

Investors Seek Strong Deals, Report Rising Yields

By Jennifer Dockery, Staff Writer, Novogradac & Company LLP

In October, the Journal of Tax Credit Housing reported that many low-income housing tax credit (LIHTC) investors and syndicators were playing it safe in the equity market. They reported a preference for straightforward deals with experienced developers in primary markets. They were also seeing lower equity pricing and stricter underwriting standards. In early December, we asked industry experts to weigh in on how the market had changed in the last three months and what we can expect in 2009. Here's what they had to say.

'Hair-Free' Deals

Investors and syndicators still prefer deals without "hair," and they expect that trend to continue. Most of the deals getting done now are 9 percent deals proposed by experienced developers.

"It's a matter of assessing risk. Investors and syndicators want a real solid demonstrated demand for the units at the rents[developers are suggesting]. There's demand pretty much everywhere. We look really hard at sponsors' balance sheets...solid, experienced sponsors are critical," said Cynthia Lacasse, president of John Hancock Realty Advisors (JHRA), an active equity investment firm.

Todd Crow, executive vice president at PNC Multifamily Capital (PNC), an active syndicator and direct investor in LIHTCs, agrees and also believes that trend will continue into 2009.

"At the moment, our investors like 9 percent deals. They have to be strong, or they won't get sold," Crow said. He expects that most deals in 2009 will be larger 9 percent deals in primary or secondary markets.

For Beth Stohr, LIHTC director at U.S. Bank Community Development Corporation (USBCDC), an active direct LI-

HTC investor, the strength of the market and demand for the product is crucial. Yet, she says, she also looks very closely at the developer.

"It sounds very simplistic, but experience, depth and sustainability are number one. Among other things, we are looking for sound underwriting and performance in the GP's [general partner] portfolio and a plan for riding out the economic storm," Stohr said.

Returned Credits and Rising Yields

"Now, for every deal that a syndicator or direct investor can do, they have 10 deals to choose from," Lacasse said. This is a 360 degree turn from a year ago when the LIHTC industry was a seller's market.

Although most investors and syndicators had hoped that the government bail-out would have stabilized LIHTC pricing by now, that has not been the case. Credit prices continue to fall as yields rise. In many places, credit prices are in the low 70s, and investors expect them to fall even further in 2009.

"If you have someone who you know and trust, I would seek to partner with them over someone who is offering a higher price. Certainty of execution should be a premium for developers today," Crow said.

Because of the limited investor base, many developers, especially those awarded credits in 2007, may not be able to find a home for their deals. Numerous states have seen credits returned, and have enacted policies to help developers return credits that were allocated to deals that are no longer viable in today's uncertain market.

"Only about one-third of awarded credit is finding investors from traditional sources. For the first time ever, we

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had to turn credits back in to state authorities," said Tom Capp, chief operating officer at Gorman & Company, a developer based in Wisconsin. Capp said that his company is focusing on deals in stronger markets, such as Phoenix.

According to Doug Able, senior vice president of capital markets at Enterprise Community Investment Inc. (ECI), a tax credit syndicator, the greatest challenge in today's market is finding true equilibrium.

"We are in a very dislocated market relative to a shortage of capital and yield requirements by investors," he said.

Stohr expects that yields will continue to rise in the first part of 2009 as investors try to determine their appetite for investing. Some investors have speculated that yields could range from 9.5 percent to 10 percent by the end of 2009.

Lacasse said, "I would expect pricing to decline at the deal level...until you get to equilibrium. I don't know

if that is going to happen in the first three months, six months or next year. We haven't seen the effect of the 130 percent [boost] or full 9 percent."

Investors: New and Old

One effect of higher yields is that additional investors are entering the market. As of early December, most new investors have been banks and insurance companies, Stohr said. According to Crow, many of the "new" investors are actually investors that are returning to the market. Capp said that his company has had some success with regional banks and large companies that have an interest in a particular area.

Traditional investors also remain active. According to Stohr, the companies that are investing invested more in 2008 than in previous years.

"It is the method of how the investments are being done that has changed. With more direct and single investor/proprietary funds, it is a quieter market. No open competition on who is closing the most, just working to fill

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the investment bucket,” Stohr said. In 2008, USBCDC increased its direct LIHTC investments by 50 percent.

As a direct investor, PNC invested the same amount in 2008 as it did in 2007, but it saw its syndicated investments fall by 40 percent. Crow expects the first and possibly second quarters of 2009 to be slow for the company due to the state of the financial markets. “I can’t imagine a worse environment and we’re still managing to get business done,” Crow said.

EIC also expects its investments to be lower, due in most part to a lack of available capital. Lacasse said that JHRA will continue investing in the market, but she wasn’t sure at what level.

Looking to the Future

Syndicators, investors and developers expect the LIHTC market to stabilize as the rest of the financial markets stabilize. With legislative changes, they said, the LIHTC market could improve even faster. Suggested changes include shortening the LIHTC investment period from 10 years to five years, changing Community Reinvestment Act requirements and raising the allowable income levels for residents of LIHTC properties.

“The tax credit has had about as long a run as any major housing production program. A lot of good work has been done... This program has a future that needs to continue,” said Paul Cummings, senior vice president of tax syndication at ECI. ❖

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