Renters, Homeowners & Investors: The Changing Profile of Communities
February 26, 2013
Renters, Homeowners & Investors: Panel 2

JIM PARK: It's great to be here, and it's great seeing many, many friends from the industry, from the advocacy community here in this room. I do want to thank the Fed staff from throughout the country for organizing this event and putting this program together. It is an issue that the Fed has been in the center for many, many years. And I'm glad that you're continuing the dialogue around impact of distressed assets to neighborhoods, future home-buyers, and the work that we're all involved with. Let me--and we're going to have Marie start out, and just by way of--you have backgrounds on both these individuals in the document, so I won't belabor that. But Marie comes from a large statewide CDFI out of New Jersey, doing some lot of great work in regards to community stabilization and workaround REOs. We're excited to have Marie talk about what's happening from the on the ground, boots on the ground perspective about what's happening there. We're also very lucky to have Sean Dobson, come who heads up Amherst Securities. Amherst, I think, have traditionally, at least people from this business, on the--whether it's servicers or people in the investment business have viewed the research out of Amherst as some of the best in the business. And we've--I've always looked at it very carefully and have found it to be exceedingly helpful to the business that we're in. This is a--and we're also thankful that, Sean, you came out and you didn't bring your bulletproof vest as an investor as well. But I also want to--the session, the opportunities and limits of private capital flows in communities, it's an interesting title because it sounds like an economist wrote it on the one hand, the other hand, the opportunities and limits. But I think there are--I think, to the point that we went through early on, there are some important things that private capital has on to stabilize neighborhoods, I think, in the early, early years, and I think the question going forward is, what will be the role of private capital and how will that impact communities? How will community groups work with these institutions? And--and I think that's a big challenge that we're facing as advocates, as industry, and as people who care about the housing recovery, a sustainable housing recovery for the long haul. One thing that I would just--I would just sort of tee up some of the issues, now that we--Jacque is not here today. I am going to use his time a little bit to sort of share my thoughts. I would say, one--one is that the market shifts are quite substantial and has been quite dramatic, you know, in this side of the business, in terms of the defaulted assets, REOs, and so on. As someone who has been in that business now for about six years, I--I guess many of us thought that the--the REO inventory would continue to rise through 2012 and well into 2013. And that the--there would be excess inventory in the marketplace. That certainly has not been the case, and I think it's caught most of us people in this business, people who are--servicers, banks, to some extent by surprise, because every one was talking about--remember the shadow inventory? That shadow was cast by a little mouse, I think. It's really has not turned into be, much in the way of a shadow inventory. And it has happened because of a lot of different reasons over the last several years. I think the AG settlement slowed things down, recalibrated the appetite for holding on to these assets. There were a lot of other players coming in to the marketplace and other non-bank servicers that were coming in, acquiring these assets. They have very different kinds of long-term whole strategy and appetite for these assets, than a, let's say, a Bank of America or someone like that, who wants to push it out. And so, you--you don't see those inventories coming in the same way. You also have seen--I would say, a massive influx of investors coming in. I know that data that we saw early on went up to --I think 2011, I think it was. I do think 2011, 2012, the investor appetite increased quite substantially. It certainly wasn't captured by that data that was presented. And I think the other thing that we don't capture many times is that there is so much that happens before a property becomes REO. I'll give you an example of Phoenix. In Phoenix, I would say, out of--there's about a hundred distressed assets going through the pipeline in Phoenix. I would say about 20 to 30 percent of it actually makes it on the other end as an REO. Other part--other go out as either through trustee sales or on short sales. So while we know, REOs still are important part of it, it's still--it's what it's representing in smaller and smaller piece of what distressed assets are about in key markets. So our influence, as we think about influencing the ultimate dynamics of the market, we have to think about the whole picture, not just the REO in the years ahead. So with that, let me turn over to Maria and talk about maybe sort of on the ground, how you're making your private-public partnership work in acquiring these assets, working with private investors.

MARIE MASCHERIN: Great, thank you. Thank you, Jim. And before I get started, I really want to thank the Federal Reserve of Philadelphia for inviting, not only myself, but New Jersey Community Capital to be at this table to have this discussion. This is very important for us [inaudible]. Thank you everyone. So New Jersey Community Capital, just to--we're a statewide CDFI. We've been around for 25 years.

[Pause]

