The Weekly Take

Coming Home: Affordable housing investment on the rise amid strong fundamentals

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Spencer Levy
For a long time, when many investors heard the term affordable housing, they often thought of transient apartments or municipal housing projects. But that perception is changing. On this episode, a leading institutional impact investor and a top adviser in this space makes the case that affordable housing is a reliable, stable asset type, and profitable, too.

Nadir Settles
Investors need to start to understand that this is just prudent to have alongside your regular multifamily. This is not an either or and people need to stop thinking about it in that way.

Spencer Levy
That's Nadir Settles, Global Head of Impact Investing at Nuveen Real Estate, which manages more than $150 billion in global assets, both public and private, and has a unique approach to the affordable housing space that we'll hear about on the show. Nuveen recently completed an acquisition of affordable housing provider Omni, marking a notable shift by institutional owners into the affordable housing space.

Armand Tiberio
The asset class is effectively now becoming the most stable asset class in the multifamily sector.

Spencer Levy
And that's Armand Tiberio, who leads CBRE's Affordable Housing Group, which includes one of the largest affordable housing financing platforms in the U.S., as well as an advisory group that has handled a wide variety of structured deals for owners and operators, including Nuveen's Omni transaction and more. Coming up, the ABCs of affordable housing, the differences between capital A and lowercase A affordable, that is, the double bottom line, and \all you need to know about an asset type that is both critically needed and largely misunderstood. I'm Spencer Levy, and that's right now on The Weekly Take.

Spencer Levy
Welcome to The Weekly Take, and this week, we're going to be revisiting one of the most important issues in real estate, which is affordable housing Armand, thanks for joining the show.

Armand Tiberio

Great to be here, Spencer.

Spencer Levy
And then we have Nadir Settles. Nadir, thank you for joining the show.

Nadir Settles
Thank you for having me, Spencer.

Spencer Levy
Great to have you, Nadir. So let's just start simply. Definitionally, capital A affordable versus lowercase A affordable. Armand, Nadir, how would you define them? Armand.

Armand Tiberio
Yeah. We in the industry have defined both capital A and little A based on two set criteria. The first one is, what are the limitations in which a renter coming in can be charged rent, and what is the maximum amount of income that tenant can also be charged. Industry wide, the cutoff is capital A affordable is at a 60% of area median income. And little A runs from 60% up to around 150%. So inside the affordable world, if the overall asset sits in a location where there is a 60% limitation of area median income to be charged to the tenant, for both rent as well as for qualification of income, that becomes capital A affordable.

Spencer Levy
Anything to add to that, Nadir?

Nadir Settles
No, I would just say when we talk about capital A affordable or deep affordability, that is where there's a huge shortage of available units when you're talking somewhere around 7 million units and need it for those earning less than 60% of area median income, as Armand calls it, the AMI.

Spencer Levy
Terrific. And for our listeners purposes, capital A affordable means that you're using LIHTC, low income housing tax credits. Is that a fair way to describe it, Armand?

Armand Tiberio
No. Well, it's kind of interesting. It's a good question. It's really defined by virtue of how much money do the tenants make and how much rent is being charged or capped and limited on what you can charge to those tenants based on the demographic of a specific location. Capital A affordable, for example, could be a HUD project that is financed with a HAP contract, which is a subsidy contract coming from HUD, but doesn't actually come with any type of Section 42, which is the low income housing tax credit program. Any type of formal regulatory restrictions on the asset.

Nadir Settles
One thing I'll add to that, Spencer, because there is a delineation when we talk about deeply affordable because that is where there is a deep shortage of units. There's approximately somewhere about 7 million affordable units that are required today. And so a huge supply-demand imbalance that's favorable to institutional investors. But there's certainly an element, as you start to think about how do you provide for inclusive communities, but to maintain the fiber of those communities where you can just have a workforce where the fire person and the teacher and other people that are doing services

that may not qualify for deeply affordable, but still, it's unaffordable for them to live in their community. And inclusive communities can both benefit from living in one area.

