KAIROS
INVESTMENT MANAGEMENT

Debunking the Myths of Affordable Housing

The Affordable Housing Crisis

The U.S. is currently undergoing a major housing crisis with only 37 affordable rentals available for every 100 low-income household resulting in a deficit of 7 million affordable homes. These statistics are staggering and have contributed to growing wealth inequalities across the country. The creation and preservation of affordable housing will be paramount to solving the housing affordability crisis for those in need.

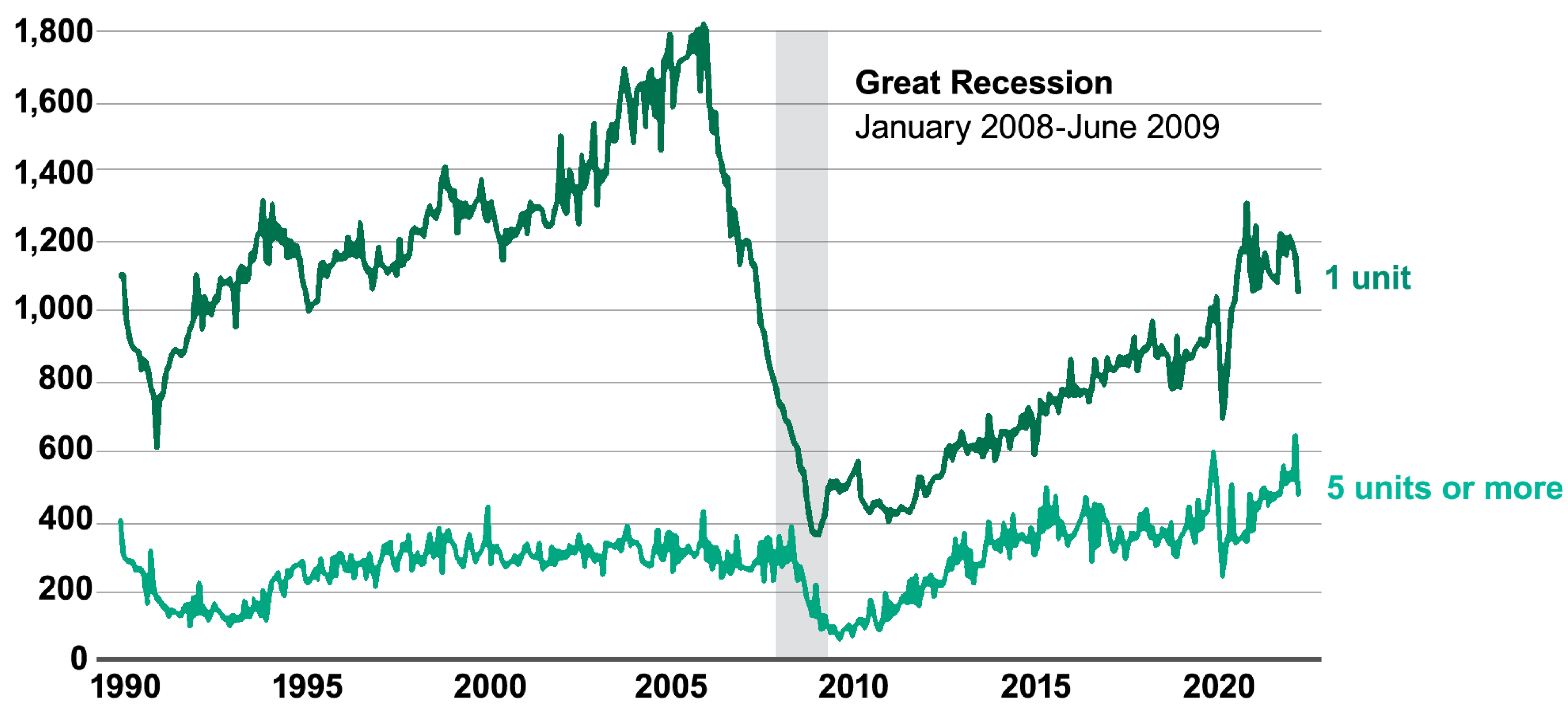
The root of the current housing shortage can be traced back to the Great Recession when new construction starts declined sharply. This downturn not only pushed potential homebuyers out of the market, but also exerted upward pressure on rental prices. The graph below illustrates the significant drop in supply and the slow recovery to pre-2008 levels:

Kairos Real Estate Impact Strategy

The Kairos Real Estate Impact Strategy ("Kimpact"), an impact fund structured to generate financial returns through affordable housing investments, presents a solution to the current affordable housing crisis. Kimpact purchases, owns, and manages affordable housing, including Low-Income Tax Credit (LIHTC), self-regulated market rate, manufactured housing, and 55+ communities in secondary and fast growth markets throughout the U.S. The impact strategy goes beyond offering quality affordable housing as a means to affect positive change in tenants' lives; it also strives to make a significant environmental and social impact through initiatives such as water conservation, energy efficiency, waste reduction improvements, and resident programs based on the demographics of tenants and their specific needs.

