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Leveraging Sustainable Finance to Preserve and Grow Affordable Housing

Executive summary

- The United States faces a critical affordable housing shortage of 7.3 million units, driven by a shrinking middle class and challenges in developing new and preserving existing units at scale
- Emerging enablers such as policy incentives, growing institutional investment, and standardized impact measurement frameworks are fostering growth in the sector
- Sustainable finance can play a pivotal role, with tools like green bonds and sustainability-linked loans aligning financial incentives with sustainability goals
- Leveraging sustainable finance can help as it can attract diversified sources of capital to alleviate the housing crisis

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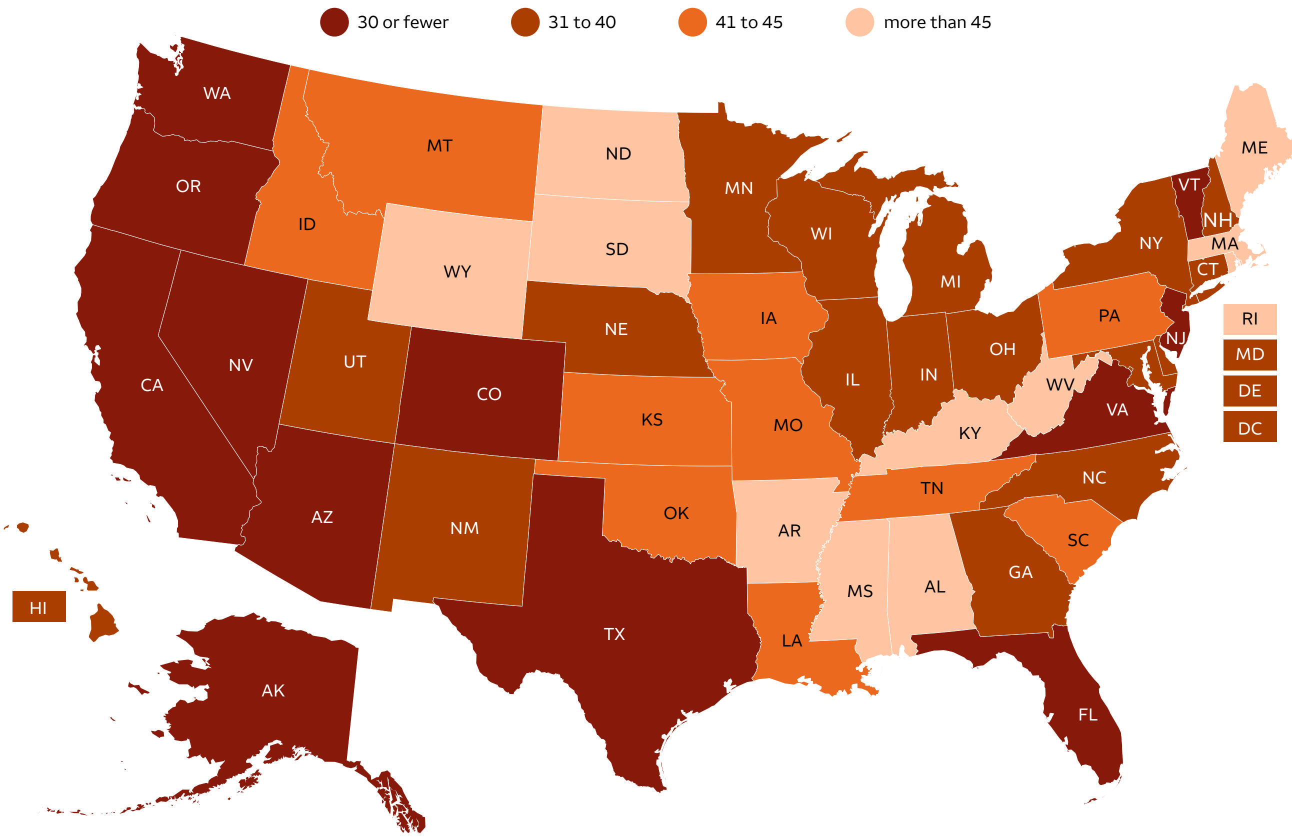
Challenges abound: A snapshot of affordable housing

