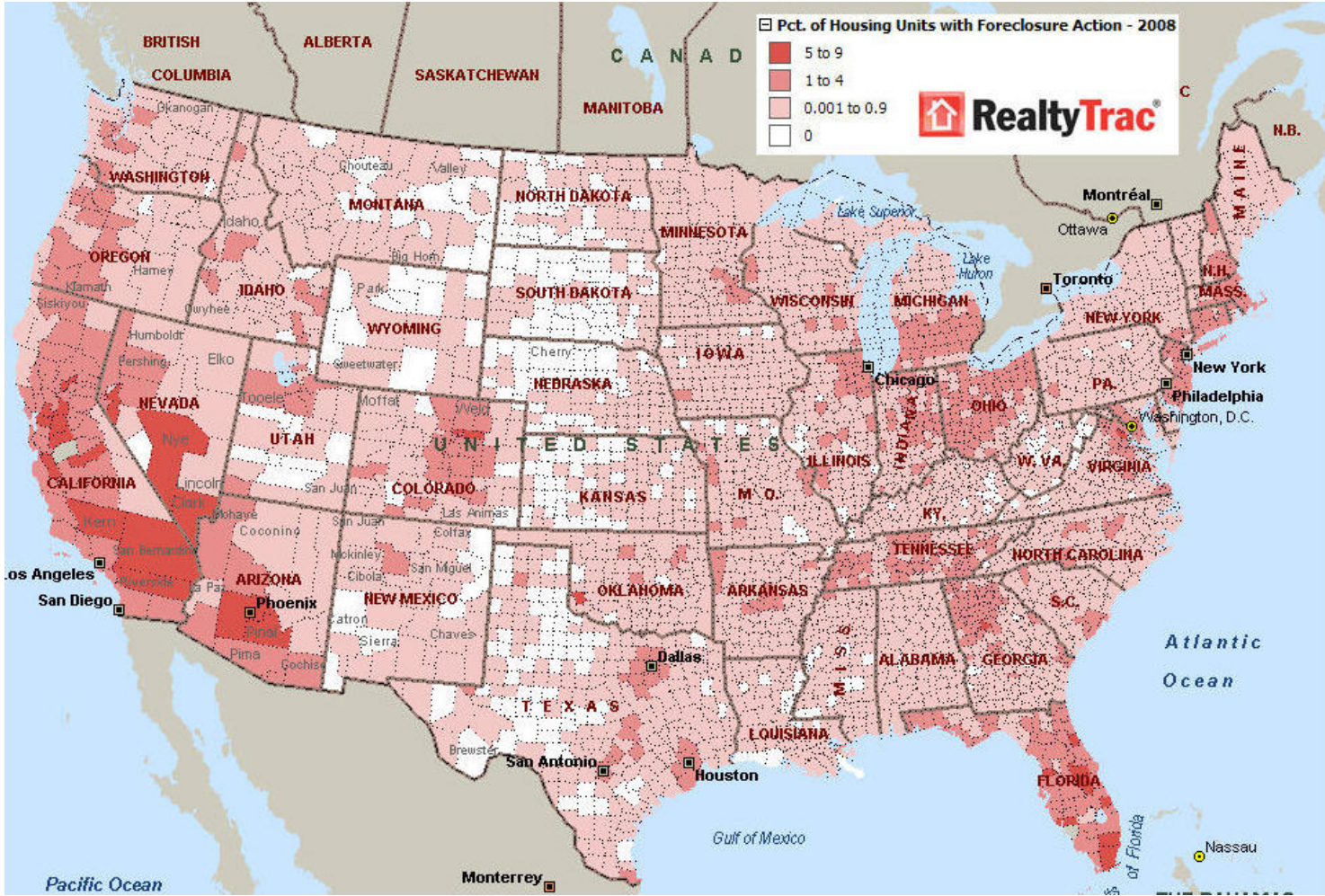
*Each party has come to rely on the other's primacy in its area
This is symbiosis, and it's why LIHTC's record is outstanding*

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US homeownership foreclosure rates: 2008

Do these people turn into renters?

