Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 24

MEETING DATE: **January 21, 2026**

SUBJECT: **Education: Real Estate**

SUBMITTED FOR: **___ Action** **_X_ Information**

RECOMMENDATION

Receive and file educational presentation on affordable housing considerations in the Real Estate asset class, as presented by Townsend Group.

PURPOSE/STRATEGIC PRIORITY

This item provides the Board with investment related education as identified in the 2026 Annual Investment Plan.

DISCUSSION

In 2025, SCERS' Board requested education on affordable housing and related real estate investment strategies that focus on the segment. At the January meeting, SCERS' real estate consultant, Townsend Group, will be presenting education on affordable housing. The presentation will provide key terms, definitions, and characteristics of affordable housing, industry data, types of investment strategies, targeted returns, and historical performance of the segment. Townsend will also provide current exposures that SCERS' investment portfolio has to affordable housing.

ATTACHMENTS

- Board Order
- Townsend Affordable Housing Overview

Prepared by:	Reviewed by:
/S/	/S/
Steve Davis Chief Investment Officer	Eric Stern Chief Executive Officer

Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
January 21, 2026

AGENDA ITEM:

Education: Real Estate

THE BOARD OF RETIREMENT hereby approves the Staff recommendation to receive and file educational presentation on affordable housing considerations in the Real Estate asset class, as presented by Townsend Group.

I HEREBY CERTIFY that the above order was passed and adopted on January 21, 2026 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES (Present but not voting):

Chris Giboney Board President	Eric Stern Chief Executive Officer and Board Secretary

Affordable Housing Overview

January 2026

Table of Contents

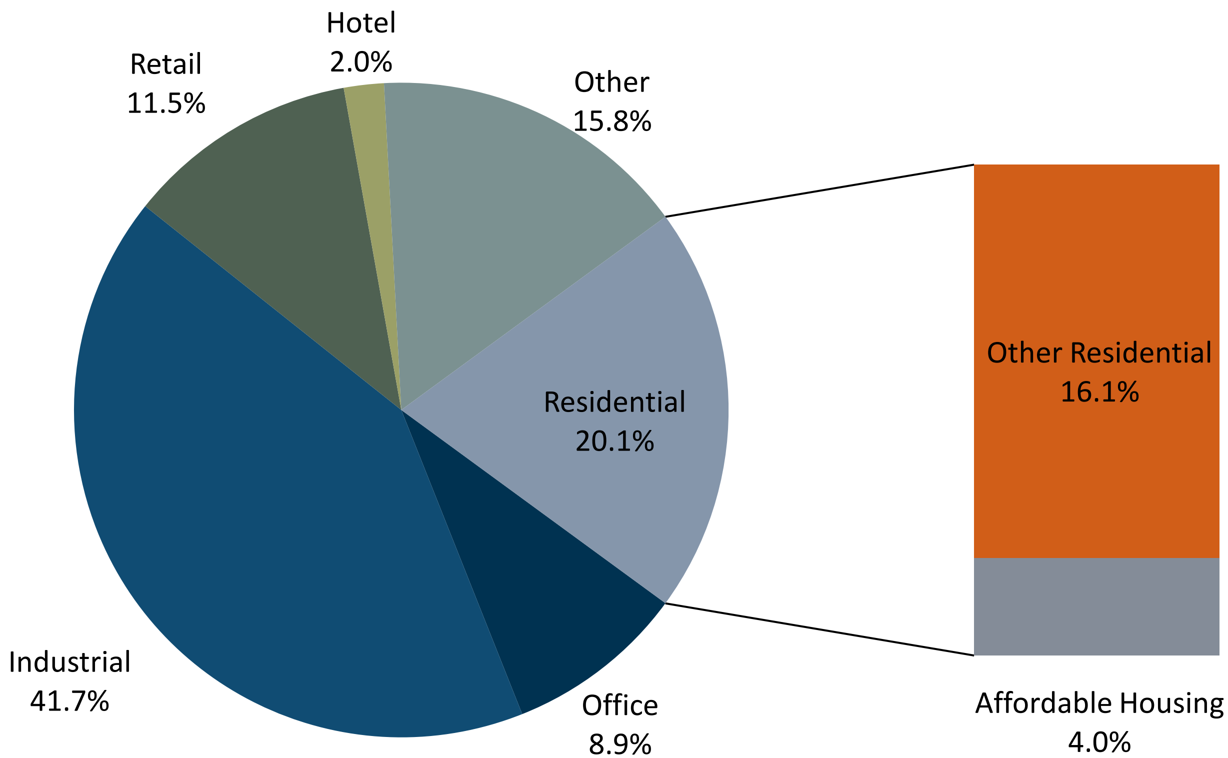
1. Background
2. Defining Affordable Housing
3. What We're Hearing
4. Investment Strategies
5. Affordable Housing Financing
6. Conclusion

Background

- In 2025, SCERS' Board requested additional education on strategies in the affordable housing space
- Housing affordability has been a topic of increasing interest to institutional investors for several years
- Increased costs of new construction (labor and materials), tighter credit standards, higher interest rates, and relatively stagnant income growth have impacted affordability nationally
- Unlike traditional multifamily, no institutional database exists tracking affordable housing investments
- Data is imperfect – the following is based on available information, including some estimates and assumptions made by experienced investors in this space
- This presentation is a summary of research compiled from various industry sources, intended to outline prominent strategies within affordable housing and describe observed historical performance
- Townsend continues to actively evaluate the space and views may change
- Further research is underway to provide insights and identify executable options that satisfy client need and return requirements

SCERS’ Affordable Housing Exposure

- As of 3Q 2025, 4.0% of SCERS’ Real Estate Portfolio was comprised of affordable housing properties
- Affordable housing accounted for 19.8% of SCERS’ residential investments and 5.7% of all US investments
- Nearly all of this is Naturally Occurring Affordable Housing



Source: Townsend. Townsend’s views are as of the date of this publication and may be changed or modified at any time and without notice.