New construction dropped dramatically after the Great Recession, reducing the supply of new housing

Number of new privately owned housing projects started by property type, January 1990-May 2022



Affordable Housing Definition

What is Affordable Housing?

The U.S. Department of Housing and Urban Development (HUD) defines housing as affordable if the cost of rent and utilities does not exceed 30% of the gross monthly household income. The two main types of affordable housing are 'big A' and 'little a.'

'Big A' affordable housing refers to formal, government-sponsored affordable housing programs. These programs offer tax credits, subsidies, or other financial incentives to create housing that is affordable for households with incomes 60% or lower than the median income in the surrounding area, also known as the Area Median Income (AMI).

'Little a' affordable housing refers to housing that is affordable without being part of specific government programs, such as naturally occurring affordable housing where market forces alone make housing affordable for certain income groups, typically with incomes ranging from 60% up to around 120% of AMI.

Affordable Housing Solutions

LIHTC properties, self-regulated market rate properties, and Fannie Mae loans and facilities play a pivotal role in addressing the current affordable housing crisis in the U.S.

A. LIHTC Properties

The Low-Income Housing Tax Credit (LIHTC) program, enacted through the Tax Reform Act of 1986, is an example of ‘big A’ affordable housing. The program subsidizes the acquisition, development, and rehabilitation of properties that adhere to specific standards related to gross rent and AMI. With a legacy spanning over three decades, the LIHTC market is worth approximately $18 billion, representing nearly half of all federally assisted homes each year.

LIHTC provides investors, primarily developers, with a dollar-for-dollar reduction in their federal tax liability, contingent upon compliance throughout a 15-year period. The tax credits, distributed annually over 10 years, require owners to maintain rent restrictions and make units available to low-income tenants for at least 30 years after completion. State specific durations differ: California requires 55 years; Texas, 40 years; Florida, 30 years; Washington, 50 years, etc.

LIHTCs are tailored to subsidize either 30% or 70% of the low-income unit costs. The 30% subsidy results in a 4% tax credit to investors and primarily covers rehabilitations but can also be utilized in new construction projects incorporating other subsidies, whether federal, state, or local. The 70% subsidy yields a 9% tax credit, supporting new developments without requiring additional federal subsidies, although subsidies can still be applied.

Properties qualifying for LIHTC generally experience lower debt service payments and higher occupancy rates compared to market rate multifamily properties. Reduced debt service payments, attributed to the financial benefits from tax credits or subsidies provided by LIHTC, alleviate financial burdens on property owners. Within Kimpact’s current debt portfolio, 68% of loans have fixed rates ranging from 2.92% to 5%, significantly below prevailing market rates of 5.87% to 10.5%, thereby creating positive leverage. Additionally, the increased demand for affordable housing contributes to higher occupancy rates, as there is a consistent need for affordable rental options. These factors collectively contribute to the strong financial viability and stability of LIHTC properties.

B. Self-Regulated Market Rate Properties

Self-regulated market rate housing, an example of ‘little a’ affordable housing, also presents a viable choice for low-income renters. In the U.S., market rate apartments are typically 93 to 94% occupied, leaving 6 to 7% of units vacant. Rather than seeking market rate tenants for these empty units, investors are proactively addressing the housing crisis by converting these spaces into affordable housing for low-income tenants.

This bipartisan issue is rapidly gaining traction across different states, with targeted programs actively incentivizing affordable housing conversions. A standout example is House Bill 2071, enacted in Texas, on April 4, 2023. Real estate owners and operators can leverage this groundbreaking legislation to entirely eliminate multifamily properties from their tax rolls, provided that at least half of their units are rented to tenants earning up to 80% of AMI. This measure not only marks a crucial turning point, propelling affordable housing initiatives into the forefront of progressive legislative action, and does so right in the heart of Texas.

However, considering the extended restricted periods with commitments often lasting 30 years, traditional real estate private equity firms face challenges in buying and operating converted affordable housing that may not align with their typical investment timeframes. Kimpact offers an appealing solution, allowing investors to participate in an open-ended fund accepting new commitments quarterly. With a perpetual time horizon, Kimpact differs from closed-ended funds that may need to sell investments due to their finite lifespan.

