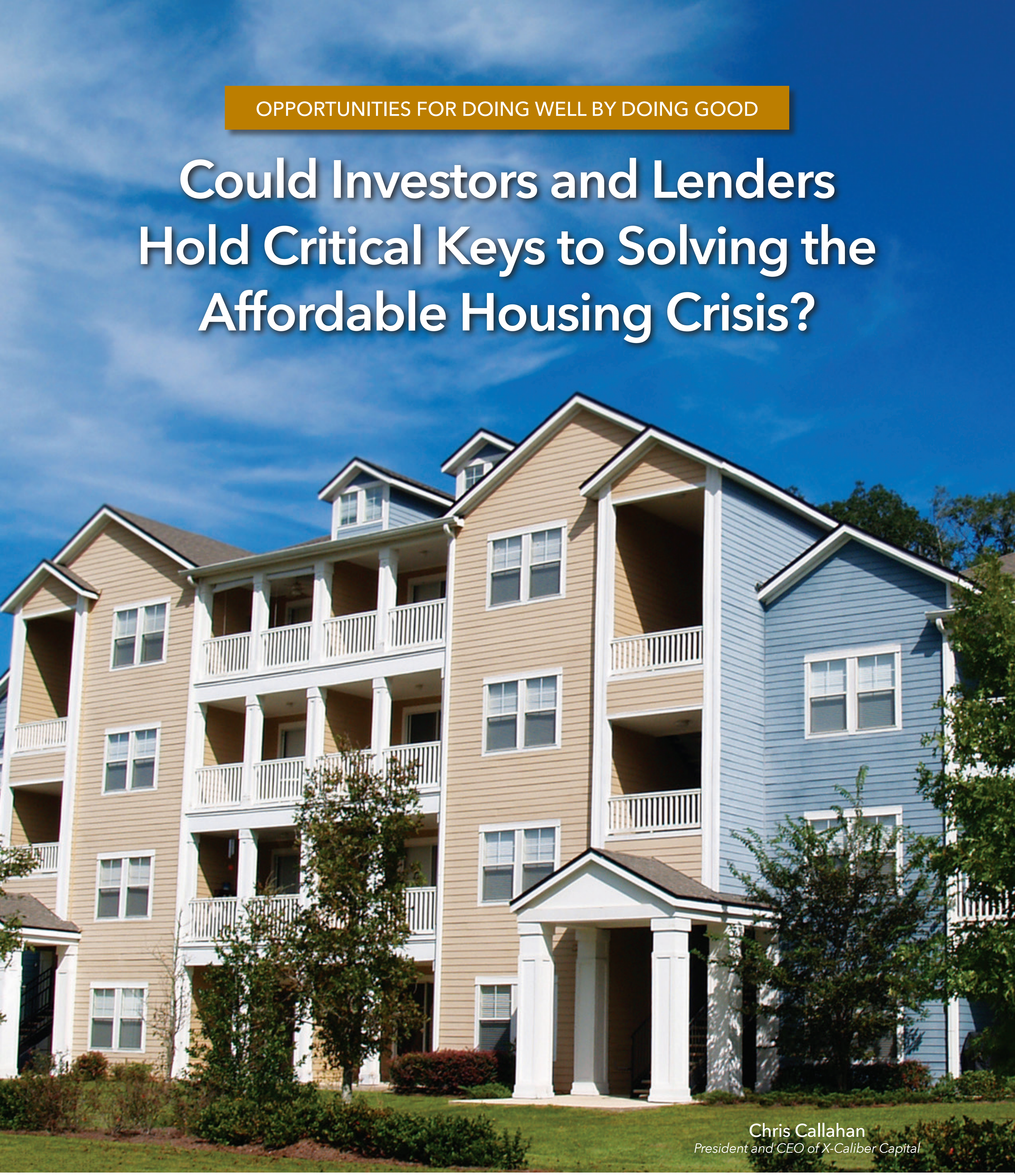
OPPORTUNITIES FOR DOING WELL BY DOING GOOD

Could Investors and Lenders Hold Critical Keys to Solving the Affordable Housing Crisis?