DEFINING AFFORDABLE HOUSING

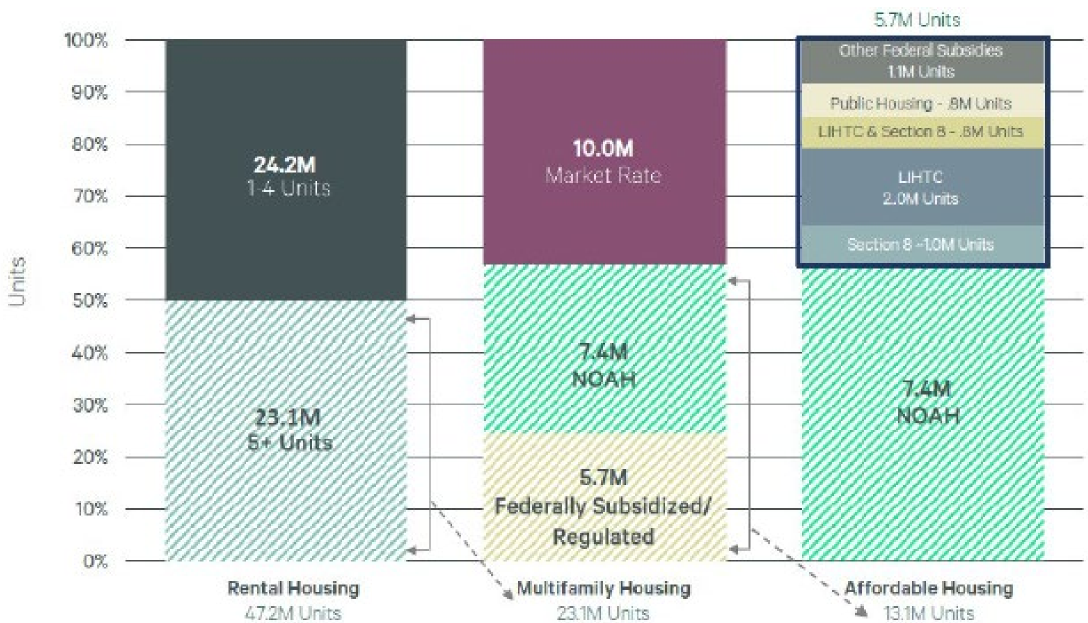
Certain Common Terms

- **Affordability**
  - — Occupant pays 30% or less of their gross income for housing costs, including utilities
- **Area Median Income "AMI"**
  - — Mathematical midpoint in a frequency distribution of earned pre-tax incomes within a defined geographic area
  - — HUD refers to the figure as Median Family Income ("MFI"), which is based on a four-person household
- **CRA**
  - — The Community Reinvestment Act of 1977, requires banks and other lenders to provide a minimum level of financing solutions in low- and moderate-income neighborhoods (where median family income in a specific community is <80% of AMI)
- **FMR Standard**
  - — "Fair Market Rent" Standard set by HUD that governs permissible rents to charge on subsidized housing properties, as well as annual permissible rental increases
- **HUD**
  - — Department of Housing and Urban Development
- **LIHTC**
  - — Low Income Housing Tax Credits; investment strategy further defined later in this presentation
- **NOAH**
  - — Naturally Occurring Affordable Housing; market-rate, less expensive product that is also referred to as essential housing
- **Subsidized Housing**
  - — A broad term describing government (local, state, and/or federal) programs that reduce the costs of housing for residents, with no connection to the quality, location, or type of housing
  - — LIHTC, Section 8, rent controlled, and rent stabilized housing are all examples

Universe Characteristics

The ongoing housing supply/demand imbalance is a function of high costs of new construction, relatively tight credit standards for single family mortgages, and relatively stagnant income growth, further limited by higher interest rates

Size of National Affordable Housing Market



	Market Rate (A/B)	NOAH	Subsidized
Cap Rates (Stabilized)	4.25%	5.0%	5-6%+
Occupancy	94%	94-96%	97%+
Delinquency/ Credit Loss	0.85%	1.00%	0.25%
Turnover	60%	40%+	20-25%

Townsend's views are as of the date of this publication and may be changed or modified at any time and without notice.
Source: ULI, Fannie Mae, CBRE Affordable Housing, JCHS America's Rental Housing 2020 Report, NMHCU.S. Census Bureau, L-M Fund Management, American Housing Survey 2023, Townsend Research

Affordability Characterizations

As previously noted, HUD defines affordability as an occupant paying 30% or less of their gross income for housing costs, including utilities

General Income Tiers[1]