C. Fannie Mae Loans and Facilities

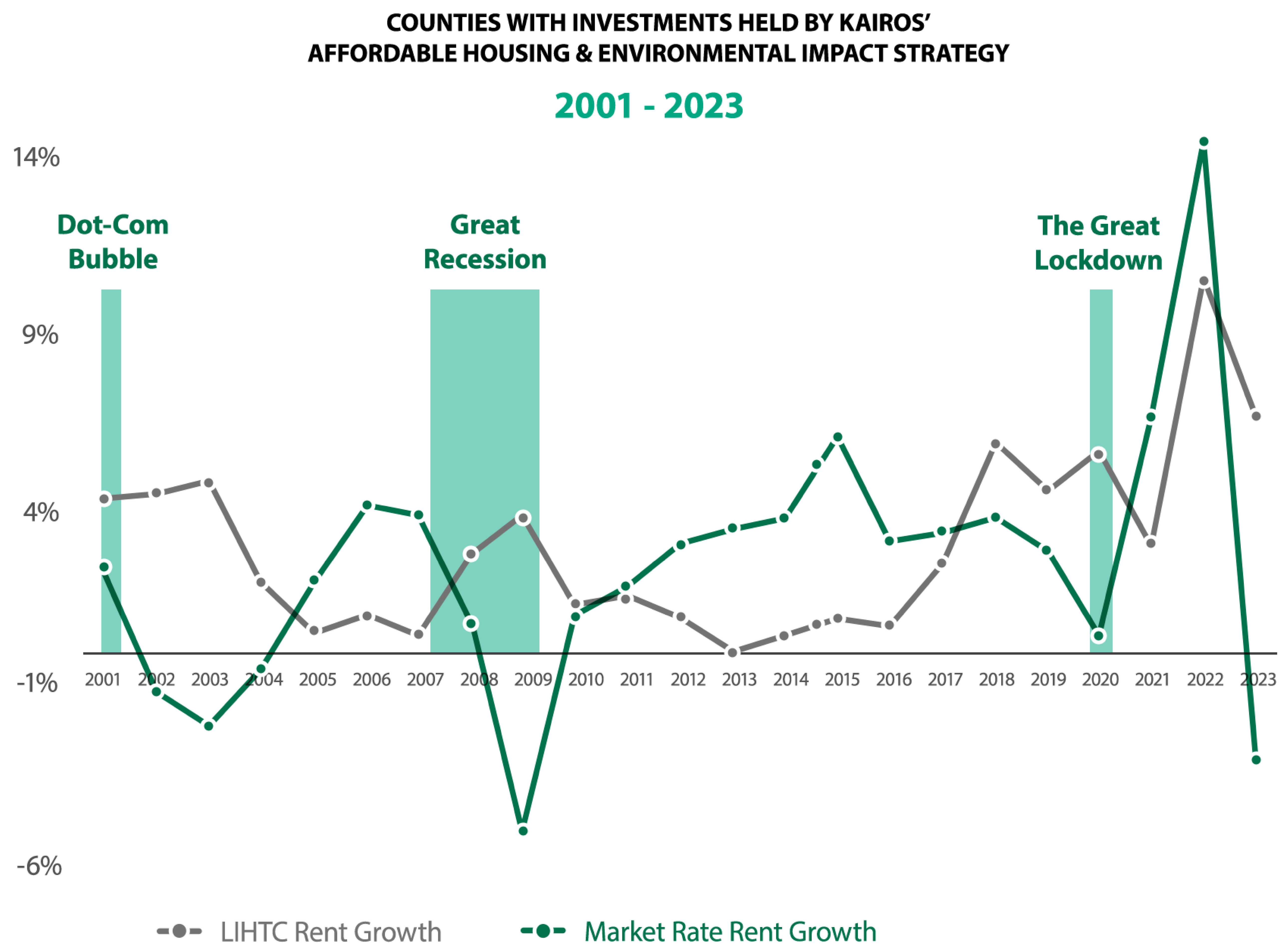
Established in 1938, Fannie Mae is a government agency that purchases mortgages from lenders in order for these lenders to free up capital to facilitate other loans. This process ensures the continued availability of affordable mortgages, especially in challenging capital market environments. Fannie Mae’s affordable housing loans, distinguished by competitive interest rates, high loan-to-value ratios, and primarily non-recourse terms, provide real estate investors with an attractive option.

During the second half of 2022, Kairos secured its first tranche of debt, a $175 million credit facility backed by Fannie Mae, consisting of $140 million in fixed debt and $35 million in floating rate debt. The terms of the facility span 10 years, featuring interest only payments, with fixed rate debt at 4.61% and floating rate debt at SOFR plus 2.09%. The facility strategically positions the firm to act and close on affordable housing opportunities with much greater efficiency, providing for greater capital flexibility, stability, and pricing efficiencies.

The Investment Opportunity

Contrary to assumptions that lower-income residents might present challenges such as unruliness, unpredictability, and missed payments, Kairos' research reveals a different reality. Affordable housing properties defy these stereotypes, boasting 23% higher rent collection rates, 43% higher occupancy rates, and an 11% year-over-year increase in occupancy rates compared to the market rate.

Another common misperception about affordable housing is that there are limitations to rent growth. The reality is quite the opposite—affordable properties regularly experience than average rent growth compared to their market rate counterparts. In fact, LIHTC properties have maintained an annual rent growth rate nearly 60 basis points (bps) higher than the market rate. Notably, in 2023, market rate properties experienced a 3.5% decline in rents while affordable housing rent grew by 6.5%. Affordable rent growth is determined by the 3-year rolling AMI growth, ensuring a consistent upward trend, whereas market rate multifamily is more prone to experiencing periods of negative growth. The graph below illustrates LIHTC rent growth versus market rate rent growth from 2001 to 2023 in counties with Kimpact investments:



Kairos creates and preserves affordable housing around the country with a portfolio that offers unique risk-adjusted returns with more consistent rent growth, higher occupancy, and better collections than market rate multifamily properties, all while contributing to positive environmental and social impacts.