There we go. Our mission statement, we try to transform disadvantaged communities through strategic investments of capital and knowledge. And just to provide a quick snapshot of our track record over the couple of years, we not only do direct lending but we're an allocatee in New Market Tax Credits. And we do a tremendous amount of third party managed assets in a variety of forms. And we also try to track--well, not try, do track our impact in housing education or early education and jobs. What we try to do, actually, New Jersey Community Capital saw back in 2008 the need--or we saw this kind of train coming down the pike. And we were involved in a transaction, back in 2008, that acquired in bulk 47 investor-defaulted notes from JPMorgan Chase originally started out with WaMu. Most of those mortgages were located in the Greater Newark, Essex County area. And those notes required the entity, they required them to go through the entire re-titling process. We couldn't find--if the owners weren't found, there were people that were in there as renters. So the task was set and it took several years to go through and clear title. But what it actually showed us is that the model of a non-profit coming in with private capital could be in the market and could be an active participant in the market. So that kind of laid the groundwork--laid the groundwork for the 2000, our participation in the 2012 FHA distressed note sale. That was four cities and New Jersey Community Capital led the way in becoming--in bidding in two other cities, Tampa and Newark. We originally bid on 399 notes of the FHA-delivered 245 notes. And you could see they're pretty much evenly split between Newark and Tampa. The interesting thing that, in Newark, it's about a 121 notes, but that actually represents about a little over 200 properties. The profile of the housing stock in Newark is many of the houses are two and three family units, unlike Tampa where it's more traditional single family residences. The uniqueness of this transaction for us is that, one, it was done with no public subsidy. It was done with the combination of private equity and private debt. It was a fifth--the capital structure is pretty much 50-50, and with investors, mission-oriented or mission-oriented investors to come in and purchase those notes. Our goal here is what we call a restart strategy, which is what we see as a high touch, high touch to the homeowner. Most of these properties in the city of Newark, of the 200 plus properties, we know there's at least 165 that are occupied. So it's at 35, so like 12 percent are vacant. And I'm only going to really focus--I apologize--I'm only going to focus on the Newark. That's because we're a New Jersey-based organization, our primary work on the ground will be in Newark. High touch, we partnered with several homeowner counseling agencies and the goal is to be in touch with the homeowner, have boots on the ground with the homeownership counseling centers, and start to have a conversation with the homeowners about what it's going to take for them, given the new value of their homes, plus their own economic situation, and to reset those mortgages so that they could stay in their home if they choose to stay in their home. So that's our goal. And our--it's really attempt to reset a majority of the mortgages that bring back in line more traditional, economic, and value parameters. But also, we have to realize that, in some cases, homeownership is not going to work for everyone. So the program also provides for, deed in lieu with some financial support to relocate homeowners. Also, as I just said, not all the properties are occupied, so we're going to have to deal with completing foreclosure and dealing out with the vacant properties. Our goal is on the vacant properties that they remain in community--in the community development field with local CDCs, and that they get repurposed back into the community. I just want to go through--there are four underlying principles of what we had to say or what drove us in this model. First of all, was New Jersey Community Capital's understanding and local knowledge of the marketplace. Also, working with our capital partners and our debt providers, we were--we employed a very disciplined financial model. Internally, we had a tremendous amount of discussions, you know, what if--a lot of what ifs really drilling down. The other one was community knowledge and homeowner behavior focus. We see this as a key aspect on the restate--reset side, because a lot of these homeowners and New Jersey's an equity state, so foreclosures, a hundred--900 plus days at this point. So somebody--it's very possible, someone has been living in a house for three plus years and not paid a mortgage. So suddenly, they're going to get a knock at the door and ask, you know, they're going to be asked to start paying their mortgage. So granted at a lower amount, but--so how they react to that is going to be a critical aspect of the success of the program. And, you know, we're still--we've just started this program, so we're still trying to feel our way. Our thoughts, or we've been to most--a lot of the properties in Newark, and we think that a lot of these people sort--you know, they have families there. They're into their--they're rooted into the community. So we're hoping that they're--when they sit down in the prospects of having to relocated the family, and realize that they've been in the house for a couple of years, that hopefully will do it. The other thing that was very key is operating a control of--was had to be, had to stay with New Jersey Community Capital. And this was a very key aspect, one that was heavily negotiated with our private equity partners. Typical private equity, you know, I guess it's the golden rule, those with the golden rule. So, they always--they really push back, they wanted operating control. They wanted governance control. And we basically said no. We are the ones, we know these communities, and, from the get-go, we need to have operating control to do what we need to do to get the job done. And then, finally, we felt, as a CDFI and a non-profit, we need to be compensated for our risk. So on those four principles, that's why we went to it. And questions?

JIM PARK: Great. Well, I think what we're going to do is we'll hold question until Sean does his presentation. Okay, Sean?