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Lending and Investing for the Greater Good

Headlines top The New York Times,
Forbes and The Wall Street Journal:

The US is battling a housing crisis. Supply of affordable housing is unable to meet growing demand, and affordability is at an all-time low.

Just last month, a group of more than 40 housing organizations united in request and urgency, seeking to form a Presidential Council on Housing Affordability.

We are, as others suggest, at a critical time of action. As a housing ecosystem that includes investors and lenders, we find ourselves at a pivotal time of opportunity to be able to address the pressing need for affordable housing. With a pandemic-induced reality that has accelerated innovative public/private partnerships, we are discovering new ways to come together to find common solutions. Partners are advancing their prudent business goals, while at the same time directing capital that makes a meaningful impact in addressing this national crisis.

The purpose of this report is to explore the housing crisis and evolving landscape through the lens of possibilities by examining the following: What is the state of affordable housing today? How should we be evaluating affordability? [Spoiler: the historical definition is evolving.] What are some insights for selecting affordable housing investments with true community impact? And finally: What are some opportunities and benefits for owners, managers, lenders and mission-oriented investors to invest smartly while delivering a solution to a crisis that has been, for all purposes, impossible to solve?

The State of Affordable Housing: A Growing Concern

Those of us engaged in the housing ecosystem are well-aware that the nation's housing crisis did not materialize overnight. In fact, the lack of affordable housing has been pervasive and growing over several decades.

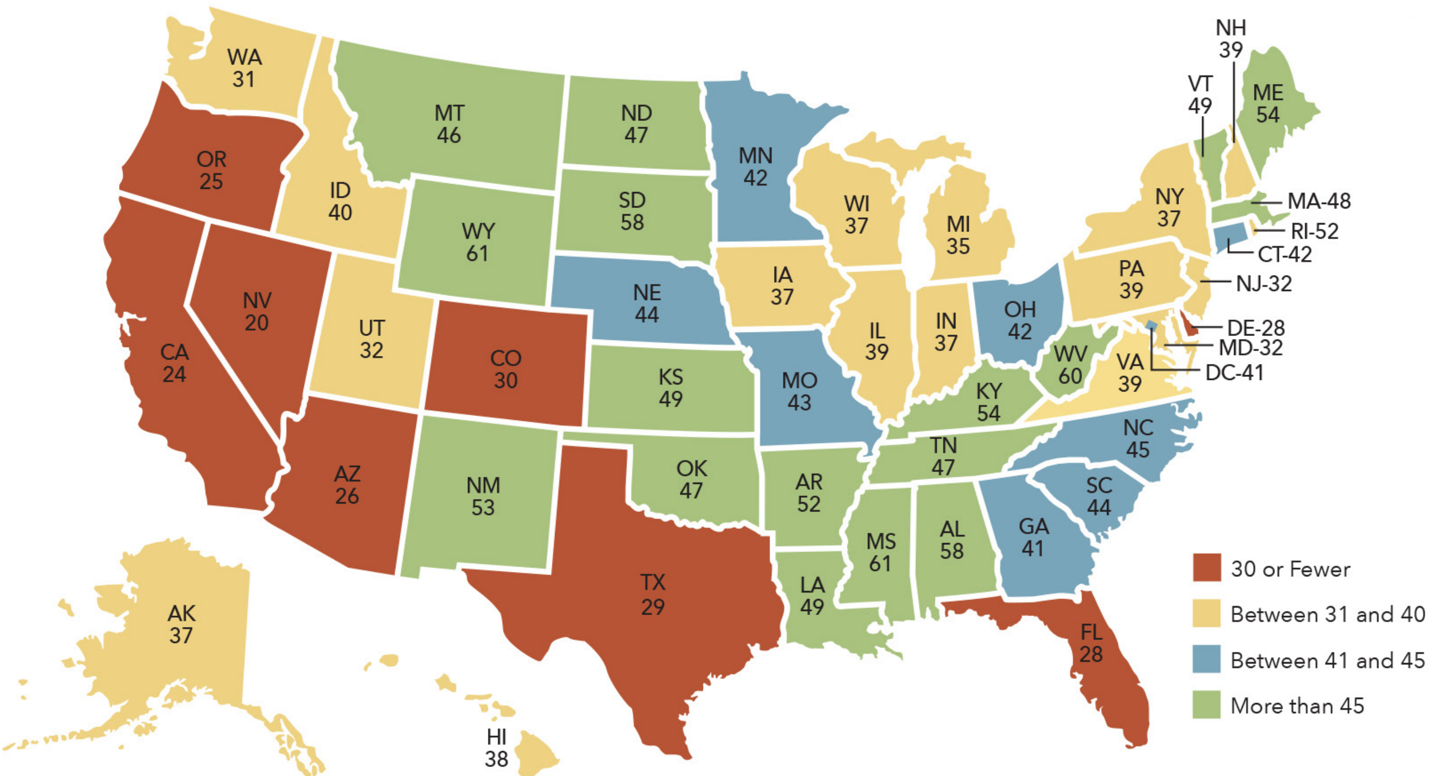
According to a 2021 report from the National Low Income Housing Coalition, the US has a shortage of 6.8 million affordable rental homes. Particularly challenging, for every 100 extremely low-income households that would qualify for affordable rentals, there are only 37 homes available to meet that need. While the needs are more prevalent in certain regions–for example, the extreme West, Northeast, Texas and Florida–the issue isn't isolated to those geographies. In fact, currently every state in the country has an insufficient supply of affordable rental housing for this lowest income population.