Spencer Levy
I was actually going to get to that later in today's discussion. But let's get right down to this mixed income nature. I think that’s what you're getting to, Nadir, because I think if you go back historically into the affordable housing space, there's been a lot of different structures used. And I think the one that was used historically, which didn't work well, was where people would essentially earn their way out of capital A affordable. Their income would get above a certain level and then they'd have to leave. And so I think what you're saying, Nadir, is that your goal here for affordable housing as a whole is to keep people in these communities, even if they do rise above that income level. Is that a fair way to put it?

Nadir Settles
That is. That's right, right? Hopefully, what you'd like to see is that maturity of people living in a community. They've invested in the community. They work in that community. You're seeing so much affordable housing getting pushed to the suburbs. So if you're in these urban centers where you can have people go from capital A affordable to hopefully to supportive services that you're incorporating within your buildings or allowing for that mobility, and then people are able to still live in their community, but in more affordable units as they progressed from affordable to workforce housing. And hopefully we're starting to evolve to the point where we can start to understand home ownership, and you can go through that process. Now from an institutional investment perspective, predominantly, we're focused on capital A affordable. That's where the deepest need is at. But, we don't want to lose sight on lowercase A. That certainly helps to build more inclusive communities.

Armand Tiberio
Yeah, I mean, first of all, nothing has less than a 30 year minimum regulation in the country. But to your point, you're correct. Starting in really 2024, 2025, we're going to see the first round of assets that were placed in service back in 1991, ‘92, ‘93, when the program of the low income housing tax credit really kicked off. To some degree, some of them will be owned by non-profits and they will self restrict. A lot of them, to some degree, will end up getting redeveloped with new tax credits. But it's become harder and harder to actually do more new deals. States are now starting to realize, hey, look, we need to expand incentive based programs to owners who would otherwise be really naturally just raising rents and rehabbing units to market rate rents, to actually keeping them at a lower threshold of rent and income for tenants that are rising.

Nadir Settles
And I'll add one thing there, because Armand is spot on around that impending problem, and that's where I think there has to be a reshift in thinking of, how does preservation look? Because affordable housing is a pandemic. Private capital can't solve this and it's not going to just be LIHTC. And so public municipalities can't solve this and you're going to start to see more of creative solutions being done, and more of a public-private partnership in creative thinking around supporting, from an economic perspective as well, whether it's some sort of subsidized debt, some soft debt, low interest rate loans, right? Various different other aspects to be able to ensure that you don't have this deficit that's just compounding without anyone with a proper solution, right? So those that want to preserve and you don't get the tax credits, municipalities are going to work with private investment to ensure that there's ways for affordable units to be preserved.

Spencer Levy
And I think we would all agree the key is exactly the way you framed it, Nadir, which is, it's a public-private partnership. And whether that public is federal, whether that public is local, they both play a hugely important role. But I think the key and the reason why we're having this episode is just the other pillar, which is the huge importance of institutional capital flowing into the space. Some of the largest institutions in the world are now looking at this space not only favorably, but as a place that they're going to try to put a lot more capital to work. So with that, maybe this is a good segway, an Nadire, why don't you tell us about the Omni deal?

Nadir Settles
Yeah, so the Omni deal is amazing and it actually puts Nuveen in a unique situation to face the market every day with 550 people that do everything from development to construction management to property management to safety to investment management, right? We've been doing this from an investment management and allocation perspective at Nuveen Real Estate, for 30 years, we invested in our first affordable housing and then we started going direct about ten years ago. And so we've been doing this for a long time. But as you look at, how do you get good execution as far as the efficiency for managing, great control in the operations and trying to provide a dignified living for the residents there, owning the whole value chain and being able to operate as one from an end-to-end perspective is very unique. And that's what the Omni transaction gave us. And so today, with that acquisition came about 20,000 units, with pipeline that we bought, and we probably have in the deeply affordable, as Armand named it, capital A affordable, about 35,000 units. It allows Nuveen to be vertically integrated, which is very different, whether it's development, whether it's rehabs or whether it's actually what I call regenerative community development, to where you can actually build this combination of capital A plus workforce. We are a one stop shop for that, and that's what the Omni transaction gave us.

