

THE BROOKINGS INSTITUTION

FALK AUDITORIUM

INNOVATIONS IN AFFORDABLE HOUSING FINANCE IN THE DC REGION

Washington, D.C.

Wednesday, November 9, 2022

PARTICIPANTS:

JENNY SCHUETZ

Senior Fellow, Brookings Metro

AJ JACKSON

Executive Vice President, Social Impact Investing, JBG SMITH

ZACHARY MARKS

Chief Real Estate Officer, Housing Opportunities Commission of Montgomery County

* * * * *

Jenny Schuetz [00:06:31] Hello, everyone. Happy post-election day. Is everybody exhausted from staying up until two in the morning or did people call it a night and wake up this morning to find out? We still don't know. A little bit of both. Excellent. Well, thank you so much for joining us here in person. We are delighted to be back to doing in-person events. This is actually the first in-person housing event we have done. So hopefully we'll have a great conversation. I'll give you just a little bit of opening remarks before we bring our panelists up and get into the into the meat of the subject.

I suspect that many of you here today know that the need for housing of all kinds and especially affordable housing is urgent in the D.C. region as it is everywhere in the country. So for those of you who've been sort of following our moving target of how much housing we need to build, the Metropolitan Washington Council of Governments estimated the region needs about 320,000 new homes between 2020 and 2030. And this came out before the pandemic, which put a little bit of hitch into our housing production. So we are going to be stretching to build enough homes just to keep up with population growth and job growth. The good news on the demand side is the reason that we have such an urgent need for housing is that our region is growing, that we have a ton of well-paying jobs, we have industries moving in. Feels like every other month there's a new company that announced they want to expand their operations here. So all of this is fantastic. We also know that many of our jurisdictions have great public schools. They have great parks and outdoor recreation. We are a region that is drawing people, and we should keep that in mind that that's better than the alternative.

But it does create then growth pressures and we also have some relatively long sort of difficulties on the supply side. So since the Great Recession, the whole country has been short of construction workers. We have lost a lot of people who just didn't go into the field because of shortfalls in immigration, we have fewer construction workers as well. The cost of labor and materials have been going up and up and up. We were just having a conversation before the session about things like specialized parts that are made in the Ukraine that are no longer available, which are not just local problems, but they feed into the shortage and the cost of building. Obviously, we also have rising interest rates, which is not great if you're trying to take out a loan, either a construction loan or to buy a house. So we have a need for housing. We have some difficulties on the supply side.

And in particular, of course, all of us are here because the most urgent need is housing that is affordable to low- and moderate-income households. We know that across the country, the poorest

25% of households spend more than half of their income every month on housing, which crowds out food and transportation, health care and all the other things that families need. We know that there is a gap between what people are able to pay as a percentage of their income and just the basic operating costs to provide housing. Right. And so that's essentially the math problem that affordable housing has to figure out. How do you plug that gap between income and the rent that covers operating costs? So we are going to explore today a couple of different models. We have two fantastic panelists who are going to talk to us about some different models in the region, leaning more on the public sector, more on private capital, different approaches to new construction versus acquisitions. We're going to have a chance to really dig into a lot of these issues.

We are joined today by AJ Jackson. AJ heads the Social Impact Investing for JBG Smith, where he leads the Washington Housing Initiative, an innovative platform that partners market driven investment with mission driven sponsors to create affordable workforce housing and increase economic mobility in high opportunity neighborhoods. AJ will give us lots more details on how the Washington Housing Initiative works. AJ earned a B.A. with honors from University of Alabama and an MBA with distinction from Harvard Business School. We are also joined today by Zachary Marks. Zach is the chief real estate officer for Montgomery County's Housing Opportunities Commission. In this role, he's responsible for HOC's property related activities, including real estate acquisitions and development, property maintenance management and asset management. And Zach is a graduate of the University of Richmond with a B.A. in journalism, holds a master's in education from Hopkins and an MBA with real estate concentration from UNC.

So AJ and Zach, please join me up on the on the stage and we're going to open with AJ giving us, we'll have about 5 to 7 minutes opening remarks from each of them and then do a moderated Q&A, about the last 10 to 15 minutes, we'll open it up for audience questions. So, AJ and Zach, welcome.

AJ Jackson [00:11:45] Shall we kick it off. So. Good afternoon, everyone. Again, I'm A.J. with JBG Smith. For those who don't know, JBG is a publicly traded real estate company based in the Washington, D.C. area. We own and manage about 15 million square feet of office buildings, apartments and retail, and that includes owning and managing about 10,000 apartment units in the region. I lead social impact investing at JBG. And what that means is we have a platform that invests in market rate, affordable housing and then makes investments to both stabilize the property and

stabilize the residence to create value for our investors and for the people who live in our and our communities.

I think we can kick this off. So what does that mean? Who are we? Are we serving? So we serve what we call the missing middle in the market rate, affordable space. And what that generally means is people who earn too much to qualify for traditional housing programs, but not enough to be financially stable, paying their rent, and the other basic bills that they've got to cover. In the Washington area, that means generally 50 to \$100000 in income. A lot of people talk about policemen, firefighters, teachers, but it's also your payroll clerks or I.T. specialists, the people that make your everyday run, the people that make your business run. And so that's really who we're targeting. I think it's important to clarify where we are on the housing spectrum with this solution, because there is need up and down and this is a targeted, targeted fund, targeted intervention in a specific part of the housing ecosystem.