> "Simply stated, the supply of rental stock is not meeting demand."

Simply stated, the supply of rental stock is not meeting current demand. What makes today's plight especially woeful is that the supply has worsened while the demand for affordable housing has grown during the global pandemic's economic fallout.

As we witnessed, not only were low-wage workers who rely on rental stock disproportionately affected by deep unemployment–the rate temporarily skyrocketing to 14.7% in April 2020–but would-be homeowners were stalled by the same labor issues, soaring home prices and supply chain delays. These factors created a perfect storm–crowding rental markets and driving up record-high rent increases. In fact, the March 2022 Rent.com Rent Report shows steady

Rental Homes Affordable and Available per 100 Extremely Low-Income Renter Households by State



Note: Extremely low-income (ELI) renter household have incomes at or below the poverty level or 30% of the median income. Source: NLIHC tabulations of 2019 ACS PUMS Data.
Source: The GAP: A Shortage of Affordable Homes. Used with permission from National Low Income Housing Coalition.

year-over-year national increases in rental price trends. According to the report, March 2022 rents soared an average of 21.8% over just a year ago for two-bedroom units, and several markets jumped more than 40%, and one exceeded 70% (71.8% in Fresno, Ca.). Of course, compounding these rental cost factors for all families is soaring inflation, charting 8.5% in March, the highest in 41 years.

> March 2022 rents soared an average of 21.8% over just a year ago for two-bedroom units

Harvard's Joint Center for Housing Studies (JCHS) has also reported on this deficit of affordable housing, noting there was a significant decline in low-rent housing stock intended for low-and moderate-income renters available. During the decade before the pandemic, the number of available low-cost (less than $600 monthly) housing units fell by 3.9 million units between 2011 and 2019. Combine this diminishing supply of affordable housing with an aging one, and it's no surprise why our most vulnerable populations struggle to find a stable place to call home.

Looking forward, there is some positive news in the multifamily sector with some momentum on supply. While overall rental stock remains lower than demand, the number of permits for multifamily dwellings rebounded last year to the highest in almost four decades and starts for buildings with five units or more jumped 13.7% in January to a rate of 524,000 units. While the industry is likely to experience lags in availability due to supply chain constraints and a trend to build larger projects that take additional time, this is certainly a step in the right direction and will benefit renters across all income quintiles.