Armand Tiberio
The Omni transaction was a very unique asset in the sense that you had a going, existing management group that was highly well-regarded. It was a vertically integrated corporation that was executing on a daily basis. And we haven't seen a transaction like that, quite frankly, of scale, exist in our capital A affordable world to date. So that is a very new transaction. Even if I look to the deal that we did a couple of years ago between the selling of the AIG portfolio to Blackstone, the infrastructure of what was there with AIG was really mainly just asset management. They were not actively doing any new deals. They hadn't done new deals in many years, quite frankly. And so it wasn't a fully integrated, all things execution wise. And so that's what Omni was really, really unique with. And when Nadir and myself and the rest of his executive team sat down together a couple of years ago, which is really, Nadir, it was about a two and a half year conversation, and...

Nadir Settles
Yeah, not to interrupt you, but you're right. We commissioned Armand to Chicago. We had the whole executive team there and we laid out the vision and we said, we're going to enter into the space and we know we can achieve the double bottom line. So when you think about the support of services and the wraparound, we know we can do that really well. But how do we get the execution? Because that's what we want to offer. We want to offer great performance to our investors. We want to offer a great execution, and we know we can offer the great supportive services. And we had that meeting with Armand and about six months later, he called.

Spencer Levy

Nadir, you used a term that's common in the industry called the double Bottom Line. Can you explain to our listeners what that means?

Nadir Settles
Yeah, that means we are fiduciary. At no point should you not get the right risk adjusted return. You should not be sacrificing return because you need to invest in the impact space. You should always get paid for the risk you're taking. That's one bottom line. And the double of it is emphasizing the “s”. And this is where I was kind of cautious. I wanted to say the sustainability side and I wanted to say ESG, but this is where impact investing and investing in affordable housing is not just about the return. There are people that approach it that way. And I think investors will see Nuveen Real Estate, just by our DNA, that we are authentic about approaching this as the double bottom line, and we don't sacrifice returns to get that. But this is not an ESG outfit.

Armand Tiberio
Yeah. To the credit of Nuveen, it's never been a situation where institutional capital is not interested in capital A affordable, but it's been very, very difficult, not only from an educational perspective, but from a scale perspective. The average size individual transaction still to the day in the United States of these affordable transactions runs somewhere in the ballpark of $12 to $15 million per asset. In the world of institutional market rate real estate, that's really a private client capital type of size deal. That's not something that you have people out there in the institutional world really being able to purchase on a day in and day out basis because it's just not large enough. And so the problem is, you have this size and efficiency disconnect. And so the Omni transaction, to Nadir’s point, we had been working with the existing ownership group of Omni. We sat down and we looked at the market and one of their big concerns was, can we find value and can we find a buyer that's going to come in and respect and see a future and a vision for the 500 employees that they had working for, right? They didn't want to just sell their real estate. They wanted to see if there was a buyer that could see the value of what they had built to date, but more importantly, put a vision that was a new vision to take it to a whole nother level. And that's where this came from.

Spencer Levy
It's really important people understand that by going into capital A affordable, you are not sacrificing return. You are getting the same returns as you can on market rate, and then you get this second bottom line that is so critically important. Is that a fair way to put it, Nadir?

Nadir Settles
That is absolutely a fair way to put it. We emphasize the “S” in ESG and amplify that impact. And how do you amplify that impact? It's by creating that better tomorrow for your residents. So, again, threading things together, we talked about, how do you have that maturation of someone going from affordable housing to potentially workforce housing and being able to stay in the same community? Well, how do you start to pull the levers that go beyond the four walls to do that? It's increasing financial literacy. It's education, it’s job training. So within some of our apartments right now, we have a myriad of different services. But one is, we've partnered with a nonprofit construction group that takes people, our residents, to a program to where they can go get a proper construction trade licensing, and be ready for a construction job. And that job is going to pay 80 to $100 an hour. And so that is the kind of upskilling, job training that we're doing right in our communities. Health and wellness. How do we create a scenario where where you live doesn't determine how long you live, right? And so it's time to make healthcare more equitable.