So how does it work? We have a fund that we've raised for investors of about \$115 million that we invest at the speed of the market, using the creativity and the flexibility of private capital to partner with nonprofits and with local governments to preserve affordability and prevent displacement, and then to invest in resident stability in existing units. So we're buying existing, naturally occurring, affordable housing or existing what we call in the industry class B, Class C apartments, an older apartment. If you think things that are sort of plus 30 years old in high opportunity neighborhoods around the region. We can talk more later about what that what that means. The basics of what our intervention does is we invest as a lender to replace what would otherwise be private equity in these transactions.

So in a typical real estate transaction, this is illustrative, we'd be 70% first mortgage, 30% equity from the investor. We take about two thirds of that equity and replace it with investment from our fund, which is a little bit lower cost and a lot longer term than most private equity. And what that does is that allows a mission aligned buyer to compete with a private investor to acquire assets and keep them affordable versus converting them to luxury housing. So that's the basics of how the housing model works. We can talk more about that. Just some of what we've done around the region. We've invested in about 1750 units so far since 2020. We made our first investment in January of 2020, deployed about \$40 million in capital to do that. And that \$40 million is leveraged to acquire about half a billion dollars' worth of real estate.

So for those not steeped in affordable housing, that's a much faster pace and a much lower dollars per door than traditional affordable housing interventions, because what we're doing is acquiring assets that already exist, leveraging them with other private capital, and then maintaining their afford, and then maintaining their affordability over time, everything that we invest in, we put a covenant of at least 15 years on. Some things have much longer covenants to really stabilize that affordability over the long run. And then finally, we partner, as I've mentioned, with nonprofits and with local governments around the region to make this possible. Local governments really provide the policy tools that enable us to both accelerate and expand our investment platform in in key regions, Montgomery County or Alexandria, the district, etc. So that's a really quick overview of what we do. We'll talk more about it, I think, in the, in the Q&A. Thank you.

Zachary Marks [00:15:54] Thanks for having me today. I'm Zach Marks with the Housing Opportunities Commission, which is a fancy name for the Housing Authority for Montgomery County. And we, you know, I think what's sort of gotten us the most the most pub lately is a fund that that we created with a council member locally. And and so a couple of things to sort of frame up here. So one, we do everything else, too. So the housing production fund is supposed to produce housing. It's not, it's not intended to be a replacement for all the other tools that you may be familiar with. It's not intended to be a silver bullet for, you know, extremely low income up to, you know, up to market rate. It is designed to get units on the ground much faster than we are currently doing in Montgomery County.

The council government's goal for Montgomery County is about 3300 units a year. And in the last two years, really the first two years of that, that adventure, we've produced about 60% of that number, I think, in total. And so it's not going to happen with just the private sector. The private sector is doing what it does, and it's producing those units. The Housing Opportunities Commission happens to be producing some of those units as well. And so we were approached by a councilmember who wanted a, wanted to create an affordable housing platform. And one of the legs to that stool, is, was what became the housing production fund. And he came to us and he said, what can, what can the council do to to support what you're doing? We, one of the sort of, one of the things that sometimes gets lost is that some folks think the housing production fund was the beginning of mixed income production by HOC, but in fact, it was a crucial tool to scaling something that HOC had been kind of doing for decades, which is this mixed income housing model. We didn't know we were

doing social housing until people told us, so it was nice to hear we were doing something that had a name, but we just really were approaching mixed income housing for some technical reasons around financing, but also because Montgomery County has kind of always been a high cost, high rate area. And the commission has always believed that housing should be integrated from a social economic perspective, and that if somebody is going to get that sweet, sweet market rate rent to do something good with, then why, why not us? So that is a model that HOC had actually been producing since the late eighties, if you can believe it.

And so very similarly to what AJ explained, we also, after some thinking and some workshopping ideas, because we've never had anybody come and say, how can I, how can I help you and and say whatever you want, you know, within reason. But so it was really disorienting at first and then it was really great. We also felt like the place to target was the capital, the part of the capital stack that's typically funded by private equity. So which is to be distinguished from low-income housing tax credit equity, that because of our mixed income projects, there are often sufficient returns to attract private investors. And so HOC is has done a couple of those where we've built buildings and we've put in matching capital with the private sector.

But as you may know, that tends to be very expensive money captures it can also capture a lot of the upside. And we frankly view our real estate pipeline as lower risk than the private sector for a bunch of totally normal reasons that, you know, do not mean I'm imputing the private sector just the nature of how we produce and pursue these transactions. We just they're just less risky for various reasons. And so we knew that the Council of Governments goal was something that the Council took very seriously. We want we knew that we could be a part, we could actually do more than what we were already doing to help it meet those goals. We knew that the solutions almost certainly have to come out of the public sector because, again, the private sector's already sort of, you know, maximizing what it can do with what's on the table. And so the production fund is a, is really the simplest. You may know people who are in affordable housing by the level of brain damage they have around trying to use affordable housing finance. And what's so weird about the housing production fund is it's the absolute stone simplest approach to affordable housing, and it is in fact, not what's challenging.

