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Tax Credit Developers and Investors*

Changed Conditions Increase Need for, Impact, Market Studies, Site Selection

The market study is a key part of the development process for a low-income housing tax credit (LIHTC) project.

Generally prepared by a qualified market analyst, this document provides a reasoned judgment of whether or not a proposed LIHTC project is likely to be successful, based on an analysis of a wide variety of collected information and data – about the project, site, surrounding neighborhood, market, local population, employment and income, rents and housing costs, and competing apartment properties.

State housing credit agencies (HCAs) require a market study for all new LIHTC projects. A number of state HCAs have adopted requirements based on model standards developed by the National Council of Affordable Housing Market Analysts, that contain recommendations for the content and preparation of market studies. (*For details, visit <http://www.housingonline.com>.)*

The market study is more important today for proposed LIHTC projects and more challenging to prepare, according to market analysts and others interviewed by the *Tax Credit Advisor*. Changes from a year ago include an economic downturn in the U.S. overall and in many local markets, sharply lower housing credit prices and a shortage of available tax credit equity, increased unemployment, rising home foreclosures and vacant homes, and a big hike in the price of gas. These factors can affect the market study for a proposed LIHTC project, project viability, and site selection.

Current Trends

One new trend in market studies is a “lot more

concern, a lot more due diligence being paid to the market study by users,” said Bethesda, MD market analyst Blair Kincer, a partner in the national accounting and consulting firm of Novogradac & Company LLP. Kincer said more individuals and firms that before didn’t order their own market study are now ordering them, including developers, syndicators, lenders, and equity investors. Given the sharp drop in credit pricing, shortage of equity, and other factors, he indicated the market study has become more popular and scrutinized because developers want to make sure they have a good project that will be able to attract equity, while lenders and finance sources want a market study they can have confidence in.

Another trend is “more and more scrutiny” by state housing credit agencies of market studies for proposed housing credit projects, said Columbus, OH market analyst Rob Vogt, of VWB Research. Kincer also said state agencies are asking for more information in the market study. Texas, for example, has begun to ask for a discussion of the density of multifamily housing within certain geographic areas, he noted.

Some sources suggested the rising number of foreclosed and vacant homes in many communities is impacting – in ways often not yet fully understood – local rental markets, market studies, and the viability of new LIHTC projects. “I think we’re only at the tip of the iceberg in terms of its impact on housing markets,” said Vogt. Some argue the local supply of rental units is being boosted as more and more homes – those foreclosed and those of speculators in trouble – are rented out. At the same time, many displaced

homeowners are now competing for rental units, including laid-off workers.

Sacramento-based market analyst Mary Ellen Shay, of M.E. Shay & Co., who prepares market studies for LIHTC projects primarily in California, said she recently prepared a market study for a proposed LIHTC project with four-bedroom units in Oxnard, CA. Shay said that where once it was tough here to find any four-bedroom rental units as comps for a tax credit project, “when I was there three weeks ago, I had probably 20 four-bedroom rentals [houses], all in new or close to new subdivisions, where people had lost their homes [or were] trying to rent them out to prevent a foreclosure.” She said a similar high foreclosure rate has occurred in a number of other former fast-growth communities in California.

Shay said rents on foreclosed homes today generally aren’t at levels affordable to LIHTC income-eligible households, but are still dropping.

Vogt said in Ft. Myers, FL, an overbuilt condo market, “an awful lot of this condominium product is for rent and directly competitive with 60 percent tax credit properties.”

Site Selection, Trends

LIHTC site selection is still driven heavily by states’ qualified allocation plans and scoring systems, which often reserve part of their annual credit authority for specified geographic regions, and often offer points in their application scoring process for sites with certain location traits, like proximity to public transit and basic services. “If you want to win [a credit allocation in California],” said Shay, “you’ve got to put your sites where they are close to schools, grocery stores, medical facilities, and things like that.”

Bethesda, MD CPA John Mackey, a principal in the national accounting and consulting firm of Reznick Group, suggested that it is tougher today for developers to find viable sites for new LIHTC projects. The sharp fall in housing credit prices has created a funding gap for many projects that is being worsened by a dramatic rise in construction costs that Mackey predicted will continue, particularly for oil-based construction materials like roofing. As a result, LIHTC developers are less able to compete for sites.

Mackey said owners of land generally aren’t willing today to cut their sales price, despite a funding gap for new LIHTC projects, but instead

are willing to wait for the real estate cycle to rebound. Mackey suggested acquisition/rehab projects often make more sense today than new construction; construction costs per unit are generally less, and, he added, “a lot of acquisition/rehabs are at points in their lives where the existing partners would like to be out of them and may be willing to recognize more changes in the marketplace than just pure land sellers.”

Some sites may be not apparent at first. For example, in Westchester County, NY, an affluent, high-cost suburb of New York City, the county is exploring the possible development of affordable housing on land in underutilized office business parks. (*To view study, http://www.westchestergov.com/pdfs/HOUSING_OfficeParkHousingStudy20080313.pdf*)

Madison, WI CPA Michael Kendhammer, a principal in the accounting and consulting firm of Suby, Von Haden & Associates, S.C., advised developers in trying to find a viable site for an LIHTC project to “work more closely with the local municipalities on where the [housing] needs are and where the growth patterns are in a market.”

Kendhammer said a trend in Wisconsin is a growing choice by some developers of smaller and rural communities in the state as sites for new LIHTC projects. He said often “big box” firms are opening stores in these communities, which attract “linkages” like health care, shopping, and banking facilities, which in turn draw new residents. “What yesterday was a cornfield is now a prime location” for a new multifamily or single-family development, Kendhammer noted.

One developer doing this is Paul Gerrard, one of the family owners of the La Crosse, WI-based Gerrard Corporation, which develops affordable and market-rate rental and owner-occupied housing, plus commercial real estate.

Gerrard, whose firm has developed several LIHTC projects, indicated he specializes in developing projects in small Wisconsin communities “that are next to a large metropolitan area, but being discovered by folks coming out of urban downtowns. They want a little bit different quality of life for their family or their parents.” He said several years ago his firm noticed a pattern of young families with good jobs in a major city, deciding to live in these smaller outlying communities – “beyond the suburbs” – and being followed by their parents and grandparents.

One current LIHTC project by Gerrard Corporation is a 24-unit development in Hudson, WI, a fast-growing community of 10,000 close to Minneapolis-St. Paul. "They have been getting big box retailers, they have very good jobs, they have a strong growing economy," Gerrard said. He described the new project as a "cottage-style" apartment complex made up of fourplexes and eightplexes where each unit will have a garage. "It really simulates a home – it's not your central corridor building," Gerrard noted. In addition to housing credit equity, funding sources include federal HOME program funds and a Rural Development Section 538 guaranteed loan subsidized by interest credit. □