SEAN DOBSON: Okay, great. I didn't bring any slides, I apologize. Often, I have too many to go through. So this is good discipline for me. I'll tell you a little bit about myself and about Amherst. Amherst is a financial services company dedicated to US real estate finance. And, you know, that's the speech that my guys make me put together for the elevator. But if you dive in a little further, it's last year, we transacted about 90 billion dollars in mortgages backed by both legacy and government-guaranteed mortgages in our brokerage investment banking arm and into our asset management business. I think one of the reasons that I was invited today is that we have one of these national, single-family acquisition, acquire to rent strategies. We launched the fund. We started this process. We started this process in 2009, because at that point, we decided that across the investment landscape of US real estate finance whether there were choices to buy loans and bonds and all kinds of businesses that works both to single family housing. We thought that the absolute best place to put your investment dollar was in the asset itself. So, late in 2009, we started working through how would someone of our scale and our investor scale approach buying a diversified national portfolio, single family homes and manage those through the rental process. So, I was a little bit, I did make sure that most of the tomatoes were picked before my presentation started. So, that's who we are. The fund that we're currently deploying is going to buy between five and 8,000 homes, most of them this year. It's currently out in about eight markets buying homes, a dozen to three dozen a day I think is the current pace. So, when we approached this in 2009, our research was one of the first alarms for the housing crisis in 2006. And to be a dedicated finance platform, that's all that's coming makes this unique. By the time, to bring us up to today, it's important to understand from a policy maker's perspective I think that the magnitude of the problem in housing. And we spent a fair amount of time consulting with various agencies, many of which are represented today, in understanding how their policies might be tweaked to help solve the housing crisis. And we think that solving the housing crisis is paramount to the recovery of the economy. But if you take, if you scan back and take a look at those with macro perspective, people have quoted the foreclosure statistics and they'll tell you that approximately, 7 million homes were going to be put back into the market because of foreclosures and because of defaults and mortgages. So, when you think about 7 million, it's hard to get, some sort of, you know, a benchmark for that. But I think of it this way, is in the US, we're forming about a million homes. There are about a million households formed in a given year. If home ownership rates are going to be 60, 64 percent, then we don't think they are, that they are going to be lower than that, for new households formed. That means that new families can absorb about 600,000 homes a year. So, on the demand side from natural household formation, maybe you'd get 600,000 new families that would like to buy a home each year, provided that they can qualify for a mortgage. And we'll talk about that in a minute. On the backside of this, you have normal construction, normal supply of homes from people that, for whatever reason or downsizing or deciding not to own the home for age or lifestyle reasons, their homes are coming back onto the market. So, what we saw without some sort of process from policy makers to stimulate some demand, was at least, a lost decade in housing. The US economy can't withstand the lost decade. Most of you have seen the impact that the housing has on GDP, a lost decade in housing is probably a lost generation in US economic growth. So, we began looking at this from two sides, is that we saw this mass of supply a problem. And then when we look, focus closely on the demand problem, it's okay. Well, where will these homes going to go? Well, the first thing we do just to be, you know, logical people, is we sent people out in the field to find out where they're going now, and is that solution sustainable. So, what did we find in 2009 when we went to the Arizona foreclosure auction? We found a little bit of what you saw this morning and we found that at the foreclosure auction, maybe about a third of the real estate that was in default was, going to transact. And of that, 60 plus percent of it was being sold to investors for all-cash. And these investors had sort of one of the two plans. Most frequently, the plan was to sort of shine the house up, get it into what we call transforming from a house to a home which means, these homes are not in horrible condition but they need a little tender loving care. They're not the kind of home that couples are going to walk in with their kids and say "Geez, this feels like home." They're dirty. There's nothing terribly wrong with them but they need some management. Most of these investors were converting these houses to homes, putting it back on the market and then a buyer would show up with a 97 LTV, FHA insured mortgage to buy that home, for almost double what the investor had paid for it. So we thought that was an interesting use of capital and how sustainable is that? And so that trade didn't attract us for a couple of reasons, not at least of which was, it's unlikely that there's a num--that the number of--that you'll be able to find, that many new homeowners to come and buy this supply. So the other investors had a different strategy which was to buy the homes in the least amount, you know. We saw thousands of these investors and we still see thousands of investors and as the research today pointed out, that is exactly correct is that the bulk of these homes are being sold to investors who are buying one to six units. Now, why one to six? Well, this is where I think policy makers are going to have a big impact. Why would you stop at six if you already have--if you're going to go the trouble of marketing the property [inaudible] then why stop at six? Well you stop at six because that's as many homes as Freddie Mac will allow you to finance. All right. These people are--the people at the auctions might be showing up with the homes to pay cash, but many of them end up with an investor mortgage which provides them, and I think it's a fantastic program. But it has impacts on the market that I think we need to--we need to think through. So, the other thing that we noticed that was an anomaly that I don't think everyone was focused on is that here we have this tremendous housing crisis. You have effective unemployment at 17 percent. You have maybe a decade worth of excess housing inventory that's coming. And it feels like the road is coming to an end. At the same time, we're watching our multifamily properties, escalate their rents and tighten, and their vacancy rate is dropping to unheard-of levels. Vacancy rates in a multifamily project, that's well-run, 93 percent occupied, 94 percent occupied. We're seeing vacancy rates drop to zero. We're seeing lines of people getting on the waiting list for properties. So here we are with this anomaly. We've got seven million units of supply. We've got home prices in a downward spiral, and you have more demands for rental properties than you can shake a stick at. So as an investor, our responses, well this is simple. We convert the single family homes to rental. But to do this, and to do this in scale, to make this meaningful, we have to go through the process that we're going through today. And that's to make the single families scattered sites rental business look and feel more like the multifamily rental business. So, I threw down a couple of factoids here to help sort of stimulate the conversation, that I think maybe not everyone knows. In the US, there are more rented single-family homes than there are rented apartments by about two million. So it's about thirteen million out of eighty million housing units out there that have been rented for a long time. So this is also what we tell investors is that this is the new old thing, okay? There is nothing new about a third party owning the home. By contrast though, the multifamily market has a very robust mortgage system available to it. Many of those mortgages are guaranteed by the FHA and by the GSEs. So, on the one end we have 13 million units out there that are either paid for in cash or financed with mortgages that are directed to consumers. Where the mortgage itself is structured off of the borrower's FICO score. And then on the other hand, we have this multifamily product where the property is underwritten based on professional management that's audited and is based on the property it self’s value, its construction, its quality and more importantly its cash flow. So this is--so this is where policy makers and I think the allocators of credit in the world, need to sort of come together and sit down, because you know what the world's first reaction was to the housing crises? And people saw this as good news, it was to build more houses, and so it's insanity. So, because you can get an apartment complex financed with an FHA or a GSE-guaranteed mortgage, there's plenty of credit available for that product.

People did the natural thing for investors to do, as they see demand, they see a lack of supply, apartments seem to be built, they go out and they break ground on a bunch of apartments. So it exacerbated the supply issue and housing nationally through our finance policies. So this is--so I'll wrap up. I don't want to--I think the best thing for us to do is now, you sort of know who we are, who I am anyway, and how we've been in this process since late 2009. And we've been in the process of diagnosing what's wrong with the mortgage markets since we detected the bubble in housing and the problem in the credit--mortgage credit markets in 2005. So one of those platforms that was out advising people to get out of the way of the train in 2006 when the world was sort of frothy and happy about home prices. And then we've turned that early information advantage all the way through to now, a national program, where our goal is to do something that we're profit-motivated, okay. So our goals are simple, is to make our shareholders and our investors an above market return on capital. So, but in doing that, what we're doing is building a national transformation system that allows capital to flow into single-family equity. So if you think about that for a second, there's five trillion dollars' worth of first lien mortgages out there in the US. There's another eight hundred billion dollars' worth of home equity loans but in essence, they have the difference between--the consumer is supposed to have equity below them. There's no institutional source for that equity slice. And that's what we're doing. So I think that the policy benefit for what we're doing is that, now, you'll have, if we're successful, what you'll have is an ultimate source of demand for this asset. So the asset won't be strictly tied to mortgage credit availability, it'll be tied to its value in terms of where it sits amongst other investment asset classes. So I think this is transformational. I think it's the opportunity that came from the crisis, and our system, in our--we have a significant infrastructure deployed to become part of that new mechanism that transfers large swaths of capital into single-family equity.