In fact, it's a feature that it's so easy to explain from a technical standpoint, but the challenges are really around our perspective of what government is capable of. I think it's a kind of an American

tradition to to believe that the government can't actually walk and chew gum. It can't actually produce market rate goods. And what HOC happened to have been doing for a long time was producing high quality new housing that is indistinguishable from from private sector housing. And so we wanted to scale that up to try to meet this 3300 units a year. And so this is, this is a revolving, municipally financed fund that replaces the really expensive private equity out of, you know, all the big cities in the U.S. And, and it lowers that that cost of capital sufficiently to where it gives my commission the confidence to to say, yeah, well, we'll do six deals instead of two, because now we know the the capital stack is complete going into the deal. It's that that confidence is is huge for a board that's trying to make smart decisions about how many things should we do at once. We were lucky. I was lucky in that HOC, the people that came before me had produced so many high quality mixed income units that the council was aware of that. So they didn't need to be sold on that.

HOC also brings permanent financing tools. Council was, you know, because we're also the Housing Finance Agency. And so the council knew that. So there were lots of things we had in place that made this successful for for for us in Montgomery County. And as I've talked to other folks around the country, there are definitely going to be you know, there's different states of play. You have different politics. And so, you know, I consistently say that our model is from Montgomery County. It can absolutely be tweaked for and improved for, for for other parts of the country, too. But just sort of the clothes, the general ideas here where that and the only way we're going from 1600 units to 3300 units a year is speed. Right. We have to have speed, simplicity and scalability because we're already doing the LIHTC deals and they take 97 years like we're already doing the stuff that's already there or we're doing that. But if we are truly going to try and and meet this need, then that means doing things that are scalable, that are simple, that are elegant, and that can and that can be really scalable that, you know, you're not changing the business model by doing two, three, four more deals on the margin. So.

Jenny Schuetz [00:23:36] Great. And it strikes me actually that sort of one way to think about what both of you were doing, that picture that AJ showed us of the capital stack where you have 30% equity and 70%, 70% debt. So this would be standard for like a private sector deal in the traditional world of affordable housing finance, in a LIHTC deal or something like that. You wouldn't have two pieces of that, right? You'd have like ten slices. So you've got, you know, some funding coming from the sale of the LIHTC credits. You've got some bonds, you've got probably some gap financing. And

so part of the complication with traditional affordable housing finance is that to put together ten slices in the stack that covers 100% of the construction costs, you've got to have a bunch of people who are assembling the financing sources. Right. And lining up the rules and the timing.

So what you have both done in slightly different ways is simplify the capital stack, fewer sources, so that it takes less time and less work to put it together. Is that a fair way to describe what you're doing?

AJ Jackson [00:24:35] Absolutely. And it's essential in the preservation space, because in the preservation space, you don't have time. Right. It's a typical transaction. In a you know, in the Commonwealth of Virginia, for example, you might have a 30- or 45-day study period and you're expected to close 30 or 45 days later, right, to somewhere between 60 and 90 days. You don't have time to put together a seven-layer capital stack. And and by the way, the seller is looking for who has the capital to give me certainty of execution before I even assign the contract. So it was a feature that we tried to design in from the beginning, was that moving at the speed of the market and being flexible with capital.

Zachary Marks [00:25:10] Yeah. And on the, on the production side it is the idea is the average LIHTC deal in Montgomery County is 130 units. So it's the way these programs are written, it basically produces the same building over and over again. You get 30 units. And so you're not going to, you know, you're not going to get the 3300 that way alone. And so the general idea here is create something that doesn't use, doesn't cannibalize the LIHTC, the standard affordable housing tools that can be scaled for production.

And, and frankly, one of the other interesting things that didn't occur to us at the time looks like genius now, but total accident, was that, was how much the private sector actually was attracted to the to the structure too. So the, which was good because we have a natural affinity to work working in public private partnerships. So I think and we can't do it without it, I mean, you can't produce at this volume with the staff you had when you were producing, you know, less volume. So it's that, it's that simplicity of the stack that allows you to focus on on the logistics of making these things happen.

Jenny Schuetz [00:26:17] So one of the differences between your approaches so far, the Washington Housing Initiative has mostly been focused on preservation. So acquiring buildings and the housing production fund is primarily new construction. Is that right? Talk a little bit about what are the pros and cons of doing acquisition versus new construction? Where do they, where do they fit

together? Are they serving different kinds of locations or fitting somehow a different kind of model of housing?

AJ Jackson [00:26:47] Let's kick it off. I mean, for us, preservation was about a couple of things. One, it was, as we would say in business, the white space, but it was the area where there was significant need and not a lot of focus. So I think a thing that's not widely appreciated out of outside of housing circles, most people who live in housing that's affordable to them, live in housing that's on any kind of program. It's naturally affordable. But in fact, we are losing that housing. So there are less units every year that are naturally affordable than there were the year before, because those buildings are either torn down and redeveloped or because the units are renovated through what we call value add, and the rents are pushed to luxury levels. And so we saw that as a space where there was a real need, you could actually create affordability through preservation. So that was that was sort of one part of it.