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Unpacking the Definition of Affordable Housing

If you ask a housing expert to define affordable housing, you are likely to receive multiple responses. That's because the term has both a formal definition, provided by the Department of Housing and Urban Development (HUD) and used for government subsidy programs, and one or more informal understandings, coined by various industry experts. Let's unpack a few.

As an official definition, HUD considers housing affordable if housing expenses, including utilities, are 30% or less of a family's gross annual income. In short, this 30% is what a renter is expected to pay when receiving subsidized housing. Households that pay above this 30% threshold are considered "cost-burdened" or "rent-burdened" because they could have difficulty paying for other essential expenses like food, clothing or medical fees. Those who pay 50% or more of their gross annual income on housing expenses are considered "severely cost-burdened."

Income Definition Categories	
Area Median Income (AMI)	The median family income in a metropolitan or nonmetropolitan area; a geographic barometer
Extremely Low Income	Households with income at or below the poverty guideline or 30% of AMI, whichever is higher
Very Low Income	Households with incomes between extremely low income and 50% of AMI
Low Income	Households with incomes between 51% and 80% of AMI
Middle Income	Households with income between 81% and 100% of AMI
Above Median Income	Households with income above 100% of AMI
Cost-Burdened	Households that spend more than 30% of gross income on housing costs
Severely Cost-Burdened	Households that spend more than 50% of gross income on housing costs

Source: Derived from National Low Income Housing Coalition and HUD

HUD has for decades used a ratio of personal income to area median income (AMI) to determine eligibilities for housing subsidies and tax credit programs that have become synonymous with affordable housing guidelines. For example, the deepest housing subsidies are allocated to extremely low-income residents, defined as those whose gross household incomes are at or below the federal poverty guideline or are 30% of AMI, whichever is higher.

Those who partner with HUD lending programs will most certainly adhere to these standard definitions, particularly for computing subsidy and compliance calculations, when evaluating affordability.

However, others who serve the housing market who are not defined by HUD or other government-regulated lending programs might describe housing affordability a bit broader, as detailed later in the paper. But first, let's consider some compelling data, specifically around cost burden.

According to the National Low Income Housing Coalition, almost half (49%) of all renters are considered cost-burdened. Notably, these renters are spread across all income levels.

As one might expect, those in the very lowest income brackets by far report the greatest incidence of cost burden–those spending more than 30% of their income on housing. Not only are those most vulnerable populations dependent on affordable housing and allocating a great portion of their incomes accordingly, but this group was also among the first to suffer wage losses during the pandemic, further compounding their economic insecurity.

Core Types of Affordable Housing

1 | Public Housing – HUD-based program. Operated and managed by the federal government; coordinated with local housing agencies. Tenant must live in specific, designated residences. Eligibility limited to low-income individuals and families.

2 | Subsidized Housing – A generic term covering all federal, state or local government programs that reduce the cost of housing for low- and moderate-income residents. Typically describes designated units in market-rate developments; privately owned.

- Project Based Voucher – Subsidy vouchers are attached and applied to individual units whose landlords contract with state or local public housing agencies for eligibility. Subsidy not portable.
- Section 8 Housing Choice Vouchers – Tenant-based. Subsidy vouchers go directly to and are portable with tenants. Subsidizes deeply affordable. Tenants can rent any apartment that meets program guidelines.
- LIHTC – Tax subsidies directed to investors to reduce federal tax liability in exchange for financing development of affordable rental housing.