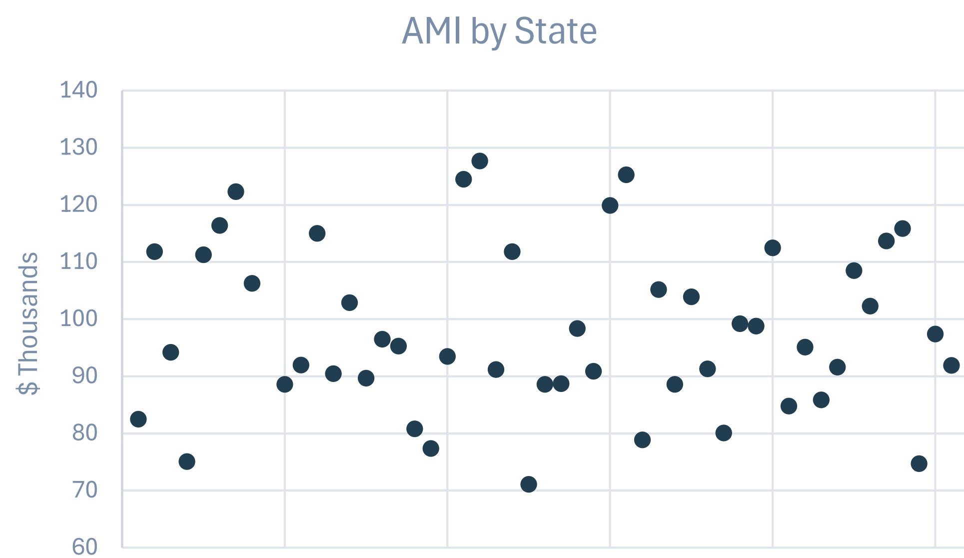
- Low Income (at or below 80% of AMI)
- Very Low Income (at or below 50% of AMI)
- Extremely Low Income (at or below 30% of AMI)

There is little consensus around naming conventions for strategies within affordable/attainable housing as a broad subset. However, attainable Commercial Real Estate subsectors can be generally described as below:

- Workforce (rents at 80-120% of AMI)
- Affordable (rents 60-80% of AMI)
- Subsidized (below 60% of AMI)

AMI ranges considerably by state, from ~$75,000 in West Virginia to ~$128,000 in Massachusetts

- This means that a very low-income family[1] can afford monthly rent up to $940 in WVA or $1,600 in Massachusetts
- While an extremely low-income family[1] can afford monthly rent up to $560 in WVA or $960 in Massachusetts



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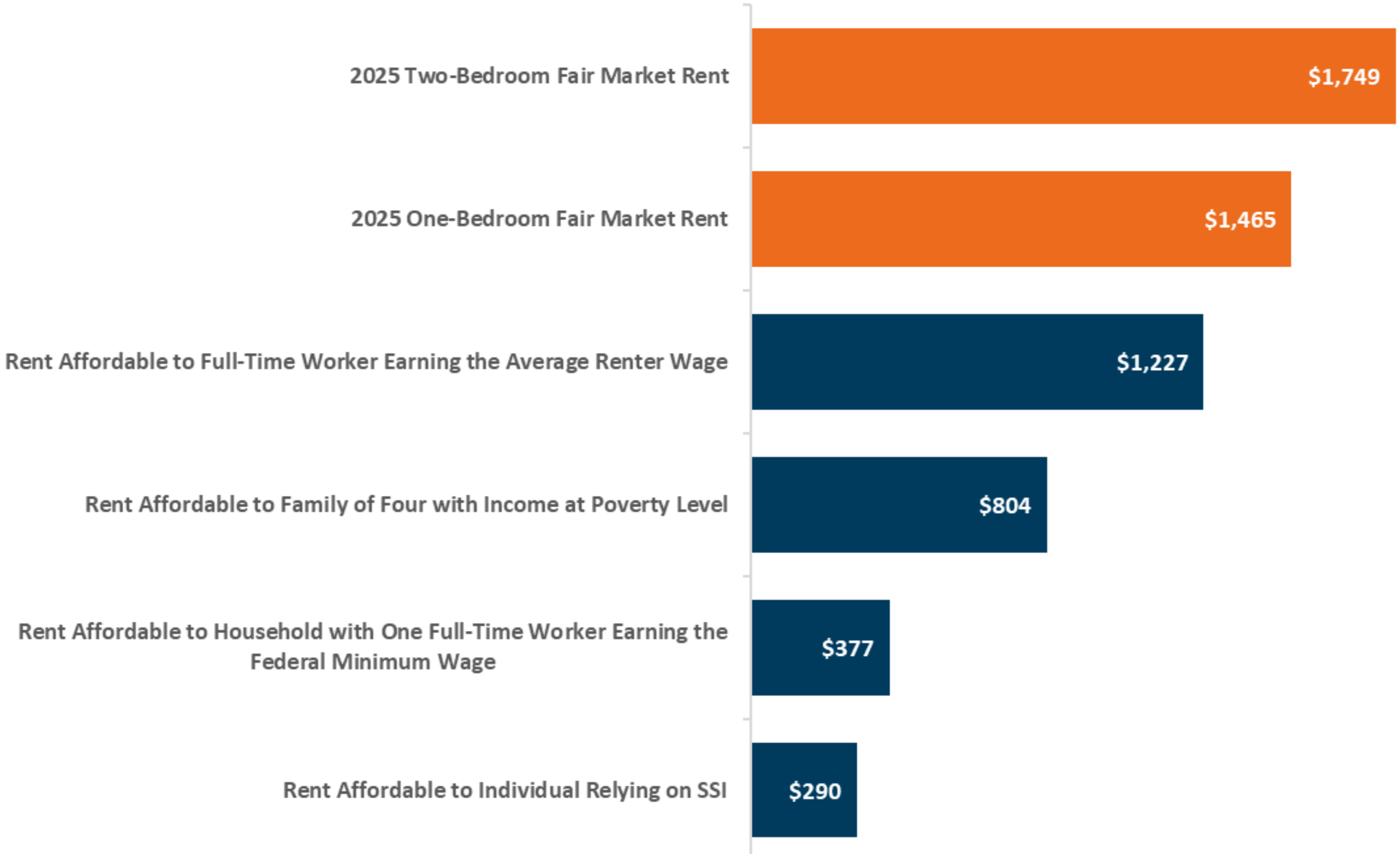
[1]As defined by the HUD Section 8 Program