The other was it was much faster than development. And to Zack's point, we're trying to move, move quickly here. Third, it's much cheaper. So it cost us on average maybe \$250,000 to buy a unit and almost two x that to build a unit. Right. And so it's a faster, cheaper way to do something. The third is that it's we can focus the affordability in the locations that provide the most opportunity for residents from a socioeconomic perspective. So we call them high impact locations. But what that means is we can go into, for example, northwest D.C. and acquire existing apartment units and make a portion of those units affordable and give people access to high opportunity locations, which is a core principle of our model is investing in affordability in the places where residents are going to thrive and not just in places that are cheap because they're not good places to live because those don't produce good outcomes over over the long term. And then finally.

Jenny Schuetz [00:28:19] Could you spell out what high opportunity means to you guys.

AJ Jackson [00:28:22] So for when we look at high, when we look at high opportunity, high impact locations, we look at a whole series of data, but we look at population growth. We look at access to retail and transit to amenities. We look at educational levels, we look at crime statistics. We look at sort of a whole suite of data that in essence, back to the work of Raj Chetty and others saying what are the locations in which people who live there are most likely to have better outcomes over time, better life outcomes for children, better physical and mental health outcomes for adults over time. And let's invest in those places. And again, not places that are just cheap because no one wants

to live there. Right. And so that's not being in food deserts, not being in places that are cut off from transportation, not being places that are very high poverty, very high crime, etc.

And then the last thing which, which maybe is the most important certainly to our investors is that we figured out a way to generate return during preservation. We haven't figured out a way to generate return during production without using something like Zach's fund. And we believe that it's important to generate return because if we can attract private capital, that's what truly makes the model scalable, right? In this country, things that are profitable are things that get scaled. And so it's important to us to make money not so that we can make money, but so that we can attract more capital to addressing the issue.

Zachary Marks [00:29:39] Yeah. I mean, it's, you know, supply side solutions. The, the, the real bug in the machine is that they take a long time. I mean, it takes two years, three years to entitle a deal in Montgomery County. It's going to take 2 to 3 years to build that deal. So the, you know, the person that needs an affordable housing unit tomorrow is out of luck. So, you know, but it doesn't mean we don't do those things that, you know, that get toward, get more toward the root of the issue, which is we need to preserve these naturally occurring units because they're so dear, because there aren't enough units, there's not enough supply in the market.

So so like as I said at the beginning, it's that the HPF was designed to do a specific thing and that is to be a supply side solution to accompany, not replace, not to supersede in importance, the stuff that needs to be done, you know, in the immediacy. So it's HOC does preservation as well because these, one of the things we've found in doing that preservation is not only do we lose these units to either market rate acquirers who just elevate the rents or to developers, who just knock the buildings down and put something up and don't replace the inventory. But one of the other things we found is that actually a lot of these units are already gone. And what I mean by that is the people that live there, if these were restricted units at by income, that was relative to the actual rent being charged, none of these people would qualify to live there. That, in fact, you have folks in these units making 120% of AMI and they've got a nice deal and love living at these properties because they they tend to be really nice places to live, as AJ said.

So and I just lastly say, in terms of high, high impact, one of the things that we have found that is most important are the families that live in our properties is access to, to schools. And it is not, there is not going to be equitability of access to schools even in a place, you know, even in

progressive Montgomery County. And so when we create 20% of our preservation units at 50% AMI and give families an opportunity to live in downtown Bethesda or to go to Bethesda, Chevy Chase, you know, places like that, you know, the value is not just in like making their household budget better. It really is upward mobility.

Jenny Schuetz [00:31:57] Yeah, I'm curious a little bit because the sort of the location decision is a little bit different when you're doing preservation. It's a question of what's available right and what you can compete for when you're doing new construction. Are you looking for specific kinds of sites? To what extent are you using publicly owned land? Are you, do you do you have sort of like a master plan of parts of the county where you would like to do something and you're waiting for it to come up? Or are you also kind of opportunistic when something is available?

Zachary Marks [00:32:29] It tends to be more the latter. There's, I mean, you know, the idea I think it often gets said that, you know, everything's built out or, you know, there's not, but it's just not it's just not the case. Like, you know, and I don't like to say it too loudly because I want everything to be up zoned. But but the reality is that we do everything from repurposing our own portfolio. We're one of the largest landlords by unit count in the county. And so oftentimes what it is, is it was a previous preservation acquisition that 30 years down the line turned into a redevelopment. You know, we had one of our one of our deals that tends to get talked about a little bit is called the Lindley. It's on just off Connecticut Avenue. It's right next to the Chevy Chase Lake Town Center that is being developed. And HOC owned 64 units there on five acres for a long time. And, you know, that's not super dense and it's actually where the purple line stations are going to go, you know, God willing. And and so we turn that 64 units into a 200-unit multifamily building and actually funded the building by selling off two thirds of the land to a townhome developer and taking a profit participation and just chucking the profits into the deal as as our equity for that deal.

This was pre HPF, if we had had that production fund at the time. We'd have done that for sure. But, but most of the time we're just looking for because we don't want to do 130 units, we want to do 400 units, you know, two, three or four- or 500-unit deals with the production fund. We're looking for, you know, the same thing every else is, which is transit oriented. Sometimes that's on our own land. Sometimes that's on land we've acquired. Sometimes we take over a deal from the private sector because it's not working for them. And sometimes that's on land that the county owns and it really is just catch as catch can.

