

LIHC MONTHLY REPORT

A MONTHLY PUBLICATION OFFERING NEWS, OPINION, FEATURES AND COMMENTARY ON THE LOW-INCOME HOUSING TAX CREDIT INDUSTRY

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LIHC Equity Market: Stalled or Rebounding?

By Jane Bowar Zastrow, Editor, Novogradac & Company LLP

It isn't an in-your-face trend just yet but some see the shift in yield spreads beginning to have a quiet effect on the way investors are viewing the equity market. "Our investors are out there every day, and each week and month we see increasing tax credit yields and decreasing alternative investment yields," says Kevin Costello, senior vice president of corporate investment for Boston Capital Corporation. Driving the change, he says, are the Federal Reserve Board rate reductions that make alternative investments less attractive, and the upward movement of tax credit yields that make Low-Income Housing Tax Credits (LIHCs) more attractive.

Other industry professionals are less sure of the health of the equity market. One characterized it as being in a "decided state of confusion."

"We haven't seen substantial allocations this year, so it's difficult to say what's going on in the market" says David Sebastian, president of Columbia Housing. Populous states like Texas, California, New York and Florida still haven't awarded their 2001 tax credits. But as credits hit the market, action is picking up and, everyone agrees, investors are chasing the 9 percent new construction credits.

While the pool of housing credit investors appears to be diminishing as investor yields rise and developer credit prices fall, the flight to quality looms large. "A year ago, folks would pay the same for a tax credit, no matter what," says Sebastian. "Today they are stratifying their pricing and will pay more for 9 percent transactions than for 4 percent, and more for new and less for rehab projects."

"The capital coming to the table knows how it fits into the market, what level of investment it seeks and the rates of return it needs," says Costello. "It's a much more sophisticated market than previously and investors are assessing markets, identifying trends, comparing investments and making two- to five-year decisions based on a methodical search."

As for investors buying acquisition rehabilitation credits that have bond financing? Sebastian says, "not investors we deal with."

Some companies deliberately slowed their activities this year for a number of reasons, including a potential credit glut, energy crisis concerns and the Technical Advice Memorandum (TAMs) issued by the Internal Revenue Service that severely limit the costs that can be included in a property's eligible basis. "We saw a shift last winter —

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LIHC Equity Market

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that a needed correction was coming. There were fewer investors and an unprecedented number of sellers," says David Kunhardt, director of Community Investments for AEGON USA Realty Advisors, Inc. He says Aegon will continue its cautionary stance. "Unless you can tell me the economy is seriously picking up and people are saving more and spending more and that investments in manufacturing and durable goods are picking up fast, our overall target for the year is one-half of last year," says Kunhardt, who sees the usual summer market uptick but little else because of the state of the economy.

Sebastian, who also does not want to be caught long in uncertain times, says those who operate as an intermediary are often filling the gaps. "For high-quality 9 percent transactions, we're still seeing plenty of deals on the margin," he says. "That's why it's so difficult to read the market without all the credits being allocated."

"It's part of a process – I can't say there's a stampede – but investors are trying to assess how they are going to maintain yields in portfolios with quality investments."

*Kevin Costello,
Boston Capital Corporation*

The economy may impact those investors who operate on the margin, but it does not affect affordable housing need or supply. "Housing is one of the few strong sectors this year and as a lender we've been pushing to do more multifamily lending," says Kunhardt. "We see that market remaining quite strong in the mid and lower range."

With investors looking for higher yields tied in for longer periods of time, and corporate investors looking to LIHCs that have given them 7.5 percent after tax, those investments with taxable yields at 7 percent or 8 percent after tax are beginning to lose luster, Costello says. "I've talked with a lot of corporations that pulled back and are now starting to talk and look," he says. "It's part of a process – I can't say there's a stampede – but investors are trying to assess how they are going to maintain yields in portfolios with quality investments. Tax credit investments have logged some pretty impressive statistics and with an excess of \$3 billion in market equity there's a lot of good data to look at."

With increased prices in yields as they mark to market, and with the real likelihood of another rate drop or two, Costello says investors and allocations will be affected. "The market is more favorable for LIHCs," he concludes. ♦

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