AFFORDABILITY EXAMINED

Despite impactful shifts in financial and domestic policy, one economic truth has rung true for more and more Americans over the past decade: affordable rents have become increasingly out of reach.

When evaluating households burdened by rent, defined as a household where monthly rent exceeds 30% of household income, it's clear the number of renters finding themselves squeezed out of housing that fits their needs and income bracket is growing larger.

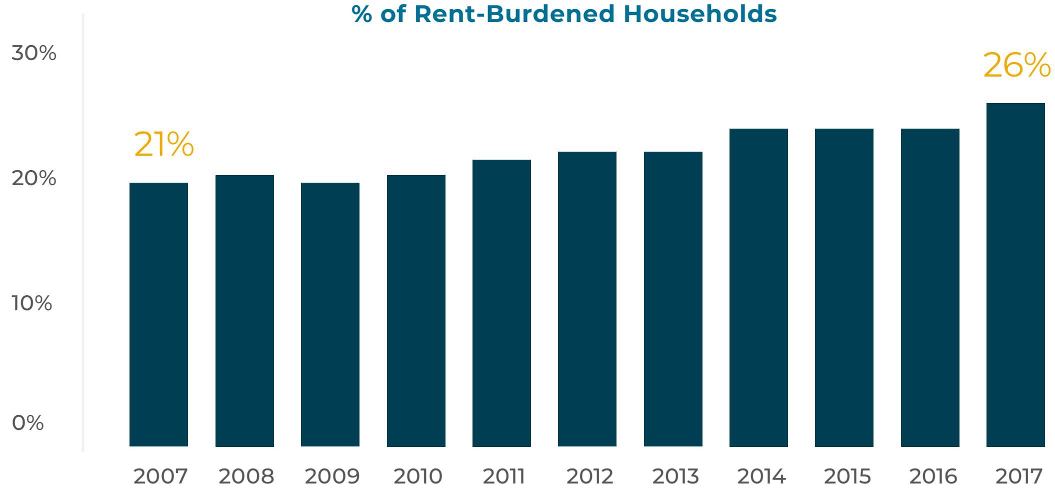
26%

From 2000 to 2017, the percentage of burdened households expanded rapidly, up to 26%.

We here at Berkadia feel it is important to examine this major issue as we head into 2020 and beyond. This report explores the full scope of the nation's rent-burden problem, isolates likely causes, and recommends a path forward for members of the commercial real estate industry.

Rent-Burdened Housing Affects Every American

Notably, the pace at which households are becoming burdened by rent has accelerated since 2007:



*Berkadia Research; Federal Reserve Bank of St. Louis; Axiometrics

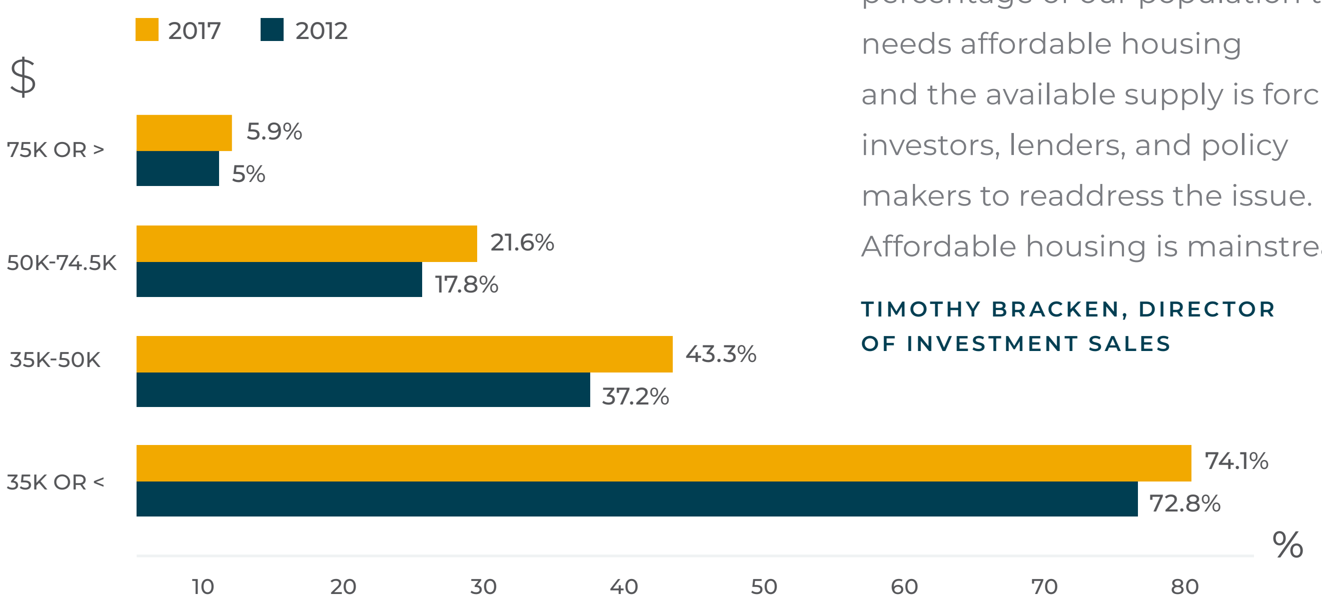
From 2007 to 2017, the percentage of burdened households expanded rapidly, up 500 basis points to 26%. Additionally, the rate at which households become burdened is also accelerating and has been doing so for over a decade.