JIM PARK: Right. Sean, that was a success because no tomatoes flew across the room.

Well, thank you.

So that's great. Let me ask a couple of questions, and then I'll open it up to the audience to do the same. Let me first start with Marie. You said, which was a bit of a surprise, that you don't use any public dollars in your acquisition.

In this model--

In this model?

--we did not. Correct.

So, typically, you--so if you're deploying, using private capital, and, obviously, early on in the days, I think there were some hard, you know, return thresholds that people are expecting. So number one, has that has been lowered, from your vantage point, have people's return expectations been dropped? Number one. Or, two, are you getting sufficiently deep enough discount so that it doesn't really matter what the return threshold is from your investor side?

So I guess the answer is no to the--no, there are investment grade returns projected to be paid to the investor. They are not guaranteed returns, so the investor is at risk. But those, based on the model, the financial model, it's investor grade returns. The debt is paid, market rate return for the risk. And it really comes down to that discipline financial model every time if the, you know, if the rate of return goes up, it's very simple. If the rate of return goes up, the price you have to pay has to go down. So it really ends up--unfortunately, somebody has to bear the impact of that, and it was on the purchase price. Yeah.

Sean, let me throw a question your way, as well, and then we'll open up to a bigger, a larger and broader discussion. In some ways, I think too, I think it was Allen Mallach who talked early on about, you know, those different investor types that are out there. Early on, I guess people where I would say more opportunistic about their acquisition strategy and buying and flipping and getting out. Part of it was, I think, because the home prices were still dropping, people then want to hold on to it for the long haul. The more and more I talk to investors nowadays, there's this--the five to seven-year window that they want to hold this asset class. And then they want to unload it and really participate, not so much on the annual return, but really participate on the long-term home price appreciation. Is that the strategy that you think makes sense in today's market or is that different depending on the market you're in?

SEAN DOBSON: Well, I hate to sort of sound like an economist, but I think the answer is yes. Is that the--there's two business opportunities here. One of them is to create a business that plans what used to be the subprime mortgage market, which is--the question that I like to ask people is, if there had been a robust supply of this housing available, and it was competing for tenants fairly, would you have designed a system that put a homeowner with a low credit score and potentially no equity, into a loan whose payment was going to increase by 30 or 40 percent in two years, right? And so, we think that there is a segment of the population that's going through a credit repair, bad things happen in life. There's divorces and there's deaths in the family, and there's medical problems that destroy people's credits and cause them to be unfinanceable in the capital markets. Or bankruptcies. Those borrowers were pushed towards this loan structure that was meant to re-season on their credit and then pay off that loan. And there was an implied penalty in the loan that they took out through resetting their payment at the end of a couple of years. So that's a bad idea. And a better idea is to supply them with something--a housing situation that still meets their needs, is affordable, and a reporting infrastructure that makes sure that their credit score is curing with their proof of their payment of the leases. And so I think that that's one opportunity is to say, okay, let's rethink how people get this--let's rethink this on- ramp to housing ownership and maybe it's the reentry ramp which is the subprime mortgage market. The other opportunity is housing is just undervalued, right? I wasn't going to say cheap, but that sounds a little casual. But it's the housing--housing prices are way too low. And they're way too low based on where--any metric that we would look at in terms of affordability versus the cost of capital and the fair cost of capital. And what people--and what the demand for housing is, and what their rental streams would supply. So we think that as investors, we look at this and, we know, you're always trying to optimize that trade. As investors, we think about, okay, at this point in the cycle, you really just want to own assets and you want to--you want to choose those assets carefully because you can't--you can't paint housing as a broad brush that we talked about today. But we think that in three to five years housing will have rebounded significantly for a very simple reason. And this is because in our markets, once a borrower is three, to maybe in the worse case, seven years past their previous mortgage default, they're fungible again. And if you look at where we are in time, the bulk of these defaults happened in 2009 really in volume. And so we're already seeing in Phoenix, consumers who defaulted in 2009 returned to the market. And an interesting policy question about this is, the homeowners that defaulted in Phoenix in 2009 were foreclosed up on in 2009. That foreclosure process is 9 to 11 months, okay? The homeowners that defaulted on their home in New Jersey are still in the home in 2012. So there is a link to the time it takes for the housing market to cure and the process with which you deal with defaults and it's an undeniable link. Places like Florida and we think about the damage done to the market. A couple of statistics, I would like to remind people of 'cause they get bullish on the housing, want to go buy everything, that's not hogtied down. Every fifth house in the State of Florida is in foreclosure. So think about that. Drive down a block, you know, imagine yourself driving down a neighborhood down the street of a neighborhood in Florida at one, two, three, four foreclosure. That's a lot of homes, right? And it's unclear how sustainable the metabolization is for the current process to take up--to take out these homes. So we think that once a foreclosure is final, three to five years later, you get a nice echo boom for housing demand. We think that in Florida, that's an extra three to five years past the date that it is in Texas or in Arizona.

