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Too few residential units in Boston, or too many? - by Daniel Calano

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Boston is in one of the biggest building booms in its history. The great recession is now about 10 years in the rear view mirror, and although building started slowly, it has now reached historically high peaks. Public policy continues to call for more housing, rightfully since there is very little affordable housing in the Boston metro area. In order to increase affordable housing, the solution has been to build more housing, regardless of price, and presumably the new supply would drive prices down relative to demand.

Increased supply is clearly a sound solution to a paucity of housing. For example, mayor Walsh of Boston has revised a 2030 housing goal of 33,000 new housing units to 69,000, an increase of 30%. Mayors in other cities like Boston are pushing public policy in the way of enterprise zones, tax breaks, below market financing, tax credits and so on. This has definitely helped push supply, but historically there has been a down side to policy induced supply. Remember historic tax credits, essentially syndicated and sold for high income earners? It resulted in some beautiful rehabs of old buildings, but in many cases, true economic rents were too low in these older cities to sustain buildings. Remember the notion that every American should own a home, fostered in part by policies allowing low equity and low documentation loans? While having a short-term positive impact, there was considerable suffering among some in the aftermath.

An article way back in 2014 said how too many apartments were pushing rents down. Well, that's some success! Once again, lower rents make more units more affordable which is a good thing. However, the down side in "increased supply" reducing prices is that loans made based on higher rents can falter. Things like loan-to-value ratio and debt service coverage, otherwise forgotten in the many legal documents of real estate development, pop up to the surface. Even if the lowered rents still cover developers' debt service, it can cause lower asset value, which can fall below the loan to value ratio, causing default in the loan.

There are also some demographic trends that should be considered in reviewing demand/supply. "What do millennials, now occupying new, shiny apartments in metro areas, do when they marry and have children who need schools?" Is the school system ready to take it on? Private school in urban areas is not an option, both for the costs and for the admissions. Another quandary is, "Who is occupying apartments and condominiums?" In a recent Boston Globe article, it was said that the top half dozen new towers in Boston have non-resident ownership occupying as many as 2/3 of the units. While these "non-residents" may be live in places like Florida, and therefore occupy their units on a part-time basis, many non-residents are investors looking for cash flow and security. How does that improve housing stock? What happens to these units when lower rents change the cash-flow model?

The development process can be long, with downstream unintended consequences. Projects that were a glint in the eye two years before, at the beginning of a process, require another two years before building is completed, occupied and cash flowing, essentially making the development cycle 4-5 years. Further, once development is underway, let alone pushed by policy, it can be very hard to "time to the market." Monies have been spent in land purchase, permitting costs, architectural, legal and political. Loan commitments have been made to banks. When supply is pushed by public policy,

we all should keep in mind that there is a very long tail to the process.

Way back in the severe early 1990s recession, I remember thinking and advising that not only should developers get out at the peak, if they could pick it, they should get out two years before the peak. It is that long tail of development that I had in mind, whereby even if you realized the peak was at hand, you were obligated to keep going. And, adding supply to a market that was already obviously slowing, is not only painful, but potentially apocalyptic. Perhaps this sounds too negative, and more jobs and more population could certainly make it an unnecessary worry, but we should also remember the so popular expression: "Be careful what you wish for."

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