Jenny Schuetz [00:34:28] Do you guys have a secret strategy that you can share with us on how you go looking for properties? Because there are lots of older, affordable housing buildings across the region and it looks like you've worked in a couple of the jurisdictions sort of around. Do you have a actually have you done something in the district?

AJ Jackson [00:34:44] We have. So we've— we've done work in the district, Montgomery County, in Prince George's County, Arlington and Alexandria. So our secret strategy honestly, our secret strategy does start with our high impact location map. You know, we look at that data at the block level, then up to the census tract level. And we we screen out a lot of things that don't pass that don't pass that filter. But the secret sauce, if there is any, is the fact that JBG Smith is certainly the largest public real estate company in the region, maybe the largest real estate company in the region. And so that does afford us access to a lot of deal flow. And we see pretty much everything that we could that we would want to see. We have great relationships across the investment sales community and in the region. And so that does that does help us to kind of see everything and underwrite everything and identify in that regard. But it it's all up against that locational allocation filter.

Jenny Schuetz [00:35:40] Got it. Zooming out a little bit to a sort of higher-level policy question on housing Twitter, where I spend far too much of my time, there are frequent debates about sort of what the the public sector and the private sector can and should be doing in the affordable housing space. And to sort of grossly oversimplify, this often comes down to things like private sector entities are always going to want to maximize their profit. And so if they own real estate in a high value and appreciating market like the D.C. region, they will always want to push rents, right? Because rents are going up. And if you can do that, why not? So in some sense, you know, it's there are people who argue it's really important to have some chunk of the housing stock that is not owned by private entities, whether that's public agencies or non-profits. And there are there are people who are strongly advocating for the public sector in particular to own, develop and manage more of the properties.

And then there's also push back saying, well, but public agencies also have some constraints. Right. You guys have been clever about creating a financing system that is somewhat less dependent on Congress, which gives you some insulation. But public agencies have more constraints. Traditionally, they haven't been able to move fast, to acquire properties, to compete, to have access to private capital the same way. So I'm sort of curious, how do you see sort of, you know, do you think

it's really important to have housing that is owned outside of the private sector as sort of a buffer against rising rents? Does it matter less who owns it as long as you have affordability covenants on it? You know, what sort of the key advantages of a public sector agency and the private sector in this space?

Zachary Marks [00:37:21] Yeah, I mean, and I'm definitely so I'm definitely the kind of person who's not. Like I'm not very exclusionary personally when it comes to solutions in this kind of an, you know, this kind of an industry. So I'm very much a, a yes and sort of person. So I think there are and I think there are definitely ways to incentivize the the private sector to do more of what you want. But but working, understanding their business model and working with that business model, what we have found is that some benefits of the governmental ownership is that it's easier for the council to be confident in sending us funds to build stuff we're going to own than it is for the, you know, the county who is a taxing entity to be turning money over to the private sector. Right. I mean, some of the main reasons why these programs are so complicated is because somewhere at some point, some private sector entity broke the rule and the rest of the class can't have a cupcake. So it's just it's one of these things that because of that crossing, that threshold from public to private, it doesn't meet our, you know, one of our three S's, which apparently I invented right there. So which is speed, you can't have speed through the tax credit program because so much of it is about compliance, and are we doing too much for the private sector? And there is there is this in government and it's understandable.

So I'm not saying this, you know, I'm not saying this in a way that is critical necessarily, but that in government there is this gut reaction that if the private sector likes what we just did, then we must have screwed it up. So and we have those discussions where it's like, didn't you incent incentivize them so that they would do this? Yes. But they like it. They're smiling. So so I think that's part of it, is that it's easier when particularly when the bodies have a good relationship. But in this case, the council, and HOC, they knew enough about each other. And because it's keeping more of the value inside the government ecosystem, it became a real benefit to the speed with which and probably the size with which they took their first step.

And I would just say the other one of the other benefits of public ownership is that the county has something called Montgomery County has something called the voluntary rent guidelines, which I'm pretty sure nobody volunteers for except us as a policy. So so even our market rate units and our mixed income developments are operating under the voluntary rent guidelines, which means rents

went up on renewal 1.4% last year. And I think you might imagine that's attractive to even our market rate tenants. And so there are other ways to sort of Trojan Horse in some stuff that may not be successful as a mandate but could simply be successful as implementing it through your very willing housing authority.

AJ Jackson [00:40:11] So yeah, I would agree with a lot of that. I mean, I think that it is a both and we're in a both and situation, or all of the above situation with regard to with regard to housing and whatever you can do that increases the effective supply of housing up and down the spectrum is something worth doing and the ownership is less of a concern to me although I do think that the speed issue is a significant issue, particularly in preservation, where the private sector has a bit of a bit of an advantage.

I also think that over time the the the financial motivation that keeps investment in the asset, right, capital investment in the asset over the long run is something that's important. Right. And it's not unique to housing. There's some really bad examples in the public housing side, but it's not unique to housing it's unique across you talk to the GSA, across office buildings, across a lot of publicly owned assets where it can be very difficult to finance capital over the long run. I think HOC is a little bit of a unique organization in that it is a nice hybrid of both and can operate outside of some of the, you know, legislative appropriation constrictions that would that would that are causing us problems in other in other places. But there's I think there's there's room for both. And it's really about understanding what the incentives and motivations are for each for the public sector, in the private sector, and then designing programs to to harness those towards the goal that you want, but also understand the risks that come along, come along with that.