Source: HUD, Townsend Research

WHAT WE’RE HEARING

National Average Rents and Affordability

Rents are Out of Reach for Many Renters[2]



[2]The analysis includes fair market rent on homes in a minimum decent condition, excluding luxury housing. The figures above assume renters spend no more than 30% of income on housing. Based on 2025 data.
Source: National Low Income Housing Coalition

What We're Hearing in the Industry

TOWNSEND® GROUP

- **"For the third consecutive year, in 2023, the number of cost-burdened renters (those spending more than 30 percent of their income on housing and utilities) reached a record high at 22.6 million renters (50 percent). This includes more than 12.1 million (27 percent) who are severely burdened, spending more than half of their income on housing."**

  – State of the Nation's Housing 2025, Joint Center for Housing Studies of Harvard University

- **"The U.S. has a shortage of 7.1 million rental homes affordable and available to renters with extremely low incomes – that is, incomes at or below either the federal poverty guideline or 30% of their area median income, whichever is greater. Only 35 affordable and available rental homes exist for every 100 extremely low-income renter households. Extremely low-income renters face a shortage in every state and major metropolitan area."**

  – National Low Income Housing Coalition

- **"Without accounting for early exits, roughly one-third of all currently active LIHTC units are set to expire by 2035; this figure far eclipses the number of units that left the program previously.**

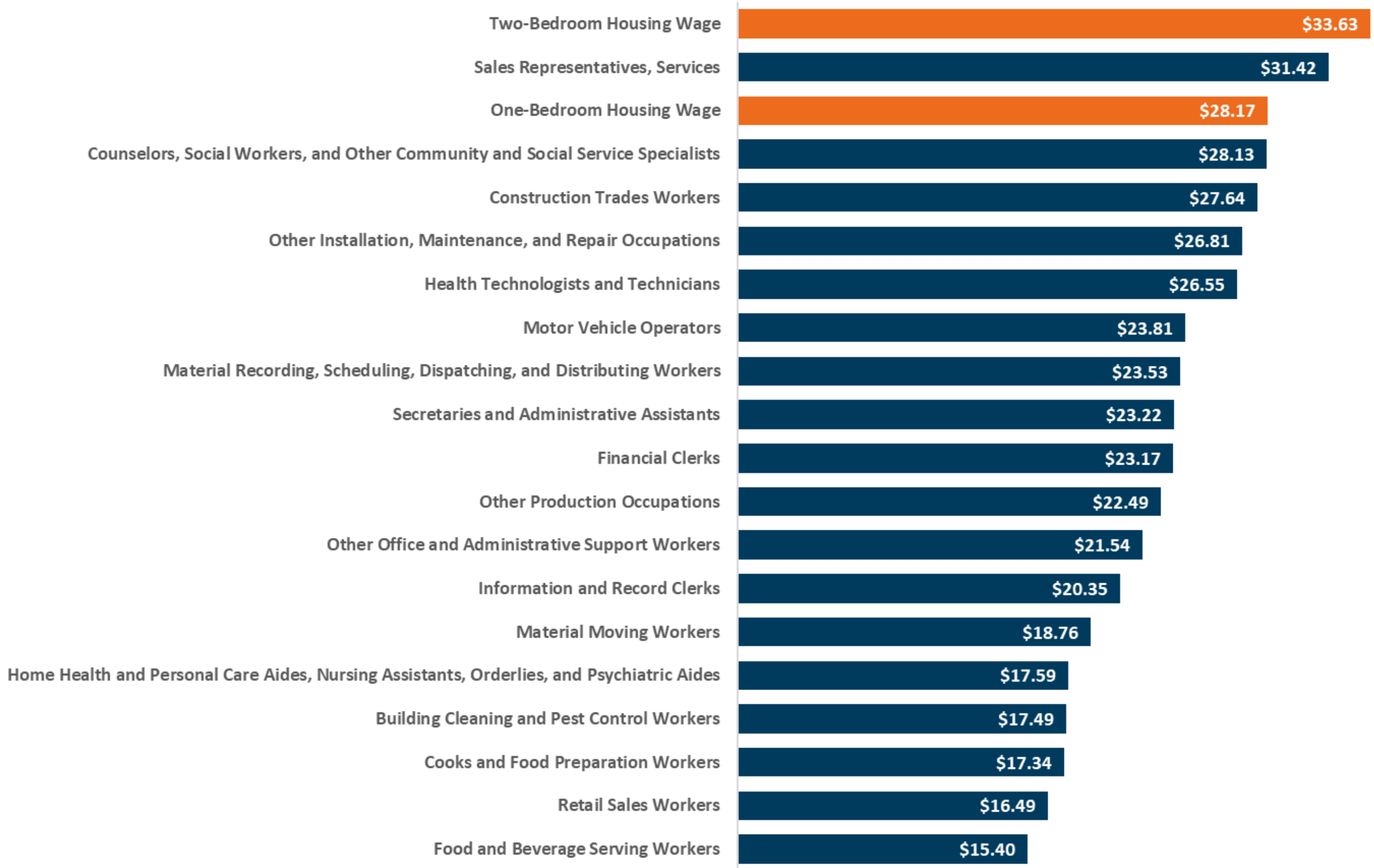
  – Federal Reserve Bank of Chicago

- **"In a recent Pew Research Center survey, 69% of Americans said they were "very concerned" about the cost of housing, up from 61% in April 2023."**

