Richard Roberts

The Building Blocks for Private Investment in New York City's Underserved Communities

It is good to see everybody, and I trust you are having an informative day. First, I want to thank Christine Cumming and Michael Schill for inviting me to participate in this conference. I thought I would share with you briefly the perspective of someone who invests in the neighborhoods and communities that are the focus of today's discussions. We all bring different perspectives to this issue, either from government, the nonprofit sector, or the private sector. I think that I add an interesting view: that of someone who is focused on generating a fair, risk-adjusted return on the firm's capital.

Goldman Sachs' Urban Investment Group is an opportunity fund that specializes in making investments in a broad range of opportunities that we refer to as the urban emerging market. We invest in minority-owned businesses, which for the most part are located in or provide goods and services to core urban areas: generally low- and moderate-income areas. In addition, we are investors in urban real estate. We are a comprehensive real estate investor in the sense that we focus not only on housing but on other types of real estate as well.

There are, of course, more traditional sources of private-sector capital for these markets. First among them is the Community Reinvestment Act. As we heard earlier, and as many of us know firsthand, the act has had a dramatic effect in terms of directing private-sector resources into urban neighborhoods. The government-sponsored mortgage enterprises—Fannie Mae and Freddie Mac—are another traditional source. For many years, there has also been a host of tax-motivated incentives, such as the low-income housing tax credit and other types of tax partnerships. Quite frankly, the biggest of these tax-motivated sources has been the mortgage interest deduction, which encourages people to become homeowners no matter where they live. The deduction has had a strong effect on directing private-sector resources into urban neighborhoods, although its reach is limited to those capable of becoming homeowners.

One of the things we have found is that there has been tremendous pressure on corporate earnings over the past year or two, making it very difficult for us to invest our money. Even with the increases in the low-income housing tax credit, syndicators report that it has been very difficult to raise tax credit equity for projects. For those of us who historically have been developing these projects, we do not see that pressure. Now, you may see it in pricing and other areas, but it has been very tough to raise tax credit equity. That is just something to consider when you are heavily dependent upon these types of mechanisms to attract resources. That being said, all of this tends to be supplementary to the capital that the government and the not-for-profits and philanthropic organizations provide.

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These traditional private-sector sources of capital in combination with government have fueled tremendous investment and change in many of these neighborhoods and communities. More recently, opportunity funds have started to appear. These funds, which are separate and apart from distressed investors, look for dislocations or problems in the market, and there are always some. We are investors who believe that there is value in these markets and that in a fair and appropriate way it is possible to earn adequate risk-adjusted returns. Opportunity funds have emerged because of the increased number of people focusing on the commercial opportunities in these neighborhoods. For example, Porter began by focusing on the retail disallocation in low-income neighborhoods and how density in these neighborhoods might create real opportunities. With this success, others began to realize that, from an opportunity fund standpoint, investing in these neighborhoods might actually make sense.

From a housing standpoint, we are dependent upon several things. One is a vibrant for-sale market, because we tend not to focus on being a long-term holder. However, it should be noted that long-term investors in multifamily housing have not done so badly. That is probably one of the best performing asset classes over time. But when compared with other asset classes, it tends to represent a much longer hold on your money. In addition, there is an emphasis on, for obvious reasons, market rate opportunities because, as a general matter, we think we can do better with respect to our returns.

There are many different funds that have focused on similar investments. CPC now has a fund that focuses on opportunities here in New York. Both Jerry Salama and Magic Johnson have opportunity funds focused on the inner city. Magic's tends to be more focused on the commercial front while Jerry's is more of a multifamily, affordable housing fund. In addition, Fannie Mae has a very important and aggressive equity fund in this arena: the American Communities Fund. All of these examples represent people attracting institutional money with fair and very aggressive rates of return. That leads to some conclusions.

First, the money tends to be very expensive. We are not looking for 9 percent tax credit yields. If we could earn 9 percent in New York, we would be ecstatic. But as a general matter, we are looking for something much more aggressive. We are obviously willing to assume some real risks, which has not been the case with other investors. Why are we so willing? One reason is that we believe that these markets are strong. We have been looking at the research of Porter and others in terms of the underlying strength of the markets, and we believe that there is a good amount of value there.

Second, the quality-of-life improvements that have occurred in low- and moderate-income areas throughout the country have made the areas much more attractive candidates for investment. Third, we recognize the type of first-loss position that the government and not-for-profit sectors have assumed. The massive public investment that has occurred in places like Harlem and the South Bronx has created a platform for us to start looking at other potential investments.

The demographic trends are undeniable. When you look at the growth of immigrant communities and communities of color throughout the country, and the fact that they are disproportionately located in urban areas, you can conclude that there are strong investment opportunities not only in real estate, but also in a host of commercial activities ranging from cable television to radio to retail.

The prospect of attractive returns for investors like us is based on the strong likelihood of rising economic fortunes in these areas. But also, quite frankly, in tough economic times, pricing tends to come down—and the idea is to buy low and hopefully sell high. So if you believe the demographic trends and the density story, then do not worry about the fact that the macroeconomic environment is not ideal. Because if you can buy economically and invest economically, you ultimately will earn your returns.

From a policy standpoint, some things must occur for this trend of more aggressive investment to continue. I will focus on New York because it is the area I know best. For one, there needs to be continued emphasis on quality-of-life improvements. The favorable underlying trends, such as declining crime, have made these communities attractive places for investment. Should there be a reversal in these trends and crime rates start to rise again, these areas will quickly become much less attractive for what I call unassisted equity capital.

There also needs to be greater emphasis on regulatory reform and cost reduction. We have seen a number of projects where people come in and say, for instance, that the time is right for a hotel in a particular underserved community or market. The first thing we ask them is whether they have a site plan and whether the site is entitled. If the site is not entitled, it can take fifteen months or more just to determine whether the project can be built on a proposed site. By that time, all of the other things that we are looking at in terms of our economic and financial analysis will have changed. From the standpoint of committing capital, you have to be able to move with some degree of certainty and you have to be able to move relatively quickly. There are many opportunities to invest. Why wait on a particular project to be entitled when you can invest elsewhere and earn a fair and appropriate return?

That strategy applies not only to land-use planning and site designation, but also to the allocation of the particular groups with whom the government decides to work. We have seen a number of projects that were very worthwhile and appropriate. Because we can invest anywhere, we are going to invest with

people who we think can actually make the project take shape. But if the city or the state or some other governmental entity is wedded to a certain organization or group because of other considerations, it is very difficult for us to think about committing capital to that particular project.

People ask me why, as the former Housing Preservation and Development commissioner, did I decide to go to an opportunity fund? I often answer that we have been able to move an agenda of affordable housing and community development very far, and I feel very fortunate to have been a part of the most recent history of that agenda. Government has played a role in advancing that agenda, as have the nonprofits and the private sector. However, there needs to be a more wide-ranging discussion. That is to say, I do not think that opportunity funds or funds like the ones operated by Goldman Sachs are by any stretch of the imagination the complete answer or right for every project. But I do believe that people who willingly invest in low- and moderate-income areas, rather than in a range of other opportunities where capital can flow, need to be at the table to participate in the discussion. I say this because private capital can go a long way toward stretching the resources of the other players.

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