Jenny Schuetz [00:41:37] Great. So I'm going to give one more question to both of you before we open it up to audience questions. So if you want to be thinking about questions, you have, now's a good time to do that. I know that both of you spend a fair amount of time talking to people in other parts of the country who are interested in what you do, interested in developing something like the impact pool or something like the housing production fund. I think it's fair to say that Montgomery County is a very high capacity government and a pretty high resource government. Not all local jurisdictions have sort of the resources, the breadth of expertise, the access to capital that you have and sort of past experience with relevant programs. And JBG Smith obviously brings the private sector expertise. And you have figured out also how to tap into private capital markets to create this

impact pool. But if other organizations in other parts of the country were interested in replicating the kinds of things you've done, what are sort of the key things? What are the kind of staff, knowledge, capacity? What kind of external partnerships or relationships and Zach what kind of support, especially from local elected leaders, is critical to making this kind of thing happen?

Zachary Marks [00:42:48] Yeah. I mean, again, it's just, it's it's it's really weird to not spend 90% of my time on explaining how the financing works. So really, the complexity to this fund and this, this approach is really in things like capacity and political will and and self, frankly, governmental self-belief as well. I mean, I mentioned earlier that, you know, we often just have this natural feeling that the government can't do things, but the government often feels this way about itself, that it doesn't even have this self-belief, that it can produce something like this. And so I think it's important to be to do sort of take that sort of inventory.

So when I talk to folks around the country there, there are wildly different states of play. You have places that have a development agency that has a track record, you know, other places that don't have it at all. You have places that have robust nonprofit, you know, nonprofit organizations who are really nervous about, you know, are you about the crowd them out? You know, you have prevailing wage interests from unions. You have you know, you have purists that think the mixed income that HOC does is the devil's work. And how are you doing something that only has 30% affordable in in, you know, in project. And so. And what I say is you just got to be honest about what you have in your political inventory. What are you dealing with? What are your challenges? Who are your, who can be your potential allies? Because those unions can be your potential allies. You know, and and where are you going to get the people who can execute on these deals there? You know, you need allies in private sector for a long time.

Before I came to HOC and I've been at HOC for ten years, but if I were trying to do this by myself, I'd be doing one deal, two deals a year. And new construction deals are impossible. So. So, you know, it's really being honest about what kind of capacity you have today, what kind of capacity you want to build in the long run, what you want your staff to look like. How are you going to convince them to come work for a silly old housing authority that, you know, has its headquarters in an old elementary school building? Hypothetically.

So so it's it's really these kinds of things that you have to think about and try to play. And what I sort of encourage folks to do is just to try to identify those points of strength and kind of build

outward from those assets you have. And to be very open minded about, not open minded, but open eyed, about how your governance is going to work. I mean, we're we're still a public housing authority and structure, so we have our own challenges. You know, we didn't talk about some of the some of the challenges that we have, but which I can do later or never. But. But yeah. Like its, governance is really important. How do you maintain trust? How do you maintain transparency? How do you make sure that what you're producing is stuff that your elected officials want to see and can be proud of? So.

AJ Jackson [00:45:52] Yeah. And we've we've talked to a lot of folks and seen a lot of examples of preservation efforts around the country. And I think the one thing that is critical that we underestimated when we when we launched the housing initiative is actually having a high capacity private sector partner who is established in the real estate space. So I think working with and we partner with civic groups, with nonprofits and when we got off the ground, I think that's with foundations. I think all of that is important in terms of building community buy in, in terms of building political will, in terms of raising capital. But at the end of the day, if you're trying to compete in the private real estate market to acquire assets and preserve them, then you need a known entity in that market that has credibility, trust and capacity. And I think that's really something that that JBG brought to the table that we didn't value as highly, I guess, because we weren't looking at ourselves quite that way when we got into it. But we know that we are. We are.

Your earlier question, we are seeing deals because of who we are. We are winning deals because people believe in our ability to execute. And it's not some sort of start up nonprofit idea that maybe has the money, maybe doesn't. And so that that, I think is is an underestimated component of the success on the preservation, if you're trying to do a preservation fund.

Jenny Schuetz [00:47:05] Great. Well, I know that you guys are bursting with interesting questions. And we have, Karen will be carrying around a microphone. We always like to encourage you to phrase your question in the frame or a question, rather than in the form of a statement or a comment. And if possible, to keep it fairly brief. And if you wouldn't mind introducing yourself and your organization.

Audience Member [00:47:30] I am Scott Sowers. I'm a reporter for the bond buyer. And I have a question about bonds. Do they play a role in the financing? You mentioned very briefly debt,

and there was a graphic up that I should take a picture of if you can get that back. I love it. But is there a role for immunities in what you're doing, either one of you?