So one would--potentially could argue this in terms of the, that sort of a new, on rent theory that, you know, we're obviously converting--we lost about 4 million household to foreclosure, I think to date. Those people are not either living with someone else or they're renting, so you have a whole group of folks that are becoming renters and there'll be more in the next several more years. But the home prices as you point out, is low right now. People are--a lot of home buyers are competing against investors in the marketplace. And so some people would, potentially could argue that you're locking people out when the prices are low, you know. Financing is very affordable, so. And they don't get the upside of the home price appreciation. I mean Phoenix, I remember in 2009, I mean, we--there was about 10 years of inventory or something crazy like that and now, it's down to three to six months or what have you.

Right.

It is, some of those swings have been so dramatic and I think the industry as a whole was sort of ill-prepared for the rapid shift. The question is, when the market starts to rebound, the home prices go up 20 percent every year potentially in markets like Phoenix. Will these people be again priced out and be in a situation where they have to really buy a--unaffordable home, unsustainable home at that point.

I think the risk is there. I have always thought about, when I look at the policy responses in Washington and we go after, we sort of, you know, rush head long into this modification where we're trying to say every loan is in default. And then I think about the person in California who happened to be at the point in their life where they needed a home, right? They had a family. They needed a yard. And they chose to have a home. But when they went to the real estate markets in 2006, they got to compete for that asset with a bunch of people who lied on their mortgage applications, right? So they have to pay a price that was unsustainably high for themselves and for the asset. And what have we done to help these borrowers? Nothing, right, until they default. So I think that it's an important question because it puts the problem in relief from what people would normally react to. Homeowners, you know, have a distinct advantage against investors. And so, you know, why, these 13 million homes that are out there owned by investors, why isn't there--so one of the interesting questions is why can't I go up to the nearest stock exchange and buy a stock for the top 10 owners of single-family rental real estate, right? I can do that for a multifamily. You [inaudible] can’t do that for single-family homes. Well I think that the reason, we don't know. But our opinion is, is that the reason is because that's the--the tax advantages that are available and the financing advantages are better available, and the cost of the capital that's available to the homeowner makes them a better bid for the real estate, provided they can get a mortgage. So it all comes back to access to credit. The question, they will be able to outbid third party owners of the real estate because they get to buy a home that's--it's from an investor's perspective, it's a dream transaction. I buy the asset with as little as 3 percent equity down. I get all the upside, right, and so commonly, it's 15 percent down. I get all the upside. I pay you a running rate of interest on the note which, by the way, if rates go down, I get to call that and issue another note at the lower rate. And if asset prices get up, I get all the reward and if asset prices go down, here's the keys, okay? So, and I get to tax deduct that leverage and there's no margin calls. If my home price goes down 7 percent, 10 percent, 15 percent, you as my lender can't call up and ask for more equity as if I was buying the stock. So given that--this is the paradigm for financing single-family houses in the United States, unless that changes, consumers will outbid investors for these homes, once they're able to qualify for a mortgage. So to me, the question is not--there's no choice, I think, for having investors buy homes today because there's no place else for them to go, right? They're simply a demand—a supply and demand imbalance based on the availability of credit. And I think that when you look at what credit needs to be available to get demand stimulated from this group of potential borrowers, it's scary, kind of one you have to make. So I think that it's all about mortgage standards and financing for your consumers that determines whether or not these consumers get locked out perpetually.

Yeah. Well I'll make this one quick comment and then we'll open it up to questions on that. I, you know, on the--from the ground level, what I see is this, so I mean, I do see--if you have a comparable bid on a home today in the marketplace, one is finance and other is a cash deal, you're going to get the cash deals. You're going to win out a hundred percent of the time because, one, you know, who knows, 45 days, six days of financing process. Who knows what's going to happen at the end?

Right.

JIM PARK: And the other big issue that we don't really talk about right now is the appraisal issue because they're just--there is this multiple bids on properties in today's market, people are starting to overbid on homes. And so people would rather take a cash deal today. They don't want the appraisal contingency. They don't want to deal with having to come up with the difference somehow or reduce their price later on with the financing deal. So I still think it's--in terms of whether it's distress sale or not, it's the--it's really stacked against the home owner, to some extent, the people who want to finance these deals until investors start to pull back a little bit in terms of their strong appetite in the marketplace. But it's--but it's at the same time, that's how the markets recovered as well, so we can't, you know, it's sort of two edges of this knife. With that, any questions? Yes?

[Pause]

GEORGE MCCARTY: Yeah, I'm George McCarty from the Ford Foundation. Always with the first question, because I'm patient. So anyway, Sean, I do want to commend you for being willing to get up in front of the room that fifty four percent of whom said, you know, investors are doing more damage in the market than good. So I want to--

SEAN DOBSON: You actually have multiple, you know, you responded at multiple times.

Exactly. I was out gathering up all the other--

It would have been 90 percent.

Otherwise.

So, I want to just kind of explore, kind of one the--I don't know, the mysteries of the last few years because there were lots of people on the nonprofit side who were running head long into this idea of lease to own as kind of a solution to the market where they're going to acquire properties with NSP or something else. They're going to then convey them to either the existing homeowners or some other home owners to lease until they could cure their credit, then they would convey their home on the lease to own thing and I just go on record and saying, I thought that was really a bad idea, right? And I still do. But I find it interesting to kind of contrast that to what private capital is doing right? Which, you might also call a lease to own except there's one really key difference which is--and correct me if I'm wrong, there's no intention on your part to actually sell the home to the person who's currently leasing it. When you decide to, whatever your exit strategy is, that exit strategy is just going to be the sell to the highest bidder, I mean, is that correct?

That's right.

And so, and you also have no intentions to convey kind of into the upside to the lessee that he has lived in the home during that period because I--and this is a question I would expect a large proportion of your return on investment is going to be made on the exit as opposed to the cash flow that you're going to generate during the time--the holding period while you're doing the leasing, right? So the first questions is, how much have your return on investment is going to be from the appreciation that you're going to get at the end? But hold on to that 'cause there's a couple of other things that I just wanted to kind of--

Just keep talking, 'cause the longer you talk, the less I can get myself in trouble.