Between 1997 and 2007, the percentage of rent-burdened households across the nation increased 400 basis points to 21%. The rise in rent-burdened households has evolved into a real issue, and that's not the end of the story.

RENT BURDENS INCREASING ACROSS INCOME LEVELS

One might be tempted to assume that this shift is being driven exclusively by low-income renters, but the reality is that Americans across every tax bracket have seen the cost of housing begin to chip away at their income.

% of Rent-Burdened Households by Income



*U.S. Census American Community Survey

> The widening gulf between the percentage of our population that needs affordable housing and the available supply is forcing investors, lenders, and policy makers to readdress the issue. Affordable housing is mainstream.
>
> **TIMOTHY BRACKEN, DIRECTOR OF INVESTMENT SALES**

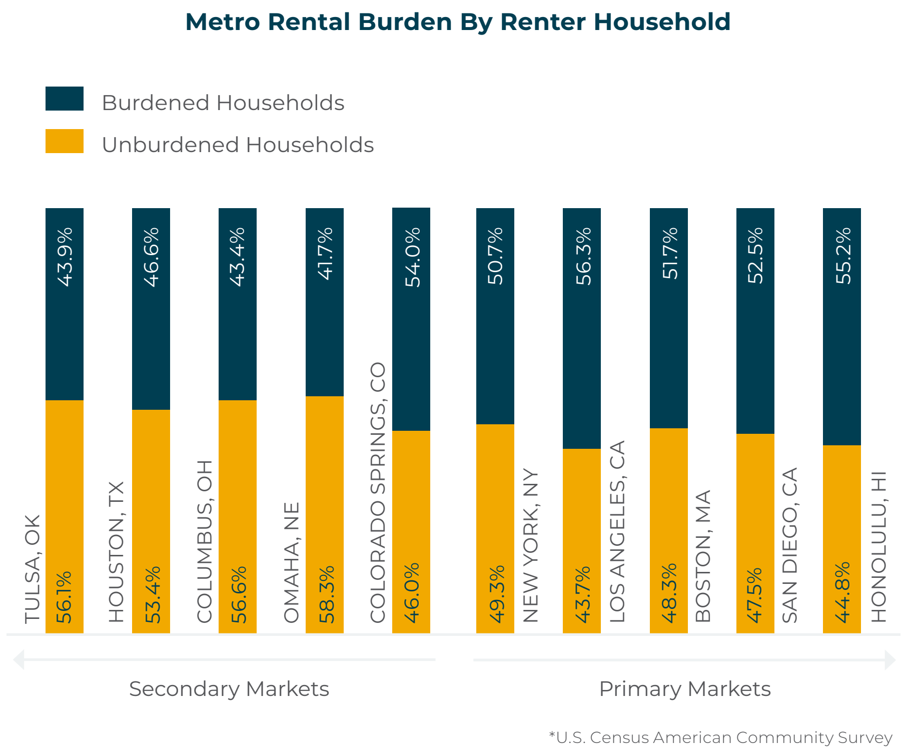
Low-income households, those earning a median annual income of $34,000 or less, do compose a large proportion of the renters who are burdened by housing costs. However, between 2012 and 2017, it was lower-middle- and middle-income earners who were most seriously affected by this trend.

Among lower-middle-income households (between $35,000 to $49,999 annually), the number of families setting aside greater than 30% of their income for rent increased 610 basis points. Likewise, the share of middle-income households (earning between $50,000 and $75,000) that transitioned into rent-burdened status over the past five years increased 3.8%.