There is undoubtedly an affordability crisis in the United States. Affordable housing, as defined by the U.S. Department of Housing and Urban Development, is housing for which the occupant is paying no more than 30% of gross income for shelter costs, including utilities.[1] According to the National Low Income Housing Coalition, an estimated 35 affordable rental units are available for every 100 extremely low-income renters* in the U.S., resulting in a nationwide shortage of 7.3 million affordable and available rental home units. Further, 70% of all extremely low-income families are severely cost burdened, spending more than half their income on rent.[2]

Figure 1: Affordable and available rental home units per 100 extremely low-income renter households



Source: National Low Income Housing Coalition

Several factors contribute to persistent undersupply in the market. Between 1971 and 2023, the share of Americans in the middle class has fallen from 61% to 51%, while the share of Americans in the lower-income class** has increased from 27% to 30%, leading to higher demand in the affordable housing sector.[3] Views against building homes in certain areas (which may be referred to as a not-in-my-back-yard (NIMBY) sentiment) and a fragmented policy environment has made it challenging to increase the affordable housing inventory at scale. Furthermore, affordable housing typically requires a patchwork of subsidies and tax abatements to garner investor interest to capitalize transactions and the existence of such subsidies and tax abatements are highly dependent on federal, state, and local policy environment. These complexities have led some investors to avoid investing in the sector altogether.

*Extremely low-income renter: renter whose income is at or below either the federal poverty guideline or 30% of the area median income (AMI), whichever is higher
**Lower-income class: households have incomes less than two-thirds of the U.S. median household income

Focusing on the enablers

The long-term solution to a lack of affordable housing is simple—build more units. Where we have seen growth in affordable housing, several factors have converged to enable this, including expanded policy action at the state level, institutional investors looking to deploy more capital into the sector, and increased consistency and transparency in reporting affordable housing impact metrics. These enablers support the estimated 230,000+ fully affordable housing deliveries anticipated in the U.S. over the next five years.[4]

Policy action supporting the growth in affordable housing can be seen in many states including Florida, New York, and California. In Florida, the Live Local Act, passed in 2023, addresses tax exemptions for affordable housing and funds programs providing low-interest loans for the production and preservation of multifamily units for very-low income*** households.[5] In 2024, New York Governor Kathy Hochul created tax incentives for new multifamily housing following expiration of the previous scheme in 2022.[6] California offers its own state-level Low-Income Housing Tax Credit (LIHTC) to support the development of affordable housing. These state-level credits are used to bridge financing gaps that cannot be fully covered by federal low-income housing tax credits or other sources.[7]

This policy action, combined with increased data suggesting favorable return characteristics, is driving more institutional capital into the affordable housing sector. The Global Impact Investing Network estimates that over 3,907 organizations currently manage $1.571 trillion in impact investing assets under management (AUM) worldwide, representing 21% compound annual growth of the total impact investing market since 2019. An estimated 34% of investors and 35% of AUM are focused on the U.S. and Canada markets.[8]

In recent years, asset managers and private equity firms have ranked among the largest owners of U.S. subsidized affordable housing properties as they seek strong returns, diversification, and value creation opportunities while helping to drive impact.[9] Starwood Capital, for example, has acquired several affordable housing portfolios since 2015,[10] while Blackstone has around 100,000 affordable housing units and is on track to be the largest preserver of affordable housing in the U.S.[11] Additionally, Apollo agreed to acquire Bridge Investment Group, a major investor in affordable multifamily properties, for $1.5 billion in February 2025.[12] Firms such as Nuveen, TPG, and Stone Point Capital all have dedicated affordable housing funds as well, attracting allocation from notable investors such as CalPERS.[13] Nuveen, one of the largest institutional investors with a vertically-integrated affordable housing platform, cites a strong income stream, favorable risk return profile and resiliency across economic cycles as key drivers for funds investing in affordable housing.[14]

