SESSION II – Town Hall

Reporter – David Silverstein

Moderator – Richard Ormond, Esq, – Shareholder at Buchalter

Panelists – Bert Haboucha – President, Atlas Capital Advisor
Dr. Mark Palim – Vice President and Deputy Chief Economist, Fannie Mae;
John Vella – Chief Revenue Officer, Altisource
Larry White – Regional Vice President, Carrington Real Estate Services.

Due to REOMAC's standing as the premier trade organization in the Real Estate Owned (REO) and default arenas, access to high-level executive talent is only a phone call away. The five calls that went out to construct this year's Town Hall session at REOMAC's 2017 Summit were answered by: Robert Haboucha , Atlas Capital Advisor; Richard Ormond, Esq, Buchalter; Dr. Mark Palim, Fannie Mae; John Vella - Altisource and Larry White, Carrington Real Estate Services.

There was much discussion amongst the panelists; unfortunately, there was much more good information than we can fit into this article as space is limited. This article focuses on the panelist's version of our current real estate market, where we have recently been and where we are heading.

Some of the panelists compared and contrasted our 2008 economic factors with our current environment. Virtually all the experts talked about the need to repurpose a myriad of once valuable "community building" real estate, which now suffers from economic and functional obsolescence. Many of the five panelists made future predictions.

Here is what each had to say:

Richard Ormond

After introducing the panelists, Ormond took the opportunity to go on record that he is rolling back some of the doom-and-gloom scenarios he discussed at REOMAC's Annual Dinner Meeting. He still prognosticates interest rates will continue to rise, but not to the levels of 8, 9 or 10 percent for a single-family conforming loan. As the panel moderator, Ormond struck first with the reality that "Brick and mortar is dying and malls are turning into showrooms, or ghost towns." Virtually all the panelists acknowledged a need to repurpose many of our nation's shopping malls that are no longer serving as city centers due to functional and economic obsolescence. The once thriving and revolutionary mega brick and mortar shopping experience is now dwarfed by the online shopping experience.

Ormond believes, "The next generation of buyer is interested in a 'we-work-live-space'". In fact, these two observations are in part the answer to each other's problem. To some extent dead malls have been turned into some form of housing. Most notably, the Arcade Providence Micro-Lofts are a 2012 historical preservation project built within the nation's first enclosed shopping mall erected in 1828. Although it's not a true "we-work-live-space" the lofts cater to a daily bicycle commuting, city-centered workforce, almost the same thing. Clearly, it's a good idea; rents have gone from $550.00 per month to $800.00 in four years due to demand.

It's impossible to discuss housing and not bring up Black Rock and that is exactly what Ormond did. Ormond's sense is because "Black Rock is the largest single family home owner" they can force a "rental vs. buy/sell market". I think we need Black Rock on our next REOMAC panel discussion: what are they thinking and what is their exit strategy?

He thinks, "shadow banking is important", but what is it? He offers a definition via a follow-up email: "Private lenders and private equity groups providing lending outside the normal banking channels, usually with stricter terms, higher interest and, many times, with equity play." This means if I want financing I'm going to pay high interest and give up equity. Ormond believes this will be a reality for some needing to refinance as nearly ONE TRILLION DOLLARS worth of commercial loans come to maturity over the next two years.

I know from previous coverage of Ormond's talks that he is not shy about delving into doom and gloom scenarios. In fact, it's expected. He is on record with the following: "There is nearly a 1 trillion dollar market of commercial loans that are maturing over the next two years—many of which were extended, modified or placed into forbearance in the last crisis—so those loans in particular will not be eligible to be extended or modified further. Plus, with rising interest rates, refinance for many properties will become impossible. This, in my opinion, will be the leader in the next recession—driven by second tier and third tier market commercial real estate not being able to be refinanced and banks not wanting to own it."

This scenario will tank some undercapitalized regional banks. I'd like to think they would offer loan workouts as often as possible. Whatever will happen is starting to happen now. We shall see how this plays out. A two-year window is not too long a time to wait. Given our current political climate, I don't think the government will be bailing anyone out this time. Pure capitalism will abound.

