

# Investing in Affordable Housing for Impact and Return





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Affordable housing in many areas of the US is in high demand while supply has remained stubbornly low. This is slowly starting to change as the private market has more incentive to build affordable housing due to changes in zoning, more subsidies, and financial and political support from companies and local governments who want all sorts of workers to be able to live locally, including teachers, police, firefighters, retail/restaurant/hotel staff. There is a big difference between quality affordable housing that is well-planned, well-financed, and well-built and “slumlord” type housing that benefits only the owner. Quality affordable housing is typically built near public transportation, schools, and parks which can play a critical role in making communities more secure and vibrant, both socially and economically.

Underinvested in for decades despite strong growth in demand, we believe that quality affordable housing is both a prime investment opportunity and a way to help alleviate the US housing shortage. Our focus at Citizen Mint is finding those investments in the private markets that fund affordable housing – either through debt or equity – that are most likely to deliver a reasonable return on investment as well as quality housing for families.

## Market Dynamics

A spike in rents in many areas has exacerbated an affordable housing crisis, creating a myriad of challenges for cities, municipalities and states, including higher homelessness, crime, and reduced standards of living for a growing part of the population.

At the same time, wages are not rising fast enough to keep up with rents, and that’s been true for more than a decade. The result is that trillion of dollars will need to be invested in affordable housing over multiple decades to satisfy the demand.

## For perspective:



SOME

# 44 MILLION

U.S. HOUSEHOLDS ARE RENTERS, OF THESE

# 80%

HAVE HOUSEHOLD INCOME BETWEEN \$36,000 & \$60,000 A YEAR

(SOURCE: NATIONAL MULTIFAMILY HOUSING COUNCIL)

ABOUT

# 25%

OF U.S. HOUSEHOLDS WERE ALREADY LIVING IN SOME TYPE OF AFFORDABLE HOUSING IN 2019

AND WE BELIEVE THIS NUMBER HAS



# INCREASED

SINCE THEN DUE TO A SURGE IN RENTS THE PAST TWO YEARS

(SOURCE: CENSUS BUREAU 2019)



FOR EVERY

# 100

LOW-INCOME HOUSEHOLDS, ONLY

# 37

AFFORDABLE HOMES ARE AVAILABLE & NO SINGLE STATE HAS AN ADEQUATE SUPPLY.

(SOURCE: NATIONAL LOW INCOME HOUSING COALITION (NLHC))



# Types of Affordable Housing

There are technically three types of “affordable” housing, based on the income levels of the occupants:

**Low-income housing:** Occupants earn 50% or less of their area's median income (AMI).

**Affordable housing:** Occupants pay no more than 30% to 40% of their income for housing

**Workforce housing/  
attainable housing:** Occupants are middle-income (earning 60% to 120% of their area's median income), often working in sectors essential for local communities – healthcare, education, police/firefighters, retail, hospitality. Because these households do not qualify for low-income or affordable housing programs, they often struggle to find quality and safe living arrangements.

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## Why Invest in Affordable Housing

Affordable housing can be a sound long-term investment for many reasons:

- **Reliable ROI:**

High demand for affordable housing means units are quick to fill-up when new buildings are complete. This lowers vacancy risk and helps create a consistent return on investment (ROI).

- **Consistent Cash Flow:**

Rents can be subsidized by federal, state and local agencies. This translates into steady cash flow for investors as the property is almost always full or near capacity.

- **Hedge Against Inflation:**

Real estate prices and rents can continue to rise in an inflationary environment.

- **Recession Resilience:**

Properties stay in demand throughout the economic cycle, and especially during recessions as people lose jobs and are priced out of more costly rentals.

- **Diversification:**

Affordable housing as an asset has low correlation with public equities, allowing it to add to portfolio stability during times of market volatility.

- **Tax Depreciation  
Flow-through:**

Depreciation on investment real estate, including affordable housing properties, is allocated (flows through) to the individual investors and can be used to lower income and capital gains taxes generated by other investments.



