Castle Lanterra Properties

Creating housing, community for the workforce

Jonathan A. Schein, senior vice president and managing director of global business development for Institutional Real Estate, Inc., recently spoke with **Elie Rieder,** founder and CEO of Castle Lanterra Properties LLC. An excerpt of their conversation follows.

I understand Castle Lanterra Properties has a big focus on workforce housing.

Yes, we have been investing for 18 years. Currently, under the Castle Lanterra platform, we own and manage over 7,000 apartments across 22 properties. We focus domestically in U.S. markets where there is strong millennial growth, income growth and job diversity.

What opportunities does workforce housing present to investors that affordable housing does not? How do you differentiate between the two?

Workforce housing is distinct from affordable housing, targeting middle-income households generally earning 60 percent to 120 percent of the area median income, or AMI. Workforce housing is also distinct from class A luxury rentals, which target high-earning groups, as well as affordable housing, which targets the lowest income groups. Another key distinction is that there is no ceiling on asking rents in workforce housing. They are free-market units, while government-stabilized housing or rent-stabilized units both have ceilings on the maximum allowable rents and rent growth. The class B and class C multifamily buildings that generally comprise workforce housing offer very good fundamentals for investors.

How so?

There are a number of reasons: strong demand, diminishing supply; low vacancy rates; steady and controlled growth; value-add upside through capital improvements and operational efficiencies; and resiliency throughout the real estate cycle.

By being able to offer a high-quality product at rents that are substantially below comparable properties in the downtown core, we are able to capitalize on a "flight to value" when renters become increasingly price-sensitive during market downturns and are willing to compromise on the convenience of living in the downtown core for the benefit of paying up to $500 less in rent in some cases.

What is causing the strong demand right now?

There has been a significant shift in the percentage of renters versus owners. More people are choosing to rent than own for a variety of reasons. People who are renters by necessity earn less than $75,000 a year and make up 80 percent of the renter demand in the workforce housing segment. The so-called "renter's society" is expected to grow to more than 7 million people by 2025.

According to Harvard University's Joint Center for Housing Studies' latest report, 11.2 million households below the median income competed for 7.3 million units. The new supply that has come online in the years since then has predominantly been geared toward the luxury market. With the price of developable multifamily sites spiking 62 percent between 2012 and 2017, coupled with the combined costs of construction, labor, materials rising 25 percent over that same period, developers need to charge premiums in order to cover their basis and still earn a profit.

There has also been a 27 percent median-rent increase between 2011 and 2016 across the United States, despite wages rising at a much slower pace. So the combination of stagnant wages and significant increases in rents has created acute housing-affordability issues for many people.

What are the biggest indicators that the market in a certain city or area will become "hot" in a few years?

There are seven main indicators we look for: (1) sustained job and income growth, (2) strong infrastructure, (3) access to mass-transit and highway systems, (4) diversified local economy, (5) highly rated school system, (6) inadequate supply of high-quality rental properties within the submarket and, finally, (7) lifestyle amenities, such as retail, entertainment and recreation. We are looking in many growth markets, where we see these qualities and where we can acquire quality real estate properties at attractive valuations and then enhance them to provide both an outsized return for investors and a better living environment for residents.

How do you see investors approaching environmental issues with their real estate investments?

As resource prices continue to rise and as more regulatory incentives to combat climate change are put in place, both investors and developers have become more sensitive to environmental issues. Environmental, Social and Governance (ESG) investing has always been a big part of European investment strategies, and that is slowly making its way into American companies. Investors recognize the real estate market today is very millennial driven. To appeal to millennials and to get them to buy into projects and properties, investors and developers need to buy into what makes them happy. Environmental and social issues play a major role in that.

How is this playing out in the multifamily sector, specifically?

As multifamily owner/operators, there are several ways in which we can proactively reduce our carbon footprint and be sensitive to the environment. These include LED lighting; low-flow plumbing fixtures; using recycled materials in our renovations, roofing and insulation enhancements; and introducing solar panels. We also have used technology to help us monitor energy use and be more efficient with consumption, including the use of timers to control air and heat systems, as well as the ability for residents to control their lighting, temperature and lock settings remotely via phone app. It is a win-win for both the owner and resident.

It hits all the buttons. What is Castle Lanterra doing specifically related to ESG initiatives?

