REAL ESTATE CAPITAL

A sector you can't afford to ignore

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Debt funds look poised to benefit from the need to preserve affordable housing in large US cities.

It was a relatively small deal but it may have signalled something big. This summer, Pembrook Capital Management stepped in with a $16.6 million loan to support the acquisition of the Mark Twain Hotel in Chicago by NHP Foundation, a New York-based not-for-profit real estate corporation.

The Mark Twain Hotel has not actually been a hotel since before the Second World War, having transitioned to become a provider of single-room occupancy (SRO) property. Like many similar buildings in Chicago, it was in line to be sold for development until Pembrook and NHP came knocking, among the first investors to take advantage of a new piece of legislation introduced in 2014 to preserve the city's affordable housing.

The SRO Preservation Ordnance hit the law books as part of an attempt by the city to try to stop the loss of affordable housing units. Some 2,200 SRO places disappeared between 2011 and 2014, before the new law required any owner putting an SRO property up for sale to submit a Notice of Intent to Sell and provide a 180-day period in which priority is given to any buyer intending to preserve the property's affordable housing. In the case of the Mark Twain Hotel, 152 units were safeguarded.

Other major American cities, such as New York and Los Angeles, are also beginning to appreciate that a dwindling affordable housing stock creates a major social problem. "The issue of affordability is very real for residents of American cities as rents and property values rise," said Pembrook CEO Stuart Boesky when the deal was announced.

Pembrook, a debt fund manager, confesses to being enthusiastic about the affordable housing sector. Wary of risk and also the regulation around the sector, banks have retreated from lending to it directly. This means the sector is not overly competitive and decent returns can be made.

Moreover, banks are increasingly committing capital to it through debt funds such as Pembrook. In part, this is due to the Community Reinvestment Act (CRA), which was introduced in 1977 and encourages banks to help meet the needs of borrowers in low- and moderate-income neighbourhoods. When the banks want to extend their operations into a new location or acquire a rival, they may be prevented from doing so unless they have an acceptable CRA rating – and supporting affordable housing is a rating-booster.

Investing in accordance with ESG principles is another reason why investor demand appears to be growing. Last month, Pembrook hired former Ford Foundation executive Lisa Davis as a director to help originate investments that promote affordable housing, job creation and the revitalisation of under-served neighbourhoods. She sees the growing awareness of ESG in the US as a trend that will help her attract a new generation of investors into affordable housing and urban regeneration.

There are limits to the sector's potential growth. For one thing, you need experience of what can be quite a complicated, if lucrative, area to invest in. It's also not a sector yet big enough to sustain multibillion-dollar funds, either on the equity or debt side. But for mid-market lenders and smaller community development-type institutions, affordable housing has many attractions.

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