Stepping Up to the Challenge: Finding Creative Solutions to Support Workforce Housing Creation and Preservation

By Maggie Burke, Senior Vice President of Agency Finance at Capital One

I have worked in commercial real estate for nearly 10 years, and I still learn new things every day. Last month, I attended my first Tampa Bay ULI Affordable Housing Committee meeting, where we discussed affordable and workforce housing. With representatives in attendance from nearly every sector of the commercial real estate ecosystem, I was fascinated to learn we all define workforce and affordable housing differently.

To me, workforce housing represents the market between rent-restricted or subsidized housing and luxury housing. Workforce housing is for renters whose income is too high to qualify for rent-restricted or subsidized housing but too low to qualify for luxury properties. Every day, we see, meet and engage with people who live in workforce housing. These residents can include our friends and family members – like my sister who is a teacher in Chicago, my brother-in-law who is in the Army, my sister-in-law who is a nurse, and numerous others who work in finance, hospitality, healthcare or the automotive industry, to name just a few professions and industries.

In many cases, this means their income is at or below 80% of the area median income (AMI) in a standard market like Tampa or Kansas City, up to 100% of AMI for cost-burdened markets like Chicago, Washington, DC, or San Francisco, or up to 120% of AMI in very cost-burdened markets like Los Angeles, Miami or Philadelphia.

High rental demand, low affordability

It's nearly impossible to read national or local news without finding a headline about the housing affordability challenges we face in every part of the country – spanning urban, suburban and rural communities and impacting households across the income spectrum. The rise in home prices and interest rates continues to squeeze potential buyers out of the home ownership market and drive up the number of renter households. Meanwhile Gen Z – which represents nearly one-fourth of the US population – is entering prime renting age only to find an increased demand for affordable and workforce rental housing and fewer available options given the housing pressures facing their Millennial counterparts.

Data from the Joint Center for Housing Studies of Harvard University report on America's Rental Housing 2024 also points to the loss of low-rent housing, which the report defines as units with rents below $600. When adjusting rents for inflation, the study found the share of these units decreased by six percentage points over the past decade – falling from 22% of the total housing market to just 16% of the market.

Workforce housing preservation presents financing challenges

One challenge with developing and renovating workforce or affordable housing is balancing cost with the overall capital stack required to bring more units to the market. These properties can be associated with an older vintage, which may present property maintenance challenges. However, there are fewer programs targeted specifically toward workforce housing to help bridge the amount of debt the property can carry and the capital needed to keep rents affordable for workforce housing residents. Therefore, we need to get creative as an industry and engineer capital stacks that allow for the creation, preservation and renovation of workforce housing.

I am fortunate to work for a bank that is taking action to combat the workforce housing shortage. Capital One was named Freddie Mac's Top Lender of Workforce Housing Preservation in 2023. We also have invested equity into a number of dedicated workforce housing funds over the last few years. These funds target acquiring assets that serve communities at or below 80% of AMI. In addition, we are utilizing our balance sheet to finance new workforce housing developments by offering interim bridge loans through the lease-up that are refinanced with long-term Fannie Mae, Freddie Mac or FHA debt to preserve affordability.

Putting capital structures and programs to work

To finance workforce housing, a number of our clients are utilizing local and state tax exemption programs and incentives in conjunction with various equity and financing structures – ultimately building a capital stack that allows them to develop and preserve workforce housing while maintaining returns for their investors.

The Agencies are also taking meaningful steps to fill in gaps in the capital stack. Fannie Mae's Sponsor Dedicated Workforce Housing (SDW) product and Freddie Mac's Workforce Housing Preservation Program (Prez) are two examples of loan products focused on preserving workforce housing. These products are available to borrowers who elect to preserve or create a minimum of 20% of units in a multifamily property at levels affordable to residents earning between 80% AMI or, in certain cost-burdened markets, up to 100-120% AMI.

Amy Finn, Fannie Mae Multifamily Product Development Senior Director shared that "the SDW product will help solve rental affordability, accessibility and sustainability challenges that missing-middle renters currently face. With this creative financing solution, Fannie Mae and our partners can increase the supply of workforce rental units across the country and support long-term housing stability for renters." Fannie Mae launched SDW in Fall 2023. In 2023, SDW completed $520 million of volume, inclusive of 25 properties helping to create or preserve approximately 2,400 rental units with rent restrictions. This product – alongside other solutions that preserve, promote and expand affordability – advances Fannie Mae's mission to ensure households with modest means in every market can access quality, affordable housing.

And according to Meg McElgunn, Vice President of Conventional Product & Sales at Freddie Mac, this product is "a triple win because the owner of the asset often ends up getting better credit and pricing terms, the tenants can live in an affordable unit for a longer period of time, and Freddie Mac is doing business that helps preserve affordable rents." Freddie Mac helped preserve over 3,000 units at workforce housing levels in 2023, and they are on their way to achieving their 5,000-unit goal for 2024. This type of program is inherent to Freddie Mac's mission-focused DNA, and continues to be a key driver in the success of their preservation efforts, along with other products and initiatives.

I recently closed a loan alongside our Freddie Mac colleagues through the Prez program. My client was acquiring a 1970s vintage asset in the St. Louis MSA and agreed to restrict 20% of the units to serve residents at 80% of AMI. In this particular case, we were able to achieve 75% leverage with six years of interest-only at a 1.25x DSCR. Most importantly, no residents were displaced, and the restrictions will last through the life of the loan.

The pricing discount, coupled with the advantageous credit terms, resulted in higher cash-on-cash returns for their investors throughout their hold period. Since the rent restrictions ran with the loan agreement, there was no impact to the exit cap rate. Therefore their overall projected returns were extremely competitive. They were able to attract common equity to acquire the asset in a very volatile market environment when most investors were sitting on the sidelines.

Housing as a foundation for positive resident outcomes

Beyond rent preservation, many sponsors provide onsite resident services that support resident health and wellness, community involvement, education, financial literacy and overall economic stability. My clients have found a direct correlation between the implementation of these programs and improved property economics. These programs have resulted in a reduction of bad debt and a more stable resident base, which reduces turnover and marketing costs, resulting in increased cash flow to their investors.

Capital One is a top-10 Agency Lender by volume and was named Freddie Mac's Top Lender of Workforce Housing Preservation in 2023. Capital One serves on the Freddie Mac Advisory Council and Fannie Mae DUS Advisory Council, which provides us with opportunities to work directly with the Agencies, share feedback on their programs, and champion their new *conventional loan products dedicated to furthering their mission of expanding affordable, quality rental housing across the country.*