Even the nation's highest earners were not immune to the creep of challenging rent cost burdens, with the percentage of wealthy and upper-middle-income households burdened by their monthly rent payments increasing 90 basis points.

RENT BURDENS AFFECTING DIVERSE METROS

This trend of progressively burdensome rental costs is not exclusive to coastal urban centers or popular metros with a high cost of living. Rent is becoming increasingly unaffordable, even in cost-friendly environments where renters are paid reasonable wages.

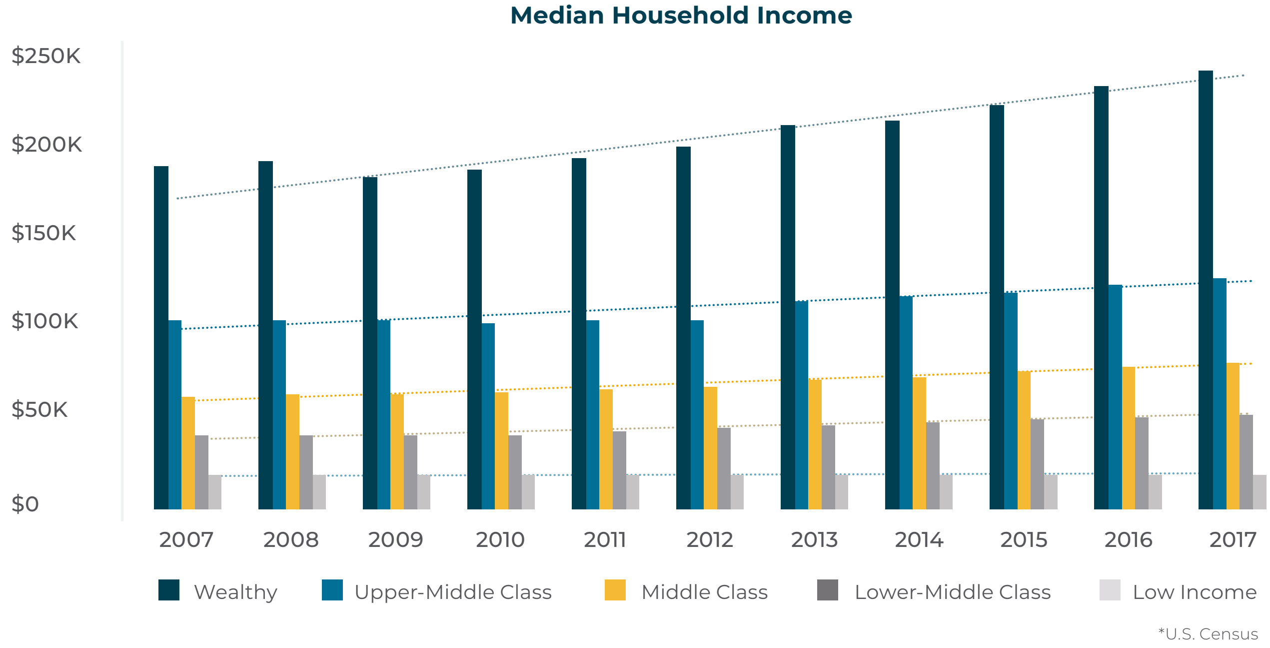


Consider the above comparison of 10 metros from across the country. The five metros on the right represent coastal gateway markets where concerns around affordability are common, while the five metros on the left represent examples of emerging tertiary markets. Traditionally, these are markets where renters might expect to have an easier time tracking down affordable housing.

Notice how the percentage of rent burdened households, households where renters are spending over 30% of their median income on rent, is significant across the board. Why are a growing number of renters, regardless of their market, struggling to find a rental unit that fits their budget?

While a comparison of average effective rent and median household income is helpful for painting a wholistic picture of rental housing affordability, this perspective fails to account for how income growth over the past few years has increasingly prioritized top earners. This trend has limited the ability of lower-middle and middle-income households to keep pace with skyrocketing rental costs.

Consider this visual representation of how income distribution has become increasingly top heavy over the past decade:



Note how the two highest bands, representing households earning roughly $75,000 or above, have seen their incomes expand more significantly than those households in the lower bands between 2007 to 2017. The incomes of middle-, lower-middle-, and low-income households have remained relatively stagnant over the same period. This explains why a large portion of the population has had minimal opportunity to upgrade into nicer, more modern apartments.