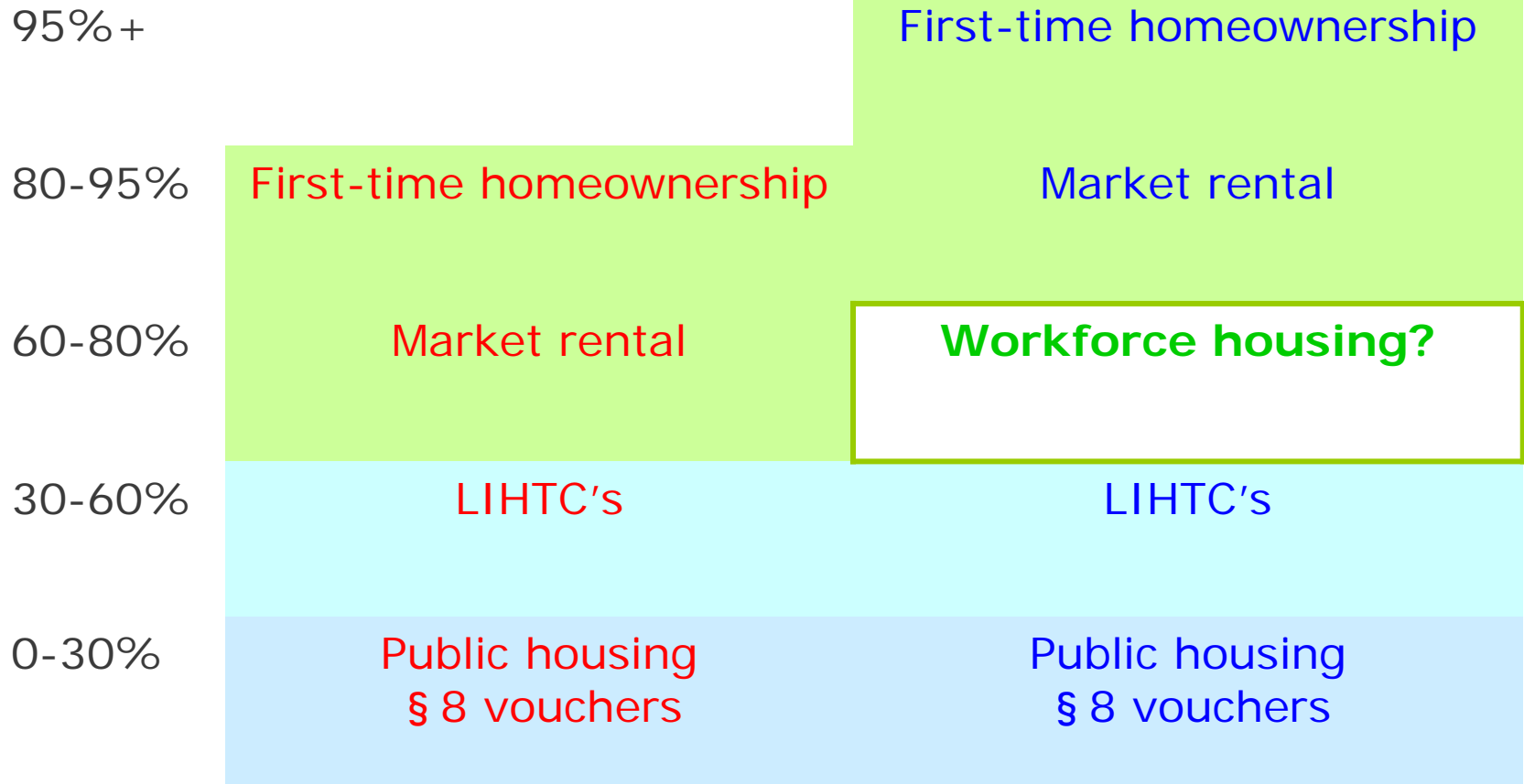


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Workforce housing:

An unmet need in urbanizing areas



Workforce housing is the *only* income range not assisted by some form of Federal resource

What has to change?

Not individual entities, whole systems

- **LIHTC delivery system**
 - Lengthy, expensive, slow, and risky
 - Over-engineered, fault-intolerant
 - LIHTC pricing is stratifying ... some places have no Bid price
- **Public housing system**
 - Under-funded
 - Over-regulated
 - Housing authorities cannot act like true owner
- Long-term ownership: **“Mission Entrepreneurial Entities”**
 - Consolidate by geography
 - Specialize by expertise; grow to scale
- **Workforce housing** must become an asset class
 - Not seen as a national problem, no standardized resources
 - Difficult to coordinate effective capital-markets response
- **Bank regulation and capitalization**
 - Create the “Bank of Glass”
 - Every position must be collateralized with some risk capital



Every shakeout creates space and opportunity for more evolved creatures to thrive ...



“You wouldn’t believe the dinosaurs I used to work with”

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Questions?

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