Zachary Marks [00:47:51] Absolutely. So the two core places where we we are using bonds, the HPF is actually populated by a originally a \$50 million issuance by HOC. The county is actually paying the principal and interest for the 20 year bond, after which the fund is free. And so. Absolutely, we absolutely, absolutely part of our our strategy here is is coming out of the HFA a portion of HOC. And then one of the things that was really important to the council in believing that this revolving fund is actually going to revolve is our ability to permanently finance. And we use the FHA (inaudible) share and we've used the Federal Finance Bank program as well. So both taxable and tax exempt issuances, I know the FFB isn't technically bonds, but but certainly our ability to bond finance things is central to making this revolving fund go.

Jenny Schuetz [00:48:50] Which in part getting back to the capacity question before. So HOC can issue debt separately from the county and obviously having a strong credit rating of the public agency is important for that.

AJ Jackson [00:49:04] And we've used private activity bonds to structure our our subordinated debt in some of our investments. And that's that's a great tool because it's not volume capped and because it allows us to generate a higher after tax return for our investors, which is obviously compelling to them in terms of attracting capital. So there is a role, there's some more, I won't bore everybody, but there's some more restrictions around some tighter restrictions around affordability at deeper levels that come with that program that don't work for every transaction. But when it works, it's, it can be a way to to to to attract more capital.

Audience Member [00:49:42] My name's Bill (inaudible). I'm not really here representing an organization. I would hope anything I might say wouldn't dissuade you, either of you, from giving me your card when I ask you for it after the session is over. I'm not an academic. I'm not a professional in this base. I've got a variety of practical experience related to housing and finance. You mentioned the purple line. I hope to live long enough to ride that purple line if it's ever actually built. At university in New Hampshire, east side of which essentially is Prince George's, west side of which is Montgomery has been known for some time to be speculated about as to its future and who will actually be housed there or the commercial tenants there. I don't know that whatever the university is doing with regard to the smart growth element of it will be successful unless there is some constructively coercive role

government will play in ensuring that a lot of people who live there now, not under the best of conditions, will be able to live there then if they never occur.

So I'd be interested in knowing what role Montgomery County can play, at least with regard to the west side of New Hampshire. And sir, from JBG, I actually don't remember, I apologize, I don't know if it's possible to punch up your few slides, but the first or second of which indicated that JBG had collected investments from a variety of sources and then expended a smaller portion of that which had been invested. I'm curious to know what when it was invested, when was the collection made? And what's the balance from what was collected that's been expended in these variety of programs? What's it doing and why hasn't more of it been expended?

AJ Jackson [00:51:37] So we've raised, the impact pools a fund. So we've we've raised about \$150 million in commitments to the fund, meaning commitments from investors into the fund. We've actually deployed about 40 million of that, and that's since January of 2020. So right before the start of COVID, is when we when we made the first investment. We've deployed about 40 million of that. We have another about 30 million that's committed. So transactions that have not yet closed but are under contract and working through the settlement process. And then we'll continue to essentially do more of the same over the next, you know, the next year or two as we commit the rest of the fund to the projects. So we're basically just committing it as we as we find opportunities that we like, we get in the competitive process. And when we win, then we make we make investments.

Zachary Marks [00:52:20] Yeah, it just I think it's a, it's a question that obviously you have a real understanding of that that real estate market and why it's so vulnerable. So I would just say one of the best things that if somebody asked me like, what's the HOC's sort of best, you know, value to the county itself? And it's the ability to do large scale development and preservation. And so having an entity like that be able to go into an area that you're terrified to upset and you're worried about gentrification and things of that nature, having some having a group that's really capable of coming in and you know that HOC doesn't do displacement. We don't if there's 100 units on the ground, that is the floor. And we're probably going to put back more than that in terms of restricted units. So I would say that's the biggest role that an HOC type of entity could play, and that's why it's important to have them stood up with capacity and money because as AJ said, the market's not going to wait for you. So.

Audience Member [00:53:42] I am Jamie Butler. I am with the Washington Interfaith Network. So I've got a question. If you could add one or two new financing tools to DC government's toolkit for building affordable housing. What might they be?

AJ Jackson [00:54:02] Do you wanna tell DC how to do their-

Zachary Marks [00:54:04] I mean, the good news is we're really close by. No, I mean, the legislation is very straightforward. It's very elegant. And once it's done, it's a budget line item. So the council was so pleased at how the program started, that they came back and they they doubled the size of it the next year or so. And because of the municipal finance structure of it. So one of the things because we were working on this fund in the middle of COVID when we didn't know if there would be a budget ever again, we couldn't suggest a program that was really expensive. And so the first 50 million was issued such that the principal and interest annually for 20 years on the first 50 million is \$3 million. We charge our projects 5%. 5% on \$50 million is 2.5 million a year. And the way it's currently structured, it gets sent back to the county. So that means they're on a net basis paying \$500,000 a year for 20 years, and then they have a free \$50 million revolving fund continuing to churn. And so I would definitely encourage you to look at DC, to look at the using the power of municipal finance and firing it into somebody capable of of delivering units.

AJ Jackson [00:55:19] Yeah, I think, I think there is an opportunity for more funds for preservation, particularly in the workforce space where there's there's not the same focus that there's been in other, in other jurisdictions. And I think more broadly as, as as Zach said, to me, the power of the government with regard to capital is really its ability and willingness to take first loss and to incentivize other capital to come and to speak sort of very broadly, I think oftentimes the policies that are created are about filling all of the capital stack or a significant chunk of the capital stack. And I don't think that's really necessary. And I don't think that there's enough taxing authority to solve the problem if that's going to be the approach. So it's really about where can you take the first loss, where can you take the exposure that attracts private capital to pile in behind you and really leverage the public dollars to to incentivize significant investment?

