Affordable Multifamily Housing:
Lessons Learned from the Pandemic

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The pandemic that has plagued the US and the world since March 2020 has had an impact on every business and all types of commercial and residential real estate. Although 2020 started off promising, the COVID-19 pandemic caused several commercial real estate sectors, including retail and hospitality, to swerve off course beginning in the spring. As of mid-2021, those sectors are still struggling to recover as the crisis wanes and the economy regains its footing.

Meanwhile, affordable housing has remained relatively strong, stable, and steady throughout the pandemic. Many players in the sector say despite blips in the first and second quarters of 2020, last year was comparable to 2019 in total property listing volume, pricing, and interest from investors. Sales volume leaped dramatically in the third quarter of 2020, and the fourth quarter was strong as well, which bodes well for 2021.

In fact, affordable housing has a long history of performing well in all economic climates, weathering many storms and black swan events, which is why institutional investors continually turn to this sector as a staple of their portfolios.

As an affordable housing owner/operator, Avanath expected the worst but has been delighted by the durability of its portfolio over the past 16 months. Needless to say, we at Avanath learned many lessons over the course of this crisis about what an investor needs to weather a global crisis of this magnitude—and some unchanging truths about the affordable multifamily housing sector along the way.

Lesson #1: A Deep Well of Operating Experience Helps Inform Strategy During a Crisis

Avanath is heavily invested in affordable housing, owning and operating 90 apartment communities in 13 states, comprising more than 11,000 apartment units. More than 85% of its communities are rent-regulated affordable properties—eligible for the Low-Income Housing Tax Credit, project-based Section 8, and local rent-restricted affordable properties. Most of Avanath's residents have household incomes of between 40% and 80% of area median incomes set by the US Department of Housing and Urban Development (HUD), and they typically earn between \$25,000 and \$60,000 annually.

Avanath communities are mainly located in major metropolitan areas—Los Angeles/Orange County, San Diego, Seattle, Denver, Austin, Dallas, Chicago, Detroit, Raleigh-Durham, Orlando, Fort Lauderdale, Boston, New York City, and Washington, DC—most with relatively high housing costs. Approximately 40% of Avanath households are Section 8 voucher holders and pay no more than 30% of their income on rent, with HUD making up the balance.

Avanath's primary business model is to acquire and renovate existing affordable properties with the goal of preserving long-term affordability. Avanath is vertically integrated, including property and construction management. Operating rent-regulated properties requires interaction with HUD, state housing finance agencies, and numerous public housing authorities—more than 40 entities in total. Avanath properties are capitalized through a series of discretionary funds with institutional investors.

In short, Avanath has a deep well of operating experience and expertise that helped inform its strategy during the pandemic, ultimately leading to strong results for investors despite the crisis.

Lesson #2: Swiftly Establishing Top Priorities Is Essential

At the start of the pandemic, I quickly assembled Avanath's 12 senior leaders to design and implement pandemic protocols to address (1) potential rising rental delinquencies, (2) property operating procedures, (3) navigation of stay-at-home orders in 13 states and multiple local jurisdictions, (4) remote-work processes and technology capabilities, and (5) communications with key constituents—residents, investors, and public-sector partners.

The most immediate priority was making sure that residents and frontline, on-site staff were protected and safe. Unfortunately, trash pickup and maintenance of grounds, hallways, and apartments could not be conducted on Zoom—teams had to have direct interaction with residents. Making sure that on-site staff had the appropriate protective gear and sanitation supplies was the first thing the leadership team addressed.

Lesson #3: Resident Engagement and Communication With All Constituents Is Paramount

Having an open dialogue and a positive relationship with residents during the pandemic was imperative. This would not have been possible if there had been limited relationships prior to the crisis. Avanath works hard 24/7 to enrich the lives of residents, beyond providing quality housing—including wellness, after-school, financial literacy, and other programs. A resident engagement team works with on-site staff to develop activities with residents, building rapport in the process.

In March 2020, Avanath decided to implement a 10% rental discount for the month of April. Average rent was about $1,300 per month, making this discount $130. Avanath did not do this without input from its investors because this rental discount had an 11 basis point impact on returns. After hearing Avanath's COVID-19 strategy, including the one-month rental discount, investors expressed overwhelming support, residents responded positively, and public housing agency constituents also strongly supported Avanath's actions.

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The Avanath leadership team anticipated that between 5% and 10% of residents might ask for rental forbearance—potentially 500 to 1,100 resident requests. A "SWAT" team was formed to handle this potential deluge of requests. Surprisingly, the actual number of rental modification requests was fewer than 70.

Historically, Avanath's rent-collection loss is low, with a collection loss in 2019 of .35% versus that of market-rate properties ranging from .60% to 1%. Certainly, Avanath's delinquencies have increased since March 2020, fluctuating between 1% and 4%. Because the eviction moratorium eliminates late fees, many residents have been paying later—with delinquencies over time stabilizing at 1%.