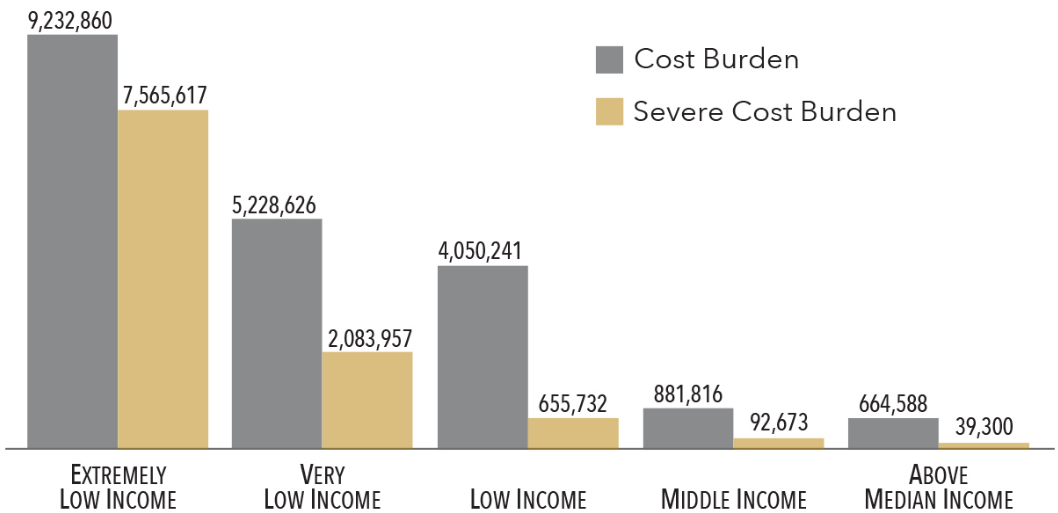
3 | Workforce Housing – Housing that helps middle-income workers, such as childcare workers, nurses, firefighters and teachers (typically earning between 60% and 120% of AMI) live close to their place of employment.

4 | Naturally Occurring Affordable Housing – NOAH
Could be located in lower-rental communities or in buildings in which families have subsidies, such as FHA loans, but buildings do not. Represents the majority of affordable rentals in the country; most in metro areas. Investments would increase access to low-cost rentals across all quartiles with no subsidies needed.

But looking beyond the lowest two quintiles of income: Who makes up the burgeoning members of other quintiles, such as the low- and middle-income households whose housing costs are also more than 30% of their income? And what does this reveal about actual affordability across all rental stock? Many of those who are cost-burdened and who also spend more than 30% of their income on housing are essential community workers–teachers, city employees, health care and childcare workers who are unable to afford to live in the same geographies in which they work.

These workers, who neither qualify for subsidized housing nor can afford market-rate housing near their places of employment, could potentially qualify for workforce housing. Where available, such workforce housing programs extend affordable housing options to middle-income workers, often community employees, who typically earn between 60% and 120% of AMI. Initiatives such as local zoning ordinances, regulatory incentives, state financing programs, local assistance or employer programs make local or regional workforce housing programs possible. As an example, take a grade school teacher who lives in a subsidized apartment owned by a school district in Los Angeles–a unit the

Renter Households with Cost Burden by Income Group, 2019



Source: NLIHC tabulations of 2019 ACS
Source: The GAP: A Shortage of Affordable Homes. Used with permission from National Low Income Housing Coalition.

teacher would otherwise be unable to afford on his or her current salary, via a subsidy the district considers a terrific retention tool.

As such, the need for workforce housing for community workers is just one example of addressing affordability concerns that may extend beyond HUD's formal subsidy definitions. Other, more broad frameworks for evaluating affordability are also emerging within the industry, such as:

- A dataset that provides expanded insights at the neighborhood level and measures affordability by combining costs of both housing and transportation to access jobs, services, transit and amenities: Housing + Transportation Affordability Index. (Center for Neighborhood Technology/CNT).
- Financial assessments/asset-building: 1) Can a renter working 40 hours a week earning a living wage afford a typical two-bedroom apartment? Or: 2) Would an individual be able to afford living in this apartment while still building savings for assets in the future? (Housing practitioners)
- Residual income approach–evaluating a household's full scope of expenses using spending estimates to calculate what a household can actually afford (Harvard Joint Center for Housing Studies).

Working Together: Private Sector Opportunities to Join a Growing Ecosystem

While today's challenge might appear daunting, opportunities for the private sector to address needs for affordable housing are expanding like never before.