While income inequality is a major factor contributing to the increase in rent-burdened households nationally, it is far from the only one. A full spectrum of social, political, and economic forces is at play behind this trend.

A stronger understanding of these forces helps to contextualize why rental housing has become less accessible to a large portion of the population.

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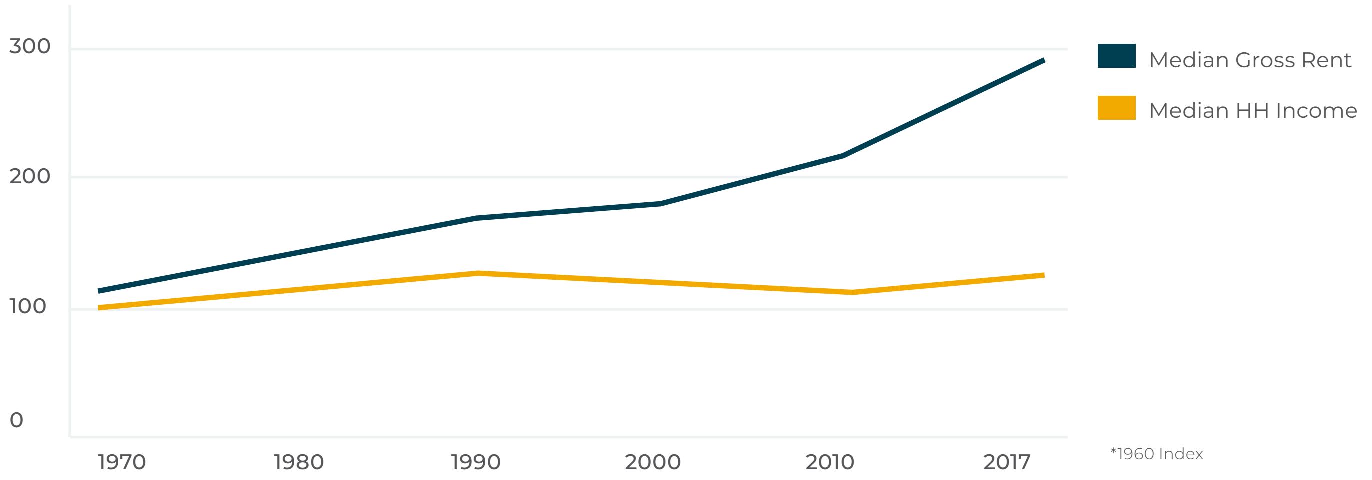
> Affordable rents are accelerating in areas where average median incomes have improved, and this trend is encouraging new players to jump into the affordable space.
>
> **BRUCE FURNISS, SENIOR DIRECTOR OF INVESTMENT SALES**

FACTORS CONTRIBUTING TO RISE IN RENT-BURDEN HOUSEHOLDS

Rents have become more expensive nationwide, more rapidly than most households' monthly income has increased. This trend is not new, however, and has been the status quo since the 1970s. What has changed, especially over the past decade, is the growing distance between these growth rates.

Compare the significant gap between median gross rent and median household income that exists today to the 1970s, when household income and rent costs were accelerating at a much more even pace. If economic trends continue their current trajectory, that gap is likely going to continue widening as we head into 2020 and beyond.