  – Pew Research Center

Income and Rental Rate Disparity

Of 25 Most Common US Professions, 17 Pay Lower Median Wages Than Equivalent One- and Two-bedroom Housing Wages[3]

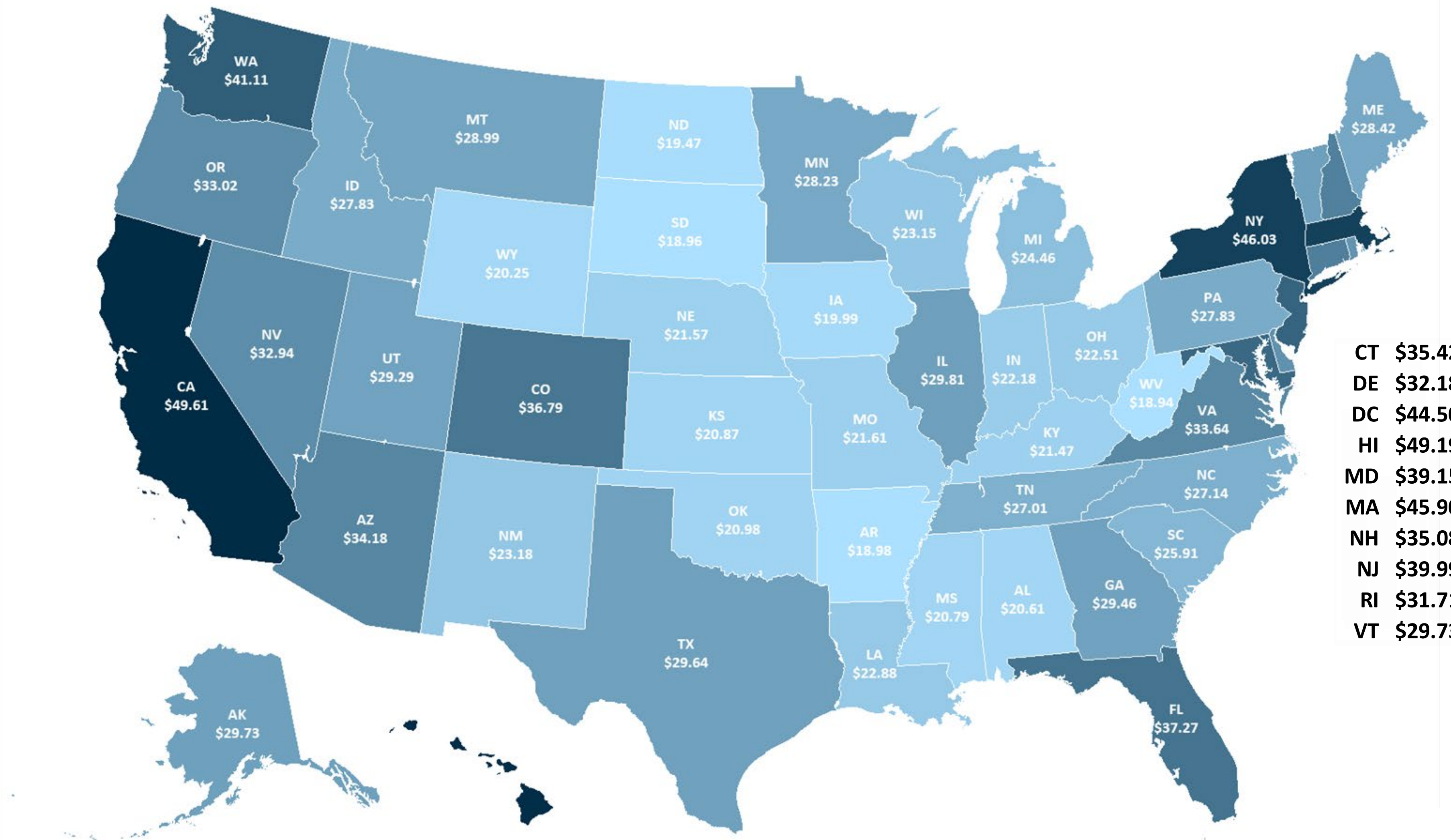


[3]For a modestly priced rental home, where a tenant does not pay more than 30% of their income on rent while working full-time (40 hours per week, 52 weeks per year). These 18 occupations employ approximately 74 million people—nearly half of the entire U.S. workforce.

Source: National Low Income Housing Coalition

2025 Two-Bedroom Rental Housing Wages

Significant Variation by State[4]



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[4]Represents the hourly wage that a full-time worker must earn (working 40 hours per week, 52 weeks per year) in order to afford Fair Market Rent for a two-bedroom rental home, without paying more than 30% of income on rent.

