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COMMUNITY CAPITAL

MARKET COMMENTARY Q1:2024

Amidst Challenging Times, Opportunity Awaits

Last year proved to be a challenging one for the commercial real estate market, and the multifamily space was not immune. Thanks to higher borrowing costs brought about by rising mortgage rates and uncertain property valuations, multifamily loan originations were down 46% in 2023 versus the prior year, according to the Mortgage Bankers Association[1].

Market consensus is that interest rates are expected to fall later this year. Around one out of two economists believe the Federal Reserve will begin trimming short-term rates for the first time in May, and 70% expect rates will go down in June[2]. If that should come to pass, clarity on loan rates and valuations should thaw debt markets for multifamily owners and developers, driving opportunities in debt financing.

Predictions for the direction of interest rates, however, are notoriously wrong. And even if the Fed's so-called "dot plot" — which charts expectations for every member of the Federal Open Market Committee — is correct and the central bank ends up cutting rates three times this year, don't expect an immediate snapback in multifamily deal activity[3].

Part of this stems from the supply and demand factors at play, which in turn casts a spotlight on how the affordable housing part of the multifamily space stands apart. From the start of 2023 to the end of this year, more than 900,000 new multifamily units will have come onto the market, in large part from deals signed in 2021 and 2022, when transaction activity was significantly higher[4]. More than 500,000 of those units have already been delivered. And more than 440,000 additional units are expected to hit the market this year[5]. Combined, this oversupply is expected to push the national vacancy rate on market-rate apartments to 6.25%, according to Fannie Mae[6].

Multifamily rents, as a result, have been declining for five straight months, according to the Yardi Matrix Multifamily National Report. For the full year of 2023, rent growth was virtually unchanged, rising just 0.3%[7].

The affordable housing part of the multifamily market, however, is one area where supply isn't outstripping demand. Far from it. That's because affordable housing is distinct from other parts of the multifamily sector. The need for housing that's safe, sanitary, and affordable grows regardless of economic circumstance. In good times, when the economy is expanding, rising rents increases the need for affordability. In challenging times, when the labor market weakens and incomes begin to fall, demand continues to grow as incomes fall or stagnate.

The "acyclical" nature of affordable housing explains why occupancy rates for multifamily units have been remarkably stable — holding steady within a tight band between 96.3% and 97.9% since 2008. The occupancy rate for affordable housing units financed with housing tax credits stood at 97.2% in 2022, the most recent year for which there is data[8]. By comparison, the occupancy rate for the broader multifamily market stood at 94.5% in 2022[9], and it's expected to fall to 93.75% this year, according to Fannie Mae[10].

One thing affordable housing hasn't been immune to is the effect of rising financing and insurance costs associated with a higher rate environment. Nearly one third of affordable housing providers who had to renew their insurance last year saw an increase in premiums of at least 25%, according to a report from the National Leased Housing Association[11].

While rising insurance costs are being felt throughout the multifamily space, the impact is particularly acute in affordable housing. Housing providers are taking steps to manage these rising costs, including increasing deductibles, decreasing operating expenses, and increasing rent, according to a survey by NDP Analytics[12]. Affordable housing providers, though, are constrained in raising rents, unlike their market-rate counterparts, and typically face thinner operating margins to begin with. Overall, this added uncertainty is affecting transaction pricing and underwriting and is a key source of stress in existing properties.

On the plus side, multifamily affordable housing is gaining support from policymakers. At the end of January, the House of Representatives passed a $78 billion bipartisan tax bill that included provisions that would benefit the Low-Income Housing Tax Credit (LIHTC) program[13]. The bill, which must still be taken up by the Senate, calls for the restoration of the increase to the ceiling for the 9% LIHTC that had been in place through 2021. It also reduces the percentage of project costs that must be covered by private bond financing for 4% tax credits, potentially expanding the number of projects that can be developed.

Given the opportunities in the private market and the support we see elsewhere, we remain optimistic about the year ahead and confident about affordable housing debt's ability to increase the supply of affordable housing at a time when demand is high and growing.

