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Investors Show Increased Interest in Bond Deals

By Jennifer Hill, Staff Writer, Novogradac & Company LLP

Bond-financed developments and the associated 4 percent low-income housing tax credits (LIHTCs) have never been as attractive to investors as their 9 percent counterparts. The risks and losses are traditionally greater and the amount of tax credits is typically lower – a tricky combination to underwrite even in a healthy economy. But as the market slowly began to recover, investors told the Novogradac Journal of Tax Credits in May that they intended to increase LIHTC investments in 2010. Now, more than halfway through the year, banks and attorneys report that 4 percent deals are becoming an increasingly larger piece of the LIHTC pie.

Four percent LIHTC investment activity is still nowhere near 9 percent levels, but for investors coming out of the recession with renewed tax credit appetites, especially those who need to meet Community Reinvestment Act (CRA) requirements, 4 percent credits are the next best thing. “Every syndicator is looking at bond deals this year and has a limited appetite for them,” said Erik Hoffman, an attorney at Klein Hornig LLP. Last year, he recalled, some investors were unwilling to even discuss a bond deal.

At that time, the 2009 passage of the American Recovery and Reinvestment Act’s Section 1602 LIHTC exchange program changed the LIHTC playing field in a few unexpected ways. States pre-allocated huge portions of 9 percent credits for this year and next to fund as many deals as possible through the exchange program, crowding out private equity investments in 9 percent LIHTCs and contributing to a tax credit scarcity. Four percent LIHTCs were not included in the exchange program, so both CRA- and yield-driven investors – many

of whom returned to the market this year – are giving those deals a closer look. And although investors would prefer to invest in 9 percent deals, they’re simply not available.

In response, 4 percent credit pricing in urban markets has risen to the low 80 cents from approximately 70 cents in 2009, Hoffman estimated. “There’s a lot more money chasing a limited amount of product,” said Raoul Moore, Enterprise Community Investment’s senior vice president of tax credit syndication. “It’s a function of the economy turning around.” Last year, Enterprise provided approximately \$100 million in 4 percent LIHTC equity and projections indicate that that amount will increase to roughly \$163 million by the end of 2010.

Investors’ Changing Appetites

“Last year we would have really only done 4 percent deals where we were standing by an existing [developer] client,” said Todd Crow, PNC Real Estate’s vice president and manager of tax credit capital. Out of the roughly \$400 million in LIHTC equity PNC provided in 2009, Crow estimates that 15 percent went to 4 percent credits. And even that was a struggle, he said. This year the bank’s total LIHTC investments have gone up, and Crow anticipates that PNC will close around \$650 million in LIHTC investments with 4 percent LIHTCs making up about 20 percent of the total.

PNC’s investors are primarily financial services companies, but he noted that insurance companies in particular have a greater appetite this year than in previous years, a trend that Moore has also noticed at Enterprise. At Boston Capital, a greater number of investor clients this year – again mainly coming

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from the financial services and insurance industries – has enabled the firm to be more open to 4 percent deals, said Corine Sheridan, vice president and director of LIHTC business development.

“We’ve tried to do bond deals because some of our developer clients are very good at it,” Sheridan said, echoing Crow’s preference for experienced developers that have established a track record with the firm. “Last year there was a lack of capital, so investors preferred the easiest transactions: 9 percent, new construction deals.” Boston Capital anticipates closing roughly \$85 million to \$90 million in 4 percent LIHTC transactions this year, compared with last year’s \$24.4 million in 4 percent equity.

Because Citi Community Capital concentrates on major urban areas, the firm typically sees more 4 percent action than the average investor, said managing director Andrew Ditton. He said Citi has invested in more 4 percent credits this year than in 2009, but the bank’s numbers are skewed by a \$210 million investment the bank provided in a massive deal with the New York City Housing Finance Agency (NYCHA) in March.

The Makings of a Good Deal

The NYCHA transaction was an outlier by all accounts, but PNC’s Crow said it’s true that 4 percent transactions tend to be larger projects, due to the expenses associated with bond issuance. In general, rural markets aren’t able to support a development large enough to bear those costs. However, developers have been able to acquire a number of smaller projects in rural areas and group them together under one bond transaction. This allows them to spread out a single issuance’s fixed costs. It’s not a preferred product, Crow said, but an experienced developer can make it work. PNC has invested in a few bundled transactions in Washington, California and Texas.

Crow said PNC also likes to see 4 percent deals used as a preservation strategy. Preservation of Affordable Housing (POAH) is currently working with PNC to bundle two 4 percent deals with a 9 percent credit allocation. “We are finding that we can tie more attractive investments with those that might not be as attractive to an investor as long as the underlying real estate and economics of the deal are sound,” said Patricia Belden, POAH’s development manager. In most cases POAH delivers credits at acquisition, and has increased the amount of in-place, upfront rehab on recent transactions.

Bond deals that don’t rely heavily on foreclosable debt to pencil out are also more likely to make the cut. “The ultimate objective is to see those bonds retire when the construction completes,” Crow said. Once achieved, the deal should have an earnings and risk profile similar to a 9 percent transaction. Hoffman said a developer’s best chance of attracting investment is by making the investor’s benefit stream mirror that of a 9 percent transaction. Ditton

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said the only real differences in 4 percent transactions are that the equity amount is lower and the debt amount is higher than in 9 percent deals. As an investor, "you either get comfortable with that or you don't," he said.

Ditton is encouraged by the velocity of the 4 percent LIHTC market, despite the lack of an exchange program for the credit. Hoffman expects competition for bond deals to continue at least through the end of the year and into early 2011. "I don't think it's a blip, I think we're moving toward a strong interest in bond deals," he said. "Investors are willing to do those deals provided it's with a strong sponsor in a strong market." ❖

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