ADRR Board Discussion

Are the Challenges Our Larger Downtowns Now Face Properly Scoped Out? Downtown Housing

May 6 to 11, 2022

INTRODUCTION

Since its inception, members of the American Downtown Revitalization Review's (ADRR) Board have engaged in a near continuous e-mail dialogue about a wide range of issues, trends and opportunities that do not, in our opinions, always receive the attention they need and deserve in other media outlets and industry publications. The vitality of these conversations is evident in the number who join and/or read these back-and-forths more than two years after the ADRR's launch; indeed, over time, non-Board members have added to the ferment with their own observations and insights.

As most others concerned about downtown revitalization, we at the ADRR have been trying to understand the challenges the Covid19 pandemic has generated and to identify effective strategic and programmatic responses to them. To help speed progress in this effort, our editor, David Milder, wrote "Are the Challenges Our Larger Downtowns Now Face Properly Scoped Out?" It can be accessed at:
https://theadrr.com/wp-content/uploads/2022/05/Are-the-Situations-Our-Large-Downtowns-Now-Face-Properly-Scoped-Out-MW-edits-0426222.pdf

In it he looked at: the strength of downtown offices and how they are being impacted by remote work; downtown housing; downtown retail, and downtown public order and safety. After reviewing a draft of that article, the ADRR board engaged a in discussion of these challenges. The edited transcript of these discussions is being posted to The ADRR website in four parts, one for each challenge, as they are completed. They are also being distributed via our MailChimp emails. Below is the transcript on downtown housing.

PARTICIPANTS

Jerome Barth, Town Square Consulting
Charles Buki, CZB
Richard Florida, Rotman School of Management, University of Toronto
Paul Levy, Center City District, Philadelphia
Andrew Manshel, author, attorney, former BID manager
David Milder, DANTH, Inc and The ADRR

DATES for complete discussion:
May 4 to 12, 2022

THE DISCUSSION

David Milder May 6, 2022 at 2:23:38 PM EDT
I wonder if we can turn the discussion more to housing now.

Paul's report on the State of Center City said that it had become the fastest growing residential section of its city and region, and that 9 million SF of office space had been converted to residential and hotel uses over the past two decades.

The table below indicates to me that desirability of living in and near Center City has not subsided during the crisis.

Residential Sales, Median Sale Price, and Days on Market in Center City and Philadelphia

AREA	2019	2020	2021	% CHANGE 2019-2020	% CHANGE 2020-2021	% CHANGE 2019-2021
Sales						
Core Center City	803	732	1,110	-9%	52%	38%
Extended Center City	2,221	2,485	3,234	12%	30%	46%
Greater Center City	3,024	3,217	4,344	6%	35%	44%
Adjacent ZIP Codes	2,566	2,861	3,338	11%	17%	30%
Philadelphia	16,924	16,341	19,285	-3%	18%	14%
Median Sale Price						
Core Center City	$405,000	$432,000	$425,000	7%	-2%	5%
Extended Center City	$405,000	$427,000	$451,250	5%	6%	11%
Greater Center City	$405,000	$429,900	$449,950	6%	5%	11%
Adjacent ZIP Codes	$280,000	$300,000	$310,000	7%	3%	11%
Philadelphia	$214,500	$240,000	$263,000	12%	10%	23%

Dave Feehan has often mentioned the new housing going in and near downtown Des Moines, and I saw a few months ago some very impressive stats on the units that have gone into downtown LA. Moody's recent report also shows continued strong demand for downtown housing and the high premiums residents are willing to pay for such units.

Stantec, and some other consulting groups as well as some urban oriented public interest groups are also arguing that housing is the horse to ride to recover from this crisis.

The issue it seems to me is not simply housing, but affordable housing. In turn, the complexity of that problem is compounded by 1) current market forces and continuing low production of units and 2) the expansion of the population that is now concerned about affordability to include people who can reasonably be said to have quite comfortable incomes, and are prone to be creatives and knowledge workers.

Andy and others will probably say that these comfortable income folks who can't afford the prices in and near their downtowns will just find units in more distant locations in their cities, or in its suburbs or exurbs. While a lot of that was already happening pre crisis when 30

somethings deciding to nest or recently nested moved to the burbs, is that something our downtowns can now tolerate without weakening? In an age of Zoom and remote work can they, in Paul's words cope with "a wave of digital suburbanization, which is like the '60s and '70s, when people moved out and left cities behind?"