Lesson #4: Multiple Factors Impact High Rent-Collection Rates

Avanath's rental delinquency rate during the pandemic was lower than that of market-rate properties, which had delinquencies ranging from 3% to 7% for numerous reasons:

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2021 provided rental-assistance funding for Section 8 recipients, covering loss of income for those residents, who represent 40% of Avanath's resident base. Many landlords avoid renting to Section 8 recipients because of the administrative burdens and negative perceptions of the resident profile. The Avanath operating platform was built to serve the Section 8 resident base, including an in-house compliance team of 12 professionals. As a result, Avanath's Section 8 collections were not impacted during the pandemic.
- Another 15% of Avanath's portfolio comprises affordable seniors' communities. These are age-restricted (typically 55 and above) and income-restricted properties that provide independent living apartments. These seniors rely on pensions and Social Security income, which were not impacted by the pandemic. Collections in these seniors' communities were very close to 100%.
- Avanath's goodwill with its residents that has evolved over the years through resident engagement activities, as well as the April 2020 rent discount, helped contribute to the very high collection rate.
- Finally, Avanath residents value their long-term housing stability in well-maintained and attractive, affordable communities, where they pay only 30% of their income for rent. The Avanath leadership team

learned that many residents were paying their rent but did not have enough money for food and other necessities. Because the rent modification SWAT team did not have the wave of anticipated rental modifications, that team was deployed to help direct resources from local charities, governmental agencies, and food banks to residents.

Lesson #5: Within a Crisis, Preparing for Other Crises Is Important

Avanath's leadership team met three times a week and maintained constant communication with staff across the country to quickly assess conditions and

situations at Avanath properties and to calibrate operational strategies accordingly.

Although the primary focus was on issues created by the pandemic, other situations arose. For instance, after George Floyd's death, protests occurred close to several Avanath properties, requiring an immediate focus on the safety of on-site staff and the properties. Later in the summer of 2020, wildfires were close to two of Avanath's California properties, requiring preparation for the evacuation of residents. Winter ice storms and power outages in Texas caused plumbing failures and resulted in considerable water damage in half the apartments in a 280-unit community in Austin.

These additional crises during the pandemic required considerable planning to address the situations while maintaining the pandemic protocols of following social distancing recommendations and keeping physical environments sanitized.

Lesson #6: Crises Often Create Opportunities For Change

As previously mentioned, housing finance agencies and public housing authorities are important constituents in the affordable housing world. Prior to the pandemic, most required a physical inspection of an apartment prior to the move in of a Section 8 resident. This often added five to ten days to the move-in process—a costly delay to both the landlord and the tenant.

Although online leasing has been a practice of market-rate apartment owners for years, the involvement of public agencies limited this practice in the affordable housing world. During the pandemic, however, most public agencies transitioned to working virtually and suspended the practices of physical unit inspections and often the requirements for physical documents, enabling Avanath to do the majority of leasing online. This translates into increased occupancy and improved turnover cycle time. I believe these practices will continue after the pandemic.

Future Investment Prospects

With these and many other lessons learned during the COVID-19 pandemic, as well as an improving economy, what is the investment prognosis for the affordable rental sector? Evidence shows that the category is extremely well positioned to deliver strong returns for institutional investors for the following reasons:

Increasing Market Demand for Affordable Rentals

Affordable housing demand continually outstrips supply because developers typically prioritize luxury, market-rate development over workforce and affordable communities.

There was a significant undersupply of affordable rental units prior to March 2020, which the pandemic has exacerbated. Minimal expansions to the affordable housing supply have occurred during the pandemic, while demand continues to grow. Avanath's same-store affordable housing metrics have all supported the company's investment thesis. Since March 2020

- occupancy held at around 96%,
- resident turnover declined from 20% to 18%,
- rents grew by 3.6%.

Rising Home Prices

Another factor driving affordable housing demand is the steady increase in home prices across most US markets. The *Financial Times* reported that the S&P/Case-Shiller Home Price Index rose 14.6% year-over-year in April, the highest reading in more than 30 years. A 20-city composite covering US metropolitan areas including Dallas, Miami, New York City, and San Francisco showed a 14.9% year-over-year rise in home prices, the largest annual increase since 2005.

As home prices soar, more people are forced out of homeownership and into rental housing, creating another driver for affordable housing.

Increasing AMI

Rent increases in most rent-regulated apartment properties are tied to increases of area median income (AMI), published every year by HUD. Even with the pandemic, in the Avanath markets, AMI has increased 3.17% so far in 2021 and is projected to increase 4.46% in 2022. I believe that actual AMI growth in 2022 will exceed the projection, given the scarcity of hourly workers and the wage inflation that exists today.

More Public-Sector Enhancements

President Joe Biden's administration has proposed considerable funding for more affordable housing, including 5 million to 15 million more Section 8 vouchers, which will have a positive impact on affordable housing communities.

Additionally, many state and local governments challenged by housing affordability are increasing their economic incentives for affordable rentals. For instance, Florida is increasing its tax abatement for affordable properties from 50% to 100%.

Greater Demand for Larger Apartments

Although many developers in the conventional apartment industry have focused on smaller units—studios and one-bedroom units—targeting millennial renters, over the past few years, Avanath has focused on acquiring properties with large apartments, particularly three- and four-bedroom units. These more-spacious apartments are in strong demand and have extremely low turnover.

The typical resident profile for large units is a multigenerational family in which family members provide eldercare or childcare. The demand for large apartments is also fueling the demand for single-family rentals.

A Light at the End of the Tunnel for Institutional Investors

As an affordable housing owner/operator, Avanath navigated many challenges during the height of the pandemic. As with most businesses across the country, Avanath learned a great deal during this adversity. It is a stronger company today and is very optimistic about the future opportunities in the affordable housing sector.

The strength of affordable housing remains clear both in times of prosperity and during crises such as the COVID-19 pandemic. While other commercial real estate sectors tend to be volatile in the face of economic downturns and unforeseen events, affordable housing is much more resistant to these disruptors. With factors such as increasing demand for affordable units, limited supply, decreasing home affordability, and more public-sector enhancements, the affordable housing category is positioned to perform well far into the future. ■

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