Okay. Because, you know, New Jersey Community Capital and many others who were also thinking about trying to do this but one of the things that I think or one of the reasons that we've kind of left the door open for private capital to solve was going in the market, is because basically the nonprofits tied their hands behind their back and the New Jersey Community

Capital site, you guys made the decision to go with no public capital and actually provide some return to investors so you could actually probably execute faster if, I don't know, but maybe--and that's a question. So you could tell me, why did you decide to not use private, uh public capital to do this? And to move forward with a similar model, but that's actually going to have to generate kind of results because ultimately, the pace with which this economy, the housing sector the economy recovers is going to be dictated by how quickly we can transactions going, right? So, and how much are you sacrificing in terms of the ROI that you're going to get relative to the ROI, private capital is going to get, choosing to do it the way you do it. Anyway, so I don't know, is that--

JIM PARK: Sean I think you got out of this question because it's been-- [Multiple Speakers]

Sean, the first question is how much of his ROI is actually is dictated by the exit?

SEAN DOBSON: Right.

And he admitted that they have no intention of actually kind of making sure that the same person that leases a home is going to end up being the final occupant, right? So how much of your ROI is found at the exit?

It's forecasted, it may be zero, right? It may be zero if it's in housing market but we believe that a half to two thirds of our return will come from capital appreciation.

So, two questions, why no subsidy? One, our president is an impatient man Wayne Meyer, if you know him. He just couldn't wait. To this day, there's been discussion about, particularly in New Jersey, and I don't want us to disparage New Jersey but, you know, they're still trying to figure out how to put, how to bring subsidy to solve the problem and they haven't done it yet. So, there is a, how long, how much longer is the non profit world just going to sit back and let other forces dictate it's their outcomes that they want to achieve. So, he just said, I'm going to go do this myself. Now, he didn't do it himself. The other thing quite honestly is he had private capital and other partners who said to him, "We're with you and go do this and find the other partners and the private capitals." So, we also had some very supportive funders as well. And then we have some skin in the game. So, impatience is probably, maybe not the correct word, but basically, you know, if we don't do it know, we're never going to do it. In terms of return, our goal is to modify or reset most of the mortgages. We are going to have to take some properties back so they'll be, we may keep them or sell them out into the marketplace or lease them, so we will have some rental portfolio. But I believe the goal is to try to modify a majority of the mortgages, season them in-house. And then, the long-term payback is can you, because of the CRA rules, as they sit today, a lot of lenders will now purchase those pool, hopefully of performing, modified single family mortgages. And that would create a return at the back end as well, so.

Yes ma'am?

SANDY JOHNSON: Thank you. Sandy Johnson, City of Camden Redevelopment Agency and my question goes to private funding EB-5 employment-based funding under the Immigration Investment Act, what has been your experience or do you know of any one who's had an experience with this type of investment in housing? What were the challenges and to your knowledge how were they cured?

We spent not enough time but we spent a fair amount of time looking at the hardest fit funds, their sort of goals, aspirations. We looked at various programs to assist investors and to draw capital. And we maybe were the ones that are impatient. We were sitting here saying, this is time. This asset is undervalued. It's--the natural buyer has lost their financing capacity. The asset has overrun its down trade, and we need to buy it now. And so, when we looked at these programs, most of them had a lot of high aspirations and tons of friction. So, we backed away from all sources of public-private partnerships, and we backed away from public source funding because it was high friction, it was slow. It had a confused messaging, from our perspective, a confused message and then confused goals. And so, we said, to heck with it, private capital is faster and cheaper. And so, we just, we went out and sourced the capital to take all the risks ourselves, because we couldn't figure out. And for us, it was just difficult to navigate the process. So I don't know anything about EB-5.

Well, I guess, EB-5 is an IS statute that allows for foreign capital move in. You have to generate, for every half a million dollars that we have to generate, I think, 10 jobs over a two-year period. I'm not that sure how much housing business it's actually supported. It's not a lot of hotels, commercial developments, and so on, things that are naturally more inclined to create ongoing jobs. It's little tougher, I think, in a housing project. So for every half a million, you have to create 10 jobs. That ratio, I think, makes it kind of takes it out of the sphere of what would be relevant for the housing market. You can definitely do it for hotels. But it's harder for--maybe assisted living, you can potentially do it, but I don't think it's widely used for housing side. Okay, other question, Paul? [Inaudible Remark] Notice that Paul doesn't need a mic. [laughter]

PAUL WEECH: Sure, thanks. Yes. Paul Weech of the Housing Partnership Network, we've been looking at the scattered-site rental challenge and opportunity very closely also. And I had two questions. One, for the whole panel, but I'm particularly focused on property management side. You know, one of the things that's very clear to us from the work we've done is scale--you're going to require scale to do that. And so, I'd love to hear from you, Sean, and others on the panel, generally, your thoughts on it. Just sort of what--where do you think the threshold is? How big an inventory has to be before you'd start to make money on the property management side of this inventory? How you're solving for that? Are you doing it yourself? You're building your own property management function? And then the second one, you alluded in your opening remarks, financing. You know, what kinds of products on the debt side do we have or do we need to develop to manage large portfolios of this stuff?

Sure. You may start.

Go ahead.