In regard to our political climate, Ormond sees: "There is talk of eliminating regulations, interest rates are in flux and the political climate (even within each of the parties themselves) is volatile. This will lead to unintended messages leading markets astray for better or for worse." He further states the market is rallying because investors think they will be getting favorable tax code reform that he thinks will be difficult to pass.

He referenced Citi Bank's Hourglass Theory: banks will make money available for the Gucci's at the top and T.J. Maxx's at the bottom, starving the middle class because it's not a burgeoning market. At first glance the concept seems sinister, but they do need to answer to their shareholders.

Ormond's remaining comments had to do with our growing urban neighborhoods. He shares these observations with some other panelists. "If you can recognize it on a map and you know someone in that city, then it is a better buy than a city that you have never heard of or that you don't know anybody in."

Bert Haboucha

Haboucha is clear about the changing face of retail. "Online retailers are taking advantage of the fact that many consumers still like to touch, even if they now want to buy online." He cites Tesla as a perfect example. "Although you order the car online, you can go sit in it" at a retail location not resembling a traditional "car dealership, with hundreds of cars in inventory, offices, lounges finance department and other things. It is a small space, maybe 1,500 square feet in a mall, has two or three cars on display, and a bunch of people with iPads available to answer questions." According to Haboucha, you can still test drive the cars.

The "test drive" model is a poignant metaphor for our changing brick and mortar marketplace. Consumers want a touchy feely experience with many of the products they buy, yet want to shop online for the best price and terms. According to Harboucha "retailers are being used as showrooms" and as "display cases" by an Internet empowered consumer.

Haboucha introduced the audience to the concept of open air Lifestyle Centers and how they are, for the communities that can financially support them, the new shopping mall experience. These new "community building" retail spaces "seem to be heavily populated with bars and restaurants, which is what keeps them alive, since many shoppers don't shop." He offered a few Southern California examples: The Grove in Los Angeles, Irvine Spectrum and The Americana in Glendale. He discussed the Santa Monica Mall as a brilliant redux of a once "old, ugly, closed in mall" forced to compete with its adjacent and early adaptor of the lifestyle center concept, the 3rd Street Promenade, which put it out of business. Now the neighbors co-exist as a much larger lifestyle experience. And all this just three blocks from world famous Santa Monica Beach.

The concern nationally is many, or most, communities don't have anywhere near the tax base of the western part of Southern California. For communities no longer able to support their malls, they must think about repurposing these assets. If they don't act quickly enough the once-upon-a-time shining symbols of prosperity will be suburban blight. It will be psychologically difficult for communities to deal with this and deeply affect morale.

"Some malls were built in a way that makes upgrading far more expensive than tearing down." Haboucha continued, "Some may now be perfect redevelopments into apartment or mixed use, but not another 1,000,000 square foot mall." Haboucha makes it clear the old mall model is both functionally and economically obsolete.

Many readers of the REOMAC Update are Realtors working within the traditional brokerage model of large offices and 6 percent commissions. Haboucha pulled no punches observing this model is dying alongside the one million square foot shopping mall. If we can face reality and embrace change we have an opportunity to observe the changing face of real estate and how it's being brokered. The key to sustainability is being proactive and not to dwell in "what was." Being fluid with our nation's changing needs will add longevity to our real estate and real estate brokerage businesses.

Haboucha made note that in 2007 it appeared to be cheaper to buy than to rent until the homeowner got into their new home and realized there was no landlord to call when issues arose. "On the surface 97 percent and 95 percent loans were tantalizing products."

He made an interesting observation that high-growth cities like Austin and Nashville are "learning to grow hand in hand with public transportation." He poses the question: "How can we max tech" to benefit the consumer and the brokerage? It's no secret the vast majority of home shoppers start independently and online.

Habucha likes to remind us that term limits are a good thing because politicians serve the immediate needs of their constituency over the highest and best good of the larger community. Another frequent concern of his is the massive and expensive compliance requirements for starting a new, and maintaining, an existing bank with fewer than one billion in assets. Most bankers complain about the endless compliance issues, yet the largest banks are laughing all the way to the bank because they can afford the cost of doing business.

