TCR
TRAMMELL CROW RESIDENTIAL

Developing attainable housing to meet the growing demand

David "Mac" McWhorter, executive director of the Institute for Real Estate Operating Companies (iREOC), recently spoke with **Ken Valach,** CEO of Trammell Crow Residential, the multifamily development company of Crow Holdings, about the launch of the company's workforce/attainable housing platform, Allora. An excerpt of their conversation follows.

CONTRIBUTOR

Ken Valach is the CEO of Trammell Crow Residential, Crow Holdings Industrial and Crow Holdings Office.

Trammell Crow Residential (TCR) is a very well-known developer of luxury multifamily housing. I understand that you are now expanding your reach into the workforce/attainable housing niche. Can you tell me a little bit about that?

Allora is Trammell Crow Residential's workforce housing platform, which we refer to as attainable housing. Allora is aimed at delivering high-quality, affordable, lifestyle-focused apartments to growing communities of middle-income residents across the United States. While TCR is known for luxury Class A housing, our attainable strategy is not as new as it might seem. We began building attainable or workforce housing in the early 2000s, but paused after the Great Financial Crisis, when excess housing inventory reduced the demand. In today's economic climate, as the cost of living in our most dynamic cities is pricing out those with lower and moderate incomes, the strong need for housing presents an opportunity to expand into the attainable segment again. Allora targets people who make 80 percent of area median income (AMI) for the local market. While 80 percent AMI is the target, it is location dependent. For example, in parts of California we may target 120 percent of AMI and still be creating attainable housing. As for rents, we are targeted to be approximately 15 percent to 20 percent lower than luxury Class A in the same market.

Is attainable or workforce housing the same as affordable housing?

Yes and no. Affordable housing tends to refer to developments that are able to keep rents low because they use low-income housing tax credits, bonds or other government subsidies. These communities are required to set aside a certain percentage of units for low-income families and might have market-rate units in the same building. They often target the lower end of low-income, or less than 60 percent of AMI. This is something we have done in the past, but it is not a business we are in today other than a couple of legacy properties we still own. Allora apartments are new, Class A rental homes affordable to middle-income residents, and we do not use any subsidies other than those available to any developer in the market.

Why are you focusing on this initiative today?

From 2000 to 2015, 7.3 million units of housing were underproduced in the U.S. The National Multifamily Housing Council determined that 4.6 million apartments are needed by 2030 to meet demand. This lack of supply combined with high government regulation, impact fees and increased construction costs in recent years have driven rental rates up and created an affordability crisis. The need for affordable housing has only increased as the U.S. rebounds from the pandemic. Even pre-COVID, with favorable job and household growth over the prior few years, housing demand increased, but new supply lagged, resulting in housing prices increasing well in excess of income. Many middle-income families cannot afford to buy or own homes, and aren't eligible for government assistance. The problem will only worsen. Middle-income households are expected to grow by 180,000 by 2024. In these challenging economic times, quality, attainable housing is more in demand than ever. We believe everyone deserves access to safe, affordable, conveniently located housing. We decided to find a solution.

So, how are you developing below-market-rate housing if you are not using low-cost subsidies?

We have found ways to be very cost-conscious through thoughtful site selection and design, and have focused on reducing the time to build the communities. By focusing on standardization and consistency, material waste is reduced and timelines are accelerated. We purchase material in bulk, and limit legal, architect and consultant fees. Allora communities offer premium finishes but not necessarily top-of-the-line, with granite countertops and vinyl plank flooring, which not only look great, but last longer, thus reducing maintenance costs. Communities also feature simplified lifestyle amenities, including pools and fitness centers. Essentially, we look to reduce costs while still delivering a product residents are proud to live in. When we reduce costs, we can reduce rents.

How do you know when an attainable development makes economic sense?

First, we determine what to charge for rent. Let's say the target resident makes 80 percent of AMI in an area where the median family income is $70,000. So, we multiply $70,000 by 80 percent to get a $56,000 annual income target. We aim to limit rent payments to no more than a third of income: $56,000 multiplied by 33 percent equals $18,480 per year or $1,540 per month. Once the target rent is determined, we calculate the yield required to interest investors. From there, we solve for where total costs need to come in to make it all work. Because there is a system, land acquisition costs, legal costs and construction costs can be accurately forecast. We know early in the process whether a particular project makes sense, and can make a quick decision to move forward or look elsewhere. That ability to make quick decisions is a cost savings in and of itself.

