

THE BUZZ

In Addition to Legislation: How the Obama Administration Can Stimulate LIHTC Investments

By Buzz Roberts, Local Initiatives Support Corporation

It is crucial for Congress to pass legislation to stimulate private investment in low-income housing tax credit (LIHTC) properties. But the Obama Administration can also complement legislation by taking some steps on its own. These executive policies would not themselves require congressional action and could have a positive and swift effect on investment markets. Here are three possibilities:

Fannie Mae and Freddie Mac could guarantee LIHTC investments made by others. Because the future status of Fannie Mae and Freddie Mac is uncertain, it may not be practical for them to make new LIHTC investments for their own portfolios. However, these government sponsored enterprises (GSEs) could use their considerable expertise to help restore the LIHTC investment market by guaranteeing investments made by others, including banks and other less experienced corporate investors. In past years, other financial companies have provided such guarantees but are no longer in a position to do so. Although Fannie and Freddie are currently under federal conservatorship, they continue to guarantee debt securities – indeed, their mortgage backed securities are essential to a functioning home mortgage market – and the federal government has promised to provide \$200 billion if necessary to keep Fannie and Freddie up and running. Prospective investors would probably place a high value on their guarantee of LIHTC investments.

Guaranteeing LIHTC investments would provide a source of profit to the GSEs and credit risk protection for investors. It would appeal to investors unfamiliar with affordable

housing or with those who would prefer for someone else to take the risks and responsibilities of an LIHTC investment.

For bank investors, a GSE guarantee might offer another advantage. Currently, if a bank buys a mortgage backed security, a GSE guarantee reduces by 80 percent the amount of risk-based capital the bank must hold – a major benefit in a time of capital constraints. The question is whether the same reduced capital requirement would apply to LIHTC equity investments backed by a similar GSE guarantee. The banking regulators should clarify that it would.

Fannie and Freddie could also use other financial capacities to structure a guaranteed investment to help attract new investors. For example, by dividing into shorter-duration segments what normally is a 15- to 17-year investment, investors unwilling to make a long-term investment could participate. Similarly, to optimize investor yields, the GSEs' access to credit markets might enable them to allow investors to make their capital contributions in installments over time. The Federal Housing Finance Agency (FHFA), which oversees Fannie Mae and Freddie Mac as their conservator, could encourage and support this guarantee approach. Fannie and Freddie should work with the FHFA on a guarantee structure.

Regulators could increase flexibility of Community Reinvestment Act (CRA) policies concerning regional investments. Regional and local banks could greatly expand their LIHTC investments but many of these banks need (and

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want) to co-invest with others through large regional or national funds. These funds offer safety, risk diversification and efficiency, especially for relatively new and small-scale investors. However, current CRA policy guidance limits the recognition of investments made through regional and national multi-investor funds, thus undermining the effectiveness of CRA to motivate such LIHTC investments. The CRA regulation itself does allow recognition for bank investments in a region that includes a bank's local "assessment area." However, supplemental interagency Q&A guidance (revised January 6, 2009) maintains two obstacles.

First, Q&A §___.12(h)-6 limits credit for regional investments to banks that already are adequately addressing the community development needs of their major assessment areas. The desire to address local needs is valid. However, a bank with numerous assessment areas may not be certain at the time it needs to make an investment decision that a subsequent examination will conclude that the bank has met this requirement. It should be possible to find another standard by which banks are

encouraged to meet local needs without discouraging regional investments.

Second, Q&A §___.12(h)-7 gives bank examiners discretion to grant less CRA credit for investments in large regions. However, many funds require regions as large as a quadrant of the country to be workable and efficient. Many banks are reluctant to invest in such funds because they will not know how much CRA credit they will get until they are examined, perhaps a year or more later. A very large bank, by investing directly or by enlisting LIHTC syndicators to set up a fund in which it is the sole investor, can avoid these obstacles and target its LIHTC investments to the locations where it will get the most CRA credit. Ironically, these approaches divert money away from the broader multi-investor funds that regional and local banks would prefer. Adding sufficient flexibility should not require a statutory or regulatory change; the four federal banking regulators could jointly modify the Q&A guidance on CRA.

The Treasury could co-invest along with private inves-

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tors in LIHTCs. A quick way to increase LIHTC investment capital on a temporary basis would be for the U.S. Treasury Department to invest. But it hardly seems practical for Treasury officials to select the deals, negotiate pricing and terms, disburse the funds based on development progress and monitor investments over time. A co-investment approach, in which the Treasury would match private investments in a pooled fund, could easily address these concerns. For example, if a syndicator raises \$50 million from private investors, the Treasury could invest, say, an additional \$50 million on the exact same terms as the private investors with respect to price, underwriting, payment structure, etc. The private investors and the Treasury would be equal participants in all of the projects receiving investment from the fund. The only difference would be that Treasury would not have any voting rights in the partnership.

Why would the Treasury make such an investment? The first reason is to stimulate the construction and preservation of affordable housing and the jobs, income, tax revenue and community revitalization that would result. Second, Treasury would receive the same rate of return as the private investors, though of course Treasury would

simply “retire” the tax credits rather than actually claim them. And finally, Treasury’s participation in the market would re-balance supply and demand, resulting in a more stable and higher price for LIHTCs and a more efficient tax expenditure for the federal government. To avoid overheating the market, the Treasury could even set a maximum price beyond which it would not pay. As the private market returned to health, the Treasury’s participation would naturally diminish. ❖



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