The Gramm-Leach-Bliley Act (GLBA) and Sarbanes-Oxley Act (SOX) are making the big banks bigger and closing out competition.

Haboucha leaves us with a funny anecdote: "Oddly we say 'too big to fail' but we never say 'too fat to die.'"

John Vella

Vella stresses there are a large amount of resources flowing within banks and mortgage companies towards keeping compliant with all of the regulations. This is making the "cost margins very thin." The impact of the current regulatory environment has placed a strain on operating margins. There is a concerted effort underway to streamline the origination process through utilization of data integrations, analytics and automated workflow that will lower cost and insure compliance. In order to serve a large customer base that is currently being neglected, we will see the continuous emergence of non-QM loans. The non-QM loans are for a niche borrower who does not fit the QM guidelines but is still a good risk and credit worthy.

Although the 2008 downturn remains fresh in the minds of those in the default industry, Vella is confident the vast majority of non-performing residential loans have "gone through the pipeline." As a result of prior lending standards, loans that are currently originated are performing very well due to tighter credit standards and improved underwriting. We are at "historically low foreclosure rates" and now would be an excellent time to look at the lending regulations to potentially open up the non-QM credit box. "Homeownership has been impacted by the lack of access to credit and the millennial mindset and capabilities towards homeownership." Vella explained that non-performing loans are often bought by investors whom may or may not also be "special servicers". What's important to note is that these "special servicers and non-bank servicers" are the beneficiaries of large bank and agency loan and MSR sales.

The Altisource client list consists of many of the top financial and specialty servicers and originators in the industry. The Altisource product suite covers end-to-end solutions for the originators, loan servicers and real estate investment community.

In the future, the home buying experience will involve a real estate agent in three different capacities. First, you will have a buyer who will continue to utilize the agent as the primary source of information and transaction management with only some assistance utilizing online capabilities. In the second scenario, the homebuyer will use a combination of help from the real estate agent and the online experience with more of an emphasis on all the functionality that is currently being provided through the online search process. In the third scenario, the buyer will primarily use all the features and functionalities of the online experience with only some transactional assistance from the real estate agent.

However, in all of the scenarios, the real estate agent will continue to be relevant and considered a trusted advisor to the buyer.

Dr. Mark Palim

While some say retail is dead, Dr. Palim says, "we are over retailed." The audience chuckled when he said he saw an out of business shopping mall being used for "drone racing." Other panelists concurred they had also heard of shopping mall drone racing. Palim says as shopping malls become obsolete they will be either repurposed or torn down completely and made into something else. He said multi-family housing would be a common new use for the malls that are "holding space" in our communities.

Palim said, "Everyone is multi-family building" and we are not coming online with enough condominiums and single-family homes for the Millennials and others who will eventually buy. He shared, "There has been a lot said about Millennials being different" when in fact "their desire to buy is just as strong as the generations before them." He said they are waiting for the right time. We should remember Millennials "came of age in a bad economy." Fannie research shows 90 percent of Millennials want to eventually buy a home and 90 percent of the reasons they aren't buying now are economic. More specifically, a few of the factors slowing their purchases are: student loan debt, insufficient income, high rents, the inability to save a down payment and credit scores. He states "basic economic things like job growth" would help Millennials achieve their goal more quickly.

In regard to credit scores, Palim said the nation's overall credit scores for new home buyers are up 40 points since the 2008 recession. Rising credit scores is a good thing. It's a significant indicator people have enough money to pay their mortgages. He takes some issue with those who think the entire lending environment is in a "tight credit box." He sees qualified buyers and a shortage of inventory. He thinks having far fewer adjustable rate mortgages (ARM's) and underwriting standards having moved up as a good thing.

