THE AFFORDABLE HOUSING ASSET CLASS

ULI HOUSING OPPORTUNITY CONFERENCE
FEBRUARY 5, 2019
Executive Summary

Affordable Housing -- What is it?

- Housing (rental in this case) affordable to households earning less than 60% of median income
- Approximately half of the nation’s 20.4M units of multifamily housing should be classified as “affordable”
- Half of the affordable housing is subsidized, by a wide variety of public policies/subsidies
- Half of our affordable housing is “naturally-occurring,” non-subsidized but in many places at risk of being improved to unaffordable
- Affordable housing is meaningfully driven by for-profit entities, with over half of owners, managers, and developers being for-profit.
Affordable Housing – How does it perform as an investment?

- The asset class performance is strong -- especially in downturns -- driven primarily by its stability of income.
- Interest/appeal correctly driven by (1) consistently high occupancies (2) low turnover, and (3) lower and slower growing operating and capital expenses.
- Result -- Per-square-foot revenues and NOIs that are comparable to, if not higher than those at market-rate properties.
- Dramatic growth in transaction volume driven by influx of institutional capital
- Result -- Cap rates for subsidized assets have compressed to be on par with conventional properties, though volatility remains high.
Executive Summary Cont.

What is the outlook for demand of affordable rental housing?

- Affordability of housing broadly under threat from value add investing and new development unusually focused on high cost locations
- Regularly expiring subsidy contracts will naturally constrain the supply of subsidized affordable housing.
- Historical and projected trends in housing costs and wage stagnation indicate a persistent and pervasive need for affordable housing
I. Size and Scope

Affordable Rental Housing Supply

Key Players

Transactions
Size and segmentation of rental housing

About 25% of rental housing is affordable multifamily

- More than half of the rental housing stock is small-format, with 1 to 4 units.
- 50% of multifamily (5+) units are "affordable," with or without subsidies.
- 48% of "affordable" housing receives government subsidies.

**Rental Housing**
- 5+ Units: 20.4 M units
- 1-4 units: 23.1 M units

**Multifamily Housing**
- Rent Subsidized: 4.9 M units
- Market-rate, 1-2 stars: 5.3 M units
- Market-rate, 3+ stars: 10.2 M units

**Affordable Housing**
- Other Subsidized: 1.7 M units
- Public Housing: 1.0 M units
- LIHTC: 1.0 M units
- Project-Based Section 8: 1.2 M units
- Naturally Occurring Affordable Housing: 5.3 M units

Total Units:
- 43.5 million
- 20.4 million
- 10.2 million
Affordable buildings: low-density, older
Reflects lower construction costs and depreciation

**Distribution of Units in Subsidized Affordable Buildings, by Building Type 2000 – 2017**

- **High-rise**: 15+ stories, 1 or more buildings
- **Mid-rise**: 4-14 stories, 1 or more buildings
- **Low-rise**: 1-3 stories, 1-3 buildings
- **Garden**: 1-3 stories, 4 or more buildings

**Median Age of Affordable and Market-Rate Rental Homes 2017**

- **Affordable Rental Homes**
  - Median Age: 54 years
- **Market-Rate Rental Homes**
  - Median Age: 37 years

Based on Zillow research. Units surveyed include both multifamily and single-family. “Median Age” stated is the weighted mean of the median age across 100 largest metros.

Sources: CoStar; Zillow; RCLCO
Most affordable housing players are for-profit
Across ownership, management, and development roles

Profit Status of Owners of Actively Subsidized Units
(# affordable units)
2017

Owners
1,683,597

Profit Status of Managers of Actively Subsidized Units
(# affordable units)
2017

Managers
13,299

Profit Status of Top 50 Developers,
by Construction Starts in 2016
(# affordable units)
2016

Developers
1,803

Sources: National Housing Preservation Database; Affordable Housing Finance; RCLCO