And how do we cure food security, afterschool programs, tutoring, summer programs for kids, incorporating daycares, and certainly connectivity, right? We've seen the digital divide and it's time to equalize that. And that's where we went and worked with a lot of the providers to ensure that we were offering free Wi-Fi, or subsidized Wi-Fi in a lot of instances. So that's where the double bottom line comes about. And you got to be really intentional about that, which is why we just don't say that we're an affordable housing group. Affordable housing is critically important to anchoring down communities and ensuring that housing stability is there, but then we invest in our communities and ultimately trying to empower our residents for a better tomorrow. And that's how we put the double bottom line together in every investment that we make. And I think historically, investors have been concerned with the complexity of the space. There's a social impact to it, as well as returns that can be achieved here. Even just as a part of portfolio construction, investors need to start to understand that this is just prudent to have alongside your regular multifamily, like this is not an either or, and people need to stop thinking about it in that way, to say that, hey, I may invest in affordable housing this year or invest in market rate housing. Actually, they have different benefits at different points in the cycle. And so you should have both of them as part of a portfolio construction, because affordable housing, if you think about today, in a downturn, you've got low vacancy. It's a very stable investment. You have outperformance. You're not losing valuation the same as you are with market rate. Occupancies are stable. NOI is growing. We're getting healthy AMI increases. But during upswings, you're going to have moments where your market rate performance is getting very high year over year rent increases and affordable is not. So it's that stabilizer. It's kind of cyclical, and it's that stabilizer and it adds to a portfolio.

Armand Tiberio
One of the biggest hurdles of institutional equity, if we were to roll back over the last decade, has been, there is this misnomer that capital A affordable housing is some of the roughest locations. It's some of the worst constructed assets. It’s some of the worst tenancy make-up of criminals, etc. And in reality, the program has produced, since 1990, over 3 million units nationwide. The vast majority of this product is sitting in the communities where everybody in the institutional world already owns market rate housing. They don't even know the difference between the property sitting across the street that was built in 1995, and it's their market rate asset, versus the project that’s one block away that's 1995 construction that's sitting at 60% of AMI and is a capital A. So it's this first hurdle of saying, no, these are tenants. These are folks that are paying rent, that are good folks that are working, that have jobs, right? Yes, maybe they've come from the homeless side of the equation. They've gotten their feet back underneath them and they're progressing. And one day hopefully they will own a home, etc.. But it's not this perception which was definitely there. I mean, I remember working in this sector in 2000, 2005 whereby you walk into an institutional investors offices and you sit down and you get up on a whiteboard, you start describing what actual capital A affordable is, and they're like, well, gosh, why do we want to buy these assets and believe that we have like the highest crime rate in the entire neighborhood? That's just not true. And I think what's happened is over the last decade, as folks like Nadir and others in the institutional world have actually stuck their toe in, have realized this, have raised their hand and said, no, this is what our experience is. The Daryl Carter, as an example, the Blackstone now, etc. – people are starting to wake up and realize, no, this is really an asset class. And more importantly, to Nadir’s point, it's now accepted in 2023 is a great example of this, right? The market is effectively frozen right now in the market rate world. In our affordable space, to Nadir’s point, totally countercyclical, occupancies have never been higher. We’re receiving, for the first time in the almost 20 years I've been doing this, true wage growth, which translates to higher increases in rents, which is helping to offset the last two years worth of inflation on

the expense side. The asset class is effectively now becoming the most stable asset class in the multifamily sector to be compared to what historically had always been core, core plus type investment vehicles. And that is a spectacular thing for people to finally wake up and see, in my book.

Nadir Settles
If institutional investors are taking away anything from this conversation, it's about the resiliency. But as Armand talks about favorable markets and people not even realizing that the same asset is in the same markets they like, what are the factors that are people looking at when they're looking at multifamily? Because yes, they are in the same market, right? And in looking at, what are the demographics? Well, these are the same strong demographics. Migration, population growth. Well, the markets that we're in are that, right? But the one thing that market rate doesn't have that affordable will have for the foreseeable decade is this supply-demand imbalance that is going to be favorable. Full stop, right? And market rate won't have that. And so that's why I say it needs to be together. It needs to be a proper part of portfolio construction because of its resiliency and its stability as you look into the future.

Spencer Levy
One of the things that you said, Armand, struck me, which was the average size of the deal, you said I think it was approximately 12 to $15 million. You know what that reminds me of? That reminds me of the self-storage sector. So, A, do you agree with my analogy? But part B, if you were to take a look at the entire capital A sector, what percentage of it is institutionally owned today versus privately owned today?