## Impediments to Affordable Housing

If the investment benefits of affordable housing are many, why do we then have a constant shortage? The main reason is the gap between construction costs and rents: while construction costs are market rate, the rents charged can be relatively low. For affordable housing developments to be sound investments, they often need to qualify for funding and incentive programs sponsored by federal housing agencies, including the Federal Housing Administration (FHA), Fannie Mae, Freddie Mac.

Other federal support can include:

### **Low-Income Housing Tax Credits**

Builders of affordable housing may pay little or no federal taxes.

### **Housing Choice Voucher Program (Section 8)**

Federal rent subsidies paid to any landlord renting to low-income families, the elderly, or the disabled. These subsidies allow renters to look beyond subsidized housing projects to what is available in the private market, including single-family homes, townhouses, and apartments.



# Risks

In addition to government financing, there are a variety of risks associated with affordable housing:

**Entitlement Risk:**

Finding, acquiring and developing an existing building or land for affordable housing. This usually includes permitting and/or approval to convert a property from one asset type to another.

**Construction Risk:**

Risk here include design errors, unknown site conditions, poorly defined scope, and/or changes in the availability and pricing of labor and materials.

**Stabilization Risk:**

Stabilization is achieved when at least 80% of the property is occupied 9 to 12 months after coming to market. Many new construction projects use higher-cost financing for the construction and stabilization phases. Then they attempt to refinance at a lower rate. If stabilization takes longer than expected, and if interest rates rise dramatically, this can lead to financial distress.

**Financing Risk:**

Financing risk is present throughout a real estate investment project, given a variety of loan options.

**Entitlement Loan:**

High interest rate, “hard-money” loans from private lenders as banks are less likely to lend to developers in the early stages of a project due to the high risk involved.

**Construction Loan:**

Once permits are issued, the rate on construction loans depends on the market environment, risk appetite of investors, and forecasted time to stabilization.

**Stabilized Loan:**

After the property has achieved 80% occupancy, it can potentially be refinanced at a lower interest rate. The rate greatly depends on market rate trends, which can turn negative – Example: interest rates rise beyond what was expected when the work began.

**Leverage Risk:**

Taking on too much debt, in most cases exceeding 70% of the value of development opens up investors to major risks if the work takes longer to complete or vacancy rate remains over 20%.

At Citizen Mint, we delve into the details of affordable housing ventures in the private markets to determine which are likely to work financially as well as for the communities around them. The two things often go hand-in-hand. Because interest rates are rising, we are especially focused on debt as part of the capital structure and the impact of higher rates on refinancing.

## Case Study – Canton Lofts



Like many other cities in the US, Seattle struggles with homelessness, crime, and many unsafe living conditions. While there are complex issues around each of these items, affordable quality housing is part of the ultimate solution to these challenges. Several forward-thinking developers have recognized this need and are actively creating a pipeline of opportunities that will provide thousands of new affordable and attainable housing units over the next decade.

One specific example, was the development of class-A 80-unit multi-family affordable housing complex in Pioneer Square neighborhood. This building took a decrepit lot in the middle of one of

the cities highest concentrations of homeless populations and turned it into quality building that provides modern amenities to renters. While it was originally focused on renters earning between 50-80% of area median income (AMI), the county reached out to the developers and agreed to purchase the building to house families and individuals struggling with homelessness. We believe this particular investment shows the ability of governments and private investors to work in concert with each other providing a compelling market-rate return for investors while effectively housing hundreds of individuals.



# Qualified Opportunity Zones (QOZs)

Opportunity Zones were created as part of the Tax Cuts and Jobs Act of 2017 to spur development in economically distressed communities throughout the U.S. The goal is to attract capital for a variety of new business development within these Zones by offering tax incentives to investors.

The tax benefits of investing in QOZ Funds (QOFs) include deferral of re-invested capital gains from other investments until Dec. 31, 2026. Investors will also enjoy the benefit of not having to pay capital

gains on the eventual sale of the investment if it is held for a minimum of 10 years (all investments in QOFs must be sold by Dec 31, 2047).

