

THE VALUATION REPORT

A MONTHLY PUBLICATION ON THE LOW-INCOME HOUSING TAX CREDIT INDUSTRY

September 2005, Volume IV, Issue IX, Published By Novogradac & Company LLP

Market Analysis Can Help Owners Weigh Options in Making Year 15 Decisions

By Brandi Day, Real Estate Analyst

As of 2002, properties funded with the low-income housing tax credit (LIHTC) began to reach the end of their initial 15-year compliance period. Although an extended compliance period is commonplace today, there are many properties scheduled to leave the LIHTC rolls over the next few years.

Property owners should make plans for the future of the property well in advance of the 15-year deadline. Owners desiring to sell their property can indicate their intentions to the state housing agency overseeing the tax credits as early as year 14. However, selling the property is only one option. A market analysis will help determine if the property should apply for additional tax credits and extend the compliance period, be sold, converted to market-rate use or converted to condominiums.

Legal Considerations

In making this decision, several specific areas must be considered. The first is the legal ramifications of a change in the property's operation. Some governments allow lower parking ratios or high density for affordable housing developments than for market-rate communities. Other zoning variances (such as allowable use) also may have been made specifically for the benefit of an affordable housing development. These could put legal restrictions on the property's design and operation.

In addition, if significant renovations are planned, the property may have to comply with revised building codes put in place since the property's original construction. This is a concern in states such as Florida, where recent hurricane activity has spurred tighter building codes. Compliance with revised standards is often tied to a change in a property's use or the extent of its renovation.

Zoning and building codes as well as other legal issues may limit options for the future of an LIHTC property. If that is not the case, a thorough market analysis can help determine the best course of action.

Market Considerations

As with any market study, an analysis to determine the future for a property at the end of its compliance period needs to examine the current and projected health of the rental market. This includes factors such as planned construction, projected increases or decreases in employment, current vacancy rates and the presence and depth of rental concessions.

The property's current and past performance history can be a good indicator of the future. How long was the property's initial absorption period? Were concessions necessary? Were units pre-leased? The answers to these questions can give some indication of the property's attractiveness in the market.

Also, past problems may indicate the property needs to be repositioned in the market. However, if the property has consistently been a strong operator, changes may be unnecessary or required only to meet the financial needs of the owner. Questions to ask along this line include: Has the property consistently operated at a stabilized occupancy? Have concessions been necessary to obtain a stabilized occupancy? Is it difficult to find income-eligible tenants with a good rental history in the market?

However, a healthy historical performance is not a guarantee for the future. Market changes must be taken into account. Assuming the LIHTC property was new construction, it will be 15 years old at the end of its com-

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pliance period. It is likely to have maintenance issues and deteriorated curb appeal associated with age. In addition, apartments, like any other commodity, change with age. The new communities under construction in 2005, both LIHTC and market-rate, have larger units and more amenities than those constructed in 1990.

The American Housing Survey, produced by the Department of Housing and Urban Development (HUD), provides some insight into recent market changes. An analysis of data from the 1997 and 2003 reports shows the median square footage of an apartment unit increased 1.8 percent, from 1,276 square feet to 1,299 square feet, during the six-year period. Among those units constructed in the four years prior to each survey year, the change was even more dramatic: the median unit size increased 10.9 percent, from 1,209 square feet to 1,562 square feet.

With the "bigger is better" mentality of the American consumer, unit size is increasingly important. So are additional amenities such as storage units and garages that allow residents to store their extra belongings. Storage has special appeal to renters who are living temporarily in an apartment while waiting to purchase or build a home.

Other features of increasing popularity include a business center or computer room; multiple pools, playgrounds and laundry facilities (particularly in larger communities); and Internet access. Of course, features vary by region and market. A detailed look at competitors will reveal the specific trends in an area. However, it generally should be assumed that in order to compete with the newly constructed properties in the market, significant amenity upgrades will be necessary in addition to basic cosmetic changes. This will apply whether the desire is to have the property function as a LIHTC or market-rate community.

Repositioning in the Market

Without extensive renovations, a property may be well-suited to meet the needs of middle-market renters – meaning those who do not qualify for government-sponsored affordable housing and who either cannot or prefer not to pay the higher rents at newer, more luxurious Class A properties. Most markets are suffering from a diminishing supply of housing at this level. Either communities are older and in poor condition or they are newly built or renovated and have correspondingly high rents. The rising costs of land and construction materials makes it financially unfeasible without government assistance to build new properties that are not high-rent Class A properties. Therefore, an LIHTC community at the end of its compliance period could become the perfect solution for the middle-market renter who is looking to live in a simple, decent place with basic amenities. While new amenities and extensive upgrades might be necessary to compete in the Class A apartment market, paint, carpet and some other basic cosmetic improvements may be

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ISSN 1541-2474

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the only requirements to compete as a Class B property in year 16.

The key to determining demand for this type of property, as well as the minimum requirements for a specific property to be competitive, is a thorough analysis of the existing competing properties. Some things that should be considered are: Are there other Class B properties in the area? What occupancy level are they able to maintain? Are concessions necessary to achieve this? Have they seen an increase or decrease in demand over the past year or two? Are there employers in the neighborhood whose workers would be in the market for lower-priced housing? Office administrative staff, entry-level professionals or well-paid laborers would all be a target market.

A comparison to Class A properties must also be made to determine if the rents of a converted property are significantly lower. A small rental savings of less than 5 percent may not be enough incentive for a resident to give up additional amenities.

The final consideration is the property's location. One that was up-and-coming 15 years ago may not be popular today. Location alone may relegate a property to Class B rents, despite amenities or curb appeal. Employment, shopping and recreational opportunities must be nearby or conveniently accessible to ensure a strong future performance.

Conclusion

There are many factors to consider when deciding the future of an LIHTC property at the end of its compliance period. Changes in location, apartment trends and property age will affect a property's future. To make an informed decision, it is best to start the process early and with a market study that will determine the current condition of the market, the LIHTC property's position in it, and what upgrades or changes will be necessary to ensure the property's future competitiveness in the market. ❖

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