Armand Tiberio
Let me break down two parts of that question. The first question or the first part of it is specifically to the size of the asset. There is a very mathematical reason as to why capital A affordable was built on the smaller unit scale size, which is the reason why it's driving that value of 10 to $15 million in value. It's not because it's just cheaper product. It's because the size of the product. Go back to the two buildings built in 1995, one block away from each other. The market rate deal might be a 250 to 300 unit deal. And the Affordable Housing Project was only 125 units. The reason for that is because there's not enough subsidy out there to build bigger scale projects. That is a holistic problem that we have to solve in the United States. It's not a lack of resources of people wanting to build bigger projects. It's a lack and a scarcity of the source of funding in order to do it. That's a big problem. As to the second part of your question. I would say the overall ownership in the country is still very much self-storage. You and I have talked about this before. It's a mom and pop. And when I talk about mom and pop, I'm not saying the owners overall just don't know what they're doing. It was always a regional, more local developer game. The reason for that is, it was a lot of folks that were able to put these projects together. They were only 100 units, 125 units. A lot of state allocation programs out there don't want a large, vast number of the projects to only go to one developer. So they've got specific rules. In the state of Florida, you're only allowed, for example, X number of deals per year. So they want it spread out. They wanted to move it out. And they also, Spencer, wanted to geographically spread it out. There was a high concentration and a benefit given to the fact that you would put a project in a suburban location, not an urban location, or even a tertiary location in order to provide housing for farm workers in the Central Valley of California, etc.. So the institutional ownership today is still a very, very small fragment of the total ownership. I would tell you it's probably still less than 10% nationwide.

Spencer Levy

Very similar to self-storage, how that has a small percentage. That creates the opportunity.

Armand Tiberio
It does. It does. That’s, there's the institutional mindset is now turning. It's trying to figure out how to enter this space and do it at scale. And that is going to be the next decade of a challenge. So it's everybody waking up to the fact that folks like Nadir and Nuveen, paying attention to this double bottom line, right? And that is a social impact that we all need to be aware of. It's a good thing, by the way. It's not a bad thing. It's an absolute good thing. And accepting and providing and helping and educating more institutional capital into the space is an absolute necessity in order for this program and for the continuation and the preservation of this affordable stuff well into the future of the next decade, plus.

Spencer Levy
We've talked quite a bit today about the importance of public-private partnership. I think we’ve talked a great length about how important institutions are, the private side. We've talked a great length about tax credits on the public side, but there are other elements where the public can play a role in improving the availability, the building of affordable, capital A affordable housing, not the least of which is known as NIMBYism. What's your point of view on that issue, Armand?

Armand Tiberio
There is a global necessity that everybody agrees with, that we have a massive shortage of affordable housing in the country. As far as solutions are concerned, I think we are starting to see a lot of various different government agencies, both at the federal level, as at the state level, starting to really roll up their sleeves and recognize, hey, we've got to come up with new ways and new solutions to not only incentivize the growth of more affordable housing, but also where those sources of capital are going to come from in order to be able to provide the actual execution and creation of it.

Nadir Settles
And just for historical context, the LIHTC policy was built during the Republican administration, and we call it a purple issue, because everyone realizes that affordability is the next pandemic. That's why it's a purple issue that I think will continue to be supported from a LIHTC perspective at the federal level. But then at the state level, states are starting to think about more creative ways to ensure that developers and investors of affordable housing can be able to continue to invest in this space in a very efficient manner, because you're not able to make rents justifY the investment. And so how do we help to support that? Because they know that private capital can't just do this, and public municipalities can't just do this. And so how do we work together? And from an implementation perspective, they're coming up with various different ways and more will be thought of. But there's soft debt, there's low interest loans, there can be contributions of land. It could be tax abatements. States are thinking they can do bonding capacity and how to increase it, right? Zoning, right? A lot of this zoning is archaic and to incorporate more affordable housing and build denser, that needs to be reworked and moved through some legislative process. And then the NIMBYism. I think, listen, that's always going to be a point of view depending on where you're at. That's where you have to get as local as local gets. You can't make these investments parachuting. You need to go in and talk with the local municipalities, talk with the local church, talk with the community. A lot of times, the people live in the community anyway. Affordable housing just doesn't encourage gentrification where you're moving people out of the community. And so they think they’re building new in their backyard, but they're not building new in the backyard, they’re

building better in their backyard. And so I think they just need to understand it better. And I think there will be more empathy and more agreement for the NIMBYism part of this.