So, I ask:

- Will housing be a viable engine for downtown growth and recovery?
- Do we need to be concerned about the affordability of downtown units if only people who can afford very high priced units keep buying them?
- If affordability is an issue, has our thinking about it been as creative as it could be? The solutions I've seen seem to mostly revolve around financial incentives. What about technological responses? Other cost cutting measures?

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Richard Florida May 7, 2022 at 9:26 AM
Great piece (on the current status of the economy: https://www.nytimes.com/2022/05/06/business/economy/jobs-report-april-2022.html?referringSource=articleShare) and great comments.

I am simple minded on all of this. I think the core issue is housing prices. I have never ever in my life seen housing prices get this out of line with incomes. Those articles a month or so ago which showed that the average house in America out-earned the average American worker last year should be the signal alert.

Maybe … it is the case that incomes have grown to the point where people can spend a higher fraction of them on housing. But I don't think they can spend this much.

When people can't afford to buy houses, the market has to adjust.

While many think "soft landing," I fear a much more significant correction coming.

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Paul Levy May 7, 2022 at 9:32 AM
Don't focus so much on housing prices as on monthly mortgage payments. When interest rates hit historic lows, housing prices can rise and not create a crisis for the middle and upper middle class. But the problem is huge at lower income levels.

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Richard Florida May 7, 2022 at 9:38 AM
Here is how I see it. And I may be wrong.

Housing prices have now crossed into an interesting kind of story that I've never seen before.

On the one hand, the dispersion of people outside of superstar cities, even though it's a small percentage of people, has gone not only to raise housing prices in adjacent suburbs, but also to raise them in the rest of our cities. Everywhere I go, from Nashville to Tulsa to Bentonville. I

hear the same refrain. The New Yorkers and investors are beating us out for housing. those factors have driven prices up considerably - more than a third in many places. And rents have risen even more, by as much is 50% in some places.

What is really troubling is even if somebody has equity and can pay the higher prices, the carrying costs in terms of property taxes and insurance have become really unsustainable.

In Miami for example it takes about 4% of the purchase price to carry a property in terms of property taxes and insurance.

Right now, to buy a decent home in Miami Beach you'd have to spend between $4 and $6 million. That is a house that was probably $1 million or less two years ago. The math on that gets very hard to carry for anyone except the super rich. When I take a glance at housing prices in places like Austin, or Nashville or even downtown Bentonville, or even walkable suburbs like Birmingham Michigan, housing prices are starting to range from $1.5 million to 3 million or more. That's a lot of money.

That encourages incumbent owners to lock in - it becomes impossible to trade your existing unit for a new one. Even if you could make a ton of money, and even if you can afford the cost of entry to another unit, we can't afford the upsurge in carrying costs. I see it every day all around me.

Something has to come that will cause the market to readjust and reset. And we all know what that is.

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Andy Manshel May 7, 2022 at 9:55 AM
Rich,
But what about Cleveland, St. Louis and all those other places where housing ISN'T expensive? Not to mention Gloversville and all of the upper tier, and places like Reading, Bridgeport, Springfield, Newark, Paterson.

This is a perception problem that the aggregate data masks.

We need more great places.

…

Richard Florida May 7, 2022 at 10:01 AM
Agree. But even in some of these places, housing in the walkable mixed use neighborhoods is getting much more pricey than it's ever been. This is very true of Detroit and Pittsburgh.

And your main point is spot on. We need more great places.

…

Andy Manshel May 7, 2022 at 10:03 AM
Pittsburgh is not on the failed city list.

Detroit still has ACRES of empty lots.

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Richard Florida May 7, 2022 at 10:08 AM
So, I guess what we were saying is that we have a supply that is out of whack with where people want to live. Surpluses in certain city centers and exurbs and surging prices in close in closer in walkable suburbs. I wish somebody would run the numbers on that

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Andy Manshel May 7, 2022 at 10:02 AM
That's a tiny slice.

We're talking about Youngstown, Akron, Lorain, Toledo …

And, housing in Cahors, a beautiful, well restored medieval city, is CHEAP. And the surrounding countryside is breathtaking and even cheaper (avec piscine). If only they weren't so stingy about foreigner mooching on their health care system. The internet connection is uniformly high speed fiber. No problem doing my trades from there.
…

Richard Florida May 7, 2022 at 10:03 AM,
I am on record as saying, housing prices and availability of good public and private schools may well cause more and more remote families to choose Midwestern communities. Sun Belt Boomtowns simply do not have the services and amenities that these families need.
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Jerome Barth May 7, 2022 at 10:09 AM
Could it be that large corporations "a la" Blackstone purchasing thousands, even dozens of thousands of homes simply skews demand upwards? Plus, they require a 10% profit margin on the final product. At the scale of the US housing market that is an enormous increase in prices that consumers will have to pay until that bubble collapses if and when we start building more?