To obtain this tax deferral, an investor has to invest the capital gains within six months (180 days) of the sale of an investment or other capital gains event. The below chart provides a hypothetical situation of investing in a QOF and the benefit it can provide to an investor over the long term.

|                                          | INVESTED IN A QUALIFIED OPPORTUNITY FUND (QOF)            | INVESTED IN OTHER ASSETS                |
|------------------------------------------|-----------------------------------------------------------|-----------------------------------------|
| CAPITAL GAIN REALIZED IN 2022            | \$1 MILLION                                               | \$1 MILLION                             |
| CAPITAL GAIN TAXES DUE IN 2023*          | NONE                                                      | \$238,000                               |
| PROCEEDS INVESTED IN 2022 (POST TAX)     | \$1 MILLION IN QOF                                        | \$762,000                               |
| CAPITAL GAINS TAXES LEVIED DEC. 31, 2026 | \$238,000<br>ASSUMING A CAP GAINS TAX RATE OF 23.8%       | NONE                                    |
| INVESTMENT SOLD IN 2032 FOR 50% PROFIT   | \$1.5 MILLION<br>(OF WHICH \$500,00 IN NEW CAPITAL GAINS) | \$1.14 MILLION                          |
| CAPITAL GAINS TAXES                      | NONE                                                      | \$90,678<br>(23.8% OF \$378,000 PROFIT) |
| TOTAL CAPITAL GAINS TAXES PAID           | \$238,000                                                 | \$328,678                               |

\*20% CAPITAL GAINS TAX PLUS THE 3.8% SURTAX ON ANNUAL INCOME ABOVE \$250,000 FOR MARRIED FILING JOINTLY (\$200,000 FOR INDIVIDUALS)

Opportunity Zones can be a great strategy for many investors with significant long-term capital gains but should be reviewed in the context of a whole portfolio strategy. This also needs to be capital that can be locked up for at least 10 years and exposed to real estate investment risk including in many cases construction/rehabilitation risk.

## Summary

Citizen Mint believes that new affordable housing can have a large, positive impact in many cities and other areas as they struggle to deal with complex issues around homelessness, crime and inequality. We are excited to bring numerous opportunities to our investors on both the equity and debt side of these deals. Invest to change the world, invest with Citizen Mint.



## AFFORDABLE HOUSING TERMS & DEFINITIONS

**AMI (Area Median Income):** Household income for the median or middle family in a region; half of households earn more than this level and half less.

**HFA (Housing Financing Agency):** State-chartered, nonprofit organizations that provide financing and services for affordable housing and related community development activities.

**HUD (The United States Department of Housing and Urban Development):** HUD develops programs to encourage the creation of affordable housing for the elderly, disabled or low-income.

**PHA (Public Housing Authority):** State and local governmental agencies that support the development or operation of low-income housing.

**NOAH (Naturally Occurring Affordable Housing):** Residential rental properties that are affordable, but are unsubsidized by any federal program. Their rents are relatively low compared to the regional housing market.

**Illiquidity Premium:** The additional rate of return an investor can expect to receive by holding an illiquid asset.

**Leverage:** The use of debt (or other financial instruments) to increase an investment's potential return. Private equity funds often invest in debt. An investment made with significantly more debt than equity is considered highly leveraged.

**Vintage:** The year a private fund closed to new capital commitments and is expected to start investing capital.

**Risk:** The chance that an investment's financial return will be different than what was expected. Risk includes the possibility of losing some or all of the value of the original investment.



## DISCLOSURE

All investments involve a level of risk, and past performance is not a guarantee of future investment results. The value of investments and the income derived from them can go down as well as up. Future returns are not guaranteed and a loss of principal may occur. All investment performance can be affected by general economic conditions and the extent and timing of investor participation in markets. Fees charged by Citizen Mint Advisors LLC will reduce the net performance of the investment portfolio.

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a full redemption for several months or longer. There is no guarantee that the amount of the initial investment can be received upon redemption. Due to the nature of the tax reporting that may be available from these types of investments, clients should expect to extend the filing of their tax returns.

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