Historical Median Rent vs Median Income

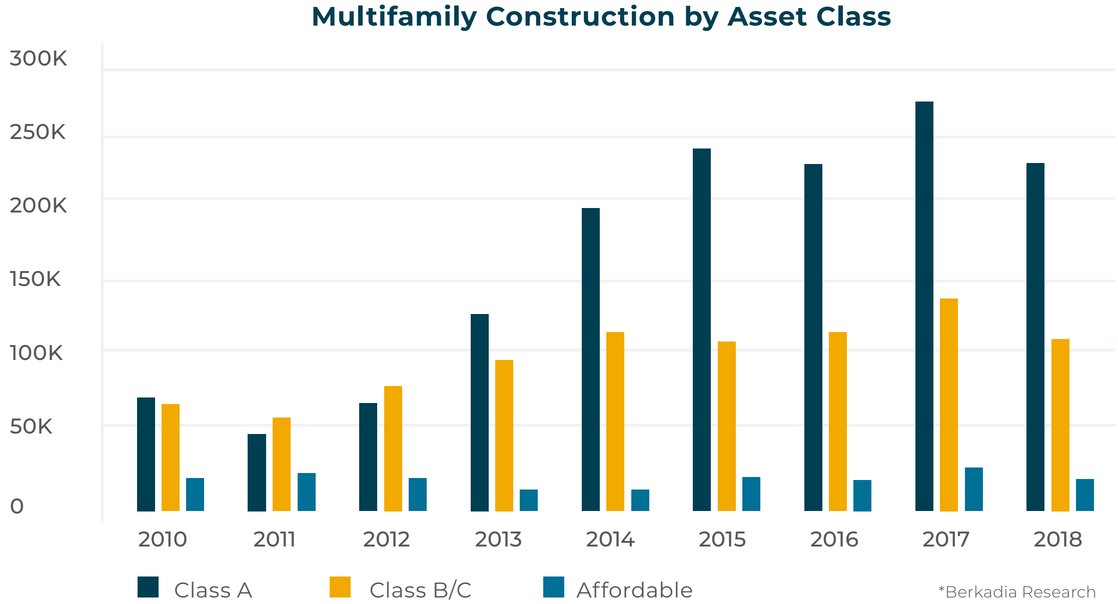


*Berkadia Research; Federal Reserve Bank of St. Louis; Axiometrics

Income Growth at Top Levels Driving Demand for Class A

As a direct result of income growth becoming increasingly top heavy across the country, developers have sought to capture the interest of top earners who are wary of settling long term and successful, childless millennial professionals who desire a strong live-work-play balance in a hip urban environment.

Examine the types of new multifamily assets coming online since 2010 and a recent preference for high-end properties is easy to spot:



The shift toward Class A assets makes perfect sense from a developer's perspective. It's also important to recognize that the increased focus on the nation's top earners has had additional, unintended consequences. If housing opportunities for Americans continue to zero in on the needs of high-income households, further stratification of housing opportunities for all Americans seems inevitable.

Evolving Economics Force Investors to Bet on High End

One should not blame the status quo on developers having an unfair bias toward Class A developments. The costs of development have risen significantly, and this has encouraged the entire industry to favor low-risk, high-reward plays in multifamily, e.g. luxurious, amenities-rich developments in select, high-demand locations.

> "I would say the biggest challenge for affordable housing developers is the value of tax credits. The value of those credits dictates if an affordable developer's capital stack is enough to rehabilitate existing properties or develop new projects.
>
> **JEREMIAH JARMIN, DIRECTOR OF INVESTMENT SALES**

Here are a few of the top economic and political factors that are contributing to this trend:

- A reduced corporate tax rate has weakened the incentive for banks and major investors to pursue and purchase tax credits
- Construction costs for multifamily development have increased by 5.6% in 2017 alone, as measured by the U.S. Bureau of Economic Analysis, including rising wages for construction workers
- The cost of land has skyrocketed, increasing by 76% from 2000 to 2016, according to data compiled by the Lincoln Institute of Land Policy
- Higher building fees, expanded regulatory requirements, and complex permitting schedules have added time-consuming steps and extra costs to the development process

WHAT ABOUT OPPORTUNITY ZONES?

> Opportunity zones are not yet a driver of affordable housing on their own, but now they're part of the bigger picture.
>
> **STEVE ERVIN,**
> **SENIOR VICE PRESIDENT**

Some have touted opportunity zones, which reward capital investments in development projects located in economically-distressed areas with reduced tax obligations, as a means of spurring affordable housing development.

Jeremiah Jarmin, Director of Investment Sales at Berkadia Affordable Housing, predicted a more subdued immediate impact.

"Opportunity zone funds could be ideal for ground up affordable housing development, but they are not currently attractive for acquisition rehab of existing affordable properties," said Jarmin. "Most investors involved in affordable housing are not capital gains driven. They tend to be large banks looking for Community Reinvestment Act (CRA) credits."

Senior Vice President Steve Ervin, who leads Federal Housing Administration (FHA) and Affordable Housing Finance at Berkadia Affordable Housing, expressed a similar cautious tone about whether opportunities zones would spur new affordable development.

"There is no silver bullet for this complicated issue. In order to tackle this problem, we will need a multifaceted approach. Opportunity zones are not yet a driver of affordable housing on their own," said Ervin. "But now they are part of the bigger picture. When combined with state and local initiatives, the lower tax rates received for opportunity zone investments could spur investment in affordable housing."

Berkadia's Demonstrated Commitment to Affordable Housing

Despite the skyrocketing demand for affordable multifamily housing, many in the industry see the space as too complicated or nuanced to challenge head on. That's why Berkadia has leveraged its expansive talent pool and centralized the company's affordable housing expertise to create a single, dedicated team: Berkadia Affordable Housing.