An investment thesis in relation to affordable housing was highlighted in a Summer 2024 research insight from Pension Real Estate Association (PREA). The research showed that in the U.S. markets, National Council of Real Estate Investment Fiduciaries (NCREIF) data suggests that over a 16-year period from 2008-2024, the most affordable properties, characterized as those with average rent per unit less than 30% of income for someone making 80% of Area Median Income (AMI), outperformed the least affordable properties by 239 basis points per year. This data suggests that multifamily investors were foregoing returns if they were not invested in the most affordable housing.[15]

Figure 2: Summary investment performance by affordability

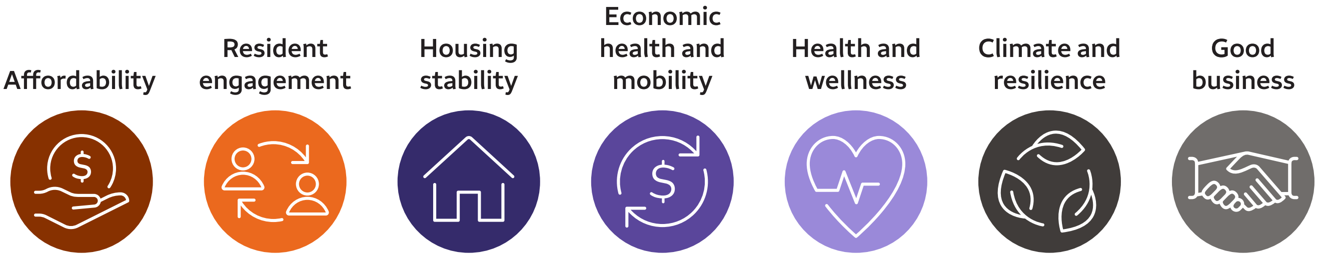
	Most affordable	Mid-market	Least affordable
Average return/quarter	1.64%	1.42%	1.06%
Volatility of quarterly returns	2.78%	2.87%	2.89%
Compound average annual return, 1Q2008 to 1Q2024	6.54%	5.62%	4.15%

Source: PREA Research based on NCREIF data

***Very-low income: households earning up to 50% of the AMI

Not only are the financial returns from investing in affordable housing compelling, but investors are also drawn to the impact that these investments can make in local communities. Historically, the sector lacked a framework to consistently measure and report impact. In 2023, the Multifamily Impact Council (MIC) created a common framework and measurement for impact investing. Developed by industry participants, the MIC's Multifamily Impact Framework (MIF) defines seven core principles that encompass the actions that multifamily owners, operators, investors, and service providers can take to deliver impact to renters across the income spectrum:[16]

Figure 3: Multifamily impact framework principles



Source: Multifamily Impact Council

Properties and portfolios must meet the minimum impact threshold for all principles to meet the MIC's guidelines for a multifamily impact investment. The MIF also advises on best practices to outperform minimum impact thresholds and improve transparency and investment decision-making. While the MIF is the sole framework designed specifically for the multifamily rental housing industry, its principles and reporting metrics align with external tools including the UN Sustainable Development Goals (SDGs), Sustainability Accounting Standards Board (SASB), and Global Real Estate Sustainability Benchmark (GRESB).[17] Utilizing the MIF could potentially demonstrate a commitment to positive impact, lend credibility to projects, and attract impact investors.

The imperative for resilient affordable housing

Today, higher interest rates and elevated operating expenses makes capitalizing real estate transactions more challenging than ever. Escalating property insurance premiums are a major contributor to higher operating expenses in real estate. According to a survey conducted by the National Leased Housing Association, nearly a third of affordable housing development insurance policy renewals for 2022-2023 had rate increases of at least 25%.[18] Similarly, a coalition of leading affordable housing providers in the U.S. saw insurance premiums rise as high as 40% annually between 2020 and 2023.[19]