Source: National Low Income Housing Coalition

INVESTMENT STRATEGIES

Naturally Affordable Housing ("NOAH")

TOWNSEND® GROUP

NOAH | LIHTC | Section 8 | Rent Regulated

Definition

- Properties charging market-rate rents, yet offering accessible value in expensive markets without government subsidies or regulation
- Often referred to as Naturally Occurring Affordable Housing ("NOAH"); alternatively described as workforce or essential housing, but definitions can vary
- Rents are generally between 60-120% of AMI, and can be higher in expensive markets (e.g. New York or San Francisco)

Characteristics

- Often garden-style apartments in Sun Belt suburbs; some groups pursue this strategy in gateway markets
- Popular among working families and young professionals, who do not qualify for subsidized housing but struggle to afford higher-end product
- Occupancy is less volatile than for Class A apartments – targeted by most new supply – but more volatile than for subsidized/regulated housing
- Current vacancy rates around 4%, below long-term average

Estimated Universe Size: $2.4 trillion
Estimated Stock: 7.4 million units

Investment Strategies

- Negotiate property tax exemptions with the jurisdiction in exchange for making the property affordable, which can boost NOI 15-70%, depending on how much of NOI is attributable to property taxes
- Most managers consulted are operators. Some also prefer to handle property management in-house, especially with labor-intensive business plans
- Tend to trade at cap rates that are on average a 50 bps premium to Class A

Regulation & Implications

- There are no specific regulations for naturally affordable housing
- However, certain regulated opportunities exist, such as forming public-private partnerships where landlord agrees to restrict rents in exchange for property tax abatements
- Lack of restrictions allows landlords to move rents with the market
- Investors are also able to underwrite the impact of planned renovations on property value and resulting changes in rental rates

Performance

Strategies generally target the following:

- Core/Core-Plus: 8-12% property-level IRR (gross)
- Value-Add: 13-16% property-level IRR (gross)
- Opportunistic: 16%+ property-level IRR (gross)

- Historical performance has been mixed across vintages, generally mirroring dispersion of other market rate product

Sources: Townsend research. Townsend's views are as of the date of this publication and may be changed or modified at any time and without notice.

Low Income Housing Tax Credit ("LIHTC")

NOAH → LIHTC → Section 8 → Rent Regulated

Definition

- In exchange for agreeing to limit tenancy to low-income households for at least 30 years, the federal government provides tax credits (9% or 4%) to developers who build or improve affordable housing
- A 9% credit is generally reserved for new construction, while 4% is typically claimed for rehabilitation and new construction financed alongside tax-exempt bonds
- Developers invest very little of their own capital, instead selling the tax credits to investors to raise required equity for the project. The sale provides a dollar-for-dollar reduction in federal income tax liabilities to buyers

Characteristics

- High initial capital outlay, more limited throughout the property's remaining life. Developers receive substantially all proceeds (15-18% of cost) from development fees
- Multifamily, single family, duplexes, and townhomes are all eligible for the program
- Occupancy has been above 96% over the last 13 years
- Turnover is roughly half of market rate housing
- These properties tend to trade at cap rates 50-100+ bps higher than comparable market rate assets

Estimated Universe Size: $780 billion
Estimated Stock: 2.6 million units (+70K-90K units pa)

Investment Strategies

- Funds rarely pursue LIHTC development or resyndication because equity needs are too small (tax credits supply most equity) and risks can exceed those of market-rate multifamily, especially in pre-development
- Approvals and allocations take ~5 years, and assets must be held for 10 years post-development, exceeding the life of most closed ended funds
- Banks are large buyers of LIHTC due to Community Reinvestment Act ("CRA") obligations

Regulation & Implications

- Tax credits are claimed over 10 years, but properties must comply for 15; noncompliance can trigger IRS credit recapture, though owners may correct violations
- After the 15-year compliance period, deed restrictions remain, but government oversight ends; state housing agencies require annual landlord certifications (varies by state)
- HUD calculates rent limits from inflation-adjusted AMI figures based on 3-year lagged survey data; rents cannot decrease, even if incomes decline

Performance

- Core/Core-Plus strategies are common, where assets are acquired either after the 10 years tax credit or 15-year compliance period expires
- These strategies target 10-14% property-level gross returns
- Once affordability restrictions expire, the landlord may (i) negotiate property tax exemptions with the local jurisdiction in exchange for maintaining affordability restrictions at the property, (ii) move rents to market, (iii) resyndicate, or (iv) voluntarily keep rents affordable

Sources: Townsend research. Townsend's views are as of the date of this publication and may be changed or modified at any time and without notice.

Project-Based Section 8

NOAH | LIHTC | Section 8 | Rent Regulated

Definition

- Landlord enters Housing Assistance Payment ("HAP") contract HUD that is tied to the property, binding them to provide affordable housing to low-income households for a set number of years
- Landlords receive market rents, where tenants pay 30% of their income on rent (minimum of $25) and government subsidizes the rest

- This differs from the Section 8 Housing Voucher Choice Program, where tenants use a voucher to pay for their rent. Because these vouchers are tenant-based rather than property-based, they allow residents to move freely and therefore do not provide an investment strategy for landlords

Characteristics

- Most properties are mid-rise 1960s and 1970s vintage because HUD stopped supporting the program for new apartments in 1983
- Very low turnover and high occupancy (98%) can be attributed to limited supply and tenant benefits tied to a specific property

- Project-based differs from the voucher program
  - Individual tenants qualify for vouchers and can use them at any property across the country
  - Project-based means the entire property qualifies for the program