For-Profit Non-Profit

12
Key players mostly developer/owners

Otherwise, institutional—whose holdings have a higher PPU

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>Units</th>
<th>Projects</th>
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<td>50</td>
<td>The Arker Cos.</td>
<td>6,676</td>
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</table>

Sources: Affordable Housing Finance; RCLCO
Transactions in institutional capital
Growth in volume reflects both acceptance and appetite

**Institutional Investor** Subsidized Housing Transaction Volume
by Total Value of Acquisitions and Sales 2001 – 2017

*Note: RCA defines “Institutional Investors” to include equity funds, pension funds, insurance companies, banks, investment managers, sovereign wealth funds, open-ended funds, and other financial services firms.

Sources: Real Capital Analytics; RCLCO
Acquisitions by institutional capital
Have favored large, high-cost, and/or fast-growing states

Subsidized Apartment Units Acquired and Price Per Unit Paid, By State 2000 – 2017

Note: Size of bubble represents number of units within any fully or partially subsidized properties that were acquired.

Sources: Real Capital Analytics; RCLCO
II. Performance Real Markets: Operations
Real Markets: Operations
Capital Markets: Pricing
Absorption has outpaced new deliveries
In seven of the eight years since the great recession
Occupancy advantage over market-rate
Subsidized: persistently higher occupancies & lower turnover

Sources: CoStar; National Apartment Association Income and Expenses Report; RCLCO
Rent growth lower, but still positive
As is expected of low-income, rent-restricted units

Rental Growth Rate of Market-rate and Subsidized Affordable Housing, by Class 2000 – 2017

Sources: CoStar; RCLCO
Per-square-foot revenues and NOI similar
And revenue as a share of the gross potential is much higher

Sources: National Apartment Association Income and Expenses Report; RCLCO
Cap rate spread has tightened
Cap rate volatility still higher (due to smaller sample)

Sources: Real Capital Analytics; RCLCO

Sources: Real Capital Analytics; RCLCO
III. Fundamental Drivers

Eroding Supply

Growing Demand
Changing dynamics of rental housing more broadly
Housing being added disproportionately in high cost locations

Distribution of New and Total Rental Apartment Inventory by Urban Neighborhood Type, 2000-2017; Top 50 MSAs

Sources: RCLCO; Axiometrics
Lifespan of subsidies has become shorter
Impending rate of subsidy expiration will be unprecedented

Duration of Housing Subsidy Contracts Over Time 1970 – 2017

Subsidy contracts have clearly trended towards being shorter:
In 1970, no contract was to last fewer than 40 years;
in 2017, no contract was to last more than 40 years.

Sources: National Housing Preservation Database; RCLCO
Existing supply is eroding
Units funded by tax credits set to expire most rapidly

Cumulative Units with Expiring Affordability Periods (Millions) 2017 – 2027

Source: Joint Center for Housing Studies 2017 tabulation of National Housing Preservation Database data, as of January 1, 2017.
Hourly wages have stagnated
Meanwhile, development costs rising – pushing rents

Sources: Bureau of Labor Statistics; Fannie Mae account of RSMeans data; RCLCO
Gross rents outpace household incomes
Reflecting costs of development and wage stagnation

Percent Change in Median Gross Rent and Median Household Income 2007 - 2014

Source: Center on Budget and Policy Priorities analysis of Census ACS data
Most new demand from low-income renters

Fastest-growing jobs over next decade earn ~$22,000

Ten Fastest-Growing Occupations (Occupation, Number of New Employees in Thousands) 2016 – 2026

- Solar PV installers: 11.9
- Wind turbine service technicians: 5.5
- Home health aides: 425.6
- Personal care aides: 754
- Physical therapist assistants: 27.2
- Software developers, applications: 253.4
- Physical assistants: 39.7
- Nurse practitioners: 56
- Mathematicians: 0.9
- Statisticians: 12.4

In the workforce, “barbell growth” in employment at low and high incomes exacerbates existing inequality.

Sources: Bureau of Labor Statistics; RCLCO