To develop new inventory, affordable housing developers typically require a modest land basis and economical building materials to reduce project level costs. As such, affordable housing is often located in areas most vulnerable to climate related risk, forcing lower income households into such neighborhoods.[20] By 2050, the number of affordable housing units at risk from sea level rise and coastal flooding is projected to more than triple, exposing affordable housing in almost all coastal states to more than one coastal flood risk event per year, on average.[21]

Because of these risks, multifamily developers and investors are increasingly embracing a more holistic approach to affordable housing by considering financial, environmental, and social impacts in their decision-making processes. Incorporating sustainable features such as energy-efficient appliances, natural lighting, and optimized HVAC systems can not only reduce operational emissions, but can also lower expenses of running such properties. While low-income tenants of large multifamily residences spend, on average, over 12% of their incomes on energy,[22] green buildings can see operational expense savings of up to 17% over a five-year period, resulting in a lower utility burden for tenants.[23] In addition, sustainable building materials are often more durable than their traditional counterparts, making them potentially more cost-effective and resilient in the long run.[24] Utilization of sustainable building products can also potentially improve tenant health and wellness by improving indoor air quality.[25] Because of the many benefits of sustainable buildings, most states prioritize awarding subsidies to projects with these attributes. As a result, building sustainably has the potential to yield economic and environmental benefits.

Every dollar matters: How sustainable finance can be supportive of growth of affordable housing

Sustainable finance can integrate a borrower's sustainability strategy into regular way financing to align stakeholders, diversify investors, and achieve explicit or implicit financing benefits. There are two types of sustainable finance formats that real estate operators can consider for either loans or bonds. The most common is the proceeds solution, in which the use of proceeds must be aligned with industry-recognized sustainability categories and defined in a green or sustainable finance framework. Often, these frameworks leverage third party metrics like green building certification, ENERGY STAR ratings, or affordable housing units meeting certain AMI thresholds. For example, Fannie Mae and Freddie Mac offer a suite of green mortgage products for borrowers that provide favorable pricing or additional proceeds for those that invest in energy and water efficiencies or pursue green building certifications.[26,27] As another example, in 2024, Wells Fargo executed a CMBS transaction secured by a high-rise apartment building featuring 30% affordable units. The development was the first multifamily residential building to achieve LEED v4 New Construction Platinum certification.[28] The transaction represented the first sustainable private label CMBS deal in the U.S. market, and its sustainable designation raised investor focus, which contributed to positive investor demand.

The other sustainable finance option that real estate operators can consider is the sustainability-linked loan (SLL) solution, which is based on outcomes. SLLs are typically incorporated into corporate or fund level credit facilities. In this format, ambitious annual targets are set over the lifetime of the loan and there is a pricing benefit if targets are achieved and pricing penalty if targets are missed. Until recently, real estate market participants have focused almost exclusively on environmental attributes like energy efficiency and green building certification. Today, there are tools and frameworks such as the MIF, to integrate into sustainable finance in support of impact investing. In late 2024, Wells Fargo structured a sustainability-linked subscription credit facility for Nuveen's U.S. Affordable Housing Fund. The three sustainability key performance indicators (KPIs) within the facility align with the company's investment objectives and the MIF principles to preserve affordable housing, provide resident services, and prioritize energy efficiency and resident health. If all three annual KPIs are achieved, the structure provides up to 7.5 basis points of savings on drawn capital. This transaction provides an example for how other asset managers and impact investors can leverage sustainable finance to potentially align stakeholders and improve financial and societal outcomes.

A more sustainable future requires housing that is resilient, efficient, and affordable. Real estate investors can support an increase in affordable housing supply by leveraging policy incentives, sourcing the most efficient capital, and creating more transparency around financial returns and impact metrics. Although headwinds persist, financing innovations like SLLs can help to make new investments more attainable. Sustainable finance demonstrates the art of the possible, creating structures to amplify existing affordable housing enablers which can improve overall societal outcomes.

For additional insights and solutions, contact the Sustainable Finance & Advisory team at Wells Fargo.

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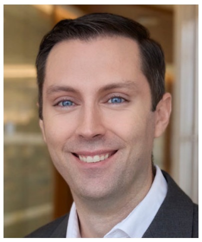

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