Public-private partnerships have had roles in helping to foster the building and preservation of affordable housing for decades. Such partnerships allow both entities to share the risks and rewards of their investments by leveraging the efficiencies and experiences of each toward a common cause. HUD's introduction of its Section 8 Project-Based Rental Assistance Program in 1974, and its revised, tenant-focused Section 8 Housing Choice Voucher program in 1983, are two early examples of such partnerships. The Low-Income Housing Tax Credit program (LIHTC), a tax credit to investors of affordable housing that has subsidized more than 2.5 million units since its inception in 1986, is another example.

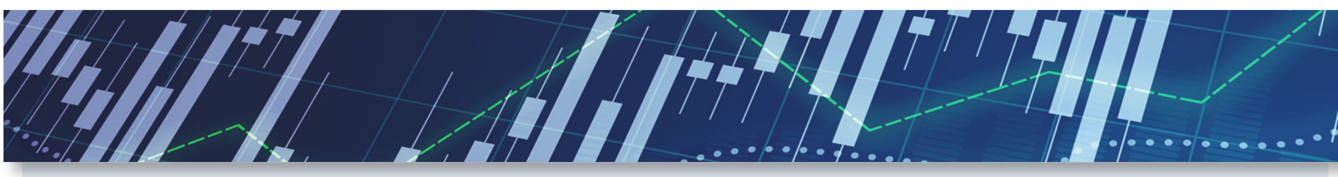
Traditionally, banks, motivated by the Community Reinvestment Act, were primary partners engaged in affordable housing programs. Later, a new type of partner joined the ecosystem–community development financial institutions

(CDFIs). CDFIs are private-sector intermediaries, such as credit unions, loan funds, and banks, whose primary mission is community development in low-income communities. The CDFI Fund, a Department of the US Treasury, was formed in 1994 to unify, certify and support the mission of CDFIs. Today, this sector numbers more than 1,300 institutions who are valuable members of the affordable housing finance arena.

By the mid-2000s, additional partners entered the ecosystem, as mission-oriented corporate and private lenders, as well as philanthropic foundations, entered an era of socially responsible investing. Complex platforms and capital stacks required early leadership and technical expertise, garnering partners with the most sophisticated and highest technical capacities. Over the last decade, their leadership has helped the industry of impact investing grow significantly, attracting partners of all sizes and from various sectors.

Today, the affordable housing ecosystem is robust, with an appetite for private sector innovation and market forces to design solutions and positively influence the public policy agenda. Further propelled by an opportunity to advance a businesses' environmental, social, and governance (ESG) strategy, many companies are finding that investing in affordable housing aligns with both their financial goals and their corporate mission.

Nontraditional partners like Microsoft and Amazon have pledged millions to create or preserve affordable housing in select markets. Community land trusts–nonprofit, community-based organizations that serve as long-term stewards–have become successful partners in the development of affordable housing real estate. And innovative development solutions, like intergenerational housing for seniors and families, and providing workforce housing near work facilities to attract and retain talent, could see opportunities for new subsidies. Meanwhile, housing agencies, government entities, and renters are benefitting from increased participation among new actors.



What to Watch: Insight and Outlook Considerations

- There's a common saying that you cannot build your way out of the housing crisis. To retain affordability, quality, and the long-term stability of homes, we must also preserve the existing housing stock. Products and partnerships that support the preservation and improvements of these properties will continue to evolve, and innovative financing structures that also support energy efficiency and renewables, like Commercial Property Assessed Clean Energy (C-PACE), as well as other green programs currently available in several states, will continue to expand. Such improvements can help reduce costs while improving the property's value. In addition, today's investments for remodels, additions, utility and weather improvements will save funds tomorrow. (Note: Learn more about C-PACE in this whitepaper from our affiliate.)
- With surging home prices coupled with higher interest rates, more people could delay becoming first-time homebuyers and continue lingering in rental markets. This could potentially drive an even greater need for workforce housing in the future. How might the market best support potential growth, as well as support the millions of rent-burdened households that do not currently qualify for current housing subsidies?
- The 2022 $1.5 trillion Federal spending bill recently passed provides HUD programs with $53.7 billion spending, a $4 billion increase over fiscal year 2021 levels. Among other provisions, some highlights include the expansion of Housing Choice Vouchers for the extremely low income and very low income, by up to 25,000 households, and includes $11 billion in funding for new or repair of affordable housing. In April, HUD published the fiscal year (FY) 2022 income limits, which determine eligibility for HUD-assisted programs. Income limits are effective immediately and must be used within 45 days of release, which is June 2.
- Much remains on the horizon for potential policy initiatives or legislation that could increase the provision or affordability of multifamily housing and preservation. Could there be new legislation, or the expansion of subsidies, which could help close the gap between traditional affordability and today's cost-burdened Amercans?