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Andy Manshel May 7, 2022 at 10:12 AM
Yes. Exactly!

And yes, we need more granular data. Absolutely.

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Richard Florida May 7, 2022 at 10:14 AM
And I hear that these folks will be the first folks to start dumping housing when prices drop.

The problem with building more is that we simply not building in the right places, and we're not building more great places to use Andy's phrase.

Issi Romen did an amazing piece of research several years ago. What he looked at was where housing was being built in the United States. What he found is that housing was being built in two places. The exurbs, and the urban center. One was sprawl the other was density.

But there was virtually no housing been built in close-in suburbs, in particular in walkable suburbs. That was the missing middle.

That's the stuff that's getting bid up way out of proportion.

The issue is can we find a way to build a kind of housing families desire? It's a huge issue. To solve it we would have to figure out a way to make our cities and towers family friendly.

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Richard Florida May 7, 2022 at 11:06 AM
Smart. Really smart. They don't need this headache. This is going to become a big political football

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Charles Buki May 7, 2022 at 11:14 AM
My hunch is its rough sledding to pin the value- to- income and rent to income ratios on any one thing. My housing clients occupy a really wide spectrum (Aspen/Park City ….Seattle/Austin…Chattanooga/Memphis….Ann Arbor/Chapel Hill….Johnstown PA/Canton OH…Rochester/Baltimore/Buffalo…Greenville, SC/Dutchess County, NY) and they are all facing very real pressures. From what I see, there are some interesting inputs shaping market conditions. In no particular order:

- One is exportable equity from comparably stronger markets. Home equity rich SF expats don't jump to Fargo, it's too great a distance. The style gap from SF to Portland OR, or Seattle or Boulder of Austin works. But the same outmigration occurs down ladder where a Boston or DC expat may opt for Charlotte or Atlanta, or a former equity rich resident of Austin may head for OKC or Tulsa or Bentonville, and a Boston export may decamp for Portland ME. The core of this part of the input story is, I think, the economy has created too many top quintile households relative to few places these households aspire to be in, and the spillover plus technology is creating a cascading inflow of high % cash buyers into formerly second and third tier markets where local-economy based incomes (and ordinary savings) can't compete.
- A second is the post 2008 credit squeeze in the buyer market plus low interest rates meant that the former reduced the volume of bankable buyers and the latter increased the buying power of those with savings and excellent credit. The net of this is a lot, and I think A LOT of pressure on the rental market. For the first time I would say in decades, MF developers like Bozzuto can charge and get break even rents without any PILOTs or other incentives, so, and this is important, as we are talking about Seattle, Portland, SF, LA, SD, Boulder/Denver, Austin, Chicago, DC, and Boston. The rest, even those with strong housing markets at the very top (occupying a tiny slice of pizza on the city pie), still generally have to incentivize the private market (Pittsburgh, Philadelphia, Atlanta, Charlotte) for all but the top.
- The third is the combined role of hard money in the middle and bottom (Cleveland, Milwaukee, Baltimore, Buffalo) combined with corporate actors who realize that a SF

home can be squeezed and by siphoning replacement reserves, generate competitive cap rates. This creates one more group of buyers contributing to reduced inventory.

- And the fourth is the impacts of demographic on the cohorts that have delayed marriage, delayed home buying, and who, now locked out of the buyer market, are contributing to even more pressure on the rental side.
- I don't see zoning playing an especially relevant role, no matter what the home builders on the right or the ADU crowds on the left insist, except in a very few markets. And I cannot make any sense at all of Phoenix.

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Richard Florida May 7, 2022 at 11:17 AM
Charles –

Really nicely said.

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Andy Manshel May 7, 2022 at 11:22 AM
This is really great.

Just the kind of granular information I was asking about.

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David Milder May 7, 2022 at 1:56 PM
Charles,

Thanks for that very helpful and multi-faceted analysis!

Since our concern is mainly with housing in and near downtowns, I was wondering why you mention the poor Millennials, but not the often dollar rich senior /empty nester market segment?

…

Charles Buki May 7, 2022 at 2:04 PM
David I should have mentioned the pipeline being clogged at the backend by cohorts born pretty much from about 1938-1958 who are not exiting the system. As a consequence we have a housing pipeline version of the allegorical python trying to digest a baby elephant. You are right to point out the constraints that a limited supply will have on pricing when compounded by the real heavy impacts that so many household who are now in their 60s and 70s. The same households by the way don't just have a ton of housing equity, they entered the stock market and have matured during a historical eras of growth so they have not only a lot of housing money but a lot of stock market wealth.