Armand Tiberio
A lot of people associate capital A affordable housing with crime, right? They associate it not with all of the positive aspects. And so there is this adoption or NIMBYism, as you talk about. We have to somehow project out a new message around not only the need for it, but also the positive aspects that it can have on communities around the country. That is without a doubt, part of this problem, is to get people, to get the constituents of the population around these communities that need them more than anything, or need more affordable housing than anything to really get buy-in in a way that is not looked at as a negative but is really looked at as a positive.

Spencer Levy
Let me ask one more specific question, and then I'm going to ask both of you for final thoughts. One of the things that I've also noticed of a shift in institutional mindset is not about affordable, but just generically, is the shift of large institutions going away from saying, we're just going to be asset managers of a property to buying Opco's. To buying the operating entities as well, and being a partner in that. That to me is a major shift in the business that's happened in the last decade, when there were very few institutions that would do Opco, but now we're seeing more. Do you agree with that, Nadir?

Nadir Settles
I do. And you're right. You're starting to see more of these transactions. I think more institutional investors are thinking about ways and where it makes sense and how deep they want to go to vertically integrate, or align themselves in strategic partnerships if you don't want to go deep. We're going to go deep in the space. You've seen our commitment that we've come out with to 15 billion in five years, and we're at almost half of that in 18 months. And so in our commitment to go deep, we want to make sure that we built the best execution, and that was vertically integrating for Nuveen. Others that want to just invest in this space because they see it as a great investment for portfolio construction, they may choose to align with a specialized partner that can assist with development, property management, manufacturing, and then they can make portfolio decisions. In either execution, you're going to start to see, to your point, people align or buy the capabilities that allows them to really offer the best execution.

Spencer Levy
Great. So final thoughts, Armand.

Armand Tiberio
I think if I were to try to drive home any one message around the space, it's the recognition of how resilient this asset class really is. There's a lot of disjointedness right now in the commercial real estate market, as you know. There's a lot of fear in this commercial real estate market, as you know. We're going to finish this year having another banner year across all silos of what we do: debt, equity, structured finance, and the investment sales. And so it's really driving that message home that the continuation of investing in affordable A is not only something that is absolutely necessary, it's actually really, really good for institutions, and private investors alike, because it's an asset class that definitely has, without a doubt, some of the strongest demand and some of the strongest fundamentals of any piece of real estate that we've seen. And I think it's demonstrated by the market we're living in right now.

Spencer Levy
Nadir, final thoughts?

Nadir Settles
Yeah, I'll augment Armand's comments a little bit on the returns side, but I'll emphasize what we do and what we'll continue to show in our investments, which is that double bottom line. And I think that's just important for investors, institutional investors, private investors, to know about the space, is, they can participate in the space in a meaningful and prudent way and be in responsible investing. But affordable housing really does provide attractive risk-adjusted returns. But, it assists with stabilizing communities, which is very important.

Spencer Levy
Well, on behalf of The Weekly Take, I want to thank Armand Tiberio, our Vice Chairman, head of our Affordable housing practice. Congratulations on helping facilitate the Omni and so many other large transactions. Thanks for joining the show.

Armand Tiberio
Thanks, guys. Appreciate it.

Spencer Levy
And Nadir Settles, the Head of Impact Investing at Nuveen. We want to thank you so much for joining the show. Congratulations, as well, on the Omni deal, and all of your future plans in the affordable housing space. Nadir, thank you so much.

Nadir Settles
Thank you, Spencer. And thank you, Armand.

Armand Tiberio
Thank you, buddy.

Spencer Levy
For more on affordable housing and related content, please visit our website, CBRE.com/TheWeeklyTake. You can share this episode and reach out to us with the “Talk to Us” button on our home page – a simple click to send your thoughts or questions that we might follow up on in a future episode. And don't forget to subscribe, rate and review us wherever you listen. We'll be back with insights into other sectors, including informative perspectives for real estate investing, operations and more. We'll talk workplace with our annual take on CBRE’s U.S. Office Occupiers Sentiment Survey, and we'll feature other thought leadership from around the world, as well. For now, thanks for joining us. I'm Spencer Levy. Be smart. Be safe. Be well.