MARIE MASCHERIN: So we--because the properties are going to be concentrated in Newark, we think we can--even though they're scattered, they're going to be relatively in a concentrated geographic area. So we think we can manage them with the management company. New Jersey Community Capital does have a non-profit real estate development arm. And we're looking to make entertain or enter into partnerships with other property management companies in order to do that. But that clearly is one of the challenges that you face with them. So, I'm not sure we've gotten it yet, but we know it's on the horizon, and as we take these properties back, part of it will depend how long we hold--the entity holds them, and how quickly, if they can be sold out into the--the properties that we do take back, how long they can be sold, how quickly they can be sold out to other entities?

I would say, from a private market perspective, unless you're going to, as an investor, you're going to hold the asset and you want to cross-subsidize a property management function, because I think, typically, you would have to hit by the 40 to 50 unit level before you can actually make it economically feasible over the long haul. So that's been, I think, the general rule of thumb in most markets. But I know, because of larger institutions coming in, there has been obviously more influx of property management operations coming up. I do think it has squeezed down the margins on that business, and you do wonder what that's going to do to, really, the properties. How are you going to really maintain the properties in the way that you should, given that all the margins are being squeezed across the board. Now, at the same time, I would say, it also has brought more professionalism to some extent because people are scaling up their business and they have to meet more of a broader market standard requirements. And when you're managing two, three properties, you know, with mom-and-pop shop, you know, you may not, you come out, you may not, you know, follow all the rules. You may overlook certain things. So, I do think there's, you know, at the end, I think there's one hand, this, the other hand, you know, that the--the upside clearly as well.

For us, we have two strategies because we're buying everywhere. If we don't think we're going to get to about 300 units, 3 to 400 units on a market, we outsource the property management. As I mentioned before, we believe there's around 13 million leased single-family homes in the US. A large chunk of them are professionally managed. So, we have for example, six individual companies that manage properties for us --just in Atlanta. There were six, highly-qualified market standard property managers that we then put through our diligence and compliance functions to approve them as--as a provider for our platform. And just six in Atlanta, there is four and there's four in Orlando, there's a half a dozen or more in Houston. So, these businesses exist. They're--they're small, non- conforming businesses and we think the part of the--the second part of the question was standardizing financing for the product has to do with having--maybe what you would consider to be a master service or sitting on top of that--that local market, service provider to make sure that it is compliant, to make sure that it's Fair Housing Act compliant, to make sure that the properties are maintained. Now, in our model, our private managers are incentivized to over maintain the property because in addition to collecting a percentage of the rents as their fee, they collect a percentage of many repairs that they do. So, one of the things that we like to do is vertically integrate and have our own office in the market to keep from having a conflict of interest with our manager but in this case, the conflict of interest would serve to create more investment in the property in a higher repair maintenance budget.

MARY TINGERTHAL: Good afternoon, I'm Mary Tingerthal from the Minnesota Housing Finance Agency. Question for Sean. I'm curious if you could wave a magic a wand and level the playing field between--

The way at that Capitol Hill? [laughter]

--between the investor/owners of single family and homeowners.

All right.

What would be your attitude about holding those properties as long-term investments as you might do with a--apartment building?

Right.

And how does that calculate into your return where you said that 50 percent of your return comes from the eventual sale presumably to a home owner?

Right. So the way we look at this transaction is right now equity in housing is very illiquid, right? You as a home owner know that it's very expensive to transact. You end up paying this brokerage commission and it's difficult. So, what we see happening is this equity becoming more liquid. And what I--what I think is in our strategy is that we believe that the product that we're building, which is a stabilized cash flow stream backed by a high quality asset that's professional managed. We think that that cash flow stream will be more valuable than it cost us to create it. Whether we actually sell the home back to the consumer or where we sell the whole bundle into the capital markets, remains to be seen and it's a value decision. So, now, in my company, we're a relatively small group of professionals in the finance business, we don't have unlimited resources to go and acquire millions and millions of homes but it could be that we end up being a service provider for those people who do want to just hold them as cash flow investments for 20 or 30 years. I think that in some markets, that would absolutely be the answer. Well, the point I was trying to make before is that if we reach equilibrium as we had--as we had prior to the 60s in the U.S. I'm sorry, post the 60s in the US, then the consumers will probably drive home prices to a point that a third party passive investor wouldn't find them interesting. They'll be better--better uses for capital over time. And so, this is sort of a--it's push-pull, we think that there's an opportunity to sell it as a professionally managed cash flow stream. And then there's an opportunity for the asset to revert back to its normal--to its traditional consumer, traditional buyer which is the consumer. And we don't know which way it's going to go.

All right. All right, I think we have a question right over here.

Actually, that was a—[inaudible].

Is that right?

Any other questions? No other questions? It's--

I have a question for Sean.

Oh, no. Oh, no. I was almost out of it. [Multiple Speakers]

When you talk about the exit strategy for you folks, when you buy a portfolio in a marketplace, have you talked about how many years or how would the length of time you'd have to go through to liquidate a portfolio? I mean, or is the model just a bolt--