Jenny Schuetz [00:56:12] And I'll just comment. I know that DC had to fight recently, well, a couple of years ago over sort of whether to dedicate funding to, you know, workforce. So the sort of the tier that doesn't usually qualify for subsidies and the politically this is often a really hard part where advocates will say, how can we spend public money on sort of middle-income tiers when there are

really poor people who are not getting any kind of subsidy? But I think the preservation focus is a really important one, because if preservation doesn't happen, there will be more low-income people who are facing more cost burdens, and you will need more of the tax revenues for very low income, right? So like preserving this idea, a strategy of preserving the existing buildings before they fall out of stock is really critical to keeping the size of the pool smaller for where the deep subsidy needs to go.

AJ Jackson [00:57:03] There's I mean, this is not this is beyond this forum, but there is a whole dearth of research about really the impacts of middle income, the lack of middle-income affordability on all sorts of negative externalities way down the housing spectrum. So whether it's creating more subsidy, creating more homelessness, all these all of these things that we don't like and have to have heavily subsidized for lower income people get exponentially worse when we squeeze the middle without support. And so I think we have to think about solutions that address the middle as well as the lower end of the spectrum.

Jenny Schuetz [00:57:35] Okay. We're going to take the last two questions.

Audience Member [00:57:39] Hi, everybody. My name is Alex Cabral. I'm a lender at National Housing Trust. A question for both of you. What, if any, modifications have you made to your underwriting, structuring terms that make the funds that you have at your fingertips more accessible to local, small or emerging developers or developers of color?

Audience Member [00:58:10] Hi, I'm Jillian Copeland. I'm from Mainstreet Connect in Rockville. And we are a nonprofit. I am not a real estate developer, but I am married to one. So that's the good news. And we've worked with Zach well, he's worked with Zach many times. Zach's amazing, by the way. If you don't know him, I know you are too, AJ, but I haven't worked with you. So really quick question for you. If you had a sweet deal, right, like all the criteria is met, HOC's involved, missing middle is there, that's the sweet spot. If you have a credible developer and a really mission driven organization that you're working with, would you consider new construction?

AJ Jackson [00:58:49] Absolutely. We're not we're not opposed to do construction. The reason we focus on preservation is because we can't make the numbers work in new construction. But if we had. Yeah, if we're if we're partner with Zach in the in the fund, then yeah, absolutely. I think that you have to have preservation and production back-to-back to both and, again, the reason we focus on preservation is because we can attract private capital at scale to do preservation. We can't attract private, capital scale to do production because the cost of building any unit is virtually the

same. Whether it's affordable workforce or market rate, it's virtually the same. And so if you're getting less revenue for the same cost, you're not generating the return that attracts the private, the private capital. I'm sorry, to your question about, could you repeat the question about engagement with—

Audience Member [00:59:32] Financing more accessible... (inaudible)

AJ Jackson [00:59:37] So that's actually that is a focus for us. And there's a lot of flexibility in how we structure financing. So a lot of the things that can be hurdles in terms of balance sheet of the developer, right, in terms of guarantee requirements or in terms of flexibility of of of payment terms. We really look at on a deal by deal basis with the sponsor and say, okay, is there a way to structure this financing that gets the deal done? One of the benefits of having, again, the JBG Smith platform is that we have a lot of real estate capacity as well, which gives us the opportunity to take a little bit more risk with sponsors who might not get access from other capital providers because they don't have the capacity to step in operationally and support them so that it happens sort of asset, asset by asset. But that is part of what we what we look at.

Zachary Marks [01:00:29] And I would say so the only, only HOC can use our fund, which is great for me. But, but I think a) I would agree with Jay's point that because HOC plans on being majority or outright owner of the deal and is going to be the balance sheet monster in the room, we can we can basically just make a decision based on the quality of the opportunity so that we don't need, you know, so if, you know, if a startup developer found a great site and brought it to us, we don't care that the startup developer doesn't have a balance sheet. We weren't going to ask him anyway. So, you know, or if somebody, you know, somebody had any other skill that could be leant to the deal. Having HOC's involvement, we follow both Section three policies for for our federally financed deals, but we have our a similar program for all the other development we do. So having more projects flowing through HOC is also benefiting, you know, benefiting, you know, benefiting communities of color because we, we have both targets and we look to exceed those targets in terms of participation.

So I think and frankly, we and we say this to our nonprofits as well, we, you know, we don't have the capacity in-house to do this all by ourselves. So we actually need these kinds of partnerships. And and again, we don't because we don't need the the big scary stuff, the balance sheet stuff. It really allows us to choose partners based on the quality of the opportunity.

Jenny Schuetz [01:02:13] Well, thank you all very much for joining us this afternoon. I want to thank our panelists, AJ and Zach, for joining us. Acknowledge also that Brookings has benefited from financial support from JBG Smith in the past. And we appreciate very much you all taking some time out of your day to come and join us. And hopefully all of you are fired up with ways to go build more affordable housing in the region. Thanks very much.