…

David Milder May 7, 2022 at 2:25 PM

That's us, clogging up the whole thing, but what about the potential to attract more of them out of their single family homes into downtown apts? Is it that the downtown prices are higher than what they can get from selling the single family homes?

Charles, I also would appreciate your view on the potential to create more suburban benchmarked affordable downtown housing.

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Charles Buki May 7, 2022 at 2:57 AM
The demand for the senior living downtown - whether primary or pied a terre remains elusive to me. I'd love to know what others think. Obviously, there's plenty of demand I just don't understand how to calibrate it or appreciate it.

The downtown housing issue is very complex I think primarily for one reason. Opportunity cost. The infrastructure and potential for high $/SF nets means any housing developed for any HH with incomes generally less than 2x city median (or about 1.5x AMI) is really hard to justify. So it will require massive subsidy and then the question is why? What is the necessity for housing downtown not lived in by HHs with regular peoples' incomes. I don't have a dog in this fight. I am just pointing out it's a tough subsidy to defend unless/until you have a serious buildup of negative externalities that demand redress.

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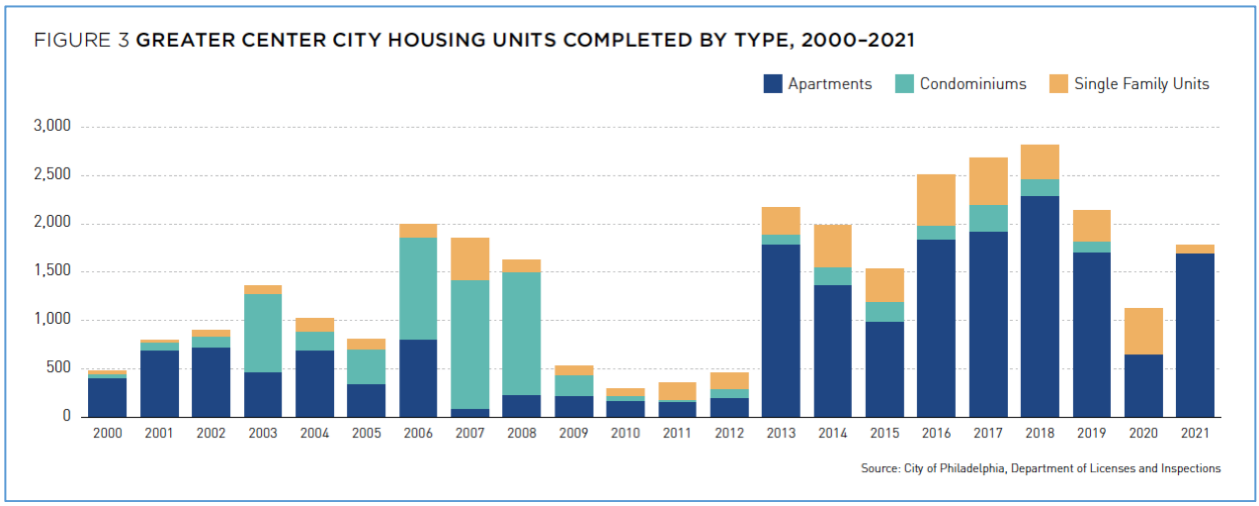
Paul Levy May 8, 2022 at 8:07 AM
When discussing downtown living (and seniors in particular), we should acknowledge the broad range of differences across cities, even if there are certain national demographic trends, that are impacting all downtowns, such as aging boomers, millennials, smaller households and national real estate trends, diversification of downtown land-use and mortgage interest rates. Second, there are handful of US cities that did not completely lose a downtown residential population in the postwar years – Boston, Philadelphia, San Francisco - (NYC is in unique category) and many to most, which starting building downtown residential populations in the 1990s – so the duration of experience with downtown living is also a major factor.

Geographic definitions are essential too and many of you know the work we did back in 2013 to define "residential downtown" based on a live-work percentage threshold, using LEHD data to create geographic boundaries. See:
https://centercityphila.org/research-reports/downtown-rebirth-documenting-the-live-work-dynamic-in-21st-century-u-s-cities

If you accept this way of thinking about downtown living, geographic boundaries alone can encompasses in different cities housing that is newly constructed high-rise, apartment or condo; converted loft, factory or office buildings, town-houses, duplexes or free-standing single family housing. This is particularly important when discussing "senior living" downtown. In most cities that started early, the "back-to-the-city" movement of the late 1960 and 1970s was really a "stay in the city" movement of recent college graduates from all those universities that benefitted from urban renewal to expand their urban campuses and so there was a generation

of boomers who bought their first house after graduation or after graduate/law school and stayed in the city and have aged in place and are living in neighborhoods that are generationally diverse. At the same time, there are apartment buildings in Philadelphia built in the 1960s and 1970s which have become naturally occurring senior housing and then four unique (for Philadelphia) coop developments in the late 1960s and early 1970s which are also now largely senior citizen buildings.