Well, we have a permanent capital applied to this. And so--so for us, it's a matter of--of there'll be no fire sale. There'll be no need of fire sale and it's a matter of execution. So, I think the nice thing about the lease cash flow is that it doesn't--it creates a return that's far greater than anything else in fixed income these days. And so it takes away that need, that need to sell. So if interest rates rocketed up, and there became more attractive investments someplace else. And in this one, as I was trying to put down a list of positives and negatives and clearly, I think there's more positives than negatives. So, one of the negatives for housing is that you'll make housing more correlated to the capital markets, right? And the economists can argue to both sides of that. But as more institutional investors own this as a class, if stocks go down a lot, then they might want to sell their homes and buy stocks. So it creates volatility in the asset class, not that there's not already a lot of volatility in an asset class but it makes them more correlated to other financial instruments. But when we talked about liquidating the real estate, for us as an investor, it's been--it's been paramount to create this professional asset management business because we may liquidate our ownership in the asset. And this is important. We may liquidate our ownership in the asset, and some other investor may decide to buy it and then sell it and the houses may never hit the market, right? Because, what's--you know, if we could have decoupled the foreclosure from the--from the asset transfer process, we wouldn't have seen this amount of this duress--this amount of stress. So the fact that--the fact that a home goes from investor A to investor B, doesn't create any supply and demand impact on consumer transactions. And I think that's what's an important benefit from this process. Now, I don't want to overstate the impact here because this group of investors that keep their name in the paper and--and successfully avoided being grilled other than me. Collectively, we've bought 30,000 homes or something, 25 to 30 thousand homes. The mom-and-pop investors are out there. We think they've purchased upwards of $200 billion dollars for the real estate, since the crisis hit. So, that's really where--where the capital is flowing and that's where the asset classes is seeing its marginal--its marginal bid. The benefit that's seen in the last few months, and I think if you update those slides, that we saw in the morning, for the last three quarters, you'll see a lot of variance. You'll see a lot of shifts more of that institutional demand and less of that retail demand. But in the end, what's--the benefit as stated from that is that in real estate, the marginal transaction is everything, right? That appraisal that you need to get to qualify for that mortgage. The way the process is done today is it's off of comparable sales. So as the marginal transaction is priced higher, the fungibility of the whole--of the whole neighborhood increases. And right now, we need those marginal transactions to--to inflate and change to--change the direction of housing.

So in your view, from an investor point of view, do you see a fundamental shift to this asset class as investment base? I mean, it's not--early on, it was viewed as more of an opportunistic, I guess a flip business or whatever I think Alan described it, I can't keep track of all of these titles, but--

Just don't call me an ogre.

No.

Milking is bad. I figured that they--

Yeah, milking is not good. But so--but you do see a fundamental shift in, as a business class, as an asset class.

That's what we're trying to do. We're trying to make this--put this on the asset allocation menu with pension funds that's managing for a group of teachers and they can choose between blue chip stocks and municipal bonds. Right now, they can choose to buy multifamily apartment complexes in the public REIT market. They can buy a pool of mortgages. They can buy a pool of subprime mortgages. But what they haven't been able to do in the past, is buy a pool of professionally-managed single family homes. And so that's--that's really what we're trying to build is that platform that allows them to make that asset allocation decision when they like to.

Great. Without any further question, let me bring this panel to--oh, one question down here.

[Inaudible Question]

Oh, well, your capital's market rate as I understood it and so is Sean's. Now Sean's exit strategy, he's going to get as much as the market can bear, your exit strategy is constrained on the upside by your mission of trying to keep the same home owner in there, and you have this high touch process which I presume cost money. You know, some of that is being--is your partner agencies, the homebuyer counseling agencies and so on. But I don't quite get how you can provide market returns and constrain your upside on the exit and compete with Sean's, you know, model.

Well, first of all, the model includes all of the projected cost to hold, maintain, do all the counseling and get through the program. So, all of the cost of bringing in the third parties are really part of that financial model from day one. So that's number one. Number two, the other thing is--it's not a guaranteed return. So, and the private equity firm is mission-oriented. So, perhaps, in their mind, they feel--they maybe have taken a little bit of a haircut on the return because they're mission-oriented as well. And so, we think the way it is. I'm guessing that maybe Sean's return is perhaps a little better at than, I mean I don't know. But it's still--but it's still, you know, investment grade has a range, right? So, we thought it was important that we drive the model and as Sean alluded to, you drive the model, unfortunately that means that the purchase price has to, you know, if you put the returns in and you put the length of time that you think you're going to have to hold that asset to get the homeowner through, and you have to pay for the counseling and you have to pay for maintenance or foreclosure, that it ultimately ends up what you pay for the asset, and how much cushion you built in there, so.

SEAN DOBSON: I would say one thing. All things aren't equal in the marketplace right now. I mean--an access to inventory is everything. So, it's not so much, you know, as much capital as out--there is out there, chasing these deals. Inventory is really the king still. And I think in many ways, because of the kinds of stuff that Marie and her organization--and many other folks around the table are doing--it gives you a leg up, which is access. And you know, Sean has to compete out in the marketplace, grab what he can. If you can get a first look, initial look--a discount that’s not widely available. I think, that's why some of the private capital want to attach themselves to a organization like Marie's and--

Well, I should say, we're motivated, perfectly economically motivated to sell the home to the existing homeowner. They should have to the existent tenant. They should have the highest economic bid for the asset. And when we buy homes at the foreclosure auction and they're still occupied by their previous homeowners, we try to move heaven and earth to get them to convert to lease, to keep them in the place. It's obviously the least damage to their personal life and existence than to have to move. We're aligned with them in that because it's very expensive for us to take in the house, rehabilitate it and market it and find a new tenant. So we're aligned with the homeowner in both cases if they can qualify for a mortgage. But the bet we're not willing to make and this is something that maybe this audience can fix. We're not willing to make that the mortgage market can straighten itself out in a reasonable period of time. And so, we're looking for liquidity for this asset from some other place. And this, it says a lot. You know, this is a platform that did $90 billion dollars of mortgage transaction last year, and it's a fiasco right now to reach in a mortgage. You don't know what the regulations are. You don't know what the regulations want or meant--or meant to be and you don't know what--and investors are rightfully shy, for making a loan that is not government-guaranteed because they got completely fleeced in the last cycle. So, that could take a long time to cure.

JIM PARK: Okay, with that, let me thank Marie for all the great work you're doing and let's thank Sean for having the courage to come to this panel. We've invited a lot and lot of others and you’re the only one that showed up, so, thank you very much.

[Applause]