Creating Attainable Housing Through Innovative Solutions:

A Conversation with ABR Capital Partners' Director of Acquisitions, Peter Heller

ABR Capital Partners' Director of Research (ABR) recently spoke with Peter Heller (PH), a director in ABR's Acquisitions group, about the nation's housing affordability challenges and some of the innovate housing solutions ABR is pursuing.

ABR: The nation's housing shortage has made it very hard for many people to buy a home or find affordable rental housing. Growing the supply of workforce housing is often mentioned as one of the solutions to this problem. Before we get into the nuances of workforce housing, how would you define it?

PH: It's a good question. I'm not sure there's an exact definition. I think most people would define workforce housing as housing that is affordable to individuals who earn between 60% and 120% of the area median income, or AMI. Workforce housing is sometimes blended with attainable housing and I've often heard that the difference between the two is that workforce housing is closer to 60% to 100% of AMI and attainable housing can reach into the 120% of AMI range.

ABR: What's the difference between workforce housing and capital "A" affordable housing?

PH: Workforce housing is true market-rate housing, whereas capital "A" affordable is government subsidized housing with income verification requirements. It's interesting, the cost of building both types of housing has grown significantly over the past few years. I've seen reports that the cost of building new apartments in the U.S. has gone up by 40% since the pandemic.

ABR: What's driving demand for workforce housing?

PH: I think there are a few things driving demand for this product. There's the cost of single-family housing and how out of reach it is for so many people in the United States. Roughly 75% of U.S. households can't afford a median priced new single-family home and I've seen reports that 60% of households can't afford a $300,000 home, which is tough. Pulling back the layers a bit more, that 60% to 120% of AMI band that I mentioned earlier makes up at least 50% of total renter demand. It is the largest cohort of renters in the country and a lot of people in it have been priced out of homeownership. Also, incomes haven't kept pace with rent growth in a lot of markets, and that's also created more demand for workforce housing.

ABR: How do institutional investors view workforce housing?

PH: I think it's definitely become more popular. It is a cycle-resilient asset class in the sense that you could have a market downturn and Class A renters might downgrade to Class B apartments, but Class B renters, unfortunately, really have nowhere else to go, so that demand is very resilient. We've seen this recently with the record new supply in Class A housing. Nationally, there's been flat rent growth in the Class A segment and negative growth in some markets, but Class B properties have continued to achieve some moderate rent growth.

ABR: Are there any markets you find particularly interesting?

PH: I think there's a need for workforce housing across the country, though we really do like to follow some of the population growth in the Southeast, in the "smile" states. The Carolinas, Texas, and Tennessee consistently rank high in migration and population growth and are markets that we continue to like for this type of housing. The Midwest has also surprisingly outperformed.

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ABR: Congress is working on a bill that targets some of the country's housing affordability challenges. The Senate version of the bill contains provisions that some economists believe might make certain types of housing less affordable instead of more affordable. What are your thoughts on the housing bill?

PH: We actually just invested in our first build-to-rent, or BTR community about six weeks ago, so we're watching the bill closely. My take on the bill is that any legislation that curtails new development and the deployment of capital into new housing will be detrimental in the long run. I really like to point to Austin as the premier example of letting the free market work its way through an affordability issue. Austin's population grew by more than 360,000 over the last five years, but because its apartment inventory also grew by more than 30%, rents have actually fallen below where they were in 2019. Austin's experience is a great example of what can happen in a development-friendly environment when regulatory constraints are reduced and supply is allowed to respond to demand.

ABR: In addition to BTR, what are some other housing strategies ABR is working on?

PH: Before we started raising capital for our latest fund we took a step back as a team, put our heads together, and went over some themes that we feel very strongly about. One of those themes is affordable, or middle-market housing. We have high conviction in the demand from the middle-market segment of the renter demographic and are exploring creative ways to satisfy this demand and create new, affordable housing for this population. To date, we've invested in two strategies that we've identified and we're closely watching a third.

One strategy we like a lot is converting purpose-built student housing into market-rate multifamily. What's really compelling about this strategy is that we're able to buy recent vintage student housing assets that are mispriced because they're underperforming for the student demographic, but there's still multifamily demand where these properties are located. Because of this, we've been able to buy these assets at a favorable basis, implement a business plan that executes our investment strategy, and lease units to conventional renters at rates that are below 80% of AMI across the portfolio.

Another strategy we like involves BTR communities. As I mentioned earlier, we invested in our first BTR community this year and acquired it at an attractive basis. This allows us to keep rents very affordable, and again, we’re monitoring the housing legislation that's working its way through Congress to see how a final bill might affect this segment of the market.

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A final strategy that we have not transacted on yet, but are closely monitoring, is the conversion of extended-stay hotels to apartments. It’s very similar to our student housing strategy. It's almost a cousin of that strategy, though we think it works much better in infill, high-rent markets. Think of New York or D.C., where you can buy an extended-stay hotel, typically a Gen 1 hotel that was built in the 1980s or 1990s, and then convert it into a high-quality apartment. Our goal with this strategy is to offer renters converted hotel units at a meaningful discount to nearby Class A multifamily. We think that after being converted, these properties will provide a better housing experience to renters who are willing to trade size—because the units are slightly smaller since they were formerly hotel rooms—for a higher quality aesthetic, services, and amenities.

ABR: What are some of the challenges you've seen with these strategies?

PH: They each present their own challenges. You can run into zoning issues with extended-stay hotel conversions. You need to go through a rezoning effort for these assets and that's something that we'd prefer not to take on, so we've found a creative structure to defray that risk. But the conversion process for these properties can still be very time intensive and you don't always get the approvals you want at the end of the day.

Student housing conversions are a little bit more streamlined. The barriers there are mostly finding the right assets and unit mix. Many student housing properties were built with four-beds and four-baths, or five-beds and five-baths. That's not our target. The assets we've acquired have a more traditional apartment unit mix: one-bed, two-beds, and three-beds. They skew more heavily towards two- and three-bed units than your traditional apartment community might, but that actually works well for the families we're targeting.

ABR: Have you considered any other creative housing solutions?

PH: We're always on the lookout for new solutions. We are very curious and end up researching many strategies that we choose not to invest in before we land on the ones that we have high conviction in. We've looked at a lot of office conversions, which is another potential solution here. What we've found there is that the cost tends to be roughly in line with the cost of building new multifamily. It can work well in high-rent markets where you have some irreplaceable real estate, like New York, D.C., Chicago, and some other high-cost markets, but it's a harder solution in lower-rent locations unless it's heavily subsidized. But it's interesting, and we've spent a lot of time looking at, we just haven't found an ideal office conversion project.

We've also spent a lot of time looking at manufactured housing. I think there are some really creative ways that new development of manufactured housing could solve some of the affordability issues we have today, but it's just incredibly hard to build new manufactured housing communities. There are lots of zoning hurdles and NIMBYism that make it challenging. All of that is to say that we're constantly on the lookout for innovative ways to create new housing, and we'll keep looking.

Disclosures

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