Estimated Universe Size: $390 billion

Estimated Stock: 1.3 million units

Investment Strategies

- Relatively few of these assets remain. Generally one smaller strategy within a broader affordable housing portfolio
- Tenants pay 30% of income, but HUD pays the difference between tenant payment and market rate lease
- Includes built in rental increases (paid by HUD) every five years
- The program is subject to annual appropriations from Congress

Regulation & Implications

- Can mark rents to market once every 5 years via third-party study
- Properties also receive annual rent increases through annual operating cost adjustment factor increase, as determined by HUD for each state
- Some properties have age restrictions (55+)
- Household income may not exceed 80% of AMI; at least 40% of subsidized units that become available annually must go to extremely low-income families (poverty line or ≤30% AMI); most remaining units must serve very low-income tenants (≤50% AMI)

Performance

- Generally focused on Core/Core-Plus strategies targeting 10-14% property-level IRR (gross)

- Lack of dedicated funds and limited direct opportunities limits data on this space

- Other considerations include common statistical challenges like survivorship bias

Sources: Townsend research. Townsend's views are as of the date of this publication and may be changed or modified at any time and without notice.

Rent Regulated

NOAH → LIHTC → Section 8 → Rent Regulated

Definition

- Properties may include rent and rental increase caps; landlords may be allowed to raise rents slightly to recover costs for major building improvements, subject to strict limits
- Vacancy decontrol: landlords may raise rent to market rates upon a unit turning; when a new tenant occupies the unit, they will pay a limited increase annually
- Vacancy control: when a tenant vacates, the rent remains regulated. The landlord can only increase rent by the amount allowed under local rent control guidelines, even between tenancies

Characteristics

- Rent regulations generally apply to pre-1980s buildings, varying by geography; most jurisdictions exempt new development
- California caps annual rent increases at 5% + regional CPI (max 10%), with exemptions by building age/type
- Applies only where stricter local rent control doesn't exist
- No cap on rent increases when a unit turns over to a new tenant

Estimated Universe Size: $750 - $900 billion (CA), $300 billion (NY)

Estimated Stock: 2.5 -3 million units (CA), 1 million units (NY)

Investment Strategies

- Rent regulated apartments experience higher occupancy than those without it because tenants elect to stay to avoid paying higher rents elsewhere
- This requires underwriting longer hold periods when acquiring new properties
- May include rent and rental increase caps, as well as increase limits on capital spent on physical improvements

Regulation & Implications

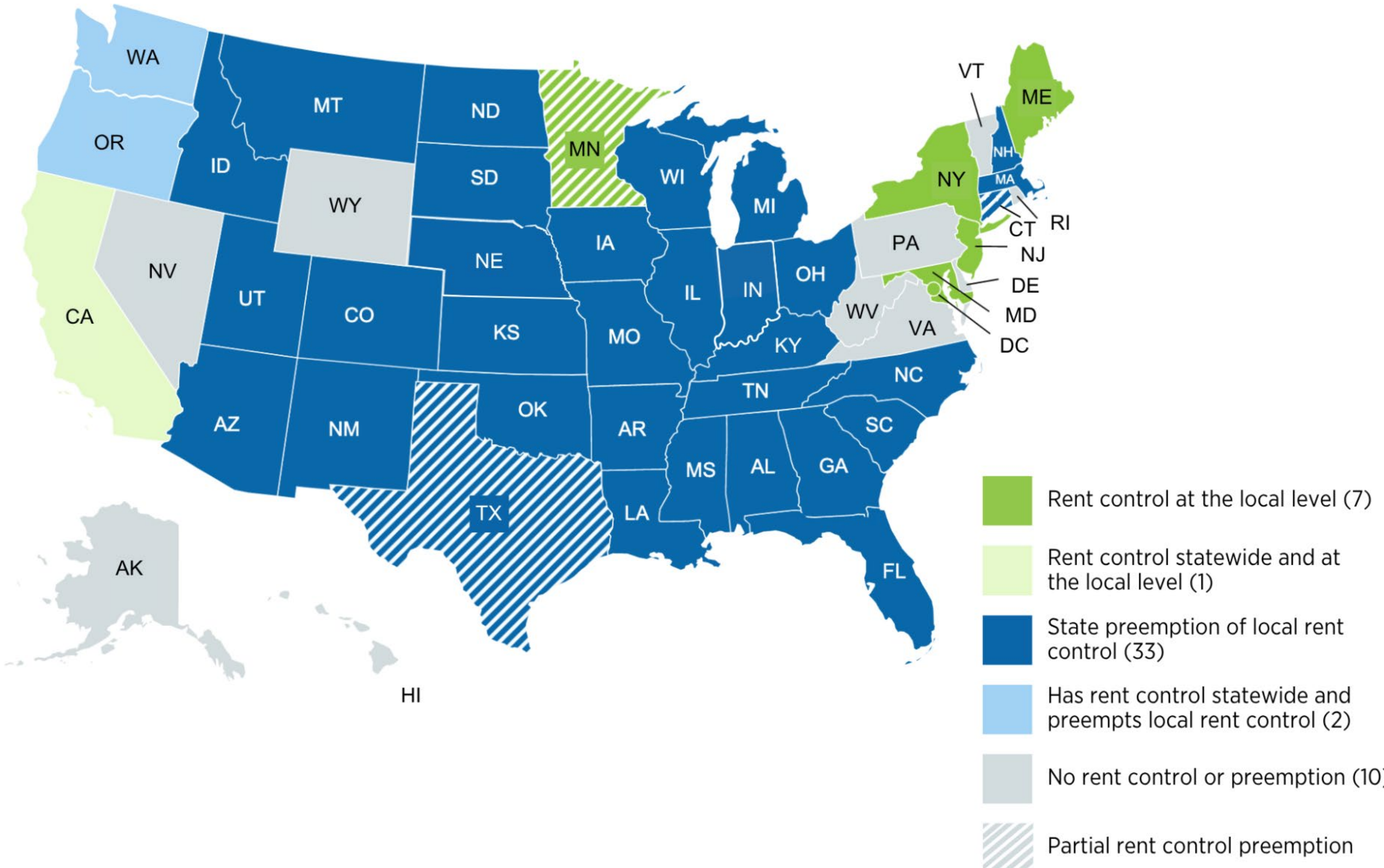
- Rent regulations are set statewide and/or locally. The map on the following slide shows rent control laws by state
- Most California multifamily projects face inclusionary housing rules requiring a percentage of units as Below Market Rate (BMR) for low-income households. In return, cities grant density bonuses, allow extra market-rate units beyond base zoning, and offer concessions like reduced parking