MICHAEL J. LOHMEIER
Chief Investment Officer

1 *Quarterly Survey of Commercial/Multifamily Mortgage Bankers Originations Q4 2023.* Mortgage Bankers Association.
2 *"The Fed Will Cut Rates Fewer Times and Start Them Later Than Market Hopes, According to CNBC Fed Survey,"* CNBC.com. Jan. 30, 2024.
3 *"Fed Holds Rates Steady, Indicates Three Cuts Coming in 2024,"* CNBC.com. Dec. 14, 2023.
4 *"Inside Multifamily's Supply Problem,"* GlobeSt. Oct. 9, 2023.
5 *U.S. Real Estate Market Outlook 2024,*CBRE.
6 *Multifamily Economic and Market Commentary*, Fannie Mae Multifamily Economics and Strategic Research. January 2024.
7 *Multifamily National Report—December 2023*, Yardi Matrix. Jan. 10, 2024.
8 *Affordable Housing Credit Study: A Comprehensive LIHTC Property Performance Report.* Cohn Reznick. November 2023.
9 *Multifamily Economic and Market Commentary*, Fannie Mae Multifamily Economics and Strategic Research. January 2023.
10 *Multifamily Economic and Market Commentary,* Fannie Mae Multifamily Economics and Strate-gic Research. January 2024.
11 *"Survey Finds Significant Insurance Cost Increases for Affordable Housing Providers,"* Affordable Housing Finance. Oct. 12, 2023.
12 *Increased Insurance Costs for Affordable Housing Providers,* NDP Analytics. October 2023.
13 *"House Passes Tax Package With LIHTC Improvements,"* Affordable Housing Finance. Feb. 1, 2024.

Photo credit: *Harmony at the Park*

Q4 2023 INVESTING HIGHLIGHTS

Deal activity throughout the multifamily space slowed amid rising interest rates and uncertainty, which affected the affordable housing segment of the market too. In 2023, IMPACT helped finance 6,196 units of affordable housing through new commitments, purchases, and bridge loans totaling $452.5 million.

While below 2022's record of $627 million in financing, 2023 was still a strong year for IMPACT by historic standards. The fourth quarter provided a boost, with 21 total deals representing more than $166 million closed or committed in the final three months of the year, financing 1,990 units of affordable housing. Examples of such deals are below:

$166 M
in new commitments and purchases in Q4

SPOTLIGHT PROPERTY: HARMONY AT THE PARK

- **Address:** 1950 East Polk Street Phoenix, AZ 85006
- **Property Description:** This 120-unit new construction development, part of a multi-phased project with the City of Phoenix, is located 1.5 miles east of downtown on the site of the former public housing developments built in the 1940s and 1950s. The project will include 4 residential elevator buildings and a pool house. In Phase 1, 35 of the units are covered by Project Based Vouchers (PBV); 50 units are LIHTC units set aside for tenants making between 40% and 60% of AMI; and the remaining 35 units are unrestricted market rate units.
- **Sponsor:** A joint venture between Gorman & Company LLC and the City of Phoenix. The City of Phoenix will transfer the land to the development LLC through a ground lease.
- **Governmental Support:** $5.4M in City of Phoenix subordinate loans.
- **AMI Restrictions:** Individual units restricted between 30% and 60% of AMI.
- **Amenities:** Pool, community room, fitness center, children's play area, and BBQ grills.
- **IMPACT Financing:** $10.8M in Taxable Permanent Loans
- **Originator:** Bank of America

Photo credit: *Google Maps*

SPOTLIGHT PROPERTY: MODEL CITY II

- **Address:** 1000 Stonegate Rd. Kingsport, TN 37660
- **Property Description:** Originally constructed in 1973 and renovated in 2010 with LIHTC equity, this 256-unit multifamily development consists of 16 two-story residential buildings and a leasing office across a 21.5-acre property. 100% of the units are covered by Section 8 Project Based Vouchers (PBV).
- **Sponsor:** LHP Development, LLC ("LHP")
- **Governmental Support:** $2.9M Tennessee Housing Development Agency subordinate loan.
- **AMI Restrictions:** All units restricted in line with a Section 8 contract, to less than or equal to 60% AMI
- **Amenities:** Clubhouse, laundry area, playscape, playground, basketball court, and barbeque picnic area
- **IMPACT Financing:** $28.5M Bridge Loan
- **Originator:** Rose Community Capital

Photo credit: Apartments.com

ADDITIONAL IMPACT UPDATES:

- In celebration of our 25th anniversary, IMPACT released a new video series about the firm's history, exploring what sparked IMPACT's creation, what drove our leading insurance company founders to unleash capital at scale to advance opportunity in underinvested communities, and the social impact case for affordable housing investments. You can view the four-part video series here.
- Read IMPACT Community Capital's newest commentary: Bridging the Gap: Opportunities in Short-Term Loans to Address Long-Term Affordability.

THANK YOU to all our investors, owners, employees and lending partners for supporting our mission and vision.

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