BERKADIA AFFORDABLE HOUSING is a national specialty platform within Berkadia, providing mortgage banking, investment sales, advisory, and equity sourcing to owners of income-restricted or subsidized multifamily properties, primarily through Low-Income Housing Tax Credit (LIHTC) and the U.S. Department of Housing and Urban Development (HUD) programs. Additionally, the platform connects clients to Berkadia affiliates that specialize in municipal banking and LIHTC syndication services.

BERKADIA®

AFFORDABLE HOUSING

BERKADIA SALES ADVISORY SERVICES	BERKADIA DEBT CAPITAL SERVICES	RIVERSIDE CAPITAL, LLC	JEFFERIES FINANCIAL GROUP
1 INVESTMENT SALES	2 MORTGAGE BANKING	3 TAX CREDIT SYNDICATION	4 BOND UNDERWRITING

This strategic organization affords Berkadia a unique position in the affordable housing space as one of few firms that can guide clients through every step of the process, from investment sales to underwriting. These services are not tied to or bundled with one another, but together they represent the full ecosystem of knowledge and expertise necessary to bring an affordable housing development to fruition.

Timothy Bracken, Director of Investment Sales at Berkadia Affordable Housing, noted how Berkadia's strategy to centralize affordable housing services under a single banner has served as a major benefit for clients.

"For buyers, it offers a single point of contact who knows the market and can help them grow their network," said Bracken. "For sellers, it provides a clear portal through the entire transaction. There's a peace of mind that comes with dealing with one team instead of a handful of unrelated parties."

PROVEN SOLUTIONS FROM BERKADIA AFFORDABLE HOUSING

Berkadia Affordable Housing is a collaborative effort that combines the talents of experienced affordable housing specialists, the nation's leading affordable housing lender, and LIHTC syndication specialists to maximize Berkadia's full breath of industry knowledge and submarket familiarity. Each component of the platform is a proven solution supported by professionals with decades of combined experienced.

1 Sales Advisory Services

Berkadia's affordable housing investment sales team offers disposition, valuation, and advisory services to clients acquiring fee or partnership interests for new construction, acquisition rehab, re-syndication, post-Year 15 yield, and market-rate conversion. Thanks to access to one of the broadest industry data sets in the country, our advisors use best-in-class research to quantify sales, rent, and expense comparables.

Sales advisory services include...

- Disposition or recapitalization
  - Section 42 LIHTC
  - Section 8 project-based housing assistance payments (HAP) contracts
  - Section 202 and 236
  - USDA rural development
- Valuation
  - Rent, income, or age-restricted assets
  - GP/LP interests

2 Debt Capital Solutions

Berkadia's mortgage banking team is the nation's largest combined lender of HUD and government-sponsored enterprise (GSE) debt products. For the past two decades, the team has been among the most active FHA and HUD lenders in the affordable and market rate sector. Leveraging this capital market strength translates to agency and loan optionality for clients, as well as the potential to bridge opportunities on its own balance sheet.

Berkadia's Debt Capital Solutions team has arranged...

- Over $10 billion in Freddie Mac loans for affordable properties through 2018
- Over $6 billion in Fannie Mae loans committed to affordable properties through 2018
- Over $1 billion in loans for affordable projects in 2018 alone

3 Riverside Capital, LLC

Riverside Capital is a full-service tax credit investment company that offers equity capital to developers of high-quality affordable housing. Riverside has secured the financing and syndication for over 7,700 affordable apartments, representing $1 billion of equity capital. The company is a joint venture between Berkadia and The Michaels Organization, the nation's top affordable developer, and serves as Berkadia Affordable Housing's LIHTC syndication expert.

With an average 17+ years of LIHTC experience, leadership at Riverside Capital...

- Maintains a $200M+ national pipeline of LIHTC projects
- Has expanded the company's portfolio by 108% since 2014
- Delivers within 1% of LIHTC tax credits based on initial projections

4 Jefferies Financial Group

Jefferies Financial Group is one of the nation's pre-eminent investment banks specializing in tax-exempt bond underwriting for affordable housing projects. In addition to providing bond underwriting services, Jefferies Financial Group is a global, full-service investment banking firm, owning and holding investments in manufacturing, beef processing, telecommunications, real estate, and energy.

Direct additional questions about mortgage banking, investment sales, and equity sourcing to a Berkadia Affordable Housing contact:

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