Income and impact

The case for affordable housing debt

By Michael Lohmeier

Emerging from a tumultuous 2020, investors face a number of challenges. For long-term investors the environment of historically low yields continues. Many traditional fixed-income strategies are not generating the income investors need. At the same time, 2020 exposed social and economic inequalities that fostered greater interest and demand for impact investing. In fact, many investors now look to use their capital not just to generate positive financial returns but to also provide positive impact in the communities they live and work in, particularly as we embark on a post-COVID recovery.

One asset class, affordable housing debt, can help investors strive to achieve both objectives.

DEFINING AFFORDABLE HOUSING DEBT

Affordable housing debt is distinct from traditional mortgage, fixed income and real estate investments. It is characterized by diversified pools of commercial mortgage loans on properties tailored to low-income tenants, specifically those earning less than 60 percent of the area median income. These properties typically have significant government support via subordinate financing, low-income housing tax credits and other subsidies. Affordable housing debt is first lien-position mortgages on affordable multifamily rental properties owned and operated by institutional-quality owners and property managers.

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It should also be noted that affordable housing debt, as described here is not investing in single-family owner-occupied affordable mortgages and not the subprime investments associated with 2008's financial crisis.

THE ESG FACTOR

As its core objective, affordable housing debt seeks to deliver positive social impact — the "S" in ESG — by addressing the extreme shortage of safe and sanitary housing for low- to moderate-income families. Access to affordable housing affects virtually every aspect of a family's life, from health to access to educational and career opportunities.

Yet according to data from the National Low Income Housing Coalition, there are at least 7 million units needed to bridge the gap between the supply of affordable rental homes and the demand (characterized by households earning 30 percent or less of area medium income). According to HUD data, an average of just over 100,000 affordable housing multifamily rental units are developed annually across the country, a pace of development that would take nearly seven decades to erase just the existing shortage.

The existing supply/demand imbalance is exacerbated by the economic fallout from the pandemic that has hit renters and people of color particularly hard. Before the pandemic, almost 50 percent of American workers didn't earn enough hourly income to afford a one-bedroom apartment in most communities. More than 60 percent of black and Latino workers don't earn enough to afford a one-bedroom apartment.

Between mid-March and mid-September 2020, 49 percent of renter households reported a loss of income. Additionally, 59 percent of Latino renters, 53 percent of black renters (versus 45 percent of white renters) lost income. As families and communities work to recover from the impact of COVID-19, access to affordable housing provides more stable, safe homes, which has been found to have a positive, long-term impact on health, education and personal savings.

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A LOW-CORRELATION, LOW-VOLATILITY INVESTMENT

The current, extreme supply/demand imbalance in affordable housing contributes to the acyclical nature of affordable housing debt. Performance for property and debt investors is not highly correlated with broader economic or market trends. This is because affordable housing is in such short supply that in periods when the economy is doing well, there is high demand for affordable housing as market rate rents soar. In uncertain economic periods like the current pandemic-fueled slowdown, demand remains high for affordable housing as household income becomes strained.

The acyclicality of affordable housing has historically generated lower-volatility and low-correlated exposure to traditional fixed-income asset classes. The insatiable demand for affordable housing in bull and bear markets has also contributed to stable investment outcomes for debt investors, including consistent income and market-rate returns across cycles.

HISTORICAL COLLATERAL PERFORMANCE OF AFFORDABLE HOUSING

In addition to this consistent income, over the past 15 years, the foreclosure rate for affordable housing has not exceeded 1 percent, and the most recent cumulative foreclosure rate for low-income housing tax credit-eligible loans was 0.65 percent, according to CohnReznick's latest report on housing tax credit investments. By comparison, S&P Global Ratings reports the global corporate default rate eclipsed 4 percent during the 2009 recession.

During the COVID pandemic, borrower forbearance requests from affordable multifamily rental properties have been minimal. At IMPACT Community Capital, we've had a total of eight forbearances in place across our portfolio of over 400 loans as of Nov. 1, 2020. Freddie Mac reports similar results in its November forbearance report. For Q-deals, referring to Freddie Mac's taxable affordable multifamily securitization platform, only 3.4 percent of loans entered the forbearance program.

AFFORDABLE HOUSING GOING FORWARD

As the economy's path back to normalcy takes shape, affordable housing continues to play an important role in the recovery. On a positive note, with the recently approved stimulus package and more rapid COVID vaccine distribution, the economy will likely show modest improvement. However, real economic growth may not markedly improve until third quarter 2021 as families and businesses feel more confident the worst of the pandemic is behind us. The same is true in the affordable multifamily space. Demand for affordable housing will continue to grow, as families struggle to make ends meet even with the additional stimulus provided. Borrowers will continue to muddle through with potential forbearances and delinquencies for those who are no longer able to manage payments until growth in the real economy takes flight.

While these are challenging times for investors, the performance of affordable multifamily rental properties shows the resilience of strategies that may offer diversifying, stable cash flows while meeting the critical and basic human need for safe, sanitary and affordable housing. ■

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