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Investing in Affording Housing: Opportunities, Benefits and ESG

In addition to the obvious social returns of providing families with safe and affordable homes that strengthen communities, investments in affordable housing offer several benefits to owners and managers:

- **Strong and stable cash flow.** Most multifamily owners report extremely low vacancy rates due to long tenure and steady waitlists for qualified tenants. In addition, rental income is typically stable or rising, and expenses are largely predictable.

- **Attractive borrower rates.** Investments in affordable housing receive favorable lending terms. Qualified HUD lenders can offer borrowers more attractive terms, such as higher LTV, lower rates and lower guarantee fees.

- **Asset diversification.** Stable assets such as housing can balance other investments in an owner's portfolio.

For social impact investors, the interest in affordable housing has never been stronger. And there's good reason:

- **Affordable housing offers long-term stability** and solid fund performance through changing business cycles.

- **Affordable housing provides outstanding opportunities** to pursue social impact, and in some cases, environmental, for ESG strategy. The focus on ESG has grown exponentially over the past two years–some describing a strong strategy as a gating item for other business.

Beyond The Numbers: Characteristics That Protect Affordability, Build Community

- Is the housing built, preserved and priced to meet the needs and fill gaps the community?
- What is the scale of the buildings, including number of units? Is it appropriate for this community?
- What percentage of the units will be affordable? How long will the subsidies remain?
- Are essential services nearby, such as grocery, health, education, public transportation, parks? Is the community safe and walkable?
- Are partners local? Did the community provide input on the development?
- Will utilities be affordable for tenants?
- What is the partner's history of anti-displacement and its mechanisms for reporting, accountability and transparency?
- Are there ways for tenants to build community?

The Bottom Line: What Will It Take?

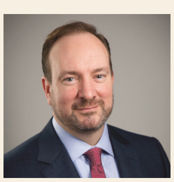
Those who choose to invest part of their portfolios in affordable housing are experiencing a triple bottom line for their investments, their companies and their communities–doing well by doing good. The market is ripe for innovation, not just in the transaction selection or the layers of capital stack, but also in the partners and models executed for these much-needed projects.

As the crisis continues to unfold, what we need to reverse this direction seems clear: Vision, innovation and collaboration. This is certainly possible among the various lending and investing partners across the housing ecosystem; we are already seeing it. From their successes, the industry will undoubtedly scale.

Successful models will be flexible, share risk, bring critical capital for a competitive and timely acquisition, and tackle challenges in equity for underserved and rural populations. Roles for investors are needed and growing. Beyond tax credits and subsidies, there are new financial models as well, such as real asset funds, that have scaled to leverage private capital ownership and well-designed housing that will last.

What will it take to actually solve the nation's housing crisis–both from a housing stock availability standpoint and affordability standpoint? In the words of HUD Secretary Fudge from a public lecture at Harvard: We have the tools; we need the will to get it done.

As an industry and nation, I believe we can do just that.



Chris Callahan is president and CEO of X-Caliber Capital, a national real estate finance and investment firm focused on providing commercial funding solutions that make a positive impact on some of the country's greatest challenges. The firm provides short- and long-term capital solutions that support four areas of focus: affordable housing, senior housing and healthcare, energy efficiency initiatives, and rural communities, and has integrated that mission into the company's business strategy, described as lending and investing for the greater good.

This is the first in a series of white papers in which X-Caliber will track current economic conditions and issues as they relate to our mission. Stay tuned for more throughout 2022.

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