Performance

- Generally Non-Core strategies targeting 13-18% property-level IRR (gross)
- Data is limited, but most funds with significant investments in subsidized housing performed below median over all vintages

Sources: Townsend research. Townsend's views are as of the date of this publication and may be changed or modified at any time and without notice.

Rent Regulation Laws by State



Source: National Apartment Association. Townsend's views are as of the date of this publication and may be changed or modified at any time and without notice.

Gross Property Target Return Summary by Strategy

Naturally Affordable	▪ Core/Core-Plus: 8-12% property-level IRR (gross) ▪ Value Added: 13-16% property-level IRR (gross) ▪ Opportunistic: 16%+ property-level IRR (gross)
LIHTC	▪ Development (Syndication) & Redevelopment (Resyndication): Infinite returns, given the developer itself is not contributing equity, but also significant risk associated with pre-development and compliance requirements ▪ Core/Core-Plus: 10-14% property-level IRR (gross)
Section 8	▪ Core/Core-Plus: 10-14% property-level IRR (gross)
Rent Regulated	▪ Non-Core: 13-18% property-level IRR (gross)

- Returns above are gross and property-level, which differs from the net, fund-level returns investors typically consider; this may include 150-500+ bps difference for fund-level fees and expenses
- Across all real estate investments, investors target the following net, fund-level returns by strategy:
  - Core (6-8%), Core-Plus (8-11%), Value Added (11-14%), and Opportunistic (14%+)
- Historically, affordable housing strategies have used higher leverage than market rate, which can increase investment risk
- Historical fund-level return data is scarce, and the available track record has been mixed; exercising selectivity, creating the right alignment, and partnering with the best groups can result in outperformance
- Funds investing in affordable housing have often pursued multiple strategies, including market rate, which further limits true fund level performance comparison

Sources: Townsend research. Townsend's views are as of the date of this publication and may be changed or modified at any time and without notice. Actual results and developments may differ materially from those expressed or implied herein.

AFFORDABLE HOUSING FINANCING

Affordable Housing Financing

- The most popular sources of debt are the agencies—Fannie Mae and Freddie Mac
  - — HUD financing is used by borrowers seeking higher leverage than the agencies can provide
  - — For loans that do not qualify for agency financing (i.e., development), banks, debt funds, and life insurance companies are common alternatives
- Agencies have a mandate and special allocations for affordable housing, offering higher leverage and lower interest rates than market-rate financing
  - — In addition to providing lower interest rates for government subsidized housing, the agencies also provide favorable rates for NOAH properties, which they define broadly
  - — Agency caps for multifamily lending increased from $70B each in 2024 to $74B each in 2025, with at least 50% allocated to affordable housing
  - — Typical agency terms include long interest-only periods, 1.20–1.25 DSCR, and up to 80% LTV, with even higher leverage for certain affordable executions
  - — Borrowers can also receive lower rates from the agencies for providing social services at their properties, such as afterschool programs for children
- In addition to supporting affordable housing through debt, the Federal Housing Finance Agency (“FHFA”) also increased Fannie & Freddie’s allowance to invest in LIHTC equity to $2B each in 2025

Sources: Federal Housing Finance Agency, National Housing & Rehabilitation Association, Federal Register, CBRE, The Real Deal. Townsend’s views are as of the date of this publication and may be changed or modified at any time and without notice.

Conclusion

- Housing affordability has become a nationally recognized challenge; the universe of formally offered opportunities to invest in affordable housing is growing, but remains limited
- While some market rate housing strategies can target higher absolute returns, those returns typically come with higher cyclicality and refinance/lease-up risk
- Affordable housing demand is supported by persistent supply shortages and record levels of rent burden. At the same time, LIHTC portfolios have historically exhibited very high occupancy, with low delinquency and default
- Taken together, this suggests a lower-volatility cash-flow profile that can make affordable housing compelling on a risk-adjusted basis—particularly when paired with conservative underwriting and strong manager execution
- Townsend is resourced to assist investors building out an affordable housing portfolio and have done so with other clients
- As with any investment opportunity
  - — Offerings considered will follow the standard investment approval process
  - — Any affordable housing investment considerations will be made according to SCERS' Master Investment Policy Statement, which speaks to the consideration of non-economic factors, including ESG, in conjunction with other relevant economic factors when evaluating investment opportunities that help SCERS achieve its strategic objectives
- Townsend continues to actively evaluate the space and views may change