Why aren't more developers doing this type of housing, given the demand?

The lack of attainable housing is not from lack of desire on developers' part — many would like to be doing more. Municipal policies and regulations add unnecessary costs and often hinder development. Zoning often favors the homeowner constituency, protecting those who already live in a community at the cost of keeping others out. Towns that prohibit multifamily communities view them as a threat to property values, schools and a specific way of life. Homeowners often view renters as transient and not as invested in the community. In addition to zoning requirements, developers frequently face onerous impact fees, which serve as another barrier to rental housing. These are fees charged by local governments for the purpose of providing new or expanded public capital facilities required to serve the development. We see communities where the impact fee for an average 950-square-foot apartment is the same as for a single-family home. That discourages apartments and favors single-family homes. So, controlling building costs is just one part of meeting the demand for attainable housing. Finding the right location, working with the town council and the community, and generally calming fears around multifamily housing are critical functions of a developer's day-to-day job.

Has anything surprised you as you've resurrected this strategy?

One of the things that has surprised me is how reluctant some of the most progressive communities in the country have been. For example, we were working with a Colorado city to provide attainable housing and had preliminary approval for our project, which was a low-rise garden apartment with landscaped and privacy-fenced surface parking. However, on second reading, one of the planning commissioners thought that when he drove by the apartments, he might see too many cars parked on the surface. So, they required us to put underground parking below two buildings. That additional cost adds $400 to $500 more in rent per month for the residents in those buildings. If the underground parking costs $400 extra rent per unit, that means the resident's rent will be $4,800 more per year than with surface parking. Let's round that to $5,000. If rent is aimed at one-third of income, someone has to make an additional $15,000 per year to be able to afford that community. This is a city with a severe shortage of housing, especially affordable housing, and yet they insisted on costly and unnecessary additions. And unfortunately, they are not alone in their resistance to much-needed housing.

What locations are you targeting for Allora?

We currently have Allora projects planned or under construction across Texas, North Carolina and the Baltimore area. We are looking closely at other cities across the Sun Belt as well: high-opportunity markets with strong job and population growth where there is desire to create attainable housing. This product is needed nationally, but there are many challenges, as highlighted previously.

Do investors have to give up returns to partner with you on these projects?

We have institutional joint-venture partners with us in every project, and we structure the financing so they can expect the same return as any multifamily opportunity with a similar risk/return profile. We understand the return requirements of our partners, and that influences the types of sites we acquire. Now that we have our model in place, we would like to find additional capital sources that accept a lower return, so we could do more in the attainable sector. For example, we would like to preserve and refurbish older housing, but those numbers simply don't work if investors are looking for a return around 15 percent. If investors were satisfied with a return below 12 percent, that would open up more opportunities for us. Additionally, it might open up a site where the city puts a few more restrictions on us, but we could still develop.

As an investor, why would I want to invest in attainable housing as opposed to luxury housing?

Attainable housing has a risk/return profile that is very attractive to investors. When you think of the luxury universe of renters, you are talking about a very small percentage of the population. Workforce housing attracts a much broader segment of renters. Since the demand is much higher, the returns tend to be more bond-like. We are in lease-up on our first Allora community and expect the yield to be approximately 70 basis points higher than a nearby newly constructed market-rate community. We believe attainable housing is a resilient asset class with reliable income streams and favorable operating expenses. Some investors in this niche are also looking to make a positive social impact. Given two investments with similar risk/return profiles, they will choose the one that does the most good. Attainable housing can have the type of positive impact on people's lives that investors would like to be a part of, especially during challenging times, all while realizing solid returns.

OVERVIEW

Trammell Crow Residential (TCR) is a market-leading developer of multifamily communities across the United States, and has delivered nearly 260,000 apartments to date. Founded in 1977, TCR is part of Crow Holdings, a privately-owned real estate investment and development firm with a 70-year history, $20 billion in assets under management, and a strong track record of performance, partnership and innovation. For more information, please visit www.crowholdings.com/tcr.

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