We are driving significant operational cost savings while elevating the standard of living for residents — this is the cornerstone of CLP's ESG investment program. Through the acquisition and improvement of workforce housing, we provide more attractive housing options for those who earn too much to qualify for affordable housing, yet fall short of the necessary income requirements to purchase a home or live in a luxury rental community.

Castle Lanterra acquires class B and C communities and truly raises the bar by repositioning these assets to include fitness centers, business centers, Internet cafes, automated package-retrieval systems, gaming and recreation rooms, dog parks, and other outdoor amenities.

Similar to the principles that guide ESG investing, at Castle Lanterra we pride ourselves in providing a safe and engaging environment for our residents.

Some examples include increased security measures throughout the property, using interior and exterior cameras, electronically controlled access to garages, and courtesy patrol officers at select properties. We also offer bus shuttle services at select properties and holiday events throughout the year. We organize local clothing and food drives, community athletic leagues, annual academic scholarship programs, college internships, regularly scheduled fitness classes, cooking classes, and all different types of social events to really create a sense of belonging and a sense of home.

I imagine that sense of community really keeps your turnover low.

It definitely does. As owners, we certainly value resident retention, but it becomes personally fulfilling to know that we are making a difference in our communities and in the lives of our residents.

Our residents are the workforce of America — typically the middle class who serve our communities — teachers, police officers, firefighters. It is really a good feeling for us to be able to give back and provide safety, the amenities and the quality of life that they deserve.

The Tax Cuts and Jobs Act includes a policy aimed at incentivizing developers to build more affordable housing options, including workforce housing. Tell me a bit about opportunity zones. What are they?

Opportunity zones are part of a new community development program established by Congress in the Tax Cuts and Jobs Act of 2017 that encourages long-term investments in low-income, urban and rural communities nationwide. An essential theme is that any tax payer, U.S. or foreign, is able to invest capital gains into a qualified opportunity fund that is organized for the purpose of investing in a qualified opportunity-zone property.

How do you see opportunity zones making a difference?

According to Harvard's Joint Center for Housing Studies, of the 43 million renter households in the United States, nearly half are cost burdened, which means they are spending more than 30 percent of their income on housing. Most developers have not seen the value of being in the workforce housing space, which causes a supply-and-demand mismatch. Now developers are incentivized to develop these properties, and our communities can start bridging the gap between supply and demand in the space, and also help families climb out of being cost burdened.

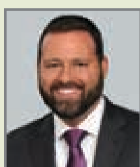
How do opportunity zones differ from free enterprise zones from the 1990s?

There are a couple significant differences. Syndicators organize and market opportunity funds, which can invest more expansively than earlier programs could. The Treasury certified 8,700 opportunity zones, many of which already attract businesses and investments. By comparison, Congress authorized only 40 enterprise zones and 40 renewal communities. Enterprise zones focused on highly depressed areas in the urban core that had long suffered from deterioration, population and job loss. Opportunity zones, on the other hand, tend to focus more on local markets that are somewhat depressed but have the potential for sustained economic growth. They also create a platform that allows for smaller, individual investors to benefit from a tax perspective, versus what was previously reserved only for large corporations and entities.

Is CLP thinking about taking advantage of opportunity zones in some specific way, or do you just see it as more of a broader market influence?

We focus on making investments that are prudent and stand on their own feet, irrespective of the tax implications. If we see a good investment in an opportunity zone, then the potential tax advantages would only be viewed as an accretive element to the investment itself.

CONTRIBUTOR



Elie Rieder is the founder and chief executive officer of Castle Lanterra Properties. An active real estate investor, owner and manager since 1998, Rieder was named to *Real Estate Forum*'s "50 Under 40" list in 2017 and was awarded Manager of the Year in 2017 for performance, innovation and strategy by *Real Estate Finance & Investment.* In his personal life, he volunteers his time and energy to numerous charitable organizations and community associations focused on providing food, shelter and education for underprivileged families, both locally and abroad.

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CORPORATE OVERVIEW

Formed in 2009, **Castle Lanterra Properties (CLP)** is a privately held real estate investment company that seeks to acquire well-located multifamily properties in primary and lower tier markets with sound underlying fundamentals and meaningful growth potential. Through a rigorous value-enhancement program, CLP aims to reposition each asset with the goal of maximizing bottom-line performance and elevating the property's competitive positioning within the market. The firm adheres to five key principles: • Robust and in-depth market knowledge • Top talent • Thorough due diligence • Hands-on operational and strategic management • Integrity, decisiveness and certainty of execution.

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