No talk on American economics would be complete without discussing the powerhouse baby boomer generation. Palim lay to rest a common misconception that baby boomers were going to exit suburbia and rent apartments in our city centers. Although this is happening, it's not happening at the levels previously theorized. Palim's research shows "baby boomers want to age in place." They want to stay in their equity rich single-family homes and have something to pass on to their heirs. It's no secret baby boomers are home equity rich and cash poor. He thinks reverse mortgages are a bad idea for most people and if you need one to stay in your home, its probable time to sell. He thinks reverse mortgages are too expensive.

According to Palim, Baby Boomer's own 25 percent of the homes yet control 50 percent of the nation's home equity.

When pressed about large institutional investors owning so many rental homes he didn't seem as concerned as the other panelists. He offered the following statistics. "Less than 2 percent of the single family rental homes (that's 1 to 4 units in Fannie language) are owned by investors who own 1,000 homes or more. 85 percent of the single family rental homes are owned by people who own 10 or more."

When the conversation came around to our current market conditions mirroring some of the same factors we saw immediately before the 2008 downturn, he largely abstained from the conversation. He did say we have "home price appreciation and steady rent growth" helping our economy. He did voice concern for the thinly capitalized mortgage banks who will be adversely affected if the market downturns.

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Finally, based on Fannie's Mae's research, real estate agents "will remain trusted advisors" to the home buying and selling public!

Larry White

Like all the panelists, White came prepared with interesting observations on our current housing market. Some of what he sees: "There has been a consolidation of the urban markets since the 2008 crash which brought people back from the outlining areas. The current market is experiencing a lack of inventory. Builders are not building entry-level homes in lieu of more profitable Higher-end homes." People in housing can't stop talking about Millennials. White says the two factors that traditionally pushed home ownership, getting married and having children are two things Millennials are pushing off.

White sees similarities between our current housing market and the market leading up to our 2008 downturn. He says to look at the headlines: lack of inventory, rapid appreciation, multiple-offers over asking, appraisal issues, waiving inspections, and loosening of lending standards. He cautioned when people pay over appraisal they may be limiting their exit strategies and it causes them to take on more risk.

White had a lot to say about our changed single-family rental market as a result of our last downturn. He references hedge funds as "a huge reason for the increase in rental homes." He gave a startling statistic of 11 million rental homes in 2009 and now there are over 15 million in 2017. He said large funds were able to borrow money, "pennies on the dollar," to acquire these properties. He said the BlackStone Group currently owns over 40,000 rental units. He hypothesizes they will eventually treat their properties as loan portfolios and rate them A, B and C. The C's, will without question be sold because they underperform or do not fit their hold strategy. The B's are a question mark and the A's they will keep.

"With rising prices you will see more start to sell their homes and inventory start to increase along with new home builds. Our markets generally last 8-12 years and we are 10 years into it. This one may last a little longer but as inventory increases, people don't have exit strategies, etc. We will see default rates rise and a shift. This is when an investor would most likely take their profits off the table."

White says the funds owning these properties are "extremely savvy" and he doesn't see them "loosing potential profits." He made an analogy between timing the sale of Apple Stock when it was $700/$800 a share to the hedge funds timing their exit strategy. It will be interesting to see how and when they exit. I hope they exit the market with a level of social responsibility.

White also sees Realtors remaining as "trusted advisors" to homebuyers and sellers.

<u>In conclusion</u>:

- Most panelists think lending standards need to be loosened to create homeownership and banking over-regulation needs to be rolled back.
- There isn't enough attention being paid, and it's not profitable enough, to build entry level homes.
- Brick and mortar retail will never be completely dead but it's shrinking rapidly and being repurposed in a myriad of ways.
- Open-air Lifestyle Centers are filling in for shopping malls and they are heavily leveraged with places to eat and drink.
- The new retail experience is a "touchy feely" experience before the consumer buys online.
- Baby boomers want to keep their houses and age in place.
- Millennials want to buy homes but can't afford them, yet.
- The hedge funds will be exiting the housing market in stages and for the highest possible returns. It is unlikely their sell-off will trigger housing depreciation, because that would be counter-productive.
- Interest rates will be going up but our unsettled political climate may slow that process. And,
- Realtors will remain "trusted advisors" even-though the traditional brokerage model is changing ■