Our second big wave then came with the passage of our 1997 ten year tax abatement for the conversion of vacant office and industrial buildings to residential use – the only subsidy we have – which applies citywide, but for demographic and real estate reasons, we were able to capitalize upon downtown. When that abatement was expanded in 2000 to include new construction, it coincided with a trend of many boomers who had been living in the suburbs and who were now empty nesters who wanted the proximity to arts, entertainment and restaurants and the ability to walk to walk and liked the proximity to our abundant downtown hospitals and med schools and that gave us our condo boom in the decade of the 2000s (see graphic below). But these condo buildings are also generationally diverse.



2008-2010 largely put an end to condos and our downtown market in the core shifted to apartments, but rowhouse conversion and construction continues at a healthy pace in which we call extended Center City and adjacent areas, while we now have two major condo buildings under construction and a third about to start.See:
https://centercityphila.org/research-reports/report-the-center-holds-residential-resiliency-2022

So, while those ages 20 to 34 make up 44% of the core Center City population, residents ages 55 to 64 make up 9% and those 65 and over constitute 18% of the population in the core. Charles, perhaps you were only talking about purpose-built senior housing, but I think it is worth broadening the definition.

Jerome Barth May 11, 2022 at 9:17 AM

Allow me to share and summarize a very detailed post I recently received from a local Brooklyn broker I follow. It has interesting -and unsurprising- insights as to the cost of housing in some metros. The post speaks to some of the dysfunction that ultimately leads to higher costs for all people seeking housing.

In this case, the broker and his team marketed a 12 unit building for rehabilitation, but a single tenant derailed the sale, costing the owner their retirement plan, which they had been investing towards for 35 years. The tenant "holding out" for a payout resulted in a 25% discount, $900,000 in sales proceeds, and created a result with no clear winner. The sale is probably typical of many such situations under NYC Rent Laws.

This transaction was for a building on Linden Blvd off Rogers Avenue in Flatbush, Brooklyn. Owned and occupied by a single-family since 1988, most of the tenants were relatives. The owner had expected to deliver the building vacant. The building attracted strong interest and within 3 weeks there were a dozen offers above $3M, finally hitting our the asking price of $3.5M or $460 per SF / $155 per BSF.

But the landlord's agreement with his tenants unraveled. There were 6 tenants remaining out of the 12 units, and all had previously agreed to buyout amounts or vacancy terms that made the collective group happy. A month out from closing, those terms started to change.

A parenthesis on the technicality of NYC's rent laws: the only way an investor can justify making improvements to a building is if they can increase rents to repay those costs over time. The new rent laws prohibit the landlord's ability to increase rents, unless they undergo a "substantial rehab", which would essentially classify the structure as a "new building". By law, a new building would not be subject to rent stabilization, although taxes would get reassessed, which benefits the city. This requires serious improvements however and typically means that the building must be vacant upon purchase. Even having one tenant in a building means you can't improve the rest of the vacant units, as your ability to qualify as a "substantial rehabilitation" becomes restricted. This freezes your legal rents and makes those units unleasable. One standout tenant prevents 11 new units from hitting the market. This is the problem with NYC and is ultimately leading to supply issues and rising rents, even while thousands of units sit vacant in disrepair.

In this case, three tenants walked away from the past agreement. Two of the three went back to the table, but the last refused. After multiple attempts, the broker, and owner agreed it was time to forfeit the existing contract and re-market as 11 of 12 units vacant. The impact was a difficult and intensive marketing campaign, complicated by a building that was now encumbered with little to no upside. The price was finally set at $2.6M, a $900K reduction from the vacant value, but in line with the risks of a partially occupied building.

While there may end up being a winner in this deal, whether it be the tenant ultimately getting a significant payoff, or the developer untapping value, the landlord of 35 years was the one

forced to take the hit. This is the theme of the current system which does not properly weigh the indirect impacts and unintended consequences of the protections afforded to tenants.

We need change, and we need to voice our opinions as to why these regulations don't work in the real world. Yes, tenants should have rights, but the city will not become more affordable unless all the participants in the system have a measure of security, including landlords.